DIRECTORS' REPORT
NETIA S.A. GROUP
for the year ended December 31, 2009

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This Directors' Report presents the financial results of Netia S.A. ("Netia", the "Company", the "Issuer") and the consolidated financial results for the Netia S.A. Group ("Netia Group").

1 Characteristics of the Netia Group

1.1 The Netia Group's structure

The consolidated financial statements as at and for the year ended December 31, 2009 include the financial statements of the Company and the following subsidiaries:

- In2Loop Polska Sp. z o.o.
- Netia Corpo Sp. z o.o. (previously operating under the name Net 2 Net Sp. z o.o.)
- InterNetia Holdings Sp. z o.o. Group (previously operating under the name InterNetia Sp. z o.o.)

The financial statements of the InterNetia Holdings Sp. z o.o. Group include the financial statements of InterNetia Holdings Sp. z o.o. ("InterNetia Holdings") and its subsidiaries:

- Internetia Sp. z o.o. (previously operating under the name Air Bites Polska Sp. z o.o.) and its wholly-owned subsidiaries eTychy Sp. z o.o. and Global Connect Sp. z o.o.
- UNI-Net Poland Sp. z o.o.

Changes within the Netia Group's structure

The Management of Netia S.A. executed the transactions described below as part of an ongoing plan to simplify the Netia Group and consolidate operations into Netia S.A. and Internetia Sp. z o.o. in order to extract increased operational synergies.

***Registration of new subsidiaries (not in thousand*)**

On January 30, 2009, the Company subsidiary, Netia UMTS Sp. z o.o. ("Netia UMTS"), was registered in the National Court Register. Netia acquired 100 Netia UMTS' shares (with a par value of PLN 50 per share) constituting 100% of Netia UMTS' share capital and giving Netia 100% of the voting power at Netia UMTS' general meeting of shareholders. Netia UMTS was merged with Netia on November 30, 2009.

On August 4, 2009, the Company's subsidiary, Net 2 Net Sp. z o.o. (currently operating under the name Netia Corpo Sp. z o.o. "Netia Corpo"), was registered in the National Court Register. Netia acquired 100 Net 2 Net's shares (with a par value of PLN 50 per share) constituting 100% of Netia Corpo's share capital and giving Netia 100% of the voting power at Netia Corpo's general meeting of shareholders. The book value of Netia Corpo in Netia's accounts amounts to PLN 5,000.

Mergers with subsidiaries

On February 27, 2009 Netia merged with its wholly-owned subsidiary Tele2 Polska Sp. z o.o. ("Tele2 Polska"). The merger was carried out through the transfer of the acquired company's assets to Netia (merger by acquisition) without any increase in Netia's share capital and without any share exchanges.

On May 29, 2009 Lanet Sp. z o.o. ("Lanet") merged with its wholly-owned subsidiaries Seal-Net Sp. z o.o. ("Seal – Net") and Easy Com Sp. z o.o. ("Easy Com"). The merger was carried out through the transfer of the acquired companies' assets to Lanet (merger by acquisition) without any increase in Lanet's share capital and without any share exchanges.

On May 29, 2009 Connect Systemy Komputerowe Sp. z o.o. ("Connect") merged with its wholly-owned subsidiaries Cybertech Sp. z o.o. ("Cybertech") and Netster Sp. z o.o. ("Netster"). The merger was carried out through the transfer of the acquired companies' assets to Connect (merger by acquisition) without any increase in Connect's share capital and without any share exchanges.

On June 30, 2009 Systemy Informatyczne Netis Sp. z o.o. ("Netis") merged with its wholly-owned subsidiary Ticom Sp. z o.o. ("Ticom"). The merger was carried out through the transfer of the Ticom's assets to Netis (merger by acquisition) without any increase in Netis' share capital and without any share exchanges.

On July 31, 2009 InterNetia Holdings merged with its wholly-owned subsidiary Uni-Net Sp. z o.o. ("Uni-Net"). The merger was carried out through the transfer of the Uni-Net's assets to InterNetia Holdings (merger by acquisition) without any increase in InterNetia Holdings' share capital and without any share exchanges.

On August 31, 2009 Internetia Sp. z o.o. ("Internetia") merged with the following subsidiaries:

- Connect Systemy Komputerowe Sp. z o.o.
- Interbit Sp. z o.o.
- Lanet Sp. z o.o.
- Przedsiębiorstwo Informatyczne Punkt Sp. z o.o.
- Systemy Informatyczne Netis Sp. z o.o.

The merger was carried out through the transfer of the acquired companies' assets to Internetia (merger by acquisition) in exchange of shares in the increased Internetia's share capital.

On November 30, 2009 Netia merged with its two wholly-owned subsidiaries Netia UMTS Sp. z o.o. and Netia Spółka Akcyjna UMTS S.k.a. The merger was carried out through the transfer of the acquired companies' assets to Netia (merger by acquisition) without any increase in Netia's share capital and without any share exchanges.

Transfer of shares' ownership (not in thousands)

On February 27, 2009, the InterNetia Holdings, Netia's subsidiary, transferred the ownership of the below mentioned shares in its subsidiaries:

- 2,039 shares in the share capital of Easy Com, with the total nominal value of PLN 1,019,500, to another Netia's subsidiary operating under the business name Lanet. These shares represent 100% of the share capital and confer the right to 100% of the votes at Easy Com's meeting of shareholders. The transfer of the above referred shares was made in execution of the agreement concluded by InterNetia Holdings and Lanet on February 27, 2009. The shares represent an in-kind contribution in exchange for which InterNetia Holdings acquired 400 newly issued shares in Lanet, with the nominal value of PLN 500 and at the issue price of PLN 21,182.20 each for a total price of PLN 8,472,880.

- 200 shares in the share capital of Cybertech, with the total nominal value of PLN 50,000, to another Netia's subsidiary operating under the business name Connect. These shares represent 100% of the share capital and confer the right to 100% of the votes at Cybertech's meeting of shareholders. The transfer of the above referred shares was made in execution of the agreement concluded by InterNetia Holdings and Connect on February 27, 2009. The shares represent an in-kind contribution in exchange for which InterNetia Holdings acquired 2,000 newly issued shares in Connect, with the nominal value of PLN 50 and at the issue price of PLN 2,079 each, i.e., for a total price of PLN 4,158,000.

Corporate separation of Uni-Net Poland Sp. z o.o.

On May 29, 2009 Uni-Net Poland Sp. z o.o. ("Uni-Net Poland"), a subsidiary of InterNetia Holdings, was registered in the National Court Register. Uni-Net Poland was established through the corporate separation from Uni-Net. The corporate separation has been carried out pursuant to Article 529, §1, subsection 4 of the Commercial Companies Code through the division and transfer of business to the new entity Uni-Net Poland with a decrease in Uni-Net's share capital.

Acquisitions

On December 7, 2009 Internetia Sp. z o.o., the Company's subsidiary, concluded an agreement for the acquisition of 1,200 (not in thousand) shares in the share capital of eTychy Sp. z o.o. ("eTychy") with the total nominal value of PLN 600 for all these shares, which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price of all these shares has been set at PLN 4,798.

On December 22, 2009 Internetia Sp. z o.o., the Company's subsidiary, concluded an agreement for the acquisition of 12,400 (not in thousand) shares in the share capital of Global Connect Sp. z o.o. ("Global Connect") with the total nominal value of PLN 620 for all these shares, which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price of all these shares has been set at PLN 8,245.

1.2 Information on basic products and services

The Netia Group provides various voice telephony and data transmission services. These services include switched, fixed-line voice telephone services (including domestic long-distance, international long-distance and fixed-to-mobile services), Integrated Services Digital Network ("ISDN"), Voice over Internet Protocol ("VoIP"), voice mail, dial-up and fixed-access Internet, leased lines and frame relay and MPLS services. The Netia Group also offers wholesale services (including the wholesale termination of in-bound traffic, ducts, dark fiber and co-location services), services based upon intelligent networks (free phone, split charge and premium rate services) and provides broadband Internet access with ADSL technology. These services are offered over Netia's own copper or fiber networks and, selectively, over network facilities leased from other operators.

Since 2006, the Netia Group has been providing voice and broadband services using WIMAX technology running over 3.6 – 3.8 GHz frequencies that were acquired by the Group in 2005.

Taking advantage of the new opportunities arising from changes in the regulatory environment, the Company concluded a bitstream agreement with Telekomunikacja Polska S.A. ("TP SA") and commercially launched its broadband Internet access services over TP SA's network in January 2007. During the third quarter of 2007 the Company began offering Netia voice services to TP SA customers including the arrangement whereby the customer pays a monthly fee to Netia as well as the hitherto call by call charges. Netia in turn has to pay a line rental fee to TP SA under the Wholesale Line Rental (WLR) administrative decision issued by the telecommunications regulator (Urząd Komunikacji Elektronicznej, "UKE"). During 2008 Netia has begun to install its own equipment in the TP SA network nodes using a form of regulated access called Local Loop Unbundling (LLU) and has begun connecting customers using this form of regulated access.

In September 2008 the Company acquired Tele2 Polska Sp. z o.o. ("Tele2 Polska", merged with Netia in February 2009), a company providing voice and broadband services Poland-wide on the basis of regulated access to the TP SA network, including call by call, WLR and BSA.

The Netia Group is also expanding the footprint of its own network and broadband customer base by acquiring local fast ethernet operators. Since the beginning of 2007, the Netia Group has acquired 22 such operators with a total of 94,188 (not in thousands) active customers. Additionally, since the end of 2008 the Netia Group has acquired 6,523 (not in thousands) customers and local networks from other Ethernet operators.

To further broaden Netia's product offer, including convergent services, Netia started offering mobile services in September 2008. Netia provides its mobile service based on a Mobile Service Provider Agreement with P4 Sp. z o.o. ("P4"), enabling Netia to buy mobile services wholesale from P4 and resell them as Netia branded mobile services. In the third quarter of 2009, the scope of this cooperation has been expanded to cover mobile broadband services as well as mobile handset based voice and data services.

The Netia Group is also engaged in the installation and supply of specialized mobile radio communication services (public trunking) in Poland through its subsidiary UNI-Net Poland (established in May 2009 through a corporate separation from UNI-Net).

The Netia Group's revenues in 2008 and 2009 are presented below:

	Year ended December 31, 2008	Share in total revenues	Year ended December 31, 2009	Share in total revenues
	(PLN)	%	(PLN)	%
Direct voice, including:	487,609	43 %	743,395	50 %
Monthly fees	*226,436*	*20 %*	*457,523*	*31%*
Calling charges	*260,345*	*23 %*	*285,541*	*19 %*
Indirect voice	56,809	5 %	65,654	4 %
Data	373,533	33 %	520,460	35 %
Interconnection revenue	89,175	8 %	66,917	4 %
Wholesale services	71,905	6 %	81,592	5 %
Other telecommunication revenue	25,601	3 %	22,489	2 %
	1,104,632	**98 %**	**1,500,507**	**100 %**
Radio communication services	7,762	1 %	5,364	0 %
	1,112,394	**99 %**	**1,505,871**	**100 %**
Discontinued activity				
Wholesale international voice traffic termination	8,774	1 %	-	-
	1,121,168	**100 %**	**1,505,871**	**100 %**

1.3 Sales market (not in thousands)

The Netia Group operates on the telecommunications services market. The market for fixed line telephony services decreased from approximately 10,6 million lines at the end of 2008 to 10,0 million at the end of 2009 and is continuing to fall. The penetration of fixed line telephony in Poland was 72% of households at the end of 2009.

Following the market liberalization and introduction of services based on bitstream access (BSA), wholesale line rental (WLR), and local loop unbundling (LLU) the Netia Group is able to offer Internet access and voice services, nationwide, via the TP SA's copper network. As a result, Netia has modified its strategy to focus on this new opportunity. The market for broadband services has increased significantly to an estimated 5,6 mln subscribers at the end of 2009 from 5,1 mln in December 2008. This market has the highest growth of all fixed telecommunication segments and this trend is expected to continue over the next few years. In 2009 household Internet penetration reached 40% and the Netia Group became the leading alternative for broadband services to the national telecom operator (TP SA). Based on published market share estimates, Netia projects that it acquired 30% of broadband net additions during 2009. The Netia Group's broadband subscribers base increased to 559,317 at December 31, 2009 from 413,645 a year earlier. The Netia Group estimates that its share of total broadband market subscribers has increased from 8.1% to 10.0% during the past twelve months.

The Netia Group has its own access networks built out in areas inhabited by approximately 65% of Poland's population. At the end of 2009, Netia served _217,418 broadband customers using the wholly owned copper and fiber networks. The country-wide backbone network and the ability to upgrade the existing access network allows the Group to broaden its operations, simultaneously obtaining independence from the networks of other operators.

The Netia Group started an important expansion of access and backbone networks in 2006 as a result of the implementation of its WiMAX project. At the end of 2009 telecommunications services based on WiMAX technology using 100 active base stations, were available in 181 cities and towns. The number of WiMAX broadband Internet ports reached 17,079 at December 31, 2009 (up from 16,834 at the end of 2008). Using WiMAX radio base station infrastructure, the Group intends to spread its activities to additional cities and suburbs offering a full scope of telecommunications services (telephony services, Internet access and data transmission).

As of December 31, 2009, Ethernet networks acquired by the Netia Group since mid-2007 provided broadband access to a total of 105,678 mostly residential customers as compared to 90,507 customers at December 31, 2008, with approximately 415,000 homes passed. During 2009 the Netia Group acquired in total 5 Ethernet networks (including both purchases of companies and asset transfers) with 16,925 active customers and 88,000 homes passed. The acquisition program is part of Netia's strategic objective to acquire one million broadband customers and up-sell voice services to the existing subscriber base of the acquired Ethernet providers. The Netia Group remains fully dedicated to consolidation of the fragmented Polish Ethernet ISP market.

In Q4 2009 Netia continued to extend the reach of its LLU-based services. Netia had 297 unbundled nodes at December 31, 2009, reaching approximately 2.5 million active customer lines. As of today, Netia has 301 nodes unbundled and work has begun on the final annual wave of LLU development that is expected to take the total of unbundled nodes to over 500 by the end of 2010. Netia served 48,117 customers over LLU as at December 31, 2009 as compared to 1,320 at December 31, 2008. Netia has been migrating 1play customers to the higher margin LLU services under a process which began in May 2009. Migrations of 2play customers to full LLU access started in November 2009, following implementation of technology solutions that are expected to reduce migration costs significantly. By the end of 2009 Netia migrated 24,519 1play and 2play clients.

The Netia Group runs its operations within one geographical area, that is the territory of Poland.

The Netia Group renders its services both to business and residential customers. In 2009 none of the customers exceeded 10% share in the Netia Group's sales. TP S.A. "Łącza" was the largest supplier for the Netia Group (approx. 20% of the turnover). TP S.A. "Łącza" is not a related party to the Company.

1.4 Development perspectives for the Netia Group's operations

Growth prospects (not in thousands)

Our key objective is to further strengthen our leadership position among alternative telecom operators in the Polish broadband market. We aim to reach one million broadband customers until the end of 2012, predominantly based on Local Loop Unbundling (LLU), wholesale Bitsteam Access (BSA) and Netia's own access networks. Our priority in this area is to strongly increase our customer base using LLU access, both by targeting new customers in our LLU coverage areas and by migrating customers from Wholesale Line Rental (WLR) and BSA onto LLU. We expect that those activities will enable us to enhance the profitability of voice and broadband services and will allow us to offer a broader range services to a greater number of customers. A key priority is to continue to boost the proportion of our customer base taking more than one service from Netia as this drives profitability through the proportionate reduction in back office expenses.

Our aspiration is to comprehensively meet our customers' communications needs. To achieve that, we have been offering mobile voice services to our business segment customers, both as an extension to existing product bundles and as stand-alone mobile services. In 2009 we also launched mobile broadband services offered to both residential and business customers. Both of these mobile services have been provided in partnership with mobile network operator P4. In the first half of 2010 we also plan to launch IPTV services, which will be offered in bundles with fixed voice and broadband services. IPTV services will be provided based on our own access network and LLU. Making the IPTV and mobile services available to our customers will enable us to boost the value of our customer base, as well as will contribute to meeting a wider range of our customers' needs and strengthening our relationships with them.

The next element of our strategy is related to maintaining our position in the corporate and carrier segments. We will focus on the most attractive areas in the business segment, aiming to improve profitability in the corporate segment while limiting incremental capital expenditure. In the carrier segment our goal is to increase the utilisation of existing capacity and other assets by selectively pursuing projects that require limited investment and which are considered low risk for the returns available.

In September 2008 we finalised the acquisition of Tele2 Polska, which significantly enhanced the scale of our operations and also increased the potential for up-selling of broadband, value-added services and content to Tele2 Polska customer base. We completed the integration activities in the third quarter of 2009, which we expect to allow us to capture 46 million PLN in annual synergies from 2010 onwards, far above our original expectations. Going forward, we may consider further acquisitions. In particular we seek to continue the acquisitions of local Ethernet-based networks and to participate in further consolidation among altnets if opportunities arise.

In 2009 we also completed a cost reduction and efficiency improvement programme known as Project "Profit". We expect that the implemented initiatives will enable us to reduce our cost base by over 128 million PLN in 2010, which will help us to achieve the targeted EBITDA margin of 23% by 2010 and 28% by 2012.

A critical enabler for successful accomplishment of Netia's growth plans is an organisational culture characterised by focus on customer needs, entrepreneurship and efficiency. Our objective is to maintain a spirit of dynamism and proactivity at Netia, which will enable us to effectively face the challenges posed by the market and our competitors.

Network Infrastructure

Deregulation of telecommunication market results in dynamic development of Netia Network both in terms of backbone network capacity and coverage of access networks based on TP SA infrastructure. In parallel to limited geographical expansion of access networks, our backbone network is expanded in new areas based on leased infrastructure from other vendors. Delivery of broadband access to the customers is realized both by capacity upgrades of existing points of interconnect with TP SA and by construction of additional interconnection points enabling delivery of services based on BSA regulations. In parallel to BSA extension, construction of LLU access nodes in the TP SA network is under intensive development. At December 31 2009, 297 LLU nodes had been deployed by Netia from a total plan of over 500 expected to be fully deployed by the end of 2010. This LLU network is expected to give us access to 3.6 million or 42% of TPSA access lines Poland–wide. Implementation of modern ADSL/VDSL technologies in LLU nodes will enable delivery of advanced services requiring broadband access (i.e IPTV, VoD, VoiP, MPLS).

Development of Netia's own broadband access based on copper infrastructure is focused on implementation of new technologies increasing bandwidth delivered to the customer. Acquisition of Ethernet networks is followed by the upgrade of their infrastructure in terms of capacity delivered to access nodes required by modern services i.e. IPTV and in terms of enabling remote management and automatic service provisioning of new services in these networks. As a result of upgrades Netia Ethernet Networks build in Fiber To The Building technology will be able to deliver up to 100Mb/s capacity to each customer.

2 Major factors for the activities of the Netia Group

2.1 Major risks and threats related to the operational activities

Risk of changes to the Netia Group's strategy

On April 18, 2007 the Company announced the main assumptions of its new operational strategy. Financial guidance regarding this strategy was last updated on April 6, 2009 to take account of the material impact of the Netia's strategic cost reduction project. No assurance can be given as to whether new strategic initiatives included in Netia's strategy, will be successful, and if not, whether they may adversely affect the operating activity of the Netia Group, its financial standing or its overall performance.

Risk of changes in the shareholder structure, which may influence business activity

Currently, Netia is not controlled by any strategic investors, and its shares are held by a large number of shareholders. Novator Telecom Poland II S.a.r.l. („Novator"), previously the largest single shareholder of Netia (31.3% of the Company's share capital). sold all of its holdings of Netia shares during the first half of 2009. In the same period ING Otwarty Fundusz Emerytalny and clients of Pioneer Pekao Investment Management SA increased their share in the Company's share capital and according to the information provided to the Company hold 48,010,027 and 38,891,802 shares constituting 12.3% and 10.0% of the Company's share capital and representing 10.3% and 10.0% of the total number of votes at the General Shareholders' Meeting of the Company, respectively. Moreover Third Avenue Management LLC ("Third Avenue") holds 93,720,763 shares representing 24.1% of the Company's share capital and 24.1% of the aggregate number of votes at the Company's General Shareholders' Meeting. The subsidiaries of SISU Capital Limited hold 39,043,006 shares representing 10.0% of the Company's share capital and 10.0% of the aggregate number of votes at the Company's General Shareholders' Meeting. Neither Netia's corporate documents nor the provisions of Polish law provide for any serious restrictions to changes in control over the Issuer in the event of third parties acquiring a considerable number of shares. Thus, such changes of control may materially affect the composition of the Company's Supervisory Board and the Management Board and, in turn, the strategy and business activity of the Netia Group. Due to the above, the Issuer cannot guarantee that any adopted strategy of the Netia Group will be pursued in accordance with its initial objectives.

Risk connected with the impact of potential future takeovers and acquisitions of large-scale businesses

Revenues and financial performance of the Netia Group may be materially affected by takeovers of and mergers with other entities that operate large scale telecommunications businesses. Upon the Company's takeover of another entity, the process of fully integrating this entity may carry high risks, e.g. resignation of key employees, the loss of a certain segment of its customers or high costs of the entire integration process.

The fragmented market of alternative operators rendering wireline telephone services may result in increasing consolidation within the Polish market. The Company intends to evaluate potential takeovers and acquisitions whenever such possibilities arise. The performance of such transactions requires the special involvement of the Company's high-ranking managers and may entail high costs connected with the identification and evaluation of the candidates for takeover, the negotiating of agreements and integration of the entities acquired. The Netia Group may require additional funding in order to conduct such transactions.

The benefits from potential takeovers will depend mostly on the extent to which the Netia Group is able to integrate the acquired entities into its structures. Future company acquisitions may entail acquiring existing liabilities and the risk of undisclosed liabilities. The Netia Group cannot guarantee that beneficial takeover possibilities will arise in the future, nor, if such possibilities arise, that they will result in the successful integration of the acquired entities with the Netia Group. Failure to integrate the acquired entities into the structures of the Netia Group and / or the failure to generate the expected operating and strategic synergies may adversely affect the operations and financial standing of the Netia Group.

Risks relating to the acquisition, integration and development of Ethernet network operators

An important element of Netia's strategy to expand its broadband subscriber base is the acquisition of Ethernet network operators. Our plans require that these companies, which typically have no more than 5,000 customers at the time of acquisition, are integrated into Netia's core operations. We aim to continue to grow the subscriber bases connected to the networks that we acquire and to upsell their customers voice services in addition to the internet access that they currently purchase. We cannot provide any assurance that we will be successful in implementing this strategy in whole or in part in any or all of the Ethernet networks that we have acquired or will acquire. Costs of integration may exceed our plans or we may discover undisclosed liabilities post acquisition. Customers may prove reluctant to switch to services provided by Netia directly or unwilling to switch to Netia voice services from their current providers. Moreover the price of such Ethernet networks may increase to the point that further acquisitions are uneconomic, making it more difficult for Netia to reach its subscriber growth objectives. Failure to fully implement our strategy in regard to Ethernet network operators may adversely affect the operations and financial standing of the Netia Group.

Technological risk

The telecommunications sector is an area witnessing dynamic technological changes. In designing and expanding its networks, the Netia Group uses the latest technical solutions. However, it is not possible to predict how the Netia Group's operations may be affected by technological advances in the field of fixed-line telephony, wireless transmission, voice services based on Internet or cable television telephony. In particular, the business activities of the Netia Group may be affected by the trend to provide telecom services via wireless or portable platforms, with wireless broadband access and third/forth generation mobile cellular telephone systems equipped with IP. Due to the difficulties in predicting future technological developments, market potential and regulatory environment, Netia may sometimes invest in technologies that ultimately do not deliver the expected returns. When such a situation occurs, it can have a significant negative impact on our results and financial condition.

Foreign currency risk

Approximately 65% of Netia's typical annual capital investment programme and up to 10% of typical operating expenses are either invoiced in foreign currencies or are invoiced in Polish Złoty based on price lists expressed in foreign currencies. Netia operates a Risk Management Committee that decides, from time to time, to hedge these exposures to foreign currency risks and if so, the proportion of the exposure to be hedged. Whilst Netia's hedging activities are designed always to reduce Netia's exposure to earnings volatility through changes in exchange rates (i.e. Netia does not speculate), we can give no assurance that entering into hedging transactions will result in higher earnings or cash-flows that if we had not hedged the Company's currency exposures.

Risk of employment termination by key executives and difficulties related to the recruitment of new, competent executives

The activity of the Netia Group is dependent on the quality of the work of its staff and employees in executive positions. The Management Board cannot guarantee that the possible termination of employment by some of its key executives will not adversely affect the financial standing and performance of the Netia Group, which, should some of its executives terminate their employment, may then lack executives with sufficient knowledge and experience in the field of management and operating activity. Changes in composition at the Company's executive levels may result in disruptions in the Netia Group's business activity.

Risk resulting from changes in the Telecommunications Law

The Telecommunications Law came into force on September 3, 2004 (except for certain regulations that came into force on January 1, 2005 in result of implementation of so-called "2002 directives package"). On April 24, 2009, the lower chamber of the Polish Parliament (Sejm) passed the act on the amendment of Telecommunications Law and other acts. The purpose of the above-mentioned amendment was to harmonize Polish provisions with the legal framework of the European Union. This amendment to the Telecommunications Law (the "New Amendment") entered into force on July 6, 2009.

Pursuant to the Telecommunications Law, binding until July 6, 2009, each public telecommunications network operator was required to conduct negotiations concerning interconnection agreements upon another telecom operator's request. According to the New Amendment, the extent of an obligation to negotiate agreements on telecommunications access, imposed on non-SMP operators, has been limited to cover only the obligation to negotiate agreements for the interconnection of networks.

The President of UKE is entitled to settle disputes between parties to the negotiations; a dispute can be settled by virtue of an administrative decision, which will replace an agreement on that issue if one of the negotiating parties is a public telecommunications network operator obliged to provide telecommunications access.

Provisions of the New Amendment introduce a number of other changes in the current obligations of telecommunications entrepreneurs, concerning, in particular, the terms and conditions regarding entering into and the modification of retail agreements (i.e. agreements with clients), protection of subscribers, number portability, data retention, as well as national defence, security and public safety and order obligations. The act specified also the competences of the President of UKE concerning the methods of verification of charges, proposed by SMP entrepreneurs for wholesale services provided by such an entrepreneur; the act introduced also the guarantees concerning the independence of the Regulator (amendment required by relevant EU legislation; according to the act, the prerequisites for the recall of the Regulator are limited to extraordinary circumstances. The act ensures also the durability of the term of office of the President of UKE). Compliance with the provisions of the New Amendment, specifically with respect to the increased protection for subscribers and new duties regarding national defence and security, public security and the safeguard of the public order, may increase the operational costs of the Netia Group in future years.

Two further amendments of the Telecommunications Law are currently in the legislative process. The Sejm is considering a draft of the act „for the support of the development of services and networks for broadband telecommunications", prepared by UKE. According to the guidelines for the law published by the President of UKE, one of the goals of the draft act is to improve the investment process in telecommunications infrastructure.

A draft of the act „on the amendment of the act on gambling and other acts" was passed to the Council of Ministers. The said draft provides the imposition of the obligation to block access to so-called "prohibited websites and services" in the Internet on telecommunications entrepreneurs providing Internet access services. The draft provides also for the broadening of current obligations to co-operate with competent State authorities in the scope of combating the "prohibited websites and services". The costs of performance of all of the above-mentioned obligations are to be borne by telecommunications entrepreneurs.

At this stage it is hard to indicate whether and when the new regulations would enter into force, and how they will materially affect the activities of the Group.

Risks resulting from the obligation to provide universal services

The Telecommunications Law states that the obligation to provide universal services shall rest with the operator selected pursuant to a decision of the President of UKE issued after a tender procedure. The President of UKE issued a decision assigning TP SA as the operator required to provide universal services until May 8, 2011. Telecommunications providers whose revenues from telecom activities exceed PLN 4,000 have to co-finance the funding of this obligation. The share in the funding that a telecommunications provider will be required to provide shall also be established by a decision of the President of UKE; however, it may not exceed 1% of the telecommunications provider's revenues in the given calendar year. The amount of the share in the funding of the universal service shall constitute a deductible cost, as defined by the Act on Corporate Income Tax.

TP SA applied to the President of UKE for a subsidy towards the incurred costs of the universal service provision. The application pertains to the subsidy towards the costs for the period from May 8, 2006 to December 31, 2006 and for the years 2007 and 2008. The President of UKE refused to subsidize the costs of services provided by TP SA that form a part of the universal service in 2006. Having considered TP SA's claim, the court reversed the decision of the President of the UKE. The Presidents of UKE and KIGEiT filed cassation appeals against the decision of the court. The Supreme Administrative Court dismissed the cassation appeals. The Management Board is unable to give any assurance that, following re-examination of the case, TP SA's motion for a subsidy towards the universal service will not be granted.

TP SA applied to the President of UKE for a subsidy towards the incurred costs of the universal service provision for the years 2007 and 2008. The Management Board is unable to give any assurance that both of the above-mentioned applications of TP SA will be granted.

Whereas Management believes that TP SA's investment record does not justify payment of universal service subsidies and intends to take all possible steps to avoid having to make such contributions. At the present stage Netia may not guarantee that the Group will not be required to co-finance the funding of universal services.

Risks related to holding a position of SMP

The President of the UKE issued the decision, whereby it has designated Netia as a telecommunications operator holding significant market power in the market for call termination in its fixed public telephone network, in the area of the network where the termination is executed. At the same time, UKE imposed regulatory obligations that relate to:

- providing access to the network (including the use of network elements and associated facilities to the extent they are used to provide call termination services in the fixed public telephone network of Netia),
- non-discrimination (obligation not to discriminate between telecommunications operators with regard to telecommunications access to the call termination services in its fixed public telecommunications network, in particular to offer the same conditions in comparable circumstances, as well as to offer the services and to provide the information on the conditions not less favorable than used within own enterprise or in relations with affiliates);
- transparency (comprising the publication of the information in matters concerning provision of telecommunications access with regard to the provision of call termination services in the fixed public telecommunications network of Netia S.A., on technical specifications of networks and telecommunications equipment, network characteristics, terms and conditions of the services and of the use of networks, as well as on the fees).

In the performance of the obligation imposed on Netia in the above mentioned decision of the President of the UKE, the Company published information on the conditions of telecommunications access with regard to call termination services in the fixed public telephone network of Netia by posting them on the internet site of Netia S.A., at: http://www.netia.pl/informacje,dla_biznesu,42,921.html. The published document, hereinafter the "Netia IC Offer" contains information as required in the Decision of the President of the UKE, necessary for the preparation by the interested entrepreneurs of an application pertaining to the provision of telecommunications access with regard to call termination services in the fixed public telephone network of Netia.

No assurance can be given as to whether Netia will not be obliged to perform some other duties set out in the Telecommunications Law imposed on a telecommunications operator holding significant market power in the market with respect to call termination services in the fixed public telephone network.

Asymmetry of interconnection rates depends on the policy of UKE

The President of UKE issued a decision amending the agreement between Netia and TP SA on interconnection of networks in which it established the level of asymmetry of rates for call termination on Netia's network in relation to the rates for call termination on TP SA's network. According to the above-mentioned decision, rates for the services are to be symmetrical by January 1, 2014.

The Management Board is unable to give any assurance that term sheet of achieving of rate's asymmetry for call termination in Netia's network in relation to the rates for call termination in TP SA's network, will not be accelerated or otherwise changed by the President of UKE.

(All amounts in thousands, except as otherwise stated)

Dependence of the Company on TP SA due to telecommunication access services

Risks relating to margin squeeze testing of bitstream access charges

On October 22, 2009 the President of UKE and TP SA signed an agreement laying down rules for the performance by TP SA of obligations with regard to telecommunications access ("The Settlement Agreement between the President of UKE and TP"). The Settlement Agreement provides that the fees for individual services in the scope of telecommunications access that follow from the applicable reference offers will be valid until January 31, 2012. The nominal value of the fees specified for that period for broadband access under the BSA offer will be determined while taking under consideration the retail prices of the TP SA's offer for the day October 10, 2009. Changes to the rules for financial settlements for broadband access to TP SA's network as specified in the Settlement Agreement will be effective as a result of a decision of the President of UKE on the introduction and adoption of the relevant reference offer and after prior publication of the position of the President of UKE on the rules of a margin squeeze test ("MS") for operators alternative to TP SA.

On the basis of a draft understanding, constituting appendix to the Settlement Agreement between the President of UKE and TP, Netia and TP executed a separate understanding ("Understanding") on the December 23, 2009. The Understanding provides that the rates for specific services in the scope of telecommunications access, arising from reference offers, shall be binding until December 31, 2012.

Under the above-mentioned principle, Netia and TP SA have specified conditions for settlements for broadband access to TP SA network. Payments for the use of subscribers' connections applied for to TP SA until October 10, 2009 are, from January 1, 2010 calculated at their nominal value, while taking into account retail prices of TP SA as of October 10, 2009. The parties have also adjusted the amount of wholesale rebate to the BSA reference offer, and introduced payments for settlements between operators according to the currently binding BSA Offer.

Payments for the use of subscribers' connections, for which the applications were filed to TP SA after October 10, 2009 will be settled under previous rules specified in the BSA reference offer, until the introduction of the MS test is agreed by President of UKE. The rules of MS test are currently subject of negotiations between President of UKE, TP SA, Netia and other alternative operators. When MS test is introduced, Netia and TP will apply charges, which will be based on 'cost plus' formula. The charges for transmission speeds currently offered by TP on the basis of the currently binding BSA reference offer may not be higher than these binding on October 10, 2009.

The Management cannot assure that the rules of MS test will provide sufficient guarantee of price non-discrimination by TP SA in the future.

Risks related to amendments to reference offers

TP SA is an operator obliged by virtue of the decision of the President of the UKE to prepare and present for approval draft offers for telecommunications access that specify frame terms and conditions of contracts on telecommunications access to the network of TP SA for particular wholesale services.

As part of the Settlement Agreement TP SA has withdrawn its complaints decisions of the President of UKE that modified the reference offers.

Management cannot provide any assurance that new disputes will not arise between TP SA and UKE that may create significant risks or uncertainties for the Netia Group.

Frame interconnection offer (RIO)

The President of the UKE approved the "reference offer of TP SA on the telecommunications access with regard to call initiation, call termination, and wholesale network access". The decision was made immediately binding and enforceable. After scrutinizing the motion of TP SA for reconsideration of the case, the President of the UKE issued a decision amending the content of the approved frame offer. The amendments are of an organizational nature. In particular, the President of the UKE did not approve TP SA's request to change fees for services covered in the offer. According to the Settlement Agreement between the President of UKE and TP, TP SA withdrew the complaint filed to the administrative court and the proceedings was discontinued.

Management cannot provide any assurance that new disputes will not arise between TP SA and UKE that may create significant risks or uncertainties for the Netia Group.

Frame interconnection offer with regard to broadband access service ("BSA" or "Bitstream")

The President of the UKE approved "the reference offer of TP SA of the terms of telecommunications access with regard to broadband access service, including the broadband data transmission", which modified the terms of the broadband access that were agreed in the contract between Netia and TP SA. The decision approving TP SA's offer was made immediately binding and enforceable. After scrutinizing a motion of TP SA and KIGEIT for reconsideration of the case the President of the UKE issued a decision amending the content of the approved frame offer. The amendments are of organizational nature. In particular, the President of UKE did not approve TP SA's request to change fees for services covered in the offer. According to the Settlement Agreement between the President of UKE and TP, TP withdrew the complaint filed to the administrative court and the proceedings was discontinued.

Management cannot provide any assurance that new disputes will not arise between TP SA and UKE that may create significant risks or uncertainties for the Netia Group.

Frame offer with regard to access to local loops and sub-loops („RUO")

The President of UKE approved "the reference offer of TP SA on the framework terms of telecommunications access with regard to local loop and sub-loop access service and related facilities with regard to full and shared access". Following the examination of TP SA and KIGEiT's motion for reconsideration of the case, the President of UKE amended the above-mentioned approved framework offer by means of a decision. The changes are not significant.

Due to the possibility that TP SA's reference offers, based on which the companies from the Netia Group concluded contracts for telecommunications access with TP SA, and subsequent decisions of the President of UKE that replaced or amended the contract, may be withdrawn or new reference offers may be approved by President of the UKE, the Management Board cannot assure that the terms on which Netia uses access to the network of TP SA will remain unchanged in the future, despite the fact that according to the Settlement Agreement, TP SA undertook to withdraw the appeals.

<u>*Risks related to a threat to the stability of the decisions on telecommunication access services*</u>

The terms and conditions under which the companies from the Netia Group use the services requiring telecommunication access to the network of TP SA substantially arise from decisions of the President of the UKE. These decisions amend or replace contracts with TP SA on telecommunications access.

According to the Settlement, TP SA withdrew complaints against decisions issued for Netia, including the so-called flat interconnection rate ("płaska stawka interkonektowa", PSI), WLR, BSA services.

Additionally, in the Understanding Netia and TP SA undertook to conclude a WLR contract and to amend current BSA contract and collocation contracts in order to replace decisions of the President of UKE with such contracts and to adjust the terms of cooperation between the Parties to currently existing reference offers of TP SA. Although these contracts ensure the durability of Netia's rights to access to TP SA network, the Management Board cannot assure that individual conditions of telecommunications access contained in the contracts may not in the future be less favourable than the future decisions of the President of UKE.

Interconnection

The rendering of telecommunications services by the Netia Group is dependent on the possibility of accessing the telephony network of TP SA. Except for some cases, calls initiated in Netia's network ending outside this network, including the majority of international and domestic long distance calls by subscribers of the Netia Group companies, are - due to technical reasons - executed via the network of TP SA. According to the provisions of the Telecommunications Law TP SA is required to connect companies such as Netia to its network.

In the past Netia has had many disputes with TP SA over interconnection, in particular in relation to the interconnection agreements of its former subsidiary El-Net (now merged with Netia SA). In order to avoid further disputes and to prevent conflict escalation, in December 2006 Netia concluded an agreement with TP SA on closing all disputed issues. Finally, on June 30, 2007 Netia and TP SA concluded contracts related to interconnection that thoroughly regulate the cooperation between operators.

According to the contract for interconnection between Netia and TP, this contract applies to the cooperation of TP SA also with regard to the connection of networks performed on the basis of separate contracts concluded by companies from Netia Group the rights and obligations of which were acquired by Netia under the Commercial Companies Code.

In the performance of the Understanding Netia has confirmed this rule on January 22, 2010 by placing with TP SA a binding declaration indicating the contract on interconnection between Netia and TP SA dated 30th June 2007 as the basis for the service for all subscribers of Netia with regard to interconnection.

In the performance of the Settlement, TP SA has withdrawn complaint against the decision of the President of UKE that amended the above interconnection contract with regard to specifying the so-called flat interconnection rate, used to settle types of traffic indicated in the decision that is directed to selected connection points between Netia and TP Sa networks. Until the court issues the decision and until it becomes valid and binding, the Management cannot assure that the proceedings will in fact be discontinued.

Wholesale network access service of TP SA (WLR)

SOKiK reversed the decision of the President of UKE (nevertheless, SOKiK did not suspend the enforcement of the decision in subject), specifying the rules of using by Premium Internet, whose rights and obligations were assumed by Tele2 Polska as a result of the merger of companies effective as of December 31, 2008 (and subsequently, the above-mentioned rights and obligations were assumed by Netia on February 27, 2009), the wholesale network access service of TP SA. On May 6, 2009, the Court of Appeal reversed the judgment of SOKiK and ordered a de novo trial to be conducted by the court of first instance.

The President of the UKE has issued to Netia SA a decision allowing wholesale network access service of TP SA ("The Decision"). On the basis of this decision, prior to the merger of Premium Internet and Tele2 Polska, Netia filed to TP SA a binding statement on the use of WLR services on the terms that follow from the Decision on WLR Lines of Tele2 Polska, with the consent of this company. As a result of this statement Netia SA took over the provision of WLR services on WLR Lines of Tele2 Polska.

In the performance of the Understanding, TP SA has withdrawn its complaint against the decision of the President of UKE. Until the court issues the decision on discontinuance of the proceedings and until it becomes valid and binding, the Management cannot assure that the proceedings will in fact be discontinued.

Bitstream Access

In the performance of the Settlement, TP SA has withdrawn its complaints against decisions issued by the President of the UKE to SOKIK, including:

- the decision that modified rules for calculating remuneration for TP SA for the BSA services provided to Netia. Rules were modified by raising the bulk rebate for the special version of the service (i.e., provided on the basis of the periodic contract) from 41% to 51%;

- the decision amending the contract referred to above, in the scope of (i) lowering the fee for making the link available from PLN 81 to PLN 40,98 (not in thousands) (ii) the principles of forecasting and the settling of forecasts in relation to the installation fee, provided for in the decision, (iii) introduction of charge of PLN 40,98 (not in thousands) for resignation from the service - in exchange for the balancing fee Netia was previously obliged to pay in case subscriber terminates contract on the provision of broadband access with the usage of TP's links prior to the lapse of the term, for which the contract was concluded; (iv) other significant terms of using the BSA service by Netia.

Until the court issues decisions on discontinuance of the proceedings and until they become valid and binding, the Management cannot assure that the proceedings will in fact be discontinued.

In the performance of the Settlement and the Understanding, TP SA has withdrawn all complaints that directly affected the operations of Tele2 Polska.

Risks related to the decisions of the President of UKE on the service of termination of calls in mobile networks (hereinafter referred to as "MTRs") (not in thousands)

In January 2009 the President of UKE issued temporary decisions amending agreements on the interconnection of networks between Netia and Polska Telefonia Cyfrowa Sp. z o.o., Netia and Polkomtel SA as well as Netia and PTK Centertel Sp. z o.o. by lowering the mobile termination rates (MTRs) in public mobile telephone networks of the above-mentioned mobile networks operators to the level of PLN 0.2162 per minute. In June and July 2009 the President of UKE issued decisions (which replace the above-mentioned temporary decisions) on the amendment of the interconnection agreements, concluded between Netia and the above-mentioned operators, by setting the MTR at the level of PLN 0.1677 per minute.

PTK Centertel Sp. z o.o., Polkomtel SA and Polska Telefonia Cyfrowa Sp. z o.o. appealed against the temporary decisions of the President of UKE. The Management Board can not assure that the decisions will not be amended or reversed by the court, thereby materially increasing our interconnection costs.

Risks related to Tele2 Polska's business

As a conseqence of the acquisition in September 2008 of the shares of Tele2 Polska, the Netia Group has acquires a material part of the financial risks related to its prior activity.

In the performance of the rights of Netia provided for in the Settlement with TP, on January 22, 2010, Netia placed with TP a binding declaration indicating the BSA contract concluded by Netia as the basis of servicing subscribers to whom the services were provided under the contract concluded between Tele2 Polska and TP.

In the performance of the Settlement and the Understanding, TP SA has withdrawn all complaints that directly affected the operations of Tele2 Polska.

Risks related to a threat to the stability of the decision on telecommunication access services

Interconnection

In the performance of the Settlement, TP SA has withdrawn its complaint against the decision of the President of UKE that specified the rules for the use by Tele2 Polska of the „Flat Rate" service. Until the court issues a decision to discontinue proceedings and until it becomes binding, the Management Board cannot assure that the proceedings will in fact be discontinued.

Wholesale network access service of TP SA (WLR)

The President of the UKE issued a decision specifying conditions for the use by Tele2 Polska of the wholesale network access to TP SA on the conditions of the "reference offer of TP SA on the telecommunications access with regard to call initiation, call termination, and wholesale network access" approved by UKE in the decision dated April 8, 2008.

In the performance of the Settlement, TP SA has withdrawn complaint against the decision of the President of UKE. Until the court issues the decision and until it becomes valid and binding, the Management cannot assure that the proceedings will in fact be discontinued.

Risks related to the TP SA's requests to change its obligations with respect to telecommunications access

Wholesale network access service of TP SA (WLR)

TP SA appealed against the decision of the President of the UKE refusing the request made by TP SA to change the fees for WLR services provided to Tele2 Polska. The Management Board cannot assure that following court proceedings the decision of UKE will not be reversed or annulled.

In the performance of the Settlement, TP SA has withdrawn complaint against the decision of the President of UKE and the proceedings was discontinued.

Risks related to TP SA's claims for payment

TP SA filed against Tele 2 Polska a claim demanding the payment of PLN 59,091 as damages incurred by TP SA as a result of the performance of the decision of UKE specifying wholesale access to the TP's network (WLR). In the opinion of the Management Board, based on an external legal opinion, the TP SA claim for the payment of the said sum raised against Tele 2 Polska is groundless.

On February 27, 2009 as a result of the acquisition of Tele2 Polska, Netia has become a party of the above proceeding. TP SA has withdrawn the case and waived the claim. The proceeding was discontinued.

- a claim demanding the payment of PLN 3,313 as a remuneration for the traffic terminated or originated in TP SA's network in the excess of the agreed on the basis of the usual wholesale rates and the flat rate (PSI) for the period from November 13, 2007 to January 4, 2008. In December 2008 the court issued the order to pay for the sum of PLN 3,313 Netia objected the order to pay, so the order turned invalid.

- a claim demanding the payment of 7,600 for the difference between usual wholesale rates and the flat rate (PSI) for the traffic terminated or originated in TP SA's network for the period from May 1, 2007 to November 13, 2007. In July 2009 the court issued an order to pay. Netia appealed the order.

Netia became a party to the above proceedings on February 27, 2009, as a result of the merger with Tele2 Polska.

TP SA has withdrawn the above cases and waived the claims. The proceedings were discontinued.

Risks related to regular inspection procedures and the procedures regarding the practices infringing the collective consumer interest

In February 2009 the President of UKE issued the decision fining Tele2 Polska with the amount of PLN 500 for the exchange of traffic between Tele2 Polska and TP SA in breach of conditions of the so-called "flat interconnection rate". Tele2 Polska appealed against the above-mentioned decision, nevertheless the Management Board can not assure that the appeal will be allowed and the decision will be reserved.

In December 2008 the President of the Office for the Protection of Competition and Consumers (UOKiK) issued a decision in which he stated that Tele2 Polska had breached the collective consumer interest by charging a fee of PLN 100 (not in thousands) to its consumer clients for early termination of agreements concluded for a specified term. In the decision the President of UOKiK imposed on Tele2 Polska a fine of PLN 3,978. With respect to the imposed fine, the decision of the President of UOKiK was not made immediately binding and enforceable. Tele2 Polska has appealed against the said decision. Due to the merger of Tele2 Polska and Netia, on February 27, 2009 Netia became a party to the above-mentioned proceedings conducted by SOKiK. In the decision dated on January 15, 2010 SOKiK has decreased the fine to PLN 1,989.

Despite the deep conviction of the legitimacy of the appeal charges, the Management Board can not ensure that, in case an appeals is filed, the court will change the decision of President of UOKiK, and specifically, that the fine will be repealed or decreased.

The Appellate Court rendered two judgments in which it held that the standard terms and conditions and price lists used by Tele2 Polska are abusive with respect to an obligation of a consumer subscriber to reimburse the operator for the costs of requests for payment and debt collection proceedings. Both judgments of the appellate court are final and binding. Therefore Tele2 Polska is obliged to amend the standard contracts. The Management Board cannot assure that as a result of the aforementioned judgments, the Netia Group will not incur further costs regarding possible private claims for reimbursement.

Other regulatory risks

The President of the UKE is regularly carrying out inspections of compliance of the companies from Netia Group with the provisions of the Telecommunications Law. In cases provided for in the Telecommunications Law, the President of UKE may fine the companies from the Group with a fine up to 3% of revenues of the previous calendar year.

The Management Board can not assure that with regard to all inspection procedures UKE agrees that the position of Netia and the activities of the Netia Group are consistent with regulatory requirements and the law to the extent that eliminates the risk of a fine.

Risk of increased competition

The Netia Group's main competitors in the field of telephone services are TP SA and mobile network operators, and in some geographic areas also other operators providing wireline telephone services including some cable television networks. Within the market for corporate telephony services, the main competitors are numerous providers of various sizes, the most significant of which is TP SA. Poland has witnessed a considerable increase in competition, which may intensify even further, considering the lack of legal barriers in entering the market and the improving terms of regulated access to TP SA's network. Netia is unable to evaluate the extent to which new market participants will use the availability of their rights, particularly with regard to the significantly lower costs of entering the market than those incurred by the Netia Group. The Management is unable to evaluate the extent to which intensification of competition would adversely affect the Netia Group's activity.

Risk of competition from TP SA and TP SA's compliance with regulatory decisions

TP SA occupies a leading position among wireline telephone service operators in Poland. At the same time, it enjoys a stable position on the market for data transmission. Within the scope of wireline telephone services, the Netia Group encounters competition from TP SA in all the geographic areas in which it operates. TP SA is a much larger entity than the Netia Group and possesses a much wider backbone and access networks. It enjoys long-established relationships with many customers which the Netia Group considers its target customers, including many companies operating in areas where the Netia Group conducts its business activities. The infrastructure used by TP SA in these areas is comparable to the infrastructure of the Netia Group in terms of the technologies employed.

Moreover, TP SA still maintains a leading position among operators of domestic long-distance calls, which enables it to offer more flexible tariffs. It is difficult to predict what policies TP SA will pursue with regard to tariffs, the selection of target markets and arrangements concerning access to its infrastructure and interconnections as a reaction to the extension of the network by the Netia Group and more intense competition from the Netia Group in various areas of the country. However, the Management expects that TP SA will compete with the Netia Group on prices and for the most attractive customers. In the past, the Netia Group was forced to lower its prices in order to attract new customers and retain the current ones, and such measures may also be necessary in the future. The Management expects that TP SA will maintain a strong competitive position against the Netia Group on Warsaw market and in most geographic areas where the Netia Group provides telephone services, and will continue to compete with the Netia Group in other fields, including data transmission services and internet access. It is possible that aggressive competition from TP SA will materially and adversely affect the revenues of the Netia Group and the results of its operating activity.

TP SA owns most local loop access networks and has, in the past, offered other operators access to the network of these local loops on terms that, in many cases, render the addition of a customer to the network too expensive. However, since 2006 a new telecommunications regulator has issued decisions creating unified offers in the area of regulatory access to the TP SA network which Netia currently considers to be commercially viable. As a result, in 2006 the Netia Group signed a new cooperation agreement with TP SA that allows Netia to offer Internet access to TP SA's customers using a regulated TP SA wholesale service known as bitstream access. In January 2007 President of UKE issued a decision changing an interconnect agreement between TP SA and Premium Internet SA., the Company's subsidiary (merged with Tele2 Polska in 2008, and then merged with Netia in February 2009), regarding wholesale line rental (WLR). This decision constituted the basis for a new type of access to TP SA's network, enabling the Netia Group to offer voice services to TP SA customers. Moreover, in April 2007 the Company concluded an agreement with TP SA on local loop unbundling. The Netia Group uses local loop unbundling in providing voice and data services and in the future intends to offer differentiated value added services such as IPTV. Whilst key commercial terms of these services, as set by the regulatory decisions, are currently commercially attractive, operational cooperation with TP SA in order to provide and maintain such services to end customers needs to be much more coordinated than has been the case in the past. Despite the conclusion of the Settlement and the Understanding, the Management can give no assurance that TP SA will provide the required level of cooperation or that the regulator will respond by effectively enforcing TP SA's cooperation. Furthermore, we can give no assurance that market developments, future court judgments or future regulatory decisions may not render the current opportunities to reach customers via TP SA access networks no longer commercially viable.

TP SA may decide to build a new generation network

The most modern fixed line telephony networks being deployed around Europe by incumbent operators and by cable TV operators utilize fiber to the curb (FTTC), fiber to the building (FTTB) or fiber to the home (FTTH) to significantly increase bandwidth delivered to the end user. New build Networks based on IP protocols will eliminate the traditional telephony equipment and copper access cables and will replace it by fiber optic cables and new generation optical transmission systems Moreover, many incumbents are lobbying to receive relief from regulatory obligations for a period of time in order to improve their returns from such large investments. New generation networks (NGNs), if deployed in Poland, could materially deteriorate the economic returns Netia plans to earn from regulatory access products such as bitstream, WLR and LLU. Management can give no assurance that TPSA will not finally chose to deploy such a NGN network and, if it does so, whether the regulator will ensure alternative network operators such as Netia enjoy fair access to such a network on acceptable economic terms.

Competition from cellular mobile telephone operators

In recent years, services offered by cellular telephone operators have negatively affected wire line telephone operators. This stems largely from mobile substitution, where subscribers choose to make telephone calls using their mobile phones in preference over fixed telephones, resulting either in less traffic or disconnections for fixed line operators. Mobile substitution becomes more pronounced as mobile tariffs decline, as they have in recent years, converging with traditionally lower cost fixed line tariffs. Similar substitution effects may also apply to broadband services, given the increased take-up of mobile broadband services offered by mobile operators.

To help mitigate the losses to mobile operators, Netia has begun to offer convergent products via a wholesale mobile service provider agreement to take mobile services, both voice and broadband, from P4 that Netia may then resell under the Netia brand to Netia customers.

Since 2008, certain Polish mobile operators have been marketing fixed internet access services via the fixed access network of TP SA, on the basis of regulated bitstream access decisions. This represents a significant new source of competition for market share in the fixed broadband market.

Other sources of competition

Over the last several years, competition for voice and Internet services has increased from cable television operators. Triple play bundles (voice telephony, Internet access and cable television) have proven to be particularly challenging. However, Netia is reviewing alternatives to combat this threat. Specifically, IPTV offers fixed line telephone operators the ability to compete directly with cable television operators. The importance of IPTV and related services (such as video on demand) is being analyzed in the context of Netia's strategy to expand its share of the broadband market. In particular, the Company is considering the launch of an IPTV offering taking content from the "n" satellite TV platform. A letter of intent has been signed and tests are ongoing, but we can provide no assurance that this innovative partnering approach will be concluded with a commercial agreement, will be successful with Netia's customers or that returns on investment will be acceptable.

Market consolidation

Market consolidation through acquisitions remains an effective way for fixed line operators to strengthen their market position by utilizing the effects of scale. In the past Netia has successfully acquired several telecommunications operators making it the market leader for consolidation.

Whilst acquisitions of large scale telecommunications businesses are not crucial to the Company's strategy Netia continues to closely monitor the situation of all its main altnet competitors and may choose to try to acquire one or more of these competitors in the future if the opportunity arises. Some acquisitions may consume a considerable portion of Netia's financial resources and no assurance can be given that expected synergies from such acquisitions will be reached as planned.

Certain potential acquisition targets, should they become available for sale, would require Netia to raise significant amounts of financial indebtedness and / or to issue new shares or equity related instruments in order to fund a transaction. Management cannot guarantee that such funding will be available when needed on acceptable terms or that such an acquisition would not significantly increase the funding risk profile of the Netia Group.

Moreover, should we be outbid by a competitor on any particular large acquisition opportunity, our position as the leading alternative operator on the Polish telecommunications market and the strategic advantages that this position creates may be materially affected.

Strategic importance of P4 to Netia's future development

The successful development of P4 into an important player on the Polish mobile market, having significant market share and being able to self-finance its continued development is in turn important for Netia with respect to being able to achieve its own development plans. The successful and profitable implementation of the Transmission Agreement with P4, under which Netia is providing substantially all the transmission services for the initial roll-out of P4's UMTS network depends on P4's long term ability to build out its network and meet its obligations to Netia. The carrying value in Netia's accounts of the transmission network built by Netia for P4 to lease is dependent on P4's financial situation, P4 Management's willingness to continue using Netia's services and any mobile market consolidation that might include P4.

Partly in order to mitigate the above described risks, on July 24, 2009 Netia and P4 concluded an agreement for the sale of the transmission equipment used by Netia to provide services to P4 under the Transmission Agreement. Based on this agreement P4 is purchasing the transmission network from Netia in exchange for extending the notice periods in the Transmission Agreement, thereby materially reducing Netia's exposure to P4's financial situation and business prospects.

The Management can provide no assurance that P4 will develop in accordance with its current business plans and, should P4 underperform those plans, this may have a material financial impact upon the results and cash flows of Netia from its commercial agreements with P4 and may also limit Netia's opportunities to grow its own fixed line and mobile service provider activities. No assurance can be given that Netia can find an alternative supplier of wholesale mobile services on acceptable financial terms or at all if P4 ceases to operate or is sold to another owner.

Cost reduction project

On April 6, 2009 Netia announced the implementation of project "Profit", a comprehensive operating cost reduction project aimed at cutting PLN 100 million (not in thousands) from ongoing operating expenses on an annual basis starting from 2010. Whilst the project was planned in detail with assistance from experienced international management consultants and the project was completed smoothly in line with Management's expectations, Management can give no assurance that in future all savings delivered under the project will be sustainable. Moreover, cost-reduction activities may generate unforeseen costs elsewhere in the organization or may need to be cancelled or reversed due to unexpected adverse impacts on quality or customer satisfaction. Accordingly, Management can give no assurance that the "Profit" project will deliver results in line with the announced plans.

WiMAX license requirements

On October 27, 2005 Netia WiMax S.A. (merged with Netia in 2006) and Netia WiMax II S.A. (merged with Netia in 2008) received the reservations of the 3.6-3.8 GHz frequencies, which are to be used to provide telecommunication services based on the WiMAX technology. The terms of licenses issued to the Company's former subsidiaries require them to meet annual connected capacity milestones in the future, as measured at the end of each year, subject to demand in the territory and population of Poland. Considering changes in the telecommunications market and, in particular, the advent of regulated access to the fixed line network of the incumbent fixed line operator, TP SA, the Company submitted applications to change future territorial and population coverage commitments for WiMax and on October 31, 2007 the Polish regulator issued a decision reducing the initial milestones. The amended milestones alloted for the years 2008 and 2009 regarding population coverage were exceeded whilst there was a marginal underperformance of the territorial coverage requirements. In the event that license obligations are not met by an operator, the UKE has the power to confiscate the relevant license, if the issue is not rectified. However, historically such measures have rarely been used.

Tax regulations and their interpretation (not in thousands)

Regulations relating to value-added tax, corporate income tax, and payroll (social) taxes have radically changed in comparison to the tax regulations, which existed prior to the economic and political transformation in Poland. The lack of reference to well-established practices and the relatively short period in which these new tax regulations have been in place often results in a lack of clarity and consistency in the regulations. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. Tax settlements, together with other areas of legal compliance are subject to review and investigation by a number of authorities, which are entitled to impose severe fines, penalties and interest charges. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems. The tax authorities may at any time inspect the books and records of the Company and may impose additional tax assessments with penalty interest and penalties within 5 years from the end of the year when a tax is due.

In August 2009 the Company received a decision of the Director of the Tax Control Office in Warsaw ("UKS Director") according to which Netia's corporate income tax ("CIT") due for the year 2003 was set at PLN 58.7 million plus accrued penalty interest of PLN 41.5 million ("The Tax Decision"). The Tax Decision was issued despite the legal arguments presented by the Company, which stated that the conclusions delivered by the Tax Control Office were incorrect and groundless. According to the UKS Director, Netia understated its taxable revenues by PLN 303 million by excluding from its revenues the accrued and not received interest from loans granted by Netia in previous years to its subsidiaries which subsequently merged with Netia on December 31, 2003.

According to Netia, the Tax Decision of the UKS Director is in conflict with the relevant tax regulations and the Company appealed against the Tax Decision issued by the UKS Director and also against various procedural decisions of the Tax Authorities. The UKS Director's Tax Decision was not final and was not enforceable as it was issued by the first instance tax authority. As at December 31, 2009, the Local Tax Chamber was in the process of dealing with the Company's appeal to the decisions of the UKS Director.

The Company has received opinions from several independent tax and legal advisors which conclude that the claims of the Director of the Tax Control Office have no legal grounds. Accordingly, as at December 31, 2009, the Company did not create a provision for any part of the alleged tax arrears reported in the Tax Decision.

On February 16, 2010 Company learned that the Local Tax Chamber partially upheld the Decision of the UKS Director (see section "Subsequent events"), The Local Tax Chambers' Decision is binding on the Company and must be settled whilst the Company will now appeal to the Polish Court. Based on the tax and legal advice received, Management intends to take all legal measures necessary to overturn these tax decisions in the Polish Court and believes that the Company's arguments will ultimately be upheld. Accordingly, Management has not recognised the Local Tax Chamber's decision as a taxation expense for the financial year ended December 31, 2009 and will instead treat funds paid over to the tax authorities as an overpayment of tax.

Despite Management being highly confident in the merit of its arguments there is a high degree of instability of the interpretation of Polish tax regulations by the Tax Authorities and the Courts. Consequently, Management cannot provide assurance the arguments presented by our advisors in defending this matter will be accepted by the Courts and that Netia will not have to pay the taxes and interest claimed by the Tax Authorities.

2.2 Factors and events having a significant influence on the operations of the Netia Group and the financial results achieved in 2009

Cost saving initiatives (not in thousands)

Following the acquisition of Tele2 Polska in September 2008 which significantly augmented the scale of the business, Netia performed a comprehensive cost review across all functional areas of the Company. Areas for operating cost optimization were indentified, with a target to reduce full year operating expenses for year 2010 and onwards by PLN 100 million. The program included a reduction of Netia's headcount, review of control and reporting processes, increase in work effectiveness, span of control increase and contract renegotiations. After 12 months of implementation 90% of all initiatives were already completed and another 10% are in the implementation phase. Value-wise, already implemented initiatives exceeded total savings envisaged for year 2009 and reached PLN 74.3 million due to accelerated implementation and better than estimated savings from many projects. Management plans the annual savings realized via Project Profit will amount to PLN 123 million gross in 2010, surpassing the originally targeted PLN 100 million. After off-setting cost increases associated with unit price increases, planned pay rises or new projects, net savings anticipated for 2010 and going forward in Netia opex are PLN 96.0 million.

Post acquisition integration of Tele2 Polska (not in thousands)

In Q3 2009, Netia completed the post acquisition integration of Tele2 Polska with migration of billing and customer care processes from Tele2 Polska's outsourced legacy systems onto Netia's systems, which was the last major element of Tele2 Polska's integration into the Netia Group. Annualised synergies projected to be delivered in 2010 from completed initiatives total PLN 46.2 million, 54% above the original estimate of PLN 30.0 million, and are made up as follows:

Original annualised savings target *(PLN'M)*	**Area**	**% Complete**	**2010 savings secured** *(PLN'M)*	**New 2010 target** *(PLN'M)*	**Description**
20.0	Network	85%	16.0	18.8	Leased lines cancellation, IC points rationalisation
	Billing and IT	100%	9.6	9.6	Consolidation into single platform
10.0	Marketing	100%	10.6	10.6	Brand elimination, reduced joint A&P budget
	Customer Care	100%	0.8	0.8	Consolidation into single common least cost process
	Finance processes	100%	1.3	1.3	Optimised cash collection, financial services and audit fees
	Management fees	100%	3.6	3.6	Not payable
	Migration to copper lines	10%	0.0	1.5	Pilot project completed. Full migration of approx. 8k customers planned for 2010
30.0		**TOTAL:**	**41.9**	**46.2**	

Synergies delivered from the integration of Tele2 Polska are additional to the cost savings expected from the Profit Project described above. The integration project lasted one year following Tele2 Polska's acquisition in September 2009. These synergies represent approximately 11% of Tele2 Polska's stand-alone sales for 2008. In 2009 delivered synergies amounted to PLN 27.3 million.

Settlement with TPSA

On October 22, 2009 UKE published a non-binding settlement with TPSA that requires TPSA, amongst other obligations, to enter into bi-lateral agreements with alternative operators, including Netia. The scope of these bi-lateral agreements should include, but is not limited to, the settlement of the contingent assets and liabilities and cancellation of the related court proceedings between Netia and TPSA.

In relation to the above settlement, on December 23, 2009 Netia and TPSA obliged themselves to withdraw their law suits and terminate all court disputes, including the resignation from all claims (see also "Agreements essential for the Netia Group's operations" below). As a result of the settlement of disputes between Netia and TPSA, during the year ended December 31, 2009, PLN 5,630 was recorded as other income, PLN 3,745 reduced network maintenance costs and PLN 5,951 reduced other expenses within "Cost of sales".

Deferred income tax asset

Following the Management's assessment of the recoverability of tax loss carry-forwards and timing differences against future taxable profits, in 2009 the Netia Group recognized PLN 79,400 of deferred income tax asset. This assessment was based on the budget for 2010 and Netia's business plan for years 2010-2014. Rapid subscriber growth, costs savings, synergies from the Tele2 Polska acquisitions, successful migration of customers to LLU and the prospect of stable regulatory access rates provide management with sufficient visibility of future profits to justify recognition of the deferred tax assets.

Operational data (not in thousands)

Broadband

Broadband subscribers increased to 559,317 at December 31, 2009 from 413,645 a year earlier, 6% above the 2009 target as a result of accelerating sales during Q3 and Q4 2009. By the end of 2010, Netia aims to reach over 680,000 broadband subscribers through further organic growth, with potential for a higher figure pending additional Ethernet networks acquisitions. Netia provides its broadband services using the following technologies:

Number of broadband ports	**2008**	**2009**
xDSL and FastEthernet over Netia's own fixed-line network	171,933	200,060
Bitstream access	227,441	293,782
WiMAX Internet	12,110	17,079
LLU	1,320	48,117
Others	841	279
Total	**413,645**	**559,317**

(All amounts in thousands, except as otherwise stated)

Broadband ARPU was PLN 60 in Q4 2009 as compared to PLN 60 in Q4 2008. Aggressive promotions in the second half of 2009 were offset by customers choosing high speed services, resulting in a stable ARPU. Minor refinements to revenue recognition accounting in Q4 2009 were responsible for the sequential ARPU increase. Broadband ARPU is expected settle between PLN 50 and PLN 60 per month in the medium term.

Broadband SAC increased to PLN 206 in Q4 2009 from PLN 165 in Q4 2008. The year-on-year increase was driven mainly by a higher rate of bundled products (OneOffice solution for SOHO/SME clients, 2play WLR+BSA and LLU-based products) in the acquisition cost structure. 2play services are more profitable and Netia therefore offers higher sales commissions per unit. The sequential increase in SAC was associated with growing share of LLU-based products in the acquisition cost structure and temporary delays in activating newly subscribed LLU lines following the record sales levels in Q4 2009.

Local loop unbundling (LLU)

Netia connected its first clients through an unbundled TP SA loop under a pilot project in Warsaw during December 2007, and the soft launch of LLU-based services was made in Q1 2008. In 2009 Netia continued to extend the reach of its LLU-based services. As at December 31, 2009 Netia had 297 unbundled nodes, reaching approximately 2.5 million customer lines.

Netia served 48,117 customers over LLU as at December 31, 2009 as compared to 1,320 at December 31, 2008. Netia has been migrating 1play customers to the higher margin LLU services under a process which began in May 2009. Migrations of 2play customers to full LLU access started in November 2009, following implementation of technology solutions that are expected to reduce migration costs significantly. By the end of 2009 Netia had migrated 24,519 1play and 2play clients onto LLU.

Acquisitions of local Ethernet network operators.

As of December 31, 2009, Ethernet networks acquired by Netia since mid-2007 provided broadband access to a total of 105,678 mostly residential customers as compared to 90,507 customers at December 31, 2008, with approximately 415,000 homes passed. The acquisition program is part of Netia's strategic objective to acquire one million broadband customers and up-sell voice services to the existing subscriber base of the acquired Ethernet providers. Netia remains fully dedicated to consolidation of the fragmented Polish Ethernet ISP market.

During 2009 Netia acquired a total of 5 Ethernet networks (including purchases of companies and asset transfers) with 16,925 active customers and 88,000 homes passed.

Voice lines (own network and WLR)

Voice lines (own network and WLR (wholesale line rental)) totaled 1,158,448 at December 31, 2009 as compared to 1,065,516 at December 31, 2008. By the end of 2010, Netia aims to have approximately 1,225,000 voice subscribers (own network + WLR), with the additional subscribers to be acquired organically. The year-on-year increase in the number of voice lines resulted mainly from growth within WLR-based voice services. Netia began offering WLR during Q4 2007, selling to both voice-only customers and bitstream broadband customers as a 2play offering. Subsequently, in September 2008 Netia acquired Tele2 Polska, thereby acquiring an additional 504,007 WLR customers and subsequently the WLR base has continued to grow since the acquisition with 70,262 WLR customers added during 2009. During 2009, Netia grew its base of voice customers using relatively low cost VoIP technology from 11,921 to 43,867, principally in the business segment or over LLU to residential customers. Over time, the Company expects to gradually reduce its reliance on traditional switched telephony, thereby reducing its cost base.

Netia provides its voice services through the following types of access:

Number of voice lines	**2008**	**2009**
Traditional direct voice	364,722	349,824
Incl. ISDN	*127,304*	136,350
Incl. Legacy wireless	*40,742*	37,316
Voice over IP*(excl. LLU)*	10,507	19,734
WiMAX voice	15,904	21,526
WLR	672,969	743,231
LLU voice over IP	1,414	24,133
Total	**1,065,516**	**1,158,448**

Voice ARPU per WLR line amounted to PLN 51 in Q4 2009 as compared to PLN 56 in Q4 2008. The year-on-year decrease in ARPU is associated with the overall tariff reduction trends in the market and successful efforts to extend contracts with former Tele2 Polska customers by updating legacy tariffs to current market levels.

Voice ARPU per Netia network subscriber line amounted to PLN 62 in Q4 2009 as compared to PLN 67 in Q4 2008, with the annual decrease reflecting overall tariff reduction trends and reduced usage, by corporate customers in particular, in light of the economic environment.

Blended voice ARPU was PLN 55 in Q4 2009 as compared to PLN 60 in Q4 2008. The annual decrease reflects overall tariff reduction and lower usage trends, while the quarter-over-quarter slight increase in ARPU reflects the sequential increase in WLR ARPUs. In the medium term, Netia expects blended voice ARPU to stabilize.

(All amounts in thousands, except as otherwise stated)

Indirect voice

CPS lines (carrier pre selection) totaled 116,628 at December 31, 2009 as compared to 176,035 at December 31, 2008. Netia is focused on the conversion of Tele2 Polska's CPS customers to WLR and is not actively acquiring new CPS customers.

Indirect voice ARPU per CPS line was PLN 36 in Q4 2009 as compared to PLN 39 in Q4 2008. Tariff reductions, reduced call volumes and conversion of better customers to Netia's WLR or LLU offers is responsible for the year-on-year ARPU decline.

2.3 Agreements essential for the Netia Group's operations

Annex to the UMTS Agreement

On July 24, 2009 Netia and P4 concluded an agreement for the sale of the transmission equipment (the "Sale Agreement") used by Netia to provide transmission services to P4 under the UMTS transmission solutions delivery frame agreement dated July 3, 2006 (the "UMTS Agreement") and an annex to the UMTS Agreement. The Sale Agreement was entered into on the following terms and conditions:

1. The transmission equipment will be purchased by P4 in three batches.
2. The total price for the transmission equipment is PLN 65,418, of which:
   a) PLN 22,832 is payable by P4 on the date of purchase of the first batch of the transmission equipment, i.e. August 1, 2009;
   b) PLN 21,141 is payable by P4 on the date of purchase of the second batch of the transmission equipment, i.e. January 1, 2010; and
   c) PLN 21,445 is payable by P4 on the date of purchase of the third batch of the transmission equipment, i.e. July 1, 2010.
3. The legal title to the given batches of the transmission equipment will be transferred to P4 after P4 pays the price for a given batch, however not earlier that on the dates indicated above.

No adjustments to the net book value of these assets was made at December 31, 2009 as the Management expects to record a profit on disposal (a gain of PLN 5,298 was recognized on disposal of the first batch, which took place in 2009).

Agreement on rates for telecommunications access

In relation to the agreement signed on October 22, 2009 between the President of the UKE (the Regulator) and TPSA (the "Agreement"), on the basis of which it was resolved that the currently binding rates for the telecommunications access should be applied in relations between TPSA and alternative operators ("AO") until December 12, 2012, on December 23, 2009 Netia and TPSA (the "Parties") reached an agreement with respect to the scope and substance covered in a sample agreement between TPSA and AO, representing Annex 4 of the above mentioned Agreement between the President of UKE and TPSA. The Parties agreed that the wholesale rates for telecommunications access (i.e., interconnection, wholesale line rental ("WLR"), local loop unbundling ("LLU"), bitstream access ("BSA") and access to ducts) binding in the reference offers as at October 10, 2009 will remain in force until December 31, 2012 as follows:

- amount of WLR wholesale charge will remain unchanged for the 3 year period,
- amount of LLU wholesale charge will remain unchanged for the 3 year period,
- amount of BSA wholesale charge for broadband services delivered by Netia to existing subscribers at currently offered transmission speeds will remain at the level not higher than the amount of charged fee as agreed on October 10, 2009 for the 3 year period,
- rules for setting BSA wholesale charges for new Netia subscribers who will be taking currently offered transmission speeds, which shall be based on a 'cost plus' formula, including the margin squeeze test, are not covered by the aforementioned agreement and are currently subject to negotiations between TP, UKE and AO under to the Agreement. The charge may not be higher than the amount of BSA wholesale charge as agreed on October 10, 2009 for the 3 year period,
- rules for setting BSA wholesale charges for new Netia subscribers who will be taking newly offered transmission speeds, unavailable as at October 10, 2009, shall be based on a 'cost plus' formula, including the margin squeeze test, and are not covered by the above agreement and are currently subject to negotiations between TP, UKE and AO under to the Agreement.

Furthermore, Netia and TPSA undertook to withdraw the law suits filed against each other including the waiver of claims and to discontinue all court disputes,.

Credit facility agreement

The credit facility agreement has been described in detail under the point "Loans Agreements".

3 Financial condition of the Netia Group

3.1 Consolidated statement of financial position

As at December 31, 2009, non-current assets amounted to PLN 1,897,761 (81% of total assets) as compared to PLN 1,888,671 at the end of 2008. The main change within non-current assets is recognition of deferred tax assets relating to unused tax losses, for which future is now considered probable. It was partially offset by a decrease of "property, plant and equipment" mainly caused by disposal of transmission equipment (see point "Agreements essential for the Netia Group's operations") and a decrease of intangible assets due to their amortization.

Current assets at December 31, 2009 in the amount of PLN 442,828 increased by 12% as compared to PLN 394,034 at the end of 2008. The change was mainly attributable to the Company's investments in treasury notes, which as at December 31, 2009 amounted to PLN 60,000 in nominal value.

As at December 31, 2009, the equity amounted to PLN 2,025,451, comprising 87% of total equity and liabilities and increased by 5% as compared to PLN 1,928,481 at the end of 2008 (the main factors influencing the net result are described in point "Factors and events having a significant influence on the operations of the Netia Group […]")

Non-current liabilities amounted to PLN 14,585 and decreased slightly as compared to PLN 27,335 at the end of 2008, mainly due to the netting of recognized deferred tax assets with deferred tax liabilities and the change in estimation of provisions recognized in the Tele2 Polska purchase price allocation process, that have subsequently been released as a result of the settlement with TP SA.

As at December 31, 2009, current liabilities amounted to PLN 300,640 and decreased by 8% as compared to PLN 326,889 at the end of 2008, mainly due to the lower level of accrued expenses being a result of signed settlement with TPSA (see point "Factors and events having a significant influence on the operations of the Netia Group […]") and the lower level of other payables following payments to former owners of Tele2 Polska made in 2009.

3.2 Consolidated income statement

Telecommunication revenue, excluding IVT, increased by 35% to PLN 1,500,507 from PLN 1,104,632 in 2008. Data revenue increased to PLN 520,460, up by 39% from PLN 373,533 in 2008, 28 percentage points being attributable to broadband-related organic growth, 6 percentage points to acquisitions of Ethernet operators and 5 percentage points to data transmission connections for P4. Revenue from direct voice services increased by 52% to PLN 743,395 from PLN 487,609 for 2008, driven by the Netia Group's organic additions of WLR voice customers and the acquisition of Tele2 Polska.

The overall revenue increase was also supported by higher revenue in indirect voice (an increase of 16% year on year or PLN 8,845), associated with the acquisition of Tele2 Polska's CPS client base, and wholesale services (an increase of 13% year on year or PLN 9,687). Interconnection revenue decreased between the comparable periods by 25% year on year or PLN 22,258, mostly as a result of lower volumes of transit traffic.

Cost of sales increased by 22% to PLN 1,005,518 from PLN 823,513 for 2008 and represented 67% of total revenue as compared to 73% for 2008. The cost of sales in 2009 was reduced by PLN 9,695 due to the settlement of disputes and claims with TP SA. Excluding the above gain, the cost of sales increased by 23% to PLN 1,015,213 and represented 68% of total revenue. The margin improvement reflects increased scale, better interconnection rates and cost reduction initiatives.

The increase in cost of sales in 2009 resulted mainly from higher level of network operations and maintenance costs, driven by the costs of rapidly expanding bitstream and WLR wholesale access customer base, including Tele2 Polska's operations as well as the LLU roll-out and new Ethernet networks.

Gross profit for 2009 was PLN 500,353 as compared to PLN 297,655 for 2008, an increase of 68%. Gross profit margin increased to 33.2% from 26.5% for the prior year.

Selling and distribution costs increased by 23% to PLN 338,446 from PLN 275,185 for last year and represented 22% of total revenue as compared to 25% in 2008. The inclusion of expenditures related to Tele2 Polska customer operations was the main driver of this increase.

General and administration costs increased by 19% to PLN 173,458 from PLN 146,270 for 2008 and represented 12% of total revenue as compared to 13% in 2008, reflecting the increased scale of Netia operations. The cost increase was driven by the addition of Tele2 Polska's expenses and increasing use of leased assets by the Netia Group.

Other income was PLN 17,890 as compared to PLN 11,599 in 2008, and included PLN 5,630 related to the settlement agreement with TP SA associated with the agreement on rates for telecommunications access reached on December 23, 2009.

Other gains, net were PLN 9,965 as compared to PLN 12,942 in 2008. This included a gain of PLN 5,298 on disposal of the first of three tranches of radio transmission equipment to P4 and a gain of PLN 2,537 on sales of property and other fixed assets while in the prior year period the Netia Group recorded a gain of PLN 5,093 on the disposal of certain assets related to the Company's IVT activities and a gain of PLN 6,214 on property sales.

EBITDA was PLN 312,802 and EBITDA margin increased to 20.8% as compared to EBITDA margin of 15.2% in 2008.

Operating profit (EBIT) was PLN 14,236 as compared to a operating loss of PLN 99,706 for 2008, reflecting increased scale, synergies realized on the Tele2 Polska acquisition, 'Profit' project savings and falling interconnection costs as a percentage of revenue.

Net finance cost was PLN 13,143 as compared to net finance income of PLN 830 in 2008 and was related mainly to foreign exchange losses and losses on foreign exchange hedging contracts.

Income tax benefit of PLN 87,572 was recorded in 2009 following the recognition of the deferred income tax assets.

Profit was PLN 88,665 as compared to a profit of PLN 230,605 for 2008. Profit for the prior year period included a gain from disposal of Netia's shares in P4 of PLN 353,381.

3.3 Consolidated statement of cash flows

Net cash generated from operating activities amounted to PLN 300,119 for 2009 and increased by 76% as compared to PLN 170,794 in 2008. The increase was due to higher operating margins and higher revenues recorded in 2009.

Net cash used for the purchase of fixed assets and computer software decreased by 7% to PLN 237,774 for 2009 from PLN 257,053 for 2008 reflecting a reduction in capital investment.

Other significant cash outflow / inflow items during 2009 included PLN 57,055 related to the purchases and disposals of the short-dated treasury bonds, payments of PLN 44,999 made in connection with the acquisitions executed in 2008, including PLN 26,502 paid to Tele2 AB to reimburse the seller for excess cash and working capital outstanding in Tele2 Polska versus the amounts targeted at the acquisition date in the share purchase agreement and paid in Q2 2009, PLN 12,753 of purchase consideration for the Ethernet companies acquired in 2009, and PLN 43,973 proceeds on sale of fixed assets to P4 (representing the first two tranches of transmission equipment under the sale transaction). As a result, net cash used in investing activities during 2009 amounted to PLN 303,317 as compared to PLN 69,388 of cash from investing activities in 2008.

Net cash used in financing activities in 2009 amounted to PLN 7,037 and net cash used in financing activities during 2008 amounted to PLN 108,116. These outflows were related to finace lease payments and additionally to credit facility repayments in 2008 (this credit facility is described in "Loans agreement").

3.4 Financial resources management and assessment of the possibility of executing the planned investments

Following its new strategy announcement in April 2007, Netia invested in broadband and other services such that free cash flows was negative in 2007 and 2008. In 2009, the Netia Group has begun to generate free cash flows once more and this trend of improving cash flows is expected to continue subject to the impact of any or all risk factors indicated in section "Major risks and threats related to the operational activities". Moreover, as at December 31, 2009 the Netia Group had net cash available of PLN 181,203, PLN 60,000 in nominal value of treasury notes and was debt free with a PLN 295,000 credit facility available to finance any future investment requirements. Accordingly, Management sees no immediate threats to financing of its currently planned organic investments.

A detailed description of risks related to the Netia Group's financial instruments has been presented in the consolidated financial statements (Note 4).

3.5 Loans Agreements

Undrawn borrowing facilities

On June 29, 2009 the Company concluded an annex to the Amended and Restated Credit Facility Agreement ("Annex") with Rabobank Polska S.A. as the arranger, Bank Millennium S.A., Bank Gospodarki Żywnościowej S.A. and Raiffeisen Bank Polska S.A., relating to the Facility Agreement concluded on 15 May 2007 (the "Facility").

Pursuant to the Annex the total Facility amount was decreased by PLN 80,000 from PLN 375,000 to PLN 295.000 (the amount of the term loan was decreased from PLN 325,000 to PLN 245,000; the revolving loan has not changed and continues to amount to PLN 50,000). The Facility is to be repaid by June 30, 2013. The Facility bears interest at a variable interest rate of WIBOR plus a margin dependent on financial ratios and the Company must pay a commitment fee on the undrawn, uncancelled amount of the Facility commitment. The proceeds from the Facility can be used to finance the Netia Group's capital expenditures, its general corporate purposes and the acquisition of companies whose business activities are substantially similar to the business activities of the Group. Furthermore, pursuant to the Annex, the Company may use funds accumulated on its accounts to repurchase its own shares for a total consideration up to PLN 100,000. Netia may utilize up to PLN 50,000 in each of 2009 and 2010. Netia was also granted consent to dispose of certain fixed assets whereby the first PLN 80,000 of proceeds may be retained by the Company without making mandatory facility prepayments or cancellations. The specific assets consented are: the former head office located in Warsaw at ul. Poleczki 13, and the transmission equipment used by Netia to provide backhaul services to P4 under the UMTS transmission solutions delivery frame agreement.

The cumulative draw downs under the Facility made in previous years amounted to PLN 205,000 and were repaid in full in 2008.

The repayment of the Facility is secured by the following: capped mortgages on the right of perpetual usufruct of the Company's real estate at ul. Poleczki 13 in Warsaw; registered pledges on: (i) the collection of movables and property rights acquired by Netia as a result of its merger with Świat Internet S.A., (ii) a collection of Netia's movables and property rights, (iii) shares in InterNetia Holdings Sp. z o.o.; and assignment as collateral security of Netia's receivables under certain agreements. Moreover, the Company's subsidiary (InterNetia Holdings Sp. z o.o.) irrevocably and unconditionally guaranteed punctual performance by the Company of all its obligations under the Facility up to the maximum amount of PLN 468,750. Until the mergers of Uni-Net Sp. z o.o. and InterNetia Holdings Sp. z o.o. on July 31, 2009, and the Company and Netia Spółka Akcyjna UMTS s.k.a. on November 30, 2009, the repayment of the Facility was also secured by registered pledges on shares in Uni-Net Sp. z o.o. and Netia Spółka Akcyjna UMTS s.k.a., which were also guarantors.

Bonds

On September 11, 2008 Netia issued 1 unsecured registered bond in the nominal value of PLN 94,500 and 1 unsecured registered bond in the nominal value of EUR 40,340, with the repurchase date falling on September 12, 2010 and with a right of Netia for an earlier repurchase. The above bonds were offered to the Company's subsidiary, Netia Spółka Akcyjna UMTS s.k.a. for the issue price equal to the nominal value of each of the bonds.

On September 30, 2008 Tele2 Polska, the Company's subsidiary, purchased from Netia 1 unsecured registered bond in the nominal value of PLN 20,000 with the repurchase date falling on September 30, 2010 and with a right of Netia for an earlier repurchase. Tele2 Polska purchased the above bond for the issue price equal to the nominal value thereof.

The Company's liability under these bonds was eliminated due to merger of Netia and Tele2 Polska in February 2009 and merger of Netia and Netia Spółka Akcyjna UMTS s.k.a. in November 2009.

3.6 Loans, warranties and collaterals granted

Loans granted

The following loans were paid out by the Company in 2009:

- to InterNetia Holdings Sp. z o.o., the Company's subsidiary, with a total value of PLN 11,080 (out of which PLN 1,080 were repaid in 2009). The outstanding loans are not due as at the balance sheet date.

The following loans granted by the Company were repaid in 2009:

- by InterNetia Holdings Sp. z o.o.in the amount of PLN 10,230,
- by Lanet Sp. z o.o. (merged with Internetia Sp. z o.o. in 2009) in the amount of PLN 2,775,
- by Neotel Communications Polska Sp. z o.o. in the amount of PLN 185.

4 The Company's supervisory or governing authority

4.1 Rights of the Supervisory and Management Board's members

According to the Company's Statute the bodies of the Company are the General Shareholders' Meeting ("GSM"), the Supervisory Board and the Management Board.

GSM operates in accordance with the rules set forth in the Commercial Companies Code and the Company's Statute. GSM decides in matters provided for in the Commercial Companies Code, and in particular regarding decisions on the division and distribution of profit. No approval of the GSM is required for the purchase or sale of the right of real estate ownership, the right of perpetual usufruct or share in such right, without limitations upon the value of such transaction. The Company has not adopted any by-laws of the GSM. Amendments of the Company's Statute need to be adopted by 3/4 majority of the votes cast.

The Supervisory Board shall consist of up to 9 members. Members of the Supervisory Board shall be elected and dismissed by the GSM for a term of office of 5 years. One member of the Supervisory Board shall be appointed and dismissed by holders of series A1 shares. At all times at least two of the Supervisory Board members shall be "independent".

The competency of the Supervisory Board shall include general supervision of the activities of the Company. Resolutions of the Supervisory Board shall be required in matters provided for in the Commercial Companies Code and:

a) presentation to the Company's GSM of a written report on the results of the Supervisory Board's examination of the Company's financial statements, Management Board report and Management Board's recommendations with respect to the distribution of profits or coverage of losses;
b) the issuance of by-laws for the Management Board and the appointment and removal of the members of the Management Board, setting or changing the compensation and defining other terms and conditions of employment of the Management Board members, as well as setting and changing any incentive plan for the Management Board members and other key employees;
c) approval of business plans and budgets for the Company;
d) granting consent for any transaction whose value exceeds the PLN equivalent of EUR 1,250 in a single or a series of related transactions, or in the course of one year in the case of agreements entered into for unlimited duration or for periods longer than one year;
e) making any investments in or financing the activities of companies whose core and actual scope of business activity does not include telecommunications activity;

f) consent to the commencement, settlement, assignment, compromise or release of any claim of or against the Company in excess of the PLN equivalent of EUR 600 in a single or series of related acts or the equivalent amount in PLN or other currencies;

g) consent to the adoption of a performance stock option plan in accordance with § 5A of the Statute;

h) appointment of the expert auditor to audit the Company's financial statements;

i) provided that the value of the Company's obligations exceeds the PLN equivalent of EUR 100, the conclusion by the Company of any contracts with an Affiliate shall; require the approval of at least one of the independent members. For the purposes of this point, an "Affiliate" shall mean: (i) a member of the Management Board or Supervisory Board of the Company or the cousin or relative of up to the second degree of such member, or an entity controlled by such person or their cousin or relative of up to the second degree; (ii) a shareholder holding shares entitling it to at least 5% of votes at the General Meeting; or (iii) an entity controlled by, controlling or under common control with the persons listed under (i) and (ii); (iv) an entity in which the Company has, directly or indirectly, any equity stakes or voting powers. "Control" shall mean the possibility of exerting influence, whether direct or indirect, on the management or business policy of the controlled entity through holding voting shares in such entity, under a shareholders' agreement, an agreement for official receivership of votes (umowa syndykowania głosów) or in any other similar manner, even if not connected with a written agreement. For the purposes of the above definition, "control" shall not apply to any companies controlled by Netia S.A.

The Management Board of the Company shall consist up to 10 members. The Supervisory Board shall decide on the number of Management Board members. The Management Board members shall be appointed and dismissed by the Supervisory Board for a term of office of 5 years.

The Management Board shall manage the activities of the Company, shall adopt resolutions necessary for performance of tasks and shall represent the Company before courts, authorities, offices and third parties. The Management Board shall handle the matters, which are not within the exclusive competence of the GSM or the Supervisory Board. Two members of the Management Board acting together or one member of the Management Board acting together with a commercial proxy (prokurent) shall be authorised to make declarations and to sign on behalf of the Company.

The members of the Management Board do not have any rights related to deciding about the issue or redemption of the Company's shares.

4.2 Changes in the Management Board and Supervisory Board in 2009

Changes in the Management Board

On August 4, 2009 the Company's Supervisory Board appointed Mr. Grzegorz Esz as member of the Management Board, effective October 1, 2009.

Due to the above change as at December 31, 2009 the Company's Management Board consisted of the following members:
- Mirosław Godlewski – President,
- Jonathan Eastick,
- Grzegorz Esz,
- Piotr Nesterowicz,
- Tom Ruhan.

Changes in the Supervisory Board

Effective March 9, 2009 Mr. Pantelis Tzortzakis resigned from his position as Member of the Company's Supervisory Board.

Effective April 9, 2009 Mr. Marek Gul resigned from his position as Chairman and member of the Company's Supervisory Board.

Effective April 9, 2009 Mr. Piotr Czapski, Mr. Constantine Gonticas, Mr. Kazimierz Marcinkiewicz and Mr. Bruce McInroy resigned from their positions as Members of the Company's Supervisory Board.

The Company's ordinary shareholder's meeting held on April 9, 2009 appointed the following individuals to Netia's Supervisory Board: Mr. Stan Abbeloos, Mr. Benjamin Duster, Mr. George Karaplis, Mr. Nicolas Maguin, Ms. Ewa Pawluczuk and Mr. Piotr Żochowski.

Due to the above changes as at December 31, 2009 the Company's Supervisory Board consisted of the following members:
- Benjamin Duster – Chairman,
- George Karaplis – Vice-Chairman,
- Stan Abbeloos,
- Raimondo Eggink,
- Nicolas Maguin,
- Ewa Pawluczuk,
- Tadeusz Radzimiński,
- Jerome de Vitry,
- Piotr Żochowski.

4.3 System for controlling employee share option schemes

At present, there is one incentive scheme in force in the Netia Group (an employee share option scheme) approved by the Supervisory Board in 2002 ("the Scheme"). The Scheme is aimed at providing incentives which will encourage, retain and motivate highly-qualified people in senior management positions, employees, co-operators, consultants and the members of the Company's Management Board, its associates and subsidiaries to act in the shareholders' interests by granting them options for the Company's series K shares of the new issue. As soon as the options granted to the participants in the Scheme are exercised, the Company will issue shares in the Company, constituting an equivalent of the profit on the options exercised. The participants are not obliged to pay for the nominal value of the shares. The number of series K shares which can be issued for the purposes of the Scheme may not exceed 18,373,785.

The execution of the Scheme has been entrusted to the Company's Supervisory Board. To the extent provided for in the Scheme, the Supervisory Board, at its exclusive discretion, shall make decisions relating to, among other things, participation in the Scheme, the allotment of options, and the terms & conditions of their being exercised. The Company's Management Board may present the Supervisory Board with recommendations related to other employees' participating in the Scheme.

4.4 Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2009

The compensation and related cost of remuneration (including bonuses paid and accrued) of members of the Company's Management and Supervisory Board are presented below:

	PLN
Remuneration of current members of the Management Board	
Mirosław Godlewski	1,690
Jonathan Eastick	1,651
Grzegorz Esz	282
Piotr Nesterowicz	1,167
Tom Ruhan	1,257
	6,047

	PLN
Remuneration of current members of the Supervisory Board	
Benjamin Duster	68
George Karaplis	68
Stan Abbeloos	68
Raimondo Eggink	112
Nicolas Maguin	68
Ewa Pawluczuk	68
Tadeusz Radzimiński	96
Jerome de Vitry	112
Piotr Żochowski	-
	660
Remuneration and termination benefits for the former members of the Supervisory Board	135
Remuneration of members of management boards of subsidiaries	1,049
Total	**7,891**

The members of the Company's Management and Supervisory Boards do not collect any additional remuneration for being members of the authorities of the subsidiaries.

In addition, the members of the Management and Supervisory Boards participate in a scheme which consists of awarding bonuses in the form of Netia's shares, under which some of them have received share options.

The movements in the number of options held by members of the Company's Management Board are presented below (number of options not in thousands):

Options	Mirosław Godlewski	Jonathan Eastick	Grzegorz Esz	Piotr Nesterowicz	Tom Ruhan	Total
At the beginning of the year	13,334,000	10,938,314	-	6,666,500	5,666,500	36,605,314
Granted	-	-	4,166,500	-	-	4,166,500
At the end of the year	13,334,000	10,938,314	4,166,500	6,666,500	5,666,500	40,771,814

The members of the Supervisory Board did not have any share options as at December 31, 2009. Due to Mr. Piotr Czapski's appointment, as at December 31, 2008 members of the Supervisory Board held 1,000,000 options,. After Mr. Piotr Czapski's resignation from his position, these options are no longer treated as options held by members of the Supervisory Board.

Moreover, the Company's ordinary shareholder's meeting held on April 9, 2009 approved changes of rules of remunerating the Supervisory Board members, according to which each independent Supervisory Board member (as defined in the Company's Statute) elected by the General Meeting, who remains in office after these rules come into force received a one time grant of 50,000 Restricted Stock Units ("RSU") corresponding to one ordinary share in the Company having the value equal to the market price of Company shares. Under the terms of the scheme one of the Supervisory Board's members, Mr Piotr Żochowski, has waived his right to participate in the scheme. As at December 31, 2009 the total number of RSU granted to the members of the Company's Supervisory Board was 350,000.

The Company recognizes the cost of share-based awards to employees (including share options and RSU) over the vesting period. Due to the above the cost of options granted to the members of the Management Board recorded in the year ended December 31, 2009, is as follows:

	Cost of options
	PLN
Mirosław Godlewski	2,909
Jonathan Eastick	2,015
Grzegorz Esz	621
Piotr Nesterowicz	880
Tom Ruhan	1,150
	7,575

The cost of RSU recorded in year ended December 31, 2009 amounted to PLN 375.

4.5 Shares held by members of the Management Board and Supervisory Board of the Netia Group

Number of shares held by members of the Management Board (not in thousands)

As at December 31, 2009 and December 31, 2008 Mr. Mirosław Godlewski – the Company's President of the Management Board – held 10,000 and nil shares of the Company, respectively.

As at December 31, 2009 and December 31, 2008 Mr. Tom Ruhan – a member of the Company's Management Board – held 253,593 shares of the Company.

As at December 31, 2009 and December 31, 2008, Mr. Jonathan Eastick – a member of the Company's Management Board – held 35,500 and 25,000 shares of the Company, respectively.

Number of shares held by members of the Supervisory Board (not in thousands)

As at December 31, 2009 and December 31, 2008, Mr. Raimondo Eggink – a member of the Company's Supervisory Board – held 20,000 shares of the Company.

As at December 31, 2009 and December 31, 2008, Mr. Tadeusz Radzimiński – a member of the Company's Supervisory Board – held 6,000 and 2,000 shares of the Company, respectively.

As at December 31, 2008, Mr. Constantine Gonticas and Mr. Bruce McInroy – the former members of the Company's Supervisory Board (see point "Changes in the Management Board and Supervisory Board in 2009") – held 143,000 and 150,000 shares of the Company, respectively. Due to their resignations from their positions, these shares are no longer treated as shares held by members of the Supervisory Board .

4.6 Agreements concluded by the Company and the members of the Management Board, providing for compensation in the event of their resigning or being dismissed from their positions without a sound reason or when they are dismissed or made redundant due to the Company's merging through acquisition

Under a labour contract the Supervisory Board of Netia granted one member of the Management Board compensation should that person be dismissed from his position without a justified reason. Should that member of the Management Board be dismissed, Netia will be required to pay a one-off severance payment stipulated in the employment agreement, being the equivalent of the three times the monthly salary in the amount of PLN 255, as at December 31, 2009.

Furthermore, an employment contract of another member of the Management Board shall not be terminated without the Supervisory Board's recommendation in the form of resolution. Otherwise the Company will be required to pay a one-off severance payment being the equivalent of the six times the monthly salary in the amount of PLN 377, as at December 31, 2009.

Upon a decision of the Supervisory Board, one of the members of the Management Board who resigns from his position and/or terminates employment and indicates a particular conflict of interest, shall be entitled to receive the severance payment equal to the aggregate amount of monetary compensation due in connection with performance of his duties as the member of the Management Board for the period of one calendar year immediately preceding the year in which the resignation from his position or termination of employment occurred.

4.7 Changes in the basic management principles of the Netia Group

Changes in the Management Board and Supervisory Board

Changes in the Management Board and Supervisory Board were discussed in point 4.2 above.

Legal changes

Due to the ongoing process of internal consolidation of Netia's subsidiaries, in 2009 Netia merged with Tele2 Polska and two other subsidiaries - Netia S.A. UMTS s.k.a. and Netia UMTS Sp. z o.o.. Tele2 In addition several the Company's subsidiaries held indirectly merged with Internetia Sp. z o.o. (the mergers were described in "The Netia Group's structure"). The purpose of the internal consolidation is to simplify and make the Netia Group's capital structure more transparent. The Management Board believes that this will positively impact the Netia Group's operations through reduction of administrative costs, including a decrease in the scale of intercompany transactions in its daily operations.

Organizational changes

In 2009 Netia twice conducted group lay off processes, decreasing headcount by 19%. It caused many changes in organizational structures. Mainly these changes meant simplifying and flattening the structure. The goal of changes was to achieve cost savings and to increase work efficiency.

5 Major Shareholders and share capital

5.1 Shareholders holding more than 5% of the votes at the General Shareholders' Meeting of Netia (not in thousands)

Based on the information presented to the Company by the shareholders, as at December 31, 2009 significant blocks of the Company's shares were held by the following entities (the interest and the number of votes calculated on the basis of the number of shares constituting the Company's share capital as at the balance sheet date):

ING Otwarty Fundusz Emerytalny

In 2009 ING Otwarty Fundusz Emerytalny increased their share holding in the Company's share capital and held a total of 48,010,027 of the Company's shares constituting 12.3% of its share capital and representing 12.3% of the total number of votes at the General Shareholders' Meeting of the Company.

Pioneer Pekao Investment Management SA

In 2009 the clients of Pioneer Pekao Investment Management SA increased their share holding in the Company's share capital and held a total of 38,891,802 of the Company's shares constituting 10.0 % of its share capital and representing 10.0 % of the total number of votes at the General Shareholders' Meeting of the Company.

Subsidiaries of SISU Capital Limited

The subsidiaries of SISU Capital Limited held a total of 39,043,006 of the Company's shares constituting 10.0% of its share capital and carrying 10.0% of the total number of votes at the General Shareholders' Meeting of the Company. The number of the Company's shares held by the subsidiaries of SISU Capital Limited has not changed since December 31, 2008.

Third Avenue Management LLC

Third Avenue Management LLC held 93,720,763 shares constituting 24.1% of the Company's share capital and carrying 24.1% of the total number of votes at the General Shareholders' Meeting of the Company, inclusive of the shareholding of Third Avenue International Value Fund described below. The number of the Company's shares held by Third Avenue Management LLC has not changed since December 31, 2008.

Third Avenue International Value Fund

Third Avenue International Value Fund held 19,594,034 of the Company's shares constituting 5.0% of the Company's share capital and representing 5.0% of the total number of votes at the General Shareholders' Meeting of the Company. The number of the Company's shares held by the subsidiaries of Third Avenue International Value Fund has not changed since December 31, 2008.

Based on the information presented to the Company as at December 31, 2008 Novator Telecom Poland II S.a.r.l. held 121,784,294 shares constituting 31.3% of the Company's share capital and representing 31.28% of the total number of votes at the General Shareholders' Meeting of the Company. During the first quarter of 2009 Novator Telecom Poland II S.a.r.l. sold all of its holdings of Netia shares.

(All amounts in thousands, except as otherwise stated)

5.2 Agreements which could lead to changes in shareholding proportions in the future

On the basis of an incentive scheme, the Company may also issue a maximum of 18,373,785 series K shares no later than by December 31, 2012. In connection with certain authorised people having exercised the rights arising from that scheme, the Company had already issued 5,054,520 series K shares as at December 31, 2009.

5.3 Holders of all securities which grant special control rights in relation to the Company

Mr. Andrzej Radzimiński holds 1,000 (not in thousands) series A1 shares which give him the right to appoint and dismiss a member of the Supervisory Board.

5.4 Limitations on the transfer of ownership rights to the Issuer's securities and limitations on exercising the voting rights carried by the Issuer's shares

Netia's corporate documents do not contain any limitations, which significantly limit changes in the control of the Issuer as a result of third parties' purchasing substantial amounts of shares.

Each Netia share carries one vote at the GSM. There are no limitations on exercising the voting rights from the Company's shares.

Mr. Andrzej Radzimiński holds 1,000 (not in thousands) series A1 shares which give him the right to appoint and dismiss a member of the Supervisory Board.

6 Other information

6.1 Transactions with related parties

The following transactions were concluded between the Company and its subsidiaries during 2009:
- sale and purchase of telecommunications services;
- sale of other services (rental and book-keeping services) to subsidiaries;
- sale and purchase of fixed and intangible assets.

A detailed list of transactions with subsidiaries has been presented in the Company's financial statements (Note 38).

Other transactions with subsidiaries have been described in points "Loans, warranties and collaterals granted" and "Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2009".

6.2 Guidance and medium term outlook (not in thousands)

On October 14, 2008 the Management Board of the Company announced an outlook for the 2009 financial year, which was revised on February 10, 2009. Full guidance for 2009 is set out below:

2009 Guidance	
Number of broadband service clients *(excl. Ethernet acquisitions)*	525,000
Number of voice service clients *(own network and WLR)*	1,150,000
Unbundled local loop (LLU) nodes	300
Revenues *(PLN m)*	1,520
EBITDA *(PLN m)*	260
Investment outlays (excl. M&A) *(PLN m)*	260

On April 6, 2009 the Management Board of the Company raised its guidance for Adjusted EBITDA (excluding one-off restructuring cost) for the 2009 financial year from PLN 260 million to PLN 290 million. This update in the earnings outlook follows further strong progress on Company's profitability in the first quarter.

Following extensive preparatory work, in the first quarter of 2009 the Management began implementation of a comprehensive cost reduction project with the objective of eliminating PLN 100 million of operating expenses from the cost base for the 2010 financial year. Accordingly, EBITDA for 2009, net of reorganization expenses, was forecasted at PLN 265 million.

Having taken note of the more difficult trading conditions in the first half of 2009, the impact of the sale of the transmission network to P4 and the smooth implementation of "Profit" project, on August 6, 2009 Netia increased its EBITDA guidance for 2009 by 4% to PLN 275 million with Adjusted EBITDA guidance remaining unchanged at PLN 290 million.

(All amounts in thousands, except as otherwise stated)

On November 5, 2009 Netia increased its EBITDA guidance for 2009 to PLN 290.0 million and Adjusted EBITDA guidance to PLN 300.0 million. Capital investment outlays guidance was decreased to PLN 250.0 million and revenue guidance was decreased to PLN 1,495.0 million. The continued weakness in corporate segment sales and reduction of the carrier segment's exposure to low margin or riskier projects is behind reduced revenue guidance whilst accelerated delivery on Tele2 Polska integration synergies and Project Profit cost reductions are driving the profitability upgrades. At the same time, a stronger than previously expected rebound in demand for broadband services and an aggressive promotions pipeline has allowed Netia to return to its original 2009 guidance of 525,000 broadband customers. In parallel, the voice service target has been revised downwards to 1,165,000.

The following table presents the Company's current estimates of all elements of the 2009 guidance in comparison to the guidance published previously on August 6, 2009:

2009 Guidance	**previous**	**updated**
Number of broadband service clients *(excl. Ethernet acquisitions)*	510,000	525,000 +
Number of voice service clients (own network, WLR and LLU)	1,200,000	1,165,000 +
Unbundled local loop (LLU) nodes	300	300
Revenues (PLN m)	1,500	1,495
Adjusted EBITDA [1] (PLN m)	290	300
EBITDA (PLN m)	275	290
Investment outlays (excl. M&A) (PLN m)	260	250

[1] *Adjusted EBITDA excludes one-off restructuring costs related to the cost reduction program (the "Profit" project) of PLN 15m and a gain of PLN 5m on the sale of the first tranche of P4 transmission assets.*

Subscriber guidance excludes potential for further Ethernet network acquisitions which remain important to Netia's strategy but are difficult to forecast in time and amount.

The final operating and financial results of the Netia Group for 2009 were materially in line with the above guidance.

Guidance for 2010 and medium term outlook

In February 2010 Netia announced its guidance for 2010:

	Actual 2009	**Guidance 2010**
Number of broadband service clients *(excl. Ethernet acquisitions)*	559,317	680,000
Number of voice service clients (own network, WLR and LLU)	1,158,448	1,225,000
Unbundled local loop (LLU) nodes	297	500+
Revenue (PLN m)	1,505.9	1,550.0+
Adjusted EBITDA (PLN m)	303.9	355.0+
Adjusted EBITDA margin (PLN m)	20%	23%
EBITDA (PLN m)	312.8	360.0+
EBIT (PLN m)	14.2	60.0+
Capital investment (excl. M&A) (PLN m)	246.4	220.0
Capital investment to sales (%)	16%	14%

Subscriber guidance excludes potential for further Ethernet network acquisitions which remain important to Netia's strategy but are difficult to forecast in time and amount. In addition, Netia forecasts to be net profitable for the full year 2010.

The medium term outlook for Netia remains unchanged as set out below:

Mid term outlook	
Revenue growth (CAGR) total	3% - 5%
Revenue growth (CAGR) in retail market segments	5% - 10%
EBITDA margin in 2010 (%)	23%
EBITDA margin in 2012 (%)	28%
Net profit by	2010
Capex to sales down to 15% by	2010
1 million broadband subscribers	2012

The objective of free cash-flow positive results by 2010 was achieved a year earlier than planned. Netia expects to grow its free-cash flows year on year from hereon as it continues to implement its broadband driven growth strategy.

6.3 Information on the registered audit company

The financial statements of Netia and the consolidated financial statements of the Netia Group for 2009 and 2008 were audited by Ernst & Young Audit Sp. z o.o. on the basis of a contract concluded on March 30, 2007.

The total fees specified in the contract with the registered audit companies, payable or paid for the audit and review of the financial statements and for other services are presented below:

Item	**2008**	**2009**
Audit of stand-alone and consolidated financial statements	384	471
Review of stand-alone and consolidated financial statements	362	433
Other services	71	57
Total...	**817**	**961**

6.4 Compliance with corporate governance rules

The Management Board of the Company represents that in 2009 the Company complied with the corporate governance rules stated in the document entitled "Code of Best Practice for WSE Listed Companies". As per the Company's declaration published in the current report dated February 28, 2008 since the "Code of Best Practice for WSE Listed Companies" became effective on January 1, 2008, the Management Board of the Company declares that it appreciates the importance of corporate governance rules provides in that document and the role played by those rules in enhancing the transparency of stock exchange listed companies, and it has exercised duly diligent efforts for those rules to be observed in Netia to the greatest extent possible. According to the Management Board's best knowledge in 2009 non of the rules stated in the "Code of Best Practice for WSE Listed Companies" was breached by the Company. All rules were applied by the Company according to the wording presented in the above mentioned document.

6.5 Subsequent events

Tax decision (not in thousands)

On February 16, 2010 the proxy of Netia S.A. (the "Company" or "Netia") was informed of the issuing of a decision ("Decision") of the Director of the Tax Chamber in Warsaw ("Tax Chamber Director") according to which Netia's corporate income tax ("CIT") due for the year 2003 was set at PLN 34.2 million plus penalty interest of approximately PLN 25.3 million. The decision closes proceedings related to Netia's appeal of a decision of the Director of the Tax Control Office in Warsaw ("UKS Director") according to which Netia's corporate income tax ("CIT") due for the year 2003 was set at PLN 58.7 million plus penalty interest amounting to PLN 41.3 million.

The decision of the Tax Chamber Director was issued despite legal arguments presented by the Company, which claimed that the conclusions delivered by the Tax Control Office were incorrect and groundless. According to the Tax Chamber Director and the UKS Director, Netia understated its taxable income by PLN 247.5 million by excluding from its revenues the accrued and not received interest from loans granted by Netia in earlier years to subsidiaries which subsequently merged with Netia on December 31, 2003. The Director of UKS, as the first instance tax authority, claimed in its earlier decision that Netia understated its taxable income by PLN 303 million.

In the opinion of the UKS Director and subsequently the Tax Chamber Director, the fact that the Company did not claim the repayment of the loans and accrued interest from its subsidiaries justifies the adjustment of Netia's revenues pursuant to Article 11 of the CIT Act. According to this regulation, the tax authorities are entitled to make adjustments to taxable revenues if, as a consequence of a capital relationship or a personal relationship, a taxpayer provides services to related parties on terms more favourable than those generally accepted at the time and place where such service is provided, and as a result of these transactions the entity does not report taxable income or reports lower income than expected had such relationships not existed.

According to Netia, the decisions of the UKS Director and the Tax Chamber Director are in conflict with the relevant tax regulations. In addition to major procedural faults, Netia believes that the tax authorities' decisions incorrectly interpret and apply a number of material regulations. According to the Company the following are the most important deficiencies:

1. Incorrect interpretation of art. 11 of the CIT Act (which deals with transfer pricing), especially the notion of "services" and "more favorable conditions" and assumption that the non-commencement of the execution procedure constitutes such a service of the lender towards the debtor on non-market conditions. Such interpretation of this provision and its application towards the Company is not justified in the light of the fact that in the decision issued by the tax authorities it was confirmed that loans were granted on market terms; (interest, payment terms, etc.).

2. Failure to consider the absolutely mandatory prohibition on broadening the interpretation of art. 11 of the CIT Act, which covers exceptions from the principle of taxing actual revenue, without special care and consideration of all business, legal and economic circumstances. In the case of Netia the tax authorities did not take into account issues such as:

   - Netia was not able to report interest income in 2003 because even if Netia had received interest from its subsidiaries the amount received would have been spent on the repayment of Netia's interest liabilities (and the repayment of the interest would have been a tax deductible cost);

   - the execution of interest by court enforcement proceedings, which according to the Tax Chamber Director and the UKS Director is the only proper way to proceed when debts remain unpaid, would be inefficient from a business and economic point of view and would have led to the bankruptcy of the subsidiaries. The Company chose the less expensive way, by settling its receivables through merger with its subsidiaries and thereby taking over their operating assets. In parallel to this restructuring, Netia restructured its own liabilities with the external lenders to the group;

   - to assess Netia's conduct of non-commencement of a formal execution procedure (comparable market transaction) in the case of loans granted to its subsidiaries the tax authorities considered exclusively the loan granted by Netia to Millennium Communications; in fact, Netia was involved in numerous litigations with Millennium Communications due to the unsuccessful acquisition of that company by Netia.

3. Ignoring the norms of art. 12 of the CIT act by rejecting in the decision the rule that exclusively interest received constitutes taxable revenue (on the cash basis) and leading to the situation where the tax payer's revenue is assessed in violation of general principles relating to the mode of revenue generation.

4. Netia's taxable losses were settled incorrectly, resulting in a significant overstatement of tax being claimed. Whilst the Tax Chamber Director has recognized some of the Company's corrections to the CIT calculation in respect to 2003, reducing the claimed amount by PLN 15.0 million, the Company continues to claim other increases in taxable expenses that the Tax Chamber Director has not accepted.

The Tax Chamber Director's decision, which partially upholds the decision of the UKS Director, is enforceable as a decision of the second instance tax authority and Management expects to settle the liability without delay.

Netia has received opinions from several independent tax and legal advisors, as well as tax law experts, which conclude that the claims of the Directors of the Tax Control Office and the Tax Chamber have no legal grounds. Accordingly, Management has not recognised the Local Tax Chamber's decision as a taxation expense for the financial year ended December 31, 2009 and will instead treat funds paid over to the tax authorities as an overpayment of tax.

Netia will undertake all possible legal steps to prove that the decision of the Tax Chamber Director was groundless.

Warsaw, February 19, 2010