



**MANAGEMENT BOARD'S REPORT ON  
ACTIVITIES OF  
PGE POLSKA GRUPA ENERGETYCZNAS.A.  
for the year 2009**

Warsaw, March 2010

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## **1. General information about PGE S.A.**

### **1.1. General information about the Company**

The Company was established as Polskie Sieci Elektroenergetyczne S.A. -- a company wholly owned by the State Treasury -- by the Minister of Industry on August 2, 1990 and was registered in the District Court on September 28, 1990. The Company was entered into the National Court Register maintained by the District Court in Warsaw, XII Commercial Division of the National Court Register, under the National Court Register number KRS 0000059307.

As at the date of the preparation of these financial statements, the registered office of the Company was located in Warsaw at ul. Mysia 2. Until July 30, 2009, the registered office of the Company was located in Lublin at ul. Garbarska 21a.

PGE Polska Grupa Energetyczna S.A. ("PGE", "PGE S.A.", the "Company") is the parent company of PGE Polska Grupa Energetyczna S.A. Capital Group ("Group", "Capital Group", "PGE Group", "PGE Capital Group"). On May 9, 2007, the State Treasury made a contribution in kind to Polskie Sieci Elektroenergetyczne S.A. in the form of 85% of the shares of PGE Energia S.A. and BOT Górnictwo and Energetyka S.A. In exchange, the State Treasury acquired newly issued shares in the increased share capital of PSE S.A. The formation of Polska Grupa Energetyczna was the result of the government "Programme for the electro energy sector" adopted in March 2006.

The core business activities of the Group companies are activities involving:

- the mining of lignite,
- the production of electricity,
- the production and distribution of heat,
- the distribution of electricity,
- wholesale trading and retail sales of electricity,
- other services related to the performance of the abovementioned tasks.

The business is conducted on the basis of appropriate licences granted to individual entities constituting the Group.

The controlling entity of the Company is the State Treasury.

The Management Board's Report on the activities of PGE covers the period from January 1, 2009 to December 31, 2009.

### **1.2. Organisational and capital relationships of PGE S.A.**

As at the end of 2009, PGE S.A. directly held shares in:

- 18 subsidiaries,
- 3 affiliates,
- 6 other companies.

Changes which took place in the structure of the long-term financial assets of PGE S.A. during the 12-month period ended December 31, 2009 are described in detail in note No. VI.7-10 of the Notes to the PGE S.A. financial statements for 2009.

As at December 31, 2009, PGE S.A. does not have any branches.

### **1.3. Changes in the organisation and management of PGE S.A. and the Capital Group**

#### **Changes in the organisation and management of PGE S.A.**

As at the end of 2009, the Organisational Rules adopted by the Management Board in Resolution No. 448/66/2009 dated November 13, 2009 and approved by the Supervisory Board in Resolution No. 97/VIII/2009 dated November 20, 2009 were in effect.

The abovementioned Organisational Rules replaced the Organisational Rules approved by the Management Board in Resolution No. 137/24/2009 dated April 9, 2009 and the Supervisory Board Resolution No. 49/VIII/2009 dated April 28, 2009. Changes in the Organisational Rules were primarily due to the expansion in 2009 of the composition of the Management Board of PGE S.A. and the new division of the responsibilities of the individual Members of the Management Board related to it.

## **Changes in the organisation and management of the Capital Group**

During the period ended December 31, 2009, PGE S.A. did not discontinue any significant areas of its operations.

In 2009 two strategic projects were being implemented in PGE, as the parent company of PGE Capital Group: the PGE Consolidation Programme and the Non-Energy Asset Management Concept with regard to PGE Capital Group.

### **Consolidation Programme**

In May 2009, the Management Board of PGE S.A. approved a preliminary concept of the PGE Consolidation Programme and in November 2009 the Definition and Schedule of the Consolidation Programme, and the division of rights and responsibilities of the project participants.

The purpose of the Consolidation Programme is to gain a strong market position and a sound financial standing to ensure, without limitation, the required further development of the PGE Capital Group through legal and organisational consolidation of companies in the following areas:

- electricity retail sales,
- electricity distribution,
- conventional energy production,
- renewable energy production,

in the form of consolidating entities, as well as business changes in the wholesale trading area. The Program covers the reorganisation of an intricate capital structure, the implementation of an optimum management structure and the centralisation of functions performed in particular areas, as well as the achievement of synergy in the PGE Capital Group.

So far, under the Consolidation Programme, following actions were taken: (i) selection of consolidating companies in particular areas, (ii) adoption and signing of the merger plan of PGE S.A. and its subsidiaries: PGE Górnictwo i Energetyka S.A. and PGE Energia S.A., and (iii) signing of the merger plans of PGE's subsidiaries in the following business areas:

- conventional energy production (an acquiring company is PGE Elektrownia Bełchatów S.A.),
- renewable energy production (an acquiring company is PGE Energia Odnawialna S.A.) ,
- electricity sale to final users (an acquiring company is PGE Obrót S.A.),
- electricity distribution (an acquiring company is PGE Dystrybucja S.A.).

In addition, on February 16, 2010, the Management Board of PGE S.A. made a decision on the intension to merge PGE with its subsidiary, PGE Electra S.A. The purpose of the merger is to increase the transparency of the group and allocated cash flows and margins to a company listed on the Warsaw Stock Exchange. This will allow for further financial cost reduction and enable to pay dividend to shareholders.

### **Non-core asset management programme within the PGE Capital Group**

In 2009, the PGE Capital Group adopted the "Non-core asset management concept within the PGE Capital Group". The aim of the programme is to transparently separate core activity from other activities as well as disposal and reorganisation of the assets.

It is assumed that by simplifying the structure of capital relations and organisational structures of the PGE Group, as well as by enforcing uniform management standards, the following effects will be achieved:

- the achievement of a transparent business model of the PGE Capital Group (focusing on core activities);
- the assurance of transparency in the management of power companies' assets and expenses;
- releasing power companies' resources, involved in non-core assets;
- the reduction of costs of services not connected with core activities.

As a result of implementation of the above programme, non-core assets, in form of companies and areas not separated from core activities of the companies, were identified and the disposal and reorganisation processes within the PGE Group were initiated.

By the end of 2009 under the programme shares/stocks of two companies were sold, liquidation of one company was completed and redemption of shares in one company was made. In December 2009, the sale of shares in one of the listed companies was initiated.

After the balance-sheet date, till the date of approval of this report by the Management Board of the Company, the shares in three additional companies, a holiday resort were sold and part of shares in one of the listed companies were sold, liquidation of one company was completed and a conditional agreement with an investor for the sale of one company was signed.

In connection with process of disposal of non-core assets, the valuations of seven assets was completed and the valuations of another assets are carried out. Currently project focuses on disposal and reorganisation of the remaining assets.

#### 1.4. Employment

Employment in PGE Polska Grupa Energetyczna S.A. as at the end of 2009 amounted to 260 people and was lower than at the end of 2008 by 43 people, that is, by 14.2%. Average employment in PGE Polska Grupa Energetyczna S.A. amounted to 283.32 full-time equivalents in 2009.

Table No.1 Employment	As at December 31, 2009	As at December 31, 2008	Change %
Total employment (in persons)	260	303	-14.2%
Total employment (in full-time equivalents)	259.4	300.5	-13.7%
Average annual employment (full-time equivalents)	283.3	262.7	7.8%

The decrease in employment was mainly the result of the restructuring process as well as natural departures.

#### 1.5. Information about shares and other securities of PGE S.A. and major shareholders of PGE S.A.

##### 1.5.1. Share capital and ownership structure

As at the report date, the share capital of PGE S.A. amounted to PLN 17,300,900,000 and was divided into 1,730,090,000 shares with a nominal value of PLN 10.00 each, including:

- 1,470,576,500 series A bearer shares,
- 259,513,500 series B bearer shares.

The existing shares in the share capital have been issued and fully paid. There are no preferences attached to the Company's shares. The same rights are attached to all of the shares, including the right to one vote per share at the Shareholders' Meeting. All the existing shares were created pursuant to the applicable provisions of the Code of Commerce, the Commercial Companies Code and the Articles of Association.

The Management Board of PGE S.A. does not have any information about agreements which may contribute to future changes in the proportions of shares held by the existing shareholders. On January 26, 2010, the Management Board of PGE S.A. approved and signed the merger plan with its subsidiaries PGE Energia S.A and PGE Górnictwo i Energetyka S.A. ("Acquired companies"). As a result of the merger new shares of PGE S.A. will be issued for the purpose of the merger, and acquired by the shareholders of Acquired companies in exchange for their shares held in the Acquired companies (with the exemption that PGE S.A. will not acquire its own shares in exchange of the shares of Acquired companies). After the registration of new shares in the registry court, the shares of PGE S.A. will be diluted.

### **1.5.2. Own shares**

As at December 31, 2009, PGE S.A. did not hold any own shares. The Company's shares were not held by any subsidiary thereof or a third person acting on behalf or to the benefit of the Company, either.

Among persons managing and supervising PGE S.A. as at December 31, 2009, in accordance with information held by PGE S.A., the shares of the mother company were held by: Marcin Zieliński, Chairman of the Supervisory Board (500 shares of a nominal value of PLN 5,000), Maciej Bałtowski, Member of the Supervisory Board (1,364 shares of a nominal value of PLN 13,640), Ryszard Malarski, Member of the Supervisory Board (5 shares of a nominal value of PLN 50), and Katarzyna Prus, Member of the Supervisory Board (273 shares of a nominal value of PLN 2,730). As at December 31, 2009, members of the Management and Supervisory Boards of PGE S.A. did not hold any shares/shares in other companies related to the mother company.

### **1.5.3. Control system of employees share scheme**

In 2009, PGE S.A. did not maintain any employees share schemes.

### **1.5.4. Use of proceeds from issues**

On November 2, 2009, gross funds from the offer for the issue of shares of PGE Polska Grupa Energetyczna S.A. of PLN 5,968,810,500.00 were credited to the escrow account kept with Bank PEKAO S.A. Funds in the escrow account were blocked till the fulfilment of all formal requirements connected with the registration of new shares and company share capital by the Company, i.e. till December 1, 2009.

On December 1, 2009, PGE S.A. received funds from its stock exchange debut from the escrow account and it has been able to manage proceeds from the issue since then. Proceeds from the issue are used in accordance with goals described in the prospectus. Funds are successively spent for the repayment of short-term and long-term debts, including the refinance of debt taken to finance the first and second tranche of payment related to the purchase of minority stakes in certain subsidiaries from the State Treasury. Other financial surpluses are allocated to finance the activity and invested in short-term safe bank deposits.

In addition, in 2009 PGE S.A. was issuing bonds under the bond programs described in p. 2.3 of thereof. Funds acquired from bonds issue were used to finance current operations of PGE S.A. and investments carried out by selected subsidiaries.

## **1.6. Remuneration for PGE S.A. authorities**

### **Rules for determining and amount of remuneration paid out to Management Board members in 2009**

Management Board members are employed on the basis of employment contracts. Remuneration and benefits payable to the Management Board are defined in accordance with the provision of the act on salaries of persons managing certain legal entities (the "Salary Cap Act"). Pursuant to this act, remuneration and benefits may be paid to Management Board members in the following forms: monthly salary, annual award, fringe benefits, severance pay.

Pursuant to the Salary Cap Act, the maximum monthly salary of the Management Board member may not exceed 6-times monthly salaries in the corporate sector, without awards payable from profit in the fourth quarter of a previous year, as published by the President of the Polish Statistical Office.

Pursuant to the Salary Cap Act, Management Board members may obtain an annual award which may not exceed their three average monthly salaries in the preceding year. Rules for annual awards are defined in the Regulation of the Minister of Treasury dated March 12, 2001 on detailed terms and conditions for granting annual awards to persons managing certain legal entities and a draft annual award application (Journal of Laws of 2001, No 22, item 259, as amended).

Pursuant to the Salary Cap Act, Management Board members may also obtain fringe benefits, which may not exceed 12 average monthly salaries applied to calculate their monthly salary. The list of fringe benefits is presented in the Regulation of the Prime Minister dated January 21, 2003 on detailed list of fringe benefits payable to persons managing certain legal entities and rules for allocating such benefits (Journal of Laws of 2003, No 14, item 139).



Pursuant to the Salary Cap Act, in the case of dismissal or termination of an employment contract or a civil contract for reasons other than the violation of basic employment duties, a Management Board member may receive a severance pay that is not bigger than 3 monthly salaries.

Management Board members are also subject, to a limited extent, to certain provisions of the PSE Collective Bargaining Agreement of October 7, 1999 and certain provisions of the Collective Bargaining Agreement for Employees of the Power Industry of May 13, 1993. Pursuant to those acts, Management Board members are entitled to certain benefits like a right to use electricity up to 3,000 kWh per annum at a discounted price. The discounted price amounts to 20% of the household price tariff. The other benefit is a right to private medical health care at Lux-Med worth up to PLN 1,210.80 in 2009.

Based on the Supervisory Board's resolution of October 23, 2008, Management Board members were granted additional benefits in the form of third party insurance for Management Board members. Under the insurance contract of October 24, 2008 between PGE S.A. and TU Allianz Polska S.A., insurance covered third party liability of Management Board members due to their functions. The contract was concluded for annual period starting from October 24, 2008 till October 23, 2009. Based on an annex of April 23, 2009, Supervisory Board members have also been covered by the third party insurance. Total additional benefit under the agreement for the Management Board members of PGE S.A. amounted to PLN 9,900 in 2009. On October 23, 2009, PGE S.A. concluded the Third party insurance for Capital Company Authorities with TU Allianz Polska S.A. for the term from October 24, 2009 to October 23, 2010.

In addition, pursuant to the above Supervisory Board's resolution, Management Board members were granted an additional benefit in the form of third party insurance covering liability relating to the prospectus. On October 16, 2009, PGE S.A. concluded an insurance contract covering third party liability resulting from the prospectus with TU Allianz Polska S.A. for the period from October 16, 2009 to October 15, 2015. The Company has the individual interpretation of the head of the Revenue for the above contract, based on which such a benefit is not considered as a taxable income of an employee.

In addition, the Company concluded no-competition agreements with Management Board members. The agreements specify the duration of such a restriction and the amount of the remuneration that the Management Board member will receive as compensation for not engaging in competing activity and not performing any work under employment contract or on any other factual or legal basis to the benefit of an entity running competing activity in relation to the Company. During six months from the date of termination of the employment contract, the Company shall pay to a Management Board member a monthly compensation in the amount equal to the monthly remuneration received by a given Management Board member for the last full calendar month when his employment contract was valid.

Remuneration paid (on accrual basis) by PGE S.A., Group entities other than PGE S.A. in 2009 to the Management Board members of PGE S.A., who performed their functions in 2009, by person, is presented in the table below.



Table 2: Remuneration paid in 2009 to members of the Management Board of PGE S.A.

Full name of a Management Board member	Function	Remuneration paid by PGE S.A. in 2009 *	Remuneration paid by Group entities other than PGE S.A. in 2009
Tomasz Zadroga	President of the Management Board	239,024.16	386,674.59
Marek Szostek	Management Board Vice-president in charge of Organisation	99,593.40	9,485.11
Piotr Szymanek	Management Board Vice-president in charge of Corporate Affairs	239,024.16	136,287.44
Wojciech Topolnicki	Management Board Vice-president in charge of Development and Finance	238,553.05	137,917.66
Marek Trawiński	Management Board Vice-president in charge of Operations	239,024.16	266,797.87

\* excluded surcharges.

The remuneration, including surcharges, paid by the Company to all persons that acted as Management Board members for a period in which they performed such functions and after the termination of their functions in 2009 amounted to PLN 1,603.04 thousand in total, but the information concerning persons not being Management Board members as at December 31, 2009 is not included in the above table. As at December 31, 2009 remuneration paid to persons not being Management Board members of the Group entities other than PGE S.A. amounted to PLN 110.50 thousand. In addition, persons not being Management Board members as at December 31, 2009 received benefits resulting from the termination of their employment and post-employment benefits amounting to PLN 119.51 thousand and PLN 268.45 thousand respectively.

#### Rules for defining and amount of remuneration paid out to Supervisory Board members

Rules for remuneration of Supervisory Board members are defined on the basis of the Salary Cap Act. On the basis of the Salary Cap Act, such remuneration may amount maximum to one average monthly salary in the corporate sector without awards payable from the profit in the fourth quarter of a previous year, as published by the President of the Polish Statistical Office.

Remuneration paid by PGE S.A. and Group entities other than PGE S.A. in 2009 (accruals basis) to present members of the Supervisory Board of PGE S.A. who performed their functions in 2009, by person, is presented in the table below.

Table 3: Remuneration paid in 2009 to members of the Supervisory Board of PGE S.A.

Full name of a Management Board member	Function	Remuneration paid by the Company in 2009 as consideration for the performance of functions in the Supervisory Board	Remuneration paid by the Company in 2009 under employment contract	Remuneration paid by Group entities other than PGE S.A. in 2009
Marcin Zieliński	Chairman of the Supervisory Board	42,940.28	-	24,500.00
Maciej Bałtowski	Supervisory Board Member, Vice-Chairman of the Supervisory Board	42,940.28	-	-
Jacek Barylski	Supervisory Board Member	42,940.28	-	-
Wojciech Cichoński	Supervisory Board Member, Secretary of the Supervisory Board	42,940.28	162,741.19	-
Małgorzata Dec*	Supervisory Board Member	16,813.08	-	-
Ryszard Malarski**	Supervisory Board Member	38,445.19	-	-
Katarzyna Prus	Supervisory Board Member	42,940.28	-	-
Zbigniew Szmuniowski	Supervisory Board Member	42,940.28	-	-

\* appointment date: July 30, 2009

\*\* appointment date: January 14, 2009

In 2009, based on the annex to the insurance contract of October 24, 2008 between PGE S.A. and TU Allianz Polska S.A., Supervisory Board members were granted fringe benefits in the form of third party insurance for Supervisory Board members. The contract was in force till October 23, 2009. Therefore, on October 23, 2009, PGE S.A. concluded a new contract on Third party insurance of Capital Company Authorities with TU Allianz Polska S.A. for the term from October 24, 2009 to October 23, 2010. In addition, Supervisory Board members are subject to the third party insurance connected with the prospectus..

## 2. Description of the business activities of PGE S.A.

### 2.1. Description of the business activities of PGE S.A.

The core business activity of PGE S.A. is the wholesale trading of electricity. As part of its auxiliary business activities, PGE S.A. provides support services to Capital Group companies, leases IT systems, and leases office space.

PGE Polska Grupa Energetyczna S.A. is the parent company of PGE Capital Group. The business activities of the Group are organised into five segments:

- Mining and Generation, including lignite mining and the generation of electricity and heat from conventional sources,
- Renewable Energy generation, including the production of electricity from renewable sources,
- Wholesale Trading of electricity and related products,
- Distribution of electricity, and
- Retail sales of electricity.

Apart from the above five major business lines, the PGE Group also runs activities in other areas, including telecommunications. The Group also comprises other companies whose core activity consists in the provision of auxiliary services to other companies from the energy and mining sectors. Such services include, without limitation:

- construction, repairs, modernisation and investment works relating to power equipment,
- comprehensive diagnostic tests and measurements of power and electrical machinery and equipment,
- management of side products of coal combustion, development and implementation of technologies for the use of such products, and the rehabilitation of degraded sites,
- medical and social services.

## **2.2. Main investments in Poland and abroad**

PGE did not make any significant acquisitions of shares of other companies in 2009. As at the date of these financial statements, no binding obligations were undertaken regarding any acquisition project.

In 2009, PGE S.A. held investments classified as investments in financial instruments in the amount of PLN 24,780.8 million compared with PLN 20,669.1 million in 2008. The division of financial instruments into categories was presented in note No. VI.13 of the Notes to the PGE S.A. financial statements for 2009.

The main item is composed of investments in subsidiaries in the amount of PLN 18,891.9 million in 2009, which were described in note No. VI.7-10 of the Notes to the PGE S.A. financial statements for 2009.

PGE, as the central entity of PGE Group, performs functions with regard to ensuring individual entities from the Group funds for the financing of investments and operating activities. The instrument which the company uses for this purpose is bonds issue. The amount of bonds issued amounted to PLN 2,452.5 million in 2009 compared with 2,309.6 million in 2008. Bonds have been described in detail in note No. VI.15 of the Notes to the PGE S.A. financial statements for 2009.

## **2.3. Description of significant agreements**

The agreements, which in opinion of PGE were concluded in ordinary course of activities and are significant for operations of PGE and PGE Group, are described below.

### **Electricity sales agreements concluded by PGE Group companies**

At the turn of 2009 and 2010, PGE S.A. concluded electricity purchase agreements for 2010 and the years 2011-2016 with the biggest electricity producers in the PGE Group, i.e. PGE Elektrownia Bełchatów S.A., PGE Elektrownia Turów S.A., PGE Elektrownia Opole S.A. and PGE Zespół Elektrowni Dolna Odra S.A.

### **Agreements on the finance of PGE S.A. and its subsidiaries**

#### PGE bond issuance program of up to PLN 2 billion

On May 19, 2009, PGE S.A. entered into three agreements relating to a bond issue program ("Programme"): (i) an indenture to acquire bonds to which the parties are PGE S.A. and ING Bank Śląski S.A., Societe Generale S.A., BNP Paribas S.A. Branch in Poland, Nordea Bank Polska S.A. and Powszechna Kasa Oszczędności Bank Polski S.A. (as the Lead Managers and the Bonds Issue Program Underwriters) and ING Bank Śląski S.A. (as the Issue Agent), (ii) an Agency and Deposit Agreement for the Bonds Issue Program with ING Bank Śląski S.A. ((as the Issue Agent, Paying Agent and Depositary) and Societe Generale S.A., BNP Paribas S.A. Branch in Poland, Nordea Bank Polska S.A. and Powszechna Kasa Oszczędności Bank Polski S.A. ((as Agents, Paying Sub-agents and Sub-depositaries), and (iii) a Dealer Agreement for the Bonds Issue Program with ING Bank Śląski S.A., Societe Generale S.A., BNP Paribas S.A. Branch in Poland, Nordea Bank Polska S.A. and Powszechna Kasa Oszczędności Bank Polski S.A. (as Dealers). On July 21, 2009 Bank Handlowy w Warszawie S.A. signed an Accession Agreement, while on November 13, 2009 Caja de Ahorros y Pensiones de Barcelona "la Caixa" (Savings Bank) Polish Branch of the International Enterprise (as Additional Underwriters). Thus, as of the Accession Agreement signing date, these banks acquired rights and took over obligations arising from the indenture to acquire bonds of May 19, 2009.

The maximum amount of the Programme is PLN 2 billion. Under the Programme, the Company may issue zero coupon bonds with maturities of up to one, three or six months, but not longer than 180 days. The maturity of the last series of bonds may be determined in a different manner but will in no event be after November 15, 2010.

According to the terms of the issue, the bonds are not secured. According to the Indenture, in consideration of the Underwriters' commitment to acquire the bonds, PGE made additional representations to the Underwriters on submission to execution pursuant to the relevant provisions of the Civil Procedure Code. Additionally, the Indenture provides that certain key PGE Group members, on the occurrence of the events specified in the Indenture, will undertake additional obligations under Article 391 of the Civil Code with respect to the Issuer's performance of its obligations under the bonds, the Underwriters or Authorized Entities.

As a rule, the yield of bonds is guaranteed at a reference rate increased by a guaranteed margin. The reference rate is the relevant WIBOR rate for deposits with a maturity corresponding to the maturity of bonds (different rules for establishing yield are applied to the last series of bonds and bonds issued to redeem bonds of the previous series). The Indenture also defines the methods of determining the issue price for the bonds that the Underwriters are bound to pay in order to acquire the bonds.

#### PGE Bond issuance program of a maximum value of PLN 5 billion to companies of the PGE Group

On May 11, 2009, PGE S.A. concluded an Agency Agreement with ING Bank Śląski S.A. (as Agent for Issue and Payments) regarding the establishment of the bond issue made to companies of the PGE Group ("Program for the Group").

Under the Program for the Group, the Company may issue coupon or zero coupon bonds. Zero coupon bonds can be issued with a maturity of not less than fourteen days and not more than six months, and coupon bonds can be issued with a maturity of not less than twelve months and not more than three years. Bonds are not in paper form or secured. Bonds issued under the Program for the Group are not subject to acquisition guarantee.

The Company intends to offer bonds issued under the Program to an organized group of investors, consisting of entities of which the Issuer is the direct or indirect dominant entity, within the meaning of the CCC.

#### Letter of promise concerning the financing for the new investment at PGE Elektrownia Opole S.A.

Given the planned strategic investment in the PGE Group consisting of the construction of blocks 5 and 6 in PGE Elektrownia Opole S.A., on July 29, 2009, PGE S.A. executed a promise in favor of PGE Elektrownia Opole S.A. to provide the financing for this investment with an estimated value of EUR 3.158 billion. Till December 31, 2009, PGE S.A. did not make a decision on the form of financing for the investment in question.

#### **Memorandum on the initiation of cooperation relating to nuclear energy between PGE S.A. and Electricite de France S.A.**

On November 17, 2009, PGE S.A. signed the Memorandum of the initiation of cooperation within the field of nuclear energy ("Memorandum") with Electricite de France S.A. ("EDF"). The Memorandum provides for study works concerning (i) the feasibility of the development of nuclear reactors in the EPR technology (Evolutionary Power Reactor of Areva) in Poland, (ii) the feasibility of the construction of the first EPR block in Poland by 2020. Both parties also agreed that they would begin negotiations on industrial partnership for the construction of nuclear EPR power plants in Poland. The Memorandum does not provide EDF with an exclusivity right with regard to its cooperation with PGE S.A. in terms of nuclear energy.

#### **Memorandum on the cooperation relating to nuclear energy between PGE S.A. and GE Hitachi Nuclear Energy Americas**

On March 1, 2010 PGE S.A. and GE Hitachi Nuclear Energy Americas signed a Memorandum concerning nuclear power industry cooperation. The memorandum provides for joint activities related to a feasibility study for the development of the ABWR (Advanced Boiling Water Reactor) and ESBWR (Economic Simplified Boiling Water Reactor) nuclear reactor in Poland by the year 2020 and the potential construction and operation of such reactors in the first Polish nuclear power plant. Besides, both companies confirm that they will hold talks on a potential industry partnership related to the nuclear project in Poland. The memorandum does not provide GE Hitachi Nuclear Energy Americas with an exclusivity right with regard to its cooperation with PGE S.A. in terms of nuclear energy.

## 2.4. Transactions with related entities

In 2009 PGE S.A. was a party to a number of transactions with related parties, including entities constituting PGE Group, members of PGE S.A. bodies, and the State Treasury and entities controlled by the State Treasury.

In 2009 PGE S.A. identified transactions with 48 entities controlled by the State Treasury. The total value of these transactions has been presented in the table below.

Table No. 4. Transactions with related entities (in PLN thousand)	Total as at December 31, 2009
Receivables	800,321.6
Liabilities	1,300,385.3
Transactions allocated as assets	2,453,830.8
Sales revenues	10,854,287.6
Other operating revenues	58.0
Financial income	1,349,569.5
Operating expenses	10,108,541.7
Other operating expenses	275.2
Financial expenses	75,107.2

In 2009 PGE S.A. sold electricity to PGE Electra S.A. and PGE Zakład Energetyczny Warszawa-Teren S.A. in an amount which exceeded 10% of the transactions in wholesale trading.

Table No. 5. Transactions with recipients from the Group (in PLN thousand)	transaction value	share [%]
PGE Electra S.A.	5,375,622.2	49.6
PGE Zakład Energetyczny Warszawa-Teren S.A.	1,085,294.3	10.0

In 2009, over 97% of the energy purchased by PGE S.A. came from producers from within the Group. A list of suppliers in which the turnover exceeded 10% of the total amount of PGE S.A. operating expenses has been presented below.

Table No. 6. Transactions with generators from the Group (in PLN thousand)	transaction value	share [%]
PGE Elektrownia Bełchatów S.A.	5.067.193,6	50,1
PGE Elektrownia Turów S.A.	2.150.842,4	21,3
PGE Elektrownia Opole S.A.	1.561.383,2	15,4

In the opinion of the Company, transactions with related parties were concluded under market conditions (on an arm's-length basis) or based on production costs or in accordance with other principles arising out of the guidelines of the Organisation for Economic Cooperation and Development (OECD) regarding transfer prices, the Corporate Income Tax Act, and the ordinance of the Minister of Finance dated October 10, 1997 concerning the manner of determining the revenues of taxpayers through the estimation of prices in transactions concluded by these taxpayers (Dz. U. [Polish Journal of Laws] of 1997, No. 128, item 833, as amended). Information regarding transactions with related parties was presented in note No. VI.55 of the Notes to the PGE S.A. financial statements for 2009.

## 2.5. Information concerning significant proceedings in front of court, body appropriate for arbitration proceedings or in front of public administration authorities

As at December 31, 2009, PGE S.A. and its subsidiaries were not a party of any proceedings concerning payables or debts whose total value would constitute at least 10% of the Company's equity, except for applications filed by generators from PGE Group to confirm excise tax overpayment and tax return together with interest for the years 2006-2008 and the first two months of 2009. Total

overpaid tax to be returned to the PGE Group companies may amount to approximately PLN 3.4 billion, excluding interest (the generators are entitled to interest on overpaid excise tax, accrued from the date of payment of the overstated tax). Such proceedings are described in Note 46.5 to the consolidated financial statements.

Significant proceedings pending in front of courts, competent arbitration authority or public administration authority are described in note No. VI.30 of the Notes to the PGE S.A. financial statements for 2009 and Note 39 to the consolidated financial statements.

## **2.6. Key R&D achievements**

In 2009, PGE S.A. continued the creation of competences to the benefit of nuclear energy development in Poland, strengthened cooperation with state authorities, R&D centres, international organisations, and foreign companies. It carried out analytic, information and educational activities, including: (i) the analysis of best practices relating to organisational, financial, legal and corporate solutions for the management of nuclear power plant construction projects, (ii) the programme of location research for the nuclear power plants in Poland, (iii) guidelines for advance general assessment of standard project of nuclear power plant in Poland, (iv) the long-term forecast of electricity production source development in the light of the energy policy of Poland and EU and perspectives for investments of PGE S.A., (v) the strategic assessment of social and economic consequences of nuclear industry development in Poland.

In 2009, PGE S.A.'s activities in the area of nuclear energy comprised cooperation in establishing organisational, legal and administrative conditions to the benefit of the construction of a nuclear power plant in Poland, development of competences and organisational preparation of PGE S.A. to take up the role of an investor for nuclear power plants in Poland, initiation and coordination of studies and analyses connected with the preparation of nuclear power plant construction in Poland.

Since February 2008, PGE S.A. has been a member of the Consortium CO2EuroPipe Project. The purpose of participating in the CO2EuroPipe project is to determine the possibilities of developing infrastructure to transport CO<sub>2</sub> on an industrial scale, prepare draft legislation in this regard, and create a concept of a network for the transportation and injection of CO<sub>2</sub> from power plants to storage locations, as well as to determine the requirements related to transport infrastructure, injection strategy, and the possibility of using existing structures and equipment.

PGE S.A., along with PKE, Vattenfall, Dalia, Electrabel, Edf, and PGE GiE, participates in the work of the Polish Platform of Clean Coal Technologies Platform (PPCCT) (*Platforma Czystych Technologii Węglowych*). The PPCCT is an initiative of the abovementioned energy sector companies for clean coal technologies with particular emphasis on CCS (carbon capture & storage).

PGE S.A. actively cooperates with international organisations. PGE S.A. participated in the meeting organised in May 2009 in Copenhagen by the presidents of Alstom Power, Vattenfall, and Duke Energy regarding the reduction of the share of coal in the production of electricity and as a result the reduction of the levels of carbon dioxide in the atmosphere. PGE S.A. along with the Companies of the Group cooperates through the Polish Electricity Committee (PEC) with the Union of the Electricity Industry EURELECTRIC. Cooperation with EURELECTRIC allows for the monitoring of the positions and proposals of this organisation in the matter of clean coal technologies, including CCS. PGE S.A. is a member of the Baltic Ring Committee for Cooperation in the Area of Electricity BALTREL. Through the signing of an agreement in May 1998, the committee constitutes a formalised initiative for the cooperation of 17 electro energy companies and organisations from 11 Baltic countries.

## **2.7. Events after the balance-sheet date**

Significant events affecting the business activities of PGE S.A. that took place during the financial year and after it ended, until the date of the approval of the financial statements were described in detail in note No. VI.49 of the Notes to the PGE S.A. financial statements for 2009.

# **3. Overview of the economic and financial situation of PGE S.A.**

## **3.1. Factors and events affecting the achieved financial results.**

### **Macroeconomic situation**

The PGE S.A. runs its activities mainly in Poland. Therefore it has been and will be dependent on macroeconomic trends existing in Poland. As a rule, there is a positive correlation between the growth of electricity demand and economic growth. Thus, the macroeconomic situation of Poland has a direct impact on financial results achieved by the PGE Group. Particularly, the global recession and the



decline in demand for products of energy-consuming branches of the Polish industry during 12 months of 2009 contributed to the decrease of electricity demand for in the National Power System by approximately 4.0% in comparison to 12 months of 2008.

Table No. 7: Key economic ratios connected with the Polish economy.

Key data	2009	2008
Real GDP growth (% of growth) <sup>1</sup>	1.7*	5.0
Annual inflation rate (% of consumer prices) <sup>2</sup>	3.5	4.2
Domestic electricity consumption (TWh) <sup>3</sup>	148.7	154.9

\* estimated data of IBnGR.

Source: <sup>1</sup> Polish Central Statistical Office, real growth of GDP in constant previous year's price, with corresponding period of preceding year = 100; <sup>2</sup> Polish Central Statistical Office, inflation rate, with corresponding period of preceding year = 100; <sup>3</sup> PSE Operator S.A.

## Sales of electricity

Table No. 8. Electricity sales (in TWh)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Electricity sales volume</b>	<b>57.5</b>	<b>59.0</b>	<b>-2.5%</b>
Electricity wholesale	57.1	58.2	-2.1%
Electricity sales on the Balancing Market and to Balancing Group	0.1	0.1	0.0%
Other electricity sales (export)	0.3	0.7	-57.1%

In the 12-month period ended December 31, 2009, PGE S.A. sold 57.5 TWh of electricity, which constituted a decrease of 2.5% compared with sales in the same period of 2008 (59.0 TWh). The decrease in the sales in 2009 compared with 2008 was primarily due to the effects of the discontinuation of purchases of electricity from generators outside the PGE Group, primarily in relation to the termination of Long-Term Contracts for the delivery of electricity (LTC) at the end of March 2008 as well as the effects of the worsening of the economic situation resulting in a decline in demand for electricity. The sales of energy by PGE were mostly directed to the Group companies. PGE did not have other energy off-takers, with the turnover volume exceeding 10% of Company's total revenues, beside ones described in p. 2.4.

## Purchases of electricity

Table No. 9. Electricity purchases (in TWh)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Electricity purchase volume</b>	<b>57.5</b>	<b>59.0</b>	<b>-2.5%</b>
Electricity purchase (from Capital Group and from third parties)	56.0	56.9	-1.6%
Electricity purchase on the Balancing Market	0.1	0.1	0.0%
Import	1.4	2.0	-30.0%

Changes occurred between 2009 and 2008 in the structure of electricity purchases from producers from the Group and from outside of the Group. These changes were the result of the discontinuation of purchases by PGE S.A. of electricity from producers from outside of the Group under LTCs after their termination at the end of March 2008. In 2009, PGE S.A. purchased electricity in Poland only from PGE Group producers and did not have other energy suppliers, with the turnover volume exceeding 10% of Company's operating expenses, besides ones described in p. 2.4.

The purchases of electricity abroad decreased by 30.0% primarily because of the limitation of the access to transborder transmission capabilities by the Polish transmission system operator (TSO) and the lower amount of purchases from Sweden (introduction of limits for import of energy by Swedish operator).

## Electricity prices

Electricity prices quoted on domestic and international market have significant impact on the financial results of PGE S.A. and PGE Capital Group.

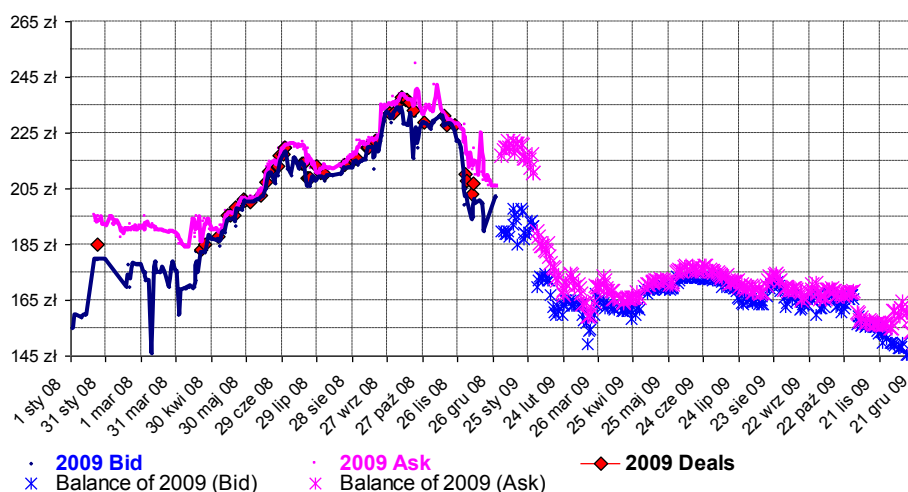
### Domestic market



In 2009, similarly to previous years, on the wholesale market, electricity was traded mainly on the basis of bilateral contracts and futures contracts concluded through brokerage platforms, such as TFS and GFI.

In 2008, quotations of yearly base contracts for 2009 fluctuated from approximately PLN 185 /MWh in May to approximately PLN 230 /MWh in October. In 2009, quotations of the Balance of the Year 2009 product fell even to approximately PLN 160 /MWh. This resulted from the shift of excise tax charging place effective from March 1, 2009, as well as the decline in demand for electricity arising from economic downturn.

Chart: Quotations of BASE 2009 and Balance of the Year 2009 products



Source: Argus European Electricity Market

In spite of the reduction of demand for electricity in Poland in 2009 in comparison to the preceding year, the scale of trading at the Polish Power Exchange ("TGE") and the Electricity Trading Platform ("POEE") in short-term contracts increased in comparison to previous years. The total volume of sales under SPOT transactions in 2009 amounted to 3.07 TWh for TGE and 4.36 TWh for POEE, i.e. increased respectively by approximately 45% on TGE and 24% on POEE.

In comparison to 2008, 2009 SPOT prices were lower, which was partially connected with the movement of excise duty from energy producers to entities selling energy to end-users.

Table No. 10: BASE prices for SPOT contracts

	BASE prices for SPOT contracts (PLN/MWh)			
	2008		2009	
	TGE	POEE	TGE	POEE
Quarter 1 .....	190.53*	186.19*	193.38*	197.51*
Quarter 2 .....	176.55*	174.08*	157.03	158.15
Quarter 3 .....	227.55*	229.18*	168.31	169.20
Quarter 4 .....	194.85*	196.24*	169.42	172.30

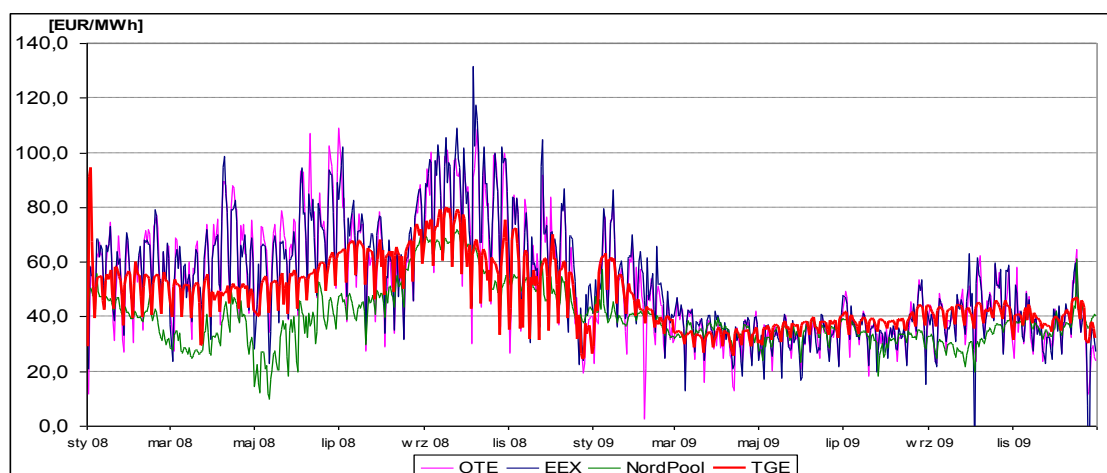
\* Prices till March 1, 2009 include excise in amount of 20 PLN/MWh

Since January 1, 2009, a sole settlement price has been applied on the Balancing Market. The unification of a settlement price and the establishment of balancing groups resulted in the change of the character and size of volumes achieved on the balancing market, as compared to 2008. The volume of turnover on the balancing market decreased significantly and amounted to 3.6 TWh in 2009 in comparison to 4.8 TWh in the previous year. Contrary to 2008, in 2009 the balancing market was dominated by the sale of energy by participants. Average weekly settlement prices of deviations, did not differ much from market prices (i.e. SPOT prices), similarly to 2008.

#### International market

In 2009, as compared to 2008, spot prices declined significantly in Poland (on TGE) and on neighbouring markets: EEX (Germany), OTE (the Czech Republic), and NordPool (Scandinavian countries). In spite of fundamental differences between markets, price trends were similar. The volatility of daily prices was also much smaller in 2009 than in the previous year.

Chart: Comparison of electricity prices on TGE and international markets



### 3.2. Financial results of PGE S.A.

#### Income statement

Table No. 11. Income statement prepared in accordance with Polish Accounting Standards (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
Net sales of products, goods and materials	10,929,870.2	9,704,400.9	12.6%
Cost of products, goods and materials sold	10,388,911.6	9,243,268.1	12.4%
<b>Gross sales result</b>	<b>540,958.6</b>	<b>461,132.8</b>	<b>17.3%</b>
<b>% total sales</b>	<b>4.9%</b>	<b>4.8%</b>	
Costs of sales and general and administrative costs	150,793.0	155,300.1	-2.9%
<b>Profit (loss) on sales</b>	<b>390,165.6</b>	<b>305,832.7</b>	<b>27.6%</b>
Other operating income	7,628.7	126,165.8	-94.0%
Other operating expenses	51,115.7	291,859.3	-82.5%
<b>EBIT</b>	<b>346,678.6</b>	<b>140,139.2</b>	<b>147.4%</b>
<b>% total sales</b>	<b>3.2%</b>	<b>1.4%</b>	
Financial income	1,585,697.4	689,937.9	129.8%
Financial expenses	213,069.3	98,325.6	116.7%
<b>Gross profit</b>	<b>1,719,306.7</b>	<b>731,751.5</b>	<b>135.0%</b>
<b>% total sales</b>	<b>15.7%</b>	<b>7.5%</b>	
Income tax	80,666.9	78,719.5	2.5%
Other statutory reductions in profit	198,142.1	99,570.2	99.0%
<b>Net profit</b>	<b>1,440,497.7</b>	<b>553,461.8</b>	<b>160.3%</b>
<b>% total sales</b>	<b>13.2%</b>	<b>5.7%</b>	
<b>EBITDA</b>	<b>355,544.0</b>	<b>154,711.3</b>	<b>129.8%</b>
<b>% total sales</b>	<b>3.3%</b>	<b>1.6%</b>	

The net profit of PGE S.A. amounted to PLN 1,440.5 million in the financial year ended December 31, 2009, an increase of 160% compared with the financial year ended December 31, 2008.

The net profit margin of the Company (the ratio of net profit to total sales) was 13.2%. The increase of the net result was due to better results in operating activity, other operating activity, and financial activity respectively by:

- PLN 84.3 million, including in sales of electricity by PLN 69.2 million, and sales of products by PLN 15.2 million,
- PLN 122.2 million in other operating activity, mainly as a result of creation in 2009 of lower balance sheet provisions,
- PLN 781.0 million in financial activity, including mainly from higher dividends from shares received by PGE S.A. amounting to PLN 942.1 million.

### Amount and structure of total revenues

Table No. 12 Total revenues (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Total revenues</b>	<b>12,523,196.3</b>	<b>10,520,504.6</b>	<b>19.0%</b>
Net sales of products, goods and materials	10,929,870.2	9,704,400.9	12.6%
Other operating income	7,628.7	126,165.8	-94.0%
Financial income	1,585,697.4	689,937.9	129.8%

In 2009, PGE S.A. achieved total sales of PLN 12,523.2 million an increase of 19% compared with 2008.

The increase in the sales of products and goods by 12.6% compared with 2008 took place primarily as a result of an increase in electricity sales. The sales by products and sales directions have been presented in table 13 below.

The drop in the sales of other activities was caused by a decrease in revenues from the leasing of IT systems and telecommunications services by PLN 2.9 million compared with the previous year. Sales of auxiliary activity have been presented in table 14 below.

The decrease in other operating income by PLN 118.5 million was primarily caused by the profit in 2008 from the transfer of electrical power lines to the State Treasury in the form of a dividend in kind in the amount of PLN 121.9 million.

The increase in financial income resulted from dividends paid out to PGE S.A. in the amount of PLN 1,209.3 million. In addition, in the financial income, the revaluation of investments was recognised (a reversal of a write-off made in previous years) in the amount of PLN 190.3 million, including for Exatel S.A. in the amount of PLN 188.3 million as well as realised and accrued interest in the total amount of PLN 169.9 million, including for bonds held by PGE S.A. (PLN 132.5 million).

Table No. 13. Electricity sales (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Electricity sales</b>	<b>10,852,498.6</b>	<b>9,624,077.5</b>	<b>12.8%</b>
Electricity sales to SSD and PGE Electra	10,775,565.7	8,705,122.7	23.8%
Electricity sales on the Balancing Market and to Balancing Group	19,832.5	9,019.1	119.9%
Other electricity sales (mainly export)	50,924.3	118,397.2	-57.0%
Revenue from sales of additional services	-47.0	789,392.1	-100.0%
Other revenues (OHT services)	6,223.1	2,146.4	189.9%

The increase in revenues generated from the sales of electricity to SSD and PGE Electra and to the balancing market in 2009 compared with 2008, primarily resulted from an increase in the prices of electricity on the wholesale market.

During the first quarter of 2008, with regard to sales in Poland, PGE S.A. achieved revenues from sales of auxiliary services to PSE Operator S.A. on the basis of a concluded bilateral agreement. After the termination of Long-Term Contracts for the delivery of electricity (LTC) with producers, PGE S.A. ceased to provide contract management services for PSE Operator S.A.

The reason for achieving lower revenues from export by PLN 67.1 million was the inability to export electricity (lack of cross-border interconnections capacities due to decision of the Polish transmission system operator TSO) in connection with the historic contract concluded by PGE S.A. with Atel (currently Alpiq Holding AG). Additionally, in February 2009 PGE decided to cease performing of a

electricity sales agreement with other contractor, in connection with the insolvency and bankruptcy proceedings of that contractor.

Table No. 14. Auxiliary services revenues (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Auxiliary services revenues</b>	<b>77,371.6</b>	<b>80,323.5</b>	<b>-3.7%</b>
Sales of support services	66,731.9	64,554.3	3.4%
Revenues from leasing of IT systems and telecommunications	2,747.3	4,629.6	-40.7%
Revenues from space lease	6,172.5	7,044.3	-12.4%
Other revenues	1,719.9	4,095.3	-58.0%

As part of the auxiliary activity of PGE S.A., the increase in revenues by PLN 2.2 million compared with the previous year was the result of the performance of support services agreements for PGE Group Companies. The agreements have been in effect since January 2008 and were signed following the "Agreement concerning the principles for the cooperation of PGE S.A. with PGE Capital Group Companies", that is, the document specifying the principles and scope of the cooperation of Group Companies in order to build a highly effective organisation implementing the strategy of Polska Grupa Energetyczna. The increase was primarily the result of services provided in the area of brand management and the performance of public relations activities.

In 2009, a complete settlement took place of the support agreement with PGE GiE as a subcontractor of PGE S.A. in connection with the performance of integration services for companies from the mining and generation segments. The termination of the agreement took place on October 31, 2009 and was the result of the selection by PGE S.A. of PGE Elektrownia Bełchatów S.A. as the integrator of the mining and generation segments with regard to the Consolidation Programme.

In other revenues there was a decline by PLN 5.1 million compared, primarily as a result of the discontinuation of services regarding access to a part of the SAP system to PSE-Operator S.A. after its complete separation in March 2008, as well as the termination at the end of 2008 of agreements with PSE Operator S.A. for providing access to the LAN network in the Mysia 2 building as well as the MIS system as well as rental of part of the building at ul. Mysia 2 for PSE Operator S.A.

#### Amount and structure of revenues, by geographic regions

Table No. 15. Revenues by geographic regions (in PLN thousands)	Total net income				
	2009	(%) share	2008	(%) share	% change
Domestic market	10,878,945.9	99%	9,586,394.4	99%	13%
EU member states	50,924.3	1%	75,308.5	1%	-32%
Other countries			42,698.1	0%	-100%
<b>Total</b>	<b>10,929,870.2</b>	<b>100%</b>	<b>9,704,401.0</b>	<b>100%</b>	<b>13%</b>

In 2009 and 2008 PGE obtained revenues mainly from electricity sales on domestic market. During whole year 2009, the Company pursued electricity sales under the agreement with Vattenfall AB. In comparison to 2008, PGE did not sell electricity under the historical agreement with Alpiq Holding AG.

#### Amount and structure of total expenses

Table No. 16. Total expenses (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Total expenses</b>	<b>10,803,889.6</b>	<b>9,788,753.0</b>	<b>10.4%</b>
Own cost of sales	10,388,911.6	9,243,268.1	12.4%
Cost of sales and general and administrative expenses	150,793.0	155,300.0	-2.9%
Other operating expenses	51,115.7	291,859.3	-82.5%
Financial expenses	213,069.3	98,325.6	116.7%

In 2009, the business activity expenses of PGE S.A. totalled PLN 10,803.9 million and were 10.4% higher than in the previous year.

The own cost of sales in 2009 was PLN 10,388.9 million, an increase of 12.4% compared with 2008. The increase in own cost of sales was caused by a 23.2 % increase in the costs of purchasing energy by PGE S.A. from the producers in the Group, on the balancing market and from import, caused by an increase of energy prices on the market. The higher costs of the production of electricity by producers was primarily due to the increase in the prices of raw materials and the increase of the prices of purchasing CO<sub>2</sub> emissions allowances in order to cover their shortage for 2008 – 2009.

In addition, the increase in electricity purchase prices from the producers in the Group was affected by the mechanism used to determine prices based on market conditions. With regard to own cost of sales, the production costs of sold products decreased due to costs of providing additional services which were lower by PLN 789.4 million compared with the previous year.

In 2009, total cost of sales of PGE S.A. was PLN 72.3 million, a decrease of 8.8%. The primary cause of the decrease in sales costs was a limitation of the costs of reserving transmission capacities as well as a decrease in the costs of transit fees in light of the discontinuation of the performance of the Atel contract in 2008.

The general and administrative expenses of PGE S.A. in 2009 amounted to PLN 78.4 million and were higher by PLN 2.4 million compared with the previous year.

In the other operating expenses in 2009, the provision for disputes with foreign contracting parties in relation to the performance of commercial agreements was increased by PLN 43.6 million. This provision amounted to PLN 289.1 million in 2008.

The increase of financial expenses by PLN 114.7 million was caused by the write-off made in 2009 for the revaluation of AWSA S.A. bonds by PLN 29.4 million and cost of interest from debt securities (own bonds), from short-term credits, which was higher by PLN 62.4 million.

### The Company's assets

Table No. 17. Assets (in PLN thousand)	Period 1-12 of	Period 1-12 of	Change %
	2009	2008	
<b>Non-current assets</b>	<b>21,018,516.2</b>	<b>20,419,710.9</b>	<b>2.9%</b>
Intangible assets	3,810.0	2,974.7	28.1%
Tangible fixed assets	74,424.9	75,941.7	-2.0%
Long-term receivables	2,041.6	2,367.6	-13.8%
Long-term investments	20,701,201.0	20,149,674.4	2.7%
Long-term prepayments	237,038.7	188,752.5	25.6%
<b>Current assets</b>	<b>4,937,968.7</b>	<b>1,342,380.5</b>	<b>267.9%</b>
Inventory	242.9	166.8	45.6%
Short-term receivables	836,912.5	777,312.5	7.7%
Short-term investments	4,079,601.1	519,442.0	685.4%
Short-term prepayments	21,212.2	45,459.2	-53.3%
<b>Assets</b>	<b>25,956,484.9</b>	<b>21,762,091.4</b>	<b>19.3%</b>

The reason for the increase in PGE S.A. assets in the 12-month period ended December 31, 2009 compared with the same period ended December 31, 2008 was the increase in financial resources by PLN 3,182.0 million, mainly resulting from an inflow of proceeds related to IPO.

The non-current assets of PGE S.A. as at December 31, 2009 and December 31, 2008, amounted to PLN 21,018.5 million and PLN 20,419.7 million respectively. The increase in the value of non-current assets by PLN 598.8 million was caused by: (i) an increase in the value of long-term investments by PLN 623.0 million related primarily to the purchase of the shares of PGE Elektrownia Opole and PGE Kopalnia Węgla Brunatnego Turów S.A., the increase in the capital of PGE Electra S.A., and the establishment of PGE Energia Jądrowa S.A., (ii) the reversal of the impairment write-off made for Exatel S.A. in the amount of PLN 188.3 million, (iii) the buyout of bonds issued by PGE Group Companies and the reclassification of a part of the bonds from the long-term securities to short-term securities, respectively in the amount of PLN 41.2 million and PLN 194.7 million, (iv) the revaluation (decrease of valuation) of AWSA bonds in the amount of PLN 29.4 million.

The value of bonds (short- and long-term), in particular issued by PGE Group Companies and taken up by PGE S.A., as at December 31, 2009 compared with December 31, 2008, increased by PLN 114.5 million. As at December 31, 2009, the Company held bonds issued by PGE Elektrownia Turów S.A., PGE ZEDO S.A., and PGE KWB Bełchatów S.A. A detailed description of securities held by PGE S.A., including bonds in particular, is provided in notes VI.14,15 of the Notes to the PGE S.A. financial statements for 2009.

Table No. 18. Liabilities and equity (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
<b>Equity</b>	<b>24,196,441.6</b>	<b>17,795,739.8</b>	<b>36.0%</b>
Share capital	17,300,900.0	14,705,765.0	17.6%
Reserve capital	5,449,548.8	2,100,155.6	159.5%
Revaluation reserve	3,695.1	3,696.2	0.0%
Other reserve capitals	0.0	414,017.0	-100.0%
Previous year profit (loss) (retained earnings)	1,800.0	18,644.2	-90.3%
Net profit (loss)	1,440,497.7	553,461.8	160.3%
<b>Liabilities and provisions for liabilities</b>	<b>1,760,043.3</b>	<b>3,966,351.6</b>	<b>-55.6%</b>
Provisions for liabilities	398,055.4	343,648.2	15.8%
Long-term liabilities	0.0	0.0	
Short-term liabilities	1,352,752.0	3,613,369.6	-62.6%
Accruals	9,235.9	9,333.8	-1.0%
<b>Liabilities and equity</b>	<b>25,956,484.9</b>	<b>21,762,091.4</b>	<b>19.3%</b>

As at December 31, 2009 and as at December 31, 2008, the total equity of PGE S.A. amounted to PLN 24,196.4 million and PLN 17,795.7 million respectively, which constitutes 93% and 82% respectively of the total equity and liabilities. The capital of minority shareholders as at December 31, 2009 amounts to PLN 2,595.1 million. The increase in the total equity resulted from an increase in the share and reserve capital from the debut of the Company on the Stock Exchange as well as the net profit achieved for the reporting period. From the released other reserve capital and profit for the previous year, in 2009 a dividend in the amount of PLN 941.8 million was paid to the State Treasury.

The change of the level of long-term provisions in the 12-month period ended December 31, 2009 arises primarily from the increase of the provision for the claims of Aare Tessin Ltd. for Electricity ("Atel") – currently Alpiq Holding AG – in the amount of PLN 61.8 million.

The liabilities and short-term provisions decreased from PLN 3,613.4 million as at December 31, 2008 to PLN 1,352.8 million as at December 31, 2009 primarily in relation to: (i) a decrease in liabilities for issued debt securities by PLN 2,024.4 million, (ii) a decrease in borrowings from banks in the short-term part of the financing by PLN 434.1 million, (iii) an increase in the level of trade liabilities by PLN 194.9 million.

Funds obtained from the new issuance of shares of the Company were designated for the repayment of debt from short-term debt securities (bonds) issued by PGE S.A. as well as borrowings maintained on the current account. The increase of trade liabilities by PLN 190.9 million in 2009 compared with 2008 was the result of the growth of liabilities toward related entities for settlements for the purchase of electricity.

### Cash flow statement

Total cash flows from the operating, investing, and financing activity in PGE S.A. as at December 31, 2009 amounted to PLN 3,189.8 million.

The difference between the level of cash indicated in the balance sheet and that indicated in the cash-flow statement arises out of currency translation differences from the valuation of cash and interest, which accrued but was not received as at the reporting date. This was described in detail in note No. VI.46 of Notes to the PGE S.A. financial statements for 2009.

Net cash flows from the operating activity in 2009 amounted to PLN 312.5 million compared with PLN 237.4 million in 2008, which means an increase of approximately 32%. This increase was caused primarily by the achievement of a higher operating result. In addition, the higher level of cash from



operating activity in 2009 compared with 2008 was achieved through maintaining the cycle of settling receivables and liabilities at a similar level.

In 2009, cash flows from investing activity totalled PLN 673.3 million compared with PLN (-1,453.2) million in 2008. The increase in net cash flows from the investing activity in 2009 was caused by a dividend payment for PGE S.A. of PLN 1,019.3 million compared with the dividend payment in 2008 of PLN 167.6 million.

In order to arrange the ownership structure in PGE S.A., in 2008 and 2009 expenses were incurred for the purchase of shares in companies of PLN 2,040.0 million and PLN 340.0 million respectively. The difference between the expenses incurred by PGE SA for the purchase of bonds issued by PGE Group companies and the inflows from their redemption amounted in 2009 to PLN (-2.0) million compared with PLN 342.6 million in 2008.

Net cash from the financing activity in 2009 amounted to PLN 2,187.7 million, compared with the level of PLN 954.2 million in 2008. Changes in cash flows from the financing activity in 2009 compared with 2008 were conditioned by the inflows from the issuance of new shares of PGE S.A. on the Warsaw Stock Exchange, which amounted to PLN 5,917.5 million. Thanks to the inflows obtained in 2009, the repayment of borrowings on the current account along with interest amounted to PLN 443.0 million was made, while in 2008 the inflows from borrowings which were made, less paid interest, amounted to PLN 423.2 million. In 2008, PGE S.A. as a result of the issue of own bonds obtained net cash in the amount of PLN 993.3 million, while in 2009 the redemption of own bonds took place in the amount of PLN (-2,033.3) million.

Expenses for dividend payment and profit distribution to the State Treasury in 2009 were incurred in the amount of PLN 1,118.8 million, with expenses of PLN 407 million in 2008.

### 3.3. Financial ratios

Table No. 19. Financial ratios	Period 1-12 of 2009	Period 1-12 of 2008
<b>Return on sales ROS (in %)</b>		
Net profit x 100% / net revenues	<b>13.2%</b>	<b>5.7%</b>
<b>Return on equity ROE (in %)</b>		
Net profit x 100% / equity – net profit	<b>6.3%</b>	<b>3.2%</b>
<b>Debt ratio (in %)</b>		
Liabilities and provision for liabilities x 100% / total equity and liabilities	<b>6.8%</b>	<b>18.2%</b>
<b>Current ratio</b>		
Current assets / short-term liabilities	<b>2.8</b>	<b>0.3</b>

### 3.4. Publication of financial forecasts

PGE S.A. did not publish forecasts of the Company's financial results for year 2009.

## 4. Management of financial resources and financial liquidity.

During financial year ended December 31, 2009 PGE S.A. and the subsidiaries financed its activities from funds generated from operating activities, funds received from the dividends as well as from credits and issues of bonds.

After the successful stock market debut in November 2009, the Company held significant financial surpluses. Until the time of designation of the funds for investments, they were allocated for the repayment of the short- and long-term debt of the Company, including the refinancing of debt incurred for the financing of the first and second payment tranches for the repurchase of minority blocks of shares in some subsidiaries from the State Treasury. The remaining financial surpluses are designated for the financing of the business activity and other surpluses are short-term, safe bank deposits.

In addition, PGE has unused credit limits in banks, which can be used at any time in order to finance the current business activity of the Company.



Table No. 20. Debt (in PLN thousand)	Period 1-12 of 2009	Period 1-12 of 2008	Change %
Bank loans	1.4	434,101.3	-100.0%
Debt securities	522,663.1	2,547,036.4	-79.5%
Indebtedness	522,664.5	2,981,137.7	-82.5%
Cash	3,198,077.5	16,095.2	19769.8%

The results achieved by PGE and the companies from the Group together with unused credit limits, secure the funds sufficient for financing of operating activities of PGE.

Wyniki osiągnięte przez PGE S.A. jak i spółki z Grupy oraz posiadane wolne limity kredytowe gwarantują wystarczające środki na finansowanie bieżącej działalności operacyjnej Spółki.

#### 4.1. Rating

In the second half of 2009, PGE S.A. was rated by Moody's Investors Service Ltd at A3. Fitch Ratings rated PGE S.A. at BBB+ and unsecured debt of PGE S.A. at A. Such ratings reflect the positive assessment of low credit risk connected with investments in debt securities of PGE S.A.

#### 4.2. Credit agreements, loans, and bond issuance programme

In 2009, PGE Polska Grupa Energetyczna S.A. did not terminate any agreements pertaining to credits. In 2009 the Company did not enter into any new loan or credit agreements.

The financing agreements concluded in 2009 were related to the conclusion of agreements for two bond issuance programmes: (i) Bond Issue Programme up to the maximum value of PLN 2 billion and (ii) PGE Bond Issue Programme up to the maximum value of PLN 5 billion directed toward PGE Group companies. The abovementioned agreements have been described in chapter 2.4.

As at December 31, 2009, PGE S.A. did not hold issued bonds in connection with the Bond Issue Programme up to a maximum value of PLN 2 billion. As at December 31, 2009, the total nominal value of bonds issued under the PGE Bond Issue Programme up to PLN 5 billion directed toward PGE Group companies for the Group amounted to PLN 525.0 million.

In 2009, PGE S.A. also benefited from an agreement concluded on February 4, 2005 with PKO Bank Polski S.A. for the servicing of bonds issue up to the amount of PLN 350.0 million. The agreement expired on December 31, 2009.

A detailed description of credits and issuances of debt securities is presented in note VI.25 and 26 of the Notes to the PGE S.A. financial statements for 2009.

#### 4.3 Guarantees

A detailed description of guarantees made by PGE S.A. has been presented in note No. VI.30 of the Notes to the PGE S.A. financial statements for 2009. In 2009 the Company did not receive any guarantees.

In addition, some of the PGE Group companies granted guarantees in favor of the banks for the liabilities of PGE, under the agreements described in p. 2.3.

#### 4.4 Significant off-balance sheet items

A description of significant off-balance sheet items has been presented in note No. VI.3 of the Notes to the PGE S.A. financial statements for 2009.

#### 4.5 Evaluation of investment capacities

On-going and future investments are and will be financed from funds obtained from the IPO, funds generated by the core activity of PGE S.A. and the PGE Group, and from external financing. Financial results achieved by PGE S.A. and the PGE Group and low debt level in 2009 confirm that the Group owns sufficient resources to achieve its investment goals, including capital investments.

### 5. Financial and market risk management

In their business activity, PGE S.A. companies become parties to various types of agreements and financial contracts subject to non-financial risks.

In ordinary business activity, activities of PGE S.A., its financial results and cash flows are exposed to various types of financial and market risks, including interest rate risk, foreign currency risk, price risk, credit risk, and liquidity risk. Each risk could have a negative impact on business activities, financial standing and performance of operations.

**Interest rate risk.** PGE S.A. finance its operating and investing activities partially from debts bearing variable interest rates or investments in financial assets bearing a variable or fixed interest rates. The Company are exposed to interest rate risk connected with deposits, cash, investments in bonds issued by Autostrada Wielkopolska S.A., and liabilities resulting from loans received and bonds issued.

PGE S.A. identifies interest rate risk connected with reference rates of WIBOR, EURIBOR and LIBOR.

**Foreign currency risk.** Currency risk is connected with the sale of finished products and the purchase of materials in foreign currencies.

The PGE Group is mainly exposed to currency risk connected with foreign exchange rates of EUR/PLN, USD/PLN, CHF/PLN and SEK/PLN. Major sources of exposure to currency risks are as follows: the purchase or sale of electricity under contracts expressed or indexed in foreign currencies, fees on the purchase of transmission power expressed or indexed in foreign currencies, financial assets expressed in foreign currencies, capital investments expressed or indexed in foreign currencies.

**Price risk.** Because of their business activity, PGE Group companies are exposed to the volatility of cash flows and financial results in the domestic currency due to changes in prices of electricity.

Managing price-related risks on the Polish market is quite difficult with no long-term price indices and no instruments suitable for hedging transactions, which is particularly important in a long-time perspective..

**Credit risk.** The credit risk is related to potential credit defaults such as client's insolvency, incomplete repayment, and significant delay in the repayment of debt or other departures from the contract terms.

Transactions that may involve credit risk for PGE include short term investments (deposits, participation units in investment funds and buy-sell-back transactions) and trade receivables.

A superior goal of credit risk management is to accept and control credit risk at a defined level which directly results from major business goals for electricity trading.

PGE manages counterparty credit risk mainly by using the following mechanisms: the evaluation of customers' financial standing and the setting up credit limits; requiring credit collaterals from customers with lower financial standing; covenants for credit risk and standardisation of credit collaterals; system of current monitoring of payments and early debt collection system; cooperation with business intelligence agencies and debt collection companies.

**Liquidity risk.** PGE runs active cash investment policy. This means that PGE monitors its financial surplus, forecasts future cash flows and carries out its investment strategy on the basis thereof.

PGE's current liquidity is regulated mainly based on current account credits. PGE is responsible for coordination of the financial process of the Group. PGE issues bonds, which are acquired, without limitation, by entities with financial surplus. Funds from the issue are then used to take over bonds issued by those of PGE Group companies that indicate need for external sources of financing.

PGE monitors its liquidity periodically by analysing cash flows from operating activities and maturities of both investments and financial assets.

## **6. Projected development of PGE and PGE Capital Group**

### **6.1. Factors significant for the development of PGE**

In opinion of the Company's Management Board the following factors below will affect the results of the Company in 2010 and potentially in next years:

- the demand for electricity;
- the prices of electricity on the wholesale market;
- the availability of crossborder transmission capacities;
- amendment of the Energy Law and other acts pertaining to the introduction of the obligation to sell electricity in tenders or through the exchange by producers constituting vertically integrated groups and entitled to receive compensation in the scope of the LTC Act;

- a possibly different resolution of legal, tax, or other conditional liability disputes, of which the most significant have been presented in note VI.30 of the Notes to the PGE S.A. financial statements;
- a change of the macroeconomic environment of PGE S.A., including in particular interest rates and foreign exchange rates, whose value affects the valuation of the assets and liabilities indicated by the Group;
- the PGE Group consolidation process,
- the pace of work in connection with the “Non-Energy Asset Management Concept in the PGE Capital Group”,
- arriving to the target organisational model of PGE Group and a strong corporate centre.

## **6.2. Implementation of strategy for the Capital Group in 2010**

The primary goal of PGE is the increase of the value of the Company through the profitable satisfaction of the needs of recipients in the scope of electricity and heat. The strategy assumes four main goals:

- expansion in Poland and abroad;
- creation of an integrated company;
- improvement of effectiveness;
- improvement of competitiveness and the regulatory environment.

In accordance with the strategy of PGE S.A. and the Group, the Company intends to continue its activity in the area of wholesale trading of electricity on the Polish market as well as on foreign markets and provide support services for the entities from PGE Group under the centralised functions.

According to the business model, PGE will carry out activities with regard to ensuring of financing of key investment projects for the Group, which include:

- the construction of the new 858 MW unit in PGE Elektrownia Bełchatów S.A.
- construction of a new coal-fired units in PGE Elektrownia Opole S.A.
- construction of a new unit in PGE Elektrownia Turów S.A.
- construction of a steam-gas unit and installation for biomass combustion in PGE ZEC Bydgoszcz S.A.
- implementation of wind farm construction program.

In addition, on February 16, 2010, the Management Board of PGE S.A. decided to merge PGE with its subsidiary PGE Electra S.A. The purpose of this merger is the increase in the transparency of the group and the allocation of cash flows and margins appropriate for a company listed on the Warsaw Stock Exchange. This will enable the further reduction of financial costs and simplify the payment of the dividend to shareholders.

The completion of work with regard to the Consolidation Programme and the project “Non-Energy Asset Management Concept under the PGE Capital Group”, a detailed description of which was presented in chapter 1.3, will result in the implementation of an optimal management structure along with the centralisation of the functions performed in individual areas of business, as well as the achieving of synergy effects in PGE Capital Group.

## **7. Risks and threats of the PGE and the Capital Group**

The activity of PGE and major PGE Capital Group companies, for which PGE is a parent company, as well as other entities operating in the electro energy sector, is exposed to a number of both external risks and threats connected with market and regulatory environment, as well as internal risks and threats accompanying their operations.

Key risks and threats, to which the Company’s and PGE Capital Group’s activities are exposed, are described below.

## **7.1. Risk factors connected with market environment and general macroeconomic situation in Poland and in the world**

### Risk connected with macroeconomic situation in Poland and in the world

Risks connected with macroeconomic situation in Poland and in the world mainly result from the volatility of interest rates and foreign exchange rates, fuel prices, CO<sub>2</sub> emission allowances, as well as risks connected with the availability of raw materials required in the production of electricity and heat.

### Risk relating to an increase in competition (free right to choose an energy supplier)

Given the on-going development of the retail market, increasing knowledge of energy recipients on market operation and their rights (including a TPA rule), as well as increasing activeness of energy sellers, the PGE Group is exposed to the risk of losing its existing customers in the retail market and the risk of decreasing margin on sale to the existing customers. It is, however, necessary to point out that market development is also an opportunity for the retail sales segment of the PGE Capital Group to acquire new customers from outside the historic operating area of the Retail Sales Companies of the PGE Capital Group and increase both sales and profit.

### Risk of a decrease in demand for electricity

The PGE Capital Group's income is substantially dependant on the consumption of power and heat by final users. In a long run, power consumption is to grow. However, there is no guarantee that such a growth will occur and that the rate of growth will achieve an assumed level. Demand for electricity may decline, in particular, as a result of: (i) economic slowdown, (ii) possible reduction of power consumption by recipients of low economic standing, (iii) development of new energy saving technologies. Decreasing growth rate of demand for electricity and limited access to interconnectors limiting opportunities for exporting electricity produced by the Group may have a significant adverse impact on the activity and financial results of Group companies. A special threat resulting in the decline in demand for electricity is the world financial crisis, which commenced in the second half of 2008 and whose consequences were also recorded by the Polish economy in 2009 and may be visible in subsequent years, as well.

The decline in demand for electricity, caused by the of economic slowdown, may be also connected with delays in payments for electricity and distribution services, which may contribute to the higher number of overdue receivables resulting in higher costs to finance operating activities.

## **7.2. Risk factors connected with regulatory and legal environment**

### Political risk

The activity of the PGE Capital Group in key operating areas, i.e. mining and generation, distribution and sale of electricity and heat, is subject to legislation, government regulation and government policy adopted by Polish authorities and agencies, authorities of the European Communities and the European Union, and other states. Changes in such legislation, regulations and/or policies may be influenced by political factors, which in turn may affect business activity of the Group including, inter alia, the regulation of electricity prices, heat prices and distribution services for offtakers, in particular households.

### Risk of changes in law and other regulations relating to our activity, as well as changes in interpretation or application thereof

The Group's activity is subject to numerous Polish and European laws and regulations (including treaties, orders, directives, decisions of the European Commission, and decisions of the European Tribunal of Justice) and international law (treaties, other international agreements).

The provisions of the laws, regulations, decisions, positions, opinions and actions of relevant authorities important for the Group's activity are subject to changes. In particular, the Energy Law was amended several times, and some of the amendments introduced significant changes with respect to core business areas. Types, directions and scopes of such amendments may have an unpredictable impact on the Group's activity.

The Group's activity is also significantly dependant on decisions, positions, opinions and other actions of Polish authorities, authorities of the European Communities and the European Union, and authorities of other states, but certain decisions, positions, opinions and other actions of such authorities do not take the form of laws, but must be, in practice, applied by the Group companies. In

particular, in the energy sector, an authority regulating the Polish fuel and energy market is the President of the Energy Regulatory Office, who is competent, for example, to grant and withdraw concessions based on which we run our activity, and approve (to a defined extent) and control the application of electricity and heat tariffs in terms of their compliance with the provisions of the Energy Law, including the analysis and verification of costs applied by power companies as reasonable to calculate prices and rates under tariffs. For the violation of obligations set forth in the Energy Law, the President of the Energy Regulatory Office may impose pecuniary fines of up to 15% of income earned by the entity subject to the fine (PGE S.A. or a Group company) in a previous tax year and, if the fine is related to the licensed activity, the fine may amount to 15% of income earned on the licensed activity by the fined entity in the previous fiscal year.

#### Risk related to the requirement for licences

The Group's core activity is subject to a number of licenses, including in particular the electricity and heat generation, the distribution of electricity and heat, and electricity and heat trading, as well as the lignite mining, and fuel gas trading. In order to continue business activity, the Group needs to maintain and extend existing licenses. Any withdrawal or limitation of a license or the imposition of additional conditions under the license may cause that Group companies will not be able to run their activities, their activities will be significantly limited or substantially influenced otherwise.

#### Risk connected with tariffs and an obligation to submit tariffs for approval

The performance of the PGE Capital Group depends, to a considerable degree, on the level of the prices that customers of Group companies pay for electricity, heat, distribution services, and other goods and services. According to the Energy Law, power companies with licenses define tariffs. Tariffs should be calculated in such a manner so that to cover, without limitation, reasonable operating expenses, including reasonable return on equity, and protect recipients' interest against unreasonable prices and rates. Tariffs of selected types of activity are subject to the approval by the President of the Energy Regulatory Office. Therefore, there is a risk that they will not be approved or will be approved with delay or will be approved otherwise than requested. In particular, pursuant to the Energy Law, the President of the Energy Regulatory Office is authorised to analyse and verify reasonable expenses applied by power companies to calculate tariffs and define reasonable return on equity for business entities filing tariffs for approval. Reasonable expenses and reasonable return on equity have a direct impact on fees and prices that power companies may define in their tariffs. The reduction of reasonable expenses or reasonable return on equity will result in lower fees and prices. In the process of tariff approval, the President of the Energy Regulatory Office may question reasonable expenses suggested by the Company, may not recognise certain expenses as reasonable or may question assets used to calculate reasonable return on equity.

#### Risk of changes to the Energy law

In 2009, the work to change the Energy Law in order to obligate power producers to sell electricity in a manner ensuring public and equal access to such energy was carried out. In accordance with the amendments, obligation to trade on the electricity exchange platforms applies to 15% of energy generated by any producer, and additionally, if a producer is authorised to receive funds to cover stranded costs under the act of June 29, 2007 on principles for covering costs generated by producers as a result of the earlier termination of long-term power and electricity sales agreements, the stock obligation applies to the whole energy generated. The above amendment to the Energy Law was published in the Journal of Laws on February 8, 2010 and will come into force 30 days after the publication date, i.e. as of March 10, 2010. The enforcement of such statutory changes influences the sale of energy by producers.

Furthermore, the amended Energy Law introduces a system of supporting electricity production in the highly efficient cogeneration of units fed with methane that is renewable and mined at the bottom mining works in hard coal mines that are active, are being liquidated or have been already liquidated or fed with gas obtained from biomass processing.

#### Risk connected with the application of the Excise Act

The transfer of an obligation to pay excise from electricity producers to entities selling electricity to end-users as of March 1, 2009 is subject, in practice, to the detailed analysis of all issues connected with the calculation and collection of the tax by competent services at PGE Group companies. Because of the shortage of experience and stabilised practice both at PGE Group companies and tax authorities, many detailed mechanisms of the Excise Tax, like the construction of a tax duty, excise



payment and declaration duty, principles for excise exemptions or registration obligations, rise controversies and doubts.

Given the above doubts, as well as further changes in the excise anticipated by the Ministry of Finance, which in the Ministry's opinion, are to solve interpretation problems connected with the provisions of the act, it is difficult to fully and clearly predict the final impact of the applicable and future regulations on the final shape and complete scope of related tax burdens within the PGE Group.

#### Risk connected with the programme of CO<sub>2</sub> emissions reduction

The electricity and heat generation at power plants and CHP plants fuelled with fossil fuels is connected with relatively high CO<sub>2</sub> emissions. Therefore, any regulations on the reduction of emission of CO<sub>2</sub> to the environment, including regulations coming within the so called power and climate package of the European Union, will have a significant impact on the Group's activity. In particular, the limited number of free CO<sub>2</sub> emission allowances, mean that CO<sub>2</sub> emissions outside the scope of free allowances allocated to Polish installations under NAP requires the purchase of EUA emission allowances or CER or ERU units, the prices of which fluctuate.

#### Risk of restrictions on emissions of substances other than CO<sub>2</sub> to the environment and the enforcement of more restrictive BAT standards

The activity of Group companies, including in particular the electricity and heat generation, is connected with the emission of not only CO<sub>2</sub>, but NO<sub>x</sub>, SO<sub>2</sub>, dusts and other substances, to the environment. The systems that require an integrated permit, i.e. systems that, due to their type and scale of operation, may materially pollute some component parts or the environment as a whole, must comply with the best available techniques requirements (Best Available Techniques, "BAT"), and that involves making significant investment expenditures. It is also possible that, in future, requirements for the best available techniques will be more restrictive or the scope thereof will be expanded and the Group will be forced to make substantial expenses to adapt to new requirements. Therefore, there is a risk that certain of our equipment or installations will not be adjusted to applicable requirements by the imposed deadline, which may reduce electricity output.

### **7.3. Risk factors connected with the operating activity of the PGE Capital Group**

#### Risk of disruption of fuel supplies to our power plants, CHP plants and heat plants

The generation of electricity and heat by Group power plants, CHP plants and heat plants depends on fuel supplies, including lignite (in particular to PGE Elektrownia Bełchatów S.A. and PGE Elektrownia Turów S.A.), hard coal (in particular to PGE Elektrownia Opole S.A. and PGE ZEDO S.A.), and gas. There is a risk of disruptions in fuel supplies to Group's generating units, mainly for technical reasons (breakdown), natural reasons (calamities, difficult weather conditions), social reasons (strikes), economic and political reasons (limited supply of fuel or transport services and imposing unfavorable conditions of supply and transport) and other reasons. Any break or limitation in fuel supplies may cause a break or significant limitation in electricity or heat generation.

#### Risk relating to obtaining debt financing

A part of the Group's activities is financed from external sources (bank loans, bonds, etc.). PGE S.A. and Group companies are parties to many financial agreements of the complex legal structure. It is possible that in future it will be difficult to obtain new finance at an amount and terms desired by the Group. This may be caused by still unstable situation in the financial and capital markets in Poland and abroad, poor general economic situation in Poland and abroad, or other reasons that are unpredictable now. In particular, the economic crisis, which in 2008 occurred in many EU member states and the United States, may have a negative impact on the Group's activity. The crisis is reflected, without limitation, by significant reduction of finance granted by commercial banks or additional collaterals requested thereby. Such circumstances may, at the same time, extent the procedure of finance acquisition, have a negative impact on terms of finance, and result in the growth of costs in the form of higher interest rates, commissions, etc. More difficult finance acquisition conditions will affect the Group's results.

#### Risk connected with the termination of long-term power and electricity purchase contracts (LTC)

PGE S.A. and certain Group generators were parties to LTC. The termination of LTC set forth in the LTC Act is a precedential programme of this type in Poland. The provisions of the LTC Act defining, in particular, terms for the calculation, payment and adjustments of funds to cover stranded costs, calculation and payment of such funds to generators coming within capital groups (including PGE

Capital Group), tax consequences of LTC termination and fund payment, as well as other issues, are complicated and there is no defined practice for their application in Poland. Producers that terminated LTC and are authorised to receive funds to cover stranded costs, including PGE Group generation companies, are exposed to an obligation to return funds received in the case of the negative (annual or final) correction of stranded costs. On July 31, 2009, the President of the Energy Regulatory Office issued decisions concerning the annual correction of stranded costs for 2008 (the first partial year in which the Act is in force) in relation to PGE Group generation companies that are entitled to receive funds to cover their stranded costs under the LTC Act. All such decisions, in the opinion of their addressees, are unfavourable and were issued against the LTC Act. Some decisions provided for an obligation to return to Zarządca Rozliczeń S.A. the correction of annual stranded costs of approximately PLN 141 million in total. PGE Group generation companies authorised to receive funds to cover stranded costs under the LTC Act appealed to the court against all decisions of the President of the Energy Regulatory Office concerning the annual adjustment of stranded costs for 2008.

In addition, it is necessary to point out that the LTC Act does not directly provide for the merger of producers authorised to receive funds to cover stranded costs under the LTC Act. Lack of such regulations generates a risk that funds obtained by producers under the LTC Act will be reduced, which may have a negative impact on the Group's financial results and delay its ongoing consolidation.

#### Risk of transfer prices

The Company and its subsidiaries have concluded, and continue to conclude, many transactions with the other PGE Group members. These transactions specifically relate to the sale of fuels, electricity, emission allowances, certificates of origin and certain services. Even though the Company and the Group companies carefully follow the arm's length principle in dealings with related parties, and even though they are now implementing unified standards regarding the compiling of documentation and procedures in this regard, we can not preclude potential disputes with the tax authorities in this regard.

#### Risk relating to court, arbitration and administrative proceedings

PGE S.A. and other PGE Group companies are parties to court, arbitration or administrative proceedings that are important for the Group's activity. The Group takes up actions aiming at the settlement of such cases to our benefit, but there is a risk that they will be resolved unfavourably for Group companies. There is also a risk that in future other proceedings will be initiated against PGE S.A. and other PGE Group companies, which will be resolved unfavourably for us, which may have an adverse impact on the Group's activity and performance.

Risks connected with court, arbitration and administrative proceedings that are essential for the PGE's and Group's activities are described in note VI.30 of the Notes to the PGE S.A. financial statements for 2009 and in Note 39 to the consolidated financial statement for the year ended December 31, 2009.

#### Risk of collective disputes

At PGE S.A. and Group companies, there are over 100 company and intercompany trade unions associating over 27 000 employees of the Group. Based on binding legal regulations, trade unions can influence the legislative process. They also have various instruments at their disposal to influence employers, including collective disputes. PGE Group companies are parties to corporate and intercompany collective bargaining agreements. In addition, managements of many PGE Group companies concluded so called social agreements with trade unions. Such agreements provide for many rights of employees and trade unions. A need to consult or agree on certain actions with trade unions may delay, and even prevent from, certain actions and cause collective disputes, including strikes or other forms of employee protests. In addition, in the case of any significant Group employment reductions in the future, an obligation to pay high compensations to employees may delay or significantly reduce the Company's ability to take up such actions or increase the costs thereof.

#### Risk of long-lasting and expensive consolidation of PGE Group

The PGE Capital Group was established as a result of the government strategy for the power sector in Poland. Its ownership and management structure must be adjusted to the Group's activity in major business lines. Pursuant to its policy, the PGE Capital Group implements the Consolidation Programme to simplify its corporate structure and concentrate its core activity in six companies responsible for each business line of the Group. There is a risk that the performance of Group consolidation actions will be difficult, delayed or will generate significant costs.



## 7.4 Other risks and threats related to Wholesale trading activity

The following includes risks and dangers in Wholesale trading area, not mentioned above:

- the risk related to the implementation of international trade, including the availability of cross-border capacities,
- the risk of the continuity of the operation of IT systems,
- the risk of the inability to obtain new personnel or the loss of current employees.

## 8. Entity authorised to audit financial statements

An entity authorised to audit stand-alone yearly financial statements of PGE S.A. is KPMG Audyt Sp. z o.o. The financial statement audit agreement was signed on November 21, 2008 for two years and covers the audit of stand-alone and consolidated financial statements for 2008 and 2009, as well as reviews of interim half-year consolidated financial statements prepared for the period ended June 30, 2009 and June 30, 2010.

Table No. 21 Fee payable to an entity authorised to audit financial statements (PLN thousands)	2009	2008
<b>Remuneration of KPMG Audyt Sp. z o.o., including:</b>	<b>4,008.0</b>	<b>5,755.0</b>
Obligatory audit of the yearly financial statements and audit for IPO purposes	2,433.0	2,095.0
Other attestation services	105.0	-
Tax advisory	-	-
Other services (IPO)	1,470.0	3,660.0

## 9. Statement on implementation of corporate governance

This Statement on implementation of corporate governance in PGE Polska Grupa Energetyczna S.A. in 2009 was prepared on the basis of art. 91 section 5 point 4 of the Regulation of the Minister of Finance dated February 19, 2009 on current and periodic information published by issuers of securities and on conditions under which such information may be recognized as being equivalent to information required by the regulations of law of a state which is not a member state (Dziennik Ustaw of 2009, no. 33, item 259 as amended) and the resolution of the Management Board of the Warsaw Stock Exchange no. 718/2009 of December 16, 2009.

### 9.1 Corporate governance principles which the Company was obliged to follow in 2009

Since the day of the first quotation of shares of PGE Polska Grupa Energetyczna S.A. ("Company", "PGE") i.e. November 6, 2009, the Company is obliged to follow the corporate governance principles described in "Best Practices of WSE Listed Companies" (further: Best Practices), adopted with the Resolution of the Board of the Warsaw Stock Exchange ("WSE") no. 12/1170/2007 on July 4, 2007. During preparations to the stock exchange debut of the Company, the Management Board passed a resolution approving Best Practices for application.

The Management Board of the Company acts with due diligence to observe all the principles of Best Practices. However, not all recommendations prescribed by the Best Practices may be followed, which is beyond the Company's control (see point 9.2 below).

For the full text of the Best Practices, see the official corporate governance website of the Warsaw Stock Exchange: [www.corp-gov.gpw.pl](http://www.corp-gov.gpw.pl).

### 9.2 Information on exceptions in application of the corporate governance principles

In 2009 the Company applied the corporate governance principles except principle no. 5 included in 'Recommendations for Best Practice for Listed Companies' described in point 1 of the Best Practices. Incomplete application of the aforementioned recommendations is related to provisions of the Act dated March 3, 2000 on remuneration of managers of certain legal entities (Dziennik Ustaw, 2000, no. 26 item 306) which describes the maximum remuneration of the members of the Company's authorities. Given the application of the said Act, the Supervisory Board and the General Meeting of Shareholders of the Company have limited options to change the remuneration of the members of the Management Board and Supervisory Board at the level which corresponds to the scope of

responsibilities resulting from the functions performed in the authorities, the size of the Company and its economic results.

### **9.3 Description of the basic properties of internal control systems and risk management systems used in the Company during preparation of the financial statements and consolidated financial statements**

The Company applies the following mechanisms of internal control and risk management during preparation of the financial statements: internal procedures which regulate the process, management mechanisms for information system used for financial recording and reporting with protection mechanisms, principles of supervision over preparation of financial statements, principles of verification and evaluation of reports, internal audit, corporate risk management and other elements of control.

Basic regulations applicable to preparation of financial statements include: the Company's accounting policy, IFRS-compliant accounting policy of the PGE Capital Group, the procedure of closing accounting books and preparing consolidated financial statements of the PGE Capital Group in accordance with requirements of the Warsaw Stock Exchange. The IFRS-compliant accounting policy of the PGE Capital Group constitutes directives for companies subject to consolidation, which must be followed during preparation of IFRS-compliant reporting packages. The aforementioned regulations and guidelines ensure uniform accounting and statements principles in the PGE Group. In addition, in the financial reporting area, PGE S.A. and the companies subject to consolidation follow operational procedures/instructions on the accounting document control and recording and procedures of preparing tax documentation when entering into transactions with related entities.

The Company keeps accounting books in the integrated information system. The system ensures division of competencies, coherent entries in the books and control between the general ledger and subsidiary ledgers. The system can be modified to ensure adequacy of the technical solutions to the changing accounting principles and legal standards. The system includes documentation for the end user section and the technical section. The system documentation undergoes regular verification and update. The Company has implemented organisational and system-wide solutions to ensure that the system is properly used and protected, and that the access to data and hardware is secured. The access to financial and accounting system records and financial reporting records is restricted with relevant rights granted to authorised employees as required for their actions and responsibilities. The accounting books in companies subject to consolidation are kept in autonomous information systems. Regardless of the control mechanisms built into the information systems, management control mechanisms are implemented into the process of preparing financial statements in PGE S.A. and companies subject to consolidation. Such mechanisms include separation of responsibilities, verification of correctness of data received, authorisation by the superior, independent arrangements, etc.

Director of the Accounting Department of the Company is responsible for supervision over the preparation of unit and consolidated financial statements. Persons responsible for conducting books of account and the Management Board of the companies are responsible for preparation of reporting packages to be consolidated.

Statutory auditors perform an independent assessment of reliability and correct preparation of the financial statements of PGE S.A. and financial statements of companies subject to consolidation. Two auditing companies were appointed to audit 2009 financial statements of most important Companies in the PGE Group. The PGE Group has implemented a multi-stage process of approving financial statements with the participation of Supervisory Boards. Unit and consolidated financial statements of PGE S.A. are evaluated by the Supervisory Board. The Audit Committee operates within the Supervisory Board and is responsible, among others, for reviewing interim and annual financial statements of the Company. Unit financial statements of the companies subject to consolidation are evaluated by the Supervisory Boards of such companies. The financial statements are approved by the General Meetings of the Companies.

The Company has implemented internal audit to perform an independent and objective evaluation of the risk management and internal control systems. The internal audit operates on the basis of the internal audit regulations based on the international standards of professional internal audit practices. The audit performs scheduled and ad hoc auditing tasks both in the parent companies and companies within the Group. The audit plans are developed on the basis of risk analyses. Audit results are reported to the Management Board of PGE S.A.

The PGE Group has implemented the corporate risk management process. Risk management is aimed at providing information about threats of failure to achieve business goals, reducing adverse effects of such threats and undertaking preventive or recovery steps. PGE Group risks relating to various operating segments are identified and evaluated; then preventive steps are undertaken. Risk owners are responsible for managing identified risks.

As part of the controlling activities, periodical management reporting is evaluated for reasonable information, in particular in the context of analysis of deviations from assumptions in the financial plans.

#### **9.4 Shareholders with a majority stake**

As at December 31, 2009, the sole shareholder with a majority stake was the State Treasury with 1,470,576,500 shares accounting for 85% of the share capital of the Company, which entitle the State Treasury to 1,470,576,500 votes, accounting for 85% of the total number of votes at the General Meeting.

#### **9.5 Shareholders with special control powers**

Company shares are ordinary, bearer shares listed at the Warsaw Stock Exchange. Company shares are not privileged.

Despite the fact that the shares are not privileged, the Statutes provides for special powers for the State Treasury as long as it is the shareholder of the Company. In accordance with statutory provisions, the State Treasury may demand in writing that the Management Board convene the General Meeting, demand that certain matters be placed on the agenda, submit draft resolutions pertaining to matters placed on the agenda of the General Meeting or matters which may be placed on the agenda, and obtain copies of announcements printed in the Monitor Sądowy i Gospodarczy - Official Gazette Publishing Office.

In accordance with the Statutes of the Company, the State Treasury is authorised to appoint one member of the Supervisory Board by means of a written statement submitted to the Company at the General Meeting or outside the General Meeting, through the Management Board, where the State Treasury may exercise this power regardless of the voting right when appointing other members of the Supervisory Board.

Pursuant to the Act of June 3, 2005 on particular powers of the State Treasury and exercise of such powers in the companies of particular importance for the public order or public security (Dziennik Ustaw, 2005, no. 132 item 1108), the Minister of Treasury, as long as the State Treasury is a direct or indirect shareholder, may object to a resolution of the Management Board or another legal action by the Management Board, aimed at administration of a Company asset that is essential for the Company's operations. The objection applies solely to the legal action of the Company of particular importance for the public order or public security if there are reasonable grounds to suspect that such an action breaches the public order or public security. The Minister may also object to resolutions made by the General Meeting relating to:

- 1) winding up of the Company,
- 2) moving the registered office of the Company abroad,
- 3) changing the subject of activities of the Company,
- 4) sale or lease of the undertaking or its organised part and placing a limited material right on the undertaking

if there are reasonable grounds to suspect that such a resolution breaches the public order or public security.

At February 12, 2010 the Lower Chamber of Polish Parliament has passed the Act on exercising of particular rights of the State Treasury in respect of some companies and capital groups manage in electricity, oil and gas fuel sector. In March 2010 the Act was assumed by the Senate and at the day of this statement is still in legislative procedure. When this Act will entry into force, the Act dated on June 3, 2005 will be abolished.

#### **9.6 Limitations regarding exercise of the voting rights in shares**

There are no limitations regarding exercise of the voting rights in shares of the Company.

## **9.7 Limitations regarding the transfer of ownership of the Company's securities**

The existing limitations regarding the transfer of ownership of the Company's securities are based on the State Treasury's obligation under which from October 6, 2009 for a period of 180 days from the first quotation of the rights to shares (i.e. November 6, 2009) on the Warsaw Stock Exchange, the State Treasury would not issue, offer, sell, commit to sell, pledge or otherwise dispose of (or make a public announcement of an issue of an offering, sale or disposal) Company's shares or securities convertible to Company's shares or granting rights to Company's shares by exercising rights related to such securities, warrants or other rights which allow the purchase of the Company's shares or other securities or financial instruments the value of which is fixed directly or indirectly by making a reference to the price of underlying securities, including equity swaps, futures and options, without a prior written consent of managers of the initial public offering of PGE S.A. (i.e. UniCredit CAIB Poland S.A. and Goldman Sachs International, jointly referred to as the IPO Managers).

In addition, under the Underwriting Agreement signed on October 27, 2009, the Company incurred an obligation under which in the period from the day the Underwriting Agreement is executed for a period of 180 days from the first quotation of the shares on the Warsaw Stock Exchange (i.e. December 15, 2009), the Company would not issue, offer, sell, commit to sell, pledge or otherwise dispose of (or undertake similar actions or actions with a similar effect) any ordinary shares of the Company or any securities similar to ordinary shares of the Company without the consent of the IPO Managers. This obligation also involves options, warrants or other rights to ordinary shares of the Company, securities convertible to shares of the Company or securities which grant rights to obtain shares of the Company.

## **9.8 Amendments to the Company's Statutes**

In accordance with provisions of the Code of Commercial Companies, any amendments to the Company's Statutes require a resolution to be passed by the General Meeting and an entry to the register of entrepreneurs. A resolution on amendments to the Company's Statutes is made with a majority of three fourth votes. The General Meeting of the Company may authorise the Supervisory Board to agree on the uniform text of the amended Company's Statutes or introduce other editing changes as specified in the resolution of the General Meeting. Amendments to the Company's Statutes shall be valid from the day an entry is made to the register of entrepreneurs.

## **9.9 Activities and powers of the General Meeting, shareholder rights and exercise of such rights**

Activities of the General Meeting are described in the Code of Commercial Companies and the Company's Statutes. The Management Board of the Company intends to present the General Meeting with Rules of General Meeting for approval. The Rules regulate additional issues related to the activities of the General Meeting. The Company's Statutes is available on the PGE's website at [www.pgesa.pl](http://www.pgesa.pl).

### **a) Convening and cancelling the General Meeting**

The General Meeting is convened in circumstances described in the Code of Commercial Companies and the Company's Statutes.

The General Meeting of Shareholders is held as an ordinary or extraordinary meeting and is generally convened by the Management Board. The Supervisory Board may convene ordinary General Meeting if the Management Board fails to convene the Meeting on the date specified in the Code of Commercial Companies and the Statutes. The Supervisory Board may convene an extraordinary General Meeting at any time if advisable.

Shareholders representing at least half of the share capital or at least half of total votes in the Company may convene the extraordinary General Meeting. The Shareholders shall appoint the chairman of that General Meeting.

The Management Board shall convene the General Meeting on its own initiative, at the written demand of the Supervisory Board or demand of the shareholder or shareholders representing at least one twentieth of the share capital or at the written demand of the State Treasury as long as the State Treasury remains a shareholder of the Company. The shareholder or shareholders representing at least one twentieth of the share capital submit the demand for convening the General Meeting to the Management Board in writing or by e-mail. As long as the State Treasury remains a shareholder of the Company, the State Treasury may demand in writing that the General Meeting be convened.

The General Meeting should be convened within two weeks of the demand by the Supervisory Board, shareholder or the State Treasury. If the General Meeting is not convened within two weeks of the demand, the registry court may authorise the shareholders making such a demand to convene the Extraordinary General Meeting.

The Ordinary General Meeting of Shareholders should take place no later than within six months of the end of the financial year. The shareholder or shareholders representing at least one twentieth of the share capital may demand that certain matters be placed on the agenda of the next General Meeting. The demand should be presented to the Management Board no later than twenty one days before the proposed date of the meeting. The demand should include a justification or draft resolution on the proposed matter of the agenda. The demand may be submitted in writing or by e-mail. If the demand referred to in subpar. 3 is made after the date referred to in art. 401 § 1 of the Code of Commercial Companies, then it is treated as a request to convene the Extraordinary General Meeting.

The Management Board shall immediately, however no later than eighteen days before the scheduled date of the General Meeting, announce changes to the agenda, in the manner appropriate for convening of the General Meeting.

Before the date of the General Meeting, the shareholder or shareholders representing at least one twentieth of the share capital may present the Company in writing or by e-mail with draft resolutions on the matters introduced to the agenda of the General Meeting or matters to be introduced to the agenda. The Company shall immediately announce the draft resolutions on its website.

General Meetings take place at the registered office of the Company.

The General Meeting of Shareholders is convened by an announcement made on the Company's website and in the manner prescribed for provision of current information pursuant to provisions of the Act dated July 29, 2005 on public offering, conditions governing the introduction of financial Instruments to organised trading, and public companies (Dziennik Ustaw 2009, no. 185, item 1439).

Materials issued to shareholders in connection with the General Meeting, in particular draft resolutions proposed for voting by the General Meeting and other essential materials are provided by the Company in the time sufficient to evaluate such materials, on the corporate website of the Company at [www.pgesa.pl](http://www.pgesa.pl).

The Company shall make efforts to ensure that cancelling of the General Meeting or changing the date of the Meeting does not prevent or restrict the exercise of the shareholder right to participate in the General Meeting.

#### **b) Competencies of the General Meeting of the Company**

Within its basic competencies, the General Meeting:

- reviews and approves the report of the Management Board on the activities of the Company, financial statements and the consolidated financial statements for the past financial year,
- grants approval of fulfilment of duties by the Members of the Supervisory Board and Members of the Management Board,
- makes a decision on the distribution of profit or covering the loss,
- appoints and recalls Members of the Supervisory Board and determines rules of remuneration for the Members of the Supervisory Board,
- agrees on the acquisition and lease of the undertaking or its organised part and placing a limited material right thereon,
- enters into the credit, loan, suretyship or similar agreement with a member of the Management Board, Supervisory Board, proxy, liquidator or in the name of any of such persons,
- increases and reduces the share capital of the Company,
- issues convertible bonds or preferential bonds, issues subscription warrants,
- makes decisions regarding claims for repair of damage caused during founding of the company, management or supervision over the company,
- merges, transforms and divides the Company,
- redeems shares,



- amends the Statutestatutess and changes the essential subject of activities of the Company,
- dissolves and winds up the Company,
- fixes remuneration for the Members of the Management Board of the Company.

The sale and purchase of real property, perpetual usufruct or share in real properties does not require a resolution of the General Meeting.

The General Meeting of Shareholders may vote on resolutions pertaining only to matters included on the detailed agenda, subject to art. 404 of the Code of Commercial Companies.

#### **c) Participation in the General Meeting of the Company**

The right to participate in the General Meeting is available only to persons who are shareholders of the Company sixteen days before the date of the General Meeting (date of registration of participation in the General Meeting).

A shareholder may participate in the General Meeting provided that the shareholder presents a personal certificate confirming the right to participate in the General Meeting issued by the entity which keeps the securities account.

A shareholder participates in the General Meeting and exercises the right to vote in person or through the Proxy. Proxy to participate in the General Meeting and exercise the right to vote must be granted in writing or in electronic form. Proxy granted in electronic form should be sent to the e-mail address of the Company stated in the announcement on the General Meeting. From the date the General Meeting is convened, the Company provides a form with a specimen of proxy in electronic form on its website. The Proxy of a shareholder exercises all the rights of the shareholder unless proxy provides otherwise. The Proxy may grant further proxies unless text of the proxy stipulates otherwise. One Proxy may represent more than one shareholder. In such a case, the Proxy may vote differently with the shares of each shareholder. If the shareholder has shares recorded in more than one securities account, the shareholder may appoint a Proxy to exercise rights in shares recorded in each account.

Members of the Management Board and the Supervisory Board may participate in the General Meeting.

Members of the Supervisory Board and the Management Board provide explanations and information pertaining to the Company to participants of the General Meeting, within the scope of their competencies and the scope necessary to decide on matters discussed by the General Meeting.

During the General Meeting, each shareholder may propose draft resolutions regarding matters entered on the agenda.

#### **d) Voting at the General Meeting of Shareholders**

Resolutions of the General Meeting are passed with the absolute majority of votes, subject to other provisions of the Code of Commercial Companies and the Company's Statutes. The absolute majority is understood as more votes in favour of than votes against or abstaining.

One Company share carries the right to one vote at the General Meeting of Shareholders.

The shareholders may participate and exercise the right to vote at the General Meeting of Shareholders in person or through their plenipotentiaries.

A shareholder may cast different votes for each of his/her shares.

Subject to governing provisions of the law and of the Statutes, the voting shall be open. A secret voting is administered during appointments and motions for recalling or prosecuting members of Company's authorities or liquidators, and during voting on personal matters. A secret voting should be also administered when requested by at least one of the shareholders present or represented at the General Meeting. The General Meeting may pass a resolution to override secret voting for matters pertaining to founding of a commission appointed by the General Meeting.

### **9.10 Members and activities of the Company's management and supervisory bodies and the Company's committees**

Activities of the Management Board and the Supervisory Board are regulated by the provisions of the Code of Commercial Companies, the Company's Statutes, the Rules of the Management Board and the Rules of the Supervisory Board. Activities of such authorities of PGE Polska Grupa Energetyczna

S.A. are also subject to the corporate governance principles established by the Warsaw Stock Exchange. The Company's Statutes and the Rules of the Management Board and Rules of the Supervisory Board are available on the PGE's website at [www.pgesa.pl](http://www.pgesa.pl).

## A. Management Board

### Members of the Management Board

In 2009, the Management Board of the Company consisted of:

Name and surname of the Member of the Management Board	Function
Tomasz Zadroga	President of the Management Board
Marek Szostek	Vice-President of the Management Board responsible for Organisation since Nov 20 2009 Vice-President of the Management Board Aug 3, 2009 –Nov 19, 2009
Piotr Szymanek	Vice-President of the Management Board responsible for Corporate Affairs since Apr 28, 2009 Vice-President of the Management Board responsible for Legal and Corporate Affairs Dec 15, 2008 –Apr 27 2009
Wojciech Topolnicki	Vice-President of the Management Board responsible for Development and Finance since Apr 28, 2009 Vice-President of the Management Board responsible for Finance Dec 15, 2008 –Apr 27, 2009
Marek Trawiński	Vice-President of the Management Board responsible for Operations since Apr 28, 2009 Vice-President of the Management Board responsible for Trade and Distribution Dec 15, 2008 – Apr 27, 2009
Adam Cichocki	Vice-President of the Management Board responsible for Human Resources Dec 15, 2008 – Feb 27, 2009
Henryk Majchrzak	Vice-President of the Management Board responsible for Manufacturing Dec 15, 2008 – Feb 27, 2009

### Rules of appointing and recalling the management staff

The Management Board consists of two to seven members: the President and other Members acting as Vice-Presidents. Members of the Management Board are appointed for a joint term of office of three years.

The Management Board or individual members of the Management Board are appointed and recalled by the Supervisory Board. In addition, each Member of the Management Board may be recalled or suspended by the General Meeting or, for major reasons, suspended by the Supervisory Board. A resolution of the Supervisory Board on the suspension of a Member of the Management Board must include a justification. The Supervisory Board may delegate members of the Supervisory Board to perform activities of the Members of the Management Board on a temporary basis. A Member of the Management Board submits his/her resignation in writing to the Supervisory Board at the address of the registered office of the Company.

### Competencies of the Management Board

The Management Board administers affairs of the Company and represents the Company in all court and out-of-court affairs. The Management Board deals with all the matters related to managing the affairs of the Company, not reserved by the law or Statutes for the General Meeting or the Supervisory Board.

Co-operation of two Members of the Management Board or one member of the Management Board with a proxy is required to make statements on behalf of the Company. Statements made to the



Company and letters served the Company may be performed by one Member of the Management Board or a proxy.

Members of the Management Board are authorised and obliged to manage the affairs of the Company jointly. Each Member of the Management Board may manage the affairs which fall within the scope of ordinary activities of the Management Board, without a prior resolution of the Management Board, within the agreed division of responsibilities unless any Member of the Management Board objects. Resolutions of the Management Board must be made for all the affairs which fall beyond the scope of ordinary activities of the Company. If there are equal votes at the meeting of the Management Board, the President of the Management Board has the decisive vote.

In accordance with the Statutes, resolutions of the Management Board are required in particular for:

- purchase (taking up) or administration over the following assets: (a) real properties, perpetual usufruct or shares in real properties; (b) assets other than real property worth more than €400,000; (c) shares, stocks or other titles of participation in companies;
- encumbering eligible assets as listed above with a limited material right for the amount (sum of the collateral) in excess of €400,000;
- entering into contracts other than listed above or obligations other than listed above, in excess of €400,000;
- granting of guaranties and suretyship by the Company;
- approving the rules of the Management Board;
- approving the organisational rules of the Company's undertaking;
- establishment and liquidation of branches;
- entering into contracts not related to the subject of activities of the Company specified in the Statutes;
- making donations and release from debt;
- appointment of proxies;
- approval of annual and long-term financial plans of the Company;
- approval of the Company's development strategy;
- deciding on the method of exercising the right to vote at the general meetings of companies in which the Company holds shares or stocks;
- matters referred by the Management Board to the Supervisory Board for review, and matters not reserved for the Board's competencies.

The Statutes does not provide for detailed regulations which authorise Members of the Management Board to decide on the issue or redemption of shares.

### **Activities and organisation of work of the Management Board**

The Management Board manages Company's affairs in a transparent and effective manner based on and within the limits of the governing provisions of the law, including the Code of Commercial Companies, provisions of the Company's Statutes, Rules of the Management Board and other internal regulations governing in the Company.

The works of the Management Board are headed by the President of the Management Board. The Management Board makes decisions in the form of resolutions passed at the meetings. The Management Board meets when required, not less often than once a week. Meetings of the Management Board are convened by the President of the Management Board on his/her own initiative or on the motion of a Member of the Management Board, stating the agenda. The notification of the meeting date is distributed to the members of the Management Board at least two working days before the planned date of the meeting. In reasonable circumstances, the meeting may be convened one day prior to the scheduled meeting. When the President of the Management Board is absent, meetings of the Management Board are convened by the appointed member of the Management Board. Meetings of the Management Board are presided by the President of the Management Board or another member of the Management Board. The agenda can be changed if all members of the Management Board are present at the meeting and all the members agree to such a change.

Minutes are taken for each meeting of the Management Board and signed by the members of the Management Board present at the meeting. The minutes are stored in the Book of Minutes.

Resolutions of the Management Board are passed with an absolute majority of votes in an open voting. A secret voting is administered for personnel matters and when requested by a member of the Management Board. All members of the Management Board must be properly notified of the scheduled meeting and at least half of the members of the Management Board must be present for the resolutions to be valid. A resolution on appointment of proxies requires an unanimous decision of all members of the Management Board. A member of the Management Board voting against a resolution may present an opposing opinion with a justification. Resolutions are made in writing or using means of direct remote communications.

The Rules of the Management Board divide competencies of members of the Management Board regarding the ordinary management to operating areas in which individual members of the Management Board perform the leading role. For the functions performed, each member of the Management Board is assigned appropriate scope of responsibilities for the Company's affairs.

## **B. Supervisory Board**

### **Members of the Supervisory Board**

In 2009 the Supervisory Board consisted of:

<b>Name and surname of the member of the Supervisory Board</b>	<b>Function</b>
Marcin Zieliński	Chairman of the Supervisory Board
Maciej Bałtowski	Vice-Chairman of the Supervisory Board
Wojciech Cichoński	Secretary of the Supervisory Board
Jacek Barylski	Member of the Supervisory Board
Katarzyna Prus	Member of the Supervisory Board
Zbigniew Szmuniewski	Member of the Supervisory Board
Ryszard Malarski	Member of the Supervisory Board since Jan 14, 2009
Małgorzata Dec	Member of the Supervisory Board since Jul 30, 2009
Mikołaj Budzanowski	Member of the Supervisory Board since Jul 20, 2009

### **Rules of appointing and recalling the supervisory personnel**

The Supervisory Board consists of seven to nine members appointed and recalled by the General Meeting. In addition, the State Treasury is authorised to appoint and recall one member of the Supervisory Board by means of a written statement presented to the Company at the General Meeting of Shareholders or outside the General Meeting, through the Management Board, where the State Treasury exercises this right regardless of the right to vote on appointing other members of the Supervisory Board.

In accordance with provisions of the Statutes, the Supervisory Board should comprise at least one person appointed by the General Meeting out of persons which meet the criteria of independence as specified by the corporate governance principles approved by the Warsaw Stock Exchange. Candidates for the position of a member of the Supervisory Board submit a statement regarding their independence.

If the State Treasury fails to make the appointment or the General Meeting fails to appoint aforementioned members of the Supervisory Board, or if such persons are not members of the Supervisory Board, the Supervisory Board may pass binding resolutions nonetheless.

The Chairman of the Supervisory Board is appointed by the General Meeting. The Supervisory Board appoints the Vice-Chairman and Secretary out of its members.

Members of the Supervisory Board are appointed for a joint term of office of three years. The mandate of a member of the Supervisory Board expires at the latest on the day of the General Meeting which approves the financial statements for the past complete financial year during which the member of the

Supervisory Board performed his/her function and in other cases as provided for by the Code of Commercial Companies. A member of the Supervisory Board may be recalled by the General Meeting at any time, except the member of the Supervisory Board appointed by the State Treasury, which may be recalled by the State Treasury only.

### **Activities and organisation of the Supervisory Board**

The operating procedure of the Supervisory Board is described in the Rules of the Supervisory Board of PGE Polska Grupa Energetyczna S.A.

The Supervisory Board performs its obligations collectively, however, it may delegate individual members for temporary and independent performance of certain supervisory activities. The Supervisory Board meets as required, not less often than once every two months.

The first meeting of the Supervisory Board of the new term of office is convened by the chairman of the General Meeting during which the Board was appointed, before the General Meeting concludes the session. The meeting date cannot occur more than two weeks after the date of the General Meeting. If the meeting is not convened as described above, the first meeting of the Supervisory Board shall be convened by the Management Board within four weeks of the date of the General Meeting.

Meetings of the Supervisory Board are convened by the Chairman of the Supervisory Board or the Vice-Chairman in the absence of the Chairman. The Meeting of the Supervisory Board should be also convened on demand of each Member of the Supervisory Board or the motion of the Management Board (the person filing the motion proposes the agenda). The meeting should be convened within two weeks. If the Chairman of the Supervisory Board fails to convene the meeting within that period, the person filing the motion may convene the meeting on his/her own, stating the date, place and proposed agenda. The meeting of the Supervisory Board is convened by sending out a written invitation to all members of the Supervisory Board at least seven days before the schedule date of the meeting. This period of seven days may be shortened to two days for major reasons. The agenda may be changed if all members of the Supervisory Board are present at the meeting and no one objects to the change.

Members of the Supervisory Board must present reasons for their absence at the meetings in writing.

The Supervisory Board passes resolutions if at least half of the members of the Supervisory Board are present at the meeting and all the members have been invited. The Supervisory Board passes resolutions in an open voting. A secret voting is administered when requested by a member of the Supervisory Board, and during voting on personal matters. Resolutions of the Supervisory Board are made in writing or using means of direct remote communications. The latter cannot be used for resolutions on the appointment or recalling of the Vice-Chairman and Secretary of the Supervisory Board, and appointment, recalling or suspending a Member of the Management Board. Resolutions of the Supervisory Board are passed with an absolute majority of votes. If there are equal votes at the meeting of the Supervisory Board, the Chairman of the Supervisory Board has the decisive vote.

The Supervisory Board may appoint ad hoc commissions out of the Supervisory Board members.

Members of the Management Board and other persons in an advisory capacity, invited by the Chairman or Vice-Chairman of the Supervisory Board, may participate in the meeting of the Supervisory Board.

In order to perform its duties, the Supervisory Board may require the Management Board to provide information on all material issues pertaining to activities of the Company and risks related to such activities.

The Supervisory Board prepares a report on its activities. The report is submitted to the General Meeting of Shareholders.

### **Competencies of the Supervisory Board**

The Supervisory Board maintains a continuous supervision over activities of the Company in all areas of the Company's activities.

In accordance with the Statutes, the Supervisory Board:

- reviews the report of the Management Board on the activities of the Company and the unit financial statements for the past financial year for compliance with the books, documents and the actual status. This also applies to the consolidated financial statements of the capital group if any;

- reviews the motions of the Management Board on the division of profit or covering the loss;
- presents the General Meeting with a written report on the results of activities referred to in the aforementioned two points;
- appoints the statutory auditor to audit the unit financial statements and the consolidated financial statements of the capital group if any;
- approves the annual and long-term financial plans of the Company, specifies the scope and dates of presentation of such plans by the Management Board;
- approves the development strategy of the Company;
- approves the rules which lays down detailed operating procedure of the Supervisory Board;
- approves the rules of the Management Board of the Company;
- defines essential terms of employment of members of the Management Board as well as terms of other contracts signed with the members, subject to competencies of the General Meeting to fix the remuneration for such members;
- provides opinions on all the motions for resolutions submitted by the Management Board to the General Meeting;
- approves the organisational regulations of the Company;
- delegates members of the Supervisory Board to perform, on a temporary basis, activities of the members of the Management Board who cannot fulfil their duties;
- grants consent for the members of the Management Board to hold positions in authorities of other companies.

In addition, in accordance with the Statutes, the Supervisory Board grants a consent for:

- purchase (taking up) or administration over the following assets: (a) real properties, perpetual usufruct or shares in real properties; (b) fixed assets other than real property; (c) shares, stocks or other titles of participation in companies – worth or exceeding €5m;
- encumbering eligible assets as listed above with a limited material right for the amount (sum of the collateral) equal or in excess of €5m;
- entering into the following agreements by the Company: (a) agreements of donation or release from debt worth at least €5,000, (b) agreements not related to the statutory subject of activities of the Company worth at least €5,000;
- granting of guaranties and suretyship to entities other than companies and co-operatives which are direct and indirect subsidiaries (as defined by the Code of Commercial Companies);
- entering into contracts for construction or establishing a connection with the power systems of other countries;
- entering into contracts other than listed above or incurring of obligations other than listed above worth or exceeding €100m, where entering into contracts or incurring of obligations consisting in electricity trade with direct or indirect subsidiaries (as defined by the Code of Commercial Companies) does not need any consent;
- payment of an advance against the expected dividend.

### **C. Committees**

In accordance with the Company's Statutes, the Rules of the Supervisory Board or a resolution of the General Meeting may provide for establishment of committees within the Supervisory Board, in particular the audit committee and the remuneration committee. The current Rules of the Supervisory Board provide that the Supervisory Board may appoint standing or ad hoc committees, acting as collective advisory and opinion-making bodies of the Supervisory Board. The particular goal of the committees is to provide the Supervisory Board with opinions and recommendations on matters within the competencies of the committees. The committees are established by the Supervisory Board out of its members. The committee consists of 2 to 5 persons. The committee appoints a chairman out of its members. The chairman convenes meetings of the committee, manages works of the committee and represents the committee in relations with the authorities and employees of the Company. The

mandate of a committee member expires with the expiry of the mandate of the member of the Supervisory Board, resignation from membership in the committee or recalling from the committee by the Supervisory Board. Each Member of the Supervisory Board may participate in committee meetings. The committee chairman may invite to the meetings members of the Management Board, Company employees and other persons whose participation is advisable. Decisions of the committee are made on a consensus basis.

The following standing committees work within the Supervisory Board: the Audit Committee, the Strategy and Development Committee, the Appointment and Remuneration Committee, and the Corporate Governance Committee.

### **I. The Audit Committee**

The Audit Committee is responsible for auditing the whether internal financial controls are performed in a correct and effective manner in the Company and the PGE Capital Group. The Audit Committee also co-operates with statutory auditors of the Company.

In particular, the Audit Committee:

- monitors the work of statutory auditors of the Company and presents the Supervisory Board with recommendations on the appointment and remunerating statutory auditors of the Company,
- discusses the scope of audit with the statutory auditors of the Company before the audit of the annual financial statements and monitors the work of the statutory auditors of the Company,
- reviews interim and annual financial statements of the Company (unit and consolidated), focusing in particular on:
  - all the changes of accounting standards, principles and practices,
  - main areas to be audited,
  - major corrections resulting from the audit,
  - statements on the going concern,
  - compliance with governing provisions on book-keeping.
- discusses with the competent persons all the issues or reservations which might arise out of the audit of the financial statements,
- analyses letters addressed to the Management Board by the statutory auditors and responses of the Management Board; checks independence and objectiveness of audits conducted by the statutory auditors,
- expresses opinions on the Company's policy on dividends, profit distribution and issue of securities,
- reviews the management accounting system,
- reviews the internal control system (including the mechanisms of financial and operational control, risk assessment and management control) and the annual report,
- analyses reports of internal auditors of the Company and main conclusions of other internal analysts and responses of the Management Board to such conclusions; examines the level of independence of internal auditors,
- performs an annual review of the internal audit programme, co-ordinates the work of internal and external auditors and examines the operating conditions of internal auditors,
- co-operates with the organisational units of the Company responsible for the audit and control and performs a periodical evaluation of their work,
- reviews all the other issues related to the audit of the Company, highlighted by the Committee or the Supervisory Board,
- informs the Supervisory Board of any major issues related to the activities of the Audit Committee.

In 2009, the Audit Committee consisted of:

Name and surname	Function
until Jan 29, 2009	
Wojciech Cichoński	Chairman
Zbigniew Szmuniowski	Committee Member
since Jan 29, 2009	
Wojciech Cichoński	Chairman
Jacek Barylski	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
since Sep 1, 2009	
Wojciech Cichoński	Chairman
Jacek Barylski	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
Małgorzata Dec	Committee Member
since Nov 3, 2009	
Wojciech Cichoński	Chairman
Maciej Bałtowski	Committee Member
Jacek Barylski	Committee Member
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member

## II. The Corporate Governance Committee

The Corporate Governance Committee:

- evaluates the implementation of the corporate governance principles in the Company and presents the Supervisory Board with initiatives in this area,
- provides opinions on normative acts and other documents of the Company presented to the Supervisory Board, which considerably affect the corporate governance,
- initiates and prepares proposals of changes for normative acts of the Supervisory Board.

In 2009 the Corporate Governance Committee consisted of:

Name and surname	Function
until Jan 29, 2009	
Maciej Bałtowski	Committee Member
since Jan 29, 2009	
Katarzyna Prus	Chairwoman
Maciej Bałtowski	Committee Member
Mikołaj Budzanowski	Committee Member until Jul 20, 2009
Ryszard Malarski	Committee Member



### III. The Strategy and Development Committee

The Strategy and Development Committee provides opinions and recommendations to the Supervisory Board regarding planned investments which considerably affect the Company's assets. In particular, the Strategy and Development Committee:

- provides opinions on all the strategic documents submitted to the Supervisory Board by the Management Board,
- provides opinions on the annual and long-term financial plans, as well as the development strategy of the Company.

In 2009 the Strategy and Development Committee consisted of:

Name and surname	Function
	until Jan 29, 2009
Zbigniew Szmuniowski	Committee Member
	since Jan 29, 2009
Ryszard Malarski	Chairman
Mikołaj Budzanowski	Committee Member until Jul 20, 2009
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
	since Sep 1, 2009
Ryszard Malarski	Chairman
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member

### IV. The Appointment and Remuneration Committee

The Appointment and Remuneration Committee is responsible for facilitating achievement of strategic goals of the Company by presenting the Supervisory Board with opinions and motions on the development of the management structure, including the organisational solutions, remuneration system and selection of properly qualified personnel.

In particular, the Appointment and Remuneration Committee:

- initiates and provides opinions on the system of appointing the members of the Management Board;
- provides opinions on the Company management system solutions proposed by the Management Board, aimed at ensuring the effectiveness, cohesion and security of Company management,
- performs a periodic review and recommends the rules of fixing motivational remuneration for the members the Management Board and top management, taking into account the interest of the Company,
- performs a periodic review of the system of remunerating the members of the Management Board and the managerial staff reporting directly to the members of the Management Board, including the manager contracts and motivational systems, and presents the Supervisory Board with proposals of developing such systems in the context of pursuing the strategic objectives of the Company,
- presents the Supervisory Board with opinions justifying the award of remuneration dependant on results in the context of evaluation of the level of achievement of specific tasks and goals of the Company,
- evaluates the human resources management system in the Company.

In 2009 the Appointment and Remuneration Committee consisted of:

Name and surname	Function
	until Jan 29, 2009
Wojciech Cichoński	Chairman
Maciej Bałtowski	Committee Member
	since Jan 29, 2009
Maciej Bałtowski	Chairman
Jacek Barylski	Committee Member
Wojciech Cichoński	Committee Member
Katarzyna Prus	Committee Member
Marcin Zieliński	Committee Member

## 10. Statements of the Management Board

### 10.1. Statement on the reliable preparation of the financial statements

To the best knowledge of the Management Board of PGE Polska Grupa Energetyczna S.A., the annual financial statements and comparable data were prepared in accordance with the governing accounting principles, present a fair, true and reliable view of the material and financial situation of PGE Polska Grupa Energetyczna S.A. and its financial result.

The report of the Management Board on the activities of PGE Polska Grupa Energetyczna S.A. presents a true view of the development, achievements and situation of the Company, and provides a description of the basic risks and threats.

### 10.2. Statement on the entity authorised to audit the financial statements

The Management Board of PGE Polska Grupa Energetyczna S.A. declares that the entity authorised to audit the financial statements, which audits the annual financial statements, has been appointed in accordance with provisions of the law. The entity and the statutory auditors fulfilled all the requirements for issuing an unbiased and independent opinion on the audit, in accordance with the governing provisions and professional standards.

Warsaw, March 15, 2010.

Signatures of Members of the Management Board of PGE Polska Grupa Energetyczna S.A.

*Tomasz Zadroga*

*President of the Management Board*

*Wojciech Topolnicki*

*Vice-president of the Management  
Board*

*Marek Szostek*

*Vice-president of the Management Board*

*Piotr Szymanek*

*Vice-president of the Management  
Board*

*Marek Trawiński*

*Vice-president of the Management Board*