

**THE REPORT OF THE SUPERVISORY BOARD
OF PGE POLSKA GRUPA ENERGETYCZNA S.A.
ON THE EVALUATION OF THE COMPANY'S POSITION IN THE YEAR 2016, INCLUDING
OPINIONS ON THE COMPANY'S INTERNAL CONTROL, RISK MANAGEMENT AND
COMPLIANCE SYSTEMS AS WELL AS THE INTERNAL AUDIT FUNCTION.**

PGE Polska Grupa Energetyczna S.A. (hereinafter also referred to as "PGE", "PGE S.A.", "Company") has been bound by the corporate governance principles specified in "The Good Practices of Companies Listed on the Warsaw Stock Exchange 2016" ("The Good Practices") adopted by a resolution of the Board of the Warsaw Stock Exchange, and adopted by the Management Board of PGE S.A. in resolution no. 19/03/2016 of 19 January 2016.

This report has been prepared on the basis of The Good Practices and includes a brief assessment of the Company's position, taking into consideration its internal control, risk management and compliance systems as well as the internal audit function. This evaluation has been prepared based on the documents submitted by the Management Board, discussions held with the members of the Management Board during the meetings of the Supervisory Board and discussions held during the meetings of the permanent committees operating within the Supervisory Board, as well as the following documents submitted to the Supervisory Board of PGE Polska Grupa Energetyczna S.A.: "PGE Polska Grupa Energetyczna S.A. The EU-IFRS-consistent standalone financial statements for the year ended 31 December 2016" and "The Management Board's report on the activities of PGE Polska Grupa Energetyczna S.A. for the year ended 31 December 2016".

1. Significant events

On 6 September 2016 the Supervisory Board of PGE S.A. approved the Updated Strategy of the PGE Capital Group as submitted by the Management Board. The updated version of the strategy is to adjust the Group's operations to the changing business environment. In the updated version of the document, the Group addresses also the risks and opportunities related to, among other things, fuel prices changeability, the directions of the climate policy, the evolution of the market model, and the development of new technologies. According to the updated strategy, the mission of the PGE Group is to ensure security and development through reliable deliveries, technical perfection, modern services and partner relationships. The building of value for shareholders and key role in ensuring the country's energy security are the primary objectives to pursue by the PGE Group.

In 2016 PGE S.A. coordinated the following projects carried out in the key operating segments of the PGE Capital Group as set forth in the aforementioned strategy.

Key projects implemented in 2016

Construction of new power generation units in the PGE Opole Power Plant	<ul style="list-style-type: none">● construction of two power generation units, each with a capacity of 900 MW● budget: approx. PLN 11 billion (net, exclusive of financing costs)● expenditures incurred so far: approximately PLN 6.7 billion● fuel: hard coal● net efficiency: 45.5%● contractor: a consortium of the following companies: Rafako, Polimex-Mostostal and Mostostal Warszawa in cooperation with GE as the entity managing the project on behalf of the consortium● commissioning of the ready units: unit 5 – 2nd half of 2018, unit 6 – 1st half of 2019● 31 January 2014 - issue of Notice To Proceed● status: assembly works at unit 5 are advanced, a boiler leakage test is being prepared; at unit 6, the assembly of the pressure part of the boiler and the auxiliary equipment in the turbine house is being continued; in December 2016 70% of the works were completed
Construction of a new power generation unit in the PGE Turów Power Plant	<ul style="list-style-type: none">● construction of a power generation unit with a capacity of 490 MW● budget: approx. PLN 4 billion (net, exclusive of financing costs)● expenditures incurred so far: approximately PLN 0.6 billion● fuel: lignite● net efficiency: 43.1%● contractor: a consortium of the following companies: MHPSE, Budimex and Tecnicas Reunidas● commissioning of the ready unit: 1st half of 2020● 01 December 2014 - issue of Notice To Proceed● status: the foundation works for the main parts of the unit are at the final stage; the erection of the boiler communication pylon was completed; the assembly of the steel structure of the turbine house was initiated
Construction of a new power generation unit in the Gorzów Cogeneration Plant	<ul style="list-style-type: none">● construction of a cogeneration unit with an electrical capacity of 138MWe and thermal capacity of 88 MWt● budget: approx. PLN 550 million (net, exclusive of financing costs)● expenditures incurred so far: approximately PLN 491 million● fuel: local nitrogen-rich gas or network high methane gas (Group E)● general net efficiency: 84%● contractor: a consortium of the companies from the Siemens Group● 03 October 2013 - issue of Notice To Proceed● status: the unit was commissioned on 31 January 2017

<p>Construction of a thermal processing and energy recovery plant in the Rzeszów Cogeneration Plant</p>	<ul style="list-style-type: none"> ● construction of a thermal processing and energy recovery plant in the Rzeszów Cogeneration Plant - approximately 8 MWe in condensation (4.6 MWe + 16.5 MWt in cogeneration) ● budget: approx. PLN 293 million (net, exclusive of financing costs) ● expenditures incurred so far: approximately PLN 15 million ● fuel: municipal wastes ● boiler net efficiency: 86% ● contractor: a consortium of the following companies: TM.E.S.p.A. Termomeccanica Ecologia and Astaldi S.p.A ● commissioning: 1st half of 2018 ● 22 December 2015 - execution of a contract with the contractor, 8 April 2016 - issue of Notice To Proceed ● status: the works related to the construction of the administration building and the main building are being continued; the erection of the boiler support structure was initiated
<p>Investments in renewable energy sources</p>	<p>Gniewino Lotnisko wind farm</p> <ul style="list-style-type: none"> ● budget: approx. PLN 516 million (net, exclusive of financing costs) ● capacity: 90 MW (30 turbines, each with a capacity of 3 MW) ● June 2014 - agreement for the delivery of wind turbines (Alstom) ● August 2014 - construction works agreement (CJR) ● status: the project is completed; the use permit was acquired in December 2015; the generation concession was acquired in January 2016 <p>Kisielice II wind farm</p> <ul style="list-style-type: none"> ● budget: approx. PLN 79 million (net, exclusive of financing costs) ● capacity: 12 MW (6 turbines, each with a capacity of 2 MW) ● January 2015 – “turn-key” wind farm construction agreement (Mega) ● status: the project is completed; the use permit was acquired in December 2015; the generation concession was acquired in February 2016

At present the combined installed capacity of the PGE Group's wind farms is **529 MW**.

<p>Modernisation and replacement investments</p>	<p>Comprehensive modernisation of units 7-12 in the Bełchatów Power Plant</p> <ul style="list-style-type: none"> ● project objective: To extend the units’ lifetime to 320,000 hour, which will allow the use of the existing fuel resources and to increase the units’ efficiency by approx. 2 percentage points ● progress of works: in the years 2013-2015 units 7, 8, 11 and 12 were commissioned. On 21 June 2016 unit 9 was commissioned and unit 10 was commissioned on 28 September 2016. ● budget: approx. PLN 4.6 billion (net, exclusive of financing costs). ● fuel: lignite ● completion deadline: 2017
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The modernisation of the flue gas desulphurisation plant for units 3-12 in the Bełchatów Power Plant;

- **project objective:** Decrease of SO₂ emissions to the level to be effective after the implementation of the IED Directive (<=200 mg/Nm³)
- budget: approx. PLN 156 million (net, exclusive of financing costs)
- fuel: lignite
- completion deadline: July 2016

Change in the furnace waste storage technology for units 1-12 and construction of an ash transport system as well as a suspension production and transport system for unit 14 in the Bełchatów Power Plant

- **project objective:** Ensuring the possibility of utilising furnace waste from units 1-12 in the Bełchatów Power Plant until the exhaustion of the lignite deposits. During the implementation stage it became necessary to adjust unit 14 to the new furnace waste transport and storage technology.
- progress of works: works related to the filling and securing of the site remain to be performed. Tender processes and preliminary works related to installations for unit 14 are being continued.
- budget for units 1-12: approx. PLN 450 million (net, exclusive of financing costs)
- budget for unit 14: approx. PLN 91 million (net, exclusive of financing costs)
- completion deadline: 2018

NO_x emission reduction at units 1, 2 and 4 in the Opole Power Plant

- **project objective:** NO_x emission reduction at units 1, 2 and 4 in the Opole Power Plant to the level to be effective after the implementation of the IED Directive (<=200 mg/Nm³).
- budget: approx. PLN 148 million (net, exclusive of financing costs)
- fuel: hard coal
- completion deadline: October 2016

The construction of the flue gas desulphurisation plant for units 4-6 in the Turów Power Plant

- **project objective:** Decrease of SO₂ emissions to the level to be effective after the implementation of the IED Directive (<=200 mg/Nm³)
- progress of works: in June 2016 the installation was commissioned
- budget: approx. PLN 530 million (net, exclusive of financing costs)
- fuel: lignite
- completion deadline: 1st quarter of 2017

Construction of the GD.1. overburden conveyor line in the Bełchatów Lignite Mine (Szczerców Field)

- **project objective:** Increase of the mine's production capacity to the level ensuring the satisfaction of demand for lignite from the Bełchatów Power Plant
 - budget: approx. PLN 100 million (net, exclusive of financing costs)
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- fuel: lignite
- completion deadline: October 2016

Construction of a flue gas denitrification plant and a flue gas desulphurisation plant for the OP-230 boilers 3 and 4 in the Bydgoszcz Cogeneration Plant

- **project objective:** Decrease of NO_x and SO_x emissions from boilers 3 and 4 to a level allowing their further operation after 2017
- progress of works: the project is at the announcement stage
- budget: approx. PLN 52 million (net, exclusive of financing costs) for the denitrification plant and approx. PLN 50 million (net, exclusive of financing costs) for the desulphurisation plant
- fuel: hard coal
- completion deadline: 2018

Modernisation of the Pomorzany Power Plant

- **project objective:** Decrease of SO_x and NO_x emissions from the Benson OP-206 boilers to a level necessary to meet the requirements of the future BAT conclusions as well as ensuring the power plant's operation until approximately 2040
- progress of works: contracts with the main contractors were executed (with respect to the construction of the IOS and deNO_x plants and some extra-contractual tasks). The general contractors of the IOS and SCR plants are preparing documentation for basic designs and documents necessary to obtain building permits
- project budget: approx. PLN 364 million (net, exclusive of financing costs)
- fuel: hard coal
- completion deadline: for NO_x – 2017/2018 (unit A/B), for FGD - 2019

Comprehensive reconstruction and modernisation of units 1-3 in the Turów Power Plant

- **project objective:** adjusting the units to the future requirements resulting from BAT conclusions with respect to allowable emissions of SO_x, NO_x and dust and increasing their availability and efficiency as well as increasing the nominal electrical capacity of each turbine generation set by approximately 15 MWe
- progress of works: the basic design for the particular islands and the detailed design for the boiler, turbine, generator and precipitator were received
- budget: approx. PLN 759 million (net, exclusive of financing costs)
- fuel: lignite
- completion deadline: 2020

Construction of a flue gas desulphurisation plant and a flue gas denitrification plant for the WP-70 boilers at the Lublin Wrotków Cogeneration Plant

- **project objective:** adjusting the WP-70 boilers to the emission standards meeting the requirements of the future BAT conclusions
 - progress of works: the tender processes for the selection of the General Contract and the Contract Engineer are being finalized
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	<ul style="list-style-type: none">● budget: approx. PLN 95 million (net, exclusive of financing costs)● fuel: hard coal● completion deadline: 2018
The grid losses reduction project	<ul style="list-style-type: none">● project objective: to reduce the costs of purchasing electricity to● the undertaken activities:<ul style="list-style-type: none">- the replacement of the HV/MV, MV/LV transformers with low-loss transformers- the reconstruction and modernisation of the network: constructing new HV/MV and MV/LV stations, increasing the cross sections of the HV, MV and LV lines, shortening the MV and LV lines,- the maintenance of the optimum network operation arrangement, the elimination of negative energy transfers in the high voltage network, the optimisation of partitions within the medium voltage network,- the reduction of load unbalance in the low voltage networks.● project effects: lowering the balancing difference index in 2016 to the level of 5.77% (in 2015 the index equalled 5.91%); in 2016 the balancing difference volume was 2.41 TWh, while the volume of energy supplied to customers rose by 2.8% in comparison to that of 2015.● Actions taken in 2016:<p>In March 2016 the project guidelines were updated for the years 2016-2020. The update took into consideration the continuation of the activities decreasing the balancing difference in PGE Dystrybucja S.A.</p>
The updated commercial strategy	<ul style="list-style-type: none">● project objective: achieving the maximum margin on the sale of electricity with the simultaneous minimization of risks related to the commercial activity● Actions taken in 2016:<p>The sale of electricity was carried out in accordance with the conditions resulting from the optimization of the utilization of the particular power generation units in connection with the level of variable costs, the level of market prices, the liquidity of the market, the regulatory and statutory conditions, with the simultaneous assessment of risks related to remaining in the so-called "open position". In view of the "power exchange obligation" effective in 2016, the basic direction in the sale of electricity was the Polish Power Exchange. Sale was conducted in the forward market and the spot market, where the contract position was balanced. Unsold free capacities were offered on the balancing market. The company used also the additional sales channel to transmission and distribution network operators. The execution of the contracting plan took into consideration the directions of commercial activities, the methods of securing positions, the limits of risks and open trade positions, as well as product optimization. The execution of the wholesale strategy included also the implementation of solutions improving the processes conducted in the area, the implementation of IT solutions supporting the area's activities, and the initiation of work on the</p>

	<p>development of solutions adjusting the manner of the area's operations to new challenges connected with changes in the conditions for conducting the activity of wholesale trade.</p>
CRM Billing	<ul style="list-style-type: none">● project objective: the implementation of systems supporting billing processes and customer service in the companies PGE Obrót S.A. and PGE Dystrybucja S.A. in order to improve operational effectiveness and to provide tools supporting processes in the area of billing and customer service, to improve the competitive position by developing the product offer and to improve the quality of customer service by implementing supporting IT tools.● Actions taken in 2016:<ul style="list-style-type: none">- the initiation of a purchase procedure under the regime of the Public Procurement Act; its objective is the delivery and implementation of the billing and customer service systems for PGE Obrót S.A. and PGE Dystrybucja S.A. A list of contractors meeting the conditions for participation in the procedure was established.- the completion of the implementation of a new centralized "eBOK" portal for the customers of PGE Obrót S.A. together with an application for mobile devices called "mBOK", made available for the Android and iOS platforms. The "eBOK/mBOK" solution received the PayU Lab Award in the category of "eCustomer Experience – Energy".- the preparation of a central measurement base for remote readings in PGE Dystrybucja S.A. together with the construction of a layer for the transmission and monitoring of the transfer of data from measuring systems.
The Human Resource Management Strategy ("HMR Strategy")	<ul style="list-style-type: none">● project objective: supporting the business strategy in the effective achievement of its objectives by ensuring the strategic and effective management of human resources and the optimization and standardization of HR processes.● Actions taken in 2016:<p>in 2016 the PGE Group continued work on the implementation of the initiative described in the Human Resource Management Strategy. Among other things, the PGE Group completed the first addition of the Business Partner HR Academy and the Academy of the Manager of Personnel and Payroll Processes, adopted the Architecture of Positions and designed IT tools (the SAP HRM module). The process of implementing these solutions in the particular business lines is underway.</p>
The SAP Programme	<ul style="list-style-type: none">● project objective: to increase operational effectiveness, among others, through the standardization of processes within the Group, the increase of transparency by creating a uniform register of economic events and creating a foundation for the development of shared services centres within the PGE Capital Group and the integration of systems <p>Within the scope of the SAP Programme, the PGE Capital Group implemented the ERP System in the fields of accounting, controlling, logistics ("RiL"), purchase invoice circulation ("OFZ"), uniform control</p>

files ("JPK"), assets management ("AM"), human capital management ("ZKL"), data consolidation and reporting ("FC"), and SAP Fiori.

- **Actions taken in 2016:** the completion of implementation work in the RiL and AM areas in the companies Ramb sp. z o.o., MegaSerwis sp. z o.o., Bestgum Polska sp. z o.o., Eltur-Serwis sp. z o.o., Elbis sp. z o.o., Betrains sp. z o.o. In July the implementation of the Purchase Invoice Circulation area was completed, and in August the Human Capital Management area was implemented. Within the Human Capital Management area, the implementation work related to the HRM Career and Development project for the companies belonging to the PGE Capital Group was completed. The implementation process comprised also the subsidiaries PGE S.A. and PGE GiEK S.A. The JPK project was finalized in the following companies: PGE S.A., PGE GiEK S.A., PGE Dystrybucja S.A., PGE Energia Odnawialna S.A., PGE Obrót S.A., PGE Systemy S.A., PTS Betrains sp. z o.o., Bestgum Polska sp. z o.o., Eltur-Serwis sp. z o.o., MegaSerwis sp. z o.o., Ramb sp. z o.o., PGE Dom Maklerski S.A., Exatel S.A. The SAP programme comprised more than 50 companies in the PGE Capital Group together with their branches. The implementation of the SAP system comprised over 20,000 users in the RiL, ZKL, AM, and FC areas in all companies in the PGE Capital Group and is one of the largest implementations of the SAP system in Europe.

Key innovation projects implemented in 2016

The "Power-to-Gas" concept

- **project objective:** To develop energy storage technologies within the scope of the "Power-to-Gas" system consisting in the conversion of the surpluses of electricity, mainly that generated by wind farms, into hydrogen in the electrolysis process, with a possibility of its subsequent use in various technological configurations.

- **main activities:**

- a feasibility study for the construction of a Power-to-Gas plant was developed on the basis of a joint order placed by PGE S.A. and Operator Gazociągów Przesyłowych Gaz-System S.A. At present a plan of the Power-to-Gas project is being prepared for the selected location and a hydrogen usage scenario.
- Since 2016 design works have been performed by PGE Energia Odnawialna S.A. with the substantive support of PGE S.A.

Cooperation with the National Centre for Research and Development ("NCRD")

- **project objective:** PGE Capital Group's use of public funds available within the Smart Growth Operational Programme, for whom NCRD is the implementing institution.

- **main activities:**

- within the scope of the works on the signing of a Joint Venture Agreement, the PGE –NCBR Agreement was being adjusted to the new POIR guidelines constituting the source of financing for a part of the budget of the Joint Venture (public funds). The PGE – Contractor Agreement was reviewed and modified; the Agreement secures the interests of both parties with respect to

intellectual property rights resulting from the projects and determines the principles of the commercialization of their results. Furthermore, within the context of the initiated Power Generation Sector Programme (PBSE), an additional modification of the proposal for a research agenda was necessary. The objective of the Joint Venture is to address the challenges which the Group has to face as the largest entity in the sector, and through this, to increase the level of innovativeness of the PGE Capital Group and the whole Polish power generation sector.

- in September 2016 NCBR announced the launching of a Feasibility Study for the Power Generation Sector Programme (PBSE). It is a coherent research agenda plan for the scope of the power generation value chain. The implementation of the plan is to constitute a response to the key challenges faced by the whole sector.

Involvement in the capital structures supporting the development of new technologies and solution as well as small businesses

- **project objective:** to implement a new model of developing and implementing new solutions allowing for the management of high-risk undertakings with the simultaneous shortening of time necessary to launch new solution onto the market (for the purposes of one's own activities or sale to other entities)
- **main activities:**
 - within the scope of the involvement of the PGE Group in capital mechanisms, a plan of reaching the Group's own Fund (CVC) was prepared. Within the scope of the implementation of the plan, the Group's own funds were allocated and the process of applying for public funds was initiated
 - the company PGE Nowa Energia started its activities; it is to deal with the acceleration of small firms, develop contact networks and facilitate deal flows within fund-based investments.

Electromobility

- **project objective:** to popularize and develop electric transport in Poland
 - **main activities:**
 - The activities are divided into two groups: individual transport – passenger cars used for professional and private purposes and bus transport – public means of transport for urban areas.
 - In December 2016 PGE launched a project comprising a pilot plan for the development of electromobility system infrastructure in Łódź. The objective of the project is to verify the business model based on fleet cars and the possibility of its replication in other locations. PGE will manage the charging infrastructure, provide quick charging services and gradually increase the scale of the business and improve the offer for customers. The project will comprise the commissioning of 6 fast public charging stations and the provision of services in the
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field of installing and managing free charging stations for fleet customers. Within the scope of the project, on 1 December 2016 PGE signed a letter of intent with the Łódzkie Province Governor. Thus the parties initiated talks on determining the possibilities and conditions of cooperation on the “e-Mobility” project.

- in October 2016 the company ElectroMobility Poland S.A. was established (in cooperation with other three Polish power utilities); the company is responsible for ensuring the dynamic development of individual electromobility in Poland.
- PGE established cooperation with bus manufacturers in order to develop, test and prepare for implementation a public transport model based on electric buses and providing for a further utilization of batteries after their use in vehicles. This issue is of particular importance for improving the economic results of the whole electric vehicles usage model in which batteries constitute the largest cost item.

Recycling

- **project objective:** to develop and implement a new technology for the recycling of lithium batteries, in particular those used in system energy storages and in electric vehicles in order to acquire strategic materials from used lithium batteries: cobalt, nickel and copper. This is an important project in light of the forecast dynamic growth in the markets of the aforementioned materials and the legal requirements providing for the necessity to collect and recycle used batteries.
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2. Description of the business activities of the PGE Capital Group

With respect to revenues, installed capacities and electricity generation and sales volumes, the PGE Capital Group is Poland's largest vertically integrated power utility. The parent company of the PGE Capital Group is PGE S.A.

The PGE Group's business activities are currently organised in the following segments.

- **Conventional Generation**

The operation objective of the segment is the prospecting for and mining of lignite as well as the generation of electricity and heat in the Group's conventional power plants and cogeneration plants as well as the provision of auxiliary services in the aforementioned scope.

- **Renewable Power Generation**

The operation objective of the segment is the generation of electricity from renewable sources and in pumped storage hydropower plants.

- **Trade**

The operation objective of the segment is the sale and purchase of electricity and gas on the wholesale market, the trade in CO₂ emission allowances and property rights resulting from energy origin certificates as well as the purchase and delivery of fuels, the sale of electricity and the provision of services to end users.

- **Distribution**

The operation objective of the segment is the distribution of electricity and the management of local distribution networks.

- **Other Activities**

Other Activities comprise the provision of services by the subsidiaries for the benefit of the Capital Group, e.g. the organisation of the acquisition of financing, the provision of IT, telecommunication, accounting and personnel services. Additionally, the segment of Other Activities comprises the operations of the subsidiary whose main object is to prepare and implement the nuclear power plant construction project.

3. Changes in the organisation of the Company and the Capital Group

Establishment of new subsidiaries On 15 September 2015 PGE Polska Grupa Energetyczna S.A. ("PGE S.A.") established two single-member capital companies with their respective registered offices in Warsaw, in the form of limited liability companies, each with a share capital of PLN 10,000. The companies, PGE Inwest 17 sp. z o.o. and PGE Inwest 18 sp. z o.o., were registered in the National Court Register on 20 October 2016 and 19 October 2016 respectively. On 19 October 2016 the companies PGE S.A., ENEA S.A., ENERGA S.A. and TAURON Polska Energia S.A. established a capital company called ElectroMobility Poland S.A. with the registered office in Warsaw and the share capital of PLN 10,000,000. Each founder acquired 25% of shares in the company's capital; the company was entered in the National Court Register on 7 December 2016. On 29 December 2016 PGE S.A. established a single-person capital company with its registered office in Warsaw under the business name of PGE Towarzystwo Funduszy Inwestycyjnych S.A., with the share capital of PLN 750,000; the Company was entered in the National Court Register on 27 January 2017.

Increasing share capitals in subsidiaries. On 2 February 2016 the Extraordinary General Meeting of the company PGE Trading GmbH with its registered office in Berlin adopted a resolution concerning an increase in the company's share capital. The share capital was increased by way of a cash contribution made by PGE S.A. The share capital was increased by EUR 2,000,000, i.e. from EUR 3,350,000 to EUR 5,350,000. The share increase was entered in the German equivalent of the Polish National Court Register on 7 March 2016. On 22 June 2016 the Ordinary General Meeting of Shareholders of such companies as PGE Inwest 5 sp. z o.o., PGE Inwest 6 sp. z o.o., PGE Inwest 7 sp. z o.o., PGE Inwest 8 sp. z o.o., PGE Inwest 9 sp. z o.o., PGE Inwest 10 sp. z o.o., PGE Inwest 11 sp. z o.o., PGE Inwest 12 sp. z o.o., PGE Inwest 13 sp. z o.o., PGE Inwest 14 sp. z o.o., PGE Inwest 15 sp. z o.o. adopted the resolutions concerning the increase of the share capital of the companies. The share capital was increased by way of cash contributions made by PGE S.A. In each company, the share capital was increased from PLN 10,000 to PLN 20,000; the increases were entered in the National Court Register in the period from July to September 2016. On 7 December 2016 the Extraordinary General Meeting of the company PGE Inwest 13 sp. z o.o. adopted a resolution to increase the share capital by the amount of PLN 730,000, i.e. from PLN 20,000 to PLN 750,000. The share capital was increased by way of a cash contribution made by PGE S.A.; it was entered in the National Court Register on 27 January 2017. On 20 December 2016 the Extraordinary General Meeting of PGE Inwest 15 sp. z o.o. adopted a resolution concerning an increase of the company's share capital by PLN 50,000, i.e. from PLN 20,000 to PLN 70,000. The share capital was increased by way of a cash contribution made by PGE S.A.; it was entered in the National Court Register on 22 March 2017. On 21 December 2016

the Extraordinary General Meeting of PGE EJ 1 sp. z o.o. adopted a resolution concerning an increase of the company's share capital by PLN 34,999,020, i.e. from PLN 275,859,450 to PLN 310,858,470. The share capital was increased by way of cash contributions made by all shareholders, i.e. PGE S.A., KGHM Polska Miedź S.A., TAURON Polska Energia S.A. and ENEA S.A., in proportion to the size of their respective shareholdings; the increase was entered in the National Court Register on 15 February 2017.

Company mergers. On 19 September 2016 the Extraordinary General Meetings of the companies PGE Inwest 4 sp. z o.o. and RAMB sp. z o.o. adopted a resolution concerning the merger of the companies. The merger was carried out by transferring to the Acquiring Company (PGE Inwest 4 sp. z o.o.) all assets of the Company Being Acquired (RAMB S.A.) and the dissolution of the Company Being Acquired without its liquidation. In connection with the aforementioned merger, the share capital of the Acquiring Company was increased from the amount of PLN 10,000 to the amount of PLN 38,926,000 by way of creating 38,916 new shares with a par value of PLN 1000 each. As the sole shareholder in the Acquiring Company, PGE S.A. acquired all shares in the increased share capital of the Acquiring Company in return for the shares to which it was entitled in the share capital of the Company Being Acquired. On 16 December 2016 the merger of PGE Inwest 4 sp. z o.o. and RAMB sp. z o.o. was registered at the National Court Register.

The Extraordinary General Meetings of the companies PGE Energia Natury PEW sp. z o.o. and PGE Energia Natury sp. z o.o. (subsidiaries of PGE Energia Odnawialna S.A.) adopted merger resolutions on 17 August 2016. The merger of the companies was effected by way of transferring to PGE Energia Natury PEW sp. z o.o. (the Acquiring Company) all assets of PGE Energia Natury Omikron sp. z o.o. (the Company Being Acquired) and the dissolution of the Company Being Acquired without its dissolution. In connection with the aforementioned merger, the share capital of the Acquiring Company was increased from the amount of PLN 31,000,000 to the amount of PLN 146,000,000 by way of creating 115,000 new shares with a par value of PLN 1000 each. As the sole shareholder in the Acquiring Company, PGE Energia Odnawialna S.A. acquired all shares in the increased share capital of the Acquiring Company in return for the shares to which it was entitled in the share capital of the Company Being Acquired. On 31 August 2016 the merger of PGE Energia Natury PEW sp. z o.o. and PGE Energia Natury Omikron sp. z o.o. was registered at the National Court Register.

Acquisition or disposal of shares/interests by the subsidiaries. On 10 March 2016 PGE Górnictwo i Energetyka Konwencjonalna S.A. ("PGE GiEK S.A.") concluded with PGE S.A. a sales agreement for the sale of 6,812 shares in RAMB sp. z o.o. with its registered office in Piaski (Kleszczów Commune), held by PGE GiEK S.A., constituting 100% of the company's share capital. On 26 April 2016 PGE GiEK S.A. concluded an agreement concerning the commencement of the operation of company Polska Grupa Górnicza sp. z o.o. ("PGG"). On 29 April 2016 the Extraordinary General Meeting of PGG adopted a resolution to increase the share capital by the amount of PLN 1,805,557,200 to the amount of PLN 2,305,607,200 by creating new shares to be acquired by the following companies: PGE GiEK S.A., ENERGA Kogeneracja sp. z o.o., PGNiG TERMIKA S.A., Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych, Towarzystwo Finansowe Silesia sp. z o.o. and WĘGLOKOKS S.A. PGE GiEK S.A. acquired 3,611,111 shares with the nominal value of PLN 361,111,100, constituting 15.7% of the share in the increased share capital of PGG. On 25 July 2016 the increase in PGG's share capital was entered in the National Court Register. PGE S.A. and PGE Inwest 2 sp. z o.o. (100% shares held by PGE S.A.) concluded on 13 June 2016 sales agreement for the sale of

220,000 inscribed shares of Telewizja Familijna S.A. in bankruptcy with its registered office in Warsaw, held by PGE S.A., constituting 11.96% of the company's share capital. As of the sales agreement date the ownership right to the shares in Telewizja Familijna S.A. in bankruptcy was transferred to PGE Inwest 2 sp. z o.o. PGE Energia Odnawialna S.A. ("PGE EO S.A.") concluded on 22 June 2016 with Bank Ochrony Środowiska S.A. ("BOŚ") an agreement for the acquisition of the new shares in the increased capital of BOŚ. The offer was submitted under a private subscription procedure. On 23 June 2016 PGE EO S.A. acquired 2,000,000 ordinary bearer shares with the combined par value of PLN 20,000,000. On 12 July 2016 the increase in the BOŚ share capital was entered in the National Court Register. On 5 August 2016 the said shares were credited to the deposit account belonging to PGE EO S.A. In consequence of the aforementioned transaction, at present PGE EO S.A. holds shares constituting 3.18% of the share capital of BOŚ. On 3 November 2016 the Extraordinary General Meeting of PGG adopted a resolution concerning an increase in the share capital by the amount of PLN 366,667,000 to the amount of PLN 2,672,274,200 by way of creating new shares. PGE GiEK S.A. acquired 833,333 shares with a par value of PLN 83,333,300 constituting 3.1% of the increased share capital of PGG; on 27 January 2017 the increase of the share capital of PGG was entered in the national court register.

4. The economic and financial position

Key financial data	Unit	Year ended 31 December 2016	Year ended 31 December 2015	change %
Sales revenues	PLN million	10,847	10,929	-1%
Earnings before interests and taxes (EBIT)	PLN million	495	715	-31%
Earnings before interest, tax, depreciation and amortisation (EBITDA)	PLN million	510	730	-30%
Net cash from operating activities	PLN million	874	797	10%
Net cash from investment activities	PLN million	-4,931	-1,448	-
Net cash from financing activities	PLN million	3,977	-318	-
Net profit per share	PLN	0,85	0,95	-11%
EBITDA margin	%	5%	7%	
Shares and interests in subsidiaries	PLN million	29,678	29,469	1%
Working capital	PLN million	4,491	1,903	136%
Net debt/LTM EBITDA*	x	9,17	4,26	

*LTM EBITDA - EBITDA for the past 12 months from the balance sheet date

In 2016 PGE S.A. reported **revenue from sales** at PLN 10,847 million as compared to PLN 10,929 million in 2015, which indicates a decrease by 1%.

Revenue from sales - a fall by PLN 82 million

Positive impact	<ul style="list-style-type: none"> • an increase in revenue from sales of electricity by PLN (+) 538 million, including an increase in the sales volume by PLN (+) 884 million and a decrease in the average sales price by PLN (-) 345 million • an increase in revenues from sales of gas and gas transport services by PLN (+) 130 million, mainly because of an increase in the volume of traded gas • an increase in revenue from sales of support services by PLN (+) 92 million
Negative impact	<ul style="list-style-type: none"> • a decrease in revenue from sales of property rights by PLN (-) 589 million, mainly because of a fall in the volume of sales of green Property Rights and the termination of sales of red, yellow and violet Property Rights • a decrease in revenue from sales of CO₂ emission allowances by PLN (-) 218 million resulting from lower sales prices • a decrease in revenue from sales of services under the Generation Capacities Commercial Management Agreement ("ZHZW"), sales of the Commercial and Technical Services ("OHT") and maintenance of the Balancing Group PLN (-) 35 million

In the years 2014 - 2016 the Company generated revenue mainly in the domestic market. An increase in revenue from operations conducted in EU countries in 2016 in comparison to that in 2015 results mainly from an increase in sales of gas.

Cost of own sales in 2016 amounted to PLN 10,157 million, which constitutes an increase by 1.4% in comparison to PLN 10,012 million in 2014. The reason for this was a higher volume of sales, mainly sales of electricity.

Gross profit on sales in 2016 amounted to PLN 690 million as compared to PLN 917 million in 2015, which means a 25% decrease. This decrease results mainly from the lower electricity sales result, which decreased by PLN 287 million, i.e. from PLN 411 million in 2015 to PLN 124 million in 2015. The decrease occurred first of all because of electricity sales prices lowered in July 2016 for PGE Obrót by PLN 9 /MWh for the purpose of improving the Company's financial situation. Simultaneously, the energy purchase prices were at a level only slightly lower than in the previous year.

Sales and distribution costs amounted to PLN 46 million, which constitutes a 24% increase over these costs in 2015. This increase results mainly from higher costs of gas transmission services and higher commissions paid to PGE Dom Maklerski S.A., which is the Company's agent for energy and gas sales transactions. The higher costs of gas transmission services result from the higher trading volumes and the higher costs of acquiring import transmission capacities.

General and administrative expenses amounted to PLN 142 million, which constituted a 14 % decrease in comparison to the 2015 result. A decrease in general and administrative expenses resulted from the reversal of the provision for the costs of the Voluntary Leave Programme, lower costs of marketing operations and lower costs of third-party services.

Result on other operating activities in 2016 was PLN (-) 7 million; in comparison to the result achieved in 2015 it is lower by PLN (-) 6 million. The main reason for the lower result is the PLN 7 million donation for the benefit of the Polish National Foundation, which constitutes an item of other operating costs.

Table: Other operating activities

PLN million	2016	2015	change %	2014	change %
Other operating revenue	1	8	-88%	10	-20%
Other operating expenses	8	9	-11%	11	-18%
Result on other operating activities	-7	-1	-	-1	0%

4.1 Statement of financial position

Non-current assets of PGE S.A. as at 31 December 2016 and 31 December 2015 equalled PLN 39,079 million and PLN 35,788 million respectively.

Non-current assets - increase by PLN 3,291 million

Increase	<ul style="list-style-type: none"> an increase in loans and receivables by PLN 2,795 million, including in consequence of acquiring bonds issued by the subsidiaries by PLN 2,669 million, a partial reversal of a revaluation write-down concerning bonds issued by Autostrada Wielkopolska S.A. in the amount of PLN 89 million and an increase in loans granted to subsidiaries by PLN 37 million an increase in the value of derivatives of securing transactions related to issued bonds and incurred loans for the combined amount of PLN 313 million an increase in interests and shares in the subsidiaries by PLN 209 million, mainly in consequence of acquiring shares from minority shareholders of PGE GiEK - an increase by PLN 191 million and an increase in the value of shares and interests in other companies by PLN 18 million an increase in financial assets available for sale by PLN 3 million in consequence of acquiring shares in the company ElectroMobility Poland S.A.
Decrease	<ul style="list-style-type: none"> a decrease in deferred income tax asset by PLN (-) 24 million a decrease in the value of tangible fixed assets by PLN (-) 3 million in consequence of depreciation of the value of an office building a decrease in the value of intangible assets by PLN (-) 2 million in consequence of depreciation of intangible assets

PGE S.A. purchases bonds issued by the companies belonging to the PGE Capital Group. Funds acquired from bond issues are used to finance investment projects, to refinance financial liabilities, and finance current operations. Changes related to bonds acquired by PGE S.A. are described in note no. 20.1.1 to the financial statements of PGE S.A. for the year 2016.

Current assets of the Company as at 31 December 2016 and 31 December 2015 equalled PLN 5,572 million and PLN 3,752 million respectively.

Current assets - increase by PLN 1,820 million

Increase	<ul style="list-style-type: none">• an increase in trade receivables and other receivables by PLN 2,431 million, including an increase in deposits by PLN 2,299 million, an increase in cash pooling by PLN 308 million, and a simultaneous decrease in trade receivables by PLN (-) 144 million• a decrease in the value of derivatives related to the valuation of forward currency transactions related to the purchase of CO₂ and gas by PLN 2 million
Decrease	<ul style="list-style-type: none">• a decrease in other short-term assets by PLN (-) 338 million; it results mainly from a decrease in advance payments for the purchase of electricity and gas by PLN (-) 267 million and a decrease in receivables related to participation in a tax capital group by PLN (-) 59 million• a decrease in inventories by PLN (-) 249 million, including a decrease in the value of CO₂ emission allowances by PLN (-) 125 million and an increase in the value of energy origin certificates by PLN 10 million• a decrease in cash and cash equivalents by PLN (-) 81 million• a decrease in the value of income tax receivables by PLN (-) 79 million

Equity as at 31 December 2016 and 31 December 2015 equalled PLN 34,638 million and PLN 33,454 million.

Equity - an increase by PLN 1,184 million

Increase	<ul style="list-style-type: none">• the allocation of net profit in the amount of PLN 1,598 million for the year ended 31 December 2016• an increase in financial instruments valuation capital by PLN 166 million in consequence of using securing transactions for a loan received from PGE Sweden AB
Decrease	<ul style="list-style-type: none">• the payment of shareholder dividend in the amount of PLN (-) 467 million• other expenditures in the amount of PLN (-) 113 million

Long-term liabilities as at 31 December 2016 and 31 December 2015 equalled PLN 8,932 million and PLN 4,280 million respectively.

Long-term liabilities - an increase by PLN 4,652 million

Increase	<ul style="list-style-type: none">• an increase in liabilities related to incurred bank credits and loans
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	by PLN 4,638 million
	<ul style="list-style-type: none"> an increase in the value of the deferred income tax asset provision by PLN 33 million an increase in provisions for long-term employee benefits by PLN 1 million
Decrease	<ul style="list-style-type: none"> a decrease in consequence of the lower valuation of derivatives related to transactions for issued bonds and incurred loans jointly by PLN (-) 20 million

Short-term liabilities as at 31 December 2016 and 31 December 2015 equalled PLN 1,081 million and PLN 1,806 million respectively.

Short-term liabilities - a decrease by PLN 725 million

Increase	<ul style="list-style-type: none"> an increase in income tax liabilities by PLN 4 million
Decrease	<ul style="list-style-type: none"> a decrease in the current part of bank loans and credits by PLN (-) 551 million, including a decrease in cash pooling liabilities by PLN (-) 684 million and an increase in credits and loans by PLN 133 million a decrease in trade payables and other payables by PLN (-) 118 million a decrease in consequence of the valuation of derivatives related to forward commodity transactions for the purchase of CO₂ and forward currency transactions related to the purchase of CO₂ and gas jointly by PLN (-) 34 million a decrease in other non-financial liabilities by PLN (-) 22 million, including a decrease related to settlements within the Tax Capital Group by PLN (-) 89 million, a decrease in VAT by PLN (-) 47 million, with a simultaneous increase in capital increase tax by PLN 110 million a decrease in short-term provisions for employee benefits by PLN (-) 4 million

4.2 Statement of cash flows

- Net cash flows from operating activities** in 2016 amounted to PLN 874 million as compared to PLN 797 million in 2015.
- Negative net cash flows from investing activities** in 2016 amounted to PLN (-) 4,931 million as compared to negative net cash flows of PLN (-) 1,448 million in 2015. The level of cash flows from investing activities in 2015 was influenced by the acquisition and buyout of bonds issued by the companies belonging to the Capital Group – PLN (-) 2,651 million, the opening of a term deposit over 3 months in the amount of PLN (-) 2,290 million, the provision of financing for the companies belonging to the PGE Capital Group within the cash pooling mechanism in the amount of PLN (-) 991 million and dividends received from the companies belonging to the PGE Capital Group in the amount of PLN 1,063 million

Positive net cash flows from financing activities in 2016 amounted to PLN 3,977 million as compared to negative net cash flows of PLN (-) 218 million in 2015. In 2016 the level of cash flows from financing activities was determined mainly by incurred credits and loans in the amount of PLN 4,648 million, the paid dividend in the amount of PLN (-) 467 million (the dividend was lower by PLN 991 million than that in 2015) and paid interest in the amount of PLN (-) 203 million.

Net debt and basic financial ratios

Table: The Company's net debt as at 31 December 2016, 31 December 2015, and 31 December 2014

PLN million	31	31	31
	December	December	December
	2016	2015	2014
A. Cash ⁽¹⁾	331	611	830
B. Cash equivalents	1,601	1,402	2,158
C. Securities marketable and available for sale (2)	0	0	0
D. Liquidity (A) + (B) + (C)	1,932	2,013	2,988
E. Investments held to maturity as well as loans and receivables (3)	2,948	350	69
F. Short-term debt and current part of long-term debt (4)	704	1,255	58
G. Other short-term financial debt ⁽⁵⁾	0	0	0
H. Short-term financial debt (F) + (G) ⁽⁶⁾	704	1,255	58
I. Net short-term financial debt (H) - (D) - (E)	-4,176	-1,108	-2,999
J. Long-term bank credits and loans	7,878	3,240	2,754
K. Issued bonds	976	976	1,000
L. Other long-term credits, loans or other liabilities ⁽⁵⁾	0	0	0
M. Long-term financial debt (J) + (K) + (L) ⁽⁶⁾	8,854	4,216	3,754
N. Net financial debt (I) + (M)	4,678	3,108	755

Notes:

(1) Exclusive of cash of limited availability; mainly funds constituting security for settlements with the company Izba Rozliczeniowa Giełd Towarowych S.A.

(2) Includes shares listed on active markets, units of participation in investment funds classified as financial assets available for sale and acquired bonds, bills of exchange, commercial papers and investment fund participation units classified as assets available for sale

(3)	Includes acquired short-term bonds, bills of exchange, commercial papers classified as investments held to maturity, acquired bonds, bills of exchange and commercial papers, granted loans and deposits classified as loans and receivables
(4)	Includes credits and bonds
(5)	Includes liabilities under lease agreements and rental agreements with purchase option
(6)	Exclusive of other financial liabilities valued at amortized costs

Table: Basic financial ratios

	For years ended 31 December		
	2016	2015	2014
Net return of sales (%)			
net financial result x 100% / net revenues	15%	16%	56%
Return on equity (%)			
net financial result x 100% / (equity)	5%	5%	16%
Trade receivables turnover (days)			
average gross trade receivables x 365 days / net revenues	20	21	26
Debt ratio (%)			
liabilities x 100% / total liabilities and equity	22%	15%	11%
Liquidity ratios			
current assets / current liabilities	5	2	9

The Company's financial results and open credit lines guarantee sufficient funds for the financing of the Company's current operations.

In order to optimise cash flows of the companies belonging to the PGE Capital Group, to improve the effectiveness of liquidity management and to ensure short-term financial security for the PGE Capital Group companies, the PGE Capital Group provided the service of true and non-refundable cash pooling in the capacity of the pool leader, i.e. the entity responsible for the coordination of the cash pooling service within the Capital Group. The relevant agreements were entered into on 22 December 2014.

5. The sponsoring policy

PGE S.A. has implemented its own Sponsoring Policy. It was adopted by the Management Board of PGE Polska Grupa Energetyczna S.A. in its resolution no. 296/59/2015 of 30 September 2015 within the document entitled The Brand Strategy. Another document regulation sponsoring activities is "The Principles of Conducting Sponsoring Activities within the PGE Capital Group" adopted by the Management Board of PGE S.A. in its resolution no. 18/03/2014 of 21 January 2014 and by the Supervisory Board of PGE S.A. in its resolution no. 160/IX/2014 of 29 January 2014.

The compliance of the sponsoring policy with "The Principles of Conducting Sponsoring Activities within the PGE Capital Group" is evaluated every year within an examination of the effectiveness of

sponsoring activities carried out by an independent external auditor. An evaluation of conducted activities is included in a yearly report submitted to the Management Board and the Supervisory Board of PGE S.A. The effect of a positive evaluation of the followed sponsoring policy is yearly resolutions adopted by the Management Board of PGE S.A. and approving the aforementioned reports as well as the Supervisory Board's approval of information on the results of the aforementioned examinations.

In 2016 the effectiveness of sponsoring activities was as follows:

- for the sponsoring of sport - 229%
- for the sponsoring of culture - 142%
- for other sponsoring (special events) 323%

The effectiveness of all sponsoring projects executed by PGE Polska Grupa Energetyczna S.A. equals 248%, which indicates their high usefulness. Furthermore, in 2016 this index was by 56% higher than that of 2015 (192%).

A positive evaluation of the report for the year 2016 was reflected in the Management Board's resolution no. 155/29/2017 of 19 April 2017, approving the report on the effectiveness of sponsoring activities in the year 2016. The Supervisory Board became acquainted with the aforementioned documents and acknowledged them at the meeting held on 09 May 2017.

The Supervisory Board regards the sponsoring policy pursued by PGE S.A. as rational.

6. Charitable and social activities.

The PGE Capital Group is actively involved in various social activities. The main areas of the Company's involvement in social affairs were defined in "The General Management Procedure for Activities in the Area of Social Involvement in the PGE Group" adopted in 2014. PGE follows also "The Good Practices in the Areas of the Social Accountability of Business in Companies with State Treasury shareholdings" adopted by the State Treasury Ministry in 2016. PGE takes care of the development of the areas where it conducts its business activities. Every company belonging to the PGE Group participates actively in dialogues conducted with local communities. The process of communication and social consultations connected with the implementation of key projects of PGE GiEK S.A. is conducted on a regular basis. It aims at supporting project-related activities by minimizing speculation concerning particular tasks. The Company is also involved in environmental protection activities, e.g. by connecting individual users to heating networks within the scope of the KAWKA programme, which contributes to the improvement of air quality in Gorzów Wielkopolski. Simultaneously, the Company supports local initiatives in the areas of strategic projects related to the Złoczew and Gubin deposits. PGE Dystrybucja S.A. maintains good partner relationships with the local governments as well as users and owners of land where the Company conducts numerous projects and modernization works. The Company's branches organize "Energy fora" or regular meetings with the representatives of local governments aimed at providing them with the most important information on the development plans of the Company and its branches, major construction and modernization projects, as well as general activities on the energy market. PGE Energia Odnawialna S.A. cooperates closely with the local communities and local governments in the areas where the Company's both wind- and water-based generation assets are located. Dialogues conducted with the authorities of particular communes and support for initiatives important for the local communities allow the Company to develop effectively local partner relationships. In 2016 the Company provided financial assistance for road infrastructure repairs in the commune of Czernichów, where the first photovoltaic power plant of the PGE Capital Group and the

Porąbka – Żar Pumped Storage Hydropower Plans are located, which was very important for commune inhabitants. PGE EJ1 sp. z o.o. carries out the Development Support Programme for the Location Communes. Its objective is to strengthen partner relationships with the local community and the authorities of the communes of Choczewo, Gniewino and Krokowa by supporting initiatives important for inhabitants and the development of the areas where capital expenditure projects are conducted. In 2016 PGE EJ1 sp. z o.o. spent PLN 2 million on this Programme. Among other things, it helped to finance the construction of a nuclear energy laboratory in the Secondary Schools Group no. 2 in Wejherowo.

The employees of PGE Capital Group develop their pro-social involvement through participation in the PGE corporate volunteering programme. The “We Help” employee volunteering programme has been implemented in the PGE Capital Group since 2014. Almost 330 employees – PGE volunteers spent 30,000 hours on activities supporting local communities. The volunteers’ activities comprised 110 projects in 55 localities in 12 provinces. The PGE volunteers repaired 83 rooms and 9 playgrounds, organized 25 meetings integrating local communities, 16 workshops for children and youths, 14 educational programmes in the areas related to power generation.

The involvement of the PGE Group in public affairs is effected mainly by the PGE Foundation, whose activities are based on its statutes. For 5 years the PGE Foundation has been supporting the activities of the local communities in the areas where the PGE Group conducts its business operations. The PGE Foundation's objective is to ensure the transparency of its activities and the development of all stakeholders’ involvement. The Foundation conducts charitable activities, participates in the organization of the PGE employee volunteering programme called “We Help” and carries out its own original social programmes, e.g.

- “The Energy of Innovation” – a competition for young scholars who are given an opportunity to establish business cooperation with the PGE Capital Group. Competition participants are requested to submit innovative solutions related to the business activities of the PGE Group. The first edition of the competition attracted 39 projects, which were analysed and assessed by PGE's internal experts. The winning projects have a good chance of being implemented.
- “A Schoolbag Full of Energy” – a programme started over a decade ago by energy sector employees in Łódź. Since 2015 the following companies have been engaged in the programme: Fundacja PGE, PGE Dystrybucja S.A., PGE EJ 1 sp. z o.o., PGE GiEK S.A. and PGE Systemy S.A. First-year pupils from families in difficult social circumstances identified by local social assistance centres receive schoolbags full of necessary supplies. In the years 2015-2016 the PGE Foundation and companies belonging to the PGE Capital Group distributed about 6000 such schoolbags among pupils in 9 provinces.

The Supervisory Board regards the charity policy pursued by PGE S.A. as rational.

7. The remuneration policy

The remuneration package for the employees and directors of PGE S.A. consists of a permanent part (comprising a base salary), a variable part (comprising annual bonuses for directors, quarterly bonuses for other employees and discretionary awards) and non-payroll benefits. Since 2014 PGE S.A. has used market payroll data to monitor the competitiveness of its remuneration packages. Annual bonuses for directors and quarterly bonuses for employees depend on a degree to which individual objectives have been achieved (management by objectives). Furthermore, PGE S.A. provides its employees with a wide

range of non-salary benefits such as medical care, a pension programme, the compensation of the costs of meals, electricity or commuting to work, a programme of making additional payments to trainings or fully refunding them. PGE S.A. employees receive also benefits from the Corporate Social Benefits Fund.

In 2016 the members of the Management Board of PGE S.A. were remunerated under agreements entered into with the Company for the provision of managerial services. The Management Board remuneration consists of a fixed part and a bonus depending on the implementation of the objectives and targets established by the Supervisory Board of PGE S.A. The agreements for the provision of managerial services include non-competition provisions effective during their terms and after their expiry. At their own cost, the managers have taken out civil liability insurance covering their activities related to the management of the Company.

On 9 September 2016 the Act on the principles of determining the amount of remuneration for people managing certain companies (Journal of Laws of 2016, item 1202, as amended) – so-called new Chimney Salaries Act – came into force. The new Chimney Salaries Act regulates, among other things, the method of determining the principles of establishing remuneration for members of management boards and supervisory boards in companies where the State Treasury holds shares (including PGE), and, in particular, specifies how remuneration for members of management boards and supervisory boards is determined and granted (the principles of establishing remuneration for members of management boards and supervisory boards are determined by general meetings and supervisory boards adopt relevant resolutions on particular conditions of remuneration for members of management boards), specifies obligatory elements of agreements for the provision of management services entered into with members of management boards as well as principles and conditions of granting severance pays or entering into non-competition agreements. On 14 December 2016 the Extraordinary General Meeting convened upon a motion submitted by the Minister of Energy representing the State Treasury acting in the capacity of a shareholder adopted a resolution on the shaping of the principles of remuneration for members of the Management Board of PGE S.A.

The amount of remuneration in 2016 for the members of the Supervisory Board of PGE S.A. was determined in accordance with the Act on the remunerations of people managing certain legal entities ("Chimney Salaries Act"), according to which it cannot be higher than the average monthly salary in the business sector exclusive of profit-based bonuses in the fourth quarter of the year, pursuant to the provisions of the Chimney Salaries Act. In connection with the new Chimney Salaries Act, the principles of remuneration for members of the Supervisory Board were changed. On 14 December 2016 the Extraordinary General Meeting adopted a resolution on the principles of shaping remuneration for members of the Supervisory Board providing for a monthly salary for members of the Supervisory Board calculated as a product of the average remuneration in the business sector exclusive of profit-based bonuses in the fourth quarter of the previous year as announced by the President of the Chief Statistical Office and the following factor: 1.7 (for the Chairperson of the Supervisory Board), 1.5 (for the other Members of the Supervisory Board).

8. Factors important for the development

According to the Supervisory Board, the factors listed below will influence the Company's and the Capital Group's financial results at least in the next quarter:

Market environment

Demand

- the volume of demand for electricity and heat
- seasonality and weather conditions

Energy market

- the prices of electricity on the wholesale and retail markets
- the prices and tariffs on the electricity and heat retail market
- heat transmission and distribution tariffs and electricity distribution tariffs

Related markets

- the prices of property rights (energy origin certificates)
- the availability and prices of fuels used in the generation of electricity and heat, in particular the prices of hard coal, natural gas and biomass, as well as fuel transport costs
- the prices of CO2 emission allowances

Power generation infrastructure

- the availability of cross-border transmission capacities
- increased power generation capacities in the national power system, including those based on renewable energy sources and cogeneration
- the development and modernisation of power grids

Macroeconomic environment

- the GDP growth rate, especially in the industrial production sector
- interest rates and currency exchange rates, which influence the valuation of the Group's assets and liabilities

Regulatory environment Domestic

- work on a new Energy Policy for Poland until 2050,
 - the implementation of the Strategy for Responsible Development indicating challenges and strategic projects for the energy sector
 - changes in the range of the system services such as:
 - modifications of the current mechanism of the system service called the Operating Power Reserve
 - the launching of the subsequent packages of demand reduction services
 - the implementation of a capacity market
 - subsequent amendments to the Renewable Energy Sources Act, in particular with respect to the optimization of the RES support system and the cogeneration support system
 - the scope of the obligation to redeem RES energy origin certificates in the following years
 - the parameters and schedule of auctions for RES installations and the level of reference prices
 - the Wind Farm Construction Act – no possibility of constructing new wind farms at a distance from the nearest buildings shorter than the tenfold height of a turbine
 - different court decisions concerning property tax calculation bases (a mast or a whole installation together with a turbine); the results of the explanatory proceedings conducted by the President of the Energy Regulatory Office with respect to the issue of certificates of origin for energy generated from biomass in some branches of PGE Górnictwo i Energetyka
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Konwencjonalna S.A. ("PGE GIEK S.A.")

- the final settlement of the compensations for stranded costs on the basis of the Power Purchase Agreements Act
- the issue of derogation in the next ETS settlement period (after 2020)
- changes to the energy efficiency directive ("EED")
- the issue of the implementation of a quality tariff in the distribution system; in consequence of this implementation, regulated revenue levels will depend on the SAIDI and SAIFI indexes
- the draft Water Management Act with respect to additional financial burdens to be imposed on power utilities for the use of water for power generation purposes
- work on a legislation package aimed at the transformation of the linear economy into the circular economy); it may result in changes in the classification of the by-products of the coal combustion process
- possible adverse settlement of legal disputes

**Regulatory environment
International**

- the ETS directive revision process, including the provisions specifying the following: the level of the linear reduction factor, the division of emission allowances into those sold at auctions and those allocated free of charge, the cancellation of a particular volume of allowances, the functioning of the market stability reserve, the amount of resources to be allocated to the Modernization Fund and the manner of their distribution, the use of the compensation mechanisms – the Modernization Fund and the allocation of free emission allowances
 - the European Commission's legislative proposals constituting a part of the Clean Energy for All Europeans package – the so-called "Energy Winter Package". The legislative process has been initiated with the participation of the Council of the European Union and the European Parliament. From the point of view of the PGE Capital Group, the key elements of the package are as follows: draft amendments to the renewable energy sources directive, a draft regulation on the energy union management system, a draft regulation on the internal energy market, draft amendments to the directive concerning common rules for the internal market in electricity, draft amendments to the directive concerning energy efficiency, draft amendments to the ACER regulation, a draft regulation on the development of contingency plans related to the exposure to the low energy supply risk;
 - the BAT revision process) – changes related to the future emission levels of SO₂, NO_x, dust and new pollutants (including mercury), uncertainty with respect to the final date of the publication of BAT conclusions (probably 2017) and the deadline for the adjustment of generation assets to the new
-

requirements – 4 years from the publication of BAT conclusions;

- the process of the prior notification of guidelines for the Polish capacity market to the European Commission. The initiation of the process of agreeing the future formula of the capacity market in Poland with the European Commission.
-

9. Risks and threats to PGE S.A. and the PGE Capital Group.

Similarly to other entities in the power generation sector, the companies belonging to the PGE Capital Group are exposed to risks and threat resulting from the specific character of their business activities and the functioning in the particular market and regulatory environment.

The most important risks and threats to which the Company and the PGE Capital Group are exposed include the following:

- market (product) risks related to the prices and volumes of the Group's products and services, in particular:
 - the market prices of electricity and related products,
 - the sales volumes of electricity,
 - tariffs (regulated prices),
- property risks related to the development and maintenance of the assets, in particular:
 - breakdowns,
 - damage to assets,
 - development and investments,
- operational risks related to the course of the economic processes, in particular:
 - generation costs,
 - generation of electricity and heat,
 - fuel management,
 - human resources,
 - social dialogues,
- regulatory and legal risks related to the fulfilment of requirements imposed by both external and internal legal environments, in particular:
 - legal changes in the support systems,
 - the purchase costs of the property rights and CO₂ allowances to be bought
 - compensations for the termination of long-term power purchase agreements,
 - environmental protection,
 - the unresolved legal status of real properties,
 - concessions,
 - discriminatory actions,
- financial risks related to financial management, in particular:
 - credit risks,
 - liquidity risks,
 - interest rate risks,
 - currency risks.

10. EVALUATION OF THE INTERNAL CONTROL, RISK MANAGEMENT AND COMPLIANCE SYSTEMS AS WELL AS THE INTERNAL AUDIT FUNCTION.

10.1. THE INTERNAL CONTROL AND RISK MANAGEMENT SYSTEMS

PGE S.A. operates an internal control system as well as a risk management system. These systems comprise all solutions developed and implemented by the Company's management and employees with a view to achieving a reasonable assurance that the Company's business objectives are being achieved. It is the Management Board that is responsible for the establishment of these systems as well as their development, functioning and respective strategies.

The key elements of the Company's internal control and risk management systems include the following:

- 1) the Company's internal processes, both automatic and manual control mechanisms limiting the level of risks related to the achievement of business objectives,
- 2) the Group's risk management process allowing the Company the orderly and comprehensive - on the basis of the approach common for the whole Group - identification, measurement, monitoring and current management of financial and non-financial risks occurring during the course of business operations. The objective of these activities is to maintain risks accompanying the activities of the PGE Group and exerting considerable influence on its value at an appropriate level with respect to determined business objectives by limiting negative consequences of such threats or taking pre-emptive or corrective measures.

In the PGE Capital Group, risk management is based on the GRC (Governance – Risk – Compliance) model. It makes it possible to adjust and integrate the process at all management levels in the particular operating areas of the Group. The establishment of the Risk Committee reporting directly to the Management Board, reporting directly to the Management Board ensures the supervision over the effectiveness of the risk management processes in the Group. The definition of risk functions within the corporate risk management system allows an independent evaluation of particular risks, their impact on the PGE Capital Group as well as the limitation of control of significant risks specific for the use of the concept of economic capital by means of the instruments.

As the Corporate Centre responsible for the management of the Group, PGE S.A. creates and implements solutions in the area of risk management architecture in the PGE Capital Group. In particular, it develops risk management policies, standards and practices, prepares and develops internal IT tools supporting the process, determines global appetite for risk and relevant limits, and monitors their levels.

Risk mitigating activities are presented below.

Market (product) risks

Activities: The PGE Group has implemented internal principles of market (price/volume) risk management comprising the determination of global appetite for risk, risk limits based on the “at risk” measure and it manages the consolidated exposure to the price risk by means of the mechanisms securing risk levels exceeding the acceptable level. The principles specify uniform process organisation assumptions in the context of trade strategies and mid-term planning. The PGE Group has developed principles for a strategy of securing its key exposures in the area of electricity and related products trading; they correspond to appetite for risk in a mid-term perspective. A particular position security level is determined on the basis of the results of measuring the price risk related to electricity and related products. Target security levels are determined with respect to the Group's financial position, in particular the objectives resulting from the adopted strategy.

The PGE Group examines, monitors and analyses the markets of electricity and related products in pursuit of the optimal utilisation of its generation and trading potential.

Regulatory and legal risks

Activities: The business activities of the PGE Capital Group are subject to numerous national and international regulations and laws. The monitoring of implemented and proposed legal changes allows for the minimization of the negative impact of regulations on the activities in the basic business segments. PGE S.A. is one of the members of the Polish Electricity Association, which has an office in Brussels. Through its activities, the Association influences actively the proceeding and shaping of EU regulations, and also participates in dialogues with EU institutions.

The Group adjusts internal regulations and business practices so that the conducted activities are consistent with the sector regulations and the applicable legal regulations.

Property risks

Activities: The PGE Capital Group actively pursues its strategy of development and modernisation of the generation capacities. It diversifies the current structure of production sources with respect to power generation technologies. At present the PGE Capital Group is carrying out two key investment projects (Opole, Turów), a number of network investments as well as modernisation and development undertakings. All maintenance and repair operations are conducted on a regular basis. In case of breakdowns or damage to property, the Company takes out insurance covering its most important generation assets. The Company systematically improves the reliability of energy supply to end users.

Operational risks

Activities: The PGE Capital Group's financial results depend to a considerable degree on costs incurred within the scope of the conducted business activities. The Company optimizes its activities, for example, by monitoring the prices and reserves of fuels as well as securing their supplies by means of long-term contracts with suppliers and pricing formulas. The inspections, overhauls and modernizations of the existing assets optimize the duration of the equipment's usability and availability of the key generation assets. The level of costs is influenced by the Company's access to partly free CO₂ emission allowances and the purchase of the remaining quantity of such allowances based on the security of sales margins.

The Company also conducts intensive and effective dialogues with social partners in order to prevent the escalation of any disputes and to develop the most advantageous solutions in the area of employment and related costs within the PGE Capital Group.

Financial risks

Activities: The PGE Group controls its credit risks related to commercial transactions. Before a transaction is entered into, the Company conducts an assessment of the business partner, determines the partner's rating and credit limit, which are regularly monitored. Exposures exceeding the determined limits are secured in accordance with the PGE Capital Group's credit risk management policy.

The PGE Capital Group uses a central financing model according to which, as a matter of principle, external financing is acquired by PGE S.A. Within the PGE Capital Group, the subsidiaries take advantage of various intra-group financing sources such as loans, bonds or cash pooling agreements. The liquidity risk is monitored by means of the periodic liquidity planning tools, i.e. forecasts of rolling cash flows from operating, investing and financing activities. With respect to the currency risk and interest rate risk, the PGE Capital Group has adopted internal principles of managing these risks. The companies belonging to the PGE Capital Group enter into derivative transactions related to

instruments based on an interest rate and/or currency (IRS, CCIRS) exclusively for the purpose of securing identified exposures to the risks.

- 1) the dedicated function of investigative control focusing on the identification of malfeasances and the conduct of evidence and protective proceedings in PGE S.A. and the PGE Group;
- 2) the controlling function; in its scope, periodic managerial reports are evaluated with respect to the rationality of information included in them, in particular within the context of analysing deviations from the assumptions adopted in financial plans.

In particular, the following internal control and risk management tools are used in the process of drawing up the Company's financial statements: internal procedures regulating the process, the mechanisms of managing IT systems used in financial information recording and reporting as well as their protective mechanisms, the principles of supervision over the preparation of financial statements, the principles of the verification and evaluation of financial statements, internal audits and corporate risk management as well as other elements of control. An independent evaluation of the reliability and correctness of the financial statements prepared by PGE S.A. and the companies subject to the process of consolidation is carried out by certified auditors. Two firms have been selected to audit the 2015 financial statements prepared in the key companies of the PGE Group. They will be responsible for the review of half-annual financial statements as well as the preliminary and major audit of the financial statements. The PGE Group operates a multi-stage process of approving financial statements, including also the participation of the Supervisory Boards. It is the Supervisory Board that evaluates the standalone and consolidated financial statements of PGE S.A. The standalone financial statements of the companies subject to the process of consolidation are evaluated by their respective Supervisory Boards. The financial statements are approved by the General Meetings of Shareholders.

According to the Company Statutes, the Supervisory Board exercises permanent supervision over the Company's operations in all areas of activity.

Once a year the Supervisory Board adopts its own plan of work taking into consideration the necessity of the Supervisory Board's becoming familiar with important materials describing the Company's financial position and providing information on possible risks.

The Supervisory Board supervises the Company's internal control system mainly through its Audit Committee. The major objective of the Audit Committee is providing the Supervisory Board with recommendations and opinions concerning matters belonging to its scope of operation, i.e. the examination of the correctness and effectiveness of conducting internal financial inspections in the Company and the PGE Group as well as cooperation with the Company's auditors.

10.2. Internal audit.

PGE S.A. operates an internal audit system whose objective is to carry out an independent and objective evaluation of the internal control and risk management systems. The Company's internal audit functions on the basis of the internal audit regulations developed in accordance with the international standards of professional internal audit practices. Audits comprise planned and summary audit tasks both in the parent company and the PGE Group's other companies. Audit results are reported to the Management Board of PGE S.A. Periodically (i.e. once every six months) the Chairperson of the Audit Committee functioning within the Supervisory Board of PGE S.A. receives information of audits carried out in a given reporting period. Subsequently, the Chairperson of the Audit Committee forwards such information to the Supervisory Board of PGE S.A. The implementation of recommendations from conducted audits is the responsibility of the audited entities (i.e. the companies belonging to the PGE Capital Group and the organisational units of PGE S.A.). The internal

audit unit of PGE S.A. monitors recommendation implementation processes at the end of each quarter.

The Supervisory Board evaluates positively the internal control system, the risk management system and the internal audit function used in PGE S.A. in the year 2016.

10.3 The compliance management system within the PGE Capital Group

Since November 2015 the PGE Capital Group has been building a compliance management system. The system is to comprise solutions applicable to all employees of the PGE Capital Group, including its management personnel; it is to be implemented in all companies belonging to the PGE Capital Group.

1. Major objectives of the compliance function.

The main objective of the compliance function in the PGE Capital Group is to support the implementation of the Strategy of the PGE Capital Group as the most effective and flexible power utility in Poland and to minimize non-compliance risks which could result in penalties, fines or tarnished reputation in consequence of non-compliance with regulations and standards sanctioned by the law or constituting the best practices in the sector.

2. Detailed objectives of the compliance function.

In order to achieve successfully the main aims and objectives, the following should be done:

- The organisational culture of the PGE Capital Group on the basis of the legal compliance principle, the ethical standards and the sustainable business principles (the code of ethics, the code of conduct for business partners, the anti-corruption policy and other general policies and procedures) should be developed;
- Clear and transparent processes ensuring the possibility of identifying, clarifying and immediately eliminating any cases of non-compliance should be implemented;
- Education activities and communicate issues related to compliance with the law and internal regulations as well as promoting fairness and honesty should be conducted.

3. Assessment of maturity – Compliance Management System – status as at 31 December 2016

Objective of the Compliance Management System	Status level
Implementing a structured programme of compliance with the law and other regulations in the PGE Capital Group	Defined
Implementing a compliance risk analysis process in order to limit the possibility of the occurrence of such risks	Defined
Establishing and implementing ethical values and principles in the PGE Capital Group (The Ethical Code of the PGE Capital Group)	Managed
Implementing a system for reporting irregularities (whistleblowing)	Defined
Raising consciousness concerning compliance with the law, in particular by way of educational initiatives and effective communication of compliance issues	Managed

Objective of the Compliance Management System

1) Implementing a structured programme of compliance with the law and other regulations in the PGE Capital Group (organizational tasks)

Scope: Establishing an organizational units responsible for compliance issues and developing a related structure in the companies belonging to the PGE Capital Group

Activities:

- Establishing the position of Compliance Director – November 2015
- Establishing the Compliance Office in PGE S.A. - July 2016
- Appointing Compliance Coordinators – from September 2016 gradually in all companies belonging to the Group
- Sectioning off the compliance structures and providing them with relevant authorizations
- Determining the methods of effective cooperation in order to execute the tasks of the compliance function.

Scope: Developing an internal regulation describing the Compliance Management System

Activities:

- Developing a process describing the compliance function and including this process in the Operating Model of the PGE Capital Group (July 2016)
- Developing and agreeing upon the main internal regulation in the area of compliance (19 July 2016): 1.08. Compliance Management Process; General Compliance Management Procedure PROG 00087/A
- Start of activity: “Separating the compliance structures from the compliance control structures in the Business Lines and Segments of the Capital Group” (resolution no. 422/82/2016 of 20 September 2016)

Scope: Support and consultancy for the Business Lines, Branches and other Segments

Activities:

- Numerous meetings with the Management Boards of the Business Lines and other Segments
- Meetings with the Coordinators of the 10 key companies belonging to the Group
- A meeting of the Compliance Office and the Compliance Coordinators from the Branches of PGE GIEK S.A. (October 2016)
- A meeting with the Compliance Inspector in PGE Dystrybucja S.A. (October 2016)
- A meeting of the Compliance Office and the Compliance Coordinators from the 10 companies providing support and technical maintenance services to the PGE Capital Group (e.g. Bestgum Polska sp. z o.o., PTS „Bettrans” sp. z o.o., Elmen sp. z o.o., Eltur-Serwis sp. z o.o.)

Scope: Developing cooperation with the PGE organizational units which are of key importance for compliance activities

	Activities: <ul style="list-style-type: none">• Establishing and maintaining cooperation with: Risk Department, Audit Department, Security Department, Legal Department, Management Department, Human Resource Department, Regulating Management Department/Strategy Department, Procurement Department
2) Operationalizing the programme of compliance with the law and other regulations in the PGE Capital Group	Scope: Identifying relevant legal requirements and internal regulations Activities: <ul style="list-style-type: none">• Identifying the requirements of the law and internal regulations relevant for the compliance issues in the PGE Capital Group (September 2016)• Conducting activities in cooperation with PGE Systemy S.A. to establish a database• Initiating cooperation with the Legal Department with a view to ensuring a method of the ongoing updating of the requirements of the law• Maintaining cooperation with DS/WZR with respect to providing information on amendments to the existing regulations and plans of new regulations related to the compliance issues Products: The list of requirements (an Excel file) is share point available (continually updated by the Company and Compliance Office)
	Scope: Compliance Programmes Activities: <ul style="list-style-type: none">• On the basis of the conclusions and recommendations resulting from the identification of requirements and risks related to compliance as well as received notifications of irregularities, the Company prepared an action plan for the area of compliance for the year 2017:• The Compliance Programme of the PGE Capital Group – 25 October 2016• Compliance Programmes in the Segments – advanced projects – December 2016 Products: PGE Capital Group Compliance Programme 20 Compliance Programmes of the business segments
3) Implementing a compliance risk analysis process in order to limit the possibility of the occurrence of such risks	Scope: Non-compliance risk analysis and their mitigation Activities: <ul style="list-style-type: none">• Compliance risk identification and assessment (September 2016)• Arrangements with the Risk Department in order to harmonize the solutions in the scope of risk management Products: Compliance risks sheets for the Corporate Centre and the Business Segments
4) Establishing and implementing the	Scope: PGE Capital Group's Code of ethics Activities:

ethical values and principles of the PGE Capital Group	<ul style="list-style-type: none">• Establishing the Ethical Code of the PGE Capital Group by the Management Board and the respective Management Boards of the companies belonging to the PGE Capital Group (6 June 2016)• Adopting the Ethical Code of the PGE Capital Group in the form of a resolution (all companies of the Group until 30 September 2016) <p>Products: PGE Capital Group's Code of ethics</p> <hr/> <p>Scope: Including the values in the key documents of the Group</p> <p>Activities:</p> <ul style="list-style-type: none">• Including the selected values of the PGE Capital Group in the planned directions of activities specified in the updated Strategy of the PGE Capital Group• All internal regulations related to the compliance issues are subject to approval by the Compliance Office <p>Products: The updated Strategy of the PGE Capital Group until 2020</p>
5) Implementing a system for reporting irregularities (whistleblowing)	<p>Scope: Establishing a contact point for whistleblowers</p> <p>Activities:</p> <ul style="list-style-type: none">• Placing the contact data (email address) on the PGE Capital Group intranet (July 2016)• Placing the number of the telephone for whistleblowers in the intranet and on the gkpge.pl website (July 2016) <p>Products: E-mail: uczciwybiznespge@gkpge.pl Telephone line: +48 340 12 02</p> <hr/> <p>Scope: Activities related to the control of notifications</p> <p>Activities:</p> <ul style="list-style-type: none">• Maintaining a register of notifications of irregularities• Conducting clarifying investigations• Preparing internal regulations <p>Products: A register of notifications Reports on clarifying investigations</p>
6) Raising consciousness concerning compliance with the law, in particular by way of educational initiatives and effective communication of compliance issues	<p>Scope: Internal trainings</p> <p>Activities:</p> <ul style="list-style-type: none">• Internal trainings on the PGE CG's Code of Ethics• Adaptation trainings• Workshops for Coordinators (Compliance Team)• Workshops for Managing Team• Preparing guidelines, training materials and substantive support for Compliance Coordinators• Development of content-related input for e-learning• Development of the Compliance Training Plan for 2016 (adopted on 09 May 2016)• Development of the Training Plan for the Compliance Academy (as an element of the Compliance Programme 2017 – the resolution of the Management Board of PGE S.A. no. 447/89/2016 of 25 October

2016)

Products: Cycle of 18 Trainings in PGE S.A. on the Code of Ethics for all the PGE S.A.'s employees, 7 Workshops for Compliance Coordinators, Presentation and training materials, 2 presentations (Code, harassment presentations), The Training Plan for 2016, The Training Plan for 2017

Scope: The training courses taught by external experts

Activities:

- Train the Trainer trainings
- Anti-corruption trainings
- Counter-intelligence preventive trainings

Products: combining 5 trainings

Scope: Communication activities Corporate and Companies Centre at the PGE CG

Activities:

- Creating and maintaining the Compliance tab on the PGE Intranet
- Publishing the Ethical Code of the PGE Capital Group on the corporate website
- Publications on the IPK and in "Under the Umbrella"
- Developing information materials related to compliance
- Developing a communication plan (as an element of the 2017 Compliance Programme; resolution no. 447/89/2016 of 25 October 2016)

Products: A tab on the IPK

A file on the IPK

15 publications

Codes, leaflets and posters

A communication plan

4. Organization of the compliance function in the PGE Capital Group (status as at 31 December 2016)

The Supervisory Board of PGE S.A.

The Supervisory Board supervises and monitors the compliance management system within the PGE Capital Group, evaluates the effectiveness of the compliance system and function on the basis of, among other things, periodic reports. The tasks related to the ongoing supervision and monitoring of the compliance system will be the responsibility of the Audit Committee of the Supervisory Board.

The Management Board of PGE S.A.

Within the internal control system, the Management Board of PGE S.A. implements and maintains, besides the risk management function and the internal audit function within the internal control system, an effective compliance management system, implements adequate and effective solutions ensuring that the employees and executives of the PGE Capital Group will conduct business activities in an honest and ethical manner consistent with the legal and

regulatory obligations and with the adopted Code of Ethics of the PGE Capital Group; in particular, the Management Board approves the general procedure of the compliance management system within the PGE Capital Group;

- in PGE S.A., implements a compliance-related organisational structure and manages the execution of the compliance management process within the PGE Capital Group and provides resources necessary for the effective execution of the process;
- ensures that the unit competent for compliance issues has full access to information and data necessary for the fulfilment of its tasks;
- receives information on completed and proposed activities related to compliance issues, including improvement-oriented activities, within the PGE Capital Group;
- at least once a year provides the Supervisory Board with an evaluation of the effectiveness of the functioning of the compliance management system together with a relevant report;
- exercises direct supervision over the unit competent for compliance issues;
- in cooperation with the Compliance Committee, determines the main directions of compliance management within the PGE Capital Group.

Compliance Office at PGE S.A.

- Establishing the organization of the compliance function in the PGE Capital Group
- The Director of the Compliance Office is guaranteed direct access to the Management Board and the Supervisory Board of PGE S.A.
- Defining the substantive scope (issues and topics related to compliance) and the organizational scope – the whole PGE Capital Group
- The Director of the Compliance Office held meetings with the Management Boards of the companies belonging to the PGE Capital Groups, presenting the objectives and tasks of the compliance function to be executed at the level of the whole Group and at the level of the particular business segments.

The structure of compliance in the Business Lines and Segments of the PGE Capital Group as well as the other companies belonging to the PGE Capital Group

- The Management Boards of the Business Lines appointed Compliance Coordinators in their respective areas; Compliance Coordinators were also appointed in the Branches of the PGE Capital Group, PGE Obrót and PGE Dystrybucja.
- The Management Boards of the Business Segments appointed Compliance Coordinators in their respective areas.
- Compliance Coordinators were also appointed in the other companies belonging to the PGE Capital Group.

5. Compliance system audit results

In view of the fact that the compliance function was being implemented in the organization in 2016, no internal or external audits were carried out with respect to the assessment of the functioning of the Compliance Management System.

A preliminary external audit of the adjustment of the System to the requirements of the ISO 19600 is planned for the second half of 2017; therefore, a request has been submitted to

include the following task in the 2017 audit plan: An internal audit of the Compliance Management System.

Furthermore, in 2016 the result of the legal audit of a few companies belonging to the PGE Capital Group constituted a basis for planning activities within compliance programmes for these companies.

6. Monitoring and measurement of results

At present the Compliance Management System is at the implementation stage.

Therefore, monitoring covers first of all progress in the performance organizational works, for example, the adoption of the Ethical Code of the PGE Capital Group, procedures, the appointment of coordinators and the application of the guidelines issued by the Compliance Office. With respect to the substantive content, the used measures concerned the following:

- the ratio of employees trained in the compliance issues to the total number of employees,
- questionnaires, e.g. ones assessing the knowledge of the Ethical Code of the PGE Capital Group, information on organizational activities conducted in the companies belonging to the PGE Capital Group,
- participants' assessment of the training in the Ethical Code of the PGE Capital Group.

The Supervisory Board evaluates positively the functioning of the Compliance Management System in PGE S.A. in 2016.

11. AN EVALUATION OF THE COMPANY'S FULFILMENT OF ITS INFORMATION OBLIGATIONS.

11.1. The information obligations concerning the application of the principles of corporate governance specified in the Regulations of the Warsaw Stock Exchange

The Management Board of PGE S.A. approved The Good Practices of the Companies listed at the WSE 2016 ("DPSN 2016"; effective as of 1 January 2016) – as obligatory for the Company and exercised due diligence in order to comply with their principles. In 2016 the Company followed the DPSN 2016, excluding 2 recommendations: IV.R.2, VI.R.1. and 2 detailed principles: I.Z.1.15, III.Z.2

- I. Recommendation IV.R.2 included in Chapter IV "General Meeting and relations with shareholders" concerning an obligation to provide shareholders with a possibility to participate in a general meeting based on the use of means of electronic communication.

The PGE Management Board proposed twice that the shareholders amend the Company Statutes and the Regulations of the General Meeting, introducing provisions allowing the organisation of general meeting in a manner specified in The Good Practices. The shareholders did not approve the proposal neither at the Ordinary General Meeting held on 30 May 2012 nor at the Extraordinary General Meeting held on 27 June 2013. The Management Board does not rule out the possibility of following the aforementioned principle in the future.

According to the Management Board, non-compliance with the aforementioned principle will have no impact on the reliability of the information policy and does not create any risk of limiting or hindering the shareholders' participation in general meetings. The Company provides a real-time broadcast of the General Meeting.

- ii. Recommendation VI.R.1 included in Chapter VI “Remuneration” concerning the possession of a remuneration policy and principles of determining such a policy for the members of the company's bodies and key managers.

In 2016 the Company did not have a developed uniform remuneration policy and principles of determining such a policy. The Company and its subsidiaries are obliged to comply with the provisions of various Collective Labour Agreements which considerably limit its freedom in the shaping of remuneration policies.

Before 14 December 2016 the remuneration of the members of the Supervisory Board had been equal to one average monthly salary in the business sector exclusive of profit-based bonuses in the fourth quarter of the year, in accordance with the Act on the remunerations of people managing certain legal entities. On 14 December the Extraordinary General Meeting convened upon a motion submitted by the Minister of Energy representing the State Treasury acting in the capacity of a shareholder, pursuant to the provisions of the Act of 9 June 2016 on the principles of determining the amount of remuneration for people managing certain companies (Journal of Laws of 2016, item 1202, as amended), adopted a resolution on the principles of shaping remuneration for members of the Supervisory Board providing for a monthly salary for members of the Supervisory Board calculated as a product of the average remuneration in the business sector exclusive of profit-based bonuses in the fourth quarter of the previous year as announced by the President of the Chief Statistical Office and the following factor: 1.7 (for the Chairperson of the Supervisory Board), 1.5 (for the other Members of the Supervisory Board) (resolution no. 5 of the Extraordinary General Meeting of PGE S.A.). The aforementioned Extraordinary General Meeting adopted a resolution on the shaping of the principles of remuneration for members of the Management Board of PGE S.A. (resolution no. 4 of the Extraordinary General Meeting of PGE S.A.).

- iii. The detailed principle I.Z.1.15 included in Chapter I “Information policy and communication with investors” concerning the Company’s policy of diversity with respect to the company's governing bodies and key managers.

On 25 January 2016, on its website, in the corporate governance tab, the Company published explanations concerning the fact that it did not possess a diversity policy; consequently, it is assumed that the principle is complied with by publishing information on the Company's not possessing a diversity policy and the Company is not obliged to publish a report required under § 29 clause 3 of the Regulations of the Warsaw Stock Exchange.

- iv. The detailed principle III.Z.2. included in Chapter III “Internal systems and functions” concerning the direct subordination of people responsible for risk management, internal audits and compliance to the President or another member of the Management Board.

In accordance with the current organizational structure, people responsible for risk management, internal audits and compliance report directly to a member of the Management Board. In the first half of 2016, i.e. until 1 July 2016, this principle was not followed in the case of the person responsible for compliance.

In 2016 there occurred no incidents resulting in the necessity to publish reports on the Company's incidental or permanent failure to follow the particular principles of The Good Practices of the Listed Companies (DPSN) 2016.

11.2. Information obligations concerning the applications of the corporate governance principles specified in the regulations applicable to current and periodical information to be released by issuers of securities

The Regulation of the Minister of Finance of 19 February 2009 on current and periodical information to be released by issuers of securities and the conditions for recognizing as equivalent information required under

the laws of a country which is not a Member State (Journal of Laws of 2014, item 133, as amended) obliges issuers of securities to publish announcements about the application of the corporate governance principles in an annual report on an issuer's activities (§ 91 clause 5 item 4). In 2016 the Company included a relevant announcement about the application of the corporate governance principles in the report on the Company's activities in 2015, and on its website at www.gkpgge.pl in accordance with the principle I.Z.1.12 of DPSN 2016. The aforementioned announcement includes the following information meeting the requirements specified in the regulation:

- The corporate governance principles applicable to the Company in 2015,
- Information on refraining from the application of the corporate governance principles
- A description of the basic features of the systems of internal control and risk management related to the process of drawing up standalone and consolidated financial statements
- The Company's shareholders holding significant blocks of shares
- The Company's shareholders having special controlling powers
- Limitations in the exercise of voting rights related to existing shares
- Limitations in the assignment of titles to securities issued by the Company
- The principles of amending the Company Statutes
- The manner of the functioning of the General Meeting and its basic powers as well as the shareholders' rights and their exercise
- The personal composition and activities of the Company's management and supervisory bodies as well as their committees
- The remuneration of the members of the governing bodies of PGE S.A.
- Information on shares and other securities.

A declaration on the application of the corporate governance principles in 2016 was included in the report on the activities of PGE and the PGE Capital Group for the year 2016 published on 7 March 2017; it was also posted on the Company's website.

The Supervisory Body evaluates positively the manner of the Company's fulfilment of its information obligations concerning the application of the corporate governance principles as specified in the Regulations of the Warsaw Stock Exchange and the rules of providing current and periodic information by issuers of securities.

Chairperson of the Supervisory Board
of PGE Polska Grupa Energetyczna S.A.

/-/ [an illegible signature]

Anna Kowalik

Members of the Supervisory Board:

Jarosław Głowacki-/ [an illegible signature].....

Janina Goss-/ [an illegible signature].....



Supervisory Board

PGE Polska Grupa Energetyczna S.A.

Witold Kozłowski
Grzegorz Kuczyński/-/ [an illegible signature].....
Radosław Osiński/-/ [an illegible signature].....
Mieczysław Sawaryn/-/ [an illegible signature].....
Artur Składanek/-/ [an illegible signature].....

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[An oblong stamp:]
LEGAL COUNSEL
Bartłomiej Korusiewicz
Ld-P-270
/-/ [an illegible signature]

[An oblong stamp:]
PGE Polska Grupa Energetyczna S.A.
Legal Department
Director
Iwona Warsewicz
/-/ [an illegible signature]