

BRASIL TELECOM SA  
Form 20-F/A  
August 07, 2009  
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As filed with the Securities and Exchange Commission on August 7, 2009

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F/A**

(Amendment No. 1)

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

**OR**

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2008**

**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**

## **BRASIL TELECOM S.A.**

(Exact Name of Registrant as Specified in Its Charter)

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

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

**SIA/Sul, ASP, Lote D, Bloco B**  
**71215-000 Setor de Indústria, Brasília, DF, Brazil**

(Address of Principal Executive Offices)

**Roberto Terziani**  
**Investor Relations Director**  
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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

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

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

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: 9.375% Notes due 2014

The total number of issued shares of each class of stock of Brasil Telecom S.A. as of December 31, 2008 was:

249,597,049 common shares, without par value

311,353,239 preferred shares, without par value

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

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

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

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

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  Other

Standards as issued by the International

Accounting Standards Board

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

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



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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 20-F/A, or Amendment No. 1, is being filed solely to amend the Annual Report on Form 20-F for the fiscal year ended December 31, 2008, or the Original Form 20-F, as filed by Brasil Telecom S.A. with the U.S. Securities and Exchange Commission on July 13, 2009 to provide clarifications requested by the U.S. Securities and Exchange Commission of the information relating to the restatement of the presentation of the reconciliations of differences between Brazilian GAAP and U.S. GAAP of shareholders' equity as of December 31, 2007 and net income for the two years period then ended contained in:

note (1) to the table setting forth U.S. GAAP statement of operations data, and note (1) to the table setting forth U.S. GAAP balance sheet data, both contained in Item 3. Key Information Selected Financial Information; and

Note 36 to Brasil Telecom S.A.'s consolidated financial statements at December 31, 2008 and 2007 and for the three year period ended December 31, 2008.

No other changes are being made to the Original Form 20-F, although Exhibits 12.01, 12.02 and 13.01 have been re-filed in their current form. The Annual Report on Form 20-F, as amended by this Amendment No. 1, continues to speak as of the date of its original filing, and Brasil Telecom S.A. has not updated the disclosure as of a later date.

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**PRESENTATION OF FINANCIAL AND OTHER INFORMATION**

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

On July 6, 2009, the exchange rate for *reais* into U.S. dollars was R\$1.971 to US\$1.00, based on the selling rate as reported by the Central Bank of Brazil (*Banco Central do Brasil*), or the Central Bank. The selling rate was R\$2.337 to US\$1.00 at December 31, 2008, R\$1.771 to US\$1.00 at December 31, 2007 and R\$2.138 to US\$1.00 at December 31, 2006, in each case, as reported by the Central Bank. The *real*/U.S. dollar exchange rate fluctuates widely, and the selling rate at July 6, 2009 may not be indicative of future exchange rates. See Item 3. Key Information Exchange Rates for information regarding exchange rates for the *real* since January 1, 2004.

Solely for the convenience of the reader, we have translated some amounts included in Item 3. Key Information Selected Financial Information and elsewhere in this annual report from *reais* into U.S. dollars using the selling rate as reported by the Central Bank at December 31, 2008 of R\$2.337 to US\$1.00. These translations should not be considered representations that any such amounts have been, could have been or could be converted into U.S. dollars at that or at any other exchange rate.

Unless otherwise indicated or the context otherwise requires:

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

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

all references to Brasil Telecom Holding are to Brasil Telecom Participações S.A., the immediate holding company of Brasil Telecom;

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

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

**Financial Statements**

We maintain our books and records in *reais*.

Our consolidated financial statements at December 31, 2008 and 2007 and for the three years ended December 31, 2008, as adjusted and restated for the changes in accounting practices described below, have been audited, as stated in the report appearing herein, and are included in this annual report.

We prepare our consolidated financial statements in accordance with accounting practices adopted in Brazil, or Brazilian GAAP, which are based on:

Brazilian Law No. 6,404/76, as amended, which we refer to as the Brazilian Corporation Law; and

the rules and regulations of the Brazilian Securities Commission (*Comissão de Valores Mobiliários*), or the CVM.

On December 28, 2007, the Brazilian government enacted Law No. 11,638/07, which became effective on January 1, 2008, amended the Brazilian Corporation Law and changed certain accounting policies under Brazilian GAAP. In December 2008, the CVM issued *Deliberação*

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565/08, or Deliberation 565/08, implementing these changes in accounting policies. For a discussion of the principal changes introduced by Law No. 11,638/07 and Deliberation 565/08 as they relate to our financial statements, see Item 5. Operating and Financial Review and Prospects Financial Presentation and Accounting Policies Presentation of Financial Statements and notes 2(a) and 2(f) to our audited consolidated financial statements included elsewhere in this annual report.



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In order to make our financial statements at December 31, 2007 and for the two years ended December 31, 2007 comparable to our financial statements at December 31, 2008 and for the year ended December 31, 2008, we have restated our previously issued financial statements at December 31, 2007 and for the two years ended December 31, 2007 included in our consolidated financial statements at December 31, 2008 and for the year ended December 31, 2008 to conform to the changes in accounting policy introduced by Law No. 11,638/07 and Deliberation No. 565/08.

Brazilian GAAP differs in certain important respects from accounting principles generally accepted in the United States, or U.S. GAAP. For a discussion of certain differences relating to our financial statements, see note 36 to our audited consolidated financial statements included elsewhere in this annual report.

The U.S. GAAP reconciliation of our financial statements as of December 31, 2007 and for the two years ended December 31, 2007 included in our audited consolidated financial statements has been restated to correct errors in the calculation of our net income and shareholders' equity under U.S. GAAP. For a discussion of these errors and their effect on our U.S. GAAP net income and shareholders' equity, see Item 5. Operating and Financial Review and Prospects U.S. GAAP Reconciliation and note 36(n) to our audited consolidated financial statements included elsewhere in this annual report.

### **Share Split**

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

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

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

### **Rounding**

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

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

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

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

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

competition in the Brazilian telecommunications sector;

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

changes in the legal and regulatory environment that affect the telecommunications industry and our business in general, including issues relating to the remuneration for the use of our network;

the Brazilian government's telecommunications policies, and changes in or developments of ANATEL regulations applicable to us;

the cost and availability of financing;

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

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

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

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

a longer than anticipated continuation of the current worldwide economic downturn or further deterioration in the Brazilian and world economies;

inflation and fluctuations in exchange rates;

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

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

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

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

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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**

**Selected Financial Information**

The following selected financial data have been derived from our consolidated financial statements. The selected financial data at December 31, 2008 and 2007 and for the three years ended December 31, 2008 have been derived from our audited consolidated financial statements included elsewhere in this annual report. The selected financial data at December 31, 2006, 2005 and 2004 and for the years ended December 31, 2005 and 2004 have been derived from our audited consolidated financial statements that are not included in this annual report, other than the U.S. GAAP reconciliation of this selected financial data as described below.

On December 28, 2007, the Brazilian government enacted Law No. 11,638/07, which became effective on January 1, 2008, amended the Brazilian Corporation Law, and changed certain accounting policies under Brazilian GAAP. In December 2008, the CVM issued Deliberation 565/08 implementing these changes in accounting policies. For a discussion of the principal changes introduced by Law No. 11,638/07 and Deliberation 565/08 as they relate to our financial statements, see Item 5. Operating and Financial Review and Prospects Financial Presentation and Accounting Policies Presentation of Financial Statements and notes 2(a) and 2(f) to our audited consolidated financial statements included elsewhere in this annual report.

In order to make our financial statements at December 31, 2007 and for the two years ended December 31, 2007 comparable to our financial statements at December 31, 2008 and for the year ended December 31, 2008, we have restated our previously issued financial statements at December 31, 2007 and for the two years ended December 31, 2007 included in our consolidated financial statements at December 31, 2008 and for the year ended December 31, 2008 to conform to the changes in accounting policy introduced by Law No. 11,638/07 and Deliberation No. 565/08. We have not restated our financial statements at December 31, 2006, 2005 or 2004 and for the two years ended December 31, 2005 to conform these changes in accounting policy because we cannot provide this information without unreasonable effort and expense and, therefore, the selected financial data at and for these periods may not be comparable.

Our consolidated financial statements are prepared in accordance with Brazilian GAAP, which differs in certain important respects from U.S. GAAP. For a discussion of certain differences relating to our financial statements, see note 36 to our audited consolidated financial statements included elsewhere in this annual report.

The U.S. GAAP reconciliation of our financial statements as of December 31, 2007 and for the two years ended December 31, 2007 included in our audited consolidated financial statements has been restated to correct errors in the calculation of our U.S. GAAP net income and shareholders' equity at this date and for these periods. The U.S. GAAP reconciliation of the selected financial data at December 31, 2006, 2005 and 2004 and for the years ended December 31, 2005 and 2004 have also been restated to correct errors in the calculation of our U.S. GAAP net income and shareholders' equity at this date and for these periods, however, the restatement of the U.S. GAAP reconciliation of this selected financial data has not been audited. For a discussion of these errors and their effect on our U.S. GAAP net income and shareholders' equity, see Item 5. Operating and Financial Review and Prospects U.S. GAAP Reconciliation and note 36 to our audited consolidated financial statements included elsewhere in this annual report.

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We have included information with respect to the dividends and/or interest attributable to shareholders' equity paid to holders of our common shares and preferred shares since January 1, 2004 in *reais* and in U.S. dollars translated from *reais* at the commercial market selling rate in effect as of the payment date under the caption Item 8. Financial Information Dividends and Dividend Policy Payment of Dividends.

This selected financial data should be read in conjunction with Item 5. Operating and Financial Review and Prospects and our audited consolidated financial statements included elsewhere in this annual report.

|  | For the Year Ended December 31, |            |                     |                     |            |            | 2008(1)<br>(in millions of<br>US\$, except<br>per share<br>amounts) |
|--|---------------------------------|------------|---------------------|---------------------|------------|------------|---|
|  | 2004                            | 2005       | 2006<br>as restated | 2007<br>as restated | 2008       |            |   |
| (in millions of <i>reais</i> , except per share amounts and as otherwise indicated)      |                                 |            |                     |                     |            |            |   |
| <b>Statement of Operations Data</b>  |                                 |            |                     |                     |            |            |   |
| <i>Brazilian GAAP:</i>   |                                 |            |                     |                     |            |            |   |
| Net operating revenue  | R\$ 9,065                       | R\$ 10,139 | R\$ 10,297          | R\$ 11,059          | R\$ 11,297 | US\$ 5,731 |   |
| Cost of sales and services   | (5,845)                         | (6,526)    | (6,465)             | (6,383)             | (6,209)    | (3,150)    |   |
| Gross profit   | 3,220                           | 3,613      | 3,832               | 4,676               | 5,088      | 2,581      |   |
| Operating expenses   | (2,153)                         | (3,547)    | (2,976)             | (3,308)             | (3,234)    | (1,641)    |   |
| Operating income before financial<br>expense, net  | 1,067                           | 66         | 855                 | 1,368               | 1,853      | 940        |   |
| Financial expense, net   | (580)                           | (596)      | (312)               | (275)               | (274)      | (139)      |   |
| Operating income (loss)  | 487                             | (530)      | 543                 | 1,093               | 1,579      | 801        |   |
| Non-operating income (expenses),<br>net  | (160)                           | (149)      |                     |                     |            |            |   |
| Income (loss) before taxes and<br>minority interest                                      | 327                             | (679)      | 543                 | 1,093               | 1,579      | 801        |   |
| Income tax and social contribution<br>tax benefit (expense)                              | (44)                            | 389        | (101)               | (295)               | (551)      | (280)      |   |
| Minority interest  | (6)                             | (13)       | 3                   | 2                   | 2          | 1          |   |
| Net income (loss)  | R\$ 277                         | R\$ (303)  | R\$ 445             | R\$ 800             | R\$ 1,030  | US\$ 522   |   |
| Number of shares outstanding at year<br>end, excluding treasury shares (in<br>thousands) | 541,608                         | 541,619    | 547,272             | 547,272             | 547,499    | 547,499    |   |
| Net income per share at year end   | R\$ 0.51                        | R\$ (0.56) | R\$ 0.81            | R\$ 1.46            | R\$ 1.88   | US\$ 0.95  |   |
| Net income per ADS at year end   | 1.53                            | (1.67)     | 2.43                | 4.38                | 5.65       | 2.86       |   |

(1) Translated for convenience only using the selling rate as reported by the Central Bank at July 6, 2009 for *reais* into U.S. dollars of R\$1.971=US\$1.00.

|   | For the Year Ended December 31, |                         |                         |                         |      | 2008(2)<br>(in millions of<br>US\$, except<br>per share<br>amounts) |
|---|---------------------------------|-------------------------|-------------------------|-------------------------|------|---|
|   | 2004 (1)<br>as restated         | 2005 (1)<br>as restated | 2006 (1)<br>as restated | 2007 (1)<br>as restated | 2008 |   |
| (in millions of <i>reais</i> , except per share amounts and as otherwise indicated) |                                 |                         |                         |                         |      |   |

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**Statement of Operations Data**

*U.S. GAAP:*

|                           |                   |       |      |        |      |        |      |        |      |        |      |       |      |
|---------------------------|-------------------|-------|------|--------|------|--------|------|--------|------|--------|------|-------|------|
| Net operating revenue     | R\$               | 9,070 | R\$  | 10,149 | R\$  | 10,306 | R\$  | 11,058 | R\$  | 11,298 | US\$ | 5,732 |      |
| Net income (loss)         |                   | 235   |      | 108    |      | 616    |      | 868    |      | 1,129  |      | 573   |      |
| Net income per share: (3) |                   |       |      |        |      |        |      |        |      |        |      |       |      |
| Common shares             | basic and diluted |       | 0.43 |        | 0.20 |        | 1.13 |        | 1.59 |        | 2.06 |       | 1.05 |
| Preferred shares          | basic and diluted |       | 0.43 |        | 0.20 |        | 1.13 |        | 1.59 |        | 2.06 |       | 1.05 |

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|   | For the Year Ended December 31,   |                         |                         |                         |         | 2008(2)<br>(in millions of<br>US\$, except<br>per share<br>amounts) |
|---|---|-------------------------|-------------------------|-------------------------|---------|---|
|   | 2004 (1)<br>as restated   | 2005 (1)<br>as restated | 2006 (1)<br>as restated | 2007 (1)<br>as restated | 2008    |   |
|   | (in millions of <i>reais</i> , except per share amounts and as otherwise indicated) |                         |                         |                         |         |   |
| ADs basic and diluted                               | 1.29  | 0.60                    | 3.39                    | 4.77                    | 6.18    | 3.14  |
| Weighted average shares outstanding (in thousands): |   |                         |                         |                         |         |   |
| Common shares basic and diluted                     | 249,597   | 249,597                 | 249,597                 | 249,597                 | 249,597 | 249,597   |
| Preferred shares basic and diluted                  | 292,011   | 292,022                 | 297,675                 | 297,675                 | 297,902 | 297,902   |

- (1) During the year ended December 31, 2006, our management identified certain errors relating to the U.S. GAAP adjustments for capitalized interest and the depreciation of the step-up in basis of companies under common control that are included in the reconciliation of shareholders' equity and net income between Brazilian GAAP and U.S. GAAP as of December 31, 2006 and for the year then ended. At that time, our management evaluated the significance of these errors and concluded that the impact was not material to the financial statements taken as a whole and therefore, recorded the effect in the related U.S. GAAP adjustments as of December 31, 2006 and for the year then ended. During the year ended December 31, 2007, our management identified certain additional errors relating to the same U.S. GAAP adjustments that are included in the reconciliation of shareholders' equity and net income between Brazilian GAAP and U.S. GAAP as of December 31, 2007 and for the year then ended. At that time, our management evaluated the significance of these errors and concluded that the impact was not material to the financial statements taken as a whole and therefore, recorded the effect in the related U.S. GAAP adjustments as of December 31, 2007 and for the year then ended. Subsequent to the issuance of our financial statements for the year ended December 31, 2007 and the acquisition of control of our company by Telemar, our management revised its calculation of the amount of these previously identified errors, reassessed the related impact on the respective years, and concluded that these errors were material to the financial statements taken as a whole. These errors relate to the calculations used to determine the U.S. GAAP adjustments relating to (1) capitalized interest and (2) the step-up in the basis of the fixed assets of certain entities under common control that were contributed to our company, as described in Notes 36(a) and 36(k)(vi), respectively, to our audited consolidated financial statements included elsewhere in this annual report. The errors related to the U.S. GAAP adjustment for capitalized interest arose from miscalculations of (1) the rates used to depreciate capitalized interest and (2) the inclusion of fully depreciated assets in the calculation. This resulted in a restatement to the components of the calculation for this difference included in Note 36(a) to our audited consolidated financial statements included elsewhere in this annual report. While the Brazilian GAAP numbers in this disclosure have been restated, our financial statements prepared under Brazilian GAAP were not impacted as these amounts are estimates used solely for the purpose of the U.S. GAAP adjustment. The error relating to the U.S. GAAP adjustment for the step-up in basis of fixed assets arose from an error in the calculation of the rates used to calculate the depreciation for this item. As a result, the related adjustments in the reconciliation of shareholders' equity and net income have been restated from the amounts previously reported. The following table sets forth the reconciliation between our net income under U.S. GAAP as previously reported and as restated.

|  | For the Year Ended December 31,                          |         |         |         |
|--|--|---------|---------|---------|
|  | 2004   | 2005    | 2006    | 2007    |
|  | (in millions of <i>reais</i> , except per share amounts) |         |         |         |
| Net income under U.S. GAAP (as previously reported)                | R\$ 285  | R\$ 169 | R\$ 687 | R\$ 767 |
| Difference in:   |  |         |         |         |
| Capitalized interest   | 5  | 1       | 1       | (0)     |
| Amortization of capitalized interest                               | (71)   | (79)    | (110)   | 139     |
| Depreciation of Step-up in basis of companies under common control | (9)  | (15)    | 1       | 14      |
| Deferred tax effect on adjustments                                 | 26   | 32      | 36      | (52)    |
| U.S. GAAP net income (as restated)                                 | R\$ 235  | R\$ 107 | R\$ 616 | R\$ 868 |
| Net income per share: (a)  |  |         |         |         |
| As previously reported:  |  |         |         |         |
| Common shares basic and diluted                                    | 0.53   | 0.31    | 1.26    | 1.40    |
| Preferred shares basic and diluted                                 | 0.53   | 0.31    | 1.26    | 1.40    |
| ADs basic and diluted  | 1.59   | 0.93    | 3.78    | 4.20    |
| As restated:   |  |         |         |         |
| Common shares basic and diluted                                    | 0.43   | 0.20    | 1.13    | 1.59    |

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|                                    |      |      |      |      |
|------------------------------------|------|------|------|------|
| Preferred shares basic and diluted | 0.43 | 0.20 | 1.13 | 1.59 |
| ADs basic and diluted              | 1.29 | 0.60 | 3.39 | 4.77 |

- (a) In accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, or SFAS 128, basic and diluted earnings per share have been calculated, for U.S. GAAP purposes, using the two class method. See note 36(d) to our audited consolidated financial statements included elsewhere in this annual report.
- (2) Translated for convenience only using the selling rate as reported by the Central Bank at July 6, 2009 for *reais* into U.S. dollars of R\$1.971=US\$1.00.
- (3) In accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, or SFAS 128, basic and diluted earnings per share have been calculated, for U.S. GAAP purposes, using the two class method. See note 36(d) to our audited consolidated financial statements included elsewhere in this annual report.



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|  | At December 31,        |           |           |         |           |                       |
|--|------------------------|-----------|-----------|---------|-----------|-----------------------|
|  | 2004                   | 2005      | 2006      | 2007    | 2008      | 2008(1)               |
|  |                        |           |           |         |           | (in millions of US\$) |
|  | (in millions of reais) |           |           |         |           |                       |
| <b>Balance Sheet Data</b>  |                        |           |           |         |           |                       |
| <i>Brazilian GAAP:</i>   |                        |           |           |         |           |                       |
| Cash and cash equivalents  | R\$ 2,398              | R\$ 1,730 | R\$ 2,542 | R\$ 584 | R\$ 1,479 | US\$ 750              |
| Short-term investments   |                        |           | 89        | 1,847   | 562       | 285                   |
| Trade accounts receivable  | 2,112                  | 2,153     | 2,128     | 2,190   | 2,210     | 1,121                 |
| Total current assets   | 5,689                  | 5,272     | 6,053     | 5,977   | 6,139     | 3,115                 |
| Property, plant and equipment, net   | 8,300                  | 7,593     | 6,535     | 5,690   | 5,902     | 2,994                 |
| Intangible assets  | 1,136                  | 1,220     | 1,163     | 1,237   | 1,632     | 828                   |
| Total assets   | 17,403                 | 16,107    | 15,998    | 15,535  | 17,670    | 8,965                 |
| Short-term loans and financing (including current portion of long-term debt) | 586                    | 824       | 971       | 390     | 659       | 334                   |
| Short-term debentures  | 494                    | 608       | 46        | 9       | 12        | 6                     |
| Short-term swaps relating to loans and financing                             | 24                     | 57        | 116       | 119     | 90        | 46                    |
| Total current liabilities  | 4,696                  | 5,363     | 4,637     | 4,412   | 4,792     | 2,431                 |
| Long-term loans and financing  | 3,056                  | 2,627     | 2,370     | 2,523   | 2,913     | 1,478                 |
| Long-term debentures   | 1,020                  | 500       | 1,580     | 1,080   | 1,080     | 548                   |
| Long-term swaps relating to loans and financing                              | 102                    | 292       | 304       | 288     | 132       | 67                    |
| Shareholders equity  | 6,481                  | 5,497     | 5,528     | 5,505   | 6,241     | 3,166                 |

- (1) Translated for convenience only using the selling rate as reported by the Central Bank at July 6, 2009 for *reais* into U.S. dollars of R\$1.971=US\$1.00.

|  | At December 31,        |             |             |             |           |                       |
|--|------------------------|-------------|-------------|-------------|-----------|-----------------------|
|  | 2004 (1)               | 2005 (1)    | 2006 (1)    | 2007 (1)    | 2008      | 2008(2)               |
|  | as restated            | as restated | as restated | as restated |           | (in millions of US\$) |
|  | (in millions of reais) |             |             |             |           |                       |
| <b>Balance Sheet Data</b>  |                        |             |             |             |           |                       |
| <i>U.S. GAAP:</i>  |                        |             |             |             |           |                       |
| Cash and cash equivalents  | R\$ 492                | R\$ 356     | R\$ 402     | R\$ 584     | R\$ 1,479 | US\$ 750              |
| Short-term investments   | 1,906                  | 1,374       | 2,229       | 1,847       | 562       | 285                   |
| Intangible assets  | 1,908                  | 1,978       | 1,971       | 2,630       | 3,106     | 1,576                 |
| Property, plant and equipment, net   | 9,722                  | 8,915       | 7,806       | 5,933       | 6,087     | 3,088                 |
| Total assets   | 18,796                 | 17,663      | 17,993      | 17,423      | 19,615    | 9,951                 |
| Short-term loans, financing and debentures (including current portion of long-term debt) | 831                    | 1,148       | 815         | 399         | 671       | 340                   |
| Short-term swaps relating to loans and financing   | 17                     | 54          | 115         | 119         | 90        | 46                    |
| Long-term loans, financing and debentures  | 3,888                  | 2,963       | 3,945       | 3,603       | 3,993     | 2,026                 |
| Long-term swaps relating to loans and financing  | 72                     | 275         | 301         | 288         | 132       | 67                    |
| Total liabilities (including funds for capitalization and minority interests)            | 11,704                 | 11,145      | 11,049      | 10,501      | 11,890    | 6,032                 |
| Shareholders equity  | 7,094                  | 6,518       | 6,944       | 7,329       | 7,725     | 3,919                 |

- (1) During the year ended December 31, 2006, our management identified certain errors relating to the U.S. GAAP adjustments for capitalized interest and the depreciation of the step-up in basis of companies under common control that are included in the reconciliation of shareholders equity and net income between Brazilian GAAP and U.S. GAAP as of December 31, 2006 and for the year then ended. At that time, our management evaluated the significance of these errors and concluded that the impact was not material to the financial statements taken as a whole and therefore, recorded the effect in the related U.S. GAAP adjustments as of December 31, 2006 and for the year then ended. During the year ended December 31, 2007, our management identified certain additional errors relating to the same U.S.

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GAAP adjustments that are included in the reconciliation of shareholders' equity and net income between Brazilian GAAP and U.S. GAAP as of December 31, 2007 and for the year then ended. At that time, our management evaluated the significance of these errors and concluded that the impact was not material to the financial statements taken as a whole and therefore, recorded the effect in the related U.S. GAAP adjustments as of December 31, 2007 and for the year then ended. Subsequent to the issuance of our financial statements for the year ended December 31, 2007 and the acquisition of control of our company by Telemar, our management revised its calculation of the amount of these previously identified errors, reassessed the related impact on the respective years, and concluded that these errors were material to the financial statements taken as a whole. These errors relate to the calculations used to determine the U.S. GAAP adjustments relating to (1) capitalized interest and (2) the step-up in the basis of the fixed assets of certain entities under common control that were contributed to our company, as described in Notes 36(a) and 36(k)(vi), respectively, to our audited consolidated financial statements included elsewhere in this annual report. The errors related to the U.S. GAAP adjustment for capitalized interest arose from miscalculations of (1) the rates used to depreciate capitalized interest and (2) the inclusion of fully depreciated assets in the calculation. This resulted in a restatement to the components of the calculation for this difference included in Note 36(a) to our audited consolidated financial statements included elsewhere in this annual report. While the Brazilian GAAP numbers in this disclosure have been restated, our financial statements prepared under Brazilian GAAP were not impacted as these amounts are estimates used solely for the purpose of the U.S. GAAP adjustment. The error relating to the U.S. GAAP adjustment for the step-up in basis of fixed assets arose from an error in the calculation of the rates used to calculate the depreciation for this item. As a result, the related adjustments in the reconciliation of shareholders' equity and net income have been restated from the amounts previously reported. The following table sets forth the reconciliation between our shareholders' equity under U.S. GAAP as previously reported and as restated.

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|   | 2004      | At December 31,<br>2005                      2006<br>(in millions of reais) |           | 2007      |
|---|-----------|---|-----------|-----------|
| Total shareholders equity under U.S. GAAP (as previously reported)                                  | R\$ 7,072 | R\$ 6,558   | R\$ 7,055 | R\$ 7,339 |
| Difference in:  |           |   |           |           |
| Capitalized interest  | 12        | 13  | 14        | 14        |
| Amortization of capitalized interest  | 21        | (58)  | (168)     | (29)      |
| Step-up in basis of companies under common control, net of amortization until 2001 and depreciation | (0)       | (15)  | (14)      | (0)       |
| Deferred tax effect on adjustments  | (11)      | 21  | 57        | 5         |
| Total shareholders equity under U.S. GAAP (as restated)   | R\$ 7,094 | R\$ 6,518   | R\$ 6,944 | R\$ 7,329 |

(2) Translated for convenience only using the selling rate as reported by the Central Bank at July 6, 2009 for *reais* into U.S. dollars of R\$1.971=US\$1.00.

**Exchange Rates**

Prior to March 14, 2005, there were two principal foreign exchange markets in Brazil:

the commercial rate exchange market; and

the floating rate exchange market.

Most trade and financial foreign-exchange transactions were carried out on the commercial rate exchange market. The floating rate exchange market generally applied to transactions to which the commercial market rate did not apply.

On March 4, 2005, the National Monetary Council (*Conselho Monetário Nacional*) enacted Resolution No. 3,265, as well as additional regulations, that consolidated the two foreign exchange markets into a single foreign exchange market, effective as of March 14, 2005, in order to make foreign exchange transactions more straight-forward and efficient. Consequently, all foreign exchange transactions in Brazil are now carried out in this single foreign exchange market through authorized financial institutions. We cannot predict the impact of the enactment of any new regulations on the foreign exchange market.

Foreign exchange rates continue to be freely negotiated, but may be influenced from time to time by Central Bank intervention. From March 1995 through January 1999, the Central Bank allowed the gradual depreciation of the *real* against the U.S. dollar. In January 1999, the Central Bank allowed the *real*/U.S. dollar exchange rate to float freely. Since then, the *real*/U.S. dollar exchange rate has been established mainly by the Brazilian interbank market and has fluctuated considerably. From December 31, 2000 through December 31, 2002, the *real* depreciated by 80.6% against the U.S. dollar. From December 31, 2002 through December 31, 2007, the *real* appreciated by 49.9% against the U.S. dollar, and in 2008, the *real* depreciated by 31.9% against the U.S. dollar. At July 6, 2009, the selling rate for U.S. dollars was R\$1.971 per US\$1.00. In the past, the Central Bank has intervened occasionally to control unstable movements in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to allow the *real* to float freely or will intervene in the exchange rate market through a currency band system or otherwise, or that the exchange market will not be volatile as a result of political or economic instability or other factors. We also cannot predict whether the *real* will depreciate or appreciate in value in relation to the U.S. dollar in the future.

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

| Year | Reais per U.S. Dollar |           |           | Period End |
|------|-----------------------|-----------|-----------|------------|
|      | High                  | Low       | Average   |            |
| 2004 | R\$ 3.205             | R\$ 2.654 | R\$ 2.917 | R\$ 2.654  |
| 2005 | 2.762                 | 2.163     | 2.413     | 2.341      |
| 2006 | 2.371                 | 2.059     | 2.168     | 2.138      |
| 2007 | 2.156                 | 1.733     | 1.930     | 1.771      |
| 2008 | 2.500                 | 1.559     | 1.834     | 2.337      |

| Month                      | Reais per U.S. Dollar |           |
|----------------------------|-----------------------|-----------|
|                            | High                  | Low       |
| January 2009               | R\$ 2.380             | R\$ 2.189 |
| February 2009              | 2.392                 | 2.245     |
| March 2009                 | 2.422                 | 2.238     |
| April 2009                 | 2.290                 | 2.170     |
| May 2009                   | 2.148                 | 1.973     |
| June 2009                  | 2.007                 | 1.930     |
| July 2009 (through July 6) | 1.971                 | 1.934     |

Source: Central Bank

**Risk Factors**

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

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

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

Our fixed-line telecommunications services in Region II face increasing competition from mobile services as the prices for mobile services decline and approach those of fixed-line services. According to ANATEL, from December 2005 to December 2008, the number of fixed lines in service in Brazil increased from 39.8 million to 41.1 million. We expect the number of fixed lines in service in Brazil to continue to stagnate or decline, as certain customers eliminate their fixed-line services in favor of mobile services, and the use of existing fixed lines to decrease as customers make additional calls on mobile phones as a result of promotional rates (such as free calls within a mobile provider's network). The rate at which the number of fixed lines in service in Brazil declines depends on many factors beyond our control, such as economic, social, technological and other developments in Brazil. In addition, new fixed lines that we install are expected to be less profitable than existing ones because new fixed-line customers generally have lower incomes than our existing customers, subscribe to our lower cost service plans and generate fewer chargeable minutes of usage. Because we derive a significant portion of our operating revenue from our traditional local fixed-line telecommunications services (for the year ended December 31, 2008, these services represented 38.5% of our gross operating revenue), a reduction in the number of our fixed-lines in service would negatively affect our operating revenue and margins.

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We also compete in the market for local fixed-line services with other fixed-line service providers, primarily with Empresa Brasileira de Telecomunicações – Embratel, or Embratel, and GVT S.A., or GVT, in Region II. Embratel competes with us for residential customers in Region II through services that it provides using the cable infrastructure of its affiliate, Net Serviços de Comunicação S.A., or Net, as described below. In addition, we compete with smaller companies that have been authorized by ANATEL to provide local fixed-line services. In March 2007, ANATEL adopted the General Regulation of Portability (*Regulamento Geral de Portabilidade*), which established the general rules regarding portability of fixed-line numbers, which allow customers to move to a new home or office or switch service providers while retaining the same fixed-line number. Implementation of number portability commenced in August 2008 and was completed in March 2009. We believe that number portability may negatively affect our local fixed-line business, particularly our services to corporate customers, because it allows our customers to overcome their general resistance to changing their fixed-line telephone numbers and thereby allows our competitors to attract these customers.

In November 2005, Embratel, our main competitor in fixed-line services, announced a telecommunications services agreement with Net, a cable television company that is our main competitor in the broadband services market. Both companies are affiliates of Teléfonos de México S.A.B. de C.V., or Telmex, one of the leading telecommunications service providers in Latin America. This agreement supports the offering to the Brazilian residential market of integrated voice, broadband and pay television services through a single network infrastructure. This bundling strategy has increased competition in the local fixed-line services and broadband businesses, which may require us to increase our marketing and capital expenditures, or reduce our rates to maintain market share, in each case leading to a reduction in our profitability.

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

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

The mobile services market in Brazil is extremely competitive. As of December 31, 2008, according to information available from ANATEL, we had an estimated 14.4% share of the mobile services market in Region II, based on the total number of subscribers as of that date. We face competition from in Region II from large competitors such as Vivo Participações S.A., or Vivo, and Telecom Americas Group, which markets its services under the brand name Claro, and TIM Participações S.A., or TIM, which had estimated market shares of 32.8%, 27.7% and 24.9% in Region II, respectively, as of that date. Vivo, TIM and Telecom Americas Group are each controlled by multinational companies that may have more significant financial and marketing resources and a greater ability to access capital on a timely basis and on more favorable terms than us.

Our ability to generate revenues from our mobile services business depends on our ability to increase and retain our customer base. Each additional customer subscribing to our service entails costs, including sales commissions and marketing costs. Recovering these costs depends on our ability to retain such customers. Therefore, high rates of customer churn could have a material adverse effect on the profitability of our mobile services business. During 2008, our average monthly churn rate in the mobile services segment, representing the number of subscribers whose service is disconnected during each month, whether voluntarily or involuntarily, divided by the number of subscribers at the beginning of such month, was 4.1% per month.

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

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

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

In Brazil, unlike in the United States and elsewhere, a caller chooses its preferred long-distance carrier for each long-distance call, whether originated from a fixed-line telephone or a mobile handset, by dialing such carrier's long-distance carrier selection code. The long-distance services market in Brazil is highly competitive. Our principal competitors for long-distance services originating on fixed-line telephones in Region II are Embratel (an affiliate of Telecom Americas Group) and GVT. We compete for long-distance services originating on mobile telephones in Region II with Embratel, Telecomunicações de São Paulo S.A., or Telesp (an affiliate of Vivo), and TIM. Generally, callers placing fixed-line long-distance calls in Brazil tend to select the long-distance carrier affiliated with the provider of their fixed-line service. Similarly, callers placing mobile long-distance calls in Brazil tend to select the long-distance carrier affiliated with the provider of their mobile or fixed-line service. Embratel, as the incumbent long-distance service provider, is the most aggressive of these competitors, offering discounts and other promotions from time to time in an effort to increase its market share in the long-distance market. Competition in the long-distance market may require us to increase our marketing expenses or provide services at lower rates than those we currently expect to charge for such services. If competition in the domestic long-distance market increases, it could have a material adverse effect on our revenues and margins. See Item 4. Information on the Company Competition Long-Distance Services.

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

Competition in data transmission services is not subject to significant regulatory restrictions and, therefore, the market is open to a large number of competitors. Some competitors, such as cable operators, offer telephone and broadband services, which does not require them to use our network, thereby allowing them to reach our clients without paying interconnection and/or mobile network usage fees to our company. Additionally, we anticipate that ANATEL will auction radio frequency licenses, possibly in 2010, that may be used to establish Worldwide Interoperability for Microwave Access, or WiMax, networks. The implementation of WiMax networks may allow other ISPs to deploy wireless Internet Protocol, or IP, networks over a much greater area, for a much lower cost, than previously possible. This reduced deployment cost may give our competitors, or new entrants into the data transmission market, the ability to provide Voice over Internet Protocol, or VoIP, and other data services over WiMax networks at lower rates than we are able to offer.

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

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

Companies in the telecommunications industry must adapt to rapid and significant technological changes that are usually difficult to anticipate. The mobile telecommunications industry in particular has experienced rapid and significant technological development and frequent improvements in capacity, quality and data-transmission speed. Technological changes may render our equipment, services and technology obsolete or inefficient, which may adversely affect our competitiveness or require us to increase our capital expenditures in order to maintain our competitive position. For example, in 2008, we invested R\$288 million in our network and R\$487 million in licenses in connection with the implementation of our Universal Mobile Telecommunications System, or UMTS, services, which we refer to as 3G services, in Region II. While we have been upgrading our fixed-line networks with technologically advanced fiber optic cable with a microwave overlay for use in our long-distance services, it is possible that alternative technologies may be developed that are more advanced than those we currently provide. If

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ANATEL auctions radio frequency spectrum for use in the development of WiMax networks, we expect that we may be required to participate in these auctions and deploy a WiMax network to remain competitive in the broadband services market. Even if we adopt new technologies in a timely manner as they are developed, the cost of such technology may exceed the benefit to us, and we cannot assure you that we will be able to maintain our level of competitiveness.

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

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

In October 2008, ANATEL published items that are on its regulatory agenda in the short-term (up to two years), medium-term (up to five years) and long-term (up to 10 years). In the short-term, ANATEL is expected to address the following items, among others: (1) review of and amendments to concession agreements to include additional obligations to expand existing networks; (2) assessment of the adequacy of fixed-line regulations in light of the convergence of telecommunications services; (3) regulation of service providers with significant market power; and (4) establishment of additional obligations to extend mobile networks, including broadband services, to rural areas. We cannot predict when regulations regarding these matters will be proposed, whether these regulations will be adopted as proposed or whether ANATEL, the Brazilian Ministry of Communications or the Brazilian government will adopt other telecommunications sector policies in the future or the consequences of such policies on our business and the business of our competitors.

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

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

In 2008, monthly subscription fees represented 21.6% of our gross operating revenue. The enactment of legislation terminating the monthly subscription fees would have a material adverse effect on our results of operations.

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

We provide fixed-line telecommunications services in Region II pursuant to concession agreements with the Brazilian government. Our concession agreements expire on December 31, 2025, and may be amended by the parties every five years prior to the expiration date. ANATEL will engage in public consultation in connection with each five-year amendment to discuss its proposals for new conditions and quality and universal service targets. The first amendment to each of the concession agreements is expected to become effective on January 1, 2011. In connection with each of these amendments, we are currently discussing modifications to our concession agreements with ANATEL. On March 30, 2009, ANATEL published a public notice of the proposed modifications to these concession agreements. In this public notice, ANATEL proposed amendment to the General Plan on Universal Service that would (1) require the expansion of our fixed-line network to all municipalities (*municípios*), which are analogous to counties in the U.S, with more than 30,000 inhabitants, (2) require us to provide service to a large number of additional areas, including indigenous villages, rural schools, health clinics, military bases, federal and state highway police stations, public aerodromes and environmental conservation organizations, and (3) require the fixed-line concessionaires to install an aggregate of up to approximately 110,000 additional public telephones, which number may be reduced as a result of ongoing changes in ANATEL regulations decreasing the number of public telephones required per inhabitant. The public consultation period in connection with the March 30, 2009

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public notice ended on June 22, 2009, although the final amendments to our concession agreements have not yet been determined. Our obligations under the concession agreements may be subject to revision in connection with each amendment. We cannot assure you that any of these amendments will not impose requirements on our company that will require us to undertake significant capital expenditures or will not modify the rate setting procedures applicable to us in a manner that will significantly reduce the gross operating revenue that we generate from our fixed-line businesses. If the amendments to our concession agreements have these effects, our business, financial condition and results of operations could be materially adversely affected.

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

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

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

On an almost weekly basis, we receive inquiries from ANATEL requiring information from us on our compliance with the various service obligations imposed on us by our concession agreements. If we are unable to comply satisfactorily with those inquiries or our service obligations under our concession agreements, ANATEL may commence administrative proceedings in connection with such noncompliance. We have received numerous notices of commencement of administrative proceedings from ANATEL, mostly due to our inability to achieve certain targets established in the General Plan on Quality Goals and the General Plan on Universal Service, among others. We had recorded provisions in the amount of R\$149 million as of December 31, 2008 in connection with fines sought to be imposed by ANATEL. Additional fines from ANATEL or fines in excess of the provisioned amount could adversely impact our financial condition and results of operations. See Item 4. Information on the Company Regulation of the Brazilian Telecommunications Industry and Item 8. Financial Information Legal Proceedings Civil Claims Administrative Proceedings.

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

*We may be unable to implement our 3G network or our projects to upgrade and enhance our existing mobile networks in a timely manner or without unanticipated costs.*

Following our receipt in December 2007 of the radio frequency licenses necessary to offer 3G services in Region II, we have undertaken significant capital expenditure programs to implement the networks necessary for us to provide these services. In addition, we have undertaken a project to upgrade a portion of our mobile network to enable us to increase the capacity of this network. Our ability to achieve our strategic objectives relating to our mobile services depends on and will depend on, in large part, the successful, timely and cost-effective implementation of these networks and projects. Factors that could affect this implementation include:

our ability to generate cash flow or to obtain future financing necessary for such implementation;



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delays in the delivery of telecommunications equipment by our vendors;

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

delays resulting from the failure of third party suppliers or contractors to meet their obligations in a timely and cost-effective manner. Although we believe that our cost estimates and implementation schedule are reasonable, we cannot assure you that the actual costs or time required to complete the implementation of these networks will not substantially exceed our current estimates. Any significant cost overrun or delay could hinder or prevent the successful implementation of our business plan and result in revenues and net income being less than expected.

*We depend on key suppliers and vendors to provide equipment that we need to operate our business.*

We depend upon various key suppliers and vendors, including Ericsson, Alcatel-Lucent, Nokia and Huawei, to provide us with network equipment, which we need in order to expand and to operate our business. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements. If these suppliers or vendors fail to provide equipment or service to us on a timely basis, we could experience disruptions, which could have an adverse effect on our revenues and results of operations, and we might be unable to satisfy the requirements contained in our concession and authorization agreements.

*We are permitted to negotiate rates for interconnection to our mobile networks with providers of fixed line-services. ANATEL arbitration of these rates as a result of our failure to reach agreement with providers of fixed line-services may result in reductions of the interconnection rates that we currently charge.*

In order to receive or send calls from or to customers of other Brazilian and international fixed-line and mobile networks, we must interconnect with the networks of our competitors. The Brazilian General Telecommunications Law (*Lei Geral das Telecomunicações*) requires all telecommunications service providers to interconnect their networks with those of other providers on a non-discriminatory basis. ANATEL sets the interconnection rates that fixed-line networks may charge.

Interconnection rates that mobile networks charge have typically been higher than the rates set by ANATEL for fixed-line networks. As a result, mobile operators generally have received a large portion of revenues generated by fixed-to-mobile calls, while fixed-line networks generally have received a small portion of revenues generated by mobile-to-fixed calls. Since July 2004, the interconnection rates that mobile networks may charge have been freely negotiable. Brazilian laws and regulations provide that if interconnection rates for mobile networks are not agreed among telecommunications service providers, ANATEL is empowered to arbitrate, at its discretion, the interconnection rates that mobile telecommunications companies may charge.

When we began offering mobile services, we were each unable to agree with fixed-line service providers on the interconnection rates that we would charge the fixed-line service providers. Similarly, none of the other mobile services providers were able to agree with fixed-line service providers on the interconnection rates that they would charge the fixed-line service providers at the time that their authorizations to provide mobile services were granted. Each of the mobile services providers and the fixed-line service providers with which they interconnected commenced arbitration proceedings before ANATEL to establish the applicable interconnection rates. ANATEL established provisional rates applicable to each mobile services provider, pending a final decision in the arbitration proceedings.

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An initial decision approving these provisional rates was rendered in September 2007, but an appeal remains pending before ANATEL's Council of Directors (*Conselho Diretor*). We cannot predict whether the final interconnection rates established by ANATEL will be equivalent to those currently applied by us. If ANATEL sets interconnection rates that mobile operators may charge at a level that differs substantially from the current level, our results of operations may be materially adversely affected.

*Our controlling shareholder, TmarPart, has control over us and our controlled companies.*

We are controlled indirectly by Telemar Participações S.A., or TmarPart, which, as of July 6, 2009 indirectly held 99.3% of the voting shares of Brasil Telecom. TmarPart's shareholders are parties to two shareholders' agreements governing their equity interests in TmarPart. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders' TmarPart Shareholders' Agreements. Our controlling shareholder and its controlling shareholders are entitled to appoint a majority of the members of our board of directors, and they have the power to determine the decisions to be taken at our shareholders' meetings on matters of our management that require the prior authorization of our shareholders, including in respect of related party transactions, corporate restructurings and the date of payment of dividends and other capital distributions. The decisions of our controlling shareholder and its controlling shareholders on these matters may be contrary to the expectations or preferences of holders of our indebtedness, including holders of our preferred shares and ADSs.

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

At December 31, 2008, we had total consolidated indebtedness excluding swap adjustments, of R\$4,679 million and a ratio of debt to equity of 1.3:1.

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

incur additional debt;

grant liens;

pledge assets;

sell or dispose of assets; and

make certain acquisitions, mergers and consolidations.

Furthermore, some of our debt instruments include financial covenants that require us and/or our subsidiaries to maintain certain specified financial ratios. As a result of adjustments in our provision for contingencies in 2009, including in connection with Telemar's acquisition of control of our company, we expect that we will not comply with certain covenants set forth in our debt instruments with the Brazilian National Bank for Economic and Social Development (*Banco Nacional de Desenvolvimento Econômico e Social*), or BNDES, and The Japan Bank of International Cooperation, or JBIC, and in our debentures as of June 30, 2009. Under each of these debt instruments the creditor has the right to accelerate the debt if, at the end of any fiscal quarter, we are not in compliance with the covenants containing these ratios. We have received a waiver from BNDES and are currently seeking waivers from JBIC and the holders of our debentures in respect of the anticipated breach of these covenants. We cannot provide investors with any assurance that these waivers will be obtained. See Item 5. Operating and Financial Review and Prospects Indebtedness and Financing Strategy Long-Term Indebtedness. In general, the occurrence of an event of default under one of our debt instruments may trigger defaults under our other debt instruments. If we are unable to incur additional debt, we may be unable to invest in our business and make necessary or advisable capital expenditures, which could reduce future operating revenue and adversely affect our profitability. In addition, cash required to serve our existing indebtedness reduces the amount available to us to make capital expenditures.

If our growth in net operating revenue slows or declines in a significant manner, for any reason, we may not be able to continue servicing our debt. If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to renegotiate or refinance our

indebtedness, seek additional equity capital or sell assets. We may be unable to obtain financing or sell assets on satisfactory terms, or at all. For more information regarding our debt instruments and our indebtedness at December 31, 2008, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

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

We are subject to numerous legal and administrative proceedings. It is difficult to quantify the potential impact of these legal and administrative proceedings. We classify our risk of loss from legal and administrative proceedings as probable, possible or remote. We make provisions for probable claims but do not make provisions for possible and remote claims. At December 31, 2008, we had provisioned R\$1,449 million for probable claims relating to various tax, labor and civil legal and administrative proceedings against us.

At December 31, 2008, we had claims against us of approximately R\$1,672 million in tax proceedings, R\$633 in labor proceedings and R\$1,220 million in civil proceedings with a risk of loss classified as possible and for which we had made no provisions. See note 28 to our audited consolidated financial statements included elsewhere in this annual report. We do not include in our financial statements the estimated contingency in connection with proceedings in respect of which we consider the risk of loss to be remote.

As the result of Telemar's acquisition of control of our company in January 2009, we have changed our criteria for estimating probable losses in connection with labor proceedings and the recognition of tax credits for the Tax on the Circulation of Merchandise and Services (*Imposto Sobre a Circulação de Mercadorias e Serviços*), or ICMS (a state value-added tax on sales and services), in order to align our policies with those of Telemar. As a result, we have recorded additional provisions for labor proceedings and tax proceedings in 2009 in the amount of R\$325 million and R\$387 million, respectively.

Additionally, as the result of certain judicial decisions in 2009, we have reclassified the probability of loss in certain civil proceedings involving Companhia Riograndense de Telecomunicações, or CRT, the leading fixed-line telecommunications service company in the State of Rio Grande do Sul that we acquired in 2000, from possible to probable. As a result, we have recorded an additional provision in 2009 in the amount of R\$1,153 million in connection with the proceedings.

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

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

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

*We are subject to delinquencies of our accounts receivables.*

Our business significantly depends on our customers' ability to pay their bills and comply with their obligations to us. In 2007 and 2008, we recorded provisions for doubtful accounts in the amount of R\$348 million and R\$370 million, respectively, primarily due to subscribers delinquencies. As a percentage of our gross operating revenue, our provision for doubtful accounts was 2.0% at December 31, 2007 and 2.2% at December 31, 2008.

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

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

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*If key members of our senior management team were to resign, or if we are unable to attract and retain skilled management, our business could be materially adversely affected.*

Our ability to remain competitive in our markets and achieve our growth strategy depends on our senior management team. We may not be able to continue to successfully attract and retain skilled management. If key members of our senior management team were to resign, or if we are unable to continue to attract and retain skilled management, our business, financial condition and results of operations could be adversely affected.

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

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

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

We incur costs associated with the unauthorized and fraudulent use of our networks, including administrative and capital costs associated with detecting, monitoring and reducing the incidence of fraud. Fraud also affects interconnection costs and payments to other carriers for non-billable fraudulent roaming. Improper use of our network can also increase our selling expenses if we need to increase our provision for doubtful accounts to reflect amounts we do not believe we can collect for improperly made calls. Any increase in the improper use of our network in the future could materially adversely affect our costs and results of operations.

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

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

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

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

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### ***Risks Relating to Brazil***

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

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

political instability;

devaluations and other currency fluctuations;

inflation;

price instability;

interest rates;

liquidity of domestic capital and lending markets;

energy shortages;

exchange controls;

changes to the regulatory framework governing our industry;

monetary policy;

tax policy; and

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

Uncertainty over whether possible changes in policies or rules affecting these or other factors may contribute to economic uncertainties in Brazil and to heightened volatility in the Brazilian securities markets and securities issued abroad by Brazilian issuers. The President of Brazil has considerable power to determine governmental policies and actions that relate to the Brazilian economy and, consequently, affect the operating

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and financial results of businesses, such as our company. The term of Brazil's current President, Luiz Inácio Lula da Silva, expires in January 2011, and under Brazilian law he is not permitted to run for another four-year term in the October 2010 elections. Uncertainty regarding the election of President Lula's successor and speculation about the policies that may be implemented by the Brazilian federal or state governments could adversely affect our business, results of operations and financial condition.



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

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

We may also face significant liquidity challenges if conditions in the financial markets do not improve. Our ability to access the capital markets or the commercial bank lending markets may be severely restricted at a time when we would like, or need, to access such markets, which could have an impact on our flexibility to react to changing economic and business conditions. The financial and credit crisis could have an impact on the lenders under our existing credit facilities, on our customers, or on the ability of our suppliers to meet scheduled deliveries, causing them to fail to meet their obligations to us. If the global financial and credit crisis deepens further, it could have an adverse effect on the demand for our services and our ability to fund our planned growth.

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

During the four decades prior to 1999, the Central Bank periodically devalued the Brazilian currency. Throughout this period, the Brazilian government implemented various economic plans and used various exchange rate policies, including sudden devaluations (such as daily and monthly adjustments), exchange controls, dual exchange rate markets and a floating exchange rate system. Since 1999, exchange rates have been set by the market. The exchange rate between the *real* and the U.S. dollar has varied significantly in recent years. For example, the *real*/U.S. dollar exchange rate increased from R\$1.955 per U.S. dollar on December 31, 2000 to R\$3.533 on December 31, 2002. The *real* appreciated against the U.S. dollar by 8.1% in 2004, 11.8% in 2005, 8.7% in 2006 and 17.1% in 2007. In 2008, primarily as a result of the international financial crisis, the *real* depreciated by 31.9% against the U.S. dollar and prompted foreign investors to remove billions of *reais* from the Brazilian Securities, Commodities and Futures Exchange (*BM&FBOVESPA S.A. - Bolsa de Valores Mercadorias e Futuros*), which we refer to as the BOVESPA.

A significant amount of our financial assets and liabilities are denominated in or indexed to foreign currencies, primarily U.S. dollars and Japanese yen. As of December 31, 2008, R\$791 million, or 16.9% of our financial indebtedness, was denominated in a foreign currency, excluding including swap adjustments. When the *real* depreciates against foreign currencies, we incur losses on our liabilities denominated in or indexed to foreign currencies, such as our U.S. dollar-denominated long-term debt and foreign currency loans, and we incur gains on our monetary assets denominated in or indexed to foreign currencies, as the liabilities and assets are translated into *reais*. If significant depreciation of the *real* were to occur when the value of such liabilities significantly exceeds the value of such assets, including any financial instruments entered into for hedging purposes, we could incur significant losses, even if their value has not changed in their original currency. This could adversely affect our ability to meet certain of our payment obligations. A failure to meet certain of our payment obligations could trigger a default under certain financial covenants in our debt instruments, which could have a material adverse effect on our business and results of operations. Additionally, we currently have currency swaps in place for a portion of our foreign currency debt. If the cost of swap instruments increases substantially, we may be unable to maintain our hedge policy, resulting in an increased foreign currency exposure which could in turn lead to substantial foreign exchange losses.

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

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

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

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

Since the introduction of the *real* in 1994, Brazil's inflation rate has been substantially lower than in previous periods. However, actions taken in an effort to control inflation, coupled with speculation about possible future governmental actions, have contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. More recently, Brazil's rates of inflation, as measured by the General Market Price Index - Internal Availability (*Índice Geral de Preços - Disponibilidade Interna*), or IGP-DI, published by Fundação Getúlio Vargas, or FGV, were 12.1% in 2004, 1.2% in 2005, 3.8% in 2006, 7.9% in 2007 and 9.1% in 2008. According to the Broad Consumer Price Index (*Índice Nacional de Preços ao Consumidor Ampliado*), or IPCA, published by the Brazilian Institute for Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*), or IBGE, the Brazilian consumer price inflation rates were 7.5% in 2004, 5.7% in 2005, 3.1% in 2006, 4.5% in 2007 and 9.1% in 2008.

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

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

Our financial expenses are affected by changes in the interest rates that apply to our floating rate debt. At December 31, 2008, we had, among other debt obligations, R\$2,564 million of loans and financing that were subject to the TJLP (*Taxa de Juros de Longo Prazo*), or TJLP, a long-term interest rate, R\$1,106 million of local commercial paper and debentures that were subject to the Interbank Certificate of Deposit (*Certificado Depositário Interbancário*), or CDI, rate, an interbank rate, and R\$282 million of loans and financing that were subject to Japanese Yen LIBOR.

The TJLP includes an inflation factor and is determined quarterly by the Central Bank. In particular, the TJLP and the CDI rate have fluctuated significantly in the past in response to the expansion or contraction of the Brazilian economy, inflation, Brazilian government policies and other factors. For example, in 2008, the CDI rate increased from 11.18% per annum at December 31, 2007 to 12.38% per annum at December 31, 2008. A significant increase in any of these interest rates, particularly the CDI rate, could adversely affect our financial expenses and negatively affect our overall financial performance.

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

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

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

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

A more restrictive policy could increase the cost of servicing, and thereby reduce our ability to pay, our foreign currency-denominated debt obligations and other liabilities. Our foreign-currency denominated debt represented 16.9% of our indebtedness on a consolidated basis at December 31, 2008. If we fail to make payments under any of these obligations, we will be in default under those obligations, which could reduce our liquidity as well as the market price of our preferred shares and the ADSs.

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

***Risks Relating to Our Preferred Shares and the ADSs***

*Our preferred shares and the ADSs have limited voting rights.*

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

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

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

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

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

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

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

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

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

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

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

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

Although insider trading and price manipulation are crimes under Brazilian law, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or the markets in some other jurisdictions. In addition, rules and policies against self-dealing or for preserving shareholder interests may be less well-defined and enforced in Brazil than in the United States and certain other countries, which may put holders of our preferred shares and the ADSs at a potential disadvantage. Corporate disclosures also may be less complete or informative than for a public company in the United States or in certain other countries.

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

We are organized under the laws of Brazil, and all of the members of our board of directors and all of our executive officers and our independent public accountants reside or are based in Brazil. The vast majority of our assets and those of these other persons are located in Brazil. As a result, it may not be possible for holders of 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. In addition, because substantially all of our assets and all of our directors and officers reside outside the United States, any judgment obtained in the United States against us or any of our directors or officers may not be collectible within the United States. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain conditions are met, holders may face greater difficulties in protecting their interests in the case of actions by us or our board of directors or executive officers than would shareholders of a U.S. corporation. In addition, there is doubt as to the applicability and enforceability of civil liabilities under the Securities Act or the Exchange Act through lawsuits filed before Brazilian courts.

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

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

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

The Brazilian securities markets are substantially smaller, less liquid and more volatile than major securities markets in the United States. The BOVESPA, which is the principal Brazilian stock exchange, had a market capitalization of R\$1,375.3 billion (US\$588.5 billion) at December 31, 2008 and an average daily trading volume of US\$3.1 billion for 2008. In comparison, the New York Stock Exchange, or the NYSE, had a market capitalization of US\$16.7 trillion at December 31, 2008 and an average daily trading volume of US\$152.6 billion for 2008. There is also significantly greater concentration in the Brazilian securities markets. The ten largest companies in terms of market capitalization represented approximately 52% of the aggregate market capitalization of the BOVESPA at December 31, 2008. The ten most widely traded stocks in terms of trading volume accounted for approximately 53% of all shares traded on the BOVESPA in 2008. These market characteristics may substantially limit the ability of holders of the ADSs to sell preferred shares underlying the ADSs at a price and at a time when they wish to do so and, as a result, could negatively impact the market price of the ADSs themselves.

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**ITEM 4. INFORMATION ON THE COMPANY**

**Overview**

We are the largest telecommunications service provider in Region II in Brazil, based on revenues and customers as of and for the year ended December 31, 2008, according to information available from ANATEL and other publicly available information. We offer a range of integrated telecommunications services that includes fixed-line and mobile telecommunications services, data transmission services (including broadband access services), internet service provider, or ISP, services and other services, for residential customers, small, medium and large companies, and governmental agencies.

According to the IBGE, Region II (which consists of the Federal District of Brazil and nine states of Brazil located in the western, central and southern regions of Brazil) had a population of approximately 43.5 million as of April 1, 2007, representing 23.6% of the total Brazilian population, and represented approximately 26.2% of Brazil's total gross domestic product, or GDP, for 2006 (the most recent period for which such information is currently available).

***Fixed-Line Telecommunications Services***

Our traditional fixed-line telecommunications business in Region II includes local and long-distance services, network usage services (interconnection) and public telephones, in accordance with the concessions and authorizations granted to us by ANATEL. We believe we were one of the largest fixed-line telecommunications companies in South America in terms of total number of lines in service as of December 31, 2008. Based on our 8.1 million fixed lines in service as of December 31, 2008, we were the principal fixed-line telecommunications service provider in Region II, with an estimated market share of 51.3% of the total fixed lines in service in this region as of December 31, 2008, according to our internal estimates. For the year ended December 31, 2008, our highly mature fixed-line business generated R\$10,775 million in gross operating revenue, which represented a decline of 1.4% compared to the year ended December 31, 2007.

***Mobile Telecommunications Services***

We offer mobile telecommunications services in Region II through our subsidiary 14 Brasil Telecom Celular S.A., which we refer to as Brasil Telecom Mobile. We believe that we are one of the principal mobile telecommunications service providers in Region II, with 5.6 million mobile subscribers as of December 31, 2008 and an estimated market share of 14.4% of the total number of mobile subscribers in this region as of December 31, 2008, according to information available from ANATEL. For the year ended December 31, 2008, our mobile services business generated R\$2,561 million in gross operating revenue, which represented an increase of 4.7% compared to the year ended December 31, 2007.

***Data Transmission Services***

We offer a variety of high-speed data transmission services, including services offered by our subsidiaries BrT Serviços de Internet S.A. and Brasil Telecom Comunicação Multimídia Ltda. We also operate a fiber optic cable system that connects the United States, Bermuda, Brazil and Venezuela through our subsidiaries Brasil Telecom Cabos Submarinos Ltda., Brasil Telecom Subsea Cable System (Bermuda) Ltd., Brasil Telecom of America Inc. and Brasil Telecom de Venezuela S.A. Our broadband services, primarily utilizing Asymmetric Digital Subscriber Line, or ADSL, technology, are marketed in Region II under the brand name Turbo. As of December 31, 2008, we had 1.8 million ADSL subscribers, representing 22.2% of our fixed lines in service at that date. We also provide voice and data services to corporate clients throughout Brazil through our network in Region II, through the network of Telemar Norte Leste S.A., or Telemar, in Region I, and through cooperation agreements with other telecommunications network operators in Region III. For the year ended December 31, 2008, our data transmission services business generated R\$4,070 million in gross operating revenue, which represented an increase of 36.5% compared to the year ended December 31, 2007.

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### ***Other Services***

We operate an internet portal through our subsidiary Internet Group do Brasil S.A. under the brand name *iG* that was the second largest internet portal in Brazil in terms of the number of unique visitors in 2008, according to Ibope/NetRatings. We also started a call center business for the sole purpose of providing services to our company and our subsidiaries. For the year ended December 31, 2008, our internet services business and call center services generated R\$700 million in gross operating revenue, which represented an increase of 49.6% compared to the year ended December 31, 2007.

Our principal executive office is located at SIA/Sul, ASP, Lote D, Bloco B 71215-000 Setor de Indústria, Brasília, DF, Brazil, and our telephone number at this address is (55-61) 3415-1414.

### **Our History and Development**

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

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

### ***Privatization of Telebrás***

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

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

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

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

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



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

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

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

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

Following the formation of Brasil Telecom Holding, it provided fixed-line telecommunications services through nine separate operating subsidiaries, including our company, each of which provided telecommunications services in one of the nine states of Region II or the Federal District of Brazil. In February 2000, Brasil Telecom Holding implemented a corporate reorganization, which resulted in each of its other fixed-line operating companies being merged into our company.

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

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

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

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

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

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

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

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

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

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

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

In May 2004, we acquired substantially all of the share capital of MetroRED Telecomunicações Ltda., or MetroRED, that we did not own. Prior to this acquisition, we owned 19.9% of the share capital of MetroRED. We have changed the corporate name of MetroRED to Brasil Telecom Comunicação Multimídia Ltda., or Brasil Telecom Multimídia. Brasil Telecom Multimídia is a leading local fiber optic network provider, with 343 kilometers of local area network in São Paulo, Rio de Janeiro and Belo Horizonte, and a 1,600 kilometer long-distance network linking these three metropolitan areas. Brasil Telecom Multimídia also has an internet solutions data center in São Paulo which provides internet support to our customers.

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

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

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

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

### ***Acquisition by Telemar Norte Leste S.A.***

On January 8, 2009, Telemar acquired indirectly all of the outstanding shares of Invitel S.A., or Invitel, and 12,185,836 common shares of Brasil Telecom Holding owned by the shareholders of Invitel. As of December 31, 2008, Invitel owned 100% of the outstanding shares of Solpart, which owned 52.0% of the outstanding voting share capital, representing 19.0% of the outstanding share capital, of Brasil Telecom Holding, which, in turn, owned 67.2% of the outstanding share capital, including 99.1% of the outstanding voting share capital, of our company.

Following this acquisition, Telemar owns indirectly an aggregate of 43.5% of the outstanding share capital of Brasil Telecom Holding, including 61.2% of the outstanding common shares of Brasil Telecom Holding. Through this ownership interest in Brasil Telecom Holding, together with other shares of Brasil Telecom that Telemar owns indirectly, Telemar owns an aggregate of 37.7% of our outstanding share capital, including 51.5% of our outstanding common shares.

For additional information about the controlling shareholders of Telemar, see Item 7. Major Shareholders and Related Party Transactions Major Shareholders.

### **Corporate Structure**

The following chart presents our corporate structure and principal subsidiaries as of July 6, 2009. The percentages in bold italics represent the percentage of the voting capital owned directly and indirectly by the parent company of each entity, and the percentages not in bold italics represent the percentage of the total share capital owned directly and indirectly by the parent company of each entity.

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

***Our Service Areas***

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

fixed-line telecommunications services in Region II;

long-distance telecommunications services throughout Brazil;

mobile telecommunications services in Region II; and

data transmission services throughout Brazil.

In addition, we have authorizations to provide fixed-line local telecommunications services in Regions I and III. Region I consists of 16 states of Brazil located in the northeastern and part of the northern and southeastern regions of Brazil. Region III consists of the State of São Paulo. Our revenues are derived primarily from operations in Region II.

Region II consists of the Federal District of Brazil and nine states of Brazil located in the western, central and southern regions of Brazil. Region II covers an area of approximately 2.9 million square kilometers, which represents approximately 33.5% of the country's total land area and accounted for approximately 26.2% of Brazil's GDP in 2006. The population of Region II was 43.5 million as of April 1, 2007, which represented 23.6% of the total population of Brazil as of that date. In 2006, per capita income in Region II was approximately R\$13,626, varying from R\$7,041 in the State of Acre to R\$37,600 in the Federal District of Brazil.

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

| State              | Population<br>(in millions)<br>(2007) | Population per<br>Square<br>Kilometer<br>(2007) | % of GDP<br>(2006) | GDP Per<br>Capita<br>(in reais)<br>(2006) |
|--------------------|---------------------------------------|---|--------------------|---|
| Rio Grande do Sul  | 10.6                                  | 37.6  | 6.6                | 14,310                                    |
| Paraná             | 10.3                                  | 51.6  | 5.8                | 13,158                                    |
| Santa Catarina     | 5.9                                   | 61.5  | 3.9                | 15,638                                    |
| Goiás              | 5.6                                   | 16.6  | 2.4                | 9,962                                     |
| Mato Grosso        | 2.9                                   | 3.2   | 1.5                | 12,350                                    |
| Federal District   | 2.5                                   | 423.3   | 3.8                | 37,600                                    |
| Mato Grosso do Sul | 2.3                                   | 6.3   | 1.0                | 10,599                                    |
| Rondônia           | 1.5                                   | 6.1   | 0.6                | 8,391                                     |
| Tocantins          | 1.2                                   | 4.5   | 0.4                | 7,210                                     |
| Acre               | 0.7                                   | 4.3   | 0.2                | 7,041                                     |
| Total              | 43.5                                  |   | 26.2               |   |

Source: IBGE.

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

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

**Our Services**

Our telecommunications services consist of:

local fixed-line services, primarily in Region II, but also in Regions I and III, including installation, monthly subscription, metered services, collect calls and supplemental local services;

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domestic long-distance services and international long-distance services primarily from Region II, placed through fixed-line and mobile telephones using long-distance carrier selection codes (*Código de Seleção de Prestadora*), which in our case is represented by the number 14;

mobile telecommunications services utilizing 2G and 3G technology;

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

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

traffic transportation services;

public telephone services (*Terminais de Uso Público*);

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

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

the operation of the iG internet portal.

***Local Fixed-Line Services***

As of December 31, 2008, we had approximately 8.1 million local fixed-line customers in Region II. As the result of Telemar's acquisition of control of our company in January 2009, we do not plan to offer local fixed-line services in Region I. Although we continue to assess our strategic plans with regard to providing such services in Region III, we do not currently plan to offer local fixed-line services to residential customers in Region III due to the size of the investment that would be required.

Local fixed-line services include installation, monthly subscription, metered services, collect calls and supplemental local services. Metered services include local calls that originate and terminate within a single local area. ANATEL has divided Region II into 1,772 local areas.

Under our concession agreements, we are required to offer two local fixed-line plans to users: the Basic Plan per Minute (*Plano Básico de Minutos*) and the Mandatory Alternative Service Plan (*Plano Alternativo de Serviços de Oferta Obrigatória*), each of which includes installation charges, monthly subscription charges, and charges for local minutes. As of December 31, 2008, 48.7% of our fixed-line customers subscribed to the Basic Plan per Minute or the Mandatory Alternative Service Plan.

In addition to the Basic Plan per Minute and the Mandatory Alternative Service Plan, we offer a variety of alternative fixed-line plans that are designed to meet our customers' usage profiles. As of December 31, 2008, 51.3% of our fixed-line customers subscribed to alternative plans.

We permit subscribers to our alternative plans to design their own plans, selecting from a menu of options, including: (1) the number of local minutes per month for calls to fixed-line telephones; (2) the number of local minutes per month for calls to mobile telephones; and (3) the number of long-distance minutes per month. We also offer bundled plans that include these elements and broadband services or dial-up internet connection services for a fixed monthly rate, which we offer under the brand name *Pluri*.

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

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

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

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

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

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

We provide domestic long-distance services for calls originating from Region II through interconnection agreements, mainly with Telemar in Region I and Telesp in Region III, that permit us to interconnect directly with their local fixed-line networks, and through our network facilities in São Paulo, Rio de Janeiro and Belo Horizonte. We provide international long-distance services originating from Region II through agreements to interconnect our network with those of the main telecommunications service providers worldwide.

### ***Mobile Long-Distance***

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

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

### ***Mobile Telecommunications Services***

As of December 31, 2008, we had approximately 5.6 million subscribers located in 1,015 municipalities in Region II. As of December 31, 2008, we had a 14.4% share of the mobile services market in Region II based on the total number of subscribers as of that date. As of December 31, 2008, 82.5% of our customers subscribed to pre-paid plans and 17.5% subscribed to post-paid plans.

### ***Pre-Paid Customers***

Pre-paid customers activate their Brasil Telecom Mobile cellular numbers through the purchase and installation of a SIM card in their mobile handsets. Our pre-paid customers are able to add credits to their accounts through the purchase of pre-paid cards at prices that vary based on the number of minutes available or through the purchase of additional credits over the phone which can be charged to the customer's credit card or included on their bill for fixed-line services. These credits are valid for a fixed period of time following activation. In 2008, we also sold mobile handsets with preinstalled SIM cards at subsidized prices to attract pre-paid customers.

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In 2009, we adopted a strategy under which we do not subsidize the purchase of mobile handsets in connection with our acquisition and retention of pre-paid customers in the retail consumer segment.

We offer Pula-Pula subscriptions to its pre-paid customers which allow these customers to receive bonus minutes with each purchase of additional credits. In addition, we launched *Crédito Especial*, a services which provides the customer with an emergency credit of R\$3.00 for the price of R\$0.60 payable when the customer adds credit to the customer's account.

In 2009, as part of our program to converge our offers with those of Telemar, we began offering Oi Ligadores and Oi Cartão Total in Region II.

### *Post-Paid Customers*

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

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

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

Under our authorizations to provide personal mobile services, we are required to offer a basic post-paid mobile plan that includes activation charges, monthly subscription rates and charges for local calls. As of December 31, 2008, 1.7% of our mobile customers subscribed to our basic post-paid plan. In addition to the basic plan, we offer a variety of alternative post-paid plans that are that are designed to meet our customers usage profiles.

We offer (1) plans which permit a subscriber to purchase a fixed number of minutes per month for local calls to other fixed-line or mobile subscribers; (2) budget plans which permit a subscriber to purchase a fixed number of local and long-distance minutes per month, but restrict outgoing calls after the purchased minutes have been consumed other than calls made using a pre-paid card, and (3) 3G plans providing data transmission at speeds from 300kbps to 1Mbps.

Under Telemar's authorization from ANATEL to acquire control of our company, we are required to offer to our customers the same plans that Telemar offers to its customers by December 31, 2009. In addition to our existing plans, Telemar's plans include family plans which permit a subscriber to purchase a fixed number of minutes per month for local calls that may be shared by up to four individuals.

### *Roaming*

We have roaming agreements with Oi, CBTC and Sercomtel, providing our customers with automatic access to roaming services when traveling outside of Region II in areas of Brazil where mobile telecommunications services are available on the GSM standard.



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

### *3G Broadband Services*

In 2007, we were granted an authorization and the related frequency licenses by ANATEL to offer 3G mobile services in Region II. The deployment of our 3G network allows us to offer data communication services to our personal mobile services customers at greater speeds than those made available by our previously existing 2G networks. As of December 31, 2008, we had launched 3G services in a total of 49 municipalities, including the Federal District and the nine state capitals in Region II, and had approximately 100,900 3G mobile broadband users.

### *Data Transmission Services*

#### *Broadband Services*

We provide high-speed internet access services using ADSL technology, which we refer to as broadband services, to residential customers and businesses in the primary cities in Region II and under the brand name Turbo. As of December 31, 2008, we offered broadband services in 1,546 municipalities in Region II. As of December 31, 2008, we had 1.8 million ADSL customers.

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

As of December 31, 2008, we had upgraded approximately 38.8% of our fixed-line network to enable this portion of our network to support ADSL2+. ADSL2+ is a data communications technology that allows data transmission at speeds of up to 24 Mbps downstream and 1 Mbps upstream, which is much faster than data transmission through conventional ADSL. ADSL2+ permits us to offer a wider range of services through our Turbo 2.0 service and Internet Protocol Television, which we refer to as IP TV, a television service that is based on broadband internet access.

We charge monthly fees to our broadband users that choose iBest or iG as their ISP. We do not charge fees to our fixed-line customers that choose iBest or iG as their ISP for dial-up internet access. As of December 31, 2008, iBest and iG had an aggregate of approximately 4.0 million registered dial-up users. In the beginning of 2007, we launched a flat-fee dial-up service, called Internet Toda Hora (Internet all the time) under which our fixed-line subscribers can access the internet through dial-up connections during evening and weekend hours for a flat fee without using the local minutes that they purchase under their fixed-line plans.

#### *Commercial Data Transmission Services*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

### *Use of Our Mobile Network*

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

### *Traffic Transportation Services*

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

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

### *Public Telephone Services*

We own and operate public telephones throughout Region II. As of December 31, 2008, we had approximately 227,900 public telephones in service, all of which are operated by pre-paid cards. For a discussion of how we account for the sale of the pre-paid cards, see Item 5. Operating and Financial Review and Prospects Financial Presentation and Accounting Policies Critical Accounting Policies and Estimates Revenue Recognition.

### *Value-Added Services*

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

### *Advanced Voice Services*

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

### *iG Internet Portal*

We operate an internet portal under the brand name iG that was the second largest internet portal in Brazil in terms of the number of unique visitors in 2008 according to Ibope/NetRatings. In 2008, iG was visited by 13.3 million unique visitors, and as of December 31, 2008, iG had approximately two million registered subscribers and hosted 7.5 million e-mail accounts. iG has launched several collaborative tools like blogs, chat, photo album, video player and an online dating service, and has developed new channels that promote the creation and distribution of content created by the user. We entered into an agreement with Google that allows iG to offer e-mail services using

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Gmail's platform and use Google's search engine throughout the portal. We have entered into agreements under which we are licensed to distribute a variety of content through the iG portal, such as entertainment, news, sports and education, including an agreement to launch the Second Life game in Brazil. We generate revenue through the iG portal from (1) monthly subscription fees that we charge to registered users of this portal, (2) fees charged to place advertisements on this portal, and (3) fees that we receive from fixed-line service providers based on the number of minutes that their subscribers are connected to this portal.

### **Rates**

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

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

##### *Local Rates*

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

Under our concession agreements, we are required to offer two local fixed-line plans to users: the Basic Plan per Minute and the Mandatory Alternative Service Plan, each of which includes installation charges, monthly subscription charges, and charges for local minutes. As of December 31, 2008, 48.7% of our fixed-line customers subscribed to the basic fixed-line plan or the mandatory alternative fixed-line plan.

The monthly subscription fees under the Basic Plan per Minute and the Mandatory Alternative Service Plan vary in accordance with the subscribers' profiles, as defined in the applicable ANATEL regulations. The monthly subscription fee for the Basic Plan per Minute includes the use of 200 local minutes per month by residential customers and 150 local minutes per month by commercial customers and trunk line customers. The monthly subscription fee for the Mandatory Alternative Service Plan includes the use of 400 local minutes per month by residential customers and 360 local minutes per month by commercial customers and trunk line customers. We only deduct two local minutes from a Basic Plan per Minute customer's monthly allotment and four minutes from a Mandatory Alternative Service Plan customer's monthly allotment for each local call made, regardless of the duration of the call, during the following off-peak hours: Monday through Friday between midnight and 6 a.m.; Saturdays between midnight and 6 a.m. and between 2 p.m. and midnight; and any time on Sundays and Brazilian holidays. If the minute limits are exceeded, customers will incur additional metered-minute charges, the prices of which vary depending on whether the customer is a Basic Plan per Minute subscriber or a Mandatory Alternative Service Plan subscriber. If a customer does not use all of the minutes covered by the monthly subscription fee, the minutes cannot be carried over to the next month.

In addition to the Basic Plan per Minute and the Mandatory Alternative Service Plan, we are permitted to offer non-discriminatory alternative plans to the basic service plans. The rates for applicable services under these plans (e.g., monthly subscription rates and charges for local and long-distance calls) must be submitted for ANATEL approval prior to the offering of the plan to our customers. In general, ANATEL does not object to the terms of these plans. As of December 31, 2008, 51.3% of our fixed-line customers subscribed to alternative plans.

Under our fixed-line rate plans, we charge for calls based on the period of use; the charge unit is a tenth of a minute (six seconds), and rounding is permitted to the next succeeding tenth of a minute. There is a minimum charge period of 30 seconds for every call. However, calls of three seconds or less are not charged, except in certain specific instances as provided for in ANATEL regulations.

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

On an annual basis, ANATEL increases or decreases the maximum rates we are authorized to charge for our basic service plans. ANATEL decreased the rates we may charge by an average of 0.43% as of July 13, 2006, and increased these rates by an average of 2.14% as of July 20, 2007 and 3.01% as of July 24, 2008. In addition, we are authorized to adjust the rates applicable to our alternative plans annually by no more than the rate of inflation, as measured by the Technical Supervision Institute (*Instituto Técnico Superior*), or IST. Discounts from the rates set in basic service plans and alternative service plans may be granted to customers without ANATEL approval.

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

| Monthly subscription rates for Basic Plan per Minute (1) | Year Ended December 31, |       |       |
|--|-------------------------|-------|-------|
|  | 2006                    | 2007  | 2008  |
|  | (in reais)              |       |       |
| Basic Plan per Minute (residential)                      | 27.28                   | 27.86 | 28.69 |
| Basic Plan per Minute (commercial)                       | 40.36                   | 41.23 | 42.48 |
| Basic Plan per Minute (trunk lines)                      | 39.98                   | 40.85 | 42.09 |

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

*Local Fixed Line-to-Mobile Rates*

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

VC1 rates vary depending on the time of the day and day of the week, and are applied per minute for the duration of the call. As with local fixed-line calls, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call.

On an annual basis, ANATEL increases or decreases the maximum VC1 rates we are authorized to charge. In 2006 ANATEL did not change the maximum VC1 rate we were authorized to charge. ANATEL authorized us to increase our VC1 rates by an average of 3.34% as of July 20, 2007 and 3.03% as of July 24, 2008. Discounts from the VC1 rates approved by ANATEL may be granted to customers without ANATEL approval.

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

|   | Year Ended December 31, |      |      |
|---|-------------------------|------|------|
|   | 2006                    | 2007 | 2008 |
|   | (in reais)              |      |      |
| Per-minute charges for local fixed-line calls made to mobile telephones (1) | 0.48                    | 0.50 | 0.51 |

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

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

If a caller selects one of our carrier selection codes for a long-distance call that originates and terminates on fixed-line telephones, we receive the revenues from the call and must pay interconnection fees to the service providers that operate the networks on which the call originates and terminates. Rates for these long-distance calls are based on the physical distance separating callers (which are categorized by four distance ranges), time of the day and day of the week, and are applied per minute for the duration of the call. As with local fixed-line calls, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call.

On an annual basis, ANATEL increases or decreases the maximum domestic fixed line-to-fixed line long-distance rates we are authorized to charge. ANATEL decreased these rates by an average of 2.77% as of July 13, 2006 and increased these rates by an average of 2.14% as of July 20, 2007 and 3.01% as of July 24, 2008. Discounts from the domestic fixed line-to-fixed line long-distance rates approved by ANATEL may be granted to customers without ANATEL approval.

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

| Domestic long-distance rates per minute (1) | Year Ended December 31, |      |      |
|---|-------------------------|------|------|
|   | 2006                    | 2007 | 2008 |
|   | (in reais)              |      |      |
| 0 to 50 km                                  | 0.22                    | 0.24 | 0.24 |
| 50 to 100 km                                | 0.31                    | 0.33 | 0.35 |
| 100 to 300 km                               | 0.35                    | 0.35 | 0.36 |
| Over 300 km                                 | 0.36                    | 0.36 | 0.37 |

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

*Mobile Long-Distance*

Rates for long-distance calls that originate or terminate on mobile telephones are based on whether the call is an intrasectoral long-distance call, which is charged at rates designated by ANATEL as VC2 rates, or an intersectoral long-distance call, which is charged at rates designated by ANATEL as VC3 rates. If the caller selects one of our carrier selection codes for the call, we receive the revenues from the call and must pay interconnection fees to the service providers that operate the networks on which the call originates and terminates. The applicable VC2 and VC3 rates vary depending on the time of the day and day of the week, and are applied per minute for the duration of the call. As with local fixed-line calls, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call.

On an annual basis, ANATEL increases or decreases the maximum VC2 and VC3 rates we are authorized to charge. ANATEL authorized us to increase our VC2 and VC3 rates by an average of 7.99% as of July 27, 2006, 3.29% as of July 18, 2007 and 3.01% as of July 23, 2008.



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

| Per-minute charges for mobile long-distance calls (1) | Year Ended December 31, |      |      |
|---|-------------------------|------|------|
|   | 2006                    | 2007 | 2008 |
|   | (in reais)              |      |      |
| VC2   | 1.04                    | 1.08 | 1.11 |
| VC3   | 1.19                    | 1.23 | 1.26 |

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

**Mobile Rates**

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

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

Under ANATEL regulations, we are required to submit a basic post-paid service plan and a basic pre-paid service plan to ANATEL for its approval. As of December 31, 2008, 1.7% of our mobile customers subscribed to our basic post-paid plan and less than 1.0% of our mobile customers subscribed to our basic pre-paid plan.

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

We charge for all mobile calls made by our pre-paid customers, and for mobile calls made by our post-paid customers in excess of their allocated monthly number of minutes, based on the length of the call. As with local fixed-line services, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call.

In addition to the basic service plans, we are permitted to offer non-discriminatory alternative plans to the basic service plans. The rates for applicable services under these plans (e.g., monthly subscription rates, charges for local and long-distance calls and roaming charges) must be submitted for ANATEL approval prior to the offering of the plan to our customers. In general, ANATEL does not object to the terms of these plans. As of December 31, 2008, substantially all of our pre-paid customers subscribed to these alternative plans.

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

Rates under our basic and alternative mobile plans may be adjusted annually by no more than the rate of inflation, as measured by the IST. These rate adjustments occur on the anniversary dates of the approval of the specific plans. Discounts from the rates set in basic service plans and alternative service plans may be granted to customers without ANATEL approval. The rate of inflation as measured by the IST was 3.20% in 2006, 3.17% in 2007 and 6.56% in 2008.



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***Network Usage (Interconnection) Rates***

***Fixed-Line Networks***

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

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

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

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

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

TU-RL rates vary depending on the time of the day and day of the week, and are applied per minute for the duration of the call. As with local fixed-line calls, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call.

Charges for the use of our local fixed-line network to terminate local calls originating on the network of another local fixed-line service provider are only billed and due when usage of our network exceeds 55% of the total traffic registered between our network and the network of the other telecommunications service provider.

On January 1, 2006, our TU-RL rate was reduced to 50% of the rate included in our Basic Plan per Minute for a local fixed-line call, which is adjusted on an annual basis by ANATEL. See [Local Fixed-Line Rates](#) [Local Rates](#). On January 1, 2007, our TU-RL rate was reduced to 40% of the rate included in our Basic Plan per Minute for a local fixed-line call, which is adjusted on an annual basis by ANATEL. As of the date of this annual report, our TU-RL rate during peak hours (i.e., between the hours of 9 a.m. and noon and 2 p.m. and 6 p.m. on weekdays) is R\$0.031 per minute. ANATEL announced that beginning in 2008, the method used to determine the TU-RL rates would be based on a cost methodology, known as long-run incremental costs. However, IN October 2007, ANATEL published an official letter delaying this change until 2010.

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

TU-RIU rates vary depending on the time of the day and day of the week, and are applied per minute for the duration of the call. As with local fixed-line calls, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call. On January 1, 2006, our TU-RIU rate was reduced to 30% of our domestic fixed line-to-fixed line long-distance rates for calls of more than 300 km, which are adjusted on an annual basis by ANATEL. See [Local Fixed-Line Rates](#) [Domestic Long-Distance Rates](#) [Fixed Line-to-Fixed Line](#). As of the date of this annual report, our TU-RIU rate during peak hours is R\$0.12 per minute.

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

| Fixed-Line Network Usage Rates (1) | Year Ended December 31, |       |       |
|------------------------------------|-------------------------|-------|-------|
|                                    | 2006                    | 2007  | 2008  |
|                                    | (in reais)              |       |       |
| TU-RL                              | 0.037                   | 0.030 | 0.031 |
| TU-RIU                             | 0.081                   | 0.083 | 0.087 |

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

*Mobile Networks*

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

The terms and conditions of interconnection to our mobile networks, including the rates charged to terminate calls on our mobile networks, which are designated by ANATEL as VU-M rates, commercial conditions and technical issues, are freely negotiated between us and other mobile and fixed-line telecommunications service providers, subject to compliance with regulations established by ANATEL relating to traffic capacity and interconnection infrastructure that must be made available to requesting providers, among other things. We must offer the same VU-M rates to all requesting service providers on a nondiscriminatory basis. As with local fixed-line calls, the charge unit is a tenth of a minute (six seconds), rounding is permitted to the next succeeding tenth of a minute, and there is a minimum charge period of 30 seconds for every call.

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

An initial decision approving these provisional rates was rendered in September 2007, but an appeal remains pending before ANATEL's council of directors. We cannot predict whether the final interconnection rates established by ANATEL will be equivalent to those currently applied by us. We and the other mobile services providers negotiate provisional agreements each year to establish rate increases for the VU-M charged by the mobile services providers, subject to a final decision of ANATEL in the arbitration regarding the initial provisional VU-M charges established by ANATEL.

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

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

In July 2008, a provisional agreement among the incumbent fixed-line service providers, as well as CTBC Telecom and Sercomtel, and the mobile services providers, including Brasil Telecom Mobile, was submitted to ANATEL that established an average increase in the VU-M rates of 2%, and provided that the VU-M rates would be increased by an amount equal to 68.5% multiplied by the percentage increase in VCI approved by ANATEL in 2008.

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Until June 2006, charges for the use of our mobile network in connection with local calls originating from another fixed-line or mobile telecommunications service provider were only billed and due when usage of our network exceeded 55% of the total traffic registered between our network and the network of such other telecommunications service provider. In July 2006, the full billing system was adopted under which (1) we are permitted to charge for the use of our mobile networks based on the volume of traffic originated on the fixed-line or mobile network of other telecommunications service providers that terminates on our mobile networks, and (2) we are required to pay other mobile telecommunications service providers based on the volume of traffic originated on our fixed-line or mobile networks that terminates on their mobile networks.

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

|   | Year Ended December 31, |      |      |
|---|-------------------------|------|------|
|   | 2006                    | 2007 | 2008 |
|   | (in reais)              |      |      |
| Per-minute charges for local fixed-line calls made to mobile telephones (1) | 0.40                    | 0.41 | 0.42 |

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

**Data Transmission Rates**

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

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

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

**Marketing**

In 2008, we incurred R\$178 million in marketing expenses, primarily to promote the cost savings available through our bundled service plans and diversify our sales efforts. Throughout 2008, our principal marketing effort was to continue to offer integrated promotions by bundling our various services, such as mobile communications, ADSL services, fixed-line services and public telephone services. Beginning in February 2008, ANATEL regulations have required mobile services providers to unblock the mobile handsets of their customers, permitting mobile users to choose a different service provider than the handset supplier. As a result and in line with our plans to integrate our marketing efforts with Telemar, we have recently adopted a strategy of selling SIM cards on a stand-alone basis to acquire new pre-paid customers and retain existing ones.

We use a broad range of marketing channels, including television, radio, billboards, exterior signage, telemarketing, direct mail and internet advertising to market our fixed-line, mobile, long-distance and broadband services. We also sponsor sporting events and individual athletes, as well as cultural events, such as fashion shows,

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theatrical performances and popular music concerts. The goal of our marketing initiatives is to increase brand awareness in our targeted customer base and expand the use of our distribution channels.

Our sales channels have historically been divided into direct and indirect channels. In addition, we have historically sold our services to commercial customers of all sizes through a direct sales force. Our direct channels include sales through telephone marketing, owned stores and stands, and internet sales, while our indirect channels include sales through specialized dealers and major retailers.

Our principal direct distribution channels in 2008 were:

telemarketing, which accounted for approximately 70% of our sales of fixed-line plans, 63% of our sales of broadband service subscriptions and 21% of our sales of post-paid mobile plans in 2008. Our telemarketing sales channel consists of approximately 1,100 sales representatives that answer more than 500,000 calls per month. This channel provides us with the ability to pro-actively reach new customers, thereby increasing our client base and revenues, and also receive calls prompted by offers in numerous types of media.

72 exclusive Brasil Telecom service stores and kiosks located in the largest shopping malls and other high density areas throughout Region II that are focused on sales of higher value-added services (fixed-line, mobile and broadband services). This channel accounted for approximately 5.2% of our sales broadband services subscriptions, 15% of our sales of post-paid mobile plans and 8% of our sales of pre-paid mobile cards in 2008.

Our principal indirect distribution channels in 2008 were:

94 exclusive agents with 497 salespeople trained to sell our services door-to-door in Region II in places where customers generally are not reachable by telemarketing. This channel accounted for approximately 17% of our sales of fixed-line plans, 14% of our sales of broadband services and 6% of our sales of pre-paid mobile plans in 2008.

approximately 2,200 large and small retail stores through which we primarily sell SIM cards, pre-paid mobile cards and post-paid mobile plans. This channel accounted for approximately 53% of our sales of pre-paid mobile plans and 4% of our sales of post-paid mobile plans in 2008.

735 multi-brand mobile services stores through which we primarily sell post-paid mobile plans, SIM cards and pre-paid mobile cards. This channel accounted for approximately 16% of our sales of broadband services subscriptions, 29% of our sales of post-paid mobile plans and 33% of our sales of pre-paid mobile plans in 2008.

Following Telemar's acquisition of control of our company in January 2009, we have begun to integrate our marketing programs with those of Telemar. Telemar targets its marketing efforts on three separate segments of the telecommunications services market: (1) retail customers; (2) high-value residential customers and medium and small commercial customers; and (3) large commercial customers.

Following the implementation of these integration efforts, (1) we will market our local fixed-line services, pre-paid and post-paid mobile services, long-distance services and dial-up internet access to retail customers, placing greater emphasis on drug stores, supermarkets, newsstands and similar outlets because we believe that these channels will enable us to achieve broad distribution of our pre-paid services with relatively low distribution costs; (2) we will market our local fixed-line services, broadband services, post-paid mobile services and long-distance services to high-value residential customers and medium and small commercial customers; and (3) we will market our local fixed-line services, broadband services, post-paid mobile services, long-distance services and commercial data transmission services to large commercial customers.

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### **Billing and Collection**

#### ***Fixed-Line Telephone Services***

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

We are required to include in our monthly bills charges incurred by our customers for long-distance services provided by other long-distance service providers upon the request of these providers. We have billing agreements with each long-distance telecommunications service provider that interconnects with our networks under which we bill our customers for any long-distance calls originated on our networks that are carried by another long-distance service provider and transfer the balance to the relevant provider after deducting any access fees due for use of our networks.

Payments are due within an average of 13 days after the billing date. We charge late-payment interest at a rate of 1% per month plus a one-time late charge of 2% of the amount outstanding. At December 31, 2008, 37.5% of all accounts receivable due from our fixed-line customers were outstanding for more than 30 days and 17.7% were outstanding for more than 90 days, as compared to 36.7% and 27.2%, respectively, at December 31, 2007.

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

#### ***Mobile Telecommunications Services***

We bill our mobile post-paid customers on a monthly basis and itemize charges in the same manner as we bill our fixed-line customers. See Fixed-Line Telephone Services. In addition, the monthly bills also provide details regarding minutes used and roaming charges. Payments are due within an average of 13 days after the billing date. We charge late-payment interest at a rate of 1% per month plus a one-time late charge of 2% of the amount outstanding. At December 31, 2008, 48.8% of all accounts receivable due from our mobile customers were outstanding for more than 30 days and 32.8% were outstanding for more than 90 days, as compared to 58.8% and 45.3%, respectively, at December 31, 2007.

ANATEL regulations permit us to partially suspend services to a mobile customer when the customer's account is more than 15 days past due, restrict all incoming calls received and outgoing calls made by a mobile customer when the customer's account is more than 45 days past due, and cancel services to a mobile customer when the customer's account is more than 75 days past due, provided in each case that 15-days' prior notice has been given to that customer prior to the imposition of each restriction. The cancellation process thus comprises several stages, including customer notification regarding the referral of their delinquency to credit bureaus, before services to the mobile customer may be ultimately cancelled due to non-payment. Notices range from text messages to active calls for negotiation with the customer. Our collection system enables us to access delinquent subscribers' accounts according to their payment profile. This profile takes into consideration, among other things, the length of subscription, the outstanding balance of the account and the longest payment delays. We have also implemented an information tool to assist with account management which is designed to warn subscribers of high outstanding amounts due and unpaid.

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

Our network is comprised of a physical and logical infrastructure through which we provide fully integrated services, whether fixed-line or mobile, voice, data or image, thereby optimizing available resources.

We monitor our networks remotely from our centralized national network operations center in Florianópolis. Network operating and configuration platforms, located at the network operations center, perform failure monitoring, database and configuration management, security management and performance analysis for the entire network.

**Fixed-Line Network**

Our fixed-line network includes a network of access lines connecting customers to digital exchanges, digital exchanges, trunk lines connecting digital exchanges and long-distance transmission equipment. As of December 31, 2008, our access network served approximately 8.1 million fixed-line subscribers and approximately 1.8 million ADSL subscribers. As of December 31, 2008, we provided ADSL services in 1,546 municipalities.

During 2008, the number of installed access lines in our fixed-line network declined by approximately 400,000 lines as a result of the disconnection of analog terminals in order to reduce network maintenance costs.

In 2008, we provided fixed-line services at 100 new localities, 65 of which were provided with group access and 35 of which were provided with individual access, and we visited more than 478 localities to confirm data on our record of localities. As of December 31, 2008, we offered fixed-line services in approximately 8,909 locations, either with individual or group access.

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

|  | As of and For Year Ended<br>December 31, |         |         |
|--|--|---------|---------|
|  | 2006                                     | 2007    | 2008    |
| Installed access lines (in millions)             | 10.4                                     | 10.8    | 10.4    |
| Access lines in service (in millions)            | 8.4                                      | 8.0     | 8.1     |
| Public telephones in service (in thousands)      | 277.9                                    | 281.8   | 277.9   |
| Broadband access lines in service (in thousands) | 1,317.7                                  | 1,567.8 | 1,805.5 |

Our fixed-line network is fully digitalized. Our transmission infrastructure connects these digital switches to two international gateway switches. Additionally, our network supports advanced services, including pre-paid and toll-free services.

Our long-distance network consists of fiber-optic cable networks and microwave links that we use to provide long-distance services within Region II. We have extended long-distance fiber optic networks that connect the state capitals in Region II and the Federal District. Most of the large urban areas of Region II are also connected by our fiber optic cable networks.

Our long-distance network is modern, has an infrastructure prepared to support a capacity of 400 Gbps and is equipped with an automatic control system that provides for a high level of availability and flexibility for configuration and provisioning. Our transmission infrastructure has the capacity to accommodate our customers' demand for long-distance, internet and data transmission services and other telecommunications service providers' demand for transmission facilities.

**Mobile Network**

Our mobile network is a GPRS based network. We offer GPRS/EDGE technology for data and 1,800/900 MHz for voice. We have GPRS coverage in 100% of the localities covered and EDGE in all capitals of the states in our service areas. Our mobile networks have unique data cores that are fully integrated with our fixed-line data networks.

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As of December 31, 2008, our mobile network, consisting of 2,874 active radio base stations, covered 1,015 municipalities, or 90.0% of the urban population in Region II.

With the acquisition of new radio frequencies and the authorization to provide 3G services in Region II, we started the implementation process for our new 3G network. This project is designed to provide the necessary capacity for up to 120,000 customers and includes the installation of 1,418 active radio base stations, Node-Bs and systems provided by Ericsson and Nokia. This project also involves the connection of 19 3G control units and the expansion of our data and network transmission.

Our mobile networks are directly interconnected to the national and international long-distance networks of all long-distance service providers operating in Regions I, II and III and all mobile services providers in Regions I, II and III.

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

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

Our broadband network uses ADSL as a broadband access technology using our existing fixed-line networks with speeds of up to 8 Mbps (download) and 512 Kbps (upload). We are implementing DSLAMs/Ethernet technology on a significant portion of our network to support ADSL 2+ technologies that allow us to offer higher speed services. We implemented an address control and name resolution system for our IP networks with the objective of optimizing resources and improving the availability of internet access services.

We are deploying a Metro Ethernet network, which is a network that covers a metropolitan area to connect our subscribers to the internet. With the implementation of this technology, we are now able to provide IP TV, a television service that is based on broadband internet access. We are also deploying optical fiber networks based on GPON technology together with VDSL2 for fiber to the building.

Our dial-up IP platform supports dial-up access from the fixed-line networks. We operate an internet backbone network and a fully IP-routed network, which provides a backbone for all internet dedicated and dial-up services and VPN offerings. Our internet backbone connects to the public internet via international links that we maintain abroad. With these international links, we do not need to rely on other companies to connect our outbound internet traffic with the internet backbones of international ISPs.

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

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

frame relay data services (a data transmission service using fast protocols based on direct use of transmission lines) from 64 Kbps up to 34 Mbps;

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

aggregation network services for ADSL platforms.

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

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### ***Call Center***

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

### ***Competition***

Our industry is highly competitive. The competitive environment is significantly affected by key trends, including technological and service convergence, market consolidation and combined service offerings by service providers. See Item 5. Operating and Financial Review and Prospects Principal Factors Affecting Our Financial Condition and Results of Operations.

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

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

We are the leading provider of local fixed-line services in Region II with 8.1 million fixed lines in service as of December 31, 2008 and an estimated market share of 85.0% of the total fixed lines in service in this region as of December 31, 2008, according to our internal estimates. Our principal competitors in Region II for fixed-line services are (1) GVT, which has an estimated market share of 10.2% of the total fixed lines in service in this region as of December 31, 2008, according to our internal estimates, and (2) Embratel, which has an estimated market share of 4.9% of the total fixed lines in service in this region as of December 31, 2008, according to our internal estimates.

Embratel provides local fixed-line services to residential customers through the cable network owned by its affiliate Net in the portions of Regions I and II where Net provides cable television service. As a result, Net is able to offer cable television, broadband and telephone services as a bundle at a very competitive price. Net has engaged in efforts to promote Embratel's fixed-line service by offering free local fixed line service to its customers for a period of one-year. Because this promotion is ongoing, we are unable to evaluate the number of our fixed-line customers that are served by Embratel through Net that will cancel their subscriptions with us when the promotional period ends. We expect competition from Embratel to increase as the cable network of Net expands through internal growth and as a result of acquisitions, such as its recently completed acquisition of Big TV.

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

We expect to continue to face competition from mobile services providers, which represent the main source of competition in the local fixed-line service market. As of December 31, 2008, there were 39 million mobile subscribers (including our mobile customers) in Region II, a 20.7% increase over December 31, 2007. The increase in the number of mobile users, in addition to reduced mobile services rates, is expected to continue to adversely affect the number of fixed-line subscribers and the volume of local fixed-line traffic. In addition, because mobile providers offer promotions and service plans that permit subscribers to make calls within the mobile provider's network at rates that are less than those charged for calls from a fixed-line telephone to a mobile telephone, we believe that we may be vulnerable to traffic migration as customers with both fixed-line and mobile telephones use their mobile devices to make calls to other mobile subscribers.



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We believe that number portability, which was implemented in Brazil between August 2008 and March 2009, may negatively affect our local fixed-line business, because it may allow our customers to overcome their general resistance to changing their fixed-line telephone numbers and thereby allow our competitors to attract these customers.

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

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

The long-distance services market is highly competitive. For the year ended December 31, 2008, based on internal data and publicly available information, we were the leader in long-distance services provided to customers in Region II in terms of the volume of traffic from calls originated in these regions.

Our principal competitors for long-distance services originating on fixed-line telephones in Region II are Embratel and GVT. We compete for long-distance services originating on mobile telephones in Region II with Embratel, Telesp, TIM and GVT.

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

In addition, the offering of plans by other mobile services providers that include free minutes for calls to other subscribers of those mobile services providers may adversely impact our revenues from mobile long-distance calls if our mobile customers migrate to our competitors to remain within the network of the people to whom they plan to place long-distance calls.

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

### ***Mobile Services***

The mobile telecommunications services market in Brazil is characterized by intense competition among providers of mobile telecommunications services. According to IBGE, approximately 77% of the Brazilian population lived in areas with at least three mobile services providers in 2007. We expect the auction carried out by ANATEL in September 2007 for additional radio frequency spectrum for use by mobile services providers to lead to even greater competition. As a result of the grant of these new radio frequency licenses, each region in Brazil will have at least four mobile services competitors.

We compete primarily with the following mobile services providers:

Vivo, which is a joint venture between Telefónica S.A. and Portugal Telecom S.A. and markets its services under the brand name Vivo. Vivo provides services throughout Brazil.

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

Telecom Americas Group, which is a subsidiary of América Móvil S.A.B. de C.V., an affiliate of Telmex, and markets its services under the brand name Claro. Telecom Americas Group provides services throughout Brazil.

Of these competitors, Telecom Americas Group has been the most aggressive. Its strategy for gaining market share has included heavily subsidizing traffic and sales of mobile handsets. Vivo and TIM have been more conservative with respect to handset subsidies.

As of December 31, 2008, we had a market share of 14.4% of the total number of subscribers in Region II, ranking behind Vivo with 32.8% Claro with 27.7% and TIM with 24.9%. According to information available from ANATEL, we captured 20.1% of all new mobile subscribers in Region II during 2008.

We believe that as the fourth entrant in the mobile services market in Region II, our mobile business will benefit from number portability, which was implemented in Brazil between August 2008 and March 2009, because it may allow us to overcome the general resistance of long-time users (usually high-value customers) to changing their mobile telephone numbers and thereby allow us to attract these customers from our competitors.

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

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

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

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

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

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

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

authorizations to provide personal mobile services in Region II;

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



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

an authorization to provide international long-distance services originating from any location in Brazil; and

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

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

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

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

expires on December 31, 2025;

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

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

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

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

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

These concession agreements required us to render services in public telecommunications offices that serve as business centers for low-income populations. In April 2008, these concession agreements were amended to remove the obligation to construct new public telecommunications offices and replace it with obligations to provide (1) transmission lines connecting our fiber-optic internet backbones to municipalities in our concession area in which we did not provide internet service, which we refer to as backhaul, and (2) internet services in urban schools. Under these amendments, we are obligated to set up backhaul in 452 municipalities and provide internet services to 15,099 urban schools in Region II. We were required to provide backhaul to 40% of these municipalities and internet services to 40% of these schools by December 12, 2008. However, our obligation to provide backhaul has been enjoined pending the outcome of a lawsuit seeking to classify the facilities that we construct to meet this obligation as property that is part of our concession and will therefore revert to the Brazilian government. Under the amendments, we are required to provide backhaul to 80% of these municipalities and internet services to 80% of these schools by December 31, 2009 and all of these municipalities and schools by December 31, 2010.

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



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We are currently discussing modifications to these concession agreements with ANATEL. On March 30, 2009, ANATEL published a public notice of the proposed modifications to these concession agreements. In this public notice, ANATEL proposed amendment to the General Plan on Universal Service that would (1) require the expansion of our fixed-line network to all municipalities with more than 30,000 inhabitants, (2) require us to provide service to a large number of additional areas, including indigenous villages, rural schools, health clinics, military bases, federal and state highway police stations, public aerodromes and environmental conservation organizations, and (3) require the fixed-line concessionaires to install an aggregate of up to approximately 110,000 additional public telephones, which number may be reduced as a result of ongoing changes in ANATEL regulations decreasing the number of public telephones required per inhabitant. The public consultation period in connection with the March 30, 2009 public notice ended on June 22, 2009, although the final amendments to our concession agreements have not yet been determined. The final modifications will become effective on January 1, 2011.

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

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

expires on December 31, 2025;

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

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

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

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

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

We are currently discussing modifications to these concession agreements with ANATEL. On March 30, 2009, ANATEL published a public notice related to these concession agreements proposing new conditions and quality and universal service targets. The public consultation period in connection with the March 30, 2009 public notice ended on June 22, 2009, although the final amendments to our concession agreements have not yet been determined. The final modifications will become effective on January 1, 2011.

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

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

We hold nine licenses to use radio frequency spectrum in specific geographic regions. These licenses grant us permission to use the applicable radio spectrum for 15 years from the date of grant and are renewable for additional 15-year terms. We will be required to pay an amount equal to 2.0% of the prior year's net operating revenue from personal mobile services upon renewal of the license and on every second anniversary of the renewal. Our radio frequency spectrum licenses expire between 2017 and 2022.



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Our authorization agreements are subject to network scope and service performance obligations set forth in these authorization agreements. Under these obligations, as of the date of this annual report, we are required to service all municipalities in Region II with a population in excess of 100,000. A municipality is considered serviced when the covered service area contains at least 80% of the urban area in the municipality. As of the date of this annual report, we have satisfied the network scope and service performance obligations set forth in these authorization agreements.

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

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

We have been granted radio frequency licenses by ANATEL that govern our use of the frequencies necessary to provide 3G services in Region II. Each of these licenses grants us permission to use the applicable radio spectrum for 15 years from the date of grant and is renewable for additional 15-year terms. We will be required to pay an amount equal to 2.0% of the prior year's net operating revenue from personal mobile services upon renewal of the license and on every second anniversary of the renewal. These licenses expire in 2023.

These radio frequency licenses include network scope obligations. Under these obligations, we are required to provide the following services in Region II:

service 168 municipalities that did not have mobile services at the time these licenses were granted with either 2G or 3G mobile telecommunications services, with half of those municipalities serviced by April 30, 2009, which obligation we have satisfied, and the remaining municipalities serviced by April 30, 2010;

provide 3G service to all state capitals, the Federal District and all municipalities with a population in excess of 500,000 by April 30, 2010;

provide 3G service to all municipalities with a population in excess of 200,000 by April 30, 2012;

provide 3G service to all municipalities with a population in excess of 100,000 and to 50% of the municipalities with a population in excess of 30,000 and less than 100,000 by April 30, 2013;

provide 3G service to 60% of the municipalities with a population in excess of 30,000 by April 30, 2016; and

provide 3G service to 242 municipalities with a population of less than 30,000 by April 30, 2016.

A municipality is considered serviced when the covered service area contains at least 80.0% of the urban area in the municipality. Our failure to meet these targets may result in the imposition of penalties established in ANATEL regulations and, in extreme circumstances, in termination of our personal mobile services authorizations by ANATEL.

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

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





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

We have entered into authorization agreements with ANATEL that govern our authorizations to provide international long-distance services originating from anywhere in Brazil. These authorizations do not have termination dates and require us to comply with quality of service obligations set forth in the General Plan on Quality Goals.

**Multimedia Services Authorization Agreement**

In May 2003, ANATEL granted us a Multimedia Communication Services authorization together with the related spectrum license, permitting us to provide high speed data service throughout Brazil.

**Capital Expenditures**

Our capital expenditures on property, plant and equipment and intangible assets were R\$2,678 million in 2008, R\$1,398 million in 2007 and R\$1,451 million in 2006.

The following table sets forth our capital expenditures on plant expansion and modernization for the periods indicated.

|  | Year Ended December 31, |                  |                  |
|--|-------------------------|------------------|------------------|
|  | 2006                    | 2007             | 2008             |
|  | (in millions of reais)  |                  |                  |
| Mobile network and systems                 | R\$ 282                 | R\$ 279          | R\$ 1,145        |
| Data transmission equipment                | 275                     | 240              | 275              |
| Voice transmission                         | 263                     | 146              | 389              |
| Telecommunications services infrastructure | 250                     | 226              | 236              |
| Information technology services            | 97                      | 127              | 143              |
| Other                                      | 285                     | 381              | 490              |
| <b>Total capital expenditures</b>          | <b>R\$ 1,451</b>        | <b>R\$ 1,398</b> | <b>R\$ 2,678</b> |

**Number Portability**

We implemented the systems necessary for us to comply with ANATEL's number portability requirements. This project was commenced in September 2008 and was completed in March 2009. The total cost of this project in 2008 was R\$221 million.

**Commencement of 3G Services in Region II**

In December 2007, we acquired radio frequency licenses in an auction conducted by ANATEL to provide 3G mobile services in two of the nine regions into which Brazil has been divided by ANATEL for purposes of providing 3G services. These licenses have allowed us to commence providing 3G services throughout Region II. The total cost of these licenses was R\$488 million. We have undertaken a project to develop our 3G network in Region II. This project is designed to provide the necessary capacity for up to 120,000 customers and includes the installation of 1,418 active radio base stations, Node-Bs and systems provided by Ericsson and Nokia, the connection of 19 3G control units and the expansion of our data and network transmission. By providing 3G services, we believe that we will strengthen our bundling strategy in Region II. This total cost of this project in 2008 was R\$288 million.

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### ***Upgrade of Our Core Mobile Network***

We have undertaken a project to upgrade our core mobile network, with the primary goal of fully integrating our mobile network into the mobile network of Telemar. We have engaged Nokia to replace our existing core mobile network, which relies on technology from Ericsson, with a new core mobile network that uses the same Nokia technology employed in Telemar's existing core mobile network to facilitate the integration of our networks.

### ***Enhancement of Our Mobile Network***

We are undertaking a project to upgrade a portion of our mobile networks to enable us to increase the capacity of these networks. We plan to replace 3,060 of our radio base stations, all of which previously employed Alcatel technology, with Huawei base stations. We expect the replacement of these radio base stations to be completed by May 2010.

### ***2009 Capital Expenditure Budget***

Our 2009 capital expenditure budget, including our budget for expenditures in 2009 on the projects described above, totals approximately R\$2,000 million. We plan to finance such expenditures through operating cash flows and long-term financings. From this total, we have budgeted 29% of our 2009 capital expenditure budget to the mobile telephone services business, and 60% to the fixed-line business, which includes the capital expenditures that will be necessary in order for us to meet our regulatory targets.

### **Research and Development**

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

As part of the privatization process of Telebrás, the newly formed telecommunications service providers, including our company, contributed to the Foundation for Research and Development of Telecommunications (*Fundação Centro de Pesquisa e Desenvolvimento em Telecomunicações*), or Foundation CPqD, which is a research and development center formerly operated by Telebrás that develops telecommunications technology to be applied in Brazil.

Our current agreement with Foundation CPqD provides for access to telecommunications software developed by Foundation CPqD and technological services provided by Foundation CPqD, including equipment testing, consulting and training services. We made disbursements to Foundation CPqD of R\$18 million in 2006, R\$12 million in 2007 and R\$14 million in 2008.

Since 2006, we have performed research in cooperation with equipment and systems suppliers designed to develop new technologies and services. In 2007, we modified our *Único* service, a service enabling subscribers to use their mobile device on our fixed-line network through a wireless local area network, or Wi-Fi, connection, to include Wi-Fi access and GSM seamless integration. As a result, we believe that we are the first Brazilian carrier to launch services that use next generation network architecture.

We have also developed a technology laboratory that includes space for equipment test and assembly. This laboratory performs a variety of functions, such as operation support systems, business support systems and information security. We conduct trials of technologies from different vendors in this laboratory to evaluate these technologies for deployment. Our costs associated with this laboratory were R\$5 million in 2008.

We participate in telecommunications standards bodies, technical associations and committee forums such as the European Telecommunication Standards Institute (ETSI), the Telecommunication and Internet Services and Protocols for Advanced Networking (TISPAN), the Third Generation Partnership Project (3GPP), and the Fixed Mobile Convergence Alliance (FMCA) in order to contribute and gather expertise in globally applicable technical specifications, technical reports and telecommunications standards.

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

Our principal properties, owned and leased, are located in Regions II. As of December 31, 2008, we owned 3,155 properties. As of December 31, 2008, we also leased 3,625 operational properties from third parties.

At December 31, 2008, the net book value of our property, plant and equipment was R\$5,902 million. Our main equipment consists of transmission equipment, trunking and switching stations (including local, tandem and transit telephone exchanges), metallic and fiber-optic cable networks and lines, underground ducts, posts and towers, data communication equipment, network systems and infrastructure (including alternating and direct current supply equipment) and motor-generator groups.

Buildings represented 6.3% of the net book value of our property, plant and equipment; underground ducts, post and towers represented 20.0% of the net book value; plant and equipment related to switching stations represented 4.7%; transmission equipment represented 44.2%; construction in progress represented 17.1%; and other fixed assets represented 7.7%.

All property, plant and equipment that are essential in providing the services described in our concession agreements are considered reversible assets, which means that, should our concession agreements expire or terminate without being renewed, these assets will automatically revert to ANATEL. There are no other encumbrances that may affect the utilization of our property, plant and equipment. For more details, see note 19 to our audited consolidated financial statements included elsewhere in this annual report.

### **Intellectual Property**

We believe the trademarks that identify us and our business are important for us, and as a result, we have taken steps to protect them. We have 237 trademarks registered with the National Institute of Industrial Property (*Instituto Nacional de Propriedade Industrial*) or INPI, along with 392 pending trademark applications. Among the various trademarks we have registered with the INPI, three are being contested by third parties. Additionally, of the 392 pending trademark applications, 18 have been challenged by third parties.

We have 233 domain names registered with the Center of Information and Coordination of Dot Br - NIC. Br, an agency responsible for registering domain names in Brazil. The information included on our websites or that might be accessed through our websites is not included in this annual report and is not incorporated into this annual report by reference.

We have filed seven patent applications with the INPI. Requests for technical examination have been submitted to the INPI for all of these patent applications. Once examination is concluded, a decision accepting or rejecting the application will be issued. If granted, the patent will have a term of 20 years from the date of filing and no less than ten years from the date the application is granted.

Following Telemar's acquisition of our company, we have used the Oi brand name with the permission of Telemar.

### **Insurance**

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

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

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We believe that our current insurance coverage is suitable to our operations. For more details on our insurance policies, see note 33 to our audited consolidated financial statements included elsewhere in this annual report.

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

#### ***Overview***

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

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

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

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

The four principal providers of fixed-line telecommunications services in Brazil, Telemar, Brasil Telecom, Telesp and Embratel, provide these services under the public regime. In addition, CTBC Telecom and Sercomtel, which are secondary local fixed-line telecommunications service providers, operate under the public regime. All of the other providers of fixed-line telecommunications services and all providers of personal mobile services and data transmission services in Brazil operate under the private regime.

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

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

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

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

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

universal access to telecommunications services;

stimulation of employment and development of the Brazilian telecommunications sector;

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

the financial equilibrium of existing concession agreements.

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

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

#### *Private Regime Authorizations*

With the goal of introducing competition in fixed-line telephone services in Brazil, the federal government granted four private-regime authorizations in 1999 to permit fixed-line service providers to compete with the incumbent fixed-line concessionaires. Three of these authorizations were granted to providers of local and intraregional long-distance services in the three fixed-line service regions. Embratel currently holds two of these authorizations, which allows it to provide local fixed-line services in Regions I and III, and GVT holds the other authorization, which allows it to provide local fixed-line services in Region II. The fourth fixed-line authorization, to provide domestic and international long-distance services throughout Brazil, is currently held by Intelig. Since 2002, the number of authorizations to provide fixed-line services that the federal government may issue is unlimited.

#### *Public Regime Concessions*

Each of the public regime service providers operated under a concession agreement that expired at the end of 2005. Each of these providers entered into new concession agreements in December 2005 that extended their concessions for an additional 20-year period expiring in December 2025. Under these new concession agreements, each of the public regime service providers are required to comply with the provisions of (1) the General Plan on Universal Service that was adopted by ANATEL in June 2003, (2) the General Plan on Quality Goals that was adopted by ANATEL in June 2003, and (3) the General Plan on Competition Targets (*Plano Geral de Metas de Competição*), which has not yet been adopted by ANATEL.

The concession agreements provide that ANATEL may modify their terms in 2010, 2015 and 2020 and may revoke them prior to expiration under the circumstances described below under Termination of a Concession. The modification right permits ANATEL to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions. ANATEL

is obligated to engage in public consultation in connection with each of these potential modifications.

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### *Rate Regulation*

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

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

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

A provider may increase rates for individual services within the local rate basket or the long-distance rate basket by up to 5% more than the IST so long as the rates for other services in that rate basket are reduced to the extent necessary to ensure that the weighted average increase for the entire rate basket does not exceed the permitted annual rate adjustment.

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

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

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

### *General Plan on Universal Service*

The General Plan on Universal Service was approved by ANATEL in June 2003 and became effective in January 2006. The General Plan on Universal Service sets forth the principal network expansion and modernization obligations of the public regime providers, such as providing public telephones in towns with a population in excess of 100, and installing residential fixed lines within seven days of a request in towns with a population in excess of



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300. In addition, public regime providers must comply with the Special Individual Access Class (*Acesso Individual Classe Especial*) rules, which are designed to require service for economically disadvantaged people. Under the Special Individual Access Class rules, a qualifying customer may subscribe to a service plan, limited to one fixed-line per household, and pay a lower monthly fee for service than under the basic service plans.

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

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

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

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

ANATEL has not yet adopted final unbundling rules or rates for full unbundling, although we expect that the rates that we would receive from other telecommunications services providers accessing our fixed-line networks will be lower than the rates we currently charge our customers for providing fixed-line and broadband internet services. As of December 31, 2008, no unbundled lines had been used by competitors in our region.

### *Service Restrictions*

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

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

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

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

On November 20, 2008, Brazil's president issued Decree No. 6,654, which modified the General Plan of Grants (*Plano Geral de Outorgas*) applicable to the fixed-line telecommunications industry. This decree eliminated a provision of ANATEL's regulations that prohibited one public regime provider from holding more than 20% of the voting shares of any other public regime provider. As a result of the elimination of this provision, Telemar was no longer prohibited from acquiring indirect control of Brasil Telecom.

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*Termination of a Concession*

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

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

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

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

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

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

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

the transfer of the concession without ANATEL's authorization;

the dissolution or bankruptcy of the provider; or

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

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

*General Plan on Quality Goals*

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

modernization of the network;

responses to repair requests;

responses to change of address requests;

rate of call completion;

operator availability;

availability of services to customers;

personal services to customers;

issuance of bills;

responses to mail received from customers; and

quality of public telephones.

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

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

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

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

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

Under the personal mobile service regulations:

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

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

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

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

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

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

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

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

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

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

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

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In preparation for auctions of spectrum in Bands F, G, I and J (2.1 GHz), ANATEL issued regulations that divide the Brazilian territory into nine regions for purposes of operations using these frequency bands. In December 2007, ANATEL auctioned radio frequency licenses to operate on each of these frequency bands in each of the nine regions and the related licenses to use these frequency bands. In this auction, we acquired the radio frequency

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licenses necessary to offer 3G services in two of the nine regions delineated by ANATEL for 3G services (corresponding to Region II under the personal mobile services regime). The use of these frequency bands will allow personal mobile services providers to offer 3G services to their customers.

### *Personal Mobile Services Rate Regulation*

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

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

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

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

### *Obligations of Personal Mobile Services Providers*

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

### *Network Expansion Obligations*

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

### *Quality of Service Obligations*

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

### *Additional Obligations*

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

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

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

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

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

reimburse unused pre-paid credits;

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

permit customers to change service plans without penalties;

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

increase the grace period for defaulting customers prior to blocking partial or total access from 15-30 days after the date a bill is due to 30-60 days.

### ***Interconnection Regulations***

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

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

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

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

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

In 2006, the TU-RL rates that fixed-line service providers could charge each other to terminate a call on their respective networks were reduced to 50% of the rate included in their Basic Plan per Minute for a local fixed-line call. In 2007, the TU-RL rates of the fixed-line service providers were reduced to 40% of the rate included in their Basic Plan per Minute for a local fixed-line call. ANATEL announced that beginning in 2008, the method used to determine the TU-RL rates would be based on a cost methodology, known as long-run incremental costs. However, in October 2007, ANATEL published an official letter delaying this change until 2010.

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

### *Interconnection Regulations Applicable to Personal Mobile Services Providers*

Interconnection fees are charged at a flat rate per minute of use of a personal mobile services provider's network. Prior to February 2005, interconnection rates charged by Band A and Band B providers were subject to a price cap stipulated by ANATEL. Since February 2005, the terms and conditions of interconnection agreements of



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all personal mobile services providers, including the rates charged by the operator of the network to terminate a call on its mobile network (the VU-M rate), commercial conditions and technical issues, are freely negotiated between mobile and fixed-line telecommunications service providers, subject to compliance with regulations established by ANATEL relating to traffic capacity and interconnection infrastructure that must be made available to requesting providers, among other things.

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

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

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

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

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

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

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

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

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

In July 2006, ANATEL issued regulations regarding the fees that may be charged for the use of mobile networks by personal mobile services providers with significant market power in the mobile interconnection market. These regulations will become effective as of a future date to be established by ANATEL. Under these regulations, ANATEL will determine, based on a fully allocated cost model, a reference value for VU-M rates of providers that are deemed to hold significant market power. This reference value will be reassessed every three years. In order to determine whether a provider has significant market power, ANATEL will establish criteria that consider:

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

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the economies of scope and scale available to that provider;

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

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

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

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

that provider's access to financing sources.

In 2007, ANATEL developed a cost-based methodology that is expected to take effect in 2010 to determine reference values for the VU-M of mobile services providers having significant market power, which will be used in the case of arbitration by ANATEL of the value of VU-M. In 2008, mobile services providers began providing ANATEL with annual operating data, which is intended to support ANATEL's cost-based methods for determining interconnection fees.

***Number Portability Regulations***

Number portability is the ability of a customer to move to a new home or office or switch service providers while retaining the same fixed-line or mobile telephone number. In March 2007, ANATEL adopted the General Regulation of Portability (*Regulamento Geral de Portabilidade*), establishing the deadlines and general rules regarding port