

# Risk and opportunity management.

Risk early warning system expanded and improved // PTC arbitration proceedings and court cases settled

## Risk management system.

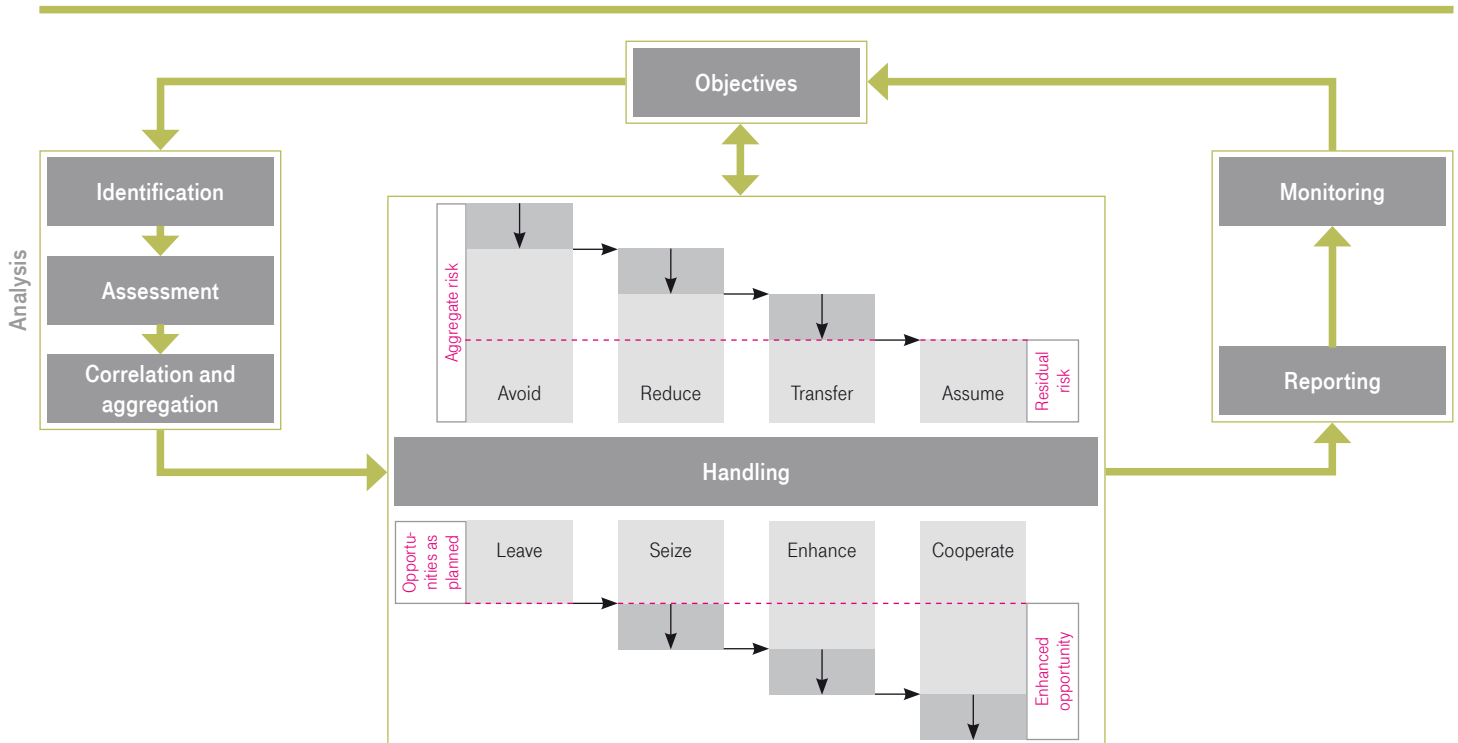
Our environment is characterized by rapid technological progress, increasingly intense competition, and far-reaching regulatory decisions in mobile and fixed-network communications. We master these challenges by systematically managing risks and opportunities using a holistic risk early warning system.

Our Group-wide risk management system covers all strategic and organizational control and monitoring measures for managing risks, focusing on

early identification and assessment of risks and opportunities. Only in this way are we able to introduce measures for preventing and responding to risks at an early stage.

We regularly analyze risks and opportunities, both in our operating segments and in our central Group units. The early warning systems used for identifying risks at an early stage are based on prescribed Group-wide methods and are tailored to specific requirements. Risks are identified in the form of scenarios, for example, and assessed on the basis of their size and probability of occurrence. The reference variables for the potential scope are our target values (e.g., EBITDA).

### The risk management system (RMS).





Our risk management system aggregates essential EBITDA-assessed individual risks, using combination and simulation processes and taking probabilities of occurrence and correlations into account. In addition, it analyzes issues that could adversely affect our reputation and image. These components are factored into the assessment of the aggregate risk position.

Our risk management unit regularly reports to the Board of Management on risks and their development. The Board of Management in turn informs the Supervisory Board. The Audit Committee of the Supervisory Board examines the quarterly risk report at its meetings. Principal opportunities and risks are reported quarterly, with additional ad hoc reports generated in the event of unexpected risks. Materiality thresholds for risks are defined for each reporting level. In addition, a so-called risk cockpit is regularly prepared at Group level for the Board of Management. It aggregates and analyzes KPIs relevant to the telecommunications industry collected from sources within and outside of the Group. This instrument is being developed further on an ongoing basis and, as a supplementary early warning system, it lets us focus on selected risk areas that are critical for the Group.

The Group Risk Management/Insurance unit is in charge of the methods and systems used for this form of independent reporting that has been standardized across the Group. It also ensures that the risk early warning system works efficiently.

We attach particular importance to managing risks arising from individual financial positions. All financial transactions, in particular the use of derivatives, are subject to the principle of risk minimization. To this end, we record all financial transactions and risk items in a central system. The Group management is informed about these positions on a regular basis. We use derivatives to hedge interest rate and currency exposures that could have an effect on cash flow as well as other price risks.

Depending on the type and volume of the financial transaction, prior approval is required from the Board of Management, which is also regularly briefed on the scope and amount of the current risk exposure. We use simulations to assess the impact of various market developments, which involves devising a series of market and worst-case scenarios. We use selected derivative and non-derivative hedging instruments to hedge market risks. However, we only hedge risks that affect cash flows. We use derivatives exclusively as hedging instruments; not for trading or other speculative purposes.

Where accounting risks are concerned, our risk management system links in with our internal control system to ensure that all accounting-related risks are recorded in the risk management system. The internal control system as well as clear regulations and guidelines within the Group ensure the compliance of the consolidated financial statements. Risks that could present an obstacle to compliance with regulations are to be identified at an early stage, assessed, and promptly communicated and minimized. This is exactly what risk management ensures.

Internal Audit regularly verifies whether our risk management processes are working effectively. The external auditors mandated by law to audit the Company's annual financial statements examine whether the risk management system is able to identify at an early stage risks and developments that could jeopardize the Company's future. The system's effectiveness is ensured.

In addition, our risk management system helps us recognize business opportunities and risks early on. It complies with the statutory requirements for risk early warning systems and conforms to German corporate governance principles.

## The risks.

Of all the risks identified for the Group, the following section examines those risk areas or individual risks that could, as it stands today, materially affect Deutsche Telekom's financial position and results and, by way of the profits and losses of the Company's subsidiaries, also Deutsche Telekom AG's financial position and results of operations.

### Economic environment.

The global economy recovered further in 2010. However, after a marked upswing in the first half, the growth lost a little of its momentum in the last six months of 2010. Risks to the economic development result from the still volatile financial and foreign currency markets, pressure on private consumption owing to high unemployment in some countries, and the dangers arising from high levels of national debt in many countries. Operations in some countries of our Europe operating segment also face potential risks as a result of the challenging macroeconomic situation, ongoing intense competition, and the taxes on mobile revenues that were recently imposed or raised in some of these countries. Economic developments in Greece, Romania and Croatia entail particular uncertainties. Risks may also result from the strong fluctuation in exchange rates, in particular between the U.S. dollar and the Southern and Eastern European currencies.

### Industry and competition.

Prices for voice and data services decreased again in 2010 in the fixed network and in mobile communications, due to continually strong competition and technological progress. There is a general risk that price reductions cannot be compensated by corresponding volume growth.

Competition-induced pressure, particularly in the fixed network, could increase even further, for example, if (regional) telecommunications carriers significantly expand their market coverage and the trend toward bundled products continues. Competition is also intensifying due to technological innovations and the increasing substitution of fixed-network by mobile communications. Moreover, previously pure-play mobile communications providers in Germany are increasingly offering fixed-network and DSL products. Rival DSL providers sell bundled products integrating broadband and VoIP that do not require a separate telephone line.

Cable operators also intensify competition, since they can provide private homes and smaller companies throughout Germany with telecommunications products that require them to neither build out their own network nor lease unbundled local loop lines from Deutsche Telekom. These companies are expanding their range of services to include triple-play products and products with high transmission rates, for example. In certain regions competitors are extending their own fiber-optic network to the home so that they are independent of our network there, too. Another significant competitive trend is that we have to compete with players from outside the telecommunications sector as such, including major consumer electronics and Internet companies. We are therefore exposed to the risk of a further loss of market share, beyond the loss already suffered, and falling margins.

The anticipated renewed decline in prices in mobile voice telephony and mobile data could have a negative effect on our mobile revenue. Among the reasons for the decrease in prices are discount operators that are expanding in Germany and elsewhere in Europe.

In the United States we are challenged by the fact that we are the smallest of the four national wireless carriers. T-Mobile USA has to continue driving its product and service quality and pricing.

The ICT market in our Systems Solutions operating segment is also experiencing intense competition, falling prices, restraint in the awarding of projects, and long sales cycles. This creates a potential risk of revenue losses and declining margins for T-Systems. On the one hand, the situation has fundamentally improved due to the economic upturn, especially in Germany. On the other, the market for big deals has become even more challenging, which could adversely affect T-Systems' ICT business.

### Products, services, and innovations.

As a result of rapid technological progress and ongoing technological convergence, technologies and products may to some extent substitute one another. This could lead to lower prices and revenues in both voice and data traffic. But new and refined smartphones and data services will be new sources of mobile Internet revenue.

Where broadband demand is concerned, the German market is expected to approach saturation level at some point. Market growth already began to slow down in 2010, which may negatively affect the continued successful sale of IPTV products such as Entertain. We are improving the market opportunities for mobile Internet by continuously expanding our high-performance mobile network. Should, however, mobile data applications not develop as expected, revenue targets may be missed. Furthermore, investments in network construction and build-out and in existing and future mobile communications licenses may take longer to pay off than expected.

### Regulation.

Deutsche Telekom is subject to sector-specific market regulation in cases where national regulatory bodies consider it to have "significant market power" in the relevant telecommunications market. Hence we still face ex-post control of anti-competitive practices in the German market for fixed-network telephone lines and related packages. Furthermore, we have to offer our competitors cost-based upstream services such as access to the local loop, bitstream access, and fixed-network and mobile termination in wholesale markets. Our other European subsidiaries are also subject to corresponding regulatory regimes in the fixed-network and mobile areas.



The regulator has extensive powers to intervene in product design and pricing, with significant effects on our operations. We can only to a limited extent anticipate such interventions, which may intensify existing price and competitive pressure. There are concerns that regulatory interventions in Germany and other European countries may impact the revenue trend in the core fixed-network market and in the mobile communications market in the medium and long term.

Investments in next-generation access (NGA) require a modified and investment-friendly regulatory framework that provides, for example, for a fair distribution of risk among investors and access seekers while allowing for the necessary price flexibility. Otherwise, there is risk that these investments will not be as cost effective as planned.

The German Telecommunications Act, which forms the main legal framework for regulation, must be amended by the end of May 2011, primarily to reflect the revised EU Directives that apply in the industry. The Directives were amended to encourage operators to invest in new high-speed networks. It is also expected that the Act will be amended to reflect new consumer protection requirements.

We re-applied for rates for the unbundled local loop (ULL) line on January 20, 2011. We expect a decision in March 2011. We applied for a rate of EUR 12.90 for access to the most important line, the ULL. The level of the ULL rate is a decisive factor in the profitability of a nationwide infrastructure. It also generates incentives for a further expansion of broadband, particularly the roll-out of new fiber-optic networks.

The rulings on the ULL monthly charges from 1999 and on the ULL one-time charges from 2001 and 2002 were revoked with final and binding effect. The Federal Network Agency must now decide again on these charges. The court has not formally stipulated preliminary rates with which the Federal Network Agency has to agree, so it is generally not clear whether and to what extent rates will be changed. The Federal Network Agency re-approved the one-time ULL rates for the period April 2002 through June 2003 in its decision dated January 20, 2011. The rates were cut compared with the decision in 2002 – by 3 to 8 percent for the most important provisioning and take-over options and by 11 to 15 percent for termination options. The rates decision applied only for plaintiffs who prevailed in the court case. This is because, under the Telecommunications Act in its 2002 form, the rates only applied to individual agreements.

**Net neutrality.** To this day, there is still no generally accepted and at the same time technically appropriate definition of this term and it is increasingly becoming a subject of public debate. There are even demands from some quarters that all data packets should be treated in exactly the same way, both in technical and in commercial terms. Content and application providers in particular expect network operators to continue expanding their transport capacities and their infrastructure in the years to come.

The translation of the new provisions of the European Directives into national law gives national regulatory authorities the power to impose minimum quality of service requirements. We are currently not aware of any regulatory intervention in Germany that goes beyond the implementation of the Directives. The Federal Ministry of Economics believes that functioning competition and the planned obligations to maintain transparency are sufficient to meet the Directives' requirements.

#### Personnel.

In 2010, we once again used socially responsible measures to restructure the workforce in the German part of the Group, essentially by means of voluntary redundancies, partial and early retirement, and employment opportunities for civil servants and employees offered by Vivento, especially in the public sector. We will continue our workforce restructuring program on the required scale in the future. If it is not possible to implement the corresponding measures as planned or at all, this may have negative effects on our financial targets and profitability.

When Group units that employ civil servants are disposed of, it is generally possible to continue to employ them at the Group unit to be sold, provided the civil servant agrees or submits an application to be employed at the respective unit in future. However, there is a risk that they may return from the unit sold to Deutsche Telekom, for example, after the end of their temporary leave from civil servant status. There are currently some 3,000 civil servants who are entitled to return to Deutsche Telekom in this way. This risk can be reduced by compensation payments, for example, but not completely ruled out.

**Year-end bonus for civil servants.** In November 2004, the Federal Republic of Germany passed the first Act to amend the Act on the Legal Provisions for the Former Deutsche Bundespost Staff (Postpersonalrechtsgesetz – PostPersRG), which abolished the obligation on Deutsche Telekom and other successor companies to Deutsche Bundespost to pay active civil servants an annual year-end bonus under the German Federal Act on Bonus Payments (Bundessonderzahlungsgesetz). This Act was reviewed at several court instances. In December 2008, the Federal Administrative Court decided to refer the case to the Federal Constitutional Court for a judicial review pursuant to Art. 100 of the Basic Law. A Federal Constitutional Court decision is expected in early 2011. If the court rules that the abolition of the bonus payment was unconstitutional, a supplementary payment for the period 2004 to June 2009 may have to be made.

**Reduced pay tables.** With the entry into force of the reform of civil service law on February 11, 2009, the legislator integrated the previous year-end bonus paid annually in accordance with the German Federal Act on Bonus Payments into the basic monthly salary for all federal civil servants. In accordance with § 78 of the Federal Civil Service Remuneration Act (Bundesbesoldungsgesetz), this does not apply for civil servants employed by the Deutsche Bundespost successor companies. Some civil servants also appealed the new, reduced pay tables. The Stuttgart Administrative Court has submitted two cases to the Federal Constitutional Court for it to evaluate whether this was constitutional. Depending on the outcome, supplementary payments may have to be made for the period beginning July 2009.

#### IT/NT infrastructure.

Information technology (IT) and network technology (NT) infrastructure comprises all buildings (network nodes), communication services (network), and hardware and software used for information processing. Our IT/NT resources and structures represent the Group's organizational and technical backbone. IT/NT is both the core foundation of the gigabit society, and the basis for innovative new telecommunications products and services.

We want to minimize the risks resulting from the operation and architecture of the IT/NT infrastructure. Hence we consider costs/benefits, quality, and security, and exploit their full potential.

We again launched comprehensive programs in 2010 to adapt our IT systems and IT infrastructure to changing customer needs and new organizational structures resulting from the One Company project. These Group-wide programs are being further pursued in 2011. Inadequate planning and management of these programs could lead to disruptions in business processes, resulting in revenue losses or increased costs.

Six Group-wide Next Generation IT (NG IT) programs form the framework for all IT-related components in the Group's transformation programs. NG IT helps us realize our IT strategy and implement the Group's target IT architecture with a focus on harmonizing, standardizing and consolidating our applications and infrastructure. Group-wide projects prepare solutions, for instance for forward-looking, comprehensive customer relationship management, convergent-products billing, and future IT support for the finance, human resources, and procurement functions. All of these IT programs are designed to simplify our IT architecture and improve, among other things, network stability and reduce the risk of downtimes as the network becomes more efficient.


We are replacing all the different heterogeneous architectures, access types and services with a standardized architecture – with shared aggregation, transport and access levels. Risks in this area may affect all IT/NT systems and products that require Internet access. Since the IT/NT landscape is highly complex, any problems, for instance between new and existing IT/NT systems, could disrupt our business processes and products in mobile telephony and otherwise.

We counteract risks from hacker attacks, spam mail/calls, viruses/trojan software and network downtimes with a wide range of measures including firewalls, virus scanners, technical early warning systems (e.g., development of data volumes) and redundant systems and data centers. We also have organizational and technical emergency procedures in place to minimize damage. Furthermore, we have Group-wide insurance cover for insurable risks.

#### Data privacy and data security.

The security and privacy of customer data are our top priority. After all, they are a vital precondition of a trusting relationship between the Company and its customers. Just how important these issues are for us is demonstrated by the fact that we created a separate Board of Management department for Data Privacy, Legal Affairs and Compliance in 2008, and put together a comprehensive action package for improving data privacy, increasing data security, and enhancing transparency. This department standardizes and implements the necessary data privacy, security, and compliance measures throughout the Group. We also set up an external Data Privacy Advisory Council comprising leading data privacy experts and representatives from politics, academia, industry and independent organizations. The Council met a total of five times in 2010; further meetings have been scheduled for 2011.




 For information on the current status of data privacy at Deutsche Telekom, please refer to [www.telekom.com/datenschutz](http://www.telekom.com/datenschutz) (site available in German only).

To guarantee the highest standards in operational data privacy, we have launched comprehensive action plans and pressed on with existing measures. To enhance data privacy even further, we introduced a “list review tool” in 2010. It ensures that personal data can only be used for as long as is absolutely necessary – and only by a defined group of people. We also introduced personalized one-time passwords for a sales partner portal, which significantly improves the authentication of sales partners, makes it much more difficult for unauthorized third parties to access the system, and reduces the risk of misuse. We have planned further measures for 2011 to improve access protection for sensitive data, including a pilot project for a mobile transaction authentication number (mTAN), which protects access to the contract data of fixed-network customers. Sales partners can only access customer data once the customer has authorized them to do so using an mTAN sent to their cell phone.

With regard to internal system development processes, we have improved the security and privacy of personal data. The Privacy & Security Assessment ensures that security and privacy requirements are considered at an early stage when designing new systems and applications. We have set up a uniform interface for system development processes that enables us to optimally assess risks inherent to the system and to effectively manage them using appropriate data privacy and security measures and activities. Security and data privacy have thus become a design criterion for new systems.

We want to further raise the awareness of our employees, especially our executives, of the issue of data privacy and data security. For this reason, we have increased the depth of the existing training and annual data audits.

Our goal is the sustainable optimization of transparency in the area of data privacy. We regularly publish a voluntary report on the status of data privacy/data security, which we submit to our Supervisory Board and the Federal Commissioner for Data Protection. It is also made available to the public. The first data privacy reports were published in April 2009 and May 2010.  In October 2008, we launched the website [www.telekom.com/datenschutz](http://www.telekom.com/datenschutz)\* that provides information on the current status of data privacy at Deutsche Telekom in Germany and on current and critical data privacy incidents. We therefore go beyond the legal requirement to provide information prescribed by the legislator on September 1, 2009 with the amendment to § 42a of the Federal Data Protection Act.

We minimize the occurrence of data security and data privacy incidents by optimizing the combination of preventive and reactive measures.

## Health and the environment.

Electromagnetic fields (EMFs) are associated with potential environmental and health damage. There is intense public debate of this issue. Existing public acceptance problems relate both to the networks and the use of terminal equipment. In mobile communications, for instance, these problems particularly impact on the roll-out of mobile communications networks. In the fixed network, they affect sales of cordless DECT phones and devices that use WiFi technology. Apart from the legal risks, there may be regulatory initiatives, for example, the implementation of preventive measures in mobile communications. The World Health Organization (WHO) has declared that, on the basis of current scientific knowledge, there are no known adverse effects on health, provided internationally acknowledged threshold levels are not exceeded. Nor does the WHO expect any serious dangers to arise in the future, though it does recommend continued research due to ongoing scientific uncertainties.

We aim to overcome doubts among the general public by pursuing an objective, scientifically well-founded, and transparent information policy. For instance, we are an active contributor to an industry initiative by German mobile communications enterprises – Informationszentrum Mobilfunk – a broad-based platform for information and dialog for the general public. Our efforts to provide state-of-the-art technologies also include supporting scientific research that aims to detect potential risks at an early stage. Aside from long-term involvement in the Research Association for Radio Applications (Forschungsgemeinschaft Funk – FGF), for us this specifically entails funding the Federal Government’s research activities within the scope of the German Mobile Telecommunications Research Programme and the Environmental Research Plan. A recent development is the foundation of the EMF scientific forum (Wissenschaftsforum), an important research platform that fills the gap opened up by the dissolution of the Research Association for Radio Applications. We are one of the co-founders and financial supporters of the scientific forum. In addition, when T-Mobile adopted its EMF policy in 2004 it introduced measures for all national companies to promote transparency and information, encourage involvement in the issue, and contribute research funding. These measures aim to minimize potential legal and regulatory issues as well as problems of acceptance among the general public.

\* Where the management report refers to Internet pages, the content of these pages does not constitute part of the management report.

### Procurement.

As a service provider and an operator and provider of IT/telecommunications products, we cooperate with a variety of suppliers of technical components, such as software, hardware, transmission systems, switching systems, outside plant, and terminal equipment.

Supply risks cannot be entirely ruled out. Delivery bottlenecks, price increases, changes in the prevailing economic conditions or suppliers' product strategies may have a negative impact on our business processes and our results. Risks may result from the dependence on individual suppliers or from individual vendors' defaulting as a direct result of the economic crisis. We employ a large number of organizational, contractual, and procurement strategy measures to counteract such risks. Measures we have introduced include a supplier evaluation system, based on KPIs some of which have a certain predictive quality. In this way we can identify supplier risks as early as possible and introduce risk management measures in good time.

### OTE.

Deutsche Telekom holds 30 percent plus one share in OTE and has management control under the terms of a shareholder agreement. The now ruling socialist party in Greece, PASOK, had expressed criticism of the partial sale of OTE to us ahead of its success in the elections on October 4, 2009. Nevertheless, the risk that the government may seek to renegotiate aspects of the shareholder agreement is very small as, under normal circumstances, amendments to the shareholder agreement can only be made by consensus.

### Legal risks.

**Litigation.** Deutsche Telekom is party to several proceedings both in and out of court with government agencies, competitors, and other parties. The proceedings listed below are of particular importance from Deutsche Telekom's point of view.

- **Lawsuit on prospectus liability.** There are around 2,600 ongoing lawsuits from around 16,000 alleged buyers of T-Shares sold on the basis of the prospectuses published on May 28, 1999 and May 26, 2000. The amount in dispute totals approximately EUR 80 million. Some of the actions are also directed at Kreditanstalt für Wiederaufbau (KfW) and/or the Federal Republic of Germany as well as the banks that handled the issuances.

The Frankfurt/Main Regional Court has issued certified questions to the Frankfurt/Main Higher Regional Court in accordance with the German Capital Investor Model Proceedings Act (Kapitalanleger-Musterverfahrensgesetz – KapMuG) relating to the DT2 and DT3 public offerings and has temporarily suspended the initial proceedings. The last hearing in the DT3 model proceedings was held on December 15, 2010. The parties have the opportunity to respond again in writing. The Court has announced it will issue a ruling in the second quarter of 2011. To all intents and purposes, the proceedings for a preliminary ruling on DT2 are currently suspended.

Around 12,000 additional supposed buyers of T-Shares had initiated conciliatory proceedings with a state institution in Hamburg, the "Öffentliche Rechtsauskunfts- und Antragsstelle der Freien und Hansestadt Hamburg (ÖRA)." Around 8,000 of these proceedings have been completed and the remaining 4,000 or so that had not yet been fully completed were stopped by ÖRA in a letter to Deutsche Telekom AG dated March 4, 2010 based on a ruling by the Hamburg Higher Regional Court issued on February 10, 2010.

- **Toll Collect.** In the arbitration proceedings between the principle members of the Toll Collect consortium (Daimler Financial Services AG, Deutsche Telekom and the consortium company Toll Collect GbR) on the one hand and the Federal Republic of Germany on the other regarding disputes relating to the truck toll collection system, Deutsche Telekom received the Federal Republic's statement of claim on August 2, 2005. In the statement of claim, the Federal Republic maintained its claim to lost toll revenues of approximately EUR 3.51 billion plus interest for the delayed commencement of operations on September 1, 2003. The total claim for contractual penalties amounted to EUR 1.65 billion plus interest. The contractual penalties are based on alleged violations of the operator agreement (lack of consent to subcontracting, delayed provision of on-board units and monitoring equipment). In a letter dated May 16, 2008, the Federal Republic recalculated its claim for damages for lost toll revenues and reduced it minimally by EUR 169 million. The new claim is approximately EUR 3.3 billion plus interest. The main claims by the Federal Republic (including contractual penalties) amount to around EUR 4.99 billion.



The defendants responded on June 30, 2006. The plaintiff responded in writing on February 14, 2007. Following further exchanges of submissions between the parties, a first hearing took place in June 2008 during which the arbitration court discussed legal issues with the parties, yet shed no light on the possible outcome of the case. The parties have submitted further written responses since then. Various witnesses and experts were heard at another hearing in December 2010. A further deadline of May 20, 2011 was set for the parties to respond in writing.

- **Arbitration proceedings and court cases relating to the acquisition of shares in PTC (Polska Telefonia Cyfrowa Sp.z o.o.; PTC).** Deutsche Telekom AG reached an agreement with Vivendi (France), Elektrim (Poland), and Elektrim's creditors in December 2010 regarding the various legal disputes about the interests in PTC in Poland, giving it full and undisputed ownership of PTC. Deutsche Telekom and its subsidiaries paid approximately EUR 1.4 billion to Elektrim and Vivendi in January 2011 under the terms of the agreement. Settlement of all legal disputes between the parties was also agreed, including the arbitration proceedings filed by Vivendi SA in Geneva, Switzerland, and various other court cases and arbitration proceedings. Claims for damages by Vivendi SA in Paris, France, and Vivendi SA in Seattle, United States, were already rejected with legally binding effect in 2010.
- **telegate AG/Harisch.** On October 19, 2005, following enforcement proceedings, Deutsche Telekom AG received a claim for damages of approximately EUR 86 million plus interest from telegate AG. telegate alleges that Deutsche Telekom AG charged excessive prices for the provision of subscriber data between 1997 and 1999, which resulted in telegate AG having insufficient funds available for marketing measures and preventing it from achieving its planned market share. Following enforcement proceedings, Deutsche Telekom AG received a claim for damages of approximately EUR 329 million plus interest from Dr. Harisch, also on October 19, 2005. Dr. Harisch alleges that the excessive prices for the provision of subscriber data between 1997 and 1999 caused telegate AG's equity ratio to decrease significantly on several occasions, resulting in the need for capital increases. This required Dr. Harisch and another shareholder to release shares from their own holdings, thereby diluting their remaining shareholdings. The plaintiff has now increased his claim by approximately EUR 283 million. The amount in dispute has thus risen to approximately EUR 612 million. The action is still pending before the Cologne Regional Court in the first instance.
- **Claims for damages due to price squeeze.** Competitors have claimed for damages from Deutsche Telekom on the grounds of a price squeeze between local-network wholesale and retail prices that the European Commission had identified in 2003 as part of a decision to impose fines. Vodafone (formerly Arcor) is seeking damages of currently EUR 223 million plus interest. This case was suspended until the European courts issued a final decision relating to the fine ruling by the European Commission. On April 10, 2008, the European Court of First Instance dismissed Deutsche Telekom AG's claim for reversal of the fine ruling. The appeal filed by Deutsche Telekom AG against this ruling was rejected by the European Court of Justice (ECJ) on October 14, 2010. The European Commission's decision, which requires Deutsche Telekom to pay a fine of EUR 12.6 million plus interest, is therefore final and non-appealable. The national court will not be permitted to issue any ruling that would be contrary to the ECJ's decision in the continued proceedings for damage compensation. The amount of the loss suffered by competitors was not the subject of the case brought before the ECJ. Versatel and EWE Tel in 2011 filed claims for damages against Telekom Deutschland GmbH for around EUR 70 million and around EUR 82 million respectively, and NetCologne for around EUR 73 million, plus interest. HanseNet has filed proceedings for a declaratory judgment obligating Deutsche Telekom AG and Telekom Deutschland GmbH to reimburse HanseNet for all damage caused by the price squeeze as established by the European Commission. Another competitor has filed a claim for damages of around EUR 27 million plus interest.
- **Rates for unbundled local loop lines.** In November 2008, the Cologne Administrative Court revoked the rates approval for the unbundled local loop line (ULL) from 1999 with regard to the monthly charges. Both Deutsche Telekom AG and the Federal Network Agency filed complaints against non-allowance of appeal. In a ruling dated October 5, 2009, the Federal Administrative Court rejected these complaints because the points raised relate to the previous legal situation. The rulings of the Cologne Administrative Court revoking the approvals thus became final and binding and the rate approval proceedings from 1999 applied again, i.e., the Federal Network Agency must decide again on ULL monthly charges for the period from February 1999 to March 2001.

Regarding the 2001 ULL rate approvals, the Federal Administrative Court in its ruling on June 23, 2010 upheld an appeal relating to the ULL monthly charges against the ruling of the Cologne Administrative Court on August 27, 2009 on the complaints against non-allowance of appeal filed by Deutsche Telekom AG and the Federal Network Agency. Relating to the ULL one-time charges for the period April 2001 through March 2002, the court rejected the complaint against non-allowance of appeal. The ruling of the Administrative Court revoking the approvals thus became final and binding and the Federal Network Agency has to decide again on the ULL one-time charges.

On June 30, 2010, the Federal Administrative Court dismissed the complaints against non-allowance of appeal filed by Deutsche Telekom AG and the Federal Network Agency against the ruling by the Cologne Administrative Court on November 19, 2009 relating to the 2002 approval of ULL one-time charges for the period April 2002 through June 2003. In a ruling dated January 19, 2011, the Federal Network Agency approved new charges for the plaintiffs for the period specified.

All other rulings of the Federal Network Agency on ULL rates since 1999 have been challenged and, apart from the 1999 ULL one-time charges, are therefore not final.

- **Review of contracts in the F.Y.R.O. Macedonia and Montenegro.** The audit of the financial statements of Magyar Telekom for the 2005 financial year identified contracts for which it was not possible at the time to fully ascertain an appropriate business background. The Audit Committee of Magyar Telekom commissioned an independent law firm with investigating the lawfulness of these contracts. Magyar Telekom informed the U.S. authorities (the Department of Justice and the SEC), who then initiated investigations into potential breaches of the Foreign Corrupt Practices Act (FCPA). Magyar Telekom and Deutsche Telekom as the parent company of the Group cooperated fully with these investigations and reviewed and improved their compliance programs. Magyar Telekom's and Deutsche Telekom's legal representatives are currently in talks with the U.S. authorities about the status of the investigation

and the possibility of bringing the proceedings to a close. The outcome of these talks cannot be foreseen. It is also not foreseeable at present whether the U.S. authorities will take action and if so what kind, if an agreement cannot be reached to conclude the proceedings. The public prosecutors' office in Bonn has launched its own investigations having received a request for legal assistance from the U.S. authorities.

- **IPR risks.** Like many other large telecommunications/Internet providers, Deutsche Telekom is exposed to an increasing number of IPR (intellectual property rights) disputes. For Deutsche Telekom, there is a risk that it may have to pay license fees and/or compensation. Some disputes may result in cease-and-desist orders.
- **IPR proceedings against ADSL technology.** Deutsche Telekom AG is facing four proceedings alleging patent infringements relating to DSL data transmission processes. Specifically, the patents concerned relate to special processes used to check the quality of DSL channels, to code data, to set transmission rates, and to correct transmission errors. The German Federal Patent Court upheld Deutsche Telekom's first-instance claim regarding two of the patents and declared them void. A nullity suit is pending against another of the patents and a fourth nullity suit is in preparation but has not yet been filed. Two proceedings before the German infringement court have been suspended and the other two are unscheduled, meaning no hearings have been set for the allegations of violations.
- **OTE Lannet case.** In May 2009, Lannet Communications SA filed a lawsuit claiming compensation for damages of EUR 176 million arising from the allegedly unlawful termination of services (mainly interconnection services, unbundling of ULLs, and leasing of dedicated lines) by OTE. A court hearing is set for February 17, 2011.

Furthermore, Deutsche Telekom intends to defend itself and/or pursue its claims resolutely in each of these court, conciliatory, and arbitration proceedings.



### Anti-trust proceedings.

- **Proceedings by Anti-Monopoly Commission in Poland.** The Polish Anti-Monopoly Commission (UOKiK) initiated several legal proceedings in 2010 against a number of Polish telecommunications companies, including PTC. The providers are suspected of collusion. The UOKiK also accuses PTC of infringing customer interests in various ways. Under Polish law, the maximum fine for both cases is set at 10 percent of the revenues from telecommunications services or 10 percent of taxable revenues.
- **European Commission investigates Slovak Telekom.** In April 2009, the European Commission started an investigation into allegedly abusive behavior of Slovak Telekom in the retail and wholesale broadband market in Slovakia. According to the European Commission, such an infringement could consist of refusing access to the unbundled local loop, margin squeeze situations in these products as well as other discriminating behavior. In December 2010, the European Commission formally extended the investigation to include Deutsche Telekom as Slovak Telekom's parent company, allowing the European Commission to also hold Deutsche Telekom liable for Slovak Telekom's alleged infringements. Should the investigation of the European Commission arrive at finding an infringement of European competition law, it could impose fines against Slovak Telekom and Deutsche Telekom.

### Financial risks.

Most of our financial risks arise from liquidity, credit, currency, and interest rate risks. Risky investments by subsidiaries in Southern and Eastern Europe in particular exist on account of operational requirements and transfer restrictions. We monitor and manage these risks by means of regular analysis and evaluation of the investment risks.

To ensure the Group's and Deutsche Telekom AG's solvency and financial flexibility at all times, we maintain a liquidity reserve in the form of credit lines and cash. The primary instruments used for medium- to long-term financing are bonds and medium-term notes (MTNs) issued in a variety of currencies and jurisdictions. These are generally issued via Deutsche Telekom International Finance B.V. and are forwarded within the Group as internal loans.

As of December 31, 2010, 21 banks had granted us credit lines totaling EUR 12.6 billion. The situation on the international financial markets eased considerably in 2009 and, in particular, toward the end of 2010. From today's perspective, access to the international debt capital markets is not jeopardized. The 2010 financial year was marked by substantial new issuances. Throughout 2010, we raised EUR 3.1 billion in debt capital in various markets.

Although a number of banks declined to extend credit lines in 2008, partly due to lending restrictions, and partly due to the crisis-induced consolidation in the banking sector, all existing bilateral lines, with one exception, were extended after January 2009. In addition, a new line of credit was agreed in 2010 and another credit line that had been withdrawn in 2008 was extended once more.

At December 31, 2010, Deutsche Telekom's credit rating with Moody's was Baa1, while Fitch and Standard & Poor's rated us BBB+. All three agencies gave us a "stable" outlook. If our rating fell below certain defined levels, interest rates for some of the bonds and MTNs issued would rise.

### Impairment of Deutsche Telekom's assets.

The value of the assets of Deutsche Telekom and its subsidiaries is reviewed periodically. In addition to the regular annual measurements, specific impairment tests may be carried out when, for example, changes in the economic, regulatory, business or political environment could impact negatively on the value of goodwill, intangible assets or items of property, plant and equipment. These tests may lead to the recognition of impairment losses that do not, however, result in disbursements. This could impact to a considerable extent on our results, which in turn may negatively influence the T-Share price.

### Sales of shares by the Federal Republic or KfW.

As of December 31, 2010, the Federal Republic and KfW jointly held approximately 32.0 percent in Deutsche Telekom AG, while the Blackstone Group held 4.4 percent. On April 24, 2006, the Blackstone Group purchased an interest in Deutsche Telekom AG's share capital from KfW.

The Federal Republic may continue its privatization policy and sell further equity interests, including shares in Deutsche Telekom AG, in a manner designed not to disrupt the capital markets and with the involvement of KfW. On May 16, 2008, KfW issued a five-year exchangeable on shares of Deutsche Telekom AG. Exchangeables are debt certificates that the holder can exchange during a pre-determined period and at a pre-determined conversion price for shares in another company (in the case of the KfW exchangeables referred to here, for registered shares in Deutsche Telekom AG). If the conversion price is exceeded, KfW may exchange the exchangeables submitted to it for shares in Deutsche Telekom AG and if the holders of the exchangeables exercise the conversion option, it must exchange them. When the exchangeables mature, KfW has the right to pay them out in Deutsche Telekom shares. This exchangeable has a volume of EUR 3.3 billion and a conversion price of EUR 14.9341. There is a risk that the sale of a significant volume of Deutsche Telekom shares by the Federal Republic or KfW, or any speculation to this effect, could have a negative short-term impact on the price of the T-Share.

### Aggregate risk position.

The assessment of the aggregate risk position is based on a consolidated review of all significant risks or risk areas. The Company's aggregate risk position did not change significantly in 2010 compared with the prior year, despite severe competition and price pressure, the regulatory framework, the economic environment, and major challenges in terms of staff restructuring and service quality. As it stands today, there is no risk to our Company's continued existence as a going concern.

### The opportunities.

In March 2010, we introduced our new Fix – Transform – Innovate strategy, with which we aim to broaden our revenue mix by focusing on new pockets of growth in addition to the traditional access business in fixed-network and mobile communications. Through our five strategic action areas (please refer to the section "Group strategy and Group management"), we intend to specifically focus on the challenges and opportunities in the market and safeguard our successful positioning in the long term. The results of operations and financial position of Deutsche Telekom AG are also indirectly affected via the results of its subsidiaries.

In countries where we offer mobile communications services, we will further enhance our performance and invest specifically in next-generation technologies. Furthermore, we will develop innovative services and expand our portfolio of high-quality mobile handsets. We will also systematically continue to integrate fixed-network and mobile communications, which will enable us to further improve customer service, leverage synergies from integration in marketing, distribution and customer service, and open up additional cross-selling revenue potential. Thanks to new innovative services and calling plans we have been able to set ourselves apart from our competitors more clearly.

We believe the mobilization of data services and, in particular, mobile Internet access, offer the best growth opportunities in our industry. Another strategic opportunity is to offer innovative, non-device-specific and convergent services. Besides our own services and solutions, we are also entering into selected cooperative ventures and positioning ourselves long-term as a strategic partner for key players in other sectors, e.g., as an exclusive online content partner or for the marketing of innovative terminal equipment such as the Windows Phone 7, the T-Mobile G2 in the United States, and Apple iPhone and iPad.

We are forecasting a rapid increase in global data traffic in the coming years. Our goal is therefore to continue to transform operations by becoming more efficient, but also by supplying the greater bandwidth required. At T-Systems, we are pushing ahead with restructuring and increasing profitability at sector level. T-Systems offers unrivaled expertise and a unique product portfolio on the basis of its global infrastructure of data centers and networks.