Warsaw, November 8, 2005

COMMENT ON THE FINANCIAL REPORT FOR 2005 THIRD QUARTER

The below comment comprises both financial data of the Company and the consolidated financial results of Netia S.A. Group (the "Netia Group").

1. Selected financial data

Selected financial information of the Netia Group

	Nine-month period ended September 30, 2005	Year ended December 31, 2004	Nine-month period ended September 30, 2005	Year ended December 31, 2004
	PLN in thousands	PLN in thousands	EUR in thousands	EUR in thousands
Revenue	670,501	863,394	165,217	191,092
Profit from operations	76,262	85,155	18,792	18,847
Profit before income tax	87,496	113,029	21,560	25,016
Profit for the period attributable to equity holders of the Company	70,665	158,514	17,412	35,083
Net cash provided by operating activities	269,995	315,691	66,529	69,871
Net cash used in investing activities	(233,959)	(292,299)	(57,649)	(64,694)
Net cash provided by / (used in) financing activities	(101,306)	54,915	(24,963)	12,154
Total assets	2,560,613	2,532,561	653,785	620,878
Total liabilities	211,492	241,943	53,999	59,314
Non-current liabilities	58,645	57,441	14,973	14,082
Current liabilities	152,847	184,502	39,026	45,232
Capital and reserves attributable to the Company's equity holders	2,343,323	2,285,432	598,305	560,292
Share capital	397,833	366,956	101,576	89,962
Number of shares as at reporting date (not in thousands)	397,833,440	366,956,325	397,833,440	366,956,325
Weighted average number of ordinary shares in issue (not in thousands)	378,750,743	358,096,167	378,750,743	358,096,167
Weighted average number of ordinary shares for diluted earnings per share (not in thousands)	392,592,292	381,476,802	392,592,292	381,476,802
Basic earnings per share (not in thousands)	0.19	0.44	0.05	0.10
Diluted earnings per share (not in thousands)	0.18	0.42	0.04	0.09

Selected financial information of the Company

	Nine-month period ended September 30, 2005	Year ended December 31, 2004	Nine-month period ended September 30, 2005	Year ended December 31, 2004
	PLN in thousands	PLN in thousands	EUR in thousands	EUR in thousands
Revenue	568,171	740,857	140,002	163,972
Profit from operations	66,467	67,673	16,378	14,978
Profit before income tax	91,813	77,655	22,624	17,187
Net profit	79,544	118,517	19,600	26,231
Net cash provided by operating activities	235,009	311,007	57,908	68,834
Net cash used in investing activities	(207,382)	(305,085)	(51,101)	(67,524)
Net cash provided by / (used in) financing activities	(101,306)	54,915	(24,963)	12,154
Total assets	2,363,272	2,405,582	603,399	589,748
Total liabilities	121,150	152,573	30,932	37,405
Non-current liabilities	499	500	127	123
Current liabilities	120,651	152,073	30,805	37,282
Equity	2,242,122	2,253,009	572,466	552,343
Share capital	397,833	366,956	101,576	89,962
Number of shares as at reporting date (not in thousands)	397,833,440	366,956,325	397,833,440	366,956,325
Weighted average number of ordinary shares in issue (not in thousands)	378,750,743	358,096,167	378,750,743	358,096,167
Weighted average number of ordinary shares for diluted earnings per share (not in thousands)	392,592,292	381,476,802	392,592,292	381,476,802
Basic earnings per share (not in thousands)	0.21	0.33	0.05	0.07
Diluted earnings per share (not in thousands)	0.20	0.31	0.05	0.07

2. The Netia Group's structure

The consolidated financial statements includes financial statements of the Company and the following subsidiaries:
UNI-Net Sp. z o.o.
Regionalne Sieci Telekomunikacyjne El-Net S.A.
Polbox Sp. z o.o.
Netia Globe S.A.
Netia Świat S.A. Group
Netia Ventures Sp. z o.o.
as well as the income and expenses of P4 Sp. z o.o. („P4") (operating under the name „Netia Mobile Sp. z o.o.") for 8 months of the year 2005, that is until 70% of shares in P4 were sold. As from August 23, 2005 Netia Group started accounting for the investment in P4 using equity method.
The Netia Świat S.A. Group's financial statements includes financial statements of Netia Świat S.A. and Świat Internet S.A. Group.
Świat Internet S.A. Group's financial statements includes financial statements of Świat Internet S.A. and the HFC Internet Sp. z o.o. Group.

3. Changes within the Netia Group's structure

P4

As P4 - previously the Company's subsidiary, was announced a winner of the mobile telephony UMTS frequency tender, the P4's Shareholders' Agreement ("Agreement") was concluded on August 23, 2005, by the following entities: the Company, Netia Ventures Sp. z o.o. ("Netia Ventures"), P4, Novator One L.P., Novator Telecom Poland S.a.r.l. ("Novator") and Novator Poland Pledge Sp. z o.o. in organization (Novator and Netia Ventures both called "Shareholders"). Netia Ventures is a 100% subsidiary of the Company, and Novator is a 100% subsidiary of Novator One L.P.

P4 was registered in September 2004. Its shares were subscribed by Netia Ventures - 99 shares constituting 99% of share capital, and by Netia Globe S.A. („Netia Globe") - 1 share constituting 1% of share capital.

Upon that Agreement, Novator has purchased 70 P4's shares ("Shares") at the price of PLN 70 thousands and subscribed for 23,940 Shares issued as part of P4's capital increase at the nominal value of PLN 11,970 thousands and for the amount of PLN 251,300 thousands. Netia Ventures has subscribed for 10,260 Shares in the increased P4's share capital at the nominal value of PLN 5,130 thousands and for the amount of PLN 107,700 thousands. The increase of share capital was registered on October 13, 2005. As a result, Novator is the holder of 24,010 Shares constituting 70% of the Shares in the P4's share capital. Consequently, Netia Ventures is the holder of 10,290 Shares constituting 30% of the Shares in the P4's share capital. In total, based on the Agreement, the Shareholders are obligated to make contributions of up to the amount of EUR 300,000 thousands in proportion to their share in the P4's share capital.

Due to the execution of the provisions of the Agreement, since August 23, 2005 the Company does not control P4. However, the Netia Group has a 30% interest in P4 and still has a significant influence over P4's financial and operating policy. The Netia Group started accounting for the investment in P4 using equity method from August 23, 2005, when it became an associate.

HFC Internet Group

On September 30, 2005 Świat Internet S.A. ("Świat Internet"), one of the Company's subsidiaries, acquired 100% of the share capital of HFC Internet Sp. z o.o., a parent company of HFC Internet Sp. z o.o. Group ("HFC Internet Group"), a telecommunication services provider, for PLN 3,050 thousands. HFC Internet Sp. z o.o. controls one operating subsidiary.

The Netia Group accounted for the acquisition of HFC Internet Group using the purchase method and started consolidating the financial statements of HFC Internet Group as of September 30, 2005. Given the close proximity to the reporting date, the provisional fair values of assets, liabilities and contingent liabilities acquired are based on amounts from HFC Internet Group's historical accounting records and will therefore be subject to adjustments as additional information is obtained. Such additional information may include reports from valuation specialists, information related to pre-acquisition contingencies and calculation of the related deferred income taxes. A detailed review of these assets, liabilities and contingent liabilities will be performed during the course of the period ending December 31, 2005, which may result in further adjustments to the carrying amounts of identifiable net assets as at the acquisition date.

Details of provisional fair value of net assets acquired and goodwill as of the date of the acquisitions are as follows (in thousands):

	(PLN)
Purchase consideration, including transaction costs of PLN 190	3,240
Negative provisional fair value of net assets acquired	10,282
Goodwill	**13,522**

The assets and liabilities recognized in the consolidated balance sheet arising from the acquisition, as at the acquisition date, are as follows (in thousands):

	(PLN)
Cash and cash equivalents	8,367
Receivables	10,662
Inventories	505
Prepayments	37
Fixed assets	5,942
Intangible assets	23
Provisions	(3,230)
Short-term loans	(24,899)
Trade liabilities	(4,227)
Other liabilities and accruals	(3,462)
Negative provisional fair value of net assets acquired	**(10,282)**

4. Netia's shareholders holding at least 5% of the votes in the General Shareholders' Meeting as at the date of filing of this report

According to the information provided to the Company by its shareholders, as at the date of filing this report, the following shareholders held more than 5% of votes at the General Shareholders' Meeting (share in capital as well as the number of votes are calculated in consideration of the number of the shares making up the share capital as at November 8, 2005):

4.1. Subsidiaries of SISU Capital Limited

Subsidiaries of SISU Capital Limited held in total 23,743,225 shares, constituting 5.92% of the Company's share capital and giving 5.92% of the votes in the General Shareholders' Meeting. The number of shares held by the subsidiaries of SISU Capital Limited has not changed since August 10, 2005.

4.2. Subsidiaries of Montpelier Asset Management Ltd

Subsidiaries of Montpelier Asset Management Ltd held in total 21,154,135 shares, constituting 5.27% of the Company's share capital and giving 5.27% of the votes in the General Shareholders' Meeting. In addition, Mr. Nicholas Cournoyer, the Managing Director of Montpelier Asset Management Ltd, held 9,000 shares. The number of shares held by the subsidiaries of Montpelier Asset Management Ltd has not changed since August 10, 2005.

4.3. Subsidiaries of Griffin Capital Management Ltd

Subsidiaries of Griffin Capital Management Ltd held in total 20,464,626 shares, constituting 5.10% of the Company's share capital and giving 5.10% of the votes in the General Shareholders' Meeting. The number of shares held by the subsidiaries of Griffin Capital Management Ltd has not changed since August 10, 2005.

4.4. Subsidiaries of Pioneer Pekao Investment Management S.A.

In the three-month period ended September 30, 2005, the subsidiaries of Pioneer Pekao Investment Management S.A. increased their share in the Company's capital and held in total 20,314,557 shares constituting 5.06% of the Company's share capital and giving 5.06% of the votes in the General Shareholders' Meeting (as at the date of filing the previous interim report the subsidiaries of Pioneer Pekao Investment Management S.A. held in total 19,764,194 shares).

In the three-month period ended September 30, 2005, the subsidiaries of J.P.Morgan Chase & Co. as well as Powszechny Zaklad Ubezpieczeń S.A. together with its subsidiary Powszechny Zaklad Ubezpieczeń na Życie S.A. decreased their share in the Company's share capital and as at the date of filing the herewith report did not exceed the level of 5% of the votes in the General Shareholders' Meeting.

5. Changes in shares and share options held by members of the Company's Management Board and Supervisory Board

Since adopting the employee share option scheme (the „Plan") on June 10, 2003 to September 30, 2005, the Supervisory Board approved for issue a total number of 14,023,719 options for members of the Management Board as well as for Netia's key employees. The options are exercisable until December 20, 2007. The strike price, depending on the agreement, ranges between PLN 2.53 and PLN 4.48 per share.

In the three-month period ended September 30, 2005 the following changes took place in the number of options granted under the Plan:

Three-month period ended September 30, 2005	
At the beginning of the period	8,696,159
Granted	543,628
Expired	(543,628)
At the end of the period	8,696,159

The movements in the number of options held by members of the Company's Management Board are presented below:

Member of the Management Board	**June 30, 2005**	**Options granted**	**Options expired**	**September 30, 2005**
Wojciech Madalski	4,530,236	-	-	4,530,236
Kent Holding	543,628	-	-	543,628
Paul Kearney	1,087,257	-	-	1,087,257
Piotr Czapski	-	543,628	-	543,628
Irene Cackett*	543,628	-	(543,628)	-
Total	**6,704,749**	**543,628**	**(543,628)**	**6,704,749**

*Options expired due to resignation from the Management Board

The members of Supervisory Board did not hold any options as at September 30, 2005.

The amount of shares held by the members of the Supervisory Board did not change in the three-month period ended September 30, 2005. As at September 30, 2005 Mr. Andrzej Radzimiński, member of the Supervisory Board, held 10,000 ordinary shares and 1,000 series A1 shares, which give the right to appoint and dismiss one member of Netia's Supervisory Board. Nicholas Cournoyer, the President of the Supervisory Board, the Managing Director of Montpelier Asset Management Ltd, held 3,000 series A shares and 6,000 series J shares.

6. Legal proceedings

Millennium

In August and September 2000, the Company entered into certain agreements to acquire all of the outstanding equity of Millennium Communications S.A. ("Millennium"), a provider of telecommunications services in Warsaw. Certain advances were made to Millennium following the execution of the agreements, and currently a loan of EUR 2.9 million (PLN 11.4 million at the September 30, 2005 exchange rate) increased by the applicable interest is outstanding from Millennium. In December 2000, the Company brought a claim for the repayment of the loan against Millennium in the District Court in Warsaw. The matter is still pending. In 2001, a valuation allowance of PLN 17.0 million was recorded as other operating expense against the outstanding amount receivable from Millennium as a result of the events described above.

On February 11, 2003, the District Court ruled in the Company's favor for the return of the principal amount of the loan and the related interest. That judgment was appealed by Millennium. Following a question on the matter of law to the Supreme Court, the Court of Appeal announced judgment on October 6, 2004 stating that the District Court made a procedural mistake, which caused the case to be returned for reexamination.

In September 2003, Newman Finance Corp. ("Newman"), Millennium's sole shareholder, filed a claim against the Company for damages of PLN 45.4 million, which is the equivalent of EUR 11.5 million plus interest accrued since the date of filing the claim until the date of payment. This claim was filed for damages incurred when a security was placed over Millennium's shares between January 4, 2000 and November 1, 2002 in connection with litigation concerning Millennium's failure to perform the agreements entered in August and September 2002. On June 8, 2005 the District Court dismissed the claim. The Court determined that Newman neither proved the damage occurrence nor its magnitude. On July 20, 2005, Newman filed an appeal.

On November 7, 2003 Millennium and Genesis Sp. z o.o. ("Genesis"), two shareholders of the Company, filed claims with the Regional Court in Warsaw for the suspension of the registration in the relevant registry of the Company's merger with certain of its subsidiaries pursuant to a resolution adopted by the Company's Extraordinary General Shareholders' Meeting on October 30, 2003. The Regional Court registered the merger in the register of entrepreneurs on December 31, 2003. Also, the court refused to allow Millennium and Genesis to participate in the registration proceedings, which Millennium and Genesis appealed with the District Court in Warsaw on January 12, 2004. On September 7, 2004 the District Court in Warsaw allowed Millennium and Genesis to participate in the registration proceedings. Separate claims were brought by Millennium and Genesis with the District Court in Warsaw requesting the invalidation of the resolution on the Company's merger adopted by the Company's Extraordinary General Shareholders' Meeting on October 30, 2003. The Company received the claims on June 3, 2004 and petitioned the court to dismiss them both as wholly unfounded and also requested that the shareholders make a payment equaling ten times the amount of Netia's court costs. On April 27, 2005 the District Court dismissed both claims on merits. On July 1, 2005 Millennium and Genesis filed an appeal.

On April 5, 2005, Millennium filed a claim against El-Net in connection with the alleged acts of unfair competition of El-Net against Millennium. Millennium sought to prohibit El-Net from submitting offers or other market proposals and conducting any commercial activities in relation to a pool of 30,000 telephone numbers held by El-Net. The claim was delivered to El-Net on May 23, 2005. El-Net filed an answer to the claim on June 6, 2005 in which requested to dismiss the claim as wholly unsubstantiated.

In May 2005, Millennium filed a motion to secure the claim against Netia in connection with the alleged acts of unfair competition of Netia against Millennium. The Court issued a decision on June 20, 2005, in which the claim was secured by an injunction prohibiting Netia from submitting offers or other market proposals and conducting any commercial activities in relation to 30,000 telephone numbers mentioned in preceding paragraph. The decision was delivered to Netia on June 28, 2005, and was appealed on July 5, 2005. The injunction is still in force. Millennium filed a motion against Netia in connection with the claim to which the injunction pertained to. The claim was delivered to Netia on August 24, 2005. Netia filed an answer to the claim on September 7, 2005 in which rejected the claim as wholly groundless and unsubstantiated.

In July 2005, Millennium filed a motion to secure the claim against El-Net for determination that an agreement between El-Net and Millennium concerning provisions of telephone services and the use of the 30,000 telephone numbers by Millennium was not effectively terminated by El-Net. The Court issued a decision on August 8, 2005, in which the claim was secured by an injunction prohibiting El-Net from submitting offers or other market proposals and conducting any commercial activities in relation to those 30,000 telephone numbers. The motion was delivered to El-Net on August 31, 2005, and was appealed by El-Net on September 5, 2005. On August 21, 2005, Millennium filed a motion against El-Net in connection with the claim to which the injunction pertained to. The claim was delivered to El- Net on October 5, 2005. El-Net filed an answer to the claim on October 19, 2005 in which requested to dismiss the claim as wholly unsubstantiated.

Management, having obtained legal advice, does not believe that the settlement of the matters described above will have a material adverse effect on the Netia Group's financial condition. Accordingly no liability has been recorded for the claims.

Minority shareholders

On August 1, 2002, the Company received a copy of a claim filed with the District Court in Warsaw by an individual shareholder demanding the cancellation of sections 10, 11 and 13 of Resolution No. 2 adopted by the Company's General Meeting on April 4, 2002. The individual shareholder claimed that the distribution of the Company's warrants under the financial restructuring was harmful to the minority shareholders and violated good custom. On August 14, 2002, the Company responded requesting the District Court to dismiss the claim. At the court hearing held on February 4, 2004, the District Court in Warsaw decided to forward the claim to the Regional Court for the capital city of Warsaw for its determination. At the hearing held on April 21, 2005 the Regional Court returned the claim due to the plaintiff's failure to comply with the legal claim requirements. On May 19,2005, the minority shareholders filed a complaint regarding this return. In a second similar matter, a minority shareholder's claim was dismissed on merits by the Regional Court in Warsaw. On March 25, 2005, the minority shareholder filed an appeal.

Management, having obtained legal advice, does not believe that the settlement of the matters described above will have a material adverse effect on the Netia Group's financial condition. Accordingly no liability has been recorded for the claims.

7. Factors which may have an impact on the result of the Netia Group

Risk of changes to the Netia Group's strategy

The performed Restructuring has become the basis for developing a strategy which enables the Company to pursue its mid-term and long-term objectives. In May 2003, the Supervisory Board approved the basic aims of the Netia Group's development strategy. The Business Plan was approved by the Supervisory Board in October 2003 and is being executed in accordance with the objectives. However, it is possible that the detailed solutions it includes will be modified and it cannot be predicted whether such changes 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

As a result of the Restructuring, Netia is not controlled by any strategic investors, and its Shares are held by a large number of shareholders. Following the issue of series H shares on December 23, 2002, the share of the pre-Restructuring shareholders in the share capital fell below 10%. Moreover, on May 16, 2003, the pre-Restructuring shareholders obtained subscription warrants entitling them to acquire series J shares. Netia also granted options for series K shares to certain members of the Management Board and officers as part of the stock option plan. Due to decision of the early repayment of the outstanding installment obligations, in March 2005 the Company issued 5,875,610 ordinary series I shares. Additionally, on September 30, 2005 the share and subscription warrant buy-back program was completed. Under the whole Program, the Company acquired in total 27,693,462 of its own shares and 3,569 subscription warrants. If all subscription warrants (not taking under consideration two-year subscription warrants, which expired on April 29, 2005) and all options for shares are used and if all treasury shares are cancelled, series J and series K shares will constitute 20% of the Company's share capital. Consequently, the share of the present shareholders in the share capital of the Company will be reduced. 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 that third parties should acquire a considerable number of the shares. Thus, such changes in control may occur and materially affect the composition of the 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 the newly adopted strategy of the Netia Group will be pursued in accordance with its initial objectives. Furthermore, it is possible that the new shareholders might develop a new strategy that may be materially different to the current one.

Risk connected with the impact of potential future takeovers and acquisitions

One of the basic objectives of the strategy adopted by the Netia Group, which may materially affect its revenues and financial performance, is takeovers or mergers with other entities. Should the Company fail to achieve this aim, it may not be able to produce the planned operating and financial results in the future. Moreover, upon the Company's takeover of another entity, the process of fully integrating this entity may carry high risks, e.g. employment termination by key employees, the loss of a certain segment of its customers or high costs of the entire integration process.

The highly fragmented market of alternative operators rendering wireline telephone services may result in their increasing consolidation within the Polish market. The Company shall evaluate potential takeovers and acquisitions whenever such possibilities should 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 candidates for the takeover, the negotiating of agreements and integration of the entities acquired. The Netia Group may request 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 the acceptance of existing liabilities and the risk of concealed 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. Failures to integrate the acquired entities into the structures of the Netia Group may adversely affect its activity and its financial standing.

Technological risk

The telecommunications sector is an area witnessing dynamic technological changes. In designing and expanding its networks, the Netia Group uses the newest technical solutions. However, what cannot be predicted is how the Netia Group's activity may be affected by technological advances in the field of fixed-line telephony, wireless transmission, and voice transmission protocol via the Internet or cable television telephony. In particular, the activity of the Netia Group may be affected by the tendency to provide telecom services via wireless or portable platforms, with wireless broadband access and third generation mobile cellular telephone systems equipped with the IP. Even if the Netia Group succeeds in adapting its activity to such technological advances, it cannot be guaranteed that other market participants with whom the Netia Group must cooperate will be able to adapt to these changes, at least to the same extent.

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 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 New Telecommunications Law includes provisions compliant with the new package of EU directives in the field of telecommunications, i.e. "Package 2002". The New Telecommunications Law entered into force on September 3, 2004, with the exception of several provisions which shall enter into force on January 1, 2005.

On the basis of the New Telecommunications Law, the President of the URTiP may impose obligations on operators controlling access to subscribers, so as to ensure that end users are able to communicate with users of another telecom provider, including the obligation to interconnect networks. The following obligations may be imposed upon a telecommunications provider which is deemed to have a significant position on one of the telecom markets listed in the resolution of the competent Minister of Telecommunications: the obligation to grant other operators access to the network, especially with regard to its interconnection or mutual use of the local subscriber loop; the obligation to calculate costs and relate the network access tariffs to these calculations; the obligation to maintain regulatory accounts separately for each of the telecom services. The New Telecommunications Law does not define the size of the area in which the market position of a telecommunications provider is evaluated. As a result, the President of the URTiP may name telecommunications providers as having a significant position in a small area, in which even a small telecommunications provider can have a significant market share. This will serve as basis for imposing any other regulatory obligations upon such company, which will have to be proportional to the superior market position of the company, i.e. to the extent that it prevents effective competition on the given telecom market.

Pursuant to the New Telecommunications Law, each public telecommunications network operator is obliged to conduct negotiations concerning interconnection agreements upon another telecom operator's request. However, the President of the URTiP shall be obliged to resolve any disputes between the parties to the negotiations by an administrative decision, which shall replace the relevant agreement only if one of the negotiating parties is a public telecommunications network operator obliged to provide the interconnection.

The New Telecommunications Law states that the obligation to provide universal services shall rest with the operator selected pursuant to a decision of the President of the URTiP issued after a tender procedure. Should no bids for the provision of a universal service or particular sub-services be submitted, the President of the URTiP shall entrust the provision of the universal service to a provider of generally available fixed-line telecom services with a significant market position. Telecommunications providers whose revenues from telecom activity exceed PLN 4,000 thousand will have to co-finance the performance of this obligation, by co-financing the funding of universal services, if the funding has been assigned to the telecommunications provider selected on the basis of the decision of the President of the URTiP. The share in the funding that a telecommunications provider shall be obliged to provide shall also be established by a decision of the President of the URTiP; 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.

The present stage of development of the telecommunications market in Poland does not guarantee that the Netia Group will not be obliged to co-finance the funding of universal services on the terms described above. However, this obligation shall not arise until the end of 2005.

Should no provider of generally available fixed-line telecom services with a significant market share be selected on the basis of the provisions of the New Telecommunications Law, the obligation to provide services shall rest with the provider of the said telecom services having the highest number of subscriber lines within the given area. However, until telecommunications providers obliged to provide a universal service have been selected, the obligation to provide a universal service shall rest with the provider deemed as having a significant position on the market for telephone services in fixed-line telephone networks on the basis of the previous regulations, i.e. TP S.A. This operator shall not be entitled to receive funding on the grounds of providing universal services. Until telecommunications providers obliged to provide a universal service on the basis of the New Telecommunications Law have been selected, the Netia Group shall not be obliged to participate in providing additional payments.

The New Telecommunications Law shall oblige telecommunications providers to pay annual telecommunications fees of up to 0.05 % of the provider's annual revenues from telecommunications activity generated in the financial year 2 years prior to the year to which the annual fee pertains, if the annual revenues exceed PLN 4,000 thousand. The amount, manner of calculation and payment of the fee shall be established by way of a resolution. The amount of the annual telecommunications fee shall constitute a deductible cost as defined by the Act on Corporate Income Tax.

The decisions issued by the President of the URTiP pursuant to the New Telecommunications Law obligate Netia and El-Net to execute subscribers' right to retain their numbers when changing operators as from January 1, 2006. Despite Netia and El-Net's preparations to be able to perform this obligation and arrangements with other telecommunication operators, the Management Board cannot guarantee that it will be possible enter into an agreement with each of them to define the terms and conditions of cooperation between the parties to the extent required to execute the subscribers' rights to retain his/her number as from January 1, 2006.

Dependence of the Company on TP S.A. due to interconnections

The provision of telecommunications services by the Netia Group is dependent on access to the telephone network of TP S.A. With several exceptions, telephone calls initiated in the Netia and El-Net network and terminating beyond it, including most international and domestic long-distance calls of Netia subscribers, are, due to technical reasons, performed via the network of TP S.A. Pursuant to the New Telecommunications Law, TP S.A. is obliged to interconnect telecom providers such as Netia and El-Net with its network. Operating subsidiaries of the Netia Group, of whom Netia is a legal successor, and El-Net concluded interconnection agreements with TP S.A. for each area in which Netia conducts telecommunications activity on the basis of its telecommunications permit.

However, the delays and difficulties that arose in the past in relation to concluding interconnection agreements with TP S.A. led to Netia postponing commencement of commercial activity in certain areas. Problems also appeared in connection with the conclusion of an interconnection agreement with TP S.A. concerning the provision of domestic long-distance calls by Netia. In addition, TP S.A. currently fails to fully execute the decisions of the President of the URTiP concerning interconnection tariff settlements in the field of interconnecting Internet access of the "0-20" type. Further difficulties or delays related to the establishment of interconnections with TP S.A. may limit Netia's capacity to provide these telecommunications services and materially and adversely affect its business activity.

On January 31, 2006 the agreement between Netia and TP S.A. on cooperation and settlements for Netia's additional-fee services on 0-708 numbers dated January 9, 2003 might be terminated. Despite TP S.A.'s obligation under the New Telecommunications Law to ensure telecommunication access and provide end users connected to its network with connections to non-geographical numbers in the territory of Poland, including 0-708 numbers, in Netia's network, the Management Board cannot guarantee that continuity of such services will be ensured by entering into a new agreement with TP S.A. before the termination of the agreement of January 9, 2003.

Netia filed a motion with the President of the Consumer and Competition Protection Office (UOKiK) to institute anti-monopoly proceedings in connection with TP S.A.'s practices limiting competition involving preventing access to the network and imposing an onerous contractual condition that made it possible for Netia S.A. to provide audiotext services on 0-708 numbers and a motion to issue a provisional injunction obligating TP S.A. not to raise charges for calls to 0-708 1xx xx numbers until the final decision closing the proceedings in this matter is issued. On October 3, 2005 the President of the UOKiK issued decision No. DOK2-411-10/05/MKK on instituting anti-monopoly proceedings against TP S.A. and on October 10, 2005 decision No. UOKiK DOK-127/05 obligating TP S.A. not to charge fees for calls to 0-708 1xx xx numbers in the gross amount of PLN 0.71 per minute, according to TP S.A.'s pricelist prevailing as at October 1, 2005 [...] until March 10, 2006. Although the President of the UOKiK issued a provisional decision according to Netia's motion, the Management Board cannot guarantee that the anti-monopoly proceedings instituted by the President of the UOKiK will be closed with a decision obligating TP S.A. to restore access to the network and not to impose the contractual condition that makes it impossible for Netia S.A. to provide audiotext services on 0-708 numbers.

On November 7, 2005 Netia moved to the District Court in Warsaw for securing the claims resulting from the agreement concluded by Netia and TP S.A. on January 9, 2003, by ordering TP S.A. to perform the agreement until a legally binding decision in the case regarding Netia's main claim is issued. Although in Netia's opinion there are justified grounds for the court to issue a decision on securing the company's claims, the Management Board cannot guarantee that the court will issue a judgment according to Netia's demand.

On December 31, 2004 TP S.A. filed a motion to the President of the URTiP for a decision on telecommunication access defining the terms and conditions of cooperation regarding network interconnection between TP S.A. and Netia, pursuant to the "TP S.A.'s framework network interconnection offer" approved by the President of the URTiP in its decision of March 5, 2004. On February 3, 2005 TP S.A. filed a motion to the President of the URTiP to ascertain the expiry of the Regulator's decision dated October 18, 2002 in the matter of amending the network interconnection agreement concluded on May 18, 2001 between TP S.A. and Netia.

Considering TP S.A.'s stance, which was the basis of TP S.A.'s claims in the aforementioned proceedings, on April 20, 2005 Netia filed a claim to the court to ascertain the existence of a legal relationship between Netia and TP S.A. resulting from the network interconnection agreements concluded by the parties. As it was necessary to resolve the preliminary question, i.e. a common court had to issue a ruling in the case filed by Netia, on April 29, 2005 Netia applied to the President of the URTiP to suspend the proceedings instituted on the basis of TP S.A.'s motion to issue a decision replacing the telecommunication access agreement with regard to network interconnection with Netia. In its decision of July 28, 2005 the President of the URTiP suspended *ex officio* the proceedings instituted on TP S.A.'s motion until the common court issues a ruling on ascertaining the existence of a legal relationship between Netia and TP S.A. on the basis of network interconnection agreements concluded by the parties. On August 10, 2005 TP S.A. filed a motion with the President of the URTiP to reexamine the case closed with the decision of the President of the URTiP issued on July 28, 2005. Although the premises for suspending the arbitration proceedings before the President of the URTiP remain valid, the Management Board cannot guarantee that the President of the URTiP will uphold the decision issued in this matter. Netia's motion to suspend the arbitration proceedings was attached by the President of the URTiP to the files of the case instituted on the motion of TP S.A. to ascertain the expiry of the decision dated October 18, 2002. In its decision of August 8, 2005 the President of the URTiP suspended *ex officio* also the proceedings instituted on the motion of TP S.A. until the common court issues a ruling on ascertaining the existence of a legal relationship between Netia and TP S.A. on the basis of the network interconnection agreements concluded by the parties. On August 22, 2005 TP S.A. filed to the President of the URTiP a motion to reexamine the case closed with the decision of the President of the URTiP dated August 8, 2005. Although the premises for suspending the arbitration proceedings before the President of the URTiP remain valid, the Management Board cannot guarantee that the President of the URTiP will uphold the decision issued in this matter.

Despite the verdict of the Provincial Administrative Court (Wojewódzki Sąd Administracyjny) to overrule the decision of the President of the URTiP approving TP S.A.'s offer and unjustified, in Netia's opinion, claims and charges raised by TP S.A. in the cassation appeal filed with the Supreme Administrative Court (Naczelny Sąd Administracyjny), the Management Board cannot guarantee that the President of the URTiP will refuse to issue a decision according to TP S.A.'s motions.

In 2002 TP S.A. applied to El-Net for amending the network interconnection agreement of December 3, 1999 defining the terms and conditions of the cooperation between the parties in the Warsaw numbering zone. As it was impossible to agree on a common stance in this matter through negotiations, on August 7, 2003 TP S.A. applied to the President of the URTiP for a decision replacing the network interconnection agreement. In its decision of June 25, 2004 the President of the URTiP refused to accept TP S.A.'s motion. TP S.A. sued the decision of the President of the URTiP to the Competition and Consumer Protection Court. Although, in the Company's opinion, the claims raised by TP S.A. are unjustified, the Management Board cannot guarantee that the decision of the President of the URTiP will be upheld.

On April 28, 2005 El-Net received from TP S.A. notices terminating the agreements concluded with the company of December 3, 1999 defining the terms and conditions of cooperation of the parties in the Warsaw numbering zone, of May 27, 1997 defining the terms and conditions of cooperation of the parties in the Bydgoszcz numbering zone, of June 17, 1999 defining the terms and conditions of cooperation of the parties in the Słupsk numbering zone, and of June 17, 1999 defining the terms and conditions of cooperation of the parties in the Koszalin numbering zone. Finding TP S.A.'s termination of the agreements illegal, El-Net applied to the District Court in Warsaw for securing the claims resulting from the said agreements. Pursuant to El-Net's motion, in its decision of July 4, 2005 the District Court in Warsaw gave El-Net an injunction, ordering TP S.A. to perform, and prohibiting it from terminating, the network interconnection agreements, until a legally binding decision is issued in the case regarding El-Net's main claim. On July 15, 2005 TP S.A. filed an appeal against the injunction decision of the District Court in Warsaw. In the Management Board's opinion, TP S.A.'s charges are unjustified from legal perspective, however the Management Board cannot guarantee that the court of appeal will issue a verdict as a result of which the injunction decision will be upheld.

On June 19, 2005 El-Net filed a claim with the District Court in Warsaw to order TP S.A. to perform concluded network interconnection agreements, to maintain telecommunication access to the TP S.A. network stipulated therein and to abandon the act of unfair competition hindering RST El Net's access to the market by terminating and failing to perform the agreements concluded with the Company. Despite its firm belief that the claims pursued are justified, the Management Board cannot guarantee that the Court will issue a decision as demanded in the claim filed by El-Net.

In September 2001, the President of the URTiP issued a decision deeming TP S.A. a dominant operator on the market for telephone services provided in fixed-line telephone networks. Originally, TP S.A. appealed against this decision before the Antimonopoly Court. However, it withdrew the appeal in May 2002, following the cancellation by the President of the URTiP of the fine imposed upon TP S.A. amounting to PLN 30,000 thousand for the non-fulfillment of the decision of the Minister of Telecommunications of December 15, 2002 establishing the detailed terms of cooperation and settlements between TP S.A. and Niezależny Operator Międzystrefowy Sp. z o.o., and a fine of PLN 50,000 thousand for submitting incorrect information to the President of the URTiP concerning the revenues of TP S.A. from leased lines, necessary for evaluating the market position of TP S.A. With reference to the decision of the President of the URTiP which deemed TP S.A. a dominant operator, TP S.A. was obliged to submit for the approval of the President of the URTiP framework offers defining the terms on which TP S.A. would conclude interconnection and lease-line agreements with other operators (Framework Agreements). Since October 1, 2003, TP S.A. has also been obliged to prepare and submit for the approval of the President of the URTiP an offer defining the framework terms of agreements on access to local subscriber loops. On June 18, 2003, the President of the URTiP rejected the drafts of four framework offers concerning the terms of interconnection agreements submitted by TP S.A. On May 20, 2003, another draft framework offer of TP S.A. defining the terms of network interconnection agreements was rejected for procedural reasons, because TP S.A. had not withdrawn its complaint filed at the Supreme Administrative Court concerning the decision of the President of the URTiP on the rejection of the previous draft framework interconnection offers of TP S.A. The President of the URTiP has declared that the procedure concerning the approval of the previous draft framework offers is still in progress and that no applications to approve the new draft framework offers may be made until a decision in this case has been issued by the Supreme Administrative Court or until TP S.A has withdrawn the complaint. Other draft framework offers have been rejected by the President of the URTiP because they include numerous references to the draft framework interconnection offer, so that the remaining three draft framework offers could not function independently. The President of the URTiP has also deemed the presented draft framework offers as inconsistent with the provisions of the Telecommunications Law, in particular due to: the lack of justification for using different tariffs for various types of operators; the incorrect classification of services; restricting the permitted interconnections to types of services specified in the framework offers; restricting the operators using the framework offers to operators offering local, domestic long-distance, international long-distance and cellular telephone services; introducing the requirement for other operators to provide a minimum transit traffic volume and charging additional fees for traffic below this volume. Upon the approval of the framework offers of TP S.A., the terms of agreements presented by TP S.A. to other operators should not be less favorable than the terms defined in the framework offers. Moreover, each agreement should be negotiated separately. Should the parties fail to reach an agreement on the terms of interconnection, the President of the URTiP may establish the terms of such an agreement by way of an administrative decision. As a result of changes in the New Telecommunications Law, the notion of an operator with a dominant position is not used anymore and TP S.A. is now classified as an operator with a significant market share. Nevertheless, its obligations described above have not changed. Pursuant to the temporary provisions of the New Telecommunications Law, the aforementioned obligations of TP S.A. will remain in force until the President of the URTiP issues a decision selecting a telecom operator with a significant market share on the relevant market, or imposing the regulatory obligations specified in the New Telecommunications Law upon it.

On January 5, 2004, TP S.A. submitted another draft offer to the President of the URTiP defining framework terms of interconnection agreements, replaced by the draft of February 3, 2004. The KIGEiT (Polish Chamber of Commerce for Electronics and Telecommunications), of which Netia is a member, was admitted to the said proceedings and submitted comments concerning the draft offer. It moved for the rejection of the draft offer as it was inconsistent with the provisions of law, did not allow for current market and economic conditions and did not ensure effective competition. Despite the reservations voiced by KIGEiT in the course of the proceedings, by virtue of the decision of March 5, 2004, the President of the URTiP approved "the Framework Offer of TP S.A. concerning Interconnections". On March 23, 2004, KIGEiT filed an accusation against the aforementioned decision by moving for its reconsideration. KIGEiT claimed that the decision on the approval of the offer was issued in breach of the provisions of administrative procedure and material law, in particular the Telecommunications Law.

By virtue of a decision of June 30, 2004 the President of the URTiP upheld the decision on the approval of TP S.A.'s offer. On August 4, 2004, the KIGEiT challenged the decision of the President of the URTiP with the Provincial Administrative Court in Warsaw. In its verdict of July 12, 2005 the Provincial Administrative Court in Warsaw overruled the decision of the President of the URTiP on approving TP S.A.'s offer. TP S.A., as a party to the proceedings before the Provincial Administrative Court, filed a cassation appeal to the Supreme Administrative Court. As at the date of signing the consolidated financial statements, the Supreme Administrative Court has not issued a verdict regarding the complaint submitted by TP S.A. Despite ascertaining the legal defect of the decision issued by the President of the URTiP on approving TP S.A.'s offer, the Management Board cannot guarantee that the Supreme Administrative Court will issue a decision as a result of which the ruling of the Provincial Administrative Court will be upheld.

Due to fact that for the duration of the proceedings pending before the Provincial Administrative Court, this court, as well as the Supreme Administrative Court – after reviewing KIGEiT's complaint of November 29, 2004 – refused to suspend the execution of the decision of the President of the URTiP, until the verdict to overrule them, the terms of the network interconnection agreements laid down in the offer constituted TP S.A's negotiation position in the negotiations of the network interconnection agreement. Pursuant to the law TP S.A. is not obligated to offer to operators requesting interconnection contractual terms that are more advantageous than the ones laid down in the offer approved by the President of the URTiP.

In the verdict on overruling the decision of the President of the URTiP the Provincial Administrative Court did not share KIGEiT's stance regarding the alleged failure to set the rates for the services provided by TP S.A. in interconnected networks according to the provisions of the Telecommunication Law. Hence, the Management Board cannot ensure that these rates in TP S.A.'s new offer will be lower than envisaged in the offer approved by the decisions of the President of the URTiP that have been overruled. Agreements concluded on the basis of TP S.A.'s new offer may envisage fees for exchange of services in interconnected operator networks that are higher than those applicable pursuant to the arbitration decisions of the President of the URTiP. In the case the Company concludes a new interconnection agreement with TP S.A., these higher fees could be set off by introducing the so-called asymmetrical rates in favor of the Company. On the basis of applicable provisions this is justified as Netia, in contrast to TP S.A., does not have the obligation to set cost-based rates for traffic in interconnected networks. So far, issuing decisions setting the terms of interconnection agreements, the President of the URTiP applied only symmetrical rates. The Management Board cannot guarantee that the practice applied by the President of the URTiP to date will be changed, even considering the fact that at least one of independent operators managed to negotiate asymmetrical rates in its agreements.

Pursuant to the New Telecommunications Law, as well as the provisions of the act amending the Telecommunications Law, which entered into force in October 2003, the President of the URTiP is guaranteed the right to influence the content of framework offers, including the right to change interconnection fees, including the right to adapt the same to legal requirements, i.e. according to the so-called cost principle. In case the affected operator submits a draft framework offer on telecommunications access that is not compliant with the provisions of law and the needs of the market indicated by the President of the URTiP, the New Telecommunications Law obliges the regulator to change such draft framework offer and approve the same and, in case the affected operator does not submit the framework offer within the prescribed deadline, to determine its contents. By virtue of those rights, the President of the URTIP is conducting proceedings aimed at determining the contents of the framework offer of TP S.A. concerning the co-use of certain infrastructure. The KIGEiT, of which Netia is a member, is participating in the proceedings as a party.

On February 28, 2005 the President of the URTiP issued a decision on introducing *ex officio* an offer to be applied by TP S.A. in agreements with other operators that defined framework terms of agreements on access to local subscriber loop in the portion pertaining to full and shared access to the loop. Pursuant to the justification thereof, the decision is a partial solution. The offer should also comprise provisions pertaining to ensuring broadband access to TP S.A.'s telecommunication network nodes, the so-called bit-stream access.
Pursuant to the transitional provisions of the New Telecommunication Law, these proceedings are pending according to the procedure set out in the provisions of the previous act.

Considering the fact that in the decision of February 28, 2005, the President of the URTiP did not take into account certain material elements of KIGEiT's stance presented in the proceedings preceding the issuance of the decision, the Chamber filed a motion of March 14, 2005 to reexamine the case. The decision on introducing TP S.A.'s offer defining the framework terms of agreements on shared and full access to the local subscriber loop was challenged by TP S.A. in its letter of March 14, 2005. In its decision of August 9, 2005 the President of the URTiP overruled in full the decision of February 28, 2005 and introduced TP S.A.'s offer defining framework conditions of agreements on shared and full access to a local subscriber loop in a new wording. Also in this ruling the President of the URTiP did not take into account the charges raised by KIGEiT in the motion to reexamine the case. On September 9, 2005 KIGEiT appealed against the decision of the President of the URTiP to the Provincial Administrative Court. The decision of the President of the URTiP was also sued by TP S.A. As at the date of signing the consolidated financial statements the Supreme Administrative Court has not issued a ruling in this matter and the Management Board cannot guarantee that the ruling will take into account the charges raised by KIGEiT in its complaint. However TP S.A.'s offer introduced by virtue of the decision of the President of the URTiP is subject to execution due to the immediate enforceability order awarded to it.

On September 2, 2004, the President of the URTiP initiated proceedings ex officio aimed at determining the contents of the framework offer of TP S.A. concerning the access to the local subscriber loop. On August 9, 2005 the President of the URTiP issued a decision on introducing a „framework offer defining the terms for Telekomunikacja Polska S.A. to conclude telecommunication line lease agreements with other operators". Due to the fact that in the decision of August 9, 2005 the President of the URTiP did not take into account certain material elements of KIGEiT's stance presented during the proceedings preceding the issuance of the decision, on August 19, 2005 the Chamber filed a motion to reexamine the case. Under the temporary provisions of the New Telecommunications Law, these proceedings are conducted in accordance with the rules set forth in the previous version of that law. The KIGEiT, of which Netia is a member, is participating also in these proceedings as a party.

A significant rise in the fees that the Netia Group will be obliged to pay by virtue of future interconnection agreements (excluding renewable agreements), or the failure to decrease interconnection fees in the event of a possible reduction of telephone charges for Individual Customers, may result in its achieving lower margins or the inability to offer telephone services at competitive prices. Moreover, the interconnection fees that Netia is obliged to pay for international or domestic long-distance calls via the network of TP S.A. are computed on the basis of relevant TP S.A. tariffs and not the prices that Netia's own customers are charged. Therefore, the change in Netia rates without an analogous change in TP S.A. tariffs may adversely affect Netia's financial performance.

Risk of increased competition

The Netia Group's main competitors in the field of telephone services are TP S.A. and cellular network operators, and in some geographic areas also other operators providing wireline telephone services. Within the unregulated market for data transmission services, the main competitors are numerous providers of various sizes, the most significant of which is TP S.A. Poland has witnessed a considerable increase in competition, which, as can be expected, will intensify even further, considering that since January 2002, every operator meeting the minimum requirements set forth in the Telecommunications Law has been able to obtain a telecommunications permit for the provision of telecom services. Pursuant to the New Telecommunications Law, every telecommunications provider may pursue telecommunications activity on the basis of its entry into the Register of Telecommunications Providers kept by the President of the URTiP. Netia is unable to evaluate the extent to which new market participants will use the availability of such rights, particularly with regard to the significantly lower costs of entering the market than those incurred by the Netia Group. The Warsaw market will probably continue to witness intense competition for customers. The Management Board is unable to evaluate the extent to which the intensification of competition will affect the Netia Group's activity.

Competition from TP S.A.

TP S.A. 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 and indirectly, through its dependent entity where it holds a majority stake, on the cellular telephone market. Within the scope of wireline telephone services, the Netia Group encounters competition from TP S.A. in all geographic areas it operates in. TP S.A. is a much larger entity than the Netia Group and possesses much wider backbone and access networks. It enjoys long-established relationships with many customers that the Netia Group considers as its target customers, including many companies operating on the territory of the Netia Group's operation. The infrastructure used by TP S.A. in these territories is comparable to the infrastructure of the Netia Group in terms of the technologies employed.

Moreover, until the end of 2002, TP S.A. had the exclusive right to provide international long-distance calls in Poland and 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 S.A. 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 Board expects that TP S.A. will compete with the Netia Group for prices and 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 Board expects that TP S.A. will maintain a strong competitive position against the Netia Group on the 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 S.A. will materially and adversely affect the revenues of the Netia Group and the results of its operating activity.

TP S.A. owns most local loops and offers 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. Even though the New Telecommunications Law provides a basis for the President of the URTiP to oblige operators with a dominant market share to enable other enterprises to use its network on equal terms, in many cases the Netia Group is unable to negotiate satisfactory terms with TP S.A. It cannot be guaranteed that the Netia Group will be able to expand its network to urban areas, where TP SA's extensive telecommunications infrastructure already exists, unless the President of the URTiP should issue relevant decisions, and the principles of interconnecting other operators to the local loop are regulated.

Pursuant to the Telecommunications Law, since January 1, 2003, operators other than TP S.A. have also obtained permits to provide international telecom services, at a cost of EUR 2,500 per permit. The plans of the Netia Group allow for projected revenues arising from its activity on the International Calls market. The ability to provide such services is dependent on ensuring the necessary infrastructure and executing the terms of interconnection agreements with TP S.A.

As TP S.A. occupies a leading position on the telecommunications market in Poland and the Netia Group's areas of activity are usually different from those of other independent operators, all indirect subscribers of the Netia Group that use its domestic long-distance telephone services are subscribers of TP S.A. So far, TP S.A. has refused to issue invoices to its subscribers using long-term telephone services via Netia, which forces the Netia Group to conclude separate agreements with such customers and issue separate invoices. This inconvenience discourages many potential users of the indirect services rendered by the Netia Group as part of their domestic long-distance telephone services, which, consequently, results in a decrease of potential revenues. Moreover, the necessity to conclude separate agreements and issue separate invoices entails additional costs. This situation may continue.

Competition from other independent operators

Before the Telecommunications Law entered into force on January 1, 2001, the Minister of Telecommunications granted licenses for the provision of local telecom services within a given geographic area (usually within a given number zone) to one private operator (apart from TP S.A.). With regard to the system of telecommunications permits issued on the basis of the said Law, since January 1, 2002, obtaining licenses has entailed much higher costs. As a result of the fact that obtaining a permit is significantly cheaper than obtaining a license, and the fact that the lengthy process of obtaining a license has been eliminated, many new operators have obtained such permits. Pursuant to the New Telecommunications Law, telecommunications activity may be pursued on the basis of an entry in the Register of Telecommunications Providers kept by the President of the URTiP. Therefore, the Netia Group expects the number of operators active in the areas it conducts its activities to increase. In 2003 there was a swap of license fee liabilities of the then-operating subsidiaries of the Netia Group, and in the case of the fees El-Net was obliged to pay, necessary measures were introduced to enable their swap for investment outlays. However, it cannot be guaranteed that the Netia Group will not be forced to pay these fees in the future, which may give new market participants certain advantage over the Netia Group.

In some areas where the Netia Group operates, there are large institutions with their own internal telecommunications networks (where the users of the telecom services of such institutions include, additionally, the inhabitants of the given area), which reduces the potential revenues that the Netia Group could generate in these areas, and such operators may be a potential source of competition in the future.

Competition from cellular mobile telephone operators

Cellular telephony services have recently been deemed as competitive to the services of wireless telephone operators. This can be explained by the increased price competition from cellular network operators, which then lowered their rates in relation to operators of wireline telephone services that continue to balance their tariffs. Moreover, the offer of cellular telephone operators includes, among others, tariff plans based on a system of prepayments for calls made, without additional subscription fees. These operators have entered into interconnection agreements with TP S.A. on terms more favorable than for operators of wireline telephone services. Additionally, in the light of Polish law, mobile cellular telephone services are not universal services. Therefore, mobile cellular telephone operators are not obliged to provide services to all customers wishing to use these services.

Due to resolution of the tender for the UMTS frequency P4, Netia Group’s affiliated company, intends to start providing mobile telephony services. There are additional risks pertaining to conducting this type of activity. The main risk is related to the significant saturation of the mobile telephony market and the fact that the existing operators have a well-developed radio network and customer base. Also, in the nearest future a tender for GSM frequencies will be invited, which may additionally increase the number of operators. In addition there is a risk that mobile virtual network operators (MVNO) will appear. The pace of network development and the possibility of accessing the networks of existing operators under domestic roaming constitute important risk elements. The total value of the Netia Group’s investment is limited to EUR 90 million. The expected benefits for the Netia Group include exclusivity for direct distribution of P4 products and the related revenues, the possibility of providing outsourcing services for P4, development of a convergent offer generating additional revenues, and limiting loss of fixed-line telephony clients, and guaranteed access to mobile telephony products while P4 has the license.

Other sources of competition

The Netia Group also encounters competition in the field of voice services from companies offering alternative forms of such services, e.g. cable network services. Moreover, in the course of the development of the data transmission and internet services, the competition from numerous providers of such services is increasing, especially with regard to voice transmission technologies via the Internet, including providers that use the broadband ADSL access. The future impact of the competition from providers of said services on the activity of the Netia Group cannot be estimated.

Market consolidation

The highly fragmented market of alternative operators rendering wireline telephone services may result in their increasing consolidation within the Polish market. In its pursuit of one of the objectives of the approved strategy, that is, the acquisitions of other entities, the Netia Group does not dismiss any methods of consolidation, and it is possible that it will continue to participate in mergers with competitors. However, the Netia Group’s role in the consolidation process may be insignificant, in particular if no additional funding can be obtained. The Management Board is unable to describe the impact of such consolidation on the financial standing of the Netia Group and its impact on the shareholders of Company.