



**MANAGEMENT BOARD'S REPORT ON
ACTIVITIES OF
PGE POLSKA GRUPA ENERGETYCZNAS.A.
for the year 2010**

Warsaw, March 15, 2011

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1. General information about PGE S.A.

1.1. General information about the Company

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

The registered office of the Company is located in Warsaw at ul. Mysia 2.

PGE Polska Grupa Energetyczna S.A. ("PGE", "PGE S.A.", the "Company") is the parent company of PGE Polska Grupa Energetyczna S.A. Capital Group ("Group", "Capital Group", "PGE Group", "PGE Capital Group"). PGE Polska Grupa Energetyczna S.A. runs its activities through its headquarter with no branches.

The controlling entity of the Company is the State Treasury, which held 69.29% of the share capital as at December 31, 2010.

The core business activities of PGE S.A. include:

- a) Activities of head offices and holdings, except financial holdings,
- b) Activities of holding companies,
- c) Regulation of and contribution to more efficient operation of businesses,
- d) Rendering of other services related to tasks referred to in p. a-c,
- e) Trading of electricity and related products.

Activity with regard to the electricity trading is carried out pursuant to the requirements resulting from the Energy Law of April 10, 1997.

The Management Board's Report on the activities of the Company covers the period from January 1, 2010 to December 31, 2010.

1.2. Changes in the organisation and management of PGE S.A. and the Capital Group

Changes, which took place in the structure of the long-term financial assets of PGE S.A. during the 12-month period ended December 31, 2010, are described in detail in Note VI.8-12 of the Supplementary information and explanations to the financial statements of PGE for 2010.

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

During the period ended December 31, 2010, PGE S.A. did not discontinue any significant areas of its operations.

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. The details of the programme are described below.

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 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 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. 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. As from the merger registration date, PGE took over all the competences of PGE Electra S.A. At the same time PGE acts as the Corporate Center of PGE Capital Group.

In the accounts of PGE S.A. the merger was settled with the pooling of interests method. The details of the mergers are presented in Note VI.1 of the Supplementary information and explanations to the financial statements of PGE for 2010.

In connection with the above changes, the Organisational Rules adopted by the resolution no. 513/75/2010 of November 17, 2010 and approved by the resolution of the Supervisory Board no. 206/VIII/2010 of November 24, 2010, were binding at PGE as at the end of the year.

Changes in the organisation and management of the Capital Group

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. Its aim was to adapt the corporate and management structure to running the activities in the Group's main business lines and to deliver the structure in which, in every area of Group activities there is only one company, concentrating all the assets and operations from the particular 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) conventional generation (formerly: mining and generation); (ii) renewables; (iii) distribution of the electric energy; (iv) retail sale of electric energy.

The following entities were merged in Conventional Generation (mining and 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.

The merger with PGE Elektrownia Opole S.A. is currently ongoing.

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.

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

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.

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. As a result of the merger, the acquired companies (PGE Górnictwo i Energetyka S.A. and PGE Energia S.A.) were dissolved without going into

liquidation. As a result of the merger the share capital of PGE S.A. was increased by PLN 1,396,937,270.

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 of the acquired companies 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.

The works under Consolidation Programme are continued with regard to building a organisational structure and identification of efficiency improvement and competitiveness programs.

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., which was previously owned by PGE, was 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. Employment

As at December 31, 2010 the employment in PGE Polska Grupa Energetyczna S.A. amounted to 369.7 FTEs, which was by 114.3 FTEs less than as at December 31, 2009, i.e. lower by 23.6%. Average employment in PGE Polska Grupa Energetyczna S.A. amounted to 382.7 FTEs.

| Tabel 1. Employment | As at December 31, 2010 | As at December 31, 2009 | % change |
|---|----------------------------|----------------------------|----------|
| Total employment (FTEs) – as at Dec. 31, 2010 | 369.7 | 484.0 | -23.6% |
| Average annual employment | 382.7 | 547.9 | -30.2% |

The data on employment in 2010, include the effects of the merger of PGE S.A. with PGE GiE and PGE Energia S.A., that took place on August 31, 2010 and the merger of PGE S.A. with PGE Electra S.A., that took place on December 31, 2010. Data on employment in PGE S.A. in 2009 were transformed for comparison purposes and constitute a total employment in FTEs in above mentioned companies, as at December 31, 2009.

As a result of the merger of the companies, according to provisions of the Labour Act, employees of the acquired companies, as of the date of the merger, were taken over, pursuant to art 23 of the Labour Act. 13 employees were taken over from PGE GiE S.A., 2 employees from PGE Energia S.A. and 96 employees from PGE Electra S.A. In addition, 4 employment contracts with taken over employees were terminated, before end of September 2010. As a result of Voluntary Redundancy Program implemented in PGE Electra S.A., employment contracts with 17 employees taken over from PGE Electra S.A. will be terminated by March 31, 2011.

For comparison, table below presents data concerning employment as at December 31, 2009 in companies merged in 2010.

| Tabel 2. Employment As at Dec 31, 2009 | PGE S.A. | PGE Electra* | PGE GiE* | PGE Energia* |
|---|----------|--------------|----------|--------------|
| Total employment (in full-time equivalents) | 259.4 | 104.7 | 101.9 | 18.0 |
| Average annual employment (full- time equivalents) | 283.3 | 105.1 | 144.7 | 14.9 |

* data as at December 31, 2009, provided by the companies

A significant difference occurred in PGE GiE S.A. between employment as at December 31, 2009 and August 31, 2010, when the merger with PGE GiE S.A. and PGE Energia S.A. was registered. In connection with the implementation of the Consolidation Program and decision on creation of holdings responsible for each business line, what caused a change in a role of PGE GiE S.A. in management of companies from PGE GiE Group, the employment restructuring process was initiated and that affected the reduction of employment by 131.7 FTEs as at August 31, 2010. In a company, responsible for management of conventional energy companies, 64 employees have been employed.

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

1.4.1. 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 3. Number and type of shares of PGE S.A. as at December 31, 2010.

| 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. |
| Total | | | 1,869,783,727 | 18,697,837,270.00 | |

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 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 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 VI.I of the Supplementary information and explanations to the financial statements of PGE for 2010.

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, 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 4. The structure of the share capital as of December 31, 2010 is as follows:

| | 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 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 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.

1.4.2. 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 an 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.

1.4.3. 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 5: PGE shares held by the persons acting on behalf of material direct subsidiaries of PGE S.A.

| Company | Name and surname | Function | Number of shares |
|---|-------------------------|--|-------------------------|
| PGE Górnictwo i Energetyka Konwencjonalna S.A. | 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 |
| PGE Elektrownia Opole S.A. | Jan Pilipionek | Member of the Management Board | 6,110 |
| | Czesław Łukowski | Proxy | 5,570 |
| PGE Obrót S.A. | 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 |
| PWE Gubin Sp. z o.o. | Cezary Bujak | From September 1, 2010 till September 6, 2010 - Proxy, | 299 |
| | | From September 7, 2010 - Member of the Management Board | |

1.4.4. Control system of employees share scheme

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

1.4.5. 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 1.4.1. 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.

Proceeds from the issue of bonds under the bond programs 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.

1.5. 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 member 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 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 used the company cars for private purposes, what was settled according to the regulations binding in PGE.

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 6: 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 VI.55 of the Supplementary information and explanations to the financial statements of PGE for 2010).

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 7: 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 to all of the Supervisory Board members for performing the functions in the Supervisory Board amounted to PLN 367.5 thousand in 2010. Additionally, the remuneration paid out to the Supervisory Board members of PGE GiE S.A., PGE Energia S.A. and PGE Electra S.A. amounted to PLN 280 thousand.

2. Description of the business activities of PGE Capital Group

2.1. Description of the business activities of PGE Capital Group.

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

- Conventional Generation (formerly Mining and Generation), extraction of lignite and generation of electricity and heat from conventional sources and distribution of heat,
- Renewable Energy, including electricity generation from renewable sources and in pumped storage power plants,
- Wholesale Trading of electricity, related products and fuels,
- Distribution of electricity,
- Retail Sales of electricity.

The wholesale trading of electricity and related products is carried out directly by PGE S.A. It is the main activity of the company. In the other operations, PGE provides so called supporting services to the PGE Group companies, leases IT systems and rents offices.

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.:

- building, renovation and modernization works and investments in electricity equipment,
- comprehensive diagnostic tests and measurements of electricity machines and equipment,
- managing by-products of coal combustion, developing, implementing and using technologies and rehabilitation of degraded areas,
- medical and social services.

2.2. Main investments in Poland and abroad.

In 2010 PGE S.A. held investments classified as investments in financial instruments at the level of PLN 30,066.5 million as compared to PLN 27,480.5 million in 2009. The split of financial instruments by category is presented in Note VI.18 of the Supplementary information and explanations to the financial statements of PGE for 2010.

The main item is shares in affiliates in amount of PLN 24,489.8 million in 2010, which are described in Note VI.9-11 and 15-16 of the Supplementary information and explanations to the financial statements of PGE for 2010.

PGE, as the central entity of PGE Group, performs functions with regard to ensuring individual entities from the Group with funds for the financing of investments and operating activities. The instrument which the company uses for this purpose is bonds issue. The value of bonds issued amounted to PLN 4,937.5 million as at December 31, 2010 compared with PLN 2,452.5 million as at December 31, 2009. Bonds are described in detail in note VI.20 of the Supplementary information and explanations to the financial statements of PGE for 2010.

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

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 29 September 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 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 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.

2.3. Description of significant agreements.

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

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.

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.

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 completion of the transaction requires positive verdict of the Court of Competition and Consumer Protection in case of PGE's appeal against the decision of the President of the Office of Competition and Consumer Protection prohibiting concentration of PGE and Energa S.A. The detailed description of the agreement is presented in chapter 2.2. by the description of the purchase of Energa S.A. shares.

Agreement for purchase of shares of PGE Górnictwo i Energetyka Konwencjonalna S.A., PGE Obrót S.A. and PGE Dystrybucja S.A. from the State Treasury

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 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 Konwencjonalna 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 Energa 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.).

Memoranda on the cooperation relating to nuclear energy

One of the most important events, with regard to the "nuclear project", was signing in 2010 of two Memoranda on cooperation in the area of nuclear energy with American-Japanese conglomerates GE Hitachi Nuclear Energy Americas and Westinghouse Electric Company LLC. Together with Memorandum with French company Electricite de France S.A. (EDF) signed in November 2009, PGE signed three Memoranda, which aim is cooperation with regard to feasibility study for the development

of reactors, in given technology and construction of nuclear power plant in Poland by 2020. Within cooperation with each company, working groups were formed, which are preparing appropriate analyses in following areas: localization criteria, transmission grid, aspects of law, project's schedule, term of issuing permissions or financial and market analysis.

2.4. Transactions with related entities

In 2010 PGE S.A. was a party to a number of transactions with related parties, including entities constituting PGE Group, members of PGE S.A. bodies, and the State Treasury and entities controlled by the State Treasury.

In 2010 PGE S.A. identified transactions with 28 entities controlled by the State Treasury. The total value of these transactions is presented in the table below.

| Table 8. Transactions with related entities (in PLN thousand) | Total as at December 31, 2010 |
|--|-------------------------------------|
| Receivables | 1,184,424.4 |
| Liabilities | 2,506,584.5 |
| Transactions allocated as assets | 4,943,783.9 |
| Sales revenues | 7,722,827.7 |
| Other operating revenues | 602.3 |
| Financial income | 2,755,867.9 |
| Operating expenses | 9,981,690.5 |
| Other operating expenses | 86.9 |
| Financial expenses | 3,386.0 |

In 2010 PGE S.A. sold electricity to PGE Obrót S.A. in an amount which exceeded 10% of the transactions in trading.

| Table 9. Transactions with recipients from the Group (in PLN thousand) | transaction value | share [%] |
|---|-------------------|-----------|
| PGE Obrót S.A. | 6,948,836.6 | 90.0 |

In 2010 over 93.4% of the energy purchased by PGE S.A. came from producers from the Group. A list of suppliers in which the turnover exceeded 10% of the total amount of PGE S.A. operating expenses is presented below.

| Tabel 10. Transactions with generators from the Group (in PLN thousand) | transaction value | share [%] |
|--|-------------------|-----------|
| PGE Górnictwo i Energetyka Konwencjonalna S.A. | 8,331,500.6 | 83.5 |
| PGE Elektrownia Opole S.A. | 1,513,031.2 | 15.2 |

In the opinion of the Company, transactions with related parties were concluded under market conditions (on an arm's-length basis) or based on production costs or in accordance with other principles arising out of the guidelines of the Organisation for Economic Cooperation and Development (OECD) regarding transfer prices, the Corporate Income Tax Act, and the ordinance of the Minister of Finance dated October 10, 1997 concerning the manner of determining the revenues of taxpayers through the estimation of prices in transactions concluded by these taxpayers (Dz. U. [Polish Journal of Laws] of 1997, No. 128, item 833, as amended). Information regarding transactions with related parties is presented in Note VI.63 of the Supplementary information and explanations to the financial statements of PGE for 2010.

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. significant proceedings in front of court, body appropriate for arbitration proceedings or in front

of public administration authorities are described in Notes VI. 37 and VI. 56.5. of the Supplementary information and explanations to the financial statements of PGE for 2010.

2.6. Key R&D achievements

Nuclear energy

In 2010 PGE continued works in the area of nuclear energy. PGE prepared the analysis of best practices relating to organisational, legal and corporate solutions for the management of nuclear power plant construction projects. Agencja Rynku Energii carried out a research ordered by PGE, presenting the long-term forecast of electricity production source development in the light of the energy policy of Poland and EU. Additionally, the potential possibilities of the development of the national electronegry system in years 2010-2050 were done – each of the scenarios showed the necessity of the nuclear energy development.

The research for localisation of the nuclear power plant was also made. 6 out of 27 possible localisations submitted by the Government Plenipotentiary of Polish Nuclear Energy, were selected and proper analyses were carried out. The conclusions of this report will provide the basis for further activities.

The agreements with foreign partners (Electricite de France SA, GE-Hitachi Nuclear EnergyAmericas LLC, Westinghouse Electric Company LLC) were concluded. In cooperation with the above mentioned contractors, the feasibility studies on development of nuclear reactors in EPR, ABWR/ESBWR and AP1000 reactors as well as the potential construction of the first such reactor in Poland by the year 2020.

At the current preparation stage, it is necessary that the Polish Government adopts the Polish Nuclear Energy Program by the end of June 2011, key legal regulations comes into effect and the localisation of the power plant is chosen by the end of 2013, as well as the technology provider is chosen. It is also necessary to work out a cooperation model, select construction partner and work out investment financing principles. In addition it is necessary to choose owners' engineer with experience in preparation and management of the large nuclear investments.

New technologies

The studies in the Polish Platform of Clean Coal Technologies ("PPCCT") were continued in 2010. PPCCT is an initiative by the energy sector companies for the clean coal technologies, with particular emphasis on CCS (Carbon Capture & Storage). The goal of the PPCCT is the identification of technical, economical and financial, legislative and social aspects connected with the clean coal technologies, working out a joint PPCCT attitude towards above subjects, and then activities for the creation of legal, technical, economical and financial instruments and gaining social approval in order to reduce CO₂ emissions from coal-fired power plants and CHPs in Poland through implementation of clean coal technologies.

On June 16, 2010 PGE joined scientific-industrial consortium "Carbon Fuel Cells" on the ground of the Consortium Agreement with other Financing Members (GRUPA TAURON Południowy Koncern Energetyczny S.A., Katowicki Holding Węglowy S.A., Kompania Węglowa S.A.) and Execution Members (University of Technology in Częstochowa, Silesia University of Technology, University of Technology in Wrocław). The purpose of the consortium is 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.

Since February 2008, PGE S.A. has been a member of the Consortium CO2EuroPipe Project. The purpose of the CO2EuroPipe project is to determine the possibilities of developing infrastructure to transport CO₂ from the main emissions sources in Europe to the most suitable storage locations, as well as devices necessary for injection in these locations. The organisational, financial, legal, environmental and social aspects will also be analysed in order to prepare transportation network meeting the security requirements at the reasonable costs. The list of data on CO₂ sources in particular regions will be created with information concerning capacities and accessibility (as well as durability) of the storage locations. In this way the map of CO₂ transportation will be created, taking into consideration the year 2020 as the beginning for the CCS technology.

Cooperation with international organisations

PGE S.A. actively cooperates with international organisations. PGE S.A. along with the Companies of the Group cooperates through the Polish Electricity Committee (PEC) with the Union of the Electricity

Industry EURELECTRIC. PGE S.A. is a member of the Baltic Ring Committee for Cooperation in the Area of Electricity BALTREL. Participation in BALTREL committee gives possibilities to influence the concept of the electro energy market in that part of Europe. PGE participates in the studies of ETP ZEP (European Technology Platform For Zero Emission Fossil Fuel Power Plants Advisory Council). ETP ZEP was created in order to allow the European power plants fired by solid fuels reaching CO₂ emission of zero.

2.7. 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 VI. 56. of the Supplementary information and explanations to the financial statements of PGE for 2010.

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

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 11. Key economic ratios connected with the Polish economy.

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

* estimates by Polish Statistical Office (GUS)

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

Sales of electricity

| Table 12. Electricity sales (in TWh) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|---|------------------------|------------------------|--------------|
| Electricity sales volume | 54.9 | 58.6 | -6.3% |
| Electricity wholesale - domestic | 53.0 | 56.4 | -6.0% |
| International sales | 0.6 | 1.2 | -46.1% |
| Electricity sales on the Balancing Market and to Balancing Group | 1.3 | 1.1 | 25.7% |

In the 12-month period ended December 31, 2010 PGE S.A. sold 54.9 TWh of electricity, what constituted a decrease of more than 6% compared with sales in the same period of 2009 (58.6 TWh). Decrease by 1.7 TWh as compared to 2009, results from the different conditions for the electricity sales i.e. adapting the trading model of the Group to the „power exchange obligation”, what caused that starting from August 9, 2010, energy sold up till that date by PGE S.A., has been sold directly by PGE Elektrownia Bełchatów S.A. (SPOT contracts). Moreover, the decrease of the volume of the electricity sold, resulted also from the lower availability of the generation capacities in 2010 as compared to 2009, resulting mainly from the breakdowns, which occurred in the generators from PGE Group in 2010.

Purchases of electricity

| Table 13. Electricity purchases (in TWh) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|--|------------------------|------------------------|--------------|
| Electricity purchase volume | 54.9 | 58.6 | -6.3% |
| Electricity purchase (from Capital Group and from third parties) | 54.0 | 56.8 | -4.9% |
| Electricity purchase on the Balancing Market | 0.3 | 0.5 | -27.7% |
| Import | 0.6 | 1.4 | -56.4% |

Changes occurred between 2010 and 2009 in the structure of electricity purchases from producers from the Group and from outside of the Group, what was described above. These changes resulted in reduction of energy volume purchased by PGE S.A. directly from one of the producers from the Group. In addition, the reduction of energy volume purchased from the producers from the Group, was mainly caused by the breakdowns (flood in Turów power plant, steam-gas unit failure at Rzeszów CHP, failure of two power units at Pomorzany CHP) and reduction of production in coal-fired power plants with regard to CO₂ costs.

The purchases of electricity abroad decreased by 56.4% primarily because of the limitation of the access to transborder transmission capabilities by the Polish transmission system operator (TSO) and the expiry - as from August 2010 - of the agreement with Vattenfall on energy exchange on the Poland-Sweden connection.

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 CO₂ 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)

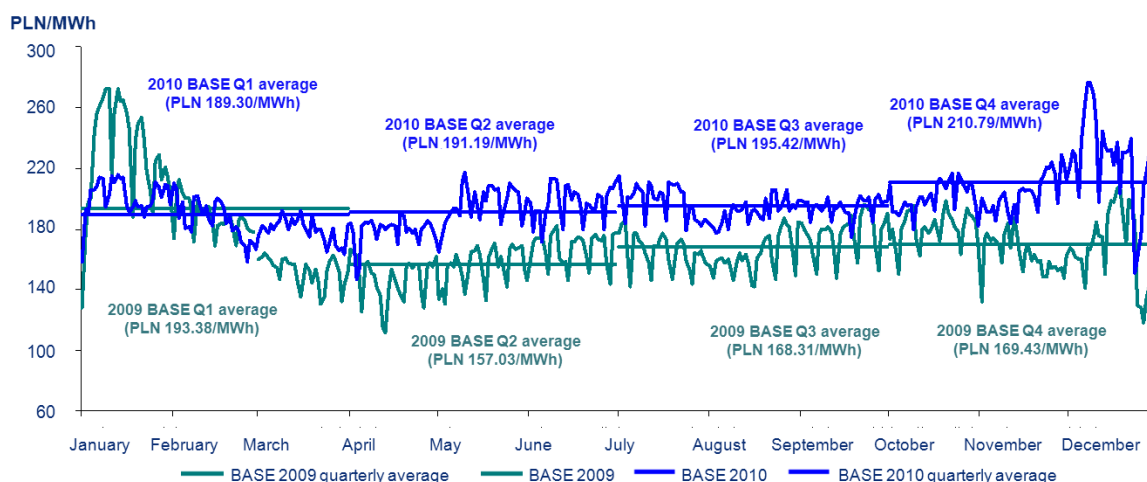
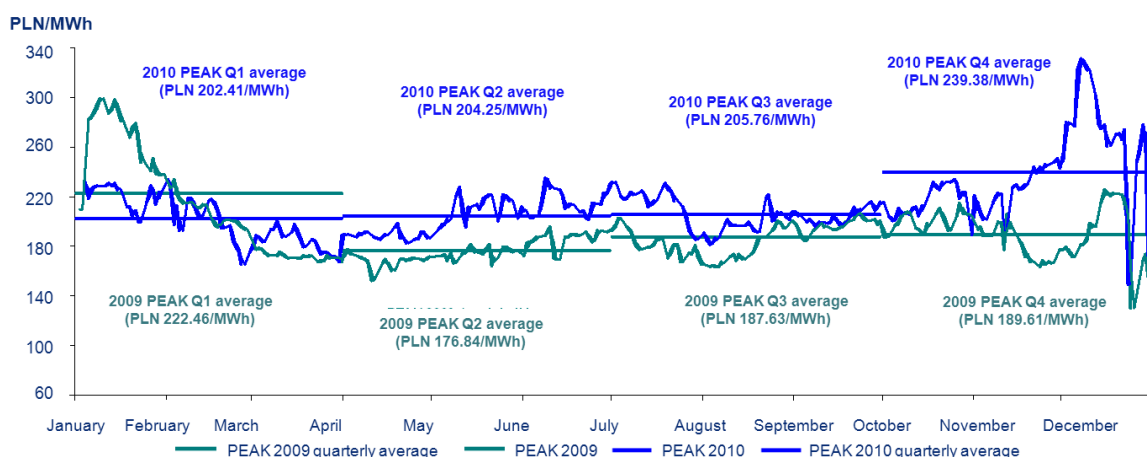


Chart. Daily and quarterly peak prices in SPOT transactions in 2009–2010 (TGE)



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.

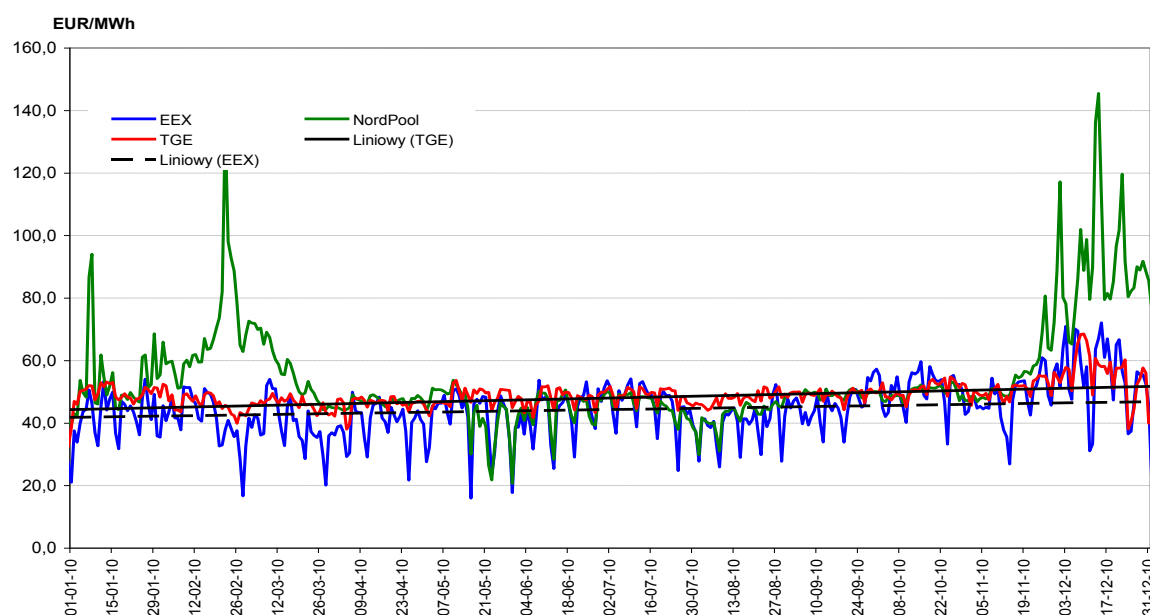
The prices on the balancing market moved analogically as the SPOT market prices. Non-balancing in the scale of the whole system in 2010 was on average 2.14%, what corresponded with the trading volume on the balancing market on the level of 3.3 TWh.

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.

3.2. Financial results of PGE S.A.

Profit and loss account

| Table 14. Income statement prepared in accordance with Polish Accounting Standards (in PLN thousand) | Period 1-12 2010 | Period 1-12 2009 | % change |
|--|---------------------|---------------------|---------------|
| Net sales of products, goods and materials | 11,663,346.3 | 12,532,100.4 | -6.9% |
| Cost of products, goods and materials sold | 11,330,513.8 | 11,895,786.5 | -4.8% |
| Gross sales result | 332,832.5 | 636,313.9 | -47.7% |
| % total sales | 2.9% | 5.1% | |
| Costs of sales and general and administrative costs | 114,675.1 | 156,088.1 | -26.5% |
| Profit on sales | 218,157.4 | 480,225.9 | -54.6% |
| Other operating income | 12,747.5 | 13,882.3 | -8.2% |
| Other operating expenses | 15,914.6 | 56,005.0 | -71.6% |
| EBIT | 214,990.3 | 438,103.1 | -50.9% |
| % total sales | 1.8% | 3.5% | |
| Financial income | 2,857,519.3 | 1,462,861.8 | 95.3% |
| Financial expenses | 62,052.6 | 211,430.0 | -70.7% |
| Gross profit | 3,010,457.1 | 1,689,534.9 | 78.2% |
| % total sales | 25.8% | 13.5% | |

| Table 14. Income statement prepared in accordance with Polish Accounting Standards (in PLN thousand) | Period 1-12 2010 | Period 1-12 2009 | % change |
|--|---------------------|---------------------|---------------|
| Income tax | 90,023.2 | 100,361.8 | -10.3% |
| Other statutory reductions in profit | 10.4 | 198,142.1 | -100.0% |
| Net profit | 2,920,423.5 | 1,391,031.0 | 109.9% |
| % total sales | 25.0% | 11.1% | |
| EBITDA | 235,227.7 | 459,079.9 | -48.8% |
| % total sales | 2.0% | 3.7% | |

The net profit of PGE S.A. amounted to PLN 2,920.4 million in the financial year ended December 31, 2010, an increase of 109.9% compared with the financial year ended December 31, 2009.

The net profit margin of the Company (the ratio of net profit to total sales) was 25.0%. The increase of the net result was due to better results on financial activity, particularly from increased dividend payments by the subsidiaries by PLN 1,454.6 million.

Amount and structure of total revenues

| Table 15. Total revenues (in PLN thousand) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|--|------------------------|------------------------|-------------|
| Total revenues | 14,533,613.1 | 14,008,844.5 | 3.7% |
| Net sales of products, goods and materials | 11,663,346.3 | 12,532,100.4 | -6.9% |
| Other operating income | 12,747.5 | 13,882.3 | -8.2% |
| Financial income | 2,857,519.3 | 1,462,861.8 | 95.3% |

In 2009, PGE S.A. achieved total sales revenues of PLN 14,533.6 million - an increase of approximately 4 % compared with 2009.

The decrease in the sales of products and goods by ca. 7% compared with 2009 occurred primarily as a result of a decrease in electricity sales revenues.

| Table 16. Electricity sales revenues (in PLN thousand) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|--|------------------------|------------------------|--------------|
| Electricity sales revenues | 10,372,635.8 | 11,133,477.4 | -6.8% |
| Sales on the domestic wholesale market | 9,987,384.4 | 10,715,780.4 | -6.8% |
| International sales | 127,206.2 | 225,176.1 | -43.5% |
| Electricity sales on the Balancing Market and to Balancing Group | 258,045.2 | 192,520.9 | 34.0% |

The decrease in revenues generated from the sales of electricity by PLN 761.1 million, resulted from lower by 3.7 TWh volume of electricity sold (more detailed description is presented in previous chapter) and lower electricity sale price by PLN 1.1/MWh. The average electricity sale price in 2010 amounted to PLN 188.8/MWh, and was nominally lower than in 2009 (PLN 189.9/MWh). However, through the first 2 months of 2009, energy price included excise tax. After elimination of the excise tax impact, the electricity sale price for PGE rose by ca. PLN 2/MWh in 2010 as compared to values in 2009.

Territorial structure of sales revenues is presented in Note VI. 40 of the Supplementary information and explanations to the financial statements of PGE for 2010 and below.

| Table 17. Revenues by geographic regions (in PLN thousands) | Total net income | | | | |
|---|---------------------|-------------|---------------------|-------------|--------------|
| | 2010 | (%) share | 2009 | (%)share | % change |
| 1. Revenues from sales of products | 104,386.8 | 1% | 116,953.5 | 1% | -10.7% |
| a. Poland | 103,992.6 | 1% | 116,241.6 | 1% | -10.5% |
| b. export, intra-community sales | 394.2 | 0% | 711.9 | 0% | -44.6% |
| 2. Net revenues from sales of goods and materials | 11,558,959.5 | 99% | 12,415,146.9 | 99% | -6.9% |
| a. Poland | 11,171,093.4 | 96% | 11,740,717.6 | 94% | -4.9% |
| b. export, intra-community sales | 387,866.1 | 3% | 674,429.3 | 5% | -42.5% |
| Total | 11,663,346.3 | 100% | 12,532,100.4 | 100% | -6.9% |

In 2010 and 2009 PGE obtained revenues mainly from electricity sales on domestic market. During 2010, the Company pursued export electricity sales on the Poland-Sweden connection and through its subsidiary Electra Deutschland, what – together with the reservations of transborder capacities – amounted to PLN 127.6 million. In addition PGE S.A. was also selling CO2 allowances in intra-community sales.

| Table 18. Revenues from sale of related products (in PLN thousand) | Period 1-12 of | | % change |
|--|--------------------|--------------------|--------------|
| | 2010 | 2009 | |
| Revenues from sale of related products | 1,225,986.8 | 1,321,590.6 | -7.2% |
| Sales of goods (property rights, CO2 allowances) | 1,186,320.4 | 1,281,915.5 | -7.5% |
| Sales of services connected with the electricity (OHT services, management of sales of electricity, property rights, etc.) | 39,666.4 | 39,675.1 | 0.0% |

Sales of goods in 2010 mainly included: (i) Sales of property rights (certificates of origin of electricity and (ii) trading of CO2 allowances, that was executed in 2 segments: for the needs of generators from PGE Group and for the needs of the external contractors.

Sales of services in 2010 mainly included: (i) rendering of OHT services for the PGE Group companies and external contractors, (ii) , management of sales of electricity for the generators from PGE Group, (iii) management of sales of property rights in intra-group transactions and (iv) transit trading of hard coal.

| Table 19. Revenues from other operations (in PLN thousand) | Period 1-12 of | | % change |
|---|-----------------|-----------------|---------------|
| | 2010 | 2009 | |
| Total revenues: | 64,723.7 | 77,282.0 | -16.2% |
| Revenues from other operations, including | 64,720.3 | 77,278.4 | -16.2% |
| <i>Sales of support services</i> | <i>42,557.8</i> | <i>59,586.4</i> | <i>-28.6%</i> |
| Revenues from sales of materials | 3.3 | 3.6 | -8.1% |

Within other operations of PGE, the biggest decrease in revenues was related to rendering of support services for the companies from the PGE Group. The agreements have been in effect since January 2008 and were signed following the "Agreement concerning the principles for the cooperation of PGE S.A. with PGE Capital Group Companies", that is, the document specifying the principles and scope of the cooperation of Group Companies in order to build a highly effective organisation implementing the strategy of Polska Grupa Energetyczna. Within the support services, PGE GiE performed integration services for companies from the mining and generation segment.

The growth of revenues from financial activities was affected by dividends paid to PGE S.A. from subsidiaries and other companies in amount of PLN 2,534.5 million, i.e. by PLN 1,454.6 million more than in the previous year and higher revenues from the bonds possessed, which were issued by the Group companies, in amount of PLN 220.2 million, higher by PLN 79.4 million, and interest on cash deposits in amount of PLN 68.1 million, higher by 37.0 million. Increase of financial revenues in 2010 was partially compensated by lower by PLN 187.1 million revenues from the revaluation of investment (reversal of a write-off made in previous years) in amount of PLN 190.6 million, including PLN 188.3 million for Exatel.

Amount and structure of total expenses

| Table 20. Total expenses (in PLN thousand) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|---|------------------------|------------------------|--------------|
| Total expenses | 11,523,156.1 | 12,319,309.6 | -6.5% |
| Cost of goods sold | 11,330,513.8 | 11,895,786.5 | -4.8% |
| Selling and general and administrative expenses | 114,675.1 | 156,088.1 | -26.5% |
| Other operating expenses | 15,914.6 | 56,005.0 | -71.6% |
| Financial expenses | 62,052.6 | 211,430.0 | -70.7% |

In 2010, the business activity expenses of PGE S.A. totalled PLN 11,523.2 million and were by 6.5% lower than in the previous year.

Cost of goods sold in 2010 amounted to PLN 11,330.5 million, what means decrease by 4.8% compared with 2009. The decrease of cost of goods sold was affected by lower costs of electricity purchases by PLN 457.6 million as compared to 2009. With the electricity purchase price higher by PLN 3.71/MWh as compared to the previous year, the lower cost of electricity purchase resulted from lower volume of the electricity purchased by 3.7 TWh. Higher electricity purchase price is a result of higher generation costs by producers, mainly resulting from growth of prices of raw materials and growth of costs of purchase of CO₂ allowances.

In 2010 total selling expenses of PGE S.A. amounted to PLN 7.9 million, what constituted a drop by PLN 53.8 million as compared to the previous year. The primary cause of the decrease was a limitation of the costs of reserving transmission capacities on Poland-Sweden connection.

The general and administrative expenses of PGE S.A. in 2010 amounted to PLN 106.8 million and were higher by PLN 12.4 million compared with the previous year. The growth of the general and administrative expenses was mainly caused by the increase in the marketing and public image expenses (advertisement and sponsoring expenses higher by more than PLN 5 million) and bearing of the costs related to the implementation of the Consolidation Programme (increase in advisory services expenses by ca. PLN 3 million).

In the other operating expenses in 2010, a provision for transmission costs was created in amount of PLN 11.7 million. In addition, in 2009 in connection with the revaluation, the provision for disputes with foreign contractor was increased by PLN 43.6 million in relation to the execution of commercial agreements, while in 2010 this provision was reversed in amount of PLN 11.5 million.

The decrease of financial expenses by PLN 149.4 million was mainly caused by lower costs of the issued bonds (interest + issue-related fees) by PLN 104.7 million and growth in 2009 of the write-off made for the revaluation of AWSA S.A. bonds by PLN 29.4 million.

The Company's assets

| Table 21. Assets (in PLN thousand) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|------------------------------------|------------------------|------------------------|--------------|
| Non-current assets | 23,220,770.4 | 23,499,499.3 | -1.2% |
| Intangible assets | 6,519.2 | 11,079.2 | -41.2% |
| Tangible fixed assets | 86,504.2 | 84,250.4 | 2.7% |
| Long-term receivables | 3,358.5 | 3,457.0 | -2.8% |
| Long-term investments | 22,903,348.3 | 23,161,628.4 | -1.1% |
| Long-term prepayments | 221,040.2 | 239,084.3 | -7.5% |
| Current assets | 8,782,136.7 | 5,561,287.7 | 57.9% |
| Inventory | 31,318.2 | 68,261.9 | -54.1% |
| Short-term receivables | 1,461,676.1 | 1,151,667.8 | 26.9% |
| Short-term investments | 7,163,168.2 | 4,318,862.4 | 65.9% |
| Short-term prepayments | 125,974.2 | 22,495.6 | 460.0% |
| Assets | 32,002,907.1 | 29,060,787.0 | 10.1% |

The non-current assets of PGE S.A. as at December 31, 2010 and December 31, 2009 amounted to PLN 32,002.9 million and PLN 29,060.8 million, respectively. The increase in the value of non-current assets by PLN 2,942.1 million was mainly caused by: (i) an increase by PLN 2,586.0 million in the value of long-term and short-term investments, including increase in value of shares by PLN 3,256.9

million and bonds issued by the Group companies by PLN 2,485.1 million, what caused (ii) drop in cash by PLN 3,001.8 million.

Increase in shares was mainly related to the purchases of shares of PGE Górnictwo i Energetyka S.A., PGE Obrót S.A., PGE Dystrybucja S.A. in amount of PLN 3,098.4 million from the State Treasury. The detailed description of the transaction is presented in Note VI. 9 of the Supplementary information and explanations to the financial statements of PGE for 2010.

As at December 31, 2010, the Company held bonds issued by PGE GiEK Branch Elektrownia Bełchatów, PGE GiEK Branch Elektrownia Turów, PGE GiEK Branch Zespół Elektrowni Dolna Odra, PGE GiEK Branch KWB Bełchatów, PGE GiEK Branch ZEC Bydgoszcz. The detailed description of the securities held by PGE S.A., in particular bonds, is presented in Note VI.20 of the Supplementary information and explanations to the financial statements of PGE for 2010. Through the issue of bonds, which are being purchased by PGE S.A., the Group companies are financing mainly investments in generation assets.

| Table 22. Liabilities and equity (in PLN thousand) | Period 1-12 of 2010 | Period 1-12 of 2009 | % change |
|--|------------------------|------------------------|--------------|
| Equity | 28,519,569.9 | 26,935,055.8 | 5.9% |
| Share capital | 18,697,837.3 | 17,300,900.0 | 8.1% |
| Capital of the subsidiaries to raise the capital of PGE S.A. | 0.0 | 1,396,937.3 | -100.0% |
| Own shares | -229.0 | 0.0 | |
| Reserve capital | 6,727,591.7 | 6,591,665.8 | 2.1% |
| Revaluation reserve | 3,692.6 | 3,695.1 | -0.1% |
| Other reserve capital | 49,779.3 | 0.0 | |
| Retained earnings - profit (loss) | 120,474.5 | 271,463.5 | -55.6% |
| Net profit (loss) | 2,920,423.5 | 1,391,030.9 | 109.9% |
| Appropriation of the net profit during the financial year (negative value) | | -20,636.8 | |
| Liabilities and provisions for liabilities | 3,483,337.2 | 2,125,731.2 | 63.9% |
| Provisions for liabilities | 418,826.5 | 405,369.1 | 3.3% |
| Long-term liabilities | 0.0 | 0.0 | |
| Short-term liabilities | 3,048,824.9 | 1,709,534.9 | 78.3% |
| Accruals | 15,685.8 | 10,827.2 | 44.9% |
| Liabilities and equity | 32,002,907.1 | 29,060,787.0 | 10.1% |

As at December 31, 2010 and as at December 31, 2009 the total equity of PGE S.A. amounted to PLN 28,519.6 million and PLN 26,935.1 million respectively, which constitutes 89.1% and 92.7% of the total equity and liabilities, respectively. In 2010 the share capital was increased by PLN 1,396.9 million as a result of merger of PGE S.A. with PGE Górnictwo i Energetyka S.A. and PGE Energia S.A. As a consequence of the merger, PGE S.A. purchased 22,898 own shares for PLN 579 thousand. More detailed description of the own shares is presented in chapter 1.5.

In addition, the increase in the total equity also resulted from the net profit achieved for the reporting period in amount of PLN 2,920,423.5 thousand.

The reserve capital was increased by PLN 136.3 million in accordance with the distribution of the profit for 2009. The remaining part of the result in amount of PLN 1,335.3 million was paid out to the shareholders of the Company in form of dividend.

Short-term liabilities increased by PLN 1,339.3 million as compared to the previous year. The increase was a result of: (i) increase by PLN 1,277.6 million of liabilities related to the debt securities issued, (ii) increase by PLN 177.0 million of short-term bank credits.

Funds obtained as a result of the issue of the short-term debt securities (bonds) by PGE, were intended mainly for expenses connected with the arrangement of the structure of shares held by the Company.

Decrease in trade liabilities by PLN 138.4 million in 2010 as compared to 2009 primarily resulted from decrease of the liabilities toward related entities, mainly relating to settlements for the purchase of electricity.

Cash flow statement

Total cash flows from the operating, investing, and financing activity in PGE S.A. as at December 31, 2010 amounted to PLN (-) 3,152.1 million.

The difference between the level of cash indicated in the balance sheet and that indicated in the cash-flow statement amounts to PLN (-) 9.0 million and mainly results from currency translation differences from the valuation of cash and cash equivalents (PLN (-)8.8 million) and from the change in the interests from deposits.

Net cash flows from the operating activity in 2010 amounted to PLN 324.2 million compared with PLN 468.8 million in 2009, which means a decrease by approximately 31%. The decrease is a result of lower result achieved on the trading of electricity as compared to the previous year. The decrease in the electricity trading was caused by: (i) increase in the unit cost of electricity purchase, and (ii) decrease in volume of the energy sold, what was described in detail in the previous chapters.

W 2010 cash flows from investing activity totalled PLN (-)3,547.2 million compared with positive cash flows in amount of PLN 585.4 million in 2009. The decrease in the net cash flows from investing activity by PLN 4,132.7 million in 2010 was mainly affected by expenses for the purchase of shares and expenses for the purchase of bonds issued by the companies from the Group.

In order to arrange the ownership structure, in 2010 and 2009 expenses for the purchase of shares in companies were born in PGE S.A. in amount of PLN 3,205.5 million and PLN 270.5 million, respectively.

The difference between the expenses incurred by PGE SA for the purchase of bonds issued by PGE Group companies and the inflows from their redemption amounted in 2010 to PLN (-) 2,264.9 million, as compared to PLN (-) 2.0 million in 2009.

Net cash from the financing activity in 2010 amounted to PLN 79.9 million, compared with the level of PLN 2,174.8 million in 2009. Lower cash flows from the financing activity in 2010 as compared to 2009 results mainly from the inflows in 2009 from the issuance of new shares of PGE S.A. on the Warsaw Stock Exchange, which amounted to PLN 5,917.5 million.

As a result of the issue of the bonds, PGE obtained net cash in amount of PLN 1,244.5 million in 2010, while in 2009 it beared expenses in amount of PLN (-) 2,002.3 million.

Expenses for dividend payment and profit distribution to the State Treasury in 2010 amounted to PLN 1,333.6 million, with expenses in amount of PLN 1,162.4 million in 2009.

In 2010, the net inflows from the credits in current accounts was recorded in amount of PLN 177.0 million, while in 2009 the credits in current account were repaid in amount of PLN (-) 437.8 million.

3.3. Financial ratios

| Table 23. Financial ratios | Period 1-12 2010 | Period 1-12 2009 |
|---|---------------------|---------------------|
| Return on sales ROS (in %) | | |
| Net profit x 100% / net revenues | 25.0% | 11.1% |
| Return on equity ROE ROE (in %) | | |
| Net profit x 100% / (equity – net profit) | 11.4% | 5.4% |
| Debt ratio (in %) | | |
| Liabilities x 100% / total equity and liabilities | 10.9% | 7.3% |
| Current ratio | | |
| Current assets / short-term liabilities | 2.9 | 3.3 |

3.4. Publication of financial forecasts

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

4. Management of financial resources and financial liquidity

After the successful stock market debut in November 2009, the Company held significant financial surpluses in 2010. Moreover, in 2010 PGE S.A. generated funds from operating activities, funds received from the dividends as well as from short-term credits and issues of bonds.

PGE S.A. allocated generated funds for financing of investments and refinancing of loans in companies from the Group by purchasing bonds issued by these companies, for arranging its ownership structure and for payment dividend to the shareholders from the profit for 2009.

| Table 24. Debt (in PLN thousand) | Period 1-12 of 2010 | Period 1-12 of 2009 | Change % |
|-------------------------------------|------------------------|------------------------|----------|
| Bank loans | 229,805.2 | 52,783.0 | 335.4% |
| Debt securities | 1,781,326.4 | 503,758.5 | 253.6% |
| Indebtedness | 2,011,131.6 | 556,541.5 | 261.4% |
| Cash | 259,447.3 | 3,411,515.8 | -92.4% |

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

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. Credit agreements, loans, and bond issuance programme

Current account credit agreements, concluded by PGE S.A. in 2007, were terminated successively in 2010.

In 2010 four current account credit agreements, in total amount of PLN 800 million, were concluded for 3 years from the signing dates. Specification of current account credit agreements is presented in the table below.

| Table 25. Credit agreements | Type of credit | Amount (in PLN thousand) | Reference rate |
|--|-----------------|-----------------------------|-------------------|
| Bank Handlowy w Warszawie S.A. | current account | 200,000.0 | WIBOR 1M + margin |
| Nordea Bank Polska S.A. | current account | 200,000.0 | WIBOR 1M + margin |
| Bank Pekao S.A. | current account | 200,000.0 | WIBOR 1M + margin |
| Bank Pekao S.A. | current account | 150,000.0 | WIBOR 1M + margin |
| Bank Societe Generale S.A. Poland Branch | current account | 200,000.0 | WIBOR 1M + margin |

As at December 31, 2010, value of borrowings in PGE S.A. amounted to PLN 229.8 million.

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.

As at December 31, 2010, the total nominal value of bonds issued under the programme amounted to PLN 1.8 billion.

On November 9, 2010 the Company signed two agreements concerning the bond issue programme. 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.

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

A detailed description of credits and issuances of debt securities is presented in Note VI.31-33 and 56.6 of the Supplementary information and explanations to the financial statements of PGE for 2010.

In 2010, in PGE S.A. granted two loans to its subsidiaries: PGE Systemy S.A. and PGE Inwest Sp. Z o.o., that amounted to PLN 3.6 million as at December 31, 2010.

A detailed description of loans is presented in note VI. 21 of the Supplementary information and explanations to the financial statements of PGE for 2010.

4.3. Guarantees

Guarantees granted by PGE Group companies are presented in Note VI.37 of the Supplementary information and explanations to the financial statements of PGE for 2010.

4.4. Significant off-balance sheet items

Significant off-balance sheet items are described in Note VI.4 of the Supplementary information and explanations to the financial statements of PGE for 2010.

4.5. 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, PGE S.A. become parties to various types of agreements and financial contracts subject to non-financial risks.

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

Interest rate risk - PGE S.A. finance their operating and investing activities partially from debts bearing floating interest rates or investments in financial assets bearing a floating or fixed interest rates. PGE S.A. is 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.

Liquidity risk – PGE S.A. runs active cash investment policy. This means that PGE S.A. monitor its financial surplus, forecast future cash flows and carry out its investment strategy on the basis thereof.

PGE's current liquidity is regulated mainly based on current account credits. PGE is responsible for coordination of the financial process of the Group, securing the Group companies with the source of investment financing on one side and possibility of allocation of surpluses on the other side. PGE issues bonds, which are acquired, without limitation, by entities with financial surplus. Funds from the issue are then used to purchase bonds issued by those of PGE Group companies that indicate need for external sources of financing.

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

Credit risk - a superior goal of credit risk management is to accept and control credit risk at a defined level which directly results from major business goals for electricity trading. PGE manages counterparty credit risk on the basis of the policy and procedure adopted in that area. In order to minimise the contractor's credit risk, the trading is executed within the limits granted on the ground of credit standing of the contractor. In case of customers with weak financial condition, trading may be subject to delivery of collateral. High recovery rate collaterals are preferred. Payments from contractors and credit exposure are monitored on current basis. In order to minimize losses connected with the lack of punctual payment from a contractor, the early debt collection system is applied.

Foreign currency risk - Currency risk is connected with the sale of finished products and the purchase of materials in foreign currencies and repayment and incurring of financial liabilities, which are expressed in foreign currencies.

PGE S.A. 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: purchase or sale of electricity denominated in foreign currencies or indexed to the exchange rates, financial assets (deposits) denominated in foreign currencies, capital investments (deposits) denominated in foreign currencies or indexed to the exchange rates.

Price risk - because of their business activity, PGE S.A. is exposed to the volatility of cash flows and financial results in the domestic currency due to changes in prices of electricity.

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

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

The activity of PGE and major PGE Capital Group companies, for which PGE is a parent company, as well as other entities operating in the electro energy sector, is exposed to a number of both external 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 S.A. and PGE Capital Group's activities are 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 S.A. and 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, CO₂ 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 and PGE S.A.

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

Income of PGE S.A. and Group's companies 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 PGE S.A. and Group companies.

6.2. Risk factors connected with regulatory and legal environment

6.2.1. Political risk

The activity of the PGE Group and PGE S.A. 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 and PGE S.A. 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 activity of PGE S.A and PGE Group 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 from than applied for. For the violation of obligations set forth in the Energy Law, the President of the Energy Regulatory Office may impose pecuniary fines of up to 15% of income earned by the entity subject to the fine (PGE S.A. or a Group company) in a previous tax year, and if the fine is related to the licensed activity, the fine may amount 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 core activity of PGE S.A and Group 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 PGE S.A. and 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 the application of the Excise Act

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

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

6.2.7. Risk connected with the programme of CO₂ emissions reduction

The electricity and heat generation at power plants and CHP plants fuelled with fossil fuels is connected with relatively high CO₂ emissions. Therefore, any regulations on the reduction of emission of CO₂ 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 CO₂ emission allowances under NAP II for 2008-2012 as compared to NAP I for 2005-2007 mean that CO₂ 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 CO₂ emission allowances for generators for 2013-2020. Additionally, according to the assumptions of the third settlement period, from 2020 free CO₂ emission allowances will not be granted

6.2.8. Risk of restrictions on emissions of substances other than CO₂ 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 CO₂, but NO_x, SO₂, 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 PGE and PGE Capital Group

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

The generation of electricity and heat by Group power plants, CHP plants and heat plants depends on fuel supplies, including lignite (in particular to generating units of Elektrownia Bełchatów and Elektrownia Turów), hard coal (in particular to generating units of PGE Elektrownia Opole S.A. and ZEDO), 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 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 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. It must be added that all the above phenomena are mostly unpredictable.

6.3.3. Risk relating to obtaining debt financing

A part of activities of PGE S.A. and The Group 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.

6.3.4. 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 and adversely affect the operating results and financial condition of PGE S.A. and PGE Group.

6.3.5. 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 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 cost 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.

6.3.6. 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 cannot preclude potential disputes with the tax authorities in this regard.

6.3.7. 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.

Over 100 company and inter-company trade unions are present in the PGE 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.

6.3.8. 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 CO₂ emission rights;
- availability of cross-border transmission capacities;
- 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;
- possible different decision in law, tax and other contingent liabilities disputes, from which most relevant were presented in Note VI.37 of the Supplementary information and explanations to the financial statements of PGE for 2010;
- 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;
- 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.;
- pace of changes being implemented as a result of the Consolidation Program;

- the pace of work in connection with the “Non-Energy Asset Management Concept in the PGE Capital Group”;
- arriving to the target organisational model of PGE Group and a strong corporate centre.

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 the strategy of PGE S.A. and of the Group, the Company intends to continue activities relating to the electricity wholesale trading in the domestic and international markets, and to render supporting services for the companies from the Group. In order to increase the transparency of the Group, costs reduction and efficiency improvement, pursuant to the decision of the Management Board of PGE S.A. on the merger with PGE Electra S.A., the merger was registered in the National Entry Register on December 31, 2010.

In 2011 PGE will coordinate 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 CO₂ allowances).

According to the business model of the Group, PGE S.A. will perform activities securing the financing of the key investments projects described above.

8. 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. PGE's 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> | 2010 | 2009 |
|--|--------------|----------------|
| Fee of KPMG Audyt Sp. z o.o., including: | 327.8 | 4,008.0 |
| 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 |

9. 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.

9.1. 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.

9.2. 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).

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

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

Basic regulations applicable to preparation of financial statements include: the Company's accounting policy, IFRS-compliant accounting policy of the PGE Capital Group, the procedure of closing accounting books and preparing consolidated financial statements of the PGE Capital Group in accordance with requirements of the Warsaw Stock Exchange. The IFRS-compliant accounting policy of the PGE Capital Group constitutes directives for companies subject to consolidation, which must be followed during preparation of IFRS-compliant reporting packages. 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.

9.4. 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).

9.5. Shareholders with special control powers

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

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

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

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.

9.6. Limitations regarding exercise of the voting rights in shares

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

9.7. Limitations regarding the transfer of ownership of the Company's securities

The 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).

9.8. Amendments to the Company's Statutes

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

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

Activities of the General Meeting are described in the Code of Commercial Companies and the Company's Statutes. The 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.

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.

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.

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

Activities of the Management Board and the Supervisory Board are regulated by the provisions of the Code of Commercial Companies, the Company's Statutes, the Rules of the Management Board and the Rules of the Supervisory Board. Activities of such authorities of PGE Polska Grupa Energetyczna S.A. are also subject to the corporate governance principles established by the Warsaw Stock Exchange. The Company's Statutes and the Rules of the Management Board and Rules of the Supervisory Board are available on the PGE's website at www.pgesa.pl

A. Management Board

Members of the Management Board

In 2010, the Management Board of the Company consisted of:

| Name and surname of the Member of the Management Board | Position |
|---|--|
| 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:

| Name and surname of the member of the Supervisory Board | Function |
|--|---|
| 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 Szmuniewski | 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:

| Name and surname | Function |
|---------------------------------|------------------|
| 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:

| Name and surname | Function |
|---------------------------------|------------------|
| 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:

| Name and surname | Function |
|---------------------------------|------------------|
| 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 |

10. Statements of the Management Board

10.1. Statement on the reliable preparation of the financial statements

To the best knowledge of the Management Board of PGE Polska Grupa Energetyczna S.A., the annual 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.

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

The Management Board of PGE Polska Grupa Energetyczna S.A. declares that the entity authorised to audit the financial statements, which audits the annual 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*