

Enclosure to resolution of the Supervisory Board of
PGE Polska Grupa Energetyczna S.A.
no. 113/X/2015 of 31 May 2016

**THE REPORT OF THE SUPERVISORY BOARD
OF PGE POLSKA GRUPA ENERGETYCZNA S.A.
ON THE EVALUATION OF THE COMPANY'S POSITION IN THE YEAR 2015, 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. ("PGE", "PGE S.A.", "Spółka") 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.: "The EU-IFRS-compliant standalone financial statements of PGE Polska Grupa Energetyczna S.A. for the year ended 31 December 2015" and "The Management Board's report on the activities of PGE Polska Grupa Energetyczna S.A. for the year ended 31 December 2015".

I. EVALUATION OF THE COMPANY'S POSITION IN 2015.

1. Significant events

The Supervisory Board evaluated the Company's position in the year 2015 on the basis of the following documents: "The EU-IFRS-compliant standalone financial statements of PGE Polska Grupa Energetyczna S.A. for the year ended 31 December 2015" and "The Management Board's report on the activities of PGE Polska Grupa Energetyczna S.A. for the year ended 31 December 2015".

Taking into consideration the continuously changing market conditions and challenges faced by the conventional power generation sector, the Supervisory Board was informed that PGE S.A. was verifying its strategy and carrying out a detailed review of the pending projects in order to ensure that the PGE Capital Group ("PGE Group") would follow the optimum development path, taking advantage of all market opportunities within the limits determined by the Group's financial and organisational potential.

On 9 May 2014, in its resolution no. 169/21/2014, the Management Board of PGE S.A. adopted "The strategy of PGE Polska Grupa Energetyczna S.A. for the years 2014 -2020"; the document was also approved by the Supervisory Board in its resolution no. 213/IX/2014 of 13 May 2014.

The market and regulatory situation is subject to continual changes which require that the PGE Capital Group verify its strategy by prioritising and possibly correcting its key aspirations and strategic activities.

In particular, it is necessary to accelerate the implementation of the restructuring initiatives and the improvement of the functioning of the whole organisation, which is indispensable for the faster diversification of the PGE Capital Group's generation portfolio. The Company analyses its development plans within the context of the market situation and the maximisation of its capital expenditure ("CAPEX") and operational expenditure ("OPEX").

The basic issues of such analyses include the following:

- The investment and modernisation programme
- Activities in the area of mergers and acquisitions ("M&A") and restructuring
- The optimisation of the organisational structure and effectiveness improvements programme

In 2015 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.

Name of project	Description
1.1 The Operating Model	<ul style="list-style-type: none"> • the objective of the project is to increase organisational effectiveness of the whole PGE Group through the centralisation of the managerial, decision-making, and planning functions in the Corporate Centre, with a simultaneous synergistic combination of the potential of the most important components of the Group's value, i.e. capital, experience, competence, and knowledge, located within the particular Business Lines. • the Operating Model comprises a portfolio of 51 implementation projects whose effect is a permanent implementation of prepared changes in the business processes. The Steering Committee made a decision to terminate the Operating Model Project.
1.2 The Human Resource Management Strategy ("HMR Strategy")	<ul style="list-style-type: none"> • the objective of the project is to support the business strategy in the effective accomplishment of its goal by way of the following: <ul style="list-style-type: none"> • improving the effectiveness of human resource management • ensuring the strategic management of human resources • optimising and standardising processes to maximise benefits through the operating scale and specialisation (integrating IT tools and systems), to develop a uniform operating standard, and to optimise the use of the resources • the Company started works related to the preparation and implementation of the first group of strategic initiatives.
1.3 The SAP Programme	The project's objectives include the following:

- to increase operating effectiveness by standardising processes within the Group, increasing process effectiveness, optimising the use of technical assets, improving the effectiveness of managing the system's maintenance and development,
- to increase transparency by creating a uniform economic events recording system, ensuring access to current and coherent managerial information, improving and accelerating decision-making processes
- to create foundations for the development of shared services centres within the PGE Capital Group

So far the implementation of the SAP system has comprised 18,000 user within the RiL, ZKL, AM and FC areas in all companies belonging to the PGE Capital Group.

1.4 Consolidation of RES	<p>The project's objectives include the following:</p> <ul style="list-style-type: none"> • to concentrate all activities related to the generation of electricity from RES (except for biomass firing and co-firing) in one entity, i.e. PGE EO S.A., and to reduce the number of companies and to simplify the organisational structure within the RES area • to achieve synergy effects resulting from the management of the RES Wind area together with the RES Water and ESP/RUS area • to carry out investment projects and to operate the assets in the RES Wind area with the optimum utilisation of the human and financial resources • to achieve savings in the functioning of the Renewable Power Generation segment <p>In March 2015 the Company developed and subsequently implemented the concept of consolidation within the RES area.</p>
1.5 The updated commercial strategy	<p>The project results comprise the following deliverables:</p> <ul style="list-style-type: none"> • a value chain management strategy • a wholesale sales strategy • a retail sales strategy • a risk management strategy
1.6 The grid losses reduction project	<p>The objective of the project is to reduce the costs of purchasing electricity to cover the balancing difference</p> <ul style="list-style-type: none"> • the undertaken activities: <ul style="list-style-type: none"> • the replacement of old transformers with low-loss transformers • the reconstruction and modernisation of the network • 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.

1.7 CRM Billing	<p>The objective of the programme is to implement customer billing and service systems in the Trade and Distribution segments. The programme's effects will include the following:</p> <ul style="list-style-type: none"> • improved operating effectiveness and tool-based support in the areas of customer billing and service • improved customer service quality • an improved competitive position through the development of the product offer
1.8 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 11bn (net, exclusive of financing costs) • fuel: hard coal • efficiency: 45.5% • contractor: a consortium of the following companies: Rafako, Polimex-Mostostal and Mostostal Warszawa; chief subcontractor: Alstom • commissioning of the ready units: unit 5 – 2nd half of 2018, unit 6 – 1st half of 2019
1.9 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 4bn (net, exclusive of financing costs). • fuel: lignite • efficiency: 43.1% • contractor: a consortium of the following companies: Mitsubishi-Hitachi Power Systems Europe, Budimex and Tecnicas Reunidas • commissioning of the ready unit: 1st half of 2020
1.10 Construction of a new power generation unit in the PGE 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 607m (net, exclusive of financing costs). • fuel: local nitrogen-rich gas or network high methane gas (Group E) • overall efficiency: 84% • contractor: Siemens • commissioning of the ready unit: 1st half of 2016
1.11 Investment in renewable energy sources	<p>Karwice wind farm</p> <ul style="list-style-type: none"> • budget: approx. PLN 256m (net, exclusive of financing costs) • capacity: 40 MW (16 turbines, each with a capacity of 2.5 MW) • May 2014 - "turn-key" wind farm construction agreement (Aldesa)

	<ul style="list-style-type: none"> ● status: the farm was commissioned in July 2015
	Resko II wind farm <ul style="list-style-type: none"> ● budget: approx. PLN 386m (net, exclusive of financing costs) ● capacity: 76 MW (38 turbines, each with a capacity of 2 MW) ● October 2014 - agreement for the delivery of wind turbines (Vestas) ● November 2014 - construction works agreement (Mega, Elektrobudowa) ● status: the commissioning procedure was carried out in December 2015
	Gniewino Lotnisko wind farm <ul style="list-style-type: none"> ● budget: approx. PLN 530m (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 use permit was acquired in December 2015
	Kisielice II wind farm <ul style="list-style-type: none"> ● budget: approx. PLN 87m (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 use permit was acquired in December 2015
1.12 Modernisation and replacement investments	Comprehensive modernisation of units 7-12 in the Bełchatów Power Plant <ul style="list-style-type: none"> ● the project's objectives include the following: the extension of the units' lifetime to 320,000 hour, which will allow the use of the existing fuel resources ● to increase the units' efficiency by approx. 2 percentage points ● budget: approx. PLN 4.7bn (net, exclusive of financing costs) Modernisation of the flue gas desulphurisation plant for units 3-12 in the Bełchatów Power Plant <ul style="list-style-type: none"> ● the project's objectives include the following: decrease of SO₂ emissions to the level to be effective after the implementation of the IED Directive (≤ 200 mg/Nm³) ● budget: approx. PLN 162m (net, exclusive of financing costs) 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 <ul style="list-style-type: none"> ● the project's objectives include the following: ensuring the possibility of utilising furnace waste from units 1-12 in the Bełchatów Power Plant until the exhaustion of the lignite deposits. ● budget for units 1-12: approx. PLN 454m (net, exclusive of financing costs)

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- budget for unit 14: approx. PLN 90m (net, exclusive of financing costs)

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

- the project's objectives include the following: NOx 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 148m (net, exclusive of financing costs)

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

- the project's objectives include the following: decrease of SO₂ emissions to the level to be effective after the implementation of the IED Directive (≤ 200 mg/Nm³)

- budget: approx. PLN 530m (net, exclusive of financing costs)

Construction of an overburden conveyor line in the Bełchatów Lignite Mine (Szczerców Field)

- the project's objectives include the following: 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 108m (net, exclusive of financing costs)

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

- the project's objectives include the following: decrease of NOx and SOx emissions from boilers 3 and 4 to a level allowing their further operation after 2017

Modernisation of the Pomorzany Power Plant

- the project's objectives include the following: decrease of SOx and NOx emissions from the Benson OP-206 boilers to a level necessary to meet the requirements of the IED Directive and the BAT/BREF conclusions as well as ensuring the power plant's operation until approximately 2040
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1.13

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

One of the main assumptions for the project is the PGE Capital Group's use of public funds available within the Smart Growth Operational Programme, for which NCRD is the implementing institution. The main activities include the following:

- On 1 July 2015 the partners signed a letter of intent on the establishment of a Joint Venture. The partners are continuing work on an agreement related to the Joint Venture and dealing with all formal and legal issues related to the programme.
- In October 2015 NCRD approved the Sector Programme Feasibility Study for the power generation sector prepared under the auspices of the Polish Electricity Association.
- The Company initiated cooperation with the PZU Group, which is to support and develop innovative technologies and solutions by way of preparing and launching a capital funds mechanism.

1.14

The "Power-to-Gas" concept

The objective of the project is to develop energy storage technologies within the scope of the "Power-to-Gas" system consisting in the conversion of the surpluses of electricity, mainly those generated by wind farms, into hydrogen in the electrolysis process, with a possibility of its subsequent use in various technological configurations. The concept is being developed jointly by PGE S.A. and the the company Operator Gazociągów Przesyłowych Gaz-System S.A.

2. Business activities of the PGE Capital Group

With respect to revenues, installed capacities and electricity generation 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 Power Generation** comprises the prospecting for and mining of lignite, the generation of electricity and heat in the Group's power plants and cogeneration plants as well as the provision of auxiliary services in the aforementioned scope.
- **Renewable Power Generation** comprises the generation of electricity in pumped storage hydropower plants and from renewable sources.
- **Trade** comprises the sale and purchase of electricity and gas in 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** comprises the management of local distribution networks and the transmission of electricity.
- **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

In 2015 PGE S.A. changed its equity participation in the following entities:

On 13 March 2015 PGE Górnictwo i Energetyka Konwencjonalna S.A. ("PGE GiEK") redeemed its treasury shares and decreased its share capital by PLN 27,516,540, i.e. from the amount of PLN 6,964,382,240 to the amount of PLN 6,936,865,700.

On 17 March 2015 the share capital of PGE EJ 1 sp. z o.o. was increased by PLN 132,860,000, i.e. from the amount of PLN 73,000,000 to the amount of PLN 205,860,000, by way of increasing the par value of the existing shares in the company. The increase of the par value of the shares was subscribed for by PGE in return for a cash contribution from additional payment previously contributed to the company and not returned to PGE.

On 15 April 2015 PGE entered into an agreement for the sale of 30% of shares in the company PGE EJ 1 sp. z o.o. held by PGE. The shares were purchased by KGHM Polska Miedź S.A. ("KGHM"), TAURON Polska Energia S.A. ("TAURON") and ENEA S.A. ("ENEA"). In consequence of the executed agreement, PGE holds 70%, while KGHM, TAURON and ENEA hold each 10% of shares in PGE EJ 1 sp. z o.o.

On 1 June 2015 the company PGE Energia Naturity sp. z o.o. ("PGE EN") was divided by transferring a part of this company's assets to the company PGE Energia Odnawialna S.A. ("PGE EO"), i.e. an organised part of the enterprise of PGE EN constituting the "Kisielice/Malbork" Branch with the registered office in Malbork. In connection with the aforementioned division, the share capital of PGE EN was decreased and the share capital of PGE EO was increased by, accordingly, the redemption of PGE EN shares with the par value of PLN 234,845,000 and the creation of new PGE EO shares with the par value of PLN 37,700,310. As the sole shareholder in PGE EN, PGE subscribed for all new PGE EO shares in return for the redeemed PGE EN shares.

On 30 June 2015 PGE EO (the acquiring company) was merged with the companies PGE Energia Naturity S.A. and Eolica Wojciechowo sp. z o.o. (the companies being acquired). The merger of the companies was effected by way of transferring all assets of the companies being acquired to the acquiring company. As far the merger of the acquiring company with Eolica Wojciechowo sp. z o.o. is concerned, the share capital of the acquiring company was not increased (in accordance with Article 515 § 1 of the Commercial Companies Code), and with respect to the merger of the acquiring company with PGE Energia Naturity S.A., the share capital of the acquiring company was increased by the amount of PLN 478,800,000 by way of creating new shares. As the sole shareholder in PGE Energia Naturity S.A., PGE subscribed for all new shares in the increased share capital of PGE EO in return for shares in the share capital of PGE EN to which it is entitled. In consequence of the merger, PGE EO became the sole shareholder in the following companies:

- PGE Energia Naturity Kappa sp. z o.o.,
- PGE Energia Naturity Omikron sp. z o.o.,
- PGE Energia Naturity PEW sp. z o.o.,
- PGE Energia Naturity Karnice sp. z o.o.,
- PGE Energia Naturity Bukowo sp. z o.o.,
- PGE Energia Naturity Olecko sp. z o.o.

On 13 July 2015 the company Elbest sp. z o.o. ("Elbest") was divided by way of transferring some of its assets to the company Elbest Security sp. z o.o. ("Elbest Security"), i.e. the organised part of the enterprise of Elbest used for conducting business activities in the area of providing personal and property security services. In connection with the aforementioned division, the share capital of Elbest was decreased and the share capital of Elbest Security was increased by, accordingly, the redemption of Elbest shares with the par value of PLN 5,044,000 and the creation of new Elbest Security shares with the par value of PLN 5,044,000. As the sole shareholder in Elbest, PGE subscribed for all new shares in the increased share capital of Elbest Security in return for the redeemed shares in Elbest.

On 31 July 2015 the share capital of the company PGE Inwest 2 sp. z o.o. (100% - PGE) was increased by the amount of PLN 50,000, i.e. from the amount of PLN 10,000 to the amount of PLN 60,000, i.e. by way of creating new shares. The increase in the share capital was subscribed for by PGE in return for a cash contribution.

On 21 August 2015 the share capital of the company PGE Obsługa Księgowo – Kadrowa sp. z o.o. (100% - PGE) was increased by PLN 1,000,000, i.e. from the amount of PLN 1,050,000 to the amount of PLN 2,050,000, by way of creating new shares. The increase in the share capital was subscribed for by PGE in return for a cash contribution related to an unpaid loan granted previously to the company by PGE.

On 8 October 2015 the share capital of the company PGE EO was increased by PLN 104,218,620, i.e. from the amount of PLN 825,000,310 to the amount of PLN 929,218,930, by way of issuing new shares. The increase in the share capital was subscribed for by PGE in return for a non-cash contribution in the form of shares in the company PGE Energia Naturity sp. z o.o. with the par value of PLN 99,576,000, which constitutes 100% shares in the company's share capital. In consequence of this increase, PGE EO became the sole shareholder in PGE Energia Naturity S.A.

On 16 October 2015 the share capital of the company PPGE EJ 1 sp. z o.o. was increased by PLN 69,999,450, i.e. from the amount of PLN 205,860,000 to the amount of PLN 275,859,450, by way of creating new shares. The increased share capital was subscribed for in return for cash contributions by all shareholders, i.e. PGE, KGHM, TAURON and ENEA, in proportion to their respective shareholdings in the company.

On 30 November 2015 PGE EO (the acquiring company) was merged with the companies PGE Energia Naturity Kappa sp. z o.o., PGE Energia Naturity Bukowo sp. z o.o., PGE Energia Naturity Karnice sp. z o.o. and PGE Energia Naturity Olecko sp. z o.o. (the companies being acquired). The merger of the companies was effected by way of transferring all assets of the companies being acquired to PGE EO without increasing the share capital of PGE EO.

In the period from 1 January to 31 December 2015 PGE acquired from minority shareholders in the company PGE GiEK, in consequence of a forced buyout, shares in PGE GiEK constituting in total 0.36 % of the company's share capital.

In 2015 the companies belonging to the PGE Capital Group changed their equity participation in the following entities:

On 14 January 2015 PGE EO entered into an agreement for the sale of 50% of shares in the company Energetyczne Towarzystwo Finansowo-Leasingowe ENERGO-UTECH S.A. ("ENERGO-UTECH") held by PGE EO. The shares were purchased by the companies Przedsiębiorstwo Usługowe "UTECH" sp. z o.o. with its registered office in Poznań ("UTECH") and Elektrociepłownia "BĘDZIN" S.A. with its registered office in Będzin ("EC Będzin"). In consequence of the executed agreement, PGE EO ceased to be a shareholder in ENERGO-UTECH. In order to account for the sales agreement, on 21 April 2015 PGE EO purchased

shares in EC Będzin held by UTECH (9.89% of the share capital of EC Będzin). On 8 December 2015 PGE EO sold all shares held in EC Będzin to UTECH.

On 26 February 2015 PGE GiEK (the acquiring company) was merged with the company PGE Gubin sp. z o.o. (the company being acquired) (100% - PGE GiEK). The merger of the companies was effected by way of transferring all assets of PGE Gubin sp. z o.o. to PGE GiEK S.A. without increasing the share capital of PGE GiEK.

On 31 March 2015 PGE EO (the acquiring company) was merged with the company PELPLIN sp. z o.o. (the company being acquired) (100% - PGE EO). The merger of the companies was effected by way of transferring all assets of PELPLIN sp. z o.o. to PGE EO without increasing the share capital of PGE EO.

On 22 July 2015 PGE Dystrybucja S.A. entered into an agreement for the sale of 100% shares in the company Przedsiębiorstwo Produkcyjno-Handlowe EKTO sp. z o.o. held by PGE Dystrybucja S.A. The shares were purchased by the company LCT INVEST sp. z o.o. with its registered office in Kleosin.

On 9 December 2015 ENEA Operator sp. z o.o. entered into a conditional agreement for the sale of 20% shares in the company Centralny System Wymiany Informacji sp. z o.o. with its registered office in Poznań, held by ENEA Operator sp. z o.o. The shares were purchased by the company PGE Dystrybucja S.A. The suspensive clause for the transfer of the shares to PGE Dystrybucja S.A. is the acquisition of the consent of the Office of Competition and Consumer Protection for the transaction. As at this time there is no information of the granting of such a consent by the Office of Competition and Consumer Protection.

On 23 April 2015 the branch of PGE EO called the ZEW Dębe Branch was crossed off the National Court Register.

On 31 May 2015 PGE Obrót S.A. entered into an agreement for the sale of an organised part of its enterprise. In consequence of the agreement, PGE EO purchased the following assets:

- the Dębe Hydro Power Plant,
- the Smardzewice Small Hydro Power Plant,
- the Nielisz Small Hydro Power Plant,
- the Radawa Small Hydro Power Plant,
- the Michałów Small Hydro Power Plant,
- the Górecko Kościelne Small Hydro Power Plant.

On 1 June 2015 the company BIO - ENERGIA S.A. (100% - PGE EO) was transformed into a limited liability company. The company's new business name is: BIO - ENERGIA sp. z o.o.

4. The economic and financial position

Key financial data	Standalone	Year ended	Year ended	change %
		31 December 2015	31 December 2014	
			<i>adjusted data</i>	
Sales revenues	PLN million	10.929	9.671	13%
Earnings before interest and taxes (EBIT)	PLN million	715	476	50%

Earnings before interest, taxes, depreciation and amortisation (EBITDA)	PLN million	730	489	49%
Net cash from operating activities	PLN million	797	530	50%
Net cash from investing activities	PLN million	-1.768	-320	-
Net cash from financing activities	PLN million	2	581	-100%
Net profit per share	PLN	0.95	2.92	-67%
EBITDA margin	%	7%	5%	
Shares and interests in subsidiaries	PLN million	29.469	29.046	1%
Working capital	PLN million	3.752	4.252	-12%
Net debt/LTM EBITDA*	X	4.26	1.54	

Cost of sales in 2015 amounted to PLN 10,012m, which constitutes an increase by 11% in comparison to PLN 9,021m in 2014. The reason was more intensive activity related to the resale of purchased energy for the purpose of the optimum balancing of demand from the companies belonging to the PGE Capital Group.

Gross profit on sales in 2015 amounted to PLN 917m as compared to PLN 650m in 2014, which means a 41% increase. This increase results mainly from the higher electricity sales, which increased by PLN 220m: from PLN 191m in 2014 to PLN 411m in 2015. In 2015 the Company sold approximately 3 TWh of electricity more and recorded a higher margin per one MWh than in 2014. The factor determining such circumstances was the expected serious rise in electricity prices in comparison to the previous year, which was included in the contracted fixed prices of energy sold to the companies belonging to the PGE Capital Group. Simultaneously, the energy purchase prices were at a level only slightly higher than in 2014. Unlike in 2015, an increase in market energy prices during the course of 2014 caused a fall in the energy trade margin, which contributed to lower gross profit on sales in 2014 in comparison to that in 2013.

In 2015 **sales and distribution costs** amounted to PLN 37m, which constitutes a 61% increase over such costs in 2014. 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 transmission capacities in auctions because of higher levels of gas imports.

In 2015 the **general and administrative expenses** amounted to PLN 164m, which constituted a 9% increase in comparison to the 2014 result. This increase in the general and administrative expenses is related first of all to the change in the intra-group settlements of marketing costs and the redecoration works in the office building at 2 Mysia Street.

Within the Company's other operating revenues in 2015, costs in the amount of PLN 5m were re-invoiced to the companies belonging to the PGE Capital Group. They were costs connected mainly with projects carried out by the Corporate Centre for the benefit of the companies belonging to the PGE Capital Group. Additionally, the Company sold a right of perpetual usufruct of land for PLN 3m.

The main items among the Company's other operating costs include costs re-invoiced to the companies belonging to the PGE Capital Group in the amount of PLN 5m and a PLN 1m donation for the PGE "Energia z Serca" Foundation.

Basic financial ratios	For years ended 31 December	
	2015	2014
Net return of sales (%)		
net financial result x 100% / net revenues	16%	56%
Return on equity (%)		
net financial result x 100% / (equity)	5%	16%
Trade receivables turnover (days)		
average gross trade receivables x 365 days / net revenues	19	25
Debt ratio (%)		
liabilities x 100% / total liabilities and equity	15%	11%
Liquidity ratio		
current assets / current liabilities	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.

4.1 Statement of financial position

The Company's fixed assets as at 31 December 2015 and 31 December 2014 equalled PLN 35,788m and PLN 33,101m, respectively.

Fixed assets - increase by PLN 2,687m

Increase	<ul style="list-style-type: none"> - increase in loans and receivables by PLN 2,226m, including in consequence of acquiring bonds issued by the subsidiaries by PLN 2,196m, and loans granted to the subsidiaries by PLN 30m - increase in interests and shares in the subsidiaries by PLN 423m, including an increase by PLN 349m in consequence of acquiring shares from minority shareholders and recapitalising the company PGE GiEK S.A. and an increase by PLN 74m in consequence of acquiring shares and interests in other companies - increase by PLN 39m in the value of cross-currency interest rate swaps (CCIRS) related to transactions entered into in the CO2 emission allowances market - increase by PLN 2m in the value of the deferred income tax asset - increase by PLN 1m in the value of intangible assets related mainly to the development of the Trading Strategy of the PGE Capital Group and the development of the "MOF" planning support system
Decrease	decrease in the value of property, plant and equipment by PLN 4m in consequence of depreciation of the value of an office building

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.

The Company's current assets as at 31 December 2015 and 31 December 2014 equalled PLN 3,752m and PLN 4,252m, respectively.

Current assets - decrease by PLN 500m

Increase	<ul style="list-style-type: none"> - increase in trade receivables and other receivables by PLN 356m, including PLN 320m related to the cash pooling services - increase by PLN 79m in the value of income tax receivables - increase in current assets by PLN 293m; it results from a PLN 293m increase in advance payments for the purchase of electricity and gas and a PLN 70m increase in receivables related
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	to participation in a tax capital group
Decrease	<ul style="list-style-type: none"> - decrease in cash and cash equivalents by PLN 975m - decrease in inventories by PLN 249m, including a PLN 234m decrease in the value of CO2 emission allowances and a PLN 15m decrease in the value of energy origin certificates - decrease by PLN 4m in the value of derivatives related to the valuation of forward currency transactions related to the purchase of CO2 and gas

4.2 Statement of cash flows

Total net cash flows from operating activities in 2015 amounted to PLN 797m as compared to PLN 530m in 2014.

Negative net cash flows from investing activities in 2015 amounted to PLN 1768m as compared to negative net cash flows of PLN 320m in 2014. The level of cash flows from investing activities in 2015 was influenced first of all by net cash flows related to the acquisition of bonds issued by the companies belonging to the PGE Group. In 2015 there occurred a cash outflow related to the purchase and redemption of bonds issued by the PGE Group companies for the amount of PLN 2396m, while in 2014 the Company recorded outflows of PLN 906m.

Positive net cash flows from financing activities in 2015 fell to PLN 2m as compared to positive net cash flows of PLN 581m in 2014. The level of net cash flows from financing activities in 2015 was determined mainly by incurred loans and credits, issued bonds, paid dividends, and inflows related to the cash pooling services. In 2015 inflows from loans, credits and bond issues amounted to PLN 500m, which was PLN 2220m less than in 2014. In 2015 the Company paid its shareholders PLN 1458m in dividends, which was PLN 599m less than in 2014. In 2015 the Company recorded PLN 1155m in inflows from the cash pooling services.

As the parent company of the PGE Capital Group, PGE S.A. provides the particular companies within the Group with funds for the financing of their investment projects and current activities. Such funds are provided by way of selling zero-coupon and coupon bonds. For this purpose, the companies of the PGE Capital Group entered into agency agreements with banks for the provision of services related to bond issues.

As at 31 December 2015 PGE GiEK S.A. held issued bonds for the combined nominal amount of PLN 4770m; the bonds had been acquired by PGE S.A. under the following bond issue agreements:

- The bond issue agreement entered into with ING Bank Śląski S.A. on 13 September 2010 providing for the issue of bonds up to the combined amount of PLN 4091m. On 29 November 2013 the Company signed an annex to the agency agreement extending the programme agreement until 31 December 2017. As at 31 December 2015 the Company did not hold any bonds issued under this programme.
- The bond issue agreement entered into with Powszechna Kasa Oszczędności Bank Polski S.A. on 30 November 2009 providing for the issue of bonds up to the combined amount of PLN 3700m. The agreement is to expire on 31 December 2025. As at 31 December 2015 the Company did not hold any bonds issued under this programme.

- The bond issue agreement entered into with ING Bank Śląski S.A. on 20 June 2011 providing for the issue of bonds addressed to PGE S.A. The agreement is to expire on 31 December 2025. As at 31 December 2015 the nominal value of bonds acquired by PGE S.A. under this agreement was PLN 4770m.

As at 31 December 2015 PGE EO S.A. held bonds acquired by PGE S.A. for the amount of PLN 1085m.

As at 31 December 2015 the companies belonging previously to the group of PGE Energia Naturity held bonds acquired by PGE S.A. for the amount of PLN 391.5m, including:

- PGE Energia Naturity Omikron Sp. z o.o. in the nominal amount of PLN 135m,
- PGE Energia Naturity PEW Sp. z o.o. in the nominal amount of PLN 216.5m,
- PGE Energia Naturity Sp. z o.o. in the nominal amount of PLN 40m.

PGE S.A. bond issue programme up to the amount of PLN 5000m addressed to the PGE Group companies

In 2015 PGE S.A. was a party to the agency agreement entered into on 11 May 2009 with ING Bank Śląski S.A. for the establishment of a bond issue programme addressed to the PGE Group companies. The maximum amount of the programme is PLN 5000m. Within the programme, PGE S.A. may issue coupon bonds or zero coupon bonds addressed to the PGE Group companies.

As at 31 December 2015 the Company did not have any liabilities related to bonds issued under this programme.

The PGE S.A. market bond issue for the amount of up to PLN 5000m

On 29 August 2011 PGE S.A. entered into an indefinite period agreement with Bank Polska Kasa Opieki S.A. and ING Bank Śląski S.A. for the establishment of a bond issue programme ("Programme").

The maximum amount of debt under bond issues (constituting the maximum allowable combined amount of issued and not redeemed bonds) within the Programme may not be higher than PLN 5000m.

On 27 June 2013 the parties to the agreement carried out a non-public issue of five-year, coupon, bearer bonds with a variable interest rate. The bond maturity date is 27 June 2018. On 29 June 2013 bonds with a par value of PLN 1000m were admitted to trading in the Alternative Trading System organised by the company BondSpot S.A. and the Alternative Trading System organised by the Warsaw Stock Exchange.

As at 31 December 2015 the Company's liabilities under the bond issue programme equalled PLN 1000m.

5. Significant agreements

Credit agreements

On 7 September 2015 PGE S.A. entered into a long-term credit agreement with a consortium of the following banks: BNP Paribas S.A. Branch in Poland, Société Générale S.A.,

Bank Handlowy w Warszawie S.A., ING Bank Śląski S.A., Bank Zachodni WBK S.A., mBank S.A., Powszechna Kasa Oszczędności Bank Polski S.A. and Bank Polska Kasa Opieki S.A. (Organisers and Creditors) and Bank Handlowy w Warszawie S.A. (Credit Agent).

The subject matter of the agreement is the provision of a credit in two parts, i.e. a term credit in the amount of up to PLN 3630m and an open-end credit in the amount of up to PLN 1870. The agreement expiry date falls on 30 September 2023, while the deadline for the repayment of the open-end credit falls on 30 April 2019 and the deadline for the repayment of the term credit falls on 30 September 2023. The credits' interest rates will be variable and based on WIBOR rates (reference rates) plus a margin. The agreement does not provide for the use of contractual penalties. The agreement's value meets the criterion of a significant agreement because it is higher than 10% of the Company's equity. The combined value of all other agreements entered into by PGE S.A. and its subsidiaries with the banks participating in the consortium during the 12 months before the execution of the aforementioned agreements was approximately PLN 3.2bn.

On 27 October 2015 PGE S.A. entered into two credit agreements for the combined amount of close to PLN 2bn with the European Investment Bank.

The amount of PLN 1.5bn acquired under one of these agreements will be allocated to projects related to the modernisation and development of distribution networks. The funds coming from the other agreement, i.e. the remaining PLN 0.5bn, will be spent on the financing and refinancing of the construction of cogeneration units in the Gorzów Cogeneration Plant and the Rzeszów Cogeneration Plant. The European Investment Bank will have provided the credits within 22 months from the execution of the agreements. According to the agreed conditions, the credit amounts should be repaid within 15 years from the release of the last credit instalment.

The performance of the Shareholders' Agreement of PGE EJ 1 sp. z o.o.

On 3 September 2014 the companies PGE S.A., TAURON, ENEA and KGHM (Business Partners) entered into a Shareholders' Agreement.

Under this Shareholders' Agreement, on 15 April 2015 the Business Partners entered into an agreement for the sale of shares in the company PGE EJ 1 sp. z o.o., under which each of them acquired 10% of shares in the company.

In consequence of the share sale transaction, PGE S.A. holds 70% of the share capital of PGE EJ 1 sp. z o.o., and each Business Partner holds a 10% shareholding in PGE EJ 1 sp. z o.o. In May 2015 the National Court Register entered the new text of the company's Articles of Association resulting from the provisions of the Shareholders' Agreement; in May and June 2015 the representatives of the Business Partners were appointed to the Supervisory Board of PGE EJ 1 sp. z o.o.

According to the adopted assumptions, the PGE Capital Group is to fulfil the function of the leader in the construction and operation of Poland's first nuclear power plant with a capacity of approximately 3000 MW, and the company PGE EJ 1 sp. z o.o. is to fulfil the function of the plant operator.

According to the Shareholders' Agreement, the Parties undertake together, in proportion to their respective shareholdings, to finance operations within the preliminary phase of the Programme (Development Stage). The Development Stage will comprise the determination of such elements as potential partners, including a strategic partner, technology providers,

EPC (Engineering, Procurement, Construction) contractors, nuclear fuel suppliers, the acquisition of financing for the Programme, the organisational and competence preparation of the company PGE EJ 1 sp. z o.o. for the future role of the plant operator responsible for its safe and effective operation (“integrated proceedings”) and the plant's location. The expenditure of PGE S.A. at the Development Stage will not exceed PLN 700m. The Parties to the Shareholders’ Agreement expect that further decisions concerning the Programme, including decisions concerning the particular Parties’ further participation in the next stage of the Programme, will be made directly before the completion of the integrated proceedings.

6. 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 regulating 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 2015 the effectiveness of sponsoring activities was as follows:

- for the sponsoring of sport - 205%
- for the sponsoring of culture - 177%
- for other sponsoring activities - 145%

A positive evaluation of the report for the year 2015 was reflected in the Management Board's resolution no. 124/33/2016 of 12 April 2016, approving the report on the effectiveness of sponsoring activities in the year 2015.

The Supervisory Board became acquainted with the aforementioned documents and approved them at the meeting held on 25 April 2016.

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

7. Charitable activities

The PGE Capital Group is actively involved in various social activities. It takes care of the development of the areas where it conducts its business activities. It is a partner for local communities – it supports them and cooperates with them. The Company is involved in

social activities through its PGE Foundation. The Foundation's objective is to ensure the transparency of its activities and the development of local communities through the implementation of its original programmes and the consistent donation policy. On the basis of the transparent and objective principles, the PGE Foundation supports local organisations and institution in the areas of science and education, health care, social assistance, ecology and environmental protection. In 2015 the PGE Foundation and the companies belonging to the PGE Capital Group spent PLN 6,465,945 on charitable activities (financial donations). Within the PGE Foundation, the supervisory function is exercised by the Foundation Board consisting of the representatives of the companies - benefactors. The Foundation Board approves yearly financial and substantive reports and approves the Foundation's financial plans. Furthermore, the Foundation informs the Donor about its activities, providing the Management Board and the Supervisory Board with regular reports.

The employees of PGE S.A. develop their pro-social involvement through participation in the PGE corporate volunteering programme called "We Help". Thanks to its own projects addressed to local communities, they reach places where direct assistance is needed and implement permanent and positive changes. In the years 2014-2015 over 200 employees - volunteers of PGE S.A. participated in the programme. They volunteered 16 500 hours of their free time, carrying out 70 projects in 35 locations. Evaluation surveys have shown that, for 2/3 of the volunteers of PGE S.A., the participation in the programme was the first experience of this type. All participants have declared unanimously their willingness to continue voluntary work in the future.

8. The remuneration policy

The remuneration package for the employees and directors of PGE S.A. consists of a permanent part (comprising a base salary and an annual bonus), 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, compensation of costs of meals, electricity or commuting to work.

PGE S.A. employees receive also benefits from the Corporate Social Benefits Fund.

In 2015 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.

Such agreements were entered into pursuant to the provisions of Article 3 clause 2 of the Act on the remuneration of people managing particular legal entities ("Chimney Salaries Act"). The agreements' provisions concerning remuneration result from the remuneration principles determined by the Supervisory Board.

The remuneration of the Management Board consists of a permanent part and a bonus depending on the Company's financial results.

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.

The amount of remuneration for the members of the Supervisory Board of PGE S.A. is determined on the basis of the 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.

9. Factors important for the development of PGE S.A. and the PGE Group

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	<ul style="list-style-type: none"> ● the volume of demand for electricity and heat ● seasonality and weather conditions
Energy market	<ul style="list-style-type: none"> ● the prices of electricity in the wholesale and retail markets ● the prices and tariffs in the electricity and heat retail markets ● heat transmission and distribution tariffs and electricity distribution tariffs
Related markets	<ul style="list-style-type: none"> ● 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	<ul style="list-style-type: none"> ● the availability of cross-boarder 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	<ul style="list-style-type: none"> ● 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	<ul style="list-style-type: none"> ● the implementation level and possible changes of the state's energy policy ● changes in the range of the system services such as: <ul style="list-style-type: none"> - modifications of the current mechanism of the system service called the Operating Power Reserve - the launching of the Supplemental Contingency Reserve service - the launching of the subsequent packages of demand reduction services ● amendments to the Energy Law, in particular with respect to the optimisation of the renewable energy sources and cogeneration

support systems as well as other acts

- 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 Konwencjonalna S.A. ("PGE GiEK S.A.).
- the decisions of the President of the Energy Regulatory Office concerning the implementation of the Power Purchase Agreements Act and the court's ruling on the disputes between the President of the Energy Regulatory Office and the energy producers from the PGE Group entitled to receive compensations under the PPA Act with regard to the annual adjustments of the stranded costs for the years 2009 and 2010 as well as annual adjustments of the stranded costs and annual adjustments of costs incurred by gas-fired units in the years 2009-2012
- the issue of implementing the directive establishing a scheme for greenhouse gas emission allowance trading into the national legal system, including the matter of CO2 derogations. Currently the process of acquiring free allowances in return for the execution of investment projects included in the National Investment Plan does not have an unambiguous legal basis.
- the issue of the implementation of the energy efficiency directive into the national legal system
- 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
- possible adverse settlement of legal disputes

International

- the regulations of the 2030 climate and energy package - the decisions of the climate summit in October 2014, in particular: the objective of at least a 40% CO2 emission reduction, the objective of RES's 27% share in the energy mix, the objective of a 27% increase in energy efficiency, a possibility of granting the energy sector free CO2 emission allowances (so-called derogations), a possibility of acquiring funds for modernisation projects in the energy sector. There is an urgent necessity to develop precise rules of allocating available assistance.
 - the BAT ("best available techniques") revision process – uncertainty with respect to future SO2, NOx, dust and other pollutants (including mercury) emission standards after 2020
 - the draft NEC ("National Emission Ceilings") Directive on the annual capping of national emissions of air pollutants and its impact on the energy sector
 - works on Poland's joining the market coupling mechanism
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10. Risks and threats to PGE S.A. and the PGE Capital Group

The business activities of the PGE Capital Group, similarly to the activities of other entities operating in the power generation sector, are exposed to a number of risks and threats, both external ones related to the market, legal or regulatory environments and internal ones related to the conduct of business operations.

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 and heat,
 - tariffs (regulated prices),
- property risks related to the development and maintenance of the generation 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 quantity of 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.

11. EVALUATION OF THE INTERNAL CONTROL, RISK MANAGEMENT AND COMPLIANCE SYSTEMS AS WELL AS THE INTERNAL AUDIT FUNCTION**11.1. 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:

- the Company's internal processes, both automatic and manual control mechanisms limiting the level of risks related to the achievement of business objectives,
- 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.

Within the PGE Capital Group, the risk management process is conducted on the basis of the GRC Model (Governance – Risk – Compliance), which allows the adjustment and integration of the process at all management levels in the particular operating areas of the Group. Due to the establishment of the Risk Committee reporting directly to the Management Board, the Company is guaranteed supervision over the effectiveness of the risk management processes in the whole Group. The definition of 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 risk management instruments.

As the Corporate Centre responsible for the management of the Group, PGE S.A. develops and implements solutions in the area of risk management architecture.

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 determined and 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 as well as the management of consolidated exposure to the price risk by means of the mechanisms securing risk levels exceeding the acceptable level. The market risk management principles are determined by the process organisation assumptions (which are the same for the main companies within the PGE Group) within the context of trading 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 (up to 5 years, based on the assumptions that the required market liquidity will be available). A particular position security level is determined on the basis of the results of measuring the price risk related to electricity and related products. Determining its target security levels,

the PGE Capital Group takes into consideration its financial situation, in particular its objectives determined in 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. New products launched in the retail market are advertised actively, e.g. in the nationwide marketing campaigns. Maintaining a broad product portfolio and concentrating on the adjustment of its offer to the market (both the historical and the national ones), the PGE Capital Group diversifies its channels of reaching end customers (the own sales channel, the agency sales channel) and diversifies its target groups based on receivers' volume potential. The activities aimed at the maintenance of the current customers are based on the model of a diversified portfolio of loyalising offers and acquisition-oriented activities. The catalogue includes also special offers addressed to the customers previously lost to competitors as well as so-called sector offers dedicated to particular types of business activities. The PGE Capital Group introduces also so-called combined offers. Taking care of its customers' interests, PGE pays special attention to the high quality of customer service by building its employees' competencies and shaping relationships in the areas of both corporate and individual customers. Due to the implementation of tools supporting these processes, the PGE Capital Group effectively manages information streams, which translates directly into comfort in its relations with customers as well as the better planning and organisation of sales activities.

Regulatory and legal risks

Activities: The business activities of the PGE Capital Group are subject to numerous national, European and international regulations and laws. The monitoring of both implemented and proposed legal changes ensures the minimisation of the adverse impact of regulations on operations in the basic business segments, i.e. the generation of electricity and heat, the mining of lignite, the distribution and sale of electricity and heat. In the last reporting period this function was strengthened additionally by the establishment of a separate compliance function within the structure of PGE S.A. 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. It adjusts its internal regulations and practices so that the business activities of the PGE Capital Group are consistent with the sector norms, environmental protection standards and other applicable 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 three key investment projects (Opole, Turów, Gorzów), a number of network investments, investments related to renewable energy sources 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 optimises such costs by, among other things:

1. Monitoring the (quality and quantity of) fuel inventories and changes in fuel prices. Ensuring continuity of supplies by entering into long-term agreements with suppliers and developing price determination formulas.
2. Carrying out inspections, repairs and modernisations of the assets, which translates into ensuring the optimum duration of the equipment's usability and availability of the key generation assets.
3. Acquiring partly free CO₂ emission allowances for the power plants and cogeneration plants operated by the PGE Capital Group. The balance of CO₂ emission allowances is purchased based on the assumption that the sales margin level needs to be secured.
4. Optimising the size of the workforce with respect to the HMR Strategy being implemented in the PGE Capital Group. Within the scope of the workforce optimisation activities, the companies belonging to the PGE Capital Group have launched voluntary leave programmes.

Financial risks

Activities: The PGE Capital Group controls the credit risk related to trading transactions which may generate considerable losses should a business partner fail to fulfil its contractual obligations. Before a transaction is entered into, the Company conducts an assessment of the business partner, including a financial analysis, 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.

- 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;
- 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 the particular companies.

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.

11.2. 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 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 2015.

11.3. The compliance management system within the PGE Capital Group

Since November 2015 the whole PGE Capital Group, including the parent company PGE S.A., has been working on the implementation a compliance management system. The system is to include solutions applicable to all employees of the PGE Capital Group, including its management personnel.

The objective of the compliance management system is to minimise non-compliance risks which may result in penalties, sanctions or tarnished reputation in consequence of failure to comply with regulations and standards constituting legal obligations or the best practices in a particular area. In order to achieve this objective, it is necessary:

- to develop the organisational culture of the PGE Capital Group on the basis of the legal compliance principle, the ethical standards and the sustainable business principles (a code of ethics, a code of conduct, general policies, procedures);
- to implement clear and transparent processes ensuring the possibility of identifying, clarifying and immediately eliminating any cases of non-compliance;
- to keep the employees informed with respect to the compliance issues.

The implementation and maintenance of an effective compliance management system is the responsibility of the Management Board. The employees dealing with compliance issues report directly to the President or another member of the Management Board, and are also able to report directly to the Supervisory Board or its Audit Committee.

- In November 2015 PGE S.A. started to build the compliance management system.
- In March 2016, on the basis of a resolution of the Management Board, the Company established a Compliance Office (within the structure of the Department of Organisation and Management; it is a temporary solution for organisational purposes; it does not meet the requirements of the Good Practices with respect to the independence of people responsible for compliance issues).
- In April 2016, on the basis of a resolution of the Management Board, the Compliance Office was transferred to the structure of the Internal Audit Department (at this stage, the solution does not meet the requirements of the Good Practices).
- In May 2016, on the basis of a resolution of the Management Board, the Company adopted a Compliance Training Plan.

The function of the Investigative Control is to be included in the Compliance Office in order to ensure its proper fulfilment.

The Supervisory Board of PGE S.A.

The results of compliance-related activities need to be reported periodically (at least once a year) to the Supervisory Board by the Audit Committee.

The Supervisory Board is to supervise and monitor the compliance management system within the PGE Capital Group, to evaluate the effectiveness of the compliance system and function on the basis of, among other things, periodic reports. 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 Audit Committee of the Supervisory Board will approve yearly compliance programmes, approve yearly compliance reviews, receive and (if necessary) react to notifications concerning significant risks and non-compliance incidents from the unit competent for compliance issues.

▪ 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 future 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.

The Supervisory Board evaluates positively activities undertaken by PGE S.A. in 2015 and actively participates in the development of the compliance management system.

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

12.1. 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 2013 – 2015 as obligatory for the Company and exercised due diligence in order to comply with their principles.

In 2015 the Company followed The Good Practices 2013 – 2015 with the following exceptions:

- a) Principle no. 5 included in Chapter I "Recommendations concerning the good practices of the companies listed on the stock exchange" and concerning the possession of a remuneration policy and principles of determining such a policy for the members of the corporate supervisory and management bodies.

Before the end of 2015 the Company had not developed a 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. As far as the members of the Supervisory Board are concerned, their remunerations are regulated by the provisions of the Act of 3 March 2000 on the remunerations of people managing certain legal entities, which limits the remuneration of the members of the Supervisory Board to one average monthly salary in the business sector exclusive of profit-based bonuses in the fourth quarter of the year specified in the Act. This Act does not apply to the members of the Management Board because they provide services for the benefit of the Company under agreements for the provision of managerial services.

- b) Principle no. 10 item 2 included in Chapter IV "Good practices used by shareholders" and 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 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 meetings in a manner specified in The Good Practices 2013-2015. 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 Supervisory Board shares this opinion.

In 2015 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 2013 - 2015.

12.2. Information obligations concerning the application 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 recognising as equivalent information required under the laws of a country which is not a Member State (Journal of Laws of 2014, item 133) 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 2015 the Company included a relevant announcement about the application of the corporate governance principles in the report on the Company's activities in 2014, and on its website at www.gkpge.pl in accordance with principle II.1.13 of The Good Practices 2013 – 2015.

The aforementioned announcement includes the following information meeting the requirements specified in the regulation:

- The corporate governance principles applicable to the Company in 2014
- 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.

An equivalent announcement on the application of the corporate governance principles in 2015 was included in the report on the Company's activities for the year 2015 published on 16 February 2016 and on the Company's website, in accordance with principle I.Z.1.12 of The Good Practices effective as of 1 January 2016.

The Supervisory Board 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.

Anna Kowalik

Members of the Supervisory Board:

Janina Goss
Małgorzata Mika-Bryska
Jarosław Głowacki
Mateusz Gramza
Grzegorz Kuczyński
Mieczysław Sawaryn
Artur Składanek