☐ - restated

POLISH FINANCIAL SUPERVISION AUTHORITY

Annual report R for the year 2010

(year)

(according to par. 82 s. 1 pkt 3 of the Decree of Minister of Finance dated 19 February 2009 - Journal of Laws No. 33, item 259)
for the issuers in sectors of production, construction, trade or services

for the **year 2010**, i.e. from **1 January 2010 to 31 December 2010**

including, separate financial statements prepared under: **International Financial Reporting Standards**
in currency: **PLN**

date of issuance: **23 February 2011**

TELEKOMUNIKACJA POLSKA SA
(full name of issuer)

TPSA (abbreviated name of the issuer)

Telecommunication (tel) (classification according to WSE / sector)

00-105 (post code)

Warsaw (location)

Twarda (street)

18 (number)

22 527 23 23 (telephone)

22 527 23 41 (fax)

investor.relations@telekomunikacja.pl (e-mail)

telekomunikacja.pl (www)

526-02-50-995 (NIP)

012100784 (REGON)

Deloitte Audyt Sp. z o.o.
(auditor)

SELECTED FINANCIAL DATA	PLN '000		EUR '000	
	year / 2010	year / 2009	year / 2010	year / 2009
I. Revenue	8 434 000	9 291 000	2 106 183	2 140 487
II. Operating income/(loss)	(258 000)	1 149 000	(64 429)	264 710
III. Profit before income tax	1 147 000	3 474 000	286 435	800 350
IV. Net income	1 023 000	3 357 000	255 469	773 395
V. Earnings per share (in PLN/EUR) (basic and diluted)	0.77	2.51	0.19	0.58
VI. Weighted average number of shares (in millions) (basic and diluted)	1 336	1 336	1 336	1 336
VII. Total comprehensive income	1 003 000	3 377 000	250 474	778 003
VIII. Net cash provided by operating activities	4 380 000	6 305 000	1 093 797	1 452 564
IX. Net cash used in investing activities	(1 075 000)	(1 639 000)	(268 455)	(377 598)
X. Net cash used in financing activities	(3 033 000)	(3 719 000)	(757 417)	(856 794)
XI. Total net change in cash and cash equivalents	272 000	945 000	67 925	217 712
	Balance as at 31/12/2010	**Balance as at 31/12/2009**	**Balance as at 31/12/2010**	**Balance as at 31/12/2009**
XII. Total current assets	3 658 000	3 297 000	923 667	802 541
XIII. Total non-current assets	24 959 000	25 906 000	6 302 300	6 305 925
XIV. Total assets	28 617 000	29 203 000	7 225 968	7 108 466
XV. Total current liabilities	7 420 000	5 208 000	1 873 595	1 267 708
XVI. Total non-current liabilities	8 297 000	10 099 000	2 095 043	2 458 254
XVII. Total equity	12 900 000	13 896 000	3 257 329	3 382 503
XVIII. Share capital	4 007 000	4 007 000	1 011 792	975 366

The balance sheet data as at 31 December 2010 and 2009 presented in the table "Selected financial data" was translated into Euro at the average exchange rate of the National Bank of Poland on the balance sheet dates. The income statement data, together with the statement of comprehensive income and statement of cash flows data for the years ended 31 December 2010 and 2009, were translated into Euro at an exchange rate which is the arithmetical average of the average NBP rates published by the NBP on the last day of each month of years ended 31 December 2010 and 2009.

The exchange rates used in translation of balance sheet, income statement, statement of comprehensive income and cash flow data are presented below:

1 Euro	31 December 2010	31 December 2009
Balance Sheet	3.9603 PLN	4.1082 PLN
Income statement, Comprehensive income, Cash Flow data	4.0044 PLN	4.3406 PLN

Dear Shareholders,

2010 has been a year of steady and consistent progress for TP Group. We began the year by sharing with you our medium term action plan, based on three pillars: re-focus on core business, re-engage with customers, and re-balance the operating model. I am pleased to say that the company has risen to these challenges. We have made meaningful progress in every field of activity, and in each successive quarter.

This progress translates into concrete results. We were able to meet or exceed our 2010 guidance, delivering more than PLN 2.4 billion net free cash flow, at the same time as laying the foundations for a real turnaround in 2011. Meeting our cash flow objectives once again allows us to offer attractive returns to our shareholders with a cash dividend per share of PLN1.5 – a level of return in the top tier of European telco stocks.

Regulatory breakthroughs

By far the biggest change to TP Group's competitive landscape in 2010 was brought about by the Polish Regulator's decision to remove the direct link between TP's wholesale and retail broadband prices. Now, the regulator's intervention is limited to ensuring that TP's retail prices are not predatory towards alternative operators. As the country's major supplier of wholesale data services, TP Group was seriously hampered by the previous system, which calculated the wholesale price on a "retail minus" basis and made it very hard for TP's retail broadband services to compete on price. The change to the regulations has allowed us to re-engage with the market on a level playing field.

The new, more stable and predictable regulatory environment has not just made us more competitive. It has also helped create the right conditions for us to re-focus on core business, and to make the necessary investments to support a new generation of high-speed data services. These developments benefit the whole of the Polish telecoms market, and more importantly the Polish consumer.

Regaining momentum in key markets

Our commercial performance across the Group has been solid. In mobile, four consecutive quarters of growth in the Orange customer base were accompanied by a return to revenue growth in 4Q. A new customer segmentation philosophy – based on usage patterns rather than spend – stimulated usage, boosted customer adds and helped us to regain the number 1 position in the market. And in broadband, we have worked hard on revamping our offer, with the result that we were able to reverse the downward trend, seeing the first signs of a turnaround in 4Q when we added 17,000 new customers.

Improving revenue trends

After a very tough couple of years, 2010 was characterized by steady improvement in our top line. We started the year with a decline of 10.2% in 1Q, and by 4Q we had reduced it to around -1.2% in the quarter. Full year revenue erosion was limited to 5.1%, compared to 8.8% in 2009. This vindicates our decision to focus on our core business and concentrate on establishing a sustainable leadership position in our key markets.

Robust cost saving plans implemented

We are now fully embarked on the cost saving initiatives that form a key part of our strategy to re-balance our operating model and make TP Group into a leaner and more agile business. Already, these initiatives have delivered almost half a billion zloty of savings, bringing our cost base down by almost 4%[1] versus 2009. These measures have helped us to defend our EBITDA margin at a level of 36.7[2]%.

Looking ahead

2010 was the year that TP got back into the driving seat. Our disciplined execution of the medium term action plan enabled us to regain commercial momentum and stabilize profitability while delivering on all our promises to shareholders. But we are not relaxing our effort one bit. We believe that this turnaround in the company's performance will really take off in 2011.

In 2010 we took our first steps on a number of projects which will be key to TP Group's future: a landmark deal was initiated with TVN, to offer the best bundled home entertainment packages in Poland; a potential network-

[1] costs up to EBITDA, excluding revision of the provisions for claims and litigations
[2] excluding the PLN 1.1 bn revision of provision for the dispute with DPTG, recorded in 3Q 2010

sharing project with ERA that will reap benefits for years to come; and sponsorship for Orange at the Euro 2012 Games. These projects will continue to demand energy and commitment from TP Group in the coming years.

For our mobile customers, 2011 will be the year of the smartphone: affordable Android based handsets will support a step-change in the use of mobile data services. And continued investment in our network will allow us to speed things up for everyone: mobile customers will benefit from faster data transmission thanks to the HSPA2+ roll-out, while the launch of VDSL 'fibre to the curb' will bring fixed line broadband speeds up to 40Mb/s and more.

In addition, I have just launched an exciting company-wide program that will focus the entire organization around customer excellence. Called "misja klient" – "mission customer" – it will significantly improve the way TP Group does business, taking us to the best-in-class customer service. The renewed focus on our customers should be visible not only in the products and services we offer, but also in the way we sell and deliver those products and the customer service that follows. Within the next 18 months, customer relations will become the differentiating factor for TP Group in the Polish market.

These projects will secure our future growth, but they will require investment. It is therefore essential that we continue to show discipline as we follow our medium term action plan. In 2011 and beyond, TP Group will stay focused on cutting costs, increasing efficiency and maintaining healthy cash generation.

I am proud of the way the people who make up TP Group have risen to the challenges we set ourselves in 2010. On behalf of the whole management team, I thank them for their dedication to our company. Looking back on our progress this past year, I have total confidence that we can continue to achieve all that we have set out to do in 2011 and beyond.

Maciej Witucki
President of the Board and CEO
Telekomunikacja Polska

AUDITOR'S OPINION

To the Shareholders and Supervisory Board of Telekomunikacja Polska S.A.

We have audited the attached financial statements of Telekomunikacja Polska S.A. with its registered office in Warsaw at Twarda 18 St. ("TP S.A.", "the Company"), which comprise balance sheet prepared as of 31 December 2010, income statement, statement of comprehensive income, statement of changes in equity, statement of cash flows for the financial year from 1 January 2010 to 31 December 2010 and notes comprising a summary of significant accounting policies and other explanatory information.

Preparation of financial statements and a report on the activities in line with the law is the responsibility of the Management Board of the Company.

The Management Board of the Company and members of its Supervisory Board are obliged to ensure that the financial statements and the report on the activities meet the requirements of the Accounting Act of 29 September 1994 (Journal of Laws of 2009, No. 152, item 1223, as amended), hereinafter referred to as the "Accounting Act".

Our responsibility was to audit and express an opinion on compliance of the financial statements with the accounting principles (policy) adopted by the Company, express an opinion whether the financial statements present fairly and clearly, in all material respects, the financial and economic position as well as the financial result of the Company and an opinion on the correctness of the underlying accounting records.

Our audit of the financial statements has been planned and performed in accordance with:

- section 7 of the Accounting Act,
- national auditing standards, issued by the National Council of Statutory Auditors in Poland and
- International Standards on Auditing.

We have planned and performed our audit of the financial statements in such a way as to obtain reasonable assurance to express an opinion on the financial statements. Our audit included, in particular, verification of the correctness of the accounting principles (policy) and material estimates applied by the Company, verification – largely on a test basis – of the accounting evidence and records supporting the amounts and disclosures in the financial statements, as well as overall evaluation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the audited financial statements in all material respects:

- present fairly and clearly the information material to evaluate the economic and financial position of the Company as of 31 December 2010 as well as its profit or loss in the financial year ended 31 December 2010,
- have been prepared in accordance with the International Accounting Standards, International Financial Reporting Standards and related interpretations published as Commission regulations, and in all matters not regulated in the standards – in accordance with the provisions of the Accounting Act, secondary legislation to the Act and based on properly kept accounting records,
- comply with the provisions of law and the articles of association of the Company which affect the contents of the financial statements.

Without qualifying our audit opinion, we draw attention to the following matter:

As more fully explained in explanatory note 29 to the attached financial statements, the Company is involved in a number of legal, arbitration and administrative proceedings. Any costs that may result from these proceedings are provided for when they become probable and when the amount may be reliably quantified. The amount of any provision is based on an assessment of the risk level in each case and represents the Company's best estimate of the amounts that are more likely than not to be payable. Occurrence of events during the proceedings, the outcome of which is uncertain, may lead to re-assessment of the risk and as a consequence the amount of the provisions may change.

The Report on the activities of the Company for the financial year 2010 is complete within the meaning of Article 49.2 of the Accounting Act and the Decree of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and consistent with underlying information disclosed in the audited financial statements.

....

Krzysztof Sowada
Key Kertified Auditor
conducting the audit
No. 10944

....

represented by

....

entity authorized to audit
financial statements entered under
number 73 on the list kept by the
National Council of Statutory Auditors

Warsaw, 22 February 2011

The above audit opinion together with audit report is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS OF TELEKOMUNIKACJA POLSKA S.A. FOR THE 2010 FINANCIAL YEAR

I. GENERAL INFORMATION

1. Details of the audited Company

The Company operates under the business name Telekomunikaja Polska S.A. The Company's registered office is located in Warsaw at Twarda 18 St.

The Company operates as a joint stock company established by the notary deed of 4 December 1991 in front of Katarzyna Szachułowicz-Barańska, Notary Public in Warsaw (Repertory A No. 6480/91).

The Company was entered in the Commercial Register kept by the District Court in Warsaw, XVI Business-Registry Division in Warsaw, section B, under the number RHB 29979, based on the decision of 13th December 1991. Currently, the Company is recorded in the Register of Entrepreneurs kept by the District Court in Warsaw, XII Business-Registry Division in Warsaw, under KRS No. 0000010681.

The Company has the tax identification number NIP: 526-02-50-995 assigned by Second Tax Office Warszawa – Śródmieście on 4 June 1993.

The REGON number assigned by the Statistical Office is: 012100784.

The Company operates based on the provisions of the Code of Commercial Companies.

In accordance with the Company's Articles of Association, the scope of its activity includes:
- production equipment (tele)communications [PKD 26.30.Z],
- construction of electricity and telecommunications [PKD 42.22.Z],
- electrical installation [PKD 43.21.Z],
- other retail sale performed in unspecialized shops [PKD 47.19.Z],
- retail sale of computers, peripherals and software in specialized stores [PKD 47.41.Z],
- retail sale of telecommunications equipment in specialized stores [PKD 47.42.Z],
- retail sale of audio-video equipment in specialized stores [PKD 47.43.Z],
- retail sale made by selling homes or internet [PKD 47.91.Z]
- other retail sale except stores, stalls or markets [PKD 47.99.Z],
- publishing of books [PKD 58.11.Z],
- issuing and mailing lists (such as address, telephone) [PKD 58.12.Z],
- other publishing [PKD 58.19.Z],
- production activities like movies, videos and television programs [PKD 59.11.Z],
- post-production activities Motion picture, video and television program [PKD 59.12.Z],
- distribution activities like movies, videos and television programs [PKD 59.13.Z],
- operation of sound recording and music [PKD 59.20.Z],
- television programming and broadcasting [PKD 60.20.Z],
- telecommunications activities wired [PKD 61.10.Z],
- the activities in the field of wireless telecommunications, with the exception of satellite telecommunications [PKD 61.20.Z],
- activities in the field of satellite telecommunications [PKD 61.30.Z],
- activity in the rest of telecommunications [PKD 61.90.Z],

- activities with the software [PKD 62.01.Z],
- activities of the consultancy [PKD 62.02.Z],
- activities related to facilities management [PKD 62.03.Z],
- other service activities in the field of information technology and computer [PKD 62.09.Z],
- processing data management web (hosting) and related activities [PKD 63.11.Z],
- the activities of insurance agents and brokers [PKD 66.22.Z],
- the activities of accounting, tax advice [PKD 69.20.Z],
- other advice on business and management [PKD 70.22.Z],
- activities in the field of architecture [PKD 71.11.Z],
- engineering activities and related technical consultancy [PKD 71.12.Z],
- research and experimental development on other natural sciences and engineering [PKD 72.19.Z],
- intermediation in the sale of time and place for the purpose of advertising on radio and television [PKD 73.12.A],
- mediation in the sale of space for advertising purposes in the electronic media (Internet) [PKD 73.12.C],
- market research and public opinion [PKD 73.20.Z],
- other professional, scientific and technical activities not elsewhere classified [PKD 74.90.Z],
- renting and leasing of other machinery, equipment and tangible goods not elsewhere classified [PKD 77.39.Z],
- the activities of security activities in the handling of safety systems [PKD 80.20.Z].

In the audited period, the Company conducted mainly the following business activities:
- telecommunications services including voice telephony, data transmission, tele-info, visual, multimedia and related services provided on fixed line and mobile, land and satellite networks,
- investing, service and trade activities related to telecommunications services and infrastructure,
- research and development activities in the field of telecommunications.

As of 31 December 2010, the Company's share capital amounted to PLN 4,007 million and was divided into 1,336 million ordinary shares with a face value of PLN 3 each. The ownership structure of the share capital as at 31 December 2010 was as follows:

	% of votes	*Nominal value (in PLN millions)*
France Telecom S.A.	49.79	1,995
Capital Group International, Inc.[1]	5.06	203
Other shareholders	45.15	1,809
Total	**100.00**	**4,007**

No changes in the Company's share capital value took place during the financial year.

On 5 August 2010, the State Treasury announced that it sold 4.15% shares of TP S.A. through the Warsaw Stock Exchange. We were not presented with any information other than the aforementioned in regarding valid agreements or other events that may result in material changes in the proportions of the Company's shareholding structure in audited period.

No changes in the Company's share capital took place after the balance sheet date.

As of 31 December 2010, the Company's equity amounted to PLN 12,900 million.

[1] The number of shares according to the notification by Capital Group International, Inc. on 15 October 2010.

The Company's financial year is the calendar year.

Telekomunikacja Polska S.A. presented investments in subsidiaries and related party transactions respectively in the Note 14.1 and 30 to the financial statements.

As at the opinion's date, the composition of the Company's Management Board was as follows:
- Maciej Witucki – President of the Management Board,
- Vincent Lobry – Vice President in charge of Marketing and Strategy,
- Piotr Muszyński – Vice President in charge of Operations,
- Jacques de Galzain – Board Member, Chief Financial Officer,
- Jacek Kowalski – Board Member in charge of Human Resources.

From 1 January 2010 until the opinion date the following changes took place in the composition of Management Board:
- on 14 January 2011 Mr Roland Dubois resigned from the position of Management Board Member of TP S.A.,
- on 27 January 2011 Supervisory Board of TP S.A. appointed two new board members: Mr. Jacques De Galzain and Mr. Jacek Kowalski. On the same date Supervisory Board accepted Mr. Roland Dubois resignation as a board member of TP S.A. and reappointed for another period Mr Piotr Muszyński.

The above changes were filed in the proper court register on 3 February 2011.

2. Information about the financial statements for the prior financial year

The activities of the Company in 2009 resulted in a net profit of PLN 3,356 million. The financial statements of the Company for 2009 were audited by a certified auditor. The audit was performed by authorized entity Deloitte Audyt Sp. z o.o. On 22 February 2010 the certified auditor issued an unqualified opinion on those financial statements with an emphasis of matter paragraph, stating as follows:

"As more fully explained in explanatory note 29 to the attached financial statements, the Company is involved in a number of legal, arbitration and administrative proceedings. Any costs that may result from these proceedings are provided for when they become probable and when the amount may be reliably quantified. The amount of any provision is based on an assessment of the risk level in each case and represents the Company's best estimate of the amounts that are more likely than not to be payable. Occurrence of events during the proceedings, the outcome of which is uncertain, may lead to re-assessment of the risk and as a consequence the amount of the provisions may change."

The General Shareholders' Meeting which approved the financial statements for the 2009 financial year was held on 23 April 2010. The General Shareholders' Meeting decided on the following distribution of the net profit for 2009:
- Dividends to shareholders – PLN 2,003 million,
- Supplementary capital – PLN 1,286 million,
- Reserve capital – PLN 67 million.

In accordance with applicable laws, the financial statements for the 2009 financial year were submitted to the National Court Register (KRS) on 28 April 2010. The financial statements were published in Monitor Polski B No. 1400 on 13 August 2010.

3. Details of the authorized entity and the Key Certified Auditor acting on its behalf

The audit of the financial statements was performed based on the agreement of 13 December 2010 concluded between Telekomunikacja Polska S.A. and Deloitte Audyt Sp. z o.o. with its registered office in Warsaw, al. Jana Pawła II 19, recorded under number 73 on the list of entities authorized to provide audit services kept by the National Council of Statutory Auditors. On behalf of the authorized entity, the audit of the financial statements was conducted under the supervision of Krzysztof Sowada, Key Certified Auditor, (No. 10944), from 1 September 2010 to 22 February 2011.

The entity authorized to audit the financial statements was appointed by the resolution of the Supervisory Board of 15 July 2010 based on authorization included in Article 23 p. 2.8 of the Company's Articles of Association.

Deloitte Audyt Sp. z o.o. and Krzysztof Sowada, Key Certified Auditor, confirm that they are authorized to carry out audits and meet the requirements of Article 56 of the Act on statutory auditors and their self-governing body, auditing firms and on public oversight (Journal of Laws of 2009, No. 77, item 649) to express an unbiased and independent opinion on the financial statements of Telekomunikacja Polska S.A.

4. Availability of data and management's representations

The scope of our audit was not limited.

During the audit, all necessary documents and data as well as detailed information and explanations, were provided to the authorized entity and the Key Certified Auditor, as confirmed e.g. in the written representation of the Management Board of 22 February 2011.

II. ECONOMIC AND FINANCIAL POSITION OF THE COMPANY

Presented below are the main items from the income statement as well as financial ratios describing the financial result of the Company and its financial position as compared to the same items in the previous year.

Main items from the income statement (in million PLN)	2010	2009[2]
Revenue	8,434	9,291
Operating expenses, net	(8,692)	(8,142)
Result from financial activity	1,405	2,325
Income tax	(124)	(117)
Net profit	1,023	3,357

	2010	2009
Profitability ratios		
– gross profit margin Operating income *100% / Revenue	(3%)	12%
– net profit margin Net income *100% / Revenue	12%	36%
– net return on equity Net income *100% / Total equity	8%	24%
Effectiveness ratios		
– assets turnover ratio Revenue / Total assets	0.29	0.32
– trade receivables turnover in days (Trade receivables, net year end + Trade receivables, net opening balance)/2*365 / Revenue	34	32
– trade liabilities turnover in days (Short term trade payables year end + Short term trade payables opening balance)/2*365 / (External purchases + Other operating expense)	159	146

[2] After changes in the accounting policies described in note 3.4 to the financial statement for the year ended 31 December 2010.

Liquidity/Net working capital

– debt ratio (Total current and non-current liabilities) *100% / Total assets	55%	52%
– equity to assets ratio Total equity *100% / Total assets	45%	48%
– net working capital Current assets - Current liabilities	(3,762)	(1,911)
– current ratio Current assets / Current liabilities	0.49	0.63
– quick ratio (Current assets - Inventories, net) / Current liabilities	0.49	0.63

The analysis of the above figures and ratios indicated the following trends occurring in the year 2010 in comparison to the year 2009:

- decrease of profitability ratios,
- increase of trade liabilities turnover,
- decrease of net working capital,
- decrease of liquidity ratios.

III. DETAILED INFORMATION

1. Evaluation of the accounting system

The Company has valid documentation describing the accounting principles (policy) applied, including in particular: definition of the financial year and reporting periods thereof, methods of measuring assets and liabilities and determining the financial result, method of keeping the accounting records and the system of data and file protection. The documentation of the accounting policy was developed in line with the Accounting Act and in respect to the measurement of assets and liabilities plus equity as well as evaluation of presentation of the financial statements – in line with IFRS in the form adopted by the European Union. According to the resolution of Shareholders from 18 June 2005 starting from 1 January 2006 the Company is obliged to prepare its financial statement in line with International Financial Reporting Standards. Recent changes in accounting policy were approved for use starting from 1 January 2010 based on the resolution of the Management Board No. 29 dated 2 March 2010. Principal methods of measuring assets, liabilities and the financial result were presented in the explanatory notes.

Accounting principles selected at the Company's discretion pursuant to IFRS have been selected in a manner that correctly reflects specifics of its business operations, its financial standing and performance. Beside mentioned below, the Company's accounting policy in all material aspects is appropriate and used continuously.

In the audited period the Company made a change of one accounting principle related to post-employment benefits. Until the end of 2009 TP S.A. according to IAS 19 was recognising the actuarial gains and losses using "corridor" method. Starting from 2010 the Company has been using other method also allowed by IAS 19 and recognises immediately actuarial gains and losses in the other comprehensive income, with no recycling to the income statement. The change was justified by the Management Board of the Company as better suited to its financial standing and performance. The change has been described in note 3.4 to these financial statements.

The Company's accounts are kept using the Oracle computer system in the Company's Shared Service Centre in Lublin. The Oracle system is password-protected against unauthorized access and has functional access controls. The description of the information system complies with the requirements of Article 10 clause 1 point 3 letter c) of the Accounting Act.

The opening balance resulting from the approved financial statements for the prior financial year has been properly introduced into the accounting records of the audited period.

In the audited documentation of business transactions, accounting records and the relationships between accounting entries, financial documents and financial statements complied with the requirements of section 2 of the Accounting Act.

The accounting records and evidence, the documentation of the accounting system and the approved financial statements of the Company are stored in compliance with section 8 of the Accounting Act.

The Company performed a physical count of assets and liabilities within the scope, timing and frequency required by the Accounting Act. Identified differences have been recorded and settled in the accounting records for the audited period.

2. Information about the audited financial statements

The audited financial statements were prepared as of 31 December 2010 and include:

- balance sheet prepared as of 31 December 2010, with total assets and liabilities plus equity of PLN 28,617 million,
- income statement for the period from 1 January 2010 to 31 December 2010, with a net profit of PLN 1,023 million,
- statement of comprehensive income for the period from 1 January 2010 to 31 December 2010 with a total comprehensive income of PLN 1,003 million,
- statement of changes in equity for the period from 1 January 2010 to 31 December 2010, disclosing a decrease in equity of PLN 996 million,
- statement of cash flows for the period from 1 January 2010 to 31 December 2010, showing a cash inflow of PLN 272 million,
- notes, comprising a summary of significant accounting policies and other explanatory information.

The structure of assets and liabilities plus equity as well as items affecting the profit or loss has been presented in the financial statements.

3. Information about selected material items of the financial statements

Property, plant and equipment

Explanatory notes correctly describe changes in fixed assets, including disclosure of any impairment on such assets.

Investments in subsidiaries

Explanatory notes correctly describe changes in investments during the financial year.

Loans and receivables excluding trade receivables

The account contains mainly bonds bought from TP S.A. subsidiary - TP Invest Sp. z o.o. The transaction was properly described in the financial statements.

Structure of receivables

The ageing analysis of trade receivables was correctly presented in the respective explanatory note. The audited sample did not include expired or redeemed receivables.

Liabilities

Key items of the Company's liabilities include:
- financial liabilities at amortised cost in the amount of PLN 10,136 million,
- trade liabilities in the amount of PLN 2,100 million.

The nature of contracted loans and a description of how they are secured have been presented in explanatory notes. The audited sample did not include expired or redeemed liabilities.

Provisions for liabilities

The structure of the above items is correctly described in the respective explanatory notes.
Provisions for liabilities were determined at reliably estimated amounts.
The items are recognised completely and correctly in all material respects in relation to the financial statements as a whole.

4. Completeness and correctness of drawing up notes and explanations and the report on the activities of the Company

The Company prepared the financial statement based on going concern principle. The explanatory notes give a correct and complete description of valuation principles regarding assets, equity and liabilities, principles of measurement of the financial result and preparation of the financial statements.

The explanatory notes fully describe the reporting items and present the remaining data required by the IFRS in a clear manner.

The financial statements have been supplemented with the Management Board's report on the activities of the Company in the 2010 financial year. The report contains all information required under Article 49.2 of the Accounting Act and regulation of the Decree of the Minister of Finance of 19 February 2009 on current and periodic information to be disclosed by issuers of securities. We have audited the report with respect to the disclosed information derived directly from the audited financial statements.

IV. CLOSING COMMENTS

Management Board's Representation

Deloitte Audyt Sp. z o.o. and the Key Certified Auditor received a representation letter from the Company's Management Board, in which the Board stated that the Company complied with the laws in force.

....

Krzysztof Sowada
Key Certified Auditor
conducting the audit
No. 10944

....
represented by

....
entity authorized to audit
financial statements entered under
number 73 on the list kept by the
National Council of Statutory Auditors

Warsaw, 22 February 2011

TELEKOMUNIKACJA POLSKA S.A.

IFRS SEPARATE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2010

Contents

INCOME STATEMENT 4
STATEMENT OF COMPREHENSIVE INCOME 4
BALANCE SHEET 5
STATEMENT OF CHANGES IN EQUITY 6
STATEMENT OF CASH FLOWS 7
1. Corporate information 8
2. Statement of compliance and basis for preparation 9
3. Significant accounting policies 10
4. Revenue 25
5. Operating income and expense 26
6. Restructuring costs 27
7. Gains on disposal of assets 27
8. Impairment 27
9. Finance income and expense 29
10. Income tax 30
11. Components of other comprehensive income 31
12. Intangible assets 32
13. Property, plant and equipment 32
14. Financial assets 33
15. Trade receivables, other assets and prepaid expenses 36
16. Cash and cash equivalents 37
17. Net financial debt 38
18. Financial liabilities at amortised cost excluding trade payables 40
19. Derivatives 41
20. Objectives and policies of financial risk management 43
21. Management of capital 47
22. Fair value of financial instruments 47
23. Employee benefits 48
24. Share-based payments 49
25. Provisions 50
26. Trade payables, other liabilities and deferred income 51

27. Equity 52
28. Unrecognised contractual obligations 53
29. Litigation and claims (including contingent liabilities) 54
30. Related party transactions 57
31. Subsequent events 61

INCOME STATEMENT

(in PLN millions, except for share data)

	Note	12 months ended 31 December 2010 (audited)	31 December 2009 (see Note 3.4, audited)
Revenue	**4**	**8,434**	**9,291**
External purchases	5	(3,453)	(3,458)
Labour expenses	5	(1,571)	(1,825)
Other operating expense	5	(531)	(412)
Other operating income	5	284	221
Restructuring costs	6	(15)	(22)
Gains on disposal of assets	7	65	36
Dispute with DPTG	29.d	(1,061)	-
Depreciation and amortization	12, 13	(2,399)	(2,655)
Impairment of non-current assets	8	(11)	(27)
Operating income/(loss)		**(258)**	**1,149**
Dividend income	9	1,906	2,897
Interest income	9	403	344
Interest expense and other financial charges	9	(857)	(770)
Foreign exchange losses	9	(18)	(114)
Discounting expense	9	(29)	(32)
Finance income, net		**1,405**	**2,325**
Income tax	10	(124)	(117)
Net income		**1,023**	**3,357**
Earnings per share (in PLN) (basic and diluted)	**3.4**	**0.77**	**2.51**
Weighted average number of shares (in millions) (basic and diluted)	3.4	1,336	1,336

STATEMENT OF COMPREHENSIVE INCOME

(in PLN millions)

	Note	12 months ended 31 December 2010 (audited)	31 December 2009 (see Note 3.4, audited)
Net income		**1,023**	**3,357**
Gains/(losses) on cash flow hedges	11	(9)	39
Actuarial losses on post-employment benefits	11	(16)	(15)
Income tax relating to components of other comprehensive income	11	5	(4)
Other comprehensive income/(loss), net of tax		**(20)**	**20**
Total comprehensive income		**1,003**	**3,377**

BALANCE SHEET

(in PLN millions)

	Note	*At 31 December 2010 (audited)*	*At 31 December 2009 (see Note 3.4, audited)*
ASSETS			
Intangible assets	12	1,247	1,055
Property, plant and equipment	13	12,657	13,421
Investments in subsidiaries	14	7,636	7,651
Financial assets available for sale	14	4	4
Loans and receivables excluding trade receivables	14	3,147	3,422
Financial assets at fair value through profit or loss	14	57	75
Hedging derivatives	19	45	41
Deferred tax assets	10	166	237
Total non-current assets		**24,959**	**25,906**
Inventories		41	42
Trade receivables	15	857	697
Loans and receivables excluding trade receivables	14	304	276
Financial assets at fair value through profit or loss	14	20	2
Hedging derivatives	19	-	1
Income tax assets		6	17
Other assets	15	126	232
Prepaid expenses	15	36	34
Cash and cash equivalents	16	2,268	1,996
Total current assets		**3,658**	**3,297**
TOTAL ASSETS		**28,617**	**29,203**
EQUITY AND LIABILITIES			
Share capital	27	4,007	4,007
Share premium		832	832
Other reserves	11, 24	15	31
Retained earnings		8,046	9,026
Total equity		**12,900**	**13,896**
Financial liabilities at amortised cost excluding trade payables	17, 18	7,556	9,429
Financial liabilities at fair value through profit or loss	19	90	61
Hedging derivatives	19	191	148
Employee benefits	23	269	267
Provisions	25	127	148
Deferred income	26	64	46
Total non-current liabilities		**8,297**	**10,099**
Financial liabilities at amortised cost excluding trade payables	17, 18	2,580	2,109
Financial liabilities at fair value through profit or loss	19	55	90
Hedging derivatives	19	54	1
Trade payables	26	2,100	1,371
Employee benefits	23	167	213
Provisions	25	2,176	1,164
Income tax payable		39	-
Other liabilities	26	180	194
Deferred income	26	69	66
Total current liabilities		**7,420**	**5,208**
TOTAL EQUITY AND LIABILITIES		**28,617**	**29,203**

STATEMENT OF CHANGES IN EQUITY

(in PLN millions)

	Number of shares in issue (not in millions)	Share capital	Share premium	Treasury shares	Other reserves				Retained earnings	Total
					Hedging instruments	Actuarial losses on post-employment benefits	Deferred tax	Share-based payments		
Balance at 1 January 2009 *(audited)*	**1 335 649 021**	**4,106**	**832**	**(704)**	**(28)**	**-**	**5**	**27**	**8,277**	**12,515**
Effect of change in accounting policy for post-employment benefits *(see Note 3.4)*		-	-	-	-	(36)	6	-	-	(30)
Balance at 1 January 2009 after change in accounting policy *(audited)*	**1 335 649 021**	**4,106**	**832**	**(704)**	**(28)**	**(36)**	**11**	**27**	**8,277**	**12,485**
Total comprehensive income for the 12 months ended 31 December 2009		-	-	-	39	(15)	(4)	-	3,357	3,377
Share-based payments		-	-	-	-	-	-	37	-	37
Cancellation of treasury shares	-	(99)	-	704	-	-	-	-	(605)	-
Dividends		-	-	-	-	-	-	-	(2,003)	(2,003)
Balance at 31 December 2009 *(audited)*	**1 335 649 021**	**4,007**	**832**	**-**	**11**	**(51)**	**7**	**64**	**9,026**	**13,896**
Total comprehensive income for the 12 months ended 31 December 2010		-	-	-	(9)	(16)	5	-	1,023	1,003
Share-based payments		-	-	-	-	-	-	4	-	4
Dividends		-	-	-	-	-	-	-	(2,003)	(2,003)
Balance at 31 December 2010 *(audited)*	**1 335 649 021**	**4,007**	**832**	**-**	**2**	**(67)**	**12**	**68**	**8,046**	**12,900**

STATEMENT OF CASH FLOWS

(in PLN millions)

	Note	*12 months ended* 31 December 2010 (audited)	31 December 2009 (see Note 3.4, audited)
OPERATING ACTIVITIES			
Net income		1,023	3,357
Adjustments to reconcile net income to funds generated from operations			
Depreciation and amortization	12, 13	2,399	2,655
Impairment of non-current assets	8	11	27
Gains on disposal of assets	7	(65)	(36)
Change in provisions		938	(176)
Income tax	10	124	117
Finance income, net excluding realised exchange rate effect on cash and cash equivalents		(1,396)	(2,330)
Operational foreign exchange and derivatives gains, net		(5)	(15)
Share-based payments		4	35
Change in working capital (trade)			
Decrease/(increase) in inventories		1	(8)
Decrease/(increase) in trade receivables		(134)	271
Increase/(decrease) in trade payables		176	(171)
Change in working capital (non-trade)			
Decrease/(increase) in prepaid expenses and other receivables		(45)	(13)
Increase/(decrease) in accrued expenses, other payables and deferred income		21	11
Dividends received		1,906	2,897
Interest received		82	30
Interest and interest rates effect on derivatives paid, net		(572)	(458)
Exchange rate effect on derivatives, net		(48)	124
Income tax paid		(40)	(12)
Net cash provided by operating activities		**4,380**	**6,305**
INVESTING ACTIVITIES			
Purchases of property, plant and equipment and intangible assets	12, 13	(1,892)	(1,272)
Increase/(decrease) in amounts due to fixed assets suppliers		558	(158)
Proceeds from sale of property, plant and equipment and intangible assets		89	37
Cash paid for investments in subsidiaries		-	(233)
Proceeds from investments in subsidiaries	14	192	39
Decrease in marketable securities and other financial assets	14	9	6
Exchange rate effect on derivatives, net		(31)	(58)
Net cash used in investing activities		**(1,075)**	**(1,639)**
FINANCING ACTIVITIES			
Issuance of bonds	17, 18	-	3,102
Repayment of long-term debt	17, 18	(230)	(1,938)
Decrease in bank overdrafts and other short-term borrowings	17, 18	(750)	(2,839)
Purchase of treasury shares including transaction cost	27	-	(4)
Dividends paid	27	(2,003)	(2,003)
Exchange rate effect on derivatives, net		(50)	(37)
Net cash used in financing activities		**(3,033)**	**(3,719)**
Net change in cash and cash equivalents		272	947
Effect of changes in exchange rates on cash and cash equivalents		-	(2)
Cash and cash equivalents at the beginning of the period		1,996	1,051
Cash and cash equivalents at the end of the period		**2,268**	**1,996**

1. Corporate information

1.1. Telekomunikacja Polska S.A.

Telekomunikacja Polska S.A. ("Telekomunikacja Polska" or "the Company" or "TP S.A."), a joint stock company, was incorporated and commenced its operations on 4 December 1991.

The Company is the principal supplier of telecommunications services in Poland. Telekomunikacja Polska provides services, including fixed-line telecommunications services (local calls and long distance calls – domestic and international), Integrated Services Digital Network ("ISDN"), voice mail, dial-up and fixed access to the Internet, TV and Voice over Internet Protocol ("VoIP"). In addition, the Company provides leased lines, radio-communications and other telecommunications value added services, sells telecommunications equipment, electronic phone cards and provides data transmission, multimedia services and various Internet services. Telekomunikacja Polska provides telecommunications services on the basis of entry number 1 in the register of telecommunications companies maintained by the President of Office of Electronic Communication ("UKE").

Telekomunikacja Polska's registered office is located in Warsaw at 18 Twarda St.

The Company's operations are subject to regulatory controls of UKE, the government telecommunications market regulator. Under the Telecommunication Act, UKE can impose certain obligations on telecommunications companies that have a significant market power ("SMP"). Telekomunikacja Polska S.A. is deemed to be a SMP on certain markets.

1.2. The Management Board and the Supervisory Board of the Company

The Management Board of the Company at the date of the authorisation of these Separate Financial Statements was as follows:

Maciej Witucki – President of the Management Board, Chief Executive Officer,
Vincent Lobry – Vice President in charge of Marketing and Strategy,
Piotr Muszyński – Vice President in charge of Operations,
Jacques de Galzain – Board Member, Chief Financial Officer,
Jacek Kowalski – Board Member in charge of Human Resources.

The Supervisory Board of the Company at the date of the authorisation of these Separate Financial Statements was as follows:

Prof. Andrzej K. Koźmiński – Chairman of the Supervisory Board, Independent Member of the Supervisory Board,
Olivier Barberot – Deputy Chairman of the Supervisory Board,
Olivier Faure – Secretary of the Supervisory Board,
Timothy Boatman – Independent Member of the Supervisory Board,
Thierry Bonhomme – Member of the Supervisory Board,
Jacques Champeaux – Member of the Supervisory Board,
Ronald Freeman – Independent Member of the Supervisory Board,
Dr. Mirosław Gronicki – Independent Member of the Supervisory Board,
Marie-Christine Lambert – Member of the Supervisory Board,
Prof. Jerzy Rajski – Independent Member of the Supervisory Board,
Gerard Ries – Member of the Supervisory Board,
Dr. Wiesław Rozłucki – Independent Member of the Supervisory Board,
Olaf Swantee – Member of the Supervisory Board.

The following changes occurred in the Management Board of the Company in the year ended 31 December 2010 and in the year 2011 until the date of the authorisation of these Separate Financial Statements:

On 14 January 2011, Mr Roland Dubois resigned from the position of Management Board Member of TP S.A. in charge of Finance – Chief Financial Officer. As of 17 January 2011, his duties were passed on to Mr Jacques de Galzain.

On 27 January 2011, the Supervisory Board of the Company appointed Mr Jacques de Galzain and Mr Jacek Kowalski as Members of the Management Board of TP S.A. The Supervisory Board also appointed Mr Piotr Muszyński for the subsequent term of office.

The following changes occurred in the Supervisory Board of the Company in the year ended 31 December 2010 and in the year 2011 until the date of the authorisation of these Separate Financial Statements:

Mr Vivek Badrinath resigned from the Supervisory Board of TP S.A. with effect on 22 April 2010.

On 23 April 2010, the Annual General Meeting of Shareholders appointed Mr Thierry Bonhomme and Mr Olaf Swantee to the Supervisory Board of TP S.A. and renewed mandates of the following persons, whose term of office expired as of the day of this General Meeting: Mr Jacques Champeaux, Mr Ronald Freeman and Mr Mirosław Gronicki. On the same day, the term of office in the Supervisory Board of TP S.A. expired for Mr Antonio Anguita.

Mr Raoul Roverato resigned from the Supervisory Board of TP S.A. with the effect from 26 January 2011. On 27 January 2011, the Supervisory Board co-opted Mr Gerard Ries as a Member of the Supervisory Board of TP S.A.

2. Statement of compliance and basis for preparation

These Separate Financial Statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) adopted for use by the European Union. IFRSs comprise standards and interpretations approved by the International Accounting Standards Board (“IASB”) and the International Financial Reporting Interpretations Committee (“IFRIC”).

Comparative amounts for the year ended 31 December 2009 have been compiled using the same basis of preparation.

The Separate Financial Statements have been prepared under the historical cost convention, except for the fair value applied to derivative financial instruments, financial assets available for sale, assets held for sale and debt that is hedged against exposure to changes in fair value.

Telekomunikacja Polska S.A. is the parent company of the Telekomunikacja Polska Group (“the Group”, “TP Group”) and prepares consolidated financial statements for the year ended 31 December 2010.

These Separate Financial Statements are prepared in millions of Polish zloty (“PLN”) and were authorized for issuance by the Management Board on 22 February 2011.

The principles applied to prepare financial data relating to the year ended 31 December 2010 are described in Note 3 and are based on:

- all standards and interpretations endorsed by the European Union and applicable to the reporting period begining 1 January 2010;
- IFRSs and related interpretations adopted for use by the European Union whose application will be compulsory after 1 January 2010 but for which the Company has opted for earlier application;
- accounting positions adopted by the Company in accordance with paragraphs 10 to 12 of IAS 8.

Use of estimates

In preparing the Company's accounts, the Company's management is required to make estimates, insofar as many elements included in the financial statements cannot be measured with precision. Management reviews these estimates if the circumstances on which they were based evolve, or in the light of new information or experience. Consequently, estimates made as at 31 December 2010 may be subsequently changed. The main estimates made are described in the following notes:

Note		*Type of information disclosed*
3.5.9, 8	Impairment of cash generating units and individual tangible and intangible assets	Key assumptions used to determine recoverable amounts: impairment indicators, models, discount rates, growth rates.
3.5.10, 14.2	Impairment of loans and receivables	Methodology used to determine recoverable amounts.
3.5.12, 10	Income tax	Assumptions used for recognition of deferred tax assets.
3.5.14, 23	Employee benefits	Discount rates, salary increases, expected average remaining working lives.
3.5.10, 19, 22	Fair value of derivatives and other financial instruments	Model and assumptions underlying the measurement of fair values.
3.5.13, 25, 29	Provisions	Provisions for termination benefits and restructurings: discount rates and other assumptions. The assumptions underlying the measurement of provisions for claims and litigation.
3.5.6, 3.5.7	Useful lives of tangible and intangible assets	The useful lives and the amortization method.
3.5.15, 24	Share-based payments	Model and key assumptions used to determine fair value of equity instruments granted: exercise price, historical volatility, risk-free interest rate, expected dividend yield, etc.
25	Dismantling costs	The assumptions underlying the measurement of provision for the estimated costs for dismantling and removing the asset and restoring the site on which it is located.
3.5.2, 4	Revenue	Allocation of revenue between each separable component of a packaged offer based on its relative fair value. Straight-line recognition of revenue relating to service access fees. Reporting revenue on a net versus gross basis (analysis of Company's involvement acting as principal versus agent).
3.5.11	Allowance for slow moving and obsolete inventories	Methodology used to determine net realisable value of inventories.

Use of judgments

Where a specific transaction is not dealt with in any standard or interpretation, management uses its judgment in developing and applying an accounting policy that results in information that is relevant and reliable, in that the financial statements:

- represent faithfully the Company's financial position, financial performance and cash flows,
- reflect the economic substance of transactions,
- are neutral,
- are prudent, and
- are complete in all material respects.

The main judgments made as at 31 December 2010 relate to provisions for claims and litigations, and contingent liabilities. Details are described in Note 29.

3. Significant accounting policies

This note describes the accounting principles applied to prepare the separate financial statements for the year ended 31 December 2010.

3.1. Application of new standards, amendments and interpretations

Adoption of standards, amendments to standards and interpretations which are compulsory as of January 1, 2010

The following standards, amendments to standards and interpretations (already endorsed or in the process of being endorsed by the European Union) have become effective and are compulsory as at January 1, 2010:

- Revised IFRS 3 "Business Combinations",
- Revised IAS 27 "Consolidated and Separate Financial Statements",
- Amendments to IAS 39 "Financial Instruments: Eligible Hedged Items",
- IFRIC 17 "Distribution of Non-cash Assets to Owners",
- Improvements to International Financial Reporting Standards – a collection of amendments to IFRSs, the amendments are effective, in most cases, for annual periods beginning on or after 1 January 2010,
- Amendments to IFRS 2 "Share-based Payment" - Group cash-settled share-based payment transactions.

The adoption of the standards and interpretations presented above did not result in any significant changes to the Company's accounting policies and to the presentation of the financial statements.

Standards and interpretations issued but not yet adopted

The Company has not opted for early application of the following standards and interpretations (already endorsed or in the process of being endorsed by the European Union):

- Amendments to IAS 32 "Financial Instruments: Presentation" applicable for financial years beginning on or after 1 February 2010,
- Amendments to IAS 24 "Related Party Disclosures" applicable for financial years beginning on or after 1 January 2011,
- IFRS 9 "Financial Instruments" applicable for financial years beginning on or after 1 January 2013. This standard has not been endorsed by the European Union,
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments" applicable for financial years beginning on or after 1 July 2010,
- Amendments to IFRIC 14 "Prepayments of a Minimum Funding Requirement" applicable for financial years beginning on or after 1 January 2011,
- Improvements to International Financial Reporting Standards – a collection of amendments to IFRSs, the amendments are effective, in most cases, for annual periods beginning on or after 1 January 2011. These amendments have not been endorsed by the European Union,
- Amendments to IFRS 7 "Financial Instruments: Disclosures" applicable for financial years beginning on or after 1 July 2011. These amendments have not been endorsed by the European Union.

Management is currently analyzing the practical consequences of these new standards and interpretations and the effect of their application on the financial statements.

3.2. Accounting positions adopted by the Company in accordance with paragraphs 10 to 12 of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors"

The accounting position described below is not specifically (or is only partially) dealt with by any IFRS standards or interpretations endorsed by the European Union. The Company has adopted accounting policies which it believes best reflect the substance of the transactions concerned.

Multiple-elements arrangements

When accounting for multiple-elements arrangements (bundled offers) the Company has adopted the provisions of Generally Accepted Accounting Principles in the United States, Accounting Standards Codification Topic 605-25 „Revenue Recognition – Multiple Element Agreements" (see Note 3.5.2 *Separable components of packaged and bundled offers*).

3.3. Options available under IFRSs and used by the Company

Certain IFRSs offer alternative methods of measuring and recognizing assets and liabilities. In this respect, the Company has chosen:

Standards		*Option used*
IAS 2	Inventories	Recognition of inventories at their original cost determined by the weighted average unit cost method.
IAS 16	Property, plant and equipment	Property, plant and equipment are measured at amortized historical cost less any accumulated impairment loss.
IAS 19	Employee benefits	Actuarial gains and losses on post-employment benefits are recognized immediately in their total amount in the other comprehensive income, with no recycling to the income statement.
IAS 20	Government grants and disclosure of government assistance	Non-repayable government grants related to assets decrease the carrying amount of the assets. Government grants related to income are deducted from the related expenses.
IAS 27	Consolidated and separate financial statements	Investments in subsidiares and associates are accounted at cost.
IAS 38	Intangible assets	Intangible assets are measured at amortized historical cost less any accumulated impairment loss.

3.4. Presentation of the financial statements

Presentation of the balance sheet

In accordance with IAS 1 “Presentation of financial statements”, assets and liabilities are presented in the balance sheet as current and non-current.

In accordance with IFRS 5, non-current assets and all directly attributable liabilities that are considered as being held for sale are reported on a separate line in the balance sheet.

Presentation of the income statement

As allowed by IAS 1 “Presentation of financial statements” expenses are presented by nature in the income statement.

Earnings per share

The net income per share for each period is calculated by dividing the net income for the period by the weighted average number of shares outstanding during that period. The weighted average number of shares outstanding is after taking account of treasury shares and the dilutive effect of the pre-emption rights attached to the bonds issued under TP S.A. incentive programme (see Note 24).

Change in accounting policy for post-employment benefits

In accordance with IAS 19 “Employee Benefits”, the actuarial gains and losses are recognized:
- in profit or loss either for their total amount or up to a portion using the corridor method which was the method applied by the Company until December 31, 2009,
- or in the other comprehensive income for their total amount.

The exposure draft published by the International Accounting Standards Board in April 2010 relating to the amendment to IAS 19 confirms the removal of the corridor method and proposes the immediate recognition of actuarial gains and losses in the other comprehensive income, with no recycling to the income statement.
Following this publication, the Company has decided to account for defined benefit plans actuarial gains and losses in the other comprehensive income from January 1, 2010. This change in accounting policy results in the financial statements providing more relevant and comparative information as this policy is generally applied in telecommunications industry.

Change in accounting policy for post-employment benefits affected the Company's financial statements as follows:

(in PLN millions)	*Data previously reported*	*Impact of changes in the accounting policies*	*Data currently reported*
		12 months ended 31 December 2009	
Income statement			
Labour expenses	(1,826)	1	(1,825)
Operating income	1,148	1	1,149
Net income	3,356	1	3,357
Earnings per share (in PLN) (basic and diluted)	2.51	-	2.51
Statement of comprehensive income			
Net income	3,356	1	3,357
Actuarial losses on post-employment benefits	-	(15)	(15)
Income tax relating to components of other comprehensive income	(7)	3	(4)
Total comprehensive income	3,388	(11)	3,377
Statement of cash flows			
Net income	3,356	1	3,357
Change in other provisions	(175)	(1)	(176)
Net cash provided by operating activities	6,305	-	6,305

(in PLN millions)	*Data previously reported*	*Impact of changes in the accounting policies*	*Data currently reported*
		at 31 December 2009	
Balance sheet			
Assets			
Deferred tax assets	228	9	237
Total non-current assets	25,897	9	25,906
Total assets	29,194	9	29,203
Equity			
Other reserves	73	(42)	31
Retained earnings	9,025	1	9,026
Total equity	13,937	(41)	13,896
Non-current liabilities			
Employee benefits	217	50	267
Total non-current liabilities	10,049	50	10,099

(in PLN millions)	***Before the change in the accounting policies***	***Impact of changes in the accounting policies***	***Data currently reported***
		at 1 January 2009	
Balance sheet			
Assets			
Deferred tax assets	214	6	220
Total non-current assets	23,790	6	23,796
Total assets	26,144	6	26,150
Equity			
Other reserves	4	(30)	(26)
Retained earnings	8,277	-	8,277
Total equity	12,515	(30)	12,485
Non-current liabilities			
Employee benefits	262	36	298
Total non-current liabilities	5,694	36	5,730

The balance sheet and other comparative information as at 1 January 2009, which is the beginning of the earliest period, was not presented due to immaterial effect of changes in the accounting policies.

Changes in presentation of the financial statements

Dispute with DPTG

Following the partial award in the arbitration proceedings between TP S.A. and DPTG (see Note 29.d), the Company decided to disclose separately the impact of the dispute on the Company's financial performance because it does not relate to current operations.

Changes in presentation of items of the statement of cash flows

In 2010, the Company changed the presentation of certain items of net cash provided by operating activities in the statement of cash flows. The changes comprise the presentation of the following two adjustments to reconcile net income to funds generated from operations: finance costs, net excluding realised exchange rate effect on cash and cash equivalents and operational foreign exchange and derivatives (gains) / losses, net. In previous accounting periods, the aforementioned items were grouped as follows: interest income and expense, foreign exchange (gains) / losses, net and derivatives (gains) / losses, net (for the 12 months ended 31 December 2009 amounting to PLN (2,503) million, PLN (244) million and PLN 402 million, respectively). These changes have no effect on net cash provided by operating activities.

Management believes that the current presentation better reflects the nature of transactions concluded.

3.5. Significant accounting policies

3.5.1. Effect of changes in foreign exchange rates

Transactions in foreign currencies

The principles covering the measurement and recognition of transactions in foreign currencies are set out in IAS 21 "The Effects of Changes in Foreign Exchange Rates". Transactions in foreign currencies are converted by the Company into the functional currency at the spot exchange rate prevailing as at the transaction date. Monetary assets and liabilities which are denominated in foreign currencies are remeasured at each balance sheet date at the period-end exchange rate quoted by National Bank of Poland ("NBP") and the resulting translation differences are recorded in the income statement:

- in other operating income and expense for commercial transactions,
- in financial income or finance costs for financial transactions.

Derivative instruments are measured and recognized in accordance with the general principles described in Note 3.5.10.

Currency hedges that qualify for hedge accounting are recognized in the balance sheet at fair value at each period-end. Gains and losses arising from remeasurement to fair value are recognized:

- in other operating income and expense for fair value hedges of commercial transactions;
- in financial income or finance costs for hedges of financial assets and liabilities;
- in other comprehensive income for the effective portion of the net gain or loss on cash flow hedges.

Gains and losses arising from remeasurement to fair value of currency derivative instruments that economically hedge commercial or financial transactions and do not qualify for hedge accounting are recognized as other operating income / cost or financial income / expense depending on the nature of the underlying transaction. Gains and losses arising from remeasurement to fair value of other currency derivative instruments are recognized as financial income or finance cost.

3.5.2. Revenue

Revenue from the Company's activities is recognized and presented in accordance with IAS 18 "Revenue". Revenue comprises the fair value of the consideration received or receivable for the sale of services and goods in the ordinary course of the Company's activities. Revenue is recorded net of value-added tax and discounts.

Separable components of packaged and bundled offers

Sales of packaged Internet offers are considered as comprising identifiable and separate components to which general revenue recognition criteria can be applied separately. Numerous service offers on the Company's main markets are made up of two components, a product (e.g. internet modem) and a service. Once the separate components have been identified, the amount received or receivable from the customer is allocated based on each component's fair value. The sum allocated to delivered items is limited to the amount that is not dependent on the delivery of other items. For example, the sum allocated to delivered equipment generally corresponds to the price paid by the end-customer for that equipment and the balance of the amount received or receivable is contingent upon the future delivery of the service.

Offers that cannot be analyzed between separately identifiable components, because the commercial effect cannot be understood without reference to the series of transactions as a whole, are treated as bundled offers. Revenue from bundled offers is recognized in full over the life of the contract. The main example is connection fee: this does not represent a separately identifiable transaction from the subscription and communications, and connection fees are therefore recognized over the average expected life of the contractual relationship.

Equipment sales

Revenue from equipment sales is recognized when the significant risks and rewards of ownership are transferred to the buyer (see also paragraph "Separable components of packaged and bundled offers").

For broadband services, when equipment is sold through a distributor considered as an agent, modems/laptops and telecommunications services are a single bundled offering with multiple deliverables, and the modem/laptop revenue from the sale is recognised when a subscriber is connected to the network.

Equipment leases

Equipment lease revenue is recognized on a straight-line basis over the life of the lease agreement, except in the case of finance leases which are accounted for as sales on credit.

Revenues from the sale or supply of content

The accounting for revenue from the sale or supply of content depends on the analysis of the facts and circumstances surrounding these transactions. To determine if the revenue must be recognized on a gross or a net basis, an analysis is performed using the following criteria:

- the Company has the primary responsibility for providing services desired by the customer;
- the Company has inventory risk (the Company purchases content in advance);

- the Company has discretion in establishing prices directly or indirectly, such as by providing additional services;
- the Company has credit risk.

Revenues from the sale or supply of content are recognized:

- gross when the Company is deemed to be the primary obligor in the transaction with respect to the end-customer (i.e. when the customer has no specific recourse against the content provider), when the Company bears the inventory risk, when the Company has a reasonable latitude in setting prices charged to the end-customer, when the Company has credit risk and
- net of amounts due to the content provider when the latter is responsible for supplying the content to the end-customer, for setting the price to subscribers, when the content provider bears the inventory risk, when it has credit risk.

Service revenue

Telephone service and Internet access subscription fees are recognized in revenue on a straight-line basis over the service period.

Charges for incoming and outgoing telephone calls are recognized in revenue when the service is rendered.

Revenue from the sale of phone cards is recognised when they are used or expire.

Promotional offers

For certain commercial offers where customers do not pay for service over a certain period in exchange for signing up for a fixed period (time-based incentives), the total revenue generated under the contract is spread over the fixed, non cancellable period.

Loyalty programs

Loyalty programs consist of granting future benefits to customers (such as call credit and product discounts) in exchange for present and past use of the service or purchase of goods.

Points awarded to customers are treated as a separable component to be delivered out of the transaction that triggered the acquisition of the points. Part of the invoiced revenue is allocated to these points based on their fair value and deferred.
The Company participates in a loyalty program operated by a third party. A third party supplies the awards and the Company is collecting the consideration on behalf of a third party. Revenue is measured as a net amount retained on the Company's own account and is recognised when the third party becomes obliged to supply the awards and is entitled to receive consideration for doing so.

Loyalty program that exists in the Company is without a contract renewal obligation.

Discounts for poor quality of services or for breaks in service rendering

The Company's commercial contracts may contain service level commitments (delivery time, service reinstatement time). If the Company fails to comply with these commitments, it is obliged to grant a discount to the end-customer. Such discounts reduce revenue. Discounts are recorded when it becomes probable that they will be due based on the non-achievement of contractual terms.

3.5.3. Subscriber acquisition costs, advertising and related costs

Subscriber acquisition and retention costs, other than loyalty program costs (see Note 3.5.2), are recognized as an expense for the period in which they are incurred. Advertising, promotion, sponsoring, communication and brand marketing costs are also expensed as incurred.

3.5.4. Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are capitalized as part of the cost of that asset. Qualifying assets are assets that necessarily take a substantial period of time to get ready for their intended use or sale.

3.5.5. Share issuance costs and treasury shares

External costs directly related to share issuance are deducted from the related share premium. Other costs are expensed as incurred.

If the Company purchases its own equity instruments, the consideration paid, including directly attributable incremental costs, is deducted from equity attributable to the Company equity holders and presented in the balance sheet separately under “Treasury shares” until the shares are cancelled or reissued. The Company does not recognise in the income statement any gain or loss on the purchase, sale, issue or cancellation of its own equity instruments.

Treasury shares are recognised using settlement date accounting.

3.5.6. Intangible assets

Intangible assets, consisting mainly of software and development costs, are initially stated at acquisition or production cost comprising its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, any directly attributable costs of preparing the assets for their intended use or sale and, if applicable, attributable borrowing costs.

Internally developed trademarks and subscriber bases are not recognized as intangible assets.

Research and development costs

Under IAS 38 “Intangible Assets”, development costs are recognized as an intangible asset if and only if the following can be demonstrated:

- the technical feasibility of completing the intangible asset so that it will be available for use,
- the intention to complete the intangible asset and use or sell it and the availability of adequate technical, financial and other resources for this purpose,
- the ability to use or sell the intangible asset,
- how the intangible asset will generate probable future economic benefits for the Company,
- the Company's ability to measure reliably the expenditure attributable to the intangible asset during its development.

Development costs not fulfilling the above criteria and research costs are expensed as incurred. The Company's research and development projects mainly concern:

- upgrading the network architecture or functionality;
- developing service platforms aimed at offering new services to the Company's customers.

Development costs recognized as an intangible asset are amortized on a straight-line basis over their estimated useful life, generally not exceeding four years.

Software

Software is amortized on a straight-line basis over the expected life, not exceeding five years.

Useful lives of intangible assets are reviewed annually and are adjusted if current estimated useful lives are different from previous estimates. These changes in accounting estimates are recognized prospectively.

3.5.7. Property, plant and equipment

The cost of tangible assets corresponds to their purchase or production cost or price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates, as well as including costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, and, if applicable, attributable borrowing costs.

It also includes the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, representing the obligation incurred by the Company.

The cost of networks includes design and construction costs, as well as capacity improvement costs. The total cost of an asset is allocated among its different components and each component is accounted for separately when the components have different useful lives or when the pattern in which their future economic benefits are expected to be consumed by the entity varies. Depreciation is established for each component accordingly.

Maintenance and repair costs (day to day costs of servicing) are expensed as incurred.

Government grants

The Company may receive non-repayable government grants in the form of direct or indirect funding of capital projects. These grants are deducted from the cost of the related assets and recognized in the income statement, as a reduction of depreciation, based on the pattern in which the related asset's expected future economic benefits are consumed.

Finance leases

Assets acquired under leases that transfer substantially all risks and rewards of ownership to the Company are recorded as assets and an obligation in the same amount is recorded in liabilities. Normally, the risks and rewards of ownership are considered as having been transferred to the Company when at least one condition is met:

- the lease transfers ownership of the asset to the lessee by the end of the lease term,
- the Company has the option to purchase the asset at a price that is expected to be sufficiently lower than fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised,
- the lease term is for the major part of the estimated economic life of the leased asset,
- at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset,
- the leased assets are of such a specialized nature that only the lessee can use them without major modifications.

Assets leased by the Company as lessor under leases that transfer substantially all risks and rewards of ownership to the lessee are treated as having been sold.

Derecognition

An item of property, plant and equipment is derecognized on its disposal or when no future economic benefits are expected from its use or disposal. The gain or loss arising from the derecognition of an item of property, plant and equipment is recognized in operating income and equals the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Depreciation

Items of property, plant and equipment are depreciated to write off their cost, less any estimated residual value on a basis that reflects the pattern in which their future economic benefits are expected to be consumed. Therefore, the straight-line basis is usually applied over the following estimated useful lives:

Buildings	10 to 30 years
Networks and terminals	2 to 30 years
IT equipment	3 to 5 years
Other	2 to 10 years

Land is not depreciated. Perpetual usufruct rights are amortised over the period for which the right was granted, not exceeding 99 years.

These useful lives are reviewed annually and are adjusted if current estimated useful lives are different from previous estimates. These changes in accounting estimates are recognized prospectively.

3.5.8. Non-current assets held for sale

Non-current assets held for sale are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than continuing use. Those assets are available for immediate sale in their present condition subject only to terms that are usual and customary for sales of such assets and the sale is highly probable.

Non-current assets held for sale are measured at the lower of carrying amount and estimated fair value less costs to sell and are presented in a separate line in the balance sheet if IFRS 5 requirements are met.

Those assets are no longer depreciated. If fair value less costs to sell is less than its carrying amount, an impairment loss is recognised in the amount of the difference. In subsequent periods, if fair value less costs to sell increases the impairment loss is reversed up to the amount of losses previously recognised.

3.5.9. Impairment of non-current assets

International Accounting Standard 36 „Impairment of assets" requires that the recoverable amount of an asset should be estimated whenever there is an indication that the asset may be impaired and an impairment loss should be recognized whenever the carrying amount of an asset exceeds its recoverable amount. Where possible, the recoverable amount is estimated for individual assets. The recoverable amount of such assets is determined at their fair value less cost to sell or their value in use. If it is not possible to estimate the recoverable amount of the individual asset, the Company identified the cash-generating unit ("CGU") to which the asset belongs.

In the case of decline in the recoverable amount of an item of property, plant and equipment or an intangible asset to below its net book value, due to events or circumstances occurring during the period (such as obsolescence, physical damage, significant changes in the manner in which the asset is used, worse than expected economic performance, a drop in revenue or other external indicators), an impairment loss is recognized.

The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. The recoverable amount of an asset is generally determined by reference to its value in use, corresponding to the future economic benefits expected to be derived from the use of the asset and its subsequent disposal. It is assessed by the discounted cash flow method, based on management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset and the asset's expected conditions of use.

The impairment loss recognised equals the difference between net book value and recoverable amount.
Impairment tests are carried out on individual assets, except where they do not generate independent cash flows. In such cases, the recoverable amount is then determined at the level of the cash-generating unit (CGU) to which the asset belongs, except where:

- the fair value less costs to sell of the individual asset is higher than its book value; or
- the value in use of the asset can be estimated as being close to its fair value less costs to sell, where fair value can be reliably determined.

Given the nature of its assets and operations, most of the Company's individual assets do not generate cash flow independently from other assets.

3.5.10. Financial assets and liabilities

Financial assets include assets available-for-sale, assets at fair value through profit or loss, hedging derivative instruments and loans and receivables.

Financial liabilities include borrowings, other financing and bank overdrafts, liabilities at fair value through profit or loss, hedging derivative instruments, trade accounts payable and fixed assets payable.

Except for investments in subsidiaries and associates which are accounted for at cost as allowed in IAS 27 “Consolidated and Separate Financial Statements”, financial assets and liabilities are recognized and measured in accordance with IAS 39 “Financial Instruments: Recognition and Measurement”.

A regular way purchase or sale of financial assets is recognized using settlement date accounting.

Management determines the classification of financial assets and liabilities at initial recognition.

Recognition and measurement of financial assets

When financial assets are recognized initially, they are measured at fair value plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

Assets available-for-sale
Available-for-sale assets consist mainly of shares in companies and marketable securities that are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss. They are measured at fair value and gains and losses arising from remeasurement at fair value are recognized in other comprehensive income. Fair value corresponds to market price for listed securities and estimated fair value for unlisted securities, determined according to the most appropriate financial criteria in each case. Investments in unquoted equity instruments whose fair value cannot be reliably measured are measured at cost, less any impairment losses.

When there is objective evidence that available-for-sale assets are impaired, the cumulative loss included in other comprehensive income is taken to the income statement. A significant or prolonged decline in the fair value of equity instruments below costs is considered as an indicator that the securities are impaired. Impairment losses on equity instruments are not reversed through the income statement.

Dividends earned on investments in subsidiaries and assets available for sale are recognized in the income statement when the right of payment has been established.

Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and include trade receivables, cash and cash equivalents, bonds purchased from and loans granted to the Company’s subsidiaries, cash deposits paid to banks as a collateral for derivatives and other loans and receivables. They are recognized initially at fair value plus directly attributable transaction costs and are subsequently measured at amortized cost using the effective interest method. Short-term receivables with no stated interest rate are measured at the original invoice amount if the effect of discounting is immaterial. Cash flows on loans and receivables at variable rates of interest are remeasured periodically, to take into account changes in market interest rates.

Cash and cash equivalents are held primarily to meet the Company's short-term cash needs rather than for investment or other purposes. They consist of cash in bank and on hand and highly-liquid instruments that are readily convertible into known amounts of cash and are subject to insignificant changes in value.

Loans and receivables are carried in the balance sheet under: “Loans and receivables excluding trade receivables”, “Trade receivables” and “Cash and cash equivalents”.

At each balance sheet date, the Company assesses whether there is any objective evidence that loans or receivables are impaired. If any such evidence exists, the asset's recoverable amount is calculated. If the recoverable amount is less than the asset's book value, an impairment loss is recognized in the income statement.

Trade receivables that are homogenous and share similar credit risk characteristics are tested for impairment collectively. When estimating the expected credit risk the Company uses historical data as a measure for a decrease in the estimated future cash flows from the group of assets since the initial recognition.

In calculating the recoverable amount of receivables that are individually material and not homogenous, significant financial difficulties of the debtor or probability that the debtor will enter bankruptcy or financial reorganisation are taken into account.

The carrying amount of loans and receivables is reduced through an allowance account. Uncollectable receivables are written off against that account.

<u>Assets at fair value through profit or loss</u>
Financial assets at fair value through profit or loss are the following financial assets held for trading:

- financial assets acquired by the Company principally for the purpose of selling them in the near term;
- financial assets that form a part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking;
- derivative assets not qualifying for hedge accounting as set out in IAS 39.

Recognition and measurement of financial liabilities

<u>Financial liabilities at amortised cost</u>
Borrowings and other financial liabilities are initially recognized at fair value and subsequently measured at amortized cost using the effective interest method. Financial liabilities measured at amortised cost are carried in the balance sheet under “Financial liabilities at amortised cost excluding trade payables” and “Trade payables”.
Transaction costs that are directly attributable to the acquisition or issue of the financial liability are deducted from the liability's carrying value. This is because financial liabilities are initially recognized at fair value that usually corresponds to the fair value of the sums paid or received in exchange for the liability. The costs are subsequently amortized over the life of the debt by the effective interest method.

The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial instrument or, when appropriate, through the period to the next interest adjustment date, to the net carrying amount of the financial liability. The calculation includes all fees and costs paid or received between parties to the contract.

Certain borrowings are designated as being hedged by fair value hedges. Gain or loss on hedged borrowing attributable to a hedged risk adjusts the carrying amount of a borrowing and is recognized in the income statement.

<u>Financial liabilities at fair value through profit or loss</u>
Financial liabilities at fair value through profit or loss include derivatives that do not qualify for hedge accounting as set out in IAS 39 and are measured at fair value.

Upon initial recognition the Company did not designate financial liabilities as financial liability at fair value through profit or loss.

Recognition and measurement of derivative instruments

Derivative instruments are recognized in the balance sheet and measured at fair value. Derivatives used by the Company are not traded in an active market and their fair value is determined by using standard valuation techniques. Fair value is calculated using the net present value of future cash flows related to these contracts, quoted market forward interest rates, quoted market forward foreign exchange rates or, if quoted forward foreign exchange rates are not available, forward rates calculated based on spot foreign exchange rates using the interest rate parity method.

Except for gains and losses on hedging instruments (as explained below), gains and losses arising from changes in fair value of derivatives classified as financial assets and liabilities at fair value through profit or loss are immediately recognized in the income statement. The interest rate component of derivatives held for trading is

presented under interest expense within finance cost. The foreign exchange component of derivatives held for trading that economically hedge commercial or financial transactions is presented under foreign exchange gains or losses within other operating income / expense or finance cost, respectively, depending on the nature of the underlying transaction. The foreign exchange component of other derivatives held for trading is presented under foreign exchange gains or losses within finance cost, net.

The Company treats the whole derivative as its unit of account and presents derivatives either as current or non-current based on the date of last cash flows either within or beyond 12 months from the balance sheet date.

Hedging instruments

Derivative instruments may be designated as fair value hedges or cash flow hedges:

- a fair value hedge is a hedge of the exposure to changes in fair value of a recognized asset or liability or an identified portion of the asset or liability, that is attributable to a particular risk – notably interest rate and currency risks – and could affect profit or loss,
- a cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction (such as a future purchase or sale) and could affect profit or loss.

A hedging relationship qualifies for hedge accounting when:

- at the inception of the hedge, there is formal designation and documentation of the hedging relationship,
- at the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated (i.e. the actual results of the hedge are within a range of 80-125 per cent).

The effects of applying hedge accounting are as follows:

- for fair value hedges of existing assets and liabilities, the change in fair value of the hedged portion of the asset or liability attributable to the hedged risk adjusts the carrying amount of the asset or liability in the balance sheet. The gain or loss from the changes in fair value of the hedged item is recognized in profit or loss and is offset by the effective portion of the loss or gain from remeasuring the hedging instrument at fair value. The adjustment to the hedged item is amortized starting from the date when a hedged item ceases to be adjusted by a change in the fair value of the hedged portion of liability attributable to the risk hedged,
- for cash flow hedges, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized directly in other comprehensive income and the ineffective portion of the gain or loss on the hedging instrument is recognized in profit or loss. Amounts recognized directly in other comprehensive income are subsequently recognized in profit or loss in the same period or periods during which the hedged item affects profit or loss. If a hedge of a forecast transaction results in the recognition of a non-financial asset or non-financial liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability.

Derecognition of financial assets and liabilities

Financial assets

A financial asset (or where applicable a part of financial assets or part of a group of similar financial assets) is derecognized when:

- the rights to receive cash flows from the asset have expired,
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass-through' arrangement, or
- the Company has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the assets, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Financial liabilities

A financial liability is derecognized when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in profit or loss.

Fair value measurements

The Company classifies fair value measurements using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities,
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices),
- Level 3: inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

3.5.11. Inventories

Inventories are stated at the lower of cost and net realizable value. The Company provides for slow-moving or obsolete inventories based on inventory turnover ratios and current marketing plans.

Cost corresponds to purchase or production cost determined by the weighted average cost method. Net realizable value is the estimated selling price in the ordinary course of business, less selling expenses.

3.5.12. Income tax

The tax expense comprises current and deferred tax.

Current tax

The current income tax charge is determined in accordance with the relevant tax law regulations in respect of the taxable profit. Income tax payable represents the amounts payable at the balance sheet date. If the amount paid on account of current income tax is greater than the amount finally determined, the excess is recognised in the balance sheet as an income tax assets.

Deferred taxes

In accordance with IAS 12 "Income Taxes", deferred taxes are recognized for all temporary differences between the carrying amounts of assets and liabilities in the financial statements and their tax bases, as well as for unused tax losses, using the liability method. Deferred tax assets are recognized only when their recovery is considered probable, that is when future taxable profit will be available against which the temporary differences can be utilised. At each balance sheet unrecognised deferred tax assets are re-assessed. A previously unrecognised deferred tax asset is recognised to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

A deferred tax asset is recognised for all deductible temporary differences arising from investments in subsidiaries and associates, to the extent that, and only to the extent that, it is probable that:

- the temporary difference will reverse in the foreseeable future; and
- taxable profit will be available against which the temporary difference can be utilized.

In accordance with IAS 12, deferred tax assets and liabilities are not discounted. Deferred income tax is calculated using the enacted or substantially enacted tax rates at the balance sheet date.

3.5.13. Provisions

In accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", a provision is recognized when the Company has a present obligation towards a third party and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

The obligation may be legal, regulatory or contractual or it may represent a constructive obligation deriving from the Company's actions where, by an established pattern of past practice, published policies or a sufficiently specific current statement, the Company has indicated to other parties that it will accept certain responsibilities, and as a result, has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

The estimate of the amount of the provision corresponds to the expenditure likely to be incurred by the Company to settle its obligation. If a reliable estimate cannot be made of the amount of the obligation, no provision is recorded and the obligation is deemed to be a "contingent liability".

Contingent liabilities – corresponding to (i) possible obligations that are not recognized because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the Company's control, or (ii) to present obligations arising from past events that are not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or because the amount of the obligation cannot be measured with sufficient reliability – are disclosed in the notes to the Separate Financial Statements.

Restructuring

A provision for restructuring costs is recognized only when the general recognition criteria for provisions are met and when the Company:

- has a detailed formal plan for the restructuring, and
- has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Provisions for dismantling and restoring sites

The Company is required to dismantle equipment and restore sites. In accordance with paragraphs 36 and 37 of IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", the provision is based on the best estimate of the amount required to settle the obligation. It is discounted by applying a discount rate that reflects the passage of time and the risk specific to the liability. The amount of the provision is revised periodically and adjusted where appropriate, with a corresponding entry to the asset to which it relates.

3.5.14. Pensions and other employee benefits

Certain employees of the Company are entitled to jubilee awards and retirement bonuses. Jubilee awards are paid to employees upon completion of a certain number of years of service whereas retirement bonuses represent one-off payments paid upon retirement in accordance with the Company's remuneration policies. Both items vary according to the employee's average remuneration and length of service. Jubilee awards and retirement bonuses are not funded. The Company is also obliged to provide certain post-employment benefits to some of its retired employees.

The cost of providing benefits mentioned above is determined separately for each plan using the projected unit credit actuarial valuation method. This method sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation which is then discounted. The calculation is based on demographic assumptions concerning retirement age, rates of future salary increases, staff turnover rates, and financial assumptions concerning future interest rates (to determine the discount rate).

Actuarial gains and losses on jubilee awards plans are recognized as income or expense when they occur. Actuarial gains and losses on post-employment benefits are recognized immediately in their total amount in the other comprehensive income, with no recycling to the income statement. The present value of the defined benefit obligations is verified at least annually by an independent actuary. Demographic and attrition profiles are based on historical data.

Termination benefits

The Company recognizes termination benefits as a liability and an expense when it is demonstrably committed to either terminate the employment of an employee or group of employees before the normal retirement date, or provide termination benefits as a result of an offer made in order to encourage voluntary redundancy. An entity is demonstrably committed to a termination when it has a detailed formal plan for the termination and is without realistic possibility of withdrawal.

Benefits falling due more than 12 months after the balance sheet date are discounted.

3.5.15. Share-based payments

TP S.A. operates an equity-settled, share-based compensation plan under which employees render services to the Company and its subsidiaries as consideration for equity instruments of TP S.A. The fair value of the employee services received in exchange for the grant of the equity instruments is recognised as an expense, with a corresponding increase in equity, over the period in which the service conditions are fulfilled (vesting period).

France Telecom S.A. operates its own equity-settled, share-based compensation plan under which employees of the Company render services to the Company as consideration for equity instruments of France Telecom S.A.. In accordance with IFRS 2 "Share-based Payment", the fair value of the employee services received in exchange for the grant of the equity instruments of France Telecom S.A. is recognized in these Separate Financial Statements as an expense with a corresponding increase in equity, over the period in which the service conditions are fulfilled (vesting period).

The fair value of the employee services received is measured by reference to the fair value of the equity instruments at the grant date.

Vesting conditions, other then market conditions, were taken into account by adjusting the number of equity instruments included in the measurement of the transaction so that, ultimately, the expense recognised for services received is based on the number of equity instruments that are expected to vest.

4. Revenue

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Fixed line telephony services	**5,360**	**6,173**
Subscriptions and voice traffic revenue	3,998	4,794
Wholesale revenue (including interconnect)	1,346	1,351
Payphone revenue	15	27
Other	1	1
Data Services	**2,753**	**2,850**
Leased lines	606	614
Data transmission	722	724
Dial – up	5	13
Broadband and TV revenue	1,420	1,499
Radio communications	**1**	**2**
Sales of goods and other	**320**	**266**
Total revenue	**8,434**	**9,291**

Revenue is generated mainly in the territory of Poland. Approximately 4.6% and 4.2% of the total revenue for the 12 months ended 31 December 2010 and 2009, respectively, was received from entities which are not domiciled in Poland, mostly from interconnect services.

5. Operating income and expense

5.1. External purchases

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Commercial expenses	(461)	(408)
− cost of handsets and other equipment sold	*(55)*	*(37)*
− commissions, advertising, sponsoring costs and other	*(406)*	*(371)*
Interconnect expenses	(1,016)	(1,089)
Costs relating to network and IT expenses	(669)	(734)
Other external purchases	(1,307)	(1,227)
Total external purchases	**(3,453)**	**(3,458)**

Other external purchases include customer support and management services, postage costs, costs of content, rental costs, real estate operating and maintenance costs, subcontracting fees, advisory and legal services, costs of other services, supplies and equipment for internal use.

5.2. Labour expenses

(in PLN millions, except for number of employees)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Average number of employees (full time equivalent)	18,231	21,891
Wages and salaries	(1,333)	(1,454)
Social security and other charges	(302)	(333)
Capitalized personnel costs	109	89
Other employee benefits	(41)	(91)
Wages and employee benefit expenses	**(1,567)**	**(1,789)**
Share-based payments	**(4)**	**(36)**
Total labour expenses	**(1,571)**	**(1,825)**

5.3. Other operating income and expense

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Impairment losses on trade and other receivables, net	(48)	(48)
Taxes other than income taxes	(256)	(235)
− property tax and perpetual usufruct charges	*(200)*	*(181)*
− frequency fee, fees for subscribers' numbers and telecommunications charges	*(27)*	*(28)*
− other taxes	*(29)*	*(26)*
Other expense and changes in provisions, net	(227)	(129)
Total other operating expense	**(531)**	**(412)**
Income from shared resources	136	97
Late payment interest on trade receivables	22	23
Recoveries on customer bad debts written off	14	10
Operating foreign exchange gains, net	5	15
Other income	107	76
Total other operating income	**284**	**221**

In 2010 the Company accounted for PLN 200 million of property tax and perpetual usufruct charges. This amount includes PLN 34 million of property tax related to previous periods.

Other expense and changes in provisions include donations, changes in provisions for claims and litigation, risks and other charges (see Note 25), except for provision for the dispute with DPTG (see Note 29.d).

Income from shared resources includes income from intragroup sale of goods or services that reflect either shared resources or an internal organization of an administrative process (mainly IT and distribution fees).

During the 12 months ended 31 December 2010 and 2009, foreign exchange gains/(losses) presented in other operating income related to derivatives classified as held for trading under IAS 39 and economically hedging commercial transactions amounted to PLN (36) million and PLN (17) million, respectively.

Other income includes other individually immaterial items.

5.4. Research and development

In the 12 months ended 31 December 2010 and 2009, research and development costs expensed in the income statement amounted to PLN 59 million and PLN 61 million, respectively.

6. Restructuring costs

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Employee termination	(15)	(24)
Other	-	2
Total restructuring costs	**(15)**	**(22)**

Movements in restructuring provisions are described in Note 25.

7. Gains on disposal of assets

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Disposal of shares [1]	-	14
Disposals of property, plant and equipment and intangible assets [2]	65	22
Total gains on disposal of assets	**65**	**36**

[1] In the 12 months ended 31 December 2009 includes gain on disposal of investment in TP MED Sp. z o.o. (see Note 14.1).
[2] In the 12 months ended 31 December 2010 and 2009 includes gains on disposals of property amounting to 56 PLN million and 19 PLN million, respectively.

8. Impairment

8.1. Information concerning the definition of Cash Generating Units

Most of the Company's individual assets do not generate cash flow independently from other assets due to the nature of the Company's activities. The entire fixed network is treated as a separate Cash Generating Unit.

The Company considers certain indicators, including market liberalization and other regulatory and economic changes in the Polish telecommunications market, in assessing whether there is any indication that assets may be impaired. As at 31 December 2010 and 2009 the Company performed impairment tests of the fixed network. No impairment loss was recognized in 2010 and 2009 as a result of these tests.

The following key assumptions were used to determine the value in use of the fixed network:

- market value, penetration rate and market share decisions of the regulator in terms of pricing, accessibility of services, the level of commercial expenses required to replace products and keep up with existing competitors or new market entrants the impact of changes in net revenue on direct costs and
- the level of investment spending, which may be affected by the roll-out of necessary new technologies.

The amounts assigned to each of these parameters reflect past experience adjusted for expected changes over the timeframe of the business plan, but may also be affected by unforeseeable changes in the political, economic or legal framework.

CGU		*Fixed network*
	31 December 2010	*31 December 2009*
Basis of recoverable amount	Value in use	Value in use
Source used	Business plan	Business plan
	5 years cash flow projections	5 years cash flow projections
Growth rate to perpetuity	0%	0%
Pre-tax discount rate	11.0%	12.1%

Management believes that no reasonably possible change to any of the above key assumptions would cause the carrying value of fixed network cash generating unit to materially exceed its recoverable amount.

8.2. Other property, plant and equipment and intangible assets

In the 12 months ended 31 December 2010, the impairment loss on property, plant and equipment charged to the income statement amounted to PLN 9 million, primarily including a net impairment loss as a result of a review of certain Company's properties.

In the 12 months ended 31 December 2009, the impairment loss on property, plant and equipment charged to the income statement amounted to PLN 21 million, primarily including a net impairment reversal as a result of a review of certain Company's properties and an impairment loss on liquidated network assets.

In the 12 months ended 31 December 2010 and 2009, the impairment loss on intangible assets charged to the income statement amounted to PLN 1 million and 11 million respectively and was recognised as a result of a review of expected future cash flows.

8.3. Investments in subsidiaries

In the 12 months ended 31 December 2010, the impairment loss on TP S.A.'s investment in TP Teltech Sp. z o.o. charged to the income statement amounted to PLN 1 million.

In the 12 months ended 31 December 2009, the Company partially reversed the impairment loss on its investment in Virgo Sp. z o.o. in the amount of PLN 19 million and recognised the impairment loss on the investment in Wirtualna Polska S.A. amounting to PLN 14 million.

9. Finance income and expense

(in PLN millions)	*12 months ended 31 December 2010*								
	Finance income, net						*Operating income*		
	Dividend income	*Interest Income*	*Interest expense and other financial charges*	*Foreign exchange gains / (losses)*	*Discounting expense*	***Finance income / (costs), net***	*Interest income / (expense)*	*Foreign exchange gains / (losses)*	*Impairment losses*
Investments in subsidiaries	1,906	-	-	-	-	**1,906**	-	-	(1)
Loans and receivables	-	403 [(1)]	-	9	-	**412**	22 [(4)]	(6)	(41) [(5)]
– *including cash and cash equivalents*	*-*	*80*	*-*	*9*	*-*	***89***	*-*	*-*	*-*
Liabilities at amortized cost	-	-	(697) [(2)]	163	-	**(534)**	-	10	-
Derivatives	-	-	(160)	(190)	-	**(350)**	-	(36)	-
– *hedging derivatives*	*-*	*-*	*(64)*	*(97)*	*-*	***(161)***	*-*	*-*	*-*
– *derivatives held for trading*	*-*	*-*	*(96)*	*(93)*	*-*	***(189)***	*-*	*(36)*	*-*
Non-financial items	-	-	-	-	(29) [(3)]	**(29)**	-	37	(17) [(6)]
Total	**1,906**	**403**	**(857)**	**(18)**	**(29)**	**1,405**	**22**	**5**	**(59)**

(1) Includes mainly interest income on bonds issued by subsidiaries and cash and cash equivalents.
(2) Includes mainly interest expense on bonds, bank borrowings, loans from subsidiaries and change in fair value of liabilities hedged by fair value hedges.
(3) Includes discounting expense related to employee benefits, restructuring provision and provisions for dismantling.
(4) Includes late payment interests on trade receivables.
(5) Includes impairment losses on trade receivables.
(6) Includes impairment losses on other receivables and non-current assets.

(in PLN millions)	*12 months ended 31 December 2009*								
	Finance income, net						*Operating income*		
	Dividend income	*Interest Income*	*Interest expense and other financial charges*	*Foreign exchange gains / (losses)*	*Discounting expense*	***Finance income / (costs), net***	*Interest income / (expense)*	*Foreign exchange gains / (losses)*	*Impairment losses*
Investments in subsidiaries	2,897	-	-	-	-	**2,897**	-	-	(14)
Loans and receivables	-	344 [(1)]	-	(7)	-	**337**	23 [(4)]	7	(45) [(5)]
– *including cash and cash equivalents*	*-*	*28*	*-*	*(7)*	*-*	***21***	*-*	*-*	*-*
Liabilities at amortized cost	-	-	(705) [(2)]	213	-	**(492)**	-	12	-
Derivatives	-	-	(65)	(320)	-	**(385)**	-	(17)	-
– *hedging derivatives*	*-*	*-*	*(20)*	*(7)*	*-*	***(27)***	*-*	*-*	*-*
– *derivatives held for trading*	*-*	*-*	*(45)*	*(313)*	*-*	***(358)***	*-*	*(17)*	*-*
Non-financial items	-	-	-	-	(32) [(3)]	**(32)**	-	13	(16) [(6)]
Total	**2,897**	**344**	**(770)**	**(114)**	**(32)**	**2,325**	**23**	**15**	**(75)**

(1) Includes mainly interest income on bonds issued by subsidiaries and cash and cash equivalents.
(2) Includes mainly interest expense on bonds, bank borrowings, loans from subsidiaries and change in fair value of liabilities hedged by fair value hedges.
(3) Includes discounting expense related to employee benefits, restructuring provision and provisions for dismantling.
(4) Includes late payment interests on trade receivables.
(5) Includes impairment losses on trade receivables.
(6) Includes impairment losses on other receivables and non-current assets.

During the 12 months ended 31 December 2010 and 2009 there was no significant ineffectiveness on cash flow hedges and fair value hedges.

10. Income tax

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Current income tax	48	138
Deferred tax change	71	(17)
Less: Deferred tax charged to other comprehensive income	(5)	4
Total income tax	**124**	**117**

The reconciliation between the effective income tax expense and the theoretical tax calculated based on the Polish statutory tax rate is as follows:

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Net income before tax	1,147	3,474
Net income before tax, dispute with DPTG excluded	2,208	3,474
Statutory tax rate	19%	19%
Theoretical tax	420	660
Reassessment of deferred tax asset on dispute with DPTG	31	-
Change in unrecognised deferred tax asset and other	13	(10)
Income not taxable, net [1]	(340)	(533)
Effective tax	**124**	**117**

[1] Includes mainly dividends received from subsidiaries.

Due to uncertainty related to tax relief on deductible temporary differences on DPTG provision resulting from the statute of limitation, the deferred tax asset has been reassessed and decreased by PLN 31 million as at 31 December 2010.

Income not taxable and expenses not deductible for tax purposes consist of certain income and cost items, which, under Polish tax law, are specifically determined as non-taxable and non-deductible.

Deferred tax

The net deferred tax liabilities/(assets) consist of the following:

	Balance sheet		*Income statement*	
(in PLN millions)	*At 31 December 2010*	*At 31 December 2009 (see Note 3.4)*	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Property, plant and equipment and intangible assets	181	206	25	43
Impairment of financial assets	(19)	(20)	(1)	(12)
Finance costs, net	92	25	(69)	(5)
Accrued income/expense	(346)	(357)	(11)	17
Employee benefit plans	(47)	(49)	(5)	1
Deferred revenue	(23)	(17)	6	-
Other differences	(4)	(25)	(21)	(23)
Net deferred tax (assets)/liabilities	**(166)**	**(237)**	**-**	**-**
Deferred tax income/(expense)	**-**	**-**	**(76)**	**21**

Unrecognized deferred tax asset relates mainly to temporary differences, which based on the Company's management assessment could not be utilized for tax purposes. As at 31 December 2010 and 2009, deductible temporary differences, for which no deferred tax asset was recognised, amounted to PLN 85 million and PLN 22 million gross, respectively.

11. Components of other comprehensive income

11.1. Cash flow hedges

The change in fair value of cash flow hedges charged to other comprehensive income is presented below:

(in PLN millions)	*12 months ended 31 December 2010*			*12 months ended 31 December 2009*		
	Before tax	*Tax*	*After tax*	*Before tax*	*Tax*	*After tax*
Beginning of period	**11**	**(2)**	**9**	**(28)**	**5**	**(23)**
The effective part of gains/(losses) on hedging instrument	(124)	24	(100)	10	(2)	8
The amount transferred to the income statement	115	(22)	93	27	(5)	22
The amount transferred to the initial carrying amount of the hedged item	-	-	-	2	-	2
End of period	**2**	**-**	**2**	**11**	**(2)**	**9**

During the 12 months ended 31 December 2010 and 2009, interest income/(expense) on cash flow hedges that were transferred from other comprehensive income and adjusted interest expense on hedged debt amounted to PLN (46) and PLN (19) million, respectively (see Note 9).

During the 12 months ended 31 December 2010 and 2009, foreign exchange gains/(losses) on cash flow hedges that were transferred from other comprehensive income and adjusted foreign exchange differences on hedged debt amounted to PLN (69) and PLN (7) million, respectively (see Note 9).

During the 12 months ended 31 December 2010 and 2009, foreign exchange gains/(losses) on cash flow hedges that were transferred from other comprehensive income to external purchases and adjusted rental costs amounted to PLN 0 million and PLN (1) million, respectively (see Note 5.1).

During the 12 months ended 31 December 2010 and 2009, foreign exchange gains/(losses) on cash flow hedges of highly probable forecast transactions that were transferred from other comprehensive income and adjusted the initial carrying amount of property, plant and equipment amounted to PLN 0 million and PLN (2) million, respectively.

During the 12 months ended 31 December 2010 and 2009, there was no material forecast transaction for which hedge accounting was discontinued as it was no longer expected to occur.

The amounts presented in other comprehensive income as at 31 December 2010 are expected to mature and affect the income statement in the years 2011-2014.

11.2. Actuarial losses on post employment benefits

The change in actuarial losses on post-employment benefits charged to other comprehensive income is presented below:

(in PLN millions)	*12 months ended 31 December 2010*			*12 months ended 31 December 2009 (see Note 3.4)*		
	Before tax	*Tax*	*After tax*	*Before tax*	*Tax*	*After tax*
Beginning of period	**(51)**	**9**	**(42)**	**(36)**	**6**	**(30)**
Actuarial losses on retirement bonuses	(12)	2	(10)	(10)	2	(8)
Actuarial losses on other post-employment benefits	(4)	1	(3)	(5)	1	(4)
End of period	**(67)**	**12**	**(55)**	**(51)**	**9**	**(42)**

12. Intangible assets

(in PLN millions)	*At 31 December 2010*			
	Cost	*Accumulated amortization*	*Impairment*	*Net*
Software	3,702	(2,512)	-	1,190
Other intangibles	105	(36)	(12)	57
Total	**3,807**	**(2,548)**	**(12)**	**1,247**

(in PLN millions)	*At 31 December 2009*				*At 1 January 2009*
	Cost	*Accumulated amortization*	*Impairment*	*Net*	*Net*
Software	3,285	(2,286)	-	999	1,010
Other intangibles	101	(34)	(11)	56	56
Total	**3,386**	**(2,320)**	**(11)**	**1,055**	**1,066**

Movements in the net book values of intangible assets were as follows:

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Opening balance net of accumulated amortization and impairment	**1,055**	**1,066**
Acquisitions of intangible assets	566	414
Disposals and retirements	(6)	-
Amortization	(366)	(425)
Impairment	(1)	(11)
Reclassifications and other, net	(1)	11
Closing balance	**1,247**	**1,055**

13. Property, plant and equipment

(in PLN millions)	*At 31 December 2010*			
	Cost	*Accumulated depreciation*	*Impairment*	*Net*
Land and buildings	3,035	(1,110)	(90)	1,835
Networks and terminals	28,466	(17,955)	(4)	10,507
IT equipment	1,386	(977)	-	409
Investment grants	(243)	111	-	(132)
Other	159	(121)	-	38
Total	**32,803**	**(20,052)**	**(94)**	**12,657**

(in PLN millions)	*At 31 December 2009*				*At 1 January 2009*
	Cost	*Accumulated depreciation*	*Impairment*	*Net*	*Net*
Land and buildings	3,029	(974)	(86)	1,969	2,116
Networks and terminals	27,631	(16,481)	(12)	11,138	12,232
IT equipment	1,322	(903)	-	419	584
Investment grants	(246)	98	-	(148)	(163)
Other	165	(122)	-	43	76
Total	**31,901**	**(18,382)**	**(98)**	**13,421**	**14,845**

Investment grants are non-repayable and relate to certain property, plant and equipment received by TP S.A. from Public Telephone Committees (Społeczne Komitety Telefonizacji).

Movements in the net book value of property, plant and equipment were as follows:

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Opening balance net of accumulated depreciation and impairment	**13,421**	**14,845**
Acquisitions of property, plant and equipment	1,327	880
Disposals and retirements	(43)	(24)
Depreciation	(2,033)	(2,230)
Impairment	(9)	(21)
Reclassifications and other, net	(6)	(29)
Closing balance	**12,657**	**13,421**

The carrying value of equipment held under finance leases as at 31 December 2010 and 2009 amounted to PLN 17 million and PLN 22 million, respectively. During the 12 months ended 31 December 2010 and 2009 acquisitions of equipment financed through finance leases amounted to PLN 1 million and PLN 22 million, respectively. Leased assets cannot be sold, donated, transferred by title or pledged and are a collateral for the related finance lease liability.

14. Financial assets

14.1. Investments in subsidiaries and assets available for sale

The Company's investments in subsidiaries and assets available for sale are presented below:

(in PLN millions)	*At 31 December 2010*			*At 31 December 2009*		
	Cost/ Fair value	*Impairment*	*Net*	*Cost/ Fair value*	*Impairment*	*Net*
Main companies						
PTK Centertel Sp. z o.o.	*6,784*	*-*	*6,784*	*6,784*	*-*	*6,784*
TP EmiTel Sp. z o.o.	*401*	*-*	*401*	*401*	*-*	*401*
Wirtualna Polska S.A.	*197*	*(14)*	*183*	*197*	*(14)*	*183*
TP Invest Sp. z o.o.	*101*	*-*	*101*	*101*	*-*	*101*
TP Edukacja i Wypoczynek Sp. z o.o.	*102*	*(17)*	*85*	*102*	*(17)*	*85*
Otwarty Rynek Elektroniczny S.A.	*36*	*-*	*36*	*50*	*-*	*50*
Ramsat S.A.	*25*	*-*	*25*	*25*	*-*	*25*
Other	33	(12)	21	33	(11)	22
Total investments in subsidiaries	**7,679**	**(43)**	**7,636**	**7,693**	**(42)**	**7,651**
Main unlisted companies						
Exatel	*14*	*(11)*	*3*	*14*	*(11)*	*3*
Other	*1*	*-*	*1*	*1*	*-*	*1*
Total assets available for sale	**15**	**(11)**	**4**	**15**	**(11)**	**4**

Financial assets available for sale are measured at historical cost less impairment and mainly comprise shares for which there is no active market and fair value cannot be reliably measured except for the shares in ICO Global Communications (Holdings) Limited which are traded on NASDAQ.

As at 31 December 2010 and 2009 the Company owned directly the following shares in its subsidiaries:

Entity	*Location*	*Scope of activities*	*Share capital owned by TP S.A. directly*		*Share capital owned by TP S.A. directly and indirectly*	
			31 December 2010	*31 December 2009*	*31 December 2010*	*31 December 2009*
PTK-Centertel Sp. z o.o.	Warsaw, Poland	Mobile telephony services, construction and operation of mobile telecommunications networks.	100.00%	100.00%	100.00%	100.00%
TP EmiTel Sp. z o.o.	Kraków, Poland	TV and radio signals broadcasting, construction, lease and maintenance of technical infrastructure.	100.00%	100.00%	100.00%	100.00%
Wirtualna Polska S.A.	Gdańsk, Poland	Internet portal and related services including internet advertising.	100.00%	100.00%	100.00%	100.00%
OPCO Sp. z o.o.	Warsaw, Poland	Facilities management and maintenance.	100.00%	100.00%	100.00%	100.00%
Otwarty Rynek Elektroniczny S.A.	Warsaw, Poland	Provision of complex procurement solutions, including advisory, implementation and operation of e-commerce platform and IT systems, hosting.	100.00%	100.00%	100.00%	100.00%
TP Edukacja i Wypoczynek Sp. z o.o.	Warsaw, Poland	Hotel services, training and conference facilities.	100.00%	100.00%	100.00%	100.00%
TP Invest Sp. z o.o.	Warsaw, Poland	Services for Group entities, holding management.	100.00%	100.00%	100.00%	100.00%
TP TelTech Sp. z o.o. (1)	Łódź, Poland	Monitoring of alarm signals, servicing telecommunications networks, design and development of telecommunications systems.	2.15%	5.21%	100.00%	100.00%
Contact Center Sp. z o.o.	Warsaw, Poland	Call-center services and telemarketing.	0.04%	0.04%	100.00%	100.00%
Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. ("PTE TP S.A")(2)	Warsaw, Poland	Management of employee pension fund.	100.00%	100.00%	100.00%	100.00%
Fundacja Orange	Warsaw, Poland	Charity foundation.	50.00%	50.00%	100.00%	100.00%
TPSA Finance B.V. (3)	Amsterdam, The Netherlands	Financial and investment operations.	-	100.00%	100.00%	100.00%
PayTel S.A.	Warsaw, Poland	E-commerce and electronic services, including GSM prepaid services, bill charging and processing of electronic financial transactions.	100.00%	100.00%	100.00%	100.00%
Ramsat S.A.	Modlnica, Poland	Distributor of PTK Centertel and TP S.A. products on mass and business market.	100.00%	100.00%	100.00%	100.00%

(1) Change results from issuance of shares by TP TelTech Sp. z o.o. that were fully subscribed by TP Invest Sp. z o.o.
(2) In September 2010 the Company concluded a share sale agreement under which 25% shares of PTE TP S.A would be disposed to Orange Customer Service Sp. z o.o. controlled by TP Invest Sp. z o.o. The sale agreement will come into force after the Polish Financial Supervision Authority approval.
(3) The Company disposed all of its shareholding in TPSA Finance B.V. to TP Invest Sp. z o.o.

In the 12 months ended 31 December 2010 the voting power held by the Company was equal to the Company's interest in the share capital of all of its subsidiaries.

There were no significant acquisitions or divestitures in the 12 months ended 31 December 2010.

Significant acquisitions and divestitures in the 12 months ended 31 December 2009 are described below.

On 24 March 2009, the Company and LUX MED Sp. z o.o. concluded a share sale agreement under which the Company disposed of all of its shareholding in TP Med Sp. z o.o., for a sales price totalling PLN 19 million.

On 8 April 2009, Telekomunikacja Polska set up a company PayTel S.A., with a share capital amounting to PLN 12 million. The company was registered on 25 June 2009.

In May 2009, Telekomunikacja Polska purchased 100% of the shares in Ramsat S.A. – an authorized dealer of PTK-Centertel Sp. z o.o. The purchase price amounted to PLN 25 million.

On 29 June 2009, PayTel S.A. and TP EmiTel Sp. z o.o. concluded a share sale agreement under which TP EmiTel Sp. z o.o. disposed of its 100% shareholding in PayTel Sp. z o.o. to PayTel S.A., for a sales price totalling PLN 11 million. In December 2009, PayTel Sp. z o.o. merged with PayTel S.A.

On 29 September 2009, Telekomunikacja Polska and Virgo Sp. z o.o. concluded a share sale agreement under which Virgo Sp. z o.o. disposed of its 100% shareholding in Wirtualna Polska S.A. to TP S.A., for a sales price totalling PLN 197 million.

14.2. Loans and receivables excluding trade receivables

The Company's loans and receivables excluding trade receivables are presented below:

(in PLN millions)	*At 31 December 2010*			*At 31 December 2009*		
	Cost	*Impairment*	*Net*	*Cost*	*Impairment*	*Net*
Bonds issued by subsidiaries [1,2,3]	3,425	-	3,425	3,671		3,671
Loans receivables from subsidiaries [1]	6	-	6	5		5
Other	20	-	20	22		22
Total loans and receivables excluding trade receivables	**3,451**	**-**	**3,451**	**3,698**		**3,698**
Current	304	-	304	276		276
Non-current	3,147	-	3,147	3,422		3,422

(1) Includes accrued interest receivable.
(2) Included in net financial debt calculation (see Note 17).
(3) On 31 January 2009 the Company and TP Invest Sp. z o.o. concluded agreements, under which, among others, TP S.A. purchased bonds issued by TP Invest Sp. z o.o. Bonds have maturity between 2 weeks and 9 years.

The Company's maximum exposure to credit risk is represented by the carrying amounts of loans and receivables.

14.3. Financial assets at fair value through profit or loss

The Company's assets at fair value through profit or loss are presented below:

(in PLN millions)	*Fair value*	
	At 31 December 2010	*At 31 December 2009*
Derivatives – held for trading [1]	77	77
Total financial assets at fair value through profit or loss	**77**	**77**
Current	20	2
Non-current	57	75

(1) Included in net financial debt calculation (see Note 17).

The Company's maximum exposure to credit risk is represented by the carrying amounts of derivatives. The Company enters into derivatives contracts with leading financial institutions. Limits are applied to monitor the level of exposure on the financial counterparties. In case the counterparty's financial soundness is deteriorating, the Company applies the appropriate measures mitigating the default risk.

14.4. Financial assets measured at fair value

The following tables provide an analysis of the Company's financial assets that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable (see Note 3.5.10):

(in PLN millions)	*At 31 December 2010*			
	Fair value measurement			
	Level 1	*Level 2*	*Level 3*	*Total*
Financial assets at fair value through profit or loss	-	77	-	77
Derivatives – held for trading	-	*77*	-	*77*
Hedging derivatives	-	45	-	45
Total	**-**	**122**	**-**	**122**

(in PLN millions)	*At 31 December 2009*			
	Fair value measurement			
	Level 1	*Level 2*	*Level 3*	*Total*
Financial assets at fair value through profit or loss	-	77	-	77
Derivatives – held for trading	-	*77*	-	*77*
Hedging derivatives	-	42	-	42
Total	**-**	**119**	**-**	**119**

During the 12 months ended 31 December 2010 and 2009, there was no transfer between Level 1 and Level 2 fair value measurements, and no transfer into and out of Level 3 fair value measurement.

15. Trade receivables, other assets and prepaid expenses

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
Trade receivables (net of impairment) [(1), (3)]	**857**	**697**
VAT receivables	29	10
Other taxes receivables	1	3
Employee-related receivables	2	2
Other [(2)]	94	217
Other assets [(1)]	**126**	**232**
Inactivated terminals in the external dealership network	4	3
Other prepaid expenses	32	31
Prepaid expenses	**36**	**34**

(1) Additions to impairment of trade and other receivables (net of reversals) are presented in Note 5.3.
(2) Mainly includes receivables related to: advances and prepayments to suppliers, sales of fixed assets, compensations and penalties. At 31 December 2009 includes also receivables from TP Invest Sp. z o.o. concerning disposal of Virgo Sp. z o.o. shares amounting to PLN 177 million.
(3) Classified as loans and receivables under IAS 39.

TP S.A. considers there is no concentration of credit risk with respect to trade receivables due to its large and diverse customer base consisting of individual and business customers.

The Company's maximum exposure to credit risk at the reporting date is best represented by the carrying amounts of those instruments recognised in the balance sheet.

Movement in the impairment of trade, employee-related and other receivables in the 12 months ended 31 December 2010 and 2009 is presented below:

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Beginning of period	**134**	**178**
Net change in impairment	(28)	(44)
End of period	**106**	**134**

In the 12 months ended 31 December 2010 and 2009, impaired receivables written off amounted to PLN 72 million and PLN 89 million, respectively.

As at 31 December 2010 and 2009, the analysis of trade receivables that are past due but not impaired is as follows:

At 31 December 2010:

(in PLN millions)			*Past due in the following periods*		
	Carrying amount	*Neither impaired nor past due*	*Less than 180 days*	*Between 180 and 360 days*	*More than 360 days*
Trade receivables - collectively analysed for impairment	840	571	246	17	6
Trade receivables - individually analysed for impairment	17				
Total trade receivables, net	**857**				

At 31 December 2009:

(in PLN millions)			*Past due in the following periods*		
	Carrying amount	*Neither impaired nor past due*	*Less than 180 days*	*Between 180 and 360 days*	*More than 360 days*
Trade receivables - collectively analysed for impairment	697	437	256	4	-
Trade receivables - individually analysed for impairment	-				
Total trade receivables, net	**697**				

16. Cash and cash equivalents

The Company's cash and cash equivalents are as follows:

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
Current bank accounts and overnight deposits	118	128
Deposits up to 3 months	1,839	996
Securities with a maturity up to 3 months	311	872
Total cash and cash equivalents (1)	**2,268**	**1,996**

(1) Classified as loans and receivables under IAS 39.

The Company's cash surplus is invested into short-term highly-liquid financial instruments e.g. bank deposits and T-bills. The term of the investments depends on the immediate cash requirements of the Company. Short term deposits are made for varying periods of between one day and three months. The instruments earn interest which depends on the current money market rates and the term of investment.

As at 31 December 2010 and 2009, cash and cash equivalents included an equivalent of PLN 3 million and PLN 20 million, respectively, denominated in foreign currencies.

The Company's maximum exposure to credit risk at the reporting date is best represented by carrying amounts of cash and cash equivalents. The Company deposits its cash and cash equivalents with leading financial institutions with investment grade. Limits are applied to monitor the level of exposure on the financial counterparties. In case

the counterparty's financial soundness is deteriorating, the Company applies the appropriate measures mitigating the default risk.

17. Net financial debt

17.1. Analysis of net financial debt by composition and maturity

Net financial debt corresponds to the total gross financial debt (converted at the period-end exchange rate), after net derivative instruments (liabilities less assets) classified as at fair value through profit or loss, cash flow hedges and fair value hedges, less bonds purchased from TP S.A. subsidiaries, cash and cash equivalents and including the impact of the effective portion of cash flow hedges.

The maturity analysis of the Company's financial liabilities is based on contractual undiscounted payments.
As at 31 December 2010 and 2009, amounts in foreign currency were translated at the NBP period-end exchange rates. The variable interest payments arising from the financial instruments were calculated using the latest interest rates fixed before 31 December 2010 and 2009, respectively. Financial liabilities that can be repaid at any time at the Company's discretion are classified as current or non-current, depending on the expected repayment date; non-current balance is assigned to the period of the final contractual maturity date.

The table below provides a breakdown of net financial debt by category and maturity analysis of financial liabilities based on contractual undiscounted cash flows.

At 31 December 2010:

(in PLN millions)			*Undiscounted contractual cash flows [1]*							
				Non-current						*Total*
	Note	*Carrying amount*	*Within 1 year*	*1-2 years*	*2-3 years*	*3-4 years*	*4-5 years*	*More than 5 years*	*Total non-current*	
Trade payables (A)	**26**	**2,100**	**2,100**	**-**	**-**	**-**	**-**	**-**	**-**	**2,100**
Bonds	18	4,842	2,134	167	167	2,939	-	-	3,273	5,407
Bank borrowings	18	1,866	287	690	951	38	38	25	1,742	2,029
Finance lease liabilities		16	7	6	3	2	-	-	11	18
Loans from subsidiaries [3]	18	3,412	715	715	715	715	715	2,980	5,840	6,555
Financial liabilities at amortized cost – excluding trade payables		**10,136**	**3,143**	**1,578**	**1,836**	**3,694**	**753**	**3,005**	**10,866**	**14,009**
Derivatives - net [2]	19	268	166	64	63	293	-	-	420	586
Gross financial debt after derivatives (B)		**10,404**	**3,309**	**1,642**	**1,899**	**3,987**	**753**	**3,005**	**11,286**	**14,595**
Total financial liabilities (A) + (B)		**12,504**	**5,409**	**1,642**	**1,899**	**3,987**	**753**	**3,005**	**11,286**	**16,695**
Bonds issued by subsidiaries [3]	14	3,425								
Cash and cash equivalents	16	2,268								
Assets included in the calculation of net financial debt (C)		**5,693**								
Effective portion of cash flow hedges (D)		2								
Net financial debt (B)-(C)+(D)		**4,713**								

[1] Includes both nominal and interest payments.
[2] Both assets and liabilities are included.
[3] Bonds are included in the calculation as they are settled net with loans from subsidiaries.

At 31 December 2009:

(in PLN millions)			*Undiscounted contractual cash flows [1]*							
				Non-current						*Total*
	Note	*Carrying amount*	*Within 1 year*	*1-2 years*	*2-3 years*	*3-4 years*	*4-5 years*	*More than 5 years*	*Total non-current*	
Trade payables (A)	**26**	**1,371**	**1,371**	**-**	**-**	**-**	**-**	**-**	**-**	**1,371**
Bonds	18	5,711	1,682	1,461	172	172	3,048	-	4,853	6,535
Bank borrowings	18	2,126	301	295	698	953	40	64	2,050	2,351
Finance lease liabilities		20	6	6	6	3	2	-	17	23
Loans from subsidiaries [3]	18	3,681	715	715	715	715	715	2,980	5,840	6,555
Financial liabilities at amortized cost – excluding trade payables		**11,538**	**2,704**	**2,477**	**1,591**	**1,843**	**3,805**	**3,044**	**12,760**	**15,464**
Derivatives - net [2]	19	181	190	90	55	54	173	-	372	562
Gross financial debt after derivatives (B)		**11,719**	**2,894**	**2,567**	**1,646**	**1,897**	**3,978**	**3,044**	**13,132**	**16,026**
Total financial liabilities (A) + (B)		**13,090**	**4,265**	**2,567**	**1,646**	**1,897**	**3,978**	**3,044**	**13,132**	**17,397**
Bonds issued by subsidiaries [3]	14	3,671								
Cash and cash equivalents	16	1,996								
Assets included in the calculation of net financial debt (C)		**5,667**								
Effective portion of cash flow hedges (D)		11								
Net financial debt (B)-(C)+(D)		**6,063**								

[1] Includes both nominal and interest payments.
[2] Both assets and liabilities are included.
[3] Bonds are included in the calculation as they are settled net with loans from subsidiaries.

As at 31 December 2010 and 2009, most of the Company's trade payables mature within 3 months.

17.2. Analysis of net financial debt by currency

(equivalent value in PLN millions at the period-end exchange rate)	*At 31 December 2010*				
	PLN	*EUR*	*USD*	*GBP*	*Total*
Net financial debt by currency	196 [1]	4,472	46	(1)	4,713
Impact of derivatives notional amount	6,867	(6,769)	(98)		-
Net financial debt by currency after impact of derivatives notional amount	**7,063**	**(2,297)**	**(52)**	**(1)**	**4,713**

[1] Including market value of derivatives.

(equivalent value in PLN millions at the period-end exchange rate)	*At 31 December 2009*				
	PLN	*EUR*	*USD*	*GBP*	*Total*
Net financial debt by currency	1,224 [1]	4,793	47	(1)	6,063
Impact of derivatives notional amount	6,934	(6,823)	(111)	-	-
Net financial debt by currency after impact of derivatives notional amount	**8,158**	**(2,030)**	**(64)**	**(1)**	**6,063**

[1] Including market value of derivatives.

18. Financial liabilities at amortised cost excluding trade payables

18.1. Bonds

The table below provides an analysis of bonds issued by TP S.A.:

(in PLN millions)					*Amount outstanding at* [1]	
Series	*Nominal value (in millions of currency)*	*Nominal interest rate*	*Issue date*	*Redemption date*	*31 December 2010*	*31 December 2009*
T	300 EUR	4.625%	5 July 2004	5 July 2011	1,214	1,258
A1	500 EUR	6.000%	22 May 2009	22 May 2014	2,042	2,115
A2	200 EUR	6.000%	17 July 2009	22 May 2014	862	886
Short-term bonds[2]	725 PLN	zero coupon bonds	2010	2011	724	1,452
Total bonds issued by the TP S.A.					**4,842**	**5,711**
Current					2,040	1,584
Non-current					2,802	4,127

[1] Includes accrued interest and the fair value adjustment to the bonds that were hedged by fair value hedge.
[2] Short-term bonds issued to the Company's subsidiaries under the TP S.A. Bond Issuance Programme of 15 July 2002.

TP S.A. issues short-term zero-coupon bonds denominated in PLN. The bonds are offered by private placement to the Group's entities, exclusively within the territory of the Republic of Poland. The bonds are redeemed at their par value.

The weighted average effective interest rate on bonds issued by TP S.A., before swaps, amounted to 5.43% as at 31 December 2010 and 2009.

18.2. Bank borrowings

The table below provides an analysis of bank borrowings by creditor:

			Amount outstanding at [1]			
			31 December 2010		*31 December 2009*	
Creditor	*Interest rate as at 31 December 2010*	*Repayment date*	*Currency (millions)*	*PLN (millions)*	*Currency (millions)*	*PLN (millions)*
Floating rate						
European Investment Bank	1.71% [2]	15 December 2015	42 EUR	165	50 EUR	206
European Investment Bank	1.16% [2]	15 June 2012	50 EUR	197	83 EUR	343
European Investment Bank	4.04% [2]	15 June 2012	78 PLN	78	130 PLN	130
European Investment Bank	3.90%-4.29%[2,3]	17 September 2012- 15 September 2013	1,398 PLN	1,398	1,399 PLN	1,399
Bayern LandesBank (syndicated)	-	20 February 2011	-	-	(1) PLN[4]	(1)
Bank Handlowy (syndicated)	-	18 April 2010	-	-	(1) PLN[4]	(1)
Bank Handlowy (syndicated)	-	22 October 2015	(11) PLN[4]	(11)	-	-
Bank Handlowy (syndicated)	-	18 April 2013	(8) PLN[4]	(8)	-	-
Other bank borrowings	-	-	-	-	1 PLN	1
Fixed rate						
Instituto de Credito Oficial	1.25%	2 January 2021	16 USD	47	17 USD	49
Total bank borrowings borrowed by TP S.A.				**1,866**		**2,126**
Current				226		236
Non-current				1,640		1,890

[1] Includes accrued interest and bank borrowings issue costs.
[2] Floating rate determined by the bank every three months.
[3] Floating rate determined by the bank individually for every drawing.
[4] Paid arrangement fees.

The weighted average effective interest rate on the Company's bank borrowings, before swaps, amounted to 3.54% as at 31 December 2010 and 3.49% as at 31 December 2009.

18.3. Loans from subsidiaries

On 31 January 2009, the Company and its subsidiary TP Invest Sp. z o.o. concluded agreements, under which, among others, financial liabilities at amortised cost were recognised in the amount of PLN 3,909 million. As at 31 December 2010 and 2009, loans from TP Invest Sp. z o.o. amounted to PLN 3,412 million and PLN 3,681 million, respectively.

19. Derivatives

As at 31 December 2010 and 2009, the majority of Company's derivatives portfolio constitutes financial instruments for which there is no active market (over-the-counter derivatives) i.e. the interest rate and currency swaps. To price these instruments the Company applies standard valuation techniques, where the prevailing market zero-coupon curves constitute the base for calculation of discounting factors. A fair value of swap transaction represents a discounted future cash flows converted into PLN at the period-end exchange rate.

The derivative financial instruments used by the Company are presented below:

				Fair value[2] (in PLN millions)	
Type of instrument[1]	*Hedged risk*	*Hedged nominal amount (in millions of currency)*	*Maturity*	*Financial Asset*	*Financial Liability*
		At 31 December 2010			
Derivative instruments - fair value hedge					
CCIRS	Currency and interest rate risk	180 EUR	2011-2014	-	(31)
CCS	Currency risk	10 EUR	2011	-	(1)
IRS	Interest rate risk	180 EUR	2014	35	-
Total of fair value hedges				35	(32)
Derivative instruments - cash flow hedge					
CCIRS	Currency and interest rate risk	303 EUR	2014	-	(109)
CCS	Currency risk	149 EUR	2011-2012	-	(47)
IRS	Interest rate risk	53 EUR	2014	10	-
IRS	Interest rate risk	1,419 PLN	2012-2014	-	(57)
Total of cash flow hedges				10	(213)
Derivative instruments – held for trading					
CCIRS	Currency and interest rate risk	314 EUR	2011-2014	25	(82)
CCS	Currency risk	35 EUR	2014	5	-
NDF	Currency risk	668 EUR	2011	2	(28)
NDF	Currency risk	33 USD	2011	1	(6)
FX option	Currency risk	50 EUR	2011	3	(5)
IRS	Interest rate risk	217 EUR	2014	41	-
IRS	Interest rate risk	1,089 PLN	2011-2014	-	(24)
Total of derivatives held for trading				77	(145)
Total of derivative instruments				**122**	**(390)**
Current				20	(109)
Non–current				102	(281)

[1] CCIRS – cross currency interest rate swap, CCS – cross currency swap, IRS – interest rate swap, NDF – non-deliverable forward, FWD – forward.
[2] Value 0 or (0) represents an asset or a liability below PLN 500 thousand, respectively

Type of instrument[1]	*Hedged risk*	*Hedged nominal amount (in millions of currency)*	*Maturity*	*Fair value*[2] *(in PLN millions)* *Financial Asset*	*Financial Liability*
		At 31 December 2009			
Derivative instruments - fair value hedge					
CCIRS	Currency and interest rate risk	180 EUR	2011-2014	6	(4)
CCS	Currency risk	10 EUR	2011	1	-
IRS	Interest rate risk	180 EUR	2014	20	-
Total of fair value hedges				27	(4)
Derivative instruments - cash flow hedge					
CCIRS	Currency and interest rate risk	303 EUR	2014	-	(78)
CCS	Currency risk	161 EUR	2011-2012	9	(32)
NDF	Currency risk	20 EUR	2010	-	(1)
NDF	Currency risk	6 USD	2010	1	-
IRS	Interest rate risk	53 EUR	2014	5	-
IRS	Interest rate risk	1,471 PLN	2012-214	-	(34)
Total of cash flow hedges				15	(145)
Derivative instruments – held for trading					
CCIRS	Currency and interest rate risk	285 EUR	2011-2014	38	(41)
CCS	Currency risk	44 EUR	2014	13	-
NDF	Currency risk	659 EUR	2010	1	(81)
NDF	Currency risk	33 USD	2010	1	(6)
IRS	Interest rate risk	217 EUR	2014	24	-
IRS	Interest rate risk	1,259 PLN	2010-2014	-	(23)
Total of derivatives held for trading				77	(151)
Total of derivative instruments				**119**	**(300)**
Current				3	(91)
Non–current				116	(209)

[1] CCIRS – cross currency interest rate swap, CCS – cross currency swap, IRS – interest rate swap, NDF – non-deliverable forward, FWD – forward.
[2] Value 0 or (0) represents an asset or a liability below PLN 500 thousand, respectively

The Company's maximum exposure to credit risk is represented by the carrying amounts of derivatives. The Company enters into derivatives contracts with leading financial institutions. Limits are applied to monitor the level of exposure on the financial counterparties. In case the counterparty's financial soundness is deteriorating, the Company applies the appropriate measures mitigating the default risk.

The following tables provide an analysis of the Company's financial liabilities that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable (see Note 3.5.10).

(in PLN millions)	*At 31 December 2010* *Fair value measurement* *Level 1*	*Level 2*	*Level 3*	*Total*
Financial liabilities at fair value through profit or loss	-	145	-	145
Derivatives – held for trading	*-*	*145*	*-*	*145*
Hedging derivatives	-	245	-	245
Total	**-**	**390**	**-**	**390**

(in PLN millions)	*At 31 December 2009* *Fair value measurement* *Level 1*	*Level 2*	*Level 3*	*Total*
Financial liabilities at fair value through profit or loss	-	151	-	151
Derivatives – held for trading	*-*	*151*	*-*	*151*
Hedging derivatives	-	149	-	149
Total	**-**	**300**	**-**	**300**

During the 12 months ended 31 December 2010 and 2009, there was no transfer between Level 1 and Level 2 fair value measurements, and no transfer into and out of Level 3 fair value measurement.

20. Objectives and policies of financial risk management

20.1. Principles of financial risk management

The Company is exposed to some risks arising mainly from financial instruments that are issued and held as part of its operating and financing activities. That exposure can be principally classified as market risk (encompassing currency risk and interest rate risk), liquidity risk and credit risk. The Company manages the financial risks with the objective to limit its exposure to adverse changes in foreign exchange rates and interest rates, to stabilize cash flows and to ensure an adequate level of financial liquidity and flexibility.

The principles of the Company Financial Risk Management Policy have been approved by the Management Board. Operationally, financial risk management is conducted by TP Group Corporate Finance according to developed strategies confirmed by the Treasury Committee under the direct control of the Chief Financial Officer.

Financial Risk Management Policy defines principles and responsibilities within the context of an overall financial risk management and covers the following areas:

- risk measures used to identify and evaluate the exposure to financial risks,
- selection of appropriate instruments to hedge against identified risks,
- valuation methodology used to determine the fair value of derivatives,
- methods for testing hedging effectiveness for accounting purposes,
- transaction limits for and credit ratings of the leading financial institutions with which the Company concludes hedging transactions.

20.2. Hedge accounting

The Company has entered into numerous derivative transactions to hedge exposure to currency risk and interest rate risk. The derivatives used by the Company include: cross currency interest rate swaps, cross currency swaps, interest rate swaps, currency options, currency forwards and non-deliverable forwards.

Certain derivative instruments are classified as fair value hedges or cash flow hedges and the Company applies hedge accounting principles as stated in IAS 39 (see Note 3.5.10). The fair value hedges are used for hedging changes in the fair value of financial instruments that are attributable to particular risk and could affect the income statement. Cash flow hedges are used to hedge the variability of future cash flows that is attributable to particular risk and could affect the income statement.

Derivatives are used for hedging activities and it is the Company's policy that the derivative financial instruments are not used for trading (speculative) purposes. However, certain derivatives held by the Company are classified as held for trading as they do not fulfil all requirements of hedge accounting as set out in IAS 39 and hedge accounting principles are not applied to those instruments. The Company considers those derivative instruments as economic hedges because they, in substance, protect the Company against currency risk and interest rate risk.

Detailed information on derivative financial instruments, including hedging relationship, that are used by the Company is presented in Note 19.

20.3. Currency risk

The Company is exposed to foreign exchange risk arising from financial liabilities denominated in foreign currencies, namely bonds and bank borrowings denominated in EUR and USD (see Note 18) and trade receivables, trade payables and provisions of which a significant balance relates to the dispute with DPTG.

The Company's hedging policy, minimizing the impact of fluctuations in exchange rates, is set on a regular basis. The acceptable exposure to a selected currency is a result of the risk analysis in relation to an open position in that currency, given the financial markets' expectations of foreign exchange rates movements during a specific time horizon.

Within the scope of the given hedging policy, the Company hedges its exposure entering mainly into cross currency swaps, cross currency interest rate swaps and forward currency contracts, under which the Company agrees to exchange a notional amount denominated in a foreign currency into PLN. As a result, the gains/losses generated by derivative instruments compensate the foreign exchange losses/gains on the hedged items. Therefore, the

variability of the foreign exchange rates has a limited impact on the income statement, as well as other comprehensive income.

As at 31 December 2010, 99.8% (as at 31 December 2009, 99.9%) of the outstanding balance of bonds and bank borrowings denominated in foreign currencies were hedged against currency risk by use of derivative instruments. As at 31 December 2010, 75% (as at 31 December 2009, 100%) of the nominal amount of DPTG provision was hedged against currency risk.
The Company is also actively hedging the exposure to foreign exchange risk generated by operating and capital expenditures.

The Company uses the sensitivity analysis described below to measure currency risk.

The Company's major exposures to foreign exchange risk (net of hedging activities) and potential foreign exchange gains/losses on these exposures resulting from a hypothetical 10% appreciation/depreciation of the PLN against other currencies are presented in the following table.

(in millions of currency)	*Effective exposure after hedging impacting income statement*				*Sensitivity to a change of the PLN against other currencies*			
	At 31 December 2010		*At 31 December 2009*		*At 31 December 2010*		*At 31 December 2009*	
					+10%	*-10%*	*+10%*	*-10%*
Hedged item	*Currency*	*PLN*	*Currency*	*PLN*	*PLN*		*PLN*	
Bonds and bank borrowings (EUR)	-	-	-	-	-	-	-	-
Bonds and bank borrowings (USD)	3	9	2	6	1	(1)	1	(1)
DPTG provision (EUR) [(1)]	136	539	-	-	54	(54)	-	-
Total		**548**		**6**	**55**	**(55)**	**1**	**(1)**

[(1)] Potential settlement would be made in DKK.

The sensitivity analysis presented above is based on the following principles:
- unhedged portion of the notional amount of liabilities is exposed to foreign exchange risk (effective exposure),
- derivatives satisfying hedge accounting requirements and those classified as economic hedges are treated as risk-mitigation transactions,
- cash and cash equivalents are excluded from the analysis.

The changes in fair value of derivatives classified as cash flow hedges of forecast transactions affect other comprehensive income. The potential foreign exchange gains/losses on these hedges resulting from a hypothetical 10% appreciation/depreciation of the PLN against other currencies are as follows:

(in millions of PLN)	*Sensitivity of fair value of cash flow hedges to a change of the PLN against other currencies*			
	At 31 December 2010		*At 31 December 2009*	
	+10%	*-10%*	*+10%*	*-10%*
Hedged item	*PLN*		*PLN*	
Commercial transactions (EUR)	-	-	(8)	8
Commercial transactions (USD)	-	-	(2)	2
Total amount impacting other comprehensive income	**-**	**-**	**(10)**	**10**

20.4. Interest rate risk

The interest rate risk is a risk that the fair value or future cash flows of the financial instrument will change due to interest rates changes. The Company has interest bearing financial assets consisting mainly of bonds purchased from and loans granted to its subsidiaries (see Note 14) and financial liabilities consisting mainly of bonds and bank borrowings (see Note 18).

The Company's interest rate hedging policy limiting exposure to unfavourable movements of interest rates is set on a regular basis. The preferable split between fixed and floating rate debt is the result of the analysis indicating the impact of the potential interest rates evolution on the financial costs.

According to the given hedging strategy, the Company uses interest rate swaps and cross currency interest rate swaps to hedge its interest rate risk. As a result of the hedge the structure of the liabilities changes to the desired one, as liabilities based on the floating/fixed interest rates are effectively converted into fixed/floating obligations.

As at 31 December 2010 and 2009, the Company's proportion between fixed/floating rate debt (including hedging activities) was 53/47% and 56/44% respectively.

The Company uses the sensitivity analysis described below to measure interest rate risk.

The table below provides the Company's exposures to interest rate risk (net of hedging activities) assuming a hypothetical decrease/increase in the interest rates by 1 percent.

(in PLN millions)	*Potential increase /(decrease) in value resulting from 1% change of interest rates*			
	At 31 December 2010		*At 31 December 2009*	
	+1%	*-1%*	*+1%*	*-1%*
Finance costs, net	53	(53)	62	(63)
Other comprehensive income	3	(4)	2	(2)
Fair value of gross financial debt after derivatives	(62)	63	(89)	88

The sensitivity analysis presented above is based on the following principles:

- finance costs, net include the following items exposed to interest rate risk: a) interest cost on financial debt based on floating rate, after derivatives classified as hedges for accounting purpose b) interest income calculated on the bonds purchased from and loans granted to subsidiaries based on floating rate and c) the change in the fair value of derivatives that do not qualify for hedge accounting,
- the effective portion of the change in the fair value of derivatives classified as cash flow hedges is recognized directly in other comprehensive income,
- as at 31 December 2010, the fair value of gross financial debt after derivatives (excluding finance lease, loans from subsidiaries and arrangement fees) was PLN 7,104 million (as at 31 December 2009, PLN 8,153 million).

20.5. Liquidity risk

The liquidity risk is a risk of encountering difficulties in meeting obligations associated with financial liabilities. The Company's liquidity risk management involves forecasting future cash flows, analysing the level of liquid assets in relation to cash flows, monitoring balance sheet liquidity and maintaining a diverse range of funding sources and back-up facilities.

In order to increase efficiency, the liquidity management process is optimised through a centralised treasury function of the parent company, as liquid asset surpluses generated by the Company and its subsidiaries are invested and managed by the central treasury. The Company's cash surplus is invested into short-term highly-liquid financial instruments e.g. bank deposits and T-bills.

The Company also manages liquidity risk by maintaining committed, unused credit facilities, which create a liquidity reserve to secure solvency and financial flexibility. As at 31 December 2010, the Company had the following unused credit facilities amounting to PLN 3,584 million (as at 31 December 2009, PLN 5,760 million):

- PLN 2,000 million of the revolving credit lines,
- EUR 400 million of back-up credit facility.

Liquidity risk is measured by applying following ratios calculated and monitored by the Company regularly:

- liquidity ratios,
- maturity analysis of undiscounted contractual cash flows resulting from the Company's financial liabilities,
- average debt duration.

The liquidity ratio, which represents the relation between available financing sources (i.e. cash, cash collateral and credit facilities) and debt repayments during next 12 and 18 months is presented in the following table.

(in PLN millions)	*Liquidity ratios*	
	At 31 December 2010	*At 31 December 2009*
Liquidity ratio - next 12 months (%)	274%	462%
Unused credit facilities	3,584	5,760
Cash and cash equivalents	2,268	1,996
Debt repayments[(1)]	2,134	1,680
Liquidity ratio (incl. cash collaterals and derivatives) - next 12 months (%)	254%	415%
Derivatives[(2)]	166	190
Cash collateral paid	-	-
Liquidity ratio - next 18 months (%)	261%	432%
Unused credit facilities	3,584	5,760
Cash and cash equivalents	2,268	1,996
Debt repayments[(1)]	2,245	1,795
Liquidity ratio (incl. cash collaterals and derivatives) - next 18 months (%)	241%	383%
Derivatives[(2)]	185	231
Cash collateral paid	-	-

[(1)] Undiscounted principal payments on debt including PLN 725 million short-term bonds issued to Company's subsidiaries under the TP S.A. Bond Issuance Programme of 15 July 2002.
[(2)] Undiscounted net cash flows on derivatives; negative / positive amount represents positive / negative net result on cash flows.

The maturity analysis for the remaining contractual undiscounted cash flows resulting from the Company's financial liabilities as at 31 December 2010 and 2009 is presented in Note 17. The average duration for the existing debt portfolio as at 31 December 2010 is 2.2 years (as at 31 December 2009, 2.7 years).

20.6. Credit risk

The Company's credit risk management objective is defined as supporting business growth while minimizing financial risks by ensuring that customers and partners are always in a position to pay amounts due to the Company.

The main function of the Credit Committee under the control of the Chief Financial Officer is to coordinate and consolidate credit risk management activities across TP Group, which involve:
- clients' risk assessment,
- monitoring clients' business and financial standing,
- managing accounts receivable and bad debts.

The policies and rules regarding consolidated credit risk management for TP Group were approved by the Credit Committee.

The credit risk management functions were consolidated in 2010 with a dedicated organizational structure developed within TP Group Corporate Finance.

There is no significant concentration of credit risk within the Company.
Further information on credit risk is discussed in Notes 14, 15, 16 and 19.

20.7. Price risk

Pursuant to the Polish telecommunication law, prices for telecommunication services should be based on transparent and objective criteria.

In case of operators which are SMPs, UKE determines requirements for regulatory accounting and calculation of costs of telecommunication services. Fees for services provided on the relevant markets in which TP S.A. is a SMP must be approved by UKE before they become binding.

Cost calculations of wholesale services, which are provided based on regulatory obligations, are subject to examination and approval by UKE. If fees proposed by the operator, which is a SMP, are assessed as not in conformity with relevant regulations, UKE may change these fees.

The President of UKE declared in Memorandum of Understanding (see Note 28.1 c) that wholesale rates for regulated services, and for Bitstream Access (under certain conditions), will be maintained at unchanged levels until the end of 2012.

Retail prices for services provided on the relevant retail markets where TP S.A. is a SMP and under universal service obligation are subject to UKE acceptance. TP S.A. may launch promotions and price changes which have not been objected to by the President of UKE. Moreover, the retail price increases should be announced with at least one settlement period in advance.

The Company believes that it fulfils all requirements in relation to regulatory accounting and cost calculations as stipulated in the telecommunication law.

20.8. Management of covenants

As at 31 December 2010, TP S.A. was a party to loan and guarantee agreements containing financial covenant, upon which the Company should meet the following financial ratio: Net Debt / EBITDA calculated on the Group's consolidated results to be no higher than 3.5:1 confirmed on a semi-annual basis. As at 31 December 2010, the covenant was met.

As at 31 December 2009, TP S.A. had no credit facilities or borrowings subject to specific covenants with regard to financial ratios.

21. Management of capital

Capital management strategy is developed at the Group level. Capital management policy is described in the Note 23 to Telekomunikacja Polska Group IFRS Consolidated Financial Statements for the year ended 31 December 2010.

22. Fair value of financial instruments

As at 31 December 2010 and 2009, the carrying amount of cash and cash equivalents, current trade receivables and trade payables, current loans and receivables and current financial liabilities at amortised cost approximates their fair value due to relatively short term maturity of those instruments or cash nature.

As at 31 December 2010 and 2009, the carrying amount of financial liabilities at amortised cost which bear variable interest rates approximates their fair value.

A comparison by classes of carrying amounts and fair values of those Company's financial instruments, for which estimated fair value differs from the book value, is presented below.

(in PLN millions)	*At 31 December 2010*		*At 31 December 2009*	
	Carrying amount [1]	*Estimated fair value*	*Carrying amount* [1]	*Estimated fair value*
Bonds with fixed interest rate	4,842	4,955	5,711	5,853
Bank borrowings with fixed interest rate	47	42	49	42
Loans from subsidiaries with fixed interest rate	3,413	3,650	3,681	3,947
Total financial liabilities	**8,302**	**8,647**	**9,441**	**9,842**
Bonds issued by subsidiaries with fixed interest rate	3,425	3,666	3,671	3,939
Total financial assets	**3,425**	**3,666**	**3,671**	**3,939**

[1] Carrying amount includes accrued interest.

The fair value of financial instruments is calculated by discounting expected future cash flows at the prevailing zero coupon rate. In order to obtain all the necessary zero coupon rates, a theoretical zero coupon curve is constructed for each currency. Such a curve is derived from the SWAP rate curve adjusted by adding the prevailing credit spread for the debt issued by a telecom company with the same rating as the Company has. All the fair value amounts are translated to PLN at the National Bank of Poland period-end exchange rate.

23. Employee benefits

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009 (see Note 3.4)*
Jubilee awards	127	145
Retirement bonuses and other post-employment benefits	158	162
Salaries, other employee-related payables and payroll taxes due	151	173
Total carrying value of employee benefit obligations	**436**	**480**
Current	167	213
Non-current	269	267

Certain employees and retirees of the Company are entitled to long-term employee benefits in accordance with the Company's remuneration policy (see Note 3.5.14). These benefits are not funded.

The changes in the present value of liabilities related to employee benefits for the 12 months ended 31 December 2010 and 2009 are detailed in the table below:

(in PLN millions)	*12 months ended 31 December 2010*				*12 months ended 31 December 2009*			
	Jubilee awards	*Retirement bonuses*	*Other post-employment benefits*	*Total*	*Jubilee awards*	*Retirement bonuses*	*Other post-employment benefits*	*Total*
Present/carrying value of obligation at the beginning of the period	**145**	**89**	**73**	**307**	**144**	**74**	**93**	**311**
Current service cost [1]	8	4	1	13	9	5	1	15
Interest cost [2]	7	5	4	16	7	5	4	16
Benefits paid	(24)	(3)	(8)	(35)	(34)	(5)	(7)	(46)
Actuarial losses for the period	20[1]	12[3]	4[3]	36	19[1]	10[3]	5[3]	34
Curtailment [1]	(29)[5]	(20)[5]	(3)[5]	(52)	-	-	(23) [4]	(23)
Present/carrying value of obligation at the end of the period	**127**	**87**	**71**	**285**	**145**	**89**	**73**	**307**

[1] Recognised under labour expense in the income statement.
[2] Recognised under discounting expense in the income statement.
[3] Recognised under actuarial losses on post-employment benefits in the statement of comprehensive income.
[4] Curtailment of medical care provided to some of the Company's retired employees following the disposal of the Company's shareholding in TP Med Sp. z o.o. (see Note 14.1).
[5] Curtailment resulting from intragroup employee transfer to Orange Customer Service Sp. z o.o.

The valuation of obligations as at 31 December 2010 and 2009 was performed using the following assumptions:

	At 31 December 2010	*At 31 December 2009*
Discount rate	6%	6.1%
Wage increase rate	3%	3%
Expected average remaining working lives (in years)	16.6 – 17.2	14.6 – 15.7

Present value of defined benefit obligation for the current period and previous four annual periods is presented below:

(in PLN millions) *As at*	*Jubilee awards*	*Retirement bonuses*	*Other post-employment benefits*	*Total*
31 December 2010	127	87	71	285
31 December 2009	145	89	73	307
31 December 2008	144	74	93	311
31 December 2007	159	82	77	318
31 December 2006	166	76	79	321

24. Share-based payments

24.1. Group incentive programme

On 28 April 2006, the General Meeting of Shareholders of TP S.A. approved an incentive programme ("the Program") for the key managers and executives ("the Beneficiaries") of Telekomunikacja Polska and its selected subsidiaries in order to further motivate management in their efforts aimed at the Group development and the Company's value maximisation. On 12 December 2006, the Management Board of TP S.A adopted the Incentive Programme Rules for the members of the Management Board and the key managers of the Group. In order to fulfil the assumptions of the Program on 28 April 2006 the General Shareholders' Meeting decided that TP S.A. will issue not more than 7,113,000 A series bearer bonds ("the Bonds") with priority right over existing shareholders to subscribe for B series shares issued by the Company.

As a result of the Program, on 9 October 2007 TP S.A. issued 6,202,408 registered bonds with a nominal value, equal to issue price, of PLN 0.01 each with a pre-emption rights attached to the Bonds to subscribe for Company shares with priority over the existing shareholders. A total of 6,047,710 Bonds were subscribed and allocated to the Beneficiaries. The remaining Bonds which had not been subscribed, in the amount of 154,698 were acquired by an agent acting as a custodian. These Bonds may be allocated in the future to existing or new Beneficiaries in accordance with the terms and conditions of the Program.

Pre-emption rights attached to the Bonds to subscribe for the Company's shares may be exercised within seven years after the end of the restricted period. The restricted period ends on the third anniversary of the issue of the Bonds, inclusive. The redemption of the Bonds will take place on the 10th anniversary of the issue date or, in the case of the Bonds kept by the Agent acting as the custodian, after the expiration of the restricted period. One Bond gives a right to subscribe for one ordinary share with a nominal value of PLN 3. The shares acquired upon exercising pre-emption right attached to the Bond are ordinary bearer shares and are not subject to any restriction in trading. The right to subscribe for the shares shall be vested exclusively in the bondholders. The issue price of the shares is PLN 21.57 per share.

The following table illustrates the number and weighted average exercised price of equity instruments granted by TP S.A.:

	12 months ended 31 December 2010		*12 months ended 31 December 2009*	
	number	*weighted average exercised price (PLN)*	*number*	*weighted average exercised price (PLN)*
Outstanding at the beginning of the period	**4,357,425**	**21.57**	**4,746,102**	**21.57**
Granted during the year	-	-	-	-
Cancelled during the year	(422,199)	-	(388,677)	-
Exercised during the year	-	-	-	-
Expired during the year	-	-	-	-
Outstanding at the end of the year	**3,935,226**	**21.57**	**4,357,425**	**21.57**
− of which exercisable	*3,935,226*		*55,072*	-

The following table illustrates the key assumptions used in calculation of the fair value of equity instruments granted by TP S.A.:

Key assumptions	***TP S.A. plan***
Dividend yield	6%
Expected volatility	30%
Risk-free interest rate	5.59%
Exercise price	21.57
Vesting period	3 years
The weighted average expected life	7 years
Model used	binomial

During the 12 months ended 31 December 2010, the fair value of services received amounted to PLN 3 million. It was recognised in labour expenses in the amount of PLN 2 million, in investments in subsidiaries in the amount of PLN 1 million and as an increase in equity amounting to PLN 3 million.

During the 12 months ended 31 December 2009, the fair value of services received amounted to PLN 4 million. It was recognised in labour expenses in the amount of PLN 2 million, in investments in subsidiaries in the amount of PLN 2 million and as an increase in equity amounting to PLN 4 million.

24.2. France Telecom S.A. free share award plan

In 2007 France Telecom S.A. established a free share, equity-settled, award plan ("NExT plan"). Under the plan 757,782 shares were offered to employees and executives of TP SA. The grant date was established on 18 March 2008 that is the date when the main terms and conditions of the plan were announced personally to TP SA employees. The shares granted can not be sold for a period of two years after the vesting date. The fair value of shares at grant date was PLN 63.57 (an equivalent of EUR 17.95 translated at NBP period-end exchange rate at 18 March 2008).

The plan was contingent upon meeting the following criteria in France Telecom Group:

- performance conditions: achievement of the cash flow set out in the NExT plan in 2007 and 2008 (EUR 6.8 billion and EUR 6.8 billion, respectively), and cost of the plan to be covered by additional cash flow generated over the same period. The cash flow performance condition has been met in 2007 and 2008.
- beneficiaries must be contractually employed by the France Telecom Group at the end of the vesting period.

The following table illustrates the key assumptions used in calculation of the fair value of equity instruments granted by France Telecom S.A. to TP S.A. employees:

Key assumptions	***France Telecom S.A. free share plan***
Price of the underlying at the grant date	PLN 76.15 (1)
Subscription price – zero in case of free share award plan	PLN 0.00
Dividend yield	6%
Performance conditions	100%
Risk-free interest rate	3.48%
Lending-borrowing rate	5.24% (2)
Vesting period	2 years
Model used	binomial

(1) An equivalent of EUR 21.50 translated at NBP period-end exchange rate at 18 March, 2008.
(2) Corresponds to the lending-borrowing rate on France Telecom S.A. shares used to calculate the non-transferability costs.

During the 12 months ended 31 December 2010 and 2009, the fair value of services received, recognised in accordance with IFRS 2 "Share-based Payment" in labour expenses and equity, amounted to PLN 1 million and PLN 33 million, respectively.

25. Provisions

For the 12 months ended 31 December 2010 the movements of provisions were as follows:

(in PLN millions)	*At 1 January 2010*	*Increases*	*Reversals (utilizations)*	*Reversals (releases)*	*Foreign exchange effect*	*Discounting effect*	*At 31 December 2010*
Provisions for claims and litigation (see Note 29), risks and other charges	1,058	1,186	(50)	(12)	(35)	-	2,147
Restructuring provisions	124	14	(116)	-	-	5	27
Provisions for dismantling	130	-	(3)	(6)	-	8	129
Total provisions for risks and charges	**1,312**	**1,200**	**(169)**	**(18)**	**(35)**	**13**	**2,303**
Current	1,164						2,176
Non-current	148						127

For the 12 months ended 31 December 2009 the movements of provisions were as follows:

(in PLN millions)	*At 1 January 2009*	*Increases*	*Reversals (utilizations)*	*Reversals (releases)*	*Foreign exchange effect*	*Discounting effect*	*At 31 December 2009*
Provisions for claims and litigation (see Note 29), risks and other charges	1,050	65	(37)	(7)	(13)	-	1,058
Restructuring provisions	228	24	(134)	(2)	-	8	124
Provisions for dismantling	144	-	(5)	(17)	-	8	130
Total provisions for risks and charges	**1,422**	**89**	**(176)**	**(26)**	**(13)**	**16**	**1,312**
Current	1,173						1,164
Non-current	249						148

The discount rate used to calculate the present value of restructuring and dismantling provisions amounted to 4.95% - 5.92% as at 31 December 2010 and 6.1% as at 31 December 2009.

Restructuring provision

The restructuring provisions consist of the estimated amount of termination benefits for employees scheduled to terminate employment in the Company under the 2009-2011 Social Agreement.

In the fourth quarter of 2008, TP S.A. concluded a new Social Agreement for years 2009-2011 with all TP S.A. trade unions. Up to a maximum of 4,900 employees may take advantage of the voluntary departure package between 2009 and 2011. The amount of termination benefit varies depending on individual salary, employment duration and year of resignation. The basis for calculation of the employment restructuring provision is the estimated number, remuneration and service period of employees who will accept the voluntary termination until the end of 2011. As at 31 December 2010, 4,417 persons took advantage of the departure package under the 2009-2011 Social Agreement.

Dismantling provision

The dismantling provision relates to dismantling or removal of items of property, plant and equipment. Based on environmental regulations in Poland, items of property, plant and equipment which may contain hazardous materials should be dismantled and utilized by the end of their useful lives by entities licensed by the State for this purpose.

The amount of dismantling provision is based on the estimated: number of items that should be utilized, period of utilization (20-28 years), current utilization cost (obtained through a tender process conducted on normal commercial terms) and inflation.

26. Trade payables, other liabilities and deferred income

26.1. Trade payables

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
Trade payables	1,087	923
Fixed assets payables	1,013	448
Total trade payables [1]	**2,100**	**1,371**
Current	2,100	1,371
Non-current	-	-

[1] Classified as financial liabilities measured at amortised cost under IAS 39.

26.2. Other liabilities

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
VAT payable	115	127
Other taxes payables	49	16
Other	16	51
Total other liabilities	**180**	**194**
Current	180	194
Non-current	-	-

26.3. Deferred income

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
Sales of products and services billed in advance	129	103
Other	4	9
Total deferred income	**133**	**112**
Current	69	66
Non-current	64	46

27. Equity

27.1. Share capital

As at 31 December 2010 and 2009, the share capital of the Company amounted to PLN 4,007 million and was divided into 1,336 million fully paid ordinary bearer shares of PLN 3 each.

The ownership structure of the share capital as at 31 December 2010 was as follows:

(in PLN millions)	*% of votes*	*Nominal value*
France Telecom S.A.	49.79	1,995
Capital Group International, Inc. (1)	5.06	203
Other shareholders	45.15	1,809
Total	**100.00**	**4,007**

(1) Number of shares according to the notification by Capital Group International, Inc. on 15 October 2010.

As at 31 December 2010 and 2009, France Telecom S.A. owned 49.79% of shares of the Company and held 49.79% of votes at the General Shareholders' Meeting.

On 5 August 2010, the State Treasury announced that it sold 4.15% shares of TP S.A. through the Warsaw Stock Exchange in the period from 14 January to 5 August 2010.

The Company has no information regarding valid agreements or other events that may result in changes in the proportions of shares held by the shareholders.

27.2. Dividends

On 23 April 2010, the General Shareholders' Meeting of TP S.A. adopted a resolution on the payment of an ordinary dividend of PLN 1.50 per share, i.e. PLN 2,003 million. The dividend was paid on 1 July 2010.

28. Unrecognised contractual obligations

28.1. Unrecognised contractual obligations

At 31 December 2010, Management considers that, to the best of its knowledge, there are no existing unrecognised contractual obligations, other than those described below, likely to have a material impact on the current or future financial position of the Company.

a) Commitments related to operating leases

When considering the Company as a lessee, operating lease commitments mainly relate to the lease of buildings and land. Lease costs recognised in the income statement for the years ended 31 December 2010 and 2009 amounted to PLN 197 million and PLN 199 million, respectively. More than a half of the agreements is denominated in foreign currencies. Some of the above agreements are indexed with price indices applicable for a given currency.

Future minimum lease payments under non-cancellable operating leases, as at 31 December 2010 and 2009 (upon revised criteria for considering future lease payments as non-cancellable), were as follows:

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
within one year	97	127
after one year but not more than five years	110	165
more than five years	2	12
Total minimum future lease payments	**209**	**304**

When considering the Company as a lessor, future minimum lease payments under non-cancellable operating leases as at 31 December 2010 and 2009 amounted to PLN 21 million and PLN 57 million, respectively.

b) Investment commitments

Capital commitments contracted for at the balance sheet date but not recognized in the financial statements were as follows:

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
Property, plant and equipment	646	166
Intangibles	74	59
Total	**720**	**225**
Amounts contracted to be payable within 12 months after the balance sheet date	581	213

Capital commitments represent mainly purchases of telecommunications network equipment, IT systems and other software.

c) Memorandum of Understanding with UKE

On 22 October 2009, TP S.A. and UKE signed a Memorandum of Understanding concerning implementation of transparency and non-discrimination in inter-operator relations. In 2010, TP S.A. carried out activities in accordance with a schedule established together with UKE and was systematically implementing technical and organisational solutions, in order to secure non-discriminatory relations with other operators including equal access to information. It is anticipated that as TP S.A. fulfils the arrangements, the President of UKE will withdraw the consideration of functional separation of TP S.A. which had been considered by UKE as a regulatory tool to implement effective competition on regulated telecommunication wholesale markets in Poland.

Over the years 2010-2012, TP S.A. is to invest in the development of 1.2 million broadband access lines (0.479 million new lines and 0.721 million upgraded existing lines), of which 1 million lines will provide bandwidths of at least 6 Mbps. As at 31 December 2010, TP S.A. has delivered 0.45 million broadband access lines.

d) Guarantees

As at 31 December 2010 and 2009, total guarantees granted by Telekomunikacja Polska S.A. to purchasers of debt securities issued by a subsidiary company amounted to PLN 4,089 million and PLN 4,242 million, respectively. Other guarantees granted by the Company as at 31 December 2010 and 2009 amounted to PLN 14 million and PLN 7 million, respectively.

28.2. Assets covered by commitments

The gross book value of the assets held under finance leases amounted to PLN 23 million and PLN 22 million as at 31 December 2010 and 2009, respectively. Leased assets cannot be sold, donated, transferred by title or pledged and are a collateral for the related finance lease liability.

29. Litigation and claims (including contingent liabilities)

a. Issues related to the incorporation of Telekomunikacja Polska

Telekomunikacja Polska was established as a result of the transformation of the state-owned organisation Poczta Polska Telegraf i Telefon ("PPTiT") into two entities – the Polish Post Office and Telekomunikacja Polska. During the transformation process and transfer of ownership rights to the new entities, certain items of property and other assets that are currently under Telekomunikacja Polska's control were omitted from the documentation recording the transfer and the documentation relating to the transformation process is incomplete in this respect. This means that Telekomunikacja Polska's rights to certain properties may be questioned.

In addition, as the regulations concerning the transformation of PPTiT are unclear, the division of certain responsibilities of PPTiT may be considered to be ineffective, which may result in joint and several liability in respect of Telekomunikacja Polska's predecessor's obligations existing at the date of transformation.

The share premium in the equity of Telekomunikacja Polska includes an amount of PLN 713 million which, in accordance with the Notary Deed dated 4 December 1991, relates to the contribution of the telecommunication business of PPTiT to the Company. As the regulations relating to the transformation of PPTiT are unclear, the division of certain rights and obligations may be considered to be ineffective. As a result, the share premium balance may be subject to changes.

b. Tax contingent liability

Tax settlements, together with other areas of legal compliance (e.g. customs or foreign exchange law) are subject to review and investigation by a number of authorities, which are entitled to impose severe fines, penalties and interest charges. The lack of reference to well established regulations in Poland results in a lack of clarity and integrity. Value added tax, corporate income tax, personal income tax and other taxes or social security regulations are subject to frequent changes which often leads to the lack of well established regulations or legal precedents. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems.

Tax authorities may examine accounting records up to five years after the end of the year in which the final tax payments were to be made. Consequently, the Company may be subject to additional tax liabilities, which may arise as a result of additional tax audits. Telekomunikacja Polska and certain of its subsidiaries were subject to audits by the tax office in respect of taxes paid. Certain of these audits have not yet been finalised. The Company believes that adequate provisions have been recorded for known and quantifiable risks in this regard.

c. Proceedings by UKE, UOKiK and the European Commission

According to the Telecommunications Act, the President of UKE may impose on a telecommunications operator a penalty of up to a maximum amount of 3% of the operator's prior year's revenue, if the operator does not fulfil certain requirements of the Telecommunications Act. According to the Act on Competition and Consumer Protection, in case of non-compliance with its regulations, the President of the Office of Competition and Consumer Protection ("UOKiK") is empowered to impose on an entity penalties of up to a maximum amount of EUR 50 million for refusal to provide requested information or up to a maximum amount of 10% of an entity's prior year's revenue for a breach of the law.

Proceedings by UKE related to broadband access
On 25 September 2006, UKE imposed a fine of PLN 100 million on TP S.A. for the infringement of the obligation to determine the price of the services on the basis of the cost of their provision and on clear, objective and non-discriminatory criteria, as a result of not implementing the offer to sell Neostrada (Internet services) separately from the fixed line subscription (allocating costs of local loop entirely to fixed line subscription). TP S.A. did not pay the fine and appealed to the Court of Competition and Consumer Protection ("SOKiK"). On 22 May 2007, the Court invalidated the fine on procedural grounds. UKE appealed this verdict and on 10 April 2008, the Appeal Court revoked the judgment of SOKiK and remanded the case back to consideration by SOKiK. On 2 June 2009, SOKiK suspended the proceeding until the end of the European Commission proceeding against Poland in the European Court of Justice on attempts of UKE to regulate retail prices of broadband services without a prior analysis of a relevant market, the result of which could, in SOKiK opinion, impact the proceeding suspended by SOKiK.

On 22 February 2007, after TP S.A. had separated providing Neostrada from fixed line services, UKE imposed a fine of PLN 339 million on TP S.A. for non-performance of the regulatory obligation to submit its Neostrada price list for UKE's approval, and for failing to demonstrate that TP S.A. had met the requirements of the Polish Telecommunication Law that the price of services (in particular the additional charge for the maintenance of the local loop paid by the Neostrada customers who do not subscribe for TP S.A.'s traditional fixed-line analogue services on the same local loop) be based on their cost and determined on clear, objective and non-discriminatory criteria. TP S.A. did not pay the fine, and, on 7 March 2007, appealed against the decision. SOKiK suspended also this proceeding.

On 6 May 2010 the European Court of Justice passed a judgment in the European Commission proceeding against Poland. The Court ruled that by regulating retail tariffs for broadband access services without carrying out a prior market analysis, Poland has failed to fulfil its obligations under the Universal Service Directive in conjunction with the Framework Directive. On 12 November 2010, SOKiK resumed the appeal proceeding concerning the fine of PLN 100 million. TP S.A. believes that UKE has no right to challenge the Neostrada price since it is not defined as a regulated service and that the criteria used for setting Neostrada price were transparent and objective.

Proceedings by UOKiK related to IP traffic
On 20 December 2007, UOKiK issued a decision concluding that TP S.A. had engaged in practices restricting competition when it downgraded IP traffic coming from domestic operators' networks to TP S.A.'s network via foreign operators' networks and imposed a fine of PLN 75 million on the Company. At the same time, UOKiK ordered TP S.A. to immediately cease this practice. TP S.A. disagrees with the decision of UOKiK and did not pay the fine. On 2 January 2008, TP S.A. appealed to SOKiK against the decision. The matter is currently being investigated by SOKiK.

Proceedings before the European Commission related to broadband access
In September 2008, the European Commission conducted an inspection at the premises of TP S.A. and PTK-Centertel. The aim of the inspection was to gather evidence of a possible breach by TP S.A. of competition rules on the broadband Internet market. On 17 April 2009, the European Commission notified TP S.A. of initiation of proceedings on the supposed refusal to provide services and non-price discrimination on the Polish wholesale market of broadband access to the Internet. On 1 March 2010, TP S.A. received a Statement of Objections from the European Commission regarding an alleged abuse of dominant position, by refusing to supply access to its wholesale broadband services. The Company responded to the Statement of Objections on 2 June 2010 and an audience before the European Commission took place on 10 September 2010. In the course of the proceedings, state of play meetings with the European Commission also took place, with the latest meeting on 9 December 2010. TP S.A. received from the European Commission the letter of facts dated 28 January 2011 presenting evidence collected after the issue of the Statement of Objections as well as findings of the European Commission. Although the letter does not state additional objections against TP S.A., the Commission still asserts that TP S.A. has infringed the competition rules. The deadline for responding to the letter of facts is 7 March 2011.
Under European law, the European Commission may impose a fine on an entity of up to 10% of its total turnover of the preceding business year if it proves infringement of rules on competition. Moreover, the Commission may impose any behavioural or structural remedies which are proportionate to the infringement committed and necessary to bring the infringement effectively to an end. Such a decision can be appealed to the General Court (formerly the Court of First Instance). The Commission may also impose a fine of up to 1% of the total turnover of the preceding business year for providing incorrect or misleading information.

As at 31 December 2010 the Company recognised provisions for known and quantifiable risks related to proceedings against the Company initiated by UKE, UOKiK and the European Commission, which represent the

Company's best estimate of the amounts, which are more likely than not to be paid. The actual amounts of penalties, if any, are dependent on a number of future events the outcome of which is uncertain, and, as a consequence, the amount of the provision may change at a future date. Information regarding the amount of the provisions has not been separately disclosed, as in the opinion of the Company's Management such disclosure could prejudice the outcome of the pending cases.

d. Dispute with DPTG

Information on the matter has been consistently referred to in the financial statements of the Company since 2001 together with the development of the case over the years.

In 2001, a dispute arose over the interpretation of a contract for the sale and installation by the Danish company DPTG of a fiber optical transmission system (known as "North-South Link", or "NSL") for the State-owned PPTiT, the predecessor of TP SA. The contract, signed in 1991 and for which work was completed in 1994, provided for payment of part of the contract price by allocating to DPTG 14.8% of certain profit from the NSL for fifteen years from the system's installation, that is, from February 1994 to January 2009. In 1999, the parties came into disagreement regarding the calculation of this revenue. In 2001, DPTG initiated ad hoc arbitration proceedings before the Arbitration Tribunal (under UNCITRAL rules) sitting in Vienna.

The Arbitration Tribunal appointed a first expert in 2004 to evaluate the revenue "from the NSL" to be used as a basis for calculating the share attributable to DPTG. Between November 2005 and December 2007, this expert delivered three reports proposing widely differing estimates. In January 2008, a second expert named by the Tribunal to assess the appropriateness and the consistency of the first expert's models, concurred, in all material respects, with the conclusions of the latest report of the first expert. In February 2008, the President of the Austrian Federal Economic Chamber sustained the challenge filed by TP S.A. against the chairman of the Arbitration Tribunal for lack of impartiality and a new chairman was named.

In June 2008, the Arbitration Tribunal decided to split the case into two periods and to render firstly an award settling DPTG's rights for the period from February 1994 to June 2004. On 3 September 2010, the Tribunal issued its partial award for the period from February 1994 to June 2004 (Phase I). It settles DPTG's claims at DKK 2,946 million (approximately EUR 396 million) including interest. The partial award was issued after nine years of arbitration proceedings. During this time, TP S.A. consistently contested both the basis of the DPTG case and, in particular, its interpretation of the contract as a joint-venture and its related broad interpretation of the financing sub-clause at the heart of the dispute, as well as the amount claimed. According to TP S.A., the contract is a sale contract. The contract valued DPTG's supplies remaining to be paid at EUR 17 million. By 2006, DPTG had already received from TP S.A. over EUR 84 million in performance of the contract.

The partial award states that the contract is a sale contract but nevertheless awards DPTG an amount as if the contract was a joint-venture. TP S.A., its legal counsel and independent experts all believe that the amount awarded is many times higher than DPTG's rights. Given the amounts awarded for Phase I, and potentially for Phase II, and the lack of consistency of the award, it is TP S.A's position that this award is contrary to Public Policy.

Since 2001, TP S.A. has made what it considered to be an appropriate provision for this matter, as supported by outside counsel and other professional advisors. TP S.A.'s Management Board has conducted the necessary reassessment of the provision in consideration both of this partial award and of the potential award to DPTG for the period from July 2004 to January 2009 (Phase II). The provision has been increased from approximately DKK 2,050 million (an equivalent of EUR 275 million or PLN 1,100 million) to approximately DKK 4,040 million (an equivalent of EUR 542 million or PLN 2,161 million). The revised amount is made up of the sum of the Arbitration Tribunal's award for Phase I (including interest) and of the result of the linear projection of the DKK 2,001 million awarded in the partial decision of the Tribunal for the 125 months of Phase I onto the 55 months of Phase II, amounting to DKK 880 million (EUR 118 million) in principal and approximately DKK 216 million (EUR 29 million) in interest. The Management will assess the level of the provision on a regular basis taking into account further developments of the matter.

The Company's Management has been obliged to adjust the level of provision for this matter by virtue of the fact that an arbitral award has been rendered. Nevertheless, it strongly disputes both the contractual basis of the claim and the amounts awarded. Therefore, the amount of the provision should in no way be viewed as an indication by TP S.A. of the proper outcome of the dispute. On the contrary, and as mentioned above, it is the strongly held opinion of TP S.A.'s Management and its counsel that the award is in clear violation of the basic rules of Public

Policy. TP S.A.'s Management, acting in the best interests of the Company and its shareholders, will use all reasonable legal actions to resist the award issued by the Arbitration Tribunal.

As a consequence, TP S.A. did not pay the partial award. On 13 October 2010, TP S.A. challenged the three arbitrators, claiming for their dismissal from the potential further proceedings on Phase II. On 2 December 2010, TP S.A. filed a claim before the commercial court in Vienna claiming for the setting aside of the partial award. In the setting aside procedure, the court ordered a hearing on 30 March 2011.

On 22 December 2010, TP S.A. was notified by the Court in Warsaw that DPTG had filed a motion to ascertain enforceability and obtain an enforceability clause with regards to the partial award. The court hearing with regards to this matter is scheduled for 9 March 2011. TP S.A. is currently preparing a robust defence to this motion.

On 14 January 2011, DPTG filed its claim for Phase II, which amounts to DKK 2,386 million (approximately EUR 320 million) including interest. The Tribunal has directed TP S.A. to submit its answer to this claim by 27 May 2011.

e. Other contingent liabilities and provisions

Apart from the above mentioned, operational activities of the Company are subject to regulations of legal administrative nature and the Company is a party to a number of legal proceedings and commercial contracts related to its operational activities. The Company believes that adequate provisions have been recorded for known and quantifiable risks.

30. Related party transactions

30.1. Management Board and Supervisory Board compensation

Management Board compensation was as follows:

(in PLN thousands)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Short-term benefits excluding employer social security payments [1]	9,318	13,647
Post-employment and other benefits	-	1,860
Termination costs	2,225	2,550
Total	**11,543**	**18,057**

[1] Gross salaries, compensation, bonuses and non-monetary benefits.

Remuneration and bonuses, compensation and termination indemnities, including compensation under a competition prohibition clause (cash, benefits in kind or any other benefits) paid in accordance with contractual commitments, by TP S.A. to TP S.A.'s Management Board and Supervisory Board members in the 12 months ended 31 December 2010 and 2009 are presented below.

Persons that were Members of the Management Board of the Company as at 31 December 2010

(in PLN thousands)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Maciej Witucki	3,019	2,687
Vincent Lobry	2,131	350[1]
Piotr Muszyński	1,811	1,496
Roland Dubois	2,357	2,047
Total	**9,318**	**6,580**

[1] From the date of appointment

Persons that were Members of the Management Board of the Company in 2010 or previous periods

(in PLN thousands)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Mariusz Gaca	-	617[2]
Jacek Kałłaur	-	4,157[1]
Ireneusz Piecuch	-	3,308[1]
Richard Shearer [3]	2,225	3,395[1]
Total	**2,225**	**11,477**

[1] Until the termination date.
[2] For the period of appointment.
[3] In addition to the amounts presented above, as at 31 December 2009 termination benefits payable in 2010 amounted to PLN 2.2 million.

In addition to the amounts presented above, during the 12 months ended 31 December 2010, the estimated cost of share-based payments under TP S.A.'s incentive programme allocated to the Company's Management Board amounted to PLN 0.6 million. During the 12 months ended 31 December 2009, the estimated cost of share based payments under TP S.A.'s and France Telecom S.A.'s incentive programmes allocated to the Company's Management Board amounted to PLN 0.7 million. In the 12 months ended 31 December 2010, no cost was recognized in respect of France Telecom S.A.'s incentive programme as the vesting period of the programme ended in 2009. In the 12 months ended 31 December 2010 and 2009, the amount of accrued costs for bonuses for the Company's Management Board amounted to PLN 1.5 million.

In the years ended 31 December 2010 and 2009, the members of TP S.A.'s Management Board did not receive any remuneration and bonuses (cash, benefits in kind or any other benefits) from TP S.A.'s subsidiaries and associates.

In the years ended 31 December 2010 and 2009, the members of TP S.A.'s Management Board did not receive any compensation or termination indemnities, including compensation under a competition prohibition clause (cash, benefits in kind or any other benefits) from TP S.A.'s subsidiaries and associates.

Supervisory Board compensation was as follows:

(in PLN thousands)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Prof. Andrzej Koźmiński	333	318
Olivier Barberot [2]	-	-
Olivier Faure [2]	-	-
Timothy Boatman	250	239
Thierry Bonhomme [2]	-	-
Jacques Champeaux	167	159
Ronald Freeman	250	239
Dr. Mirosław Gronicki	167	159
Marie-Christine Lambert [2]	-	-
Prof. Jerzy Rajski	167	159
Raoul Roverato [2]	-	-
Dr. Wiesław Rozłucki	167	159
Olaf Swantee [2]	-	-
Antonio Anguita [1] [2]	-	-
Vivek Badrinath [1] [2]	-	-
Stephane Pallez [1] [2]	-	-
Georges Penalver [1] [2]	-	-
Total	**1,501**	**1,432**

[1] Persons that were not members of the Supervisory Board of the Company as at 31 December 2010 but were members of the Supervisory Board of TP S.A. in 2010 or previous periods.
[2] Persons appointed to the Supervisory Board of the Company employed by France Telecom S.A. do not receive remuneration for the function performed.

In the years ended 31 December 2010 and 2009, the members of TP S.A.'s Supervisory Board did not receive any remuneration, bonuses, compensation or termination indemnities, including compensation under a competition prohibition clause (cash, benefits in kind or any other benefits) from TP S.A.'s subsidiaries and associates.

In the years ended 31 December 2010 and 2009, TP S.A. did not grant any loans to members of the Management Board and the Supervisory Board.

As at 31 December 2010 and 2009, members of the Management Board and the Supervisory Board had no liabilities arising from loans granted by the Company.

In the years ended 31 December 2010 and 2009, TP S.A. did not enter into any transactions with companies in which the members of its authorities had significant shareholdings.

In the years ended 31 December 2010 and 2009, the Company did not enter into any significant transactions with members of the Management Board and the Supervisory Board and their spouses, relatives up to second degree, individuals who are guardians or wards of the above persons or other persons with whom they have personal connections or with the entities in which these persons are members of the Management or Supervisory Board, and did not grant them any loans, advances, guarantees or other agreements resulting in significant benefits for TP S.A, its subsidiaries and associates.

30.2. Related party transactions

As at 31 December 2010, France Telecom S.A. owned 49.79% of shares of the Company. France Telecom S.A. has the power to appoint the majority of TP S.A.'s Supervisory Board members. The Supervisory Board appoints and dismisses members of the Management Board.

TP S.A.'s income earned from its subsidiaries comprise mainly interconnect and leased lines, fees for distribution of products through its own sales network and property rental and related fees. The purchases from the subsidiaries comprise mainly costs of interconnect, leased lines, network services, selling fees, property rental and related fees as well as customer support and management services. Costs incurred by the Company in transactions with its subsidiaries also comprise donations to Fundacja Orange.

Revenue earned from France Telecom Group comprise mainly interconnect, data transmission and research and development services. The purchases from the France Telecom Group comprise mainly costs of leased lines, network services, IT services, consulting services, interconnect.

TP S.A.'s financial income earned from its subsidiaries comprises dividends from subsidiaries, including a dividend paid by its wholly-owned subsidiary PTK Centertel Sp. z o.o. in the amount of PLN 1,600 million in 2010 year and 2,800 in 2009 year. The financial income also comprises interest on bonds issued by subsidiaries and interest on loans granted to subsidiaries. Financial costs incurred by TP S.A. in transactions with related parties mainly comprise interest on bonds issued to the subsidiaries and interest on loans from the subsidiaries. The Company's financial receivables from its subsidiaries mainly comprise bonds issued by subsidiaries and loans granted to the subsidiaries, together with accrued interests. Financial payables to related parties comprise bonds issued to the subsidiaries and loans from the subsidiaries, together with accrued interests.

(in PLN millions)	*12 months ended 31 December 2010*	*12 months ended 31 December 2009*
Sales of goods and services to:	**1,049**	**979**
TP Group	876	816
- TP Group (subsidiaries)	876	816
- TP Group (associates)	-	-
France Telecom Group	172	163
- France Telecom S.A. (parent)	127	110
- France Telecom (group)	45	53
Purchases of goods (including inventories, tangible and intangible assets) and services from:	**1,157**	**862**
TP Group	1,009	687
- TP Group (subsidiaries)	1,009	687
- TP Group (associates)	-	-
France Telecom Group	148	175
- France Telecom S.A. (parent)	89	111
- France Telecom (group)	59	64
Financial income:	**2,228**	**3,211**
TP Group	2,228	3,211
- TP Group (subsidiaries)	2,228	3,211
- TP Group (associates)	-	-
France Telecom Group	-	-
- France Telecom S.A. (parent)	-	-
- France Telecom (group)	-	-
Financial expense:	**587**	**543**
TP Group	587	543
- TP Group (subsidiaries)	587	543
- TP Group (associates)	-	-
France Telecom Group	-	-
- France Telecom S.A. (parent)	-	-
- France Telecom (group)	-	-
Dividends paid:	**997**	**997**
TP Group	-	-
- TP Group (subsidiaries)	-	-
- TP Group (associates)	-	-
France Telecom Group	997	997
- France Telecom S.A. (parent)	997	997
- France Telecom (group)	-	-

On 24 July 2008, TP S.A., France Telecom S.A. and Orange Brand Services Limited (UK) (hereinafter referred to as “Orange”) concluded a license agreement, on which basis TP S.A. will acquire rights to use the Orange brand (trade marks) in relation to the provisioning of TV, ISP and B2B goods and services. The license fee for the use of the Orange trade mark by TP S.A. will amount to 1.6% of the Company’s operating revenue earned under the Orange brand. The agreement has been concluded for 10 years with the possibility of renewal.

(in PLN millions)	*At 31 December 2010*	*At 31 December 2009*
Receivables from:	**247**	**185**
TP Group	179	125
- TP Group (subsidiaries)	179	125
- TP Group (associates)	-	-
France Telecom Group	69	60
- France Telecom S.A. (parent)	60	52
- France Telecom (group)	9	8
Financial receivables from:	**3,435**	**3,683**
TP Group	3,435	3,683
- TP Group (subsidiaries)	3,435	3,683
- TP Group (associates)	-	-
France Telecom Group	-	-
- France Telecom S.A. (parent)	-	-
- France Telecom (group)	-	-
Payables to:	**460**	**295**
TP Group	357	203
- TP Group (subsidiaries)	357	203
- TP Group (associates)	-	-
France Telecom Group	103	92
- France Telecom S.A. (parent)	81	80
- France Telecom (group)	22	12
Financial payables to:	**8,243**	**9,398**
TP Group	8,243	9,398
- TP Group (subsidiaries)	8,243	9,398
- TP Group (associates)	-	-
France Telecom Group	-	-
- France Telecom S.A. (parent)	-	-
- France Telecom (group)	-	-

In addition to the above mentioned transactions, during the 12 months ended 31 December 2009 TP S.A. has conducted share sale/purchase transactions with its subsidiaries (see Notes 7, 14.1, 15).

31. Subsequent events

There was no significant event after the balance sheet date.

Management Board's Report on the Activity of

TELEKOMUNIKACJA POLSKA S.A.

in 2010

22 February 2011

This report on the activity of Telekomunikacja Polska (“the Company”, “the Parent Company”, “TP S.A.”, “TP”) in 2010 has been drawn up in compliance with Article 91 of the Decree of the Minister of Finance of 19 February 2009 on current and periodic information disclosed by issuers of securities and conditions for recognising as equivalent information required by the laws of a non-member state (Journal of Laws of 2009 No. 33, item 259, as amended).

CHAPTER I HIGHLIGHTS OF THE FINANCIAL STATEMENTS **6**

1 SUMMARISED FINANCIAL STATEMENTS **7**
1.1 Comments to Income Statement Items **7**
1.2 Comments to Cash Flow Statement Items **8**
1.2.1 Capital Expenditures (CAPEX) 8
1.3 Comments to Balance Sheet Items **9**
1.4 Related Parties Transactions **9**
1.5 Description of Significant Agreements **9**
1.6 Subsequent Events **9**
1.7 Information about the Loan or Borrowing Collaterals or Guarantees Provided by the Issuer or Its Subsidiaries **10**
1.8 Management of Financial Resources and Liquidity of the TP **10**
1.8.1 Bonds 10
1.8.2 Loan and Borrowings Agreements 10
1.8.3 Unused Credit Facilities 11
1.8.4 Loan Covenants 11
1.8.5. Guarantees and Collaterals 11
1.8.6 Ratings 11
1.8.7 Hedging Transactions 11
1.8.8 TP's Financial Liquidity, Net Financial Debt and Status as a Going Concern. 11

2 STATEMENTS OF THE MANAGEMENT BOARD **13**
2.1 Statement on Adopted Accounting Principles **13**
2.2 Statement on Appointment of the Licensed Auditor of TP S.A.'s Financial Statements **13**
2.3 Agreement with the Licensed Auditor **13**
2.4 Management Board's Position as to the Achievement of the Previously Published Financial Projections for the Given Period **14**

3 CORPORATE GOVERNANCE STATEMENT **15**

CHAPTER II MANAGEMENT BOARD'S REPORT ON OPERATING AND FINANCIAL PERFORMANCE OF TP S.A. IN 2010 .... **21**

4 FIXED LINE SEGMENT **22**
4.1 Financial Performance **22**
4.1.1 Fixed Line Voice Services 22
4.1.2 Fixed Line Data Services 23
4.2 Market and Competition **24**

5 MATERIAL EVENTS THAT HAD OR MAY HAVE INFLUENCE ON TP S.A AND TP GROUP'S OPERATIONS **26**
5.1 Regulatory Obligations **26**
5.2 Co-operation Agreement between TP Group and TVN **27**
5.3 CATV Operators **27**
5.4 Infrastructure Development **28**
5.5 Claims, Disputes, Fines and Investigation by the European Commission **28**
5.6 Cost Calculation Results **28**
5.7 Functional Separation (UKE's Plans) **29**

5.8 Memorandum of Understanding with UKE 29
5.9 Compensation for Universal Service Costs 30
5.10 Act of 7 May 2010 on Supporting the Development of Telecommunication Services and Networks 30

6 OUTLOOK FOR THE DEVELOPMENT OF TP S.A. AND TP GROUP 32
6.1 Market Outlook 32
6.2 TP Group's Strengths 32
6.3 TP Group's Medium Term Action Plan 33

7 TP S.A.'S MAJOR ACHIEVEMENTS IN RESEARCH AND DEVELOPMENT 34
7.1 Research and Development 34
7.2 R&D Cooperation with France Telecom 35

CHAPTER III ORGANISATION AND CORPORATE STRUCTURE 36

8 CHANGES IN TP S.A.'S STRUCTURE IN 2010 37
8.1 Changes in the Corporate Structure 37
8.1.1 Management Board 37
8.1.2 Business Units 37
8.1.3 Group's New Premises 37
8.2 Ownership Changes Effected by TP S.A. in 2010 38
8.2.1 Merger of Ramsat S.A. and Prado Sp. z o.o. 38
8.2.2 Sale of TP SA Finance BV to TP Invest Sp. z o.o. 38
8.2.3 Sale of minority stake of Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. to Orange Customer Service Sp. z o.o. 38
8.2.4 Changes of Equity in Other Subsidiaries 38
8.3 TP S.A.'s Shareholders 38

9 TP S.A.'S STRUCTURE AS OF 31 DECEMBER 2010 40
9.1 Corporate Governance Bodies of TP S.A. 40
9.1.1 TP Shares Held by Persons Who Manage or Supervise TP 40
9.1.2 Information on the Remuneration of Persons Who Manage or Supervise TP 40
9.1.3 Contracts with Management Board Members 40
9.1.4 General Assembly 40
9.2 Employment in TP S.A. 40
9.2.1 Social Agreement 41
9.2.2 Incentive Program 41

CHAPTER IV KEY RISK FACTORS 43

10 RISK FACTORS AFFECTING THE ACTIVITIES OF TP S.A. AND TP GROUP 44
10.1 Implementation of TP Group's Medium-term Action Plan 44
10.2 Timely Implementation of Regulatory Requirements 44
10.3 Launch of New Products and Services 45
10.4 Potential Saturation of Networks 45
10.5 Development of New Technologies and New Investments 45
10.6 Non-availability or Failure of Technical Infrastructure 45
10.7 Non-availability or Failure of IT Systems 45
10.8 Dependence on External Partners 46

10.9 Risk Related to Trade Agreements and Strategic Alliances 46
10.10 Availability of Skilled Employees 46
10.11 Human Resources Risk and Organisation Structure Adjustment 46
10.12 Issues Related to the Incorporation of TP 46
10.13 Tax Contingent Liability 47
10.14 Compliance with Personal Data Protection Regulations and Breach of Licence Agreements or Infringement of Copyrights 47
10.15 Environmental Risks 47

11 TELECOMMUNICATIONS SECTOR RISKS 48
11.1 Regulatory Risks 48
11.1.1 Single Reference Offer 48
11.1.2 WLR Service 48
11.1.3 Local Loop Unbundling 48
11.1.4 Bitstream Access 49
11.1.5 Leased Lines 49
11.1.6 Cable Ducts (ROI) 50
11.1.8 Telecommunication Law Amendment 50
11.1.9 New Regulation on Data Retention 51
11.1.10 Consultation by the Ministry of Infrastructure Regarding the Future of USO 52
11.1.11 Consultation of the President of UKE’s Concept of USO in Poland 52
11.2 Competitive Risks 53
11.2.1 Fixed/Mobile Substitution 53
11.2.2 WLR, BSA and LLU Wholesale Markets 53
11.2.3 Leased Lines Market 54
11.2.4 Interconnect Market 55
11.2.5 ILD (International Long Distance) Inbound and Gateway Markets 55
11.2.6 International IP Transit Market 55
11.2.7 VoIP Segment 55

12 RISK FACTORS RELATED TO MACROECONOMIC ENVIRONMENT AND FINANCIAL MARKETS 57
12.1 Macroeconomic Factors and Factors Related to Poland 57
12.1.1 Economic Growth 57
12.1.2 Inflation 57
12.1.3 Unemployment and Labour Costs 57
12.1.4 Political and Economic Factors 57
12.1.5 Changes in Regulation 57
12.1.6 Polish Tax System 58
12.2 Factors Related to Financial Markets 58
12.2.1 General Risks Related to the Polish Market 58
12.2.2 Interest Rates 58
12.2.3 Foreign Exchange Rates 58
12.2.4 Situation at the Warsaw Stock Exchange 58
12.2.5 Other Factors That May Influence the Price of TP Shares 58

13 APPENDICES 59
Appendix 1. Secondary Legislation 59
Appendix 2. Analysis of Relevant Markets 60
Appendix 3. Products and Services 61

GLOSSARY OF TELECOM TERMS...69

CHAPTER I
HIGHLIGHTS OF THE FINANCIAL STATEMENTS

as of 31 December 2010 and for the twelve-month period ended thereon

1 SUMMARISED FINANCIAL STATEMENTS

	For 12 months ended				
	31 December 2010		31 December 2009		Change
	in PLN mln	in EUR[1] mln	in PLN mln	in EUR[2] mln	
Income Statement					
Revenue	8,434	2,106	9,291	2,140	-9.2%
EBITDA	2,152	537	3,831	883	-43.8%
EBITDA margin	*25.5%*		*41.2%*		*-15,7 p.p*
Operating income	(258)	(64)	1,149	265	N/A
Operating margin	*N/A*		*12.4%*		
Net income after tax	1,023	255	3,357	773	-69.5%
*Weighted average number of shares (in millions)**	1,336		1,336		
Earnings per share (in PLN) (basic and diluted)	0.77	0.19	2.51	0.58	-69.3%
Statement of Cash Flows					
Net cash provided by operating activities	4,380	1,094	6,305	1,453	-30.5%
Net cash used in investing activities, including	(1,075)	(268)	(1,639)	(378)	-34.4%
Capital expenditures (on accrual basis)	(1,892)	(472)	(1,272)	(293)	48.7%
Net cash used in financing activities	(3,033)	(757)	(3,719)	(857)	-18.4%
Net change in cash and cash equivalents	272	68	945	218	-71.2%

	As of				
	31 December 2010		31 December 2009		Change
Balance Sheet	in PLN mln	in EUR[3] mln	in PLN mln	in EUR[4] mln	
Cash and cash equivalents	2,268	573	1,996	486	13.6%
Intangible assets	1,247	315	1,055	257	18.2%
Property, plant and equipment	12,657	3,196	13,421	3,267	-5.7%
Total assets	28,617	7,226	29,203	7,108	-2.0%
Financial liabilities at amortised costs, of which:	10,136	2,559	11,538	2,808	-12.2%
Current	2,580	651	2,109	513	22.0%
Non-current	7,556	1,908	9,429	2,295	-19.8%
Other liabilities, current and non-current	5,581	1,409	3,769	917	48.1%
Total equity	12,900	3,257	13,896	3,383	-7.2%

Notes:
1 – PLN/EUR fx rate of 4.0044 applied
2 – PLN/EUR fx rate of 4.3406 applied
3 – PLN/EUR fx rate of 3.9603 applied
4 – PLN/EUR fx rate of 4.1082 applied
** Weighted average number of shares in 12 months ended 31 December 2010*

1.1 Comments to Income Statement Items

In 2010, TP S.A.'s revenue amounted to PLN 8,434 million in 2010 and was lower by PLN 857 million as compared to 2009. The decrease in revenue resulted mainly from a PLN 796 million decline in subscription and voice traffic revenue and a PLN 79 million decrease in broadband revenue.

Operating income before depreciation and amortisation expense and impairment of non-current assets (EBITDA) amounted to PLN 2,152 million in 2010 and was PLN 1,679 million lower than in 2009.

Operating result (EBIT) amounted to PLN (258) million in 2010 and was PLN 1,407 million lower than in 2009.

In particular, year-on-year, in 2010:

- Non-income taxes increased by PLN 21 million;
- Commercial expenses were up by PLN 53 million;
- Interconnect expenses decreased by PLN 73 million;
- Labour expenses were PLN 254 million lower;
- Gain on sale of assets was higher by PLN 29 million;
- Impairment of non-current assets decreased by PLN 16 million;
- Restructuring costs were down by PLN 7 million;
- Depreciation and amortisation decreased by PLN 256 million;
- Provision for dispute with DPTG increased by PLN 1,061 million.

Net financial charges, before dividends from subsidiaries (PLN 1,906 million in 2010 as compared to PLN 2,897 million in 2009), amounted to PLN 501 million in 2010 and were PLN 71 million lower than in 2009, mainly due to an increase of PLN 59 million in interest income and an decrease of PLN 96 million in net foreign exchange gains (losses), which were partially offset by an increase of PLN 87 million in interest expense.

TP's net income (after dividends from subsidiaries) for the reported period amounted to PLN 1,023 million, which is a decrease of PLN 2,334 million compared with 2009. Earnings per share (after dividends from subsidiaries) decreased from PLN 2.51 to PLN 0.77.

1.2 Comments to Cash Flow Statement Items

In 2010, net cash provided by operating activities totalled PLN 4,380 million and was lower by PLN 1,925 million year-on-year. The decrease was partly a result of a decrease of PLN 991 million in dividends received, an increase of PLN 114 million in net interest paid and an increase of PLN 172 million in net outflow from exchange rate effect on derivatives.

Net cash used in investing activities amounted to PLN 1,075 million in 2010 and was lower by PLN 564 million compared to 2009. Compared to 2009, cash outflow on property, plant, equipment and intangible assets decreased by PLN 96 million, while proceeds from sale of property, plant, equipment and intangible assets were up by PLN 52 million in 2010. Year-on-year, in 2010, proceeds from sale of subsidiaries increased by PLN 153 million. No cash for shares in subsidiaries was paid in 2010 compared to PLN 233 million in 2009.

Net cash outflows from financing activities totalled PLN 3,033 million in 2010 and were by PLN 686 million lower than in 2009. The primary factors contributing to this change were lower outflows on repayment of short-term bank loans (down PLN 2,089 million) and lower outflows on repayment of long-term bank loans (down PLN 1,708 million), which were partially offset by a decrease of PLN 3,102 million in proceeds from issuance of bonds.

1.2.1 Capital Expenditures (CAPEX)

TP's capital expenditures totalled PLN 1,892 million in 2010 and was higher by PLN 620 million than in 2009.

TP continued its investments under the Investment Declaration resulting from the Memorandum of Understanding signed with UKE on 22 October 2009. Under the terms of the agreement, within 36 months TP is to construct and provide fixed broadband infrastructure enabling addition of 1,200,000 new broadband lines.

The investment projects included:

- Development of broadband internet access services, particularly television (TVoSAT and Videostrada TP), through purchases of subscriber terminals;
- Implementation of "Chinese walls" in accordance with the Memorandum of Understanding with UKE;
- Modernisation, development and renewal of IT infrastructure, aimed at customer service processes and costs optimisation;
- IT systems development (introduction of new offers and functionalities, modernisation and system support);
- Further development of fiber-optic network and transmission equipment, in order to launch new backbone and access lines;
- Implementation of investment projects for after-sales and marketing purposes;
- Further development of the CDMA radio network, particularly for the purpose of the NMT migration;

- Development of DVB-T(digital terrestrial television);
- Continuation of a convergent offer project;
- Expansion of the MAN ETHERNET network;
- Modernisation of network monitoring and management system;
- Development of local area networks (LANs); and
- Research and development.

1.3 Comments to Balance Sheet Items

As of 31 December 2010, total equity amounted to PLN 12,900 million and was PLN 996 million lower than one year before. The change is attributed mainly to the paid dividend of PLN 2,003 million, which was partially offset by net income of PLN 1,023 million generated in 2010.

In 2010, property, plant, equipment and intangible assets decreased by PLN 572 million year-on-year, mainly as a result of amortisation and depreciation of PLN 2,399 million, which was only partially offset by capital expenditures amounting to PLN 1,893 million (including PLN 1,892 million of capital expenditures financed through own resources and PLN 1 million financed through finance leases).

Total assets decreased by PLN 586 million in the reported period. The change resulted mainly from the aforementioned decrease of PLN 572 million in property, plant, equipment and intangible assets, a decrease of PLN 247 million in loans and receivables, which were partially offset by an increase of PLN 272 million in cash and cash equivalents.

Non-current and current liabilities increased by PLN 410 million to PLN 15,717 million as of 31 December 2010. The primary factors that contributed to the change were an increase of PLN 991 million in provisions, an increase of PLN 729 million in trade payables and an increase of PLN 96 million in liabilities on account of derivatives, which were partially offset by a decrease of PLN 1,402 million in the Company’s debt on account of bonds and bank borrowings.

In 2010, current liabilities increased by PLN 2,212 million, while non-current liabilities decreased by PLN 1,802 million. It was mainly a result of an increase of PLN 471 million in short-term financial liabilities on account of bonds and bank borrowings, an increase of PLN 729 million in short-term trade payables and an increase of PLN 1,012 million in short-term provisions, which were accompanied by a decrease of PLN 1,873 million in long-term financial liabilities on account of bonds and bank borrowings.

1.4 Related Parties Transactions

Please see Note 30 to the IFRS Financial Statements for information about TP’s transactions with related entities.

1.5 Description of Significant Agreements

TP did not conclude agreements in 2010, outside the group of associated companies, of which the value would exceed 10% of TP’s total equity.

Please see section 1.8.2 for information on loan and borrowing agreements, particularly exceeding 10% of TP’s total equity,.

On 28 April 2010 TP Emitel Sp. z o.o., a subsidiary of TP S.A., and Telewizja Polska S.A. (“TVP”) concluded an agreement for DVB-T (Digital Video Broadcasting – Terrestrial) multiplex broadcasting and network services. Pursuant to the Agreement, TP Emitel will become a technical operator of Poland’s third digital terrestrial television (DTT) multiplex. The nationwide multiplex will contain up to seven channels. Within the next ten years, TP Emitel will receive from TVP a total of PLN 615.6 million for the third multiplex signal broadcast, signal retransmission, including TVP Info channel regionalisation, as well as development and maintenance of the relevant data communication platform. TP Emitel obtained necessary radio permissions from UKE and starting from 30 September 2010 began regular broadcasting of the TV programs.

1.6 Subsequent Events

Please see Note 31 to the IFRS Financial Statements for information on subsequent events.

1.7 Information about the Loan or Borrowing Collaterals or Guarantees Provided by the Issuer or Its Subsidiaries

Please see Note 28 to the IFRS Financial Statements for information about the loan or borrowing collaterals or guarantees provided by the issuer or its subsidiaries.

1.8 Management of Financial Resources and Liquidity of the TP

TP financed its activities in 2010 mostly by use of cash generated from operating activities and raised from loans and bond issues.

In 2010, TP repaid long-term debt of loans in amount PLN 225 million and reduced liabilities on account of short-term notes acquired by other TP Group companies by PLN 726 million. All debt repayments were carried out on schedule.

TP did not raise additional financing liabilities in the reported period.

As of 31 December 2010, TP's interest-bearing liabilities totalled PLN 10,136 million (before derivatives), which is a decrease of PLN 1,402 million compared to 31 December 2009.

TP's liquidity remained solid, owing to strong cash position, amounting to PLN 2,268 million at 31 December 2010, and available credit facilities totalling the equivalent of PLN 3,584 million (please see section 1.8.3 below for details).

Based on available cash, back-up and revolving credit facilities, as well as external sources of financing, the TP has sufficient funds to carry out its investment projects, including capital investments, scheduled for implementation in 2011.

1.8.1 Bonds

In 2009, TPSA Eurofinance France SA, a subsidiary of TP, set up a Euro Medium Term Note Programme totalling EUR 1,500 million par, fully secured by TP's guarantee. The Programme enables placement of TP bonds, through TPSA Eurofinance France SA, on foreign markets. In 2009, TP issued five-year notes totalling EUR 700 million par in the Programme.

In the reported period, TP did not issue or redeem any external long-term debt notes, particularly in the Programme.

As part of liquidity management, in 2010 TP issued and redeemed short-term bonds acquired by TP Group companies in a programme, which was set up in 2002 and totals PLN 2,500 million.

Please see Note 18.1 to the IFRS Financial Statements for the detailed information on outstanding external long-term debt notes, including their terms and redemption details.

1.8.2 Loan and Borrowings Agreements

In 2010, TP concluded the following loan and guarantee agreements:

- On 25 January 2010, it concluded a revolving loan agreement with an international syndicate of banks for a total amount of €400 million. The purpose of the new agreement was to refinance a revolving overdraft facility of €550 million that secures TP Group's liquidity. The agreement was signed for a period of three years and expires on 18 April 2013. The loan interest is based on the EURIBOR rate for the relevant interest periods plus a bank margin. The agreement includes a financial covenant (please see section 1.8.4 for details);
- On 1 March 2010, it concluded an agreement with Nordea Bank Polska S.A. and Nordea Bank Finland PLC, under which the latter granted a guarantee of €83 million to the European Investment Bank to secure TP's EUR-denominated obligations under the Financing Agreement of 20 December 2000. The agreement includes a financial covenant (please see section 1.8.4 for details);
- On 23 March 2010, it concluded an agreement with PKO Bank Polski S.A., under which the latter granted a guarantee of PLN 143 million to the European Investment Bank to secure TP's PLN-denominated obligations under the Financing Agreement of 20 December 2000. The agreement includes a financial covenant (please see section 1.8.4 for details);
- On 22 October 2010, it concluded a revolving loan agreement with an international syndicate of banks for a total amount of PLN 2,000 million. The purpose of the new credit facility was to refinance a revolving overdraft facility of PLN 2,500 million that secures TP Group's liquidity. The agreement was signed for a period of five years and expires on 22 October 2015. The loan interest is based on the WIBOR rate for the relevant interest periods plus a bank margin. The agreement includes a financial covenant (please see section 1.8.4 for details);

- Two current account overdraft agreements with RBS Bank (Polska) S.A. for PLN 62 million each. The agreements provide overdraft facilities to secure TP's liquidity and current financing in the periods between 11 January 2010 and 30 June 2010 and between 1 July 2010 and 29 December 2010, respectively. On 30 December 2010, TP concluded another agreement with RBS Bank (Polska) S.A., under which it can use the overdraft facility up to the same amount of PLN 62 million in the period between 3 January 2011 and 29 June 2011.

In 2010, TP did not use any bank loans. In the same period, the bank borrowings amounting of PLN 225 million were repaid.

Please see Note 18.2 and 28 to the IFRS Financial Statements for the detailed information on all bank loans (including their maturity dates) and guarantees.

1.8.3 Unused Credit Facilities

As of 31 December 2010, TP had outstanding general-purpose credit facilities amounting to an equivalent PLN 3,584 million, specifically EUR 400 million and PLN 2,000 million.

1.8.4 Loan Covenants

Under agreements concluded in 2010, TP is a party to a loan agreement and guarantee agreements imposing an obligation to meet the ratio of net debt to EBITDA not higher than 3.5:1 (tested for the TP Group on a six months' basis). The value of the ratio on 31 December 2010 was met.

1.8.5. Guarantees and Collaterals

On 3 February 2010, the TP S.A. concluded a collateral agreement with Polska Telefonia Cyfrowa Sp. z o.o. ("PTC"), totalling PLN 6 million, with respect to liabilities of PayTel S.A., a TP's subsidiary, resulting from an agreement of 3 February 2010 between PayTel S.A. and PTC on co-operation in handling payments to PTC on PayTel S.A.'s network.

In 2010, the TP S.A. reduced to PLN 0.4 million a guarantee granted to Raiffeisen Bank Polska S.A. with respect to liabilities of PayTel S.A., a TP's subsidiary, on account of credit and guarantee facilities provided by the bank, whereas on 4 March 2010 it granted a guarantee totalling PLN 1.4 million to the Polish Branch of Societe Generale S.A. with respect to liabilities of PayTel S.A. on account of a guarantee facility provided by the bank.

In the reported period, TP requested that the Polish Branch of Societe Generale S.A. issue bank guarantees with respect to liabilities of TP Teltech Sp. z o.o., a TP wholly-owned subsidiary, towards its business partners, while TP promised to cover any claims related to payments under the guarantee. As of 31 December 2010, those guarantees totalled PLN 1.5 million.

1.8.6 Ratings

The ratings at 31 December 2010 were as follows:

Moody's Investor Services	A3, stable outlook
Standard and Poor's Rating Services	BBB+, stable outlook
Fitch IBCA	BBB+, stable outlook

1.8.7 Hedging Transactions

TP continued to minimise its exposure to foreign exchange volatility in 2010, covering almost 100% of its debt denominated in foreign currencies and 75% of the nominal amount of the DPTG provision. TP has also continued its hedging policy, securing the portions of the exposure on its operational and investment expenditures.

Please see Notes 19 and 20 to the enclosed IFRS Financial Statements for the detailed information about foreign exchange and interest rate hedging.

Please see Note 17.2 to the enclosed IFRS Financial Statements for the accounting structure of the net debt by currencies (after valuation of hedging instruments).

1.8.8 TP's Financial Liquidity, Net Financial Debt and Status as a Going Concern.

At 31 December 2010, TP's quick and current ratios decreased as compared to the end of 2009. Lower liquidity of TP was driven by an increase of PLN 1,191 million in current liabilities, which was only partially offset by an increase of PLN 361 million in current assets including an increase of PLN 149 million in

receivables. The liquidity ratios for the TP at 31 December 2010 and 31 December 2009, respectively, are presented in the table below.

	31 December 2010	31 December 2009
Current ratio Current assets / current liabilities*	0.71	0.83
Quick ratio Total current assets – inventories / current liabilities*	0.70	0.82
Super-quick ratio Total current assets – inventories – receivables / current liabilities*	0.53	0.64

*Current liabilities less provisions and deferred credits were used to determine the ratio.

TP's net financial debt (after valuation of derivatives) decreased to PLN 4,713 million at the end of 2010 (from PLN 6,063 million at the end of 2009).

Please see Note 20.5 to the enclosed IFRS Financial Statements for additional information about TP's liquidity.

2 STATEMENTS OF THE MANAGEMENT BOARD

2.1 Statement on Adopted Accounting Principles

TP Management Board, composed of:

1. Maciej Witucki - President of the Board
2. Vincent Lobry - Vice President of the Board
3. Piotr Muszyński - Vice President of the Board
4. Jacques de Galzain - Board Member
5. Jacek Kowalski - Board Member

hereby confirms that according to its best knowledge the financial statements and comparable data have been drawn up in compliance with the accounting regulations in force and reflect the TP S.A.'s property, financial standing and financial result in an accurate, reliable and transparent manner.

This Management Board's Report provides accurate depiction of the development, achievements and standing of TP S.A., including the description of major threats and risks.

2.2 Statement on Appointment of the Licensed Auditor of TP S.A.'s Financial Statements

TP Management Board hereby declares that the licensed auditor of the financial statements has been appointed in compliance with the relevant regulations and that both the auditor and the chartered accountants carrying out the audit meet the requirements to develop an impartial and independent opinion on the audited statements in compliance with the relevant regulations and professional standards.

2.3 Agreement with the Licensed Auditor

On 13 December 2010, TP concluded an agreement with an entity licensed to audit financial statements for auditing and reviewing the financial statements of TP S.A. and the consolidated financial statements of the Telekomunikacja Polska Group ("the TP Group" or "the Group") for reporting periods of 2010. Based on the agreement, Deloitte Audyt Sp. z o.o. has performed the following:

- the audit of the standalone financial statements of the Company and the consolidated financial statements of the TP Group for 2010 prepared in accordance with IFRS;
- reviews of the standalone and consolidated financial statements for the first half of 2010;
- agreed procedures concerning audit and reviews of standalone and consolidated financial statements in 2010.

The aggregate remuneration (in PLN '000) for auditing and reviewing the above-mentioned financial statements and other services rendered by Deloitte Audyt Sp. z o.o. for 2010 is presented below:

	2010
Audit of annual financial statements of the TP Group, including:	4,322
- Audit of annual financial statements of TP and the consolidated financial statements of the TP Group;	2,791
- Audit of annual financial statements of subsidiaries*.	1,531
Other authentication services to the TP Group, including:	3,488
- Review of financial statements of TP and the consolidated financial statements of the TP Group;	1,754
- Verification procedures related to internal control over financial reporting;	1,624
- Other authentication services.	122
Total amount payable by TP Group	7,822

* *The remuneration for audits of subsidiaries is payable under separate contracts between the auditor and each subsidiary.*

The aggregate remuneration for auditing and reviewing the above-mentioned financial statements and other services rendered by Deloitte Audyt Sp. z o.o. as of 2009 was as follows: PLN 2,991 thousand for audits/reviews of TP; PLN 1,874 thousand for audit-related and other services to TP; PLN 1,631 thousand for audits/reviews of subsidiaries; and PLN 1,624 thousand for verification procedures related to internal control over financial reporting.

2.4 Management Board’s Position as to the Achievement of the Previously Published Financial Projections for the Given Period

TP did not publish financial projections concerning results of the TP S.A. for 2010.

3 CORPORATE GOVERNANCE STATEMENT

(a) TP's corporate governance policy

The Company, as an issuer of securities listed on the Warsaw Stock Exchange (WSE), is obliged to comply with the corporate governance practices set out in the *Code of Best Practice for WSE Listed Companies*, which is available at http://corp-gov.gpw.pl.

(b) Corporate governance compliance

In 2010, the Company complied with the corporate governance best practice referred to above.

Furthermore, referring to the Section I of the *Best Practice*, the Company informs that:

(1) The Company has applied the recommendations of the European Commission (section I.5) for remuneration of members of supervisory and management bodies. The Supervisory Board is currently reviewing the existing rules for the purpose of further formalisation thereof.

(2) One of the Company's priorities is to ensure equal access of women and men to management positions in the Company (section I.9). Therefore, TP has developed assumptions to a project, which will determine the proportion of employing men and women on managerial posts, as well as a new set of assumptions for the recruitment process. TP has followed a policy of appointing persons with proper competence, professional experience and expertise to its supervisory and management bodies.

(c) Description of major features of TP's internal control and risk management systems with respect to the process of development of standalone and consolidated financial statements

A new TP Group Code of Ethics was adopted within the Company in 2008 which encompasses TP's relationship with customers, shareholders, employees, suppliers, competition and also with respect to the environment in which the TP S.A. operates. A warning system related to ethics and reporting of potential and actual fraud has been enhanced by the Group which is coordinated by the TP Group Ethics Committee. Training on ethics is provided to employees, which is confirmed by a personal certification. Formal channels for whistle blowing have been established, including reporting to the Chairman of the TP Audit Committee of the Supervisory Board, the Chairman of the TP Group Ethics Committee and the TP Group Internal Audit Director.

The system of internal control and risk management has been designed and implemented by the Management Board to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

TP S.A. is diligent in its approach to reporting financial results and its ongoing communication with the Polish and international investment community, as well as fulfilling its disclosure obligations. The TP Group Disclosure Committee is chaired by the Chief Financial Officer. Its role is to oversee public disclosures made by TP S.A., ensuring that they are timely, exact, transparent, complete, and presented in accordance with all relevant laws, applicable regulations and recognised practices, as well as being properly representative of the financial and operational condition of TP S.A.. In 2010, the Committee had five meetings.

The key elements of such system include the following procedures:

(1) An internal audit function, which reports directly to the President of the Management Board. The internal audit programme is annually reviewed by the Audit Committee which also analyses the Group's Internal Audit reports. In order to promote an appropriate independent outlook for the Internal Audit Department, Management Board decisions regarding the appointment and remuneration of the TP Group Internal Audit Director require, since 2005, an opinion of the Audit and Remuneration Committees.

(2) The Company conducts ongoing assessments of the quality of risk management system and controls. As part of this process, a Risk Map which enables identification and classification of TP S.A. and TP Group's financial and non-financial risks is maintained.

(3) Procedures were implemented in order to identify, report and monitor significant risks (i.e. legal, regulatory, environmental, financial reporting and operational) effectively on an ongoing basis. It provides a framework for the TP Group Internal Audit Department's ongoing risk-controlling activities.

In 2010, the Management Board again completed a comprehensive assessment of the TP S.A. and TP Group's internal controls over financial reporting. Main deficiencies were identified and corrected or appropriate action points have been launched. As a result of the assessment, the Management concluded that there were no weaknesses that would materially impact the internal control over the financial reporting at 31 December 2010.

(d) Indication of shareholders holding, directly or indirectly, significant batches of shares, including the number of shares held, the interest in the Share Capital, the corresponding number of votes and the percentage of the total voting power at the General Meeting

Shareholder	Number of shares held	Number of votes at the General Meeting	Percentage of the total voting power at the General Meeting	Nominal value of shares held (in PLN)	Interest in the Share Capital
France Telecom S.A.	664,999,999	664,999,999	49.79%	1,994,999,997	49.79%
Capital Group International, Inc.[1]	67,546,647	67,546,647	5.06%	202,639,941	5.06%
Other shareholders	603,102,375	603,102,375	45.15%	1,809,307,125	45.15%
TOTAL	**1,335,649,021**	**1,335,649,021**	**100.00%**	**4,006,947,063**	**100.00%**

(1) The number of shares as of 15 October 2010 based on information provided by Capital Group International, Inc.

(e) Indication of holders of any securities granting special control rights and description of such rights

The Company has not issued any securities granting any special control rights to shareholders or other entities.

(f) Indication of any restrictions concerning the exercise of the voting rights on shares, such as restriction of the voting rights to a certain percentage or number of votes or temporary restriction of the voting rights, or regulations according to which, in conjunction with the Company, the rights on securities are separated from the ownership of securities

The Company has not introduced any specific restrictions concerning the exercise of the voting rights on shares.

(g) Indication of any restrictions concerning transfer of ownership of the securities issued by TP

The transfer of ownership of the securities issued by the Company is not subject to any restrictions.

(h) Description of procedures for appointment and removal of managing persons and their rights, particularly the right to make decisions regarding the issuance or redemption of shares

The Management Board consists of between 3 and 10 members, including the President. They are appointed and removed by the Supervisory Board by a simple majority of the votes cast. The term of office for the member of the Management Board is three years. The Management Board’s remit comprises the management of all aspects of the Company’s affairs, with the exception of the matters which under the Polish Commercial Companies Code or the Articles of Association shall be within the competence of the General Meeting or the Supervisory Board. In particular, the powers of the Management Board include development of the Company’s strategy, economic and financial plans; establishment, transformation and liquidation of the Company’s business units; and governance of TP Group subsidiaries. Any decisions regarding the issuance or redemption of the Company’s shares are exclusively within the competence of the General Assembly.

The powers of the Management Board are detailed in the Management Board by-laws, available at www.tp-ir.pl.

(i) Description of procedures for amending the Articles of Association or the deed of the company

Any amendment to the Articles of Association requires a resolution of the General Assembly adopted by a majority of the three quarters of votes.

(j) Rules of operation of the general meeting and its major responsibilities, and description of the shareholders’ rights and the way of exercise thereof, particularly the rules resulting from the general meeting by-laws, if any, unless the information in this respect results directly from mandatory regulations

I. General Assemblies shall be held in Warsaw. The General Meeting shall be valid irrespective of the number of shares represented. According to the adopted by-laws, the General Meeting shall be opened by the Chairman of the Supervisory Board or his deputy, or, in case of their absence, by the President of the Management Board or a person designated by the Management Board. Thereafter, the Chairman shall be elected from among the persons entitled to take part in the General Meeting. After each subsequent matter on the agenda has been presented the Chairman of the General Meeting shall open a discussion giving floor to speakers in the sequence in which they have declared their willingness to speak. Upon the consent of the

General Meeting several items of the agenda may be discussed jointly. The participants may speak only on the matters which have been put on the agenda and are being considered at that moment.

II. Pursuant to the Regulations of the General Meeting of TP S.A., the shareholders have the following rights:

(1) The shareholders may take part in the General Meeting and exercise the right of vote in person or by attorneys-in-fact (other representatives).

(2) Each shareholder has the right to candidature for the Chairman of the General Assembly or to put forward one candidature for the position of the Chairman of the General Meeting to the minutes.

(3) When every point on the agenda is considered each shareholder has the right to one speech of 5 minutes and a reply of 5 minutes.

(4) Each shareholder has the right to ask questions on any matters on the agenda.

(5) The shareholder has the right to object a decision of the Chairman of the General Meeting. The General Meeting shall decide in a resolution whether the decision of the Chairman be upheld or reversed.

(6) Each shareholder has the right to suggest amendments or additions to draft resolutions, which are covered by the agenda of the General Meeting, by the time of closing the discussion over the item on the agenda referring to the draft resolution to which the suggestion is related.

(k) Composition and changes thereof in the last financial year, and description of bodies that manage, supervise or administer TP and any committees thereof

I. Composition of the Management Board and changes thereof in 2010

Composition on 1 January 2010:

1. Maciej Witucki - President of the Board
2. Vincent Lobry - Vice President of the Board
3. Piotr Muszyński - Vice President of the Board
4. Roland Dubois - Board Member

The composition of the Management Board did not change throughout 2010 and remained the same on 31 December 2010.

On January 14, 2011, Mr Roland Dubois resigned from the position of TP S.A. Management Board Member.

Mr. Jacques de Galzain and Mr. Jacek Kowalski were appointed by the Supervisory Board as a Member of the Management Board on January 27, 2011.

II. Composition of the Supervisory Board and its Committees and changes thereof in 2010

Composition on 1 January 2010:

1. Prof. Andrzej K. Koźmiński - Chairman and Independent Board Member
2. Olivier Barberot - Deputy Chairman and Chairman of the Strategy Committee
3. Olivier Faure - Board Member and Secretary
4. Antonio Anguita - Board Member
5. Vivek Badrinath - Board Member
6. Timothy Boatman - Independent Board Member and Chairman of the Audit Committee
7. Jacques Champeaux - Board Member
8. Ronald Freeman - Independent Board Member and Chairman of the Remuneration Committee
9. Dr. Mirosław Gronicki - Independent Board Member
10. Marie-Christine Lambert - Board Member
11. Raoul Roverato - Board Member
12. Prof. Jerzy Rajski - Independent Board Member
13. Dr. Wiesław Rozłucki - Independent Board Member

Mr. Vivek Badrinath resigned from his function on the Supervisory Board as from 22 April 2010. On 23 April 2010, the mandates of Messrs. Antonio Anguita, Jacques Champeaux, Ronald Freeman and Mirosław Gronicki expired. On the same day, Messrs. Jacques Champeaux, Ronald Freeman, Mirosław Gronicki, Thierry Bonhomme and Olaf Swantee were appointed by the Annual General Meeting as Members of the Supervisory Board.

Composition on 31 December 2010:

1. Prof. Andrzej K. Koźmiński - Chairman and Independent Board Member

2.	Olivier Barberot	- Deputy Chairman and Chairman of the Strategy Committee
3.	Olivier Faure	- Board Member and Secretary
4.	Timothy Boatman	- Independent Board Member and Chairman of the Audit Committee
5.	Thierry Bonhomme	- Board Member
6.	Jacques Champeaux	- Board Member
7.	Ronald Freeman	- Independent Board Member and Chairman of the Remuneration Committee
8.	Dr. Mirosław Gronicki	- Independent Board Member
9.	Marie-Christine Lambert	- Board Member
10.	Prof. Jerzy Rajski	- Independent Board Member
10.	Raoul Roverato	- Board Member
12.	Dr. Wiesław Rozłucki	- Independent Board Member
13.	Olaf Swantee	- Board Member

At present, TP S.A. has six independent members in the Supervisory Board, namely: Prof. Andrzej K. Koźmiński, Timothy Boatman, Ronald Freeman, Dr. Mirosław Gronicki, Prof. Jerzy Rajski and Dr. Wiesław Rozłucki.

Composition of Committees of the Supervisory Board on 31 December 2010:

The Audit Committee

1. Timothy Boatman – Chairman
2. Olivier Faure
3. Ronald Freeman
4. Marie-Christine Lambert

The Audit Committee is chaired by Mr. Timothy Boatman, an independent member of the Supervisory Board. He has relevant experience and qualifications in finance, accounting and audit.

The Remuneration Committee

1. Ronald Freeman – Chairman
2. Olivier Barberot
3. Olaf Swantee
4. Dr. Wiesław Rozłucki

The Strategy Committee

1. Olivier Barberot – Chairman
2. Jacques Champeaux
3. Olivier Faure
4. Dr. Mirosław Gronicki
5. Prof. Jerzy Rajski

III. Operations of the Management Board

The operations of the Management Board shall be managed by its President, who shall be the superior of all the Company’s employees. Meetings of the Management Board are chaired by the President of the Management Board or, in case of his absence, another member of the Management Board designated by the President. Resolutions may be adopted if all members of the Management Board have been duly notified about the meeting. Resolutions of the Management Board shall be adopted by absolute majority of votes of all appointed members of the Management Board. Individual members of the Management Board shall manage the areas of the Company’s operations assigned to them.

The responsibilities and obligations of the Management Board are detailed in the Management Board by-laws, available at www.tp-ir.pl.

IV. Operations of the Supervisory Board

The work of the Supervisory Board is co-ordinated by the Board Chairman with the assistance of the Board Secretary. The Supervisory Board shall hold a meeting at least once a quarter. The Management Board or a member of the Supervisory Board may demand convening a meeting, specifying a suggested agenda thereof. The Chairman of the Supervisory Board shall call a meeting within two weeks of the receipt of the aforementioned motion. In case the Chairman of the Supervisory Board fails to call a meeting within two weeks, the applicant may call it on his own, specifying the date, place and suggested agenda of the meeting. The Supervisory Board shall adopt resolutions by a simple majority of the votes cast and in the presence of at

least half of all members of the Supervisory Board. In case of equal votes, the Chairman of the Supervisory Board shall have the decisive vote.

Although the Board performs its tasks collectively, it delegates some of the work. The committees to which these tasks are delegated are described in further paragraphs.

The Supervisory Board by-laws are available at www.tp-ir.pl.

In particular, the Supervisory Board is responsible for the appointment and remuneration of the members of the Management Board, the appointment of the Company's independent auditors, and the supervision of the Company's business. As part of its supervisory responsibilities, it examines the Company's strategic plan and annual budget, monitors the Company's operating and financial performance, formulates opinions on incurring liabilities that exceed the equivalent of €100,000,000, formulates opinions on disposal of the Company's assets in exceed the equivalent of €100,000,000, evaluates the Management Board's report on the Company's activities and the Management Board's proposals regarding distribution of profits or covering losses. In considering these matters, the Board takes into account the social, environmental and ethical considerations that relate to TP S.A.'s businesses.

Furthermore, an amendment to the Polish Accounting Act, dated September 29, 1994 was published in 2009 which increased the responsibility of the members of the Supervisory Board in regards to the reliability and fair presentation of the Company's financial reporting.

V. Operations of the Committees of the Supervisory Board

(A) The Audit Committee

The task of the Committee is to advise the Supervisory Board on the proper implementation of budgetary and financial reporting and internal control (including risk management) principles in the TP Group and to liaise with the auditors of TP Group.

The key functions of the Audit Committee include:

- Monitoring the integrity of the financial information provided by the Company in particular by reviewing:
    a. The relevance and consistency of the accounting methods used by the Company and the TP Capital Group, including the criteria for the consolidation of the financial results;
    b. Any changes to accounting standards, policies and practices;
    c. Major areas of financial reporting subject to judgment;
    d. Significant adjustments arising from the audit;
    e. Statements on going concern;
    f. Compliance with the accounting regulations;

2) Review at least annually the Group's system of internal control and risk management systems with a view to ensuring that the main risks (including those related to compliance with existing legislation and regulations) are properly identified, managed and disclosed;
3) Annual review of the internal audit program, including the review of independence of the internal audit function, and coordination between the internal and external auditors;
4) Analysis of reports of the Company's internal audit department and major findings of any other internal investigations and responses of the Management Board to them;
5) Make recommendations in relation to the selection and remuneration of the Director of the Internal Audit department and on such department's budget;
6) Review and providing an opinion to the TP Management Board on transactions with related parties;
7) Monitoring the independence and objectivity of the Company's external auditors and presentation of recommendations to the Supervisory Board with regard to selection and remuneration of the Company's auditors, with particular attention being paid to remuneration for additional services;
8) Discussion with the Company's external auditors before the start of each annual audit on the nature and scope of the audit and monitoring the auditors' work;
9) Review the issues giving rise to the resignation of the external auditor;
10) Discussion (in or without the presence of the Company Management Board) of any problems or reservations, resulting from the financial statements audit;

11) Review the effectiveness of the external audit process, and the responsiveness of the Management Board to recommendations made by the external auditor;

12) Consideration of any other matter noted by the Audit Committee or the Supervisory Board;

13) Regularly informing the Supervisory Board about all important issues within the Committee scope of activity;

14) Providing the Supervisory Board with its annual report on the Audit Committee's activity and results.

(B) The Remuneration Committee

The Remuneration Committee's task is to advise the Supervisory Board and Management Board on the general remuneration and nomination policy of TP Group, determining the conditions of employment and remuneration (including the setting of objectives) of the Members of Management Board and giving recommendations to the Supervisory Board regarding salaries and the amounts of bonuses for the members of the Management Board.

(C) The Strategy Committee

The tasks of the Strategy Committee include:

(1) giving its opinion and recommendation to the Supervisory Board on the strategic plans put forward by the Management Board and any further suggestions made by the Supervisory Board regarding such strategic plan(s), and in particular on the main strategic options involved; and

(2) consulting on all strategic projects related to the development of TP Group, the monitoring of the evolution of industrial partnerships within TP Group and projects involving strategic agreements for TP Group. It then reports and makes recommendations on each of these projects to the Supervisory Board.

In particular, the Committee is invited to consider projects such as:

(1) strategic agreements, alliances, and technological and industrial co-operation agreements, including aspects of the strategic partnership between France Telecom and TP Group; and

(2) significant acquisitions and sales of assets.

CHAPTER II
MANAGEMENT BOARD'S REPORT ON OPERATING AND FINANCIAL PERFORMANCE OF TP S.A. IN 2010

4 FIXED LINE SEGMENT

4.1 Financial Performance

TP Group's fixed line business is under strong competitive pressure. In 2010, revenue declined by 9.2% year-on-year (for more information please see sections 1.1 to 1.3 above).

The decrease can be attributed to the following factors:

- fixed-to-mobile substitution in both access and traffic;
- customer price sensitivity, reflected in further migration to Wholesale Line Rental-based offers from alternative operators;
- regulatory reduction of retail fixed-to-mobile prices (in November 2009), which followed MTR cuts.

As a result, number of retail fixed voice lines declined by 11.6% year-on-year.

The broadband segment entered a stagnation phase, mainly due to intensive price competition and past regulatory framework (BSA), which had made TP S.A.'s retail service non-competitive in terms of prices throughout the majority of 2010. Broadband revenue fell by 5.3%, mainly as a result of a decrease in retail broadband customer base (down 3.8%).

In order to mitigate the trend of decreasing fixed line revenues and profitability, TP S.A. focuses on increasing its revenues from broadband and television services as well as further optimisation of its cost base (please see section 6.3 for details).

4.1.1 Fixed Line Voice Services

Fixed line voice services: revenues and key performance indicators

	For 12 months ended		
PLN million, unless indicated otherwise	31 December 2010	31 December 2009	Change
Revenues from fixed line services:	5,360	6,173	-13.2%
Subscription and traffic	3,998	4,794	-16.6%
Payphone revenues	15	27	-44.4%
Interconnect	1,346	1,351	-0.4%
Number of fixed lines, '000 (excl. WLR and WLL)	6,219	7,033	-11.6%

Mass Market

Retail fixed-line revenues saw further erosion in 2010 resulting from continuous competitive pressure and fixed-to-mobile substitution. These revenues decreased by PLN 813 million (or 13.2%) year-on-year. TP's revenues were also negatively impacted by the regulatory environment, in particular reduction of retail fixed-to-mobile prices.

TP has taken steps to contain the erosion of its fixed-line subscriber base, mainly through attempts to loyalise customers by offering promotions related to agreements for a specified time. This involves intensive sales of the relevant tariff plans ('doMowy 60',,'doMowy 300' and 'doMowy 1200'), value added services and fixed broadband internet access. Such initiatives, especially the new tariff plans, aim to increase the customer loyalty by means of 12-month or 24-month loyalty agreements. Furthermore, in the first quarter of 2010, TP Group launched fixed telephony service provided by PTK Centertel using the WLL mobile technology, thus offering price-sensitive customers an alternative to similar solutions offered by competitors.

Business Market

In the area of voice services for the business market, TP continues to develop a service portfolio based on pools of minutes and other benefits included in subscription fee. These offers are addressed mainly to SME companies. Customised offers are often prepared for upper-end customers. Sales of new access lines were supported with the 'Connection at a Fair Price' promotion and a permanent offer called 'Package for New Companies'.

4.1.2 Fixed Line Data Services

Fixed line data services: revenues and key performance indicators

	For 12 months ended		
PLN million, unless indicated otherwise	31 December 2010	31 December 2009	Change
Revenues from data services	2,753	2,850	-3.4%
of which broadband internet services	1,420	1,499	-5.3%
of which dial-up internet services	5	13	-61.5%
of which data transmission	722	724	-0.3%
of which leased lines	606	614	-1.3%
xDSL* lines, '000	1,994	2,072	-3.8%
Broadband** lines, '000	2,651	2,580	2.8%

* Excluding wholesale (BSA/LLU)
** Including SDI, wholesale (BSA) and LLU

Due to fierce competition from both CATV operators and small internet providers, the number of TP S.A.'s retail broadband lines decreased by 3.8% year-on-year. At the same time, broadband revenues fell by PLN 79 million. This drove data revenues down by PLN 97 million or 3.4% as compared to 2009.

Broadband access market – key indicators:

	31 Dec 2010	**31 Dec 2009**	**31 Dec 2008**
Market penetration rate in Poland – broadband lines (in total population)	17.0%	15.9%	14.6%
Total number of broadband lines in Poland (thousands)	6,501	6,079	5,564
Market share of TP Group (TP S.A. + PTK Centertel) by volume	35.2%	37.4%	39.4%

Mass Market

In 2010 TP S.A.'s fixed broadband residential customer base was lower than at the end of 2009. This was mainly caused by competitive pressure from CATV operators and operators offering LLU- and BSA-based services with the regulated "retail minus" pricing structure. A new offer based on the new "cost plus" pricing structure, which was launched on 1 October 2010, increased the price attractiveness of TP's service portfolio, which should positively affect the customer base evolution.
TP continued to observe a trend of increasing demand for higher broadband speeds, fuelled by price reductions for the top speed options. Owing to a promotional offer for *Neostrada* introduced in October, the share of 6 Mb/s or higher options grew to approximately 40% of new additions in Q4 2010 (compared to 4% in Q4 2009).

According to TP's estimates, the total number of mass market connections grew by 6.2% in 2010 (year-on-year), reaching approximately 5.9 million lines. This brought the overall household penetration rate (according to dwelling definition) to 43.6% at the end of 2010, still a relatively low level compared to EU benchmarks.

TP retained its strong position in innovative solutions in 2010, competing by encouraging customers to use higher bandwidth options and cutting-edge access terminals. TP continued to promote bundled offers of broadband and digital TV, offered in both xDSL and DTH (satellite digital TV) technologies, coupled with a rich content offer.

The most important development for TP's broadband offer in 2010 was the *Neostrada* price reductions made in October. This was possible due to a change of model, made by UKE in the broadband wholesale pricing from the "retail minus" to the "cost plus" model,made as a consequence of the Memorandum of Understanding signed by TP and UKE. In the former pricing structure, alternative operators used to buy TP's broadband services with a wholesale discount of almost 52%. As a result, *Neostrada* was more expensive than services offered by TP's competitors.

The offer of *Neostrada* launched on 1 October 2010 includes:

- 'Internet of Your Dreams': 12-month or 24-month agreements for 2 to 20 Mb/s options. Customers who sign a 24-month agreement are offered free service for the first two months. The mean prices throughout the term of the agreement are: PLN 49.50 for 2 Mb/s, PLN 54.08 for 6 Mb/s, PLN 58.67 for 10 Mb/s and PLN 63.25 for 20 Mb/s; and

- ‘Light Internet’ for 512 kb/s and 1 Mb/s options. Customers who sign a 24-month agreement are offered free service for the first two months. The mean prices throughout the term of the agreement are: PLN 40.34 for 512 kb/s and the same for 1 Mb/s.

Owing to great interest, TP extended its Try&Buy promotional campaign, which is now bundled with the ‘Internet of Your Dreams’ promotional offer.

- ‘Internet of Your Dreams / *Neostrada* Trial’ (extended on 1 October 2010).

  In this offer, customers can buy *Neostrada* for a promotional price, then cancel the service within the first thirty days without any cancellation fee. This promotion aims at stimulating interest in *Neostrada* by increasing the knowledge of new technologies.

Business Market

TP has a broad service portfolio for business customers, including both services for small to medium companies, which seek uncomplicated business solutions, and solutions for large corporations. TP’s services are unique in high security level and professional customer support.

Growth of the IP VPN and value-added services continued in 2010. TP stimulated sales, promoted long-term agreements and made its IP VPN offer more attractive by enhancing security packages. The IP PABX service, offering the functionality of a central communication management system, which is set-up, managed and maintained by TP, generated considerable interest.

The Internet DSL service was still popular with business customers. A new promotional offer (DSL Sprinter, DSL Sprinter for Loyal Customers and DSL Sprinter for NEO), which was launched in December 2009, turned out a marked success and was extended to 31 March 2011. Customers were offered low access fees during an initial period, reduced subscription fees for value-added services and an installation fee of PLN 1.

The *Business Package* offer generated high interest in 2010. The service provides customers with effective means of communication, including voice, internet, security package, website space and email. The ‘Package for Everyone’ promotion was introduced in June 2010. It offered a reduced monthly fee for selected business packages throughout the term of the 24-month loyalty agreement. The promotion concerned 24-month agreements and lasted till the end of the year.

On 1 August 2010, TP launched the Advanced Business SDSL Internet service. It offers a fixed symmetric internet link with no time or transfer limits. Owing to high quality of transmission, the symmetric access may be used also for the purpose of video monitoring or tele- and video-conferences. There are three service options, namely SDSL 1000, SDSL 2000 and SDSL 4000.

The development of Information and Communication Technology (ICT) services continued throughout 2010. The laptop portfolio was enhanced. A portfolio of LAN development services for business customers was extended to include LAN management service and an offer of development or expansion of a cable network on customer’s site, which was introduced in September 2010.

4.2 Market and Competition

Market for Fixed Line Voice Services

Fixed line penetration rate fell in 2010, reaching 26.1% of the population at the end of December 2010 (compared to 27.1% at the end of 2009).

Increasing penetration rate and popularity of mobile technologies have lead to fixed customer and traffic migration to mobile networks. In the CEE region, including Poland, where the fixed line penetration was low at the time of introduction of mobile technology, mobile telephony is rather a direct substitute to fixed line telephony than a complementary service.

Throughout 2010 cable television operators further expanded the range of fixed line voice and internet access services, while mobile operators developed and promoted Home Zone offers and reduced their voice tariffs in an attempt to attract fixed line customers. The number of WLR lines had increased and was accompanied by growth in services based on local loop unbundling (LLU).

Regulatory decisions had a negative impact on top line, mainly as a result of reductions in interconnection rates, both mobile termination rates, which force TP to reduce retail F2M prices, and F2F termination rates (under RIO).

Broadband Internet Access Market

According to TP’s internal estimates, Poland’s fixed broadband market expanded by 6.9% in 2010 in terms of access lines (year-on-year), a significant slowdown as compared with the 9.3% growth one year before. The

penetration of broadband services in total Poland population had reached 17% by the end of 2010 (compared to 15.9% at the end of 2009).

The growth of the broadband market value was estimated at 6.3% in 2010 (compared to 10.8% in 2009).

2010 saw strong competitive pressure from cable television (CATV) operators in terms of both offering and infrastructure investments. CATV operators' total market share grew systematically. As of the end of 2010, it was estimated at 28% by volume or 24% by value,. Gradually strengthening of CATV market position results from a growing popularity of bundled offers, which may be effectively sold by them due to CATV operators' strong position on the television market, as well as by increasing internet speeds offered for the same, or even slightly lower, price.

New technologies, including radio access, contribute to the development of small local internet providers, which, though very fragmented, represent together a marked force in the broadband market.

Market consolidation processes intensified in 2010: a few smaller internet providers were acquired by larger players, such as Netia, Multimedia Polska, Aster and Hyperion. In Q1 2011, upon acceptance by UOKiK, UPC is to complete the acquisition of Aster. Asset exchange is being prepared between Vectra and Multimedia Polska.

Significant increase in internet access rates is a trend for the near future. CATV operators have been very active in this area, investing in the DOCSIS 3.0 standard, which enhances network capacity and internet service parameters and facilitates implementation of new applications and value-added services. Towards the end of the year, Netia launched pilot service of very high transfer rate in two selected cities. TP Group announced it would too introduce fast internet access based on the VDSL technology.

Alternative telecommunication operators, including Netia, continued to compete with the use of the wholesale BSA and LLU based services, as well as based on a limited development of own networks. BSA-based access was surpassed by LLU-based access in terms of net additions. In 2010, BSA-based operators attracted fewer new customers: 71,000 (compared to 108,000 in 2009), while LLU-based lines reached 130,000 at the end of December 2010 (compared to 52,000 at the end of 2009).

TP Group has also been offering broadband services based on the CDMA radio technology. The total share of this offer in the number of TP Group broadband retail lines was estimated at ~6%.

.

5 MATERIAL EVENTS THAT HAD OR MAY HAVE INFLUENCE ON TP S.A AND TP GROUP'S OPERATIONS

Presented below are the key events that, in Management's opinion, have influence on TP S.A.'s and TP Group's operations now or may have such influence in the near future. Apart from this section, the threats and risks that may impact the TP S.A.'s and Group's operational and financial performance are reviewed in detail in the Chapter IV hereof.

5.1 Regulatory Obligations

Pursuant to President of UKE's decisions issued in 2007, TP was designated as an operator having significant market power ("an SMP operator") in relevant retail markets 1 to 7 (according to the European Commission's recommendation of 2003). As a result, some regulatory obligations were imposed on TP with respect to its activity in retail markets. These include:

- Obligation to not overprice retail services of connecting to a fixed public telephone network and being on standby to provide telecommunications services;
- Obligation not to hinder other operators' entry into the retail market for services of connecting to a fixed public telephone network and being on standby to provide telecommunications services;
- Obligation not to restrict competition by underpricing services in the market for services of connecting to a fixed public telephone network and being on standby to provide telecommunications services;
- Obligation of regulatory accounting in line with the manual approved by the President of UKE and service cost calculation based on the Forward Looking Fully Distributed Cost (FL-FDC) methodology in line with the costing description approved by the President of UKE.

With respect to the markets 1 to 7, TP has an obligation to submit costing results and regulatory accounting statements to an independent audit.

TP is also subject to an obligation to submit its price lists and terms of service provision for the President of UKE's approval with respect to services covered by the markets 1 to 7.

Furthermore, as part of the universal service obligation (USO), TP has to carry out universal service costing and submit its results to an independent audit.

The universal service is a range of telecommunication services that should be available to all end-users of fixed public telephone networks in the territory of Poland at the specified quality and at an affordable price. The USO components include:

- Connecting a single terminal at the subscriber's main location (excluding ISDN);
- Maintaining the subscriber line capable of providing telecommunication services;
- Providing national and international telephone calls, including calls to mobile networks, facsimile communications and data communications (particularly internet access);
- Providing directory enquiry services and directories;
- Providing special measures for disabled users; and
- Providing payphone services.

For additional information about USO, please see section 11.1 below.

Pursuant to President of UKE's decisions, TP is also an SMP operator in the relevant wholesale markets 8, 9, 11, 12, 13 and 14 (excluding connections between 145 locations), according to the European Commission's recommendation of 2003. The resulting regulatory obligations imposed on TP include:

- Obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to:
  - provide call origination on a fixed network (it involves enabling end-user service management, offering wholesale services for the purposes of resale (WLR), providing telecommunications infrastructure and enabling collocation and other forms of facility sharing) – the obligation resulting from the decision for the market 8,
  - provide call termination on a fixed public telephone network (it involves enabling end-user service management, offering wholesale services for the purposes of resale (WLR), providing telecommunications infrastructure and enabling collocation and other forms of facility sharing) – the obligation resulting from the decision for the market 9;
- Obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to provide unbundled access (including shared

access) to the subscriber metallic loop or a segment of the subscriber metallic loop for the provision of broadband and voice services – the obligation resulting from the decision for the market 11;

- Obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to provide broadband services, including broadband data transmission services – the obligation resulting from the decision for the market 12;
- Obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to provide leased line terminating segment services – the obligation resulting from the decision for the market 13;
- Obligation to provide other operators with telecommunications access to TP's network, including the use of network elements and associated facilities, in order to provide leased line trunk segment services – the obligation resulting from the decision for the market 14.

The obligations imposed on TP in the markets 8, 9, 11 & 12 include an obligation to calculate costs of service provision and charge access fees based on the operator's justified costs. The service costing results for these markets are subject to an independent audit.

Pursuant to SMP decisions for the markets 9, 13 & 14, TP has an obligation to determine cost-based access fees.

In addition, an obligation of regulatory accounting and submission of the relevant statements to an independent audit has been imposed on TP in all the aforementioned wholesale markets.

In May 2010, the President of UKE carried out public consultation regarding the future of the universal service in Poland (for more information, please see section 11.1.11 below).

5.2 Co-operation Agreement between TP Group and TVN

On 14 October 2010, TP S.A. and TVN Group signed a long-term framework cooperation agreement. The Framework Agreement should allow both parties to expand and strengthen their product offering, while capitalising on up-selling potential and cost synergies from the ongoing convergence of TV, broadband access and other communications services.

Upon implementation of the co-operation program under the Framework Agreement, TP Group will provide broadband and other communications services to the current and future customers of the 'n' satellite platform, while TVN Group will become the main content delivery partner for TP Group. TP Group will enhance its basic TV offering with content provided by TVN and by 'n' for the Pay TV packages. As a part of the cooperation, Pay-TV offerings will be harmonised over time to reflect the 'n' content packaging structure. Ultimately, both companies will benefit from enhanced attractiveness of the multi-play offering, up-selling potential on each other's customer bases, as well as from cost synergies from joint technical, marketing and sales activities.

Under the Framework Agreement, TP Group and TVN Group have also agreed to enter into a long-term TV-related technology co-operation. Upon its implementation, current technologies will be harmonised over time, providing a uniform customer service offering. TP's Management Board also believes that co-operation in this area will generate savings in both operating costs and investments, resulting from joint usage and development of technologies.

5.3 CATV Operators

In the broadband market, TP S.A. and TP Group are under the strongest competitive pressure from cable television (CATV) operators. At the end of 2010, CATV operators' share in the broadband market was estimated at 28% by volume or 24% by value.

CATV operators may be divided into two categories; operators concentrated in Poland's biggest cities (UPC, Aster and new players in Warsaw: Multimedia Polska and Vectra) and operators active in some selected regions (e.g. Inea and Toya).

CATV operators are perceived as having a kind of monopoly in the biggest cities of Poland, as a number of residential districts is dominated by the infrastructure of one operator, which is an entry barrier for other players. However, a process of duplicating operator's infrastructure has already begun.

CATV operators have been stimulating growth in internet access speeds through investments in the DOCSIS 3.0 standard, which enhances network capacity and internet service parameters and facilitates implementation of new applications and value-added services. As a result, some CATV operators have been offering access speeds of up to 120 Mb/s.. Inea has been testing a fibre optic cable of capacity of 250Mb/s and extending the WiMax coverage to include further cities and towns.

Cable operators have been also active in extending their service portfolio: Vectra launched a mobile broadband service in the third quarter of 2010.

A common practice of cable operators is to offer higher speeds without increasing the service price, or even to offer more services for a smaller price . In addition, CATV operators search for market niches, as illustrated by student-dedicated offers of UPC, Multimedia Polska, Inea and Toya. Another trend includes development of regionally diversified offers.

Poland’s CATV market is still fragmented, though 2010 brought the start of consolidation processes in this segment. In the third quarter of 2010, Multimedia Polska acquired Internet Solutions; in the fourth quarter Aster acquired local ISP GH Net and in the first half of 1 2011, upon acceptance by UOKiK, UPC is to complete the acquisition of Aster.

5.4 Infrastructure Development

In 2010, TP S.A. continued to enhance the infrastructure of its data networks. This included increasing the capacity of the IP backbone network and the data aggregation network as well as enhancing the capacity and geographical coverage for DSLAM access equipment. Significant investments in backbone, aggregate and access networks has been carried out pursuant to the Memorandum of Understanding with UKE dated 22 October 2009.

TP S.A. also implemented new generation DSL access switches. These are compatible with the VDSL2 access technology, which enables setting up lines of capacity of 40 Mb/s or higher.

In addition, the infrastructure for providing multimedia services, such as *Videostrada tp*, Video-on-Demand (VoD) and Digital-to-Home (DTH) satellite television, was further expanded. This has gradually increased the geographical coverage of these services and enabled service portfolio extension. In particular several high-definition (HD) channels were added to the DTH TV offer in 2010.

In 2010, TP S.A. completed a process of adapting its telephone network to the requirements of the Decree of the Minister of Infrastructure of 28 February 2008.

5.5 Claims, Disputes, Fines and Investigation by the European Commission

Please see Note 29 to the IFRS Financial Statements for detailed information about material disputes and proceedings against TP S.A., including investigation by the European Commission, as well as fines imposed thereon.

5.6 Cost Calculation Results

Under the regulatory obligations imposed on TP as an operator having significant market power in the relevant markets for call origination services on a fixed public telephone network (market 8), unbundled local loop access (market 11), bitstream access (market 12) and retail services (markets 1 to 7) as well as its obligations as a universal service provider, in 2010 TP was to carry out costing of services covered by the aforementioned markets for 2011, and submit the results thereof to an independent auditor selected by UKE. In addition, TP has an obligation to prepare regulatory accounting statements for 2009 and submit them to an independent audit.

In performance of its regulatory obligations, TP submitted a manual for drawing up regulatory statements for 2009 as well as descriptions of service costing for 2011 for the President of UKE’s approval. On 28 January 2010, the President of UKE issued a decision on TP’s service costing descriptions and regulatory reporting manual. This decision imposed on TP an obligation to carry out wholesale service costing on the avoided-cost basis. In TP’s opinion, the wholesale service costing methodology imposed by UKE is inconsistent with both EU and Polish regulations. On 11 February 2010, TP filed an application for the re-examination of the case by the President of UKE, but on 4 May 2010 the President of UKE issued a decision upholding the previously defined costing methodology.

In TP’s opinion, the wholesale costing methodology imposed by the aforementioned decision of the President of UKE is inconsistent with both EU and Polish regulations. TP filed a complaint against the aforementioned decision of the President of UKE with the Regional Administrative Court on 2 June 2010. Similar court proceedings were initiated in 2009 with respect to the last year’s costing descriptions and regulatory reporting manual. On 30 March 2010, the Regional Administrative Court rejected TP’s last year’s complaint. However, in its ruling the Court did not directly address the issue of the avoided-cost methodology, but just other specific charges raised by TP. In 2010 complaint, TP indicated only the avoided-cost methodology as a disputed issue, so the Court may be expected to address this charge.

On 29 April 2010, the President of UKE called upon Ernst & Young Audit Sp. z o.o. to audit TP’s service costing for 2011 and regulatory accounting statements. The audit started on 10 May 2010 and ended on 29

July 2010 with the submission of the audit report together with the auditor's opinion to the President of UKE and TP. The auditor's opinion contains some reservations regarding costing of services provided in the markets for call origination services on a fixed network (market 8), unbundled local loop access (market 11) and bitstream access (market 12). The auditor has stated that according to the Decision of the President of UKE of 4 May 2010, approving service costing descriptions for 2011, TP should calculate the costs of its wholesale services on the avoided cost basis, whereas TP allocated to wholesale services a portion of its fixed costs which, according to the auditor, do not meet the avoided cost definition provided in the service costing description approved by UKE.

On 15 December 2010, TP filed a cassation appeal against the Regional Administrative Court's ruling of 30 March 2010 regarding TP's complaint against the President of UKE's decision approving service costing descriptions for 2010 and regulatory reporting manual for 2008.

5.7 Functional Separation (UKE's Plans)

On 22 October 2009, TP and the President of UKE signed a Memorandum of Understanding, under which the President of UKE decided to suspend works on the functional separation of TP.

In December 2009, functional separation was included into the EU regulatory framework. Member states should implement the package within eighteen months . The European Commission holds that implementation of functional separation and its imposition on an SMP operator shall be considered only after careful market analysis, provided that other remedies have clearly failed to establish effective competition and prospectively will fail to do it in the future. Therefore functional separation shall be only regarded as a last resort remedy. A decision by the President of UKE on imposing extraordinary measures, such as functional separation, can be done only based on agreement from the European Commission. TP would have a right to appeal from such a potential decision.

On 23 April 2010, the Ministry of Infrastructure started preparations for the implementation of the new package of directives to the Polish law.

5.8 Memorandum of Understanding with UKE

On 22 October 2009, TP and the President of the Office of Electronic Communications ("UKE") signed a memorandum of understanding ("MoU") for the implementation of transparency and non-discrimination procedures in inter-operator relations. Pursuant to MoU, UKE has declared freezing wholesale rates till 2012, while TP is to invest in construction or modernisation of 1.2 million broadband access lines within that period. In addition, TP is implementing technical and organisational solutions to differentiate access rights to information within the organisation ("Chinese Walls") and to secure non-discriminatory access to information by alternative operators. It is anticipated that the President of UKE will withdraw from plans of functional separation of TP, provided that the latter implements the agreed solutions.

The President of UKE declared freezing wholesale rates till the end of 2012 at the level defined in the current reference offers. The "retail minus" methodology for defining wholesale rates were replaced with the "cost plus" mode in 2010. Over the next three years TP is to invest in 1.2 million broadband accesses, including 0.5 million new lines and 0.7 million to be upgraded. It is expected that approximately 1 million lines will have bandwidths of 6 Mb/s or more. This infrastructure will be deployed not only in conurbations, but also in small towns and across rural areas.

In 2010, TP performed its project obligations according to a schedule adopted together with UKE and systematically implemented the obligations of a permanent nature. The key permanent obligation is the application of the non-discrimination rule in TP's operating activities related to inter-operator relations. Important initiatives in this area include a KPI monitoring process for TP's wholesale and retail services and compliance with the Good Practice Code that sets communication standards and practices to build a non-discriminatory culture within the organisation. A number of rules regulating various aspects of TP's relations with alternative operators have been developed to facilitate the provision of regulated services. TP is in the process of implementation of Chinese Wall mechanisms, including IT system modifications (access profiling to prevent access of TP Retail to restricted data in IT systems) and related legal and organisational changes. The programme of Chinese Walls has been complemented by the introduction of the Restricted Data Protection Programme at TP and data access restrictions in selected TP Group companies.

At the same time, TP continued efforts aimed at implementation of a dedicated wholesale IT environment for supporting alternative operator service processes. The main components of this environment include: ISI, an electronic portal and channel for communications with alternative operators (particularly for placing orders for regulated services); PRM, a system to support the wholesale process execution; and NSRM, a wholesale billing system.

From the start of the MoU until 31 December 2010, TP had constructed and provided infrastructure enabling operation of a total of 454,300 broadband lines (including 415,900 lines in 2010), which corresponds to 127% of the target for that period set in MoU. Considering the completed projects and the expected outcome of the on-going ones, TP has already invested in the fixed broadband infrastructure accounting for 100% of its investment obligations.

The Margin Squeeze and Price Squeeze tests for broadband services have been implemented. Apart from broadband (BSA) service tests, TP and UKE have agreed upon the methodology and models of such tests for WLR and LLU services. The relevant changes related to the application of the MS & PS model have been introduced into TP's agreements with alternative operators pursuant to administrative decisions issued by UKE.

The proper implementation of MoU is verified by an external auditor on a quarterly basis. Reports on five quarterly audits conducted hitherto generally confirmed the effective implementation of MoU by TP. In addition, TP delivers a monthly report to the President of UKE, describing progress in implementation of the MOU. The report is published by UKE on its web service.

5.9 Compensation for Universal Service Costs

Pursuant to the President of UKE's decision of 5 May 2006, TP is an operator designated to provide the universal service. Owing to the economic nature of this service, an operator designated to render it is eligible for compensation equal to the universal service net costs, which is the costs which the operator would not have borne if not for the obligation to provide the universal service. The compensation is paid pro rata by all the operators (including TP and PTK Centertel) with revenues of more than PLN 4 million in the year for which the compensation is due.

The pending procedures related to compensation of the universal service net cost concern the following applications submitted by TP:

- Application for 2006: On 29 June 2007, TP applied to UKE for compensation for 2006 (8 May to 31 December). The Company calculated the deficit related to provision of the universal service at PLN 139.9 million. UKE refused to grant any compensation to TP. The Company appealed against the refusal to the Regional Administrative Court, which on 25 June 2008 reversed UKE's decision refusing to grant the compensation. The ruling was appealable and UKE appealed to the Supreme Administrative Court, which on 5 August 2009 rejected UKE's cassation appeal. Consequently, UKE has to re-examine TP's application for compensation of the net costs for 2006.
- Application for 2007: On 27 June 2008, TP filed an application with UKE for compensation for 2007. The net costs were stated at PLN 219.2 million. On 30 October 2009, the Regional Administrative Court examined TP's complaint for the President of UKE's inactivity with respect to the decision for 2007. The court ordered UKE to issue the decision within two months after the case file transfer. The ruling is appealable. The procedure at UKE is pending.
- Application for 2008: On 26 June 2009, TP filed an application with UKE for compensation for 2008. The net costs were stated at PLN 208.4 million. The procedure at UKE is pending.
- Application for 2009: On 30 June 2010, TP filed an application with UKE for compensation for 2009. The net costs were stated at PLN 236.2 million.

  During those procedures the auditor issued audit opinions. In the auditor's opinion, the calculations of the Net Costs Components including Costs, Revenues, and Indirect Benefit Components, for the years 2006 and 2007 are reasonable, true and fair, and have been prepared in accordance with the Decree on regulatory accounting and cost calculation, Decree on the net costs of services included in the universal service and in accordance with the Accounting Act. For the years 2008 and 2009, the auditor issued opinion without qualifications as well; however, the auditor included a note about the definition of unprofitable customers.

  The auditor's opinion is only a piece of evidence during the procedure. President of UKE verifies whether the net cost deficit exists and determines the net cost deficit value. President of UKE also decides weather the existing net cost deficit is an unfair burden to the operator.

5.10 Act of 7 May 2010 on Supporting the Development of Telecommunication Services and Networks

The purpose of the act is to create a legal framework allowing local governments to run a telecommunication business, particularly to provide broadband internet access.

As EU funds may be allocated to the development of broadband networks, the act provides for an easier investment process in the telecommunication industry. This would be particularly advantageous for local government entities.

The key aims of the act are as follows:

- To facilitate, as much as possible, the use by local governments of EU funds dedicated to the construction of broadband networks;
- To support local governments in order to stimulate the establishment of strong operators run by the local government and supported with public funds in rural or poorly urbanised areas; and
- To increase the President of UKE's controls over the telecommunication market in the area of capital investments.

The Telecommunication Law amendment of May 20, 2010

Please see section 11.1.8 for details of the Telecommunication Law amendment of 20 May 2010.

6 OUTLOOK FOR THE DEVELOPMENT OF TP S.A. AND TP GROUP

6.1 Market Outlook

According to TP S.A.'s estimates the value of Poland's telecommunication market declined by 2.6% in 2010 compared to a decline of 3.1% in 2009. The main factors which contributed to the decline in 2010 were falling wholesale revenues of mobile operators as a result of radical MTR reduction in 2009 and further erosion of fixed-line voice revenues.

The Polish economy showed first signs of recovery in 2010:

- Real GDP growth rate for the third quarter of 2010 was 4.2% (as reported by the Central Statistical Office), a significant improvement over the 1.8% growth in the third quarter of 2009;
- Inflation was 3.1% y/y in December 2010;
- Unemployment rate was estimated at 12.3% at the end of December, which is a much lower figure than in February 2010 (13.2%), when unemployment reached its peak during the economic slowdown.

The impact of the global financial crisis on the telecom sector results has been moderate. Facing economic slowdown, customers have tended not to reduce the usage of telecommunication services, but rather seek cost optimisation within the possibilities offered by the industry.

The main factors negatively affecting the market value in 2010 were related to the mobile market developments: (i) MTR cuts in Q1 and Q3 2009, and (ii) F2M retail price reductions, introduced by TP in April and November 2009 in the wake of MTR cuts. Intensive price competition continued in the mobile market. The resulting price erosion was only partially offset by increased usage, leading to a further decrease in ARPU and hindering mobile operators' performance.

The model for determining BSA rates was changed on October 1, 2010. These rates are to be charged by TP Group while reselling telecommunication services to alternative operators. Now, TP Group can much better adjust its prices to the market environment, which raises the attractiveness of TP's offers compared to those of the competition.

Another market development is growing popularity and availability of smartphones as well as tablets and other units that use mobile internet access. A major increase in mobile data revenues is expected as a result.

As for the activity of TP's rivals, an expected market trend is further bundling of core services offered by particular operators with other telecom services and entertainment offers. Major developments in the business market will include combining telecom offers with IT offers (ICT)as well as further growth in the machine-to-machine (M2M) segment.

At the same time, the telecommunication market has entered another evolution phase, which involves growing concentration as well as establishment of co-operation between former rivals in selected business areas. The first signs of this trend could be seen in the market. These include:

- Acquisition of Aster by UPC;
- declaration by Polkomtel's the shareholders of their intention to sell the company;
- Co-operation agreement between TP Group and TVN Group;
- Letter of intent to share frequencies signed by PTK Centertel and PTC; and
- Agreement between PTC's shareholders on the ownership structure, with T-Mobile becoming the major shareholder.

Further mergers and acquisitions are anticipated. It is possible that the structure of the telecommunication and media markets will evolve substantially in the medium term.

6.2 TP Group's Strengths

TP Group operates in a dynamic and increasingly challenging telecommunications market. Due to fierce competition and evolving market structure, actions taken by TP Group need to be determined and consistent.

TP Group companies cope well in the changing market environment. The ability to adapt to new conditions and respond to new market trends results from a number of TP Group's strengths.

The major strengths of TP Group are as follows:

- Poland's largest sales network enabling professional customer service during and after sales; simultaneously, modern distribution channels, particularly on-line, are being developed;
- Broad portfolio of services matching the changing needs of customers and enabling service integration;

- Unique market offering, which includes services from outside the core segments of the telecommunication market (i.e. e-health or e-insurance);
- TP Group's leading brands (TP, Orange, wp.pl) are trusted, associated with quality products and broadly recognised;
- Experienced workforce and well-developed work assessment and competence development system;
- Broad international co-operation and access to know-how of TP's partners from the France Telecom Group, including close co-operation and R&D experience sharing within the Orange Lab network;
- Established and predictable regulatory environment in the wake of the Memorandum of Understanding with UKE.

Owing to all these strengths, TP Group is able to provide its customers with offers which match their needs, while effectively responding to actions of its rivals.

6.3 TP Group's Medium Term Action Plan

TP Group's medium term actions are influenced by two major elements:

- Memorandum of Understanding with UKE; and
- TP Group's strategy.

The Memorandum of Understanding with UKE was signed on 22 October 2009. In terms of the Medium Term Action Plan, MoU:

- brings order to TP's relations with alternative operators;
- determines TP's objectives in terms of investments in the broadband infrastructure (1.2 million broadband access lines in 2010-2012, including 0.5 new ones); and
- introduces changes in TP Group's organisation and culture.

TP Group's action plan aims at strengthening its leadership in core markets, while preserving the Group's financial standing and revenues. The Group will flexibly respond to changing customer needs, offering an attractive range of services. It means the following efforts:

- To attain a strong leadership position in all TP Group's core markets:
    - Fixed line segment – to maximise retention initiatives and minimise revenue erosion in the segment;
    - Mobile segment – to further strengthen the Orange by making both pre-paid and post-paid service portfolio even more attractive. In addition, TP Group wants to be the innovation leader in the mobile internet segment and set development trends there;
    - Internet access – to further improve service quality by increasing transfer rates and extending the service coverage;
    - Television – to pursue co-operation with ITI in order to provide TP Group's customers with the best quality television based on rich content offering and best technological solutions;
    - further customer base expansion and service quality improvement through technology and content development. TP Group will introduce cutting-edge technologies to assure the top quality of television to its customers. In addition, the scope and attractiveness of the content offer will further increase;
    - Integrated offer – to present attractive integrated offers that will meet the needs of TP Group's customers;
- To develop infrastructure required to offer cutting-edge technological solutions to customers;
- To develop a new offer for business customers in the ICT market; and
- To assure very high quality of customer service; dedicated program, called "Misja Klient" has been launched.

7 TP S.A.'S MAJOR ACHIEVEMENTS IN RESEARCH AND DEVELOPMENT

7.1 Research and Development

Since 2009, TP Research and Development Centre (TP R&D) is a part of the international Orange Lab network, which consists of 15 Orange R&D units and laboratories in 9 countries (France, Spain, UK, Poland, China, Japan, Egypt, Jordan and USA).

Orange Lab provides innovative solutions, tests new services, develops network quality monitoring methods and carries out development and advance work on new technologies and services. A total of almost 100 projects are being implemented at present. In addition, Orange Lab co-operates with other TP's business units in the development of network and service development strategy.

Orange Labs actively promote innovation across the TP and FT Groups. In 2010, the Polish Orange Lab in conjunction with TP's business units, FT and suppliers implemented some 50 prototype or commercial solutions in the Innovation Gardens. The Innovation Gardens saw 250 meetings attended by almost 6,500 visitors in 2010. This included around 60 major events attended by representatives of FT, universities, suppliers and government administration.

Polish Orange Lab was involved in developing an innovative image of TP, through the following events:

- **Two international conferences**: Innovative Technology – Communication 2012 organised in conjunction with Nokia Siemens Network (May 2010) and Innovation Days (How modern technologies change the environment) with Alcatel-Lucent (September 2010);
- **Israeli Technology Day**: together with the Israeli Embassy and the Israeli Exports Institute;
- **International Ideas Festival**: international exhibition of the best and most innovative ideas selected in local competitions in different countries (the first such an event in FT Group's history);
- **'Telecreator' contest (2009 edition)**, which is aimed at promoting innovative projects and ideas of TP Group's employees and partners;
- **Creative workshops for school children**: co-organised with TP Group's employees involved in the Ambassador Movement (July/August 2010); a total of 8 meetings.

In 2010, the most important achievements of the Polish Orange Lab were as follows:

- The b-Link application was recognised both in Poland and abroad; in particular, it won an award at the 38th Invention Exhibition in Geneva.
- The Content Servers, a new service developed by Polish Orange Lab's experts, was introduced in the market.
- Orange Lab was involved in a project aimed at providing super-fast internet based on VDSL2 and FTTH technologies to the Warsaw University of Technology and student dormitories.
- Audio Games: the French version premiered in France.
- Pilot implementation of the Tax Deduction project at Orange Lab.
- A first application for Android (188712) was launched; it was developed by the Orange Lab Advanced Software Center and then successfully implemented for FT Group's customers.
- 'FestivAR' application was developed for the Orange Warsaw Festival.
- Orange Lab implemented tools for network monitoring at the Service Management Center (pmsSatMon, pmsMAT and pmsTSMon), winning an award at the 'Telecreator 2009' contest.
- An eco-friendly solution for energy saving at Group's DSLAMs was implemented.
- A first project for Orange Romania (IVR optimisation for post-paid customers) was completed.
- A first application for iPhone (MyBlog)was developed and implemented on AppStore by the Orange Lab Advanced Software Center;
- TPIX platform for internet traffic exchange between TP's customers was launched;
- Co-operation with Microsoft in cloud service implementation started;
- WebTV service (trial version) was launched on the orange.pl portal; first live transmissions were carried out (handled by Orange Lab in real time).
- Two new laboratories, for CDMA and FEMTO, were constructed.
- MMS Service for Orange Customer Services was implemented.
- Owing to Polish Orange Lab's involvement in the work of international standardisation organisations, such as ITU CEN, CENELEC, Broadband Forum, TeleManagement Forum and Home Gateway Initiative, and a number of contributions, TP could influence the content of new telecommunication

standards in such areas as people and environment protection against electromagnetic radiation, new generation networks (NGNs), signalling protocols, etc. Orange Labs played a major role at ITU in the assessment of human exposure to electromagnetic radiation, managing the issue internationally and representing ITU on conferences and meetings (in Kenya, Switzerland, etc.).

- TP won the ‘Crystal Brussels Sprout’ Award for its achievements in European Union Framework Programs 1999-2009. Over the last decade, the Polish Orange Lab has implemented and successfully settled seven international research grant projects under the sixth edition and nine projects under the seventh edition of the EU Framework Program. These projects included ALPHA (Architectures for fLexible Photonic Home and Access networks), aimed at developing a new generation access network (particularly all types of in-building networks); MUSE (Multi Service Access Everywhere); SPICE (Service Platform Innovative Communication Environment); and ONE LAB (An Open Networking Laboratory Supporting Communication Network Research Across Heterogeneous Environments).
- The Polish Orange Lab has been actively involved in the CHRON (Cognitive Heterogeneous Reconfigurable Optical Network) project, which is carried out under the seventh edition of the EU Framework Program (FP7). The project aims at developing cognitive algorithms for heterogeneous optical network management.
- Orange Lab employees filed 17 patent applications in 2010.
- The Consumer Research Centre was appointed the reference centre within FT Group. The Centre has been established to carry out ergonomic tests of business and mass market services.

7.2 R&D Cooperation with France Telecom

Key projects for FT:

Development

- Corporate responsibility over selected network solutions: Huawei Media Gateways, DSL and GPON Access, ZTE IN platforms, IP Routers and IMS Ericsson;
- VDSL2 and FTTH technologies;
- CDMA-based projects for Poland and AMEA countries;
- Femtocells;
- Mobile applications: Android, iPhone, Audio Games;
- New TV: platforms and services for Poland.

Research

- Cloud computing;
- Rich Communications Suite Architecture and HD Voice on TP’s network;
- Android OS-based Set Top Box;
- Accessibility solutions.

CHAPTER III
ORGANISATION AND CORPORATE STRUCTURE

8 CHANGES IN TP S.A.'S STRUCTURE IN 2010

8.1 Changes in the Corporate Structure

The main organisational changes in the TP Group's structure in 2010 included:

- Changes in the TP Group's sales structures, namely the integration of the TP Group Mass Market Sales Division and the TP Group Business Market Division into the TP Group Sales Division;
- Consolidation of TP S.A. and PTK Centertel's customer service functions through the establishment of Orange Customer Service, a TP Group company;
- Integration of TP S.A. and PTK Centertel's support functions (accounting, controlling, treasury, office administration, HR, payroll).

In addition, on 20 April 2010 the TP Management Board took an important step towards the organisational structure optimisation by adopting a resolution on limiting the number of managerial positions and linking them to the size of the area managed.

8.1.1 Management Board

There were no changes in the composition of the TP Management Board in 2010. The Management Board is composed of five Members, who have been assigned the direct supervision over the following Company's matters:

- President of the Management Board;
- Vice President of the Management Board in charge of Marketing and Strategy;
- Vice President of the Management Board – Chief Operating Officer;
- Management Board Member – Chief Financial Officer; and
- Management Board Member in charge of Human Resources.

8.1.2 Business Units

The total number of business units within TP's organisation slightly changed.

As of 31 December 2010, TP had the following business units:

1) 2 Offices (TP Management Board Office and Office of TP President's Plenipotentiary for the Implementation of the TP/UKE Memorandum of Understanding);
2) 18 Departments reporting directly to the President of TP Management Board, TP Management Board Members or TP Group Executive Officers;
3) 15 Divisions;
4) 5 TP Group Regions: North, South, East, West and Central.

In addition, five structures responsible for specific areas (i.e. Strategy & Development, Product and Content Development, Business Services Marketing, Home Services Marketing, and Content) report directly to the Vice President of the Management Board in charge of Marketing and Strategy, whereas nine structures (responsible for Accounting, Internal Control and Risk Management, Revenue Protection and Fraud Management, Corporate Finance, Real Estate Management, Tax Strategy, Investor Relations, Corporate Control and Controlling) report to the Chief Financial Officer.

8.1.3 Group's New Premises

On 22 December 2009, TP signed an agreement with Bouygues Immobilier Polska for the development and lease of new premises for the TP Group. The new location, a low rise and energy efficient complex of buildings in proximity of the city centre, will be able to comfortably host approximately 3,500 employees. The development is to be concluded by 2013, while the lease period will be ten years, with extension options secured.

On 11 June 2010, Bouygues Immobilier Polska completed the negotiations and concluded a memorandum of understanding for the purchase of land for construction of TP Group's new premises. The campus will be located at 160 Aleje Jerozolimskie Street in Warsaw.

8.2 Ownership Changes Effected by TP S.A. in 2010

8.2.1 Merger of Ramsat S.A. and Prado Sp. z o.o.

On 4 January 2010, the District Court for Cracow registered a merger of Ramsat S.A. and Prado Sp. z o.o.

8.2.2 Sale of TP SA Finance BV to TP Invest Sp. z o.o.

On 20 September 2010, TP and TP Invest Sp. z o.o. concluded an agreement, pursuant to which TP sold all shares held in TP SA Finance BV to TP Invest Sp. z o.o. The shares sold by TP are a 100% stake in TP SA Finance BV, which corresponds to the same voting power at the General Assembly of the latter.

8.2.3 Sale of minority stake of Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. to Orange Customer Service Sp. z o.o.

On 20 September 2010, TP and Orange Customer Service Sp. z o.o. (formerly Virgo Sp. z o.o.) concluded an agreement, pursuant to which TP sold 125 shares held in Pracownicze Towarzystwo Emerytalne Telekomunikacji Polskiej S.A. (TP Employee Retirement Fund Company, "PTE") to Orange Customer Service Sp. z o.o. The shares sold by TP are a 25% stake in PTE, which corresponds to the same voting power at the General Assembly of the latter.

The agreement has been concluded under a suspensory condition, i.e. approval by the Financial Supervision Commission.

8.2.4 Changes of Equity in Other Subsidiaries

TP Teltech Sp. z o.o.

On 29 July 2010, the General Assembly of TP Teltech Sp. z o.o. adopted a resolution decreasing the share capital from PLN 211,250,000 to PLN 21,125,000, i.e. by PLN 190,125,000, through a decrease in the nominal value of share from PLN 500 to PLN 50. At the same time, the General Assembly of TP Teltech Sp. z o.o. adopted a resolution increasing the share capital from PLN 21,125,000 to PLN 51,125,000, i.e. by PLN 30,000,000. The increase was effected through the issue of 600,000 new equal and indivisible shares of the nominal value of PLN 50 each. All the new shares in TP Teltech Sp. z o.o. were taken up by TP Invest Sp. z o.o.

Otwarty Rynek Elektroniczny S.A.

On 18 August 2010, the General Assembly of Otwarty Rynek Elektroniczny S.A. adopted a resolution decreasing the share capital from PLN 35,000,000 to PLN 19,333,320, i.e. by PLN 15,666,680, through the redemption of 15,666,680 shares.

TP Emitel Sp. z o.o.

On 21 December 2010, the General Assembly of TP Emitel Sp. z o.o. adopted a resolution decreasing the share capital from PLN 593,650,000 to PLN 430,150,000.

8.3 TP S.A.'s Shareholders

As of 31 December 2010, the share capital of the Company amounted to PLN 4,007 million and was divided into 1,336 million fully paid ordinary bearer shares of nominal value of PLN 3 each.

The ownership structure of the share capital based on information available on 31 December 2010 was as follows:

(in PLN millions)	*% of votes*[2]	*Nominal value*
France Telecom S.A.	49.79	1,995
Capital Group International, Inc.[1]	5.06	203
Other shareholders	45.15	1,809
Total	100.00	4.007

[1] The number of shares as of 15 October 2010 based on information provided by Capital Group International, Inc.

On 5 August 2010, the Ministry of Treasury informed that it had sold a 4.15% stake in TP on the Warsaw Stock Exchange, thus finally completing the privatisation of the Company.

As of 31 December 2010, France Telecom held a 49.79% stake in the Company. France Telecom has the power to appoint the majority of TP Supervisory Board members. The Supervisory Board appoints and dismisses members of the Management Board.

As of 31 December 2010, the Company has no information regarding valid agreements or other events that may result in changes in the proportions of shares held by the shareholders.

TP did not issue any employee shares in 2010, but an Incentive Programme for the Key Managers was launched in 2007 (please see section 9.2.2 for further details).

9 TP S.A.'S STRUCTURE AS OF 31 DECEMBER 2010

9.1 Corporate Governance Bodies of TP S.A.

For detailed information about the Management Board and Supervisory Board of TP please see section 3 above.

9.1.1 TP Shares Held by Persons Who Manage or Supervise TP

As of 31 December 2010, Maciej Witucki, President of the Management Board, held 4,000 shares in the Company.

Other members of the Management Board or Supervisory Board did not hold TP or related entities' shares as of 31 December 2010.

As part of the Company's incentive program, members of the Management Board of the Company acquired TP S.A. registered A-series first option bonds, giving the right to subscribe for the Company's shares with priority over existing shareholders.

The number of first option bonds held by members of the Management Board of the Company on 31 December 2010 was as follows:

Maciej Witucki	305,557
Piotr Muszyński	190,896

The members of the Supervisory Board of TP do not participate in the Company's incentive program and as at 31 December 2010 held no first option bonds.

9.1.2 Information on the Remuneration of Persons Who Manage or Supervise TP

Please see Note 30.1 to the enclosed IFRS Financial Statements for information on the remuneration (including profit sharing) paid or payable by the Company to the persons appointed to its management and supervisory bodies.

9.1.3 Contracts with Management Board Members

Employment contracts of the Members of TP Management Board include provisions for severance pay payable in the case of the contract termination by the Company (and in some cases due to the resignation of a Board Member) and provisions concerning compensation payable for the ban on competing activity after the termination of employment. The severance pay related to the employment contract termination is equal to six monthly salaries. The compensation for restraining from any activity competitive to that of TP for a period of twelve months after the termination of employment is up to six monthly salaries, calculated as cash equivalent for unused leave (this applies to the Management Board Members who were in charge as of the date of the Financial Statements enclosed).

9.1.4 General Assembly

On 23 April 2010, the General Assembly of TP approved a dividend of PLN 2,003 million (equivalent to PLN 1.5 per share). The dividend, net of withholding tax, was paid on 1 July 2010.

9.2 Employment in TP S.A.

As of 31 December 2010, TP employed 15,286 people (in full-time equivalents), which is a 27.5% decrease year-on-year.

TP's workforce reduction was mainly a result of a voluntary departure programme, carried out in 2010 in accordance with the Social Agreement, as well as transfer of TP's staff (mainly from customer service positions) to Orange Customer Service. Excluding this transfer, TP's workforce reduction was 9.3% as compared to the end of December 2009.

Voluntary departures were also effected in Orange Customer Service (OCS). In line with an agreement In 2010, severance pay was paid to 1,977 employees, out of which 1,849 (or 93.5%) left TP under the voluntary departure programme, and averaged PLN 58.7 thousand per employee.

TP's workforce restructuring provision after discount and utilisation was PLN 27 million at the end of December 2010.

In 2010, external recruitment in TP totalled 494 positions (excluding temporary replacement agreements), down 9.5% year-on-year. External recruitment was mainly related to sale positions and customer service staff.

9.2.1 Social Agreement

In December 2009, a departure limit for 2010 was set at 1,980, within the total limit specified in the 2009-2011 Social Agreement. The terms of compensation payments to employees, particularly long seniority ones, that would voluntarily leave the Company in 2010 were revised.

Other provisions, which concern the most important employee-related issues, such as employment policy, regular pay rises based on the Company's remuneration policy and the scope of internal mobility, recruitment and outsourcing in the Company's employment policy, did not change. In 2010, the voluntary departure programme was carried out in compliance with the agreed terms.

In January 2011, TP has informed that it reached an agreement with its Trade Unions, allowing for up to 800 voluntary departures from TP Group in 2011.

9.2.2 Incentive Program

On 28 April 2006, the General Assembly of TP approved an Incentive Program based on a "Stock Option Plan". On 12 December 2006, the Management Board of TP adopted the resolution No. 149/0/06 on adopting the Incentive Program Rules for the Members of the Management Board of TP and the Incentive Program Rules for the Key Managers of the TP Group.

The main purpose of the Program is to link the remuneration of key managers with their contribution into TP Group's development through enabling them to benefit from the planned growth of the Company's value; getting them more involved in the active management of the TP Group in order to increase its profitability.

<u>First Option Bonds</u>

The Program is carried out through issuing TP first option bonds. The issued bonds are registered bonds giving the right to subscribe, before the existing shareholders, for B-series shares issued by TP.

Pursuant to the resolution on the issue of bonds proposed by the Management Board the bonds have the nominal value of PLN 0.01 per piece and are to be issued at the issue price equal to the nominal value. Owing to the purpose of the Program, the bonds will not bear coupons. One bond will enable the subscription for one B-series share.

B-series shares carry the right to the dividend on the terms described in the information memorandum.

The issue of new B-series shares has an impact on reducing the percentage share of the existing shareholders in the share capital of TP. In the case that the bondholders exercise the rights under all the bonds, the percentage share in the share capital of all existing shareholders will be reduced by 0.508%.

<u>Size of the Program</u>

In total, 7,113,000 of bonds enabling the subscription for 7,113,000 B series shares are to be issued in the Program.

<u>Size of Individual Award</u>

The number of bonds granted to particular Beneficiaries depends on the assessment of performance and operational involvement of each Beneficiary and the level of responsibility.

<u>Exercise Period</u>

The bondholders' right to subscribe for B-series shares might be exercised within seven years, i.e. from the third anniversary of the bonds issue date to the 10th anniversary of this date. The exercise of this right will be possible, in principle, only if the Beneficiary, on the day of its exercise, is the employee or member of the governing bodies of the Company or companies from the TP Group covered by the Program. As a general rule, if the Beneficiary stops being the employee or the member of TP governing bodies or those companies before the subscription date of B-series shares, all their bonds will be redeemed by way of payment of the nominal value of these bonds.

<u>Issue Price of Shares</u>

The issue price of B-series shares taken up by the bondholders was set by the Management Board of TP on the bonds issue day and was equal to the average market price of TP shares from 20 sessions on the Warsaw Stock Exchange immediately preceding the bonds issue day.

In September 2007, TP Management Board implemented the Program and the information memorandum was sent to potential Beneficiaries. Subscription letters were sent to 356 employees (including Executive Committee members); 339 managers subscribed for options (96% of potential Beneficiaries). The grant date was set up on 9 October 2007 and the option exercise price at PLN 21.57 (average TP close price of 20

sessions on Warsaw Stock Exchange proceeding the grant date). 6,047,710 A-series bonds were allotted to eligible managers and 154,698 bonds were taken by the trustee (KBC Securities). 0.9 million options out of 7.1 million were not issued. Cost of the Program of PLN 25 million has been booked over the vesting period.

By 31 December 2010, a total of 2,112,484 options had been redeemed as a result of the termination of Beneficiaries' contracts of employment in the cases set out in the Program.

The Program is secured by a control system according to the resolution that implemented the Program in the TP Group. The Program is subject to a special procedure consistent with the reporting standards that is implemented across France Telecom Group. The controls will include the verification of the number of Program beneficiaries, Program revaluation and settlements with the employees leaving the Company.

CHAPTER IV
KEY RISK FACTORS

10 RISK FACTORS AFFECTING THE ACTIVITIES OF TP S.A. AND TP GROUP

The risks mentioned in this report are not intended to constitute an exhaustive list of all possible risks, which may impact the Group's activities. The system of internal control and risk management in TP Group is designed and implemented by the Management. This approach allows to manage the risk of failure to achieve business objectives and provides reasonable assurance against material misstatement or loss (risk management does not mean the full elimination of risk, but provides for better risk identification and the implementation of adequate measures as needed).

***

Since 2007, TP Group has been developing a risk management system in TP and Group's other major companies. The Risk Management Policy has been developed and implemented within TP Group to determine the key risk management procedures and responsibilities. These solutions include procedures for risk identification, analysis and assessment, implementation of risk mitigation measures and verification of action results. This provides the Management Board with information about the key risks within the Group, so preventive actions may be additionally supported. The major risk identification and selection process is co-ordinated by the Internal Control and Risks team and involves line personnel, managers and the TP Management Board. The review and assessment of the identified risks, the identification of the main causes and the implementation of action plans involve the participation of Group's top management.

The major risks are subject to monitoring. For such risks, preventive measures aimed at reducing the probability of their occurrence and limiting their potential impact on the Group's operations are implemented.

In line with the TP Group Risk Management Policy, an updated TP Group Risk Map is updated and submitted to the Management Board and the Audit Committee of the Supervisory Board at least once a year. The internal audit plan for each year is developed on the basis of a list of major risks approved by TP Management Board Members.

10.1 Implementation of TP Group's Medium-term Action Plan

In February 2010, TP S.A. announced a new medium-term action plan for 2010–2012, which focuses on stabilising the Group's leadership in Poland's telecommunication market, using the opportunities stemming from an agreement with UKE and re-balancing the organisation in order to achieve greater efficiency and ensure meeting the expectations of external and internal customers to the greatest possible extent.

Due to constant regulatory changes in the telecommunications market, the business action plan will be revised accordingly to assure that TP S.A.'s business objectives are fully achieved. However, owing to uncertainty as to the actions of alternative operators, there is a risk that not all the intended objectives will be achieved as planned.

Due to fierce competition and volatile regulatory environment, the Group's ability to achieve business objectives is under strong pressure, so TP carries out dedicated actions aimed at reducing the competitive pressure on its performance by improving its offers in the fixed-line and mobile segments and enhancing customer service.

10.2 Timely Implementation of Regulatory Requirements

If TP S.A. or TP Group companies are unable to satisfy the imposed regulatory requirements or fail to meet the indicated time limit, they may be at risk of administrative procedures and, consequently, administrative fines.

As provided in the Telecommunications Law, the President of UKE may impose on a telecommunications operator a penalty of up to 3% of its prior calendar year's revenues, if the operator does not fulfil certain requirements thereof.

As provided in the Law of 16 February 2007 on competition and consumer protection, in case of confirmed monopolistic practices or abuse of the collective interest of customers, the President of the Office for Competition and Consumer Protection (UOKiK) may impose on a company a penalty of up to 10% of its prior financial year's revenues or, for failing to provide the information requested or providing misleading information, a penalty of up to EUR 50 million.

According to article 13(11) of the Memorandum of Understanding between TP and UKE, in case of non-performance or improper performance by TP of the MoU provisions, including non-compliance with the auditor or President of UKE's recommendations regarding the IT audit, failure to meet the relevant deadlines or any actions inconsistent with the principles set out in the MoU, the President of UKE may resume works on imposing a regulatory obligation of functional separation on TP. Under the current legal regime, no fines can be imposed on TP for non-performance or improper performance of MoU.

10.3 Launch of New Products and Services

Fierce competition in the market and technological developments of new services result in strong pressure on price reductions in the mobile and fixed-line segments. There is a risk that the effect of price reductions will not be offset by increased volume of traffic on the network.

TP Group faces competition from not only telecom companies but also players from outside the industry, such as television or internet providers. Despite its efforts, the Company is still at risk of erosion of its revenues and market shares.

To maintain its competitive position, TP Group attempts to launch innovative products and services. Although the Company performs extensive marketing tests and has considerable knowledge of customer needs, there is a risk that some products or services may not meet customers' expectations and have to be withdrawn from the market or do not bring the expected return on investment. Such potential negative marketing effect could also lead to increased marketing spending for unplanned marketing actions or failure to generate expected revenues.

In addition, new products and services require an adjustment of network and IT systems. This is a complex and frequently time-consuming process, which poses a potential risk of delays in the market introduction of products and services. Another risk to timely implementation is consultations with UKE, which are often prolonged. Delays in the launch of new products and services may result in lower than planned take-up, posing a risk of non-achievement of the Group's budgeted financial results.

10.4 Potential Saturation of Networks

The current expansion in broadband usages, such as TV (as part of triple-play) or Internet streaming, fixed-line and mobile, has already on occasion resulted in the saturation of existing collection and transfer networks. To meet customer demand, or upon pressure from service providers or regulatory authorities, TP Group faces a challenge of undertaking significant capital expenditure programs designed to increase the capacity of its networks over the medium-term.

10.5 Development of New Technologies and New Investments

TP Group has been constantly making new investments in order to provide modern services to customers and meet the requirements resulting from MoU with UKE. This contributes to Poland's perception among foreign investors as an attractive place for new investments and, owing to improvements in the telecommunication infrastructure, encourages Poles to undertake new activities using new types of services, such as e-business. The IT awareness is growing in Poland, which stimulates the development of a modern information society.

Due to new services, changing customer needs and competitive pressure, TP Group undertakes costly investments in new technologies. There is a risk that the payback period will be longer than initially assumed. Moreover, insufficient offer and incorrect choice of technologies may negatively affect the achievement of intended revenue streams.

10.6 Non-availability or Failure of Technical Infrastructure

The technical infrastructure required to offer the Group's products and services is exposed to a risk of failure and interruption resulting from natural disasters or intentional human actions. Interruptions in technical infrastructure operations have a direct impact on provision of services and supply of products by the Group, which in turn translates into lower revenues from such products and services and a decline in customer satisfaction and the Company's image. This risk is mitigated by the proper network development planning, preventive maintenance, implementation of business continuity plans and insurance schemes. TP Group is covered by an insurance policy which protects it against loss of assets and profit if the Group's telecom infrastructure has been damaged. Aerial lines and submarine cables are excluded from the insurance policy and damage to these assets, and resulting losses, will be borne by TP Group.

10.7 Non-availability or Failure of IT Systems

As rapid implementation or modification of IT systems has become a necessity to meet customer demand for attractive offers, there may be a risk of errors resulting from insufficient testing of new services or lack of data integrity within connected systems. Potential failures and reduced availability of critical systems, resulting from frequent changes in the applications used, can lead to decreased quality of services and delayed response to changing customer needs. No major failure or non-availability of IT systems occurred in 2010.

10.8 Dependence on External Partners

TP Group concludes contracts with external partners, particularly for maintenance of its networks and telecommunication and IT infrastructure.

Although adequate safety clauses are included in the contracts, there is still a risk of non-performance by the Company's partners, resulting in delays in network maintenance projects and a decrease in quality of services provided by TP Group. At the same time, the Group has partially outsourced operation and supervision of IT systems and processes to external suppliers of computer hardware and software.

In 2010, TP Group carried out a process of consolidation of external suppliers. This enabled the Group to reduce the number of suppliers and negotiate better commercial terms, but on the other hand increased the risk related to dependence on key suppliers.

10.9 Risk Related to Trade Agreements and Strategic Alliances

In order to attain its business objectives, TP Group attempts to extend its portfolio through trade agreements and strategic alliances that enable it to use products and services of external partners. It is assumed that such bilateral agreements will bring added value to both the company and its customers. However, there is a risk that the benefits resulting therefrom will fall short of the anticipated and planned levels.

At the same time, TP Group is at risk of losing a portion of its revenues due to migration of some of the existing customers who may sign beneficial trade agreements or arrangements with other telecom service providers which are competitive to TP. TP has undertaken a number of initiatives to reduce the exposure. In particular, it has signed a co-operation agreement with TVN Group: both companies have joined forces to satisfy growing demands of customers and provide them with an offer as complete as possible.

10.10 Availability of Skilled Employees

TP Group operates in a market which is affected by a constant risk related to attracting and retaining skilled employees in all business areas. This risk is particularly noticeable in customer service and sales, where personnel turnover is relatively high, and in the technology area, where highly qualified employees need to be attracted. Changes in Poland's labour market increase the risk related to retaining of work force, and understaffing of these functions may pose a threat to the timely performance and quality of TP Group's core business processes and may hinder the achievement of the Group's business objectives.

10.11 Human Resources Risk and Organisation Structure Adjustment

TP has continued a voluntary departure programme and a workforce restructuring process based on a competence assessment system. Furthermore, TP Management Board is negotiating with trade unions on a number of issues, such as working conditions, work organisation, professional development opportunities, mobility, wage level and potential further restructuring in the future. Although the Management Board believes that the on-going professional activity plans have been generating the expected benefits, in view of dynamically changing conditions in the TP Group's business environment, including protracted slowdown in the telecommunication market, some differences in opinion may appear between the Management Board and trade union representatives regarding the assessment of such factors, which may result in social tension that could slow down the restructuring process. TP's management constantly consults with trade unions on such matters and in case of reorganisations takes action to clarify the goals and expectations.

10.12 Issues Related to the Incorporation of TP

TP was established as a result of the transformation of the former state-owned organisation PPTiT into two entities – Poczta Polska and TP. During the transformation process and transfer of ownership rights to the new entities, certain items of property and other assets that are currently under the Company's control were omitted from the documentation recording the transfer and the documentation relating to the transformation process is incomplete in this respect. This means that TP's rights to certain properties may be questioned. Consequently, TP Group launched the "Poczta Polska project" in 2009. It is aimed at identifying any real estates being the subject of dispute with Poczta Polska, reaching an agreement as to their division and developing a legal strategy towards the real estate for which TP Group's rights have been questioned.

A process of dissolution of co-ownership and regulation of limited rights in property (e.g. entering them in land and mortgage registers) is going on and will be continued for a few more years.

In addition, as the regulations concerning the transformation of PPTiT are unclear, the division of certain liabilities of PPTiT may be ineffective, which may result in joint and several liability in respect of TP's predecessor's obligations existing at the date of transformation.

10.13 Tax Contingent Liability

Tax settlements, together with other areas of legal compliance (e.g. customs or foreign exchange law) are subject to review and investigation by a number of authorities, which are entitled to impose fines, penalties and interest charges. The lack of reference to well established regulations in Poland results in a lack of clarity and integrity. Value added tax, corporate income tax, personal income tax and other taxes or social security regulations are subject to frequent changes which often lead to the lack of well established regulations or legal precedents. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems.

Tax authorities may examine accounting records up to five years after the end of the year in which the final tax payments were to be made. Consequently, the Group may be subject to additional tax liabilities, which may arise as a result of additional tax audits. Telekomunikacja Polska and certain of its subsidiaries were subject to audits by the tax office in respect of taxes paid. Certain of these audits have not yet been finalised. The Group believes that adequate provisions have been recorded for known and quantifiable risks in this regard .

10.14 Compliance with Personal Data Protection Regulations and Breach of Licence Agreements or Infringement of Copyrights

TP S.A. possesses a vast customer base and constantly undertakes activities designed to prevent leakage of its customers' data. In that respect, the Company complies with the relevant regulations, implements adequate policies, adheres to rules and guidelines, and conducts any relevant training. However, it is not possible to fully exclude the risk of an unintended leak of data. There are further risks which arise from TP Group's operations as a broadcaster of Orange Sport and Orange Sport Info television channels. The risks include that of infringing copyrights, neighbouring rights or defaming persons or entities. In addition, the broadcasts are subject to regulations regarding the editor's responsibility for content of programmes comprising the service as well as a number of regulatory obligations imposed by the Polish Broadcasting Act. The risk of potential claims on such grounds is to a great extent insured. At the same time, TP uses its best efforts to properly perform its obligations under Polish copyright law, press law, intellectual property law, Broadcasting Act and Act on Suppression of Unfair Competition. It applies to all content used in all media, including the internet. Some element of risk derives from a lack of effective control over broadcast content, in particular during broadcasting of live programmes. However, it should be noted that TP exercises due diligence in preparing programmes to prevent any unlawful materials from being broadcast.

10.15 Environmental Risks

TP S.A. believes that the Group's activities do not pose a serious threat to the environment. The Group's activities generate waste for which recycling is closely controlled, such as waste electronic equipment, electronics at end-of-life, batteries and storage cells, cables and treated poles as well as other waste.

The Group has implemented procedures for monitoring and reporting environmental impact. These procedures are aimed at limiting the impact of the Group's activities on the environment and at maintaining compliance with Polish regulations on environment protection. The Group has been a subject of environmental audits which have confirmed its compliance with Polish regulations and highlighted achievements in the field of limiting the impact on the environment. In addition, a dedicated team has been established to carry out on-going supervision regarding regulatory compliance, emission levels, as well as to meet other legal requirements in the area of environmental protection.

11 TELECOMMUNICATIONS SECTOR RISKS

This sections describes potential risks in the telecommunications sector that may affect TP S.A. and TP Group's operations except for the developments described in the section 5 above.

11.1 Regulatory Risks

Changes in the regulatory environment combined with increasing competition added to the pressure on the TP Group's top line in 2010.

TP continuously makes efforts in order to meet its regulatory obligations in the optimum way, including issues as Wholesale Line Rental (WLR), Bitstream Access (BSA) or Local Loop Unbundling (LLU).

TP Group has explored all possible legal means to protect its interest (appeals against all unjustified UKE's decisions are pending). The Group intends to turn to relevant EU institutions whenever it believes that European law is being breached.

11.1.1 Single Reference Offer

On 1 March 2010, the President of UKE obliged TP to change RIO, WLR, BSA and LLU reference offers in their entirety. TP is to introduce a single common process referred to as the Interconnection Cooperation Model, which comprises a number of component processes, including subscriber line orders, assignments, migration with/without number portability (NP), full/shared access deactivation and subscriber's decision to give up service subscription. Consequently, the deadlines for providing access to particular Regulated Services and other deadlines related to the co-operation between TP and other operators have been unified. In addition, the decision regarding draft single reference offer includes uniform collocation terms.

On 15 March 2010, TP applied to the President of UKE for the re-examination of the case that ended with the decision obliging TP to change RIO, WLR, BSA and LLU reference offers in their entirety. In its application, TP indicated that there were no legal grounds to change the three offers in the manner proposed by UKE.

On 31 March 2010, TP submitted a draft single reference offer for RIO, WLR, BSA and LLU telecommunication access for the President of UKE's approval. Then, on 19 May and 1 July 2010, TP submitted applications modifying the draft single reference offer.

On 29 June 2010, UKE, having reviewed TP's application, changed its decision on obliging TP to develop a single reference offer. On 30 July 2010, TP filed an appeal with the Regional Administrative Court, complaining that the BSA services provided via IP DSLAMs had been subjected to regulation.

On 1 July 2010, UKE released the draft single reference offer for public consultation, which ended on 30 July 2010. The draft that was consulted was not consistent with the draft reference offers submitted by TP. The President of UKE also notified the draft to the European Commission. On 3 August 2010, the Commission communicated its comments on the draft, particularly regarding the Price Squeeze test.

On 29 September 2010, the President of UKE decided to approve the draft single reference offer. The decision was made immediately enforceable. The approved offer differs from the draft submitted by TP for approval, as it covers the IP DSLAM-based access to BSA services and fails to provide for a time schedule for the implementation of the new functionalities, a fee of PLN 1.95 for interconnect settlements, changes in the Interconnection Cooperation Model or changes in the WLR price list.

On 13 October 2010, TP filed a request for the re-examination of the decision with the President of UKE, objecting the solutions which differed from the ones proposed by TP in the draft submitted for approval.

11.1.2 WLR Service

Pursuant to the Memorandum of Understanding between TP and UKE of 22 October 2009, at the end of October TP withdrew appeals against the majority of WLR decisions, except for decisions for GTS Energis, Dialog, Exatel, Premium Internet, E-Telko, Tele2, Mediatel and Netia. TP promised to withdraw appeals against the latter within 7 days after conclusion of agreements with the relevant operators that would be consistent with Appendix 4 to the Memorandum of Understanding between TP and UKE. Consequently, pursuant to an agreement between TP and Netia dated 23 December 2009 (consistent with Appendix 4 to MoU), on 24 December 2009 TP withdrew its appeal against the WLR decision for Netia (Tele2, Premium Internet), whereas pursuant to an agreement between TP and GTS Energis dated 2 June 2010 (consistent with Appendix 4 to MoU), on 8 June 2010 TP withdrew its appeal against the WLR decision for GTS Energis.

11.1.3 Local Loop Unbundling

Until 29 September 2010, TP used to perform its regulatory obligations on the basis of *TP's reference offer determining the general terms of agreements on full or shared access to local subscriber loop and related*

facilities (“RUO”), which was approved on 28 November 2008 and subsequently amended on 29 May 2009. Pursuant to the Memorandum of Understanding between TP and UKE, TP withdrew an appeal against the reference offer from the Regional Administrative Court at the end of October 2009. The proceedings in the case were discontinued pursuant to a ruling of 3 December 2009.

On 29 September 2010, the President of UKE decided to introduce the TP Reference Offer for interconnect and wholesale access to TP’s network, access to local subscriber loop to provide broadband services and access to local subscriber loop. The decision was made immediately enforceable. On 13 October 2010, TP filed a request for the re-examination of the decision. With respect to RUO, TP requested a change in a procedure for assignment of regulated services, a change in a procedure for submitting LLU service forecasts and introduction of a fee for the use of TP’s infrastructure for the purpose of LLU.

On 30 December 2010, the President of UKE designated TP as an SMP operator on the market 4/2007 (LLU) and imposed regulatory obligations on the Company. Pursuant to the decision, the scope of regulation was extended to include fibre optic loops on a conditional access basis (i.e. if there is no access to cable ducts, dark fibre or backhaul service). In addition, the President of UKE modified the costing obligation by introducing costs verified with the PS test (or other methods) as a basis for determining service fees as well as added the obligations resulting from MoU (e.g. Chinese Walls, Good Practice Code, KPIs) to the regulatory obligations related to non-discrimination and transparency.

11.1.4 Bitstream Access

In line with the Memorandum of Understanding between TP and UKE, on 6 November 2009, TP filed an application with the President of UKE for amending TP’s reference offer for broadband access, including BSA (“the BSA Reference Offer”) with respect to Section 8 (Price List). The application aims at introduction of a new ‘cost plus’ model in accordance with the Memorandum of Understanding.

On 12 April 2010, the President of UKE decided to amend the BSA Reference Offer with respect to Section 8 (Price List). Owing to the fact that the decision differed from TP’s application for amending the offer and the terms of the Memorandum of Understanding between TP and UKE, particularly with respect to Margin Squeeze and Price Squeeze tests, on 26 April 2010 TP filed an application for the re-examination of the case which ended with the decision amending the BSA Reference Offer. On 13 November 2010, TP filed a request for the discontinuation of the case in view of the President of UKE’s decision of 29 October 2010 on approval of the Reference Offer (which, among other things, regulates the BSA service price list).

On 29 September 2010, the President of UKE decided to introduce the TP Reference Offer for interconnect and wholesale access to TP’s network, access to local subscriber loop to provide broadband services and access to local subscriber loop. The decision was made immediately enforceable. The draft offer was notified to the European Commission, which communicated its objections, particularly regarding the fact that the BSA service provided via IP DSLAMs had been covered by the regulated offer. UKE’s decision accounted for the majority of TP’s demands regarding the BSA offer, particularly Margin Squeeze and Price Squeeze tests. On 13 October 2010, TP filed a request for the re-examination of the decision. With respect to BSA service and price list, TP objected the following issues: lack of time schedule for implementation of the Interconnection Cooperation Model; inclusion of the BSA service provided via IP DSLAMs in the Reference Offer, even though it is a non-regulated service; and elimination of some fees for the line and the use of infrastructure for the purpose of the BSA service.

TP began negotiations with alternative operators on amending interconnect agreements by adjusting the rates to those specified in the BSA Reference Offer of 12 April 2010. As negotiations dragged on, TP filed 17 applications with UKE for issuing decisions that would implement the settlement model set forth in the BSA Reference Offer. TP signed annexes to BSA agreements with three operators. In the fourth quarter of 2010, the President of UKE issued 14 decisions amending BSA agreements with alternative operators in line with the solutions set forth in the new Reference Offer. TP did not appeal against these decisions.

On 24 June 2010, the European Commission opened a case against Poland due to the President of UKE’s failure to notify the draft amendment to the BSA Reference Offer (approved on 12 April 2010).

11.1.5 Leased Lines

After UKE completed the market analysis and imposed regulatory obligations on TP with respect to the domestic market for leased lines services (market 13/2003) and the trunk segment of the domestic market for leased lines services (market 14), TP submitted a draft leased lines reference offer for the markets 13 & 14 (“RLLO”) in July 2009.

On 31 December 2009, the President of UKE approved RLLO (the decision was delivered to TP on 4 January 2010). TP appealed against the decision on 18 January 2010, and so did the Polish Chamber of Electronics and Telecommunications (KIGEiT).

Owing to gaps and ambiguities in the RLLO approval decision, on 5 February 2010 TP filed a request for clarifying and correcting the decision. On 15 June 2010, the President of UKE issued a decision correcting obvious mistakes, while on 24 June 2010 a decision clarifying doubts related to the approval decision. In both decisions, the President of UKE accounted for some of TP's demands.

On 18 October 2010, the President of UKE issued a decision with respect to the requests for the re-examination of RLLO, amending the Reference Offer in force. The new version of RLLO is generally more advantageous to TP than the former one, but it still includes some disadvantageous solutions. Consequently, on 19 November 2010 TP appealed against the new RLLO to the Regional Administrative Court.

11.1.6 Cable Ducts (ROI)

In June 2009, TP applied to UKE for a decision confirming the expiration of the decision which implemented ROI. The Company argued that owing to the completion of the analysis of relevant markets, the grounds for the implementation of ROI (namely interim provisions of the Telecommunication Law) were no longer valid. On 17 February 2010, the President of UKE refused to confirm the expiration of the decision on ROI approval. TP did not file a complaint.

In line with UKE's decision of 17 July 2009, that was issued upon NASK's request in August 2009, TP submitted a new draft ROI for the President of UKE's approval. The changes included incorporation of a cable chamber into the scope of a cable duct and enabling installation of operators' equipment therein, more strict regulations regarding duct obstruction removal, construction of branches connected to TP's cable ducts and procedures for reporting and handling complaints. The revised offer has not been approved by UKE yet.

On 16 July 2010, the President of UKE decided to approve ROI in a modified version compared to the draft offer submitted by TP. The approved offer generally accounts for the changes suggested by TP, but there are still some modifications which are disadvantageous to the Company. Consequently, on 30 July 2010, TP filed a request for the re-examination of the decision which implemented ROI.

11.1.7 Fixed Termination Rates on Networks of Alternative Operators (Designated as SMP Operators in the Market 9)

On 16 December 2008, upon completion of the public consultation process, the President of UKE adopted a position on the symmetry of voice call termination rates on fixed public telephone networks. According to the President of UKE's position, the maximum asymmetry index for fixed termination rates (FTRs) for call termination on TP's network within a numbering zone should be 92% from 1 January 2009 on and then should be gradually reduced to reach 0% on 1 January 2014, whereas in case of call termination outside the transit area, the FTR asymmetry with respect to TP's rates should decrease from 9% to 0% between 1 January 2009 and 1 January 2014.

This position is inconsistent with the opinion of the European Regulators Group and the European Commission, which point out that the introduction of the FTR symmetry is the optimum solution.

Based on the position of 16 December 2008, in 2010 the President of UKE issued decisions amending interconnect agreements with respect to implementation of the FTR reduction timetable (also in case of FTR symmetry between TP and alternative operators) for Netia, Inea, IT S.A., Telgam, Aster, PTK Centertel and GRS. TP appealed against these decisions to the Antimonopoly Court, claiming their inconsistency with EU regulations, European Commission's recommendations, ERG's position and the President of UKE's own position on FTR symmetry.

In the *Analysis of the Scope of Completion of the Regulatory Strategy of the President of UKE for 2008-2010*, which was disclosed to the public, the President of UKE announced a change in her position on FTR symmetry in line with the European Commission's recommendations.

11.1.8 Telecommunication Law Amendment

The Telecommunication Law amendment was published in the Journal of Laws (No. 86, item 554) on 20 May 2010. The Law was passed to comply with the EU Court of Justice's judgement of 22 January 2009 (case C-492/07). In its judgement, ECJ held that a definition of a subscriber in the Telecommunication Law was inconsistent with a definition provided in Article 2.k) of the Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks ("the Framework Directive") (Official Journal L108, p.33).

The subscriber definition has been extended and now covers:

(i) subscribers who are a party to a written telecommunication service agreement with a public telecommunication service provider; and

(ii) subscribers who are not a party to a written telecommunication service agreement with a public telecommunication service provider.

New obligations of telecommunication operators include:

1. Obligation to determine the rules of providing service to subscribers who are not a party to a written agreement according to the provisions of the Telecommunication Law amendment (Articles 59 & 60);
2. Obligation to deliver any proposed amendment to the terms of agreement in writing to subscribers who have provided their personal data (Article 60a);
3. Obligation to announce any proposed amendment to the terms of agreement (Article 60a);
4. Obligation to inform a subscriber about the right to terminate the agreement (also electronically, upon subscriber’s request) if he does not accept the proposed amendment (Article 60a);
5. Obligation to promptly announce any change to the service provider’s name, address or seat (Article 60a);
6. Obligation to announce the price list and deliver it to subscribers who have provided their personal data (Article 61);
7. Obligation to announce any proposed change to the price list (Article 61);
8. Obligation to provide a directory service to its subscribers who have provided their personal data (Article 66);
9. Obligation to transfer the number upon subscriber’s request free of charge (Article 71);
10. Obligation to provide the President of UKE free of charge with the data of subscribers who have provided their personal data (Article 78);
11. Obligation to provide pre-paid subscribers who have provided their personal data with a basic or detailed billing upon subscriber’s request (this may be provided for a fee) (Article 80);
12. Obligation to include subscriber data in the nationwide directory and the nationwide directory service upon subscriber’s consent (Article 103);
13. Obligation to inform its subscribers who have provided their personal data about any intended changes in their individual numbers and about their new numbers (Article 131).

In addition, the amendment introduced sanctions for non-performance or improper performance of some of the aforementioned obligations (Article 209(13a)).

On 18 November 2010, the President of the Republic of Poland signed Telecommunication Law amendment of 29 October 2010 (Journal of Laws No. 229, item 1499). The amendment provides that upon operator’s request the President of UKE may determine, by way of a decision, the detailed regulatory conditions defining the manner of performance of the regulatory obligations previously imposed on the operator. Moreover, such detailed regulatory conditions may specify other obligations of a telecommunication operator which, though not directly related to the performance of regulatory obligations, may contribute to the development of equal and effective competition, the development and usage of modern telecommunication infrastructure or assurance of the maximum benefits to end users in terms of variety, price and quality of telecommunication services. Failure to comply with the President of UKE will be subject to a fine of up to 3% of the operator’s revenue. The new bill came into force on 21 December 2010.

11.1.9 New Regulation on Data Retention

The Decree of the Minister of Infrastructure of 28 December 2009 on the detailed data specifications and types of public telecommunication network operators and public telecommunication service providers obligated to data retention and storage was issued pursuant to delegation set out on article 180c(2) of the Telecommunication Law. The obligation to retain, store, protect and provide applies to the data required to determine the network termination point, the telecommunication terminal, the end user, the date, time and duration of a call, the type of call and the location of the telecommunication terminal. The scope of data differs depending on the type of network and the type of service. Article 180c(2.2) of the Telecommunication Law provides that the types of public telecommunication network operators and public telecommunication service providers obligated to data retention and storage shall be determined in a decree. The new decree has imposed this obligation on operators of fixed or mobile public telecommunication networks and providers of public telecommunication services on such networks, as well as providers of public internet access, email and VoIP services. The decree came into force on 1 January 2010. In April 2010, upon TP’s request the Polish Chamber of Information Technology and Telecommunications (PIIT) applied to the Ministry of Infrastructure for amending the Decree by extending the deadline for the implementation of its requirements, particularly with respect to ineffective call data retention, by at least six months.

11.1.10 Consultation by the Ministry of Infrastructure Regarding the Future of USO

In February 2010, the Ministry of Infrastructure carried out public consultation regarding the future of the universal service in Poland. The main issues on the consultation agenda included:

- The scope of universal service obligation in view of a proposal to extend USO to include broadband access and mobile communications;
- Transparency of the process of verification of net cost compensation applications;
- Change in the model of universal service financing by operators;
- Determining the minimum number of payphones.

In its opinion, TP objected to the USO extension to broadband access and mobile telephony. Similar position was presented by the industry chambers, Polish Chamber of Electronics and Telecommunications (KIGEiT) and Polish Chamber of IT and Telecommunications (PIIT). In addition, TP pointed out that the current system was transparent and provided for the participation of operators, through the chambers of commerce, in the compensation proceedings. However, in TP's opinion, the current model of financing needed to be changed due to its ineffectiveness, as TP had received no compensation hitherto. As for the minimum number of payphones, TP called for removal of the obligation to provide payphone service in consideration of high mobile penetration.

11.1.11 Consultation of the President of UKE's Concept of USO in Poland

On 14–28 May 2010, the President of UKE carried out public consultation regarding the future of the universal service in Poland. The President of UKE presented a general concept of a new model of the universal service in Poland. The main assumptions for the universal service obligation are as follows:

- According to the President of UKE's concept, USO will not be extended to include broadband internet access;
- The President of UKE will have the right to decide, based on the market situation analysis, whether it is necessary to designate an operator designated to provide the universal service, and such a decision will be made separately for each universal service component and, if required and reasonable, separately for different parts of the territory of Poland;
- Introduction of the technological neutrality principle, which provides for:
  - considering in the market analysis any services equivalent to those of connecting new users to a fixed network, keeping the connection ready and enabling fax transmission and internet access via subscriber lines,
  - providing the aforementioned services by the designated universal service operator in the form of their functional equivalents;
- Opening the nationwide directory service to competition;
- Introducing direct support for low-income users and/or users with special needs or, alternatively, obligating the designated universal service operator to offer special tariff plans;
- The net cost of the universal service would be reimbursed either from public funds (definitely in case of extension of the scope of the universal service) or a sector fund designed similarly to the existing solution;
- Exclusion of payphones from USO;
- The President of UKE is considering two options of the payphone service: the payphone service obligation is to be either fully excluded (preferred solution) or incorporated into USO. In case of the latter option, the President of UKE's proposal provides for a period of *vacatio legis*, during which payphone availability will be negotiated with local authorities.

In response to the President of UKE's consultation agenda, TP presented its position, backing the following solutions:

- Exclusion of broadband services from USO;
- Introduction of the technological neutrality principle;
- Exclusion of the payphone service from USO.

With respect to other solutions, TP has requested the President of UKE to specify their terms and conditions in more detail.

In the wake of the aforementioned public consultation, the President of UKE published another version of the assumptions. The only change was that the payphone service was kept as part of USO. However, according to

the President of UKE's position, it does not mean that any operator will be actually designated to provide this service.

11.2 Competitive Risks

11.2.1 Fixed/Mobile Substitution

Fixed/mobile substitution is one of the major challenges for telecom operators. The process of F2M substitution has been particularly intensive in Central and Eastern Europe, where the fixed line penetration at the time of popularisation of mobile telephony was much lower than in West European countries.

The fixed/mobile substitution in Poland, like in other CEE countries, has a greater scale than in the majority of West European countries and the ratio of 'only-mobile' users is generally higher.

F2M substitution depends mainly on two factors:

- ratio of fixed line to mobile penetration; and
- the relation between mobile and fixed line prices.

Another important factor is habits of customers, who use fixed line phones to call fixed line numbers and mobile phones to call mobile numbers, which owing to high mobile penetration contributes to customer migration to mobile operators. Consequently, a great number of customers prefers to purchase a bundle of mobile/internet/convergent services rather than use fixed line services alone.

In the future, it is fixed line voice services that may become an added value to internet or mobile services. VoIP services are particularly popular in this context. They are activated over a broadband line as the equivalent of a traditional fixed line.

Finally, the aggressive pricing and communication policy of the PLAY network has also significantly added to the F2M substitution. This operator has been making use of the asymmetry of mobile termination rates on its network with respect to other mobile operators, thus adding to the F2M substitution.

In addition to the F2M substitution, bundled mobile and fixed offers have been gaining popularity in the market. By offering attractive bundling offers on their networks, wireless operators win over customers from fixed-line operators.

11.2.2 WLR, BSA and LLU Wholesale Markets

On 22 October 2009, TP and UKE concluded a Memorandum of Understanding, under which wholesale rates are to be frozen by UKE till 2012 and new procedures in inter-operator relations are to be introduced.

On 29 September 2010, the President of UKE approved a single reference offer for RIO, BSA, LLU and WLR services ("SRO"). In particular, the new SRO introduced the functionalities set forth in MoU between TP and UKE (though some implementation procedures differ from the functionalities being implemented by TP under MoU), namely:

- Uniform terms of provision of regulated services based on the Interconnection Cooperation Model;
- Introduction of ISI electronic communication;
- Departure from the 'retail minus' model if the Margin/Price Squeeze Test is positive;
- Procedure for amending the reference offer based on the Time-to-Market (TTM) mechanism;
- Regulations concerning subscriber line assignment and subscriber data change.

In addition, BSA access to TP subscribers connected to IP DSLAMs was introduced, though it had not been covered by MoU.

WLR Service

The access to TP's network based on wholesale line rental (WLR) has been provided since 2006. By the end of 2010, TP had provided WLR services to 21 operators.

In 2010, on average, TP handled 48 thousand WLR orders of alternative operators per month. TP handled about 1.4 million WLR lines.

BSA Service

The access to TP's broadband services based on access to a local subscriber loop through access to network nodes (bitstream access – BSA) has been provided since 2006.

By the end of 2010, the agreements for TP's BSA service were signed by 21 operators. The binding BSA Reference Offer has imposed on TP an obligation to provide the BSA service at the Non-managed IP, Managed IP, DSLAM and ATM levels. Alternative operators are free to choose the service option that they consider best for them, including the Non-managed IP option, in which a BSA operator needs no infrastructure of its own.

In 2010, pursuant to individual decisions issued by UKE or agreements signed by TP, the rate freezing provided for in MoU became effective with respect to all operators using the BSA service. However, the BSA price list frozen in SRO did not include an interconnect settlement fee of PLN 1.95 per active subscriber line, which had been due to TP under the BSA Reference Offer 2008; TP has been co-operating with 15 operators on such terms.

At the end of 2010, TP handled approximately 527,000 BSA lines.

LLU Service

The access to TP’s local subscriber loop (LLU service) has been provided since 2005. By the end of 2010, 24 operators had made use of the LLU offer, and the number of LLU lines handled by TP had reached 130,000.

On 30 December 2010, the President of UKE issued a regulatory decision for TP with respect to the market 4 (domestic market for provision of wholesale (physical) access to network infrastructure, including shared or fully unbundled access, in a fixed location), imposing new regulatory obligations on the Company.

11.2.3 Leased Lines Market

On 31 December 2009, the President of UKE approved the Reference Offer for telecommunication access with respect to leased line terminating segment, leased line trunk segment and leased end-to-end lines services (RLLO).

Thus, the markets 13 and 14 were regulated, except for connections between 145 locations listed in the Appendix to the President of UKE’s decision of 24 April 2009 (regarding regulatory obligations for the market 14). In addition, high-capacity lines, which are offered by TP on commercial terms negotiated with each operator on an individual basis, were included into the Reference Offer; as a result, 2.5 Gb/s and 100 Gb/s lines have been offered on the RLLO terms since December 2009.

On 22 January 2010, the President of UKE issued a decision recognising the market for leased line trunk segment services in connections between 145 locations listed in an appendix thereto as effectively competitive with no significant market players.

On 18 October 2010, the President of UKE issued a decision amending RLLO of 31 December 2009. The purpose of the amendment was to determine the correct interpretation of various provisions being the subject of dispute, which had prevented proper functioning of the Reference Offer in the market. The most significant changes were introduced to the definitions of various types of leased lines; in line with TP and KIGEiT’s proposals, the President of UKE decided not to divide leased lines into different sections any more, but simply classify them depending on the point of termination.

TP's principal competitors in the leased lines interconnect (wholesale) market are Exatel, TK Telecom (formerly Telekomunikacja Kolejowa), GTS Energis and Netia. These companies have network resources that enable them to compete with TP’s offer in terms of both quality and price. A major part of the leased lines market is the retail segment with additional competition from smaller market players that develop their retail offer on the basis of lines leased from TP or other large players.

The current RLLO provides access to this service for a broad group of customers. The companies that have used the retail leased lines services so far, may, upon registration in the register of telecom operators, use the preferential wholesale price list. The existing regulations, especially in terms of pricing, contribute to the market erosion by value. The offer is particularly attractive with respect to analog lines without an allocated frequency band.

At the same time, 2010 saw the continuation of an upward trend in the market for sophisticated data transmission services on managed networks. These solutions are increasingly popular in the business market, as they unify and simplify corporate communications and enable easy incorporation of a number of value-added services. They also enable companies to optimise their capital and operating expenses and, as a result of telecom outsourcing, focus on their core activity. For this reason, in Poland, like in other European countries, customers have been migrating from traditional data transmission services (including leased lines) to managed solutions (IP VPN / MPLS). Both TP and alternative operators follow this trend, expanding their service portfolio in this direction.

11.2.4 Interconnect Market

On 29 September 2010, the President of UKE approved a single reference offer for RIO, BSA, LLU and WLR services (“SRO”). In particular, the new SRO introduced the functionalities set forth in MoU between TP and UKE (though some implementation procedures differ from the functionalities being implemented by TP under MoU). With respect to RIO, the new reference offer no longer defines the Third Party Billing service, which is to be implemented only upon request of operators. With respect to the Nationwide Directory Service, SRO removed an obligation to provide the service in an origination model.

The President of UKE issued further decisions for alternative operators using the asymmetry model consistent with the President of UKE’s position of 16 December 2008 on the symmetry of voice call termination rates on fixed public telephone networks. UKE’s decisions have introduced a flat rate model without differentiation to tariff periods. TP has appealed against the methodology of determining call termination rates on fixed public telephone networks, which is disadvantageous to TP (as it actually results in an increase rather than a decrease in asymmetry).

11.2.5 ILD (International Long Distance) Inbound and Gateway Markets

Competition in the ILD inbound and gateway markets is still very intensive.

This is a consequence of a dramatic decrease in domestic interconnect rates and active search by domestic operators for additional sources of revenue. As a result, mobile and fixed network operators establish more and more direct interconnections with both incumbent operators and international operators that focus on voice traffic wholesale, trying to attract traffic to their own networks and win transit traffic to other domestic networks. The struggle is most dynamic in the market for mobile calls, which are still a source of relatively high revenues.

In this situation, TP has been constantly expanding its foreign interconnect base and maintaining its share in Poland’s inbound market. On the other hand, TP has been actively attracting new gateway traffic volumes by winning subsequent operators for the ILD service. These efforts increase TP’s bargaining power in its relations with foreign partners, which contributed to an increase in revenue from this service in the second quarter of 2010. As part of its international sales strategy, TP concludes short-term bilateral agreements with operators, assuring, to a great extent, stable traffic volumes, stable revenues and costs, the optimum network usage and business predictability.

TP has signed agreements with 41 domestic operators under which it provides services of call termination on foreign operators’ networks via its own network. The same model of cooperation is used in business relations with 72 foreign operators.

Another on-going trend in the market for voice calls (including ILD) is a rapid increase in VoIP household penetration rate across Europe (especially Western Europe), which in turn stimulates growth in calls effected in this technology. Therefore, a number of operators is migrating or planning to migrate from the existing TDM technology to the IP technology both within their own networks and in the interconnect traffic (also international). TP is also planning to launch two IP-based interconnect gateways in 2011. However, it is worth noting that migration to the IP technology is a long-term process and involves considerable investments in new infrastructure.

As shown by the experience of TP’s foreign partners, such as Telecom Italia, British Telecom, Deutsche Telecom or France Telecom, even though the VoIP technology has been functioning in the market for several years, the migration of complete service portfolio is a difficult and time-consuming process, so both the aforementioned operators and other foreign partners of TP are still using mixed technology and have not entirely given up TDM.

11.2.6 International IP Transit Market

TP's principal competitors in this market are the biggest national operators, which develop or lease international lines to the main traffic exchange points. The presence of international operators in Poland further intensifies competition for access to the worldwide internet resources. The activity of the biggest domestic operators and the growing volume of IP traffic handled by international players (Tier-1) have been gradually reducing TP’s position in this service market.

11.2.7 VoIP Segment

Constant growth in voice-over-Internet Protocol (VoIP) services in Poland is driven mostly by cost-conscious subscribers’ pursuit of lower voice rates. Owing to VoIP technology, some calls, namely between the users of the same VoIP internet application, are fully free of charge. This largely contributes to the popularity of this channel of communications, as reflected in the number of communicator users.

TP competes with VoIP providers with two of its services: *telefonia internetowa tp* and *neofon tp*. In November 2010, TP added an option to sign up for tariff plans with numbers from the relevant geographical zone to its VoIP portfolio. TP anticipates that this in combination with growth of broadband internet access services will facilitate increased use of the VoIP technology for voice services in 2011.

12 RISK FACTORS RELATED TO MACROECONOMIC ENVIRONMENT AND FINANCIAL MARKETS

12.1 Macroeconomic Factors and Factors Related to Poland

12.1.1 Economic Growth

The Polish economy recovery continued upward trend in 2010. After very good performance in Q2 and Q3 Polish economy real growth in 2010 based on the initial estimation of the Central Statistical Office achieved 3.8%. The GDP growth was fuelled mainly by a 3.2% increase in private consumption (year-on-year) and supported by gradual improvement in the labour market and growing volume of retail sales and production.

However, it seems impossible to clearly assess Poland’s economic outlook based on this GDP growth, as it largely depends on the condition of other European economies. The risk of another wave of crisis and financial problems of some Euroland countries, such as Greece, Ireland and Portugal, may affect further economic growth in Poland. The main risk factor for the economic growth is the length of recession in the Euroland countries, which are Poland’s main trade partners. Prolonged recession may further decrease foreign trade, cut employment and reduce investment activity. An additional risk factor is the situation of the public sector finance. The potential fiscal measures (both on the revenue and expense side) may affect the economic growth rate in the short run.

In view of the economic slowdown in other European countries, stable domestic demand should be a growth engine in Poland. However, prolonged slowdown in Europe may also affect the condition of the Polish economy.

12.1.2 Inflation

The inflation rate was 3.1% at the end of Q4 2010 (year-on-year). This rate of growth of consumer prices made the Monetary Policy Council change interest rates by 0.25 ppt. at the beginning of 2011. Such a position of the Central Bank may indicate that marked increase in the inflationary pressure in the recent months is considered as a major risk for the Polish economy. The latest turbulence in Euroland has a strong impact on the Polish currency market. Continuation of adverse external conditions, excessive depreciation of zloty against euro and a continued increase in the inflationary pressure may be influential in further changing of interest rates in the following months.

According to the inflation forecast for 2011 presented in the budget bill, the year-average inflation rate will grow to 2.3% (from 2.0% in 2010). The Monetary Policy Council is slightly less optimistic, estimating price growth in 2011 at 3.0% (year-on-year).

12.1.3 Unemployment and Labour Costs

Unemployment rate increased in 2009, reaching 12.1% by the end of the year. This trend continued till February 2010, when unemployment rate reached 13.2%. Subsequent months saw improvement in the labour market, which stabilised the rate of registered unemployment. According to initial estimates of the Ministry of Labour and Social Welfare, unemployment was 12.3% at the end of December (up 0.2pp year-on-year).

The deterioration in the labour market led to significant slowdown in wage growth, the rate of which gradually fell throughout the year. In the third quarter of 2010, nominal wage growth in the business sector averaged 2.0%.

12.1.4 Political and Economic Factors

Poland has undergone significant political, economic and social change in the last 20 years. Changes in political, economic, social and other conditions may have material effects on the business, financial condition and results of operations of the TP and Group in the future. There can be no assurance that future political decisions will not adversely affect the business, financial condition or results of operations of the TP and Group.

12.1.5 Changes in Regulation

Changes in law or regulations (or in the interpretation of existing law or regulations), whether caused by change in the Polish government or implementation of European Community law as a result of Poland’s membership in the EU, could materially adversely affect the TP’s and Group’s business, financial condition and operations. Competition, securities, telecommunication and other laws and regulations have been and continue to be subject to substantial changes in Poland.

12.1.6 Polish Tax System

Polish tax laws and regulations, in particular as regards value added tax and income tax provisions are complex and subject to frequent change, varying interpretations and inconsistent and selective enforcement by the Ministry of Finance and local authorities. Such changes in Polish tax regulations may adversely affect the legal, business and financial situation of the Group in the future. The growing public debt and budget deficit influenced the government's decision to raise VAT by 1pp (to 23% and 8%). Furthermore, the government has announced that should Poland's public debt exceed the cautionary threshold of 55% of GDP, there will be obligatory increases in VAT rates by 1pp in subsequent years until the maximum level of 25% and 10% is reached. The government is also planning increases in excise tax, which is to rise by 4pp annually. Amendment to the Excise Tax Act is necessary in order to implement the relevant EU directive, coming into force in January 2011. The excise tax increase will be the first step towards reaching the EU tax minimum and the whole process should end by 2018.

12.2 Factors Related to Financial Markets

12.2.1 General Risks Related to the Polish Market

Poland is still considered a less stable market, which is exposed to higher fluctuations in case of negative developments in global markets. Therefore, investors should exercise caution while assessing the risk of purchase of financial assets of Polish companies. In consideration of the above, investment decisions should be made by experienced investors who are able to fully assess all risks involved in such investments.

12.2.2 Interest Rates

The reference interest rate remained unchanged at 3.50% throughout 2010. In view of growing inflationary pressure, the Monetary Policy Council will probably continue started in the first quarter of 2011 a cycle of interest rate increases. The financial markets estimate the aggregate reference interest rate increase in 2011 at 1%.
A potential increase in interest rates should not have any major influence on TP Group's debt service costs, owing to high hedging ratio.

12.2.3 Foreign Exchange Rates

Foreign exchange rate fluctuations affect TP's obligations denominated in foreign currencies and settlements with foreign operators. However, this influence is greatly contained by a portfolio of hedging instruments held by TP.

In addition, the fluctuations of the PLN/EUR exchange rate may affect comparative analyses conducted by UKE, in which TP's price offer is referred to the offers of its European peers. The strong Polish Zloty may have an adverse effect, when the prices of new services are determined by UKE on the basis of the EUR-denominated benchmarks.

In 2010, the EUR/PLN rate was subject to minor fluctuations in the 3.8356–4.1770 bracket. Fluctuations were higher against the US dollar, for which the rate of exchange oscillated between 2.7449 and 3.4916. NBP's mean exchange rates of PLN against the US dollar and the Euro in 2010 were 3.0179 and 3.9939, respectively.

12.2.4 Situation at the Warsaw Stock Exchange

2010 saw an increase in the indices on the Warsaw Stock Exchange (WSE). The prime index, WIG, was up 18.7%. At the same time, TP shares gained 3.0% (or gained 13.8% excluding the dividend-related reference price change), while the large-cap index, WIG20, gained 14.9%.

12.2.5 Other Factors That May Influence the Price of TP Shares

Other than major factors already mentioned earlier in this document, the following may also result in TP share price fluctuations:

- Change in TP Group's ratings;
- Change in TP Group's debt;
- Sale or purchase of assets by the TP Group;
- Significant changes in the shareholder structure; and
- Changes in the capital market analysts' forecasts and recommendations concerning the TP Group, its competitors and partners, or business sectors in which the Group operates.

13 APPENDICES

Appendix 1. Secondary Legislation

Secondary legislation in 2010:

1. Decree of the Council of Ministers of 4 January 2010 on an emergency action plan of a telecommunication entrepreneur (Journal of Laws No. 15, item 77);
2. Decree of the Minister of Infrastructure of 18 February 2010 amending the decrees on assessment of compliance of telecommunication terminal equipment to be connected to public network and radio equipment with basic requirements and on marking thereof (JoL No. 32, item 174);
3. Decree of the Council of Ministers of 22 March 2010 on transferring and providing data in case of declaration of bankruptcy of a public telecommunication network operator or a public telecommunication service provider (JoL No. 48, item 281);
4. Decree of the Council of Ministers of 9 April 2010 amending the decree on detailed requirements for provision of the universal service and requirements for provision of the broadband internet access service to authorised entities (JoL No. 65, item 410), effective on 1 January 2011;
5. Decree of the Council of Ministers of 25 May 2010 amending the decree on the national Frequency Allocation Table (JoL No. 98, item 627);
6. Decree of the Minister of Infrastructure of 22 June 2010 amending the decree on technical requirements for telecommunication buildings and facilities and their location (JoL No. 115, item 773);
7. Decree of the Minister of Infrastructure of 25 June 2010 on fees for applications for an opinion of the President of the Office of Electronic Communications on the telecommunication activity of a local government unit (JoL No. 118, item 796);
8. Decree of the Council of Ministers of 1 July 2010 on a procedure for providing free radio transmission or transmission-reception equipment used by radiocommunication services by entities other than telecommunication entrepreneurs (JoL No. 130, item 875).

Appendix 2. Analysis of Relevant Markets

1. Market 2/2007 (call origination): on 19 November 2010, UKE initiated public consultation of a new draft decision for the market for call origination on a fixed network. The key changes with respect to the decision currently in force include:
   - Introduction of incurred costs rather than justified costs as the basis for pricing;
   - Incorporation of some provisions of MoU (e.g. KPI publication, access to systems) into the non-discrimination obligation and the transparency obligation.
2. Market 15/2003 (call origination on mobile networks): on 5 November 2010, UKE initiated public consultation of a decision recognising the market for call origination on mobile networks as effectively competitive. On 17 December 2010, upon completion of the consultation procedure, the President of UKE published the draft decision and submitted it for review by UOKiK.

Appendix 3. Products and Services

FIXED LINE VOICE

Business Customers

In 2010, in order to meet customer expectations and to improve its competitive position, TP introduced the following modifications in its business portfolio:

Price Reductions

Two price reductions for calls to Play were introduced on 1 January 2010 and 1 July 2000, respectively. The price cuts resulted from a reduction in MTRs for this operator. Currently, the price for calls to Play is PLN 0.46 per minute. No MTR reductions for Era and Plus were introduced in 2010, so the relevant F2M rates were not changed, either.

Tariff Solutions

In 2010, the leading offer was Business Plans 100, 300 and 500 for analog access and Business Plans 150, 450 and 750 for digital access. The offer is addressed mainly to SOHO customers. Major benefits of the Business Plan include: a pool of minutes for local or DLD calls on TP's network, transfer of unused minutes to the subsequent period (for the first time in TP's business plans) and the lowest ILD rates within the entire portfolio of TP's services (PLN 0.35 for calls within the European Union).

Between October 2009 and 30 September 2010, TP carried out the '50% More in the Business Plan' promotion. It offered 50% more minutes for local and DLD calls. It is the first retention offer with respect to TP's tariff plans for the business market (customers need to sign an agreement for 12 months). Unused minutes from this extra pool are transferred to the subsequent period and used first then.

A new offer with a terminal, "Phone with the Business Plan", was added to the portfolio of retention offers. It lasted between 5 May and 31 October 2010. Customers who chose a dedicated tariff option and signed a loyalty agreement for 12 or 24 months were offered a wireless fixed phone for a price starting from PLN 1.

The leading activation offer was 'Connection for a Fair Price', which was introduced in February 2010 and lasted until the end of January 2011. It concerned analog line activation. Depending on the term of agreement, either 12 or 24 months, the activation fee was PLN 1 or PLN 10, respectively. Sales of digital lines were supported with the permanent 'Package for New Companies' offer.

Several dedicated tele-sales campaigns were carried out in 2010 as part of customer retention efforts. One of the last such initiatives was the 'Chosen Numbers' campaign, which was addressed to SOHO customers using tariff plans dedicated to the mass market. The campaign aimed at strengthening the customer loyalty.

Value Added Services (VAS)

IN-based advanced services are a very important element of a service portfolio, providing special functionalities to customers that often constitute the basis for their business activity. VAS business portfolio includes mainly a broad range of corporate hotlines as well as TP Short Numbers and Teleconference services.

Two major projects were carried out in 2010:

A major modification in the 801-5 infoline service was introduced on 31 March 2010. The service is now based on flexible tariff (rather then a standard or extended plan as before). The activation fee and, the subscription fee are PLN 1 each, while the fees for of infoline calls are PLN 0 for local and intrazone calls and PLN 0.40 for M2F calls.

New division of calls in the TP Short Numbers service was introduced. If a short number is selected without an area code, the fee is charged like for local traffic, whereas if the number is preceded with an area code, the fee is charged according to the DLD price list.

Campaigns

In 2010, communication initiatives in the fixed-line voice service and VAS area were based on direct channels, mainly mailing.

Residential Customers

Promotional Offers and Initiatives

- Nationwide promotional campaign, 'TP Plan at a Discount', was launched on 8 January 2010. The media campaign lasted till 28 February. The promotion offered a 30% or 50% discount on a monthly access fee to customers signing a loyalty agreement for a period of 12 or 24 months.

- On 25 May 2010, the media campaign for the ‘TP Plan from PLN 1’ promotion started as a part of a campaign dedicated to a broad range of TP’s products. The campaign was based on a slogan, “Whether you follow your heart or your common sense, choose a TP product.” The promotion offered a discount on a monthly access fee to customers signing a 12- or 24-month loyalty agreement for one of DoMowy [Home] tariff plans.
- A nationwide promotional campaign, ‘To Tell the Truth, DoMowy Plan for up to Three Months For Free’ started on 15 October 2010. The promotion offers a reduction in the subscription fee to PLN 0 for one of selected DoMowy [Home] tariff plans.

New Services and Tariff Plans

In order to meet customer expectations and to improve its competitive position, TP launched the following promotions in 2010:

- In January 2010, ‘TP Plan with Phone from PLN 1’ promotion: a wireless telephone set for a price starting from PLN 1, provided that a loyalty agreement was signed;
- In February 2010, ‘Go Shopping with TP Plan’ promotion: a Sodexo shopping voucher as a gift to customers, provided that a loyalty agreement was signed;
- Also in February 2010, ‘TP Minutes for F2M’ promotion: a discount for the ‘TP 30 Minutes for F2M’ service, provided that a loyalty agreement was signed;
- In March 2010, ‘TP Minutes Doubled’ promotion: an additional pool of minutes for LC/DLD, provided that a loyalty agreement was signed;
- In April 2010, ‘TP Plan from PLN 1’ promotion: subscription fee reduced to PLN 1 (incl. VAT) for up to six months, provided that a loyalty agreement was signed;
- Also in April 2010, ‘TP Plan with Growing Discount’ promotion: growing discount on subscription fee throughout the term of the agreement, provided that a loyalty agreement was signed;
- Also in April 2010, the ‘TP Service Trial-up’ offer was introduced, enabling customers to try selected value-added services for no extra fee;
- In June 2010, the ‘TP Plan at a Discount’ promotion was extended. It offered up to 50% discount on subscription fee, provided that a loyalty agreement was signed;
- In August 2010, ‘Shopping with TP Plan’ promotion: a Sodexo shopping voucher as a gift to customers, provided that a loyalty agreement was signed;
- In September 2010, ‘TP Minutes for ILD and F2M’ promotion: an additional pool of minutes for ILD/F2M, provided that a loyalty agreement was signed;
- In October 2010, ‘TP Plan from PLN 0’ promotion: subscription fee reduced to PLN 0 for up to six months, provided that a loyalty agreement was signed;
- Also in October 2010, ‘TP Plan with a Phone Discount’ promotion: a wireless telephone set for a price starting from PLN 1, provided that a loyalty agreement was signed;
- In November 2010, ‘Chosen Numbers with TP Plan’ promotion: a discount on a monthly fee for the ‘TP Chosen Numbers’ service, provided that a loyalty agreement was signed;
- In September, the ‘Free CLIP for 3 Months’ promotion was extended;
- The TP Mix service was extended to include additional tariff plans.

Connection Offers

In 2010, TP offered the following network connection promotions for its customers:

- The ‘Connection from PLN 1’ offer continued until the end of January;
- On 1 February 2010, the ‘Connection for a Fair Price’ offer was introduced. The promotion offers a discount on a one-off fee for connecting the first terminal to TP’s network via analog (POTS) lines. The offer includes two loyalty agreement options:
    - POTS connection fee of PLN 10 (incl. VAT) in case of a 12-month agreement; or
    - POTS connection fee of PLN 1 (incl. VAT) in case of a 24-month agreement.

DATA SEGMENT

Business Customers

Data Transmission for Business

2010 saw further growth in sales of data transmission services. Customers are increasingly interested in them, as they find out that investments in such services pay back. Data transmission services enable customers to reduce operating costs and streamline business processes. VPN services, especially IP VPN, have been particularly popular. Customers also tend to invest more in value-added services, thus enabling TP to even better adjust its offer to their needs. In 2010, the existing services were enhanced and some new services were added to the data portfolio.

IP VPN Service for the Most Demanding Customers

In 2010, customers eagerly invested in the IP VPN service, as it not only enables them to streamline company's operations but also reduce costs. A number of value-added services is offered in addition to the basis service. It is the best proposal for multi-site companies. The service is recommended not only for large corporations but also small to medium enterprises. IP VPN is based on the MPLS protocol. The service has been offered for several years and has already won a good reputation and recognition among customers, which has enabled TP to gain advantage over the competition. Customers choose TP offer because owing to a number of possible configurations it can be perfectly tailored to their needs.

IP VPN is a cutting-edge solution that involves high security and impressive speeds of data transmission, including multimedia transmission. The service offers high flexibility and enables companies to connect a number of branches in Poland and abroad into a corporate WAN intranet. In addition, employees may be provided with fast and safe access to the internet. IP VPN is an example of a service fully managed by the operator. TP's network engineers and specialists provide comprehensive management of the corporate network, so that virtually no additional expenses are required from the customer. As a result, customers can focus on their core business instead of dealing with equipment, set-up, repairs or fault removal.

The Business IP Telephony service generated considerable interest among customers in 2010. It is based on the IP VPN solution (namely the Multimedia or Multimedia Plus options). It is also complementary to IP VPN, as together both services provide a single network for voice and data transfer. The IP PABX service is also worth mentioning, as it is a modern solution offering the functionality of a central communication management system, which is set-up, managed and maintained by TP.

City Ethernet

In July 2010, the City Ethernet and the SLA Quality Certificate for the City Ethernet services were formally added to TP's portfolio. City Ethernet offers safe data transmission and fixed access to the internet provided in the Ethernet technology at a rate of 2 Mb/s to 1 Gb/s.

The City Ethernet service is addressed to medium to large companies which need fast and reliable data transmission or safe access to the internet. The service is dedicated to companies which use integrated business applications, multimedia means of communications or data centres. Owing to high transmission parameters offered by the Ethernet technology, customers can carry out video- and teleconferences and use multimedia transmission and videophone services. The built-in mechanisms of the City Ethernet service facilitate management of IT units, which communicate with one another as if within single LAN. It enables customers to simplify the structure of their IT networks and reduce operating costs.

New SLA Services for Business

Currently, TP offers SLA (Service Level Agreement) Quality Certificate for data transmission services (Frame Relay/ATM data transmission, POLPAK-T network services, Frame Relay internet access), IP VPN, Ethernet VPN, digital leased lines and City Ethernet. Customers receive credit if SLA parameters are not met by TP; it is calculated automatically by the operator. Credit is deducted from a net monthly fee for the service to which the quality certificate applies.

SLA services are particularly important in business, where high quality parameters of data transmission services are required. SLA guarantees high quality of data transmission and fast removal of any faults, which assures the continuity and reliability of the underlying service. In addition to a standard customer service option, the SLA Quality Certificate is also offered at the Progress and Premium levels. TP has also extended the scope of its SLA – Service Package service, an additional sophisticated service offered to SLA customers.

Since September 2010, SLA Quality Certificate has been available also for City Ethernet and IP PABX customers. The service offers constant cooperation and support by a dedicated Technical Account Manager, monthly service functioning reports and constant access to on-line reports.

Internet Access Portfolio

Business Internet is a professional internet access solution for business. Our customers have valued TP's service portfolio for a wide variety of available services, options and technologies (ADSL, SHDSL, ATM, Frame Relay), which enables them to customise services according to their needs.

The DSL Internet Access service was still very popular in 2010. It enjoyed rapid growth, fuelled by a further increase in the customer base. There has been growing interest in DSL Internet Access among SME and SOHO customers, who recognise the benefits of a business dedicated service, particularly a chance to use a high quality solution for a fair price. The service offers high quality of transmission and line stability even under heavy network load.

Business customers also recognise the benefits of having a fixed (static) IP address and space for their own corporate website. They value professional hosting available as part of the service as well as high level of safety assured by the safety package (particularly a central firewall installed on TP's platform and monitored in real time by TP's IT personnel).

In 2010, in line with market expectations, TP introduced another dedicated internet access offer for business, Advanced Business SDSL Internet.

DSL Internet Access

A new promotional offer, 'DSL Sprinter', was introduced on 18 December 2009 and subsequently, owing to high popularity, extended to 31 March 2011. The promotion is also offered in a version for *Neostrada* customers ('DSL Sprinter for NEO') and the existing DSL customers ('DSL Sprinter for Loyal Customers'). All customers who have signed a 12- or 24-month loyalty agreement may sign up for the service on attractive conditions, including reduced installation and subscription fees.

On 1 November 2010, the pool of IP addresses in the Internet DSL service was extended. High-end option subscribers are now offered four or eight IP addresses, depending on their needs, while low-end option subscribers can buy four IP addresses for an additional fee. The advertising campaign for the service was launched in October and lasted till 12 November 2010. This involved advertising banners and sponsored articles on popular web portals as well as an emailing campaign.

Advanced Business SDSL Internet

On 1 August 2010, TP launched the Advanced Business SDSL Internet service on a commercial basis. The service offers a fixed symmetric internet link with no time or transfer limits. It is addressed to large corporations which seek more advanced yet uncomplicated internet access solutions, e.g. for the purpose of e-banking, on-line stores, web servers, etc. The new offer generated very high interest. Owing to high quality of transmission, the symmetric access may be used also for the purpose of video monitoring or tele- and video-conferences. There are three service options, namely SDSL 1000, SDSL 2000 and SDSL 4000.

Development of the ICT Service Portfolio

The Information and Communication Technology (ICT) comprises a number of solutions for business customers, including telecommunication and IT products and services, as well as consulting, outsourcing and other auxiliary services that support such solutions. TP has actively followed this market trend, offering a growing number of such services. As a result of combining different products and services, the Company offers integrated solutions that can meet the increasingly complex and varied customer needs. In 2010, a number of such solutions was introduced, considerably extending TP's portfolio.

Computers for Business

The service offers laptops on attractive conditions. Upon special request of TP, the computers feature unique set-up. They can be order via the www.tp.pl website. Customers can choose from among a broad range of Dell, Fujitsu, Hewlett Packard or other laptops. The offer is to be constantly extended in line with customer expectations and the market needs.

LAN Management

The LAN Management service was launched in February 2010. The service offers outsourcing of corporate LAN/WAN management to the operator. Customers can also entrust TP with the whole LAN development. Network equipment (routers and switches) offered to customers as part of the service is set-up according to their requirements and then delivered and installed on site. As a result, all pieces of equipment, such as desktop or laptop computers, servers, mass storage devices, printers, IP phones, etc., are connected into single corporate LAN. The service is offered in two options: Advanced LAN Management and Basic LAN Management.

Cisco Iron Port Email Security

TP has been actively supporting the secure data transfer policy in business. In May 2010, a new service, Cisco Iron Port Email Security, was introduced to provide additional security to corporate email systems. In the new service, customers are offered a Cisco device which assures very high protection of their corporate email against hackers and spam.

This is a much more sophisticated means of protection than standard antivirus software packages usually used by companies for this purpose. Customers do not need to update software any more, as this is done automatically by the device.

Cabling: New Solution in the ICT Service Portfolio

In September 2010, TP introduced a cabling offer, which involves the development or expansion of a cable network in a customer’s location. The service includes installation of cubicles, cables and logical (network) and electrical sockets of various manufacturers. In addition, if a network is terminated with logical and electrical sockets, fuses and protective devices are installed. The service involves design and is prepared on a case-by-case basis according to individual needs.

Content Servers

January 2010 saw the introduction of a new service for large companies, Content Servers. The offer is addressed mainly to web content providers, such as portals or web media. The service enables faster access to key news reports and information for the audience of internet portals and on-line news services. With such services TP fits perfectly well in the program of development of an information society.

Open Communication System (OCS)

TP encourages customers to use cutting-edge communication solutions, the Open Communication System (OCS) being one of them. This is an integrated communication tool which facilitates information flow management within a company. Whether using a computer, web browser or smartphone, this tool offers unified access to a number of functionalities, such as information on the availability of other users, contact list management, instant messaging, VoIP calls, audio/video conference calls, team work on documents placed on the network, etc. Modern business tools, such as OCS, enhance work load management and contribute to savings in business.

Development of Integrated Offers

Business Package: Service Bundle for SME

Business Package offers fast internet access at up to 4 Mb/s, an attractive tariff plan for voice calls, a separated virtual private network (VPN) as well as a number of additional services useful in company’s everyday operations. Small to medium companies are particularly interested in simple and integrated solutions. Business Package is such a solution. Responding to market demand, TP introduced two new packages at the beginning of 2010. On 1 June 2010, the ‘Package for Everyone’ promotion was introduced. It lasted until the end of the year and offered a reduced monthly fee for selected business packages throughout the term of the 24-month loyalty agreement.

Other Services

Domestic Leased Lines

New Rules of Service Provision, consistent with the requirements of the new Telecommunication Law, and a change to the price list were introduced on 1 March 2010. The change involved discontinuation of sales of radio lines, while the prices of leased line services remained the same.

INTERNET SOLUTIONS

Residential Customers

Broadband Internet Access

In terms of the broadband portfolio, the most important development in 2010 was the Neostrada price reduction by up to 25%, which was introduced in October. This was possible owing to a change in the broadband wholesale pricing from the "retail minus" to the "cost plus" model.

The ground-breaking offer of *Neostrada* launched on 1 October 2010 includes:

- 'Internet of Your Dreams': *Neostrada* leading promotion; 12-month or 24-month agreements for 2 to 20 Mb/s options. Customers who have signed a 24-month agreement are offered free service for the first two months. The mean prices throughout the term of the agreement are: PLN 49.50 for 2 Mb/s, PLN 54.08 for 6 Mb/s, PLN 58.67 for 10 Mb/s and PLN 63.25 for 20 Mb/s; and
- 'Light Internet': *Neostrada* promotion for 512 kb/s and 1 Mb/s options. Customers who have signed a 24-month agreement are offered free service for the first two months. The mean prices throughout the term of the agreement are: PLN 40.34 for 512 kb/s and the same for 1 Mb/s.

Owing to great interest, TP extended its Try&Buy promotional campaign, which is now bundled with the 'Internet of Your Dreams' promotional offer.

- 'Internet of Your Dreams / *Neostrada* Trial' (extended on 1 October 2010)

  In this offer, customers can buy *Neostrada* for a promotional price, then cancel the service within the first thirty days without any cancellation fee. This promotion aims at mitigating the key barrier to broadband growth, which is lack of interest due to poor knowledge of new technologies.

Another interesting promotion has been addressed to students:

- 'Study with Neostrada' promotion (launched on 11 October 2010)

  It offers cancelling the service within nine months without any cancellation fee, a reduced fee of PLN 1 for a WiFi modem and an option to use the line without a telephone set (a fee for the line is included in the subscription fee). It has generated a great interest.

Another promotion of *Neostrada* involved a reduced price of the internet access and *neofon* [softphone] bundle:

- 'Neo-calls All the Time' promotion (extended on 1 October 2010)

  In this offer, the reduced price of the *Neostrada* and *neofon* bundle was just PLN 20 higher than that of *Neostrada* alone (for 24-month loyalty agreements).

This was the second major price cut in 2010.

The key broadband promotions available in the first half of 2010 included:

- 'Your Internet' promotion (launched on 7 April 2010)

  It was a bundle promotion combining the internet access service with an anti-virus software licence, which enabled TP to promote the Safe Media standard. The 'Your Internet' promotion was not limited to reduced prices. Customers signing up for Neostrada on-line received a gift (e.g. digital camera, GPS navigation or mp4 player), which depended on the option chosen and the term of agreement.
- 'Internet Premium' promotion (launched on 7 April 2010)

  Promotion of the high-end options of *Neostrada* (6 Mb/s or higher). Fees for high speed options of *Neostrada* were reduced by up to 43%. Subscription fee was even as low as PLN 1 for up to nine months (in case of 36-month loyalty agreements). Similarly to the 'Your Internet' promotion, it offered a security package as an option.

The aforementioned bundled promotions were warmly welcomed by the market.

VoIP Services

In 2010, TP continued to develop its portfolio of VoIP services offered under the commercial brands: *telefonia internetowa tp* [TP Internet Telephony], *neofon tp* [TP softphone] and *pre-paid neofon tp*. *Telefonia internetowa tp* enables customers to use VoIP services like a traditional fixed line phone. In order to use VoIP, a customer who has signed up for TP's VoIP service needs to connect a standard analog terminal to a Livebox modem with access to TP's *Neostrada* broadband service. TP softphone services enable subscribers to make voice calls at any place in the world using a VoIP application installed on a PC with any internet connection. Another step in the service development was made in November 2010, as geographical numbers were made available for VoIP subscribers.

Multimedia Services

In terms of the multimedia portfolio, one the most important developments in 2010 was the introduction of an acquisition offer for a Neostrada and television bundle (2P) and a Neostrada, television and VoIP bundle (3P) in October. As a result, retail prices were cut by up to 20%. The reduction resulted from a change in the broadband wholesale pricing from the "retail minus" to the "cost plus" model.

Another leading offer, 'More Benefits', was launched on 20 September 2010 and concerned TV packages. It offered a null subscription fee for up to six months and an almost 60% price reduction compared to TP's standard offer of TV packages.

The ground-breaking offers bundling up Neostrada and television (2P) or Neostrada, television and VoIP (3P) introduced in 2010:

- A new premium package, consisting of *Orange Sport* and three HBO channels, was introduced in January. The promotion concerned TV packages, which were offered free for up to six months, provided that a 12- or 24-month loyalty agreement was signed;
- 'Unlimited Opportunities', *Neostrada* and television promotion, was launched on 12 March 2010. It covered the new high-speed options of Neostrada: 6 Mb/s, 10 Mb/s and 20 Mb/s;
- In April, the basic package was extended, as *Nickelodeon* (kids channel) and *Movies 24* (movie channel) were added to it;
- In May, a high definition (HD) satellite TV package was introduced. It consists of five channels: *Fox Life HD*, *Eurosport HD*, *Eurosport 2 HD*, *MTVN HD* and *Nat Geo Wilde HD*. In addition, the sixth channel, *HBO HD*, was provided to HBO subscribers;
- In June, two new channels, *TVP HD* and *Disney Channel*, were added to the satellite TV package;
- In July, the issue of separating a fee for internet access was solved;
- In August, *Baby TV* channel was added to the offer and e-invoice promotion was introduced for 2P and 3P customers;
- In September, the TV-on-demand service was implemented. It enables viewers to watch selected TV programmes within one week after their initial broadcast;
- In October, the content offer was extended, as a number of channels, including *Eska TV*, *CSB TV*, *Playhouse Disney*, *CNBC Biznes*, *TV1000* and *BBC HD*, were added.

Business Customers

Internet For Business/Internet For Business Pro (Orange)

The fixed-line broadband service, Internet For Business, is based on the BSA model and addressed mainly to the SOHO segment. In 2010, promotional efforts were mainly related to bundled sales with other Orange services: Fixed Orange For Business (PTK Centertel's WLR-based service), Orange mobile offers or Business Everywhere mobile data transmission service. Also the CDMA-based Internet For Business Pro option significantly contributed to the customer base expansion. The option provides for internet access speeds of up to 1 Mb/s in 'white zones', that is areas where no broadband services were available prior to the introduction of that service. In addition, customers were enabled to sign up for the service via an e-shop on Orange.pl website.

Both Internet For Business and Internet For Business Pro offer a pool of minutes for calls to Orange or fixed-line numbers from an Orange mobile phone. This aims at increasing the loyalty of Orange mobile customers and promoting cross-sales of mobile services to Orange fixed broadband customers who have not signed a mobile service agreement. In 2010, a retention offer for both services was introduced. It involves an increased pool of minutes for calls from an Orange mobile phone.

Orange Fixed For Business (Fixed Line Voice)

The Orange Fixed For Business service enables voice calls via a fixed analog line (POTS) and is based on TP's wholesale line rental (WLR) offer. In April 2010, a new service, ISDN BRA digital line, was added to Orange fixed-line voice portfolio. Both services offer a predefined pool for FTF calls and FTM calls to Orange, which is embedded in the subscription fee. In November 2010, a retention offer, enabling migration between tariff plans, was introduced.

Business Everywhere (Orange)

In 2010, PTK Centertel further developed its mobile internet offer, Business Everywhere. Owing to modifications and new options, sales remained stable in 2010, despite growing competitive pressure.

A SIM-only offer for data transmission services was introduced in April for customers who do not need a terminal. Such customers were offered a reduced subscription fee, even as low as PLN 1, for up to eight months (for a 36-month loyalty agreement).

The Business Everywhere portfolio was extended to include modern equipment, including netbooks (in June) and tablets (in November). As a result, customers signing up for Orange mobile internet service can choose such equipment from the dedicated offer on preferential terms (for as low as PLN 1). The offer proved a great success. Not only the service take-up increased, but also the mean ARPU across the entire Business Everywhere customer base was retained.

Another initiative aimed at making the Business Everywhere portfolio even more attractive and adapting it to the rapidly growing market for mobile internet services was the introduction of new offers, enabling flexible management of the data transfer limit, in September 2010. These include unlimited transfer options, night-time or daytime, which can be adjusted to business hours; extra transfer pools (0.5, 1 or 2 GB per day); unlimited email transfer; and an option to lift the transfer blockade for a fee.

In addition, the service software was systematically modified throughout the year. New versions with drivers for new modems from the portfolio, for both Windows and MAC operating systems, were developed.

Telemetry (Orange)

2010 saw further intensive expansion of the TP Group’s M2M customer base. Growth in sales was accompanied by an increase in ARPU across the whole SIM card base. Orange’s commitment to the M2M market resulted in the development of a dedicated sales channel for telemetry services. As a result, TP Group’s partners developing innovative M2M services have gained Orange’s support in their business growth. Customers using telemetry services can now better manage their SIM cards owing to new functionalities of the Fleet Manager application. This reflects even better adaptation of technical characteristics of Orange services to customer needs.

Orange Navigation

Various marketing efforts in this product included pre-installation of the navigation application in a majority of handsets with a GPS receiver offered by Orange; launch of a new version of the application featuring enhanced functionality and ergonomics; service communication in professional journals; and positioning of a website with information about the service on the internet. Moreover, the service was promoted on TV together with the HTC Desire handset. In addition, some loyalty offers for the service, which should contain churn and increase the customer base, are being prepared.

Email Solutions (Orange)

The portfolio of communication solutions for business customers was significantly modified in 2010. The changes applied to both new and existing customers. In the second half of the year, a data packet in the Email Package for Business was increased from 50 MB to 100 MB. The data packet increase did not change the service price and was introduced in response to the existing upward trend in data volumes sent within the service. A data packet in the Nokia Mail service was also increased from 50 MB to 100 MB; and also in this case, this involved no change in price. Other modifications concerned the MSE Mail service, for which a data packet was changed from 100 MB to 250 MB; this was accompanied by a change in price from PLN 59 (net of VAT) to PLN 16 (net of VAT).

Additional Voice Solutions (Orange)

2010 brought the implementation of the Extra Business Zone service, which enables customers to use an additional fixed-line number on their SIM card. This number is active within a radius of few hundred metres around the point set by the user. The new service is a response to solutions offered by the competition. Currently, it is offered to customers reactively in order to prevent ARPU reduction as a result of customer migration from other TP Group’s services.

In August 2010, a revolutionary solution in the area of enterprise-wide telecommunication management, Orange Virtual Exchange, was launched commercially. In addition to traditional features of a corporate PABX, it offers a number of new functionalities, including extensive IVR, Text-To-Speech message recording, integration with an external server through Web Services, fax reception and consultant group management (the consultant selection algorithm is chosen by the administrator). The Orange Virtual Exchange may be used by subscribers to any network and its main number may be either mobile (allocated by Orange or moved from another network) or fixed.

GLOSSARY OF TELECOM TERMS

Access Fee – revenues from monthly fee from New Tariff Plans (incl. Free minutes)

ARPL – Average Revenues per Line

ARPU – Average Revenues per User

AUPU – Average Usage per User

BSA – Bitstream Access Offer

CDMA (Code Division Multiple Access) – second generation wireless mobile network used also as a wireless local loop for locations where cable Access Is not economically justified

CPS/CS - Carriers Pre-Selection/Carriers Selection

DLD – Domestic Long Distance Calls

DSLAM - Digital Subscriber Line Access Multiplexer

F2M – Fixed to Mobile Calls

FVNO – Fixed Virtual Network Operator

ILD – International Calls

IP TV – TV over Internet Protocol

LC – Local Calls

LLU – Local Loop Unbundling

MAN – Metropolitan Area Network

MPLS – MultiProtocol Label Switching

MTR – Mobile Termination Rates

MVNO – Mobile Virtual Network Operator

Net FCF – Net Free Cash Flow = Net cash provided by Operating Activities – (CAPEX + CAPEX payables)

POTS – Plain Old Telephone Service

RIO – Reference Interconnection Offer

SAC – Subscriber Acquisition Costs

SDI – Permanent (Rapid) Access to Internet

SMP – Significant Market Power

USO – Universal Service Obligation

VoIP – Voice over Internet Protocol

WLL – Wireless Local Loop

WLR – Wholesale Line Rental