



**MANAGEMENT BOARD'S REPORT ON  
ACTIVITIES OF THE CAPITAL GROUP OF  
PGE POLSKA GRUPA ENERGETYCZNA S.A.  
for the year 2010**

Warsaw, March 2011

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## **1. Background information about the Capital Group of PGE Polska Grupa Energetyczna S.A.**

### **1.1. Organisation of the Capital Group**

The description of the organisation of the Capital Group of PGE Polska Grupa Energetyczna S.A. (the "Capital Group", the "Group", the "PGE Group") and the list of entities subject to consolidation are presented in Note 1 and Note 2 to the consolidated financial statements.

PGE Polska Grupa Energetyczna S.A. ("PGE S.A.", the "Company") runs its activities through its headquarter with no branches.

PGE Group companies, which have its branches are listed below:

- PGE Górnictwo i Energetyka Konwencjonalna S.A.:
  - Branch Elektrownia Bełchatów (formerly PGE Elektrownia Bełchatów S.A.),
  - Branch Elektrownia Turów (formerly PGE Elektrownia Turów S.A.),
  - Branch Kopalnia Węgla Brunatnego Bełchatów (formerly PGE KWB Bełchatów S.A.),
  - Branch Kopalnia Węgla Brunatnego Turów (formerly PGE KWB Turów S.A.),
  - Branch Zespół Elektrowni Dolna Odra (formerly PGE ZEDO S.A. and PEC Sp. z o.o. in Gryfino),
  - Branch Elektrociepłownia Lublin Wrotków (formerly PGE Elektrociepłownia Lublin-Wrotków Sp. z o.o.),
  - Branch Elektrociepłownia Kielce (formerly PGE Elektrociepłownia Kielce S.A.),
  - Branch Elektrociepłownia Rzeszów (formerly PGE Elektrociepłownia Rzeszów S.A.),
  - Branch Elektrociepłownia Gorzów (formerly PGE Elektrociepłownia Gorzów S.A. and PEC Gorzów Sp. z o.o.),
  - Branch Zespół Elektrociepłowni Bydgoszcz (formerly PGE ZEC Bydgoszcz S.A.),
  - Branch Elektrociepłownia Zgierz (formerly Energetyka Boruta Sp. z o.o.).
- PGE Obrót S.A.
  - Branch Lublin (formerly PGE Lubelskie Zakłady Energetyczne S.A.)
  - Branch I Łódź (formerly PGE Łódzki Zakład Energetyczny S.A.)
  - Branch Zamość (formerly PGE Zamojska Korporacja Energetyczna SA)
  - Branch Warsaw (formerly PGE Zakład Energetyczny Warszawa-Teren S.A.)
  - Branch Białystok (formerly PGE Zakład Energetyczny Białystok S.A.)
  - Branch II Łódź (formerly PGE ZEŁT Obrót Sp. z o.o)
  - Branch Skarżysko-Kamienna (formerly PGE ZEORK S.A.).
- PGE Dystrybucja S.A.
  - Branch Warsaw (formerly PGE Dystrybucja Warszawa-Teren Sp. z o.o.),
  - Branch Białystok (formerly PGE Dystrybucja Białystok Sp. z o.o.),
  - Branch Lublin (formerly PGE Dystrybucja LUBZEL Sp. z o.o.),
  - Branch Zamość (formerly PGE Dystrybucja Zamość Sp. z o.o.),
  - Branch Rzeszów (formerly PGE Dystrybucja Rzeszów Sp. z o.o.),
  - Branch Łódź – Teren (formerly PGE Dystrybucja Łódź-Teren S.A.),
  - Branch Skarżysko-Kamienna (formerly PGE ZEORK Dystrybucja Sp. z o.o.),
  - Branch Łódź – Miasto (formerly PGE Dystrybucja Łódź Sp. z o.o.).

- PGE Energia Odnawialna S.A.
  - Branch Czymanów (formerly Elektrownia Wodna Żarnowiec S.A.),
  - Branch Dychów (formerly PGE Zespół Elektrowni Wodnych Dychów S.A.),
  - Branch Międzybrodzie Bialskie (formerly Zespół Elektrowni Wodnych Porąbka-Żar S.A.),
  - Branch Solina (formerly Zespół Elektrowni Wodnych Solina-Myczkowce S.A.).
- Niepubliczny Zakład Opieki Zdrowotnej „MegaMed” sp. z o.o.,
  - Branch Zakład Usług Profilaktyczno – Lecznicznych „Megavita” sp. z o.o. with its registered office in Brzezie,
  - Branch Centrum Medyczne Turów sp. z o.o. with its registered office Bogatynia,
  - Branch Zakład Usług Medycznych Dolna Odra sp. z o.o. with its registered office Nowe Czarnowo.
- ELECTRA Deutschland GmbH with its registered office in Hamburg:
  - Branch Prague,
  - Branch Bratislava.

Other Group companies run their activities through the headquarters with no branches.

## **1.2. Changes in the Company and Capital Group's management rules**

In 2010, the PGE Capital Group carried out two strategic projects: PGE Consolidation Programme and a project entitled "Non-core asset management concept within PGE Capital Group".

### **Consolidation Programme**

In 2010 Consolidation Programme was carried out in PGE Capital Group. The aim of the Programme was to adapt the corporate and management structure to reflect the activities of the Group's main business lines and to create the structure in which, one company will be responsible for all activities in particular business line and will concentrate all the assets and operations in that area of activities.

As a result of the execution of the Consolidation Programme in 2010, the following formal and legal mergers took place in the given segments: (i) mining and conventional generation (formerly: mining and generation); (ii) renewables; (iii) distribution of the electric energy; (iv) retail sale of electric energy; as well as the merger of PGE Górnictwo i Energetyka S.A., PGE Energia S.A. and PGE Electra S.A. with PGE Polska Grupa Energetyczna S.A.

### **Mining and Conventional Generation ("Conventional Generation")**

PGE Górnictwo i Energetyka Konwencjonalna S.A. is a company which centralises the assets in mining and conventional generation. The merger in this segment was registered on September 1, 2010.

The following entities were merged in Conventional Generation:

1. PGE Elektrownia Bełchatów S.A. – acquiring company
2. PGE Kopalnia Węgla Brunatnego Bełchatów S.A.
3. PGE Kopalnia Węgla Brunatnego Turów S.A.
4. PGE Elektrownia Turów S.A.
5. PGE Zespół Elektrowni Dolna Odra S.A.
6. PGE Zespół Elektrociepłowni Bydgoszcz S.A.
7. PGE Elektrociepłownia Lublin-Wrotków Sp. z o.o.
8. PGE Elektrociepłownia Gorzów S.A.
9. PGE Elektrociepłownia Rzeszów S.A.
10. PGE Elektrociepłownia Kielce S.A.

11. Energetyka Boruta Sp. z o.o.
12. Przedsiębiorstwo Energetyki Ciepłej Sp. z o.o. in Gryfino
13. PEC Gorzów Sp. z o.o.

Additionally, the merger with PGE Elektrownia Opole S.A. is currently ongoing.

#### **Renewable energy**

PGE Energetyka Odnawialna S.A. is a company which centralises the assets in renewable energy (excluding the installations for co-combustion of biomass). The merger in this segment was registered on August 31, 2010.

The following entities were merged in Renewable energy:

1. PGE Energia Odnawialna S.A. – acquiring company
2. Elektrownia Wodna Żarnowiec S.A.
3. PGE Zespół Elektrowni Wodnych Dychów S.A.
4. Zespół Elektrowni Wodnych Porąbka-Żar S.A.
5. EGO-Odra S.A.
6. Zespół Elektrowni Wodnych Solina-Myczkowce S.A.

Additionally, the merger with Elektrownia Wiatrowa Kamieńsk Sp. z o.o. is currently ongoing.

#### **Distribution of electricity**

PGE Dystrybucja S.A. is a company which centralises the assets in distribution. The merger in this segment was registered on August 31, 2010.

The following entities were merged in distribution:

1. PGE Dystrybucja S.A. – acquiring company
2. PGE Dystrybucja LUBZEL Sp. z o.o.
3. PGE Dystrybucja Łódź Sp. z o.o.
4. PGE Dystrybucja Rzeszów Sp. z o.o.
5. PGE Dystrybucja Białystok Sp. z o.o.
6. PGE Dystrybucja Łódź-Teren S.A.
7. PGE Zakłady Energetyczne Okręgu Radomsko-Kieleckiego Dystrybucja Sp. z o.o.
8. PGE Dystrybucja Warszawa-Teren Sp. z o.o.
9. PGE Dystrybucja Zamość Sp. z o.o.

#### **Retail sale of electricity**

PGE Obrót S.A. is a company which centralises the assets in retail sale. The merger in this segment was registered on August 31, 2010.

The following entities were merged in retail sale of electricity:

1. PGE Obrót S.A. (formerly PGE Rzeszowski Zakład Energetyczny S.A.) – acquiring company
2. PGE Lubelskie Zakłady Energetyczne S.A.
3. PGE Łódzki Zakład Energetyczny S.A.
4. PGE Zakład Energetyczny Białystok S.A.
5. PGE ZEŁT Obrót Sp. z o.o.
6. PGE Zakłady Energetyczne Okręgu Radomsko-Kieleckiego S.A.
7. PGE Zakład Energetyczny Warszawa-Teren S.A.
8. PGE Zamojska Korporacja Energetyczna S.A.

As a result of Consolidation Programme PGE Polska Grupa Energetyczna S.A. merged with PGE Górnictwo i Energetyka S.A. and PGE Energia S.A. The merger was registered on August 31, 2010.

As a result of implementation of the Consolidation Programme, on August 3 and August 16, 2010 the extraordinary general meetings of the involved PGE Group entities, adopted resolutions concerning the mergers (merger resolutions). Few shareholders brought actions for statement of invalidity of the resolution together with the request for overruling of the merger resolutions. Additionally, the plaintiffs filed for securing the claims through suspension of the execution of the merger resolutions and suspension of the registration proceedings.

The lawsuits relate to the merger resolution of PGE Elektrownia Opole S.A., merger resolutions of PGE Elektrownia Bełchatów S.A. and PGE KWB Bełchatów S.A. (cases conducted by PGE Górnictwo i Energetyka Konwencjonalna S.A.) and merger resolution adopted by the shareholders of PGE Górnictwo i Energetyka S.A. (case conducted by PGE S.A.).

In the given cases, PGE S.A. and other defendants prepared appropriate replies to the lawsuits and actively participate in the ongoing proceedings, questioning all the charges formulated by the shareholders. In opinion of PGE S.A. and other companies, the objections are apparent and the shareholders aim at contesting the exchange parity of shares, what is unallowable under appeal against the resolutions.

In one of the given cases at the suit by the shareholder, Secus Investement Sp. z o.o. fund, on January 21, 2011, the District Court in Łódź, X Commercial Division, issued a verdict dismissing the plaintiff's appeal.

Moreover, the registration cases are conducted. These cases result from appeals against the verdicts on entry to National Court Register of the merger in conventional generation business line.

On February 11, 2011, the District Court in Łódź, as a consequence of the appeal against the verdict of the District Court Łódź-Śródmieście in Łódź, XX Commercial Division of the National Court Register ("Łódź-Śródmieście Court"), on the entry of merger of 12 acquired companies with PGE Elektrownia Bełchatów S.A. (excluding PGE Elektrownia Opole S.A. in which case registry proceeding was suspended), decided to rescind the appealed verdict and to assign Łódź-Śródmieście Court for re-examination. The ruling was made as a result of examination of appeals by three minority shareholders.

In course of re-examination Łódź-Śródmieście Court may issue once more a resolution on entry of the merger, issue resolution on refusal of the entry and cancel the existing entry. As of the report date it is hard to predict the risk of each of the particular scenarios, as well as the date when it may occur. The Company takes the position that possible cancellation of the entry will not be in accordance with the binding law.

In case of eventual cancellation of the existing entry, the legal subjectivity will be restored. It would cause a necessity of undertaking activities leading to preparation of reactivated companies to independent operating activities, including the appointment of the bodies of the company, distribution of the assets of PGE Górnictwo i Energetyka Konwencjonalna S.A. between the acquired companies, transfer of employees in accordance with the regulations on change of employer and obtaining new licences, permits and other administrative decisions required by law.

The process of reversal of the merger effects, considering the lack of sufficient law regulations, may generate series of additional risks and costs. These risks and costs cannot be fully identified and measured at this stage, when taking into account the possible different interpretations of the regulations by the public administration authorities.

PGE Górnictwo i Energetyka Konwencjonalna S.A. has taken adequate trial actions aiming at removing of the accusations expressed by the minority shareholders. The legal expertises acquired by PGE Górnictwo i Energetyka Konwencjonalna S.A. show firmly that the consolidation process should not be actually threatened by the proceeding initiated by the minority shareholders.

On the current stage of the trials it is not possible to foresee the decisions of the courts, which are ruling in the given proceedings

Moreover, on February 16, 2010 the Management Board of the Company made a decision on intention of merger of PGE S.A. with its subsidiary PGE Electra S.A. The merger took place by course of art. 492 § 1 p. 1 and art. 515 § 1 of Code of Commercial Companies i.e. through transfer of all assets of the acquired company to PGE S.A. (merger through takeover) without raising the share



capital of PGE S.A. The Management Board of PGE S.A. approved the Merger Plan with PGE Electra S.A. on October 20, 2010 and the Extraordinary General Meeting of PGE S.A. and the Extraordinary General Meeting of PGE Electra S.A. adopted the merger resolutions on December 8, 2010. The merger was registered on December 31, 2010. As from the merger registration date, PGE S.A. took over all the competences of PGE Electra S.A. At the same time PGE S.A. acts as the Corporate Center of PGE Capital Group.

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

In 2010, the PGE Capital Group continued its activities under "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.

During 2009 and 2010, under the programme, shares/stocks of 22 companies were sold, liquidations and insolvencies (bankruptcies) of 9 companies were completed, redemption of shares in one company was accomplished. In the group of other assets 4 holiday resorts and 4 other assets were sold. Moreover, in 2010 the sale of shares in one of the listed companies (Bank Ochrony Środowiska S.A.) had been continued.

After the balance-sheet date, till the date of approval of this report by the Management Board of the Company, the shares in Agencja Rynku Energii S.A. and part of shares in one of the listed companies (Bank Ochrony Środowiska S.A.) were sold.

In 2011 the sales of next shares/stocks of non-core companies, qualified to particular portfolios assigned for sale, will be finalised. The next stages of reorganization in the hotel-security-services, transport and medical areas will be implemented. The liquidation and bankruptcy proceedings of the non-core companies will also be finalized.

### **1.3. Changes in organisation of the Capital Group**

During 12-month period ended December 31, 2010 no significant changes to the Group's structure occurred, apart from the ones listed in p. 1.2 Changes in the Company and Capital Group's management rules, specified in Note 2 to the consolidated financial statements and the ones described below.

#### **Shares in subsidiaries and associates**

In 2010 and in 2011 till the approval date of this report, PGE S.A. changed its equity interest in the following entities:

- on January 8, 2010, by force of a resolution of the Extraordinary Meeting of Shareholders, the share capital of PGE Inwest Sp. z o.o. was increased to PLN 1,050,000. All shares from the increased capital were acquired by PGE S.A. The shares were fully paid for in cash. The share capital increase was registered at the National Court Register on February 23, 2010;
- on June 10, 2010 PGE S.A. acquired 5.92% of shares of PGE EC Gorzów S.A. from the State Treasury. Currently – after the Consolidation Programme - PGE Elektrociepłownia Gorzów S.A. and PEC Gorzów Sp. z o.o. constitute one of the branches of PGE Górnictwo i Energetyka Konwencjonalna S.A.;
- during the reporting period in 2010 PGE S.A. continued the acquisition of shares of PGE ZEC Bydgoszcz S.A. (currently branch of PGE Górnictwo i Energetyka Konwencjonalna S.A.) from its employees. The shares purchased by PGE S.A. did not represent more than 0.2% of the company's share capital. On June 10, 2010, PGE S.A. acquired from the State Treasury 0.32% of shares of PGE ZEC Bydgoszcz S.A. As of then, PGE S.A. held 98.97% of shares of PGE ZEC Bydgoszcz S.A., while its total shareholding in that company, together with the shares held by PGE EO S.A., was 99.5%.
- on December 3, 2010, by the resolution of the Extraordinary General Meeting of Shareholders, the share capital of PGE Energia Jądrowa S.A. was raised to PLN 62,500,000. The raise of capital took place by increasing the nominal value of shares. The increase of the share capital was registered in the National Court Register on December 22, 2010.
- on January 31, 2011 PGE Polska Grupa Energetyczna S.A. sold all of the shares held in (constituting 7.27% of the share capital) Agencja Rynku Energii S.A.



- on February 4, 2011 the meeting of shareholders of Electra Deutschland GmbH, adopted a resolution on increasing the share capital of the company by EUR 2,000,000 to EUR 3,350,000. PGE S.A. took up the share in the increased share capital. The increase of the share capital was registered on March 1, 2011.

In 2010 and in 2011 till the approval date of this report, PGE Group companies increased their capital exposure in the following entities:

- on January 22, 2010 a company named Biogazownia Woźuczyn Sp. z o.o. was registered at the National Court Register. The company was formed by PGE Energia Odnawialna S.A. on December 29, 2009;
- on March 19, 2010 a share capital increase was registered at the National Court Register for Eolica Wojciechowo Sp. z o.o. The company's share capital was increased by PLN 3,500,000. Shares from the increased capital were acquired by Elektrownia Wodna Żarnowiec S.A. (currently – after the Consolidation Programme - the branch of PGE Energia Odnawialna S.A.) and Greentech Energy Systems A/S. As a result of the share capital increase, the shareholding structure changed – the shareholding of Greentech Energy Systems A/S did not change, while the shareholding of PGE Energia Odnawialna S.A. was 0.49% and the shareholding of Elektrownia Wodna Żarnowiec S.A. was 49.51%. Currently – after the completion Consolidation Programme - PGE Energia Odnawialna S.A. holds 50% in the share capital of Eolica Wojciechowo Sp. z o.o.;
- on May 7, 2010 the increase of the share capital of Elektrownia Wiatrowa Resko Sp. z o.o. was registered at the National Court Register. The share capital of the company was increased by PLN 5,640,000 by issuing 5,640 new shares, each with the nominal value of PLN 1,000. All the shares from the increased capital were taken up by PGE Energia Odnawialna S.A. as its sole shareholder;
- on May 17, 2010 a share capital increase was registered at the National Court Register for Energoutech 1 Sp. z o.o. The company's share capital was increased from PLN 10,000 to PLN 500,000 Energoutech 1 Sp. z o.o. is a 100% subsidiary of ETF-L Energo Utech S.A.;
- on May 28, 2010 a share capital increase was registered for Bełchatowsko Kleszczowski Park Przemysłowo-Technologiczny Sp. z o.o. As a result of the increase share capital of the company amounts to PLN 14,095,500 PLN (shares held by PGE Elektrownia Bełchatów S.A. and PGE KWB Bełchatów SA in the share capital amounted to 6.07% for each company) – currently, after the Consolidation Programme – the share held by PGE Górnictwo i Energetyka Konwencjonalna S.A. in the share capital of Bełchatowsko Kleszczowski Park Przemysłowo-Technologiczny Sp. z o.o. amounts to 12.14%;
- on June 2, 2010 a share capital increase was registered (by virtue of resolution of the Extraordinary General Meeting no 3/2009 dated December 10, 2009) for ETF-L Energo Utech S.A. from PLN 2,400,000 to PLN 12,400,000 (the share of PGE Energia Odnawialna SA in the share capital has not changed and the company still holds 50% in the share capital). Afterwards, as a result of implementation of the resolution of the Extraordinary General Meeting no 4/2009 dated December 10, 2009, on September 30, 2010 PGE Energia Odnawialna S.A. took up 500 inscribed series C shares with a nominal value of PLN 10,000 each for the cash contribution in amount of PLN 5,000,000. On December 30, 2010 the Extraordinary General Meeting of Shareholders of ETF-L Energo Utech S.A. took place and adopted a resolution on share capital increase by PLN 10,000,000 (PLN 5,000,000 by each shareholder) from PLN 12,400,000 PLN to PLN 22,400,000 through the issue of 1,000 series C shares with a nominal value of PLN 10,000. The increase was registered on January 17, 2011.
- on June 23, 2010 a share capital increase was registered for Przedsiębiorstwo Energetyki Ciepłej Gorzów Sp. z o.o. (a subsidiary wholly owned by PGE Elektrociepłownia Gorzów S.A.). The company's share capital increased by PLN 900,000 to PLN 46,348,500 and all the shares from the share capital increase have been taken up by PGE EC Gorzów S.A. Currently – after the Consolidation Programme – PGE Elektrociepłownia Gorzów S.A. and PEC Gorzów Sp. z o.o. constitute one of the branches of PGE Górnictwo i Energetyka Konwencjonalna S.A.;
- on June 30, 2010 the register court issued its decision on the share capital increase at Elektrownia Wiatrowa Gniewino Sp. z o.o. (a subsidiary wholly owned by Elektrownia Wodna Żarnowiec sp. z o.o.) from PLN 14,000,000 to PLN 39,612,000;

- on July 15, 2010 PGE Elektrownia Opole S.A. purchased 42 shares of Zakład Usług Profilaktyczno-Lecznicznych Megavita Sp. z o.o. and increased its stake in the share capital of the company from 58% to 100%;
- on July 16, 2010 the share capital increase of Biogazownia Wozuczyn Sp. z o.o. was registered at the National Court Register. The share capital was increased from PLN 50,000 up to PLN 250,000. The shares from the increased share capital were taken up by PGE Energia Odnawialna S.A.;
- on July 16, 2010 the share capital increase of Biogazownia Łapy Sp. z o.o. was registered at the National Court Register. The share capital was increased from PLN 50,000 up to PLN 250,000. The shares from the increased share capital were taken up by PGE Energia Odnawialna S.A.;
- on August 10, 2010 PGE Elektrownia Opole S.A. purchased 10 shares of ELKOM Sp. z o.o. and increased its stake in the share capital of the company from 47.9% to 52.58%;
- on December 20, 2010 PGE Inwest Sp. z o.o. purchased from RWE Polska S.A. all shares held by RWE Polska S.A. in Exatel S.A., that constituted 0.537% in the share capital of the company;
- on December 31, 2010 the merger of Niepubliczny Zakład Opieki Zdrowotnej „MegaMed” Sp. z o.o. (as the acquiring company) with: Centrum Medyczne Turów Sp. z o.o. with its registered office in Bogatynia, Zakład Usług Medycznych Dolna Odra Sp. z o.o. with its registered office in Nowe Czarnowo, Zakład Usług Profilaktyczno – Lecznicznych „Megavita” Sp. z o.o. with its registered office in Brzezine (the acquired companies). The merger took place by virtue of resolutions of the Extraordinary General Meetings of Shareholders of December 23, 2010. As a result of the merger, the share capital was increased by PLN 4,906,000. Currently the share capital of the company amounts to PLN 11,962,000. After the merger PGE Górnictwo i Energetyka Konwencjonalna S.A. holds 97.4%, and PGE Elektrownia Opole S.A. holds 2.6% in the share capital of the company;
- on January 26, 2011 NOM Sp. z o.o. bought the minority stake in Energo-Tel S.A. (buyout of the minority shareholder that held 0.1% in the share capital). As a result of the transaction the share of NOM Sp. z o.o. in the share capital of Energo-Tel S.A. increased to 48.9%.

In the 12-month period ended December 31, 2010 and in 2011 till the approval date of this report, PGE Group companies reduced their capital exposure in the following entities:

- on January 28, 2010 PGE Dystrybucja Łódź Sp. z o.o. (currently – after the Consolidation Programme – branch of PGE Dystrybucja S.A.) disposed of all its shares of ElectriclightBox Sp. z o.o., representing 6% of total share capital of that company;
- on March 1, 2010 PGE Obrót S.A. disposed of all its shares of Autosan S.A., representing less than 1% of total share capital of that company;
- on March 5, 2010 PGE Elektrownia Turów S.A. (currently – after the Consolidation Programme – branch of PGE Górnictwo i Energetyka Konwencjonalna S.A.) disposed of all its shares of Energoaparatura S.A., representing less than 1% of total share capital of that company;
- on March 18, 2010 PGE Łódzki Zakład Energetyczny S.A. (currently – after the Consolidation Programme – branch of PGE Obrót S.A.) disposed of all its shares of Zakłady Przemysłu Pasmanteryjnego Lenora Sp. z o.o., representing less than 1% of total share capital of that company;
- on March 30, 2010 PGE Elektrociepłownia Gorzów S.A. (currently – after the Consolidation Programme – branch of PGE Górnictwo i Energetyka Konwencjonalna S.A.) disposed of all its shares of Przedsiębiorstwo Robót Remontowych Energorem Sp. z o.o. and Przedsiębiorstwo Robót Remontowych El-Gore Sp. z o.o., representing respectively 34% of total share capital in each of those companies;
- on May 4, 2010 ETF-L Energo-Utech S.A. sold 1,740 shares in Przedsiębiorstwo Energetyki Ciepłej we Wrześni S.A. Currently ETF-L Energo Utech S.A. does not hold any shares in the mentioned company;
- on June 14, 2010 PGE Energia Odnawialna S.A. sold all its shares (1,288 shares, i.e. 51.52% of the share capital) of Polskie Elektrownie Gazowe Sp. z o.o. in liquidation;

- on June 30, 2010 PGE Zespół Elektrowni Wodnych Dychów S.A. (currently – after the Consolidation Programme – branch of PGE Energia Odnawialna S.A.) sold all its shares (142 shares) of Ekologiczne Projekty Energetyczne Madex Sp. z o.o.;
- on July 19, 2010 PGE Zespół Elektrociepłowni Bydgoszcz S.A. (currently – after the Consolidation Programme – branch of PGE Górnictwo i Energetyka Konwencjonalna S.A.) disposed of all its shares (constituting 11.11% of the share capital) of Przedsiębiorstwo Produkcyjno-Handlowe i Usługowe Agavis S.A.;
- on January 31, 2011 PGE Górnictwo i Energetyka Konwencjonalna S.A. sold all of the shares (constituting 9.96% of the share capital) held in Agencja Rynku Energii S.A.

Table: Companies deleted from the National Court Register in the 12-month period ended December 31, 2010, in which companies from PGE Group held shares / interests

<b>Company</b>	<b>Deletion date</b>	<b>Company from the PGE Group that held shares / interests in the liquidated company</b>
Labud Sp. z o.o. in liquidation	January 20, 2010	PGE Zespół Elektrowni Dolna Odra S.A. (currently branch of PGE GiEK S.A.)
Zamojska Spółka Elektroenergetyczna Sp. z o.o. in liquidation	January 21, 2010	PGE Zamojska Korporacja Energetyczna S.A. (currently branch of PGE Obrót S.A.)
Elektrownia Turów B.V.	July 6, 2010	PGE Elektrownia Turów S.A. (currently branch of PGE GiEK S.A.)
Elektrociepłownia Bio-Ekologiczna Szczytno Sp. z o.o. in liquidation	July 23, 2010	BIO-Energia ESP Sp. z o.o.
Bogatyńsko-Zgorzelecki Park Przemysłowo – Technologiczny „Turów Park” Sp. z o.o. in liquidation	October 26, 2010	PGE Górnictwo i Energetyka Konwencjonalna S.A.

On February 9, 2010, the share capital of Elektrownia Turów B.V. under liquidation was decreased from EUR 2,001,000 to EUR 18,000 by way of share redemption and cancellation in exchange for payment to PGE Elektrownia Turów S.A. On March 30, 2010 the company's liquidation was registered at the Netherlands Chamber of Commerce.

On March 18, 2010, in connection with a liquidation, the change of entry of Mega Sp. z o.o. in the National Court Register was made (14.72% of the company's share capital is held by PGE Energia Odnawialna S.A.) – since that date the company has used the name of MEGA Sp. z o.o. in liquidation.

On June 21, 2010, in connection with a liquidation, the change of entry of WIND 1 Koszalin Sp. z o.o. in the National Court Register was made (50% of the company's share capital is held by PGE Energia Odnawialna S.A.) – since that date the company has used the name of WIND 1 Koszalin Sp. z o.o. in liquidation. The liquidation is ongoing.

During 12-month period ended December 31, 2010 PGE Capital Group did not discontinue any significant operations. The consolidated financial statements specify discontinued operations for companies, discussed in Note 19 to the consolidated financial statements.

## **1.4. Employment**

As at December 31, 2010 the employment in PGE Capital Group amounted to 45,714.95 FTEs, which was by 642.07 FTEs less than as at December 31, 2009. The biggest employment was recorded by companies from the Conventional Generation segment, which constituted approximately 49% of total employment of the Capital Group.

Employees with the secondary education represent more than 41.4% of total number of employees. Approximately 23.7% of employees has university education, 34.9% of employees has vocational or lower education.

Table: Employment at Group companies by business segment (FTEs).

	FTEs Dec 31, 2010	suspended employees* Dec 31, 2010	FTEs Dec 31, 2009	suspended employees* Dec 31, 2009
<b>Total employment of PGE Group, including: .....</b>	<b>45,714.95</b>	<b>332.40</b>	<b>46,357.02</b>	<b>266.40</b>
Conventional Generation .....	22,495.83	184.00	22,774.02	138.00
Renewable Energy .....	531.43	0.00	483.13	0.00
Wholesale Trading .....	375.71	5.00	454.38	3.00
Distribution .....	12,590.26	71.00	12,686.53	45.00
Retail Sales .....	1,799.38	5.40	1,777.83	13.40
Other consolidated companies.....	7,922.35	67.00	8,181.14	67.00

\* suspended – persons at child care leaves and unpaid leaves

## 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 of the date of this report the share capital of PGE S.A. amounts to PLN 18,697,837,270 and splits into 1,869,783,727 shares with a nominal value of PLN 10 each.

Table: Share capital of the Company.

Series/ issue	Type of shares	Type of preference	Number of shares	Value of series/issue at nominal value	Capital payment method
"A"	ordinary	n/a	1,470,576,500	14,705,765,000.00	Contribution in kind/cash
"B"	ordinary	n/a	259,513,500	2,595,135,000.00	cash
"C"	ordinary	n/a	73,241,482	732,414,820.00	merger with PGE GiE S.A.
"D"	ordinary	n/a	66,452,245	664,522,450.00	merger with PGE Energia S.A.
<b>Total</b>			<b>1,869,783,727</b>	<b>18,697,837,270.00</b>	

On August 31, 2010 the District Court of the City of Warsaw registered the merger of PGE S.A. with its subsidiaries PGE Górnictwo i Energetyka S.A. and z PGE Energia S.A. („Acquired Companies”). The merger took place pursuant to article 492 § 1 item 1 of Polish Commercial Companies Code, i.e. by way of transferring all assets of the Acquired Companies to the acquiring company (i.e. PGE S.A.) in return for shares which the acquiring company issued to the shareholders of the Acquired Companies. As a result of the merger, shareholders of the Acquired Companies received shares in increased share capital of PGE S.A. in exchange for the shares held in PGE Energia S.A. and PGE Górnictwo i Energetyka S.A. Detailed description of the Capital Group transformations during the reporting period is presented in Note 9 to the consolidated financial statements.

As a result of the merger described above, the share capital of the Company was increased from the amount of PLN 17,300,900 thousand to the total amount of PLN 18,697,837 thousand i.e. by the amount of PLN 1,396,937 thousand, by way of an issue of 139,693,727 shares, including 73,241,482 series C bearer shares and 66,452,245 series D bearer shares with a par value of PLN 10 each.

Additionally, on October 8, 2010 the State Treasury disposed of 186,978,000 shares in PGE S.A., representing 9.99% of the Company's share capital and entitling to 186,978,000 votes at general meetings of the Company, constituting 9.99% of the total number of votes. Following the transaction the State Treasury holds 1,295,637,952 shares representing 69.29% of the Company's share capital.

Table: The structure of the share capital as of December 31, 2010.

	State Treasury		Other shareholders*		Total	
	par value	share % in the share capital and total votes	par value	share % in the share capital and total votes	par value	share % in the share capital and total votes
Shares as at January 1, 2010	14,705,765,000	85.00	2,595,135,000	15.00	17,300,900,000	100.00
Issue of shares related to the merger of PGE S.A. with PGE GiE S.A. and PGE Energia S.A.	120,394,520	-	1,276,542,750	-	1,396,937,270	-
Sale of 186,978,000 PGE S.A. shares by the State Treasury on October 8, 2010	(1,869,780,000)	-	1,869,780,000	-	0.00	-
Shares as at December 31, 2010	12,956,379,520	69.29	5,741,457,750*	30.71	18,697,837,270	100.00

\* the par value of the shares held by other shareholders includes also own shares of the parent company.

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 Statutes.

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.

### 1.5.2. Own shares

As a result of the merger of PGE S.A. with PGE GiE S.A. and PGE Energia S.A., PGE S.A. purchased 22,898 own shares for PLN 579 thousand. The shares were purchased, because the application of the exchange parity caused that the shareholders of the acquired companies should have received fractional parts of the shares. As that is not possible, during the granting of the Company's shares, the down roundings were applied with regard to the number of the Company's shares due to the shareholders of the acquired companies. The fractional part of the due share was paid out as a additional cash payment (1 share = PLN 25.29). As a result of such construction, there were outstanding shares not taken up by the shareholders of the acquired companies, that PGE S.A. purchased for the fee equal to the value of the additional cash payments. The shares were purchased for redemption. The redemption of the own shares will take place pursuant to a resolution by the general meeting, through the decrease in the share capital.

As at December 31, 2010 the following companies held their own shares:

- PGE Obrót S.A. – 140 own shares purchased through squeeze-out pursuant to art. 418<sup>1</sup> § 4 of the Polish Commercial Companies Code. The shares were purchased for redemption.
- PGE Dystrybucja S.A. – 28 own shares purchased free of charge in connection with the applied exchange parity of shares.

### 1.5.3. Shares of the parent company owned by the members of management and supervisory authorities

Among persons managing and supervising PGE S.A. as at December 31, 2010, 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), Grzegorz Krystek, Member of the Supervisory Board (350 shares of a nominal value of PLN 3,500) and Katarzyna Prus, Member of the Supervisory Board (273 shares of a nominal value of PLN 2,730). As at December 31,



2010 members of the Management and Supervisory Boards of PGE S.A. did not hold any shares in other companies related to the parent company.

Table: PGE shares held by the persons acting on behalf of material direct subsidiaries of PGE S.A.

Company	Name and surname	Position	Number of shares
<b>PGE Górnictwo i Energetyka Konwencjonalna S.A.</b>	Jacek Kaczorowski	President of the Management Board	1,390
	Roman Forma	CFO	662
	Waldemar Szulc	Member of the Management Board in charge of Operations	5,090
	Krzysztof Domagała	Member of the Management Board (chosen by the employees)	7,869
<b>PGE Elektrownia Opole S.A.</b>	Jan Piliponek	Member of the Management Board	6,110
	Czesław Łukowski	Proxy	5,570
<b>PGE Obrót S.A.</b>	Henryk Małecki	President of the Management Board	3,178
	Jacek Szydło	Vice-President of the Management Board	2,939
	Elżbieta Król	Proxy	3,575
	Barbara Pyziak	Proxy	137
<b>PWE Gubin Sp. z o.o.</b>	Cezary Bujak	From September 1, 2010 till September 6, 2010 - Proxy,	299
		From September 7, 2010 - Member of the Management Board	

#### 1.5.4. Control system of employees share scheme

In 2010, PGE S.A. did not maintain any employees share schemes.

#### 1.5.5. Use of proceeds from issues

In 2010 PGE S.A. issued series C and D shares, however did not record any income from these issues (see 1.5.1. Share capital and ownership structure).

Proceeds from the issue of shares, that occurred in 2009, were successively being spent in 2010 for the repayment of the short-term and long-term debts of the company and for the refinancing of the indebtedness of PGE Group companies, including refinancing of the debt of PGE Górnictwo i Energetyka Konwencjonalna S.A. Branch Elektrownia Bełchatów (former PGE Elektrownia Bełchatów S.A.), resulting from the agreements concluded in 2006 with the commercial banks and European multilateral institutions for financing of the investment and intended for the implementation of the investment plan of the Capital Group. Funds for the repayment of the debt of PGE Górnictwo i Energetyka Konwencjonalna S.A. Branch Elektrownia Bełchatów were provided to the company through the issue of the bonds, which were purchased by PGE S.A. (see Note 42.5 to the consolidated financial statements).

Proceeds from the issue of bonds under the bond programs described in p. 4.2 were used for financing of the ongoing activities of PGE S.A. as well as for financing of the investments conducted by PGE S.A. and PGE Group companies.

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

##### Rules for determining and amount of remuneration paid out to Management Board members in 2010

From the beginning of 2010 till October 14, 2010 Management Board members were employed on the basis of employment contracts. Remuneration and benefits payable to the Management Board

members during that period was defined in accordance with the provision of the Act on salaries of persons managing certain legal entities (the "Salary Cap Act").

Till October 14, 2010 Management Board members were also subject, to a limited extent, to certain provisions of the Collective Bargaining Agreement effective in PGE S.A. and certain provisions of the Collective Bargaining Agreement for Employees of the Power Industry. Pursuant to those acts, Management Board members were 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 and later at EnelMed worth up to PLN 1,897.80 in 2010 for each of the member of the Management Board. Additionally, in 2010 the Management Board members (except for President of the Management Board) used the company cars for private purposes, what was settled according to the regulations binding in PGE S.A..

The described benefits payable to the Management Board members in 2010 did not exceed the maximum value defined in the Salary Cap Act.

In addition, no-competition agreements concluded between the Company and Management Board members were effective in the reporting period.

The resolution by the Supervisory Board no 183/VIII/2010 of October 14, 2010, sets the rules of remuneration of the Management Board members, who run business activity and with whom the Company concludes the agreement for rendering of management services, on provisions defined in art. 3 sec. 2 of the Salary Cap Act.

In connection with the above, from October 15, 2010 all members of the Management Board of PGE S.A. concluded agreements with the Company for rendering of the management services.

According to the rules, the Management Board members are obliged to purchase, at their own expense, the liability insurance with regard to the managing of the Company. In 2010, all Management Board members fulfilled that obligation.

Additionally, the agreements for rendering of management services, include clauses relating to no-competition during the contractual period and after the termination of the agreement.

Table: Remuneration paid by PGE S.A., Group entities other than PGE S.A. in 2010 to the Management Board members of PGE S.A., who performed their functions in 2010, by person\*.

Full name of a Management Board member	Position	Remuneration paid by PGE S.A. in 2010**	Remuneration paid by Group entities other than PGE S.A. in 2010**
Tomasz Zadroga	President of the Management Board	PLN 533,680.69	PLN 952,953.42
Marek Szostek	Vice-president of the Management Board in charge of Development	PLN 446,657.39	PLN 189,103.68
Piotr Szymanek	Vice-president of the Management Board in charge of Corporate Affairs	PLN 499,504.15	PLN 280,627.06
Wojciech Topolnicki	Vice-president of the Management Board in charge of Finance	PLN 495,276.39	PLN 230,983.75
Marek Trawiński	Vice-president of the Management Board in charge of Operations	PLN 508,283.63	PLN 317,844.07

\* information relates to persons, who were Management Board members as at December 31, 2010

\*\* excluded surcharges

The remuneration, including surcharges, paid by the Company to all persons that acted as Management Board members on the ground of the employment contracts and so called manager contracts, jointly with the payments related to termination of employment contract and with the post-employment benefits, amounted to PLN 3.7 million in 2010. This amount includes remuneration of the members of the Management Board of PGE S.A. and PGE GiE S.A, PGE Energia S.A. and PGE Electra S.A. until their mergers with PGE S.A. (see Note 41.3 to the consolidated financial statements).



### 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.

Table: Remuneration paid by PGE S.A. and Group entities other than PGE S.A. in 2010 to the members of the Supervisory Board of PGE S.A. who performed their functions in 2010, by person.

Full name of a Supervisory Board member	Position	Remuneration paid by the Company in 2010 as consideration for the performance of functions in the Supervisory Board	Remuneration paid by the Company in 2010 under employment contract	Remuneration paid by Group entities other than PGE S.A. in 2010
Marcin Zieliński	Chairman of the Supervisory Board	PLN 41,454.96	-	EUR 9,935.48
Maciej Bałtowski	Vice-Chairman of the Supervisory Board	PLN 41,454.96	-	-
Jacek Barylski	Supervisory Board Member	PLN 41,454.96	-	-
Wojciech Cichoński*	Supervisory Board Member	PLN 10,363.74	PLN 38,825.77**	
Małgorzata Dec	Supervisory Board Member	PLN 41,454.96	-	-
Czesław Grzesiak	Supervisory Board Member	PLN 31,314.10	-	-
Grzegorz Krystek	Supervisory Board Member	PLN 31,314.10	-	-
Ryszard Malarski*	Supervisory Board Member	PLN 10,363.74	-	-
Katarzyna Prus	Secretary of the Supervisory Board	PLN 41,454.96	-	-
Zbigniew Szmuniewski	Supervisory Board Member	PLN 41,454.96	-	-
Krzysztof Żuk	Supervisory Board Member	PLN 35,409.44	-	-

\* date of the recall from the Board – March 30, 2010

\*\* paid out in months in which the member performed their function in the Supervisory Board

Total remuneration paid out by the Company for performing the functions in the Supervisory Board amounted to PLN 0.6 million in 2010. This amount includes remuneration of the Supervisory Board members of PGE S.A. and PGE GiE S.A, PGE Energia S.A. and PGE Electra S.A. until their mergers with PGE S.A. (see Note 41.3 to the consolidated financial statements).

## **2. Characteristics of the activity of PGE Capital Group**

### **2.1. Description of the activity of PGE Capital Group**

The Group currently organizes its activities in five business lines:

(i) Conventional Generation (previously Mining and Generation), including extraction of lignite and generation of electricity and heat from conventional sources and distribution of heat, (ii) Renewable Energy, including electricity generation from renewable sources and in pumped storage power plants, (iii) Wholesale Trading of electricity, related products and fuels; (iv) Distribution of electricity and (v) Retail Sales of electricity. Apart from 5 main business lines, PGE Group holds activities in other areas, including telecommunication. The Group also comprises of other companies, whose main activity is providing ancillary control services to companies from the energy and mining sectors. These services comprise, inter alia: (i) building, renovation and modernization works and investments in electricity equipment, (ii) comprehensive diagnostic tests and measurements of electricity machines and equipment; (iii) managing by-products of coal combustion, developing, implementing and using technologies and rehabilitation of degraded areas, and (iv) medical and social services.

### **2.2. Supply markets**

#### **Supply of raw materials**

Lignite, hard coal, natural gas and biomass are key fuels used to produce electricity and heat by power plants and heat and power plants coming within the PGE Group. Fuel costs have a significant share in electricity production costs.

Until the consolidation two lignite mines PGE KWB Bełchatów S.A. and PGE KWB Turów S.A. supplied lignite to PGE Elektrownia Bełchatów S.A. and PGE Elektrownia Turów S.A. respectively. These power plants did not use any other lignite suppliers. To such an extent, it may be assumed that – until the consolidation – PGE Elektrownia Turów S.A. and PGE Elektrownia Bełchatów S.A. were dependent on lignite supplies from PGE KWB Bełchatów S.A. and PGE KWB Turów S.A., while mines were dependent on their major recipients, i.e. the power plants PGE Elektrownia Turów S.A. and PGE Elektrownia Bełchatów S.A. After the consolidation in Conventional Generation business line, demand for lignite is covered within one entity i.e. PGE Górnictwo i Energetyka Konwencjonalna S.A., and all entities mentioned above are currently branches of PGE Górnictwo i Energetyka Konwencjonalna S.A.

In 2010, the PGE Group has purchased hard coal for the needs of Group's power plants and CHPs via PGE Electra S.A., which was buying coal from, inter alia, Kompania Węglowa S.A., Jastrzębska Spółka Węglowa S.A., Katowicki Holding Węglowy S.A. and then was selling it to particular producers from the PGE Group. After the merger of PGE S.A. with PGE Electra S.A., the hard coal purchase is carried out by PGE S.A. Given the existing situation in the hard coal market and import opportunities, the PGE Group is not dependent on its present suppliers.

Natural gas for the purposes of electricity and heat production (co-generation) is supplied mainly by Polskie Górnictwo Naftowe i Gazownictwo S.A. ("PGNiG S.A."). Although since 2004 it has been theoretically possible to buy natural gas on the free market, however in practice the PGE Group's major supplier is still PGNiG S.A. Thus the PGE Group is dependent on that supplier to a certain extent.

#### **Purchase of services from PSE Operator S.A.**

According to applicable regulations, power companies operating in Poland must conclude electricity transmission service agreements with a transmission system operator ("TSO") or electricity distribution service agreements with an operator or operators of distribution systems or, if required by the scope of their activity, agreements both with a transmission system operator and a distribution system operator.

Given the above, companies operating in the electricity generation, trading and distribution areas in Poland (including PGE Group companies) are dependant, indirectly or directly, on transmission service agreements, with regard to the balancing of the power market as well, which is a typical situation in the electro energy sector. Such agreements are concluded with PSE Operator S.A., which is responsible for the operation of the electro energy transmission system, including connections with other electro energy systems, and provides electricity transmission services. Pursuant to the Energy Law, such services are provided only by the transmission system operator and transmission service agreements are obligatory. Such an obligation creates a system dependency. Power companies within the PGE Group are also subject to such dependency to an extent defined by law and determined by the scope and character of their activity. The termination or expiry of such an agreement in the case

there is no agreement concerning a new transmission contract between a power company and a transmission system operator results, in practice, in one party filing an application with the President of the Energy Regulatory Office to define terms and conditions for such a contract.

Generators from PGE Group are also dependant on agreements concerning the condition for the provision of system services by such companies to the transmission system operator, constituting an integral part of transmission service agreements. Such agreements may be concluded only with PSE Operator S.A., and the termination or expiry thereof causes that power reserved for the purpose of such services must be used on a commercial basis.

In 2010, services purchased from PSE Operator S.A. constituted approximately 15% of total operating expenses incurred by the Group. PSE Operator S.A. is a related party to PGE S.A., as both companies are controlled by the State Treasury.

### **Purchase of electricity**

Pursuant to the applicable electricity trading model in the PGE Group, in 2010, generators from PGE Group sold electricity to PGE S.A., and in scope regulated by art. 49a section 1 and 2 of the Energy Law (so called "power exchange obligation") – in the manner provided there, mainly by concluding sales agreements directly on Towarowa Giełda Energii S.A. Energy bought by PGE S.A. was sold to PGE Group companies, i.e. Retail Sales Companies and PGE Electra S.A., which sold the acquired electricity to its business partners (trading companies) outside the PGE Group, in the domestic or international market, or auxiliary to Retail Sales companies from the PGE Group. PGE Retail Sales Companies also bought energy from local sources located in the area where those companies act as a supplier of last resort. The Retail Sales companies sold a part of bought electricity to distribution system operators from the PGE Group to cover a balance difference.

During 2010, the sale and purchase of electricity for 2011 were also conducted. Organisation of the wholesale trading in PGE Group, with regards to the above transactions, was modified in order to fulfil the requirements of the amended Energy Law (above mentioned "power exchange obligation"). Apart from that, as a result of merger of PGE S.A. with PGE Electra S.A. on December 31, 2010, the wholesale trading of energy and related products was centralized in PGE S.A.

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

### **Lignite delivery agreements**

Until the consolidation, lignite for PGE Elektrownia Bełchatów S.A. and PGE Elektrownia Turów S.A. was supplied by PGE KWB Bełchatów S.A. and PGE KWB Turów S.A. based on long-term agreements concluded respectively for approximately 20 and 40 years. In relation to the long-term agreements, the parties also concluded additional agreements providing for terms of coal delivery in medium-term periods. PGE KWB Bełchatów S.A. and PGE KWB Turów S.A. are currently branches of PGE Górnictwo i Energetyka Konwencjonalna S.A.

After the merger of mining and generation companies, during the transitional period from September 1, 2010 till December 31, 2010 the lignite supplies were settled on the previous rules i.e. on the basis of the terms set for lignite supply in 2010.

As from January 1, 2011 new internal regulations on execution and settlements of the supplies of lignite between the branches were put in place of the existing agreements. Regulations were introduced in form of internal instructions determining the cooperation rules in areas of execution and settlements of supplies and ensuring the supplies of lignite among the branches. Instructions are separate for localizations, to which the agreements applied before the consolidation date.

### **Hard coal delivery agreements**

2010 was a second year of the centralised coal purchases for PGE Group power plants and CHPs. Coal supplies for these entities in 2010 were provided by PGE Electra S.A., based on the contracts concluded mainly with the domestic coal producers. Yearly agreements for purchase and resale were concluded at the beginning of 2010. During the year, the volume of purchases was supplemented by signing additional spot agreements or adequate amendments. In December 2010, the agreement with Kompania Węglowa S.A., for the hard coal supplies in 2011-2013, was signed. The agreement value is estimated at PLN 3.9 billion. As a result of incorporation of PGE Electra S.A. into PGE S.A., that took place on December 31, 2010, all effective coal agreements were taken by PGE S.A. pursuant to the rule of general succession.

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

### Agreements with electricity producers from the PGE Group

In 2010 the sales of electricity for 2011, on the basis of commercial agreements concluded by PGE S.A. with the generators from PGE Group, were commenced. On August 9, 2010 the amended Energy Law came into force - in connection with the fact that the amendments regulate in art. 49a the mode of electricity sales by the generators (so called "power exchange obligation"), the existing commercial contracts between PGE S.A. and these generators were dissolved.

At the same time, for the purchase of energy not falling under this obligation, PGE S.A. concluded an agreement with PGE Górnictwo i Energetyka Konwencjonalna S.A. The agreement is signed for indefinite term, purchase of energy is executed on the ground of the transaction settlements.

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

### PGE Bond issue program of up to PLN 10 billion

On November 9, 2010 the Company signed two agreements concerning the bond issue programme ("Programme"):

(i) Bond Purchase Commitment Agreement ("Commitment Agreement") whose parties, apart from the Company, are Bank Polska Kasa Opieki S.A., Banca Infrastrutture Innovazione e Sviluppo S.p.A., Nordea Bank Polska S.A., ING Bank Śląski S.A. (acting as Lead Arrangers) and Bank Polska Kasa Opieki S.A., Banca Infrastrutture Innovazione e Sviluppo S.p.A., Nordea Bank AB, Nordea Bank Polska S.A. and ING Bank N.V. (acting as Underwriters of the Programme) and ING Bank Śląski S.A. (acting as Issue Agent),

(ii) Bond Issue Programme Agreement ("Programme Agreement") whose parties, apart from the Company, are ING Bank Śląski S.A. (acting as Agent, Issue Agent, Paying Agent and Depository) and Bank Polska Kasa Opieki S.A. and Nordea Bank Polska S.A. (acting as Agents, Paying Sub-Agents and Sub-Depositories).

The maximum Programme amount (representing a maximum aggregate nominal amount of bonds issued and outstanding under the Programme) is PLN 10 billion. The Programme was signed for a period of 36 months from the agreements signing date and shall expire no later than on November 8, 2013.

The Underwriters of the Programme have an obligation to purchase bonds issued by the Company under the Programme, as it is stated in the Commitment Agreement. After the accession of any additional underwriter (as defined in the Commitment Agreement) the aggregate underwriting amount cannot exceed the maximum Programme amount, i.e. PLN 10 billion. Underwriters of the Programme are obliged to purchase bonds during the period from November 15, 2010 till October 31, 2013.

Bonds are to be issued as specified in article 9 paragraph 3 of the Act on Bonds dated June 29, 1995 (Journal of Laws of 2001 No. 120, item 1300 as amended), based on the Programme Agreement and the Issue Terms, as bearer discount bonds (bearer zero-coupon bonds) having immaterial form.

Under the Programme, the company is entitled to issue, as a rule, zero-coupon bonds with maturity of 1, 3 or 6 months but their maturity cannot exceed 6 months. The maturity of the last issue of bonds may be different (but not shorter than 7 days and not longer than 6 months), however the last issue maturity date cannot fall after the Programme maturity date.

Bonds under the Programme will be denominated in Polish zlotys (PLN) and the nominal value of one bond will amount to PLN 100,000. As a rule, the bonds will have a guaranteed profitability, defined as the reference rate increased by a guaranteed margin. The reference rate is the appropriate WIBOR for deposits with maturity corresponding to the bond issue maturity (different rules apply for establishing the profitability of the last bond issue and bonds issued for the purpose of, so called, rollovers of the previous bond issues). The bondholders are only entitled to the benefits of monetary nature.

Bonds issued under the Programme will be treated as unsubordinated and unsecured liability of the Company.

Funds obtained from the issue shall be allocated for the purpose of: (i) financing current activity of the Company, (ii) financing of investment and capital expenditures planned during the commitment period, concerning the activity of the Company or PGE Group companies, and (iii) refinancing of the Company's financial debt.

As at December 31, 2010 PGE S.A. did not have bonds issued under this Programme.

#### **Agreement for the purchase of shares of Energa S.A.**

On September 29, 2010 Management Board of PGE Polska Grupa Energetyczna S.A. executed with the State Treasury represented by the Minister of Treasury the agreement for the sale of shares of Energa S.A., a company with its registered office in Gdańsk. The agreement concerns the purchase of 4,183,285,468 shares constituting 84.19% of its share capital. The purchase price of all shares representing 84.19% of the share capital amounts to PLN 7,529,913 thousand (see Note 45.6 to the consolidated financial statement).

PGE S.A. declared a program of guaranteed investments to be implemented within Energa Capital Group within 10 years in the amount of PLN 5 billion. Failure to complete them will result in contractual penalties payable for the benefit of the Seller, when the aggregate liability of the Purchaser shall not exceed the amount of PLN 1 billion. Moreover PGE S.A. undertakes to keep control over Energa S.A., refrain from limiting the basic activity conducted by the company and its major subsidiaries consisting in generation, sale and distribution of electricity and heat and changing the company's registered office. Moreover, PGE S.A. undertakes to procure that the shares of Energa S.A. are introduced to trading on the regulated market on the Warsaw Stock Exchange

Effectiveness of the transaction is subject to obtaining consent of the President of the Antimonopoly Office for the concentration (condition precedent).

On January 13, 2011 the President of Office of Competition and Consumer Protection ("UOKiK") issued decision, prohibiting the purchase of Energa S.A. shares by PGE Polska Grupa Energetyczna S.A.

In connection with the above, on January 18, 2011 PGE S.A. executed with the State Treasury represented by the Minister of Treasury an annex to the agreement dated September 29, 2010 for the sale of shares of Energa S.A. In the annex, termination date of the agreement has been set for 12 months since the date of the agreement, while PGE S.A. and the State Treasury decided to suspend the course of termination date of the agreement until the date of the legally valid conclusion of the appeal proceeding against the decision of the President of the UOKiK prohibiting concentration of PGE S.A. and Energa S.A.

On January 28, 2011 the appeal was submitted to the District Court in Warsaw, Court of Competition and Consumer Protection, by the agency of President of the Office of Competition and Consumer Protection. PGE S.A. submitted the appeal against the decision of President of the Office of Competition and Consumer Protection prohibiting concentration of PGE S.A. and Energa S.A. PGE S.A. appeals for the change of the decision in whole and verdict allowing for the concentration of PGE S.A. and Energa S.A., or alternatively for abolition of the decision.

According to the information held by PGE S.A., in the middle of February 2011 President of the Office of Competition and Consumer Protection submitted the appeal of PGE S.A. to the Court of Competition and Consumer Protection in Warsaw, thereby President of the Office of Competition and Consumer Protection did not make use of the possibility of self-verification of the decision.

Till the date of this report, the Court of Competition and Consumer Protection did not bring out a verdict on the appeal by PGE S.A. against the decision prohibiting concentration of PGE S.A. and Energa S.A.

#### **Agreement for purchase of shares of PGE Górnictwo i Energetyka Konwencjonalna S.A., PGE Obrót S.A. and PGE Dystrybucja S.A.**

On December 28, 2010 the Company signed the agreement with the State Treasury. As a result of the agreement PGE purchased shares of PGE Górnictwo i Energetyka Konwencjonalna S.A. with its registered office in Bełchatów, PGE Obrót S.A. with its registered office in Rzeszów and PGE Dystrybucja S.A. with its registered office in Lublin. PGE S.A. purchased 69,582,441 shares of PGE Górnictwo i Energetyka Konwencjonalna S.A., 686,389 shares of PGE Obrót S.A. and 14,299,180 shares of PGE Dystrybucja S.A. constituting respectively 10.69% of the share capital of PGE Górnictwo i Energetyka Konecjonalna S.A., 13.87% of the share capital of PGE Obrót S.A. and 1.47% of the share capital of PGE Dystrybucja S.A. The shares were purchased for the total price of PLN 3,098,387,214.39.

The transaction is a continuation of the consolidation process and simplification of the structure of PGE Capital Group. The transaction relates to minority shares in key entities of PGE Group, that were



purchased by the State Treasury as a result of conversion of shares in accordance with the Act of September 7, 2007 on the principles of acquisition of shares from the State Treasury in the process of consolidation of energy sector companies (Dziennik Ustaw of 2007, No. 191, item 1367).

After the transaction PGE S.A. holds:

- 91.03% of the share capital of PGE Górnictwo i Energetyka Konwencjonalna S.A. (7.88% of the shares are held by PGE Obrót S.A. and 0.02% of the shares are held by PGE Energia Odnawialna S.A.),
- 99.31% of the share capital of PGE Obrót S.A.,
- 10.05% of the share capital of PGE Dystrybucja S.A. (89.91% of the shares are held by PGE Obrót S.A.).

### **Signing of the grant agreement between PGE GiEK S.A. and European Union**

On May 5, 2010 PGE Elektrownia Bełchatów S.A. (currently branch of PGE GiEK S.A.) signed a grant agreement with the European Union, represented by the European Commission, for the co-financing - in amount of EUR 180 million - of the demonstration project called "The construction of an installation for the capture, transport and geological storage of CO<sub>2</sub>".

A grant is provided from the community funds available under the European Economic Plan for Recovery (EEPR). Apart from Elektrownia Bełchatów project, five other European CCS (Carbon Capture and Storage) projects have received grants under EEPR.

Funds received by Elektrownia Bełchatów will be spent on one of the key components of the CCS system, i.e. the CO<sub>2</sub> capture component.

The Bełchatów Power Plant's CCS project is an innovative, world-scale, power engineering undertaking beneficial for environmental protection thanks to a considerable reduction of CO<sub>2</sub> emissions. The CO<sub>2</sub> capture capacity of the planned CCS installation will exceed 80%, which means that it will capture CO<sub>2</sub> in the amount of about 1.8 million tons per year. The CCS installation will be integrated with Poland's largest and most modern 858 MW power generation unit, currently under construction in the Bełchatów Power Plant.

### **Memorandum on cooperation in the area of nuclear energy between PGE S.A. and GE Hitachi Nuclear Energy Americas**

On March 1, 2010, PGE Polska Grupa Energetyczna S.A. and GE Hitachi Nuclear Energy Americas signed a Memorandum on cooperation in the area of nuclear energy. Memorandum assumes the cooperation with regard to feasibility study for the development of ABWR (Advanced Boiling Water Reactor) and ESBWR (Economic Simplified Boiling Water Reactor) technologies in Poland by 2020, including the potential construction and exploitation of the first Polish nuclear power plant. The companies also confirmed that they will hold talks on potential industrial partnership at the nuclear project in Poland. The companies did not include any exclusive rights clause in the Memorandum as to development of nuclear energy in Poland.

### **Memorandum on cooperation in the area of nuclear energy between PGE S.A. and Westinghouse Electric Company LLC**

On April 27, 2010 PGE Polska Grupa Energetyczna S.A. and Westinghouse Electric Company signed a Memorandum concerning nuclear power industry cooperation. The Memorandum provides for joint activities related to a feasibility study for the potential construction of nuclear power plant in Poland by 2020 with the use of the AP1000 nuclear reactor. The companies also declared that they will hold talks on cooperation at the nuclear project in Poland. The memorandum does not provide any exclusive rights for Westinghouse Electric Company as to development of nuclear energy in Poland.

## **2.4. Transactions with related entities**

Information about transactions with related entities are presented in Note 41 to the consolidated financial statements.

## **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, 2010 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 45.5 to the consolidated financial statements

Significant proceedings pending in front of courts, competent arbitration authority or public administration authority are described in Note 38 to the consolidated financial statements.

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

PGE Group's R&D activity is comparable to other companies from the Polish energy industry. The PGE Group carried out a number of actions in this area, mainly in order to: (i) implement new electricity production technologies, (ii) fulfil environmental requirements, (iii) reduce production costs. The most important R&D projects were as follows:

### **Nuclear energy**

In 2010 PGE Group continued gaining competencies for the development of nuclear energy in Poland, and tightened cooperation with state authorities, research and development institutions, international organizations and foreign companies. Analytical as well as information and education works were conducted. Development process was progressing, including employment of staff in entities dedicated in PGE Group for the nuclear energy project: PGE Energia Jądrowa S.A. – a company managing the Nuclear Energy business line and PGE EJ1 Sp. z o.o. – investor, and future operator of the first nuclear power plant. The scope of activities of PGE Group within nuclear energy area encompassed:

- cooperation of PGE Group in creation of the organizational, legal and administrative conditions for construction of nuclear power plant in Poland, including cooperation with Government Plenipotentiary of Polish Nuclear Energy, participation in public consultations concerning Polish Nuclear Energy Program project, as well as in creation of draft guidelines to the Act on preparation and execution of nuclear energy investments and accompanying investment and also draft amendments to the Nuclear Law,
- initiating and coordinating of study and analytical works on preparation for the construction of nuclear power plants in Poland, including study on long-term forecast on electricity generation growth in the light of Polish and EU energy policy and the prospects for PGE's investments.

PGE S.A. joined WNA – World Nuclear Association, international organization that supports development of the global nuclear energy industry.

In cooperation with the international companies, that signed cooperation memoranda with PGE S.A., i.e. Electricite de France, GE Hitachi Nuclear Americas and Westinghouse Electric Company, study works in working teams were carried out. At the end of July 2010 works on feasibility study for the development of nuclear reactors respectively in EPR, ABWR/ESBWR and AP1000 technologies, as well as the potential construction of the first such reactor in Poland by the year 2020, were finalized.

Analysis regarding the works required to conduct in organisational area for commencing the nuclear power plant construction project at PGE and defining the role of key advisors was also carried out in 2010. As a result of the works, in January 2011 following tender proceedings were started: for the owner's engineer, for the site characterisation and for the legal advisory in the project of construction of nuclear power plant in Poland.

Also, the contract for the Pre-Feasibility Study on the Construction of the first two nuclear power plants in Poland was signed at the end of 2010.

### **Construction of CCS installation at Elektrownia Bełchatów**

Taking into account EU recommendations, according to which CCS (Carbon Capture and Storage) technology is one of major methods to reduce the emission of CO<sub>2</sub> from the combustion of fossil fuels, since the beginning of 2008, PGE GiEK S.A. Branch Elektrownia Bełchatów has been developing the



concept of the construction of a demo CO<sub>2</sub> capture, transport and storage systems. The installation is to be implemented in the newly constructed 858MW unit and will be commissioned by the end of 2015.

The CCS project will allow for capture of approximately 33% of fumes stream from the 858MW unit, compressing, transporting and pumping of approximately 1.8 million tonnes of CO<sub>2</sub> per annum into geological structures. The acquisition of necessary engineering knowledge and experience in designing, constructing and operating CCS installations and then the participation in its optimisation and commercialisation will provide know-how in this area and enable further development and introduction of this innovative technology.

In 2010, the Group mainly carried out the following activities in the area of CCS installation construction:

- consultations with the European Commission on financing and technical aspects of the project,
- analysis of potential storage localisations,
- information and consultation campaign within regional and local communities.

CCS Project at PGE GiEK S.A. Branch Elektrownia Bełchatów has been qualified, together with few other European CCS projects, for the EEPR grant in amount of EUR 180 million. The grant agreement for the supplementary financing from community funds under EEPR was signed in May 2010. The process of obtaining the financing for the implementation of the project is ongoing (see p. 2.3 Description of significant agreements).

#### **Other R&D projects**

Apart from the aforementioned R&D project, PGE S.A. and particular Group companies carry out many works, including, inter alia (i) participation in the CO<sub>2</sub>EuroPipe project aiming at the definition of opportunities for the development of CO<sub>2</sub> transport infrastructure at the industrial scale, the preparation of draft legislation, the development of the concept of CO<sub>2</sub> transport and pumping networks between power plants and storing yards; (ii) participation in the Polish Platform of Clean Coal Technologies dealing with clean coal technologies from the technical, economic, financial, legislative and social point of view; (iii) joining the scientific-industrial consortium "Carbon Fuel Cells", which aims at construction and demonstration of work of a carbon fuel cell in size allowing for accomplishment of technical and economic analysis of the undertaking and determining the implementation potential; (iv) signing of the intention letter with The Chugoku Electric Power Co., Inc on cooperation in areas of coal-based conventional generation, nuclear generation, renewable energy sources and finance and investments management; (v) the execution of pilot programmes of smart metering in the distribution area.

### **2.7. Issues relating to the natural environment**

The conventional power plants and CHP plants in the PGE Group hold integrated permits that specify the type and parameters of the system, conditions for introducing substances and energy to the environment, specification of permitted types and quantities of gases and dusts, water management related issues (water consumption, collection and disposal of sewage), waste management, specification of the permitted level of noise, methods of achieving a high level of environment protection, methods of preventing failures and limiting the effects of such failures, as well as an obligation to inform of the failures, and specify obligations with respect to the monitoring of water, sewage and air protection. The PGE Group electricity generating companies also hold applicable sector permits

Mines from the PGE Group hold necessary mining sector permits for use of the environment, including: water and sewage management, waste management, noise level and emission of gases and dusts into the atmosphere.

The characteristics of the business activities of PGE Dystrybucja S.A. have direct influence on the environment and requires a number of permits for the use of the environment. Branches of PGE Dystrybucja S.A. hold permits and consents required by law to conduct their basic activity. In particular, they hold permits for the production of dangerous and non-dangerous waste. Moreover, most of the branches hold water law permits to pump sewage into water or land, including permits to dispose of purified waste water and melt water (drainage) into the ground, to pump purified household waste into the ground.

In the opinion of the Management Board, the current activity of Group companies in all material aspects meets the requirements of applicable regulations of the Environmental Law

### **Environmental actions carried out by the PGE Capital Group**

In 2010, the PGE Capital Group carried out environmental actions, including in particular:

- the fulfillment of all duties imposed on the Group companies by environmental regulations and administrative decisions, including relevant reporting and measurements, on the current basis;
- operators of installations, pursuant to the The Act of December 22, 2004 on the right to trade emissions of greenhouse gases and other airborne substances, settled emissions and rights to emissions for 2009 within the statutory date, i.e. April 30, 2010;
- continuation of the programme of reduction of noise emission to the environment, including , inter alia, construction of new highly efficient suppressors reducing noise emission in the air intake during medium refitting of the Unit 1 in PGE Elektrownia Opole S.A.;
- continuation of the works related to reduction of emissions to the atmosphere by, inter alia, construction and adjustment to new emission standards of fumes desulphurisation installations in PGE GiEK S.A. Branch Zespół Elektrowni Dolna Odra and Branch Elektrownia Bełchatów, while in PGE Elektrownia Opole S.A. denitrifying installation on Unit 3 was commissioned – it allowed the reduction of NOx emissions from 482 mg/Nm<sup>3</sup> to 180 mg/Nm<sup>3</sup>;
- a series of activities heading for reduction of water pollution, including adjustment of substations 110/15kV to requirements of protection of the environment in water-land sphere against uncontrolled oil leakages, what is connected with the construction of ecological power transformers stands (leak-proof oil sumps) with oil separators;
- actions relating to waste management i.e. the reduction of quantities of wastes, the recovery of recyclable wastes, and then the neutralisation thereof in accordance with legal requirements.

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

Significant events influencing the Group's activities which occurred after the end of the financial year till the financial statements approval date are described in details in Note 45 to the consolidated financial statements.

## **3. Management's discussion of the Group's results of operations and financial condition**

### **3.1. Factors and events influencing financial results**

#### **Macroeconomic situation**

The PGE Group 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 observed restoration of the activities in the economy triggered an increase in demand for electricity in the National Power System by approximately 4.2% in comparison to 12 months of 2009.

Table: Key economic ratios connected with the Polish economy.

<b>Key data</b>	<b>2010</b>	<b>2009</b>
Real GDP growth (% of growth) <sup>1</sup>	3.8*	1.7
Annual inflation rate (% of consumer prices) <sup>2</sup>	2.6	3.5
Domestic electricity consumption (TWh) <sup>3</sup>	155.0	148.7

\* estimates by Polish Statistical Office (GUS)

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.

#### **Termination of long-term contracts (LTC)**

Due to the termination of LTCs in accordance with The Act on coverage of stranded costs resulting at generators in relation to accelerated termination of long-term contracts ("LTC Act"), the producers being earlier the parties to such contracts obtained a right to receive compensations for the coverage

of so called stranded costs (capital expenditures resulting from investments in generating assets made by the generator before May 1, 2004 that a generator is not able to recoup from revenues obtained from sales of generated electricity, spare capacity and ancillary services in a competitive environment after early termination of LTC). The LTC Act limits the total amount of funds that may be paid to all generators to cover stranded costs, discounted as at January 1, 2007, to PLN 11.6 billion.

Table: Key data relating to PGE Group generators subject to the LTC Act.

Generator	LTC maturity	Maximum amount of stranded and additional costs
PGE Elektrownia Opole S.A.	2012	PLN 1,966 million
PGE GiEK Branch Elektrownia Turów	2016	PLN 2,571 million
PGE GiEK Branch Zespół Elektrowni Dolna Odra	2010	PLN 633 million
PGE GiEK Branch Elektrociepłownia Gorzów	2009	PLN 108 million
PGE GiEK Branch Elektrociepłownia Lublin-Wrotków	2010	PLN 617 million
PGE GiEK Branch Elektrociepłownia Rzeszów	2012	PLN 422 million
<b>TOTAL</b>		<b>PLN 6,317 million</b>

In the period provided for by the LTC Act, i.e. till December 31, 2007, PGE S.A. signed termination agreements with generators being parties to the then applicable LTCs. Therefore generators obtained a right to receive funds to cover their stranded costs.

The impact of LTC compensations on results achieved by the PGE Group is described in Note 45.1 to the consolidated financial statements.

### Sales of electricity

Table: Sales of electricity outside the PGE Capital Group (in TWh).

	2010	2009	% change
<b>Sale in TWh, including:</b>	<b>56.30</b>	<b>60.27</b>	<b>-7%</b>
Sales to end-users *	29.98	30.03	0%
Sales on the wholesale market, including:	22.82	26.42	-14%
<i>Sales on the domestic wholesale market</i>	21.07	23.24	-9%
<i>Sales to PSE Operator (for losses)</i>	0.68	1.39	-51%
<i>Sales to foreign customers</i>	1.07	1.79	-40%
Sales on the Balancing Market	3.50	3.82	-8%
Internal consumption **	5.62	4.47	26%
<b>Total outflow of electricity</b>	<b>61.93</b>	<b>64.74</b>	<b>-4%</b>

\* after elimination of intra-group sales in PGE Group

\*\* internal consumption includes energy for covering the balancing difference, energy consumption in mines and in pumped storage power plants

In 2010 and in 2009 the Group sold 56.30 TWh and 60.27 TWh of electricity, respectively. Changes in the sales structure for 2010 versus 2009 resulted mainly from lower sales on the wholesale market. The sales to the end-users in 2010 was on the similar level as in 2009. 14% decrease on the wholesale market was caused mainly by lower purchases on the market and lower electricity production by PGE Group generators. Sales to foreign customers was lower by 40% and results from lower sales realized by Electra Deutschland GmbH as a consequence of unfavourable price relation between German and Polish market and lower sales of energy from Poland.

## Purchases of electricity

Table: Purchases of electricity from outside of the PGE Capital Group (in TWh).

	2010	2009	% change
<b>Total purchases in TWh, including:</b>	<b>9.22</b>	<b>10.94</b>	<b>-16%</b>
Purchases from companies outside of the Group.....	0.80	0.69	16%
Purchases from abroad .....	1.04	2.18	-52%
Purchase from the Balancing Market.....	7.38	8.07	-9%

In 2010 and 2009 the companies from the Group purchased respectively 9.22 TWh and 10.94 TWh of electric power from outside the PGE Group. Changes in the sales structure for 2010 as compared to 2009 resulted mainly from lower purchases on foreign markets and on the balancing market. Non-domestic purchases decreased by approximately 52% in 2010 as compared to 2009 mainly due to unfavourable conditions on foreign markets and the system limitations for import of energy. Moreover, the trade agreement with Vattenfall Aktiebolag on energy exchange on the Poland-Sweden connection expired in August 2010. The purchases of electric energy from companies outside of the Group increased in 2010 as compared to 2009.

## Production of electricity

Table: Generation of electricity by the Group (in TWh).

	2010	2009	% change
<b>Total energy generation (in TWh), including:</b>	<b>52.73</b>	<b>53.80</b>	<b>-2%</b>
Lignite-fired power plants .....	35.31	35.95	-2%
Coal-fired power plants.....	12.94	13.14	-2%
Coal-fired CHP plants.....	1.38	1.55	-11%
Gas-fired CHP plants.....	1.92	2.04	-6%
Pumped storage power plants.....	0.53	0.56	-5%
Hydroelectric plants .....	0.59	0.50	18%
Wind power plants.....	0.06	0.06	0%

In 2010 and 2009, the Group produced 52.73 TWh and 53.80 TWh of electric power, respectively. In the analysed period production of electricity decreased by 2% (1.07 TWh) as compared to 2009. Production in lignite-fired power plants was lower by 2% (0.64 TWh) and in coal-fired power plants was also lower by 2% (0.20 TWh). There was also decrease of production in coal-fired CHP plants, gas-fired CHP plants and pumped storage power plants. Production in wind power plants was similar to previous year, while production in hydroelectric power plants increased.

The decrease of production of electric power in lignite-fired power plants is a result of the flood in August 2010 and successive switch-offs of five units of Turów power plant. From August 25, 2010 all the units in Turów power plant are operating in working order, however it is not a normal work system because of the reserve water supply from the Nysa river. Total outages time caused by the effects of the flood amounted to 1,724.7 hours.

The decrease of production of electric power in coal-fired power plants is a result of lower generation in Opole power plant caused by lower electricity purchase plan by PGE S.A. and limitation of production due to the CO<sub>2</sub> limits, and ipso facto increase of the share of energy purchased on the balancing market for resale. Additionally, lower production is also a result of 1-month outage of Unit 2 caused by the breakdown of the turbine in November 2010.

The decreased production in coal-fired CHP plants was due to a failure of two power units at Pomorzany CHP which caused that availability of the power units was limited and they needed to operate at lower parameters. As from February 2010, the power units have operated with reduced capacity, thus producing less electricity. From May till August 2010 repair works were commenced at Unit A, and from September till October 2010 at Unit B. Despite the repair works Unit A is still operating at reduced capacity. The Unit A needs further repairs, which will take place probably in May 2011.

The decreased electric energy production at gas-fired CHP plants was chiefly caused by the steam-gas unit failure at Rzeszów CHP, that occurred on January 31, 2010. As a result, the plant suspended

its whole electric energy production from February. The commissioning of that unit took place on August 25, 2010.

### Production and sales of heat

In 2010 the net heat production and sales in PGE Group totalled 25.6 million GJ and 24.3 million GJ and were up by approximately 12%, as compared to 2009, due to weather conditions - there was a significant drop of temperatures comparing to average temperatures in previous years

### 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

Electricity for 2010 was traded on the wholesale market on the basis of bilateral contracts especially concluded through brokerage platforms, such as TFS and GFI and through Internet Electricity Trading Platform (POEE), and also on Towarowa Giełda Energii ("TGE", Polish power exchange). During the last quarter of 2010 the volume of energy traded on TGE rose significantly as compared to the previous periods. This was caused mainly by an obligation for electric power producers (as from August 9, 2010) to sell their electric power in the mode consistent with art. 49a section 1 and 2 of the Energy Law (so called "power exchange obligation"). Introduction of this regulation was aimed at larger transparency of the transactions, supporting of creation of reliable price indexes and securing public and equal access to the electricity. The visible effect of the implementation of the power exchange obligation was gaining of the status of the main public electricity trade site by TGE, starting from the fourth quarter of 2010, especially with regard to the future transactions for 2011.

**Spot market:** Average SPOT market price on TGE in 2010 was higher than in 2009, despite the fact that until March 1, 2009 the wholesale electricity prices included excise tax. The average energy price for the base contracts in 2010 was PLN 199.86/MWh, while for the peak contracts the average energy price amounted to PLN 217.93/MWh. The SPOT market prices were stable, but significantly higher than in 2009. One of the reasons was the increase in electricity demand, however the prices were also affected by the increased prices of electricity on the neighbouring markets and rise of cost-related elements of the electricity production (price of CO<sub>2</sub> allowances and hard coal prices on the international markets). With regard to the electricity consumption in Poland, 2010 was one of the peak years: domestic energy consumption amounted to approximately 155.0 TWh, while in 2009 it was approximately 148.7 TWh

Chart. Daily and quarterly base prices in SPOT transactions in 2009–2010 (TGE)

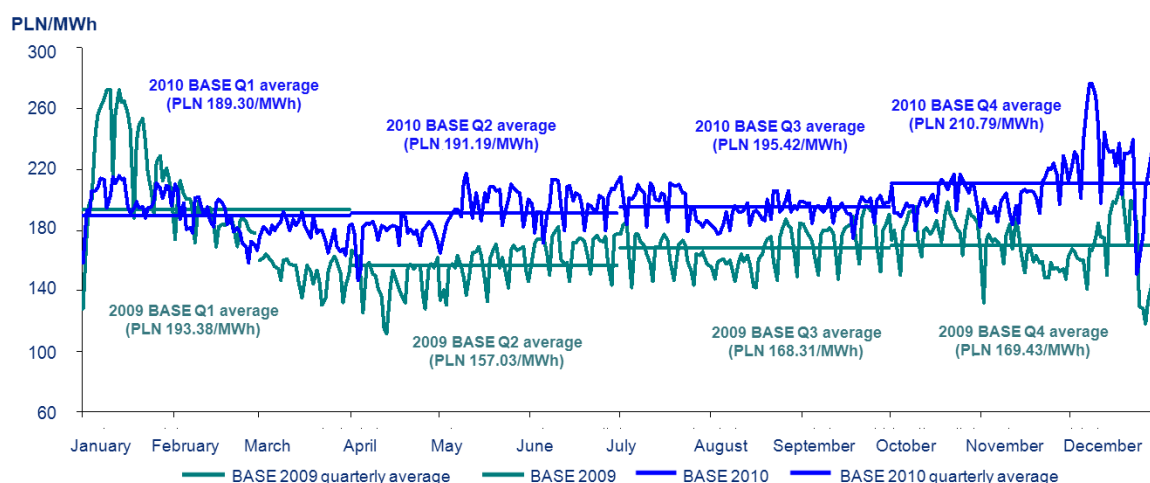
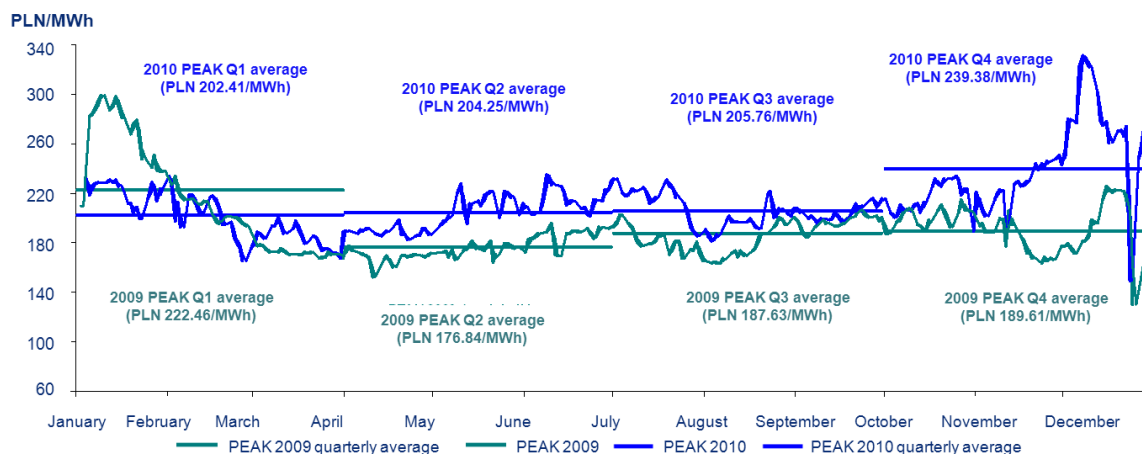




Chart. Daily and quarterly peak prices in SPOT transactions in 2009–2010 (TGE)



Total trading of electricity on SPOT market, both on TGE and POEE, amounted in 2010 to more than 12.9 TWh, i.e. almost 75% more than in 2009. In 2009 and the first half of 2010 majority of the transactions volumes was performed on POEE, while as from August 2010 the proportion changes in favour of TGE in connection with the above mentioned regulatory change. POEE changed its formula in order to adjust to the new regulations – its alliance with the Warsaw Stock Exchange shall cause that the transactions concluded on POEE are treated as fulfillment of the power exchange obligation in the understanding of the Energy Law.

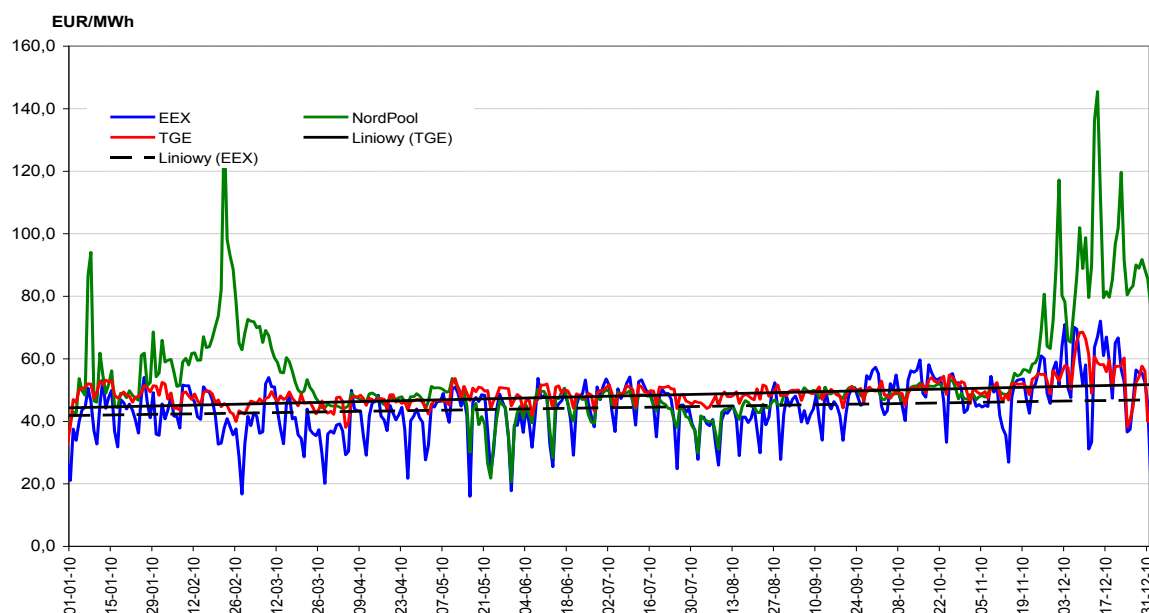
The prices on the balancing market moved analogically as the SPOT market prices. Non-balancing in the scale of the whole system in 2010 was on average 2.14%, what corresponded with the trading volume on the balancing market on the level of 3.3 TWh.

**Futures and forward market:** Just as on the SPOT market, the trading volume on the organised futures and forward market increased significantly in 2010. The futures and forwards market, regardless of the delivery date, totaled more than 104.5 TWh in 2010 (i.e. approximately 30 TWh more than in 2009). The significant increase was observed, inter alia, on the developing TGE market and was connected with the mentioned power exchange obligation levied on the electricity producers. Solely in period from November till the end of 2010, the trading volume on TGE amounted to approximately 50 TWh. In transactions concluded in 2010 on the futures and forward markets (TGE, GFI, TFS), the annual contracts for 2011 had the biggest share. Their volume totalled 64.8 TWh with an average price of PLN 193.25/MWh. Trading volume for peak products for 2011, concluded in 2010, amounted to more than 11.1 TWh and an average price was PLN 218.71/MWh. The transactions for annual products with delivery in 2012 were also recorded in 2010. Their volume amounted to 5.7 TWh at an average price of PLN 199.6/MWh. The monthly and quarterly contracts were also popular.

#### International market

In 2010, SPOT prices on the Polish market (TGE, POEE), as well as on Scandinavian market (NordPool) and German market (EEX) showed an upward trend. In particular the similar price trends between Polish and German markets were confirmed. One of the main differences between the prices on both markets is higher daily volatility of prices on EEX market. Scandinavian market is clearly different from the other markets, mainly as a consequence of the generation characteristics, which is extremely dependent on the hydrology situation.

Chart: Comparison of electricity prices on TGE and international markets.



In the second half of December 2010 the DC connection between Poland and Sweden (SwePol Link) was made available to the third parties through market coupling mechanism. Till the end of 2010, the electricity flows on the connection amounted to 47 GWh, what constituted approximately 20% of the available transmission capacities.

### **Tariffs**

PGE Group companies earn part of their income based on tariffs approved by the President of the Energy Regulatory Office: (i) tariffs for the sale of electricity to households (G tariff group), (ii) tariffs of distribution system operators ("DSO"), and (iii) heat tariffs

Sales of electricity to recipients from the G tariff group, connected to the distribution network, where the Retail Sales companies act as the supplier of the last resort, in the 12-month period ended December 31, 2010 took place on the basis of electricity tariffs approved by the President of the Energy Regulatory Office. The proceedings on the approval of the tariffs for 2010 were started on September 8, 2009 and were finalized on January 22, 2010. The approved tariffs came into force 14 days after publication i.e. on February 6, 2010, up to that date previous tariffs were binding. In 2010 sales of electricity to business off-takers (A, B, C tariff groups) were on the basis of tariffs and individually negotiated offers. Tariffs for the business off-takers were not changed in the 12-month period ended December 31, 2010 as compared to the tariffs from the end of 2009.

Distribution tariffs of distribution system operators within the PGE Group for the year 2010 were approved by the President of the Energy Regulatory Office between January 7-18, 2010. Tariffs for 2010, depending on the company, came into force between January 22, 2010 and February 2, 2010

PGE Dystrybucja S.A. and PGE Obrót S.A., on the ground of § 32 of the Regulation of the Minister of Economy dated July 2, 2007 on specific rules for setting and calculation of the tariffs and settlements in electric energy trading (Dziennik Ustaw of 2007 no. 128, item 895 as amended) known as the „tariff regulation”, have kept - till the end of 2010 – the right to conduct settlements with the off-takers on the ground of rates set in particular tariffs of the DSOs and retail sale companies from the Group, that currently are the branches in the structure of PGE Dystrybucja S.A. and PGE Obrót S.A.

The binding tariffs for electricity, electricity distribution services and heat, which are subject to the approval by the President of the Energy Regulatory Office, do not cover all costs incurred by the Group companies. At present, costs recognized by the President of the Energy Regulatory Office as justified costs to calculate tariffs for PGE Group companies are lower than costs actually incurred by these companies.

### **Distribution of electricity**

The tariff applicable for the 12-month period ended December 31, 2010 was third independent tariff of distribution system operators since the integrated distribution and retail companies (regional energy



companies) were unbundled into independent distribution companies (DSO). Distribution tariffs for 2010 approved by the President of the Energy Regulatory Office, contributed to changes in average payments for customers in particular tariff groups in comparison to year 2009:

- A tariff group – increase by 4.7%,
- B tariff group – increase by 6.5%,
- C+R tariff group – increase by 8.4%,
- G tariff group – increase by 5.2%.

An average price of energy distribution services in comparison to last tariffs binding in 2009 increased by approximately 8.6%

### **Sales of electricity**

In 2010 the retail sales companies from PGE Group, and after the consolidation PGE Obrót S.A., were selling electricity to the off-takers from G tariff group (households) on the basis of the tariffs approved by the ERO President. With regard to other off-takers, the ERO President decided in November 2007 that the retail sales market is competitive and exempted companies from an obligation to submit their tariffs for approval.

### **Prices of fuel**

Table: Volume and cost of purchase of fuels from third party suppliers in the 12-month period ended December 31, 2010 and ended December 31, 2009

	Volume ('000 tonnes) for 12-month period ended December 31,		Cost (PLN million) for 12-month period ended December 31,	
	2010	2009	2010	2009
Hard coal .....	6,467	6,987	1,661	1,915
Gas ('000 m <sup>3</sup> ) .....	553,478	561,601	401	423
Biomass.....	490	451	172	140
Fuel oil.....	48	48	72	58
<b>TOTAL</b>			<b>2,306</b>	<b>2,536</b>

In the 12-month period ended December 31, 2010 the costs of purchasing primary fuels from providers outside the Group amounted to PLN 2,306 million and were lower by approximately 9% as compared to the 12-month period ended December 31, 2009. In the 12-month period ended December 31, 2010 approximately 67% of the electricity produced was obtained from our internally sourced lignite, whose price is less susceptible to fluctuations than fuel sourced externally. However, certain factors including the aggregate amount of lignite extracted, costs of overburden removal, labour costs and environmental provisioning affect mining costs incurred by the Group and thus PGE Group's generation costs.

### **National Allocation Plan for the years 2008-2012 ("NAP II")**

The National Allocation Plan on CO<sub>2</sub> emission ("NAP") is subject to the notification to the European Commission, under the EU emission rights trading system. In connection with the fact that the European Commission reduced the quantity of CO<sub>2</sub> emission rights for Poland in both settlement periods in relation to quantities applied by Poland in the NAP, the granted limits constitute a material limitation for the electro energy sector.

As regards the second settlement period, which covers the years 2008-2012, Poland applied for emission caps of 284 million tonnes of CO<sub>2</sub>. The European Commission reduced the average free CO<sub>2</sub> emission allowances per year for Poland to 208.5 million tonnes. According to the present NAP II, utility power plants would only be authorized to emit 110.8 million tonnes of CO<sub>2</sub>, whereas Polish CO<sub>2</sub> emissions in normal circumstances are estimated at approximately 120 million tonnes per year.

Table: Allocation of emission rights limits (in Mg).

Sector	Average rights - Mg of CO <sub>2</sub> per year
Utility power plants	110,791,200
Utility CHP plants	25,391,008

The following table presents data concerning CO<sub>2</sub> emission from major Group installations in 2010 (as compared to the number of rights granted under free allocations)

Table: Emission of CO<sub>2</sub> (in Mg) from major Group installations in 2010 in comparison to the average yearly allocation of CO<sub>2</sub> emission rights

Operator	CO <sub>2</sub> emissions in 2010	Average yearly allocation for 2010 based on the NAP II
PGE GiEK Branch Elektrownia Bełchatów	29,659,590	26,937,155
PGE GiEK Branch Elektrownia Turów	10,656,954	11,158,636
PGE GiEK Branch Zespół Elektrowni Dolna Odra	6,686,372	5,680,137
PGE GiEK Branch Zespół Elektrociepłowni Bydgoszcz	1,139,309	1,155,252
PGE GiEK Branch Elektrociepłownia Gorzów*	452,063	479,305
PGE GiEK Branch Elektrociepłownia Lublin-Wrotków	586,647	570,840
PGE GiEK Branch Elektrociepłownia Rzeszów	281,716	303,155
PGE GiEK Branch Elektrociepłownia Kielce	186,383	194,547**
PGE GiEK Branch Elektrociepłownia Zgierz	92,237	104,988
PGE Elektrownia Opole S.A.	6,770,075	6,475,340
<b>RAZEM</b>	<b>56,511,346</b>	<b>53,059,355</b>

\* Branch Elektrociepłownia Gorzów originated from PGE Elektrociepłownia Gorzów S.A. and PEC Gorzów S.A.

\*\* Branch Elektrociepłownia Kielce received additional rights for 5,190 tonnes per annum for the years 2009-2012 from a reserve for new facilities. The decision to grant the additional rights was issued on December 18, 2009 and on January 5, 2011, the rights were submitted to the generator's account (a total of 10,380 tonnes).

In 2010, i.e. in the third year of the second settlement period of the EU emission trading system, the Group recorded the shortage of rights of approximately 3.5 million tons of CO<sub>2</sub>.

### 3.2. Group's financial performance

#### Consolidated statement of comprehensive income

Total sales revenues of the Group in 2010 amounted to PLN 20,476.5 million as compared to PLN 21,623.4 million in 2009. The drop of the sales revenues resulted mainly from lower – by PLN 1,198.1 million – revenues from LTC compensations. This drop was partly compensated by the increase in the revenues from sales of finished goods and merchandise which grew by PLN 115.1 million mainly as a result of: (i) increase in revenues from distribution of electric energy, (ii) increase in revenues from sales of electricity to end-users, (iii) increase in revenues from sales of heat, (iv) increase in revenues from sales of certificates of origin, and (v) growth in revenues from connection to the grid (as a result of change of accounting rules). The decrease in revenues from the sale of CO<sub>2</sub> emission rights by PLN 178.4 million and in revenues from the electricity sales on the wholesale market by PLN 579.9 million, had the negative impact on the deviation of the revenues from sales of finished goods and merchandise.

Cost of goods sold in 2010 was PLN 14,071.5 million, i.e. it grew by ca. 3% as compared to 2009. The increase of the cost of goods sold was caused by increase of tax and charges expenses by PLN 343.0 million (mainly due to increase of property rights redemption costs), higher personnel expenses by PLN 205.8 million, higher costs of materials and energy by PLN 66.4 million and growth of other costs by kind by PLN 90.0 million mainly as a result of higher fees for CO<sub>2</sub> emission. The growth of above described costs was partly offset by lower cost of external services by PLN 136.8 million, mainly resulting from lower costs of transport services and telecommunication services.

Gross profit on sales in 2010 amounted to PLN 6,404.9 million as compared to PLN 7,895.9 million in 2009, i.e. it was lower by ca. 19%. The decrease of the gross profit was mainly caused by the lower revenues from LTC compensations.

In 2010 total selling and distribution expenses of PGE Group amounted to PLN 1,527.7 million, what means approximately 12% increase as compared to 2009. The growth of selling and distribution expenses was mainly associated with higher costs of redemption of property rights incurred by PGE Obrót S.A.

In 2010 general and administrative expenses amounted to PLN 950.7 million, what means approximately 4% increase as compared to 2009.

Net income from other operating activities in 2010 was positive and amounted to PLN 258.8 million as compared to the negative figure of PLN 269.0 million in 2009.

Other operating revenues of the Group in 2010 amounted to PLN 666.4 million, which means approximately 58% increase as compared to PLN 422.6 million achieved in 2009. The increase in other operating revenues is mainly related to higher – by PLN 285.6 million – reversal of balance sheet provisions (mainly provisions for the real estate tax and disputes related to the execution of trade agreements) and higher – by PLN 110.7 million – level of received compensations, penalties and fines.

The increase of the above revenues items was partly compensated by lower level of recultivation provision valuation by PLN 131.4 million and lower revenues from reversal of revaluation write-offs by PLN 34.8 million.

The decrease in other operating expenses by PLN 284.0 million in 2010 as compared to 2009 resulted mainly from lower level of balance sheet provisions created by PLN 317.4 million with the costs of damage removal and repairs higher by PLN 75.2 million (inter alia, damage removal resulting from the flood in 2010 in PGE GiEK S.A. Branch Elektrownia Turów, PGE GiEK S.A. Branch Kopalnia Węgla Brunatnego Turów, and damage removal connected with the coal dust explosion in PGE GiEK S.A. Branch Zespół Elektrociepłowni Dolna Odra).

In 2010 the net result on financial activities was negative and totalled PLN 136.1 million, i.e. PLN 72.3 million more than in 2009.

The Group's financial revenues in 2010 amounted to PLN 422.1 million, which means increase by approximately 13% as compared to PLN 372.3 million achieved in 2009. The increase in financial revenues is mainly related to revenues from interest from financial instruments received, which were higher by PLN 142.7 million and higher level of reversed balance sheet provisions by PLN 11.9 million. The increase was partially offset by drop in profit from the disposal of investments by PLN 61.7 million and lower positive foreign exchange differences by PLN 18.6 million.

The decrease of financial expenses by PLN 22.4 million in 2010 as compared to 2009 resulted mainly from decrease of interest from financial instruments paid by PLN 95.5 million and decrease of financial expenses by PLN 28.3 million as a result of a revaluation of financial instruments. The level of financial expenses was also affected by: (i) creation of revaluation write-offs that was higher by PLN 37.2 million than in 2009 (change relating mainly to creation of revaluation write-off of SwePol Link AB), (ii) higher negative foreign exchange differences by PLN 24.4 million, (iii) higher interest expenses due to the effect of discount unwinding by PLN 14.2 million, and (iv) higher financial expenses related to creation of balance sheet provisions by PLN 13.9 million.

Gross profit of the Group totalled PLN 4,276.3 million in 2010 as compared to PLN 5,378.5 million in 2009. The decline of gross profit mainly relates to lower revenues from LTC compensations. Moreover, in 2010 the Group's gross profit margin (gross profit to total sales revenues) decreased to 20.9% from 24.9% in 2009.

As a result of the factors discussed above, the net profit amounted to PLN 3,627.1 million in 2010 as compared to PLN 4,337.2 million in 2009. In 2010 the Group identified PLN 24.2 million of profit from discontinued operations in relation to implementation of the "Non-Core" Programme in the Group. As at December 31, 2010 the Group identified six subsidiaries, which complies with the definition of the discontinued operations: Towarzystwo Gospodarcze BEWA Sp. z o.o. and Przedsiębiorstwo Wielobranżowe Agtel Sp. z o.o., ENSPRO Sp. z o.o., Budownictwo Hydro-Energetyka Dychów Sp. z o.o., Energo-Inwest-Broker S.A., Górniczy Klub Sportowy Bełchatów Sportowa S.A.

Total comprehensive income of the Group in 2010 amounted to PLN 3,628.9 million as compared to PLN 4,296.5 million in 2009.

## **Consolidated statement of financial position**

As at December 31, 2010 and December 31, 2009, non-current assets of the Group were PLN 44,137.4 million and PLN 41,964.4 million, respectively, and represented 86% and 77% of total assets, respectively.

The increase in the value of non-current assets by PLN 2,173.0 million in the year ended December 31, 2010 as compared to the year ended December 31, 2009 was mainly due to the fact that the value of property, plant and equipment increased by PLN 2,496.5 million and intangible assets increased by PLN 49.3 million. That growth was partially offset by a decrease in the value of other long-term assets by PLN 220.7 million, a decrease in the value of deferred tax asset by PLN 125.7 million and a decrease in the value of available-for-sale financial assets by PLN 103.0 million.

Shares in associates accounted for under the equity method totalled PLN 1,408.5 million as at December 31, 2010 and PLN 1,354.8 million as at December 31, 2009. The increase in the value of shares in associates by PLN 53.7 million in the year ended December 31, 2010 as compared to the year ended December 31, 2009 was caused by higher share of the parent company in the profit generated by Polkomtel S.A., reduced by the dividend received from that company.

Available-for-sale financial assets amounted to PLN 95.2 million as at December 31, 2010 and included mainly shares in entities from outside the Group which are not subject to consolidation. The decrease in available-for-sale financial assets was mainly related to reclassification of a part of shares in entities from outside the Group, from long-term assets to short-term assets.

Other long-term assets totalled PLN 264.4 million as at December 31, 2010 and were by PLN 220.7 million lower than in the year ended December 31, 2009. The decrease in other long-term assets was mainly connected with decrease in value of prepayments for property, plant and equipment by PLN 209.7 million.

Current assets of the Group as at December 31, 2010 and as at December 31, 2009 amounted to PLN 7,328.9 million and PLN 12,477.6 million, respectively.

The decrease in the value of the Group's current assets by PLN 5,148.7 million in the year ended December 31, 2010 as compared to the year ended December 31, 2009 was mainly attributable to the decrease in cash and cash equivalents by PLN 4,982.4 million, decrease in the value of other loans and financial assets by PLN 190.9 million and decrease in inventory by PLN 180.6 million. The decrease was partially offset by the increase in short-term available-for-sale financial assets by PLN 124.9 million, increase in other short-term assets by PLN 54.7 million and increase in trade receivables by PLN 35.4 million.

The decrease in cash and cash equivalents in the year ended December 31, 2010 as compared to the year ended December 31, 2009 was presented in the description of the statement of cash flows.

The decrease in the value of other loans and financial assets during the year ended December 31, 2010 as compared to the year ended December 31, 2009 was mainly due to the decrease in amounts receivable from LTC compensations by PLN 285.1 million.

The decrease in inventory in the year ended December 31, 2010 as compared to the year ended December 31, 2009 was mainly connected with the lower level of material stocks, what was partially offset by the increase of the certificates of origin of energy.

The increase in other short-term assets during the year ended December 31, 2010 as compared to the year ended December 31, 2009 was chiefly due to increase in CO<sub>2</sub> emission rights for the own needs, increased advances for deliveries and recognition of tax on civil law transactions. The increase was partially offset by decline in VAT receivables.

As at December 31, 2010 and as at December 31, 2009 total equity of the Group was PLN 37,682.8 million and PLN 38,849.8 million, respectively, i.e. it represented respectively 73% and 71% of total equity and liabilities. Non-controlling interest as at December 31, 2010 and as at December 31, 2009 amounted to PLN 598.8 million and PLN 7,681.4 million, respectively. The drop of non-controlling interest by PLN 7,082.6 million mainly resulted from the purchase of minority stakes by PGE S.A. and transfer of the minority interest to the equity attributable to the shareholders of the parent company as a consequence of the merger.

The decrease in total equity by PLN 1,167.0 million was mainly caused by the decisions of the General Meetings of Shareholders/ Assemblies of Partners in PGE Group companies related to dividend payments in amount of PLN 2,009.3 million, with the total income of PLN 3,628.9 million in

year ended December 31, 2010 and the settlement of the purchase of the additional shares in the Capital Group companies by PGE S.A. in amount of PLN (-) 3,114.7 million.

The change in long-term liabilities in the year ended December 31, 2010 mainly reflected the fact that the debt due to bank loans and borrowings was lower by PLN 2,251.8 million. The decrease in long-term debt primarily resulted from the early repayment of loans by PGE Elektrownia Bełchatów S.A. (currently PGE GiEK S.A. Branch Elektrownia Bełchatów) in the total amount of PLN 1,649.0 million. Repayment was made with the funds raised from issue of bonds purchased by PGE S.A. Additionally, the indebtedness level decreased in connection with the repayment of the investment loan by PGE Elektrownia Opole S.A. in amount of approximately PLN 425.3 million.

Short-term liabilities increased from PLN 5,835.7 million as at December 31, 2009 to PLN 6,591.4 million as at December 31, 2010 mainly due to growth of other non-financial liabilities by PLN 692.9 million (mainly due to increase in liabilities for purchase of the property, plant and equipment and in connection with the recognition of LTC liabilities), growth of other non-financial liabilities by PLN 198.4 million (mainly caused by higher liabilities due to dividends) and increase in short-term provisions by PLN 101.3 million (mainly as a result of increase of the provisions for value of property rights for redemption). Additionally, the balance of short-term liabilities as at December 31, 2010 was affected by decrease in income tax liabilities by PLN 154.7 million, decrease in trade liabilities by PLN 96.3 million and decrease in short-term debt from the interest bearing loans and credits by PLN 55.0 million.

### **Consolidated cash flow statement**

Total net cash flows from operating activities for the 12-month period ended December 31, 2010 amounted to PLN 6,611.0 million as compared to PLN 7,298.9 million in the 12-month period ended December 31, 2009. The decrease of cash flows from operating activities in the 12-month period ended December 31, 2010 as compared to the 12-month period ended December 31, 2009 was mainly caused by lower gross profit from the continued operations by PLN 1,102.3 million and change in provisions, which has negative effect on cash flows (decrease in cash flows by PLN 980.9 million). Decrease in cash flows was partially compensated by the change in receivables (increase of cash flows by PLN 666.5 million) and change in prepayments and accruals (increase of cash flows by PLN 610.3 million).

Negative net cash flow from investing activities for the 12-month period ended December 31, 2010 amounted to PLN 7,468.3 million and was by PLN 3,839.7 million higher comparing to the 12-month period ended December 31, 2009. The balance of net cash flows from investing activities for the 12-month period ended December 31, 2010, was mainly affected by expenses related to acquisition of property, plant and equipment and intangible assets in amount of PLN 4,522.4 million and other financial assets in amount of PLN 3,307.9 million.

Negative net cash flow from financial activities for the 12-month period ended December 31, 2010 amounted to PLN 4,111.8 million as compared to positive net cash flow in amount of PLN 1,898.3 million for the 12-month period ended December 31, 2009. The balance of net cash flows from financial activities for the 12-month period ended December 31, 2010, was mainly affected by: (i) proceeds from bank credits, loans, bond issues and finance lease in amount of PLN (-) 2,371.3 million, and (ii) dividends paid in amount of PLN 1,580.1 million. The negative balance of proceeds from bank credits and loans is connected, inter alia, with an early repayment of loans amounting to PLN 1,649.0 million in April 2010 by PGE Elektrownia Bełchatów S.A. (currently PGE GiEK S.A. Branch Elektrownia Bełchatów).

### **3.3. Geographical regions**

Table: Breakdown of Group's net income from continuing operations (including flows between regions), by geographic area, for years ended December 31, 2010 and 2009



in PLN million

	Total net income				
	2010	(%) share	2009	(%) share	% change
Domestic market .....	19,887.2	97%	21,144.8	98%	-6%
EU member states .....	572.1	3%	459.3	2%	25%
Other countries.....	17.2	0%	19.3	0%	-11%
<b>Total .....</b>	<b>20,476.5</b>	<b>100%</b>	<b>21,623.4</b>	<b>100%</b>	<b>-5%</b>

In the years ended December 31, 2010 and 2009, the Group earned income mainly in the domestic market.

In the financial year ended December 31, 2010, income from operations generated in the EU member states amounted to PLN 572.1 million and was higher than income from operations in the financial year ended December 31, 2009 by approximately 25%. The increase of sales to the EU member states was mainly connected with the sales of CO<sub>2</sub> allowances by PGE Electra S.A. in 2010. In the financial year ended December 31, 2010, income obtained in other countries amounted to PLN 17.2 million in comparison to PLN 19.3 million in the financial year ended 31 December 2009.

### 3.4. Business segments

Table: Breakdown of the Group's gross income (including flows between segments), by business segments, for financial years ended December 31, 2010 and 2009.

in PLN million

	Total gross income				
	2010	(%) share	2009	(%) share	% change
Conventional Generation .....	12,287.5	28%	13,388.9	30%	-8%
Renewable Energy .....	631.1	1%	547.2	1%	15%
Wholesale Trading .....	11,805.8	27%	12,723.0	28%	-7%
Distribution .....	5,064.9	12%	4,668.7	10%	8%
Retail Sales .....	12,464.6	28%	12,342.7	27%	1%
Other activity .....	1,712.9	4%	1,839.5	4%	-7%
<b>Total .....</b>	<b>43,966.8</b>	<b>100%</b>	<b>45,510.0</b>	<b>100%</b>	<b>-3%</b>
<b>Intersegment eliminations.....</b>	<b>-23,490.3</b>		<b>-23,886.6</b>		<b>-1%</b>
<b>Net income.....</b>	<b>20,476.5</b>		<b>21,623.4</b>		<b>-5%</b>

Key operating indicators are presented in p. 3.1 thereof.

Table: Key financial indicators for each business segment for the financial year ended December 31, 2010 (after eliminations).

	Conventional Generation	Renewable Energy	Wholesale Trading	Distribution	Retail Sales	Other
<i>in PLN million, unless specified otherwise</i>	<b>2010</b>					
EBITDA .....	4,476.5	280.2	202.4	1,441.2	213.5	206.9
EBIT .....	2,981.7	154.0	173.1	566.7	204.5	96.5
Capex .....	3,818.8	191.8	20.7	1,054.0	24.6	213.2
Segment Assets .	26,906.3	1,719.5	636.6	13,557.3	1,633.7	1,111.8

Table: Key financial indicators for each business segment for the financial year ended December 31, 2009 (after eliminations).

	Conventional Generation	Renewable Energy	Wholesale Trading	Distribution	Retail Sales	Other
<i>in PLN million, unless specified otherwise</i>						
	<b>2009</b>					
EBITDA .....	5,550.2	203.0	465.0	1,093.2	404.7	255.0
EBIT .....	4,026.3	77.6	439.4	263.2	397.7	135.5
Capex .....	2,484.3	91.6	13.1	993.1	6.9	136.6
Segment Assets .	24,938.0	1,636.1	823.2	13,396.4	1,497.7	1,039.5

### Conventional Generation

In 2010 total sales revenues for Conventional Generation amounted to PLN 12,287.5 million, which means 8% decline as compared to 2009. EBIT of the segment in 2010 was PLN 2,981.7 million, and EBITDA was PLN 4,476.5 million. In the previous year EBIT was PLN 4,026.3 million, while EBITDA was PLN 5,550.2 million. Decline of EBIT in 2010 as compared to 2009 was mainly due to lower income - by PLN 1,198.1 million - achieved from LTC compensations. Lower LTC revenues were partly compensated by higher result on other operation activities mainly connected with the reversal of balance sheets provisions.

In 2010 the capital expenditures in Conventional Generation segment amounted to PLN 3,818.8 million as compared to PLN 2,484.3 million in 2009.

Table: Capital expenditures incurred in Conventional Generation segment in years ended December 31, 2010 and December 31, 2009, by particular investment tasks.

<i>in PLN millions</i>	Capital expenditures		
	2010	2009	% change
Investments in generating capacities, including:	3,509.2	2,280.8	54%
<i>Development</i> .....	2,972.1	1,679.1	77%
<i>Modernization and replacement</i> .....	537.1	601.7	-11%
Purchases of finished capital goods .....	64.2	48.7	32%
IT .....	36.1	29.4	23%
Vehicles .....	7.4	15.3	-52%
Other .....	201.9	110.1	83%
<b>TOTAL</b> .....	<b>3,818.8</b>	<b>2,484.3</b>	<b>54%</b>

During 2010 the highest expenditures were incurred for the following projects: (i) complex reconstruction and modernisation of units 3-12 in Bełchatów Power Plant (PLN 1,236.0 million), (ii) construction of 858 MW unit in Bełchatów Power Plant (PLN 894.4 million), (iii) maintenance of mining abilities of Szczerców Field in Bełchatów Lignite Mine (PLN 343.3 million), (iv) construction of desulphurization installations on Units 1 and 2 in Bełchatów Power Plant (PLN 102.0 million) and (v) maintenance of mining abilities of Bełchatów Field in Bełchatów Lignite Mine (PLN 151.0 million).

### Renewable Energy

In 2010 total sales revenues in the Renewable Energy segment amounted to PLN 631.1 million as compared to PLN 547.2 million in 2009. The segment's EBIT in 2010 was PLN 154.0 million, and EBITDA was PLN 280.2 million. In the previous year, EBIT was PLN 77.6 million, and EBITDA was PLN 203.0 million. The increase of EBIT in 2010 as compared to 2009 resulted from higher revenues from sales of electricity and certificates of origin.

In 2010 capital expenditures in Renewable Energy segment amounted to PLN 191.8 million as compared to PLN 91.6 million in 2009.



Table: Capital expenditures incurred in Renewable Energy segment in years ended December 31, 2010 and December 31, 2009, by particular investment tasks.

<i>in PLN millions</i>	<b>Capital expenditures</b>		
	<b>2010</b>	<b>2009</b>	<b>% change</b>
Investments in generating capacities, including:	182.8	83.0	120%
<i>Development</i> .....	27.2	3.7	635%
<i>Modernization and replacement</i> .....	155.6	79.3	96%
Purchases of finished capital goods .....	1.2	0.2	500%
IT .....	2.4	2.2	9%
Vehicles .....	1.3	0.9	44%
Other .....	4.1	5.3	-23%
<b>TOTAL</b> .....	<b>191.8</b>	<b>91.6</b>	<b>109%</b>

### Wholesale Trading

In 2010 total sales revenues in the Wholesale Trading amounted to PLN 11,805.8 million, which means an approximately 7% decrease comparing to 2009. The segment's EBIT in 2010 was PLN 173.1 million, and EBITDA was PLN 202.4 million. In the previous year, EBIT was PLN 439.4 million, while EBITDA was PLN 465,0 million. The lower EBIT in 2010 as compared to 2009 resulted mainly from lower margin achieved on electricity sales on the wholesale market. Additionally, the wholesale companies sold in 2010 approximately 4.2 TWh less electricity than in 2009.

In 2010 capital expenditures in Wholesale Trading segment amounted to PLN 20.7 million, and constituted approximately 0.4% of total capital expenditures of PGE Group. IT expenditures constituted approximately 63% of capital expenditures in Wholesale Trading, mainly for management support systems in PGE Group and electricity trade systems.

### Distribution

In 2010 total sales revenues in the Distribution segment amounted to PLN 5,064.9 million, as compared to PLN 4,668.7 million in 2009. The segment's EBIT was PLN 566.7 million in 2010, while EBITDA was PLN 1,441.2 million. In the previous year, EBIT was PLN 263.2 million, and EBITDA was PLN 1,093.2 million. The ca. 115% growth of EBIT was mainly due to: (i) higher revenues from sales of the distribution service as a result of higher, by 0.6 TWh, volume of distributed energy, (ii) higher return on capital approved in the tariff for 2010, (iii) growth in revenues from connection to the grid (change of accounting rules).

In 2010 capital expenditures in Distribution segment amounted to PLN 1,054.0 million and constituted 20% of total capital expenditures of PGE Group. In 2009 capital expenditures in this segment amounted to PLN 993.1 million, what constituted almost 27% of total capital expenditures of PGE Group. Capital expenditures related mainly to connection of new off-takers and constituted 43% and 44% of the total capital expenditures of the segment in 2010 and 2009, respectively, and to investments connected with the construction of new HV, MV and LV power networks, constituting 33% and 32% of the total capital expenditures of the segment in 2010 and 2009, respectively.

Table: Capital expenditures incurred in Distribution segment in 2010 and 2009, by particular investment tasks.

in PLN millions

	Capital expenditures		
	2010	2009	% change
HV, MV and LV power networks.....	351.9	314.7	12%
Communication, remote switching and metering equipment.....	76.1	79.4	-4%
IT .....	47.7	51.1	-7%
Land buyout.....	3.4	3.9	-21%
Connection of off-takers .....	456.8	433.9	5%
Purchases of finished capital goods .....	41.8	42.6	-2%
Other .....	76.3	67.5	14%
<b>TOTAL .....</b>	<b>1,054.0</b>	<b>993.1</b>	<b>6%</b>

### Retail Sales

In 2010 total sales revenues in the Retail Sales segment amounted to PLN 12,464.6 million, what means increase by approximately 1% comparing to 2009. EBIT of the segment in 2010 was PLN 204.5 million, and EBITDA was PLN 213.5 million. In the previous year EBIT was PLN 397.7 million, and EBITDA was PLN 404.7 million. Decline of EBIT in Retail Sales segment by approximately 49% in 2010 as compared 2009 resulted mainly from higher expenses related to obligation of redemption of property rights (certificates of origin of electricity).

Capital expenditures in Retail Sales segment amounted to PLN 24.6 million in 2010 and constituted approximately 0.5% of total capital expenditures of PGE Group, and were mainly related to expenditures for IT (customer support systems), modernization of small hydro power plants and purchase of finished capital goods.

### Other operations

In 2010 total sales revenues in the Other operations amounted to PLN 1,712.9 million, as compared to PLN 1,839.5 million in 2009. EBIT of the segment in 2010 was PLN 96.5 million, and EBITDA was PLN 206.9 million. In the previous year EBIT was PLN 135.5 million, while EBITDA was PLN 255.0 million. Decrease of EBIT in 2010 in the Other operations as compared to 2009 resulted mainly from shifting of 6 companies to discontinued activities – sale of companies under the non-core programme.

Capital expenditures for property, plant and equipment in Other operations in 2010 amounted to PLN 213.2 million. Within the above amount PLN 54.6 million were spent by Exatel S.A. for IT development in 2010. The rest of the capital expenditures were mostly related to expenses for development and modernization of fixed assets required to render services under ancillary activities.

In the reporting period Company did not record any significant failures in its activities which would have effect on achieved results .

### 3.5. Publication of financial forecasts

In 2010 PGE S.A. did not publish forecasts of the Company's financial results for the year 2010.

On February 28, 2011 PGE S.A. published current report no. 8/2011, containing the estimates of selected consolidated financial data for 2010. Data published in the current report were the initial values, not audited and differ from the values presented in the attached audited consolidated financial statements. The particular changes are as follows:

- EBITDA is higher by approximately PLN 0.01 billion as compared to PLN 6.82 billion, disclosed in the current report, mainly as a result of disclosure adjustment of profit from the sale of subsidiaries,
- Net profit is higher by approximately PLN 0.01 billion as compared to PLN 3.62 billion, disclosed in the current report, mainly as a result of increased level of reversal of balance sheet provisions.

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

During the reporting period PGE S.A. and the subsidiaries financed its activities mainly from funds generated from operating activities, as well as from credits and issues of bonds.

Table: Group's net debt as at December 31, 2010 and 2009

in PLN million	<u>December 31,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
A. Cash <sup>(1)</sup> .....	546.5	161.7
B. Cash equivalents .....	2,078.0	7,445.5
C. Securities held for trading and available for sale <sup>(2)</sup> .....	8.6	6.5
<b>D. Liquidity (A) + (B) + (C).....</b>	<b>2,633.1</b>	<b>7,613.7</b>
<b>E. Investments held to maturity and loans and receivables <sup>(3)</sup> ....</b>	<b>32.7</b>	<b>97.0</b>
F. Short-term debt with banks and current part of long-term debt <sup>(4)</sup> ..	915.0	969.9
G. Other short-term financial debt .....	3.9	1.0
<b>H. Short-term financial debt (F) + (G) <sup>(5)</sup> .....</b>	<b>918.9</b>	<b>970.9</b>
<b>I. Short-term financial debt, net (H) - (D) - (E) .....</b>	<b>(1,746.9)</b>	<b>(6,739.8)</b>
J. Long-term bank loans and advances .....	1,804.4	4,056.3
K. Bonds issued .....	0.0	0.0
L. Other long-term loans and advances or other commitments <sup>(6)</sup> ....	6.5	0.7
<b>M. Long-term financial debt, net (J) + (K) + (L) <sup>(5)</sup> .....</b>	<b>1,810.9</b>	<b>4,057.0</b>
<b>N. Net financial debt (I) + (M) .....</b>	<b>64.0</b>	<b>(2,682.8)</b>

##### Notes

- 1 Excluding cash with restricted transferability attributable primarily to the Mining Liquidation Trust
- 2 Including stocks listed in active markets, participation units in investment funds classified as financial assets available for sale and acquired bonds, bills of exchange, bills and participation units in investment funds classified as assets held for trading
- 3 Including short-term acquired bonds, bills of exchange, bills classified as investments held to maturity, acquired bonds, bills of exchange and bills, loans granted and deposits classified as loans and receivables
- 4 Including loans and bonds
- 5 Excluding other financial commitments measured at depreciated cost
- 6 Including payables under lease and lease repo agreements

As at December 31, 2010 net financial indebtedness amounted to PLN 64 million compared to PLN (-) 2,682.8 million as at December 31, 2009. Such a significant change in the indebtedness was caused by the use of funds for the buyout of minority shares packages in key PGE Group subsidiaries from the State Treasury, payment of dividend to the shareholders and early repayment of the loans by PGE Elektrownia Bełchatów S.A. (currently PGE GiEK S.A. Branch Elektrownia Bełchatów).

Table: Selected financial ratios

	For the year ended December 31,	
	2010	2009
<b>Return on sales ROS (in %)</b>		
Net profit x 100% / net revenues	17.7	20.1
<b>Return on equity ROE (in %)</b>		
Net profit x 100% / (equity – net profit)	10.7	12.6
<b>Debtor's days (in days)</b>		
Average trade receivables (gross) x 365 days / net revenues	41	39
<b>Debt ratio (in %)</b>		
Liabilities x 100% / total equity and liabilities	26.8	28.6
<b>Current ratio</b>		
Current assets / short-term liabilities	1.1	2.1

Financial results achieved by PGE S.A. as well as PGE Group companies and unused credit limits ensure funds sufficient for financing of current operating activities of the PGE Group companies.

#### 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.

In 2010 both rating agencies sustained their ratings for PGE S.A..

Such ratings reflect the positive assessment of low credit risk connected with investments in debt securities of PGE S.A..

#### 4.2. Bonds issued

##### **PGE S.A. Bond Issue programme of up to PLN 5 billion, for PGE Group companies**

During 2010, PGE S.A. had a binding Agency Agreement with ING Bank Śląski S.A. regarding the establishment of the bond issue made to companies of the PGE Group PGE S.A. concluded on May 11, 2009. The maximum amount of the programme for the Group is PLN 5 billion. Under the Program for the Group, PGE S.A. may issue coupon or zero coupon bonds. The programme is described in detail in Note 42.4.4.2 to the consolidated financial statements.

As at December 31, 2010, the total nominal value of bonds issued under the programme amounted to PLN 1.8 billion. All bonds were zero-coupon bonds of the maturity of 1, 3 or 6 months, and were acquired by PGE Group companies.

##### **PGE S.A. Bond Issue programme of up to PLN 10 billion**

Programme is described in detail in p. 2.3. of this report. As at December 31, 2010 the Company did not recognise any debt in relation to bonds issued under the Programme.

##### **Agency agreements on the issue of bonds of PGE Group companies**

PGE S.A., as the central entity of the PGE Group, provides particular entities from PGE Group with funds to finance investments and their current activities. Such funds are provided in the form of zero-coupon and coupon bonds. For such a purpose, Group companies concluded agency bond issue agreements.

As a consequence of the consolidation and creation of PGE Górnictwo i Energetyka Konwencjonalna S.A., which incorporated most of the PGE Group companies possessing mining and generation assets (excluding PGE Elektrownia Opole S.A.), PGE GiEK S.A. took over all the liabilities of the incorporated companies, including rights and obligations resulting from the agency agreements on the issue of bonds. Agency agreements of particular companies with ING Bank Śląski S.A. were replaced by on agency agreement as from the signing date, i.e. from September 13, 2010.

As at December 31, 2010 only PGE Górnictwo i Energetyka Konwencjonalna S.A. had bonds issued, that were acquired by PGE S.A., under the following programs:

- Agency agreement with ING Bank Śląski S.A. concluded on September 13, 2010 (agreement consolidated programs of the companies comprising PGE GiEK S.A., with ING Bank Śląski S.A. as Agent) allowing for issue of bonds of up to PLN 4,091 million. The maturity date of the agreement is December 31, 2013. As at December 31, 2010, the nominal value of the bonds acquired by PGE S.A. under this agreement amounted to PLN 2,126.0 million.
- the Agency agreement for the issue of bonds of up to PLN 3.7 billion concluded on November 30, 2009 between PGE Elektrownia Bełchatów S.A. and PKO Bank Polski S.A.. The maturity date is on December 1, 2014. As at December 31, 2010, the nominal value of the bonds issued under this agreement amounted to PLN 2,872.6 million.

#### **4.3. Bank loans and advances**

Table: Loans and advances taken by PGE S.A. and PGE Capital Group companies in 2010.



Company	Branch	Bank	Type of financing	Agreement signing date (yyyy-mm-dd)	Maturity date (yyyy-mm-dd)	Amount	Currency code	Reference rate
PGE Dystrybucja S.A.	Branch Białystok	BGK	Current account credit	2010-03-31	2011-03-31	40,000,000.00	PLN	WIBOR 3M
PGE Górnictwo i Energetyka Konwencjonalna S.A.	Branch Zespół Elektrociepłowni Bydgoszcz	Bank Handlowy w Warszawie S.A.	Current account credit	2010-05-27	2011-05-27	25,000,000.00	PLN	WIBOR 1M
PGE Polska Grupa Energetyczna S.A.		Bank Handlowy w Warszawie S.A.	Current account credit	2010-07-06	2013-07-05	200,000,000.00	PLN	WIBOR 1M
PGE Polska Grupa Energetyczna S.A.		Bank Pekao S.A.	Current account credit	2010-07-21	2013-07-21	200,000,000.00	PLN	WIBOR 1M
PGE Polska Grupa Energetyczna S.A.		Societe Generale S.A.	Current account credit	2010-07-23	2013-07-31	200,000,000.00	PLN	WIBOR 1M
PGE Górnictwo i Energetyka Konwencjonalna S.A.	Branch Zespół Elektrociepłowni Bydgoszcz	Bank Pekao S.A.	Current account credit	2010-07-30	2011-07-29	25,000,000.00	PLN	WIBOR 1M
PGE Polska Grupa Energetyczna S.A.		Nordea Bank Polska S.A.	Current account credit	2010-07-30	2013-08-01	200,000,000.00	PLN	WIBOR 1M
PGE Elektrownia Opole S.A.		Bank Pekao S.A.	Current account credit	2010-12-15	2012-03-31	100,000,000.00	PLN	WIBOR 1M

Table: Loans terminated by PGE Group companies in 2010.

Company	Branch	Bank	Type of financing	Agreement signing date (yyyy-mm-dd)	Maturity date (yyyy-mm-dd)	Termination date (yyyy-mm-dd)	Amount	Currency code	Reference rate
PGE Dystrybucja S.A.	Branch Białystok	BGK O/Białystok	Current account credit	2010-03-31	2011-03-31	2010-09-18	40,000,000.00	PLN	WIBOR 3M

In 2010, PGE Polska Grupa Energetyczna S.A. and PGE Group companies granted following advances.

Table: Advances granted by PGE S.A. and PGE Group companies.

Company	Counterparty	Agreement date	Expiry date	Amount	Currency	Interest rate type	Interest rate
PGE S.A.	PGE EJ1 Sp. z o.o.	2010-10-19	2010-12-29	38,000,000	PLN	fixed	Fixed, based on market terms
PGE S.A.	PGE Systemy S.A.	2010-11-10	2014-06-10	4,400,000	PLN	fixed	
PGE S.A.	PGE Inwest Sp. z o.o.	2010-12-14	2011-06-30	2,200,000	PLN	fixed	
PGE Dystrybucja S.A. Branch Lublin (f. PGE Dystrybucja Lubzel Sp. z o.o.)	PGE Dystrybucja S.A.	2010-01-26	2010-02-28	15,000	PLN	fixed	

In addition, as described in the Note 43.12 to the consolidated financial statement, in the periods before the balance sheet date PGE S.A. made prepayments for transmission services to Vattenfall Aktiebolag. Based on the character of those transactions, in the consolidated financial statements prepared in accordance with IFRS, part of the prepayments is classified as a cost of purchase of shares in affiliates, and the other part is presented as a loan granted. As at December 31, 2010 the amount of prepayments presented as a loan granted amounted to PLN 169 million.

#### 4.4. Guarantees

Guarantees granted by PGE Group companies are presented in Note 38 to the consolidated financial statements.

#### 4.5. Significant off-balance sheet items

Significant off-balance sheet items are described in Note 38 and 39 to the consolidated financial statements.

#### 4.6. Evaluation of investment capacities

On-going and future investments are and will be financed from funds obtained from the issue of bonds, funds generated by the core activity of the PGE Group, from external financing, and funds obtained from disposal of non-core assets. Financial results achieved by the PGE Group and debt level in 2010 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, Group companies become parties to various types of agreements and financial contracts subject to non-financial risks.

In ordinary business activity, Group's activities, 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 Group companies finance their operating and investing activities partially from debts bearing floating interest rates or investments in financial assets bearing a floating or fixed interest rates. The companies 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.

The Group 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 and incurring financial liabilities 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: capital expenditures denominated or indexed in foreign currencies, loans and advances of Group companies denominated in foreign currencies, the purchase or sale of electricity under export contracts expressed in foreign currencies, purchase of electricity denominated in foreign currencies

and electricity purchase for which part of the price is indexed to the exchange rates, fees on the purchase of transmission services expressed or indexed in foreign currencies, the purchase or sale of CO<sub>2</sub> emission allowances denominated or indexed to the exchange rates, expenses connected with the current exploitation of production assets denominated or indexed to the exchange rates, , capital investments (deposits) denominated 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, heat, hard coal, natural gas, CO<sub>2</sub> emission allowances, and energy certificates of origin.

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 the Group 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.

The Group 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 Group companies run active cash investment policy. This means that they monitor their financial surplus, forecast future cash flows and carry out their investment strategy on the basis thereof.

PGE Group companies are individually responsible for their current liquidity, which is mainly based on current account credits. The Group has implemented a central financing process. PGE S.A. issues bonds, which are acquired, without limitation, by entities with financial surplus. Funds from the issue are then used to acquire bonds issued by those of PGE Group companies that indicate need for external sources of financing.

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

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

The activity of major PGE Capital Group companies, as well as other entities operating in the electrical and power sector, is exposed to a number of both external risk and threats connected with market, regulatory and legal environment, as well as internal risks and threats accompanying their operations.

Key risks and threats, to which the PGE Capital Group's activity is exposed are described below.

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

#### **6.1.1. Risk connected with macroeconomic situation in Poland and in the world**

The operations of PGE Group are affected mainly by macroeconomic factors related to Polish economy, such as interest rates, PLN exchange rate, inflation rate, unemployment rate, Polish GDP, changes in directions of the economic and tax policy of the state, and also volatility of prices of electricity, fuel, CO<sub>2</sub> emission rights, and availability of materials used for production of electric power and heat. Other than factors associated with Polish economy, our operations are also affected by macroeconomic conditions in other countries, particularly other Member States of the European Union. Any deterioration of the general economic conditions in Poland or in the world may considerably and negatively impact the operations, performance or financial standing of the Group.

#### **6.1.2. Risk relating to an increase in competition (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 activity 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 Group to acquire new customers from outside the historic operating area of the Retail Sales companies of the PGE Group and increase both sales volume and profit.

#### **6.1.3. Risk of a decrease in demand for electricity and heat**

The PGE Capital Group's income is substantially dependant on the consumption of power and heat by the end users. In a long run, power consumption is expected 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 level by recipients of low economic standing, (iii) development of new energy saving technologies, (iv) weather conditions. 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.

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

#### **6.2.1. Political risk**

The activity of the PGE Group in key operating areas, i.e. lignite mining, 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 off takers, in particular households.

#### **6.2.2. 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 dozen 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.

Moreover, environment protection regulations become more strict, and adjustment to these changes may be connected with the additional significant expenditures. Non-compliance with regard to environment protection requirements may lead to PGE Group responsibility, including financial sanctions or periodical or even permanent suspension of exploitation of particular installations.

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, and although certain decisions, positions, opinions and other actions of such authorities may 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. Therefore there is a risk that the tariffs subject to approval by the President of the Energy Regulatory Office, are not approved or are approved with delay or are approved in different form than applied for. Additionally, 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, and if the fine is related to the licensed activity, the fine may amount up to 15% of income earned on the licensed activity by the fined entity in the previous fiscal year.

#### **6.2.3. Risk relating to the requirement for licenses**

The Group's core activity is subject to a number of licenses, including licenses for the electricity and heat generation, the distribution of electricity and heat, the electricity trading, the heat trading, the fuel gas trading, as well as for the lignite mining. In order to continue business activity, the Group needs to maintain and extend existing licenses. Any withdrawal or limitation of licenses 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.

#### **6.2.4. Risk related to the obligation of public sales of electricity**

The amended Energy Law introduces an obligation for electric power producers (as from August 9, 2010) to sell, to a certain extent, their electric power on the power exchange or on a public basis with equal access through the open tender or on the internet platform on the regulated market. Considering that the new regulations are imprecise and raise significant doubts in terms of interpretation, there is no certainty how electric power producers can fulfil that obligation. In particular, interpretation doubts are raised whether the sale through the internet platform, which runs outside of the regulated market, fulfils the obligation of public sale required by the Energy Law. Therefore, there is a risk that the President of the Energy Regulatory Office may question the manner in which a given electric power producer in the Group fulfils the obligation to sell the electricity in a public manner. As a result, the President of the Energy Regulatory Office may levy certain sanctions on the energy producer, including a fine, and even question electric power sale contracts concluded by that entity.

#### **6.2.5. Risk resulting from the potential violation of antitrust regulations**

Distribution company of the PGE Group is a natural monopolist in the area of electricity distribution services. In addition, in 2009 the PGE Group held approximately 41.4% share in the electricity generation market and was one of the biggest electricity sellers in Poland. Given its monopolist or dominant position in relevant markets, the PGE Group is subject to limitations in the form of a ban on overusing its dominant position based on antitrust regulations of the Polish law and the law of the European Union. In the case of any violation thereof, antitrust authorities (the President of the Office for Consumer and Competition Protection, European Commission) may order to take up defined actions or enforce sanctions in the form of financial penalties.

#### **6.2.6. Risk connected with regulations obligating the Company to ensure the sufficient number of certificates of origin**

PGE Group companies active in electricity trading must obtain and present for redemption to the President of the Energy Regulatory Office with certificates of origin for electricity coming from renewable sources (green certificates). Alternatively, such companies may pay a substitute fee. In the case an obligation to obtain and present for redemption to the President of the Energy Regulatory Office with certificates of origin of energy from renewable sources is not fulfilled or a substitute fee is not paid, a company may be charged with a financial penalty. Similar rules apply to energy produced in the highly efficient cogeneration (yellow and red certificates). In the past, PGE Group companies were charged with sanctions for their failure to fulfil the above obligations. Such situations may also take place in future. Additionally, prices of certificates of origin are determined by current regulations, decisions of regulatory or other authorities, including in particular those relating to the definition of relevant substitute fees. Therefore, income earned by PGE Group companies from the sale of certificates of origin of energy produced thereby depends on administrative decision and legal regulations. Currently in Poland, as well as in EU institutions, a discussion lasts on the future level of support for the renewable energy producers. That may result in limiting of that support or its dependency from the market electricity price, and also in its diversification depending on the renewable energy source.

#### **6.2.7. Risk connected with the excise tax**

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 Act, 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.

#### **6.2.8. 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 limited number of free CO<sub>2</sub> emission allowances under NAP II for 2008-2012 as compared to NAP I for 2005-2007 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.

Resolutions, which will be taken in 2011, likely will decide what derogations will Poland obtain with regard to free CO<sub>2</sub> emission allowances for generators for 2013-2020. Additionally, according to the assumptions of the third settlement period, from 2010 free CO<sub>2</sub> emission allowances will not be granted.

#### **6.2.9. 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.

New Directive of European Parliament and Council of Europe no 2010/75/UE of November 24, 2010 on industrial emissions (integrated prevention of pollution and its control), called IED, introduces more strict requirements with regard to limits of pollution emissions with reference to previously binding (inter alia, LCP directive). IED Directive must be implemented to the domestic laws by January 7, 2013. IED Directive introduces increased role of the BAT reference documents (so called BREFs). More restrictive emission standards may force PGE Group 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.

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

#### **6.3.1. Risk of disruption of fuel supplies to our power plants, CHP plants and heat plant**

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 GiEK S.A. Branch Elektrownia Bełchatów and PGE GiEK S.A. Branch Elektrownia Turów), hard coal (in particular to PGE Elektrownia Opole S.A. and PGE GiEK S.A. Branch Zespół Elektrowni Dolna Odra), 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 unfavourable 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.

#### **6.3.2. Risk of insufficient stocks of fuel**

The Energy Law obliges every electricity or heat generating enterprise to maintain a stock of fuel in an amount that can guarantee the continuity of electric power and heat supply. The ERO President imposes fines (of up to 15% of income) for the failure to maintain the required level of fuel stocks. The shortage of required level of fuel stocks may also result in the suspension or reduction of electricity or heat generation.

#### **6.3.3. Risk connected with mining site rehabilitation expenses**

Mining companies representing the Conventional Generation segment must rehabilitate sites where they carry out their mining works. The Geological and Mining Act, as well as implementing regulations thereto, obligate mining companies to make contributions to the mine liquidation fund constituting 10%

of a maintenance fee. Such funds may be used only to cover costs of mine liquidation, including rehabilitation costs. It may happen that funds and reserves of mining companies allocated to such a purpose will not cover actual rehabilitation expenses that the companies will have to bear in future. This may result in a need to increase amounts payable to the rehabilitation fund, create other reserves, and finance site rehabilitation from external sources.

#### **6.3.4. Risk connected with weather conditions**

Weather conditions influence technical and economic conditions of energy and heat generation and distribution and create seasonable demand for energy. Such factors may cause limitations to energy generation, mainly as a result of water in natural and artificial basins that is used for cooling the generating units getting too hot or too low, as well as limitations to transmission capacities of the electrical and power system. In addition, bad weather conditions, including in particular the force of wind in the case of wind farms and water surface in the case of water power plants, have a significant impact on electricity production from renewable sources. While, large rains cause problems with the dehydration of opencast lignite mines. Extreme weather conditions break lines or damage electrical and power devices very often, which results in breaks of or limitations to power supply. It must be added that all the above phenomena are mostly unpredictable and in consequence may cause lowering of PGE Group income and claims by the electricity and heat off-takers for compensations or for discounts. Removal of damages in the electro energy grid is also connected with additional expenses relating to reconstruction of the damaged elements.

#### **6.3.5. Risk relating to maintenance, repairs and modernisations**

PGE Group companies' business activity consisting in lignite mining and energy generation and distribution requires regular maintenance, repairs and modernization of assets. Such actions should ensure that equipment's life is optimum and guarantee necessary availability of key assets, including cost minimisation. Untimely or inadequate maintenance or repair and operation services shorten the life and worsen parameters of assets. This may contribute to breakdowns and outages or limitations to coal mining, energy generation and power supply, which may consequently result in the reduction of the companies' income. While assets recovery and modernisation investments are subject to substantial expenditure and, at the same time, particular stages of modernisation works may be delayed, for example, by uncertainty relating to the acquisition of sufficient financial resources, protests of environmental organisations, strikes of employees, growth of costs, delays caused by contractors, difficulties in the acquisition of necessary permits, or other unexpected difficulties.

#### **6.3.6. Risk of unsettled legal status of the real estates**

In the case of many properties (land and buildings) owned by the PGE Group (in particular those used by distribution companies), there are doubts as to the legal title of such companies to use the properties. Very frequently, investments, mainly ones related to lines, were carried out in third party properties without express consent of owners. Corresponding national legal regulations are not clear and judicature on cases relating to such situations has been changed in recent years. This situation is connected with a risk of claims to be filed against PGE Group companies, like in the case of distribution system operators. We may not exclude further cases of this type and related additional costs or even a need to stop using certain properties.

#### **6.3.7. 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. Such circumstances may negatively affect the terms of financing, in particular may lead to the growth of costs of such financing (higher interest rates, commissions, etc.). Higher costs of financing may affect the Group's results.

#### **6.3.8. Risk associated with a downgrade or withdrawal of the rating of PGE**

PGE S.A. has received positive evaluations from rating agencies confirming its high reliability connected with investment in its debt securities. Nonetheless, rating agencies may at any time downgrade or inform PGE S.A. of their intention to downgrade the rating. The rating agencies may also completely withdraw their ratings which may have the same consequences as a downgrade in PGE's ratings. Any decrease in PGE's rating may increase the costs of external financing, limit access to capital markets and adversely affect the capacity of PGE Group companies to sell their products or

contract economic transaction, especially long-term ones. This may in turn decrease the liquidity of PGE S.A. and adversely affect the operating results and financial condition of PGE Group.

### **6.3.9. 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. (entity directly owned by PSE Operator, and indirectly dependant from the State Treasury) 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.

Similar situation occurred in August 2010 - eligible producers from PGE Group received decisions of the President of the Energy Regulatory Office on determining the annual adjustment of stranded costs and the annual adjustment of costs generated in gas-fuelled units for 2009. In accordance with those decisions, producers from the PGE Group are obliged to return to Zarządca Rozliczeń S.A. (Settlement Manager) a total amount of ca. PLN 566 million. PGE S.A. and generators in PGE Group participating in the compensation system disagreed with the decisions of the President of the Energy Regulatory Office and appealed against them to the District Court in Warsaw, the Court for Competition and Consumer Protection, similarly as in the previous year.

Although the ruling of the Court for Competition and Consumer Protection of May 26, 2010 with regard to annual adjustments for 2008 was favourable to producers from the PGE Group, the outcome of further proceedings cannot be definitely predicted, as the President of the Energy Regulatory Office appealed against the court's decision concerning the adjustments for 2008.

In addition, considering the fact that up till now the District Court in Warsaw - Court for Competition and Consumer Protection, suspended the appeal proceeding concerning the annual adjustment of the stranded costs for 2008 in case of Elektrownia Opole, concerning the annual adjustment of the stranded costs for 2008 and 2009 in case of Elektrownia Turów and concerning the annual adjustment of the stranded costs for 2009 in case of Zespół Elektrowni Dolna Odra, there is a risk that the decision on the merits in these cases may be postponed.

Considering the consolidation actions of PGE Group and the fact that the LTC Act does not include specific regulations as to its application to transformations of producers covered by the programme of stranded cost compensations, Chairman of the Steering Team for Implementation of the "Power Engineering Programme", acting pursuant to § 6 section 2 of the Regulation No. 55 of the Prime Minister of April 13, 2006, appointed – under Regulation no. 2 of October 5, 2009 – a working group for implementation of the LTC Act ("Working Group") in PGE Group companies after the consolidation programme. The Working Group is composed of representatives of: the Minister of the State Treasury, Minister of Finance, President of the Energy Regulatory Office, President of the Office of Competition and Consumer Protection, Zarządca Rozliczeń S.A., Ministry of Economy, and representatives of PGE S.A..

The Working Group has developed a summary report which confirms the possibility to apply the LTC Act after consolidation of producers in the Group without the need to introduce any amendments. However, during the work on the report, no consensus was reached on the matters that affect the amount of financial assistance received by PGE Group after the consolidation and there are still differences in interpretation of the LTC Act between the Producers and the President of the Energy Regulatory Office, causing the uncertainty regarding the ultimate interpretations by the President of the Energy Regulatory Office in this scope.

#### **6.3.10. 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.

#### **6.3.11. Risk of insufficient insurance protection**

The activity of the PGE Capital Group is exposed to a number of risks connected with natural calamities, breakdowns and damages. The Group's business activity is also connected with third party liability towards third persons for personal injuries, property damages or so called pure financial loss. The Group maintains insurance policies covering only certain types of damages and there is a risk of insufficient insurance coverage. In addition, there are risks that are not subject to any insurance protection or in the case of which compensations, if any, are not likely to fulfil claims or loss. Consequences of such events will be charged to costs of particular Group companies, what may have a negative impact on their results.

#### **6.3.12. 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 financial results.

Risks connected with court, arbitration and administrative proceedings that are essential for the Group's activity are described in Note 38 to the consolidated financial statement.

Over 100 company and inter-company trade unions are present in the PGE S.A. and PGE Group companies and over 27 thousand employees of the Group are members. Pursuant to the current provisions of law, trade unions influence the legislative process. They are also able to exert pressure on employers in a number of ways, including in the form of collective labour disputes. PGE Group companies are parties to a number of corporate and sectoral collective bargaining agreements. Furthermore, management boards of many Group companies have entered into social agreements with trade unions which confer considerable power upon employees and trade unions. The necessity to consult or co-ordinate certain actions with the trade unions may delay, or even render impossible, such actions and may lead to collective disputes, involving strikes or other labour protests. Furthermore, should any significant redundancy program be required in the PGE Group in the future, the obligation to make high severance payments to employees may delay or limit our ability to carry out such redundancy program or may increase its cost.

#### **6.3.13. Risk of lack of expected synergies resulting from the consolidation of the 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 in years 2009-2010 has implemented the Consolidation Programme resulting in formal and legal mergers of the entities in business lines of conventional generation, renewable energy, distribution and retail sales. Moreover, PGE S.A. merged with PGE Górnictwo i Energetyka S.A. and PGE Energia S.A. There were also organizational and legal changes in the wholesale trading area (merger of PGE S.A. with PGE Electra S.A.). In case of PGE Elektrownia Opole S.A. the merger within the segment is pending. The purpose of the consolidation programme was to simplify its corporate structure and concentrate its core activity in companies responsible for each business line of the Group. The next step is to achieve better efficiency and competitiveness of the PGE Group and to achieve cost savings. It cannot also be ruled out that after the completion of this stage of the consolidation, not all of the expected synergies and savings will be achieved.



## **7. PGE Capital Group's development perspectives**

### **7.1. Factors important for the development of the PGE Capital Group**

In the opinion of the Company Management Board, the following factors will influence the Company and the Group's performance within at least year 2011:

- demand for electricity and heat;
- electricity prices on wholesale market;
- prices of property rights;
- availability and prices of fuels used in generation of electricity and heat, in particular prices of hard coal, fuel gas and oil;
- availability and costs of CO<sub>2</sub> emission rights;
- availability of cross-border transmission capacities;
- the tariff process for 2012, including in particular costs recognised by the President of the Energy Regulatory Office as reasonable and the amount of reasonable return on equity, as well as tariff approval date;
- decisions of the ERO President related to realisation of LTC Act;
- amendment to the Energy Law and others acts concerning the introduction of an obligation to sell electricity by way of tender or through a commodity exchange by generators incorporated in vertically integrated groups and entitled to receive compensations under Act on LTCs and introduction of support system for the electricity production in highly efficient co-generation in units fired by methane released and captured at lower mining works in active, under liquidation or closed coal mines or by gas obtained from biomass processing;
- court's ruling on the dispute between the President of the Energy Regulatory Office and generators from the PGE Group entitled to receive compensations under LTC Act with regard to the annual adjustments of the stranded costs for 2008 and annual adjustments of the stranded costs and annual adjustments of costs generated in gas-fuelled units for 2009;
- decision in case of advance payments for 2011 for PGE GiEK S.A. Branch Elektrownia Turów and PGE GiEK S.A. Branch Elektrociepłownia Rzeszów. The President of the Energy Regulatory Office, referring to the effects of the consolidation in the Conventional Generation area, called – in a letter dated February 11, 2011- PGE Górnictwo i Energetyka Konwencjonalna S.A. for submission of one application, which will indicate one amount of the advance payment for PGE GiEK S.A. Branch Elektrownia Turów and PGE GiEK S.A. Branch Elektrociepłownia Rzeszów to be paid in advance for the stranded costs for 2011. However, the Management Board of PGE GiEK S.A. expresses opinion, that there are no reasons for correction of the applications submitted by PGE GiEK S.A. Branch Elektrownia Turów (former PGE Elektrownia Turów S.A.) and Branch Elektrociepłownia Rzeszów (former PGE Elektrociepłownia Rzeszów S.A.);
- possible different decision in law, tax and other contingent liabilities disputes, from which most relevant were presented in Note 38 to the consolidated financial statements;
- verdict of the Court of Competition and Consumer Protection in case of PGE's appeal against the decision on the President of the Office of the Competition and Consumer Protection with regard to the purchase of shares of ENERGA S.A. (see p. 2.3. Significant agreements);
- changes in Group macroeconomic factors, including in particular interest rates and exchange rates, values of which affects evaluation of assets and liabilities shown by the Group.

### **7.2. Realisation of PGE Capital Group's strategy in 2011**

The primary goal of the PGE Group is to increase value of the Company by profitably satisfying customer demand for electricity and heat. The strategy has been built around four main courses of action:

- domestic and foreign growth;
- development of an integrated company;



- efficiency improvement;
- improvement of competitiveness and regulatory environment.

In accordance with its strategy, the PGE Capital Group intends to continue activities relating to the generation of electricity from conventional and renewable sources, lignite mining, the sale and distribution of electricity to final consumers, the production and sale of heat, the electricity wholesale trading in the domestic and international markets.

In 2011 PGE Group will continue implementation of the projects described in p. 1.2 of this report. In addition, the Group plans to carry out its investment programme, and in particular continue the Group's key investment projects:

- the construction of the new 858 MW unit in Bełchatów power plant; the company expects that the unit will be commissioned in 2011;
- construction of a new coal-fired units in PGE Elektrownia Opole S.A. In 2011 the initial works, including selection of the IOC and acquiring of relevant permits and administrative decisions, will be carried out;
- construction of a new unit in Turów power plant. In 2011 the company will carry out geological research and other preparatory works, including, preparation of general projects, preparation of an application - with appendices - for the consent for the construction, preparation of application for the issue of decision on environmental predispositions, processing of proceedings for the selection of the contractor;
- program of construction of steam-gas units at Elektrownia Pomorzany, Elektrociepłownia Gorzów, Zespół Elektrociepłowni Bydgoszcz. The plans for 2011 include signing of an agreement with a technical and legal advisor, signing of an agreement with ENEA Operator S.A. for connection to the energy grid and signing of an agreement with Gaz-System S.A. for connection to the gas grid, obtaining permission for participation in emission rights trading scheme (obtaining free CO<sub>2</sub> allowances).

In addition, with regard to the other investment projects defined in the Group's strategy, the conception studies and analyses on the selection of the most effective variants of the implementation of the particular investments tasks will be continued.

## **8. Other significant information**

### **Adoption of the resolution concerning initiation of the process aiming at conduction of IPO of PGE Energia Odnawialna S.A.**

On June 16, 2010 Extraordinary General Meeting of PGE Energia Odnawialna S.A. adopted the resolution on initiation of the process aiming at conduction of IPO of PGE Energia Odnawialna S.A.

### **Damages in properties of PGE Elektrownia Turów S.A. and PGE KWB Turów S.A.**

At the beginning of August 2010, heavy rainfalls caused damages in assets of PGE Elektrownia Turów S.A. and PGE Kopalnia Węgla Brunatnego Turów S.A. (currently branches of PGE Górnictwo i Energetyka Konwencjonalna S.A.). As a result of the damages, the lignite's mining and electricity production in these plants were temporarily reduced. The reduction of production in PGE Elektrownia Turów S.A. was compensated by the increase of production in other plants of the Capital Group. The property affected by the flood was insured and the affected entities initiated liquidation proceedings with the insurance companies. The detailed description of costs revealed in profit and loss account in relation to the flood is included in Note 45.8 to the consolidated financial statements.

## **9. Entity authorised to audit of financial statements**

An entity authorised to audit stand-alone and consolidated financial statements of PGE S.A. is KPMG Audyt Sp. z o.o. The financial statement audit agreement was signed on November 15, 2010 for period of four years and covers the audit of stand-alone and consolidated financial statements for 2010-2013, as well as reviews of interim half-year consolidated financial statements prepared for the periods ended June 30 in years 2011-2014. Costs related to the services rendered by KPMG Audyt Sp. z o.o. in years 2009-2010 are presented in the table below.

Table: Fee payable to an entity authorised to audit of financial statements.

<i>PLN thousands</i>	<b>2010</b>	<b>2009</b>
<b>Fee of KPMG Audyt Sp. z o.o., including:</b>	<b>327.8</b>	<b>4,008.0</b>
Obligatory audit of the yearly financial statements and audit for IPO purposes in 2009	327.8	2,433.0
Other attestation services	-	105.0
Tax advisory	-	-
Other services (IPO)	-	1,470.0

In 2010 KPMG Audyt Sp. z o.o. also audited financial statements of other PGE Capital Group companies, i.e.: PGE Górnictwo i Energetyka Konwencjonalna S.A. (holding with self-balancing branches), PGE Elektrownia Opole S.A., PGE Energia Jądrowa S.A., PGE EJ1 Sp. z o.o., Exatel S.A., ELBIS sp. z o.o. and Przedsiębiorstwo Transportowe ELTUR-TRANS sp. z o.o. The fees payable from the above audits amounted to PLN 601.0 thousand.

In 2009 KPMG Audyt Sp. z o.o. audited financial statements of the following companies from the PGE Group: PGE KWB Bełchatów S.A., PGE KWB Turów S.A., PGE Elektrownia Bełchatów S.A., PGE Elektrownia Opole S.A., PGE Elektrownia Turów S.A., PGE ZEDO S.A., PGE Elektrociepłownia Gorzów S.A., PGE Elektrociepłownia Rzeszów S.A., PGE Elektrociepłownia Kielce S.A., PGE Elektrociepłownia Lublin-Wrotków S.A., PGE ZEC Bydgoszcz S.A., ELBIS Sp. z o.o.. The fees payable from the above audits amounted to PLN 1,760.0 thousand.

## **10. Statement on implementation of corporate governance**

This Statement on implementation of corporate governance in PGE Polska Grupa Energetyczna S.A. in 2010 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.

### **10.1. Corporate governance principles which the Company was obliged to follow in 2010**

In 2010 PGE Polska Grupa Energetyczna S.A. ("Company", "PGE S.A.") was 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 and amended on May 19, 2010 by the Resolution of the Board of the Warsaw Stock Exchange no. 17/1249/2010, that came into force on July 1, 2010. Management Board passed a resolution approving Best Practices for application in the Company.

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.

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).

### **10.2. Information on exceptions in application of the corporate governance principles**

Till the change of the Best Practices, i.e. till July 1, 2010 (see p. 10.1 above) 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. The rule assumed that "Remuneration of the members of the statutory bodies of the company should be tied to the performed function, should correspond with the size of the company and stay in reasonable proportion to the company's economic results." Incomplete application of the aforementioned recommendation 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.

As from July 1, 2010 the mentioned rule was changed and according to its new text „A company should have a remuneration policy and rules of defining the policy. The remuneration policy should in particular determine the form, structure, and level of remuneration of members of supervisory and management bodies. Commission Recommendation of December 14, 2004 fostering an appropriate regime for the remuneration of directors of listed companies (2004/913/EC) and Commission Recommendation of April 30, 2009 complementing that Recommendation (2009/385/EC) should apply in defining the remuneration policy for members of supervisory and management bodies of the company.”

So far, the Company has not worked out a remuneration policy and rules of defining the policy. With regard to the members of the Supervisory Board, the provisions of the of the Act on remuneration of managers of certain legal entities are applied, limiting the Supervisory Board members remuneration to one average salary in the enterprises sector, without payments from the profit in the fourth quarter of the previous year, that is announced by the President of the Polish Statistical Office. In relation to the Management Board members the given Act does not apply as from October 15, 2010 i.e. from the day when the agreements with the Company for rendering of the management services were concluded with the Management Board members and the Management Board members purchased at their own expense a liability insurance with regard to the managing of the Company (see p. 1.6 above).

### **10.3. 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. Before every reporting period the companies subject to consolidation receive detailed guidelines with regard to method and closing date of the accounting books, preparation and submitting the reporting packages and template updated for a given period. The aforementioned regulations and guidelines ensure unification of the accounting principles in the PGE Group and method of the preparation of the reporting packages by the companies subject to consolidation. 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. For the consolidation purposes, these companies prepare reporting packages, which are transferred, verified and processed in the system's consolidation module. 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 stand-alone and consolidated financial statements. Chief bookkeepers of the particular companies are responsible for preparation of the reporting packages under consolidation. These packages are then authorised by the Management Boards of the companies.

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 2010 financial statements of key companies in the PGE Group. Their duties include review of the half-year financial statements and initial and essential audit of the annual statements. The PGE Group has implemented a multi-stage process of approving financial statements with the participation of Supervisory Boards. Stand-alone 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. Stand-alone 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.

#### **10.4. Shareholders with a majority stake**

According to the company's knowledge, as at December 31, 2010, the sole shareholder with a majority stake was the State Treasury with 1,295,637,952 shares accounting for 69.29% of the share capital of the Company, which entitle the State Treasury to 1,295,637,952 votes, accounting for 69.29% of the total number of votes at the General Meeting (according to the notification received from the Minister of the State Treasury).

#### **10.5. 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.

Up to March 31, 2010, 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 was a 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 was essential for the Company's operations. The objection could have applied solely to the legal action of the Company of particular importance for the public order or public security if there were reasonable grounds to suspect that such an action breaches the public order or public security. The act was overruled on April 1, 2010 by the Act of March 18, 2010 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 (Dziennik Ustaw of 2010, no. 65, item 404). The binding act does not assume privileges of the Minister of the State Treasury connected with the possession of PGE S.A. shares by the State Treasury.

#### **10.6. Limitations regarding exercise of the voting rights in shares**

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

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

The limitations regarding the transfer of ownership of the Company's securities were 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).

#### **10.8. 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

#### **10.9. 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 additional issues related to the activities of the General Meeting are regulated by the Rules of the General Meeting approved on March 30, 2010 by the Extraordinary General Meeting.

The Company's Statutes and the Rules of the General Meeting are 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 detailed method of convening and cancelling the General Meeting is defined in the Rules of the General Meeting

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.

Shareholder or 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 Shareholder or 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 shareholder or shareholders making such a demand to convene the Extraordinary General Meeting and appoints the Chairman of this 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 is made after the date referred to in art. 401 § 1 of the Code of Commercial Companies (i.e. twenty one days), 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.

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 of 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).

Cancelling of the General Meeting or changing the date of the Meeting supervenes through announcement on the company's website. The Company makes efforts to ensure that cancelling of the General Meeting or changing the date of the Meeting creates the least negative results for the Company and the Shareholders.

Cancelling of the General Meeting is possible only on the petitioners' permission or when holding of the meeting faces extraordinary obstacles or is nonrepresentational.

Cancelling of the General Meeting and changing the date of the Meeting shall occur promptly after occurrence of rationale justifying the cancelling or change of date, but not later than seven days before the date of the General Meeting, except when it is not possible or excessively difficult under the given circumstances, then the cancelling or change of date may occur at any time before the General Meeting date.

#### **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 Statutes and changes the subject of activities of the Company,
- dissolves and winds up 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.

#### **10.10. 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 2010, the Management Board of the Company consisted of:

<b>Name and surname of the Member of the Management Board</b>	<b>Position</b>
Tomasz Zadroga	President of the Management Board
Marek Szostek	Vice-President of the Management Board responsible for Development since November 24, 2010 Vice-President of the Management Board responsible for Organisation since November 11, 2009
Piotr Szymanek	Vice-President of the Management Board responsible for Corporate Affairs, since April 28, 2009
Marek Trawiński	Vice-President of the Management Board responsible for Operations since April 28, 2009
Wojciech Topolnicki	Vice-President of the Management Board responsible for Finance: October 1, 2010 – January 5, 2011 Vice-President of the Management Board responsible for Development and Finance: April 28, 2009 – September 30, 2010

On January 5, 2011 Mr Wojciech Topolnicki, Vice-President of the Management Board responsible for Finance, was recalled from the Management Board.

###### **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 agreements other than these mentioned above or incurring liabilities other than these mentioned above in the amount exceeding €400,000, excluding agreements or liabilities related to trade transactions concerning electricity, related products or related rights as well as trade transactions concerning the purchase and sale of fuels,
- 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 may be 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 2010 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	Member of the Supervisory Board till March 30, 2010
Jacek Barylski	Member of the Supervisory Board
Małgorzata Dec	Member of the Supervisory Board
Czesław Grzesiak	Member of the Supervisory Board from March 30, 2010
Grzegorz Krystek	Member of the Supervisory Board from March 30, 2010
Ryszard Malarski	Member of the Supervisory Board till March 30, 2010
Katarzyna Prus	Member of the Supervisory Board, from April 12, 2010 acts as a Secretary of the Supervisory Board
Zbigniew Szmuniwski	Member of the Supervisory Board
Krzysztof Żuk	Member of the Supervisory Board from February 22, 2010

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

The Supervisory Board consists of five 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 Statutes of the Company and 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 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 Meeting of the Supervisory Board may 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). Then, 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 agenda may be changed if all members of the Supervisory Board are present at the meeting and no one objects to the change.

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 may be 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.

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;
- sets remuneration and other terms of agreements and concludes agreements with the members of the Management Board (including the President of the Management Board), subject to competencies of the General Meeting resulting from the binding laws;
- 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, related products and rights connected, fuel 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 (stand-alone 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, legal compliance, 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 2010, the Audit Committee consisted of:

<b>Name and surname</b>	<b>Function</b>
Until March 30, 2010	
Wojciech Cichoński	Chairman
Maciej Bałtowski	Committee Member
Jacek Barylski	Committee Member
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
March 30, 2010 – April 12, 2010	
Maciej Bałtowski	Committee Member
Jacek Barylski	Committee Member
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
Since April 12, 2010	
Małgorzata Dec	Przewodnicząca
Maciej Bałtowski	Committee Member
Grzegorz Krystek	Committee Member
Zbigniew Szmuniowski	Committee Member
Krzysztof Żuk	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 2010 the Corporate Governance Committee consisted of:

<b>Name and surname</b>	<b>Function</b>
Until March 30, 2010	
Katarzyna Prus	Chairman
Maciej Bałtowski	Committee Member
Ryszard Malarski	Committee Member
March 30, 2010 – April 12, 2010	
Katarzyna Prus	Chairman
Maciej Bałtowski	Committee Member
Since April 12, 2010	

Katarzyna Prus	Chairman
Maciej Bałtowski	Committee Member
Jacek Barylski	Committee Member
Czesław Grzesiak	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 the strategy and strategic plans submitted to the Supervisory Board by the Management Board

In 2010 the Strategy and Development Committee consisted of:

Name and surname	Function
Until March 23, 2010	
Ryszard Malarski	Chairman
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
March 23, 2010 – March 30, 2010	
Ryszard Malarski	Chairman
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
Krzysztof Żuk	Committee Member
March 30, 2010 – April 12, 2010	
Małgorzata Dec	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
Krzysztof Żuk	Committee Member
Since April 12, 2010	
Małgorzata Dec	Committee Member
Grzegorz Krystek	Committee Member
Zbigniew Szmuniowski	Committee Member
Marcin Zieliński	Committee Member
Krzysztof Żuk	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 2010 the Appointment and Remuneration Committee consisted of:

<b>Name and surname</b>	<b>Function</b>
Until March 30, 2010	
Maciej Bałtowski	Chairman
Jacek Barylski	Committee Member
Wojciech Cichoński	Committee Member
Katarzyna Prus	Committee Member
Marcin Zieliński	Committee Member
March 30, 2010 – April 12, 2010	
Maciej Bałtowski	Chairman
Jacek Barylski	Committee Member
Katarzyna Prus	Committee Member
Marcin Zieliński	Committee Member
Since April 12, 2010	
Maciej Bałtowski	Chairman
Jacek Barylski	Committee Member
Czesław Grzesiak	Committee Member
Katarzyna Prus	Committee Member
Marcin Zieliński	Committee Member

## **11. Statements of the Management Board**

### **11.1. 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 consolidated 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 Capital Group and its financial result.

The report of the Management Board on the activities of PGE Capital Group presents a true view of the development, achievements and situation of the Capital Group, and provides a description of the basic risks and threats.

### **11.2. 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 consolidated 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, 2011

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

*Tomasz Zadroga*

*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*