

TELEFONICA BRASIL S.A.

Form 20-F

March 19, 2014

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

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

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

OR

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

For the fiscal year ended December 31, 2013

OR

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

OR

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

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

TELEFÔNICA BRASIL S.A.

(Exact name of Registrant as specified in its charter)

TELEFÔNICA BRAZIL S.A.

(Translation of Registrant's name into English)

Federative Republic of Brazil

(Jurisdiction of incorporation or organization)

Avenida Engenheiro Luis Carlos Berrini, 1376, 32° andar

04571-936 São Paulo, SP, Brazil

(Address of principal executive offices)

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Email: ir.br@telefonica.com

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

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

Title of each class

Name of each exchange on which registered

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

New York Stock Exchange*
New York Stock Exchange

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

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

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

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

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

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

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

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

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

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

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

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

U.S. GAAP

International Financial Reporting
Standards as issued by the

Other

International Accounting Standards
Board

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

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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INTRODUCTION

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

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

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

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

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

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

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

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

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

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

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENT

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

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

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

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

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

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

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PRESENTATION OF FINANCIAL INFORMATION

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

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

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

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

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

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

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

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

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

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

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

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

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

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

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

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

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

Financing activities:

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

Exchange Rates

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

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

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

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

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

Source: Central Bank of Brazil, PTAX.

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

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

Source: Central Bank of Brazil, PTAX.

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

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

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D.

Risk Factors

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

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Risks Relating to Brazil

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

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

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

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

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

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

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

international financial markets.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Risks Relating to the Brazilian Telecommunications Industry and Us

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We face increasing competition from telecom service providers.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We face risks associated with litigation.

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

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

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

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

Risks Relating to the Preferred Shares and the ADSs

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

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

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

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

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

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

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

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

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

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

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

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

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

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Certain Factors Relating to Our Controlling Shareholder

Our controlling shareholder has strong influence over our business.

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

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

General

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

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

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

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

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

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

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

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

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

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

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

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

Historical Background

The Restructuring and Privatization

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

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

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

The Spin-off of Certain Data Transmission Operations

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

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

ANATEL Targets

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

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

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

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

IP Network Asset Acquisition

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

Acquisition and Reorganization of Atrium

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

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

The SCM Restructuring

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

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

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

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

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

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

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

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

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

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

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

Corporate Reorganization involving Ajato

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

Corporate Reorganization involving DABR and TTP

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

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

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

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Corporate Restructuring involving TS Tecnologia

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

Corporate Restructuring involving A.TELECOM S.A.

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

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

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

Corporate Restructuring involving Brasilcel

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

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

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

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

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

Introduction of the Vivo Brand

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

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Agreement with Telefónica and Telecom Itália

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

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

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

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

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

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

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

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

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

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

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

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

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

Corporate Restructuring involving Vivo Participações

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

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

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

positively impacting both companies.

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

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

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

The corporate structure after the merger is as follows:

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

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

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

Acquisition of Vivo Participações by Telefônica Brasil and corporate restructuring

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

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

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

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

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

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

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

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

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

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

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

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

SMP Authorizations and Corporate Restructuring

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

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

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

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

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

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

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Provision of STFC outside the state of São Paulo by Vivo

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

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

Plan for the purchase of shares issued by us

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

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

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

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

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

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

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

of Lemontree, representing 49% of its voting capital.

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

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

Restructuring involving the subsidiaries of Telefônica Brasil

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

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

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

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

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

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

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

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

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

Corporate Structure and Ownership

Our current general corporate and shareholder structure is as follows:

Capital Expenditures

Year ended December 31, 2013

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

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

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

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

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

Year ended December 31, 2012

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

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

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

Year ended December 31, 2011

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

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

B. Business Overview

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

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

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

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

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

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

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Areas of Operation

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Overview

Our services consist of:

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

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

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

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

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

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

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

Local Service

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

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

Intraregional Long-Distance Service

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

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Interregional and International Long-Distance Fixed Service

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

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

Data Services—Fixed Broadband

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

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

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

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

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

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

Pay TV services

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

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

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

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Network Services

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

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

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

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

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

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

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

Other Services

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

Digital Services

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

Interconnection

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

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

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

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

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

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

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

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

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

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

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

I-Telefónica

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

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Authorization to Provide Multimedia Services

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

Authorizations for pay TV via satellite

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

Authorization for Multichannel Multipoint Distribution Service (MMDS)

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

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

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

The STFC Concession Agreement

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

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

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

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

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

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

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

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

Services for Corporate Customers

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

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

Rates and Taxes

Rates

Overview

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

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

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

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

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

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

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

Local Rates

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

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

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

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

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

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

Regular Hours

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

Reduced Hours

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

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

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

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

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

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

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

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

Intraregional and Interregional Long-Distance Rates

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

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

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

International Long-Distance Rates

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

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

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Network Usage Charges

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

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

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

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

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

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

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

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

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

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

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

Data Transmission Rates

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

Taxes

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

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

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

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- **Contribution to the Fund for Telecommunications Regulation—“FISTEL.”** FISTEL is a federal tax applicable to telecommunications transmission equipment which serves to provide funds to cover the expenses incurred by the Federal Government in performing inspections of telecommunication services and in developing the means and improving the techniques necessary for carrying out these inspections. The fees owed to FISTEL, known as the FISTEL Taxes, are: (i) an installation inspection fee assessed on telecommunications central offices upon the issuance of their authorization certificates and (ii) an annual operations inspection fee that is based on the number of authorized central offices in operation at the end of the previous calendar year.

Exemptions for telecommunications infrastructure

In connection with the Plano Brasil Maior, a policy instituted to promote the Brazilian technology industry and foreign trade, the Brazilian Government established the special tax regime for the taxation of national broadband plans (Regime Especial de Tributação para o Plano Nacional de Banda Larga), or RePNBL. This regime provides tax exemptions for telecommunications companies for broadband network expansions. We have submitted certain projects for qualification under this exemption, in compliance with the July 2014 deadline, which are currently being evaluated by authorities.

Another initiative set forth by the Plano Brasil Maior established exemptions for machine-to-machine services. We are currently waiting for the government to take action with respect to M2M.

Billing

We send each customer a monthly bill covering all of the services provided during the prior period. Telephone service providers are required under Brazilian law to offer their customers the choice of at least six different payment dates for each month.

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

It was started in 2012 a several initiatives to integrate fixed and mobile processes and systems. The first was part of our organizational structure when in the first quarter of 2012, we combined both fixed and mobile departments optimizing and focusing resources. In that year we also certificated mobile billing processes by the ABNT.

Another strong initiative related to process and system integration was the traffic mediation system project. Started during the last semester of 2012 and launched in operation in 2013, it was integrated all operation of fixed lines traffic to the same platform as the mobile lines, reducing the risk of revenue loss, achieving better operational levels and unifying best practices.

Co-billing

In accordance with the Brazilian telecommunications regulations, we use a billing method called “co-billing” for both services, fixed and mobile. This method allows billing from other phone service providers to be included within our own invoice. Our customers can receive and subsequently pay all of their bills (including the fees for the use of services of another telephone service provider) by using one invoice. To allow for this method of billing, we provide billing and collection services to other phone service companies. We have co-billing agreements (“co-billing in”) with national and international long-distance phone service providers. Similarly, we use the same method of co-billing to bill our services on the invoices of other fixed and mobile providers. This service is charged to the Long-distance Operator, per CDR (Call Detail Record) placed in invoice.

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We use direct billing through the national registry of clients for customers who use our long-distance services through operators that have no joint billing agreement with us.

Value Added Services (VAS)

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

Third-party Services

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

Collection

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

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

For fixed customer, as a general rule, if the payment is more than 30 days overdue, service can be partially suspended. If payment is late for more than 30 days after the partial suspension, service can be fully suspended until payment is made. We offer an installment payment plan for those clients with past due balances. However, if accounts are not paid after 30 days of total suspension, the contract can be cancelled and reported to credit protection agencies.

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

The collection process involves several steps, from an internal interactive voice response, or IVR to make sure payment is made on time, followed by a phone call when a payment is late, followed by a late payment notice, and finally reporting customer information to an external credit bureau. Customer risk profile, days past due and debt balance are used to increase strategy efficiency and maximize debt recovery efforts. Amounts overdue by over 105 days, except for accounts receivables from interconnection fees, government and corporate customers, are considered provisions for doubtful accounts. The write-offs are made in accordance with Brazilian regulations, which permits a bad debt write-off for late payments of zero to R\$5,000 if they are over 180 days late or R\$5,001 to R\$30,000 if they are over 365 days late. Write-offs of late payments of over R\$30,001 that are open for more than 365 days require the commencement of a lawsuit.

During 2013, the monthly average of partial suspensions, for both mobile and fixed services, was 2,449,320 lines and the monthly average of total suspensions was 445,547 lines. For TV services, the monthly average of suspension was

16,419 terminals. The provision for doubtful accounts in 2013 was 1.43% of the total gross revenue.

Network and Facilities

Our network consists of an access layer that connects our clients through our metal or optical networks, which are connected to voice and data centers. These centers are interconnected locally or remotely through transmission equipment connected predominantly with fiber optics and occasionally through a microwave network, which together form a network layer that enables connectivity between the various central aggregate services platforms as well as interconnection with other carriers. Our network strategy is based on the expansion of the Access Network (fiber optics) to allow greater coverage and broadband (high-speed) services for our customers, as well as to develop an integrated multiservice network and multimedia applications. As a telecommunication service provider, we do

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not manufacture equipment for the construction of our networks and facilities. We buy the equipment from qualified suppliers and through this equipment we implement our networks and facilities through which we supply our services. The following table sets forth selected information about our network in aggregate:

| Wireline access lines | At and for the year ended December 31, | | | | | | | | | |
|--|--|---|-------|---|-------|---|-------|---|-------|---|
| | 2013 | | 2012 | | 2011 | | 2010 | | 2009 | |
| Installed access lines (millions) | 15.1 | | 14.8 | | 14.7 | | 14.6 | | 14.5 | |
| Access lines in service (millions) (1) | 10.4 | | 10.5 | | 11.0 | | 11.3 | | 11.3 | |
| Average access lines in service (millions) | 10.4 | | 10.7 | | 11.1 | | 11.3 | | 11.5 | |
| Access lines in service per 100 inhabitants | 23.7 | | 25.1 | | 26.5 | | 27.5 | | 27.1 | |
| Percentage of installed access lines connected to digital switches | 100.0 | % | 100.0 | % | 100.0 | % | 100.0 | % | 100.0 | % |
| Number of public telephones (thousands) | 199.1 | | 199.2 | | 215.8 | | 250.7 | | 250.5 | |
| Broadband access lines (millions) | 3.9 | | 3.7 | | 3.6 | | 3.3 | | 2.6 | |
| Access lines in service out of São Paulo (FWT) (millions) | 0.4 | | 0.1 | | - | | - | | - | |

| Mobile access lines | Year ended December 31, | | | | | | | | | |
|---|-------------------------|---|-------|---|-------|---|-------|---|-------|---|
| | 2013 | | 2012 | | 2011 | | 2010 | | 2009 | |
| Cellular lines in service at year-end (in millions) | 77.2 | | 76.1 | | 71.5 | | 60.3 | | 51.7 | |
| Contract customers (in millions) | 23.7 | | 18.8 | | 16.1 | | 12.6 | | 9.8 | |
| Prepaid customers (in millions) | 53.6 | | 57.3 | | 55.4 | | 47.7 | | 42.0 | |
| Growth in cellular lines in service during year | 1.4 | % | 6.4 | % | 18.7 | % | 16.5 | % | 15.1 | % |
| Churn(2) | 45.6 | % | 41.9 | % | 34.2 | % | 32.0 | % | 30.5 | % |
| Estimated covered population (in millions)(3) | 201.0 | | 193.9 | | 192.4 | | 190.7 | | 191.5 | |
| Penetration at year-end(4) | 136.4 | % | 132.7 | % | 123.9 | % | 104.6 | % | 90.5 | % |
| Market share(5) | 28.5 | % | 29.1 | % | 29.5 | % | 29.7 | % | 29.7 | % |

(1) Data includes public telephone lines.

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

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

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

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

Technology

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

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

allowing the inclusion of new convergent services.

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

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

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

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As content gains importance in the data world, it becomes more challenging to design a network able to meet the demand for content. High definition content has increased successfully among customers and 4K programming is coming fast, CDN assumes a key role in IPTV evolution, as it provides a better user experience and saves bandwidth at the same time.

With regards to Local Area Network, or LAN, as there is an increase in IP services, we aim to create a design that can absorb an exponential port growth for services without increasing operational costs. The result was the adoption of a new network implementation, using top of rack, or TOR and end of row, or EOR architecture. The technology reduces the amount of equipment on site and drastically decreases the use of cables, by placing small switches inside server racks, where cables are kept confined. From the rack to the site's core switches, only one pair of fiber is sufficient. The result is a significant savings in operating expenditures, as well as space, energy and air conditioning, despite the significant increase of network ports on site.

We have coped with various security threats in 2013, many of them very sophisticated to the average customer, whose business isn't network security. We have been able to expand our own network knowledge and infrastructure to protect customers from such threats. These initiatives have not only provided investments in internal security solutions that made our operations more reliable, but also leveraged new business opportunities in the managed security segment.

One of the main threats we have faced in 2013 has been Distributed Denial of Service attacks, or DDOS, as hackers attempt to shut down services by consuming all resources. DDOS counter-measures deployed in 2011 for internal protection has been widely expanded to corporate customer protection, generating new revenue and cross-selling and loyalty, as it demands Telefonica IP Internet services.

In the Value Added Services, we have been adopting new technologies to increase the speed with which we market new and enhanced services. Since 2009, we have deployed a new Service Delivery Platform, or SDP into the network, to evolve our environment through a secure and scalable solution that offers the most different value added services, including eHealth and Financial services. In 2011, we gave another step towards the evolution of our value added services environment, with the implementation of the Next Generation Intelligent Network platform, or ngIN, enabling voice call notification and call handling based services. Through the exposure of WebServices and application programming interfaces, or APIs, we introduced the Telecommunications market to Service Providers that have no Telecom specific knowledge, which explains the increasingly rapid growth of the quantity and quality of our Value Added Service offering. In addition, for the delivery of valued added services into the enterprise market, also offer another platform named Torpedo Empresas, which allow the Brazilian Banks and Financial Entities to deliver their own services, such as bank accounts notifications, financial transaction notifications and the delivery of access tokens to their customers.

We offer the IPTV service through the FTTH network using a new platform that is a reference in the world (Global Video Platform). This platform consists of pay TV with video broadcast offered through the use of the IP protocol. We made several improvements in the platform, such as the inclusion of Instant Channel Change (ICC), Picture in Picture (PiP), Live Pause, APP's (Social Network- like Facebook, Weather, Health, Multi-view, News, Kids and others) providing a better user experience. Additional services, such as pay-per-view and video on demand (VOD), are also available.

In 2014, we plan to continue the improvements in global video platforms aiming to increase competitiveness in the ITS market. New features like Timeshift and Catchup TV will be implemented and we will expand all the services to other cities of São Paulo.

The IPTV platform also offers games, interactive and connectivity services through third party contents, furthermore offers Over The Top (OTT) contents, for the broadband users, through the applications developed for smart TVs, smart phones with Google's Android and Apple's iOS, besides STBs and PCs. A new service OTT Live will deliver broadcast channels to those devices.

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

Our development plan contemplates the use of the most advanced technology available, focusing on integration with the Internet and an increase in the number of multimedia transmission services, with an emphasis on xDSL,

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

In 2012, we had a breakthrough in the M2M market, with the deployment of a new and revolutionary solution within the Brazilian market, introducing an M2M Global Platform that allows our B2B customers to have access to a Management Web Portal user interface in the internet to access online and real-time information regarding their devices. Some of the competitive advantages of the deployed solution against our previous service and those of our competitors are the Self-management of the acquired SIM Cards, to control, assign plans and tariffs or even block the use of the network by the device. In 2014, we will continue to evolve the offer, adding new functionalities.

Since 2012, “Speedy” is also offered under the Very-High-Speed Digital Subscriber Line technology (VDSL2), which allows broadband accesses of up to 25Mbps. These technologies provide high-speed Internet access through regular telephone lines. Yet in 2012, we started the implementation of Multi-Service Access Nodes (MSAN) in order to modernize the wireline network of some distant areas, integrating voice, broadband and data services on a single cabinet. We also offer broadband services using coaxial cable at speeds between of 8 Mbps up to 100 Mbps. In 2013, the product “Banda Larga Popular,” which has a speed of 250 kbps to 1 Mbps, reached 1 million and 388 thousand customers.

Through platform called DLM ASSIA, which improves the diagnosis and stability of service to customers, we increased the number of correct recommendation speed upgrade, over 410 million upgrades were made during 2013, looking for loyalty of the customer base and increased revenue.

In 2007, we initiated the implementation of the FTTH network (available through fiber optic cables running to the subscriber’s home – GPON technology) with coverage of 1.9 million homes. With this service, we reach a range of different speeds up to 200Mbps, and high definition IPTV service (HDTV).

In 2013, we surpassed the mark of 3.9 million broadband clients connected served via xDSL, fiber and coaxial cable. To reach this number of clients, we constantly search for market differentials such as new integrated services, speed upgrades and servicing of new localities, among others.

In 2011, we launched the HSPA+ technology, commercially known as 3GPlus. This technology was firstly commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11) but now is offered in 100% across our WCDMA coverage, allowing customers who have compatible terminals to achieve up to three times the value of traditional 3G’s rate. In 2013, we launched the LTE system in a new spectrum (2600 Mhz). 73 Brazilian cities were covered with 4G in 2013 (including those hosting World Cup games in 2014). Over the next years, we expect the 4G coverage will mainly support the requirements of the Brazilian Regulatory Agency.

Competition

In 2013, competition continued to increase in the market for small/medium enterprises and in the residential market due to an expansion of the coverage area realized by the main competitors, improvements on their portfolios, and also due to an increase in their commercial activity and offers for both fixed and mobile services, adding downward pressure to prices and insisting on higher discounts.

The telecom scenario in 2013 as in previous years remained very competitive and showed good progress in mobile broadband, especially for the commercial launch of 4G LTE technology in compliance with the schedule established by the Government for the cities hosting of Confederations Cup games. We played a prominent role reaching the

leadership of the 4G market through December with over 73 municipalities having coverage and remained a leader in 4G coverage by population, with 30% of the total population in the covered area.

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

Our main mobile service competitor in the states of Paraná, Santa Catarina, Pará, Ceará, Rio Grande do Norte, Pernambuco and Alagoas is TIM Celular or TIM, a Brazilian telephone company, subsidiary of Telecom Italia.

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In the states of Maranhão e Paraíba the principal mobile competitor is Oi, previously formed by Telemar Norte Leste SA and Brasil Telecom SA. The group has a concession of fixed telephony in all States and, through TNL PCS authorization to offer mobile services.

Rio de Janeiro, Rondônia, Goiânia, Distrito Federal, Bahia, Piauí and Tocantins are states where Claro is our main competitor. Claro is a mobile operator that was created in Brazil, resulting from the six regional operators: Americhel, ATL, Nordeste BCP, BCP SP, Claro Digital and Tess. In September 2003 Claro announced the consolidation of all these operators under a single brand, Claro. It is controlled by a Mexican company, America Movil Group.

In the other 11 Brazilian states (São Paulo, Acre, Amazonas, Roraima, Sergipe, Amapá, Mato Grosso, Mato Grosso do Sul, Minas Gerais, Espírito Santo and Rio Grande do Sul) we are the leader in the mobile market.

Our main competitors for the provision of fixed services are: America Móvil / Telmex group (which includes NET, Claro and Embratel), TIM (which is commercially represented by Live TIM), GVT and SKY. Our competitors employ varied strategies to gain market share. For instance, GVT expanded its operations to the city of São Paulo, with a strategy based on ultra-broadband services, high-quality customer service, and a new TV product, targeting high-income residential clients and small and medium businesses. NET restructured its portfolio TV with a focus in HD channels and kept the aggressive pricing strategy of broadband, offering 30 Mb promotionally priced at 10 Mb. Live TIM had a significant growth and reached 60k customers by the end of 2013. In the segment of low-income customers, we face competition from Embratel in TV services and NET in both TV and broadband services. SKY provides satellite pay-TV service and offers from low to high prices packages to its targets.

One of the main trends in the Brazilian telecom market is the increase of offers composed by both mobile and fixed services. NET and Claro (two companies of America Móvil group) launched “Combo Multi”, an offer with ultra-broadband, pay-TV, fixed and mobile lines all together in one package. Just as NET and Claro, Oi remains focused on the convergence strategy between fixed and mobile services.

We continue to develop and expand our product offerings, particularly those with great potential for future growth, such as broadband Internet services, pay-TV, and information technology services beyond the creation of convergence fixed-mobile deals among services. In fixed broadband, the company has expanded its portfolio of speeds according to each customer need by offering packages of 1Mbps to 200Mbps with “Vivo Internet Casa.” We emphasize the “Vivo Internet Box” option for broadband product areas where other technologies are not available with plans starting at R\$ 52.90 per month. The Company has invested heavily in expanding the fiber optic network to within the client's home in order to reach over 1.9 million homes in 25 cities in the State of São Paulo, as the only operator in São Paulo along with NET using the FTTH - Fiber to the Home technology (NET has launched FTTH for the 500Mbps speed in January of 2014, at São Paulo and Rio de Janeiro cities). In the last quarter of 2013, Vivo launched the new portfolio of Internet service Vivo Fiber, 50, 100 and 200 Mbps, with plans starting from R\$79.90/month, this ensuring that only our customers have the highest speeds of São Paulo, with competitive prices.

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

The year 2013 was also marked by the resumption of investments and growth in the pay-TV market. In the first quarter the Vivo TV Fiber was launched, providing the most watched channels allied to unique features enabled by fiber optic technology and the Mediaroom platform. The service offers thousands of content which can be watched

when the customer desires and unique applications that ensure greater interactivity. A massive campaign was also launched in the first half of the year in the state capital, leveraging the growth of 6x the monthly sales of the product, especially for customers who had already experienced Vivo's ultrabroadband.

We continue with our strategy in the corporate market as a provider of complete infrastructure solutions for information technology customers, integrating hardware packages, voice, data, Internet and network services.

To conclude, in 2013 ANATEL kept monitoring closely the quality goals of all telecom services, establishing along the period new rules and public consultation in order to increase the quality pattern. Vivo remains with its strategy focused on quality and profitability, already recognized by the market, and at the same time launching innovative services and products.

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Seasonality

Our business and results of operations are not materially affected by seasonal fluctuations in the consumption of our services.

Regulation of the Brazilian Telecommunications Industry

General

Our business, including the services we provide and the rates we charge, is materially affected by comprehensive regulation under the General Telecommunications Law and various administrative rules thereunder. Our companies that operate under a concession are authorized to provide specified services and have certain obligations, according to the Plano Geral de Metas de Universalização (PGMU), or General Plan on Universal Service Targets and the Plano Geral de Metas de Qualidade (PGMQ), or General Plan on Quality Targets.

ANATEL is the regulatory agency established by the General Telecommunications Law. ANATEL is administratively and financially independent from the Brazilian government. Any proposed regulation by ANATEL is subject to a period of public comment and, occasionally, public hearings, and its decisions may be challenged in the Brazilian courts.

Concessions and Authorizations

Concessions are licenses to provide telecommunications services that are granted under the public regime, while authorizations are licenses to provide telecommunications services granted under the private regime.

Companies that provide services under the public regime, known as the concessionary companies, are subject to certain obligations as to quality of service, continuity of service, universality of service, network expansion and modernization.

Companies that provide services under the private regime, known as the authorized companies, are generally not subject to the same requirements regarding continuity or universality of service; however, they may be subject to certain network expansion and quality of service obligations set forth in their authorizations.

Companies that operate under the public regime are Telefonica, Embratel, Oi, CTBC Telecom and Sercomtel. The primary public regime companies provide fixed-line telecommunications services in Brazil that include local, intraregional, interregional and international long-distance services. All other telecommunications service providers, including the other companies authorized to provide fixed-line services in our concession region, operate under the private regime.

Public regime companies, including us, can also offer certain telecommunications services in the private regime, of which the most significant are data transmission services.

Fixed-line Services—Public Regime. Our current concession agreements for the local, intraregional and interregional long-distance services were extended on December 22, 2005, for an additional period of 20 years.

Our current concession agreements contain a provision, amended by ANATEL on June 30, 2011, providing that they may be amended on December 31, 2015, and December 31, 2020 to establish new conditions and new targets for

universal access and quality, taking into consideration the conditions prevailing at the time, and defining, in the case of universal access targets, complementary resources, as provided by article 81 of Law No. 9,472 of 1997.

Under the renewed concession agreements and during the 20-year renewal period, we are required to pay a biennial fee equal to 2% of the gross revenue of the previous year, net of taxes and social contributions, arising from the rendering of basic service plans and alternative STFC in our concession area . See “—Obligations of Telecommunications Companies.” Each of the foregoing regulatory terms and conditions affecting (or potentially affecting) the current concession agreements, as well as current obligations under the existing concession agreements, may impact our business plan and results of operations.

Fixed-line Services—Private Regime. The Brazilian telecommunications regulation delegates to ANATEL the power to authorize private regime companies to provide local and intraregional long-distance services in each of the

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three fixed-line regions and to provide intraregional, interregional and international long-distance services throughout Brazil. ANATEL has already granted authorizations to private regime operators to operate in Region III, our concession region. ANATEL also granted other private regime companies authorizations to operate in other fixed-line regions and authorizations to provide intraregional, interregional and international long-distance services throughout Brazil in competition with Embratel. Several companies have already applied for authorization, and ANATEL may authorize additional private regime companies to provide intraregional, interregional and international long-distance services. See “—Competition.”

Since 2002 we provide local and interregional services in Regions I and II and Sector 33 of Region III, and international long-distance services in Regions I, II and III.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunication services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are included in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. In addition, ANATEL is empowered to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain certain economic and financial standards. The concession is granted for a fixed period of time and is generally renewable only once.

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

SMP Licenses

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

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

ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses) which were denominated bands “F,” “G,” “I” and “J.” Vivo acquired seven spectrum licenses in Band “J” and Vivo Participações acquired two spectrum licenses in Band “J.” In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands).

On February 3, 2003, TCO replaced its SMC Concession Contracts for Personal Mobile Service Agreements (Termos de Autorização do Serviço Móvel Pessoal) in Regions I (sub range of “B” frequencies) and II (sub range of

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

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

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

Our new SMP licenses include the right to provide mobile services for an unlimited period of time but restrict the right to use the spectrum according to the schedules listed in the old licenses (Vivo-Rio Grande do Sul (“A” band) until 2022 (renewed in 2006); Vivo-Rio de Janeiro (“A” band) until 2020 (renewed in 2005); Vivo-Espírito Santo (“A” band) until 2023 (renewed in 2008); Vivo-Bahia (“A” band) and Vivo-Sergipe (“A” band) until 2023 (renewed in 2008); Vivo-São Paulo (“A” band) until 2023 or 2024, for the cities of Ribeirão Preto and Guatapar (renewed in 2008); Vivo-Paraná/Santa Catarina (“B” band) until 2028 (renewed 2013); Vivo-Federal District (“A” band) until 2021, (renewed in 2006); Vivo-Acre (“A” band), Vivo-Rondnia (“A” band), Vivo-Mato Grosso (“A” band) and Vivo-Mato Grosso do Sul (“A” band) until 2024 (renewed in 2008); Vivo-Gois/Tocantins (“A” band) until 2023 (renewed in 2008); Vivo-Amazonas/Roraima/Amap/Par/Maranho (“B” band) until 2028 (renewed 2013); Vivo (Minas Gerais) (“A” band) until 2023 (renewed in 2007) and Vivo (for the cities where CTBC Telecom operates in the state of Minas Gerais) (“E” band) until 2020). Spectrum rights may be renewed only once over a 15-year period.

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

In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated as bands F, G, I and J. Vivo was awarded seven spectrum licenses in band “J” and Vivo

Participações was awarded two licenses, covering all the country until 2023 with 2100 MHz radiofrequency. Spectrum rights may be renewed only once over a 15-year period.

In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands), expiring in 2023:

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

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- 1800 MHz extension band of the states of Rio de Janeiro, Espírito Santo, Bahia and Sergipe;
- 1800 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;
- 1800 MHz extension band of the city of Paranaíba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;

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- 1800 MHz extension band of the cities of Londrina and Tamarana, in the state of Paraná; and
- 1800 MHz (extension sub bands in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (National coverage).

On December 1, 2011 ANATEL carried out the bidding of frequency blocks (Notice No. 001/2011/PVCP/SPV-ANATEL), divided into 54 lots, in the bands: 800 MHz (Band A in the North), 1800 MHz (sub bands extension in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (national coverage), totaling approximately R\$592 million, considered the minimum bidding price. This auction offered remaining lots from Notice No. 002/2010/SPV-ANATEL, held in December 2010, in which Vivo was one of the largest winners in the auction by acquiring radio frequency bands 900 MHz and 1,800 MHz.

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

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

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

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

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

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

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

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

- as a result, Nextel and other new 3G operators were given preferential status in the “H” band ((10 + 10) MHz) segment of the auction. Vivo, TIM and Claro were eligible to enter bids for the remaining SMP frequencies. Oi acquired the band “H” lot 8 (for the cities in the states of Mato Grosso do Sul and Goiás). CTBC acquired the band “H” lot 5 (for the cities in the state of Minas Gerais) and Nextel acquired the other band “H” lots; and

- a mobile operator, or its respective controlling shareholders, may not have geographical overlap between licenses.

In 2013, we changed the terms of our authorization regarding Band "G" (1.9 GHz) in certain locations, adapting their blocks of frequencies to 2.1 GHz and aligning them with the band "J" (3G) which provides a more efficient use of the spectrum. The alignment has not occurred in the following areas: Northeast, with exception to Bahia and Sergipe; Pelotas, Morro Redondo, Capão do Leão and Turuçu, in Rio Grande do Sul; Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in Goiás; and Paranaíba in Mato Grosso do Sul. This change is foreseen in the bidding document No 001/2007. Telefonica has no band "G" in northeast region and in Londrina and Tamarana, Paraná.

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

In order to meet the coverage obligations and the schedule defined by ANATEL, we have already made the 4G service available in the cities that hosted the 2013 FIFA Confederations Cup and that will host as well as sub-host cities for the 2014 FIFA World Cup. To complete the coverage requirements, for the next years we will meet the following coverage requirements:

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

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

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

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

After receiving the ANATEL study on the occupation of the 700 MHz frequency, published in early January 2013, the Brazilian Ministry of Communications, issued Ordinance No. 14, with guidelines for accelerated access to the Brazilian System of Digital Terrestrial Television - SBTVD-T and to broaden the availability of the radio frequency spectrum for meeting the goals set forth by the National Broadband, or PNBL. The ordinance also establishes that the ANATEL develop a proposal to regulate use of the band. Between February and May 2013, the proposal was taken to a public consultation and the discussion, which led to Resolution No. 625/2013, which approves the allocation of the 700 MHz band to the fixed and mobile services of telephony and broadband. However, the completion of the allocation process requires the migration of the TV channels that currently occupy the band as well as the conclusion of studies regarding spectrum interference between mobile and TV services that are currently being performed by

ANATEL.

Obligations of Telecommunications Companies

We and other telecommunications service providers are subject to obligations concerning quality of service, network expansion and modernization. The concession telecommunication companies are also subject to a set of special restrictions regarding the services they may offer, which are listed in the Plano Geral de Outorgas (PGO), or General Plan of Grants, and special obligations regarding network expansion and modernization contained in the General Plan on Universal Service Targets.

In 2008, the presidential decree published with the General Plan of Grants increased the flexibility of telecommunications provider groups as STFC concessionaires by allowing such providers to provide services in up

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to two General Plan of Grants regions. Before this decree, telecommunications provider groups holding STFC concessions could offer STFC services in only one region under the public regime.

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

The mobile service authorizations of Vivo involve obligations to meet quality of service standards the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL published the method for collecting these quality service standards data on April 23, 2003 (ANATEL Resolution No. 335/03 and 317/02). In July 2010, ANATEL published Public Consultation No. 27/2010, revising the General Plan of Standards of Quality of the SMP.

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

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

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

Initially, targets were defined by at least 60% of the speed hired by users and 20% of the instant speed. On November 2013, ANATEL raised the target values and in 2014 and 2015 there will be new raises.

In July 2012, ANATEL suspended the sale and activation of the mobile lines of three major Brazilian operators. Vivo was not affected by this measure. Since then, ANATEL has requested from operators, the submission of an Action Plan for Quality Improvement of the Mobile Telephony. Vivo had its plan approved on September 10, 2012. As of early 2013, ANATEL has been regularly publishing measurement results for predefined indicators.

Restrictions on Companies to Provide STFC in the Public Regime

Public regime companies are also subject to certain restrictions on alliances, joint ventures, mergers and acquisitions, including:

- a prohibition on holding more than 20% of the voting shares in any other public regime company, unless previously approved by ANATEL, according to ANATEL's Resolution No. 101/99; and
- a prohibition on public regime companies to provide similar services through related companies.

Network Expansion and Quality of Service

We are subject to the General Plan for Universal Service Targets (Plano Geral de Metas para a Universalização) and the General Plan of Quality Targets (Plano Geral de Metas de Qualidade), each of which respectively requires that we undertake certain network expansion activities with respect to our fixed-line services and meet specified quality of service targets. The timing for network expansion and benchmarks for quality of service are revised by ANATEL from time to time.

The decree altering the General Plan for Universal Service Targets rescinded in 2008 the obligation of telecommunications concessionaires to install telecommunications service centers (providing calling and data access to walk-in customers) and substituted such obligation with an obligation to roll out broadband network infrastructure

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throughout the municipalities serviced by such concessionaires. In compliance with the decree, in 2011, all municipalities in Brazil had infrastructure for broadband networking. This obligation made us implement an additional network infrastructure in 257 of the 622 municipalities in our concession region.

Moreover, we have, as have other telecommunications concessionaires, committed to provide free Internet access to public schools during the term of our concession grant (until 2025).

If a public regime company does not fulfill its obligations under the General Plan for Universal Services and the General Plan for Quality Targets, there are various monetary penalties that may be imposed by ANATEL. A company may lose its license if ANATEL considers it incapable of providing basic services under the two General Plans.

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

On June 30, 2011 the Brazilian government published Decree No. 7,512 related to the General Plan for the PGMU III. The PGMU III sets new targets for Telefone de Uso Público (public phones) density in rural and poor areas and goals related to AICE and bidding for the 450 MHz and 2500 MHz spectrum ranges (to, respectively, meet the needs of rural regions and develop fourth generation mobile telephony). Also according to the new PGMU, the backhaul used to meet the commitments of universalization was characterized as a reversible asset.

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

ANATEL approved other resolutions and consents in 2013:

- Resolution No. 607/2013: Amends the Fixed Telephony Numbering Regulation, enabling the efficient allocation of Provider Selection Codes (CSP).
- Resolution No. 608/2013: Amends the Account Separation and Allocation Regulation (RSAC) in order to make Accounts Document Separation and Allocation (DSAC) simpler and aligned to international standards.
- Resolution No. 614/2013: Establishes the new Regulation for Multimedia Communications Service (“Serviço de Comunicação Multimídia – SCM).
- Resolution No. 615/2013: Amends the Fixed Telephony Service Regulation (STFC), in order to align it with the other regulations regarding fixed telephony.
- Resolution No. 619/2013: Amends the Account Separation and Allocation Regulation (RSAC) in order to standardize the allocation of historical and current costs of operators.
- Resolution No. 622/2013: Creates conditions to enable the provision of fixed telephony in rural areas, as foreseen in the General Plan for the PGMU III.
- Resolution No. 623/2013: States that, telecommunications services providers with more than 1 million customers must create councils with society representative to discuss proposals for improving the services quality.

- Resolution No. 629/2013: Approves the Conduct Adjustment Regulation, that set the rules for the operators to swap fines for investment.

Other Regulatory Issues

In 2007, ANATEL published Resolution No. 477/2007, effective on February 13, 2008, relating to alterations in the regulation of SMP, which has contributed to an increase in our operating costs. In the new regulation, ANATEL

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notes areas of vital importance for mobile business, such as the necessity for retail stores in the cities within an operator's coverage areas, increases in the validity periods of prepaid cards and places limits on the period of time during which customers may not leave service plans. These new regulations may have an adverse effect on our revenues and results of operations. To minimize the impacts resulting from these regulatory changes, we had already prepared ourselves during the last quarter of 2007, to meet and comply with the terms set forth by the new regulation, mainly those related to the customer service which affect procedures and required significant changes to our systems. In 2009, we continued establishing retail stores in the cities within our coverage areas, pursuant to the provisions of Resolution No. 477/2007. In 2009, we also established mediation centers to attend to users with hearing and speech impediments, pursuant to the provisions of Resolution No. 477/2007. Our plans for achieving the goals set by this new regulation was extend to August 13, 2011 and all goals relating to Resolution No. 477/2007 were achieved by the company and certified by ANATEL.

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

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

Under the SMP regime, we receive revenues from interconnection fees paid to us by wire line long-distance operators due to long-distance traffic originating and terminating on our network. On March 24, 2011, ANATEL approved the corporate restructuring of Vivo Participações and Vivo, which are now controlled by the company and not by Brasilcel. The operation resulted in the final merger of shares of Vivo Participações into the company. See "Item 4. History and Development of the Company—A. Historical Background—Corporate Restructuring Involving Vivo Participações".

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

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

On July 2012, we received notice that a cost model was being revised for fixed-line as well as mobile operations. Concurrently, ANATEL published a request for comments and suggestions regarding the preparation and implementation of the cost model. Resolution No. 608/2013 began with that consultation and was published on April 2013, simplifying the accountability process and adapting the Regulatory Chart of Accounts. In August 2013, ANATEL approved Resolution No.619/2013 that standardized information about the historical and current costs of operators.

Between September and November, 2013 a Public Consultation was held by ANATEL to discuss the determination of the maximum use fees for the fixed and mobile telephony and EILD (Industrial Use of Dedicated Lines), based on the Cost Model (DSAC). The subject is now being studied by ANATEL.

New Regulations for Restricted Access Services– SeAC

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

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provision of other telecommunications services through STFC, allow us to provide Pay TV services, as well as other telecommunication services previously limited under the General Telecommunications Law.

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

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

As a result of Law No. 12,485/2011, the National Cinema Agency (Agência Nacional do Cinema), or Ancine issued one public consultation by the end of 2011 and one public consultation in 2012 to regulate the registration of economic agents.

In 2013, we had our licenses adapted to the new regulation and was recognized as an economic agent by ANCINE.

Interconnection Regulation

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

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

- the new General Regulation of Interconnection (“Regulamento Geral de Interconexão”–Resolution No. 410/2005, or “RGI”);
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the Regulation of Separation and Allocation of Costs (approved by Resolution No. 396/2005) and its annexes (approved by Resolutions No. 480/2007, 483/2007, 503/2008, 608/2013 and 619/2013);

- Resolution No 590/2012 – Regulates the use of industrial dedicated lines and sets forth new rules for providers with significant market power and reduces the standard circuit reference rate by approximately 30%. These reference rates are used in instances arbitration or other forms of alternative dispute resolutions. In addition, ANATEL granted service providers a four month period during which to adopt these rules. We have filed a claim against ANATEL to question the legality of retroactively applying this new regulation and to address ANATEL's definition of significant market power as we understand there to be competition in the areas indicated by them.
- the Regulation of Remuneration of Use of SMP Providers Networks (Resolution No. 438/2006). In November 2010, ANATEL published Resolution No. 549/2010 modifying Resolution No. 438/2006 and

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providing that the groups that include SMP operators with participation rates lower than 20% in the market of mobile telephony combined in each one of the regions of the General Plan of Authorizations of SMP (PGA-SMP), are considered groups who lack significant market power in the offer of mobile interconnection, in their respective areas of authorization;

- the Regulation of Fixed and Wireless Number Portability (Resolution No. 460/2007, effective March 2009);
 - the new Regulation of SMP (Resolution No. 477/2007, effective February 13, 2008);
- the general plan of update of the regulation of the telecommunications in Brazil (“Plano Geral de Atualização da Regulamentação das Telecomunicações do Brasil” – Resolution No. 516/2008, or “PGR”);
- the general norms of customer interaction service by telephone, with the objective of improving the quality of services (Decree No. 6523/2008);
 - the Methodology of the Calculation of the WACC (Resolution No. 535/2009);
- amendment of the regulation of the 3400 MHz to 3600 MHz band, allowing it to apply additionally to mobile services (Resolution No. 537/2010);
- the regulation of the Broadband Power Line (BPL), allowing this service to apply to multimedia communication (SCM) (Resolution No. 527/2009);
- related Invitation Document No. 002/2007/SPV-ANATEL regarding the auction organized in December 2007 of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses), denominated bands “F,” “G,” “I” and “J,” which stated that, within a maximum allowed period of eighteen months from the publication of the Terms of Authorization (it occurred on April 30, 2008), the authorizations resulting from this auction would be combined with the existing SMP authorizations of the bid winners when pertaining to the same region of the general authorization plan of SMP. In accordance with this Invitation Document, in January 2010, ANATEL published an act determining the unification of our SMP authorizations in Regions II (states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with only one SMP authorization for each of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010, for Region II and III, respectively). Vivo acquired spectrum licenses in band “J” in regions where it possesses SMP licenses. Moreover, the Invitation Document modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
- related Invitation Document No. 002/2010/ANATEL, regarding the auction organized in December 2010 of new licenses for the 1900-2100 MHz radio frequency band denominated the “H” band, for extension bands and for available frequencies at “A,” “D,” “E,” “M” and TDD bands, which modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
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the regulation for the exploration of SMP by means of Virtual Network, which makes possible the creation of the “agent” and the Authorized of Mobile Virtual Network (Resolution No. 550/2010). In accordance with this regulation approved by ANATEL, Mobile Virtual Network Operators may operate either as agents or as virtual network licensees. An agent represents the personal mobile service provider through the establishment of a representation agreement, which must be ratified by ANATEL. The agent’s activity is not defined as a “telecommunications service” so this is of significant interest to companies that operate in other sectors such as large retailers, banks and football teams. However, the activity of the virtual network licensee does fall within the definition of “telecommunications service” and is thus subject to all applicable rules;

- the assignment of the bands of 451 MHz to 458 MHz and 461 MHz to 468 MHz to the Personal Mobile Service, Fixed Switched Telephone Service and to the Multimedia Communication Service, for access to the services of telephony and data in broadband, particularly in rural areas (Resolution No. 558/2010);

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- the assignment of the bands of 2500 MHz to 2690 MHz to the Personal Mobile Service and Fixed Switched Telephone beyond Multimedia Communication Service and Pay Television by means of Multichannel Multipoint Distribution Service (MMDS) for which it was previously assigned (Resolution No. 544/2010);
- the regulation for evaluation of the efficiency of use of the radio frequency spectrum (Resolution No. 548/2010); and
- the addition of a ninth digit in the numbers of the mobile telephones of area 11, raising the capacity of numeration in the metropolitan region of São Paulo and eliminating definitively the problem of scarcity of numeration in this area (Resolution No. 553/2010).
- Resolution No. 588/2012 – Regulates network compensation for the STFC. This regulation revised the method of charging for TU-RL during the reduced time period for calls under two minutes of duration, and the change in Bill and Keep regime.
- Resolution No. 600/2012 – Approved the competition goals plan (PGMC). The main goals of PGMC are focused on the wholesale market and network infrastructure sharing, including: (1) passive infrastructure for transport and access networks; (2) call termination in mobile networks; (3) roaming (4) fixed network infrastructure for the transmission of data through copper cables in transmissions of 10mbps; and (5) wholesale fixed network infrastructure for local and long distance transmission of data under 35mbps.
- with an aim to restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to verify the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ). The new Regulation innovates by providing assessments of the network connection and their respective data transmission rate, especially aspects of availability, stability and connection speed data network. In addition, the resolution established the formation of “GIPAQ” (Group Deployment Process Quality Measurement), which will be responsible for implementing the processes on the quality indicators for the “Guaranteed Instant Transmission Rate” and “Guaranteed Average Transmission Rate.” The methodology and procedures regarding the collection of indicator data for data connections will be defined by this group, composed of providers, ANATEL and a “Quality Measurement Authority” (EAQ), which shall be responsible for implementing these processes and will be hired by the service providers until February 29, 2012. All costs associated with implementing the new procedures for measuring quality will be paid by providers of the SMP and the impacts of the Regulations are still being evaluated, mainly its financial aspect. Also, through the issuance of Resolution No. 574/2011, which approved the Rules of Quality Management (SCM-SCM RGQ) on October 28, 2011 (published in the D.O.U. on October 31, 2011), ANATEL set targets for service quality, as well as updated definitions for indicators and their calculation methods.
- the Regulation on criteria for adjustment of tariffs for calls from the STFC involving access the SMP or SME, approved by Resolution No. 576/2011, dated October 28, 2011, establishes criteria for the gradual readjustment of VCs until 2014. With respect to VU-M fees, for the period before the effectiveness of the cost model established by this Resolution, ANATEL defined transition rules if no pact is reached regarding the VU-M fees. A reduction factor (R) to be applied in the formula for readjustment of the calls involving the PSTN access the Personal Mobile Service.
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$VC_t \leq VC_{t0} \times (1-R-FA) \times (IST_t / IST_{t0})$, where R corresponds to the “Reduction Factor” (Fator de Redução) and FA to the “Damping Factor” (Fator de Amortecimento), the percentage of which depends on inflation in the corresponding period.

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

- for the first readjustment, ANATEL applied a Reduction Factor of 18% on April 2012;
- for the second readjustments, ANATEL applied a Reduction Factor of 12% on April 2013; and
- if the cost model has not yet produced results, the third readjustment will be subject to a Reduction Factor of 10% by April 2014.

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

For the VU-M fees, they remain freely negotiated and in case there is no agreement as a result of the new VC determined according the formula above, any reduction of these fees will be applied to the VU-M fee up to the VU-M / VC1 ratio to achieve 70%. From this level, the reduction will also be assessed in other components of the VCs, maintaining this ratio. As an example, in 2013, since the concessionaries and the mobile operators did not reach an agreement, ANATEL has determined that values for VC-1, VC-2 and VC-3 must be reduced by 8.77%.

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

Mobile Rate Regulation

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

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

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

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

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

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

an annual adjustment of 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

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

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

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ANATEL and the provisional agreement of VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC1) could be applied.

In June 2010, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2008 to 2009, for the application of the VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC2 and VC3).

By the end of 2011, Vivo entered into an agreement with Oi (Regions I and II) and us (Region III) for the recognition of the VU-M fee paid at the time and agreed to maintain this amount for an additional 24 months, based on the VC1 readjustment pleaded by both these companies to ANATEL. However, these fees were not approved by ANATEL due to the publication of ANATEL's Resolution No. 576/2011, which addresses the criteria for adjustment of fees for calls from fixed-lines involving access to the SMP or SME. On January 25, 2012, ANATEL published Act No. 486, with the new fees for VC1, VC2 and VC3 (with an average reduction of 10.78%) and, on February 22, 2012, ANATEL published Act No. 1,055 with new VU-M fees (with an average reduction of 14%). However, Oi obtained an injunction in Federal Court to have its readjustment request analyzed by ANATEL. This decision is subject to appeal. See “—Interconnection Regulation.”

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

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

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

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

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

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

In 2012, and according to Resolution 600/2012, ANATEL established that the mobile termination rate of reference for providers having significant market power based on a Cost Model would become effective on February 24, 2016. This termination rate was established by Resolution 438/2006 and will be used only in cases where an arbitration proceeding is necessary.

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Internet and Related Services in Brazil

In Brazil, Internet service providers, or ISPs, are deemed to be suppliers of value-added services and not telecommunications service providers. ANATEL's Resolution No. 190 requires cable operators to act as carriers of third-party Internet service providers. The Brazilian House of Representatives is considering a law that would penalize Internet service providers for knowingly providing services that allow illegal goods or services to be sold on the Internet, and would impose confidentiality requirements on Internet service providers regarding nonpublic information transmitted or stored on their networks.

Customer Service

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

Customer service segmentation model allows the company to improve its multichannel strategy. In 2013 there was a substantial progress regarding electronic channels adoption such as Vivo SMS, which was used by more than 3.5 million customers per month. Numbers kept on growing at the same speed of previous years, reaching 79% share of received contacts.

Concerning customer service quality, PROCON-SP's ranking demonstrated that Telefônica Brasil reached the best position among its largest competitors, which shows that the company is taking the right decisions to ensure customers' satisfaction. Moreover, in the last three years the company has been presenting meaningful improvements on internal processes that led to a positive impact on the volume of requests received by Market Regulatory Agencies, such as Fundação PROCON-SP.

According to the last data published by ANATEL, Vivo managed to continue as the top telecommunications mobile company in Brazil by having the smallest complaint ratio between the national reach telecommunications groups, as well as reaching number 1 position in regards to Attendance Performance Index (IDA) – the company placed best in 54 out of 55 months of evaluation. Similar results were reported by SINDEC (National System of Consumer Protection Information), which gathers information of Procons from all over the country and that showed a 10% substantiated complaints reduction in comparison to the previous year. Not enough, it has the best KPIs among its competitors as stated by the second edition of the project “Consumer Defense Public Indicators”, published by Ministry of Justice. Furthermore, it was considered the company with the best resolution rate in relation to other players in the telecom industry reaching 89.64%.

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

Marketing and Sales

During 2013, we integrate channels to offer standardized solutions and customer service along with innovation and best practices for the sale of fixed and mobile services.

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

- Vivo Own Stores: focused on individual clients and located on strategic points, our own stores provide a highly trained team built up to guarantee the best sales experience for the customer. The main drive of this channel is innovation. As a result, most stores have available self assistance services for value added

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services and recharges. We also offer special treatment for Premium clients with scheduled appointments via the Internet to assure “no waiting in line.”

- **Exclusive Dealers:** The exclusive dealers channel is composed by companies, certified to provide our full portfolio through an adequate distribution network to cover the geographic dimensions of the country. Although the channel offers the whole portfolio, the channel is focused on the post-paid product.
- **Recharge channels:** Composed by around 70 distributors that deliver pre-paid product and services to small and medium companies in various market sectors throughout the country. This is the largest channel for prepaid recharge and access, with a huge growth of virtual recharge year by year.
- **Retail Channel:** With strong alliance with the main retailers in Brasil, focused in prepaid recharges and data services.
- **Telesales:** sales through active and passive telemarketing call centers, employing highly trained sales associates, focused on fixed lines, data services and migration from pre-paid to postpaid plans.
- **E-commerce:** As a key component of the Company’s transformation process to become a Digital Telco and to deliver more value to its customers, Telefônica Brasil has put strong focus on the Online Channels in 2013. In the web portal www.vivo.com.br, customers can obtain up-to-date information to the company’s products and services, including specific sections for corporate customers and online self-service. A total of more than 300 different services and requests can be managed online. Besides, a new mobile site tailored for smartphones was launched during the year, as well as new applications and improvements in the look and feel and functionalities of the existing online channels. The e-commerce processes are also being improved on a continued basis, to leverage on the strong e-commerce growth observed with web users in Brazil. Current e-commerce capabilities include but are not limited to the sales of mobile handsets and plans, and the portfolio of services of fixed and mobile businesses, top-ups and VAS. Some results of this strategy in 2013 were:
 - Increase of 27% on customer care transactions, supported mainly by a strong focus on “Meu Vivo”, the company’s self-care service that is available on the web and also on apps;
 - Partnerships with the main players of credit card and e-payments market, as well as the development of new Online channels, which increased the number of online top-ups in 500%;
 - 44% increase on web and mobile portals visits, having the mobile portal surpassing the web portal for the first time, representing 58% of the overall online traffic;
 - 35% increase of the online sales transactions vs. 2012, due to the good performance of innovative marketing campaigns such as the participation for the first time in the Black Friday in November, and the re-launch of the online store for mobile handsets and services;
 - 59% increase on the penetration of the e-invoice, with significant cost reduction for the company;
 - Vivo’s web portal renewal in October brought strong results in user satisfaction: 86% of users consider extremely easy to use the site (Source: Bridge Research).
- **Door-to-door sales:** aiming to approach corporate and individual clients, we dispose physical channels of assistance, such as door-to-door sales of services by outsourced small companies and own team consultants. Main focus in fixed and data services.
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Person-to-person sales: our business management team offers customized sales services, ensuring high customer loyalty and a strong customer relationship resulting from customized consulting telecommunication and IT services and technical and commercial support.

Our Network

In 2013, the company continued the consolidation of a robust network, capable of delivering to the customer its expectation. Advanced in the migration of TDM to NGN core, reaching 43% of fixed traffic, modernization of switches and adaptation of the infrastructure of datacenters. For example, we began of the implementation of project that exchange optical cabinets (ARO) for MSAN.

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The FWT is the result of the integration between the mobile and the fixed environments and allowed the company to explore the fixed telephony service in regions outside São Paulo region. It grew more than 241% in 2013.

During 2013, the number of broadband accesses in the fixed network increased by 189 thousand customers. The company's portfolio related to xDSL broadband products includes speeds from 250 kbps to 25Mbps. The product "Banda Larga Popular", which is an initiative of the state of São Paulo, provides broadband at affordable prices to low-income population, with speeds that range from 250 kbps to 1Mbps. Last year, the product reached 1 million and 388 thousand clients. The company also offers broadband services provided via coaxial cable, with speeds that range from 8 Mbps to 100 Mbps.

Using the platform called DLM ASSIA, which improves the diagnosis and stability of our customers and to increase the index of assertiveness in recommending upgrade speed, were performed more than 410 thousand upgrades for 2013, thus seeking the loyalty of the customer base and increase the revenue.

Another important characteristic of the network is the availability of FTTH, the most advanced optical fiber broadband technology available. It allows the use of data rates until 200Mbps. By the end of 2013, the company had over 204 thousand clients using this technology. From these, over 35 thousand customers also use the IPTV service — a system through which television services are delivered using the Internet Protocol.

In 2013, the "Vivo Speedy" service reached 3.9 million customers. The service is provided using xDSL, FTTH and coaxial cables.

In 2011, we launched the HSPA+ technology, commercially known as 3GPlus, working across our 3G network. This technology was commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11). In 2012, the service was extended to national coverage 3G. The 3G Plus allowing customers who have compatible terminals to achieve even higher transmission rates, reaching up to three times the value of traditional 3G's rate. In 2013, we launched the LTE technology, commercially known as 4G Plus. This technology was commercially launched in April, 2013 in Confederations Cup host cities (Brasília, Fortaleza, Recife, Rio de Janeiro, Belo Horizonte and Salvador) and in São Paulo.

During the year 2013, we continue to expand strongly our 3G network, reaching around 3,137 municipalities or 87.96% of the population covered by this technology. With 2G technology reaching 3,754 municipalities or about 91.10% of the population at the end of 2013.

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

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

service platforms and communications backbones.

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

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

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Contract Customers for Mobile Services

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

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

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

Interconnection Charges

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

Bill and Keep

ANATEL adopted partial “Bill and Keep” rules for interconnection charges in July 2003. The rules provided that an SMP operator paid for the use of another SMP operator’s network in the same registration area only if the traffic carried from the first operator to the second exceeded 55% of the total traffic exchanged between them. In that case, only those calls that surpassed the 55% level were subject to payment for network usage.

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

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

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Roaming Fees

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

Wireless Device Sales

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

Operating Agreements

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

Interconnection Agreements

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

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

Roaming Agreements

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

Fraud Detection and Prevention

During 2013, we continued our work in combating the two main types of fraud, as follows:

- **Subscription fraud:** is a type of fraud that occurs when the issuance of one or more accesses are granted without the consent of the real “holder” of identification documents with the main objective of not paying the phone bill. Fraud can occur when a customer has its identification documents stolen and signatures are forged. We had a 9.76% decrease in subscription fraud-related expenses in 2012.
- **Identity Fraud:** also known as “social engineering,” is identity fraud, which takes place through call centers, where a caller who has access to information belonging to our existing clients reaches out to our call centers and makes unauthorized alterations and activations. We had a 91.3% decrease in this type of fraud-related expenses compared

to expenses with identity fraud in 2012. The decrease in identity fraud was a result of measures implemented to detect and prevent frauds.

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

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

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

Roaming Agreements

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

Telefônica Brasil S.A. does not have any contractual relationship with these Iranian operators; however, as part of the Telefonica Group, it adheres to the roaming agreements with Telefonica S.A.'s subsidiaries described below.

Telefonica S.A.'s subsidiaries were party to the following roaming agreements with Iranian telecommunication companies in 2013:

- (1) Telefónica Móviles España ("TME"), its Spanish directly wholly-owned subsidiary, has roaming agreements with (i) Mobile Telecommunication Company of Iran ("MTCI"), (ii) MTN Irancell ("Irancell"), and (iii) Taliya ("Taliya").

The Company has been advised that, during 2013, TME recorded the following revenues related to these roaming agreements: (i) 386,817.93 euros from MTCI, (ii) 741.69 euros from Irancell, (iii) none from Taliya.

TME also holds a Roaming Hub agreement through its 55% directly-owned subsidiary, Link2One, a.e.i.e. ("L2O"). Under this agreement, L2O provides a roaming hub service to Irancell enabling the latter to maintain a relationship with other members of the hub. Some members of the hub are also entities of the Telefónica Group. Under this roaming hub service, for 2013, L2O has billed Irancell 114,764 euro.

- (2) Telefónica Germany GmbH & Co. OHG ("TG"), Telefonica S.A.'s German 76.83% indirectly-owned subsidiary, has a roaming agreement with MTCI. TG recorded 147,319.39 euros in roaming revenues under this agreement in 2013.
- (3) Telefónica Ireland Limited ("TIR"), Telefonica S.A.'s Irish directly wholly-owned subsidiary, has a roaming agreement with MTCI. TIR recorded 1,558.66 euros in roaming revenues under this agreement in 2013.
- (4) Telefónica UK Ltd ("TUK"), TSA's English directly wholly-owned subsidiary, has a roaming agreement with Irancell. TUK recorded 840.41 euros in roaming revenues under this agreement in 2013.
- (5) Pegaso Comunicaciones y Sistemas, S.A. de C.V. ("PCS"), Telefonica S.A.'s Mexican directly wholly-owned subsidiary, has a roaming agreement with Irancell. PCS recorded 62.99 U.S. dollars in roaming revenues under this agreement in 2013.
- (6) Telefónica Argentina, S.A. and Telefónica Móviles Argentina, S.A. (together TA), Telefonica S.A.'s Argentinean directly wholly-owned subsidiaries, have a roaming agreement with Irancell. TA recorded 65.89 U.S. dollars in roaming revenues under this agreement in 2013.

(7)Telefónica Celular de Nicaragua. S.A. (“TCN”), Telefonica S.A.’s Nicaraguan 60% indirectly-owned subsidiary, has a roaming agreement with Irancell. TCN recorded 12.65 U.S. dollars in roaming revenues under this agreement in 2013.

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

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

International Carrier Agreement

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

Pursuant to this agreement, both companies interconnect their networks to allow for international exchange of traffic. TIWS recorded 13,252 euros in revenues under this agreement in 2013. The net profit recorded by TIWS pursuant to this agreement did not exceed such revenues.

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

C. Organizational Structure

On December 31, 2013, 91.58% of our voting shares were controlled by three major shareholders: SP Telecomunicações Participações Ltda. With 50.47%, Telefonica S.A. with 25.68% and Telefônica Internacional S.A. with 15.43%. Telefônica Internacional is the controlling shareholder of SP Telecomunicações and, consequently, holds directly and indirectly 65.90% of our common shares and 40.42% of our preferred shares. Telefônica Internacional is a wholly owned subsidiary of Telefônica, S.A. of Spain.

Subsidiaries

Telefonica Data S.A., or Tdata is a wholly owned subsidiary headquartered in Brazil, whose corporate purpose is to provide and operate telecommunications services; provide value added services (SVAs); provide integrated business solutions in telecommunications and related activities; manage the provision of technical assistance and maintenance services of telecommunications equipment and network, consulting services regarding telecommunications solutions and related activities, and design, implementation and installation of telecommunication-related projects; sell and lease telecommunications equipment, products and services, value-added services or any other related services, provided or supplied by third parties; provide third parties with telecommunications infrastructure; manage and/or develop activities that are necessary or useful for performing such services in accordance with applicable law; provide business trading services in general and provide technical support services in IT, including consulting, installation and maintenance of goods, applications and services, licensing or sub licensing of any kind of software, and storage and management of data and information. On July 1, 2013, part of its net assets were spun-off and merged into the Company and, on the same date, parts of the net assets of Vivo and A.TELECOM were merged into Tdata (Note 1b).

Associated Companies

Aliança Atlântica Holding B.V. (Aliança): Headquartered in Amsterdam, Netherlands, this entity has a 50% interest held by Telefônica Brasil and cash generated from sale of Portugal Telecom shares in June 2010. Through May 8, 2012, the Company held equity interest in Zon Multimédia, a Portugal Telecom group company that renders services involving pay television, Internet, distribution of audiovisual contents, cinema and telecommunication services. This equity interest was disposed of on May 8, 2012.

Companhia AIX de Participações (AIX): Headquartered in Brazil, this entity is engaged in holding an interest in Refibra consortium, and in performing activities related to the direct and indirect operation of activities related to the construction, completion and operation of underground networks or optical fiber ducts.

Companhia ACT de Participações (ACT): Headquartered in Brazil, this entity is engaged in holding an interest in Refibra consortium, and in performing activities related to the rendering of technical support services for the preparation of projects and completion of networks, by means of studies required to make them economically feasible, and monitor the progress of Consortium-related activities. From January 1, 2013 with the entry into force of IFRS 11 Joint Arrangements, investments in these entities were accounted for retrospectively using the equity method.

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D. Property, Plants and Equipment

Our main physical properties for providing fixed services involve the segments of switching (public switching telephone network-PSTN), transmission (optic and wireless systems), data communication (multiplex devices, IP network), infrastructure (Energy systems and air conditioned) and external Network (fiber optic and metallic cables), which are distributed in many buildings in the State of São Paulo and in the main cities out of the State of São Paulo. Some of these buildings are also used in administrative and commercial areas.

Our properties are located throughout the State of São Paulo and in the main cities out of the State of São Paulo. At December 31, 2013, we used 2,181 properties in our operations, 1,401 of which we own, and we have entered into standard leasing agreements to rent the remaining properties.

Pursuant to Brazilian legal procedures, liens have been attached to several properties pending the outcome of various legal proceedings to which we are a party. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings.”

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

As of December 31, 2013, we had 188 cellular switches and other equipment installed in 57 owned spaces, 10 leased spaces and 26 shared spaces. We lease most of the sites in which our cellular telecommunications network equipment is installed. The average term of these leases is five years (subject to renewal for additional five-year terms) and ten years in the Northeast. Our 30,970 base stations and other network equipment are installed in cell sites, administrative buildings and administrative facilities. In addition, we own 11 administrative building and we lease 36 administrative areas, 10 kiosks and 305 retail stores.

At December 31, 2013 the net book value of our property, plant and equipment amounted R\$18.4 billion (R\$17.6 billion at December 31, 2012).

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes and other information appearing elsewhere in this annual report and in conjunction with the financial information included under “Item 3. Key Information—A. Selected Financial Data.” We prepared our consolidated financial statements included in this annual report in accordance with IFRS.

Overview

Our results of operations are principally affected by the following key factors.

Brazilian Political and Economic Environment

The Brazilian economy has experienced different rates of growth this decade. According to IBGE, the Brazilian GDP expanded approximately 2.3% in 2013, compared to 0.9% in 2012.

Consumer prices, as measured by the IPCA, registered a variation of 5.9% in 2013. Accordingly, growth in consumer prices was higher than the inflation target established by the Central Bank, of 4.5%. In 2011 and 2012, the variations of IPCA were 6.5% and 5.8%, respectively. Inflation, as measured by the General Price Index, or the IGP-DI, calculated by Fundação Getúlio Vargas, which includes wholesale, retail and home-building prices, increased 5.0% and 8.1% in 2011 and 2012, respectively. In 2013, the IGP-DI increased 5.5%.

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As inflation rates measured by IPCA still remain above inflation target, Central Bank increased the basic interest rate during 2013. The SELIC rate increased to 10.0% by the end of 2013, from 7.25% by the end of 2012.

Brazil finished 2013 with a trade balance surplus of US\$ 2.6 billion, compared to US\$ 19.4 billion in 2012. Exports remained at US\$ 242 billion, but imports increased 7.4%, to US\$ 240 billion. Foreign Direct Investments inflows into the country decreased slightly, reaching US\$ 64 billion, compared to US\$65.3 billion in 2012. On the other hand, portfolio investments increased to US\$ 25.8 billion in 2013, in comparison to US\$ 8.8 billion in 2012. As a consequence of this performance of external accounts, international reserves decreased US\$3 billion compared to 2012 to US\$376 billion at end of 2013.

As a result of this worsening in domestic economic data, such as inflation, external accounts, and interest rates, besides increased risk aversion in the international capital markets led to a higher country risk in 2013. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI + Brazil), which tracks total returns for traded external debt instruments in the emerging markets, reached 224 basis points by the end of 2013 from 142 basis points at the end of 2012.

As a consequence, the real depreciated against the U.S. dollar in 2013 by 14.6%. The exchange rate on December 31, 2013 was R\$2.34/US\$1.00, from R\$2.04/US\$1.00 on December 31, 2012.

Our business is directly affected by the external environment and the Brazilian economy. If the Brazilian economy enters a period of continued recession, then demand for telecommunications services is likely to decline. Similarly, depreciation of the Brazilian real against the U.S. dollar may reduce the purchasing power of Brazilian consumers and, as a consequence, negatively affect the ability of our customers to pay for our telecommunications services.

Impact of Inflation on Our Results of Operations

Before 2006, the fees we charged our customers were periodically adjusted by ANATEL based on the inflation rates measured by the General Price Index (IGP-DI).

Starting in 2006, telephone fees were indexed to the IST, which is a basket of national indexes that reflect the telecommunications sector's operating costs. Such indexing will thus reduce inconsistencies between revenue and costs in our industry and therefore reduce the adverse effects of inflation on our business. The IST for the last 12 months is 4.92% according to the last data published by ANATEL with reference to December 2012.

The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2009 through 2013:

| | Inflation Rate (%) as Measured by IGP-DI(1) | Inflation Rate (%) as Measured by IPCA(2) | Inflation Rate (%) as Measured by IST(3) |
|-------------------|---|--|---|
| December 31, 2013 | 5.5 | 5.9 | 4.9 |
| December 31, 2012 | 8.1 | 5.8 | 4.9 |
| December 31, 2011 | 5.0 | 6.5 | 4.9 |
| December 31, 2010 | 11.3 | 5.9 | 5.6 |
| December 31, 2009 | (1.4) | 4.3 | 2.1 |

-
- (1) Source: IGP-DI, as published by the Fundação Getúlio Vargas.
 - (2) Source: IPCA, as published by the Instituto Brasileiro de Geografia e Estatística.
 - (3) Source: IST, as published by the Agência Nacional de Telecomunicações.

Regulatory and Competitive Factors

Our business, including the services we provide and the rates we charge, is subject to comprehensive regulation under the General Telecommunications Law. As a result, our business, results of operations and financial conditions could be impacted by the actions of the Brazilian authorities, including:

- delays in the granting, or the failure to grant, approvals for rate adjustment;

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- the granting of licenses to new competitors in our region; and
- the introduction of new or stricter requirements for our operating concession.

A series of new regulations became effective in 2013. See “Item 4. Information on the Company—B. Business Overview.” The most important among these regulations were:

- Resolution 607/2013 - Numbering on long distance calls
- Resolution 608/2013 – Account separation and allocation (DSAC)
- Resolution 611/2013 – Billing Areas Change
- Resolution 614/2013 – Regulation of SCM
- Resolution 615/2013 – Regulation of STFC
- Resolution 617/2013 – Regulation of Private Limited Service (“Serviços Limitado Privado – SLP”)
- Resolution 619/2013 – Current and historical costs (DSAC)
- Resolution 622/2013 – FATB Regulation
- Resolution 623/2013 – Users Council
- Resolution 624/2013 –Femtocell Regulation
- Resolution 625/2013 – Allocation of the 700 MHz band
- Resolution 628/2013 –Conduct Adjustment Term Regulation

We expect the following issues to become effective as new regulations or to be subject of one or more Public Notices in 2014, with an exact timeline yet to be determined by ANATEL.

- Local Areas Regulation
- Concession Agreement Review
- 700 MHz Auction
- Productivity Factor Calculation
- Public Use Telephone Regulation
- Treatment, Collection and Offer Regulation
- Reversible Assets

- Consumer Rights
- Infrastructure Share
- Use of Spectrum Regulation
- Sanctions and Conduct Adjustment
- Cost Model (DSAC)
- Systemic Disruption Regulation

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- WACC Regulation
- Mobile Telephony (SMP) Regulation

Number Portability came into effect in Brazil in September 2008. Number Portability allows clients within a limited geographic locale to relocate or change their telephone operator without the need to change their telephone number (for either a fixed or mobile line). Number Portability rights for all of our clients became effective in March 2009.

In addition to regulatory considerations, our business is affected by competition from other telecommunications providers. We began to face competition in our region in July 1999, and we anticipate that competition will contribute to declining prices for fixed-line telecommunications services and increasing pressure on operating margins. Our future growth and results of operations will depend significantly on a variety of factors, including:

- Brazil's economic growth and its impact on the greater demand for services;
- the costs and availability of financing; and
- the exchange rate between the real and other currencies.

Foreign Exchange and Interest Rate Exposure

We face foreign exchange risk due to our foreign currency-denominated indebtedness, accounts payable (including our capital expenditures, particularly equipment) and receivables in foreign currency. A real devaluation may increase our cost of debt and certain commitments in a foreign currency. Our revenue is earned in reais, and we have no material foreign currency-denominated assets, except income from hedging transactions, interconnection of international long-distance services and services rendered to customers outside Brazil. Equity investments in foreign companies also suffer effects with variations in the exchange rate.

On December 31, 2013, 15.9% of our R\$8.753 billion of financial indebtedness was denominated in U.S. dollars and UMBNDES. See Note 18 to the Consolidated Financial Statements. Devaluation of the real causes exchange losses on foreign currency-denominated indebtedness and commitments and exchange gain on foreign currency-denominated assets and corporate stakes in foreign companies.

We use derivative instruments to limit our exposure to exchange rate risk. Since September 1999, we have hedged all of our foreign currency-denominated bank debt using swaps. Since May 2010, the company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures, or assets (issued invoices) minus liabilities (received invoices) for foreign exchange exposures, substantially reducing the company's risk to fluctuations in exchange rates. However, we remain exposed to market risk resulting from changes in local interest rates, principally the CDI – Certificate of Interbank Deposits (Certificado de Depósito Interbancário), which is an index based upon the average rate of operations transacted among the banks within Brazil). This exposure to the CDI is present in long derivatives positions and financial investments, which are indexed to percentages of the CDI. Substantially, most of our debt is exposed to long term interest rates. On December 31, 2013, R\$2.442 billion of our indebtedness was subject to the variations of the TJLP. The loan with the BNDES accrues interest at the Long Term Interest Rate (acronym in Portuguese TJLP) and is fixed every quarter by the National Monetary Council (acronym in Portuguese CMN). Between July 2009 and June 2012 the rate was kept at 6.0% p.a.. From July to December 2012 it was 5.5% p.a., being lowered to 5.0% p.a. as of January 2013. Additionally, R\$1.394 billion of our indebtedness was subject to

the variation of the U.S. dollar and UMBNDES. However, our foreign currency debt is swapped under hedging arrangements for variable-rate real-denominated obligations based on the CDI. We invest our excess cash mainly in short-term instruments that earn interest based on the CDI. See Note 36 to the Consolidated Financial Statements and “Item 11. Quantitative and Qualitative Disclosures about Market Risk.”

Since we have foreign currency derivatives with notional amounts substantially equivalent to our borrowings and invoices issued and received denominated in foreign currency, we do not have material exchange rate exposure with respect to these contracts. However, we could still continue to have exchange rate exposure with respect to our planned capital expenditures, approximately 50.0% of which are denominated or indexed in foreign currencies (mostly U.S. dollars). We systematically monitor the amounts and time of exposure to exchange rate fluctuations and may contract for hedging positions, when appropriate, at our discretion.

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Discussion of Critical Accounting Estimates and Policies

The preparation of financial statements included in this annual report in accordance with IFRS involves certain assumptions and estimates that affect the amounts presented for revenue, expenses, assets and liabilities and disclosures of contingent liabilities in the notes to the financial statements. Therefore, the uncertainty relating to these assumptions and estimates could lead to results that require a significant adjustment to the accounting value of assets or liabilities affected in future periods. Although we review these estimates and assumptions in the ordinary course of business, the presentation of our financial condition and results of operation often requires our management to make judgments regarding the effects on our financial condition and results of operations of matters that are inherently uncertain. Actual results may differ from those estimated under different variables, assumptions or conditions. Note 3 of our Consolidated Financial Statements includes methods used in the preparation of those financial statements and includes a summary of the significant accounting policies. The areas involving a higher degree of judgment or complexity are described below.

Accounting for long-lived assets

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives. Intangible assets with indefinite useful lives, including goodwill, are not amortized, but are, instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining the fair value at their acquisition dates, particularly for assets acquired in business combinations and for determining the useful lives of the assets over which they are to be depreciated or amortized as well as their residual value. Asset lives are assessed annually and changed when necessary to reflect current evaluation on the remaining lives in light of technological change, network investment plans, prospective utilization and physical condition of the assets concerned.

The carrying values and useful lives applied to the principal categories of property, plant and equipment, and intangibles, are disclosed in Notes 13 and 14 to our consolidated financial statements.

Impairment of nonfinancial assets, including goodwill

An impairment loss exists when the accounting value of an asset or cash-generating unit exceeds its recoverable amount, which is the higher between the fair value less selling costs and the value in use. The estimated fair value less selling costs is based on the information available from transactions involving the sale of similar assets or the market price less additional costs regarding the disposition of such asset. The value in use is based on the model of discounted cash flow. Cash flows are derived from the budget and do not include activities of reorganization for which the company has not yet been committed or significant future investments that will improve the group of assets of the cash-generating unit subject to the test. The recoverable amount is sensitive to the discount rate used in the method of discounted cash flows as well as to the projected future cash flow and the expected future growth rate used for the purposes of determining terminal value. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The carrying value of goodwill and the key assumptions used in performing the annual impairment assessment are disclosed in Notes 3.j) and 14 to our consolidated financial statements.

Provisions for tax, labor, civil and regulatory proceedings

We record provisions for tax, labor, civil and regulatory claims where an outflow of resources is considered probable and a reasonable estimate can be made of the likely outcome. The assessment of the likelihood of loss includes assessing the available evidence, the hierarchy of laws, the available jurisprudence, the most recent court decisions and its materiality in the legal system as well as the evaluation of the case by external counsels. Provisions are reviewed and adjusted to take into account changes in circumstances such as the applicable prescriptive period, results from tax inspections or additional exposure identified based on newly issued court decisions. A significant change in these circumstances or assumptions could result in a corresponding increase or decrease the amount of our provisions.

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Additional information on provisions for tax, labor, civil and regulatory proceedings is disclosed in Notes 3.p) and 20 to our consolidated financial statements.

Pension and other post-retirement benefit plan

The cost of defined benefit retirement plans and other post-employment medical care benefits and the present value of pension obligations are determined using actuarial valuation methods. The actuarial valuation methods involves the use of assumptions about discount rates, expected future salary increases, mortality rates, health care costs trend rates and future increases in retirement benefits and pensions. The obligation of a defined benefit is highly sensitive to changes in these assumptions. All assumptions are reviewed at each year-end. The mortality rate is based on mortality tables available in the country. Future increases in wages and retirement benefits and pensions are based on expected future inflation for Brazil. The assumptions reflect historical experience and our judgment regarding future expectations.

The value of the net pension obligation at December 31, 2013, which is the key financial assumptions used to measure the obligation as well as the sensitivity of the IAS 19 (revised) pension liability at December 31, 2013 and of the income statement charge in 2013/14 to changes in these assumptions are disclosed in Note 35 to our consolidated financial statements.

Fair value of financial instruments

When the fair value of financial assets and liabilities presented on the balance sheet cannot be obtained in active markets, it is determined using valuation techniques, including the method of discounted cash flow. The data obtained for the use of these methods are based as much on the information prevailing in the market as possible. However, when it is not feasible to obtain such information in the market, a certain assumption level is required to establish the fair value. The assumption includes consideration of the data that was used, such as the liquidity risk, credit risk and volatility. Changes in the assumptions regarding these factors could affect the presented fair value of financial instruments.

Additional information on fair value of financial instruments is disclosed in Notes 3 k), l) and m) and 36 to our consolidated financial statements.

Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable income. We record provisions based on reasonable estimates for possible auditing by tax authorities from the jurisdictions in which we operate. The value of these provisions is based on several factors such as experience from previous tax audits and different interpretations of tax regulations by the taxable entity and the competent tax authority in charge. Such differences of interpretation may arise in a wide variety of subjects, depending on the prevailing conditions in the domicile of the company. As a result, we may be required to pay more than our provisions or to recover less than the assets recognized.

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

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

Additional information on taxes is disclosed in Notes 3.q), 8, 9 and 17.

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Revenue recognition

Customer Loyalty Program

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

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

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

Multiple-element arrangements

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

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

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

Additional information on revenue recognition is disclosed in Note 3.u) to our consolidated financial statements.

Provision for doubtful debts

We provide services to consumer and business customers, mainly on credit terms. We know that certain debts due to us will not be paid through the default of a small number of our customers. Estimates, based on our historical experience, are used to determine the level of debts that we believe will not be collected. These estimates include such factors as the current state of the economy and particular industry issues.

Additional information on provision for doubtful debts is disclosed in Notes 3.b) and 6 to our consolidated financial statements.

Sources of Revenue

The breakdown of our gross operating revenue is presented net of discounts granted. In addition, we categorized our revenue according to the following groups:

- Telephony services

Includes revenues from fixed and mobile telephony highlighting:

- Local: includes the sum of revenues from monthly subscription fees, installation fees, local services, public telephony and fixed-to-mobile revenues (VC1);
- Domestic long-distance: includes the sum of fixed-to-mobile revenues (VC2 and VC3), public long-distance telephony and domestic long-distance;

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- International long-distance: includes the sum of revenues from international public telephony and international long-distance; and
 - Usage charges: which include measured service charges for calls, monthly fee and other similar charges;
 - Data Transmission and value added services
 - Data Transmission: includes the sum of infrastructure rental revenues and data transmission; and
- Charges for call forwarding, call waiting, text messaging (SMS), call blocking and Data Services, such as WAP and ZAP, downloads and MMS services, which are charged only when the customer's plan excludes these services.
 - Interconnection charges
- Interconnection charges (or network usage charges) are amounts we charge other cellular and fixed-line service providers for the use of our network;
 - Pay TV
 - Includes TV services through satellite, cable or IPTV technology;
 - Sale of goods and equipment
 - The sale of wireless devices and accessories; and
 - Other Services
- Other services include integrated solution services offered to residential and corporate clients, such as Internet access, private network connectivity and leasing of computer equipment, and
- Other telecommunications services such as extended service, detects, voice mail, cellular blocker, among others.

Results of Operations

The following table sets forth certain components of our net income for each year ended December 31, 2013, December 31, 2012 and December 31, 2011 as well as the percentage change of each component. In 2011, we acquired 100% of shares of Vivo Participações. See Note 4 to our consolidated financial statements. Our consolidated financial statements include the former operations of Vivo Participações and Vivo since April 1, 2011.

Because Vivo Participações and Vivo are included in our financial statements for nine months in 2011, our results of operations in 2013 and 2012 are not fully comparable with our results of operations in 2011. We have made certain changes to our accounting criteria and elected to apply these changes retroactively to part of our financial statements for the years 2012 and 2011 to make them comparable to our 2013 financial statements. Implementation of these accounting changes did not create any difference for our results of operations or shareholders' equity.

On July 1, 2013 our shareholders approved the corporate reorganization with the merger of Vivo S.A. into us. See Note 1.b) to our consolidated financial statements.

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| | Year ended December 31, | | | Percent change 2013-2012 | Percent change 2012-2011 | | |
|---|-------------------------|--------------------|--------------------|--------------------------------|--------------------------------|--------|----|
| | 2013 | 2012 (Restated) | 2011 (Restated) | | | | |
| | (in millions of reais) | | | | | | |
| Net operating revenue | 34,721.9 | 33,919.7 | 29,116.6 | 2.4 | % | 16.5 | % |
| Cost of services and goods | (17,542.2) | (16,557.5) | (15,035.2) | 5.9 | % | 10.1 | % |
| Gross profit | 17,179.7 | 17,362.2 | 14,081.4 | (1.1 | %) | 23.3 | % |
| Operating expenses: | | | | | | | |
| Selling | (9,686.1) | (8,693.7) | (6,948.2) | 11.4 | % | 25.1 | % |
| General and administrative | (2,177.9) | (2,145.3) | (1,782.9) | 1.5 | % | 20.3 | % |
| Other operating revenues, net | (383.4) | 687.7 | 441.5 | (155.8 | %) | 55.8 | % |
| Total operating expenses, net | (12,247.4) | (10,151.3) | (8,289.6) | 20.6 | % | 22.5 | % |
| Equity in earnings (losses) of associates | (55.1) | 0.6 | 4.3 | - | | - | |
| Operating income before financial expense, net | 4,877.2 | 7,211.5 | 5,796.1 | (32.4 | %) | 24.4 | % |
| Net financial expenses | (214.8) | (291.2) | (141.0) | (26.3 | %) | 106.6 | % |
| Net income before income and social contribution taxes | 4,662.4 | 6,920.3 | 5,655.1 | (32.6 | %) | 22.4 | % |
| Income and social contribution taxes | (946.5) | (2,468.1) | (1,292.9) | (61.7 | %) | 90.9 | % |
| Net income | 3,715.9 | 4,452.2 | 4,362.2 | (16.5 | %) | 2.1 | % |
| Net income attributable to: | | | | | | | |
| Shareholders of company | 3,715.9 | 4,453.6 | 4,355.3 | (16.6 | %) | 2.3 | % |
| Noncontrolling interests | - | (1.4) | 6.9 | (100.0 | %) | (120.3 | %) |
| Net income | 3,715.9 | 4,452.2 | 4,362.2 | (16.5 | %) | 2.1 | % |

Net Operating Revenue

Net operating revenues increased by 2.4% to R\$34,721.9 million in 2013 from R\$33,919.7 million in 2012 mainly due to higher fixed and mobile data revenues, and increase in VAS revenues, besides some commercial initiatives that have been implemented by the Company during 2013. It was partially offset by the maturity of fixed voice and MTR reduction that affected mobile network usage. Net operating revenues grew 16.5% to R\$33,919.7 in 2012 from R\$29,116.6 million in 2011.

Capital Expenditures (Capex)

In 2013, we invested R\$6.033 million to support our current annual results and competitive position. Excluding the capital expenditures with acquisition of licenses it represented an increase of 10.2% when compared to 2012. A significant portion of resources was allocated to the expansion of our client base while maintaining the quality of the services provided. As a percentage over net operating revenues the ratio increased from 15% in 2012 to 16% in 2013 (excluding the effect of licenses). A significant portion of resources was allocated to the expansion of our client base while maintaining the quality of the services provided.

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

country.

Results of Operations for the Year Ended December 31, 2013 Compared to the Year Ended December 31, 2012

Operating Revenue

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue increased 3.4% to R\$51,965.6 million in 2013 from R\$50,264.6 million in 2012, impacted by the increase in fixed and mobile data revenue, a higher mobile VAS revenue, and increase of smartphones sales. The variations are explained as follows:

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| | Year ended December 31, | | Percent change | |
|--|-------------------------|-------------|----------------|----|
| | 2013 | 2012 | 2013-2012 | |
| | (Restated) | | | |
| | (in millions of reais) | | | |
| Telephony services | 26,428.6 | 26,555.1 | (0.5 | %) |
| Data transmission and value added services | 16,294.9 | 14,389.8 | 13.2 | % |
| Interconnection charges | 3,820.0 | 4,453.4 | (14.2 | %) |
| Pay TV | 645.0 | 805.3 | (19.9 | %) |
| Sale of goods and equipment | 3,479.8 | 2,792.6 | 24.6 | % |
| Other services | 1,297.3 | 1,268.4 | 2.3 | % |
| Gross operating revenue | 51,965.6 | 50,264.6 | 3.4 | % |
| Value-added and other indirect taxes | (17,243.7) | (16,344.9) | 5.5 | % |
| Net operating revenues | 34,721.9 | 33,919.7 | 2.4 | % |

Telephone services: There was a decrease of R\$126.5 million in revenue from telephony services, or 0.5%, explained mainly by the decrease in fixed to mobile tariff (VC) in April 2013. This decrease was partially offset by the increase in postpaid plans called “Vivo ilimitado.”

Data transmission and value added services: Revenue from data transmission and value added services increased by R\$1,905.1 million, or 13.2% compared to 2012. This increase is a result of the growth in sales of 3G, 3G Plus and 4G postpaid data packages tied to smartphones and an increase in sales of data packages to prepaid customers.

Interconnection charges: Revenue from interconnection charges decreased by R\$633.4 million, a 14.2% decrease in relation to 2012. This variation is mainly related to the decrease in mobile termination rates.

Pay TV: Revenue from Pay TV totaled R\$645 million in 2013, a decrease of 19.9% in the Pay TV’s gross revenue in relation to 2012. This variation is mainly related to the disconnection of MMDS customers due to the occupation of the spectrum by 4G operators. It was partially offset by the acceleration of DTH sales since June 2013, reflecting the selective relaunching of DTH TV services in some regions of São Paulo.

Sale of goods and equipment: Revenue from the sale of goods and equipment in 2013 totaled R\$3,479.8 million, an increase of 24.6% compared to 2012. The variation in 2013 is mainly explained by the increase in smartphone sales, increase in postpaid customers, and by the change in our sales model for SME segments.

Others services: Revenues from other services totaled R\$1,297.3 million, an increase of 2.3% compared to 2012. This increase is mainly a result of higher hardware sales for corporate SME segments.

Cost of Services and Goods

The following table sets forth the components of our costs of services and goods sold for 2013 and 2012, as well as the percentage change from the previous year.

| | Year ended December 31, | | Percent change | |
|--|-------------------------|------|----------------|--|
| | 2013 | 2012 | 2013-2012 | |

| | (Restated) | | | |
|---|------------------------|-------------|-------|---|
| | (in millions of reais) | | | |
| Cost of goods sold | (2,117.9) | (1,801.9) | 17.5 | % |
| Depreciation and amortization | (4,265.1) | (4,131.8) | 3.2 | % |
| Outside services and other | (3,645.4) | (3,373.1) | 8.1 | % |
| Interconnection charges | (3,842.3) | (4,012.1) | (4.2) | % |
| Rent, insurance, condominium fees, and leased lines | (1,428.0) | (969.3) | 47.3 | % |
| Personnel | (522.1) | (459.7) | 13.6 | % |
| Taxes, fees and contributions | (1,721.4) | (1,809.6) | (4.9) | % |
| Cost of services and goods | (17,542.2) | (16,557.5) | 5.9 | % |

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Cost of services and goods increased by 5.9% to R\$17,542.2 million in 2013 from R\$16,557.5 million in 2012. The variations are explained as follows:

Cost of goods sold: Cost of wireless devices and accessories increased by 17.5% to R\$2,117.9 million in 2013, from R\$1,801.9 million in 2012. The increase in 2013 was mainly due to the increase in smartphone sales, which is a result of higher sales of postpaid and data plans, change in our sales model for SME segment, and an increase in hardware sales for corporate segments.

Depreciation and amortization: Depreciation and amortization expenses increased by 3.2% to R\$4,265.1 million in 2013, from R\$4,131.8 million in 2012. The increase in 2013 was mainly due to investments in transmission infrastructure and network.

Outside services and other: Cost of third-party services and other increased by 8.1% to R\$3,645.4 million in 2013, from R\$3,373.1 million in 2012, mainly due to the increase in mobile content as a result of a higher number of applications offered to our customer base and an increase in Pay TV content.

Interconnection charges: Interconnection charges decreased by 4.2% to R\$3,842.3 million in 2013, from R\$4,012.1 million in 2012. The decrease in 2013 is mainly due to the reduction of Mobile termination rates beginning in April 2013.

Rent, insurance, condominium fees, and leased lines: Rent, insurance, condominium fees, and leased lines increased by 47.3% to R\$1,428.0 million in 2013, from R\$969.3 million in 2012. The increase in rent expenses was impacted by the leaseback of sold tower spaces, and also due to expansion of 3G and 4G coverage.

Personnel: Personnel expenses increased by 13.6% to R\$522.1 million in 2013, from R\$459.7 million in 2012. The increase in 2013 was mainly explained by the organizational restructuring action carried out in the year and due to the collective bargaining implemented in January 2013.

Taxes: Taxes decreased by 4.9% to R\$1,721.4 million in 2013, from R\$1,809.6 million in 2012. The decrease in 2013 was primarily attributable by a reduction in Fistel fee mainly due to a restructured policy in prepaid disconnections and of burden for renewal of concession licenses and authorization, which is based upon a percentage of revenues, explained by lower fixed revenue.

Operating Expenses

The following table sets forth the components of our operating expenses for each of the years ended December 31, 2013 and 2012, as well as the percentage change from the prior year.

| | Year ended December 31, | | Percent change | |
|--------------------------------------|----------------------------|-------------|-------------------|----|
| | 2013 | 2012 | 2013-2012 | |
| | (Restated) | | | |
| | (in millions of reais) | | | |
| Selling expenses | (9,686.1) | (8,693.7) | 11.4 | % |
| General and administrative expenses | (2,177.9) | (2,145.3) | 1.5 | % |
| Other net operating income (expense) | (383.4) | 687.7 | (155.8 | %) |
| Total | (12,247.4) | (10,151.3) | 20.6 | % |

Operating expenses increased by 20.6% to R\$12,247.4 million in 2013, from R\$10,151.3 million in 2012. The increase in 2013 reflects mainly due to an increase in selling expenses.

Selling expenses: Selling expenses increased by 11.4% to R\$9,686.1 million in 2013, from R\$8,693.7 million in 2012, mainly due to the selling efforts to improve fixed services, focusing on growth, in addition to the increase in the postpaid mobile customers base, supported by a commercial policy focused on adding value. The most relevant costs that increase in a year over year bases are: commission, tied to higher data packages adoption, call center and advertising related to the fixed services turnaround.

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General and administrative expenses: General and administrative expenses increased by 1.5% to R\$2,177.9 million in 2013, from R\$2,145.3 million in 2012. The lower increase was primarily due to austerity measures implemented by us during the year.

Other net operating income (expense): The net amount of other operating income (expense) decreased by 155.8% to R\$383.4 million in 2013, from R\$687.7 million in 2012. The high volume of revenue from sale of towers in 2012 in the amount of R\$1,114 million justifies the decrease of 155.8% in 2013.

Financial Result

For the year-end period ended on December 31, 2013, net financial expenses reached R\$214.8 million, decreasing by R\$76.4 million or 26.2% when compared to the period ended December 31, 2012, mainly due to lower average indebtedness in 2013.

Income and Social Contribution Taxes

We recorded expenses from income and social contribution taxes in the amount of R\$946.5 million in 2013, an decrease of 61.7% from an expense of R\$2,468.1 million in 2012. The decrease in 2013 was due to lower income before income and social contribution taxes. The effective rate of income tax and social contribution decreased to 20.3% in 2013 compared with 35.7% in 2012, mainly due to interest on shareholders' equity payments made in 2013, which is deductible for income tax purposes, and also to recognition of tax losses carry forwards in our subsidiary TData not recognized in previous years.

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

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

Operating Revenue

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue increased 16.7% to R\$50,264.6 million in 2012 from R\$43,058.6 million in 2011, impacted by increase in telephony services and data transmission and value added services. The variations are explained as follows:

| | Year ended December 31, | | Percent change | |
|--|----------------------------|------------|-------------------|---|
| | 2012 | 2011 | 2012-2011 | |
| | (Restated) | (Restated) | | |
| | (in millions of reais) | | | |
| Telephony services | 26,555.1 | 24,254.2 | 9.5 | % |
| Data transmission and value added services | 14,389.8 | 10,929.3 | 31.7 | % |
| Interconnection charges | 4,453.4 | 3,785.0 | 17.7 | % |

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| | | | | |
|--------------------------------------|-------------|-------------|------|----|
| Pay TV | 805.3 | 865.4 | (6.9 | %) |
| Sale of goods and equipment | 2,792.6 | 2,135.2 | 30.8 | % |
| Other services | 1,268.4 | 1,089.5 | 16.4 | % |
| Gross operating revenue | 50,264.6 | 43,058.6 | 16.7 | % |
| Value-added and other indirect taxes | (16,344.9) | (13,942.0) | 17.2 | % |
| Net operating revenues | 33,919.7 | 29,116.6 | 16.5 | % |

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

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

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

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

Sale of goods and equipment: Revenue from the sale of goods and equipment in 2012 totaled R\$2,792.6 million, an increase of 30.8% compared to 2011. The variation in 2012 is mainly a result of the increase in the sale of smartphones, a growth of postpaid customers over the year and as a result of the change in the sales model for SME segment and foreign exchange. Revenues from sales of wireless devices and accessories are reported before commissions and promotional discounts, and include value-added taxes. In general, the purpose of wireless device sales is to encourage growth in customers and traffic (and not necessarily to generate profits). Accordingly, we subsidize part of the costs of wireless devices for post-paid customers.

Others services: Revenues from other services totaled R\$1,268.4 million, an increase of 16.4% compared to 2011. This increase is mainly a result of higher revenues from providing integrated solutions for the corporate segment.

Cost of Services and Goods

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

| | Year ended December 31, | | Percent change | |
|---|----------------------------|-------------|-------------------|----|
| | 2012 | 2011 | 2012-2011 | |
| | (Restated) | (Restated) | | |
| | (in millions of reais) | | | |
| Cost of goods sold | (1,801.9) | (1,284.3) | 40.3 | % |
| Depreciation and amortization | (4,131.8) | (3,581.9) | 15.3 | % |
| Outside services and other | (3,373.1) | (2,918.4) | 15,6 | % |
| Interconnection charges | (4,012.1) | (4,537.1) | (11.6 | %) |
| Rent, insurance, condominium fees, and leased lines | (969.3) | (913.3) | 6.1 | % |
| Personnel | (459.7) | (380.1) | 20.9 | % |
| Taxes, fees and contribution | (1,809.6) | (1,420.1) | 27.4 | % |
| Cost of services and goods | (16,557.5) | (15,035.2) | 10.1 | % |

Cost of services and goods increased by 10.1% to R\$16,557.3 million in 2012 from R\$15,035.2 million in 2011. The variations are explained as follows:

Cost of goods sold: Cost of wireless devices and accessories increased by 40.3% to R\$1,801.9 million in 2012, from R\$1,284.3 million in 2011. The increase in 2012 was mainly due to the increased sales of smartphones, which is

linked to higher sales of postpaid and data plans, exchange and because of the change in the sales model for corporate segment.

Depreciation and amortization: Depreciation and amortization expenses increased by 15.3% to R\$4,131.8 million in 2012, from R\$3,581.9 million in 2011. The increase in 2012 was mainly due to investments in transmission infrastructure and network.

Outside services and other: Cost of third-party services and other increased by 15.6% to R\$3,373.1 million in 2012, from R\$2,918.4 million in 2011, mainly due to network maintenance and pay TV content.

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

Rent, insurance, condominium fees, and leased lines: Rent, insurance, condominium fees, and leased lines increased by 6.1% to R\$969.3 million in 2012, from R\$913.3 million in 2011. The increase in 2012 was mainly due to expansion of 3G coverage.

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

Taxes: Taxes increased by 27.4% to R\$1,809.6 million in 2012, from R\$1,420.1 million in 2011. The increase in 2012 was primarily attributable to growth of the customer base, reflecting the increase in Fistel spending.

Operating Expenses

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

| | Year ended December 31, | | Percent change | |
|-------------------------------------|----------------------------|------------|-------------------|---|
| | 2012 | 2011 | 2012-2011 | |
| | (Restated) | (Restated) | | |
| | (in millions of reais) | | | |
| Selling expenses | (8,693.7) | (6,948.2) | 25,1 | % |
| General and administrative expenses | (2,145.3) | (1,782.9) | 20,3 | % |
| Other net operating income | 687.7 | 441.5 | 55.7 | % |
| Total | (10,151.3) | (8,289.6) | 22.5 | % |

Operating expenses increased by 22.5% to R\$10,151.3 million in 2012, from R\$8,289.6 million in 2011. The increase in 2012 reflects mainly due to an increase in selling expenses.

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

General and administrative expenses: General and administrative expenses increased by 20.3% to R\$2,145.3 million in 2012, from R\$1,782.9 million in 2011. The increase in 2012 reflects an increase in maintenance along with the opening of the new integrated office of the company.

Other net operating income: The net amount of other operating income increased by 55.7% to R\$687.7 million of other revenues in 2012, from R\$441.5 million of other revenues in 2011. The increase in 2012 is mainly due to revenue from sales of non-strategic assets in 2012.

Financial Result

For the year-end period ended on December 31, 2012, net financial expenses reached R\$291.2 million, increasing by R\$150.2 million or 106.5% when compared to the period ended December 31, 2011, mainly due to lower interest

income on financial assets and the consolidation of Vivo and Vivo Participações as of April 2011. When compared with the financial expenses of the period ended December 31, 2011 including results of Vivo and Vivo Participações for the first quarter of 2011, net financial expenses for the year-end period ended on December 31, 2012 have increased R\$111.3 million or 62.0%.

Income and Social Contribution Taxes

We recorded expenses from income and social contribution taxes in the amount of R\$2,468.1 million in 2012, an increase of 90.9% from an expense of R\$1,292.9 million in 2011. The increase in 2012 was due to higher income before income and social contribution taxes. The effective rate of income tax and social contribution increased to 35.7% in 2012 compared with 22.9% in 2011, mainly due to lower interest on shareholders' equity payments made in 2012, which is deductible for income tax purposes.

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B. Liquidity and Capital Resources

General

We have funded our operations and capital expenditures mainly from operating cash flows and loans obtained from financial institutions, capital markets or development banks. As of December 31, 2013, we had R\$6.5 billion in cash and cash equivalents. Our principal cash requirements include:

- the servicing of our indebtedness;
- capital expenditures; and
- the payment of dividends.

Sources of Funds

Our cash flow from operations was R\$9.6 billion in 2013 compared to R\$10.1 billion in 2012, with a reduction of 4.8% in the last year compared with 2012. The decrease is a reflection of the variation in the Company's EBITDA, which was caused by an increase in cost of marketing services, commissioning, call center and rent towers.

Uses of Funds

Our cash flow used in investing activities was R\$5.5 billion in 2013 compared to R\$3,7 billion in 2012. The increase in cash flow used in investing activities of 49.0% in 2013 compared to 2012 was primarily due to payment of licenses and increase in investments.

Our cash flow used in financing activities was R\$4.6 billion in 2013 compared to R\$2.1 billion in 2012. The increase in cash flow used in financing activities of 121.2% in 2013 compared to 2012 was due primarily to increase payment of dividends in 2013 compared to 2012, along with increase payments of debentures and loans.

Indebtedness

As of December 31, 2013, our total debt was as follows:

| Debt | Currency | Annual interest rate payable | Maturity | Total amount outstanding (in thousands of reais) |
|---------------------------|----------|--|----------|--|
| BNDES loans and financing | R\$ | TJLP + 0 to 9% | 2020 | 2,441.9 |
| BNDES loans and financing | R\$ | 2.5 to 8.7% | 2019 | 171.7 |
| BNDES loans and financing | UMBDES | ECM + 2.38% yearly | 2019 | 505.5 |
| BNB loans and financing | R\$ | 10.0% | 2016 | 225.0 |
| Mediocredito | US\$ | 1.75% | 2014 | 3.5 |
| BEI | US\$ | 4.18% to 4.47% | 2015 | 885.2 |
| Resolution 4,131 | US\$ | | 2013 | - |
| Debentures | R\$ | 100% of the CDI + 0.68% to 106.8% of the CDI | 2018 | 4,129.5 |

| | | | | |
|------------|-----|---------------------------|------|---------|
| Debentures | R\$ | IPCA + 0.5% to IPCA +7.0% | 2021 | 172.1 |
| Others | R\$ | | 2014 | 219.2 |
| Total debt | | | | 8,753.6 |
| Current | | | | 1,523.7 |
| Long term | | | | 7,229.8 |

Interest and principal payments on our indebtedness as of December 31, 2013 due in 2014 and 2015 total R\$1,523.7 million and R\$1,959.6 million, respectively.

The agreements that govern the majority of our outstanding loans and financings contain certain standard restrictive covenants, which may provide for the acceleration of the full balance of our obligations in the event of any default. As of December 31, 2013, we were not in default of any of our obligations and therefore none of our liabilities were subject to acceleration.

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Capital Expenditures and Payment of Dividends

Our principal capital requirements are for capital expenditures and payments of dividends to shareholders. Capital expenditures consisted of additions to property, plant and equipment and additions to intangible assets, including licenses which totaled R\$ 6.0 billion, R\$6.1 billion and R\$5.4 billion for the years ended December 31, 2013, 2012 and 2011, respectively. These expenditures relate primarily to the expansion of our network. We may seek financing for part of our capital expenditures and cash management assistance from the Brazilian government, in particular from BNDES, which is the main government financing agent in Brazil, as well as from the local or foreign capital markets or from local and foreign financial institutions. See “Item 4. Information on the Company—A. History and Development of the Company—Capital Expenditures.”

Pursuant to our bylaws and Brazilian Corporate Law, we are required to distribute a mandatory minimum dividend of 25% of “adjusted net income” (as defined below) in respect of each fiscal year, to the extent earnings are available for distribution. Holders of preferred shares are assured priority in the reimbursement of capital, without a premium, and are entitled to receive cash dividends that are 10% higher than those attributable to common shares.

Adjusted net income, as determined by Brazilian Corporate Law, is an amount equal to our net income adjusted to reflect allocations to or from (i) legal reserve, (ii) statutory reserve and (iii) a contingency reserve for anticipated losses, if any.

We may also make additional distributions to the extent that we have profits and reserves available to distribute. All of the above distributions may be made as dividends or as tax-deductible interest on shareholders’ equity. Interest on shareholders’ equity are tax-deductible payments pursuant to Brazilian Corporate law, that a company may make, in addition to dividends, which the company may treat as financial expenses for tax and social contribution purposes. For more information on the payment of interests on shareholders’ equity, see “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Dividends and Interest on Shareholders’ Equity.” We paid dividends of R\$4.7 billion, R\$3.6 billion and R\$5.4 billion in 2013, 2012 and 2011, respectively.

Our management expects to meet 2014 capital requirements primarily from cash provided from our operations. Net cash provided by operations was R\$9.6 billion, R\$10.1 billion, and R\$8.4 billion in 2013, 2012 and 2011, respectively.

Adjustments to net income for purposes of calculating the basis for dividends include allocations to various reserves that effectively reduce the amount available for the payment of dividends. For the fiscal year ended December 31, 2013, in addition to the interim dividend and interest on own capital payments made in 2013 and 2014, management decided to submit to the Shareholders Meeting a proposal to pay additional dividends in the amount of R\$132.5 million. The proposal to pay dividends will be approved by a General Shareholders Meeting to be held on April 23, 2014. See “Item 3. Key Information—D. Risk Factors—Risks Relating to the Preferred Shares and the ADSs—Holders of our preferred shares and our ADSs generally do not have voting rights” and “Item 10. Additional Information—B. Memorandum and Articles of Association—Voting Rights.”

New Accounting Pronouncement

Recently Adopted Standards

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

We adopted all the standards, revisions of standards and interpretations issued by IASB, which entered into force as of January 1, 2013 including:

IAS 1 Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income The amendments to IAS 1 introduce a grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or recycled) to profit or loss at a future point in time (e.g., net gain on hedge of net investment,

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exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets) now have to be presented separately from items that will never be reclassified (e.g., actuarial gains and losses on defined benefit plans and revaluation of land and buildings). The amendments became effective for annual periods beginning on or after July 1, 2012. The application of these amendments affects presentation only and has no impact on the Company and its subsidiary's financial position or performance.

IAS 19 Employee Benefits (Revised): The IASB has issued a number of amendments to IAS 19. These amendments include not only basic changes, such as the elimination of the "corridor" approach and the concept of expected return on plan assets, but also simple clarifications regarding valuation, devaluation and rereasurement. This amendment became effective for annual periods beginning on or after January 1, 2013. The application of this amendment has no significant impact on the Company and its subsidiary's financial position or performance.

IAS 28 Accounting for Investments in Associates and Joint Ventures (revised in 2011): As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. This amendment became effective for annual periods beginning on or after January 1, 2013. The application of this amendment has no impact on the Company and its subsidiary's financial position or performance.

IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7): These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g., collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. This amendment became effective for annual periods beginning on or after January 1, 2013. The application of these amendments affects presentation only and has no impact on the Company and its subsidiary's financial position or performance.

IFRS 10 Consolidated Financial Statements, and IAS 27 Separate Financial Statements: IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 Consolidation -Special Purpose Entities. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 require management to exercise significant judgment to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. This standard became effective for annual periods beginning on or after January 1, 2013. This standard did not have any significant impacts on the Company and its subsidiary's financial statements.

IFRS 12 Disclosure of Interests in Other Entities: IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. This standard became effective for annual periods beginning on or after January 1, 2013. The application of this standard affects disclosures only and has no impact on the Company's and its subsidiary's financial position or performance.

IFRS 13 Fair Value Measurement: IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. Additionally, at December 12, 2013

amendments to IFRS 13 were introduced with immediate effect. The IASB stated in "Basis for Conclusions" that short-term receivables and account payables with no outstanding interest may be recognized considering the invoice amount where the effect of discounting be quantified as immaterial. This standard became effective for annual periods beginning on or after January 1, 2013. The application of this standard has no significant impact on the Company upon first-time adoption.

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New IFRS and interpretations of the IFRIC with impact on the financial position shown in these financial statements:

IFRS 11 replaces IAS 31 Interests in Joint Ventures and SIC-13 Jointly-controlled Entities - Non-monetary Contributions by Venturers. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. The application of this new standard impacted the Company's financial position and eliminated the proportionate consolidation of Aliança Atlântica Holding B.V. (Aliança), Companhia Aix de Participações (AIX) and Companhia ACT de Participações (ACT). Accordingly, investments in these entities were accounted for using the equity method. This standard became effective for annual periods beginning on or after January 1, 2013.

Recently Issued Standards

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

IFRS 2 Share-based Payment: These amendments changed the definitions relating to vesting conditions and implementation is effective for annual periods beginning on or after July 1, 2014. The Company will apply the amendment in its financial statements from its effective date.

IFRS 3 Business Combinations: The amendments changed the accounting for contingent consideration in a business combination. Contingent consideration on acquisition of a business that is not classified as equity are subsequently measured at fair value through profit or loss, whether or not included in the scope of IFRS 9 Financial Instruments. These changes are effective for new business combinations after July 1, 2014. The Company will consider the application of these changes to any business combinations that occur beginning on or after July 1, 2014.

IFRS 8 Operating Segments: The changes are related to the aggregation of operating segments, which can be combined / aggregated whether they are in accordance with the criteria of the rule, in other words, if the segments have similar economic characteristics and are similar in other qualitative aspects. If they are combined, the entity shall disclose the economic characteristics used to assess whether the segments are similar. These amendments take effect beginning on or after July 1, 2014. Considering the fact that the Company and its subsidiary operate in one operating segment, this amendment is not expected to significantly impact its financial statements and disclosure.

IFRS 9 Financial Instruments: IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after January 1, 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, moved the mandatory effective date to January 1, 2015. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Company's financial assets, but will not have an impact on classification and measurements of financial liabilities. The Company will quantify the effect in conjunction with the other phases of IASB project, when the final standard consolidating all phases is issued.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27): The amendments will be effective for annual periods beginning on or after January 1, 2014, providing an exception to the consolidation requirements for a reporting entity that meets the definition of an investment entity under IFRS 10. This exception requires an investment entity to account for its investments in subsidiaries at fair value in profit or loss. The Company does not expect these

amendments to significantly impact its financial statements, given that it and its subsidiary does not qualify as an investment entity.

IFRS 13 Fair Value Measurement: The amendment applies prospectively after July 1, 2014 . The change is related to the application of the exception financial assets portfolio, financial liabilities and other contracts. The Company and its subsidiary will evaluate the effect of implementation of this amendment on or after July 1, 2014.

IAS 16 Property Plant and Equipment and IAS 38 Intangible Assets: The amendment to IAS 16.35 (a) and IAS 38.80 (a) clarifies that a revaluation can be made as follows: i) adjust the gross carrying amount of the asset at market value or , ii) determine the market value and adjust the gross carrying amount proportionally, so that the resulting carrying amount is equal to the market value. IASB also clarified that the accumulated depreciation /

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amortization is the difference between the gross carrying amount and the carrying amount of the asset (ie gross book value - depreciation / accumulated amortization = book value). The amendment to IAS 16.35 (b) and IAS 38.80 (b) clarifies that the accumulated depreciation / amortization is eliminated so that the gross carrying amount and the book value is equal to market value. The changes will take effect retrospectively beginning on or after July 1, 2014. Implementation of these changes have no impact on the financial or operational condition of the Company and its subsidiary at the time. The Company and its subsidiary do not apply the revaluation method; therefore, the amendment will not impact the financial statements.

IAS 24 Related Party Disclosures: The amendment clarifies that an entity's providing key management personnel services to the reporting entity or to the parent of the reporting entity is a related party of the reporting entity. In addition, an entity that uses a management entity shall disclose the expenses incurred by management services. The changes will take effect retrospectively beginning on or after July 1, 2014. The Company does not expect these amendments to significantly impact its financial statements.

IAS 32 Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32: These amendments clarify the meaning of “currently has a legally enforceable right to set off the recognized amounts” and the criteria that would qualify for settlement the settlement mechanisms of clearing house systems that are not simultaneous. These amendments will become effective for annual periods beginning on or after January 1, 2014. The Company does not expect these amendments to significantly impact its financial statements.

IFRIC 21 Levies: IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability is recognized before the specified minimum threshold is reached. IFRIC 21 becomes effective for annual periods ending on or after January 1, 2014. The Company does not expect IFRIC 21 to significantly impact its financial statements.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting - Amendments to IAS 39: The amendments provide a relief on the discontinuation of hedge accounting in certain circumstances in which a hedging instrument is to be novated. These amendments will become effective for annual periods beginning on or after January 1, 2014. These amendments shall apply to future novations of derivatives.

IAS 40 Investment Property: This amendment clarifies the relationship between the definitions of IFRS 3 and IAS 40 on the classification of the investment property or owner-occupied property. The description of ancillary services in IAS 40 that differentiates between investment properties and owner occupied property (IFRS 3) is used to determine whether the transaction is a purchase of an asset or a business combination. This amendment is effective prospectively beginning on or after July 1, 2014. The Company will evaluate any possible impact in case of transactions occurring after the effective date.

C. Research and Development, Patents and Licenses

Research and Development

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

Also, to keep pace with constant innovation, we created a business incubator that helps the organization to easily handle emerging business opportunities of large sizes or risks that otherwise would be difficult to manage in the context of current business units. In 2013, R\$0.2 million was invested in innovation.

The table below presents the Telefônica Brasil investments in development, update and modernization of systems to support the launch of new products and services. In 2013, R\$18.2 million was invested in development.

| R&D investments | 2013 | 2012 | 2011 |
|---|------------------------|------|------|
| | (in millions of reais) | | |
| Development | 18.2 | 22.7 | 44.6 |
| Innovation (business incubator and tests) | 0.2 | 0.7 | 1.3 |
| Total | 18.4 | 23.4 | 45.9 |

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Patents and Licenses

Our principal intellectual property assets include:

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

D. Trend Information

For 2014, concerns about the macroeconomic scenario may be reflected in the telecom industry trends. Consumption will still lead a year of growth in the telecommunication market revenues, driven by services penetration mainly in data and TV. We expect companies in the industry to maintain the trend of consolidation and to offer integrated (bundled) services, increasing pressure on ARPUs and opening a gap between accesses and revenues growth. Data services (mobile and fixed) will be the most relevant growth driver, leveraged by the adoption of smartphone and services beyond connectivity. In the fixed-line business, we bet on the technological evolution as the way to explore the ultra-broadband and Pay TV markets value. We are well positioned to explore this opportunities, since our organization and resources are focused on developing business in these areas, always sustained by a quality of services differentiated from our competitors.

E. Off-balance-Sheet Arrangements

None.

F. Tabular Disclosure of Contractual Obligations

Our contractual obligations and commercial commitments as of December 31, 2013 are as follows:

| | Total | Up to year | 1-3 years | 4-5 years | After 5 years |
|--|--|------------|-----------|-----------|---------------|
| | (In thousands of reais, as of December 31, 2013) | | | | |
| Contractual obligations | | | | | |
| Long-term debt (1) | 8,753,555 | 1,523,712 | 4,946,822 | 2,136,378 | 146,642 |
| Pension and other post-retirement benefits | 370,351 | 7,417 | 14,827 | 14,732 | 333,375 |
| Other long-term obligations including leases | 10,302,962 | 2,416,820 | 2,351,217 | 2,014,468 | 3,520,457 |
| Total contractual obligations | 19,426,868 | 3,947,949 | 7,312,866 | 4,165,578 | 4,000,474 |
| Commercial commitments | | | | | |
| Suppliers | 6,914,009 | – | – | – | – |
| Other commercial commitments | – | – | – | – | – |
| Total commercial commitments | 6,914,009 | – | – | – | – |

(1)

Includes interest payments.

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Long-Term Debt - Principal

| | Year ending December 31, | Amount (in thousands of reais, as of December 31, 2013) |
|------------------|--------------------------|--|
| 2015 | | 1,959,575 |
| 2016 | | 515,158 |
| 2017 | | 2,472,089 |
| 2018 | | 1,807,763 |
| 2019 | | 328,615 |
| 2020 and forward | | 146,642 |
| Total | | 7,229,842 |

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ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

We are managed by a Board of Directors (Conselho de Administração) and an Executive Committee (Diretoria).

Board of Directors

Our Board of Directors comprises a minimum of five (5) and a maximum of seventeen (17) members, all shareholders, serving for a term of three years. The following is a list of the current members of the Board of Directors, their respective positions and dates of their election.

| Name | Position | Date of Appointment |
|---|---------------|---------------------|
| Antonio Carlos Valente da Silva | Chairman | April 16, 2013 |
| Santiago Fernández Valbuena | Vice-Chairman | April 16, 2013 |
| Antonio Gonçalves de Oliveira | Director | April 16, 2013 |
| Eduardo Navarro de Carvalho | Director | April 16, 2013 |
| Francisco Javier de Paz Mancho | Director | April 16, 2013 |
| José Fernando de Almansa Moreno-Barreda | Director | April 16, 2013 |
| Luciano Carvalho Ventura | Director | April 16, 2013 |
| Luis Javier Bastida Ibarguen | Director | April 16, 2013 |
| Luis Fernando Furlan | Director | April 16, 2013 |
| Narcís Serra Serra | Director | April 16, 2013 |
| Paulo Cesar Pereira Teixeira | Director | April 16, 2013 |
| Roberto Oliveira de Lima | Director | April 16, 2013 |

(*) The members of the Board of Directors have the mandate until the ordinary general meeting of 2016.

Set forth below are brief biographies of our directors:

Antonio Carlos Valente da Silva is 61 years old and acts as Chairman of the Board of Directors of Telefônica Brasil S.A. since December 2006, Chief Executive Officer of Telefônica Brasil S.A. since January 2007 and member of the Committee of Appointments, Compensation and Corporate Governance of Telefônica Brasil S.A. He is the Chief Executive Officer of Telefônica Data S.A.. He is also the President of the Board of Trustees of Fundação Telefônica, Vice-President Director of SP Telecomunicações Participações Ltda., Chairman of the Board of Directors of Telefônica Factoring do Brasil Ltda. member of the Control Committees of Media Networks Brasil Soluções Digitais Ltda. and of Telefônica Serviços Empresariais do Brasil Ltda. He was the Chief Executive Officer of the extinguished companies Vivo S.A., A. Telecom S.A., Telefônica Sistemas de Televisão S.A., Ajato Telecomunicação Ltda., Lemontree Participações S.A., GTR-T Participações e Empreendimentos S.A., Comercial Cabo TV São Paulo S.A. and TVA Sul Paraná S.A. He was the Chief Executive Officer of Vivo Participações S.A. from May 10, 2011 until October 03, 2011. He was also a member of the Board of Directors of Telefônica Internacional S.A. He was the President of Telebrasil (Brazilian Association of Telecommunications), President of Sinditelebrasil (National Union of Fixed and Mobile Telephone Service Operators) and President of Febratel (Brazilian Federation of Telecommunications). He was President of Ahciet (Asociación Iberoamericana de Centros de Investigación y Empresas de Telecomunicaciones) in the period from 2007 to 2011, President of the Official Spanish Chamber of Commerce in Brazil and President of the Euro-chambers in Brazil (an association that gathers the main Chambers of Commerce in the European Union). He is also a member of the CDES (Economic and Social Development Council of

the Presidency of the Republic of Brazil), member of the Advisory Council of CPqD, (Telecommunications Research and Development Center), member of the Executive Committee of ABDIB (Brazilian Infrastructure and Base Industries Association), and member of COINFRA (FIESP's Infrastructure Commission). He was the Chief Executive Officer of Telefônica in Peru until November 2006 and Chairman of the Board of Directors of Telefônica Móviles S.A., Telefónica Móviles Peru Holding S.A.C., Telefônica Peru Holding S.A.C. and Telefónica Multimedia S.A.C. He was also the First Vice-President of the Association for Private and Public Utilities Companies (ADEPSEP) and director of the Official Spanish Chamber of Commerce in Peru (COCEP). Prior to his appointment as Chief Executive Officer of Telefônica in Peru, he was in charge for the regulatory management of Grupo Telefônica in Latin America. He was a Vice-President of the Brazilian National

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Telecommunications Agency (Anatel), member of the Management Board of Anatel, chief and member of several Brazilian delegations at international conferences in the period from 1997 to 2004 and, in the period from 2002 to 2003, he was President of the Latin-American Forum for Telecommunications Regulators (Regulatel), an institution that gathers regulatory agencies of nineteen countries in Latin America. He was the Chairman of the Board of Telest, (Telecommunications of Espírito Santo State), was a member of the board of directors of Perdigão S/A and of Paranapanema. He also occupied several managing positions in the Telebrás System, in the areas of Telecommunication Systems Engineering, Technical Operating Planning and Corporate Planning. He worked for the Communications Ministry, being a member of the team that carried out the restructuring of the Brazilian Telecommunications System. He has a B.S. degree in Electrical Engineering from PUC/RJ, has large experience in the telecommunications market, in which he has been working since 1975. He has an MBA degree from PUC/RJ, has concluded several specialization courses in telecommunication systems in Brazil and abroad, and several specialization courses in Business Management, including Corporate Strategy at MIT/Sloan.

Santiago Fernández Valbuena, is 55 years old and acts as Vice Chairman of the Board of Directors of Telefônica Brasil and CEO of Telefónica Internacional, S.A. He is also CEO of SP Telecomunicações Participações Ltda. Since 2012 he has been a member of the board of directors of Telefónica S.A. In 2010 he was named the strategy, finance and development officer of Telefônica Group. From 2002 to 2012 he was CFO and finance officer of Telefônica Group. During this time he was also responsible for the purchasing, human resources and systems area of the Group, as well as internal auditing, corporate development, and was responsible for our subsidiaries. In 1997, he joined the Telefônica Group as head of Fonditel, the pension and social security arm of the Telefônica Group in Spain. He has served as a member of the board of directors of Portugal Telecom and Endemol Holding, in the Netherlands. Mr. Valbuena was previously an officer of Soci  t   Generale Valores and of Beta Capital in Madrid. He holds an economics degree from the Universidad Complutense in Madrid and a PhD and Master in economics from Northeastern University in Boston.

Antonio Gonalves de Oliveira is 69 years old and is a member of our Board of Directors and Control and Audit Committee. Mr. Oliveira is also a member of the Board of Directors of Paranapanema S.A. He was a member of the fiscal committee of Klabin S.A. until April 2013. He was a member of the Board of Directors of Vivo Participa es S.A. since March 2001 and Control and Audit Committee since July 2005. Mr. Oliveira was also a member of the Board of Directors of TELESP Celular S.A. and a member of the Board of Directors or Control and Audit Committee of the following businesses: Tele Sudeste Celular Participa es S.A., Telemig Celular Participa es S.A., Telemig Celular S.A., Tele Leste Celular Participa es S.A., Tele Centro Oeste Celular Participa es S.A. and Celular CRT Participa es S.A., until these companies ceased to exist. Mr. Oliveira was the chairman of the Fiscal Council of Bahia's Electricity Company (Companhia de Eletricidade da Bahia), or COELBA, from April 2006 to April 2008, chairman of the Association of Friends of the Museum of Contemporary Art of USP (Associa o de Amigos do Museu de Arte Contempor  nea da USP), or AAMAC, from 2006 to 2010, member of the Fiscal Counsel of Iguatemi Shopping Centers, from 2007 to 2008, and Melpaper, from 2009 to 2010, and a member of the Council of Representatives of the Federation of Industries of S  o Paulo (Federa o das Ind  strias do Estado de S  o Paulo), or FIESP. Mr. Goncalves de Oliveira is a member of the Advisory Board of The Welfare Fund for Employees of Banco do Brasil (Caixa de Previd  ncia dos Funcion  rios do Banco do Brasil), or PREVI, from 2008 to 2012 and was a member of the Council of Social and Economic Development of the Brazilian government and the Working Group for Small and Medium Enterprises also sponsored by the Brazilian government. He was leader of ADEBIM (Associa o de Empresas Brasileiras para a Integra o de Mercados), member of the Steering Committee and Management of the Banco do Povo de Estado de S  o Paulo and Chairman of the Deliberative Board of the Association of Brazilian Companies for Market Integration (Associa o Nacional dos Funcion  rios do Banco do Brasil), or ANABB, for eight years. In the role of sociologist, was president of the Association of Sociologists of the State of S  o Paulo, for 6 years, and director, for 4 years, the Latin American Association of Sociology. Mr. Oliveira was the executive coordinator of

the National Movement of Micro and Small Enterprise (Movimento Nacional da Micro e Pequena Empresa). Mr. Gonçalves holds a degree in Social Sciences, a master's degree in Communication Sciences and a post-graduate degree in Sociology of Organizations from the University of São Paulo (Universidade de São Paulo) in Brazil. He also holds a specialist title in Human Resources from Fundação Getulio Vargas in São Paulo and extension courses on business management topics. Mr. Oliveira is Certified Counselor by the Brazilian Institute of Corporate Governance, IBGC, due to its experience in supervisory boards and management boards.

Eduardo Navarro de Carvalho is 51 years old and is a member of our Board of Directors and President of the Service Quality and Marketing Committee. He is currently Director of Strategy and Alliances at Telefónica S.A. and member of the Executive Committee of Telefónica S.A. Previously, he was responsible for Strategic Planning and Regulatory at Telefónica Internacional S.A. From 1999 and 2005, he served as Vice President of Corporate Strategy

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and Regulatory Group at Telefonica in Brazil, participating in the Steering Committee of several companies of the Telefónica Group in Brazil. He worked for five years as a consultant at McKinsey & Company (1994-1999), during which he led projects in Brazil, Spain, Portugal and South Africa, focusing on strategies in the areas of Industry, Infrastructure and Telecommunications. He began his professional experience in the steel industry, where he worked from 1986 and 1994 in Group ARBED in Brazil. He graduated in Metallurgical Engineering from the Federal University of Minas Gerais, Brazil.

Francisco Javier de Paz Mancho is 55 years old and serves as a member of our Board of Directors and of our Nominations, Compensation and Corporate Governance Committee. Mr. Mancho is also a member of the Board of Directors of Telefónica S.A. and Telefónica de Argentina S.A. He was the President of Atento Inversiones y Teleservicios from December 2008 to December 2012. Since July 2006 he has been a member of the Executive Committee of the Superior Board of Councils. From June 2004 until December 2007, he was the President of Mercasa. He was Counselor deputy to the President and Director of the Strategic Corporate area of Panrico Donuts Group (1996–2004), General Director of the Ministry of Commerce and Tourism (1993–1996), General Secretary of Unión de Consumidores de España (UCE). Delegate Counselor of Ciudadano magazine (1990–1993), General Secretary of Juventudes Socialistas and executive member of PSOE (1984–1993). Also, he has acted in the following capacities: counsel of Túnel del Cadí (2004–2006), President of Patronal Pan and Bollería Marca (COE) (2003–2004), counsel of Mutua de Accidents of Zaragoza (MAZ) (1998–2004), counsel of Panrico Group (1998–2004), President of Observatorio de la Distribucion Comercial del Ministerio de Comercio y Turismo (1994–1996), Member of the Social and Economic Council and Permanent Commission (1991–1993 and 1996–2000) and counsel of Tabacalera, S.A. (1993–1996). Mr. Mancho holds degrees in Information and Publicity and a degree in law studies from the Executive Management Program of IESE (Universidad de Navarra).

José Fernando de Almansa Moreno-Barreda is 65 years old and is a member of our Board of Directors and President of the Nominations, Compensation and Corporate Governance Committee. He is a member of the Board of Directors of Telefónica S.A. He is also a member of the Board of Directors of Telefónica Latinoamérica S.A., Telefónica Móviles México S.A. de CV, and BBVA Bancomer Mexico. Mr. Almansa joined the Spanish Diplomatic Corps in 1974 and served from 1976 to 1992 as Embassy Secretary of the Spanish Embassy in Brussels, Cultural Counselor of the Spanish Representation to Mexico; Chief Director for Eastern European Affairs and Atlantic Affairs Director in the Spanish Foreign Affairs Ministry; Press and Political Counselor to the Spanish Permanent Representation to the North Atlantic Council in Brussels; Minister-Counselor of the Spanish Embassy in the Soviet Union; General Director of the National Commission for the 5th Centennial of the Discovery of the Americas and Deputy General Director for Eastern Europe Affairs in the Spanish Foreign Affairs Ministry. In January 1993, Mr. Almansa was appointed Chief of the Royal Household by His Majesty King Juan Carlos I. He held this post until December 2002 and is currently Personal Adviser to His Majesty King Juan Carlos I. Mr. Almansa holds a law degree from the Universidad de Deusto, Bilbao, Spain. He is a sponsor, among other affiliations, of the Foundations Reina Sofia, Conde de Barcelona, Diputación de San Andrés de los Flamencos - Carlos de Amberes Foundation, Padre Arrupe–Activa, Principe de Asturias and Euroamérica.

Luciano Carvalho Ventura is 67 years old and is member of our Board of Directors and a member of the Service Quality and Marketing Committee. He is the officer responsible for LCV Corporate Governance. He is a member of Fiscal Board of CSU CardSystem. Since 1980, he has been dedicated to corporate governance consulting and serving as an independent member of corporate boards. He is a founding member of the Instituto Brasileiro de Governança Corporativa–IBGC–Brasil (Brazilian Corporate Governance Institute) and he was a member of its Board of Directors. He was a member of the International Corporate Governance Network – England. He is professor of the course for formation of directors of the Brazilian Corporate Governance Institute and a speaker at various masters courses and seminars. He holds an MBA from Escola de Administração de Empresas de São Paulo–Fundação Getúlio Vargas, a

post-graduate degree in finance from Escola de Administração de Empresas de São Paulo da Fundação Getúlio Vargas, a degree in business management from Escola de Administração de Empresas da Universidade Federal de Pernambuco, and a degree in economics from Faculdade de Ciências Econômicas da Universidade Federal de Pernambuco.

Luis Javier Bastida Ibarguen is 68 years old and is a member of our Board of Directors and President of the Control and Audit Committee. Since 2002, he has acted as an independent consultant. During 2000 and 2001, worked in Banco Bilbao Viscaya Argentaria, where he was a member of the Steering Committee and head of the Global Asset Management Division. Mr. Bastida began working at Banco Bilbao Vizcaya Argentaria in 1988. In the period from 1994 to 2000, he was Chief Financial Officer (CFO), reporting directly to the Chairman. From 1976 to 1987, he worked at Banco Bilbao, where he had different responsibilities, mainly in areas related to finance. From

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1970 to 1976, he worked for General Electric in New York and Spain. At General Electric, he was a member of the Finance Management Program and the International Management Program and worked in various capacities in the Finance and Strategic Planning Functions. He holds degrees in Business at the E.S.T.E. University in San Sebastián–Spain and holds an MBA from Columbia University in New York.

Luiz Fernando Furlan is 67 years old and is a member of the Boards of Directors of Telefônica Brasil S.A. (Brasil), Telefónica S.A. (Spain), BRF–Brasil Foods S.A. (Brasil), AGCO Corporation (USA), as well as a member of the advisory board of Panasonic (Japan), Wal-Mart (USA) and ABERTIS Infraestructuras S.A. (Spain). Previously, he was Chairman of the Board of Directors at Sadia S.A., from 1993 to 2002 and from 2008 to 2009, company that he has held numerous executive positions from 1976 to 1993. He was Co-Chairman of the board of BRF Brasil Foods S.A. from 2009 to 2011, as well as a member of the board of Amil Participações S.A. from 2008 to 2013 and Redecard S.A. from 2007 to 2010. He served two terms as Minister of Development, Industry and Foreign Trade of Brazil from 2003 to 2007, and was a Chairman of the Board of Directors of BNDES from 2003 to 2007. Since 2008, he has been the Chairman of the Board of Directors of Fundação Amazonas Sustentável “FAS” (Brazil), and up to 2013, he is also member of the Board of Directors of Global Ocean Commission (USA) and member of Conselho Superior de Gestão em Saúde de São Paulo (Brazil). He holds a degree in Chemical Engineering from FEI (Industrial Engineering Faculty) and in Business Administration from University of Santana – São Paulo, with extension and specialization courses in Brazil and abroad.

Narcís Serra Serra is 70 years old and serves as a member of our Board of Directors and a member of the Control and Audit Committee. From 1991 to 1995, he was Vice President of the Government of Spain, and from 1982 to 1991, served as Minister of Defense. From 1979 to 1982, he was the Mayor of Barcelona. Mr. Serra holds a doctorate in economics from the Universidad Autónoma de Barcelona and is President of Barcelona Institute for International Studies (IBEI).

Paulo Cesar Pereira Teixeira is 56 years old and is a member of Board of Directors of Telefônica Brasil S.A. since November, 07, 2011. Mr. Teixeira also acts as a General and Executive Officer of Telefônica Brasil S.A. He is also General Officer of Telefônica Data S.A. and Officer of SP Telecomunicações Participações Ltda. He is also a member of the Board of Trustees of Fundação Telefônica. He began his career in the telecommunications industry in 1980, as a member of CRT’s Directive Council. From 2003 to 2011, he was the Executive Vice President of Operations at Vivo S.A. From 1998 to 2002, he acted as Vice President of Operations for Telefônica Celular (Tele Sudeste, Tele Leste and CRT). From 1995 to 1998, he was Engineering Officer and Enterprise Officer of the Telebrás System (Telems, Tele Celular Sul). He was also president of the Brazilian Roaming Association (ABR) and Officer of National Association of Cellular Providers (ACEL). Mr. Teixeira holds an electrical engineering degree from Universidade Católica de Pelotas, Brazil. He attended a New Telecommunications Techniques course at École Nationale Supérieure des Télécommunications, France, in 1992, and Advanced Management Program no IESE-Business School, in Barcelona (2001).

Roberto Oliveira de Lima is 62 years old and serves as a member of our Board of Directors and a member of the Service Quality and Marketing Committee. Mr. Lima is also a member of the Board of Directors of Edenred SARL, based in Paris/França, Naspers Ltd, based in Johannesburg, Cia Brasileira de Distribuição, based in São Paulo/Brazil, Natura S.A., based in São Paulo, and Rodobens Negócios Imobiliários, based in São Paulo/Brazil. He was the Chief Executive Officer of Vivo Participações S.A and Vivo S.A. He was also Chief Executive Officer of Instituto Vivo. Mr. Lima was Executive Vice President of Marketing and Innovation and Vice President of IT and Products and Services Engineering of the following companies: Vivo Participações S.A. and Vivo S.A., Tele Centro Oeste Celular Participações S.A., Telerj, Telest, Telebahia, Telergipe, Celular CRT S.A., TELESP Celular, Global Telecom, Telegoiás, Telemat, Telems, Teleacre, Teleron, NBT and TCO IP S.A. He was also Chief Executive Officer of Tele

Sudeste Celular Participações S.A., Tele Leste Celular Participações S.A. and Celular CRT Participações S.A. until 2006 and Telemig Celular Participações S.A. until November, 2009. He was an Officer of Telemig Celular Participações S.A. He was Chairman of the Board of Directors of Grupo Credicard from 1999 to 2005 and Chief Executive Officer of Banco Credicard S.A. from 2002 to 2005. Mr. Lima also held executive positions at Accor Brasil S.A., Rhodia Rhone Poulec S.A. and Saint Gobain S.A. He holds a degree in business administration and an MBA from Fundação Getúlio Vargas, Brazil. He holds a master's degree in Finance and Strategic Planning from the Institute Superieur des Affaires, Jouy en Josas, France.

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Executive Committee

The executive committee consists of at least four (4) and no more than fifteen (15) members, who may or may not be our shareholders, all of them appointed by our Board of Directors for a period of three years and who may remain in office until reappointed or replaced. Any of our executive officers may be removed at any time by a decision of the Board of Directors.

The following are the current members of the executive committee, their respective positions and the date of their appointment.

| Name | Position | Date of Appointment |
|-----------------------------------|---|---------------------|
| Antonio Carlos Valente da Silva | Chief Executive Officer | May 19, 2010 |
| Paulo Cesar Pereira Teixeira | General and Executive Officer | September 13, 2011 |
| Breno Rodrigo Pacheco de Oliveira | General Secretary and Legal Officer | June 14, 2011 |
| Alberto Manuel Horcajo Aguirre | Chief Financial Officer, Control and Investor Relations Officer | August, 7, 2013 |

Set forth below are brief biographies of our executive officers:

Breno Rodrigo Pacheco de Oliveira is 38 years old. Is General Secretary and Legal Officer of Telefônica Brasil S.A and Telefônica Data S.A.. He is also Corporate Secretary of the Board of Directors of Telefônica Brasil S.A., a member of the Deliberative Council of Visão Prev Sociedade de Previdência Complementar and Officer of SP Telecomunicações Participações Ltda. Mr. Oliveira is also Corporate Secretary of the Board of Directors of Telefônica Factoring do Brasil Ltda., Corporate Secretary and member of the Board of Directors of Telefônica Corretora de Seguros Ltda., member of the Control Committee of Media Networks Brasil Soluções Digitais Ltda., Telefônica Serviços Empresariais do Brasil Ltda. and Telefônica Engenharia de Segurança do Brasil Ltda. He was Officer of the following extinguished companies: Vivo S.A., A.Telecom S.A., Telefônica Sistema de Televisão S.A., Ajato Telecomunicação Ltda., Lemontree Participações S.A., TVA Sul Paraná S.A., GTR-T Participações e Empreendimentos S.A. e Comercial Cabo TV São Paulo S.A. He was also General Secretary and Legal Officer from February 3, 2011 to October 3, 2011 of Vivo Participações S.A. (when it was merged into the company) and of Vivo S.A. from April, 2005 to February, 2011. He holds a law degree from Universidade do Vale do Rio dos Sinos – UNISINOS, Brazil.

Alberto Manuel Horcajo Aguirre, is 50 years old. He is currently our CFO, controller and investor relations officer as well as CFO and controller of TData. He was formerly an executive officer of Vivo and has also been global services officer of the Telefonica Group in Madrid, where he was responsible for logistics, real estate, workspace and customer service. Mr. Aguirre has also served as purchasing director from 2004 to 2011. He was an officer in the areas of finance, human resources and general services, in our operations in Spain, Argentina, Brazil, Peru and of the Telefonica Group as a whole. He was CEO of Atento in Madrid from 2001 to 2004. Since 2002, he has served as an independent board member for the Lantero Group in Spain and was previously a board member of Transportes Azkar, also in Spain. Mr. Aguirre has also been CEO of Ardizia, the investment firm, from 1999 to 2001. Since 2010, he is patron of the Institute for Education and Research in Madrid of the University of Navarra. He holds a law degree from the Universidad Complutense in Madrid and was a Fulbright scholar at Columbia University from 1986 to 1988. In

2011 he was part of the Stanford Executive Program for advanced operations design.

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

B. Compensation

For the year ended December 31, 2013, the aggregate amount of compensation paid to all our Directors and Executive Officers was approximately R\$32.4 million, of which R\$28 million corresponded to salaries and R\$4.4 million corresponded to bonuses.

For the year ended December 31, 2013, our Directors and Officers did not receive any pension, retirement or similar benefits.

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C. Board Practices

Board of Directors

Our Board of Directors typically meets once every three months and the Chairman may call special meetings. Our Board takes action by majority vote, provided the majority of its members in office are present, with the Chairman having, in addition to his or her regular vote, the deciding vote in the event of a tie. The specific responsibilities of the Chairman include representing the Board in the General Shareholders Meetings, chairing the General Shareholders Meetings, selecting the Secretary from among those present, and calling and chairing meetings of the Board.

Our Board of Directors is responsible, among other things, for:

- establishing our general business policies;
- electing and removing the members of our executive committee, and establishing their responsibilities with due regard for legal and statutory provisions;
- supervising our management and examining our corporate records;
- calling General Shareholders Meetings;
- approving the financial statements, management reports, proposals for allocation of the company's results and the submission of such documents to the General Shareholders Meeting;
- appointing and deposing external auditors;
- determining the distribution of interim dividends;
- determining the payment of interest on equity "ad referendum" of the General Shareholders Meeting;
- authorizing the purchase of our shares to be cancelled or kept in treasury;
- appointing and removing the person responsible for internal auditing;
- approving the budget and annual business plan;
- deliberating on the issuance of new shares by increasing the corporate capital within the limits authorized by the bylaws;
- approving the issuance of commercial paper and depositary receipts;
- authorizing the sale of fixed and concession-related assets;
- approving agreements, investments and obligations in an amount greater than R\$250 million that have not been approved in the budget;
-

approving employment and compensation plans, incentive policies and professional development, regulation and staffing of the company, and the terms and conditions of collective bargaining agreements to be executed with unions representing various categories of the company's employees and adhesion or disassociation from pension plans, all with respect to employees of the company; the Board of Directors can, at its own discretion, assign to the company's officers limits to deliberate on these matters;

- authorizing the acquisition of interest in other companies on a definitive basis and the encumbrance and creation of lien on or sale of an equity interest;

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- authorizing the offering of ordinary nonconvertible unsecured debentures;
- approving the organizational structure of the company; the Board of Directors can assign to the officers limits to the exercise of such powers, subject to legal and bylaws provisions;
- approving and modifying the internal regulations of the Board of Directors;
- deliberating as to the issuance of warrants;
- deliberating, by delegation of the General Shareholders Meeting, about the following aspects related to company debentures: (i) opportunity to issue, (ii) time and conditions of expiration, amortization or redemption, (iii) time and conditions of the payment of interest, of the participation in the profits and of the premium of repayment, if any, (iv) method of subscription or placement, and (v) the type of debentures;
- approving the establishment of technical and advisory committees for advice on matters of interest to them, to elect members of such committees and approve the committees, internal regulations, which shall contain specific rules concerning their organization, functions, powers, and compensation of members;
- authorizing the sale of property, the creation of in rem guarantees and the provision of guarantees on behalf of third parties, and setting limits on the practice of such acts by the officers;
- establishing, as an internal regulation, the limits for the officers to authorize the disposition or encumbrance of permanent assets, including those related to public telecommunications services which are disabled or inoperable;
- approving the company's participation in consortia in general, and the terms of such participation; the Board of Directors may delegate such powers to the officers and establish limits, as it seeks to develop activities in line with the company's purpose;
- setting the limits for the officers to authorize the practice of reasonable gratuitous acts for the benefit of employees or the community of which the company is a part of, including the donation of unserviceable assets to the company; and
- approving the creation and closure of subsidiaries of the company, in Brazil or abroad.

The members of our Board of Directors are all shareholders, one of them being elected by the preferred shareholders in a separate voting process and the others being elected by the holders of common shares. The members of the Board of Directors are elected for a period of three years and may be reelected.

Executive Committee

Our Executive Committee is responsible for our day-to-day management and for representing us in our business with third parties. Each of our current Executive Officers has been appointed by our Board of Directors for a three-year term and may remain in office until reappointed or replaced.

Fiscal Board

Brazilian Corporate Law and our bylaws each require that we maintain a statutory Fiscal Board (Conselho Fiscal). Our statutory Fiscal Board, which is a separate and distinct entity from our outside auditors, is primarily charged with certain advisory, reporting, oversight and review functions with respect to the company's financial statements. Our statutory Fiscal Board is also responsible for rendering opinions on management's annual report and management proposals, including financial statements, to be submitted at shareholders meetings relating to a change in the company's capital composition, investment plans, budget, debenture issuances or subscription bonuses, payment of dividends and consolidations, mergers and spin-offs. However, the statutory Fiscal Board, as required by Brazilian Corporate Law and our bylaws, has only an advisory role and does not participate in the management of the company. Indeed, decisions of the statutory Fiscal Board are not binding on the company under Brazilian Corporate Law.

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In accordance with Brazilian Corporate Law and our bylaws, the Fiscal Board consists of a minimum of three (3) and a maximum of five (5) active members and an equal number of alternates.

One member of the Fiscal Board and his or her alternate must be elected by holders of preferred shares in a separate voting process. The following are the current members of the Fiscal Board:

| Members | Alternates | Date Appointed |
|-------------------------|--------------------------------|----------------|
| Flavio Stamm | Gilberto Lerio | April 16, 2013 |
| Cremênio Medola Neto | Gilmar Roberto Pereira Camurra | April 16, 2013 |
| Stael Prata Silva Filho | Charles Edwards Allen | April 16, 2013 |

Committees

Brazilian Corporate Law does not require a corporation to maintain committees responsible for ethics, corporate governance or compensation. Nevertheless, our Board of Directors has created the following committees:

- Control and Audit Committee;
- Nominations, Compensation and Corporate Governance Committee; and
- Service Quality and Marketing Committee.

Control and Audit Committee

Our Control and Audit Committee was created by our Board of Directors in December 2002 and comprises a minimum of three and a maximum of five directors, who are not members of our executive committee, and who are appointed by the Board of Directors to serve as members of the Control and Audit Committee for the duration of their respective terms as members of the Board of Directors. The Committee has its own charter, which was approved by the Board of Directors. The Committee provides support to the Board of Directors.

According to its charter, the Control and Audit Committee shall meet four times per year and report its conclusions to the Board of Directors. We anticipate that there will be some similar functions between the Control and Audit Committee and our statutory Fiscal Board.

The Control and Audit Committee, among other responsibilities that may be required by the Board of Directors, is charged with informing and providing recommendations to the Board of Directors regarding the following:

- the appointment, termination and renewal of the independent auditors, as well as the terms and conditions of the contract with the independent auditors;
- the analysis of the company’s accounts, compliance with certain legal requirements and the adoption of generally accepted accounting principles;
- the results of each internal and independent audit and management’s response to the auditor’s recommendations;
- the quality and integrity of the company’s internal control systems;

- the performance of the independent auditors, requesting opinions on the annual reports and that the main audit reports be clear and precise; and
- any communications with the internal auditors about any significant deficiencies in our control systems and identified financial conditions.

The following are the current members of the Control and Audit Committee:

| Members | Date Appointed |
|-------------------------------|----------------|
| Luis Javier Bastida Ibarquen | April 23, 2013 |
| Antonio Gonçalves de Oliveira | April 23, 2013 |
| Narcís Serra Serra | April 23, 2013 |

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Nominations, Compensation and Corporate Governance Committee

Our Nominations, Compensation and Corporate Governance Committee was established in November 1998, and was restructured in October 2004, and consists of three to five directors appointed by the Board of Directors to serve for the duration of their respective terms as members of the Board of Directors. The Nominations, Compensation and Corporate Governance Committee, among other responsibilities that may be required by the Board of Directors, is charged with informing and providing recommendations to the Board of Directors regarding the following:

- the appointment of executive officers for our company and our subsidiaries;
- the parameters on compensation for our executive officers and administrators;
- the terms and conditions of executive officers, employment agreements;
- the review of the Board’s compensation plan and any amendments;
 - the incentive plans related to compensation;
- the compensation policy for directors and executive officers of the company; and
 - the annual corporate governance report.

The following individuals are the current members of the Nominations, Compensation and Corporate Governance Committee:

| Members | Date Appointed |
|---|----------------|
| José Fernando de Almansa Moreno-Barreda | April 23, 2013 |
| Antonio Carlos Valente da Silva | April 23, 2013 |
| Francisco Javier de Paz Mancho | April 23, 2013 |

Service Quality and Marketing Committee

The Service Quality and Marketing Committee was created on December 16, 2004 and provides assistance to our Board of Directors. The Committee consists of at least three, and at most five, members of our Board selected periodically. The Committee meets from time to time, depending on the availability of its members and when called by its chair. The Committee is responsible for review and analysis of quality indices measuring our principal services and to ensure that the requisite degree of commercial assistance is furnished to our clients.

| Members | Date Appointed |
|-----------------------------|----------------|
| Eduardo Navarro de Carvalho | April 23, 2013 |
| Luciano Carvalho Ventura | April 23, 2013 |
| Roberto Oliveira de Lima | April 23, 2013 |

D. Employees

As of December 31, 2013, we had 18,532 employees. All of our employees are full-time, and are divided into the following categories: 26% in our network plant operation, maintenance, expansion and modernization; 62% in sales and marketing; and 12% in administration, finance and investor relations, human resources, inventory, technology, legal and strategic planning and management control.

Approximately 9% of our employees are union members' representative in the telecommunication industry. These unions have state representation, so we have employees represented by 27 state unions. In turn, 19 of these unions are associated with the National Federation of Telecommunications Workers (Fenattel).

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Our Collective Bargaining Agreement for these employees was renewed on September 1, 2013 and will expire on August 31, 2014.

Our management considers relations with our work force to be very good. We have never experienced a work stoppage that had a material effect on our operations.

Pension Plans

Before December 1999, the SISTEL Fundação Sistel de Seguridade Social plan, a multi-employer defined benefit plan that supplements government-provided retirement benefits, covered the employees of the former Telebrás System and we were contingently liable for all of the unfunded obligations of the plan. In January 2000, we and the other companies that formerly belonged to the Telebrás system agreed to divide the existing SISTEL plan into 15 separate plans, resulting in the creation of private plans covering those employees already enrolled in the SISTEL plan. These new private pension plans were still administered by the Fundação Sistel and have retained the same terms and conditions of the initial plan. The division was carried out to allocate liability among the companies that formerly belonged to the Telebrás system according to each company's contributions with respect to its own employees. Joint liability among the SISTEL plan sponsors will continue with respect to retired employees, who will necessarily remain members of the plans, which were called PBS plans.

Under the PBS plans, we made monthly contributions to plan equal to a percentage of the salary of each employee who was a participant plan. Each employee member also made a monthly contribution to plan on the basis of age and salary. Pension benefits of members of the PBS plan vested by the same time their retirement benefits vested under the government-provided retirement plan. Fundação Sistel operates independently from us, and its assets and liabilities are fully segregated.

Beginning in 2000, we decided to establish defined contributions plans, and offered it to participants in our PBS plans, defined benefit plans, as well as to employees who did not qualify for participation. Unlike the PBS plans, which is a defined benefit plan, defined contribution plans are financed for contributions by participating employees, as well as by us as sponsor, which are credited to the individual accounts of the participants. We are responsible for all management and maintenance expenses of these plans, including the risks of death and permanent injury of the participants.

In 2004, we created a closed pension fund, Visão Prev Sociedade de Previdência Complementar, or Visão Prev, to manage our group's pension funds. All plans previously managed by Fundação Sistel are now managed by Visão Prev, with the exception of the Sistel plan which remains under Fundação Sistel's management.

On September 1, 2013, we began offering the Visão Multi Pension Plan to all of our employees. Under this plan, employees may choose to contribute either one or two percent, plus up to an additional five percent of their salary and we will contribute between 50% to 125%, based on the length of employment. Currently, 49.1% of our employees are covered by these plans.

E. Share Ownership

None of our directors or executive officers beneficially owns, on an individual basis, 1% or more of our common or preferred shares (including ADSs representing preferred shares) or of our total equity share capital.

At the General Shareholders Meeting of Telefónica S.A. (our indirect controlling shareholder), held on June 21, 2006, the application of a long-term incentive plan—"Performance Share Plan" (PSP)—for executives of Telefónica S.A. and of other entities within the Telefónica Group, which includes Telefônica Brasil S.A. was approved. The plan grants a determined number of shares of Telefónica S.A. to selected participants who fulfill the necessary requirements.

The PSP is divided into five cycles, each of three-year duration. The eligible executives, who must remain with the Telefónica Group for a minimum period of three years commencing on the date of their eligibility, will have the right to receive stipulated shares based upon their performance in achieving targeted pre-defined results. Shares will be received at the end of each cycle. Each cycle is independent of the others, with the first cycle starting on July 1, 2006 (with distribution of shares of Telefónica S.A. starting on July 1, 2009) and each subsequent cycle commencing on July 1 of each subsequent year, up to and including, the fifth cycle, which commences on July 1, 2010 (with delivery of shares of Telefónica S.A. starting on July 1, 2013).

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The first distribution under the PSP took place in July 2009, with 56 executives (including 4 executives appointed pursuant to the bylaws) from Telefônica Brasil given the right to 239,867 shares of Telefónica S.A.

The second distribution under the PSP took place in July 2010, with 57 executives (including 4 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to 175,534 shares of Telefónica S.A.

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

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

The fifth provision related to PSP cycle which ended in July 2013, did not happen because it was not achieved the minimum established in the program for the indicator valuation Telefonica's share (TSR – Total Shareholder Return).

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

The PIP is divided into three cycles, each of three-year duration. The eligible executives, who must remain with the Telefónica Group for a minimum period of three years commencing on the date of their eligibility, will have the right to receive stipulated shares based upon their performance in achieving targeted pre-defined results. Shares will be received at the end of each cycle. Each cycle is independent of the others, with the first cycle starting on July 1, 2011 (with distribution of shares of Telefónica S.A. starting on July 1, 2014) and each subsequent cycle commencing on July 1 of each subsequent year, up to and including, the third cycle, which commences on July 1, 2013 (with delivery of shares of Telefónica S.A. starting on July 1, 2016).

The first provision related to PIP will take place in July 2014, with 95 executives (including 4 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 384,350 shares of Telefónica S.A., for which, on December 31, 2013, we have made a provision of R\$7.9 million.

The second provision related to PIP will take place in July 2015, with 108 executives (including 4 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 674,811 shares of Telefónica S.A., for which, on December 31, 2013, we have made a provision of R\$10.6 million.

The third provision related to PIP will take place in July 2016, with 124 executives (including 4 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 711,651 shares of Telefónica S.A., for which, on December 31, 2013, we have made a provision of R\$15.8 million.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

In accordance with our bylaws, we have two classes of capital stock authorized and outstanding: common shares (ações ordinárias) and preferred shares (ações preferenciais). Our common shares have full voting rights. Our preferred shares have voting rights only under limited circumstances. At December 31, 2013, Telefónica Internacional owned 15.43% of our common shares and SP Telecomunicações, owned 50.47% of our common shares. Since Telefónica Internacional owns 55.28% of the equity share capital of SP Telecomunicações, it has effective control over 43.33% of our outstanding common shares. Accordingly, Telefónica Internacional has the ability to control the election of our Board of Directors and to determine the direction of our strategic and corporate policies. Neither Telefónica Internacional, nor SP Telecomunicações, has any special voting rights beyond those ordinarily accompanying the ownership of our common or preferred shares.

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The following tables set forth information relating to the ownership of common and preferred shares by SP Telecomunicações, Telefónica Internacional and our officers and directors. We are not aware of any other shareholder that beneficially owns more than 5% of our common shares.

| Shareholder's Name | Number of common shares owned | Percentage of outstanding common shares | |
|---|-------------------------------|---|---|
| SP Telecomunicações | 192,595,149 | 50.47 | % |
| Telefónica S.A. | 97,976,194 | 25.68 | % |
| Telefónica Internacional | 58,859,918 | 15.43 | % |
| All directors and executive officers as a group | 1,511 | – | |

| Shareholder's Name | Number of preferred shares owned | Percentage of outstanding preferred shares | |
|---|----------------------------------|--|---|
| SP Telecomunicações | 29,042,853 | 3.90 | % |
| Telefónica S.A. | 179,862,845 | 24.17 | % |
| Telefónica Internacional | 271,707,098 | 36.52 | % |
| All directors and executive officers as a group | 1,305 | – | |

Telefónica Internacional is a wholly owned subsidiary of Telefónica S.A., or Telefónica. Telefónica's shares are traded on various stock exchanges, including exchanges in Madrid, Barcelona, Bilbao, Valencia, London, New York, Lima and Buenos Aires. Telefónica's business operations are concentrated in a number of sectors, including fixed and mobile telecommunications services, data communications, pay TV, integrated business solutions, e-commerce, market information and services, media content creation, production, distribution and marketing and call center services.

B. Related Party Transactions

Note 32 to our consolidated financial statements presents, in tabular format, more detailed financial information with respect to transactions and balances with related parties. We provide below a summary description of transactions with related parties.

In April 2001, we entered into a service agreement for the provision of logistics, administrative, accounting and other services with Telefônica Serviços Empresariais do Brasil Ltda., or TGestiona, an indirect wholly owned subsidiary of Telefónica. Transactions with TGestiona under this service agreement involved approximately R\$80.9 million in 2013 (compared to R\$97.7 million and R\$94.6 million in 2012 and 2011, respectively).

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

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See Note 20 of our Consolidated Financial Statements.

Legal Proceedings

We are party to legal proceedings incidental to the normal course of our business. The main categories of such proceedings include:

- administrative and judicial litigation with Instituto Nacional da Seguridade Social, the National Institute of Social Security, or INSS;
- administrative and judicial proceedings relating to tax payments;

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- lawsuits brought by employees, former employees and trade unions relating to alleged infringements of labor rights; and
- other civil suits, including litigation arising out of the breakup of Telebrás and events preceding the breakup.

Our policy with respect to provisioning for contingencies classifies the various legal proceedings to which we are party as “probable,” “possible” and “remote.” The Company and its subsidiaries are parties to labor, tax, civil and regulatory claims and set up a provision for contingencies for which the likelihood of loss was estimated as probable. Our senior management classifies each legal proceeding into one of these three categories (probable, possible and remote) based upon the advice of internal and external counsel and specialized technical advisors in charge of each matter. Due to the level of provisioning and based on its analysis of the individual cases, our management believes that no additional liabilities related to any legal proceedings will have a material effect on our financial condition or results of operations.

Provision for Tax Matters

Federal Taxes

At December 31, 2013, the company was party to administrative and judicial proceedings relating to: (i) additional contributions to the FGTS (Unemployment Compensation Fund) on deposits made by employees (the issue does not result in the reduction of part of FGTS deposits made by the company on behalf of its employees); (ii) claims resulting from the non-ratification of compensation and refund requests, formulated by the company; (iii) social contributions relating to a supposed failure to pay 11% on the value of invoices, billing and receipts from service providers hired for the transfer of labor; (iv) CIDE levied on the remittance of funds abroad relating to technical services, administrative assistance and to services of similar nature, as well as royalties; (v) fixed: non-inclusion of interconnection and EILD expenses in the FUST base and Wireless carriers: non-inclusion of revenues from interconnection in the FUST tax base; (vi) contribution to Empresa Brasileira de Comunicação, created by Law No. 11652/08; (vii) TFI/TFF on mobile stations; (viii) IRRF on Interest on shareholder’s equity; (ix) Public Price for Numbering Resources Management (PPNUM) by ANATEL instituted by Resolution No. 451/06; (x) IRPJ/PIS/COFINS resulting from the non-ratification of the companies’ offset and refund requests; (xi) Social Investment Fund (Finsocial) offset amounts; (xii) failure to pay withholding social contribution levied on services rendered, remuneration, salaries and other salary bases; (xiii) COFINS – Requirement resulting from non-inclusion of financial income into the tax base; (xiv) additional charges to the PIS and COFINS tax base, as well as additional charges to COFINS required by Law No. 9718/98; and (xv) Tax on Net Income (ILL). On December 31, 2013, total consolidated provisions amounted to R\$2,042.1 million.

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

State Taxes

On December 2013, the company was party to administrative and judicial proceedings in progress referring to (i) ICMS tax credits on electric power and tax credits without documentation (ii) ICMS not levied on telecommunication services; (iii) disallowance of ICMS tax incentives for cultural projects; (iv) ICMS on TV subscription; and (v) environmental administrative fine At December 31, 2013, total consolidated provisions amounted to R\$91.9 million.

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

Municipal Taxes

On December 31, 2013, the company was party to tax claims at a municipal level, both in the administrative and judicial sphere which, based on the opinion of its legal advisors, are classified as a probable loss. At December 31, 2013, total consolidated provisions amounted to R\$14.7 million.

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

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

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Tax Proceedings

The following tax proceedings were pending as of December 31, 2013, and, in the opinion of our management and our legal advisors, the chance of loss in these cases is “possible.”

Federal Taxes

At December 31, 2013, the company was party to various administrative and judicial proceedings in the federal sphere, which are waiting to be tried at various court levels. At December 31, 2013, the total consolidated amount was R\$3,913.9 million.

Key proceedings refer to: (i) Non-compliance manifestations due to the ratification of compensation requests made by the company; (ii) fine for distribution of dividends even in view of the alleged existence of outstanding debts payable to the federal government; (iii) social security contribution (INSS) on compensation payment for salary devaluation arising from losses caused by “Plano Verão” (Summer Plan) and “Plano Bresser” (Bresser Plan), SAT (Work Accident Insurance), Social Security and payables to third parties (INCRA and SEBRAE), supply of meals to employees, 11% retention (labor assignment); (iv) IRRF on the funds remittance abroad related to technical services and to administrative support and similar services, as well as royalties; (v) PIS levied on roaming; (vi) CPMF levied on operations resulting from the technical cooperation agreement with the National Treasury Department (STN) (offsetting through the Integrated System of Federal Government Financial Administration - SIAFI) and on foreign-exchange contracts required by the Brazilian Central Bank; (vii) IRPJ and CSLL related to deductions on revenues from reversal of provisions; (viii) Income tax and social contribution – disallowance of costs and miscellaneous expenses not substantiated; (ix) deductions of COFINS from loss in swap transactions; (x) PIS / COFINS accrual basis versus cash basis; (xi) IRPJ payable in connection with allocation of excess funds to Northeast Investment Fund (FINOR), Amazon Region Investment Fund (FINAM) or Economic Recovery Fund of the State of Espírito Santo (FUNRES); (xii) IRPJ on derivative operations; (xiii) IRPJ and CSLL – disallowance of expenses related to the goodwill paid in the acquisition of Celular CRT S.A., goodwill arising from the privatization process, Vivo’s corporate restructuring and goodwill from the mergers of Navytreet and TDBH; and (xiv) contribution to the Brazilian company of communication, created by Law No. 11.652/08.

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

State Taxes

On December 31, 2013, the company was a party to various administrative and judicial proceedings related to ICMS, at the state level, which are ongoing in various court levels. At December 31, 2013, the total consolidated amount was R\$7.088,8 million.

Key proceedings refer to: (i) provision of facility, utility and convenience services and rental of the “Speedy” service modem; (ii) international calls (DDI); (iii) undue credit related to the acquisition of items intended to property, plant and equipment; (iv) lack of proportionate credit reversal referring to the acquisition of property, plant and equipment items; (v) amounts unduly appropriated as ICMS tax credits; (vi) service provided outside São Paulo state with ICMS paid to São Paulo State; (vii) co-billing, (viii) tax substitution with a fictitious tax base (tax guideline); (ix) use of credits related to acquisition of electric power; (x) secondary activities, value added and supplementary services (Agreement 69/98); (xi) tax credits related to opposition/challenges referring to telecommunications services not provided or mistakenly charged (Agreement 39/01); (xii) shipment of goods with prices lower than acquisition prices (unconditional discounts); (xiii) deferred charge of ICMS - Interconnection (DETRAF – Traffic and Service Provision

Document); (xiii) credits derived from tax benefits granted by other states; (xiv) disallowance of tax incentives related to cultural projects; (xv) transfers of assets among business units owned by the company; (xvi) communications service tax credits used in provision of services of the same nature; (xvii) card donation for prepaid service activation; (xviii) reversal of credit from return and free lease in connection with assignment of networks (used by the company itself and exemption from public bodies); (xix) DETRAF fine, (xx) ICMS on own consumption; (xxi) ICMS on exemption of public bodies; (xxii) issue of invoices with negative ICMS amounts; and (xxiii) restructuring of ledger without prior authorization by the Treasury.

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

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Municipal Taxes

At December 31, 2013, the company was party to various administrative and judicial proceedings at the municipal level, which are ongoing at various court levels. At December 31, 2013, the total consolidated amount was R\$580.8 million.

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

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

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FUST – Universalization of Telecommunications Service

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

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

At December 31, 2013, the total consolidated amount was R\$2,185.0 million.

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

FUNTTEL – Fund for the Technological Development of Telecommunications

At December 31, 2013, the company was party to administrative and judicial proceedings which are waiting to be tried at the lower administrative court and the court of appeals. At December 31, 2013, the total consolidated amount was R\$664.3 million.

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

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

FISTEL – Telecommunications Supervision Fund

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

This collection is based on ANATEL's understanding that such extension would represent a taxable event for TFI. The Company understands that such collection is unjustified, and separately challenged the aforesaid fee in court. At December 31, 2013, total consolidated amount was R\$1.811,1 million, without the respective deposit in full.

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

PPNUM – Price Relative to the Public Administration of Numbering Resources

Our former subsidiary Vivo, along with other wireless carriers in Brazil, are challenging in court the tariff charged by ANATEL for use by such carriers of the numbering resources managed by the agency. When charged by ANATEL, Vivo made a judicial deposit referring to the amounts payable. On April 23, 2009, the carriers received a favorable sentence and the lawsuit is currently waiting to be tried at the court of appeals. At December 31, 2013, total amount was R\$2.2 million.

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

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Labor Litigation

We are also a defendant in several legal proceedings filed by former employees and outsourced employees (alleging joint or several liability), who claim, among other things, deficient overtime payment, unequal compensation, retirement wage supplements, health and security hazard compensation, free extension of health plan benefits to retirees of Company; and proceedings regarding our outsourcing practices.

In addition, we are also a defendant in a public civil action filed by the Federal Ministry of Labor which concerns our retaining of third-party companies to perform our core business. Although the likelihood of loss in this action is “possible,” no value amount has been attributed to this action because currently we are unable to calculate the total amount we will owe in the event we lose and, as a result, we have not recorded any amounts.

Civil Claims

There are several civil claims against us. We have recorded R\$970.4 million in provisions for these proceedings where the risks are deemed probable, including the civil proceedings described below and the regulatory and antitrust proceedings that follow:

- **Expansion Plan–PEX.** We are defendants in proceedings related to the possible right of individuals who purchased our shares in connection with our network expansion plan after 1996, to receive additional shares from us. These claims are in various levels of the court system. The chance of loss in such proceedings is classified on a case-by-case basis according to the facts presented in each proceeding. For the proceedings in which the chance of loss was classified as “probable,” we recorded a provision of R\$37.2 million.
- **Service Complaints.** We and our subsidiaries are defendants in certain civil actions, in various court levels, regarding claims related to our services and our ordinary course of business initiated by individual customers, civil associations on behalf of customers or by the PROCON foundation, as well as by the Federal and State Public Prosecutor’s Offices. We recorded a provision of R\$469.1 million for these claims. We are also defendants to civil actions in which the risk of loss is classified as “possible” in the amount of R\$1,383.9 million.
- **Consumer Relations Claims.** We are defendants in several civil actions initiated by individual customers in which the claims are the same or very similar from to other and, when considered individually, are not material, to which we recorded a provision of R\$93.5 million, calculated on the basis of on the statistical analysis of our historical losses in such proceedings.

There are several civil claims against us, for which we have not recorded provisions, though which we deem to be notable, including:

- **Pension Benefit Plan Spin-Off.** Sistel Participants Association in São Paulo (ASTEL)) and National Federation of Associations of Retirees and Pensioners and Participants in Pension Funds in Telecom (FENAPAS), they filed with two distinct - same object though - public civil action against the company, Sistel Foundation and others, claiming the annulment of the spin-off of the PBS pension benefit plan that occurred in 2000 which caused the creation of the specific TELESPPBS pension benefit plan, and corresponding allocation of resources resulted from the technical superavit and fiscal contingencies existing at that time. The chance of loss in both of them is possible based on the opinion of our legal advisors. The amount involved in both cases cannot yet be determined until an expert appraisal report is conducted since it includes the spun-off portion of Sistel related to the telecommunication operators from the former “Telebrás System.”

- Community Telephone Plan–PCT. We are subject to civil public action proposals claiming the possible right for indemnity of associates and entities hired for the construction of community networks connected to the network of fixed telephony operators and have not received shares for their financial investment in the municipality of Mogi das Cruzes, involving a total amount of approximately R\$281.1 million. Based on the opinion of our legal advisors, the chance of loss is possible. The appellate court has ruled in our favor and changed the lower court decision. The plaintiff filed an appeal to the Supreme Court which is awaiting resolution.

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- **Services Quality Class Action.** The Public Prosecutor Office of the State of São Paulo commenced a class action suit claiming moral and property damages suffered by all consumers of telecommunication services from 2004 to 2009 due to the bad quality of service and failures of the communications system. The Public Prosecutors Office suggested a total award against the company of R\$1 billion. A judgment was rendered on April 20, 2010 imposing the payment of damages to all consumers who proved to be eligible for the award. Alternatively, if clients do not prove themselves eligible in a number compatible with the severity of the damage after a period of one year, the judgment establishes that R\$60 million should be deposited in a special fund for protection of diffuse customer interests (Fundo Especial de Defesa de Reparação de Interesses Difusos Lesados). It is not possible to estimate how many consumers may present themselves in this procedure nor the values to be claimed by them. The parties filled an appeal and the effects of the sentence were suspended. Despite the possible degree of risk, no value amount was attributed to this action because currently we are unable to calculate the total amount to be paid by us in the event we lose and, as a result, we have not recorded any provisions.
- **Ownership of Caller ID.** Lune Projetos Especiais Telecomunicação Comércio e Ind. Ltda., a Brazilian company, filed on November 20, 2001 lawsuits against 23 wireless telecommunications operators, including TELESP Celular Participações and its subsidiaries. The lawsuits allege that those operators violated patent No. 9202624-9, related to Equipamento Controlador de Chamadas Entrantes e do Terminal do Usuário, or Caller ID, granted to Lune by the Brazilian Intellectual Property Agency—INPI, on September 30, 1997. Lune called on the operators to cease to provide Caller ID services and sought payment from them for the unauthorized use of the Caller ID system in an amount equivalent to the payment of fees received by such operators for use of the Caller ID system. On October 5, 2011, the law suit was judged groundless against the Phone Companies. The parties filled an appeal and the effects of the sentence were suspended. This decision is not final, and will be tried before the Court and Superior Court of Justice. However, Lune’s right to use patent No. 9202624-9 was suspended by a federal judge in response to a lawsuit filed against Lune and INPI by Ericsson Telecomunicações S.A., TC and Telerj Celular (formerly Vivo subsidiaries before our corporate restructuring) filed identical lawsuits against Lune and INPI and those lawsuits are still pending before the courts. In connection with this proceeding, a third company, Sonintel, and its two partners also brought an Ação de Oposição, whereby they reinvoked their rights to a previous patent related to Caller ID, and to which the above mentioned patent (No. 9202624-9) was linked. We believe, based on the opinion of outside counsel that the likelihood of an unfavorable outcome with respect to Lune’s claim against us is possible. We are unable to determine at this time the extent of any potential liabilities with respect to this claim.
- **Validity of Prepaid Plan Minutes.** We and our subsidiaries, together with other Brazilian wireless telecommunications operators, are defendants in various lawsuits brought by the public prosecutor’s office and consumer protection associations challenging the imposition of a deadline for the use of purchased prepaid minutes. The plaintiffs allege that purchased prepaid minutes should not expire after any specified deadline. Conflicting decisions have been issued by the courts reviewing this matter. Although we believe that our criteria for imposing the deadline is in compliance with ANATEL’s rules, we believe, based on the opinion of outside counsel, that the likelihood of an unfavorable outcome with respect to this claim is possible.

Regulatory and Antitrust Litigation

ANATEL

Administrative Proceedings for Noncompliance with Regulatory Obligations Brought by ANATEL – PADOs. Until December 31, 2013, the fixed and mobile services were involved in several administrative proceedings brought on grounds of alleged breach of obligation established by federal regulation, involving risk of loss that is classified as probable. The amount recorded and provisioned for the proceedings involving a risk of loss classified as probable was

R\$370.5 million. We are also defendants to such administrative proceedings in which the risk of loss classified as possible is in the amount of R\$1,685 million.

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Dividends and Dividend Distribution Policy

Priority and Amount of Preferred Dividends

The Brazilian Corporate Law generally requires that the bylaws of each Brazilian corporation specify a minimum percentage of the distributable profits comprising dividends and/or interest on shareholders' equity, or distributable amount, of the corporation for each fiscal year that must be distributed to shareholders as dividends. See "Item 10. Additional Information—B. Memorandum and Articles of Association." Moreover, each Brazilian company may issue new preferred shares for public distribution only if one of the following terms applies to the preferred shares: (i) the right to receive dividends equivalent to at least 25% of the net profit for the fiscal year, to be calculated in accordance with Article 202 of the Brazilian Corporate Law as follows: (a) priority in the receipt of dividends corresponding to at least 3% of the book value per share and (b) the right to an equal share of the profits attributable to the holders of common shares, after the holders of common shares have received a dividend equal to a minimum of 3% of the book value per share; or (ii) the right to receive dividends, at least 10% higher than those paid for each common shares; or (iii) tag-along rights of at least 80% of the price paid in the sale of control to be paid by the controlling shareholder and also including the right to receive dividends at least equal to the dividend paid to common shares.

According to our bylaws, we are required to distribute as dividends of each fiscal year ending on December 31, to the extent amounts are available, an aggregate amount equal to at least 25% of adjusted net income as a mandatory dividend. The annual dividend distributed to holders of our preferred shares is 10% higher than the dividend distributed to our common shareholders.

Under the Brazilian Corporate Law, a company is allowed to withhold payment of the mandatory dividend in respect of common shares and preferred shares if:

- management and the fiscal board report to the shareholders meeting that the distribution would be incompatible with the financial circumstances of the company; and
 - the shareholders ratify this decision at the shareholder's meeting. In this case:
- management must forward to the CVM within five days of the shareholders meeting an explanation justifying the decision at the shareholders meeting; and
- the profits that were not distributed are to be recorded as a special reserve and, if not absorbed by losses in subsequent fiscal years, are to be paid as dividends as soon as the company's financial situation permits.

For the purposes of the Brazilian Corporate Law, net profits are defined as net income after income tax and social contribution for the fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to beneficiary parties', employees' and management's participation in a company's profits and founders' shares.

Under Brazilian Corporate Law, and in accordance with our bylaws, adjusted net income is an amount equal to our net income adjusted to reflect allocations to or from (i) legal reserves, (ii) statutory reserves, and (iii) contingency reserves for anticipated losses, if any.

At each annual shareholders meeting, the Board of Directors is required to suggest the allocation of net profits obtained during the preceding fiscal year. Under Brazilian Corporate Law, we are required to maintain a legal reserve, to which 5% of our net profits must be allocated for each fiscal year, until the reserve amounts to 20% of our paid-in

capital. Net losses, if any, shall be charged against the accumulated profits, profit reserves and legal reserve, following this order.

Brazilian Corporate Law also provides for an additional allocation of net profits to special accounts, which is also recommended by management and subject to approval by shareholders at the annual shareholders meeting, including the amount of net profits that may be allocated to the contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a previous year must be either:

- reversed in the fiscal year in which the loss was anticipated, if the loss does not in fact occur; or
 - written-off if the anticipated loss occurs.

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Net profits may also be allocated to the unrealized income reserve in case the total amount of mandatory dividends exceeds the amount of realized income. Such allocation should also be suggested by management and subject to approval by shareholders at the shareholders meeting. For such purpose, realized income is the balance of net profits exceeding the sum of:

- the positive net result of equity adjustment; and
- earnings net from transactions or the accounting of assets and liabilities at market value which must be realized after the end of the subsequent fiscal year.

The amounts available for distribution are determined on the basis of financial statements prepared in accordance with the accounting practices adopted in Brazil.

If the minimum dividend to be paid to the holders of preferred shares is not paid for the period set forth in our bylaws, which in no event shall be longer than three years, the holders of preferred shares will be entitled to full voting rights until such dividend is paid in full.

Payment of Dividends

We are required by law and our bylaws to hold an annual shareholders meeting by April 30 of each year at which, among other issues, the allocation of net profits obtained during the preceding fiscal year and the declaration of dividends by decision of common shareholders are decided, acting on the recommendation of the executive officers, as approved by the Board of Directors. The payment of annual dividends is based on the financial statements prepared for each fiscal year ending December 31. Under the Brazilian Corporate Law, dividends are required to be paid within 60 days following the date the dividend is declared to shareholders of record on the declaration date, unless a resolution by the shareholders sets forth another date of payment, which must occur before the end of the fiscal year.

A shareholder has a three-year period from the dividend payment date to claim dividends in respect of its shares, after which we have no liability for the payment. Because our shares are issued in book-entry form, dividends with respect to any share are automatically credited to the account holding the share and no action is required on part of the shareholder. We are not required to adjust the amount of paid-in capital for inflation.

If a shareholder is not a resident of Brazil, he or she must register with the Central Bank of Brazil to be eligible to receive dividends, sales proceeds or other amounts with respect to his or her shares outside of Brazil. Our preferred shares underlying ADSs are held in Brazil by a Brazilian custodian, Citibank N.A., as the agent for the depositary, which is the registered owner of our shares.

Payments of cash dividends and distributions, if any, will be made in Brazilian currency to the custodian on behalf of the depositary, which will then convert those proceeds into U.S. dollars and will provide for U.S. dollars to be delivered to the depositary for distribution to holders of ADSs. If the custodian is unable to immediately convert the Brazilian currency received as dividends into U.S. dollars, the amount of U.S. dollars payable to holders of ADSs may be adversely affected by devaluations of the Brazilian currency that occur before dividends are converted and remitted. Dividends in respect of the preferred shares paid to resident and non resident shareholders, including holders of ADSs, are not currently subject to Brazilian withholding tax.

Additional Payments on Shareholders' Equity

Law No. 9,249, dated December 26, 1995, as amended, provides for distribution to shareholders of interest on shareholders' equity, which may be computed against the amount of dividends to be distributed to the shareholders. A company may treat these payments as financial expenses for income tax and social contribution purposes. This interest is limited to the daily pro rata variation of the TJLP, a nominal long-term interest rate determined by the federal government that includes an inflation factor and cannot exceed the greater of:

- 50% of net income (before deducting income taxes and the interest on shareholders' equity) for the period in respect of which the payment is made, or
 - 50% of the sum of retained earnings and profit reserves.

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Any payment of interest in respect to preferred shares to shareholders (including the holders of ADSs) is subject to Brazilian withholding tax at a rate of 15%, or 25% in the case of a shareholder domiciled in a tax haven, and these payments may be included, at their net value, as part of any mandatory dividend. If payment of interest on shareholders equity is made for a beneficiary located outside of Brazil, the Tax on Exchange Transactions (“IOF”) triggers at a rate of zero. See “Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations—Distributions of Interest on Capital.”

We declare and pay dividends and/or interest on shareholders’ equity as required by Brazilian Corporate Law and our bylaws. The declaration of annual dividends, including dividends in excess of the mandatory distribution, requires approval by the vote of a majority of the holders of common shares, and depends on many factors. These factors include our results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by shareholders. Our shareholders have historically acted on these matters based on recommendations by the Board of Directors. Within the context of tax planning, we may determine in the future that it is to our benefit to distribute interest on shareholders’ equity.

The following table sets forth the dividends or interest on shareholders’ equity paid to holders of our common and preferred shares since 2009 in reais.

| Year | Description (Dividends or Interest on Shareholders’ Equity)(1) | Common Shares (per share/in R\$) | Preferred Shares |
|------|--|--|---------------------|
| 2013 | Div/Int | 3.946735 | 4.341409 |
| 2012 | Div/Int | 2.567510 | 2.824261 |
| 2011 | Div/Int | 4.783035 | 5.261339 |
| 2010 | Div/Int | 3.616248 | 3.977873 |
| 2009 | Div/Int | 2.556431 | 2.812074 |

(1) Interest on shareholders’ equity is net of withholding taxes.

Dividends and Interest on Shareholders’ Equity

On December 9, 2009, the Board of Directors approved, subject to the shareholders’ approval, a payment of interest on shareholders’ equity for our common and preferred shares in the amount of R\$174.3 million. The actual payment occurred on April 26, 2010.

On April 7, 2010, at the General Shareholders Meeting, the shareholders approved the distribution of dividends to the common and preferred shares in the total amount of R\$1,252 million declared on the basis of the closing balance sheet on December 31, 2009. The actual payment was made as follows:

- an initial installment of R\$800 million, with payment due June 30, 2010. The actual payment occurred on April 26, 2010; and
- the remaining portion of R\$451.6 million, with payment due December 21, 2010. The actual payment occurred on December 13, 2010.

On September 29, 2010, the Board of Directors approved the distribution of interim dividends of R\$196.4 million based on earnings accumulated in our existing balance sheet as of June 30, 2010. The actual payment occurred on December 13, 2010.

On September 29, 2010, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$331.5 million. The actual payment occurred on December 13, 2010.

On December 14, 2010, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$171.7 million. The actual payment occurred on May 20, 2011.

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

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

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

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

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

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

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

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

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

On April 16, 2013, at the General Shareholders Meeting, the shareholders approved the distribution of dividends to the common and preferred shares in the total amount of R\$1,498 million declared on the basis of the closing balance sheet on December 31, 2012. This amount was paid on November 26, 2013.

On August 19, 2013, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$220 million. The actual payment occurred on November 26, 2013.

On September 19, 2013, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$220 million. The actual payment occurred on November 26, 2013.

On October 18, 2013, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$538 million and the distribution of dividends to the common and preferred shares in the total amount of R\$746 million. The actual payment occurred on November 26, 2013.

On December 18, 2013, the Board of Directors approved a payment of interest on shareholders equity for the common and preferred shares totaling R\$760 million. The payment will be made to common and preferred shareholders who were registered in the Company's books at the end of December 30, 2013. The actual payment will begin on March 14, 2014.

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On February 25, 2014, the Board of Directors of the Company approved the appropriation of dividends of R\$ 1,043 million, based on the existing profits in the balance of the fourth quarterly of 2013, to common and preferred shareholders who were registered in the Company's books at the end of the day March 10, 2014. The payment of dividends will begin on March 27, 2014.

Reverse Stock Split

In a special General Shareholders Meeting held on May 11, 2005, our shareholders approved the reverse stock split of all of our shares, under the terms of Article 12 of the Brazilian Corporate Law, at the ratio of 1,000 existing shares per one share of the same type and class. When the shares began trading on BM&FBOVESPA in unitary form on June 27, 2005, each of our ADRs, which previously represented 1,000 preferred shares, became one preferred share.

Cancellation of Treasury Stock

On March 9, 2006, a special meeting of the shareholders approved the cancellation of 1,562,387 shares of treasury stock, consisting of 1,258,508 common shares and 303,879 preferred shares. These treasury shares had been acquired as a result of a reverse stock split.

B. Significant Changes

None.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

The trading market for our common and preferred shares is BM&FBOVESPA.

Our preferred shares began trading on BM&FBOVESPA, on September 21, 1998 and are traded on BM&FBOVESPA under the symbol "VIVT4" (formerly TLPP4)." Our common shares trade under the symbol "VIVT3" (formerly TLPP3). At December 31, 2013, we had approximately 1,125.6 million common and preferred shares held by approximately 2.3 million common and preferred shareholders.

In the United States, the preferred shares trade in the form of ADRs, each representing one preferred share, issued by Citibank N.A, as depositary, pursuant to a Deposit Agreement, among us, the depositary and the registered holders and beneficial owners from time to time of ADRs. The ADRs commenced trading on the NYSE on November 16, 1998 and are traded on NYSE under the symbol "VIV" (formerly TSP). The following table sets forth the reported high and low closing sales prices for ADRs on the NYSE for the periods indicated.

| Year ended | NYSE | | BM&FBOVESPA | | BM&FBOVESPA | |
|-------------------|-------------------|-------|--------------------------------|-------|-----------------------------|-------|
| | HIGH | LOW | HIGH | LOW | HIGH | LOW |
| | (in US\$ per ADS) | | (in reais per preferred share) | | (in reais per common share) | |
| December 31, 2009 | 25.53 | 23.74 | 43.54 | 42.12 | 39.29 | 36.00 |
| December 31, 2010 | 24.53 | 22.70 | 42.03 | 38.60 | 39.30 | 36.22 |
| December 31, 2011 | 28.33 | 25.74 | 52.97 | 47.47 | 48.00 | 43.50 |

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| | | | | | | |
|-------------------------------|-------|-------|-------|-------|-------|-------|
| December 31, 2012 | 31.22 | 21.17 | 56.92 | 43.45 | 51.69 | 37.53 |
| December 31, 2013 | 27.66 | 17.94 | 54.89 | 41.66 | 48.45 | 38.24 |
| Year ended December 31, 2012 | | | | | | |
| First quarter | 31.02 | 27.02 | 56.59 | 47.50 | 50.98 | 42.77 |
| Second quarter | 31.22 | 23.31 | 56.92 | 47.30 | 51.69 | 43.20 |
| Third quarter | 25.66 | 21.35 | 51.60 | 43.45 | 47.88 | 39.40 |
| Fourth quarter | 24.08 | 21.17 | 49.28 | 43.54 | 43.65 | 37.53 |
| Year ended December 31, 2013 | | | | | | |
| First quarter | 27.66 | 24.32 | 54.12 | 48.14 | 48.24 | 43.00 |
| Second quarter | 26.94 | 21.74 | 54.89 | 48.29 | 48.45 | 43.55 |
| Third quarter | 23.50 | 19.68 | 51.50 | 45.85 | 45.50 | 41.00 |
| Fourth quarter | 22.94 | 17.94 | 50.12 | 41.66 | 44.15 | 38.24 |
| Month ended | | | | | | |
| September 30, 2013 | 23.50 | 19.74 | 51.50 | 46.40 | 45.50 | 41.35 |
| October 31, 2013 | 22.94 | 21.08 | 50.12 | 46.60 | 44.15 | 40.87 |
| November 30, 2013 | 21.35 | 19.20 | 47.60 | 43.90 | 43.85 | 39.30 |
| December 31, 2013 | 19.22 | 17.94 | 44.83 | 41.66 | 41.00 | 38.24 |
| January 31, 2014 | 20.22 | 18.43 | 47.75 | 44.21 | 42.00 | 38.55 |
| February 28, 2014 | 19.21 | 17.97 | 45.95 | 42.22 | 40.60 | 37.16 |
| March 2014 (through March 18) | 19.24 | 18.47 | 45.10 | 43.25 | 39.24 | 37.32 |

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B. Plan of Distribution

Not applicable.

C. Markets

Trading on the BM&FBOVESPA

The Brazilian Securities, Commodities and Futures Exchange (BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros), or BM&FBOVESPA, is a Brazilian publicly traded company formed in 2008 through the integration between the São Paulo Stock Exchange (Bolsa de Valores de São Paulo) and the Brazilian Mercantile and Futures Exchange (Bolsa de Mercadorias & Futuros). BM&FBOVESPA is one of the largest exchanges in the world in market capitalization, the second in the Americas and the leader in Latin America.

Trading on the exchange is conducted by authorized members. Trading sessions take place every business day, from 10:00 a.m. to 5:00 p.m. or from 11:00 a.m. to 5:30 p.m. during daylight savings time in the U.S., on an electronic trading system called Megabolsa. Trading is also conducted between 5:45 p.m. and 7:00 p.m., or between 6:15 p.m. and 8:00 p.m. during daylight savings time in Brazil, in an after-market system connected to both traditional brokerage firms and brokerage firms operating on the Internet. This after-market trading is subject to regulatory limits on price volatility of securities traded by investors operating on the Internet.

To better control the excess of volatility in market conditions, BM&FBOVESPA has adopted a “circuit breaker” system pursuant to which trading sessions may be suspended for a period of 30 minutes or one hour whenever the indices of these stock exchanges fall below the limits of 10% and 15%, respectively, relative to the index of the previous trading day. In the event the stock exchange index falls by 20% in comparison to the previous trading day, BM&FBOVESPA may determine the suspension of trading sessions for a certain period which will be at its sole discretion.

At December 31, 2013, the aggregate market capitalization of the 363 companies listed on BM&FBOVESPA was approximately US\$1,031 billion. Although all the outstanding shares of an exchange-listed company may trade on a Brazilian stock exchange, in most cases, less than half of the listed shares are actually available for trading by the public, the remainder being held by small groups of controlling entities or persons that rarely trade their shares. For this reason, data showing the total market capitalization of Brazilian stock exchanges tends to overstate the liquidity of the Brazilian equity securities market.

Regulation of Brazilian Securities Markets

The Brazilian securities market is regulated by the CVM, as provided for by the Brazilian Securities Exchange Act and Corporate Law. The National Monetary Council is responsible for supervising the CVM’s activities, granting licenses to brokerage firms to govern their incorporation and operation, and regulating foreign investment and exchange transactions, as provided for by the Brazilian Securities Exchange Act and Law No. 4595 of December 31, 1964. These laws and regulations provide for, among other things, disclosure requirements, criminal sanctions for insider trading and price manipulation, protection of minority shareholders, the procedures for licensing and supervising brokerage firms and the governance of Brazilian stock exchanges.

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Under Brazilian Corporate Law, a company is either publicly held and listed, a companhia aberta, or privately held and unlisted, a companhia fechada. All listed companies are registered with the CVM and are subject to reporting requirements to periodically disclose information and material facts. A company registered with the CVM may trade its securities either on the Brazilian exchange markets, including the BM&FBOVESPA, or in the Brazilian over-the-counter market. Shares of companies listed on BM&FBOVESPA may not simultaneously trade on the Brazilian over-the-counter market. The over-the-counter market consists of direct trades between persons in which a financial institution registered with the CVM serves as an intermediary. No special application, other than registration with the CVM (and, in case of organized over-the-counter markets, in the applicable one), is necessary for securities of a public company to be traded in this market. To be listed on the BM&FBOVESPA, a company must apply for registration with the BM&FBOVESPA and the CVM.

Trading in securities on the BM&FBOVESPA may be suspended under a request from a company in anticipation of a material announcement. Trading in the securities of a particular company may also be suspended under the initiative of BM&FBOVESPA or the CVM, among other reasons, due to the belief that the company has provided inadequate information regarding a material event or has provided inadequate responses to inquiries by the CVM or the BM&FBOVESPA.

Brazilian securities law, the Brazilian Corporate Law and the regulations issued by CVM, CMN and the Central Bank provide, among other things, disclosure requirements and restrictions on insider trading, price manipulation and protection of minority shareholders.

Corporate Governance Practices

We are a sociedade anônima, a corporation incorporated under the laws of Brazil, and are subject to the corporate governance provisions of the Brazilian Corporate Law. We comply with the regulatory requirements of the Brazilian Corporate Law regarding the independence of our Board of Directors, the establishment and composition of certain board committees and the adoption and disclosure of corporate governance guidelines.

We comply with several requirements of Brazilian and international laws to promote strong corporate governance, reduce investor uncertainties and enhance disclosure of material and other information.

With the approval of our Board of Directors and/or Officers, we implemented several measures over the last few years designed to improve our transparency and disclosure practices. We believe these measures will benefit our shareholders, and current and future investors as well as the marketplace in general. Among the measures we have implemented, we have:

- created a disclosure policy for material facts and corporate actions (Política de Divulgação de Ato e Fato Relevante);
- created a policy for internal controls related to financial information (Normativa sobre Registro, Comunicação e Controle de Informação Financeiro-Contábil);
 - created Service Quality and Marketing Committee;
 - created Control and Audit Committee;
 - created Nominations, Compensation and Corporate Governance Committee;

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

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As determined by the Brazilian Corporate Law, the compensation of senior management is approved by our shareholders at an annual shareholders meeting. The Nominations, Compensation and Corporate Governance Committee provides information and recommendations to the Board of Directors regarding the criterion for compensation.

Our rules relating to insider trading are determined in our internal rules and the corporate laws. Senior management and members of our Board of Directors and any other employee exposed to sensitive information are subject to the restrictions imposed by such rules. In addition to the prohibition on trading of our shares by such individuals when in possession of insider information, the rules establishes blackout trading periods for those periods when insider information is available. As an example, the month before the formulation and approval of our annual financial statements by our Board of Directors is considered a blackout period under the charter. In addition, the charter sets forth instructions for dealing with conflicts of interest and mandates disclosure of any such situation.

Code of Business Conduct and Ethics

Although adoption of a code of ethics is not required by Brazilian Corporate Law, we implemented a code of ethics regulating the conduct of our managers in connection with the registration and control of financial and accounting information and their access to privileged and nonpublic information and data to comply with the requirements of the Sarbanes-Oxley Act and NYSE rules. See “Item 16B. Code of Ethics.”

In addition to complying with the rules of corporate governance applicable to us under Brazilian law, we intend to gradually comply with substantially all of the new rules established by the NYSE and the SEC applicable to domestic U.S. companies.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Set forth below is certain information relating to our capital stock and a summary of certain significant provisions of our bylaws and the Brazilian Corporate Law.

General

We are registered with the Junta Comercial de São Paulo, the Board of Trade of São Paulo, or JUCESP, under No. 35.3.001588-14. According to Section 2 of our bylaws, our main corporate purpose is to provide telecommunications services and to develop those activities necessary or useful for the performance of these services, in accordance with the concessions, authorizations and permits granted to us.

There are no provisions in our bylaws with respect to:

- an officer's power to vote on proposals in which the officer has a personal interest;
- an officer's power to vote on his own compensation, even in the absence of an independent quorum;

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- age limits for retirement of officers;
- required shareholding to qualify as a manager (officer); or
- anti-takeover mechanisms or other procedures designed to delay, defer or prevent changes in our control.

Brazilian Corporate Law forbids a director to interfere in any business of the company when there is any conflicting interest between him and the company.

Brazilian Corporate Law no longer requires ownership of shares in order for a person to qualify as a member of the Board of Directors (conselho de administração) of a corporation (sociedade por ações), however our bylaws require that our directors own shares of the company.

Issuance of commercial paper and incurrence of certain debt shall be preceded by approval from our Board of Directors, according to the provisions set forth in section 17 of our bylaws.

Our capital stock comprises preferred shares and common shares, all without par value. At December 31, 2013, there were 261,308,985 outstanding preferred shares and 31,208,300 outstanding common shares. Our share capital may be increased by resolution of the Board of Directors, up to the limit authorized by our bylaws. Any increase above the capital must be approved by a general shareholders meeting.

The preferred shares are nonvoting, except under limited circumstances. They are given priority in the reimbursement of capital, without premium, and are entitled to receive a dividend 10% higher than that attributable to common shares.

Pursuant to Law No. 10,303/01, the following changes were introduced to the Brazilian Corporate Law:

- preferred shares representing 10% of our total number of outstanding shares would be entitled to appoint a representative to our Board of Directors;
 - disputes among our shareholders would be subject to arbitration, if provided for in our bylaws;
- a tender offer at a purchase price equal to fair value for all outstanding shares would be required upon a delisting or a substantial reduction in liquidity of our shares as a result of purchases by the controlling shareholders;
- any sale of control would require the shareholders to tender for the minority shareholders' common shares and, if provided for in our charter, for the minority shareholders' preferred shares, at a purchase price at least equal to 80% of the price per share with voting rights paid to the controlling shareholder;
- shareholders would be entitled to withdraw from us upon a spin-off only if it entailed a change in the corporate purpose, a reduction in mandatory dividends or the participation in a centralized group of companies;
- the controlling shareholders, the shareholders that elect members to our Board of Directors and Fiscal Board, the members of our Board of Directors and Fiscal Board and our Executive Officers would be required to disclose any purchase or sale of our shares to the CVM and BM&FBOVESPA; and

- we would be permitted to satisfy our information disclosure requirements through the Internet.

Voting Rights

Each common share entitles the holder to one vote at general shareholders meetings. Preferred shares do not entitle the holder to vote at shareholders meetings, except under specific circumstances and with respect to certain matters, as specified below. Holders of preferred shares are only entitled to attend and to discuss, but not to vote on, the issues discussed at our general shareholders meetings.

The appointment of one member of our statutory Fiscal Board, including the alternate member, takes place at the annual ordinary general shareholders meeting, upon separate vote of the holders of preferred shares, for the

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position available at the Fiscal Board. The election of a member of the Board of Directors by preferred shareholders also occurs on a separate vote, with no participation of the controlling shareholder.

Brazilian Corporate Law provides that certain nonvoting shares, such as our preferred shares, shall be entitled to voting rights in the event a corporation fails for three consecutive fiscal years to pay any fixed or minimum dividends to which nonvoting shares are entitled. In this case, the voting rights of these shares shall extend until the date on which the payment of the accrued and unpaid dividend is made.

Preferred shares are entitled to full voting rights with respect to:

- the election of one member to the Board of Directors and Fiscal Board in a straight vote;
- bylaw modifications that seek to limit preferred shareholders' voting rights in respect of selecting new Board members in a straight vote;
- any agreements for the rendering of management services (including technical assistance services) between us and any foreign affiliate of our controlling shareholder;
 - resolutions amending certain provisions of our bylaws; and
- any resolution submitted to the general shareholders meeting during our liquidation process.

Any change in the preference, benefits, conditions of redemption and amortization of preferred shares or the creation of a more favored class would require approval or ratification by holders of a majority of the preferred shares at a special meeting of the preferred shareholders. This meeting would be called by publication of a notice in two Brazilian newspapers during three days, at least 30 days before the meeting; however, it would not generally require any other form of notice.

In any circumstances in which holders of preferred shares are entitled to vote, each preferred share will entitle the holder to one vote.

Preemptive Rights

Each shareholder has a general preemptive right to subscribe for shares of the same class in any capital increase, in an amount sufficient to keep the same proportional participation of each shareholder in the total capital of the corporation. A minimum period of 30 days following the publication of the capital increase notice shall be observed by the corporation for the exercise of the preemptive right by the shareholder. The right of participation in capital increases is assignable under Brazilian Corporate Law. However, the bylaws of a publicly held company that allows capital increase may preview the issuance of stocks, debentures convertible into stocks, or subscription bonuses, without granting any preemptive rights to prior shareholders. In that case, the placement of stocks shall be made:

- upon sale on a stock exchange or public subscription;
- through an exchange of shares in a public offering, with the purpose of acquiring control of another company; or
 - for the use of certain tax incentives.

In the event of a capital increase, which would maintain or increase the proportion of capital represented by preferred shares, holders of ADSs, or of preferred shares, would have preemptive rights to subscribe only to our newly issued preferred shares. In the event of a capital increase, which would reduce the proportion of capital represented by preferred shares, holders of ADSs, or of preferred shares, would have preemptive rights to subscribe to our new preferred shares, in proportion to their shareholdings and to our new common shares only to the extent necessary to prevent dilution of their interest.

Redemption and Right of Withdrawal

According to the Brazilian Corporate Law, dissenting shareholders in a shareholders meeting shall have a right of redemption, with reimbursement of the value of their shares, in case the following matters are approved:

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- (i) creation of a new class of preferred shares or an increase in preferred shares of an existing class, without maintaining the proportion with the remaining classes;
- (ii) change in the preferences, advantages and conditions of redemption or amortization of one or more classes of preferred shares, or the creation of a class with more favorable rights or preferences;
- (iii) reduction of the mandatory dividend;
- (iv) merger into another company or consolidation with another company;
- (v) participation in a group of companies;
- (vi) change in the purpose of the corporation; and
- (vii) split-up of the corporation.

It is important to point out that (a) in items (i) and (ii), only the holders of shares of the affected type or class will be entitled to redemption; (b) in items (iv) and (v), the holders of shares of a type or class with liquidity and dispersion in the market will not have the right; and (c) in item (vii), the dissenting shareholders shall only have a right of redemption if the split-up implies a change in the corporate purpose, a reduction of the compulsory dividend or participation in a group of companies.

Reimbursement must be required by the dissenting shareholders within 30 days after the publication of the minutes of the general shareholders meeting or special meeting, as the case may be. Within 10 days after the expiration of the period, management is authorized to call a general shareholders meeting to ratify or reconsider the decision, if management understands that the payment of reimbursement to the dissenting shareholders who have exercised their redemption right may jeopardize the financial stability of the company. A shareholder who fails to exercise the right within the assigned term shall no longer be entitled to redemption.

According to the Brazilian Corporate Law, the amount to be reimbursed may only be lower than the share net value ascertained in the last balance sheet approved by the general shareholders meeting if this amount is based on the economic value of the corporation, to be duly appraised. If the decision of the general shareholders meeting takes place more than 60 days after the issuance of the last approved balance sheet, the shareholder shall be entitled to demand, together with the reimbursement, the preparation of a special balance sheet that complies with the time frame previously described.

C. Material Contracts

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

Telefônica Brasil also had authorization to provide local and long-distance telephone services under the private system (all sectors, except Sector 31), which was granted in 2002, for an unlimited period of time. On September 5, 2011, these Authorization Terms were transferred to Vivo. Telefônica Brasil and VIVO have Multimedia Communication

Service Authorization Terms, which are also material contracts. Based on this Authorization Terms, the companies are allowed to provide broadband services in the State of São Paulo (Telefônica) and all over Brazilian territory (Vivo*). The Term was signed on April 17, 2003 and March 19, 2004 for an undetermined period of time and is still currently in effect. The Authorization Terms were transferred back to Telefônica Brasil in 2013, as a result of the corporate restructuring.

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

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

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

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

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

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

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

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

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

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

- Telefônica-Rio Grande do Sul (“L” band) until 2022 (renewed in 2007) including cities in the Pelotas metropolitan area;
 - Telefônica-Rio de Janeiro (“L” band) until 2020 (renewed in 2005);
 - Telefônica-Espírito Santo (“L” band) until 2023 (renewed in 2008);
 - Telefônica-Bahia (“L” band) and Vivo-Sergipe (“L” band) until 2023 (renewed in 2008);
- Telefônica-São Paulo (“L” band) until 2023 (renewed in 2008), the cities of Ribeirão Preto, Guatapar and Bonfim Paulista (renewed in 2009) until 2024, and the cities where CTBC Telecom operates in the state of So Paulo until 2022;
 - Telefnica-Paran (excluding the cities of Londrina and Tamarana)/Santa Catarina (“L” band) until 2013;

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- Telefônica-Federal District (“L” band) until 2021 (renewed in 2006);
- Telefônica-Acre (“L” band), Vivo-Rondônia (“L” band), Vivo-Mato Grosso (“L” band) and Vivo-Mato Grosso do Sul (“L” band) until 2024 (renewed in 2008) and the city of Paranaíba de Mato Grosso do Sul until 2022;
- Telefônica-Goiás/Tocantins (“L” band) until 2023 (renewed in 2008) and the cities where CTBC Telecom operates in the state of Goiás until 2022; and

- Telefônica-Alagoas/Ceará/Paraíba/Piauí/Pernambuco/Rio Grande do Norte (“L” band) until 2022;

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

In April 2008, ANATEL auctioned off 36 blocks 2100 MHz band (3G licenses). Vivo obtained nine in the “J” band through Brasil, enabling it to provide nationwide coverage in 3G. The spectrum licenses, along with the related renewal dates, are as follows:

- Telefônica-Rio Grande do Sul (including cities in the Pelotas metropolitan area) (“J” band) until 2023;
 - Telefônica-Rio de Janeiro (“J” band) until 2023;
 - Telefônica-Espírito Santo (“J” band) until 2023;
- Telefônica-Bahia (“J” band) and Vivo-Sergipe (“J” band) until 2023;
- Telefônica-São Paulo (including the cities of Ribeirão Preto, Guatapar and Bonfim Paulista and the cities where CTBC Telecom operates in the state of So Paulo) (“J” band) until 2023;
 - Telefônica-Paran (including the cities of Londrina and Tamarana)/Santa Catarina (“J” band) until 2023;
 - Telefônica-Federal District (“J” band) until 2023;
- Telefônica-Acre (“J” band), Vivo-Rondnia (“J” band), Vivo-Mato Grosso (“J” band) and Vivo-Mato Grosso do Sul (including the city of Paranaba) (“J” band) until 2023;
- Telefnica-Gois (including the cities where CTBC Telecom operates in the state of Gois)/Tocantins (“J” band) until 2023;
 - Telefnica-Alagoas/Cear/Paraba/Piaui/Pernambuco/Rio Grande do Norte (“J” band) until 2023;
 - Telefnica-Amazonas/Roraima/Amap/Par/Maranho (“J” band) until 2023; and
- Telefnica-Minas Gerais* (including the cities where CTBC Telecom operates in the state of Minas Gerais) (“J” band) until 2023

*

On October 1, 2011, assets, rights and obligations of Vivo Participações relating to mobile operations in Minas Gerais were awarded to Vivo, a subsidiary of Vivo Participações.

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

In December 2010, ANATEL auctioned off 169 licenses in the 900 MHz, 1800 MHz and 2100 MHz frequencies. Vivo secured 23 blocks, 14 in 1800 MHz frequency band “D”, “E”, “M” and extension bands, and 9 in the 900 MHz extension bands, giving it nationwide coverage in the 1800 MHz frequency band. The spectrum licenses are up for renewal in 2023.

- “M” Band (1800 MHz) in the Federal District and the states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia and Acre;
 - Extension of the 1800 MHz band throughout the State of São Paulo;
- “D” Band (1800 MHz) in the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu in the state of Rio Grande do Sul;
 - “E” Band (1800 MHz) in the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;

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

- Extension of the 1800 MHz band in the cities of Londrina and Tamarana in the state of Paraná;

In April 2012, ANATEL auctioned off 273 licenses in the 450 MHz, and 2500 MHz frequencies. Vivo secured 1 block in 2500 MHz frequency band “X” (20 + 20 MHz) in a national basis, which came along with the right to use (and the obligations of) the 450 MHz frequency band in the states of Alagoas (AL), Ceará (CE), Minas Gerais (MG), Paraíba (PB), Pernambuco (PE), Piauí (PI), Rio Grande do Norte (RN) and Sergipe (SE), as well as the areas identified by the National Codes 13, 14, 15, 16, 17, 18 e 19, in the state of São Paulo (SP)

- Telefônica Brasil (“X” Band – 2500 MHz) until 2027 (associated to SMP service);
- Telefônica AL, CE, MG, PB, PE, PI, RN, SE (450 MHz) until 2027 (associated to STFC and SCM services);
- Telefônica in the areas identified by the National Codes 13, 14, 15, 16, 17, 18 e 19, in the state of São Paulo (SP), until 2027 (associated to SMP and SCM services).

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All the licenses referenced above may be renewed, only once, for an additional term of fifteen years upon payment of 2% of operator's net revenues from usage charges in the region described above in the year prior to the year when payment is due, and every two years during the extension period.

D. Exchange Controls

There are no restrictions on ownership of preferred shares or common shares by individuals or legal entities domiciled outside of Brazil.

The right to convert dividend or interest payments and proceeds from the sale of shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investments have been registered with the Central Bank and the CVM. The restrictions on the remittance of foreign capital abroad may hinder or prevent the custodian for the preferred shares represented by ADSs or holders of preferred shares from converting dividends, distributions or the proceeds from any sale of these preferred shares into U.S. dollars and remitting the U.S. dollars abroad. Holders of ADSs could be adversely affected by delays in, or refusal to grant any, required government approval to convert Brazilian currency payments on the preferred shares underlying the ADSs and to remit the proceeds abroad.

Resolution No. 1,927 of the CMN provides for the issuance of depositary receipts in foreign markets in respect of shares of Brazilian issuers. It restates and amends Annex V to Resolution No. 1,289 of the National Monetary Council, known as the Annex V Regulations. The ADS program was approved under the Annex V Regulations by the Central Bank and the CVM before the issuance of the ADSs. Accordingly, the proceeds from the sale of ADSs by holders outside Brazil are free of Brazilian foreign investment controls, and holders of the ADSs may be entitled to favorable tax treatment. See “—E. Taxation—Brazilian Tax Considerations.”

Under Resolution No. 2,689 of the CMN, foreign investors registered with the CVM may buy and sell Brazilian securities, including the preferred shares, on Brazilian stock exchanges without obtaining separate certificates of registration for each transaction. Registration is available to qualified foreign investors, which principally include foreign financial institutions, insurance companies, pension and investment funds, charitable foreign institutions and other institutions that meet certain minimum capital and other requirements. Resolution No. 2,689 also extends favorable tax treatment to registered investors. See “—E. Taxation—Brazilian Tax Considerations.”

Pursuant to Resolution No. 2,689 foreign investors must (i) appoint at least one representative in Brazil with the ability to perform actions regarding the foreign investment; (ii) complete the appropriate foreign investor registration form; (iii) obtain registration as a foreign investor with the CVM; and (iv) register the foreign investment with the Central Bank.

The securities and other financial assets held by a foreign investor pursuant to Resolution No. 2,689 must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank or by the CVM or be registered in register, clearing and custody systems authorized by the Central Bank or by the CVM. In addition, the trading of securities is restricted to transactions carried out on the stock exchanges or over-the-counter markets licensed by the CVM.

Registered Capital

Amounts invested in preferred shares by a non-Brazilian holder who qualifies under Resolution No. 2,689 and obtains registration with the CVM, or by the depositary representing an ADS holder, are eligible for registration with the

Central Bank. Such registration (the amount so registered is referred to as registered capital) allows the remittance outside Brazil of foreign currency, converted at the commercial market rate, acquired with the proceeds of distributions on, and amounts realized through, dispositions of such preferred shares. The registered capital per preferred share purchased in the form of ADS, or purchased in Brazil and deposited with the depositary in exchange for ADS, will be equal to its purchase price (stated in U.S. dollars). The registered capital per preferred share withdrawn upon cancellation of an ADS will be the U.S. dollar equivalent of (i) the average price of a preferred share on the Brazilian stock exchange on which the most preferred shares were traded on the day of withdrawal or (ii) if no preferred shares were traded on that day, the average price on the Brazilian stock exchange on which the most preferred shares were traded in the 15 trading sessions immediately preceding such withdrawal. The U.S. dollar equivalent will be determined on the basis of the average commercial market rates quoted by the Central Bank on such date or dates.

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An electronic registration has been issued in the name of the depository with respect to the ADSs and is maintained by the custodian on behalf of the depository. Pursuant to the registration, the custodian and the depository are able to convert dividends and other distributions with respect to the preferred shares represented by ADSs into foreign currency and remit the proceeds outside Brazil. If a holder of ADSs exchanges such ADSs for preferred shares, such holder will be entitled to continue to rely on the depository's registration for five business days after such exchange, following which such holder must seek to obtain its own electronic registration with the Central Bank. Thereafter, any holder of preferred shares may not be able to convert into foreign currency and remit outside Brazil the proceeds from the disposition of, or distributions with respect to, such preferred shares, unless such holder is a duly qualified investor under Resolution No. 2,689 and obtains its own electronic registration.

If the holder does not qualify under Resolution No. 2,689 by registering with the CVM and the Central Bank and appoints a representative in Brazil to act directly in the Brazilian market to acquire preferred shares, the holder will be subject to a less favorable Brazilian tax treatment than a holder of ADSs. Regardless of registration under Resolution No. 2,689, residents of tax havens are subject to less favorable tax treatment than other foreign investors. See “—E. Taxation—Brazilian Tax Considerations.”

Under current Brazilian legislation, the federal government may impose temporary restrictions on remittances of foreign capital abroad in the event of a serious imbalance or an anticipated serious imbalance of Brazil's balance of payments. For approximately six months in 1989 and early 1990, the federal government froze all dividend and capital repatriations held by the Central Bank that were owed to foreign equity investors, to conserve Brazil's foreign currency reserves. These amounts were subsequently released in accordance with federal government directives. There can be no assurance that the federal government will not impose similar restrictions on foreign repatriations in the future.

E. Taxation

The following discussion contains a description of the material Brazilian and U.S. federal income tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs by certain holders or beneficial owners, as described below. This summary is based upon the tax laws of Brazil and the United States as of the date of this annual report, which are subject to change, possibly with retroactive effect, and to differing interpretations. You should consult your own tax advisors as to the Brazilian, U.S. federal or other tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs, including, in particular, the effect of any state, local or non-U.S., non-Brazilian tax laws.

Although there is presently no income tax treaty between Brazil and the United States, the tax authorities of the two countries have had discussions that may culminate in such a treaty. No assurance can be given, however, as to whether or when a treaty will enter into force or how it will affect the U.S. holders of preferred shares or ADSs.

Brazilian Tax Considerations

The following discussion summarizes the material Brazilian tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs by a U.S. holder not deemed to be domiciled in Brazil for Brazilian tax purposes (a “U.S. holder”). This discussion does not address all the Brazilian tax considerations that may be applicable to any particular non-Brazilian holder, and each non-Brazilian holder should consult its own tax advisor about the Brazilian tax consequences of investing in preferred shares or ADSs.

Taxation of Dividends

Dividends paid by us in cash or in kind from profits generated on or after January 1, 1996 (i) to the depositary in respect of preferred shares underlying ADSs or (ii) to a U.S. holder or other non-Brazilian holder in respect of preferred shares will generally not be subject to Brazilian withholding tax. We do not have any undistributed profits generated before January 1, 1996. If payment of dividends is made to a beneficiary located outside of Brazil, the Tax on Exchange Transactions, described below applies at a rate of zero.

On November 11, 2013, the Executive Branch enacted Provisional Measure No. 627 (“MP 627/13”) aiming to harmonize the federal tax legislation with the International Financial Reporting Standards (“IFRS”) adopted for Brazilian accounting purposes since 2008. Although such provisional measure still needs to be approved by the Congress, the tax authorities could use the language of such provisional measure and of the Normative Ruling No. 1,397 of 2013 (“IN 1,397/13”) to take the position that any profits distributed on or after January 1, 2008 by the

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Company based on IFRS accounting figures in excess of profits ascertained in accordance with the Brazilian Generally Accepted Accounting Principles valid up to December 31, 2007 (“BR GAAP 2007”) should be subject to withholding tax. See “—Taxation of Gains.”

This potential risk is restricted only to dividends paid after November 12, 2013 that relate to profits generated within the period from January 1, 2008 to December 31, 2013 for companies that choose to apply the new taxation rules for periods beginning on or after January 1, 2014. Dividends that relate to profits generated on or after January 1, 2014 are not subject to this risk. Although we have chosen to adopt the new taxation rules, we do not believe that any dividends paid are subject to this withholding tax.

Finally, it is important to emphasize there are more than 500 amendments proposed by congressmen that would modify the original text of MP 627/13, with more than 20 specifically related to income taxation on dividends.

Distributions of Interest on Shareholders’ Equity

Brazilian corporations may make payments to shareholders characterized as interest on shareholders’ equity as an alternative form of making dividend distributions. Amounts paid as interest on shareholders’ equity (net of applicable withholding tax, as described below) may be treated as payments with respect to the dividends we are obligated to distribute to our shareholders in accordance with our bylaws (estatuto social) and Brazilian Corporate Law. The rate of interest may not be higher than the federal government’s TJLP, as determined by the Central Bank from time to time (6% per annum for 2011 and first and second quarter of 2012 and 5.5% per annum for third and fourth quarter 2012). The total amount distributed as interest on shareholders’ equity may not exceed the greater of (i) 50% of net income (before taking the distribution and any deductions for income taxes into account) for the year with respect to which the payment is made and (ii) 50% of retained earnings for the year before the year with respect to which the payment is made. Payments of interest on shareholders’ equity are decided by the shareholders on the basis of recommendations of the company’s Board of Directors. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Dividends and Dividend Distribution Policy—Additional Payments on Shareholders’ Equity.”

On November 11, 2013, the Executive Branch enacted MP 627/13, aiming to harmonize the federal tax legislation with the IFRS adopted for Brazilian accounting purposes since 2008. Although such provisional measure still needs to be approved by the Congress, the tax authorities could use the language of such provisional measure and of IN 1,397/13 to take the position that the net equity of the Company that serves as the basis for determining whether TJLP is exceeded should be defined based on the BR GAAP 2007 rules and not based on the net equity of the company ascertained in accordance with IFRS. The excess interest on shareholders’ equity paid would not be considered as a deductible expense.

This potential risk is restricted only to payments characterized as interest on shareholders’ equity made after November 12, 2013, that relate to profits generated within the period from January 1, 2008 to December 31, 2013 for companies that choose to apply the new taxation rules for periods beginning on or after January 1, 2014. Payments characterized as interest on shareholders’ equity that relate to profits generated on or after January 1, 2014 are not subject to this risk. Although we have chosen to adopt the new taxation rules, we do not believe that any previous payments characterized as interest on shareholders’ equity are affected by MP627/13.

Finally, it is important to emphasize there are more than 500 amendments proposed by congressmen that would modify the original text of MP 627/13, with more than 20 specifically related to income taxation of interest on shareholders’ equity.

Distributions of interest on shareholders' equity paid to Brazilian and non-Brazilian holders of preferred shares, including payments to the depositary in respect of preferred shares underlying ADSs, are deductible by us for Brazilian corporate income tax purposes. These payments to U.S. holders or other non-Brazilian holders are subject to Brazilian withholding tax at the rate of 15%. If the recipient of the payment is domiciled in a tax haven jurisdiction, the rate will be 25%.

If payment of interest on shareholders' equity is made for a beneficiary located outside of Brazil, the IOF applies at a rate of zero.

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Distributions of interest on shareholders' equity with respect to the preferred shares, including distributions to the depositary with respect to the preferred shares underlying the ADSs, may be converted into U.S. dollars and remitted outside of Brazil, subject to applicable exchange controls.

No assurance can be given that our Board of Directors will not recommend that future distributions of profits will be made by means of interest on shareholders' equity instead of by means of dividends.

Taxation of Gains

Gains realized outside Brazil by a U.S. holder or other non-Brazilian holder on the disposition of property located in Brazil, including preferred shares, to another non-Brazilian holder are subject to Brazilian tax. In this case, gains would be subject to a 15% withholding tax rate, except if the beneficiary is located in a low-tax jurisdiction, as defined by Brazilian law, in which case the applicable rate would be 25%.

Our understanding is that ADSs do not qualify as property located in Brazil and, therefore, are not subject to Brazilian taxes upon disposition to other non-Brazilian holders. Insofar as this understanding has not been tested through the administrative or judicial courts, however, we are unable to evaluate what the final ruling on the matter will be. If Brazilian tax authorities determine that the ADSs are properly located in Brazil, gains may be subject to income tax in Brazil.

Gains realized by U.S. holders or other non-Brazilian holders on dispositions of preferred shares in Brazil or in transactions with Brazilian residents may be free from Brazilian tax, taxed at a rate of 25% or taxed at a rate of 15%, depending on the circumstances:

- Gains on the disposition of preferred shares obtained upon cancellation of ADSs are not taxed in Brazil if the proceeds are remitted abroad within five business days of cancellation, unless the investor is a resident of a jurisdiction that, under Brazilian law, is deemed to be a tax haven.
- Gains realized on the disposition of preferred shares through transactions with Brazilian residents or through transactions in Brazil off the Brazilian stock exchanges are generally subject to tax at a rate of 15%, or 25% in the case of a non-Brazilian holder residing in a tax haven jurisdiction.
- Gains realized on preferred shares through transactions on Brazilian stock exchanges (including the organized over-the-counter market) are generally subject to tax at a rate of 15%, as of January 2005, unless the investor is entitled to tax-free treatment for the transaction under Resolution No. 2,689 of the National Monetary Council Regulations, as described immediately below. Non-Brazilian holders residing in a tax haven jurisdiction may be subject to tax at a rate of up to 25%.

Resolution No. 2,689 extends favorable tax treatment to a U.S. holder or other non-Brazilian holder of preferred shares who has (i) appointed a representative in Brazil with power to take action relating to the investment in preferred shares, (ii) registered as a foreign investor with the CVM and (iii) registered its investment in preferred shares with the Central Bank. Under Resolution No. 2,689, securities held by foreign investors must be maintained under the custody of, or in deposit accounts with, financial institutions duly authorized by the Central Bank and the CVM. In addition, the trading of securities is restricted under Resolution No. 2,689 to transactions on Brazilian stock exchanges or qualified over-the-counter markets. The preferential treatment generally afforded under Resolution No. 2,689 to investors in ADSs is not available to residents of tax havens. All preferred shares underlying ADSs qualify under Resolution No. 2,689.

There can be no assurance that the current preferential treatment for U.S. holders and other non-Brazilian holders under Resolution No. 2,689 will be maintained.

Gain on the disposition of preferred shares is measured by the difference between the amount realized on the sale or exchange and the acquisition cost of the shares sold, measured in Brazilian currency, without any correction for inflation. Although the matter is not free from doubt, there are arguments to sustain the position that the acquisition cost of shares registered as an investment with the Central Bank is calculated on the basis of the foreign currency amount registered with the Central Bank. See “—D. Exchange Controls—Registered Capital.”

Gains realized by a U.S. holder or other non-Brazilian holder upon the redemption of preferred shares will be treated as gains from the disposition of such preferred shares to a Brazilian resident occurring off a stock exchange

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and will accordingly be subject to tax at a rate of 15%, unless the non-Brazilian holder is domiciled in a tax haven jurisdiction, in which case the applicable rate would be 25%.

As of January 1, 2005, the purchase price of preferred shares sold on the Brazilian stock exchange and on the Brazilian non-organized over-the-counter market is subject to withholding tax at a rate of 0.005%, except in the case of non-Brazilian holders entitled to tax-free treatment for the transaction under Resolution No. 2,689. This tax may be offset against the 15% income tax due on the gains realized upon the sale of the shares.

Any exercise of preemptive rights relating to the preferred shares or ADSs will not be subject to Brazilian taxation. Gains on the sale or assignment of preemptive rights relating to the preferred shares will be treated differently for Brazilian tax purposes depending on (i) whether the sale or assignment is made by the depositary or the investor and (ii) whether the transaction takes place on a Brazilian stock exchange. Gains on sales or assignments made by the depositary on a Brazilian stock exchange are not taxed in Brazil, but gains on other sales or assignments may be subject to tax at rates up to 15%, or 25% in the case of residents of tax haven jurisdictions.

The deposit of preferred shares in exchange for the ADSs is not subject to Brazilian income tax if the preferred shares are registered under Resolution No. 2,689 and the respective holder is not in a tax haven jurisdiction. If the preferred shares are not so registered or the holder is in a tax haven jurisdiction, the deposit of preferred shares in exchange for ADSs may be subject to Brazilian capital gains tax at a rate of 15%.

The withdrawal of preferred shares in exchange for ADSs is not subject to Brazilian tax. On receipt of the underlying preferred shares, a U.S. holder or non-Brazilian holder entitled to benefits under Resolution No. 2,689 will be entitled to register the U.S. dollar value of such shares with the Central Bank as described above, under “—D. Exchange Controls—Registered Capital.” If a U.S. holder or other non-Brazilian holder does not qualify under Resolution No. 2,689, such person will be subject to the less favorable tax treatment described above in respect of exchanges of preferred shares. Brazil’s tax treaties do not grant relief from taxes on gains realized on sales or exchanges of preferred shares.

Beneficiaries Residing or Domiciled in Tax Havens or Low-Tax Jurisdictions

With limited exceptions, any income derived from operations by a beneficiary that resides or is domiciled in a country considered to be a tax haven is subject to income tax to be withheld by the source at a rate of 25% instead of 15%. The increased rate also applies for capital gains paid to residents of low-tax jurisdictions.

In accordance with Law No. 9,959, non-Brazilian holders of ADSs or preferred shares who are residents of tax havens have been excluded from the tax incentives granted to holders of ADSs and investors under Resolution No. 2,689 since January 1, 2000 and are subject to the same tax treatment applicable to holders that are residents of or domiciled in Brazil.

Tax on Financial Transactions (IOF Tax)

IOF, or “IOF/Exchange Tax,” is a tax on the conversion of reais into foreign currency and on the conversion of foreign currency into reais. As a general rule, the inflow of funds related to investments carried out on the Brazilian financial and capital markets by a non-Brazilian holder that has registered its investment in Brazil with the Central Bank is subject to the IOF/Exchange Tax. If the inflow is related to an investment in the stock exchange or in over-the-counter markets, IOF/Exchange will apply at the rate of 0%. Foreign exchange transactions related to outflows of funds in connection with investments carried out on the Brazilian financial and capital markets are subject to the

IOF/Exchange Tax at a rate of zero, which also applies to payments of dividends and interest on shareholders' equity. With the exception of these transactions, the rate applicable to most foreign exchange transactions is 0.38%. Other rates may apply to particular transactions and the Brazilian government may increase the rate at any time by up to 25.0% on the future foreign exchange transaction amount.

An "IOF/Bonds Tax" is due on transactions involving bonds and securities, including those carried out on a Brazilian stock exchange. The rate of the IOF/Bonds Tax applicable to the transfer of shares with the sole purpose of enabling the issuance of ADSs has been reduced to zero. The Brazilian government may increase the rate of the IOF/Bonds Tax at any time by up to 1.5% per day of the transaction amount, but only in respect of future transactions.

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Other Brazilian Taxes

There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of preferred shares or ADSs by a non-Brazilian holder except for gift and inheritance taxes levied by some states in Brazil on gifts made or inheritances bestowed by individuals or entities not resident or domiciled in Brazil or in the relevant state to individuals or entities that are resident or domiciled within this state in Brazil. There are no Brazilian stamp, issue, registration, or similar taxes or duties payable by holders of preferred shares or ADSs.

U.S. Federal Income Tax Considerations

The following are the material U.S. federal income tax consequences to U.S. Holders described herein of owning and disposing of preferred shares or ADSs, but this is not a comprehensive description of all of the tax considerations that may be relevant to a particular person's decision to hold such securities. The discussion applies only to U.S. Holders that hold preferred shares or ADSs as capital assets for U.S. federal income tax purposes and it does not describe all of the tax consequences that may be relevant to holders subject to special rules, such as:

- certain financial institutions;
- dealers or traders in securities who use a mark-to-market method of tax accounting;
- persons holding preferred shares or ADSs as part of a hedge, "straddle," integrated transaction or similar transaction;
 - persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar;
 - entities classified as partnerships for U.S. federal income tax purposes;
 - persons liable for the alternative minimum tax or the Medicare contribution tax;
 - tax-exempt organizations;
 - persons that own or are deemed to own 10% or more of our voting stock;
- persons who acquired our ADSs or preferred shares pursuant to the exercise of any employee stock option or otherwise as compensation; or
- persons holding preferred shares or ADSs in connection with a trade or business conducted outside of the United States.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds preferred shares or ADSs, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and upon the activities of the partnership. Partnerships holding preferred shares or ADSs and partners in such partnerships should consult their tax advisers as to the particular U.S. federal income tax consequences of holding and disposing of the preferred shares or ADSs.

This discussion is based on the Internal Revenue Code of 1986, as amended (the "Code"), administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date hereof. These laws are subject to change, possibly on a retroactive basis. It is also based in part on representations by the depositary and assumes that each obligation under the Deposit Agreement and any related agreement will be

performed in accordance with its terms.

You are a “U.S. Holder” if, for U.S. federal income tax purposes, you are a beneficial owner of preferred shares or ADSs and if you are:

- a citizen or individual resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state therein or the District of Columbia; or
 - an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

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THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS INTENDED FOR GENERAL INFORMATION PURPOSES ONLY. U.S. HOLDERS OF PREFERRED SHARES OR ADSs ARE URGED TO CONSULT WITH THEIR OWN TAX ADVISERS WITH RESPECT TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING OR DISPOSING OF PREFERRED SHARES OR ADSs, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, NON-U.S. AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAWS.

In general, if you own ADSs, you will be treated as the owner of the underlying shares represented by those ADSs for U.S. federal income tax purposes. Accordingly, no gain or loss will be recognized if you exchange ADSs for the underlying shares represented by those ADSs.

The U.S. Treasury has expressed concerns that parties to whom American depository shares are released before shares are delivered to the depository (“pre-release”) or intermediaries in the chain of ownership between holders and the issuer of the security underlying the American depository shares may be taking actions that are inconsistent with the claiming of foreign tax credits by holders of American depository shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain noncorporate holders. Accordingly, the creditability of Brazilian taxes, and the availability of the reduced tax rate for dividends received by certain noncorporate holders, each described below, could be affected by actions taken by such parties or intermediaries.

This discussion assumes that we are not, and will not become, a passive foreign investment company, as described below.

Taxation of Distributions

Distributions paid on ADSs or preferred shares will generally be treated as dividends to the extent paid out of current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Because we do not maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that distributions generally will be reported to U.S. Holders as dividends. Subject to applicable limitations and the discussion above regarding concerns expressed by the U.S. Treasury, dividends paid by qualified foreign corporations to certain noncorporate U.S. Holders may be taxable at the rates applicable to long-term capital gains. A foreign corporation is treated as a qualified foreign corporation with respect to dividends paid on stock that is readily tradable on a securities market in the United States, such as the New York Stock Exchange where our ADSs are traded. You should consult your tax advisers regarding the availability of the reduced tax rate on dividends in your particular circumstances.

The amount of a dividend will include any amounts withheld by us in respect of Brazilian taxes. The amount of the dividend will be treated as foreign-source dividend income to you and will not be eligible for the dividends-received deduction generally allowed to U.S. corporations under the Code. Dividends will be included in your income on the date of your, or in the case of ADSs, the depository’s, receipt of the dividend. The amount of any dividend income paid in reais will be a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of such receipt regardless of whether the payment is in fact converted into U.S. dollars. If the dividend is converted into U.S. dollars on the date of receipt, you should not be required to recognize foreign currency gain or loss in respect of the dividend income. You may have foreign currency gain or loss if the dividend is converted into U.S. dollars after the date of receipt.

Subject to applicable limitations that may vary depending upon your circumstances and subject to the discussion above regarding concerns expressed by the U.S. Treasury, Brazilian income taxes withheld from dividends on preferred shares or ADSs will be creditable against your U.S. federal income tax liability. The rules governing foreign tax credits are complex and, therefore, you should consult your tax adviser regarding the availability of foreign tax credits in your particular circumstances. Instead of claiming a credit, you may, at your election, deduct such Brazilian taxes in computing your taxable income, subject to generally applicable limitations under U.S. law. An election to deduct foreign taxes instead of claiming foreign tax credits must apply to all taxes paid or accrued in the taxable year to foreign countries and possessions of the United States.

Sale, Redemption or Other Disposition of Preferred Shares or ADSs

For U.S. federal income tax purposes, gain or loss you realize on the sale, redemption or other disposition of preferred shares or ADSs will generally be capital gain or loss, and will generally be long-term capital gain or loss if

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you held the preferred shares or ADSs for more than one year. The amount of your gain or loss will equal the difference between your tax basis in the preferred shares or ADSs disposed of and the amount realized on the disposition, in each case as determined in U.S. dollars. If a Brazilian tax on gains is withheld on the sale or disposition of preferred shares or ADSs, a U.S. Holder's amount realized will include the gross amount of the proceeds of such sale or disposition before deduction of the Brazilian tax. See “—Brazilian Tax Considerations—Taxation of Gains” for a description of when a disposition may be subject to taxation by Brazil. Such gain or loss will generally be U.S.-source gain or loss for foreign tax credit purposes. U.S. Holders should consult their tax advisors as to whether the Brazilian tax on gains may be creditable against the holder's U.S. federal income tax on foreign-source income from other sources. In lieu of claiming a foreign tax credit, U.S. Holders may make an election to deduct foreign taxes, including the Brazilian tax, in computing their taxable income, subject to generally applicable limitations under U.S. law. An election to deduct foreign taxes instead of claiming foreign tax credits applies to all taxes paid or accrued in the taxable year to foreign countries and possessions of the United States.

Other Brazilian Taxes

You should note that any Brazilian IOF Tax (as discussed above under “—Brazilian Tax Considerations”) will not be a creditable foreign tax for U.S. federal income tax purposes, although you may be entitled to deduct such tax, subject to applicable limitations under U.S. law. You should consult your tax advisers regarding the U.S. federal income tax consequences of the payment of Brazilian IOF Tax, including whether you may claim a deduction for such tax or should instead include the amount of tax paid in your initial basis in the preferred shares or ADSs.

Passive Foreign Investment Company Rules

We believe that we were not a “passive foreign investment company” (“PFIC”) for U.S. federal income tax purposes for our 2013 taxable year. However, because PFIC status depends on the composition of a company's income and assets and the market value of its assets from time to time, there can be no assurance that we will not be a PFIC for any taxable year. If we were a PFIC for any taxable year during which a U.S. Holder held preferred shares or ADSs, gain recognized by such U.S. Holder on a sale or other disposition (including certain pledges) of the preferred shares or ADSs would be allocated ratably over the U.S. Holder's holding period for the preferred shares or ADSs. The amounts allocated to the taxable year of the sale or other disposition and to any year before we became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, for such taxable year, and an interest charge would be imposed on the amount allocated to such taxable year. Further, to the extent that any distribution received by a U.S. Holder on its preferred shares or ADSs exceeds 125% of the average of the annual distributions on preferred shares or ADSs received by a U.S. Holder during the preceding three years or such holder's holding period, whichever is shorter, that distribution would be subject to taxation in the same manner as gain, described immediately above. Certain elections may be available that would result in alternative treatments (such as mark-to-market treatment) of the preferred shares or ADSs. U.S. Holders should consult their tax advisers to determine whether any of these elections would be available and, if so, what the consequences of the alternative treatments would be in those holders' particular circumstances. If we are a PFIC for any taxable year during which a U.S. Holder owned our shares, the U.S. Holder will generally be required to file IRS Form 8621 with their annual U.S. federal income tax returns, subject to certain exceptions.

Information Reporting and Backup Withholding

Payments of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and may be subject to backup withholding

unless (i) you are a U.S. corporation or other exempt recipient or (ii) in the case of backup withholding, you provide a correct taxpayer identification number and certify that you are not subject to backup withholding.

The amount of any backup withholding from a payment to you will be allowed as a credit against your U.S. federal income tax liability and may entitle you to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

Certain U.S. Holders who are individuals may be required to report information relating to their ownership of securities of a non-U.S. person, subject to certain exceptions (including an exception for securities held in certain accounts maintained by U.S. financial institutions). U.S. Holders are urged to consult their tax advisers regarding the effect, if any, of these rules on their ownership and disposition of preferred shares or ADSs.

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U.S. HOLDERS OF OUR PREFERRED SHARES OR ADSs SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE BRAZILIAN, U.S. FEDERAL, STATE, LOCAL AND OTHER TAX CONSEQUENCES OF THE OWNERSHIP AND DISPOSITION OF OUR PREFERRED SHARES OR ADSs BASED UPON THEIR PARTICULAR CIRCUMSTANCES.

F. Dividends and Paying Agents

Not applicable.

G. Statement of Experts

Not applicable.

H. Documents on Display

We are subject to the information requirements of the Exchange Act, except that as a foreign issuer, we are not subject to the proxy rules or the short-swing profit disclosure rules of the Exchange Act. In accordance with these statutory requirements, we file or furnish reports and other information with the SEC. Reports and other information filed or furnished by us with the Commission may be inspected and copied at the public reference facilities maintained by the Commission at 100 F Street NE, Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Section of the Commission, 100 F Street NE, Washington, D.C. 20549, at prescribed rates. You may also inspect these reports and other information at the offices of the New York Stock Exchange, 11 Wall Street, New York, New York 10005, on which our ADSs are listed.

In addition, the Commission maintains a website that contains information filed electronically, which can be accessed over the Internet at <http://www.sec.gov>.

We also file financial statements and other periodic reports with the CVM. Copies of our annual report on Form 20-F and documents referred to in this annual report and our bylaws will be available for inspection upon request at our offices at Avenida Engenheiro Luis Carlos Berrini, 1371 - 32º Andar, 04571-936, São Paulo, SP, Brasil.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to several market risks as a result of our commercial operations, debts obtained to finance our activities and financial derivative instruments, including exchange rate risk, interest rate risk, debt acceleration risk and credit risk. To help us manage our risks, we conduct a valuation of our financial assets and liabilities in relation to market values based on available information and appropriate valuation methodologies. However, the interpretation of market information, as well as the selection of methodologies, requires considerable judgment and reasonable estimates to produce adequate realization values. As a result, our valuation estimates do not necessarily indicate the amounts, which will be realized in the current market. The use of different market approaches and/or methodologies for the estimates may have a significant effect on the estimated realization values.

We also enter into derivative instruments to manage the risks to which we are exposed in accordance with our risk management policy. All of our derivative instruments are intended to provide coverage against the risk of variation in foreign exchange, therefore, any changes in risk factors generate an opposite effect on the hedged item. We do not hold derivative instruments for speculative purposes.

To further assist our risk management, we conduct fair value analyses of our derivative financial instruments, as well as sensitivity analyses of our risk variables and our net exposure risk. For more details of the results of our valuation analysis, risk management strategies, and sensitivity analysis of our derivative financial instruments, please see Note 36 to our 2013 consolidated financial statements.

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ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

The depositary, Citibank N.A, collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs or from intermediaries acting for them. The depositary also collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

Persons depositing or withdrawing shares must pay:

For:

| | |
|--|--|
| Up to U.S. \$5.00 per 100 ADSs (or fraction thereof) | <ul style="list-style-type: none"> · Issuance of ADSs upon deposit of Shares, excluding issuances as a result of distributions · Delivery of Deposited Securities against surrender of ADSs · Distribution of cash dividends or other cash distributions (i.e., sale of rights and other entitlements) · Distribution of ADSs pursuant to (i) stock dividends or other free stock distributions, or (ii) exercise of rights to purchase additional ADSs · Distribution of securities other than ADSs or rights to purchase additional ADSs (i.e., spin-off shares) · Depositary Services |
| Registration or transfer fees | <ul style="list-style-type: none"> · Registration of Shares or other Deposited Securities on the share register and applicable to transfers of Shares or other Deposited Securities to or from the name of the Custodian, the Depositary or any nominees upon the making of deposits and withdrawals, respectively |
| Expenses of the depositary | <ul style="list-style-type: none"> · Cable, telex and facsimile transmissions and delivery expenses as are expressly provided in the Deposit Agreement · Conversion of foreign currency |
| Taxes (including applicable interest and penalties) and other governmental charges | <ul style="list-style-type: none"> · As necessary |
| Fees and expenses incurred by the Depositary in connection with compliance with exchange control regulations and other regulatory requirements applicable to Shares, Deposited Securities, ADSs and ADRs | <ul style="list-style-type: none"> · As necessary · As necessary |

Fees and expenses incurred by the Depositary, the Custodian, or any nominee in connection with the servicing or delivery of Deposited Property

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On January 28, 2013, we entered into a deposit agreement with Citibank N.A., pursuant to which Citibank N.A. became our depositary.

Citibank N.A. has agreed to reimburse us for expenses related to establishment and maintenance expenses of the ADS program. The depositary has agreed to reimburse us for our continuing annual stock exchange listing fees. The depositary has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse us annually for certain investor relations programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to us based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not necessarily tied to the amount of fees the depositary collects from investors. During 2013, we received from Citibank N.A., our depositary, US\$2,130,201.54, for the services described above.

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PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

As of December 31, 2013, we were not in default under any of our obligations and there were no dividend arrearages or delinquencies.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS PROCEDURES

None.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, are responsible for establishing and maintaining our disclosure controls and procedures. These controls and procedures were designed to ensure that information relating to us required to be disclosed in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. We evaluated these disclosure controls and procedures under the supervision of our CEO and CFO as of December 31, 2013. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were adequate and effective and were designed to ensure that material information relating to us and our consolidated subsidiaries are made known to them by others within those entities to allow timely decisions relating to the required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). The Telefônica Brasil internal control system was designed to provide reasonable assurance as to the integrity and reliability of the published financial statements. All internal control systems, no matter how well designed, may have inherent limitations and can provide reasonable assurance that the objectives of the control system are met.

Management evaluated the effectiveness of internal control over financial reporting under the supervision of our Chief Executive Officer, or CEO and Chief Financial Officer or CFO as of December 31, 2013 based on the criteria set out in the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework, or the 1992 framework and concluded that, as of December 31, 2013, our internal control over financial reporting was adequate and effective.

Our independent registered public accounting firm, Ernst Young, has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2013. The report on the audit of our internal control over financial reporting is included herewith.

Attestation Report of the Registered Public Accounting Firm

Ernst Young, the independent registered public accounting firm that has audited our consolidated financial statements, has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2013. This attestation report appears on page F-3.

Changes in Internal Control over Financial Reporting

Our internal audit department periodically evaluates our internal controls for the main cycles, documenting by flow charts the processes used in each cycle, identifying opportunities and suggesting improvements for the existing control mechanisms. There was no change in our internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Control and Audit Committee is comprised of a minimum of three (3) and a maximum of five (5) nonexecutive directors. See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Committees—Control and Audit Committee.” Our Board of Directors has designated Luis Bastida Ibarguen, an independent member of our Board of Directors under Brazilian rules and a member of our Control and Audit Committee, as the Company’s “audit committee financial expert,” as such term is defined by the SEC. We anticipate that there will be some similar functions between the Control and Audit Committee and our statutory Fiscal Board (Conselho Fiscal), the latter of which meets the requirements of the general exemption from the listing standards for audit committees set forth in Exchange Act Rule 10A-3(c)(3). See “Item 16D. Exemptions from the Listing Standards for Audit Committees Procedures.”

ITEM 16B. CODE OF ETHICS

Fully aware of the impact it may have on its stakeholders, Telefônica established ethical principles of conduct as a means of ensuring honesty, integrity and trust, as well as respect for the law and human rights in all its activities. These Business Principles were approved in 2006 and serve as an official code of conduct for all the Group’s operations worldwide.

The principles govern our activities and relationships, generating greater trust among our audiences and optimizing long-term value for shareholders and society as a whole. We encourage all employees to familiarize themselves with these rules and obey them, and we invest in like-minded partners and suppliers. After the integration of Telefônica and Vivo, the conduct codes of the two companies were submitted to an assessment, with a view to establishing common minimum standards applicable to the new company. The result of this work was submitted to the Business Principles Committee, comprising the Corporate Communications, Corporate Institutional Relations, Human Resources, Legal Investor Relations, President’s Secretariat and Audit areas. The Committee’s role is to make decisions related to compliance with the Business Principles and to mitigate previously mapped risks that have a direct impact on the company’s strategy and reputation.

All company employees have access to the standards governing decision making, purchase and contracting processes. Additionally, they have access to confidential channels through which they may make anonymous reports, ask questions and seek advice on questions related to the business principles.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Ernst Young acted as our independent auditor for the fiscal years ended December 31, 2013, December 31, 2012 and December 31, 2011. The chart below sets forth the total amount billed to us by Ernst Young for services performed in the years 2013, 2012 and 2011, and breaks down these amounts by category of service:

| | 2013 | 2012 | 2011 |
|--------------------|-------------------------|--------|-------|
| | (in thousands of reais) | | |
| Audit Fees | 6,647 | 11,589 | 7,002 |
| Audit-Related Fees | 2,782 | 2,772 | 1,305 |
| Tax Fees | – | – | 58 |
| All Other Services | – | – | – |
| Total | 9,429 | 14,361 | 8,365 |

For the years ended December 31, 2013, December 31, 2012 and December 31, 2011, we paid our auditors, Ernst Young for auditing services rendered in the total amount of R\$9,429 thousand, R\$14,361 thousand and R\$8,365 thousand, respectively.

Audit Fees

Audit fees are fees billed for the audit of our annual consolidated financial statements prepared for purposes of filing with the SEC and to the audit with respect to processes required by Sarbanes-Oxley, with the purpose of certifying the effectiveness over our internal controls.

Audit-Related Fees

Refers to the auditing services and review with respect to our compliance with the targets established by ANATEL, as well as relates to auditing interim financial statements of subsidiaries for the purpose of restructuring process.

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Tax Fees

Refers to accounting services with respect to the preparation of tax returns.

All Other Fees

Not applicable.

Pre-Approval Policies and Procedures

Our Control and Audit committee evaluates the results of all audit and audit-related services provided by our auditors. Our Control and Audit committee has the authority to approve services to be provided by our auditors that are not specifically included within the scope of the audit. Our Board of Directors, with advice from the Control and Audit Committee, is responsible for authorizing the audit services provided by Ernst Young, the present auditor of the company. Nonaudit services are required to be pre-approved by the Control and Audit Committee pursuant to the policy for pre-approval of nonaudit services.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES PROCEDURES

Brazilian Corporate Law requires that we have a statutory Fiscal Board (Conselho Fiscal). Our statutory Fiscal Board meets the requirements of the general exemption set forth in Exchange Act Rule 10A-3(c)(3). See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Fiscal Board.” Our statutory Fiscal Board is primarily charged with certain advisory, oversight and review functions with respect to the company’s financial statements; however, the statutory Fiscal Board, as required by Brazilian Corporate Law, has only an advisory role and does not participate in the management of the company. Indeed, decisions of the statutory Fiscal Board are not binding on the company under Brazilian Corporate Law. Our Board of Directors, under Brazilian Corporate Law, is the only entity with the legal capacity to appoint and retain any independent registered public accounting firm, and decide the budget appropriation with respect to such auditors.

Since Brazilian Corporate Law does not specifically grant our statutory Fiscal Board the power to establish receipt, retention and complaint procedures regarding accounting, internal control and audit matters, or create policies for the confidential, anonymous treatment of employee concerns regarding accounting or auditing matters, we have established a Control and Audit Committee as a best corporate governance practice to address these various issues. See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Committees—Control and Audit Committee.”

We do not believe that our use of a fiscal board in accordance with Brazilian Corporate Law in combination with our Control and Audit Committee, as opposed to the provisions set forth in Exchange Act Rule 10A-3(b), materially adversely affects the ability of the Conselho Fiscal to act independently, satisfy the other applicable requirements of Exchange Act Rule 10A-3 or to fulfill its fiduciary and other obligations under Brazilian law.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

Not applicable.

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ITEM 16G. CORPORATE GOVERNANCE

Principal Differences Between U.S. and Brazilian Corporate Governance Practices

On November 4, 2003, the SEC approved new corporate governance rules established by the NYSE. Pursuant to these rules, foreign private issuers that are listed on the NYSE, such as our company, must disclose any significant ways in which its corporate governance practices differ from those followed by U.S. companies under the listing rules of the NYSE.

The significant differences between our corporate governance practices and the NYSE corporate governance standards are as follows:

Independence of Directors and Independence Tests

The Brazilian Corporate Law and our bylaws require that our directors be elected by our shareholders at a general shareholders meeting. Eleven of our directors were appointed by our common shareholders, and one director was appointed by representatives of our minority preferred shareholders. Seven of our directors are independent in accordance with rules generally accepted in Brazil.

Both the Brazilian Corporate Law and CVM establish rules in relation to certain qualification requirements and restrictions, investiture, compensation, duties and responsibilities of companies' executives and directors. We believe these rules provide adequate assurances that our directors are independent and such rules would permit us to have directors that would not otherwise pass the independence tests established by the NYSE.

Executive Sessions

According to the Brazilian Corporate Law, up to one-third of the members of the Board of Directors can be elected to executive positions. The remaining non-management directors are not expressly empowered to serve as a check on management, and there is no requirement that those directors meet regularly without management. Notwithstanding, our Board of Directors consists of ten non-management directors, seven of whom are independent directors in accordance with rules generally accepted in Brazil, and as such, we believe we are in compliance with this standard.

Control and Audit Committee/Additional Requirements

Brazilian Corporate Law and our bylaws each require that we have a statutory Fiscal Board (Conselho Fiscal). See "Item 6. Directors, Senior Management and Employees—C. Board Practices—Fiscal Board." Our statutory Fiscal Board meets the requirements of the general exemption from the listing standards for audit committees set forth in Exchange Act Rule 10A-3(c)(3). See "Item 16D. Exemptions from the Listing Standards for Audit Committees Procedures." Our statutory Fiscal Board is primarily charged with certain advisory, oversight and review functions with respect to the company's financial statements. However, the statutory Fiscal Board, as required by Brazilian Corporate Law, has only an advisory role and does not participate in the management of the company. Indeed, decisions of the statutory Fiscal Board are not binding on the company under Brazilian Corporate Law. See "Item 6. Directors, Senior Management and Employees—C. Board Practices—Fiscal Board."

In addition to our statutory Fiscal Board, we have established a Control and Audit committee as a best corporate governance practice to comply with the requirements of the Sarbanes-Oxley Act as described in Item 6C of this annual report. We anticipate that there will be some similar functions between the Control and Audit Committee and

our statutory Fiscal Board.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable.

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PART III

ITEM 17. FINANCIAL STATEMENTS

We have responded to Item 18 in lieu of responding to this Item.

ITEM 18. FINANCIAL STATEMENTS

Reference is made to pages F-1 through F-128.

ITEM 19. EXHIBITS

| Exhibit number | Description |
|----------------|--|
| 1.1 | Bylaws of Telefônica Brasil S.A., as amended (unofficial English translation). |
| 2.1 | Deposit Agreement dated as of January 28, 2013, among Telefônica Brasil S.A., Citibank, N.A., as Depositary, and Owners and Beneficial Owners of American Depositary Receipts issued thereunder.(1) |
| 4.1 | Contract and Justification of the Merger of Telefónica Data Brasil Holding S.A. into Telecomunicações De São Paulo S.A. – TELESP and Partial Spin-Off of Telefónica Empresas S.A. dated March 9, 2006.(2) |
| 4.2 | Certificate of Authorization to Provide Multimedia Communication Service between Agência Nacional de Telecomunicações – ANATEL and Global telecom S.A. dated March 19, 2004 (English language summary). (3) |
| 4.3 | Authorization Agreement of the Personal Mobile Service (Region II) between Agência Nacional de Telecomunicações – ANATEL and Telefonica Brasil S.A. dated January 18, 2010 (English language summary). |
| 4.4 | Authorization Agreement of the Personal Mobile Service (Region III) between Agência Nacional de Telecomunicações – ANATEL and Telefonica Brasil S.A. dated January 18, 2010 (English language summary). |
| 4.5 | Authorization Agreement to Provide Commuted Fixed Telephone Service in Local Modality (Regions I and II) between Agência Nacional De Telecomunicações and Telefonica Brasil S.A. dated September 5, 2011 (English language summary). |
| 4.6 | Certificate of Authorization to Provide Commuted Fixed Telephone Service in National Long-Distance Modality (Regions I and II) between Agência Nacional de Telecomunicações – ANATEL and Telefonica Brasil S.A. dated September 5, 2011 (English language summary). |
| 4.7 | Certificate of Authorization to Provide Commuted Fixed Telephone Service in International Long-Distance Modality (Regions I and II) between Agência Nacional de Telecomunicações – ANATEL and Telefonica Brasil S.A. dated September 5, 2011 (English language summary). |
| 4.8 | |

Authorization Agreement of the Personal Mobile Service (Region I) between Agência Nacional de Telecomunicações – ANATEL and Telefonica Brasil S.A. dated February 7, 2012 (English language summary).

- 4.9 Authorization Agreement for Spectrum Blocks Associated with Personal Mobile Service (Region III) between Agência Nacional de Telecomunicações – ANATEL and Telefonica Brasil S.A. dated October 16, 2012 (English language summary).

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| Exhibit number | Description |
|----------------|--|
| 4.10 | Authorization Agreement for Spectrum Blocks Associated with Personal Mobile Service (Region II) between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. dated October 16, 2012 (English language summary). |
| 4.11 | Authorization Agreement for Spectrum Blocks Associated with Personal Mobile Service (Region III) between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. dated October 16, 2012 (English language summary). |
| 4.12 | Authorization Agreement for Spectrum Blocks Associated with Personal Mobile Service and Multimedia Communication (Areas identified by the National Codes 13, 14, 15, 16, 17, 18 and 19, in the state of São Paulo) between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. dated October 16, 2012 (English language summary). |
| 4.13 | Authorization Agreement for Spectrum Blocks Associated with Personal Mobile Service and Multimedia Communication (States of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte and Sergipe) between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. dated October 16, 2012 (English language summary). |
| 4.14 | Authorization Agreement for Conditional Access Service in the Brazilian territory between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. |
| 4.15 | Authorization Agreement for Conditional Access Service in the Brazilian territory between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. |
| 4.16 | Authorization Agreement for Conditional Access Service in the Brazilian territory between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. |
| 4.17 | Authorization Agreement for Conditional Access Service in the Brazilian territory between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. |
| 4.18 | Authorization Agreement for Conditional Access Service in the Brazilian territory between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. |
| 4.19 | Authorization Agreement for Conditional Access Service in the Brazilian territory between Agência Nacional de Telecomunicações – ANATEL and Telefônica Brasil S.A. |
| 8.1 | List of Subsidiaries |
| 11.1 | Code of Ethics of Telefônica Brasil S.A.(4) |
| 12.1 | Section 302 Certification of the Chief Executive Officer. |
| 12.2 | Section 302 Certification of the Chief Financial Officer. |
| 13.1 | Section 906 Certification of the Chief Executive Officer. |

13.2 Section 906 Certification of the Chief Financial Officer.

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- (1) Incorporated by reference to our Registration Statement of American Depositary Receipt shares on Form F-6 (No. 333-185518) filed with the Commission on December 17, 2012.
 - (2) Incorporated by reference to our form CB filed with the Commission on March 14, 2006.
 - (3) Incorporated by reference to our annual report on Form 20-F (No. 001-14475) filed with the Commission on March 20, 2013.
 - (4) Incorporated by reference to our annual report on Form 20-F (No. 001-14475) filed with the Commission on April 16, 2007.

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GLOSSARY OF TELECOMMUNICATIONS TERMS

The following explanations are not intended as technical definitions, but to assist the reader in understanding certain terms as used in this Annual Report.

AICE: Acesso Individual Classe Especial is a mandatory plan offered by the telecommunication providers to low-income customers. Includes different pricing schemes for the Basic Plan (Plano Básico) and the Mandatory Offer Alternative Plan (Plano Alternativo de Oferta Obrigatória).

ADSL: Asymmetric digital subscriber line. ADSL technology allows more data to be sent over existing copper telephone lines.

Analog: A mode of transmission or switching that is not digital, e.g., the representation of voice, video or other modulated electrical audio signals which are not in digital form.

CDMA: Code Division Multiple Access, an aerial interface technology for cellular networks based on spectral spreading of the radio signal and channel division in the code domain.

CDMA 2000 1xEV-DO: 3G (third generation) access technology with data transmission speed of up to 2.4 megabytes per second.

Cellular service: A cellular telecommunications service provided by means of a network of interconnected low-powered base stations, each of which covers one small geographic cell within the total cellular telecommunications system service area.

CSP: long-distance carrier selection.

Digital: A mode of representing a physical variable such as speech using digits 0 and 1 only. The digits are transmitted in binary form as a series of pulses. Digital networks allow for higher capacity and higher flexibility through the use of computer-related technology for the transmission and manipulation of telephone calls. Digital systems offer lower noise interference and can incorporate encryption as a protection from external interference.

DTH: A special type of service that uses satellites for the direct distribution of television and audio signs for subscribers.

FATOR X: A measurement of the company's productivity, calculated by ANATEL, which is discounted by the inflation rate and is used for the calculation of the annual rate adjustment applicable to telecommunications companies.

FTTH: Internet access through Fiber Optic ("Fiber to the Home").

FWT: Fixed-phones using the wireless network ("Fixed Wireless Telephone").

GSM: Global System for Mobile Communications, a service rendered by concession from ANATEL for a specific frequency range.

Internet: A collection of interconnected networks spanning the entire world, including university, corporate, government and research networks from around the globe. These networks all use the IP (Internet Protocol) communications protocol.

IP (Internet protocol): An interconnection protocol for sub-networks, in particular for those with different physical characteristics used by the Internet.

IPTV: Pay TV with video broadcast offered through the use of the IP protocol.

MMDS: (Multichannel Multipoint Distribution Service): It's a wireless telecommunications technology, used for general-purpose broadband networking or, more commonly, as an alternative method of cable television programming reception.

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Net additions: total number of new customers acquired in any period minus the reduction in the number of customers.

Network: An interconnected collection of elements. In a telephone network, these consist of switches connected to each other and to customer equipment. The transmission equipment may be based on fiber optic or metallic cable or point-to-point radio connections.

Network usage charge: Amount paid per minute charged by network operators for the use of their network by other network operators.

PBX (Private Branch Exchange): Telephone switchboard for private use, but linked to a telephone network.

PGA-SMP: Plano Geral de Autorizações do Serviço Móvel Pessoal, or General Plan of Authorizations for the Personal Mobile Services.

PGO: Plano Geral de Outorgas, or General Plan of Grants.

PUC: Prestação Utilidade Comodidade, which are convenience services offered to fixed-line customers, such as caller ID, voicemail, call forwarding, etc.

SCM: Serviço de Comunicação Multimídia or multimedia communication services.

SMP: Serviço Móvel Pessoal or Personal Mobile Service, a service rendered pursuant to an authorization granted by ANATEL to provide mobile service in a specific frequency range.

SMS: text messaging services for wireless devices, which allow customers to send and receive alphanumeric messages.

STFC: Serviço Telefônico Fixo Comutado, or the transmission of voice and other signals between determined fixed points.

Switch: Devices used to set up and route telephone calls either to the number called or to the next switch along the path. They may also record information for billing and control purposes.

TDMA: Time Division Multiple Access, a radio interface technology for cellular networks based on spectral spreading of the radio signal and channel division in the time domain.

Universal service: The obligation to supply basic service to all users throughout a national territory at reasonable prices.

VOIP: Voice over Internet Protocol, is a technology for transmitting voice using the Internet.

VOD: Video on demand systems allow users to select and watch/listen to video or audio content on demand.

VU-M: Valor de Remuneração de Uso de Rede do Serviço Móvel Pessoal, or Compensation Value for Network Use of Personal Mobile Service.

WAP: Wireless Application Protocol, an open and standardized protocol started in 1997, which allows access to Internet servers through specific equipment, a WAP Gateway at the carrier, and WAP browsers in customers' wireless devices.

WCDMA: Wide-Band Code-Division Multiple Access, a technology for wideband digital radio communications of Internet, multimedia, video and other bandwidth-demanding applications.

Wireless devices: wireless appliances that we sell, including cellular handsets, wireless handheld devices and wireless broadband cards.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

TELEFÔNICA BRASIL S.A.

By: /s/ Antonio Carlos
Valente da Silva
Name: Antonio
Carlos Valente
da Silva
Title: Chief
Executive
Officer

By: /s/ Paulo Cesar Pereira
Teixeira
Name: Paulo Cesar
Pereira
Teixeira
Title: General and
Executive
Officer

By: /s/ Alberto Manuel
Horcajo Aguirre
Name: Alberto
Manuel
Horcajo
Aguirre
Title: Chief
Financial
Officer

Date: March 19, 2014

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Telefônica Brasil S.A.

Consolidated Financial statements

As of and for the years ended December 31, 2013, 2012 and 2011

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Telefônica Brasil S.A.

We have audited the accompanying consolidated balance sheets of Telefônica Brasil S.A. and subsidiary as of December 31, 2013 and 2012 and January 1, 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telefônica Brasil S.A. and subsidiary as of December 31, 2013 and 2012 and January 1, 2012, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with International Financial Reporting Standards (IFRS) as issued by International Accounting Standards Board.

As discussed in Note 2.1 to the consolidated financial statements, the Company adopted IFRS 11 Joint Arrangements effective January 1, 2013, which has been retrospectively applied from January 1, 2012.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Telefônica Brasil S.A. and subsidiary's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) and our report dated February 25, 2014 expressed an unqualified opinion thereon.

São Paulo, February 25, 2014

ERNST & YOUNG
Auditores Independentes S.S.

/s/ Alexandre Hoepfers
Partner

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Telefônica Brasil S.A.

We have audited Telefônica Brasil S.A. and subsidiary's internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (1992 Framework) (the COSO criteria). Telefônica Brasil S.A. and subsidiary's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's annual report on internal control over financial reporting. Our responsibility is to express an opinion on the Telefônica Brasil S.A. and subsidiary's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Telefônica Brasil S.A. and subsidiary maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Telefônica Brasil S.A. and subsidiary as of December 31, 2013 and 2012 and January 1, 2012, and the related consolidated statements of income, comprehensive income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013 and our report dated February 25, 2014 expressed an unqualified opinion thereon.

São Paulo, February 25, 2014

ERNST & YOUNG
Auditores Independentes S.S.

/s/ Alexandre Hoepfers
Partner

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Telefônica Brasil S.A.

Consolidated Balance sheets
December 31, 2013 and 2012
(In thousands of reais)

| ASSETS | Note | 12.31.13 | Consolidated | |
|--|------|------------|------------------------|----------------------|
| | | | 12.31.12 - Restated | 1.1.12 - Restated |
| CURRENT ASSETS | | 15,936,633 | 16,209,181 | 11,759,744 |
| Cash and cash equivalents | 5 | 6,543,936 | 7,133,485 | 2,889,543 |
| Trade accounts receivable, net | 6 | 5,802,859 | 5,546,938 | 5,128,142 |
| Inventories | 7 | 505,615 | 387,809 | 471,721 |
| Taxes recoverable | 8.1 | 2,191,962 | 2,052,421 | 2,495,065 |
| Judicial deposits and garnishments | 9 | 204,165 | 126,625 | 116,421 |
| Derivative transactions | 36 | 89,499 | 41,109 | 1,840 |
| Prepaid expenses | 10 | 257,286 | 248,337 | 255,056 |
| Dividend and interest on equity | 19 | 1,140 | 1,140 | 772 |
| Other assets | 11 | 340,171 | 671,317 | 401,184 |
| NONCURRENT ASSETS | | 53,604,442 | 54,041,911 | 53,728,817 |
| Short-term investments pledged as collateral | 5 | 106,455 | 109,708 | 124,668 |
| Trade accounts receivable, net | 6 | 257,086 | 93,378 | 84,855 |
| Taxes recoverable | 8.1 | 368,388 | 738,965 | 1,014,959 |
| Deferred taxes | 8.2 | 210,294 | 1,027,888 | 1,427,499 |
| Judicial deposits and garnishments | 9 | 4,148,355 | 3,909,268 | 3,374,490 |
| Derivative transactions | 36 | 329,652 | 286,278 | 225,935 |
| Prepaid expenses | 10 | 25,364 | 31,396 | 32,138 |
| Other assets | 11 | 127,793 | 92,308 | 96,049 |
| Investments | 12 | 86,349 | 142,881 | 152,256 |
| Property, plant and equipment, net | 13 | 18,441,647 | 17,604,144 | 17,146,521 |
| Intangible assets, net | 14 | 29,503,059 | 30,005,697 | 30,049,447 |
| TOTAL ASSETS | | 69,541,075 | 70,251,092 | 65,488,561 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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| | Note | 12.31.13 | 12.31.12 - Restated | 1.1.12 - Restated |
|--|------|------------|------------------------|----------------------|
| LIABILITIES AND EQUITY | | | | |
| CURRENT LIABILITIES | | 13,768,244 | 13,536,792 | 12,740,699 |
| Personnel, social charges and benefits | 15 | 431,403 | 416,252 | 495,527 |
| Trade accounts payable | 16 | 6,914,009 | 5,889,068 | 6,038,149 |
| Taxes, charges and contributions | 17 | 1,315,164 | 1,781,250 | 1,691,737 |
| Loans, financing and lease | 18.1 | 1,236,784 | 1,270,122 | 1,000,082 |
| Debentures | 18.2 | 286,929 | 702,215 | 468,624 |
| Dividend and interest on equity | 19 | 1,187,556 | 467,831 | 972,986 |
| Provisions | 20 | 561,403 | 496,790 | 416,313 |
| Derivative transactions | 36 | 44,463 | 29,586 | 51,162 |
| Deferred revenue | 21 | 817,551 | 734,573 | 761,268 |
| Payable from reverse split of fractional shares | | 389,220 | 389,510 | 389,953 |
| Authorization license | | 95,768 | 994,977 | - |
| Other liabilities | 22 | 487,994 | 364,618 | 454,898 |
| NONCURRENT LIABILITIES | | 12,878,389 | 12,033,180 | 9,417,077 |
| Personnel, social charges and benefits | 15 | 18,698 | 13,224 | 15,160 |
| Taxes, charges and contributions | 17 | 75,074 | 488,749 | 433,071 |
| Deferred taxes | 8.2 | 722,634 | 1,216,651 | 788,954 |
| Loans, financing and lease | 18.1 | 3,215,156 | 3,774,461 | 3,968,513 |
| Debentures | 18.2 | 4,014,686 | 2,253,690 | 787,807 |
| Provisions | 20 | 4,062,410 | 3,453,637 | 2,838,028 |
| Derivative transactions | 36 | 24,807 | 26,545 | 78,369 |
| Deferred revenue | 21 | 253,661 | 303,362 | 156,266 |
| Liabilities for post-retirement benefit plans | 35 | 370,351 | 392,269 | 308,893 |
| Other liabilities | 22 | 120,912 | 110,592 | 42,016 |
| TOTAL EQUITY | | 42,894,442 | 44,681,120 | 43,330,785 |
| EQUITY | | 42,894,442 | 44,681,120 | 43,330,785 |
| Capital | 23 | 37,798,110 | 37,798,110 | 37,798,110 |
| Capital reserves | 23 | 2,686,897 | 2,686,897 | 2,719,665 |
| Income reserves | 23 | 1,287,496 | 1,100,000 | 877,322 |
| Bonus on acquisition of interest from non-controlling shareholders | 23 | (70,448) | (70,448) | (29,929) |
| Other comprehensive income | 23 | 16,849 | 17,792 | 7,520 |
| Additional dividend proposed | 23 | 1,175,538 | 3,148,769 | 1,953,029 |
| Non-controlling interest | | - | - | 5,068 |
| TOTAL LIABILITIES AND EQUITY | | 69,541,075 | 70,251,092 | 65,488,561 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Telefônica Brasil S.A.

Consolidated Income Statements

For the years ended December 31, 2013, 2012 and 2011

(In thousands of reais, except earnings per share data)

| | Note | 2013 | 2012- Restated | 2011- Restated |
|---|------|--------------|-------------------|-------------------|
| Net operating revenue | 24 | 34,721,897 | 33,919,656 | 29,116,644 |
| Cost of sales | 25 | (17,542,167) | (16,557,444) | (15,035,163) |
| Gross profit | | 17,179,730 | 17,362,212 | 14,081,481 |
| Operating income (expenses) | | (12,302,606) | (10,150,704) | (8,285,386) |
| Selling expenses | 26 | (9,686,170) | (8,693,696) | (6,948,211) |
| General and administrative expenses | 27 | (2,177,891) | (2,145,308) | (1,782,971) |
| Equity pickup | 12 | (55,150) | 588 | 4,305 |
| Other operating income (expenses), net | 28 | (383,395) | 687,712 | 441,491 |
| Operating income before financial income (expenses) | | 4,877,124 | 7,211,508 | 5,796,095 |
| Financial income | 29 | 1,748,277 | 1,281,105 | 1,102,056 |
| Financial expense | 29 | (1,963,037) | (1,572,369) | (1,243,051) |
| Income before taxes | | 4,662,364 | 6,920,244 | 5,655,100 |
| Income and social contribution taxes | 30 | (946,419) | (2,468,063) | (1,292,901) |
| Net income for the year | | 3,715,945 | 4,452,181 | 4,362,199 |
| Attributed to: | | | | |
| Noncontrolling interests | | - | (1,392) | 6,881 |
| Controlling interest | | 3,715,945 | 4,453,573 | 4,355,318 |
| Basic and diluted earnings per common share | | 3.10 | 3.72 | 4.40 |
| Basic and diluted earnings per preferred share | | 3.41 | 4.09 | 4.84 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Telefônica Brasil S.A.

Consolidated Statements of comprehensive income
 For the years ended December 31, 2013, 2012 and 2011
 (In thousands of reais)

| | 2013 | 2012 - Restated | 2011 - Restated |
|--|-----------|--------------------|--------------------|
| Net income for the year | 3,715,945 | 4,452,181 | 4,362,199 |
| Unrealized losses on investments available for sale | (13,466) | (5,536) | (5,170) |
| Taxes | --4,578 | 1,882 | 1,758 |
| | (8,888) | (3,654) | (3,412) |
| Cumulative translation adjustments - operations in foreign currency | 11,525 | 5,731 | 4,520 |
| Other comprehensive income to be reclassified to gains (losses) for subsequent periods | 2,637 | 2,077 | 1,108 |
| Actuarial gains (losses) and limitation effect of the assets of surplus plans | 21,612 | (69,782) | (65,176) |
| Taxes | (7,348) | 23,726 | 22,179 |
| | 14,264 | (46,056) | (42,997) |
| Gains (losses) - derivative transactions | (5,424) | 12,416 | 3,022 |
| Taxes | 1,844 | (4,221) | (1,027) |
| | (3,580) | 8,195 | 1,995 |
| Other comprehensive income not to be reclassified to gains (losses) for subsequent periods | 10,684 | (37,861) | (41,002) |
| Comprehensive income for the year | 3,729,266 | 4,416,397 | 4,322,305 |
| Attributable to: | | | |
| Noncontrolling interests | - | (1,392) | 6,881 |
| Controlling interest | 3,729,266 | 4,417,789 | 4,315,424 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Telefônica Brasil S.A.

Consolidated Statements of changes in shareholders' equity
 For the years ended December 31, 2013, 2012 and 2011
 (In thousands of reais)

| | Capital | Premium on acquisition of non-controlling interest | Special Intangible will reserve | Capital reserves | Treasury stock | Legal Reserve | Tax Incentive Reserve | Retained Earnings | Additional proposed dividend | Other income |
|--|------------|---|--|---------------------|-------------------|------------------|-----------------------------|----------------------|------------------------------------|-----------------|
| Balances at December 31, 2010 | 6,575,480 | - | 63,074 | 2,688,207 | (17,719) | 659,556 | - | - | 1,694,099 | 4 |
| Proposed additional dividend for 2010 | - | - | - | - | - | - | - | - | (1,694,099) | - |
| Expired dividends and interest on equity | - | - | - | - | - | - | - | 107,874 | - | - |
| Capital increase due to merger of Vivo Part. Shares | 31,222,630 | - | - | 47,723 | - | - | - | - | - | - |
| Withdrawal rights to shareholders due to the Vivo merger | - | - | - | - | (3) | - | - | - | - | - |
| Repurchase of shares | - | - | - | - | (61,617) | - | - | - | - | - |
| Non-controlling interest | - | (29,929) | - | - | - | - | - | - | - | - |
| Other comprehensive income | - | - | - | - | - | - | - | (42,997) | - | 3 |
| Net income for the period | - | - | - | - | - | - | - | 4,355,318 | - | - |
| Profit sharing: | | | | | | | | | | |
| Legal reserve | - | - | - | - | - | 217,766 | - | (217,766) | - | - |
| Dividends | - | - | - | - | - | - | - | (382,400) | - | - |
| Interest on equity | - | - | - | - | - | - | - | (1,867,000) | - | - |

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| | | | | | | | | | | |
|--|------------|----------|--------|-----------|-----------|-----------|-------|-------------|-------------|----|
| Proposed additional dividend | - | - | - | - | - | - | - | (1,953,029) | 1,953,029 | - |
| Balances at December 31, 2011 | 37,798,110 | (29,929) | 63,074 | 2,735,930 | (79,339) | 877,322 | - | - | 1,953,029 | 7 |
| Additional dividend proposed for 2011 | - | - | - | - | - | - | - | - | (1,953,029) | - |
| Unclaimed dividends and interest on equity | - | - | - | - | - | - | - | 89,692 | - | - |
| Other changes | - | - | - | - | - | - | - | (3,240) | - | - |
| Repurchase of shares | - | - | - | - | (32,768) | - | - | - | - | - |
| Noncontrolling interests | - | (40,519) | - | - | - | - | - | - | - | - |
| Other comprehensive income | - | - | - | - | - | - | - | (46,056) | - | 1 |
| Net income for the year | - | - | - | - | - | - | - | 4,453,573 | - | - |
| Allocation of income: | | | | | | | | | | |
| Legal reserve | - | - | - | - | - | 222,678 | - | (222,678) | - | - |
| Interim dividend | - | - | - | - | - | - | - | (1,122,522) | - | - |
| Additional dividend proposed | - | - | - | - | - | - | - | (3,148,769) | 3,148,769 | - |
| Balances at December 31, 2012 | 37,798,110 | (70,448) | 63,074 | 2,735,930 | (112,107) | 1,100,000 | - | - | 3,148,769 | 1 |
| Proposed additional dividend for 2012 | - | - | - | - | - | - | - | - | (3,148,769) | - |
| Unclaimed dividend and interest on equity | - | - | - | - | - | - | - | 116,825 | - | - |
| DIPJ adjustment - Tax incentives | - | - | - | - | - | - | 1,699 | (1,699) | - | - |
| | - | - | - | - | - | - | - | 14,264 | - | (9 |

Other
comprehensive
income

Net income for
the year

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|-----------|---|---|
| - | - | - | - | - | - | - | - | 3,715,945 | - | - |
|---|---|---|---|---|---|---|---|-----------|---|---|

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Allocation
of income:

| | | | | | | | | | | |
|--|------------|----------|--------|-----------|-----------|-----------|-------|-------------|-----------|--------|
| Legal reserve | - | - | - | - | - | 185,797 | - | (185,797) | - | - |
| Interim interest on equity | - | - | - | - | - | - | - | (1,738,000) | - | - |
| Interim dividend | - | - | - | - | - | - | - | (746,000) | - | - |
| Additional dividend proposed | - | - | - | - | - | - | - | (1,175,538) | 1,175,538 | - |
| Balances at December 31, 2013 | 37,798,110 | (70,448) | 63,074 | 2,735,930 | (112,107) | 1,285,797 | 1,699 | - | 1,175,538 | 16,849 |
| Outstanding shares (in thousands) | | | | | | | | | | |
| VPA - Net book value of Company's shares | | | | | | | | | | |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Telefônica Brasil S.A.

Consolidated Statements of cash flows
 For the years ended December 31, 2013, 2012 and 2011
 (In thousands of reais)

| | 2013 | 2012 - Restated | 2011 - Restated |
|--|-------------|--------------------|--------------------|
| Cash generated by operating activities | | | |
| Income before taxes | 4,662,364 | 6,920,244 | 5,655,100 |
| Items not affecting cash | | | |
| Expenses (revenues) not representing changes in cash | 8,440,826 | 6,147,922 | 5,677,524 |
| Depreciation and amortization | 5,643,310 | 5,491,776 | 4,584,596 |
| Foreign exchange (gains) losses on loans | 98,105 | (1,254) | 89,549 |
| Monetary (gains) losses | 142,289 | 51,860 | (30,323) |
| Equity pickup | 55,150 | (588) | (4,305) |
| Losses on write-off/sale of goods | (122,598) | (1,049,014) | (482,109) |
| Provision for impairment - accounts receivable | 741,274 | 654,273 | 506,581 |
| Provision (reversal) of trade accounts payable | 579,225 | (73,645) | 365,415 |
| Provision (Write-offs and reversals of) for impairment – inventories | (5,901) | 791 | (8,966) |
| Pension plans and other post-employment benefits | 26,986 | (3,244) | (1,163) |
| Provisions for tax, labor, civil and regulatory contingencies | 660,771 | 514,840 | 255,420 |
| Interest expense | 596,292 | 560,885 | 416,426 |
| Provision for (Reversal of) divestiture | 19,437 | (7,854) | (33,138) |
| Provisions for customer loyalty program | 8,915 | 14,026 | 9,861 |
| Others | (2,429) | (4,930) | 9,680 |
| (Increase) decrease in operating assets: | (1,673,802) | (239,769) | (490,360) |
| Trade accounts receivable | (1,160,903) | (1,069,335) | (933,551) |
| Inventories | (111,905) | 83,122 | (47,355) |
| Taxes recoverable | (399,105) | 589,745 | - |
| Other current assets | 37,703 | 116,129 | 591,102 |
| Other noncurrent assets | (39,592) | 40,570 | (100,556) |
| Increase (decrease) in operating liabilities: | (1,853,108) | (2,774,400) | (2,714,149) |
| Personnel, social charges and benefits | 20,625 | (79,275) | (56,910) |
| Trade accounts payable | (490,538) | (614,237) | (277,632) |
| Taxes, charges and contributions | 487,854 | 134,595 | 132,569 |
| Interest paid | (625,624) | (447,712) | (496,103) |
| Income and social contribution taxes paid | (868,395) | (1,480,205) | (1,398,239) |
| Other current liabilities | (341,427) | (219,415) | (520,179) |
| Other noncurrent liabilities | (35,603) | (68,151) | (97,655) |
| Total cash generated by operating activities | 9,576,280 | 10,053,997 | 8,128,115 |

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Telefônica Brasil S.A.

Consolidated Statements of cash flows (Continued)
 For the years ended December 31, 2013, 2012 and 2011
 (In thousands of reais)

| | 2013 | 2012 - Restated | 2011 - Restated |
|--|-------------|--------------------|--------------------|
| Cash generated by (used in) investing activities | | | |
| Future capital contribution in subsidiaries | - | - | - |
| Additions to PP&E and intangible assets (net of donations) | (5,837,172) | (4,546,663) | (4,653,565) |
| Cash received from sale of PP&E items | 436,386 | 1,136,633 | 610,823 |
| Cash received from divestitures | - | 7,551 | - |
| Redemption of (investments in) investments in guarantee | 22,485 | - | - |
| Redemption of (increase in) judicial deposits | (168,075) | (326,577) | - |
| Dividend and interest on equity received | 2,577 | 8,217 | 21,640 |
| Cash and cash equivalents from consolidation of Companies | - | - | 31,095 |
| Cash and cash equivalents through business combination | - | - | 1,982,898 |
| Total cash generated by (used in) investing activities | (5,543,799) | (3,720,839) | (2,007,109) |
| Cash used in (generated by) financing activities | | | |
| Payment of loans, financing and debentures | (2,336,023) | (1,288,691) | (1,426,334) |
| Loans and debentures raised | 2,229,134 | 2,815,825 | 2,123,727 |
| Payment net of derivative agreements | 20,667 | (45,413) | 56,765 |
| Payment for reverse split of shares | (289) | - | - |
| Dividend and interest on equity paid | (4,535,519) | (3,493,997) | (5,387,601) |
| Acquisition of noncontrolling interest | - | (44,172) | (33,850) |
| Repurchase of treasury stock | - | (32,768) | (61,620) |
| Total cash used in (generated by) financing activities | (4,622,030) | (2,089,216) | (4,728,913) |
| Increase (decrease) in cash and cash equivalents | (589,549) | 4,243,942 | 1,392,093 |
| Cash and cash equivalents at beginning of year | 7,133,485 | 2,889,543 | 1,497,450 |
| Cash and cash equivalents at end of year | 6,543,936 | 7,133,485 | 2,889,543 |
| Changes in cash and cash equivalents for the year | (589,549) | 4,243,942 | 1,392,093 |

The accompanying notes are an integral part of these Consolidated Financial Statements.

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Notes to the Consolidated Financial Statements
December 31, 2013, 2012 and 2011
(In thousands of reais)

1. Operations and background

a) Background information

Telefônica Brasil S.A. (Company or Telefônica Brasil) is a publicly-traded corporation operating in telecommunication services and in the performance of activities that are necessary or useful in the rendering of such services in conformity with the concessions, authorizations and permits it has been or shall be granted. The Company, headquartered at Avenida Engenheiro Luiz Carlos Berrini, nº 1376, in the city of São Paulo, State of São Paulo, Brazil, is a member of Telefonica Group (Group), the telecommunications industry leader in Spain, also being present in several European and Latin American countries. At December 31, 2013 and 2012, Telefónica S.A., holding company of the Group, held a total of 73.81% direct and indirect interest in the Company, excluding treasury stock, including 91.76% common shares and 64.60% preferred shares.

b) Corporate restructuring

In order to streamline the Company's organizational structure, to rationalize the services provided by its subsidiaries and to concentrate service provision into two operating entities, namely the Company and its wholly-owned subsidiary (Telefônica Data S.A., TData or subsidiary), on March 15, 2012, the Company filed with the Brazilian National Telecommunications Agency (ANATEL) a request for previous approval of corporate restructuring, which became legally feasible due to legislation changes applicable to Fixed Switched Telephone Service (STFC) operators through Law No. 12,485.

This corporate restructuring process was approved by ANATEL under Act No. 3,043, of May 27, 2013, as published in the Federal Official Gazette (DOU) of May 29, 2013, subject to the conditions thereunder.

The Board of Directors' meeting of June 11, 2013 approved the terms and conditions of the corporate restructuring process involving the Company's wholly-owned subsidiaries and subsidiaries.

The corporate restructuring included spin-offs and mergers of subsidiaries and of companies directly or indirectly controlled by the Company, so that the economic activities other than telecommunications services, including the provision of Value Added Services as defined in article 61 of the General Telecommunications Law (LGT) (with such activities being jointly and generally referred to as SVAs), provided by the various wholly-owned subsidiaries/subsidiaries were concentrated in TData and the telecommunication services were consolidated by the Company.

All of the spin-offs or split-ups, as the case may be, and the merger of the net assets of the companies involved in the restructuring process took place on the same date and had the same base date (April 30, 2013), as follows: the Company merged (i) the net assets of TData, arising from its spin-off, corresponding to the activities related to the provision of service of Multimedia Communication Service (SCM); (ii) the net assets of Vivo S.A. (Vivo), arising from its split-up, corresponding to the use of Personal Communication Services (SMP), Multimedia Communication Services (SCM) and STFC in local, domestic and international long distance calls in regions I and II of the General Service Concession Plan (PGO); (iii) the net assets of ATelecom S.A. (ATelecom), arising from its split-up, corresponding to the activities related to the provision of Conditional Access Audiovisual Services (SEAC) (through DTH technology) and SCM; and (iv) Telefônica Sistema de Televisão S.A. (TST), which concentrated the activities

related to the provision of SEAC and SCM services before its merger into the Company.

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The organization chart before the corporate restructuring is summarized as follows:

Please find below a brief description of spin-offs and mergers of companies involved in the Company's corporate restructuring process.

Merger of Lemontree Participações S.A. (Lemontree), GTR-T Participações e Empreendimentos S.A. (GTR-T), Ajato Telecomunicações Ltda (Ajato), Comercial Cabo TV São Paulo S.A. (CaTV) and TVA Sul Paraná S.A. (TVA) pela TST: Immediately before the merger of TST into the Company, yet on the same date, TST merged its subsidiary Ajato and the Company's wholly-owned subsidiaries Lemontree and GTR-T as well as their related subsidiaries Sul Paraná and CaTV. These entities were valued under the provisions of article 227 of Law No. 6404/76, based on their respective book values as at April 30, 2013, as ratified by the general meeting held by TST. Merger thereof resulted in a R\$102,512 increase in TST capital, under the terms of the Merger Protocol of these entities and of TST. After the merger into TST of Lemontree, GTR-T, Ajato, CaTV and Sul Paraná ceased to exist. Except for the Company and TST, aforementioned companies were wholly-owned by T Brasil; therefore, the merger of these companies did not result in any refund to or protection of noncontrolling shareholders of the companies involved.

Merger of TST into the Company: TST was valued under the provisions of article 227 of Law No. 6,404/76, based on its respective book value as at April 30, 2013. Considering the merger of Lemontree, GTR-T, Ajato, CaTV and Sul Paraná into TST immediately before the merger of TST into the Company, the total amount of TST net assets (corresponding to the sum of net assets of TST and of the companies merged into it) merged by the Company totaled R\$226,106.

Merger of TData net assets: The net assets of TData related to SCM services were spun off and merged into T Brasil, in order to concentrate in its equity the net assets related to SVAs. The amount of TData net assets merged by the Company was valued under the terms of article 227 of Law No. 6,404/76, based on its respective book value at April 30, 2013, as ratified by the Company's general meeting. TData spun-off net assets totaled R\$34,724.

Merger of Vivo net assets: Vivo was split up in order to segregate the operation of SMP, SCM and STFC activities in local, domestic and international long distance calls in regions I and II of PGO, with the related net assets being merged by the Company. Value-added services (SVAs) and other non-telecommunication services were merged into TData and Vivo ceased to exist. The amount of Vivo net assets merged by the

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Company was valued under the terms of article 227 of Law No. 6,404/76, based on its respective book value at April 30, 2013, as ratified by the Company's general meeting. These net assets totaled R\$10,228,352.

Merger of ATelecom net assets: ATelecom was split up in order to segregate the net assets related to value-added services provided by ATelecom, which were merged into TData. The net assets of ATelecom's remaining activities were merged into the Company and ATelecom ceased to exist. The amount of ATelecom net assets merged by the Company was valued under the terms of article 227 of Law No. 6,404/76, based on its respective book value at April 30, 2013, as ratified by the Company's general meeting. These net assets totaled R\$348,624.

The merger of companies and net assets previously described did not result in any capital increase or issue of new Company shares; accordingly, the corporate restructuring did not result in any changes in interests currently held by Company shareholders.

There is no question of replacing shares of noncontrolling shareholders of the spun-off companies with shares of the merging company, since the Company was, upon the merger of net assets and/or companies, as the case may be, the sole shareholder of the companies spun off/ merged. Accordingly, an equity valuation report at market price was not prepared for calculating the noncontrolling share replacement ratio as defined in article 264 of Law No. 6,404/76 and item VI, paragraph 1, article 2 of CVM Ruling No. 319/99, based on recent understandings expressed by the Brazilian Securities and Exchange Commission (CVM) regarding consultations in connection with similar restructuring processes and based on CVM Rule No. 559, of November 18, 2008.

The merger of entities and spun-off amounts previously described did not interrupt the operations and telecommunication services provided to their customers, and such services were entirely succeeded by the Company.

Company General Shareholders' Meeting held on July 1, 2013 approved aforementioned corporate restructuring and the organization chart is now as follows:

The restructuring has been accounted for as a reorganization of entities under common control without any substantive change to the equity value of the Company, since all of the entities involved were wholly-owned immediately before and immediately after the restructuring. Accordingly, the restructuring was recorded at the book values of the entities involved. However, as a result of the restructuring, the Company recognized a tax benefit and corresponding deferred tax asset for R\$ 319,996, relating to certain tax attributes that were not expected to be realized by certain of the entities prior to the restructuring.

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c)Operations

The Company is primarily engaged in the rendering of land-line telephone and data services in the state of São Paulo, under Fixed Switched Telephone Service Concession Arrangement (STFC) and Multimedia Communication Service (SCM) authorizations, respectively. Also, the Company is authorized to render STFC services in Regions I and II of the General Service Concession Plan (PGO/2008) and other telecommunications services, such as SCM (data communication, including broadband internet), SMP (Personal Communication Services) and SEAC (Conditional Access Audiovisual Services) (especially by means of DTH and cable technologies).

Service concessions and authorizations are granted by Brazil's Telecommunications Regulatory Agency (ANATEL), under the terms of Law No. 9,472, of July 16, 1997 – General Telecommunications Law (“Lei Geral das Telecomunicações” - LGT), amended by Laws No. 9,986, of July 18, 2000 and No. 12,485, of September 12, 2011. Operation of such concessions and authorizations is subject to supplementary regulations and plans issued.

c.1) STFC service concession arrangement

The Company is the grantee on STFC concession to render land-line services in the local network and national long distance calls originated in sector 31 of region III, which comprises the state of São Paulo (except for cities within sector 33), as established in the General Service Concession Plan (PGO/2008).

The Company's current STFC service concession arrangement is effective until December 31, 2025, and may be subject to reviews on December 31, 2015 and December 31, 2020.

In accordance with the service concession arrangement, every two years, during the arrangement's 20-year term, the Company shall pay a fee equivalent to 2% (two percent) of its prior-year STFC revenue, net of applicable taxes and social contributions.

c.2) Authorizations and frequencies related to mobile telephone services

Frequency authorizations granted by ANATEL for mobile telephone services may be renewed only once, over a 15-year period, through payment, every two years after the first renewal, of fees equivalent to 2% (two percent) of the Company's prior-year revenue, net of taxes and social contributions, related to the application of the Basic and Alternative Plans of Service.

In August 2013, the Company and ANATEL executed the authorization terms for the nonexclusive use of radiofrequency blocks, on a primary basis, as a result of the realignment of the “L” band in sub-bands from 1,975 MHz to 1,980 MHz for the mobile station transmission and from 2,165 MHz to 2,170 MHz for nodal station transmission.

These authorizations were issued for the remaining terms established under item 1.9 of Public Notice No. 002/2007/SPV-Anatel, of October 23, 2007, for valuable consideration, associated to the authorization for the rendering of SMP services, amendment No. 01 to authorization No. 078/2012/PVCP/SPV-Anatel of August 14, 2013, published in the Federal Official Gazette of August 16, 2013, effective until April 29, 2023, and may be extended only once, over a 15-year period. Effectiveness of these authorizations is subject to the compliance with the requirements defined in the agreements.

The Company paid R\$451,121 for the aforementioned authorizations, which were recorded as licenses under intangible assets (Note 14) and will be amortized over the remaining periods of the licenses.

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Of the lots offered in the sale auctions of national 2.5 GHz bandwidths, linked to the 450 MHz bandwidth, conducted by ANATEL on June 12 and 13, 2012, Vivo (merged into the Company on July 1, 2013) was the winning bidder of lot 3, in accordance with public notice No. 004/2012/PVCP/SPV-Anatel for the sale of 4G broadband. The price offered for lot 3 was R\$1,050,000.

On October 11, 2012, through Act No. 5,907, ANATEL's Board decided to approve the nonexclusive use of radiofrequency blocks, on a primary basis, in sub-bands 2550 through 2570 MHz / 2670 through 2690 MHz, in connection with the authorizations to operate the Personal Communications Service (SMP) granted to Vivo (merged into the Company on July 1, 2013), as well as of other radiofrequencies in the 2.5 GHz band by the respective winning bidders of the lots mentioned in the bid. The authorization terms of the above-mentioned radiofrequency bands were executed on October 16, 2012 and published in the Federal Official Gazette (DOU) on October 18, 2012.

Accordingly, upon the actual awarding of such lot, Vivo (merged into the Company on July 1, 2013) increased its service provision capacity powered by 4G technology nationwide and has since then operated in the 2.5GHz bandwidth, with 20+20 MHz band. In addition to the 2.5GHz bandwidth, the acquired lot includes a 450 MHz bandwidth for rural areas in the Brazilian states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, São Paulo and Sergipe.

In the fourth quarter of 2012, the total amount of R\$1,050,000 was adjusted in accordance with the remaining life of licenses and recorded as licenses in intangible assets (Note 14).

The Company operates SMP services, in accordance with the authorizations given as follows:

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| Operation Area | License Expiration | | | | | | |
|---|--------------------|-----------|-----------|---------------|--------------|--------------|-----------|
| | 450 MHz | 800 MHz | 900 MHz | 1800 MHz | 1900 MHz (2) | 2100 MHz (3) | 2.5 GHz |
| Region 1 | | | | | | | |
| | | Bandwidth | Extension | Extensions | Bandwidth | Bandwidth | Bandwidth |
| | | A | 1 - | 9 and 10 - | L - | J - | X - |
| Rio de Janeiro | - | 11/29/20 | 04/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | Bandwidth | Extension | Extensions | Bandwidth | Bandwidth | Bandwidth |
| | | A - | 1 - | 9 and 10 - | L - | J - | X - |
| Espirito Santo | - | 11/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | Bandwidth | Extension | Extensions | | Bandwidth | Bandwidth |
| | | B - | 2 - | 7, 9 and 10 - | | J - | X - |
| Amazonas, Roraima , Amapá, Pará, and Maranhão | - | 11/29/28 | 04/30/23 | 04/30/23 | - | 04/30/23 | 10/18/27 |
| | | Bandwidth | Extension | Extensions | Bandwidth | Bandwidth | Bandwidth |
| | | A - | 2 - | 11 to 14 - | L - | J - | X - |
| Minas Gerais (except Triângulo Mineiro) | 10/18/27 | 04/29/23 | 04/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | | Bandwidth | Bandwidth | Bandwidth | Bandwidth | Bandwidth |
| | | | E - | E - | L - | J - | X - |
| Minas Gerais (Triângulo Mineiro) | 10/18/27 | - | 04/28/20 | 04/28/20 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | Bandwidth | Extension | Extensions | Bandwidth | Bandwidth | Bandwidth |
| | | A - | 1 - | 9 and 10 - | L - | J - | X - |
| Bahia | - | 06/29/23 | 04/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | Bandwidth | Extension | Extensions | Bandwidth | Bandwidth | Bandwidth |
| | | A - | 1 - | 9 and 10 - | L - | J - | X - |
| Sergipe | 10/18/27 | 12/15/23 | 04/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | | | Bandwidth | | | |
| | | | | E - | | | |
| Alagoas, Ceará, Pariba, Pernambuco, Piaui and Rio Grande do Norte | 10/18/27 | - | - | 04/30/23 | 12/07/22 | 04/30/23 | 10/18/27 |
| Region 2 | | | | | | | |
| | | Bandwidth | Extension | Bandwidth | Bandwidth | Bandwidth | Bandwidth |
| | | B - | 1 - | M - | L - | J - | X - |
| Paraná (except for Sector 20) and Santa Catarina | - | 04/08/28 | 04/30/23 | 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
| | | | | Bandwidth | | | |
| | | | | M - | | | |
| | | | | 04/30/23 | | | |
| | | Bandwidth | | Extensions | | Bandwidth | Bandwidth |
| | | B - | | 10 - | | J - | X - |
| Paraná Sector 20 - Londrina and Tamarana (5) | - | 04/08/28 | - | 04/30/23 | - | 04/30/23 | 10/18/27 |

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| | | | | | | | |
|--|----------|------------------------------|------------------------------|--|------------------------------|------------------------------|------------------------------|
| Rio Grande do Sul (except for Sector 30) | - | Bandwidth A - 12/17/22 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Rio Grande do Sul - Sector 30 (Pelotas, Morro Redondo, Capão do Leão and Turuçu) | - | - | - | Bandwidths D and M - 04/30/23 | Bandwidth L - 12/07/22 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Federal District | - | Bandwidth A - 07/24/21 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Goiás and Tocantins | - | Bandwidth A - 10/29/23 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Goiás (Sector 25) (7) | - | - | - | Bandwidth M - 04/30/23 Extensions 7 to 10 - 04/30/23 | Bandwidth L - 12/07/22 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Mato Grosso | - | Bandwidth A - 03/30/24 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Mato Grosso do Sul (except for Sector 22) (6) | - | Bandwidth A - 09/28/24 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Mato Grosso do Sul (Sector 22 - Paranaíba) | - | - | - | Bandwidth M - 04/30/23 Extensions 7, 9 and 10 - 04/30/23 | Bandwidth L - 12/07/22 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Rondônia | - | Bandwidth A - 07/21/24 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Acre | - | Bandwidth A - 07/15/24 | Extension 1 - 04/30/23 | Bandwidth M - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| Region 3 | | | | Extensions 9 and 10 - 04/30/23 | | | |
| São Paulo (4) | 10/18/27 | Bandwidth A - 08/05/23 | - | Bandwidth L - 30/04/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 | |
| São Paulo (Ribeirão Preto, Guataparã and Bonfim Paulista) (4) | 10/18/27 | Bandwidth A - 01/20/24 | - | Extensions 5, 9 and 10 - 04/30/23 | Bandwidth L - 04/30/23 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| São Paulo (Franca area and region) (4) | 10/18/27 | Bandwidth A 08/08/23 | - | Extensions 5, 9 L - | Bandwidth J - | Bandwidth X - | |

| | | | | and 10 - 04/30/23 | 04/30/23 | 04/30/23 | 10/18/27 |
|------------------------------|---|---|---|---------------------------|------------------------------|------------------------------|------------------------------|
| | | | | Extensions | | | |
| | | | | 9 and 10 - 04/30/23 | Bandwidth L - 12/07/22 | Bandwidth J - 04/30/23 | Bandwidth X - 10/18/27 |
| São Paulo (Sector 33) (8) | - | - | - | | | | |

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- (1) All of the authorization terms for A and B bandwidths have been renewed for 15 years. Accordingly, no additional renewal applies (once the 30-year authorization term has been completed).
- (2) Authorization terms for the L bandwidth that was linked to A or B bandwidths have been renewed together with the latter bands.
- (3) L bandwidths that have been realigned to J bandwidth have now the same renewal date as the latter band (price realignment calculation considered this point).
- (4) In São Paulo, only in cities where CN is 13 to 19, the Company holds a 450 MHz license effective until October 18, 2027.
- (5) Paraná - Sector 20 of PGO - cities of Londrina and Tamarana.
- (6) Mato Grosso do Sul - Sector 22 of PGO - city of Paranaíba.
- (7) Goiás - Sector 25 of PGO - cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão.
- (8) São Paulo - Sector 33 of PGO – cities of Altinópolis, Aramina, Batatais, Brodosqui, Buritizal, Cajuru, Cássia dos Coqueiros, Colômbia, Franca, Guaíra, Guará, Ipuã, Ituverava, Jardinópolis, Miguelópolis, Morro Agudo, Nuporanga, Orlandia, Ribeirão Corrente, Sales de Oliveira, Santa Cruz da Esperança, Santo Antônio da Alegria and São Joaquim da Barra.

d) Share trading on stock exchanges

The Company is listed in the Brazilian Securities and Exchange Commission (CVM) as a publicly-held company under Category A (issuers authorized to trade any marketable securities) and has shares traded on the São Paulo Stock Exchange (BM&FBovespa). It is also listed in the US Securities and Exchange Commission (SEC), and its level II American Depositary Shares (ADS), backed by preferred shares only, are traded on the New York Stock Exchange (NYSE).

d.1) Shares traded on BM&F Bovespa

On September 21, 1998, the Company started trading its shares on BM&F Bovespa, under tickers TLPP3 and TLPP4, for common and preferred shares, respectively.

In the Special Shareholders' Meeting of Vivo Participações S.A. (Vivo Part.) and Telecomunicações de São Paulo S.A. (Telesp) held on October 3, 2011, the merger of Vivo Part. into Telesp was approved. On the same date, its corporate name changed to Telefonica Brasil S.A. and on October 6, 2011, the Company changed its ticker codes to VIVT3 and VIVT4 for common and preferred shares, respectively, and the stock exchange code to Telefonica Brasil.

d.2) Shares traded on NYSE

On November 16, 1998, the Company started trading ADS on NYSE, which currently has the following main characteristics:

- Type of shares: preferred.
- Each ADS represents 1 (one) preferred share.
- Shares are traded as ADS under ticker "VIV" on NYSE.
 - Foreign depositary bank: Citibank N.A.
 - Custodian bank in Brazil: Citibank N.A.

e) Agreement between Telefónica S.A. and Telecom Italia

TELCO S.p.A. (in which Telefónica S.A. held a 46.18% interest) has a 22.4% interest with voting rights in Telecom Italia, being the major shareholder of that company. The Company is an indirect subsidiary of Telefónica S.A., and Telecom Italia holds an indirect interest in TIM Participações S.A. (TIM), a Brazilian telecommunications company. Neither Telefónica S.A., nor Telefonica Brasil or any other affiliate of Telefónica S.A. interfere in, are involved with or have decision-making powers over TIM operations in Brazil, also being lawfully and contractually forbidden to exercise any type of political power derived from indirect interest held as concerns operations in Brazil, directly related to TIM operations. TIM (Brazil) and

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Telefonica Brasil compete in all markets in which they operate in Brazil under permanent competitive stress and, in this context, as well as in relation to the other economic players in the telecommunications industry, maintain usual and customary contractual relations with one another (many of which are regulated and inspected by ANATEL) and/or which, as applicable, are informed to ANATEL and Brazil's Administrative Council for Economic Defense (CADE), concerning the commitments assumed before these agencies so as to ensure total independence of their operations.

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

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

Until the date of preparation of the consolidated financial statements the approval required to implement the transactions agreed on September 24, 2013 by Telefonica S.A. and other shareholders of Italian society TELCO, S.p.A has not been obtained.

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

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

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

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

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

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

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

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

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

2. Basis of preparation and presentation of the financial statements

2.1 - Basis for preparation and presentation

The Company's financial statements for the years ended December 31, 2013 and 2012 are presented in thousands of reais (unless otherwise stated) and were prepared under a going concern assumption.

The financial statements were prepared on a historical cost basis (except where different criteria are required) and adjusted to reflect the valuation of assets and liabilities measured at fair value or considering the mark-to-market valuation when these items are classified as available for sale.

The financial statements were prepared based on several valuation bases used in accounting estimates. Accounting estimates involved in the preparation of the financial statements are based on objective and subjective factors and management's judgment to determine the adequate amount to be recorded in the financial statements. Significant items subject to these estimates and assumptions include selection of useful lives and recoverability of property and equipment, measurement of financial assets at fair value, credit risk analysis to determine the allowance for doubtful accounts, as well as the analysis of other risks to determine other provisions, including the provision for contingencies.

Settlement of transactions involving these estimates may result in amounts significantly different than those recorded in the financial statements due to the criteria inherent in the estimation process. The Company reviews its estimates at least annually.

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The consolidated financial statements were prepared and are presented in accordance with the International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), which do not differ from the accounting practices adopted in Brazil, comprising the standards issued by the Brazilian Securities and Exchange Commission (CVM) and CPCs.

The financial statements report includes comparative consolidated information in relation to the previous year. Additionally, the Company presents the balance sheet and the cash flow statement at the beginning of the earliest comparative period when it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements. The additional balance sheet as at January 1, 2012 is included in the accompanying financial statements, which are in conformity with the international financial reporting standards issued by the IASB.

The accompanying financial statements were authorized for issue by the Company's management in a meeting held on February 17, 2014, as ratified by the Board of Directors in a meeting held on February 25, 2014.

The Company hereby states that the consolidated financial statements are in conformity with the IFRS as issued by the IASB, in addition to the standards, amendments and interpretations published by the IASB and by the IFRS Interpretations Committee (IFRIC), effective as of January 1, 2013:

New IFRS and interpretations of the IFRIC with no significant impact on the financial position shown in these financial statements:

IAS 1 Presentation of Financial Statements - Presentation of Items of Other Comprehensive Income: The amendments to IAS 1 introduce a grouping of items presented in other comprehensive income (OCI). Items that could be reclassified (or recycled) to profit or loss at a future point in time (e.g., net gain on hedge of net investment, exchange differences on translation of foreign operations, net movement on cash flow hedges and net loss or gain on available-for-sale financial assets) now have to be presented separately from items that will never be reclassified (e.g., actuarial gains and losses on defined benefit plans and revaluation of land and buildings). The amendments became effective for annual periods beginning on or after July 1, 2012. The application of these amendments affects presentation only and has no impact on the Company's and its subsidiary's financial position or performance.

IAS 19 Employee Benefits (Revised): The IASB has issued a number of amendments to IAS 19. These amendments include not only basic changes, such as the elimination of the "corridor" approach and the concept of expected return on plan assets, but also simple clarifications regarding valuation, devaluation and remeasurement. This amendment became effective for annual periods beginning on or after January 1, 2013. The application of this amendment has no significant impact on the Company's and its subsidiary's financial position or performance.

IAS 28 Accounting for Investments in Associates and Joint Ventures (revised in 2011): As a consequence of the new IFRS 11 and IFRS 12, IAS 28 has been renamed IAS 28 Investments in Associates and Joint Ventures, and describes the application of the equity method to investments in joint ventures in addition to associates. This amendment became effective for annual periods beginning on or after January 1, 2013. The application of this amendment has no impact on the Company's and its subsidiary's financial position or performance.

IFRS 1 First-time Adoption of International Financial Reporting Standards (IFRS): These amendments changed the meaning of effective IFRSs. According to this amendment, an entity may choose to apply either a current standard or a new standard that is not yet mandatory, but that permits early adoption, provided either the standard is applied consistently throughout the periods. These amendments are applicable only to first adopters, consequently have no

impact on the Company's and its subsidiary's financial position or performance.

IFRS 7 Disclosures - Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7): These amendments require an entity to disclose information about rights to set-off and related arrangements (e.g.,

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collateral agreements). The disclosures would provide users with information that is useful in evaluating the effect of netting arrangements on an entity's financial position. The new disclosures are required for all recognized financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32. This amendment became effective for annual periods beginning on or after January 1, 2013. The application of these amendments affects presentation only and has no impact on the Company's and its subsidiary's financial position or performance.

IFRS 10 Consolidated Financial Statements, and IAS 27 Separate Financial Statements: IFRS 10 replaces the portion of IAS 27 Consolidated and Separate Financial Statements that addresses the accounting for consolidated financial statements. It also addresses the issues raised in SIC-12 Consolidation -Special Purpose Entities. IFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by IFRS 10 require management to exercise significant judgment to determine which entities are controlled and therefore are required to be consolidated by a parent, compared with the requirements that were in IAS 27. This standard became effective for annual periods beginning on or after January 1, 2013. The Company reviewed this standard and did not identify significant impacts on its financial statements.

IFRS 12 Disclosure of Interests in Other Entities: IFRS 12 includes all of the disclosures that were previously in IAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in IAS 31 and IAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. This standard became effective for annual periods beginning on or after January 1, 2013. The application of this standard affects disclosures only and has no impact on the Company's and its subsidiary's financial position or performance.

IFRS 13 Fair Value Measurement: IFRS 13 establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. Additionally, at December 12, 2013 amendments to IFRS 13 were introduced with immediate effect. The IASB stated in "Basis for Conclusions" that short-term receivables and account payables with no outstanding interest may be recognized considering the invoice amount where the effect of discounting be quantified as immaterial. This standard became effective for annual periods beginning on or after January 1, 2013. The application of this standard has no impact on the Company upon first-time adoption.

IAS 34 Interim financial reporting: The amendment aligns the disclosure requirements for total segment assets with total segment liabilities in interim financial statements. This clarification also ensures that interim disclosures are aligned with annual disclosures. These improvements became effective for annual periods beginning on or after January 1, 2013. The application of this standard has no impact on the annual financial statements of the Company.

New IFRS and interpretations of the IFRIC with impact on the financial position shown in these financial statements:

IFRS 11 replaces IAS 31 Interests in Joint Ventures and SIC-13 Jointly-controlled Entities - Non-monetary Contributions by Venturers. IFRS 11 removes the option to account for jointly controlled entities (JCEs) using proportionate consolidation. Instead, JCEs that meet the definition of a joint venture must be accounted for using the equity method. The application of this new standard impacted the Company's financial position and eliminated the proportionate consolidation of Aliança Atlântica Holding B.V. (Aliança), Companhia Aix de Participações (AIX) and Companhia ACT de Participações (ACT). Accordingly, investments in these entities were accounted for using the equity method. This standard became effective for annual periods beginning on or after January 1, 2013, and is to be applied retrospectively for joint arrangements held at the date of initial adoption.

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In order to facilitate understanding the effects arising from application of this standard, we present below the consolidated financial statements as at January 1 and December 31, 2012, with corresponding adjustments and some reclassifications for better presentation of the consolidated information:

Consolidated Balance Sheet as at January 1, 2012

| | Balance sheet as of 01.01.12, disclosed as of 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Balance sheet as of 01.01.12., disclosed as of 12.31.13 |
|------------------------------------|---|---|--|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | 2,940,342 | (50,799) | 2,889,543 |
| Trade accounts receivable, net (a) | 5,105,860 | 22,282 | 5,128,142 |
| Dividend and interest on equity | - | 772 | 772 |
| Taxes recoverable | 2,495,066 | (1) | 2,495,065 |
| Other assets (a) | 1,268,850 | (22,628) | 1,246,222 |
| Total current assets | 11,810,118 | (50,374) | 11,759,744 |
| Noncurrent assets | | | |
| Deferred taxes | 1,428,878 | (1,379) | 1,427,499 |
| Escrow deposits | 3,374,690 | (200) | 3,374,490 |
| Other assets | 1,630,848 | (52,244) | 1,578,604 |
| Investments | 37,835 | 114,421 | 152,256 |
| Property, plant and equipment, net | 17,153,920 | (7,399) | 17,146,521 |
| Intangible assets, net | 30,053,684 | (4,237) | 30,049,447 |
| Total noncurrent assets | 53,679,855 | 48,962 | 53,728,817 |
| Total assets | 65,489,973 | (1,412) | 65,488,561 |

| | Balance sheet as of 01.01.12, disclosed as of 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Balance sheet as of 01.01.12., disclosed as of 12.31.13 |
|--|---|---|--|
| LIABILITIES AND EQUITY | | | |
| Current liabilities | | | |
| Personnel, social charges and benefits | 495,624 | (97) | 495,527 |
| Trade accounts payable | 6,037,315 | 834 | 6,038,149 |
| Taxes, charges and contributions | 1,691,991 | (254) | 1,691,737 |
| Loans, financing and lease (b) | 988,413 | 11,669 | 1,000,082 |
| Other liabilities (b) | 3,526,920 | (11,716) | 3,515,204 |
| Total current liabilities | 12,740,263 | 436 | 12,740,699 |
| Noncurrent liabilities | | | |

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| | | | |
|--|------------|------------|------------|
| Personnel, social charges and benefits (d) | - | 15,160 | 15,160 |
| Deferred taxes | 788,954 | - | 788,954 |
| Loans, financing and lease (b) | 3,959,115 | 9,398 | 3,968,513 |
| Provisions (c) | 3,147,085 | (309,057) | 2,838,028 |
| Liabilities with post-retirement benefit plans (c) | - | 308,893 | 308,893 |
| Other liabilities (b) (d) | 1,523,771 | (26,242) | 1,497,529 |
| Total noncurrent liabilities | 9,418,925 | (1,848) | 9,417,077 |
| Equity | 43,330,785 | - | 43,330,785 |
| Total liabilities and equity | 65,489,973 | (1,412) | 65,488,561 |

(a) Amounts recorded as other accounts receivable were reclassified from “Other assets” to “Accounts receivable, net” (Notes 11 and 6).

(b) Finance lease amounts were reclassified from “Other obligations” to “Loans, financing and finance lease” (Notes 22 and 18.1).

(c) Actuarial liabilities of post-employment benefit plans were reclassified from “Provisions” to a specific line “Obligations with post-employment benefit plans” (Notes 20 and 35).

(d) Liabilities relating to share-based payment plans were reclassified from “Other obligations” to “Personnel, social charges and benefits” (Notes 22 and 15).

Consolidated Balance Sheet as at December 31, 2012

| | Balance sheet disclosed as of 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Balance sheet as of 12.31.12., disclosed as of 12.31.13 |
|------------------------------------|--|---|--|
| ASSETS | | | |
| Current assets | | | |
| Cash and cash equivalents | 7,196,079 | (62,594) | 7,133,485 |
| Trade accounts receivable, net (a) | 5,513,436 | 33,502 | 5,546,938 |
| Dividend and interest on equity | - | 1,140 | 1,140 |
| Taxes recoverable | 2,052,423 | (2) | 2,052,421 |
| Other assets (a) | 1,510,004 | (34,807) | 1,475,197 |
| Total current assets | 16,271,942 | (62,761) | 16,209,181 |
| Noncurrent assets | | | |
| Deferred taxes | 1,029,598 | (1,710) | 1,027,888 |
| Escrow deposits | 3,909,474 | (206) | 3,909,268 |
| Other assets | 1,399,830 | (47,797) | 1,352,033 |
| Investments | 23,683 | 119,198 | 142,881 |
| Property, plant and equipment, net | 17,610,851 | (6,707) | 17,604,144 |
| Intangible assets, net | 30,009,289 | (3,592) | 30,005,697 |
| Total noncurrent assets | 53,982,725 | 59,186 | 54,041,911 |
| Total assets | 70,254,667 | (3,575) | 70,251,092 |

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| | Balance sheet disclosed as of 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Balance sheet as of 12.31.12., disclosed as of 12.31.13 |
|--|--|---|--|
| LIABILITIES AND EQUITY | | | |
| Current liabilities | | | |
| Personnel, social charges and benefits | 416,355 | (103) | 416,252 |
| Trade accounts payable | 5,889,377 | (309) | 5,889,068 |
| Taxes, charges and contributions | 1,781,480 | (230) | 1,781,250 |
| Loans, financing and lease (b) | 1,255,323 | 14,799 | 1,270,122 |
| Other liabilities (b) | 4,194,936 | (14,836) | 4,180,100 |
| Total current liabilities | 13,537,471 | (679) | 13,536,792 |
| Noncurrent liabilities | | | |
| Personnel, social charges and benefits | - | 13,224 | 13,224 |
| Loans, financing and lease (b) | 3,756,001 | 18,460 | 3,774,461 |
| Provisions (c) | 3,846,899 | (393,262) | 3,453,637 |
| Liabilities with post-retirement benefit plans (c) | - | 392,269 | 392,269 |
| Other liabilities (b) (d) | 4,433,176 | (33,587) | 4,399,589 |
| Total noncurrent liabilities | 12,036,076 | (2,896) | 12,033,180 |
| Equity | 44,681,120 | - | 44,681,120 |
| Total liabilities and equity | 70,254,667 | (3,575) | 70,251,092 |

- (a) Amounts recorded as other accounts receivable were reclassified from “Other assets” to “Accounts receivable, net” (Notes 11 and 6).
- (b) Finance lease amounts were reclassified from “Other obligations” to “Loans, financing and finance lease” (Notes 22 and 18.1).
- (c) Actuarial liabilities of post-employment benefit plans were reclassified from “Provisions” to a specific line “Obligations with post-employment benefit plans” (Notes 20 and 35).
- (d) Liabilities relating to share-based payment plans were reclassified from “Other obligations” to “Personnel, social charges and benefits” (Notes 22 and 15).

Consolidated Income Statement for the year ended December 31, 2012

| | Income statement as of 12.31.12, disclosed for 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Income statement as of 12.31.12, disclosed for 12.31.13 |
|-------------------------------------|--|---|--|
| Net operating revenue | 33,931,422 | (11,766) | 33,919,656 |
| Cost of sales | (16,564,464) | 7,020 | (16,557,444) |
| Gross profit | 17,366,958 | (4,746) | 17,362,212 |
| Selling expenses | (8,693,696) | - | (8,693,696) |
| General and administrative expenses | (2,148,476) | 3,168 | (2,145,308) |

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| | | | |
|-----------------------------|---------|-----|---------|
| Other operating income, net | 687,503 | 209 | 687,712 |
| Equity pickup | - | 588 | 588 |

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| | | | |
|---|--------------|----------|--------------|
| Income before financial income (expenses) | 7,212,289 | (781) | 7,211,508 |
| Financial income | 1,281,554 | (449) | 1,281,105 |
| Financial expenses | (1,572,369) | - | (1,572,369) |
| Income before taxes | 6,921,474 | (1,230) | 6,920,244 |
| | (2,469,293) | 1,230 | (2,468,063) |
| Net income for the period | 4,452,181 | - | 4,452,181 |

Consolidated Income Statement for the year ended December 31, 2011

| | Income statement for 12.31.11, disclosed as of 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Income statement for 12.31.11, disclosed as of 12.31.13 |
|---|--|---|--|
| Net operating revenue | 29,128,740 | (12,096) | 29,116,644 |
| Cost of sales | (15,039,663) | 4,500 | (15,035,163) |
| Gross profit | 14,089,077 | (7,596) | 14,081,481 |
| Selling expenses | (6,948,211) | - | (6,948,211) |
| General and administrative expenses | (1,785,658) | 2,687 | (1,782,971) |
| Other operating income, net | 442,158 | (667) | 441,491 |
| Equity pickup | - | 4,305 | 4,305 |
| Income before financial income (expenses) | 5,797,366 | (1,271) | 5,796,095 |
| Financial income | 1,103,359 | (1,303) | 1,102,056 |
| Financial expenses | (1,243,051) | - | (1,243,051) |
| Income before taxes | 5,657,674 | (2,574) | 5,655,100 |
| | (1,295,475) | 2,574 | (1,292,901) |
| Net income for the period | 4,362,199 | - | 4,362,199 |

Consolidated Statement of Cash Flow for the year ended December 31, 2012

| | Cash flow statement for 12.31.12, disclosed as of 12.31.12 | Adjustments for adoption of IFRS 11 and Reclassifications | Cash flow statement for 12.31.12, disclosed as of 12.31.13 |
|--|---|---|---|
| Income before taxes | 6,921,474 | (1,230) | 6,920,244 |
| Expenses (revenues) not representing changes in cash | 6,139,975 | 7,947 | 6,147,922 |
| (Increase) decrease in operating assets: | (557,118) | 317,349 | (239,769) |
| Increase (decrease) in operating liabilities: | (2,771,162) | (3,238) | (2,774,400) |
| Total cash generated by (used in) operating activities | 9,733,169 | 320,828 | 10,053,997 |

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| | | | |
|---|--------------|------------|--------------|
| Cash generated by (used in) investing activities | (3,397,253) | (323,586) | (3,720,839) |
| Cash generated by (used in) financing activities | (2,080,179) | (9,037) | (2,089,216) |
| Increase (decrease) in cash and cash equivalents | 4,255,737 | (11,795) | 4,243,942 |
| Cash and cash equivalents at beginning of year | 2,940,342 | (50,799) | 2,889,543 |
| Cash and cash equivalents at end of year | 7,196,079 | (62,594) | 7,133,485 |
| Changes in cash and cash equivalents for the year | 4,255,737 | (11,795) | 4,243,942 |

Consolidated Statement of Cash Flow for the year ended December 31, 2011

| | Cash flow statement for 01.01.12, disclosed as of 12.31.11 | Adjustments for adoption of IFRS 11 and Reclassifications | Cash flow statement for 01.01.12, disclosed as of 12.31.13 |
|--|---|---|---|
| Income before taxes | 5,657,674 | (2,574) | 5,655,100 |
| Expenses (revenues) not representing changes in cash | 5,683,221 | (5,697) | 5,677,524 |
| (Increase) decrease in operating assets: | (479,896) | (10,464) | (490,360) |
| Increase (decrease) in operating liabilities: | (2,719,624) | 5,475 | (2,714,149) |
| Total cash generated by (used in) operating activities | 8,141,375 | (13,260) | 8,128,115 |
| Cash generated by (used in) investing activities | (2,028,835) | 21,726 | (2,007,109) |
| Cash generated by (used in) financing activities | (4,728,913) | - | (4,728,913) |
| Increase (decrease) in cash and cash equivalents | 1,383,627 | 8,466 | 1,392,093 |
| Cash and cash equivalents at beginning of year | 1,556,715 | (59,265) | 1,497,450 |
| Cash and cash equivalents at end of year | 2,940,342 | (50,799) | 2,889,543 |
| Changes in cash and cash equivalents for the year | 1,383,627 | 8,466 | 1,392,093 |

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New IFRS and IFRIC interpretations not yet in effect as at December 31, 2013

The following IFRS and IFRIC interpretations had been published by the date of these financial statements, but their application was not mandatory:

IFRS 2 Share-based Payment: These amendments changed the definitions relating to vesting conditions and implementation is effective for fiscal years beginning on or after 1 July 2014. The Company will apply the amendments in its financial statements from their effective date.

IFRS 3 Business Combinations: The amendments changed the accounting for contingent consideration in a business combination. Contingent consideration on acquisition of a business that is not classified as equity are subsequently measured at fair value through profit or loss, whether or not included in the scope of IFRS 9 Financial Instruments. These changes are effective for new business combinations after July 1st, 2014 . The Company consider the application of these changes to any business combinations that occur beginning on or after 1 July 2014.

IFRS 8 Operating Segments: The changes are related to the aggregation of operating segments, which can be combined / aggregated whether they are in accordance with the criteria of the rule , in other words, if the segments have similar economic characteristics and are similar in other qualitative aspects. If they are combined, the entity shall disclose the economic characteristics used to assess whether the segments are similar. These amendments take effect beginning on or after 1 July 2014. Considering the fact that the Company operates in one operating segment, is not expected to significantly impact its financial statements and disclosure.

IFRS 9 Financial Instruments: IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after January 1, 2013, but Amendments to IFRS 9 Mandatory Effective Date of IFRS 9 and Transition Disclosures, issued in December 2011, postponed to an indefinite date. In subsequent phases, the IASB will address hedge accounting and impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Company's financial assets, but will not have an impact on classification and measurements of financial liabilities. The Company will quantify the effect in conjunction with the other phases of IASB project, when the final standard consolidating all phases is issued.

Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27): The amendments will be effective for annual periods beginning on or after January 1, 2014, providing an exception to the consolidation requirements for a reporting entity that meets the definition of an investment entity under IFRS 10. This exception requires an investment entity to account for its investments in subsidiaries at fair value in profit or loss. The Company does not expect these amendments to significantly impact its financial statements, given that its subsidiary does not qualify as an investment entity.

IFRS 13 Fair Value Measurement: The amendment applies prospectively after July 1, 2014. The change is related to the application of the exception financial assets portfolio, financial liabilities and other contracts. The Company and its subsidiary will evaluate the effect of implementation of new business beginning on or after July 1, 2014.

IAS 16 Property Plant and Equipment and IAS 38 Intangible Assets: The amendment to IAS 16.35 (a) and IAS 38.80 (a) clarifies that a revaluation can be made as follows: i) adjust the gross carrying amount of the asset at market value or , ii) determine the market value and adjust the gross carrying amount proportionally, so that the resulting carrying amount is equal to the market value. IASB also clarified that the accumulated depreciation / amortization is the difference between the gross carrying amount and the carrying amount of the asset (i.e. gross book value -

depreciation / accumulated amortization = book value). The amendment to IAS 16.35 (b) and IAS 38.80 (b) clarifies that the accumulated depreciation / amortization is eliminated so that the gross carrying amount and the book value is equal to market value. The changes will take effect retrospectively beginning on or after July 1, 2014. Implementation of these changes has no impact on the financial or operational condition of the Company and its subsidiary at the time. Whereas the reassessment of fixed assets and intangible assets is not allowed in Brazil, the Company does not expect impact on your financial statements.

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IAS 24 Related Party Disclosures: The amendment clarifies that an entity's providing key management personnel services to the reporting entity or to the parent of the reporting entity is a related party of the reporting entity. In addition, an entity that uses a management entity shall disclose the expenses incurred by management services. The changes will take effect retrospectively beginning on or after July 1, 2014. The Company does not expect these amendments significantly impacting its financial statements.

IAS 32 Offsetting Financial Assets and Financial Liabilities - Amendments to IAS 32: These amendments clarify the meaning of "currently has a legally enforceable right to set off the recognized amounts" and the criteria that would qualify for settlement the settlement mechanisms of clearing house systems that are not simultaneous. These amendments will become effective for annual periods beginning on or after January 1, 2014. The Company does not expect these amendments to significantly impact its financial statements.

IFRIC 21 Levies: IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability is recognized before the specified minimum threshold is reached. IFRIC 21 becomes effective for annual periods ending on or after January 1, 2014. The Company does not expect IFRIC 21 to significantly impact its financial statements.

IAS 39 Novation of Derivatives and Continuation of Hedge Accounting - Amendments to IAS 39: The amendments provide a relief on the discontinuation of hedge accounting in certain circumstances in which a hedging instrument is to be novated. These amendments will become effective for annual periods beginning on or after January 1, 2014. These amendments shall apply to future novations of derivatives.

IAS 40 Investment Property: This amendment clarifies the relationship between the definitions of IFRS 3 and IAS 40 on the classification of the investment property or owner-occupied property. The description of ancillary services in IAS 40 that differentiates between investment properties and owner occupied property (IFRS 3) is used to determine whether the transaction is a purchase of an asset or a business combination. This amendment is effective prospectively beginning on or after July 1, 2014. The Company will evaluate any possible impact in case of transactions occur after the effective date

2.2 - Bases for consolidation and significant changes at consolidation level

On consolidation, all intercompany assets, liabilities, income and expenses, as well as equity interests held, are eliminated in full.

Information on investees is described below:

Telefônica Data S.A. (TData): Headquartered in Brazil, the business purpose of this entity is to provide and operate telecommunications services; provide value added services (SVAs); provide integrated business solutions in telecommunications and related activities; manage the provision of technical assistance and maintenance services of telecommunications equipment and network, consulting services regarding telecommunications solutions and related activities, and design, implementation and installation of telecommunication-related projects; sell and lease telecommunications equipment, products and services, value-added services or any other related services, provided or supplied by third parties; provide third parties with telecommunications infrastructure; manage and/or develop activities that are necessary or useful for performing such services in accordance with applicable law; provide business trading services in general and provide technical support services in IT, including consulting, installation and maintenance of goods, applications and services, licensing or sub licensing of any kind of software, and storage and

management of data and information. On July 1, 2013, part of its net assets were spun-off and merged into the Company and, on the same date, parts of the net assets of Vivo and ATelecom were merged into TData (Note 1b).

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Vivo S.A. (Vivo): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to operate SMP services, including activities necessary or useful for the performance of these services, in conformity with the authorizations it was granted.

Vivo was split up and merged into the Company and TData on July 1, 2013 (Note 1b).

ATelecom S.A. (ATelecom): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to manage the rendering of telecommunication and installation services, to operate and maintain Internet, Intranet and Extranet solutions, business representation, mediation, intermediation and distribution of goods, to sell, agency, lease and maintain of telecommunication and general IT systems, equipment and devices, to provide advisory and technical support services regarding specification, implementation and maintenance of new voice, data and image systems, to import and export goods and services that are useful for the performance of its business purpose and to hold interests in the capital of other Brazilian or foreign entities, as a partner, shareholder or member. ATelecom was split up and merged into the Company and TData on July 1, 2013 (Note 1b).

Telefônica Sistema de Televisão S.A. (TST): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to provide Multichannel Multipoint Distribution Service (MMDS) type pay television services, in addition to general telecommunication and Internet services. TST was merged into the Company on July 1, 2013 (Note 1b).

Ajato Telecomunicações Ltda. (Ajato): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to provide telecommunication and IT services, to sell, lease, import, export, maintain and repair related equipment. Ajato was merged into TST (later merged into the Company) on July 1, 2013 (Note 1b).

GTR-T Participações e Empreendimentos S.A. (GTR-T): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to hold interests in other companies engaged in rendering pay and cable television services, telecommunication services in general, acquisition, licensing, import and distribution of own or third-party television programs, replacement parts and equipment, management and operation of telecommunication and pay television service platforms. A GTR-T was merged into TST (later merged into the Company) on July 1, 2013 (Note 1b).

TVA Sul Paraná S.A. (Sul Paraná): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to render pay and cable television services, telecommunication services in general, to acquire, license, import and distribute own or third-party television programs, replacement parts and equipment, to manage and operate telecommunication and pay television service platforms and to publish periodicals. A Sul Paraná was merged into TST (later merged into the Company) on July 1, 2013 (Note 1b).

Lemontree Participações S.A. (Lemontree): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to hold interests in other companies engaged in rendering pay and cable television services, telecommunication services in general, acquisition, licensing, import and distribution of own or third-party television programs, replacement parts and equipment, management, updating and operation of telecommunication and pay television service platforms and management and selling of data. A Lemontree was merged into TST (later merged into the Company) on July 1, 2013 (Note 1b).

Comercial Cabo TV São Paulo S.A. (CaTV): Headquartered in Brazil, the business purpose of this entity was, until June 30, 2013, to render pay television services, to provide general telecommunication advisory and consulting services, to acquire, license, import and distribute own or third-party television programs, replacement parts and equipment, to manage update and operate all types of advertising and publicity. A CaTV was merged into TST (later

merged into the Company) on July 1, 2013 (Note 1b).

Aliança Atlântica Holding B.V. (Aliança): Headquartered in Amsterdam, Netherlands, this entity has a 50% interest held by Telefônica Brasil and cash generated from sale of Portugal Telecom shares in June 2010. Through May 8, 2012, the Company held equity interest in Zon Multimédia, a Portugal Telecom group company

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that renders services involving pay television, Internet, distribution of audiovisual contents, cinema and telecommunication services. This equity interest was disposed of on May 8, 2012.

Companhia AIX de Participações (AIX): Headquartered in Brazil, this entity is engaged in holding an interest in Refibra consortium, and in performing activities related to the direct and indirect operation of activities related to the construction, completion and operation of underground networks or optical fiber ducts.

Companhia ACT de Participações (ACT): Headquartered in Brazil, this entity is engaged in holding an interest in Refibra consortium, and in performing activities related to the rendering of technical support services for the preparation of projects and completion of networks, by means of studies required to make them economically feasible, and monitor the progress of Consortium-related activities.

Direct and indirect subsidiaries and jointly controlled entities, as well as the percentage of interest held by the Company as of December 31, 2013 and 2012 are as follows:

At December 31, 2013

| Investees | Direct ownership interest | | |
|-----------------------------|---------------------------|---------------|---------------------|
| | Investor | Interest held | Total interest held |
| Wholly-owned subsidiaries | | | |
| TData | Telefônica Brasil | 100.00% | 100.00% |
| Jointly controlled entities | | | |
| Aliança | Telefônica Brasil | 50.00% | 50.00% |
| AIX | Telefônica Brasil | 50.00% | 50.00% |
| ACT | Telefônica Brasil | 50.00% | 50.00% |

At December 31, 2012

| Investees | Direct ownership interest | | Indirect ownership interest | | Total interest held |
|---------------------------|---------------------------|---------------|-----------------------------|---------------|---------------------|
| | Investor | Interest held | Investor | Interest held | |
| Wholly-owned subsidiaries | | | | | |
| Vivo | | 100.00% | - | - | 100.00% |

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| | | | | | |
|-----------------------------|----------------------|---------|-----------|---------|---------|
| | Telefônica Brasil | | | | |
| TData | Telefônica Brasil | 100.00% | - | - | 100.00% |
| ATelecom | Telefônica Brasil | 100.00% | - | - | 100.00% |
| TST | Telefônica Brasil | 100.00% | - | - | 100.00% |
| Ajato | - | - | TSTV | 100.00% | 100.00% |
| GTR-T | Telefônica Brasil | 100.00% | - | - | 100.00% |
| Sul Paraná | Telefônica Brasil | 79.29% | GTR-T | 20.71% | 100.00% |
| Lemontree | Telefônica Brasil | 100.00% | - | - | 100.00% |
| CaTV | Telefônica Brasil | 78.48% | Lemontree | 21.52% | 100.00% |
| Jointly controlled entities | | | | | |
| Aliança | Telefônica Brasil | 50.00% | - | - | 50.00% |
| AIX | Telefônica Brasil | 50.00% | - | - | 50.00% |
| ACT | Telefônica Brasil | 50.00% | - | - | 50.00% |

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The main events and changes at the consolidation level, which, given their significance, should be considered for the purpose of reviewing the consolidated financial information for the years ended December 31, 2013 and 2012 are described below:

2013 - Corporate restructuring

In order to streamline the Company's organizational structure, to rationalize the services provided by its subsidiaries and to concentrate service provision in two operating entities, namely the Company and its wholly-owned subsidiary TData, on March 15, 2012, the Company filed with the ANATEL a request for previous approval of corporate restructuring, which became legally feasible due to legislation changes applicable to STFC operators through Law No. 12,485.

This corporate restructuring process was approved by ANATEL under Act No. 3,043, of May 27, 2013, as published in the DOU of May 29, 2013, subject to the conditions thereunder (Note 1b).

2012 - Acquisition of Lemontree and GTR-T shares

On June 6, 2012, the Company exercised its option to purchase (a) the remaining 71,330,508 common shares of Lemontree, which controls CaTV, corresponding to 51% of the voting capital; and (ii) the remaining 923,778 common shares of GTR-T, holder of 50.9% of Sul Paraná common shares previously held by Abril group. The call option exercised on that date completes the acquisition of Lemontree and GTR-T remaining shares, which started with the partial exercise of the call option implemented on September 29, 2011, with the acquisition of Lemontree common shares, representing 49% of its capital. Amounts corresponding to the acquisition of the remaining common shares of Lemontree and GTR-T totaled R\$37,737 and R\$6,434, respectively.

This transaction was accounted for as an acquisition of non-controlling shareholders' interests for the purpose of disclosure and measurement in these financial statements.

Upon exercising this option, the Company became holder of 100% of the shares representing the voting and total capital of Lemontree and GTR and, indirectly, of the cable TV service operators located in the cities of São Paulo, Curitiba, Foz do Iguacu and Florianópolis.

2012 - Disposal of shares of Zon Multimédia – Serviços de Telecomunicações e Multimédia, SGPS, S.A.

On May 8, 2012, the Company disposed of 1,618,652 (1,196,395 directly and 422,257 indirectly through Aliança Atlântica) common shares representing 0.52% of the voting capital of Zon Multimédia – Serviços de Telecomunicações e Multimédia, SGPS, S.A. (ZON). Consolidated net income (amount obtained from disposal of shares held and divestiture of investments) from this transaction amounted to R\$1,486.

3. Summary of significant accounting practices

a) Cash and cash equivalents:

Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investing or any other purposes. The Company considers cash equivalents to be short-term investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. An investment normally qualifies as a cash equivalent if it has a short-term maturity, e.g. three months or less, from the date of acquisition

(Note 5).

b)Accounts receivable, net:

Trade accounts receivable are stated at the amount of services rendered under agreed-upon conditions, net of the allowance for doubtful accounts. These include services rendered to customers not yet billed to the

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balance sheet date, as well as receivables for the sale of cell phones, simcards and accessories. The allowance for doubtful accounts is recognized at an amount sufficient to cover losses, if any, and primarily considers the expected default level (Note 6).

c)Inventories:

Inventories are carried at the lower of average acquisition cost and net realizable value, and include cell phones, simcards, prepaid cards, accessories, consumables and supplies. Net realizable value is the selling price in the ordinary course of business, less estimated costs necessary to make the sale (Note 7).

A provision for impairment losses is recognized for supplies and devices deemed obsolete or stored in quantities higher than what the Company usually sells in a given period of time.

d)Prepaid expenses:

These are stated at amounts actually disbursed on services acquired but not yet incurred. Prepaid expenses are recognized in the income statement as the related services are provided and the economic benefits flow to the Company (Note 10).

e)Investments:

The Company's investments in jointly-controlled entities are accounted for using the equity method. Investments in subsidiaries are consolidated in full.

On consolidation, all intercompany assets, liabilities, income and expenses, as well as equity interests held, are eliminated in full, considering the Company's proportionate share in the net assets of the investee.

Foreign exchange differences in the net assets of Aliança (jointly-controlled entity) are recognized in the Company's equity as "Cumulative Translation Adjustment".

f)Fixed Assets, net:

Fixed assets are stated at acquisition and/or construction cost, net of accumulated depreciation and/or accumulated impairment losses, if any. Such cost includes the borrowing costs for long-term construction projects if the recognition criteria are met, and is stated net of ICMS (State VAT) credits, which were recorded as recoverable taxes.

Asset costs are capitalized until the asset becomes operational. Costs incurred after the asset becomes operational and that do not improve the functionality or extend the useful life of the asset are immediately expensed, under the accrual method of accounting. When significant parts of fixed assets are required to be replaced at intervals, the Company recognizes such parts as individual assets with specific useful life and depreciation. Likewise, expenses that represent asset improvement (expanded installed capacity or useful life) are capitalized. All other repair and maintenance costs are recognized in the income statement as incurred.

The present value of the expected cost for the decommissioning of towers and equipment on leased property is capitalized in the cost of the respective asset matched with the provision for dismantling obligations (Note 20) and depreciated over the useful life of the related assets, which do not exceed the lease term.

Depreciation is calculated on a straight-line basis over the useful life of assets, at rates that take into consideration the estimated useful life of assets based on technical studies. The assets' residual values, useful life and methods of depreciation are reviewed at each financial year end and adjusted prospectively, if appropriate.

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A fixed asset item is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement when the asset is derecognized.

g)Intangible Assets, net (including goodwill at the consolidated level):

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is its fair value as at the date of acquisition.

Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses, if any. Internally generated intangible assets, excluding capitalized development costs, are not capitalized and expenditure is reflected in the income statement in the year in which the expenditure is incurred.

The useful life of intangible assets are assessed as either finite or indefinite, as follows:

- Intangible assets with finite life are amortized over the useful economic life using the straight-line method and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed on an annual basis. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite life is recognized in the income statement in the cost/expense category consistent with the function of the intangible assets. Intangible assets include the rights to use software acquired from third parties, authorizations and licenses granted by ANATEL, customer portfolio, trademarks and other intangible items.
- Intangible assets with indefinite useful life are not amortized, but are tested for impairment annually, either individually or at the cash-generating unit level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. If not, the change in useful life from indefinite to finite is made on a prospective basis. Goodwill arising from investment acquisition is assessed as having an indefinite useful life.

Gains and losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in the income statement when the asset is derecognized.

h)Leases:

The determination of whether an arrangement is, or contains, a lease is based on the substantive aspects regarding the use of a specific asset or assets or the right to use an asset, at inception date.

Leases which transfer to the Company or subsidiary substantially all the risks and benefits incidental to ownership of the leased item are classified as finance leases. These are capitalized at the commencement of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Initial direct costs incurred in negotiating a lease are added to the carrying amount of the leased asset. Lease payments are apportioned between finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Implicit interest recognized in liabilities is allocated to the income statement over the lease term or using the effective interest rate method.

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Amounts recorded as finance leases are depreciated over the estimated useful life of the assets. However, if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases in which a significant part of the risks and benefits of ownership are retained by the lessor are classified as operating leases, and the effects are recognized in the income statement over the lease term.

The Company or subsidiary has lease arrangements classified as finance leases both as a lessor and as a lessee.

- As a lessor: lease of IT equipment (Produto Soluciona TI) for which the Company recognizes revenue, upon inception, at the present value of lease payments matched with accounts receivable.
- As a lessee: transmission equipment and media arising from a joint construction agreement with another telecomm operator, based on an optical network linked to the power transmission line, interconnecting the northern Brazilian cities to the Company's national backbone and lease of towers and rooftops (arising from sale and finance leaseback, for which the net book value of the assets upon disposal remained unchanged, a liability was recognized at the present value of minimum lease payments and deferred income was recorded at the difference between the selling price and the mentioned present value.

The difference between the nominal amount of lease payments and booked accounts receivable/payable is recognized as finance income/expenses using the effective interest rate method over the lease term (Note 18.1).

i) Analysis of the recoverability of non-financial assets:

The Company and subsidiary annually review the net book value of assets in order to evaluate events or changes in economic, operating or technological circumstances that may indicate impairment losses. Where such evidence is identified, and the carrying amount of an asset exceeds its recoverable amount, an impairment provision is recognized and the carrying amount is written down to its recoverable amount.

An asset's (or the cash generating unit (CGU) that it belongs) recoverable amount is the higher of its value in use and fair value less costs to sell.

In assessing an asset's or the CGU's value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate (based on the Capital Asset Pricing Model - CAPM) that reflects the weighted average cost of capital and the specific risks of the asset or CGU.

Fair value less costs to sell is determined considering, whenever possible, outright sale agreements in arm's length transactions between knowledgeable and willing parties less costs of disposal; if no outright sale agreements can be identified, this will be based on the market price of an active market or the price of the most recent transaction involving similar assets.

Impairment losses of continuing operations, including impairment on inventories, are recognized in the income statement in those expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased.

A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's or CGU's recoverable amount since the last impairment loss was recognized.

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The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceeds the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the income statement.

The following assets have specific characteristics for impairment testing:

i.1) Goodwill: Goodwill is tested for impairment annually at the reporting date or before that when circumstances indicate that the carrying value may be impaired. Goodwill has been allocated to the two CGU's for impairment testing.

Where the recoverable amount is less than the carrying amount, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods

i.2) Intangible assets: Intangible assets with indefinite useful life are tested for impairment annually at the reporting date either individually or at the CGU level, as appropriate, and when circumstances indicate that the carrying value may be impaired.

i.3) Determination of value in use: The key assumptions used to estimate value in use are:

- Revenue: Revenue is projected considering the growth in customer base, the evolution of market revenue in view of GDP and the Company's share in this market;
- Operating costs and expenses: Variable costs and expenses are projected in accordance with the dynamics of the customers base, and fixed costs are projected in line with the historical performance of the Company, as well as with revenue growth; and
- Capital investments: Investments in capital goods are estimated considering the technological infrastructure necessary to enable the provision of services.

The key assumptions are based on historical performance of the Company and subsidiary and, reasonable macroeconomic assumptions justified based on financial market projections, documented and approved by the Company's management.

The impairment test of the Company and subsidiary's fixed and intangible assets did not result in recognition of impairment losses for the years ended December 31, 2013 and 2012, since their estimated market value is greater than the net carrying amount as of the estimation date.

j) Business combination and goodwill

Business combinations are accounted using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree at fair value or at the proportionate share of the acquiree's identifiable net assets. Acquisition-related costs are expensed as incurred.

When the Company acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date. This includes the separation of embedded derivatives in host contracts by the

acquiree.

If the business combination is achieved in stages, the previously held equity interest is remeasured at its acquisition date fair value and any resulting gain or loss is recognized in profit or loss.

Any contingent consideration to be transferred by the acquirer will be recognized at fair value at the acquisition date. Any subsequent changes in fair value of contingent consideration classified as an asset or

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liability are to be recognized in either profit or loss or other comprehensive income. Contingent consideration that is classified as equity is not remeasured and subsequent settlement is accounted for within equity.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interest over the net identifiable assets acquired and liabilities assumed. If the fair value of the net assets acquired is in excess of the aggregate consideration transferred, the gain is recognized in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the cash-generating units that are expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill has been allocated to a CGU and part of the operation within that CGU is disposed of, the goodwill associated with the disposed operation is included in the carrying amount of the operation when determining the gain or loss on disposal. Goodwill disposed in these circumstances is allocated based on the relative fair values of the disposed operation and the portion of the CGU retained.

k) Financial instruments – initial recognition and subsequent measurement

(i) Financial Assets

Initial recognition and measurement

Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Company and subsidiary determine the classification of its financial assets at initial recognition, as it becomes an integral part of contractual provisions of the instruments.

All financial assets are initially recognized at fair value, plus, in case of investments not designated at fair value through profit or loss, transaction costs directly attributable to the acquisition of the financial asset.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the market place (regular way trades) are recognized on the trade date, i.e., the date that the Company and subsidiary commit to purchase or sell the asset.

The Company's and subsidiary financial assets include cash and cash equivalents, trade accounts receivable and other receivables, trade and non-traded financial instruments and derivative financial instruments.

Subsequent measurement

The subsequent measurement of financial assets depends on their classification, which may be as follows:

Financial assets at fair value through profit or loss: These include financial assets held for trading and financial assets designated upon initial recognition at fair value through profit or loss. Financial assets are classified as held for trading if they are acquired for the purpose of selling or repurchasing in the near term. This category includes derivative

financial instruments taken out by the Company and subsidiary that do not meet the hedge accounting criteria, as defined by applicable standards. Financial assets at fair value through profit or loss are presented in the balance sheet at fair value, with the corresponding gains or losses recognized in the income statement.

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Loans and receivables: These are non-derivative financial assets, with fixed or determinable payments, not traded in an active market. After the initial measurement, these financial assets are recorded at amortized cost under the effective interest method (effective interest rate), net of impairment, if and where applicable. The amortized cost is calculated in view of any discount or premium on the acquisition and rates or costs incurred. The amortization under the effective interest method is included in the financial income line in the statement of income. Impairment is recognized as financial expenses in the statement of income, if and where applicable.

Investments held to maturity: These are non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity whenever the Company and subsidiary expressed the intention and financial capacity to hold them to maturity. After the initial valuation, investments held to maturity are valued at amortized cost under the effective interest method, net of impairment. The amortized cost is calculated in view of any discount or premium on the acquisition and rates or costs incurred. The amortization of effective interest is included in financial income, in the statement of income. Losses on impairment are recognized as financial expenses in the statement of income. The Company and its subsidiaries did not record investments held to maturity during the years ended December 31, 2013 and 2012.

Financial assets available for sale: These are non-derivative financial assets not classified as: (i) loans and receivables, (ii) investments held to maturity or (iii) financial assets at fair value through profit or loss. These financial assets include equity and debt instruments. Debt securities in this category are those that are intended to be held for an indefinite period of time and that may be sold in response to needs for liquidity or in response to changes in the market conditions.

After the initial measurement, financial assets available for sale are measured at fair value, and unrealized gains and losses are recognized directly in the reserve for assets available for sale in other comprehensive income until the investment is written off, except for impairment losses, interest calculated using the effective interest rate method and foreign exchange gains and losses on monetary assets recognized in the income statement.

When the investment is derecognized or when impairment loss is identified, cumulative gains or losses previously recognized in other comprehensive income (loss) shall be recognized in the income statement.

The fair value of financial assets available for sale denominated in foreign currency is measured in the foreign currency and translated at the spot exchange rate of balance sheet date.

Fair value changes attributable to translation differences are recognized directly in equity.

Derecognition (write-offs)

A financial asset (or, whenever the case, a part of a financial asset, or a part of a group of similar financial assets) is derecognized when:

- The rights to receive the cash flows from the asset have expired;

The Company and subsidiary has transferred its rights to receive cash flows of the asset or has assumed an obligation to fully pay the cash flows received, without significant delay to a third party under an onlending agreement, and (i) the Company transferred substantially all risks and rewards of the asset, or (ii) the Company has neither transferred nor retained substantially all risks and rewards related to the asset, but has transferred control over the asset.

When the Company or subsidiary has transferred its rights to receive the cash flows from an asset or has entered into a pass-through arrangement, and has neither transferred nor retained substantially all the risks and rewards related to the asset, the asset is recognized to the extent of the Company's continuing involvement in the asset.

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(ii) Impairment of financial assets

The Company and subsidiary assesses at the balance sheet dates whether there is any objective evidence of impairment of the financial asset or group of financial assets. A financial asset or group of financial assets is considered to be impaired only if there is an objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (an incurred “loss event”) and this loss event impacted the estimated future cash flow of the financial asset or group of financial assets that can be reliably measured.

Evidence of impairment loss may include indication that the borrowing parties are going through significant financial hardship. The probability that they will go bankrupt or other financial reorganization, that there will be default or late payment of interest or principal may be indicated by a measurable drop in the estimated future cash flows, such as changes in maturity or economic conditions related to defaults.

Financial assets at amortized cost

With regard to financial assets at amortized cost, first, the Company or subsidiary individually tests whether there are clear evidence of impairment for each financial asset individually significant or group of financial assets that are not individually significant. If the Company concludes that there is no impairment evidence for a financial asset individually tested, whether significant or not, the asset is included in a group of financial assets with similar characteristics of credit risk and is tested as a whole in relation to impairment. Assets that are individually tested for impairment, and for which impairment loss is or continues to be recognized, are not included in any group of financial assets to be tested for impairment.

When there is clear evidence of impairment, the impairment loss is measured as the difference between the asset book value and the present value of the estimated future cash flows (excluding future credit losses expected but not incurred). The present value of estimated future cash flows is discounted at the original effective interest rate for the financial asset.

The asset book value is decreased by a provision and the loss amount is recognized in the income statement. Loans, jointly with the corresponding provision, are written off when there is no realistic perspective of its future recovery and all guarantees have been realized or transferred to the Company. If in a subsequent year the estimated impairment loss increase or decrease due to an event occurring after the impairment loss recognition, the loss previously recognized is increased or decreased, adjusting itself with the provision. In case of future recovery, if any, of an amount written off, this recovery is recognized in the income statement.

Available for sale financial investments

The Company and subsidiary assesses at the balance sheet dates whether there is objective evidence that an investment is impaired.

In the case of equity investments classified as available-for-sale, objective evidence would include a significant or prolonged decline in the fair value of the investment below its cost.

When there is evidence of impairment, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that investment previously recognized in the income statement – is removed from equity and recognized in the income statement. Increases in their fair value after impairment are recognized directly in other comprehensive income

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as financial assets carried at amortized cost. However, the amount recorded for impairment is the cumulative loss measured as the difference between the amortized cost and the current fair value, less any impairment loss on that investment previously recognized in the income statement.

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Future interest income continues to be accrued based on the reduced carrying amount of the asset, using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance income. If, in a subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the income statement, the impairment loss is reversed through the income statement.

(iii) Financial liabilities

Initial recognition and measurement

Financial liabilities are initially classified as financial liabilities measured at fair value through profit or loss, loans and financing, accounts payable, or derivatives classified as hedging instruments, as the case may be. The Company and subsidiary determines the classification of its financial liabilities upon their initial recognition.

Financial liabilities are initially recognized at fair value plus, in the case of loans and financing, transaction cost directly attributable thereto.

Company's and subsidiary financial liabilities include trade and other accounts payable, loans and financing agreements, and derivative financial instruments.

Subsequent measurement

Measurement of financial liabilities depends on their classification, which can be as follows:

Financial liabilities at fair value through profit or loss: these include financial liabilities designated upon initial recognition at fair value through profit or loss. This category includes derivative financial instruments taken out by the Company and subsidiary that do not meet the hedge accounting criteria, as defined by applicable standards.

The Company and subsidiary did not designate any financial asset at fair value through profit or loss at the initial recognition.

Loans and financing: After initial recognition, loans and financing subject to interest are subsequently measured at amortized cost, using the effective interest rate method. Gains and losses are recognized in the income statement when the liabilities are derecognized and through the amortization process under the effective interest rate method.

Derecognition (write offs)

A financial liability is written off when the obligation thereunder is discharged, cancelled or expires.

When an existing financial liability is replaced by another from the same lender with substantially different terms, or terms of an existing liability are substantially modified, such replacement or modification is treated as write-off of original liability and recognition of a new liability, and the difference in corresponding carrying amounts is recognized in the income statement.

(iv) Offsetting of financial instruments –net disclosure

Financial assets and financial liabilities are offset and the net amount is reported in the balance sheet if, and only if, there is a current enforceable legal right of offsetting the amounts recognized and if there is the intention to offset or realize the asset and settle the liability simultaneously.

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(v) Fair value of financial instruments

The fair value of financial instruments actively traded in organized financial markets is determined based on purchase prices quoted in the market at close of business at balance sheet date, without any deduction for transaction costs.

The fair value of financial instruments for which there is no active market is determined by using valuation techniques. These techniques may include the use of recent market transactions (on an arm's length basis); reference to the current fair value of another similar instrument, analysis of discounted cash flows or other valuation models.

1) Derivative financial instruments and hedge accounting

The Company uses derivative financial instruments, such as currency and interest rate swaps, to provide hedge against the risk of changes in exchange rates.

Derivative financial instruments designated in hedging transactions are initially recognized at fair value on the date in which the derivative agreement is entered into, being subsequently revaluated also at fair value. Derivatives are presented as financial assets when the fair value of the instrument is positive and as financial liabilities when the fair value is negative.

Any gains or losses arising from changes in the fair value of derivatives are taken directly to profit or loss, except for the effective portion of cash flow hedges, which is recognized in other comprehensive income.

For the purpose of hedge accounting, hedges are classified as: cash flow hedges and fair value hedges.

At the inception of a hedge relationship, the Company formally designates and documents the hedge relationship to which the Company wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. The documentation includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the effectiveness of changes in the hedging instrument's fair value in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.

As for cash flow hedges, the hedge relationship documentation also includes the highly probable forecast nature of the transaction as well as the periods expected to transfer gains or losses arising from hedge instruments from equity the income statement. Such hedges are expected to be highly effective in achieving offsetting changes in fair value or cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated.

The Company's contracts are classified as cash flow hedges when they protect from changes in cash flows that are attributable to a particular risk associated to a recognized liability that may affect the result of operations, and as fair value hedges when they protect from changes in the fair value of an identified part of certain liabilities that are attributable to a particular risk and may affect the result of operations.

Cash flow Hedges

Cash flow hedges meeting the recording criteria are accounted for as follows: (i) the portion of gain or loss from the hedge instrument determined as effective hedge shall be recognized directly in equity (in other comprehensive

income) and (ii) the ineffective portion of gain or loss from the hedge instrument shall be recognized in the statement of income.

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When the Company's documented risk management strategy for a specific hedging relationship excludes from the hedge effectiveness evaluation a specific component of gain or loss or the related cash flows from the hedging instrument, this excluded component of gain or loss is promptly recognized in financial income (expense).

The amounts recorded in other comprehensive income are promptly transferred to the income statement when the hedged transaction affects P&L, for instance, when hedged financial income or expense is recognized or when an expected sale takes place. When the hedged item is the cost of a non-financial asset or liability, the amounts recorded in equity are transferred to the initial carrying amount of the non-financial asset or liability.

If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover (as part of the hedging strategy), or if its designation as a hedge is revoked, or when the hedge fails to meet the hedge accounting criteria, any cumulative gain or loss previously recognized in other comprehensive income remains separately in equity until the forecast transaction occurs or the firm commitment is fulfilled.

Fair value hedges

Fair value hedges meeting the recording criteria are accounted for as follows: (i) gain or loss from changes in fair value of a hedge instrument shall be recognized in the income statement as finance costs; and (ii) gain or loss from a hedged item attributable to the hedged risk shall adjust the recorded amount of the hedged item to be recognized in the statement of income, as finance costs.

For fair value hedges relating to items carried at amortized cost, any adjustment to carrying value is amortized through profit or loss over the remaining term of the hedge using the effective interest rate method. The effective interest rate amortization may begin as soon as an adjustment exists and no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

If the hedged item is derecognized, the unamortized fair value is recognized immediately in profit or loss.

When an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as an asset or liability with a corresponding gain or loss recognized in profit and loss.

Current versus noncurrent classification

Derivative instruments not classified as effective hedge instrument are classified as current or non-current or segregated into short and long term portions based on an evaluation of the contracted cash flows.

- When the Company and its subsidiary expect to hold a derivative as an economic hedge (and do not apply hedge accounting) for a period beyond 12 months after the reporting date, the derivative is classified as noncurrent (or separated into current and noncurrent portions) consistently with the classification of the underlying item.
- Derivative instruments that are designated as, and are effective hedging instruments, are classified consistently with the classification of the underlying hedged item.

The derivative instrument is separated into a current portion and a noncurrent portion only if a reliable allocation can be made.

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m)Fair value measurement

The Company and subsidiary measures financial instruments, such as derivatives and non-financial assets, at fair value at each reporting date.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurement is based on the assumption that the transaction to sell the asset or to transfer the liability will take place either:

- In the principal market for the asset or liability; or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The Company and subsidiary must have access to the principal (or most advantageous) market.

The fair value of an asset or liability is measured based on the assumption that market participants would use to define the price of an asset or liability, assuming that market participants act in their economic best interest.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

The Company and its subsidiary use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All the assets and liabilities for which a fair value is measured or disclosed in financial statements are categorized within the fair value hierarchy described below, based on the lowest level input that is significant to the entire fair value measurement.

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2: valuation techniques for which the lowest level input that is significant to the fair value measurement is either directly or indirectly observable.

Level 3: valuation techniques for which the lowest level input that is significant to the fair value measurement is not observable.

For assets and liabilities recognized in the financial statements on a recurring basis, the Company and subsidiary determines whether there have been transfers among hierarchy levels, revaluing their categorization (based on the lowest level input that is significant to the entire fair value measurement) at the end of each reporting period.

For fair value disclosure purposes, the Company and subsidiary determined classes of assets and liabilities on the basis of the nature, characteristics and risks of the asset or liability and the level of the fair value hierarchy, as described above.

For the year ended December 31, 2013, there were neither transfers between "level 1" and "level 2" fair value measurements nor transfers between "level 3" and "level 2" fair value measurements. The Company has no financial

instruments categorized within level 3 of the fair value hierarchy.

The fair values of financial instruments measured at amortized cost are described in Note 36.

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n)Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily requires more than 18 months to get ready for its intended use or sale are capitalized as part of the underlying asset cost.

All other borrowing costs are expensed in the period they incur. Borrowing costs include interest expense and other costs incurred by an entity in respect of borrowings.

o)Interest on shareholder's equity and dividends

Interest on shareholders' equity

Brazilian legislation allows companies to pay interest on shareholders' equity, which is similar to payment of dividends; however, this is deductible for income taxes calculation purposes. The amount due accrued by the Company and subsidiary in its accounting records in compliance with Brazilian tax law is matched against the financial expenses account in the income statement for the year and, for the presentation of these financial statements, such expense is reversed against a direct charge to equity, resulting in the same accounting treatment adopted for dividends. The distribution of interest on shareholders' equity to shareholders is subject to withholding income tax at a 15% rate.

Dividends

The mandatory minimum dividends are recorded in the balance sheets as legal obligations (provisions in current liabilities), and the dividends in excess of such minimum amount, still not approved by the Shareholders' Meeting, are recorded in equity as dividend reserve.

p)Provisions

General

Provisions are recorded when the Company or subsidiary have a present (legal or constructive) obligation arising from past events, the settlement of which is expected to result in an outflow of economic benefits, in an amount that can be reliably estimated. Provisions are adjusted at balance sheet date considering the probable amount of loss and the nature of each contingency (Note 20).

Provisions for contingencies are presented at their gross amount, less the corresponding judicial deposits, and are classified as provisions for civil, labor, tax and regulatory contingencies. Judicial deposits are classified as assets if the conditions required for their net presentation with the provision are not available.

Provisions for civil, labor, tax and regulatory contingencies

The Company and subsidiary are party to labor, tax, civil and regulatory claims and set up a provision for contingencies likelihood of loss of which was estimated as probable. Assessment of the likelihood of loss includes analysis of available evidence, hierarchy of laws, available case law, recent court rulings and their relevance in the legal system, as well as the evaluation of outside legal advisors. Provisions are reviewed and adjusted to take into account changes in circumstances, such as the applicable statute of limitations, tax audit conclusions or additional exposures identified based on new matters or court decisions.

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Provision for demobilization of assets

This refers to costs to be incurred due to the return to the owners of the sites (locations intended for tower and equipment installation at leased property) under the same conditions at the time of execution of the initial lease agreement.

Demobilization costs are provided at the present value of expected costs to settle the obligation using estimated cash flows and are recognized as part of the cost of the particular asset. The cash flows are discounted at a current pre-tax rate that reflects the risks specific to demobilization liability. The unwinding of the discount is expensed as incurred and recognized in the income statement as a finance cost. The estimated future costs of demobilization are reviewed annually and adjusted as appropriate. Changes in the estimated future costs or in the discount rate applied are added to or deducted from the cost of the asset.

Contingent liabilities recognized in a business combination

A contingent liability recognised in a business combination is initially measured at its fair value.

Subsequently, it is measured at the higher of: i) the amount that would be recognized in accordance with the requirements for provisions above or; ii) the amount initially recognised less, when appropriate, cumulative amortization recognized in accordance with the requirements for revenue recognition.

q) Taxes, charges and contributions

Acronyms of the taxes, charges and contributions described in these financial statements are as follows:

CIDE – Contribution Tax for Intervention in the Economic Order – Federal Tax;
COFINS – Contribution Tax on Gross Revenue for Social Security Financing – Federal Tax;
CSLL – Social Contribution Tax on Net Profit – Federal Tax;
FISTEL – Telecommunications Inspection Fund;
FUNTTEL – Telecommunications Technology Development Fund;
FUST – Universal Telecommunication Services Fund;
ICMS – State VAT – State Tax;
IOF – Tax on Financial Transactions – Federal Tax;
IRPJ – Corporate Income Tax – Federal Tax;
IRRF – Withholding Income Tax – Federal Tax;
ISS – Service Tax – Local Tax;
PIS – Contribution Tax on Gross Revenue for Social Integration Program – Federal Tax;
TFF – Inspection and Operation Fees; and
TFI – Inspection and Installation Fees.

Current income and social contribution taxes

The carrying amount of assets and liabilities related to the current tax of the last year and prior years corresponds to the amount estimated to be recovered from or paid to tax authorities. The tax rates and laws used in calculating the amounts referred to above are those in effect at the balance sheet date. In the balance sheet, current taxes are presented net of prepayments throughout the year.

Current income and social contribution taxes related to items directly recognized in equity are also recognized in equity. Management periodically assesses the tax position for the cases in which tax regulations require interpretation, and sets up provisions when necessary.

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Deferred taxes

Deferred tax is generated from temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts.

Deferred tax assets are recognized for all deductible temporary differences and unused tax credits and losses, to the extent that taxable profit will likely be available so that deductible temporary differences can be realized and such unused tax credits and losses can be used, except: (i) when the deferred tax asset related to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction other than a business combination and does not impact, at the transaction date, the book profit or income or loss for tax purposes; and (ii) on deductible temporary differences related to investments in subsidiaries, where deferred tax assets are recognized only to the extent that it is probable that temporary differences will be reversed in the near future and taxable profit will likely be available so that temporary differences can be used.

The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Derecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred tax liabilities are recognized for all temporary tax differences, except: (i) when the deferred tax liability arises from initial recognition of goodwill, or an asset or liability in a transaction other than a business combination, and does not affect book profit or tax income or loss on the transaction date; and (ii) on temporary tax differences related to investments in subsidiaries, in which temporary difference reversal period can be controlled and temporary differences are not likely to be reversed in the near future.

Deferred tax assets and liabilities are measured at the tax rate expected to be applicable for the year the asset will be realized or the liability will be settled, based on tax rates (and tax law) published as of the balance sheet date.

Deferred tax assets and liabilities are not discounted to present value and are classified in the balance sheet as noncurrent, regardless of the expected realization.

Tax effects of items directly recorded in equity are also recognized in equity. Deferred tax items are recognized based on the transaction in which deferred tax was originated, in comprehensive income or directly in equity.

Deferred tax assets and liabilities are presented net if there is a legal or constructive right to offset tax assets against tax liabilities and when deferred taxes refer to the same taxable entity and are subject to the same tax authority.

Sales taxes

Revenue from services rendered is subject to ICMS or ISS taxation at the rates in force in each area and to PIS and COFINS taxation on a cumulative basis for revenue from telecommunication services, at 0.65% and 3.00%, respectively. Other revenue earned by the Company and subsidiary, including revenue from resale of goods, on a noncumulative basis, is taxed at 1.65% and 7.60% for PIS and COFINS, respectively, and by ICMS at the rates in force in each State.

Prepaid or recoverable taxes are recorded in current or noncurrent assets according to their estimated realization.

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Provisional Measure (MP) No. 627

On November 11, 2013, Provisional Measure No. 627 was issued, which introduces a number of changes in the income tax legislation, social contribution, PIS, COFINS, among which are:

- i) Repeal of Tax Regime (RTT), established by Law No. 11,941/09 of 27 May 2009, beginning on January 1, 2015, optional basis, beginning on January 1, 2014; and
- ii) Amendment of specific provisions of Decree - Law No. 1,598/77 with the objective of adapting the tax law with corporate law and accounting standards, due to the extinction of the RTT and the need to establish a new way of calculating the income tax and social contribution.

As permitted by Article No. 71 of this MP, the Company will opt for adoption of the provisions contained in Articles 1 to 66, when applicable, as of January 1, 2014, so the Federal Revenue of Brazil (RFB) will define the shape, the term and conditions for that option.

r)Other assets and liabilities

An asset is recognized in the balance sheet when it is likely that its future economic benefits will flow to the Company or subsidiary, and its cost or value can be reliably measured.

A liability is recognized in the balance sheet when the Company or subsidiary have a legal or constructive obligation as a result of a past event and it is probable that an outflow of funds will be required to settle it.

Assets and liabilities are classified as current or noncurrent. An asset is classified as current when:

- it is expected to be realized or it is intended to be sold or used in the regular operating cycle;
- it is held primarily for trading;
- it is expected to be realized within 12 months from the reporting date; or
- cash or cash equivalents, unless there are limitations on its swap or it is used to settle a liability for at least 12 months after the reporting period.

All other assets are classified as noncurrent.

A liability is classified as current when:

- it is expected to be settled in the regular operating cycle;
- it is held primarily for trading;
- it is expected to be realized within 12 months from the reporting date; or
- there is no unconditional right to defer the settlement of the liability for at least 12 months from the reporting date.

All other liabilities are classified as noncurrent.

s)Present value adjustment of assets and liabilities

Current and noncurrent monetary assets and liabilities are adjusted to present value whenever the effects are considered significant on the overall financial information. The present value adjustment is calculated using contractual cash flows and the explicit interest rate, and in certain cases the implicit interest rate, of respective assets

and liabilities.

As such, the interest rates accrued on revenues, expenses and costs associated with these assets and liabilities are discounted with a view to recognizing them on an accrual basis. Subsequently, interest thereof is reallocated to financial income and expenses in the income statements by using the effective interest rate

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method in relation to the contractual cash flows. Implicit interest rates then applied were determined based on assumptions and are considered accounting estimates.

Based on the analysis performed and on management best estimates, the Company and subsidiary concluded that the adjustment to present value of current monetary assets and liabilities is immaterial in relation to the overall financial statements, and thus did not record any adjustment.

t)Government grants and assistance

Government grants are recognized when there is reasonable assurance that the benefit will be received and the corresponding conditions were met. When the benefit refers to expense item, it will be recorded in income in equal amounts throughout the expected useful life of the corresponding benefit, on a systematic basis in relation to cost of which the benefit intends to settle.

When the Company receives non-monetary benefits, the asset and the benefit are recorded at nominal value and reflected in the income statement over the expected useful life of the asset, at equal annual amounts. The loan or assistance is initially recognized or measured at fair value. A government grant is measured as the difference between the initial carrying amount of the loan and proceeds therefrom. A loan is subsequently measured in accordance with the accounting policy.

When loans or similar assistance are provided by governments or related institutions, with an interest rate below the current applicable market rate, the effect of this favorable interest is regarded as a government grant.

The Brazilian tax legislation (Provisional Executive Order (MP) No. 2,199-14, of August 24, 2001, as amended by Law No. 11,196, of November 21, 2005), enabled legal entities holding enterprises located in areas under the supervision of Supervisory Authority for Development of the Amazon (SUDAM) and Superintendency for the Development of the Northeast (SUDENE), whose activity fall under an economy sector considered a priority, under the Executive branch ruling, to claim income tax reduction under the terms thereof.

Through the acquisition of Vivo Part. and Vivo, the Company benefits from a 75% income tax reduction, calculated based on profit from tax incentive operations (lucro da exploração) in the north region of Minas Gerais and Vale do Jequitinhonha and in the Brazilian states of Acre, Amapá, Amazonas, Maranhão, Mato Grosso, Pará, Rondônia and Roraima. This benefit will be effective up to 2013.

The profit generated by the portion subject to such benefit was excluded from calculation of dividends and may be only used in cases of capital increase or absorption of losses.

The financing lines through Banco Nacional de Desenvolvimento (BNDES), with interest rates lower than those prevailing in the market, under the scope of IAS 20/CPC 7, are recorded at fair value based on market rates. Adjustment arising from the comparison of the amount measured based on the rate agreed is upon accounted for as deferred revenue (Note 21).

u)Revenue recognition

Revenues substantially correspond to value of considerations received or receivable arising from the provision of telecommunications services and sale of goods are presented net of taxes, discounts and returns (in case of sale of goods) thereon. Revenues and expenses are stated on the accrual basis of accounting.

Revenue is recognized when it is probable that future economic benefits will flow to the Company and subsidiary, when it can be reliably measured, costs incurred in the transaction can be measured, the risks and benefits have been substantially transferred to the buyer and when specific criteria are met for every activity of the Company and subsidiary.

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The Company and subsidiary assess its revenue arrangements against specific criteria to determine if it is acting as principal or agent. The Group has concluded that it is acting as a principal in all of its revenue arrangements, except for infrastructure swap revenue.

Revenues of the Company and subsidiary comprise basically the voice portal, data and additional telecommunication services that are offered to customers through fixed-price traffic packs (paid on a monthly basis) or based on customers' consumption, remuneration network usage and sales of goods.

Recognition of revenues from telecommunication services

Revenues from telecommunication services provided are recorded on the accrual basis based on the amounts agreed upon. Local and long-distance calls are billed by the measurement process under the legislation in force. The services billed on fixed monthly amounts are calculated and accounted for on a straight-line basis. Unbilled revenues from the last billing up to the balance sheet date is recognized in the month in which the service is provided.

Revenues related to public phone cards sales are deferred and recognized in the income statement based on the estimated usage of cards.

Revenues related to pre-paid mobile recharge credits, as well as taxes payable due are deferred and recognized in the income statement to the extent services are effectively provided.

Revenues from equipment lease contracts classified as finance lease agreement are recognized in installation of equipment upon effective transfer of risk. Revenue is recognized at present value of future minimum payments provided for in contract.

Revenues from services are basically subject to the following indirect taxes: ICMS, PIS, COFINS and ISS.

Recognition of revenue and cost of goods sold

Revenues and cost of goods sold (mobile phones, simcards and accessories) are recorded when risks and rewards inherent to such goods are transferred to buyer. Sales made in own stores are recognized upon sale to final consumer. Revenues and costs of goods sold by dealers are recognized in the P&L when the device is activated, limited to 90 days after the date of sale.

Customer loyalty program

The Company has a loyalty points program that enables customers to accumulate points while paying bills regarding the usage of the services offered. The accumulated points may be exchanged for telephone sets or services, conditional upon obtaining a minimum balance of points by customer. The consideration received is allocated to the cost of sets or services at fair value. The fair value of these points is determined by dividing the discount granted by the number of points required for the redemption based on the such fidelity program. The fair value of the accumulated balance of points generated is deferred and recognized as revenue upon redemption of points

The number of points to be accounted for is determined through statistical techniques that consider assumptions and historical data on expected redemption rates, such as, expiration percentage and cancellation of points. These estimates are subject to variations and uncertainties due to changes in the behavior of customers' redemptions (Note 21).

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Membership fee and promotional campaigns

Participation fees paid for promotional campaigns by customers of the Company are deferred and recorded in P&L throughout the duration of such campaign.

Agreements combining more than one element

Commercial packages offered by the Company that combine different elements are analyzed to determine whether it is necessary to separate the different elements identified, adopting the recognition criteria that is most adequate to each situation. The total revenue generated by the package sale is distributed among its elements, which were identified at their fair values.

The fair value determination of each element then identified implies the need for complex estimates given the nature of the business.

A possible change in fair values estimates could affect the distribution of revenues between components and consequently the deferred revenues.

v) Financial income and expenses

These include interest and monetary and exchange variations arising from short-term investments, derivative transactions, loans, financing, debentures, adjustments to present value of transactions that generate monetary assets and liabilities and other financial transactions. These are recognized on the accrual basis when earned or incurred by the Company or subsidiary.

For all financial instruments measured at amortized cost and interest bearing financial assets classified as available for sale, interest income is recorded using the effective interest rate (EIR). EIR is the rate that exactly discounts the estimated future cash payments or receipts over the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability.

w) Post-retirement benefit plans

The Company and subsidiary individually sponsor pension funds of post-retirement benefits for active and retired employees, in addition to a multiemployer supplementary retirement plan and health care plan to former employees. The contributions are determined on actuarial bases and recorded on the accrual basis. Benefit plans are determined based on actuarial evaluations at the end of each year, in order to ensure that the contributions are sufficient to set up the required reserve for both current and future commitments.

The actuarial liabilities related to defined benefit plans were calculated using the projected unit credit method. Actuarial gains and losses are recognized immediately in equity (in other comprehensive income).

For plans with defined contribution characteristics, the obligation is limited to the payment of contributions, which are recognized in the P&L of the respective years.

The asset or liability related to defined benefit plan to be recognized in financial statements correspond to the present value of the obligation by defined benefit (using a discount rate based on long-term National Treasury Notes "NTNs"), less fair value of plan assets that will be used to settle the obligations. The plan assets are assets held by a privately-held supplementary pension plan entity. The plan assets are not available to the Company's creditors and

cannot be paid directly to the Company. The fair value is based on information on market prices and, in case of securities quoted, on purchase price disclosed. The value of any defined benefit asset then recognized is limited to the present value of any economic benefits available as a reduction in future plan contribution from the Company and subsidiary.

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Upon the adoption of IAS 19 (Revised) effective 1 January 2013, pension benefit costs recognized in the Income Statements are limited to service cost and the net interest cost (income) on the net defined benefit plan obligation (asset). All remeasurement effects on the plan assets and obligations are recognized initially in comprehensive income and immediately reclassified permanently in retained earnings.

x) Significant accounting judgment, estimates and assumptions

The preparation of the financial statements requires management to make judgments, estimates and assumptions supported by valuation bases used in accounting estimates. The accounting estimates involved in the preparation of the financial statements were based on objective and subjective factors considering management's judgment to determine the adequate amount to be recorded in the financial statements.

However, uncertainties involving these estimates may result in amounts significantly different from those recorded in the financial statements due to the criteria inherent in the estimation process.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities are described below:

Impairment of nonfinancial assets

An impairment loss exists when the book value of an asset or cash-generating unit exceeds its recoverable amount, which is the higher of fair value less cost of sales and value in use. The calculation of fair value less cost of sales is based on information available on sales transactions of similar assets or market price less additional costs to dispose of the asset. Calculation of value in use is based on discounted cash flow model. The recoverable value is sensitive to the discount rate used in discounted cash flow method, as well as to the receipt of estimated future cash flows and the growth rate used for extrapolation purposes.

Post-retirement benefit plan

The cost of defined benefit retirement plans and other post-retirement health care benefits and the present value of retirement obligation are determined based on actuarial valuation methods. Actuarial valuations involve the use of assumptions on discount rates, future salary increases, death rates and future increases in pension and retirement plans. The defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed annually.

The mortality rate is based on mortality tables available in Brazil. Future increases in wages and pension and retirement benefits are based on the expected future inflation rates for Brazil.

For more details on the assumptions used, see Note 35.

Fair value of financial instruments

Where the fair value of financial assets and financial liabilities recorded in the balance sheet cannot be derived from active markets, their fair value is determined using valuation techniques including the discounted cash flow model. The data for these methods is based on that prevailing in the market, whenever possible. However, when this is not feasible, a certain level of judgment is required to establish the fair value. The judgments include considerations of

inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

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Property, Plant and Equipment and intangible assets, including goodwill

The accounting treatment of investment in fixed and intangible assets includes estimating useful life period for depreciation purposes and the fair value at the date of acquisition, particularly for assets acquired in business combinations.

Useful life determination requires estimates regarding the expected technological developments and alternative uses of assets. The hypotheses related to technological aspect and its future development imply a significant level of analysis, considering the difficulties in forecasting time and nature of future technological changes.

Where impairment is identified amounting to tangible and intangible assets, an adjustment of such amount is recorded in the P&L for the year. The need to record impairment loss is determined through estimates that include, among others, the analysis of the possible impairment causes and the estimated amount thereof. In this regard, factors such as technological obsolescence, suspension of certain services and other changes are also considered in circumstances that demonstrate the need to record a possible impairment.

The Company and subsidiary periodically analyze the performance of the defined CGUs in order to identify a possible impairment in goodwill. The determination of the recoverable amount of the CGU to which the goodwill is allocated also includes the use of assumptions and estimates and requires a significant level of judgment and criterion.

Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and term of future taxable income. The Company and subsidiary set up provisions based on adequate estimates, for possible audit consequences by tax authorities of the respective jurisdictions in which it operates. The value of these provisions is based on various factors such as past experience with tax audits and different interpretation of tax regulations by the taxing entity and the relevant tax authorities. Such differences of interpretation may arise in a wide variety of matters, depending on the conditions prevailing in the respective domicile of the Company and subsidiary.

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

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

Provisions for tax, labor, civil and regulatory proceedings

Provisions are recognized when the Company has a present obligation arising from a past event, of which settlement requires an outflow of resources rated as probable and may be reliably estimated. This obligation can be legal or tacit, derived from, among other factors, regulations, contracts, customary practices or public commitments that expose third parties to a valid expectation that the Company will assume certain responsibility. The determination of the provision is based on the best estimate of the reimbursement required to settle the corresponding obligation, considering the information available on the closing date, including the opinion of independent experts, such as legal counselors.

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y)Functional and reporting currency

Company's functional and reporting currency is the Brazilian real. Transactions in foreign currency were translated at the currency exchange rate in force on the date the transaction. Assets and liabilities stated in foreign exchange were translated at the currency exchange rate in force at the balance sheet date. The exchange rate changes arising from transactions in foreign currencies are recognized in P&L as financial income or expenses.

z)Transactions denominated in foreign currency

The monetary assets and liabilities denominated in foreign currencies are translated to the functional currency (real) at the exchange rate (fx rate) in force on the transaction date and subsequently remeasured based on fx rate effective on the reporting date which, at December 31, 2013 was: US\$1.00 = R\$2.3426, €1.00 = R\$3.23068 and at December 31, 2012, was: US\$1.00 = R\$2.0435, €1.00 = R\$2.693946. Gains and losses resulting from the remeasurement of these assets and liabilities between the foreign exchange rate prevailing at the transaction and reporting dates are recognized in P&L.

aa)Employee profit sharing

The Company and subsidiary have obligations arising from employment contracts, recognizing these provisions during the year. Provisions are recorded to recognize the expense regarding employee profit sharing. These provisions are calculated on the basis of qualitative and quantitative goals set by the management and accounted for in specific accounts according to function in groups of Cost of services, Selling expenses and General and administrative expenses.

bb)Share-based payments

The Company measures the cost of transactions settled with employees and officers based on shares issued by parent company Telefónica S.A., by reference to the fair value of the equity instruments at the date at which they are granted, using the binomial valuation model. This fair value is charged to the income statement over the period until the vesting date.

cc)Treasury shares

Own equity instruments which are reacquired (Treasury shares) are recognized at cost and deducted from shareholders' equity. No gains or losses are recognized in P&L on purchase, sale, issue or cancellation of the Company's own equity instruments.

dd)Noncontrolling interests

Noncontrolling interests represent the portion of profit or loss and equity of subsidiaries not owned by the Company, thus being disclosed in the consolidated balance sheet under equity.

ee)Information on operating segments

Operating segments are defined as components of a venture for which separate financial information is made available and evaluated on a regular basis by the Company's chief operating decision maker involving the allocation of funds to an individual segment and segment performance assessment. Considering that: (i) all officers and managers' decisions

are based on consolidated reports; (ii) the Company and subsidiary's

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mission is to provide its customers with quality telecommunications services; and (iii) all decisions related to strategic planning, finance, shopping, short- and long-term investments are made on consolidated basis, the Company and subsidiary operate in a single operating segment, namely the provision of telecommunications services.

ff) Statements of cash flow

The statement of cash flows was prepared in accordance with IAS 7/CPC 03 - Cash Flow Statements using the indirect method, and reflects the changes in cash for the years reported.

4. Acquisition of Vivo Participações S.A.

On April 27, 2011 the shareholders meetings held by the Company and Vivo Participações S.A. (Vivo Part.) approved the acquisition of 100% of the shares that the Company held in the latter. Each share of Vivo Part. was substituted for 1.55 shares of the Company. This operation was recorded under the acquisition method.

The Company adopted the fair value of the shares acquired in view of the economic value report prepared by the specialized company engaged by management since it consists of a transaction between two companies under common control, the share value approximates that paid by SP Telecomunicações Participações Ltda. in the equity offering (OPA) of March 2011, which led to the acquisition of 2.65% of capital of Vivo Part., previously held by noncontrolling shareholders.

The fair values of the identifiable assets acquired and liabilities taken on from Vivo Part. were measured and recognized on the acquisition date.

These values were determined through various valuation methods, depending on the type of asset and/or liability in question, as well as the better information available and assisted by specialized advisors.

The methods and hypotheses for determination of these fair values were as follows:

Licenses

The fair value was determined through the Multi-Period Excess Earnings Method (MEEM), which is based on a calculation of discount of cash flows of future economic benefits attributable to the licenses, net of the eliminations of the charges relating to the contributing assets implied in the generation of these flows and excluding the flows attributable to the customers portfolio.

This method is based on the assumption that the intangible assets seldom generate profits by its own. Accordingly, the cash flows attributable to the licenses are those remaining after the return of all contributing assets necessary to generate the estimated cash flows. The fair value allocated to the licenses on the acquisition date reached R\$12,876,000, which is being amortized for 27.75 years.

Customers portfolio

The customers portfolio also was valued by the MEEM method, which is based on a calculation of discounted cash flows of future economic benefits attributable to the customers base, net of the eliminations of the obligations of contributions implied in their generation. To estimate the useful life remaining from the customers base, an analysis of the average length of the relationship with customers, using a churn rate method was made.

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This analysis of lives is aimed at estimating a subsistence curve which allows for the future churn profiles associated with the current customers base. As an approximation of the customers subsistence curve, the so-called Iowa curves were considered. The fair value allocated to the customers portfolio on the acquisition date reached R\$2,042,000, which is being amortized for an average period of 8.5 years.

Trademark

The fair value of the “Vivo” trademark was calculated under the “relief-from-royalty” method. In accordance with this method, the value of the asset is determined by capitalizing royalties saved in connection with the intellectual property. In other words, the trademark owner obtains profit since it owns the intangible asset instead of paying royalties for its use. Royalties saved was determined by applying a market royalty rate (expressed as a percentage of revenues) to future revenues expected to be obtained from the sale of the products or services associated with the intangible asset. A market royalty rate is usually expressed as a percentage of net revenues which an interested owner would charge an interested user for the use of an asset owned in a free transaction, being both parties duly informed. The fair value allocated to the trademark on the acquisition date reached R\$1,642,000, which is being amortized for 19.5 years.

Following are the fair value, the goodwill and the cost of participation of the identifiable assets acquired and liabilities taken on from Vivo Part. on the acquisition date:

| Information (in thousands of R\$) | Fair Value |
|-----------------------------------|--------------|
| Current assets | 7,244,124 |
| Noncurrent assets | 28,134,683 |
| Deferred tax assets, net(b) | 417,883 |
| Other noncurrent assets | 2,385,177 |
| Property, plant and equipment | 6,198,358 |
| Intangible assets (a) | 19,133,265 |
| Current liabilities | (7,964,209) |
| Noncurrent liabilities | (5,352,456) |
| Other noncurrent liabilities (c) | (5,352,456) |
| Net assets | 22,062,142 |
| Equity expenses | 31,222,630 |
| Goodwill on operation | 9,160,488 |

(a) Includes the allocation of the fair value to licenses (R\$12,876,000), to the trademark (R\$1,642,000) and customer portfolio (R\$2,042,000). The Company does not consider the trademark and the customers portfolio as deductible for tax purposes.

(b) Includes the recognition of deferred income taxes on (a) and (c).

(c) Includes the allocation of fair value attributed to the contingent liabilities for R\$283,000.

In accordance with IFRS 3(R) – Business Combination, the acquirer must recognize, on the acquisition date, contingent liabilities taken on from a business combination, even if cash outflow is not probable to settle the obligation, provided that a present obligation arising from past events and its fair value may be reliably measured. Meeting former requirements, upon the acquisition contingent liabilities were recognized at fair value of R\$283,000, which were determined in view of the estimated cash outflows for settlement on the acquisition date.

Costs incurred with the transaction were posted to P&L, in other operating expenses.

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5. Cash and cash equivalents

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|------------------------|-----------|------------------------|------------------------|
| Cash and banks | 101,921 | 94,304 | 76,316 |
| Short-term investments | 6,442,015 | 7,039,181 | 2,813,227 |
| Total | 6,543,936 | 7,133,485 | 2,889,543 |

Short-term investments basically correspond to Bank Deposit Certificates (CDB), which are pegged to the Interbank Deposit Certificate (CDI) rate variation, are highly liquid and are kept with first-tier financial institutions.

In addition, not included in the amounts above, the Company has short-term investments in the consolidated amounts of R\$106,455 at December 31, 2013 (R\$109,708 at December 31, 2012), in noncurrent assets.

6. Trade accounts receivable, net

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|---------------------------|-------------|------------------------|------------------------|
| Billed amounts | 4,485,539 | 4,066,835 | 3,695,379 |
| Unbilled amounts | 1,890,485 | 1,675,091 | 1,677,708 |
| Interconnection amounts | 859,894 | 977,644 | 896,639 |
| Gross accounts receivable | 7,235,918 | 6,719,570 | 6,269,726 |
| Provision for impairment | (1,175,973) | (1,079,254) | (1,056,729) |
| Total | 6,059,945 | 5,640,316 | 5,212,997 |
| Current | 5,802,859 | 5,546,938 | 5,128,142 |
| Non-current | 257,086 | 93,378 | 84,855 |

The aging list of trade accounts receivable, net of the provision for impairment, is as follows:

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|--------------------------------|-----------|------------------------|------------------------|
| Falling due | 4,398,791 | 4,331,163 | 4,125,659 |
| Overdue from 1 to 30 days | 795,389 | 718,693 | 631,923 |
| Overdue from 31 to 60 days | 289,783 | 215,862 | 204,775 |
| Overdue from 61 to 90 days | 166,105 | 193,291 | 115,125 |
| Overdue from 91 to 120 days | 62,122 | 60,669 | 49,815 |
| Overdue for more than 120 days | 347,755 | 120,638 | 85,700 |
| Total | 6,059,945 | 5,640,316 | 5,212,997 |

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At December 31, 2013 and 2012, no customer represented more than 10% of net trade accounts receivable.

Changes in the provision for impairment are as follows:

| | |
|---------------------------------|-------------|
| Balance at January 01, 2012 | (1,056,729) |
| Additions, net (Note 26) | (654,273) |
| Write-offs | 631,748 |
| Balance at December 31, 2012 | (1,079,254) |
| Additions, net (Note 26) | (741,274) |
| Write-offs | 644,555 |
| Merger/split as of July 1, 2013 | - |
| Balance at December 31, 2013 | (1,175,973) |

At December 31, 2013, noncurrent consolidated accounts receivable includes R\$160,478 referring to the new business model of goods for resale to legal entities, whose term for receipt is up to 24 months. The amount of unrecognized revenue (present value adjustment) on December 31, 2013 was R\$18,174.

TData has a product called “Soluciona TI,” which consists of leasing IT equipment to small- and medium-sized enterprises, for which TData receives fixed installments over the lease term. Considering the contractual terms, the Company classified this product as Finance Lease. At December 31, 2013, the consolidated noncurrent accounts receivable balance includes R\$96,608 (R\$93,378 at December 31, 2012) related to this product.

The consolidated balance of trade accounts receivable, related to finance lease, comprises the following effects:

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|------------------------------|-----------|------------------------|------------------------|
| Present value of receivables | 335,376 | 294,245 | 261,933 |
| Unrealized financial income | 7,058 | 7,757 | 8,941 |
| Gross accounts receivable | 342,434 | 302,002 | 270,874 |
| Provision for impairment | (99,791) | (86,648) | (69,375) |
| Net accounts receivable | 242,643 | 215,354 | 201,499 |
| Current | 146,035 | 121,976 | 116,644 |
| Noncurrent | 96,608 | 93,378 | 84,855 |

At December 31, 2013, the aging list of trade accounts receivable is as follows:

| Year | Trade Accounts Receivable, Gross | Present Value |
|------------------------------|---|------------------|
| Falling due up to one year | 238,768 | 238,768 |
| Falling due up to five years | 103,666 | 96,608 |

| | | |
|-------|---------|---------|
| Total | 342,434 | 335,376 |
|-------|---------|---------|

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There are no unsecured residual values resulting in benefits to the lessor nor contingent payments recognized as revenue during the year.

| 7. | Inventories | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|---|-------------|--------------------|------------------------|------------------------|
| | | Consumer materials | 58,492 | 59,417 |
| Materials for resale (a) | 498,803 | 380,163 | 435,032 | |
| Other inventory items | 6,481 | 4,005 | 6,468 | |
| Total gross | 563,776 | 443,585 | 536,047 | |
| Provision for impairment and obsolescence | (58,161) | (55,776) | (64,326) | |
| Total current | 505,615 | 387,809 | 471,721 | |

(a) This includes, among others, mobile telephones, simcards (chip) and IT equipment in stock.

Changes in the provision for impairment and obsolescence are as follows:

| | |
|---------------------------------|----------|
| Balance at January 1, 2012 | (64,326) |
| Additions | (35,972) |
| Reversals | 44,522 |
| Balance at December 31, 2012 | (55,776) |
| Additions | (29,247) |
| Reversals | 26,862 |
| Merger/split as of July 1, 2013 | - |
| Balance at December 31, 2013 | (58,161) |

Cost of goods sold, which includes amounts regarding provision for impairment and obsolescence, is stated in Note 25.

8. Deferred taxes and taxes recoverable

8.1 Taxes recoverable

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|----------|-----------|------------------------|------------------------|
| ICMS (a) | 1,556,452 | 1,631,088 | 1,665,896 |

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| | | | |
|--|---------|---------|-----------|
| ICMS agreement No. 39/CAT Admin Ruling No.06 (b) | 355,251 | 288,520 | 307,832 |
| Income and social contribution taxes (c) | 377,704 | 528,109 | 1,143,987 |

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| | | | |
|------------------------------|------------------|------------------|------------------|
| Taxes withheld at source (d) | 188,659 | 141,620 | 152,919 |
| PIS and COFINS | 63,816 | 148,092 | 210,950 |
| Other | 18,468 | 53,957 | 28,440 |
| Total | 2,560,350 | 2,791,386 | 3,510,024 |
| Current | 2,191,962 | 2,052,421 | 2,495,065 |
| Non-current | 368,388 | 738,965 | 1,014,959 |

- (a) Credits arising from additions to property, plant and equipment, subject to offsetting in 48 months.
- (b) Refund request for State Value-Added Tax (ICMS) paid for invoices cancelled at a later time.
- (c) Mainly prepaid income tax and social contribution, which will be offset against federal taxes to be determined in the future.
- (d) Credits on withholding income tax on short-term investments, interest on shareholders' equity and other, which are used as deduction in operations for the year and social contribution withheld at source on services provided to public entities.

8.2 Deferred taxes

The Company and its subsidiary calculate deferred income and social contribution tax assets considering the existence of taxable profit for the past five financial years and expected future taxable profit generation, which were based on a technical feasibility study, approved by the Board of Directors.

Significant components of deferred income and social contribution taxes are as follows:

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|---|-----------|------------------------|------------------------|
| Deferred Assets | | | |
| Income and social contribution tax losses (a) | 262,915 | 21,290 | 348,576 |
| Merged tax credit (b) | - | 9,461 | 46,962 |
| Income and social contribution taxes on temporary differences (c) | | | |
| Provisions for labor, tax and civil contingencies | 1,327,288 | 1,104,065 | 950,988 |
| Post-employment retirement plans | 143,537 | 133,371 | 104,856 |
| Provision for impairment - accounts receivable | 245,556 | 169,434 | 178,433 |
| Provision for modem and other PP&E item losses | 166,174 | 210,107 | 137,829 |
| Profit sharing | 71,948 | 62,218 | 82,564 |
| Accelerated accounting depreciation | 154,181 | 421,768 | 433,512 |
| Provision for impairment – inventories | 12,885 | 13,951 | 17,542 |
| Provision for customer loyalty program | 31,199 | 28,168 | 23,399 |
| Derivative transactions | - | 42,922 | 69,387 |
| Trade accounts payable and other provisions | 398,956 | 290,199 | 354,916 |
| Income and social contribution taxes on other temporary differences | 157,313 | 134,460 | 109,285 |

| | | | |
|---------------------------|-----------|-----------|-----------|
| Total deferred tax assets | 2,971,952 | 2,641,414 | 2,858,249 |
|---------------------------|-----------|-----------|-----------|

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| | | | |
|---|-------------|-------------|-------------|
| Deferred tax liabilities | | | |
| Merged tax credit (b) | (337,535) | (269,514) | (207,668) |
| Income and social contribution taxes on temporary differences (c) | | | |
| Technology Innovation Law | (308,490) | (416,700) | (333,156) |
| Exchange variation | - | (3,383) | (14,742) |
| Customer portfolio | (461,870) | (546,383) | (630,896) |
| Trademarks and patents | (479,548) | (508,178) | (536,808) |
| Licenses | (719,780) | (399,878) | (79,976) |
| Effects of goodwill generated upon merger of Vivo Part. Vivo Part. Goodwill | (568,338) | (344,927) | (258,695) |
| (480,366) | (266,870) | (53,374) | |
| Income and social contribution taxes on other temporary differences | | | |
| | (128,365) | (74,344) | (104,389) |
| Total deferred tax liabilities | (3,484,292) | (2,830,177) | (2,219,704) |
| Total noncurrent assets (liabilities), net | | | |
| | (512,340) | (188,763) | 638,545 |
| Deferred tax assets (liabilities), net | | | |
| Represented in the balance sheet is as follows: | | | |
| Noncurrent deferred tax assets, net | 210,294 | 1,027,888 | 1,427,499 |
| Noncurrent deferred tax liabilities, net | (722,634) | (1,216,651) | (788,954) |

Deferred taxes were determined considering future realization, as under:

- a) Income and social contribution tax losses: this represents the amount recorded by the Company and its subsidiary which, in accordance with Brazilian tax legislation, may be offset to the limit of 30% of the tax bases computed for the following years, with no expiry date.

Following are the amounts of tax credits from losses on income tax and social contribution carry-forwards recognized for the years ended December 31, 2013 and 2012 and, January 1, 2012:

| | Income tax | Social contribution tax | Total |
|---|------------|-------------------------|-----------|
| Income and social contribution tax losses at January 1, 2012 | 1,745,928 | 1,705,050 | 3,450,978 |
| Tax credit (25% + 9%) | 436,482 | 153,455 | 589,937 |
| Tax credit recognized | 259,011 | 89,565 | 348,576 |
| Unrecognized tax credit (*) | 177,471 | 63,890 | 241,361 |
| Income and social contribution tax losses at December 31, 2012 (restated) | 930,409 | 997,434 | 1,927,843 |
| Tax credit (25% + 9%) | 232,602 | 89,769 | 322,371 |
| Tax credit recognized | 12,066 | 9,224 | 21,290 |

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| | | | |
|---|---------|-----------|-----------|
| Unrecognized tax credit (*) | 220,536 | 80,545 | 301,081 |
| Income and social contribution tax losses at December 31, 2013 | 672,523 | 1,053,155 | 1,725,678 |
| Tax credit (25% + 9%) | 168,131 | 94,784 | 262,915 |
| Tax credit recognized | 168,131 | 94,784 | 262,915 |

(*) Due to the restructuring process, the T.Data recognized tax credits not recognized over the past years, so there is no credit not recognized in 2013.

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- b) Merged tax credit: represented by tax benefits arising from corporate restructuring of goodwill for expected future profitability, whose tax use follows the limit set forth in tax legislation.
- c) Income and social contribution taxes on temporary differences: amounts will be realized upon payment of provisions, effective impairment or trade receivables, or realization of inventories, as well as upon reversal of other provisions.

Changes in deferred income and social contribution tax assets and liabilities are as follows:

| Deferred tax assets | Tax losses | Deferred tax assets | Total |
|---|------------|---------------------|------------|
| Balance at January 01, 2012 (Restated) | 348,576 | 2,509,673 | 2,858,249 |
| Provision | 154,657 | 375,739 | 530,396 |
| Provision reversal | (481,943) | (265,288) | (747,231) |
| Balance at December 31, 2012 - Restated | 21,290 | 2,620,124 | 2,641,414 |
| Provision | 241,625 | 458,376 | 700,001 |
| Provision reversal | - | (368,537) | (368,537) |
| Comprehensive income | - | (926) | (926) |
| Merger/split as of July 1, 2013 | - | - | - |
| Balance at December 31, 2013 | 262,915 | 2,709,037 | 2,971,952 |

Deferred tax liabilities

| | |
|---|-------------|
| Balance at January 01, 2012 (Restated) | (2,219,704) |
| Provision | (747,326) |
| Provision reversal | 123,537 |
| Other changes that did not flow through P&L | (8,071) |
| Comprehensive income | 21,387 |
| Balance at December 31, 2012 - Restated | (2,830,177) |
| Provision | (884,798) |
| Provision reversal | 223,810 |
| Other changes that did not flow through P&L | 6,873 |
| Merger/split as of July 1, 2013 | - |
| Balance at December 31, 2013 | (3,484,292) |

The table below presents deferred income tax and social contribution for items charge or credited directly in other comprehensive income during the years ended December 31, 2013 and 2012.

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| | 12.31.13 | 12.31.12 - Restated |
|--|----------|------------------------|
| Non-realized losses on available for sale investment | 4,578 | 1,882 |
| Actuarial losses and effect of the asset ceiling on plan surplus | (7,348) | 23,726 |
| Gain (losses) on derivative operations | 1,844 | (4,221) |
| Total | (926) | 21,387 |

Following are the expected deadlines to realize net deferred tax assets.

| 2014 | 2015 | 2016 | 2017 | 2018 | 2019 onwards | Total |
|-----------|-----------|----------|----------|----------|-----------------|-----------|
| (635,572) | (113,087) | (39,151) | (71,645) | (80,702) | 427,817 | (512,340) |

These amounts are based on projections which may change in the future.

9. Escrow deposits

In some situations, in connection with a legal requirement or presentation of guarantees, judicial deposits are made to secure the continuance of the claims under discussion. These judicial deposits may be required for claims whose likelihood of loss was analyzed by the Company, grounded on the opinion of its legal advisors as a probable, possible or remote loss.

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|----------------------|-----------|------------------------|------------------------|
| Judicial deposits | | | |
| Labor | 1,036,055 | 933,866 | 789,705 |
| Tax | 2,364,913 | 2,182,513 | 1,938,270 |
| Civil and regulatory | 853,980 | 866,668 | 715,285 |
| Total | 4,254,948 | 3,983,047 | 3,443,260 |
| Garnishments | 97,572 | 52,846 | 47,651 |
| Total | 4,352,520 | 4,035,893 | 3,490,911 |
| Current | 204,165 | 126,625 | 116,421 |
| Noncurrent | 4,148,355 | 3,909,268 | 3,374,490 |

At December 31, 2013, the Company and its subsidiary had a number of tax-related judicial deposits, reaching the consolidated amount of R\$2,364,913 (R\$2,182,513 at December 31, 2012). Detailed information on the matters from which the main deposits stem, is in Note 20.

A brief description of the main tax-related judicial deposits is as follows:

- Federal contribution taxes on gross revenue for Social Integration Program (PIS) and for Social Security Financing (COFINS)

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Company and subsidiary are involved in disputes related to: (i) claim filed for overpayment of tax credits, not recognized by tax authorities; (ii) tax debt arising from underpayment due to differences in ancillary statements (Federal Tax Debt and Credit Return – DCTF); and (iii) disputes referring to changes in rates and increase in tax bases introduced by Law No. 9,718/98.

At December 31, 2013, consolidated judicial deposits amounted to R\$31,162 (R\$62,924 at December 31, 2012).

- Social Contribution Tax for Intervention in the Economic Order (CIDE)

The Company is involved in legal disputes for the exemption of CIDE levied on offshore remittances of funds arising from agreements for the transfer of technology, brand and software licensing, etc.

At December 31, 2013, consolidated judicial deposits amounted to R\$144,684 (R\$136,211 at December 31, 2012).

- Telecommunications Inspection Fund (FISTEL)

ANATEL collects Installation Inspection Fee (TFI) on extension of licenses granted and on radio base stations, mobile stations and radio links. Such collection results from the understanding of ANATEL that said extension would be a triggering event of TFI and that mobile stations, even if owned by third parties, are also subject to TFI. The Company and subsidiary challenge aforesaid fee in court.

At December 31, 2013, the consolidated judicial deposits amounted to R\$864,487 (R\$818,502 at December 31, 2012).

- Withholding Income Tax (IRRF)

Company is involved in disputes related to: (i) exemption of IRRF payment on offshore remittances for out-coming traffic (land-line operators); (ii) exemption of IRRF payment on interest on shareholders' equity recognized (mobile operators); and (iii) IRRF levied on earnings from rentals and royalties, wage labor and fixed-income investments.

At December 31, 2013, the consolidated judicial deposits amounted to R\$59,343 (R\$58,367 at December 31, 2012).

- Corporate Income Tax (IRPJ)

Company is involved in disputes related to: (i) debts stemming from offsetting of IRPJ overpayments not recognized by the Brazilian IRS; and (ii) requirement of IRPJ estimates and lack of payment – debts in the integrated system of economic and tax information (SIEF); and (iii) underpaid IRPJ amounts.

At December 31, 2013, the consolidated judicial deposits amounted to R\$28,456 (R\$25,422 at December 31, 2012).

- Contribution to Empresa Brasil de Comunicação (EBC)

Sinditelebrasil (Union of Telephony and Mobile and Personal Services) filed an injunction challenging the Contribution to Foster Public Radio Broadcasting payable to EBC, introduced by Law No. 11,652/2008. The Company and its subsidiary, as union members, made judicial deposits referring to that contribution.

At December 31, 2013, the consolidated judicial deposits amounted to R\$514,127 (R\$370,026 at December 31, 2012).

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- Social Security, Work Accident Insurance (SAT) and Funds to Third Parties (INSS)

Company was involved in disputes related to: (i) SAT and funds to third parties (INCRA and SEBRAE); (ii) joint responsibility for contract labor; and (ii) difference in SAT rate (from 1% to 3%).

At December 31, 2013, the consolidated judicial deposits amounted to R\$96,736 (R\$91,915 at December 31, 2012).

- Unemployment Compensation Fund (FGTS)

The Company filed an injunction in order to represent its right not to pay surtax of 0.5% and 10% for FGTS introduced by Supplementary Law No. 110/2001 levied on deposits made by employers (the proceedings did not result in any reduction of FGTS deposits made by the Company on behalf of its employees).

At December 31, 2013, the consolidated judicial deposits amounted to R\$70,697 (R\$66,386 at December 31, 2012).

- Tax on Net Income (ILL)

The Company filed an injunction in order to represent its right to offset amounts unduly paid for ILL purposes against future IRPJ payments.

On December 19, 2013 the Company settled the debt under discussion by including it in the Federal Tax Recovery Program (REFIS), using the judicial deposit then restricted, which is now awaiting conversion into income by the Federal Government.

At December 31, 2013, the consolidated judicial deposits amounted to R\$51,648 (R\$49,355 at December 31, 2012).

- Universal Telecommunication Services Fund (FUST)

Company and subsidiary filed an injunction in order to have their right declared not to include expenses with interconnection (ITX) and Industrial Use of Dedicated Line (EILD) in FUST tax base for landline phone carriers and not to include revenues from ITX and EILD in FUST tax base for mobile phone carriers, according to Abridgment No. 7, of December 15, 2005, as it does not comply with the provisions contained in sole paragraph of article 6 of Law No. 9,998, of August 17, 2000.

At December 31, 2013, the consolidated judicial deposits amounted to R\$371,373 (R\$341,403 at December 31, 2012).

- Provisional Contribution Tax on Financial Transactions (CPMF)

Given the merger of PTelecom Brasil S.A. into Vivo Part. (later merged into the Company) the judicial deposit balance related to the injunction filed by PTelecom Brasil S.A. was absorbed, so as to reject the requirement for CPMF on pro forma and simultaneous foreign exchange agreements, as required by the Central Bank of Brazil to translate foreign loans into investment.

At December 31, 2013, the petition filed for a writ of mandamus had an unfavorable outcome for the Company, and the aforesaid judicial deposit was converted into income for the payment of the debt under discussion.

At December 31, 2013, the consolidated judicial deposits amounted to R\$20,899.

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- State Value-Added Tax (ICMS)

Company is involved in disputes related to: (i) ICMS stated but not paid; (ii) ICMS not levied on communication in default; (iii) fine for late voluntary payment of ICMS; (iv) ICMS supposedly levied on access, adhesion, enabling, availability and use of services, as well as supplementary services and additional facilities; (v) right to credit from the acquisition of goods for the PP&E and electric energy; and (vi) activation cards for pre-paid services.

At December 31, 2013, the consolidated judicial deposits amounted to R\$38,259 (R\$34,235 at December 31, 2012).

- Other taxes, charges and contributions

Company is involved in disputes related to: (i) Service Tax (ISS) on noncore services; (ii) Municipal Real Estate Tax (IPTU) not subject to exemption; (iii) municipal inspection, operation and publicity charges; (iv) land use fee; (v) social security contributions related to supposed failure to withhold 11% on several invoices, bills and receipts or service providers engaged for workforce assignment; and (vi) Public Price for Numbering Resource Management (PPNUM) by ANATEL.

At December 31, 2013, the consolidated judicial deposits amounted to R\$93,941 (R\$106,868 at December 31, 2012).

10. Prepaid expenses

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|---------------------------------------|----------|------------------------|------------------------|
| Advertising and publicity | 167,873 | 173,688 | 172,401 |
| Rent | 35,168 | 51,207 | 43,744 |
| Insurance | 29,733 | 14,250 | 11,984 |
| Financial charges | 11,568 | 7,152 | 8,743 |
| Software maintenance, taxes and other | 38,308 | 33,436 | 50,322 |
| Total | 282,650 | 279,733 | 287,194 |
| Current | 257,286 | 248,337 | 255,056 |
| Non-current | 25,364 | 31,396 | 32,138 |

11. Other assets

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|-------------------------------------|----------|------------------------|------------------------|
| Advances to employees and suppliers | 64,991 | 97,152 | 73,646 |
| Related-party receivables | 97,748 | 58,151 | 60,499 |
| Subsidy on handset sales | 55,716 | 53,756 | 53,408 |
| Receivables from suppliers (a) | 139,563 | 479,283 | 217,255 |
| Pension plan surplus | 17,909 | 48,048 | 31,210 |
| Other realizable assets | 92,037 | 27,235 | 61,215 |
| Total | 467,964 | 763,625 | 497,233 |

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| | | | |
|------------|---------|---------|---------|
| Current | 340,171 | 671,317 | 401,184 |
| Noncurrent | 127,793 | 92,308 | 96,049 |

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(a) At December 31, 2013, the consolidated amounts include R\$362,774 referring to the disposal of nonstrategic transmission towers, received in 2013.

12. Investments

A summary of significant financial data of investees is as follows.

a) Information on investees – Jointly-controlled entities

| | At December 31, 2013 | | | At December 31, 2012 | | | At January 01, 2012 | | |
|--------------------------------|----------------------|-----------|-------------------|----------------------|---------|-------------------|---------------------|---------|-------------------|
| | Cia ACT | Cia AIX | Aliança Atlântica | Cia ACT | Cia AIX | Aliança Atlântica | Cia ACT | Cia AIX | Aliança Atlântica |
| Current assets | 11 | 10,515 | 139,414 | 10 | 13,414 | 116,322 | 8 | 7,002 | 99,330 |
| Noncurrent assets | - | 12,441 | - | - | 120,024 | - | - | 130,922 | 4,756 |
| Current liabilities | 1 | 2,950 | 2,200 | - | 3,280 | 2,302 | 2 | 4,676 | 20 |
| Noncurrent liabilities | - | 6,076 | - | - | 5,792 | - | - | 3,698 | - |
| Equity | 10 | 13,930 | 137,214 | 10 | 124,366 | 114,020 | 6 | 129,550 | 104,066 |
| Net income (loss) for the year | - | (110,436) | 136 | 4 | (550) | 1,722 | (6) | 6,502 | 2,114 |

b) Changes in investments

| | Balances at December 31, 2012 - Restated | Additions | Equity pickup | Dividend and interest on equity declared and approved | Other comprehensive income | Merger / split as of July 1, 2013 | Balances at December 31, 2013 |
|---|--|-----------|---------------|---|----------------------------|-----------------------------------|-------------------------------|
| Jointly controlled entities -Equity investments | 119,198 | - | (55,150) | - | 11,529 | - | 75,577 |
| Aliança | 57,010 | - | 68 | - | 11,529 | - | 68,607 |
| AIX | 62,183 | - | (55,218) | - | - | - | 6,965 |
| ACT | 5 | - | - | - | - | - | 5 |

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| | | | | | | | |
|--------------------------------------|---------|--------|-----------|---|-----------|-----|--------|
| Other investments | 23,683 | (148) | - | - | (13,465) | 702 | 10,772 |
| Other investments (a) | 23,683 | (148) | - | - | (13,465) | 702 | 10,772 |
| Total investments in consolidated | 142,881 | (148) | (55,150) | - | (1,936) | 702 | 86,349 |

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| | Balances at January 1, 2012 Restated | Additions | Equity pickup | Dividend and interest on equity declared and approved | Other comprehensive income | Residual value write-off | Balances at December 31, 2012 - Restated |
|---|---|-----------|------------------|---|----------------------------------|--------------------------------|---|
| Jointly controlled entities -Equity investments | 116,801 | - | 588 | (3,457) | 5,266 | - | 119,198 |
| Aliança | 52,023 | - | 861 | (1,140) | 5,266 | - | 57,010 |
| AIX | 64,775 | - | (275) | (2,317) | - | - | 62,183 |
| ACT | 3 | - | 2 | - | - | - | 5 |
| Other investments | 34,455 | - | - | - | (5,068) | (6,704) | 23,683 |
| Zon Multimédia – Direct investment (b) | 6,737 | - | - | - | (33) | (6,704) | - |
| Other investments (a) | 28,718 | - | - | - | (5,035) | - | 23,683 |
| Total investments in consolidated | 152,256 | - | 588 | (3,457) | 198 | (6,704) | 142,881 |

- (a) Other investments are stated at fair value.
- (b) On May 8, 2012, the Company sold its equity interest held in ZON (Note 2.2).

13. Property, plant and equipment, net

13.a) Breakdown

At December 31, 2013:

| | PP&E Cost | Accumulated depreciation | Net balance |
|----------------------------------|------------|-----------------------------|-------------|
| Switching equipment | 16,551,351 | (14,186,061) | 2,365,290 |
| Transmission equipment and media | 34,247,236 | (25,814,693) | 8,432,543 |
| Terminal equipment/modems | 10,763,473 | (9,295,416) | 1,468,057 |
| Infrastructure | 12,959,925 | (9,491,430) | 3,468,495 |
| Land | 314,558 | - | 314,558 |
| Other | 3,277,142 | (2,682,185) | 594,957 |
| Provision for loss | (169,979) | - | (169,979) |
| Fixed assets in progress | 1,967,726 | - | 1,967,726 |

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| | | | |
|-------|------------|--------------|------------|
| Total | 79,911,432 | (61,469,785) | 18,441,647 |
|-------|------------|--------------|------------|

At December 31, 2012 (Restated)

| | PP&E Cost | Accumulated depreciation | Net balance |
|----------------------------------|------------|-----------------------------|-------------|
| Switching equipment | 15,517,041 | (13,271,794) | 2,245,247 |
| Transmission equipment and media | 31,809,734 | (24,528,539) | 7,281,195 |
| Terminal equipment/modems | 9,883,913 | (8,334,571) | 1,549,342 |
| Infrastructure | 12,756,034 | (8,911,756) | 3,844,278 |
| Land | 316,673 | - | 316,673 |
| Other | 3,919,579 | (2,988,254) | 931,325 |
| Provision for loss | (40,286) | - | (40,286) |
| Fixed assets in progress | 1,476,370 | - | 1,476,370 |
| Total | 75,639,058 | (58,034,914) | 17,604,144 |

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13.b) Changes

| | Balance at December 31, 2012 - Restated | Additions | Write-offs, net | Transfers, net | Depreciation (d) | Balance at December 31 2013 |
|--------------------------|--|-----------|--------------------|-------------------|---------------------|-----------------------------------|
| Switching equipment | 2,245,247 | 30,948 | (101) | 639,577 | (550,381) | 2,365,290 |
| Transmission | | | | | | |
| equipment and media | 7,281,195 | 514,314 | (18,438) | 2,100,099 | (1,444,627) | 8,432,543 |
| Terminal | | | | | | |
| equipment/modems | 1,549,342 | 524,785 | (920) | 346,474 | (951,624) | 1,468,057 |
| Infrastructure | 3,844,278 | 96,103 | (24,883) | 261,168 | (708,171) | 3,468,495 |
| Land | 316,673 | - | (2,115) | - | - | 314,558 |
| Other | 931,325 | 70,673 | (2,531) | (244,040) | (160,470) | 594,957 |
| Provision for loss (b) | (40,286) | (5,492) | 9,560 | (133,761) | - | (169,979) |
| Fixed assets in progress | 1,476,370 | 3,600,201 | (10,025) | (3,098,820) | - | 1,967,726 |
| Total | 17,604,144 | 4,831,532 | (49,453) | (129,303) | (3,815,273) | 18,441,647 |

| | Balance at January 1, 2012- Restated | Additions | Write-offs, net (a) | Transfers, net (c) | Depreciation (d) | Balance at December 31, 2012 - Restated |
|--------------------------|---|-----------|------------------------|-----------------------|---------------------|--|
| Switching equipment | 1,951,085 | 59,238 | (13,686) | 706,768 | (458,158) | 2,245,247 |
| Transmission | | | | | | |
| equipment and media | 6,934,793 | 518,332 | (41,124) | 1,107,907 | (1,238,713) | 7,281,195 |
| Terminal | | | | | | |
| equipment/modems | 1,547,030 | 1,084,718 | (5,230) | (13,551) | (1,063,625) | 1,549,342 |
| Infrastructure | 4,232,294 | 41,601 | (103,592) | 392,099 | (718,124) | 3,844,278 |
| Land | 320,302 | - | (3,629) | - | - | 316,673 |
| Other | 855,593 | 217,069 | (4,036) | 59,586 | (196,887) | 931,325 |
| Provision for loss (b) | (23,435) | (2,025) | 3,555 | (18,381) | - | (40,286) |
| Fixed assets in progress | 1,328,859 | 2,419,208 | (14,834) | (2,256,863) | - | 1,476,370 |
| Total | 17,146,521 | 4,338,141 | (182,576) | (22,435) | (3,675,507) | 17,604,144 |

- (a) The consolidated amounts of net write-offs in 2012 include R\$138,812, regarding the sale of non-strategic towers and rooftops.

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- (b) Company and subsidiary recognized a provision for potential obsolescence of materials used in PP&E maintenance, based on levels of historical use and expected future use.
- (c) The balances remaining from transfers in 2012 include R\$18,773 consisting of residual values of sales of towers and rooftops pending transfer of risk and property, which will be recognized as net write-offs upon recognition of the related revenues.
- (d) Additions of depreciation costs and expenses are presented in “Depreciation and Amortization” in Notes 25, 26 and 27.

13.c) Depreciation rates

For the years ended December 31, 2013 and 2012, consolidated PP&E items were depreciated on a straight-line basis, at the following annual rates:

| | |
|----------------------------------|---------|
| | 10.00 |
| | to |
| Switching equipment | 33.33 |
| | 5.00 to |
| Transmission equipment and media | 20.00 |
| | 10.00 |
| | to |
| Terminal equipment/modems | 66.67 |
| | 4.00 to |
| Infrastructure | 66.67 |
| | 10.00 |
| | to |
| Other | 20.00 |

The annual average depreciation rate was 14.70% in 2013 and 2012.

13.d) PP&E items given in guarantee

At December 31, 2013, the Company and its subsidiary had PP&E items given in guarantee for lawsuits, amounting to R\$187,025 (R\$235,847 at December 31, 2012).

13.e) Capitalization of borrowing costs

At December 31, 2013 and 2012, the Company did not capitalize borrowing costs, as there were no qualifying assets.

13.f) Reversible assets

The concession agreement establishes that all assets comprising the Company equity and key for the service provision described in the aforesaid agreement shall be deemed reversible and an integral part of the worth of the concession. These assets will automatically revert to ANATEL upon expiration of the concession agreement in accordance with the regulation currently in force. At December 31, 2013 the residual balance of reversible assets was R\$7,270,327 (R\$6,911,508 at December 31, 2012), comprising switching and transmission equipment, terminals for public use, external energy network equipment and system and operation support equipment.

14. Intangible assets, net

14.a) Breakdown

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|--------------------------|------------|------------------------|------------------------|
| Goodwill | 10,225,280 | 10,225,280 | 10,225,280 |
| Other intangibles assets | 19,277,779 | 19,780,417 | 19,824,167 |
| Total | 29,503,059 | 30,005,697 | 30,049,447 |

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The sources of goodwill allocated to the CGU Telefônica Brasil as of December 31, 2013 and 2012:

| | |
|--|-------------------|
| Ajato Telecomunicações Ltda. | 149 |
| Goodwill Spanish and Figueira (merged in TDBH) (a) | 212,058 |
| Santo Genovese Participações Ltda. (b) | 71,892 |
| Telefônica Televisão Participações S.A. (c) | 780,693 |
| Vivo Participações S.A. (d) | 9,160,488 |
| Total | 10,225,280 |

(a) Goodwill from partial spin-off of Spanish e Figueira, which was transferred to the Company upon merger with Telefonica Data Brasil Holding S.A. (TDBH) in 2006.

(b) Goodwill generated upon acquisition of equity control of Santo Genovese Participações (parent company of Atrium Telecomunicações Ltda.), in 2004.

(c) Goodwill generated upon acquisition of TTP (formerly Navytrees) merged in 2008, economically based on a future profitability study.

(d) Goodwill generated upon acquisition/merge of Vivo Part. Upon merger in 2011.

Breakdown of and changes in other intangible assets at December 31, 2013 and 2012 were as follows:

14.b) Breakdown of other intangible assets

At December 31, 2013:

| | Cost of intangible assets | Accumulated amortization | Net balance |
|------------------------|---------------------------------|-----------------------------|-------------------|
| Software | 10,494,388 | (8,506,754) | 1,987,634 |
| Customer portfolio | 1,990,278 | (631,836) | 1,358,442 |
| Trademarks and patents | 1,601,433 | (190,980) | 1,410,453 |
| Licenses | 17,238,795 | (2,764,229) | 14,474,566 |
| Other | 152,026 | (151,690) | 336 |
| Software in progress | 46,348 | - | 46,348 |
| Total | 31,523,268 | (12,245,489) | 19,277,779 |

At December 31, 2012 (Restated)

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| | Cost of intangible assets | Accumulated amortization | Net balance |
|------------------------|---------------------------------|-----------------------------|-------------|
| Software | 10,064,993 | (8,157,989) | 1,907,004 |
| Customer portfolio | 2,114,561 | (507,552) | 1,607,009 |
| Trademarks and patents | 1,643,511 | (148,870) | 1,494,641 |
| Licenses | 16,987,547 | (2,275,703) | 14,711,844 |
| Other | 159,855 | (150,978) | 8,877 |
| Software in progress | 51,042 | - | 51,042 |
| Total | 31,021,509 | (11,241,092) | 19,780,417 |

14.c) Changes in other intangible assets

| | Balance at December 31, 2012 - Restated | Additions | Write-offs, net | Transfers, net (a) | Amortization (c) | Balance at December 31, 2013 |
|---------------------------|--|-----------|--------------------|-----------------------|------------------|------------------------------------|
| Software | 1,907,004 | 377,711 | (127) | 466,175 | (763,129) | 1,987,634 |
| Customer portfolio | 1,607,009 | - | - | - | (248,567) | 1,358,442 |
| Trademarks and patents | 1,494,641 | - | - | - | (84,188) | 1,410,453 |
| Licenses | 14,711,844 | 483,249 | - | - | (720,527) | 14,474,566 |
| Other | 8,877 | - | - | 3,085 | (11,626) | 336 |
| Software in progress | 51,042 | 335,263 | - | (339,957) | - | 46,348 |
| Total | 19,780,417 | 1,196,223 | (127) | 129,303 | (1,828,037) | 19,277,779 |

| | Balance at January 1, 2012- Restated | Additions | Write-offs, net | Transfers, net (a) | Amortization (b) | Balance at December 31, 2012 - Restated |
|---------------------------|---|-----------|--------------------|-----------------------|------------------|--|
| Software | 1,872,472 | 498,774 | (18) | 313,237 | (777,461) | 1,907,004 |
| Customer portfolio | 1,862,831 | - | - | - | (255,822) | 1,607,009 |
| Trademarks and patents | 1,578,846 | - | - | - | (84,205) | 1,494,641 |
| Licenses | 14,359,981 | 1,050,200 | - | - | (698,337) | 14,711,844 |
| Other | 16,598 | 14 | - | (7,291) | (444) | 8,877 |
| Software in progress | 133,439 | 227,572 | - | (309,969) | - | 51,042 |
| Total | 19,824,167 | 1,776,560 | (18) | (4,023) | (1,816,269) | 19,780,417 |

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- (a) Remaining consolidated balances in transfers for 2012 refers to a transfer from Goodwill to prepaid expenses in R\$7,685 and R\$3,662 from PP&E.
- (b) Additions of amortization costs and expenses are stated under “Depreciation and amortization” in Notes 25, 26 and 27.

14.d) Amortization rates

For the years ended December 31, 2013 and 2012, other intangible assets were amortized under the straight line method at the following rates:

| | |
|------------------------|-------------------|
| Software | 20.00 to 33.33 |
| Customer portfolio | 9.00 to 15.00 |
| Trademarks and patents | 5.00 |
| Licenses | 3.60 to 20.00 |
| Other | 10.00 to 20.00 |

The average annual amortization rate was 19.01% in 2013 and 2012.

15. Personnel, social charges and benefits liabilities

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|-------------------------------|----------|------------------------|------------------------|
| Salaries and wages | 21,124 | 38,640 | 40,651 |
| Social charges and benefits | 228,099 | 204,675 | 223,262 |
| Profit sharing | 182,180 | 172,937 | 214,983 |
| Share-based payment plans (a) | 18,698 | 13,224 | 15,160 |
| Other | - | - | 16,631 |
| Total | 450,101 | 429,476 | 510,687 |
| Current | 431,403 | 416,252 | 495,527 |
| Noncurrent | 18,698 | 13,224 | 15,160 |

(a) Noncurrent portion refers to share-based payment plans, Note 34.

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16. Trade accounts payable

| | 12.31.13 | Consolidated 12.31.12 - Restated | 01.01.12 - Restated |
|------------------------------|-----------|--|------------------------|
| Sundry suppliers | 6,328,081 | 5,205,202 | 5,378,066 |
| Amounts to be passed on | 160,552 | 151,809 | 146,437 |
| Interconnection / networking | 425,376 | 532,057 | 513,646 |
| Total | 6,914,009 | 5,889,068 | 6,038,149 |

17. Taxes, charge and contributions

| | 12.31.13 | 12.31.12 - Restated | 01.01.12- Restated |
|--|-----------|------------------------|-----------------------|
| Income taxes | 22,893 | 243,399 | 129,452 |
| Income and social contribution taxes payable (a) | 22,893 | 243,399 | 129,452 |
| Indirect taxes | 1,367,345 | 2,026,600 | 1,995,356 |
| ICMS (b) | 992,813 | 1,534,750 | 1,585,884 |
| PIS and COFINS | 235,573 | 362,911 | 319,885 |
| Fust and Funttel | 35,982 | 34,853 | 38,306 |
| ISS, CIDE and other | 102,977 | 94,086 | 51,281 |
| Total | 1,390,238 | 2,269,999 | 2,124,808 |
| Current | 1,315,164 | 1,781,250 | 1,691,737 |
| Noncurrent | 75,074 | 488,749 | 433,071 |

(a) Income and social contribution taxes payable are stated net of payments based on estimates.

(b) At December 31, 2012, the noncurrent portion includes R\$437,295, referring to ICMS - Programa Paraná Mais Emprego, resulting from an agreement with the Paraná State Government, involving deferral of ICMS. This agreement establishes that ICMS shall be paid on the 49th month subsequent to that in which ICMS is computed. This amount is restated based on the Annual Restatement Factor (FCA). In December 2013, the Company settled up this liability with the Paraná State Government for amounts up to September 2013.

18. Loans, Financing, Lease and Debentures

18.1 Loans, financing and finance lease

The loans, financing and finance lease are presented at fair value when applicable.

As a result of the corporate restructuring process described in Note 1b, the Company became accountable for the loan, financing and finance lease agreements which belonged to the merged entities.

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Information at December 31, 2013

| | Currency | Annual interest rate | Maturity | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|-------------------------------|---------------|-------------------------|----------|-----------|------------------------|------------------------|
| Financing – BNDES | URTJLP (a) | TJLP+ 0% to 9% | 06/15/20 | 2,441,897 | 2,911,854 | 3,063,238 |
| Financing – BNDES | UMBND (b) | ECM (c) + 2.38% | 07/15/19 | 505,525 | 455,296 | 194,276 |
| Financing – BNDES | R\$ | 2.5% to 8.7% | 01/15/21 | 171,683 | 173,793 | 155,011 |
| Loan – Mediocrédito | US\$ | 1.75% | 02/02/14 | 3,547 | 9,310 | 14,027 |
| Loan – Resolution No. 4131 | US\$ | | | - | 326,263 | 282,205 |
| | | 4.18% to | | | | |
| Loans – BEI | US\$ | 4.47% | 03/02/15 | 885,176 | 795,601 | 707,975 |
| Financing – BNB BBVA | R\$ | 10.00% | 10/30/16 | 224,958 | 338,610 | 438,279 |
| commission | | 0.43% | 02/28/15 | 276 | 241 | 221 |
| Financing - Leasing | R\$ | | | - | 356 | 726 |
| Finance lease | R\$ | | 08/31/33 | 218,878 | 33,259 | 21,067 |
| Working Capital | R\$ | | | - | - | 91,570 |
| Total | | | | 4,451,940 | 5,044,583 | 4,968,595 |
| Current | | | | 1,236,784 | 1,270,122 | 1,000,082 |
| Noncurrent | | | | 3,215,156 | 3,774,461 | 3,968,513 |

(a) Long-term interest reference unit (URTJLP) used by the Brazilian Development Bank (BNDES) as the contractual currency in financing agreements.

(b) Currency unit based on a currency basket (UMBND) used by BNDES as a contractual currency in financing agreements based on funds raised in foreign currency.

(c) The Currency Basket Charge (ECM) is a rate quarterly disclosed by BNDES.

Loans and financing

Brazilian Development Bank (BNDES)

- In October 2007, a credit facility was approved for the Company to finance investment in products produced domestically. All of these funds have been withdrawn and investment thereof are proven and accepted by BNDES.
- In August 2007, Vivo (which was merged into the Company as of July 1, 2013) took out a R\$1,530,459 financing facility from BNDES. Funds were released for the purpose of financing investment projects for implementation and expansion of the wireless capacity all over Brazil. Loans were released in installments and, as of December 31, 2011, no more funds were available for withdrawal. The agreement is effective for seven years. Principal will be repaid in 60 consecutive monthly installments as from September 15, 2009, after a two-year grace period.

- On October 14, 2011, a R\$3,031,110 credit facility was taken out from BNDES, which was adjusted to R\$2,152,098 in 2013 in view of new negotiations of credit lines and products with the bank. These funds are used in investments for expansion and improvement of the current network, implementation of the infrastructure required for new technologies, from 2011 to 2013, and construction of a data center in Tamboré (São Paulo State) and social projects.

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This agreement is effective for eight years, with its grace period ending July 15, 2014, when only interest will be paid, on a quarterly basis. After this period, interest will be paid and principal repaid within 60 consecutive monthly installments.

As the interest rates applied to two of the five sub-credit lines of this financing are lower than those prevailing in the market (TJLP and TJLP + 1.48%), this operation falls within the scope of IAS 20/CPC 7. Accordingly, using the effective interest method defined by IAS 39/CPC 38, the following comparison was considered: (i) total debt calculated based on rates defined in contract, and (ii) total debt calculated based on rates used in the market (fair value). The government grant by BNDES, adjusted to present value and deferred over the useful life of the financed asset item, resulted in a balance amounting to R\$19,950 as of December 31, 2013 (R\$18,322 as of December 31, 2012).

Through December 31, 2013, the amount of R\$2,059,717 (R\$1,802,113 through December 31, 2012) had been released.

- In January 2010, a R\$319,927 financing facility to Vivo (which was merged into the Company as of July 1, 2013) was approved by BNDES through its Investment Maintenance Program (BNDES PSI). Funds borrowed are used to improve the network capacity through acquisition of domestic equipment previously registered with BNDES (subject to Finame), and released as the investments made are proved. Through December 31, 2012, the amount of R\$184,489 was released and the remaining balance of R\$135,438 was canceled.

As the interest rates applied thereon are lower than those observable in the market (fixed interest rates varying from 4.5% to 5.5% p.a.), this operation falls within the scope of IAS 20/CPC 7. Accordingly, using the effective interest method defined by IAS 39/CPC 38, the following comparison was considered: (i) total debt calculated based on rates defined in contract, and (ii) total debt calculated based on observable market rates (fair value). The government grant by BNDES, adjusted to present value and deferred over the useful life of the financed asset item, resulted in balance amounting to R\$18,745 as of December 31, 2013 (R\$23,876 as of December 31, 2012).

- With the merger process as of July 1, 2013, Vivo (the Company since July 1, 2013) became accountable for the financing agreements which belonged to former Vivo Part., whose balance amounted to R\$23,234 as of December 31, 2013 (R\$26,825 at December 31, 2012).
- In November 2010 and in March 2011, BNDES approved credit facilities amounting to R\$ 41,95 for CaTV and Sul Paraná (which were merged into TST as of July 1, 2013 and subsequently merged into the Company). On December 28, 2012, a R\$9,493 financing line was approved by BNDES, repayable within 36 months, with six-month grace period for principal, fully released as the investments made are proved. Through December 31, 2013, R\$ 51,443 (R\$ 41,950 at December 31, 2012) had been released. These transactions also fall within the scope of IAS 20/CPC 7 because the interest rate is lower than the observable market rates (fixed interest rates varying from 2.5% to 5.5% p.a.), and government grants by BNDES, adjusted to present value, resulted – as of December 31, 2013 – in the amount of R\$1,858 (R\$2,404 at December 31, 2012).
- In December 2010, BNDES, through its Investment Maintenance Program (BNDES PSI), approved a R\$5,417 financing facility for the Company. At December 31, 2013, this balance amounted to R\$1,720 (R\$1,946 at December 31, 2012). This transaction also falls within the scope of IAS 20/CPC 7 because its interest rate is lower than the observable market rate (fixed interest rate of 5.5% p.a.), and the BNDES grant, adjusted to present value, resulted – as of December 31, 2013 – in the amount of R\$287 (R\$331 at December 31, 2012).

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On December 28, 2012, R\$21,783 and R\$331,698 financing facilities were approved for the Company and Vivo (which was merged into the Company as of July 1, 2013), respectively, by BNDES, at the rate of 2.5% p.a., for 60 months, with

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a 24-month grace period for principal, and released as the investments made are proved. Through December 31, 2013, R\$18,184 had been released.

- On August 1, 2013, financing facilities totaling R\$4,030 were approved for the Company by BNDES, at annual interest rate of 3.5%, for 60 months, with a 24-month grace period for principal, and released as the investments made are proved. Through December 31, 2013, R\$4,030 had been released.

Médiocrédito

Loan taken out in 1993 by Telecomunicações Brasileiras S.A. (Telebrás) from Instituto Centrale per il Credito a Médio Termine (Mediocredito Centrale) amounting to US\$45,546, with semiannual repayments and maturity by 2014. This loan was taken in order to build rural telephony via satellite in the state of Mato Grosso. A derivative was taken out to hedge the Company against currency risks related to this debt and, as it is an effective hedge, the hedge accounting methodology was adopted. Therefore, at December 31, 2013, the risk hedged by this instrument was recognized at fair value as of the balance sheet date.

European Investment Bank (BEI)

Vivo (which was merged into the Company as of July 1, 2013) took out a €250 million (equivalent to U\$365 million) financing from BEI. Funds were released in two installments, the first one on December 19, 2007 and the second on February 28, 2008. The agreement will be effective for seven years, with principal amount repayment in two installments, namely, on December 19, 2014 and on March 2, 2015. Interest is collected on a semiannual basis, according to each release date. This financing includes a swap agreement that converts currency risk into a percentage of CDI variation.

Banco do Nordeste (BNB)

- On January 29, 2007, a credit facility amounting to R\$ 247,240 was taken out with BNB. Funds borrowed were used to expand coverage and increase mobile network capacity in the Northeastern region of Brazil. This agreement will be effective for ten years, with principal to be repaid in 96 installments, after a two-year grace period.
- On October 30, 2008, a credit facility amounting to R\$ 389,000 was taken out with BNB. Funds borrowed were used to expand coverage and increase mobile network capacity in the Northeastern region of Brazil. This agreement will be effective for ten years, with principal to be repaid in 96 installments, after a two-year grace period.

Finance lease

Finance leases, whereby all risks and rewards of ownership of the leased item are substantially transferred to the Company, are capitalized at the inception of the lease at fair value of the leased asset or, if lower, the present value of minimum lease payments. Initial direct costs incurred in the transaction are added to cost, where applicable.

The Company has entered into agreements classified as finance lease as a lessee, for: i) lease of towers and rooftops, deriving from a sale and finance leaseback transaction; ii) lease of IT equipment; and iii) lease of infrastructure and transmission media deriving from construction projects in conjunction with another operator, based on optical network associated to the power transmission grid, connecting cities in the Northern region of Brazil to the domestic backbone of the Company. The residual value of referred assets remained unaltered through sale thereof and a liability corresponding to the present value of the mandatory minimum payments under said agreements was recognized.

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The amounts recorded in property, plant and equipment are depreciated over the shorter of the estimated useful life of the assets or the lease term.

The consolidated balance of amounts payable referring to aforementioned transactions comprises the following effects:

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|---|-----------|------------------------|------------------------|
| Present value of payables | 646,159 | 51,025 | 23,920 |
| Unrealized financial expenses | (427,281) | (17,766) | (2,853) |
| Present value of minimum payments payable | 218,878 | 33,259 | 21,067 |
| Current | 19,342 | 14,799 | 11,669 |
| Noncurrent | 199,536 | 18,460 | 9,398 |

Consolidated aging list of finance lease on December 31, 2013 is as follows:

| | Gross investment | Present value |
|------------------------|---------------------|---------------|
| Up to one year | 23,254 | 19,342 |
| From one to five years | 93,434 | 66,143 |
| More than five years | 529,471 | 133,393 |
| Total | 646,159 | 218,878 |

There are no unsecured residual values resulting in benefits to the lessor or contingent payments recognized as revenue for the year ended December 31, 2013.

18.2 Debentures

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| | Currency | Charges | Maturity | 12.31.13 | 12.31.12 - Restated | 01.01.12 Restated |
|---|----------|--------------------------|----------|-----------|------------------------|----------------------|
| Debentures (4th issue) – 1st and 2nd series | R\$ | 106.00% to 106.8% of CDI | 10/15/15 | 748,233 | 744,678 | 346,470 |
| Debentures (4th issue) – 3rd series | R\$ | IPCA+7.00% | 10/15/14 | 95,351 | 96,249 | 756,617 |
| Debentures (1st issue) – Telemig | R\$ | IPCA+0.50% | 07/05/21 | 76,722 | 72,137 | 87,390 |
| Debentures (3rd issue) | R\$ | 100.00% of CDI + 0.75% | 09/10/17 | 2,060,444 | 2,044,674 | 67,935 |
| Debentures (4th issue) | R\$ | 100.00% of CDI + 0.68% | 04/25/18 | 1,322,900 | - | - |
| Issue cost | R\$ | | | (2,035) | (1,833) | (1,981) |
| Total | | | | 4,301,615 | 2,955,905 | 1,256,431 |
| Current | | | | 286,929 | 702,215 | 468,624 |
| Noncurrent | | | | 4,014,686 | 2,253,690 | 787,807 |

Funds raised by Vivo Part. (which was merged into the Company as of October 1, 2011) – 4th Issue

On September 4, 2009, the Board of Directors of Vivo Part. approved the 4th public issue by that company of junior unsecured registered nonconvertible debentures, maturing over a ten-year period.

Total issue amounted to R\$810 million, basic offering of which corresponded to R\$600 million, plus R\$210 million due to full exercise of the additional debentures option.

Total 810,000 (eight hundred ten thousand) debentures were issued in three series: 98,000 debentures in the 1st series, 640,000 in the second series and 72,000 in the third series. The number of debentures allocated to each series was mutually agreed between Vivo Part. and the lead coordinator of the offer after completion of the book-building procedure.

Remuneration of the 1st series was 108.00% of CDI, of the 2nd series was 112.00% of CDI, and of the 3rd series was a coupon of 7.00% p.a. on face value restated based on Brazil's Extended Consumer Price Index (IPCA) variation. These debentures accrue interest payable on a semiannual basis for the 1st and 2nd series and on an annual basis for the 3rd series.

The proceeds from this offering were used to fully pay the principal of the debt referring to the 6th issue of commercial promissory notes of Vivo Part. and to support its working capital.

Transaction costs in connection with this issue, amounting to R\$55 as of December 31, 2013 (R\$ 840 as of December 31, 2012), were allocated to a contra-liabilities account as deferred cost and are recognized as financial expenses, under the contractual terms of this issue. The effective rate of this issue, considering transaction costs, is 112.13% of CDI.

Debenture holders, in a meeting held on July 29, 2011 (first call), resolved to approve the transfer of 4th Public Distribution debentures issued by Vivo Part. to Telefonica Brasil with no changes to the original terms and conditions, and corresponding amendment to the Indenture so as to reflect the change of title thereto.

On July 24, 2012, the Company's Board of Directors approved a proposal to reschedule the 1st series of 4th issue, amounting to R\$98 million at 106.00% of CDI.

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On October 15, 2012, the Company reset the terms for the 1st series of the 4th debenture issue as approved by the Board of Directors in a meeting held on July 24, 2012. The total amount reset was R\$93,150 and the Company redeemed debentures held by dissenting debenture holders in the amount of R\$4,850, and kept them in treasury for later cancellation.

On October 15, 2013, the Company reset all terms for the 2nd series of the 4th debenture issue as approved by the Board of Directors in a meeting held on September 19, 2013. The total amount reset was R\$640 million at 106.80% CDI, and a new term was scheduled, namely, October 15, 2015.

The reset of the terms and conditions for the 3rd series is scheduled for October 15, 2014.

At December 31, 2013, the total balance was R\$843,584 (R\$840,927 at December 31, 2012).

Fund raised by Telemig Celular S.A.(Telemig, company merged into Vivo Part. as of June 1, 2010) – 1st Issue

Abiding by the SMP Service Agreement, in compliance with Public Selection No. 001/07, the state of Minas Gerais, through the State Department for Economic Development, has undertaken to subscribe debentures issued by Telemig, within the scope of the “Minas Comunica” Program, using proceeds from the Fund for Universal Access to Telecommunications Services (Fundo de Universalização do Acesso a Serviços de Telecomunicações) – FUNDOMIC. Under the terms of this program, Telemig would make SMP services available to 134 locations in the areas registered under Nos. 34, 35 and 38.

Also under the program, 5,550 junior unsecured registered nonconvertible debentures, with no stock certificates issued, would be issued in up to five series.

In consideration for the certification by the State Department of Economic Development of the service to be provided to 15 locations, 621 debentures were issued in the 1st series of the 1st issue, amounting to R\$ 6,210 in December 2007. In March 2008, for the service in 42 locations, 1,739 debentures were issued in the 2nd series of the 1st issue, amounting to R\$ 17,390. At December 31, 2008, for the service in 77 locations, 3,190 debentures were issued in the 3rd series of the 1st issue, amounting to R\$ 31,900, thus completing the program to provide services to 134 locations in the state of Minas Gerais.

At December 31, 2013, this balance was R\$76,722 (R\$72,137 at December 31, 2012).

Fund raised by the Company – 3rd Issue

On July 24, 2012, the Company’s Board of Directors approved a proposal to raise funds from local financial market through issue of junior nonconvertible debentures of the Company, amounting up to R\$2 billion, with a maximum seven-year term and firm underwriting.

On September 10, 2012, total 200,000 (two hundred thousand) junior unsecured registered nonconvertible debentures were issued in a single series, with par value of R\$10,000.00 (ten thousand reais), totaling R\$2 billion, under the terms of CVM Rule No. 476, of January 16, 2009, for public distribution with limited placement efforts.

Remuneration is 100.00% of CDI, plus a spread of 0.75% p.a., based on 252 working days. These debentures yield interest with semiannual payments, with interest accrual period of five years, maturing on September 10, 2017. The

par value of the debentures will be fully repaid in a lump sum, at maturity date.

Debentures are not subject to scheduled reset.

Funds obtained through this limited offering were allocated to: (i) direct investments in 4G wireless telephony services, more specifically to settle the price of the authorization obtained by Vivo in the 4G auction; and (ii) sustaining liquidity and rescheduling of other debts already assumed by the Company.

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Transaction costs in connection with this issue, amounting to R\$ 780 as of December 31, 2013 (R\$ 993 as of December 31, 2012), were allocated to a contra-liabilities account as deferred cost and are recognized as financial expenses, under the contractual terms of this issue.

At December 31, 2013, the total balance was R\$2,060,444 (R\$2,044,674 at December 31, 2012).

Fund raised by the Company – 4th Issue

On April 11, 2013, Company Board of Directors approved a proposal to raise funds in the local market by issuing junior nonconvertible debentures in the amount of R\$ 1.3 billion, so as to maintain the Company's liquidity to honor its future financial commitments.

The net proceeds from this issue will be fully used in amortizing future debts, in capital expenditures for the projects developed and in improving the Company's financial liquidity.

Total 130,000 debentures were issued (one hundred and thirty thousand), with par value of R\$10,000.00 (ten thousand reais). The debentures have a five-year (5) maturity as from their issue date, April 25, 2013, thereby maturing at April 25, 2018. The par value of debentures will not be monetarily restated. The balance due of debentures par value will be subject to interest corresponding to 100% (one hundred percent) of the one-day extra-group accumulated variation of average daily rates of interbank deposits (DI), expressed as an yearly percentage, based on 252 (two hundred and fifty-two) working days, calculated and published daily by CETIP S.A. – Organized Markets (CETIP), plus spread of 0.68% (sixty-eight hundredths percent) p.a., based on 252 (two hundred and fifty-two) working days (Remuneration). The Remuneration shall be calculated exponentially and cumulatively on a pro-rata temporis by working days elapsed since the issue date or the remuneration payment date immediately before that, as the case may be, until the effective payment date. Banco Itaú BBA S.A. was the lead coordinator. The transaction costs associated amounted R\$ 1,200 at December 31, 2013.

As of December 31, 2013 the total amount was R\$ 1.322.900.

18.3 Payment Schedule

At December 31, 2013, breakdown of noncurrent loans, financing, finance lease and debentures by year of maturity is as follows:

| | |
|--------------|-----------|
| Year | |
| 2015 | 1,959,575 |
| 2016 | 515,158 |
| 2017 | 2,472,089 |
| 2018 | 1,807,763 |
| 2019 | 328,615 |
| 2020 onwards | 146,642 |
| Total | 7,229,842 |

18.4 Covenants

The Company has loans and financing taken out from BNDES, the balance of which as of December 31, 2013 was R\$2,943,462 (R\$ 3,360,866 as of December 31, 2012). In accordance with the agreements, there are financial and economic ratios that should be considered on a semiannual an annual basis. At this same date, all economic and financial ratios provided for under the agreements in effect were met.

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Fourth issue debentures, series 1, 2 and 3, net of issue costs, as of December 31, 2013 amounted to R\$843,530 (R\$840,087 as of December 31, 2012) and have economic and financial ratios that should be calculated on a quarterly basis. At this same date, all economic and financial ratios provided for under the agreements were met.

Third issue debentures, single series, the net balance of the costs of issuance on December 31, 2013 was R\$ 2,059,664 (R\$ 2,043,681 at December 31, 2012), have economic and financial indices that must be determined quarterly. On the same date, all economic and financial indices referred were achieved.

Fourth issue debentures, single series, the net balance of the costs of issuance on December 31, 2013 was R\$ 1,321,700, have economic and financial ratios to be calculated quarterly. On the same date, all economic and financial indices referred were achieved.

Telemig's (company merged into Vivo Part. as of June 1, 2010) agreement with the State Department of Economic Development referring to debentures – amounting to R\$ 76,722 as of December 31, 2013 (R\$ 72,137 at December 31, 2012) – includes covenants as for in-court and out-of-court reorganization, liquidation, spin-off, insolvency, voluntary bankruptcy or bankruptcy, lack of payment, noncompliance with non-fiduciary commitments and compliance with certain financial ratios. On the same date, all these covenants were met.

Loans, financing and debentures of the notes presented in Tables 18.1 and 18.2, respectively, have with specific provisions for penalty in case of breach of contract. A breach of contract provided for in the agreements made with the institutions listed above is characterized by noncompliance with covenants, breach of a clause, resulting in the early settlement of the contract.

18.5 Guarantees

At December 31, 2013, guarantees were given for part of loans and financing of the Company, as under:

| Banks | Loans/financing balance | Guarantees |
|------------------------------------|-------------------------|--|
| Brazilian Development Bank (BNDES) | R\$1,858,247 (URTJLP) | <ul style="list-style-type: none"> · Agreement (2007) R\$205,756: Guarantee in receivables referring to 15% of the higher of debt balance or 4 (four) times the highest installment. |
| | R\$505,525 (UMBND) | <ul style="list-style-type: none"> · Agreement (PSI) R\$171,683: disposal of financed asset items. |
| | R\$171,683 (PSI) | <ul style="list-style-type: none"> · Agreement (2011) R\$2,158,016: Guarantee in receivables referring to 15% of the higher of debt balance or 4 (four) times the highest installment. |
| European Investment Bank (BEI) | R\$885,176 | <ul style="list-style-type: none"> · Commercial risk guaranteed by Banco BBVA Spain. · Bank guarantee provided by Banco Bradesco S.A. amounting to approximately 100% of the financing obtained. |

Banco do Nordeste
do Brasil S.A.
(BNB) R\$224,958

· Establishing a liquid fund comprising short-term investments at amounts equivalent to 3 (three) repayment installments by reference to the average post-grace period installment.

18.6 – Changes

Changes in loans and financing, debentures and finance lease are as follows:

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| | Loans and financing | Debentures | Finance lease |
|---|------------------------|------------|---------------|
| Balance at January 1, 2012 | 4,947,528 | 1,256,431 | 21,067 |
| Inflows | 815,825 | 2,000,000 | 21,227 |
| Financial charges | 417,246 | 134,332 | 9,305 |
| Monetary and exchange adjustments | 105,617 | 8,313 | - |
| Write-offs (payments) | (1,274,892) | (443,171) | (18,340) |
| Balance at December 31, 2012 | 5,011,324 | 2,955,905 | 33,259 |
| Inflows | 289,134 | 1,940,000 | 204,821 |
| Financial charges | 279,734 | 318,571 | (1,770) |
| Monetary and foreign exchange adjustments | 195,311 | 9,097 | - |
| Write-offs (payments) | (1,542,441) | (921,958) | (17,432) |
| Merger/split as of July 1, 2013 | - | - | - |
| Balance at December 31, 2013 | 4,233,062 | 4,301,615 | 218,878 |

19. Dividends and interest on shareholders' equity (IOE)

Dividend and interest on shareholders' equity receivable and payable are as follows.

a) Breakdown of receivables:

| | 12.31.13 | 12.31.12 - Restated | 01.01.12 - Restated |
|----------|----------|------------------------|------------------------|
| Vivo | - | - | - |
| AIX | - | - | 772 |
| Aliança | 1,140 | 1,140 | - |
| TData | - | - | - |
| ATelecom | - | - | - |
| Total | 1,140 | 1,140 | 772 |

b) Changes in receivables:

| | |
|--|-------|
| Balance at January 01, 2012 | - |
| 2011 supplementary dividends | - |
| Dividend and IOE (net of Withholding tax over the Interest on Own Capital) | 1,140 |
| Dividend and IOE received | - |
| Balance at December 31, 2012 - Restated | 1,140 |

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| | |
|---|-------|
| 2012 supplementary dividends | - |
| 2013 interim dividend and IOE (net of Withholding tax over the Interest on Own Capital) | - |
| Dividend and IOE received | - |
| Merger/split as of July 1, 2013 | - |
| Balance at December 31, 2013 | 1,140 |

For the cash flow statement, interest on shareholders' equity and dividends received from the subsidiary are allocated to the Investing Activity group.

c) Breakdown of payables:

| | 12.31.13 | 12.31.12 Restated | 01.01.12 - Restated |
|---|-----------|----------------------|------------------------|
| Telefónica Internacional | 192,990 | - | 156,589 |
| SP Telecomunicações Participações | 121,135 | - | 126,283 |
| Telefónica | 159,590 | - | 129,489 |
| Compañía de Telecomunicaciones de Chile | 382 | - | 310 |
| Noncontrolling interests | 713,459 | 467,831 | 560,315 |
| Total | 1,187,556 | 467,831 | 972,986 |

d)

Changes in payables:

| | |
|--|-------------|
| Balance at January 01, 2012 | 972,986 |
| 2011 supplementary dividends | 1,953,029 |
| Interim dividend | 1,122,522 |
| Unclaimed dividend and IOE | (89,692) |
| Dividend and IOE paid | (3,493,997) |
| Other changes | 2,983 |
| Balance at December 31, 2012 | 467,831 |
| 2012 supplementary dividends | 3,148,769 |
| Interim dividend and IOE (net of Withholding tax over the Interest on Own Capital) | 2,223,300 |
| Unclaimed dividend and IOE | (116,825) |
| Dividend and IOE paid | (4,535,519) |
| Balance at December 31, 2013 | 1,187,556 |

Interest on shareholders' equity and dividends not claimed by shareholders expire within three years from the date payment commences. Should dividends and interest on shareholders' equity expire, these amounts are recorded against equity for subsequent distribution.

For the cash flow statement, interest on shareholders' equity and dividends paid to shareholders is recognized in the Financing Activity group.

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| 20. | Provisions | | | | | |
|------------------------------|------------------------------|-----------|----------------------|--------------------------------|-----------------------------------|------------|
| | a) Breakdown/Changes: | | | | | |
| | Provisions for contingencies | | | Contingent liability (PPA) (a) | Provision for decommissioning (b) | Total |
| | Labor | Tax | Civil and regulatory | | | |
| Balance at January 1, 2012 | 526,210 | 1,606,571 | 664,703 | 256,044 | 200,813 | 3,254,341 |
| Inflows | 238,830 | 230,984 | 244,595 | 766 | 21,484 | 736,659 |
| Write-offs due to payment | (37,946) | (1,665) | (109,356) | - | - | (148,967) |
| Write-offs due to reversal | (28,383) | (7,815) | (67,843) | - | (7,853) | (111,894) |
| Monetary restatement | 18,536 | 123,975 | 63,195 | 7,710 | 6,872 | 220,288 |
| Balance at December 31, 2012 | | | | | | |
| - Restated | 717,247 | 1,952,050 | 795,294 | 264,520 | 221,316 | 3,950,427 |
| Inflows | 401,908 | 198,478 | 296,175 | - | 31,404 | 927,965 |
| Write-offs due to payment | (77,137) | (97,177) | (102,948) | - | - | (277,262) |
| Write-offs due to reversal | (86,959) | (43,207) | (99,496) | (6,127) | (11,967) | (247,756) |
| Monetary restatement | 33,121 | 138,656 | 81,378 | 17,284 | - | 270,439 |
| Balance at December 31, 2013 | 988,180 | 2,148,800 | 970,403 | 275,677 | 240,753 | 4,623,813 |
| Current | 92,712 | - | 468,691 | - | - | 561,403 |
| Noncurrent | 895,468 | 2,148,800 | 501,712 | 275,677 | 240,753 | 4,062,410 |

(a) Refers to contingent liabilities arising from PPA generated in acquisition of the controlling interest of Vivo Part. in 2011.

(b) Refer to costs to be incurred to return the sites (locations for installation of base radio, equipment and real estate) to their respective owners in the same conditions as they were at the time of execution of the initial lease agreement.

The Company, as an entity and also as successor to the merged companies, and its subsidiaries are a party in labor, tax and civil claims filed in different courts. The management of the Company and its subsidiaries, based on the opinion of its legal counsel, recognized provisions for those cases in which an unfavorable outcome is considered probable.

20.1 Provisions and labor contingencies

| Nature/Degree of risk | 12.31.13 | 12.31.12 Restated | 01.01.12 - Restated |
|------------------------|----------|----------------------|------------------------|
| Probable provisions | 988,180 | 717,247 | 526,210 |
| Possible contingencies | 313,536 | 274,156 | 404,262 |

Provisions and labor contingencies involve labor claims filed by former employees and employees at outsourced companies (the later alleging joint or subsidiary liability) claiming for, among other issues, overtime, salary equalization, post-retirement salary supplements, job hazard premium, additional for unhealthy work conditions and claims related to outsourced services.

The Company is also defendant in labor claims filed by retired former employees regarding the Medical Care Plan for Retired Employees (PAMA), which require, among other issues, the annulment of the change occurred in such

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plan. The claims await decision by the Regional Labor Court of São Paulo. Based on the opinion of its legal advisors and the current jurisdictional benefits, management considers this claim as a possible risk. No amount has been allocated for these claims, since in the case of loss, it is not possible to estimate the corresponding amount payable by the Company.

Additionally, the Company is party to public civil actions filed by the Department of Labor, in respect to the decision to restrain the Company from continuing to hire outsourced companies to carry out the Company's main activities. No amounts were allocated to the possible likelihood of an unfavorable outcome related to these public civil actions in the table above, since in these phases, in the event of loss, it is not possible to estimate the Company's monetary loss.

20.2 Provisions and tax contingencies

| Nature/Degree of risk | Amounts Involved | | |
|------------------------|------------------|------------------------|------------------------|
| | 12.31.13 | 12.31.12 – Restated | 01.01.12 - Restated |
| Probable provisions | 2,148,800 | 1,952,050 | 1,606,735 |
| Federal | 2,042,098 | 1,860,803 | 1,530,789 |
| State | 91,923 | 67,426 | 63,625 |
| Municipal | 14,779 | 23,821 | 12,321 |
| Possible contingencies | 16,246,407 | 13,738,155 | 11,679,158 |
| Federal | 3,913,929 | 3,146,736 | 3,185,747 |
| State | 7,088,859 | 5,870,365 | 4,172,479 |
| Municipal | 580,853 | 544,323 | 471,876 |
| Anatel | 4,662,766 | 4,176,731 | 3,849,056 |

Provisions for probable tax contingencies

Federal taxes

At December 31, 2013, the Company and subsidiary were party to administrative and judicial proceedings relating to: (i) additional contributions to the FGTS on deposits made by employees (the issue does not result in the reduction of part of FGTS deposits made by the Company on behalf of its employees); (ii) claims resulting from the non-ratification of compensation and refund requests, formulated by the Company; (iii) social contributions relating to a supposed failure to pay 11% on the value of invoices, billing and receipts from service providers hired for the transfer of labor; (iv) CIDE levied on the remittance of funds abroad relating to technical services, administrative assistance and to services of similar nature, as well as royalties; (v) fixed: non-inclusion of interconnection and EILD expenses in the FUST base and Wireless carriers: non-inclusion of revenues from interconnection in the FUST tax base; (vi) contribution to Empresa Brasileira de Comunicação, created by Law No. 11,652/08; (vii) TFI/TFF on mobile stations; (viii) IRRF on Interest on shareholders' Equity; (ix) Price for Numbering Resources Management (PPNUM) by ANATEL instituted by Resolution No. 451/06; (x) IRPJ/PIS/COFINS resulting from the non-ratification of offset and refund requests made by the Company and its subsidiaries; (xi) Social Investment Fund (Finsocial) offset amounts; (xii) failure to pay withholding social contribution levied on services rendered, remuneration, salaries and

other salary bases; (xiii) COFINS – Requirement resulting from non-inclusion of financial income

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into the tax base; (xiv) additional charges to the PIS and COFINS tax base, as well as additional charges to COFINS required by Law No. 9,718/98; and (xv) Tax on Net Income (ILL)

At December 31, 2013, total consolidated provisions amounted to R\$ 2,042,098 (R\$ 1,860,803 at December 31, 2012).

State taxes

At December 31, 2013, the Company or its subsidiary were parties to administrative and judicial proceedings in progress referring to (i) ICMS tax credits on electric power and tax credits without documentation (ii) ICMS not levied on telecommunication services; (iii) disallowance of ICMS tax incentives for cultural projects; (iv) ICMS on TV subscription; and (v) environmental administrative fine.

At December 31, 2013, total consolidated provisions amounted to R\$ 91,923 (R\$ 67,426 at December 31, 2012).

Municipal taxes

At December 31, 2013, the Company and its subsidiary were parties to tax claims at a municipal level, in the judicial sphere which, based on the opinion of its legal advisors, are classified as a probable loss.

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

At December 31, 2013, total consolidated provisions amounted to R\$ 14,779 (R\$ 23,821 at December 31, 2012).

Possible Tax contingencies

Federal taxes

At December 31, 2013, the Company and its subsidiary were parties to various administrative and judicial proceedings, at the federal level, which are ongoing in various court levels.

Key proceedings refer to: (i) protest letters due to non-ratification of compensation requests made by the Company; (ii) fine for distribution of dividends even in view of the alleged existence of outstanding debts payable to the federal government; (iii) social security contribution (INSS) on compensation payment for salary devaluation arising from losses caused by “Plano Verão” (Summer Plan) and “Plano Bresser” (Bresser Plan), SAT (Occupational Accident Insurance), Social Security and payables to third parties (INCRA and SEBRAE), supply of meals to employees, 11% retention (labor assignment); (iv) IRRF on the funds remittance abroad related to technical services and to administrative support and similar services, as well as royalties; (v) PIS levied on roaming; (vi) CPMF levied on operations resulting from the technical cooperation agreement with the National Treasury Department (STN) (offsetting through the Integrated System of Federal Government Financial Administration - SIAFI) and on foreign-exchange contracts required by the Brazilian Central Bank; (vii) IRPJ and CSLL related to deductions on revenues from reversal of provisions; (viii) IRPJ and CSLL - disallowance of costs and sundry expenses not evidenced; (ix) deductions of COFINS from loss in swap transactions; (x) PIS / COFINS accrual basis versus cash basis; (xi) IRPJ payable in connection with allocation of excess funds to Northeast Investment Fund (FINOR), Amazon Region Investment Fund (FINAM) or Economic Recovery Fund of Espírito Santo State (FUNRES); (xii) IRPJ on derivative operations; (xiii) IRPJ and CSLL – disallowance of expenses related to the goodwill paid in the acquisition of Celular CRT S.A., goodwill arising from the privatization process and corporate restructuring of Vivo

(merged into the Company on July 1, 2013) and goodwill arising from merger of Navytree and TDBH; and (xiv) contribution to Empresa Brasileira de Comunicação, created by Law No. 11,652/08.

According to Management and the Company's legal advisors, the likelihood of loss in these proceedings is possible.

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At December 31, 2013, the total consolidated amount involved is R\$ 3,913,929 (R\$ 3,146,736 at December 31, 2012).

State taxes

At December 31, 2013, the Company and its subsidiary were parties to various administrative and judicial proceedings related to ICMS, at the state level, which are ongoing in various court levels.

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

According to Management and the Company’s legal advisors, the likelihood of loss in these proceedings is possible.

At December 31, 2013, the total consolidated amount involved is R\$ 7,088,859 (R\$ 5,870,365 at December 31, 2012).

Municipal taxes

At December 31, 2013, the Company and its subsidiary were parties to various administrative and judicial proceedings, at the municipal level, which are ongoing in various court levels.

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

According to Management and the Company’s legal advisors, the likelihood of loss in these proceedings is possible.

At December 31, 2013, the total consolidated amount involved is R\$ 580,853 (R\$ 544,323 at December 31, 2012).

ANATEL

Universal Telecommunication Services Fund (FUST)

Injunction petitioned separately by landline and wireless carriers for acknowledgement of their right to: Landline phone carriers: non-inclusion of interconnection and EILD expenses in the FUST base and Wireless carriers: non-inclusion of interconnection revenue in the FUST base, pursuant to Abridgement No. 7, of December 15, 2005, since

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it disagrees with the provisions of the sole paragraph, article 6, of Law No. 9998/00, which are waiting to be tried in the court of appeals.

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

According to Management and the Company's legal advisors, the likelihood of loss in these proceedings is possible.

At December 31, 2013, the total consolidated amount involved is R\$ 2,185,034 (R\$ 1,970,800 at December 31, 2012).

Telecommunications Technology Development Fund (FUNTTEL)

At December 31, 2013, the Company and its subsidiary were parties to administrative and judicial proceedings which are waiting to be tried at the lower administrative court and the court of appeals. Such proceedings concern the collection of contributions to FUNTTEL on other revenues (not related to telecom services), as well as on income and expenses transferred to other operators (interconnection).

According to Management and the Company's legal advisors, the likelihood of loss in these proceedings is possible.

At December 31, 2013, the total consolidated amount involved is R\$ 664,386 (R\$ 614,314 at December 31, 2012).

Telecommunications Inspection Fund (FISTEL)

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

This collection is based on ANATEL's understanding that such extension would represent a taxable event for TFI. The Company understands that such collection is unjustified, and separately challenged the aforesaid fee in court.

According to Management and the Company's legal advisors, the likelihood of loss in these proceedings is possible.

At December 31, 2013, the total consolidated amount involved is R\$ 1,811,104 (R\$ 1,589,479 at December 31, 2012), without the respective judicial deposit.

Public Price for Numbering Resource Management (PPNUM)

The Company, along with other wireless carriers in Brazil, is challenging in court the tariff charged by ANATEL for use by such carriers of the numbering resources managed by the agency. When charged by ANATEL, Vivo (merged into the Company on July 1, 2013) made a judicial deposit referring to the amounts payable. On April 23, 2009, the carriers received a favorable sentence and the lawsuit is currently waiting to be tried at the court of appeals.

According to Management and the Company's legal advisors, the likelihood of loss in these proceedings is possible.

At December 31, 2013, the total consolidated amount involved is R\$ 2,242 (R\$ 2,138 at December 31, 2012).

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20.3 Provisions, civil and regulatory contingencies

| Nature/Degree of risk | Amounts involved | | |
|------------------------|------------------|-----------|-----------|
| | 12.31.13 | 12.31.12 | 01.01.12 |
| Probable provisions | 970,403 | 795,294 | 664,703 |
| Civil | 599,868 | 487,620 | 422,890 |
| Regulatory | 370,535 | 307,674 | 241,813 |
| Possible contingencies | 3,366,707 | 2,656,850 | 1,978,973 |
| Civil | 1,681,450 | 1,491,862 | 1,118,372 |
| Regulatory | 1,685,257 | 1,164,988 | 860,601 |

Provisions for probable civil contingencies

- The Company is party to proceedings that involve right to receive supplementary amounts from shares calculated in relation to the network expansion plan after 1996 (supplement of shares proceedings). These proceedings involve various phases: 1st level, Court of Justice and Supreme Court of Justice. At December 31, 2013, considering the degree of risk involved, consolidated provision amounted to R\$ 37,191 (R\$ 31,260 at December 31, 2012).
- The Company is party to proceedings of a civil nature, in the administrative and judicial spheres, the subject of which are rights relating to the provision of services. These proceedings are filed by individual consumers, civil associations representing consumer rights, PROCON, as well as the State and Federal Public Prosecutor's Offices. Similarly, the Company is defendant or plaintiff in other proceedings the subject of which relates to matters other than those under the normal course of business. At December 31, 2013, total consolidated provisions amounted to R\$ 469,149 (R\$ 377,649 at December 31, 2012).
- The Company is also involved in various lawsuits filed by individual consumers, with similar characteristics, which individually are not considered to be material, based on provision analysis, the historical average of losses in similar proceedings. At December 31, 2013, total consolidated provisions amounted to R\$ 93,528 (R\$ 78,711 at December 31, 2012).

Provisions for probable regulatory contingencies

At December 31, 2013, the Company was party to administrative proceedings against ANATEL, which were filed based on alleged noncompliance with obligations set forth in industry regulations, as well as in legal claims discussing sanctions by ANATEL at the administrative level. The likelihood of loss in these proceedings is probable and at December 31, 2013 provisions amounting to R\$ 370,535 (R\$ 307,674 at December 31, 2012) consolidated were set up.

Possible civil contingencies

- Community Telephone Plan – PCT: Refers to a Public Civil Action to which the Company is a party and which is related to the PCT, a plan that allows purchasers of telephone line expansion plans who did not receive shares for their financial investment to claim indemnity rights, in the municipality of Mogi das Cruzes. The total consolidated

amount involved is R\$ 281,059 (R\$ 236,236 at December 31, 2012). These proceedings were assessed as a possible loss by legal counsel. The São Paulo State Court of Justice (TJSP) has reversed the

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decision and deemed the claim groundless. The carriers association of Mogi das Cruzes (plaintiff) filed a special appeal to reverse that decision, which is currently awaiting a decision.

- Class actions filed by SISTEL Members Association (ASTEL) in São Paulo State, whereby SISTEL members in São Paulo State question the changes made in the health care plan for retired employees (PAMA), and that former conditions are restored. The claim is still at the appeal stage, pending a decision by the court of appeals, which changed the dismissal decision. The likelihood of loss in these proceedings was deemed as possible by legal counsel. The amount is not measurable and the claims are uncertain due to their unenforceability, since it would be necessary to restore the plan to its previous conditions.
- Public civil actions filed by ASTEL - SISTEL Members Association in São Paulo State and FENAPAS - National Federation of Associations of Retirees, Pensioners and Pension Funds Members of the Telecommunications Industry, both against SISTEL. The Company and other carriers seek annulment of PBS pension plan spin-off, claiming “the dismantling of SISTEL Foundation supplementary pension system”, which originated several specific PBS-mirrors plans, and respective allocation of resources deriving from technical surplus and tax contingencies at the time of the spin-off. The likelihood of loss in these proceedings was deemed as possible by legal counsel. The amount is not measurable and the claims are uncertain due to their unenforceability, since it would be necessary to restore SISTEL's spun-off fund related to carriers of the former Telebrás System.
- The Public Prosecutor's Office of São Paulo State began a public class action claiming moral and property damages suffered by all consumers of telecommunications services from 2004 to 2009 due to the bad quality of services and failures of the communications system. The Public Prosecutor's Office suggested that the indemnification to be paid should be R\$ 1 billion. The decision handed down on April 20, 2010 imposes the payment of indemnification for damages caused to all consumers who have filed a suit for such damages.

Conversely, in the event that the number of claiming consumers is not in line with the gravity of damages, after the lapsing of one year, the judge determined that the amount of R\$ 60 million should be deposited in the Special Expenses Fund to Recover Natural Rights Damages (“Fundo Especial de Despesa de Reparação de Interesses Difusos Lesados”). It is not possible to estimate the number of consumers who will individually file suits nor the amounts claimed thereby. The parties filed an appeal on the merits of the case. The judgment effects are in abeyance. No amount has been assigned to the possible likelihood of an unfavorable outcome in connection with this action, since, in the case of loss, estimating the corresponding amount payable by the Company is not practicable at this time. Likewise, establishing a provision for contingency equivalent to the amount sought is not possible.

- The Company is involved in other civil claims, at several levels, related to service rendering. Such claims have been filed by individual consumers, civil associations representing consumer rights or by the Bureau of Consumer Protection (PROCON), as well as by the Federal and State Public Prosecutor's Office. It is also involved in other claims of several types related to the normal course of business. Total contingency amounts to R\$ 1,383,932 (R\$ 1,236,312 at December 31, 2012), whose likelihood of an unfavorable outcome has been assessed by their legal advisors as possible.
- The Company has received fines regarding the noncompliance with SAC Decree. We currently have various actions (administrative and judicial proceedings), whose likelihood of an unfavorable outcome has been assessed by legal advisors as possible, amounting to at December 31, 2013 R\$ 16,459 (R\$ 19,314 at December 31, 2012).
- Intellectual Property: Lune Projetos Especiais Telecomunicação Comércio e Ind. Ltda (Lune), a Brazilian company, proposed the lawsuit on November 20, 2001 against 23 wireless carriers claiming to own the patent for caller ID and the trademark "Bina". The purpose of that lawsuit is to interrupt provision of such service by carriers and to

seek indemnification equivalent to the amount paid by consumers for using the service.

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An unfavorable sentence was passed determining that Vivo (merged into the Company on July 1, 2013) should refrain from selling mobile phones with Caller ID service (Bina), subject to a daily fine of R\$ 10,000 in case of noncompliance. Furthermore, according to the sentence passed, Vivo (merged into the Company on July 1, 2013) must pay indemnification for royalties to be calculated in settlement. Motions for Clarification were opposed by all parties and Lune's motions for clarification were accepted since an injunctive relief in this stage of the proceedings was deemed applicable. Bill of review appeal in view of the current decision which granted a stay of execution suspending unfavorable decision until final judgment of the review. Bill of review for appeal at sentence phase pending decision. The likelihood of an unfavorable outcome has been assessed by legal advisors as possible. There is no way to determine the extent of potential liabilities with respect to this claim.

- Validity of prepaid plan: Vivo (merged into the Company on July 1, 2013) and other wireless carriers are defendants in several lawsuits filed by the Public Prosecutor's Office and consumer associations to challenge imposition of a period to use prepaid minutes. The plaintiffs allege that the prepaid minutes should not expire after a specific period. Conflicting decisions were handed down by courts on the matter. Although we believe that our criteria for the period determination comply with ANATEL standards, the likelihood of an unfavorable outcome has been assessed by legal advisors as possible, except for collective actions against Telemig, for which the probability of an unfavorable outcome in relation to this claim is deemed remote, also based on the opinion of our legal advisors.

Possible regulatory contingencies

- The Company is party to administrative proceedings filed by ANATEL alleging noncompliance with the obligations set forth in industry regulations, as well as legal claims which discuss the sanctions applied by ANATEL at the administrative level, rating the likelihood of loss as possible, at December 31, 2013 amounting to R\$ 1,685,257 – consolidated (R\$ 1,164,988 at December 31, 2012).
- Administrative proceedings discussing payment of 2% charge on revenue from interconnection services due to the extension of right of use of SMP-related radiofrequencies. Under clause 1.7 of the Authorization Terms that grant right of use of SMP-related radiofrequencies, the extension of right of use of such frequencies entails payment every two years, during the extension period (15 years), of a 2% charge calculated on net revenue from the basic and alternative service plans of the service company, determined in the year before that of payment.

However, ANATEL determined that the 2% charge should be calculated on revenue from service plans and also on revenue from interconnection services, which is not provided for by clause 1.7 of the referred to Authorization Terms.

Considering, based on the provisions of the Authorization Terms, that revenue from interconnection services should not be included in the calculation of the 2% charge for radiofrequency use right extension, Vivo (merged into the Company on July 1, 2013) filed administrative proceedings challenging these charges, based on ANATEL's position.

According to the Company's legal advisors, the likelihood of loss in these proceedings is possible.

- Administrative Proceeding No. 08012.008501/2007-91: It is a proceeding filed at the level of the Brazilian System for Competition Defense (SBDC) by Global Village Telecom Ltda (GVT), Intelig Telecomunicações Ltda (Intelig), Transit do Brasil Ltda. and Easytone Telecomunicações Ltda. on August 6, 2007 against Claro S.A. (Claro), Tim Brasil Serviços e Telecomunicações S.A. (TIM), TNL SCS S.A. (Oi) and Vivo (merged into the Company on July 1, 2013) for supposed trust and price squeeze practices, with the objective of increasing VUM tariff, thus increasing the costs of competitors. Due to the proceeding filed on August 21, 2008, the Department for Economic Right

(SDE) started an administrative proceeding against the defendants in order to evaluate whether the practices adopted would fit into (i) items I, III and IV, article 20 and items V, article 21 and (ii) items I, III and IV, article 20 and items I and V, all of Law No. 8,884/94, to wit trust and price squeeze.

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On March 25, 2010, SDE issued a technical note whereby: (i) it dismissed the accusation of trust against all the defendants, recommending the shelving of such charge, (ii) suggested excluding Oi from the group of defendants in the investigation of price squeeze for considering that its economic group would be responsible for paying VUM and for lack of evidence of recurrent practices of prices below VUM; and (iii) recommended condemning Vivo (merged into the Company on July 1, 2013), TIM and Claro, based on article 20, items I, III and IV, and article 21, item V, all of Law No. 8,884/94, for the increase in costs of competitors (price squeeze). On November 7, 2012, the Federal Public Prosecutor's Office issued an opinion under the same terms of SDE Note and, on March 12, 2013, the Attorney General of the Brazilian Antitrust Enforcement Agency (CADE) decided for the shelving of all charges.

On September 11, 2013, CADE, by unanimous vote, rendered inexistent the trust and price squeeze practices and shelved this proceeding.

20.4 Guarantees

At December 31, 2013, the Company and its subsidiaries granted guarantees for tax, civil and labor proceedings, as follows:

| | Property and equipment | Judicial deposits and garnishments | Guarantee letters |
|----------------------|---------------------------|--|----------------------|
| Civil, labor and tax | 187,025 | 4,352,520 | 2,263,773 |
| Total | 187,025 | 4,352,520 | 2,263,773 |

In addition to the guarantees presented above, at December 31, 2013, the Company and its subsidiaries had amounts under short-term investment frozen by the courts (except for loan-related investments), amounting to R\$ 46,451 - consolidated (R\$ 49,728 at December 31, 2012).

21. Deferred revenue

| | 12.31.13 | 12.31.12 Restated | 01.01.12 - Restated |
|------------------------------|-----------|----------------------|------------------------|
| Activation revenue (a) | 120,521 | 89,367 | 98,464 |
| Services and goods (b) | 673,810 | 596,907 | 647,629 |
| Disposal of PP&E (c) | 123,063 | 171,174 | - |
| Government grants (d) | 40,840 | 44,933 | 53,202 |
| Customer loyalty program (e) | 91,763 | 82,848 | 68,821 |
| Donation of equipment (f) | 11,076 | 16,235 | 22,638 |
| Other | 10,139 | 36,471 | 26,780 |
| Total | 1,071,212 | 1,037,935 | 917,534 |

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| | | | |
|------------|---------|---------|---------|
| Current | 817,551 | 734,573 | 761,268 |
| Noncurrent | 253,661 | 303,362 | 156,266 |

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- a) Refers to the deferral of activation revenue (fixed) recognized in income over the estimated period of duration of the customer plan.
- b) Refers to the balances of agreements of prepaid services revenue and multi-element operations, which are recognized in income to the extent that services are provided to customers.
- c) Refers to net balance of the residual value from disposal of non-strategic towers and rooftops to be transferred to income upon compliance with conditions for recognition in books.
- d) Refers to government grant deriving from funds raised with BNDES in a specific credit line (PSI Program), used in the acquisition of domestic equipment and registered at BNDES (Finame) and applied in projects to expand the network capacity, which have been amortized by the useful life of equipment.
- e) Refers to the loyalty point program maintained by the Company, which allows customers to accumulate points when paying their bills referring to use of services offered. The balance represents the Company's estimate of customers' exchanging points for goods and/or services in the future.
- f) Refers to the balances of network equipment donations from suppliers, which are amortized by the useful life of the referred to equipment.

22. Other Liabilities

| | 12.31.13 | 12.31.12 - Restated | 01.01.12- Restated |
|--|----------|------------------------|-----------------------|
| Third-party withholdings | 236,510 | 139,120 | 252,771 |
| Amounts to be refunded to subscribers | 56,746 | 45,627 | 59,265 |
| Payables to related parties | 105,164 | 57,348 | 71,452 |
| Payable for license renewal | 154,211 | 194,441 | 44,296 |
| Mutual assumptions of debt and installment | - | - | 21,587 |
| Other payables | 56,275 | 38,674 | 47,543 |
| Total | 608,906 | 475,210 | 496,914 |
| Current | 487,994 | 364,618 | 454,898 |
| Noncurrent | 120,912 | 110,592 | 42,016 |

23. Shareholders' equity

a) Capital

Paid-in capital as of December 31, 2013 and 2012 amounted to R\$ 37,798,110. Subscribed and paid-in capital is divided into shares without par value, as follows:

| Shareholders | Common shares | | Preferred shares | | Grand total | |
|-------------------------------|---------------|---------|------------------|---------|-------------|---------|
| | Number | % | Number | % | Number | % |
| Telefónica Internacional S.A. | 58,859,918 | 15.43 % | 271,707,098 | 36.52 % | 330,567,016 | 29.37 % |
| Telefónica S.A. | 97,976,194 | 25.68 % | 179,862,845 | 24.17 % | 277,839,039 | 24.68 % |

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| | | | | | | | |
|-------------------------------------|-------------|---------|------------|--------|-------------|---------|--|
| SP | | | | | | | |
| Telecomunicações Participações Ltda | 192,595,149 | 50.47 % | 29,042,853 | 3.90 % | 221,638,002 | 19.69 % | |
| Telefónica Chile S.A. | 696,110 | 0.18 % | 11,792 | 0.00 % | 707,902 | 0.06 % | |

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| | | | | | | | | | |
|---|-------------|--------|---|-------------|--------|---|---------------|--------|---|
| Total group companies | 350,127,371 | 91.76 | % | 480,624,588 | 64.60 | % | 830,751,959 | 73.81 | % |
| Other shareholders | 31,208,300 | 8.17 | % | 261,308,985 | 35.12 | % | 292,517,285 | 25.98 | % |
| Treasury stock | 251,440 | 0.07 | % | 2,081,246 | 0.28 | % | 2,332,686 | 0.21 | % |
| Total shares | 381,587,111 | 100.00 | % | 744,014,819 | 100.00 | % | 1,125,601,930 | 100.00 | % |
| Outstanding shares | 381,335,671 | | | 741,933,573 | | | 1,123,269,244 | | |
| Book value per share outstanding - R\$: | | | | | | | | | |
| At December 31, 2013 | | | | | | | 38,19 | | |
| At December 31, 2012 | | | | | | | 39,78 | | |

According to its bylaws, the Company is authorized to increase its capital up to the limit of 1,350,000,000 (one billion three hundred and fifty million) shares, common or preferred. The capital increase and consequent issue of new shares are to be approved by the Board of Directors, subject to the authorized capital limit. However, the Brazilian Corporation Law – Law No. 6,404/76, article 166, IV – establishes that capital may be increased through a Special Shareholders’ Meeting resolution held to decide about amendments to the Articles of Incorporation, if authorized capital increase limit has been reached.

Capital increases do not necessarily have to observe the proportion between the numbers of shares of each type. However, the number of preferred shares, nonvoting or with restricted voting, must not exceed 2/3 of the total shares issued.

Preferred shares are nonvoting, but have priority in the reimbursement of capital, without premium, and are entitled to dividends 10% higher than those paid on common shares, as per article 7 of the Company’s Articles of Incorporation and clause II, paragraph 1, article 17, of Law No. 6,404/76.

b. Bonus paid on acquisition of interest from non-controlling shareholders

In accordance with the accounting practices adopted in Brazil prior to the adoption of the IFRS/CPC, goodwill was recorded when shares were acquired at a higher value than their book value, generated by the difference between the book value of shares acquired and the transaction’s fair value. With the adoption of IAS 27R (IFRS 10 since 2013)/CPC 35 and 36, the effects of all acquisition of shares from non-controlling shareholders are recorded under equity when there is no change in the shareholding. Consequently, these transactions no longer generate goodwill or income, and the goodwill previously generated from acquisition from non-controlling shareholders were adjusted based on the Company’s equity. The acquisition of shares from non-controlling shareholders of Lemontree and GTR totaled R\$40,519. The balance of this account is recorded under this account. The balance of this account at December 31, 2013 and 2012 was R\$70,448.

c. Capital reserves

Special goodwill reserve

This represents the tax benefit generated by the merger of Telefonica Data do Brasil Ltda. which will be capitalized in favor of the controlling shareholders after the tax credits are realized under the terms of CVM Ruling No. 319/99. The balance of this account at December 31, 2013 and 2012 was R\$63,074.

Other capital reserves

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Other capital reserves are issue or capitalization in excess, in relation to the basic share value on the issue date.

The balance of this account at December 31, 2013 and 2012 was R\$2,735,930.

Treasury shares

These represent the Company's treasury shares arising from: i) merger of TDBH (in 2006); ii) merger of Vivo Part. shares (in 2011), and iii) repurchase of common and preferred shares. As of December 31, 2013 and December 31, 2012, balance in this account amounted to R\$ 112,107.

On November 5, 2012, the Company informed its shareholders and the market that the members of the Company's Board of Directors approved the acquisition of common and preferred shares issued by the Company, without capital reduction, for subsequent cancellation, disposal or maintenance in treasury for the purpose of increasing shareholder value. The repurchase will be made through the use of part of the existing capital reserve as of October 31, 2012, except for the reserves referred in Article 7 subsection (a) to (d) of CVM Ruling No. 10/80. This repurchase will begin from the deliberation date of the Board of Directors, remaining in force until November 4, 2013, the acquisitions being carried out on BM&FBOVESPA at market prices and is responsibility of management to decide the moment and number of shares to be acquired, whether in a single operation, whether in a series of operations, as well as to define the parameters for carrying out the repurchase, within legal limits, which may not exceed 2,894,534 common shares and 24,257,777 preferred shares.

d. Income reserve

Legal reserve

The legal reserve is set up by allocation of 5% of the net profit for the year, up to the limit of 20% of the paid-up capital stock. Legal reserve may only be used to increase capital or to offset accumulated losses. The balance of this account at December 31, 2013 was R\$1,285,797 (R\$1,100,000 at December 31, 2012).

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Tax incentive reserve

This reserve refers to the a 75% income tax reduction benefit to be applied on Profit from Tax Incentive Operations (PTIO) in the following areas: North of Minas Gerais State, Vale do Jequitinhonha and the states of Acre, Amapá, Amazonas, Maranhão, Mato Grosso, Pará, Rondônia and Roraima.

Pursuant to article 195-A of Law No. 6,404/76, the portion of profit subject to the incentive was also excluded from dividend calculation, and may be used only in the event of capital increase or loss absorption.

The balance of this account at December 31, 2013 was R\$1,699.

e. Dividends – interim and proposed

On January 10, 2013, the Company's Board of Directors approved the allocation of interim dividend amounting to R\$1,650,000, based on income recorded in the quarterly balance as of September 30, 2012, to common and preferred shareholders enrolled with the Company through the end of January 21, 2013. Payment of this interim dividend started on February 18, 2013.

On April 16, 2013, the Annual Shareholders' Meeting approved the allocation of additional dividend proposed referring to remaining balance of P&L for 2012, amounting to R\$1,498,769, as provided for in the proposal for allocation of income to common and preferred shareholders recorded by the Company up to April 16, 2013.

On August 19 and September 19, 2013, the Company's Board of Directors approved gross interim IOE allocation amounting to R\$440,000 (R\$374,000 net of withholding income tax), per allocation, to common and preferred shareholders enrolled with the Company at the end of August 30 and September 30, respectively.

On October 18, 2013, the Company Board of Directors approved the gross interim IOE allocation amounting to R\$538,000 (R\$457,300 net of withholding income tax). On that same date, the allocation of interim dividends amounting to R\$746,000 was also approved. These interim IOE and dividends were calculated based on the income recorded in balance sheet at June 30, 2013, which will be allocated to the compulsory minimum dividend for 2013. The distribution of such interest on equity and dividends will be credited to the ordinary and preferred shareholders registered in the Company's records at October 31, 2013.

On December 18, 2013, the Company Board of Directors approved, the allocation of interest on intermediate capital in the gross amount of R\$ 760,000 (R\$ 646,000 net of income tax withholding) to holders of ordinary shares and preferred shareholders registered in the Company's records at December 30, 2013

The dividends were calculated in accordance with the Company Articles of Incorporation and the Corporation Law. The table below shows the calculation of dividends and interest on equity for 2013 and 2012:

| | 2013 | 2012 |
|---|------------|------------|
| Net income for the year | 3,715,945 | 4,453,573 |
| Allocation to legal reserve | (185,797) | (222,678) |
| Total | 3,530,148 | 4,230,895 |
| (-) Tax incentives - nondistributable | (1,699) | - |
| Adjusted net income | 3,528,449 | 4,230,895 |
| Mandatory minimum dividend - 25% of adjusted net income | 882,112 | 1,057,724 |

| | | |
|--|-----------|---|
| Dividend and IOE distributed for the year (a): | | |
| Interest on equity (gross) | 1,738,000 | - |

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| | | |
|---|-----------|-----------|
| Interim dividends | 746,000 | 1,122,522 |
| Income available to be distributed | 1,044,449 | 3,108,373 |
| (+) Unclaimed IOE / dividends | 116,825 | 89,692 |
| (-) Actuarial (gains)/losses recognized and effect of limitation of surplus plan assets, net of taxes and other changes | 14,264 | (49,296) |
| Proposed additional dividend | 1,175,538 | 3,148,769 |

| Amounts per share (a) | Reais | Common | Preferred |
|--|-----------|----------|-----------|
| Interim IOE (net of IRRF), allocated in August 2013 | 187,000 | 0.156163 | 0.171779 |
| Interim IOE (net of IRRF), allocated in September 2013 | 187,000 | 0.156163 | 0.171779 |
| Interim IOE (net of IRRF), allocated in November 2013 | 457,300 | 0.381890 | 0.420079 |
| Interim IOE (net of IRRF), allocated in December 2013 | 646,000 | 0.539474 | 0.593421 |
| Interim dividend declared in October 2013 | 746,000 | 0.622983 | 0.685282 |
| Interim dividend declared in November 2012 | 1,122,522 | 0.937417 | 1.031158 |

The manner proposed by management for payment of dividends was:

For 2013: The remaining unallocated balance of net income for the year ended December 31, 2013, amounting to R\$1,044,449, plus dividends and IOE expired in 2013, amounting to R\$116,825 and other significant amounts amounting to R\$14,264, totaling R\$1,175,538, were classified as additional dividends proposed for equity and in accordance with the management proposal for allocation of income for the year, which will be submitted for approval by the Annual Shareholders Meeting.

For 2012: On April 16, 2013, the Annual Shareholders' Meeting approved the allocation of the remaining unallocated net income for the year ended December 31, 2012, amounting to R\$3,108,373, plus dividends and IOE expired in 2012, amounting to R\$89,692, and less other comprehensive income, in the amount of R\$(49,296), totaling R\$3,148,769, as provided for in the proposal for income allocation to common and preferred shareholders registered in the Company in April 16, 2013.

| | Reais | Common | Preferred (1) |
|--|-----------|----------|---------------|
| 2013 - Total proposed for deliberation – per share | 1,175,538 | 0.981691 | 1.079860 |
| 2012 - Total proposed for deliberation – per share | 3,148,769 | 2.629533 | 2.892487 |

1 10% in excess to the amount attributed to each common share, pursuant to article 7 of the Company Articles of Incorporation.

Interest on shareholders' equity

As proposed by management, IOE was paid to shareholders in 2013 pursuant to article 9 of Law No. 9249/95, net of withholding tax, as follows:

| | 2013 |
|---------------------------|-----------|
| Interest on equity, gross | 1,738,000 |
| Common shares | 553,471 |

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| | |
|-------------------------------|------------|
| Preferred shares | 1,184,529 |
| Withholding income tax (IRRF) | (260,700) |
| Interest on equity, net | 1,477,300 |

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Exempt shareholders received full IOE, free from withholding income tax.

Unclaimed dividends

The dividends and interest on equity unclaimed by shareholders expire in 3 (three) years, as from the initial payment date, pursuant to article 287, paragraph II, item “a” of Law No. 6,404, of December 15, 1976. The Company reverses the amount of unclaimed dividends upon expiration to retained earnings.

f. Other comprehensive income

Financial instruments available for sale: Refer to fair value variations of financial assets available for sale. The balance at December 31, 2013 was (R\$2,658) (R\$6,230 at December 31, 2012).

Derivative transactions: Derivative transactions refer to the effective part of cash flow hedges until the balance sheet date. The balance at December 31, 2013 was R\$6,610 (R\$10,190 at December 31, 2012).

Currency translation difference of investments abroad: Refers to currency translation differences arising from the conversion of financial statements of foreign subsidiaries. The balance at December 31, 2013 was R\$12,897 (R\$1,372 at December 31, 2012).

The breakdown of other comprehensive income for the years ended December 31, 2013 and 2012 is as follows:

| | Financial instruments available for sale | Derivative transactions | Currency translation adjustment - foreign investments | Total |
|---|---|----------------------------|---|----------|
| Balances at December 31, 2011 | 9,884 | 1,995 | (4,359) | 7,520 |
| Exchange variation | - | - | 5,731 | 5,731 |
| Futures | - | 8,195 | - | 8,195 |
| Loss on financial assets available for sale | (3,654) | - | - | (3,654) |
| Balances at December 31, 2012 | 6,230 | 10,190 | 1,372 | 17,792 |
| Exchange variation | - | - | 11,525 | 11,525 |
| Futures | - | (3,580) | - | (3,580) |
| Loss on financial assets available for sale | (8,888) | - | - | (8,888) |
| Balances at December 31, 2013 | (2,658) | 6,610 | 12,897 | 16,849 |

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24. Net operating revenue

| | 2013 | 2012 – Restated | 2011- Restated |
|--|--------------|--------------------|----------------|
| Telephony service | 26,428,677 | 26,555,103 | 24,254,154 |
| Network use | 3,820,048 | 4,453,340 | 3,785,017 |
| Data and SVA | 16,294,856 | 14,389,812 | 10,929,344 |
| Pay TV services | 644,968 | 805,319 | 865,376 |
| Other services (a) | 1,297,277 | 1,268,452 | 1,089,534 |
| Sale of goods and devices | 3,479,786 | 2,792,611 | 2,135,165 |
| Gross operating income | 51,965,612 | 50,264,637 | 43,058,590 |
| Taxes | (12,373,913) | (12,146,809) | (10,624,363) |
| Rebates and returns | (4,869,802) | (4,198,172) | (3,317,583) |
| Deductions from gross operating income | (17,243,715) | (16,344,981) | (13,941,946) |
| Net operating revenue | 34,721,897 | 33,919,656 | 29,116,644 |

(a) The amounts referring to infrastructure-related swap contracts, under the concept of agent and principal (CPC 30 and IAS 18), which were not recognized as costs and revenues for the years ended December 31, 2013 and 2012 were R\$73,391 and R\$44,758, respectively (Note 25).

No customer contributed more than 10% of gross operating revenue for the years ended December 31, 2013 and 2012.

All amounts in net income are included in income and social contribution tax bases.

25. Costs of services and goods

| | 2013 | 2012 - Restated | 2011- Restated |
|--|--------------|-----------------|----------------|
| Depreciation and amortization | (4,265,113) | (4,131,768) | (3,581,944) |
| Personnel | (522,085) | (459,707) | (380,067) |
| Interconnection and network use | (3,842,326) | (4,012,046) | (4,537,101) |
| Third party services | (3,581,735) | (3,286,832) | (2,816,766) |
| Rent, insurance, condominium fees and connection media (a) (b) | (1,428,040) | (969,262) | (913,301) |
| Taxes, charges and contributions | (1,721,434) | (1,809,640) | (1,420,101) |

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| | | | |
|---------------------------------|--------------|--------------|--------------|
| Other | (63,535) | (86,297) | (101,604) |
| Total cost of services rendered | (15,424,268) | (14,755,552) | (13,750,884) |
| Cost of goods sold | (2,117,899) | (1,801,892) | (1,284,279) |
| Total | (17,542,167) | (16,557,444) | (15,035,163) |

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(a) The amounts referring to infrastructure-related swap contracts, under the concept of agent and principal (CPC 30 and IAS 18), which were not recognized as costs and revenues for the years ended December 31, 2013 and 2012 were R\$73,391 and R\$44,758, respectively (Note 24).

(b) In 2012, the Company reversed a provision at the state road department (DER) referring to the use of right-of-ways in expressways, amounting to R\$ 244,462, since it understands that the likelihood of a disbursement referring to this matter is remote.

26. Selling expenses

| | 2013 | 2012 - Restated | 2011- Restated |
|--|-------------|--------------------|-------------------|
| Depreciation and amortization | (862,146) | (927,874) | (684,891) |
| Personnel | (1,397,550) | (1,321,397) | (1,049,978) |
| Third party services | (5,559,200) | (4,625,735) | (3,759,779) |
| Provision for doubtful receivable (Note 6) | (741,274) | (654,273) | (506,581) |
| Rent/insurance/condominium fees | (130,466) | (119,300) | (79,239) |
| Publicity and advertising | (837,801) | (867,364) | (735,622) |
| Other | (157,733) | (177,753) | (132,121) |
| Total | (9,686,170) | (8,693,696) | (6,948,211) |

27. General and administrative expenses

| | 2013 | 2012 - Restated | 2011- Restated |
|---|-------------|--------------------|-------------------|
| Depreciation and amortization | (516,051) | (432,134) | (317,761) |
| Personnel | (612,313) | (621,946) | (554,874) |
| Third party services | (804,556) | (831,592) | (692,622) |
| Rent/insurance/condominium fees and other | (244,971) | (259,636) | (217,714) |
| Total | (2,177,891) | (2,145,308) | (1,782,971) |

28. Other operating income (expenses), net

| | 2013 | 2012 - Restated | 2011- Restated |
|--|-----------|--------------------|-------------------|
| Fines and expenses recovered | 327,724 | 380,553 | 366,124 |
| Provisions for labor, tax and civil contingencies, net | (830,190) | (769,754) | (368,068) |
| Net income (loss) on disposals of assets (a) | 124,142 | 1,100,256 | 513,884 |
| Other | (5,071) | (23,343) | (70,449) |
| Total | (383,395) | 687,712 | 441,491 |

| | | | |
|--------------------------|-----------|-------------|------------|
| Other operating income | 575,959 | 1,870,995 | 1,229,144 |
| Other operating expenses | (959,354) | (1,183,283) | (787,653) |
| Total | (383,395) | 687,712 | 441,491 |

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(a) In 2013 and 2012, the Company sold 93 and 4,404 non-strategic transmission towers/rooftops for R\$33,816 and R\$1,185,101 (net of residual values), respectively. At the same time, the parties entered into a lease agreement concerning part of the towers/rooftops disposed to continue the data transmission required for its mobile telephone services.

This transaction was considered a sale and leaseback transaction, as provided for in IAS 17. The leaseback of each asset sold was analyzed by management and classified as operating or finance lease, considering the qualitative and quantitative requirements set forth in IAS 17.

The risks and benefits of such towers were transferred to buyers, except for towers whose transfer of risks and benefits rely on technical acceptance of buyer for the 2012 transaction. For such items, the sale amount was recognized as deferred income, net of residual values (Note 21).

| | | | |
|-----------------------------------|----------------------------------|--------------------|-------------------|
| 29. | Financial income (expenses), net | | |
| | 2013 | 2012 - Restated | 2011- Restated |
| Financial income | | | |
| Investment income | 625,506 | 313,258 | 336,873 |
| Gains on derivative transactions | 454,828 | 345,412 | 251,758 |
| Interest receivable | 193,264 | 187,179 | 130,524 |
| Monetary and exchange gains | 307,650 | 345,698 | 267,665 |
| Other | 167,029 | 89,558 | 115,236 |
| | 1,748,277 | 1,281,105 | 1,102,056 |
| Financial expense | | | |
| Interest payable | (825,621) | (690,979) | (484,663) |
| Losses on derivative transactions | (350,100) | (230,216) | (140,725) |
| Monetary and exchange losses | (580,386) | (409,907) | (308,966) |
| PIS/COFINS on IOE received | (21,461) | (42,273) | (18,500) |
| Other | (185,469) | (198,994) | (290,197) |
| | (1,963,037) | (1,572,369) | (1,243,051) |
| Financial income (expenses), net | (214,760) | (291,264) | (140,995) |

30. Income and social contribution taxes

The Company and its subsidiary recognize income and social contribution taxes on a monthly basis, on an accrual basis, and pay the taxes based on estimates, in accordance with interim trial balances. Taxes calculated on profit or losses for the periods covered by the financial statements are recorded in liabilities or assets, as applicable.

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Reconciliation of tax expense at standard rate

Reconciliation of the reported tax charges and the amounts calculated by applying the nominal tax rate of 34% (income tax of 25% and social contribution tax of 9%) at December 31, 2013 and 2012 is shown in the table below:

| | 2013 | 2012 - Restated | 2011- Restated |
|---|-------------|--------------------|-------------------|
| Income before taxes | 4,662,364 | 6,920,244 | 5,655,100 |
| Income and social contribution tax expenses at a 34% rate | (1,585,204) | (2,352,883) | (1,922,734) |
| Permanent and temporary differences | - | - | - |
| Equity pickup, net of effects of IOF received | (22,684) | 200 | 1,464 |
| Unclaimed dividend | (9,241) | (30,495) | (5,613) |
| Nondeductible expenses, gifts, incentives and IOE received | (118,479) | (68,052) | (47,576) |
| Deferred taxes recognized in subsidiaries on income and social contribution tax losses and temporary differences from prior years | 255,778 | - | - |
| Deferred taxes not recognized in subsidiaries on income and social contribution tax losses | (24,939) | - | - |
| Comprehensive income | - | - | - |
| Reversal of IOE allocated | 590,920 | - | 634,780 |
| Other (additions) exclusions | (32,570) | (16,833) | 46,778 |
| Tax expense | (946,419) | (2,468,063) | (1,292,901) |
| Effective rate | 20 % | 36 % | 23 % |
| Current IRPJ and CSLL | (616,895) | (1,627,439) | (925,558) |
| Deferred IRPJ and CSLL | (329,524) | (840,624) | (367,343) |

Breakdown of changes in the deferred income and social contribution taxes on temporary differences is shown in Note 8.2.

31. Earnings per share

Basic and diluted earnings per share were calculated by dividing income attributed to the Company's shareholders by the weighted average number of outstanding common and preferred shares for the year. No transactions were carried out that could have potential shares issued through the date of issuance of the consolidated financial statements; therefore, there are no adjustments of diluting effects inherent to the potential issue of shares.

The table below shows the calculation of earnings per share for the years ended December 31, 2013 and 2012:

| | 2013 | 2012 | 2011 |
|---|-----------|-----------|-----------|
| Net income for the year attributed to shareholders: | 3,715,945 | 4,453,573 | 4,355,318 |
| Common | 1,183,354 | 1,418,011 | 1,381,068 |
| Preferred | 2,532,591 | 3,035,562 | 2,974,250 |

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| | | | |
|---|-----------|-----------|---------|
| Number of shares: | 1,123,269 | 1,123,463 | 928,005 |
| Weighted average of outstanding common shares for the year | 381,336 | 381,338 | 313,748 |
| Weighted average of outstanding preferred shares for the year | 741,933 | 742,125 | 614,257 |
| Basic and diluted earnings per share: | | | |
| Common shares | 3.10 | 3.72 | 4.40 |
| Preferred shares | 3.41 | 4.09 | 4.84 |

32. Related-party transactions and balances
- 32.a) Terms and conditions of related-party transactions
- a) Fixed and mobile telephone services: fixed and mobile telephone services provided by companies of Telefónica Group;
- b) Lease of buildings and disposal of call center assets: lease of buildings owned by the Company where the call center structure is installed and disposal of property and equipment items used in call center activities to Atento Brasil, Telefonica Serviços Empresariais do Brasil and Telefonica Transportes e Logística;
- c) Support service by the customer support service, collection, back office and sales people: provided by Atento Brasil; (company belongs to the Telefónica Group until 2012)
- d) Expenses incurred: these are charged to the Company by Media Networks Latino America and Telefónica Del Peru;
- e) Digital TV services: provided by Media Networks Latino America;
- f) Lease and maintenance of safety equipment: provided by Telefonica Engenharia e Segurança do Brasil Ltda.;
- g) Corporate services: these are passed through at the cost effectively incurred on those services;
- h) Systems development and maintenance services: provided by Telefónica Global Technology;
- i) International transmission infrastructure for a number of data circuit and roaming services: provided by Telefónica International Wholesale Brazil, Telefónica International Wholesale Services Spain and Telefónica USA;
- j) Administrative management services: financial, equity, accounting and human resources services provided by Telefonica Serviços Empresariais do Brasil;
- k) Logistics and courier services: provided by Telefonica Transportes e Logística;
- l) Voice portal content provider services: provided by Terra Networks Brazil;
- m) Data communications and integrated solution services: provided by Telefónica International Wholesale Services Spain and Telefónica USA;
- n) Long-distance calls and international roaming services: provided by companies of Telefónica Group;

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o) Refund of expenses: from advisory service fees, expenses with salaries and other expenses paid by the Company to be refunded by companies of the Telefónica Group;

p) Brand Fee: Assignment of rights to use the brand paid to Telefónica;

q) Stock option plan: to employees of Telefónica; and

r) Reimbursement of expenses for the digital business to Telefónica Internacional.

For the above-mentioned transactions, the prices and other commercial conditions of contracts are agreed between the parties.

A summary of significant related-party transactions and balances is as follows:

| Parent companies | Type of transaction | Balance sheet - Assets | | | | | |
|---|---------------------|--------------------------------|--------------|-------------------|--------------------------------|--------------|-------------------|
| | | 12.31.13 | | | 12.31.12 | | |
| | | Current assets | | Noncurrent assets | Current assets | | Noncurrent assets |
| | | Trade accounts receivable, net | Other assets | Other assets | Trade accounts receivable, net | Other assets | Other assets |
| SP | | | | | | | |
| Telecomunicações Participações | o) | 28 | 183 | 6,717 | 1 | 19 | 545 |
| Telefónica Internacional | o) | - | 154 | 38,386 | - | 149 | 17,393 |
| Telefónica | o) / q) | - | 1,361 | 179 | - | 54 | 137 |
| | | 28 | 1,698 | 45,282 | 1 | 222 | 18,075 |
| Other group companies | | | | | | | |
| Telefónica USA | m) | 2,612 | - | - | 1,925 | - | - |
| Telefónica Chile | n) | - | 4,808 | - | 5,160 | - | 106 |
| Telefónica de España | n) | 230 | - | - | 2,476 | - | - |
| Telefónica Peru | d) / n) | 1,573 | - | - | 1,764 | 3,216 | 236 |
| Telefônica Engenharia de Segurança do Brasil | a) / g) / o) | 1,320 | 1,903 | 472 | 556 | 1,915 | 293 |
| Telefónica International Wholesale Services Brasil | a) / g) / o) | 6,966 | 139 | 344 | 641 | 218 | 22 |
| Telefónica International Wholesale Services Espanha | m) | 48,267 | - | - | 7,072 | - | - |
| Telefónica Moviles España | n) | 6,335 | - | - | 3,239 | - | - |
| Telefônica Serviços Empresariais do Brasil | a) / b) / g) / o) | 2,579 | 15,284 | 2,837 | 1,770 | 15,605 | 1,009 |
| Telefônica Transportes e Logística | a) / b) / g) / o) | 530 | 146 | 64 | 206 | 102 | 7 |
| Terra Networks Brasil | a) / g) / o) | 2,561 | 5,682 | 106 | 3,286 | 6,054 | 13 |
| Other | | 25,352 | 5,372 | 13,611 | 12,926 | 10,701 | 357 |

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| | a) / g) / n) | | | | | | |
|-------|-----------------|--------|--------|--------|--------|--------|--------|
| | | 98,325 | 33,334 | 17,434 | 41,021 | 37,811 | 2,043 |
| Total | | 98,353 | 35,032 | 62,716 | 41,022 | 38,033 | 20,118 |

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| | | Balance sheet - Liabilities | | | | | |
|---|---------------------|-----------------------------|-------------------|------------------------|------------------------|-------------------|------------------------|
| | | 12.31.13 | | | 12.31.12 | | |
| Parent companies | Type of transaction | Current liabilities | | Noncurrent liabilities | Current liabilities | | Noncurrent liabilities |
| | | Trade accounts payable | Other liabilities | Other liabilities | Trade accounts payable | Other liabilities | Other liabilities |
| SP | | | | | | | |
| Telecomunicações Participações | g) / o) | 50,120 | - | 6,483 | 2,685 | 4,028 | 4,689 |
| Telefónica Internacional | o) / r) | 214,523 | - | - | 601 | 1,086 | - |
| Telefónica | p) | 1,772 | 84,754 | 2,035 | 3,168 | 35,162 | - |
| | | 266,415 | 84,754 | 8,518 | 6,454 | 40,276 | 4,689 |
| Other group companies | | | | | | | |
| Telefónica USA | i) | 716 | 31 | 121 | 1,051 | 6,680 | 106 |
| Telefónica Chile | n) | - | - | - | 1,577 | - | - |
| Telefónica de España | n) | 441 | - | - | 2,158 | - | - |
| Telefónica Peru | n) | - | - | - | 49 | - | - |
| Telefônica Engenharia de Segurança do Brasil | f) | 3,550 | - | 8 | 3,828 | - | 8 |
| Telefónica International Wholesale Services Brasil | i) | 75,485 | - | 391 | 68,552 | - | 305 |
| Telefónica International Wholesale Services Espanha | i) / n) | 17,842 | 9,986 | - | 869 | 2,342 | - |
| Telefónica Mviles España | n) | 5,468 | - | - | 4,196 | - | - |
| Telefônica Serviços Empresariais do Brasil | j) / o) | 11,701 | 36 | - | 17,783 | 36 | 1,521 |
| Telefônica Transportes e Logística | k) | 25,163 | 1 | 270 | 32,648 | 272 | 165 |
| Terra Networks Brasil | l) | 883 | - | 266 | 1,366 | 19 | 291 |
| Other | e) / h) / n) | 49,281 | 146 | 636 | 15,096 | 522 | 116 |
| | | 190,530 | 10,200 | 1,692 | 149,173 | 9,871 | 2,512 |
| Total | | 456,945 | 94,954 | 10,210 | 155,627 | 50,147 | 7,201 |

| | | Income statement - Revenues (Costs and expenses) | | | |
|--------------------------|---------------------|--|--------------------|----------|--------------------|
| | | 2013 | | 2012 | |
| Parent Companies | Type of transaction | Revenues | Costs and expenses | Revenues | Costs and expenses |
| | | SP Telecomunicações Participações | g) / o) | - | (41,366) |
| Telefónica Internacional | o) / r) | 750 | (182,481) | 43,211 | - |
| Telefónica | o) / p) | 469 | (300,843) | 3,691 | (142,791) |

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| | | | | | |
|---|---------------------------|--------|------------|---------|-------------|
| | | 1,219 | (524,690) | 46,902 | (155,430) |
| Other group companies | | | | | |
| Atento Brasil | a) / b) / c) | - | - | 50,580 | (979,672) |
| Telefónica USA | i) / m) | 1,502 | (3,920) | 3,318 | (7,832) |
| Telefónica Chile | n) | 1,181 | - | - | - |
| Telefónica de España | n) | 804 | (1,857) | 4,585 | (3,736) |
| Telefónica Del Peru | d) / n) | 92 | (60) | 3,844 | - |
| Telefônica Engenharia de Segurança do Brasil | a) / f) / g) / o) | 2,463 | (7,882) | 2,374 | (7,077) |
| Telefónica International Wholesale Services Brasil | a) / g) / i) / o) | 9,078 | (200,988) | 8,725 | (120,876) |
| Telefónica International Wholesale Services Espanha | i) / m) / n) | 49,937 | (33,532) | 20,476 | (13,917) |
| Telefónica Moviles España | | 3,244 | (4,573) | - | (4,841) |
| Telefônica Serviços Empresariais do Brasil | a) / b) / g) / j) / o) | 5,221 | (80,881) | 6,125 | (97,665) |
| Telefônica Transportes e Logística | a) / b) / g) / k) / o) | 1,121 | (88,248) | 1,078 | (86,710) |
| Terra Networks Brasil | a) / g) / l) / o) | 3,875 | (579) | 7,317 | (4,448) |
| Other | a) / e) / g) / h) / n) | 18,546 | (50,234) | 8,590 | (5,526) |
| | | 97,064 | (472,754) | 117,012 | (1,332,300) |
| Total | | 98,283 | (997,444) | 163,914 | (1,487,730) |

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32.b) Management compensation

Consolidated management compensation paid by the Company to its Board of Directors and Statutory Directors for the years ended December 31, 2013 and 2012 amounted to approximately R\$32,436 and R\$21,586, respectively. Of this amount, R\$28,022 (R\$16,856 as of December 31, 2012) corresponds to salaries, benefits and social charges and R\$4,414 (R\$4,730 as of December 31, 2012) to variable compensation.

These amounts were carried as labor costs, according to the function in the groups of Costs of Services Rendered, Selling Expenses and General and Administrative Expenses (Notes 25, 26 and 27).

For the years ended December 31, 2013 and 2012, our Directors and Officers did not receive any pension, retirement pension or other similar benefits.

33. Insurance

The policy of the Company and its subsidiary, as well as of Telefónica Group, includes maintenance of insurance coverage for all assets and liabilities involving significant and high-risk amounts, based on management's judgment and following Telefónica S.A.'s corporate program guidelines. Risk assumptions adopted, given their nature, are not included in the financial statements audit scope and, as a result, were not reviewed by our independent auditor.

Maximum limits of claims (established pursuant the agreements of each company consolidated by the Company) for significant assets, liabilities or interests covered by insurance and their respective amounts are as follows:

| Line | Maximum claim limits |
|--|----------------------|
| Operating risks (with loss of profits) | 1,211,400 |
| General civil liability (RCG) | 21,160 |

34. Share-based compensations plans

The Company's controlling shareholder, Telefónica S.A., has different share-based compensation plans, which were also offered to management and employees of its subsidiaries, among which are Telefônica Brasil and TData.

Fair value of options is estimated on the grant date, based on the binomial model for pricing options which considers terms and conditions of instruments granted.

The Company refunds Telefónica S.A. for the fair value of the benefit granted to management and employees on grant date.

Significant plans effective as of December 31, 2013 and December 31, 2012 are detailed below:

a) Share incentive plan of Telefónica S.A.: "Performance Share Plan" or "PSP"

The General Shareholders' Meeting of Telefónica S.A., held on June 21, 2006, approved the adoption of a long-term incentive plan to executive officers of Telefónica S.A. and its subsidiaries, which consists of granting them, after fulfillment of the requirements set forth in the plan, with a given number of shares of Telefónica S.A., as variable

compensation.

Initially, the plan is expected to remain effective for seven years. The plan is divided into five cycles, of three years each, each starting on July 1 (“Start Date”) and ending on June 30 of the third year following the Start Date (“End Date”). At the beginning of each cycle, the number of shares to be granted to plan beneficiaries will be determined based on fulfillment of objectives set. Shares will be granted, as the case may be, after the End Date of each cycle.

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Cycles are independent, with the first one starting on July 1, 2006 (with shares granted on July 1, 2009), and the fifth cycle, on July 1, 2010 (with shares granted, as the case may be, as from July 1, 2013).

Granting of shares is conditional upon:

- Beneficiaries staying with the company for the three years of each cycle, subject to certain special conditions in relation to terminations.
- The actual number of shares granted at the end of each cycle will depend on the level of success and maximum number of shares granted to each executive officer. The level of success is based on the comparison of the evolution of shareholder remuneration considering price and dividends (Total Shareholder Return - TSR) of Telefónica share, vis-à-vis the evolution of TSRs corresponding to a number of companies quoted in the telecommunications industry, which correspond to the Comparison Group. Each employee enrolled with the plan is granted, at the beginning of each cycle, a maximum number of shares, and the actual number of shares granted at the end of the cycle is calculated by multiplying this number by the maximum level of success on the date. This will be 100% if the evolution of Telefonica's TSR is equal to or greater than the third quartile of the Comparison Group, and 30% if this evolution is equal to the average. If the evolution is maintained between the two values, a linear interpolation will be made, and, if below the median, nothing will be granted.

At June 30, 2011, 2012 and 2013, the third, fourth and fifth cycles of this incentive plan ended, and the following number of shares were attributed to officers of the Company and its subsidiary:

| Cycles | Number of shares | Par value in EUR | Final date |
|--------------------------|------------------|------------------|---------------|
| 3rd cycle - July 1, 2008 | 186,186 | 8,39 | June 30, 2011 |
| 4th cycle - July 1, 2009 | 169,323 | 8,41 | June 30, 2012 |
| 5th cycle - July 1, 2010 | 173,645 | 9,08 | June 30, 2013 |

Following the end of the third and fourth cycles, in July 2011 and 2012, total 186,186 and zero shares were issued to officers of Telefonica Brasil and its subsidiary included in those cycles, respectively. In the fourth and fifth cycle, no shares were issued as the minimum level of success established in the program for the TSR was not achieved.

b) Performance & Investment Plan (PIP)

The General Shareholders' Meeting of Telefónica S.A., held on May 18, 2011, approved a long-term program to acknowledge the commitment, differentiated performance and high potential of its executive officers at global level, by granting them with Telefónica S.A. shares.

Participants of the plan need not pay for the shares initially granted to them and may increase the number of shares receivable by the end of the plan if they decide for a joint investment in their PIP. Co-investment requires that the participant buy and maintain, to the end of the cycle, a number equivalent to 25% of shares initially granted thereto by Telefónica S.A. On participant's co-investment, Telefónica S.A. will increase initial shares by 25%.

Initially, the plan is expected to remain effective for three years. The cycle began on July 1, 2011 and will be effective until June 30, 2014. The number of shares is reported at the beginning of the cycle and, after three years from the grant date, shares are transferred to the participant if goals are achieved.

Granting of shares is conditional upon:

- maintenance of active employment relationship within the Telefónica Group on the cycle consolidation date;
- achievement, by Telefónica, of results representing fulfillment of the objectives established for the plan: the level of success is based on the comparison of the evolution or shareholder compensation, obtained through (TSR) to the evolution of the TSRs of the previously defined Comparison Group companies:

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Ø100% are granted if the TSR of Telefónica S.A exceeds the TSR of companies representing 75% of capitalization on the Comparison Group stock exchange.

Ø30% are granted if the TSR of Telefónica S.A is equivalent to the TSR of companies representing 50% of capitalization on the Comparison Group stock exchange.

Ødetermined by linear interpolation if the TSR of Telefónica S.A ranges from 50% to 75% of the capitalization of the Comparison Group stock exchange.

ØNo shares are granted if the TSR of Telefónica S.A is below the TSR of companies representing 50% of capitalization on the Comparison Group stock exchange.

The maximum number of shares attributed in the first three outstanding cycles at December 31, 2013 is as follows:

| Cycles | Number of shares | Par value in EUR | Final date |
|--------------------------|------------------|------------------|---------------|
| 1st cycle - July 1, 2011 | 380,663 | 8,28 | June 30, 2014 |
| 2nd cycle - July 1, 2012 | 672,675 | 8,28 | June 30, 2015 |
| 3rd cycle - July 1, 2013 | 477,010 | 10,39 | June 30, 2016 |

c) Global share incentive plan of Telefónica S.A.: “Global Employee Share Plan” or “GESP”

The General Shareholders’ Meeting of Telefónica S.A. held on May 18, 2011, approved the second round of the share option incentive plan of Telefónica S.A. for Telefonica Group’s employees, on a global level, including employees of Telefonica Brasil and its subsidiary. Through this plan, they are offered the possibility of acquiring shares of Telefónica S.A., which agrees to freely grant participants with a certain number of its shares, whenever certain requirements are fulfilled.

Initially, the plan is expected to remain effective for two years. Employees enrolled with the plan could acquire Telefónica S.A. shares through monthly contributions of up to 100 Euros (or equivalent in local currency), with maximum of 1,200 Euros over twelve months (vesting period). Shares will be granted, as the case may be, after the vesting period, beginning December 1, 2014, and is conditional upon:

- Beneficiaries staying with the company for the two years of the program (vesting period), subject to certain special conditions in relation to terminations.
- The exact number of shares to be granted at the end of the vesting period will rely upon the number of shares acquired and held by employees. Thus, employees enrolled with the plan, continuing with the Group, and who have held the shares acquired for additional twelve months after the vesting period, are entitled to receive one free share for each share they have acquired and held through the end of the vesting period.

The vesting period started in November 2012 and, as of December 31, 2013, employees of Telefônica Brasil and its subsidiaries enrolled with the plan totaled 1,839.

The Company and its subsidiary recorded personnel expenses referring to share-based payment plans for the years ended December 31, 2013, 2012 and 2011, as follows:

| Plans | 2013 | 2012 | 2011 |
|-------|--------|--------|--------|
| PSP | 653 | 3,994 | 10,101 |
| PIP | 11,789 | 3,000 | 4,509 |
| GESP | 2,285 | 3,435 | 2,298 |
| Total | 14,727 | 10,429 | 16,908 |

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35. Post –Retirement Benefit Plans

The plans sponsored by the Company and related benefits types are as follows:

| Plan | Type (1) | Entity | Sponsorship |
|------------|-------------|-------------------|--|
| PBS-A | DB | Sistel | Telefônica Brasil, jointly with other telecoms resulting from privatization of the Telebrás System |
| PAMA / PCE | Health care | Sistel | Telefônica Brasil, jointly with other telecoms resulting from privatization of the Telebrás System |
| CTB | DB | Telefônica Brasil | Telefônica Brasil |
| PBS | DB/Hybrid | VisãoPrev | Telefônica Brasil |
| PREV | Hybrid | VisãoPrev (2) | Telefônica Brasil |
| VISÃO | DC/Hybrid | VisãoPrev | Telefônica Brasil and Telefonica Data |

(1) DB = Defined benefit plan;
 DC = Defined Contribution Plan;
 Hybrid = Plan that offers both DB and DC-type benefits.

(2) Except for plan CELPREV, managed by Sistel.

The Company, together with other companies from former Telebrás System, sponsors private pension plans and post-employment medical benefits, as follows: i) PBS-A; ii) PAMA; iii) CTB ; iv) PBS-Telefonica, PBS-Telesp Celular, PBS-TCO, PBS Tele Sudeste Celular and PBS Tele Leste Celular; v) Plano TCP Prev, TCO Prev and CelPrev; and vi) Plano de Benefícios Visão Telefônica and Visão Celular – Celular CRT, Telerj Celular, Telest Celular, Tebahia Celular and Telergipe Celular.

The Company individually sponsors defined benefit retirement plans - Plano PBS, managed by Visão Prev. In addition, a multiemployer retirement plan (PBS-A) and health care plan (PAMA) are provided by the Company and its subsidiary to retired employees and their dependents (managed by Fundação Sistel, with constituted fund and participants contributions), at shared costs. Contributions to the PBS Plans are determined based on actuarial valuations prepared by independent actuaries, in accordance with the rules in force in Brazil. The funding procedure is the capitalization method and the sponsor's contribution is a fixed percentage of payroll of employees covered by the plan, as described below:

| Modality | % |
|------------|-------|
| PBS Telesp | 11.47 |

| | |
|--------------------------|-------|
| PBS Telesp Celular | 10.68 |
| PBS Tele Sudeste Celular | 11.73 |
| PBS Telemig Celular | 6.11 |
| PAMA | 1.50 |

For other employees of the Company and its subsidiary, there is an individual defined contribution plan - Visão Benefit Plan, which is managed by Visão Prev Companhia de Previdência Complementar. These plans are funded by contributions made by participants (employees) and by sponsors, which are credited to members' individual accounts. The Company and its subsidiary are responsible for funding all administrative and maintenance expenses

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of such plans, including members' death and disability risks. The contributions made by the Company and its subsidiary to those plans are equal to those of the participants, which range from 2% to 9% of their salaries, and from 0% to 8% of the contribution salary of Vivo Prev participants, based on the percentage chosen by the employee.

Additionally, the Company supplements the retirement benefits of certain employees of the former Companhia Telefônica Brasileira (CTB).

The Company also sponsors the CelPrev. The participant may contribute to the plan in three ways, to wit: (a) normal basic contribution: percentage ranging from 0% to 2% of their participation salary; (b) normal additional contribution: percentage ranging from 0% to 6% of part of their participation salary exceeding 10 Standard Reference Units of the Plan, and (c) volunteer contribution: percentage freely chosen by the participant, and applied on their participation salary. The sponsor may contribute in four ways, to wit: (a) normal basic contribution: contribution equal to the normal basic contribution of the participant, less contribution to fund the health allowance benefit and administrative expenses; (b) normal additional contribution: equal to the normal additional contribution of the participant, less administrative expenses; (c) volunteer contribution: volunteer contribution and with frequency determined by the sponsor, and (d) special contribution: contribution solely to sponsor's employees not belonging to PBS and who enrolled with the plan 90 days from the day CelPrev became effective.

The actuarial valuation of the plans was carried out in December 2013 and 2012, based on the registration of the participants as of August 31, 2013 for the plans managed by VisãoPrev and Sistel, both projected for December 31, 2013 and based on the participants as of August 31 and July 31, 2012 for the plans managed by VisãoPrev and Sistel, respectively, both projected for December 31, 2012, adopting the projected unit credit method. Actuarial gains and losses generated in each year are immediately recognized in net assets (in other comprehensive income).

The assets of the plans refer to December 31, 2013 and 2012, respectively. With regard to the multi-sponsored plans (PAMA and PBS-A), the plan assets were allocated in view of the company's actuarial liabilities in relation to the actuarial liabilities of the plan.

The actuarial provisions regarding the aforesaid plans are recorded in Provisions (Note 20).

The defined benefit obligation is comprised of different components, in accordance with the characteristics of the pension of each plan and can comprise the actuarial liabilities of obligations to supplement the retirement, medicare subsidy to retirees and dependents and death and disability benefits for the participants. This obligation is exposed to economic and demographic risks, such as: a) readjustments of medical costs which may affect the cost of medicare plans, b) salary growth, c) long-term inflation rate and d) life expectancy of the participants and pensioners.

The fair value of assets of the plans is comprised mainly of fixed income investments (NTNs, LFTs, LTNs and CDBs) and variable income investments (share of large, highly reputable and highly liquid companies). Due to the concentration of the fixed and variable income investments, the assets of the plans are exposed mainly to the risks inherent to the financial Market and to the economic scenario, such as: a) Market risk in economic sectors where the fixed income investments are concentrated, b) risk of events which affect the economic scenario and in the market indexes where the variable income investments are concentrated and c) long-term inflation rate which may consume the profitability of previously indexed fixed income investments.

The consolidated actuarial liabilities at December 31, 2013 and 2012 were as follows:

| | | |
|------|----------|----------|
| Plan | 12.31.13 | 12.31.12 |
|------|----------|----------|

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| | | |
|-------|---------|---------|
| CTB | 49,158 | 50,652 |
| PAMA | 321,193 | 341,617 |
| Total | 370,351 | 392,269 |

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a. Reconciliation of assets and liabilities

| | Present value of DB plan obligations | Fair value of plan assets | Net liabilities (assets) | Asset limitation | Net liabilities (assets) at 12.31.13 | |
|-----------|--|------------------------------|--------------------------------|---------------------|---|---------------------------|
| | | | | | Noncurrent assets | Noncurrent liabilities |
| PBS-A (i) | 1,208,268 | 2,125,944 | (917,676) | 917,676 | - | - |
| CTB | 49,158 | - | 49,158 | - | - | 49,158 |
| PAMA (i) | 387,460 | 66,267 | 321,193 | - | - | 321,193 |
| PBS | 205,949 | 281,127 | (75,178) | 70,458 | (4,720) | - |
| VISÃO | 9,634 | 44,778 | (35,154) | 28,480 | (6,674) | - |
| PREV | 28,247 | 79,844 | (51,597) | 45,082 | (6,515) | - |
| TOTAL | 1,888,716 | 2,597,970 | (709,254) | 1,061,696 | (17,909) | 370,351 |

| | Present value of DB plan obligations | Fair value of plan assets | Net liabilities (assets) | Asset limitation | Net liabilities (assets) at 12.31.12 | |
|-----------|--|------------------------------|--------------------------------|---------------------|---|---------------------------|
| | | | | | Noncurrent assets | Noncurrent liabilities |
| PBS-A (i) | 1,376,229 | 2,136,722 | (760,493) | 760,493 | - | - |
| CTB | 50,652 | - | 50,652 | - | - | 50,652 |
| PAMA (i) | 437,241 | 95,624 | 341,617 | - | - | 341,617 |
| PBS | 229,119 | 342,323 | (113,204) | 112,246 | (958) | - |
| VISÃO | 34,666 | 61,189 | (26,523) | 8,685 | (17,838) | - |
| PREV | 53,559 | 106,150 | (52,591) | 23,339 | (29,252) | - |
| TOTAL | 2,181,466 | 2,742,008 | (560,542) | 904,763 | (48,048) | 392,269 |

(i) Proportional participation of the Company and its subsidiary in assets and liabilities in multi-sponsored plans PAMA and PBS-A.

b. Total expenses recognized in P&L

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| | 2013 | | | 2012 | | | 2011 | | |
|-------|-----------------------|---|--------|-----------------------|---|----------|-----------------------|---|----------|
| | Current service costs | Net interest income (expense) on the net actuarial assets/liabilities | Total | Current service costs | Net interest income (expense) on the net actuarial assets/liabilities | Total | Current service costs | Net interest income (expense) on the net actuarial assets/liabilities | Total |
| CTB | - | 4,126 | 4,126 | - | 3,164 | 3,164 | - | 1,978 | 1,978 |
| PAMA | 139 | 30,811 | 30,950 | 165 | 24,179 | 24,344 | 252 | 21,010 | 21,262 |
| PBS | 644 | (101) | 543 | 853 | (13,164) | (12,311) | 821 | (7,816) | (6,995) |
| VISÃO | 4,148 | (1,722) | 2,426 | 4,601 | (10,307) | (5,706) | 3,971 | (3,878) | 93 |
| PREV | 4,270 | (2,703) | 1,567 | 3,872 | (4,741) | (869) | 2,482 | (2,308) | 174 |
| TOTAL | 9,201 | 30,411 | 39,612 | 9,491 | (869) | 8,622 | 7,526 | 8,986 | 16,512 |

c. Amounts recognized in other comprehensive income

| | 2013 | | | 2012 | | | 2011 | | |
|-------|--------------------------|-------------------------|------------------------------|--------------------------|-------------------------|------------------------------|--------------------------|-------------------------|------------------------------|
| | Actuarial (gains) losses | Asset limitation effect | Total cost recognized in OCI | Actuarial (gains) losses | Asset limitation effect | Total cost recognized in OCI | Actuarial (gains) losses | Asset limitation effect | Total cost recognized in OCI |
| CTB | (482) | - | (482) | 17,216 | - | 17,216 | 15,398 | - | 15,398 |
| PAMA | (51,336) | - | (51,336) | 43,940 | - | 43,940 | 36,581 | - | 36,581 |
| PBS | 47,542 | (51,706) | (4,164) | (48,381) | 59,051 | 10,670 | 22,643 | (12,231) | 10,412 |
| VISÃO | (6,847) | 19,045 | 12,198 | 57,611 | (35,690) | 21,921 | 30,628 | (28,903) | 1,725 |
| PREV | 5,336 | 19,684 | 25,020 | (20,559) | (3,406) | (23,965) | (6,552) | 7,612 | 1,060 |
| TOTAL | (5,787) | (12,977) | (18,764) | 49,827 | 19,955 | 69,782 | 98,698 | (33,522) | 65,176 |

d. Movement of net defined benefit liabilities (assets)

| Net interest on net defined benefit liability (asset) at 12.31.12 | Sponsor contributions for 2013 | Amounts recognized in OCI | Net interest on net defined benefit liability (asset) at 12.31.13 | Actuarial assets per balance sheet | Actuarial liabilities per balance sheet |
|---|--------------------------------|---------------------------|---|------------------------------------|---|
| | | | | | |

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| | | | | | | | |
|-------|-----------|--------|-----------|-----------|----------|-----------|---------|
| CTB | 50,652 | 4,126 | (5,138) | (482) | 49,158 | - | 49,158 |
| PAMA | 341,617 | 30,950 | (38) | (51,336) | 321,193 | - | 321,193 |
| PBS | (958) | 543 | (141) | (4,164) | (4,720) | (4,720) | - |
| VISÃO | (17,838) | 2,426 | (3,460) | 12,198 | (6,674) | (6,674) | - |
| PREV | (29,252) | 1,567 | (3,850) | 25,020 | (6,515) | (6,515) | - |
| TOTAL | 344,221 | 39,612 | (12,627) | (18,764) | 352,442 | (17,909) | 370,351 |

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| | Net interest on net defined benefit liability (asset) at 01.01.12 | Expenses for 2012 | Sponsor contributions for 2012 | Amounts recognized in OCI | Net interest on net defined benefit liability (asset) at 12.31.12 | Actuarial assets per balance sheet | Actuarial liabilities per balance sheet |
|-------|---|----------------------|--------------------------------------|---------------------------------|---|---|---|
| CTB | 34,615 | 3,164 | (4,343) | 17,216 | 50,652 | - | 50,652 |
| PAMA | 273,373 | 24,344 | (40) | 43,940 | 341,617 | - | 341,617 |
| PBS | 820 | (12,311) | (136) | 10,669 | (958) | (958) | - |
| VISÃO | (30,432) | (5,706) | (3,621) | 21,921 | (17,838) | (17,838) | - |
| PREV | (693) | (869) | (3,725) | (23,965) | (29,252) | (29,252) | - |
| TOTAL | 277,683 | 8,622 | (11,865) | 69,781 | 344,221 | (48,048) | 392,269 |

e.

Movement of defined benefit liabilities

| | Defined benefit liability at 12.31.12 | Current service cost | Interest on actuarial liabilities | Benefits paid for the year | Allocated member contributions for the year | Actuarial experience (gains) losses | Actuarial losses based on biometric assumptions | Actuarial losses based on financial assumptions | Defined benefit liability at 12.31.13 |
|-------|--|----------------------------|---|----------------------------------|---|--|---|---|--|
| PBS-A | 1,376,229 | - | 115,001 | (106,210) | - | 28,268 | 32,649 | (237,669) | 1,208,268 |
| CTB | 50,652 | - | 4,127 | (5,138) | - | 7,075 | 1,417 | (8,975) | 49,158 |
| PAMA | 437,241 | 139 | 38,759 | (15,664) | - | (2,297) | 27,808 | (98,526) | 387,460 |
| PBS | 229,119 | 644 | 19,520 | (14,181) | 190 | 1,706 | 10,962 | (42,011) | 205,949 |
| VISÃO | 34,666 | 4,148 | 2,807 | (324) | 341 | (8,580) | (19,799) | (3,625) | 9,634 |
| PREV | 53,559 | 4,270 | 4,456 | (1,707) | 171 | (7,038) | (17,983) | (7,481) | 28,247 |
| TOTAL | 2,181,466 | 9,201 | 184,670 | (143,224) | 702 | 19,134 | 35,054 | (398,287) | 1,888,716 |

| | Defined benefit liability at 01.01.12 | Current service cost | Interest on actuarial liabilities | Benefits paid for the year | Allocated member contributions for the year | Actuarial experience (gains) losses | Actuarial losses based on biometric assumptions | Actuarial losses based on financial assumptions | Defined benefit liability at 12.31.12 |
|-------|--|----------------------------|---|----------------------------------|---|--|---|---|--|
| PBS-A | 1,214,453 | - | 113,362 | (101,793) | - | 22,791 | - | 127,416 | 1,376,229 |
| CTB | 34,615 | - | 3,164 | (4,343) | - | 12,898 | - | 4,318 | 50,652 |
| PAMA | 366,660 | 165 | 35,026 | (14,821) | - | 10,538 | - | 39,673 | 437,241 |
| PBS | 242,227 | 853 | 22,780 | (13,323) | 270 | (45,066) | - | 21,378 | 229,119 |
| VISÃO | 33,986 | 4,601 | 3,085 | (1,322) | 180 | (6,738) | - | 874 | 34,666 |
| PREV | 46,251 | 3,872 | 4,260 | (1,606) | 113 | (2,286) | - | 2,955 | 53,559 |
| TOTAL | 1,938,192 | 9,491 | 181,677 | (137,208) | 563 | (7,863) | - | 196,614 | 2,181,466 |

f. Movement of fair value of plan assets

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| | Fair value of the plan assets at 12.31.12 | Benefits paid for the year | Total contributions for the year | Sponsor contributions poured in the year | Interest income on plan assets | Return on the plan assets excluding interest income | Fair value of plan assets at 12.31.13 |
|-------|---|----------------------------|----------------------------------|--|--------------------------------|---|---------------------------------------|
| PBS-A | 2,136,722 | (106,210) | - | - | 180,936 | (85,504) | 2,125,944 |
| PAMA | 95,624 | (15,664) | | 38 | 7,948 | (21,679) | 66,267 |
| PBS | 342,323 | (14,181) | 190 | 140 | 29,538 | (76,883) | 281,127 |
| VISÃO | 61,189 | (324) | 341 | 3,462 | 5,279 | (25,159) | 44,788 |
| PREV | 106,150 | (1,707) | 171 | 3,849 | 9,218 | (37,837) | 79,844 |
| TOTAL | 2,742,008 | (138,086) | 702 | 7,489 | 232,919 | (247,062) | 2,597,970 |

| | Fair value of plan assets at 01.01.12 | Benefits paid for the year | Total contributions for the year | Sponsor contributions poured in the year | Interest income on plan assets | Return on the plan assets excluding interest income | Fair value of plan assets at 12.31.12 |
|-------|---------------------------------------|----------------------------|----------------------------------|--|--------------------------------|---|---------------------------------------|
| PBS-A | 1,882,195 | (101,793) | - | - | 243,033 | 113,287 | 2,136,722 |
| PAMA | 93,287 | (14,821) | | 39 | 10,847 | 6,272 | 95,624 |
| PBS | 294,602 | (13,323) | 270 | 136 | 35,944 | 24,694 | 342,323 |
| VISÃO | 108,793 | (1,322) | 180 | 3,621 | 13,392 | (63,475) | 61,189 |
| PREV | 73,689 | (1,606) | 113 | 3,727 | 9,001 | 21,226 | 106,150 |
| TOTAL | 2,452,566 | (132,865) | 563 | 7,523 | 312,217 | 102,004 | 2,742,008 |

g.

Expected P&L for the year 2014

| | Current service cost | Net interest on net defined benefit liability/asset | Total |
|-------|----------------------|---|--------|
| CTB | - | 5,012 | 5,012 |
| PAMA | 89 | 34,590 | 34,679 |
| PBS | 436 | (576) | (140) |
| VISÃO | 1,038 | (778) | 260 |
| PREV | 1,001 | (757) | 244 |
| Total | 2,564 | 37,491 | 40,055 |

h.

Contributions by the sponsors expected for 2014

| | Sponsor contributions | Benefits paid directly by the sponsor | Total |
|-----|-----------------------|---------------------------------------|-------|
| CTB | - | 5,245 | 5,245 |

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| | | | |
|-------|-------|-------|-------|
| PAMA | 41 | - | 41 |
| PBS | 1,128 | - | 1,128 |
| VISÃO | 1,107 | - | 1,107 |
| PREV | 1,023 | - | 1,023 |
| Total | 3,299 | 5,245 | 8,544 |

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i. Weighted average of the defined benefit obligation

| | 2013 | 2012 |
|-------|-------------|-------------|
| PBS-A | 12.75 years | 10.45 years |
| CTB | 11.32 years | 9.27 years |
| PAMA | 16.01 years | 15.73 years |
| PBS | 15.01 years | 12.34 years |
| VISÃO | 8.29 years | 10.01 years |
| PREV | 13.62 years | 11.65 years |

j. Actuarial assumptions

| Plan | 2013 | | | Medical service eligibility age | Retirement age | Mortality table for nondisabled individuals | Mortality table for disabled individuals | Disability table | Turnover |
|-------|---------------------------|-----------------------------|--|---------------------------------|----------------|---|---|---------------------------------|--|
| | Future salary growth rate | Medical expense growth rate | Nominal annual adjustment rate of pension benefits | | | | | | |
| PBS | 6.18 % | N/A | 4.5 % | N/A | 57 years old | AT-2000 Basic segregated by gender, down-rated by 10% | RP-2000 Disabled Female, down-rated by 40% | Mercer Disability | N/A |
| VISÃO | 6.18 % | N/A | 4.5 % | N/A | 60 years old | AT-2000 Basic segregated by gender, down-rated by 50% | N/A | Light-Fraca, down-rated by 30 % | Turnover experienced by VISÃO p (2008 to 2013) |
| PREV | 6.18 % | N/A | 4.5 % | N/A | 60 years old | AT-2000 Basic segregated by gender, down-rated by 50% | N/A, except for TCOPrev, which uses RP-2000 Disabled Male | Light-Fraca, down-rated by 30 % | Turnover experienced by VISÃO p (2008 to 2013) |
| CTB | 6.18 % | N/A | 4.5 % | N/A | N/A | AT-2000 Basic segregated by gender, down-rated by 10% | N/A | N/A | N/A |

5% upon

| | | | | | | | | | | |
|-------|-----|-------|-------|---|-----|--|---|-----|-----|-----|
| | | | | reaching 52 years and 10 years of participation; 3% | | | AT-2000 Basic segregated by gender, down- rated by 10% | | | |
| PAMA | N/A | 7.64% | N/A | each subsequent year; 100% in normal retirement eligibility | N/A | | | N/A | N/A | N/A |
| | | | | | | | AT-2000 Basic segregated by gender, down- rated by 10% | | | |
| PBS-A | N/A | N/A | 4.5 % | N/A | N/A | | | N/A | N/A | N/A |

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In addition to the aforesaid assumptions, other assumptions common for all the plans were adopted for 2013, as follows:

- Long-term inflation rate: 4.5%;
- Discount rate at present value of the defined benefit liability: 10.77%;
- Capacity factor for salaries and benefits: 98%;
- Growth of medical costs by age (aging factor): 4%; and
- Actuarial method: PUC

| Plano | Future salary growth rate | | Medical expense growth rate | | Nominal annual adjustment rate of pension benefits | | Medical service eligibility age | Retirement age |
|-------|---------------------------|---|-----------------------------|---|--|---|---|----------------|
| | | | | | | | | |
| PBS | 6.18 | % | N/A | | 4.5 | % | N/A | 57 years old |
| VISÃO | 6.18 | % | N/A | | 4.5 | % | N/A | 60 years old |
| PREV | 6.18 | % | N/A | | 4.5 | % | N/A | 60 years old |
| CTB | 6.18 | % | N/A | | 4.5 | % | N/A | N/A |
| | | | | | | | 5% upon reaching 52 years and 10 years of participation; 3% each subsequent year; 100% in normal retirement eligibility | |
| PAMA | N/A | | 7.64 | % | N/A | | | N/A |
| PBS-A | N/A | | N/A | | 4.5 | % | N/A | N/A |

In addition to the aforesaid assumptions, other assumptions common for all the plans were adopted for 2012, as follows:

- Long-term inflation rate: 4.5%;
- Capacity factor for salaries and benefits: 98%;
- Rotation: 0.15 (length of service +1), null as from 50 years;
- Table of disability benefit request: Mercer Disability;

- Mortality table for non-disabled people: AT2000 segregated by gender;
 - Mortality table for disabled people: IAPB-57
- Growth of medical costs by age (aging factor): 4%; and
 - Actuarial method: PUC

k. Changes in actuarial assumptions in relation to the prior year

In order to fit some actuarial assumptions into the economic and demographic reality, a study was carried out to check the adherence to the plans managed by Visão Prev, which approved the new assumptions in its decision-making body.

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The assumptions with changes in relation to the prior year and which affect the defined benefit liability are as follows:

Demographic assumptions:

- Mortality table for non-disabled people
 - Mortality table for disabled people
 - Table of disability benefit request
 - Rotation index

Financial assumptions:

- Discount rate at present value of the defined benefit liability

Following are the impacts on the defined benefit liability in light of the changes in the actuarial assumptions:

| | Defined benefit liability, based on current actuarial assumptions | Defined benefit liability, based on prior-year actuarial assumptions | Difference from change in actuarial assumptions |
|-------|---|--|---|
| PBS-A | 1,208,268 | 1,413,289 | (205,021) |
| CTB | 49,158 | 56,715 | (7,557) |
| PAMA | 387,460 | 458,178 | (70,718) |
| PBS | 205,949 | 236,998 | (31,049) |
| VISÃO | 9,634 | 33,059 | (23,425) |
| PREV | 28,247 | 53,710 | (25,463) |
| Total | 1,888,716 | 2,251,949 | (363,233) |

1. Sensitivity analysis of actuarial assumptions

According to the Company, the actuarial assumption is significant, with a reasonable possibility of changes vis-à-vis the demographic and economic scenarios. The discount rate used to present value adjust the defined benefit liability might significantly change the amount of the defined benefit obligation.

Following is the sensitivity analysis of the defined benefit obligation for the 0.5% increase and the 0.5% reduction scenarios involving the discount rate used for present value adjustment of the defined benefit liability:

| Defined benefit liability, discounted to present value at a 10.77% rate | Defined benefit liability, discounted to present value at a 11.27% rate (up by | Defined benefit liability, discounted to present value at a 10.27% rate (down by |
|---|--|--|
|---|--|--|

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| | | 0.5%) | 0.5%) |
|-------|-----------|-----------|-----------|
| PBS-A | 1,208,268 | 1,157,255 | 1,263,512 |
| CTB | 49,158 | 47,323 | 51,134 |
| PAMA | 387,460 | 365,071 | 412,143 |
| PBS | 205,949 | 195,860 | 216,989 |
| VISÃO | 9,634 | 9,433 | 9,845 |
| PREV | 28,247 | 27,007 | 29,607 |
| Total | 1,888,716 | 1,801,949 | 1,983,230 |

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| m. | Allocation of assets of plans | | | | |
|---|-------------------------------|--------|---------|--------|--------|
| | PBS-A | PAMA | PBS | VISÃO | PREV |
| Investments with market value quoted in active market: | | | | | |
| Fixed income investments | | | | | |
| Nacional Treasury Note (NTN) | 1,302,601 | 53,876 | 266,580 | 32,353 | 55,710 |
| Treasury Financial Letter (LFT) | 126,428 | 204 | - | 396 | 682 |
| Nacional Treasury Letter (LTN) | 15,205 | 164 | 8,066 | 1,664 | 2,865 |
| Certificate of Interbank Deposit (CDB) | 75,815 | 12,023 | - | 759 | 1,307 |
| Debentures | - | - | - | 2,969 | 5,112 |
| Financial letter | - | - | - | 1,877 | 3,231 |
| FIDC quotes / Others | - | - | 5,420 | 1,209 | 2,081 |
| Variable income investments | | | | | |
| Investments in food and beverage industry | 88,886 | - | - | 367 | 902 |
| Investments in aerospace sector | 44,836 | - | - | - | - |
| Investments in energy sector | 206,876 | - | - | 241 | 592 |
| Investments in mining sector | 7,866 | - | - | 300 | 738 |
| Investments in oil, gas and biofuels | - | - | - | 151 | 371 |
| Investments in telephone industry | - | - | - | 85 | 209 |
| Investments in steel and metallurgy sector | - | - | - | 153 | 376 |
| Investments in water and sanitation sector | - | - | - | 13 | 32 |
| Investments in construction and engineering | - | - | - | 143 | 352 |
| Investments in the trading and distribution industry | - | - | - | 66 | 163 |
| Investments in transport sector | - | - | - | 159 | 390 |
| Investments in wood and paper industry | - | - | - | 76 | 188 |
| Investments in education sector | - | - | - | 67 | 166 |
| Investments in financial services industry / banking institutions | - | - | - | 797 | 1,960 |
| Investments in real estate | - | - | - | 52 | 127 |
| Investments in tacacco sector | - | - | - | 33 | 81 |
| Investments in sector holdings | - | - | - | 138 | 340 |
| Investments in other sectors | - | - | - | 127 | 311 |
| Investments in market index (IBrX50) | 44,857 | - | - | - | - |
| Structured investments | 10,630 | - | - | - | - |
| Real estate investments | 170,076 | - | - | - | - |
| Loans to participants | 31,868 | - | 1,061 | - | - |

Investments with market value
non-quoted in active market:

| | | | | | |
|-----------------------|-----------|--------|---------|--------|--------|
| Loans to participants | - | - | - | 593 | 1,558 |
| Total | 2,125,944 | 66,267 | 281,127 | 44,788 | 79,844 |

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n. Calendar of due dates of payments of future benefits

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 onwards |
|-------|---------|---------|---------|---------|---------|-----------------|
| PBS-A | 103,336 | 107,010 | 110,704 | 114,411 | 117,960 | 4,183,610 |
| CTB | 5,245 | 5,248 | 5,238 | 5,220 | 5,198 | 139,280 |
| PAMA | 16,643 | 18,337 | 20,182 | 22,189 | 24,344 | 2,842,005 |
| PBS | 14,861 | 15,545 | 16,542 | 17,218 | 17,885 | 1,032,487 |
| VISÃO | 1,681 | 1,693 | 1,700 | 1,709 | 1,713 | 25,344 |
| PREV | 2,818 | 2,879 | 2,943 | 3,072 | 3,151 | 156,791 |

36. Financial instruments

The Company and its subsidiary measured their financial assets and liabilities in relation to market values based on available information and appropriate valuation methodologies. However, both interpretation of market information and selection of methodologies require considerable judgment and reasonable estimates in order to produce adequate realizable values. As a result, estimates presented do not necessarily indicate the amounts that may be realized in current market. The use of different market approaches and/or methodologies may have a significant effect on the estimated realizable values.

For the years ended December 31, 2013 and 2012, the Company did not identify any significant and impairment in recoverable amount of its financial instruments.

Breakdown of financial assets and liabilities as of December 31, 2013 and 2012 and January 1st 2012 is as follows.

At December 31, 2013:

| Financial assets | Measured at fair value through profit or loss | Fair value | | | Amortized cost | | | Total fair value |
|----------------------------------|---|------------|--------------------|-----------------------|----------------------|--|------------------|------------------|
| | | Coverage | Available for sale | Loans and receivables | Level 1 Market price | Level 2 Estimates based on other market inputs | Total book value | |
| Current | | | | | | | | |
| Cash and cash equivalent (Note5) | - | - | - | 6,543,936 | - | - | 6,543,936 | 6,543,936 |
| Derivative transactions (Note36) | 893 | 88,606 | - | - | - | 89,499 | 89,499 | 89,499 |
| Noncurrent | | | | | | | | |
| Equity investments | - | - | 86,349 | - | 86,349 | - | 86,349 | 86,349 |

(Note12)

Derivative
transactions

| | | | | | | | | |
|----------|---|---------|---|---|---|---------|---------|---------|
| (Note36) | - | 329,652 | - | - | - | 329,652 | 329,652 | 329,652 |
|----------|---|---------|---|---|---|---------|---------|---------|

Total financial

| | | | | | | | | |
|--------|-----|---------|--------|-----------|--------|---------|-----------|-----------|
| assets | 893 | 418,258 | 86,349 | 6,543,936 | 86,349 | 419,151 | 7,049,436 | 7,049,436 |
|--------|-----|---------|--------|-----------|--------|---------|-----------|-----------|

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| | Measured at fair value through profit or loss | Amortized cost | Coverage | Level 2 Estimates based on other market inputs | Total book value | Total fair value |
|---|--|-------------------|---------------|---|---------------------|---------------------|
| Financial liabilities | | | | | | |
| Current | | | | | | |
| Loans, financing and lease (Note 18.1) | - | 1,236,784 | - | - | 1,236,784 | 1,417,911 |
| Debentures (Note 18.2) | - | 286,929 | - | - | 286,929 | 588,116 |
| Derivative transactions (Note36) | 871 | - | 43,592 | 44,463 | 44,463 | 44,463 |
| Noncurrent | | | | | | |
| Loans, financing and lease (Note18.1) | - | 3,215,156 | - | - | 3,215,156 | 2,923,290 |
| Debentures (Note 18.2) | - | 4,014,686 | - | - | 4,014,686 | 3,698,203 |
| Derivative transactions (Note36) | - | - | 24,807 | 24,807 | 24,807 | 24,807 |
| Total financial assets | 871 | 8,753,555 | 68,399 | 69,270 | 8,822,825 | 8,696,790 |

At December 31, 2012 (Restated):

| | Fair value | | | Amortized cost | | | |
|--|------------|-----------------------|--------------------------|----------------------------|---|---------------------|---------------------|
| | Coverage | Available for sale | Loans and receivables | Level 1 Market price | Level 2 Estimates based on other market inputs | Total book value | Total fair value |
| Financial assets | | | | | | | |
| Current | | | | | | | |
| Cash and cash equivalent (Note5) | - | - | 7,133,485 | - | - | 7,133,485 | 7,133,485 |
| Derivative transactions (Note36) | 41,109 | - | - | - | 41,109 | 41,109 | 41,109 |
| Noncurrent | | | | | | | |
| Equity investments (Note12) | - | 142,881 | - | 142,881 | - | 142,881 | 142,881 |
| Derivative transactions (Note36) | 286,278 | - | - | - | 286,278 | 286,278 | 286,278 |

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| | | | | | | | |
|------------------------|---------|---------|-----------|---------|---------|-----------|-----------|
| Total financial assets | 327,387 | 142,881 | 7,133,485 | 142,881 | 327,387 | 7,603,753 | 7,603,753 |
|------------------------|---------|---------|-----------|---------|---------|-----------|-----------|

| Financial liabilities | Measured at fair value through profit or loss | Amortized cost | Coverage | Level 2 Estimates based on other market inputs | Total book value | Total fair value |
|--|---|------------------|---------------|--|------------------|------------------|
| Current | | | | | | |
| Loans, financing and lease (Note 18.1) | - | 1,270,122 | - | - | 1,270,122 | 1,471,265 |
| Debentures (Note 18.2) | - | 702,215 | - | - | 702,215 | 811,919 |
| Derivative transactions (Note 36) | 470 | - | 29,116 | 29,586 | 29,586 | 29,586 |
| Noncurrent | | | | | | |
| Loans, financing and lease (Note 18.1) | - | 3,774,461 | - | - | 3,774,461 | 3,600,090 |
| Debentures (Note 18.2) | - | 2,253,690 | - | - | 2,253,690 | 2,158,008 |
| Derivative transactions (Note 36) | - | - | 26,545 | 26,545 | 26,545 | 26,545 |
| Total financial liabilities | 470 | 8,000,488 | 55,661 | 56,131 | 8,056,619 | 8,097,413 |

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Capital management

The purpose of the Company and its subsidiary's Capital management is to ensure that a solid credit rating is sustained before the institutions, as well as an optimum capital ratio, in order to support the Company's businesses and maximize the value to its shareholders.

The Company and its subsidiary manage their capital structure by making adjustments and fitting into current economic conditions. For this purpose, the Company and its subsidiary may pay dividend, raise new loans, issue promissory notes and contract derivative transactions. For the year ended December 31, 2013, there were no changes in the Company's objectives, policies or capital structure processes.

The Company and its subsidiary include in the net debt structure the following balances: loans, financing, debentures and finance lease (Note 18) operations with derivatives, net of cash and cash equivalents (Note 5) and short-term investments as a guarantee of the BNB financing.

The consolidated net indebtedness index on the Company's net assets is comprised as follows:

| | | |
|---|--------------|--------------|
| | 12.31.13 | 12.31.12 |
| Cash and cash equivalents | 6,543,936 | 7,133,485 |
| Loans, financing, debentures, lease and derivative transactions (net of short-term investments pledged as a guarantee for debt repayment) | (8,343,761) | (7,669,252) |
| Net debt | 1,799,825 | 535,767 |
| Net equity | 42,894,442 | 44,681,120 |
| Net debt-to-equity ratio | 4.20 % | 1.20 % |

Risk management policy

The Company and its subsidiary are exposed to several market risks as a result of their commercial operations, debts obtained to finance their activities and debt-related financial instruments.

The key market risk factors that affect the business of the Company are detailed below:

a. Currency risk

This risk arises from the possibility that the Company may incur losses due to exchange rate fluctuations, which would increase the financial expenses stemming from loans denominated in foreign currency.

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At December 31, 2013, 15.9% (19.9% at December 31, 2012) of the financial debt was denominated in foreign currency. The Company has entered into derivative transactions (exchange rate hedge) with financial institutions to hedge against exchange rate variation on its gross debt in foreign currency (R\$1,394,523 and R\$1,586,711 at December 31, 2013 and 2012, respectively). In view of this, total debt was covered by long position on currency hedge transactions (swap for CDI) on those dates.

There is also the exchange rate risk related to non-financial assets and liabilities in foreign currency, which can lead to a lower amount receivable or higher amount payable, depending on exchange rate variation for the period.

Hedge transactions were taken out to minimize the exchange rate risk related to these non-financial assets and liabilities in foreign currency. This balance is subject to daily changes due to business dynamics. However, the Company intends to cover the net balance of these rights and obligations (US\$34,500 thousand and €2,490 thousand payable at December 31, 2013 and US\$16,130 thousand and €4,140 thousand payable at December 31, 2012) to minimize the related foreign exchange risk.

b. Interest rate and inflation risk

This risk arises from the possibility of the Company and its subsidiary incurring losses due to an unfavorable change in internal interest rates, which may negatively affect financial expenses connected with part of debentures pegged to CDI and derivative short position (exchange rate hedge and IPCA) taken out at floating interest rates (CDI).

The debt taken out from BNDES is indexed by the TJLP (Long Term Interest Rate) quarterly set by the National Monetary Council, which was kept at 6.0% p.a. from July 2009 to June 2012. From July to December 2012, the TJLP was 5.5% p.a., and reduced to 5.0% p.a. as from January 2013.

The risk of inflation arises from the debentures of Telemig (merged into Vivo Part. as of June 1, 2010), indexed by the IPCA, which may adversely affect our financial expenses in the event of an unfavorable change in this index.

To reduce exposure to local floating interest rates (CDI), the Company and its subsidiary invest cash surplus of R\$6,442,015 (R\$7,039,181 at December 31, 2012), mainly in short-term financial investments (Bank Deposit Certificates) based on CDI variation. The carrying amount of these instruments approximates market value, since they are redeemable within short term.

c. Liquidity risk

Liquidity risk derives from the possibility that the Company and its subsidiary do not have sufficient resources to meet their commitments according to the different currencies and terms of execution/settlement of their rights and obligations.

The Company and its subsidiary structure the maturity dates of the non-derivative financial agreements, as shown in Note 18, and their respective derivatives as shown in the payments schedule disclosed in the referred note, in such manner as not to affect their liquidity.

The control over the Company's and its subsidiary's liquidity and cash flow is monitored daily by management, in such way as to ensure that the operating cash generation and the available lines of credit, as necessary, are sufficient to meet their schedule of commitments, not generating liquidity risks.

d.

Credit risk

This risk arises from the possibility that the Company and its subsidiary may incur losses due to the difficulty in receiving amounts billed to its customers and sales of devices and pre-activated pre-paid cards to the distributor's network.

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The credit risk on accounts receivable is diversified and minimized by a strict control of the customer base. The Company and its subsidiary constantly monitor the level of accounts receivable of post-paid plans and limit the risk of past-due accounts, interrupting access to telephone lines for past due bills. The mobile customer base predominantly uses the prepaid system, which requires prior charging and consequently entails no credit risk. Exceptions are made for telecommunication services that must be maintained for security or national defense reasons.

The credit risk in the sale of devices and “pre-activated” prepaid cards is managed under a conservative credit policy, by means of modern management methods, including the application of “credit scoring” techniques, analysis of financial statements and information, and consultation to commercial data bases, in addition to request of guarantees.

At December 31, 2013 and 2012, , the customer portfolio of the Company and its subsidiary had no subscribers whose receivables were individually higher than 1% of total accounts receivable from services.

The Company and its subsidiary are also subject to credit risk arising from short-term investments, letters of guarantee received as collateral in connection with certain transactions and receivables from derivative transactions. The Company and its subsidiary control the credit limit granted to all counterparties and diversifies such exposure among first-tier financial institutions, according to credit policy of financial counterparties in force.

Derivatives and risk management policy

All the Company’s and its subsidiary’s derivative financial instruments are intended to hedge against the currency risk arising from assets and liabilities in foreign currency, against inflation risk from its debenture and lease indexed to IPCA (inflation rate) with shorter term, and against the risk of changes in TJLP of a debt with the BNDES. As such, any changes in risk factors generate an opposite effect on the hedged end. Therefore, there are no derivative instruments for speculative purposes and the Company is hedged against currency risk.

The Company and its subsidiary have internal controls over their derivative instruments, which, according to management, are appropriate to control the risks associated with each market strategy. The Company’s results derived from its derivative financial instruments indicate that the risks have been adequately managed.

The Company and its subsidiary determine the effectiveness of the derivative instruments entered into to hedge their financial liabilities at the beginning of the operation and on an ongoing basis (on a quarterly basis). At December 31, 2013 and 2012, derivative instruments taken out were effective for the hedged debts. Provided that these derivative contracts qualify as hedge accounting, the hedged risk may also be adjusted at fair value, according to hedge accounting rules.

The Company and its subsidiary entered into swap contracts in foreign currency at different exchange rates hedging their assets and liabilities in foreign currency.

At December 31, 2013 and 2012, the Company and its subsidiary had no embedded derivative contracts.

Derivative contracts have specific provisions for penalty in case of breach of contract. A breach of contract provided for in the agreements made with financial institutions is characterized by breach of a clause, resulting in the early settlement of the contract.

Fair value of financial instruments

The discounted cash flow method was used to determine the fair value of financial liabilities (when applicable) and derivative instruments, considering expected settlement of liabilities or realization of assets and liabilities at the market rates prevailing at balance sheet date.

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Fair values are calculated by projecting future operating flows, using BM&FBovespa curves, and discounting to present value through market DI rates for swaps, as informed by BM&FBovespa.

The market values of exchange rate derivatives were obtained through market currency rates in force at the balance sheet date and projected market rates were obtained from currency coupon curves. The coupon for positions indexed to foreign currencies was determined using the 360-calendar-day straight-line convention; the coupon for positions indexed by CDI was determined using the 252-workday exponential convention.

The consolidated derivative financial instruments shown below are registered with CETIP. All of them are classified as swaps and do not require margin deposits.

| Description | Index | Notional value | | Fair value | | Accumulated effect Receivables (payables) | |
|------------------|-------|----------------|-----------|------------|-----------|--|----------|
| | | 12.31.13 | 12.31.12 | 12.31.13 | 12.31.12 | 12.31.13 | 12.31.12 |
| Swap contracts | | | | | | | |
| Receivable | | | | | | | |
| Foreign currency | | 1,339,265 | 1,520,371 | 1,843,347 | 1,923,089 | 393,232 | 305,301 |
| Citibank | US\$ | 181,230 | 181,230 | 240,175 | 216,270 | 62,099 | 39,617 |
| Votorantim | US\$ | 2,464 | 7,744 | 3,547 | 9,311 | - | - |
| Banco do Brasil | US\$ | - | 258,900 | - | 326,263 | - | 38,576 |
| Bradesco | US\$ | 474,281 | 415,464 | 626,463 | 519,481 | 50,883 | 32,931 |
| Itaú | US\$ | 36,656 | 22,520 | 37,182 | 22,239 | 394 | - |
| JP Morgan | US\$ | 443,207 | 443,207 | 645,001 | 579,331 | 204,720 | 142,065 |
| Bradesco | EUR | 12,888 | 2,613 | 12,913 | 2,613 | - | - |
| Itaú | EUR | 5,506 | 9,160 | 5,481 | 9,159 | - | - |
| | LIBOR | | | | | | |
| Bradesco | US\$ | 179,533 | 179,533 | 264,615 | 238,422 | 75,136 | 52,112 |
| Itaú | JPY | 3,500 | - | 7,970 | - | - | - |
| Floating rate | | 736,169 | - | 713,292 | - | 4,438 | - |
| Bradesco | CDI | 15,530 | - | 15,518 | - | 89 | - |
| Itaú | CDI | 20,639 | - | 20,769 | - | - | - |
| HSBC | TJLP | 100,000 | - | 96,715 | - | 552 | - |
| Citibank | TJLP | 200,000 | - | 193,430 | - | 1,233 | - |
| Santander | TJLP | 300,000 | - | 290,145 | - | 2,012 | - |
| Itaú | TJLP | 100,000 | - | 96,715 | - | 552 | - |
| Inflation rates | | 232,714 | 72,000 | 251,282 | 96,249 | 21,481 | 22,086 |

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| | | | | | | | |
|-------------------------|------|-------------|-------------|-------------|-------------|-----------|-----------|
| Itaú | IPCA | 72,000 | 72,000 | 95,351 | 96,249 | 21,159 | 22,086 |
| Santander | IPCA | 160,714 | - | 155,931 | - | 322 | - |
| Payable | | | | | | | |
| Floating rate | | (2,083,238) | (1,412,838) | (2,148,818) | (1,509,659) | (66,145) | (55,545) |
| Citibank | CDI | (381,230) | (181,230) | (377,847) | (180,418) | (7,574) | (3,765) |
| Votorantim | CDI | (2,464) | (7,744) | (7,335) | (21,336) | (3,788) | (12,025) |
| Banco do Brasil | CDI | - | (258,900) | - | (287,686) | - | - |
| HSBC | CDI | (100,000) | - | (98,891) | - | (2,727) | - |
| Bradesco | CDI | (487,169) | (418,077) | (537,975) | (463,910) | (21,932) | (26,273) |
| Itaú | CDI | (208,454) | (103,680) | (215,479) | (105,893) | (2,855) | (333) |
| Santander | CDI | (460,714) | - | (456,982) | - | (13,240) | - |
| JP Morgan | CDI | (443,207) | (443,207) | (454,309) | (450,416) | (14,029) | (13,149) |
| Foreign exchange | | | | | | | |
| | | (224,911) | (179,533) | (309,221) | (238,422) | (3,125) | (586) |
| LIBOR | | | | | | | |
| Bradesco | US\$ | (179,533) | (179,533) | (264,615) | (238,422) | (2,687) | (586) |
| Bradesco | US\$ | (15,530) | - | (15,429) | - | - | - |
| Itaú | EUR | (5,709) | - | (5,811) | - | (65) | - |
| Itaú | US\$ | (24,139) | - | (23,366) | - | (373) | - |
| Receivables | | | | | | 419,151 | 327,387 |
| Payables | | | | | | (69,270) | (56,131) |
| Receivables, net | | | | | | 349,881 | 271,256 |

a) Swaps of foreign currency (USD) vs. CDI (R\$1,456,015) – swap transactions contracted with different maturity dates until 2019, to hedge against foreign exchange variation for loans in USD (financial debt carrying amount of R\$1,394,523).

b) Swap of foreign currency (Euro and Dollar) and (CDI vs. EUR) (R\$85,775) – swap contracts entered into with maturities until February 27, 2014, in order to hedge against foreign exchange variation for net amounts payable in Euro and Dollar (carrying amount of R\$80,821 in dollar and R\$8,043 in euro).

c) Swap IPCA vs. CDI percentage (R\$95,351) – swap transactions with annual maturity dates until 2014 to hedge against the cash flow identical to the debentures (4th issue – 3rd series) pegged to the IPCA (market value R\$95,351).

d) Swaps of TJLP vs. CDI (R\$677,004) – swap transactions contracted with maturity dates until 2019, to hedge against foreign exchange variation of TJLP for loans with the BNDES (financial debt carrying amount of R\$699,417).

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e) Swap IPCA vs. CDI (R\$155,931) – swap transactions maturing in 2033 for the purpose of protecting from the IPCA variation risk of finance lease (market balance of R\$156,224).

The expected maturities of swap contracts as of December 31, 2013 are as follows:

| Swap contract | Maturity | | | 2017 onwards | Receivables (payables) at 12.31.13 |
|--------------------------|-----------|----------|----------|--------------|------------------------------------|
| | 2014 | 2015 | 2016 | | |
| Foreign currency vs.CDI | 26,886 | 212,029 | 18,986 | 89,945 | 347,846 |
| Votorantim | (3,788) | - | - | - | (3,788) |
| Bradesco | (14,839) | 7,308 | 18,986 | 89,945 | 101,400 |
| JP Morgan | (14,029) | 204,721 | - | - | 190,692 |
| Citibank | 59,276 | - | - | - | 59,276 |
| Itaú | 266 | - | - | - | 266 |
| CDI vs. Foreign currency | (152) | - | - | - | (152) |
| Itaú | (241) | - | - | - | (241) |
| Bradesco | 89 | - | - | - | 89 |
| FORWARD | (197) | - | - | - | (197) |
| Itaú | (197) | - | - | - | (197) |
| TJLP vs. CDI | (2,703) | (6,172) | (5,247) | 1,958 | (12,164) |
| Citibank | (792) | (1,774) | (1,506) | 553 | (3,519) |
| HSBC | (566) | (994) | (825) | 210 | (2,175) |
| Santander | (779) | (2,410) | (2,091) | 985 | (4,295) |
| Itaú | (566) | (994) | (825) | 210 | (2,175) |
| IPCA vs. CDI | 21,201 | 35 | (11) | (6,677) | 14,548 |
| Itaú | 21,159 | - | - | - | 21,159 |
| Santander | 42 | 35 | (11) | (6,677) | (6,611) |
| Total | 45,035 | 205,892 | 13,728 | 85,226 | 349,881 |

For the purpose of preparing the financial statements, the Company and its subsidiary adopted hedge accounting for its foreign currency swaps vs. CDI, IPCA vs. CDI and TJLP vs. CDI swap transactions providing financial debt hedge. Under this methodology, both the derivative and the risk covered are stated at fair value.

At December 31, 2013 and 2012, ineffectiveness amounted to R\$965 and R\$2,188, respectively.

For the years ended December 31, 2013 and 2012, derivative transactions generated a consolidated gain of R\$104,728 and R\$115,196, respectively, according to Note 29.

As of December 31, 2013, consolidated balances were R\$419,151 recorded in assets and R\$69,270 in liabilities to recognize the derivatives position at that date.

Sensitivity analysis of the Company's risk variables

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CVM Rule No. 604/09 requires listed companies to disclose, in addition to the provisions of Technical Pronouncement CPC No. 40 - Financial Instruments: Disclosure (equivalent to IFRS 7), a table showing the sensitivity analysis of each type of market risk inherent in financial instruments considered significant by management and to which the Company is exposed at the closing date of each reporting period, including all operations involving derivative financial instruments.

In compliance with the foregoing, all the operations involving derivative financial instruments were evaluated considering a probable scenario and two scenarios that may adversely impact the Company.

The assumption taken into consideration under the probable scenario was to keep, the maturity date of each transaction, what has been signaled by the market through BM&FBovespa market curves (currencies and interest rates). Accordingly, the probable scenario does not provide for any impact on the fair value of the derivative financial instruments mentioned above. For scenarios II and III, risk variables contemplated 25% and 50% deterioration, respectively, pursuant to the applicable CVM ruling.

Considering that the Company has derivative instruments only to cover its assets and liabilities in foreign currency, changes in scenarios are offset by changes in the related hedged items, thus indicating that the effects are nearly null. For these operations, the Company reported the value of the hedged item and of the derivative financial instrument in separate lines in the sensitivity analysis table in order to provide information on consolidated net exposure for each of the three scenarios mentioned, as follows:

Sensitivity analysis – Net exposure

| Transaction | Risk | Consolidated | | |
|----------------------------|---|--------------|-------------------|-------------------|
| | | Probable | Deterioration 25% | Deterioration 50% |
| Hedge (receivable) | Derivatives (Risk of USD devaluation) | 888,723 | 1,117,006 | 1,347,808 |
| Debt in USD | Debts (Risk of USD devaluation) | (888,723) | (1,117,006) | (1,347,808) |
| | Net exposure | - | - | - |
| Hedge (payable) | Derivatives (Risk of EUR devaluation) | 12,583 | 15,807 | 18,974 |
| Accounts payable in EUR | Accounts payable in EUR (Risk of EUR devaluation) | (19,875) | (24,844) | (29,813) |
| Accounts receivable in EUR | Accounts payable in EUR (Risk of EUR devaluation) | 11,833 | 14,791 | 17,749 |
| | Net exposure | 4,541 | 5,754 | 6,910 |
| Hedge (receivable) | Derivatives (Risk of USD devaluation) | 73,192 | 91,219 | 109,513 |
| Accounts payable in USD | Debt (Risk of USD devaluation) | (122,891) | (153,613) | (184,336) |

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| | | | | |
|----------------------------|--------------------------------------|-----------|-----------|-----------|
| Accounts receivable in USD | Debt (Risk of USD devaluation) | 42,070 | 52,587 | 63,105 |
| | Net exposure | (7,629) | (9,807) | (11,718) |
| Hedge (receivable) | Derivatives (Risk of IPCA decrease) | 95,351 | 95,593 | 96,349 |
| Debt in IPCA | Debts (Risk of IPCA increase) | (95,351) | (95,593) | (96,349) |
| | Net exposure | - | - | - |
| Hedge (receivable) | Derivatives (Risk of UMBND decrease) | 559,628 | 713,146 | 872,705 |
| Debt in UMBND | Debts (Risk of UMBND increase) | (554,739) | (706,896) | (865,032) |
| | Net exposure | 4,889 | 6,250 | 7,673 |
| Hedge (receivable) | Derivatives (Risk of TJLP decrease) | 677,004 | 729,556 | 782,191 |
| Debt in TJLP | Debts (Risk of TJLP increase) | (677,004) | (729,556) | (782,191) |

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| | | | | |
|--|------------------------------------|-------------|-------------|-------------|
| | Net exposure | - | - | - |
| Hedge (CDI payable) | | | | |
| Hedge USD (payable) | Derivatives (Risk of CDI increase) | (642,543) | (641,909) | (641,298) |
| Hedge USD and EUR (payable and receivable) | | (85,556) | (85,534) | (85,512) |
| Hedge UMBND (payable) | Derivatives (Risk of CDI increase) | (458,528) | (465,691) | (472,064) |
| Hedge TJLP (payable) | Derivatives (Risk of CDI increase) | (689,170) | (690,082) | (690,912) |
| Hedge IPCA (payable) | Derivatives (Risk of CDI increase) | (74,192) | (74,346) | (74,496) |
| | Net exposure | (1,949,989) | (1,957,562) | (1,964,282) |
| Total net exposure in each scenario | | | | |
| | | (1,948,188) | (1,955,365) | (1,961,417) |
| Net effect on variation of current fair value | | | | |
| | | - | (7,177) | (13,229) |

Assumptions for sensitivity analysis

| Risk variable | Probable | Deterioration 25% | | Deterioration 50% | |
|---------------|----------|-------------------|--|-------------------|--|
| | | | | | |
| USD | 2.3426 | 2.9283 | | 3.5139 | |
| EUR | 3.2307 | 4.0384 | | 4.846 | |
| IPCA | 0.057 | 0.0713 | | 0.0855 | |
| JPY | 2.23 % | 2.79 % | | 3.35 % | |
| CDI | 9.77 % | 12.21 % | | 14.66 % | |
| UMBND | 0.0458 | 0.0572 | | 0.0686 | |
| URTJLP | 197.41 % | 246.76 % | | 296.11 % | |

To determine the net exposure of the sensibility analysis, all derivatives were considered at market value and only hedged elements classified under the hedge accounting method were also considered at fair value.

The fair values shown in the table above are based on the status of the portfolio as of December 31, 2013, not reflecting an estimated realization in view of the market dynamics, always monitored by the Company. The use of different assumptions may significantly impact estimates.

37. Commitments and guarantees (Rentals)

The Company and its subsidiary rent equipment, facilities, and several stores, administrative buildings, and sites where the radio-base stations are located, through several operating agreements maturing on different dates, with monthly payments. As of December 31, 2013, total amount equivalent to the full contractual period is R\$5,847,391 and R\$10,302,962, for Company and consolidated, respectively.

The aging list of commitments referring to rental of stores, administrative buildings and sites under non-cancellable contracts is as follows:

| | |
|------------------------|------------|
| Up to one year | 2,416,820 |
| From one to five years | 4,365,685 |
| More than five years | 3,520,457 |
| Total | 10,302,962 |

38. Subsequent Events

On February 25, 2014, the Board of Directors of the Company approved the appropriation of dividends of R\$ 1,043,000, based on the existing profits in the balance of the fourth quarterly of 2013, to common and preferred shareholders who were registered in the Company's books at the end of the day March 10, 2014. The payment of dividends will begin on March 27, 2014.