Management Board's Report on activities of the Capital Group of PGE Polska Grupa Energetyczna S.A.

for the year 2011

Selected consolidated financial data of PGE Capital Group

	12-month period ended December 31,		12-month period ended December 31,	
	2011 (audited)	**2010** (audited) data restated	**2011** (audited)	**2010** (audited) data restated
	PLN thousand		**EUR thousand**	
Sales revenues	28,111,354	20,471,430	6,790,018	5,112,234
Net profit/loss from operating activities	4,144,480	4,149,236	1,001,058	1,036,169
Gross profit/loss (before taxation)	6,165,394	4,240,153	1,489,190	1,058,873
Net profit/loss for the reporting period	4,972,614	3,597,848	1,201,085	898,474
Net profit attributable to equity holders of the parent company	4,936,095	2,990,269	1,192,265	746,746
Total income	4,978,265	3,599,685	1,202,450	898,932
Net cash from operating activities	6,942,012	6,610,960	1,676,774	1,650,924
Net cash from investing activities	(3,326,656)	(7,468,274)	(803,521)	(1,865,017)
Net cash from financial activities	(2,311,313)	(4,111,761)	(558,275)	(1,026,811)
Net change in cash and cash equivalents	1,304,043	(4,969,075)	314,979	(1,240,904)
Net earnings per share (in PLN/EUR per share)	2.64	1.68	0.64	0.42
Diluted earnings per share (in PLN/EUR per share)	2.64	1.68	0.64	0.42
Weighted average number of shares (issued ordinary shares used for calculation of EPS)	1,869,760,829	1,776,646,943	1,869,760,829	1,776,646,943
	As at December 31, 2011 (audited)	**As at December 31, 2010** (audited) data restated	**As at December 31, 2011** (audited)	**As at December 31, 2010** (audited) data restated
Non-current assets	44,444,933	44,137,422	10,062,700	11,144,969
Current assets	14,317,698	9,742,569	3,241,645	2,460,058
Total assets	58,762,631	53,879,991	13,304,345	13,605,028
Equity	41,173,260	37,554,665	9,321,966	9,482,783
Equity attributable to equity holders of the parent	40,758,868	36,958,707	9,228,144	9,332,300
Share capital	18,697,837	18,697,837	4,233,345	4,721,318
Long-term liabilities	7,215,966	7,471,585	1,633,754	1,886,621
Short-term liabilities	10,373,405	8,853,741	2,348,625	2,235,624
Number of shares	1,869,760,829	1,869,760,829	1,869,760,829	1,869,760,829
Book value per share (in PLN/EUR per share)	21.80	19.77	4.94	4.99
Diluted book value per share (in PLN/EUR per share)	21.80	19.77	4.94	4.99

Selected financial data of PGE Polska Grupa Energetyczna S.A.

	12-month period ended December 31,		12-month period ended December 31,	
	2011 (audited)	**2010** (not audited) data restated	**2011** (audited)	**2010** (not audited) data restated
	PLN thousand		**EUR thousand**	
Sales revenues	10,137,893	11,663,346	2,448,707	2,912,633
Net profit/loss from operating activities	178,842	207,637	43,197	51,852
Gross profit/loss (before taxation)	4,962,859	2,990,102	1,198,729	746,704
Net profit/loss for the reporting period	4,556,115	2,904,878	1,100,484	725,422
Total income	4,556,420	2,904,959	1,100,558	725,442
Net cash from operating activities	(50,938)	324,038	(12,304)	80,920
Net cash from investing activities	4,120,181	(3,547,228)	995,189	(885,833)
Net cash from financial activities	(3,309,422)	79,944	(799,358)	19,964
Net change in cash and cash equivalents	759,820	(3,143,246)	183,527	(784,948)
Net earnings per share (in PLN/EUR per share)	2.44	1.55	0.59	0.39
Rozwodniony zysk na akcję (w PLN/EUR na akcję)	2.44	1.55	0.59	0.39
Weighted average number of shares (issued ordinary shares used for calculation of EPS)	1,869,760,829	1,869,760,829	1,869,760,829	1,869,760,829

	As at December 31, 2011 (audited)	**As at December 31, 2010** (not audited) data restated	**As at December 31, 2011** (audited)	**As at December 31, 2010** (not audited) data restated
Non-current assets	27,678,869	23,357,536	6,266,725	5,897,921
Current assets	5,353,189	8,530,119	1,212,006	2,153,907
Total assets	33,032,058	31,887,655	7,478,731	8,051,828
Equity	31,782,100	28,441,460	7,195,730	7,181,643
Share capital	18,697,837	18,697,837	4,233,345	4,721,318
Long-term liabilities	18,784	21,411	4,253	5,406
Short-term liabilities	1,231,175	3,424,784	278,748	864,779

Above financial data for the 12-month period ended December 31, 2011 and December 31, 2010 were converted into EUR according to the following rules:

- particular items of the assets and liabilities – according to average exchange rate published by the National Bank of Poland as of December 31, 2011 – EUR/PLN 4.4168 and as of December 31, 2010 - EUR/PLN 3.9603,
- particular items of statement of comprehensive income and statement of cash flows – according to the exchange rate constituting an arithmetic average of average exchange rates set out by the National Bank of Poland at the end of every month of the reporting period – from January 1, 2011 till December 31, 2011 - EUR/PLN 4.1401; from January 1, 2010 till December 31, 2010 - EUR/PLN 4.0044.

CONTENTS

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

1.1. Organisation of the Capital Group

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

PGE Polska Grupa Energetyczna S.A. („PGE S.A.", the „Company") does not have branches.

As at December 31, 2011 the following PGE Group companies had its branches:

- PGE Górnictwo i Energetyka Konwencjonalna S.A. („PGE GiEK S.A.") with its registered office in Bełchatów:
  - Branch Elektrownia Bełchatów,
  - Branch Elektrownia Turów,
  - Branch Kopalnia Węgla Brunatnego Bełchatów,
  - Branch Kopalnia Węgla Brunatnego Turów,
  - Branch Zespół Elektrowni Dolna Odra,
  - Branch Zespół Elektrociepłowni Bydgoszcz,
  - Branch Elektrociepłownia Gorzów,
  - Branch Elektrociepłownia Kielce,
  - Branch Elektrociepłownia Lublin Wrotków,
  - Branch Elektrociepłownia Rzeszów,
  - Branch Elektrociepłownia Zgierz.
- PGE Energia Odnawialna S.A. with its registered office in Warsaw:
  - Branch EW Żarnowiec in Czymanów,
  - Branch ZEW Dębe in Dębe,
  - Branch ZEW Dychów in Dychowie,
  - Branch ZEW Porąbka - Żar in Międzybrodzie Bialskie,
  - Branch ZEW Solina - Myczkowce in Solina.
- PGE Obrót S.A. with its registered office in Rzeszów:
  - Branch with its registered office in Białystok,
  - Branch with its registered office in Lublin,
  - Branch I with its registered office in Łódź,
  - Branch II with its registered office in Łódź,
  - Branch with its registered office in Skarżysko-Kamienna,
  - Branch with its registered office in Warsaw,
  - Branch with its registered office in Zamość.
- PGE Dystrybucja S.A. with its registered office in Lublin:
  - Branch Białystok,
  - Branch Lublin,
  - Branch Łódź – Miasto,
  - Branch Łódź – Teren,
  - Branch Rzeszów,
  - Branch Skarżysko – Kamienna,
  - Branch Warszawa,
  - Branch Zamość.
- Niepubliczny Zakład Opieki Zdrowotnej „MegaMed" sp. z o.o. with its registered office in Bełchatów:
  - Branch Centrum Medyczne Turów with its registered office in Bogatynia,
  - Branch Zakład Usług Medycznych Dolna Odra with its registered office in Nowe Czarnowo,
  - Branch Zakład Usług Profilaktyczno-Leczniczych MEGAVITA with its registered office in Brzezie.
- Elbest sp. z o.o. with its registered office in Bełchatów:
  - Branch Bogatynia,
  - Branch Dychów,

  - Branch Iwonicz-Zdrój,
  - Branch Krasnobród,
  - Branch Rogowiec,
  - Branch Wawrzkowizna.

- Przedsiębiorstwo Transportowo - Sprzętowe „Betrans" sp. z o.o. with its registered office in Bełchatów:
  - Branch ELTUR-TRANS with its registered office in Bogatynia,
  - Branch Rogowiec with its registered office in Rogowiec.

- ELECTRA Deutschland GmbH with its registered office in Hamburg:
  - Branch Prague,
  - Branch Bratislava.

Other Group companies do not have branches.

On January 2, 2012 the Elbest sp. z o.o. Branch Wawrzkowizna II was registered.

1.2. Description of the activity of PGE Capital Group

The Group currently organizes its activities in five business lines:

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

1.3. Changes in management rules in the Company and in the Capital Group

No significant changes in management rules in PGE took place in 2011.

The transformations were accomplished in PGE Group companies in hotel- security- services area i.a.

- merger of PTS Betrans sp. z o.o. with its registered office in Rogowiec (acquiring company) with Przedsiębiorstwo Transportowe ELTUR-TRANS sp. z o.o. with its registered office in Bogatynia (acquired company);

- merger of Elbest sp. z o.o. with its registered office in Rogowiec (acquiring company) with BESTUR sp. z o.o. with its registered office in Bełchatów, PHU Global-Tur sp. z o.o. with its registered office in Bogatynia, Energetyk SPA sp. z o.o. with its registered office in Iwonicz-Zdrój, Centrum Szkolenia i Rekreacji Energetyk sp. z o.o. with its registered office in Krasnobród, Media-Serwis Dychów sp. z o.o. with its registered office in Dychów (acquired companies);

- division of Elbest sp. z o.o. and PTS Betrans sp. z o.o.

Detailed description of the transformations is presented in p. 1.4. Changes in organisation of the Capital Group.

Main changes in organisation and management rules in PGE and in PGE Capital Group occurred in 2009-2010, when Consolidation Programme was carried out in PGE Capital Group. Additional information on the above Programme is presented in p. 7.2 Consolidation Programme.

1.4. Employment

As at December 31, 2011 the employment in PGE Capital Group amounted to 44,250.36 FTEs, which was by 1,065.19 FTEs less than as at December 31, 2010. The biggest employment was recorded by companies from the Conventional Generation segment, which constituted approximately 49% of total employment of the Capital Group.

Employees with the secondary education represent approximately 41% of total number of employees. Approximately 25% of employees has university education, 34% of employees has vocational or lower education.

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

in FTEs	**FTEs December 31, 2011**	**FTEs December 31, 2010***	**% change**
Total employment of PGE Group, including:	**44,317.36**	**45,382.55**	*-2%*
Conventional Generation	21,693.39	22,314.43	*-3%*
Renewable Energy......................	521.60	543.08	*-4%*
Wholesale Trading	350.11	370.71	*-6%*
Distribution	12,072.54	12,519.26	*-4%*
Retail Sales................................	1,635.18	1,793.98	*-9%*
Other consolidated companies.....	8,044.54	7,841.09	*3%*

** without suspended persons*
*** data restated*

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

1.5.1. Share capital and ownership structure

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

Table: Share capital of the Company.

Series/ issue	**Type of shares**	**Type of preference**	**Number of shares**	**Value of series/issue at nominal value**	**Capital payment method**
"A"	ordinary	n/a	1,470,576,500	14,705,765,000.00	Contribution in kind/cash
"B"	ordinary	n/a	259,513,500	2,595,135,000.00	cash
"C"	ordinary	n/a	73,241,482	732,414,820.00	merger with PGE GiE S.A.
"D"	ordinary	n/a	66,452,245	664,522,450.00	merger with PGE Energia S.A.
Total			**1,869,783,727**	**18,697,837,270**	

Table: Ownership structure of the Company's share capital as at December 31, 2011*.

	State Treasury		**Other shareholders***		**Total**	
	Nominal value of shares	% share in the share capital and votes	Nominal value of shares	% share in the share capital and votes	Nominal value of shares	% share in the share capital and votes
As at December 31, 2011	12,956,379,520	69.29	5,741,457,750**	30.71	18,697,837,270	100.00

** Ownership structure on the basis of information known to the Company.*
***Nominal value of shares owned by other shareholders include own shares of the parent company*

All of the Company shares have been paid.

Although the Company's shares are not privileged, the Statutes of the Company provide for special rights of the State Treasury until it remains a shareholder of the Company (see Note 31.2 to the consolidated financial statements).

As at the date of this report, following the sale of 7.01% in the Company, the stake of the State Treasury in the share capital decreased to 61.89%.

1.5.2. Own shares

As a result of the merger of PGE S.A. with PGE GiE S.A. and PGE Energia S.A., PGE S.A. purchased 22,898 own shares for PLN 579 thousand. The shares were purchased, because the application of the exchange parity caused that the shareholders of the acquired companies should have received fractional parts of the shares. As that is not possible, during the granting of the Company's shares, the down roundings were applied with regard to the number of the Company's shares due to the shareholders of the acquired companies. The fractional part of the due share was paid out as 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.

As at December 31, 2011 the following PGE Group companies held their own shares:

- PGE Obrót S.A. – 884 own shares purchased through squeeze-out pursuant to art. 418^1 § 4 of the Polish Commercial Companies Code. The shares were purchased for redemption.
- PGE Dystrybucja S.A. – 28 own shares purchased free of charge in connection with the applied exchange parity of shares and 91,849 shares purchased at price of PLN 13.91 per share. The shares were purchased for redemption and in order to fulfil the provisions of art. 418^1 of the Polish Commercial Companies Code.
- PGE Górnictwo i Energetyka Konwencjonalna S.A. – 25,422 own shares purchased free of charge from the shareholders on their requests pursuant to art. 418^1 of the Polish Commercial Companies Code or on the ground of the company's statutes, purchased for redemption.

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

According to the best knowledge of the Management Board of the Company, members of management and supervisory authorities of the Company as of the date of submission of this report and as of the date of publishing of the consolidated report for the third quarter of 2011 had following number of shares:

Shareholder	Number of shares as of date of publishing of the consolidated report for Q3 2011 (i.e. Nov 14, 2011) (pieces)	Change in number of owned shares (pieces)	Number of shares as of submission date of the annual report (pieces)
The Management Board	**0**	**no change**	**0**
The Supervisory Board	**623**	**no change**	**623**
Grzegorz Krystek	350	no change	350
Katarzyna Prus	273	no change	273

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

Company	Name and surname	Position	Number of shares
PGE Górnictwo i Energetyka Konwencjonalna S.A.	Jacek Kaczorowski	President of the Management Board	1,390
	Roman Forma	Vice-President of the Management Board	662
	Waldemar Szulc	Vice-President of the Management Board	5,090
	Krzysztof Domagała	Vice-President of the Management Board	7,869
PGE Elektrownia Opole S.A.	Jan Pilipionek	Member of the Management Board	5,525
	Czesław Łukowski	Proxy	5,570
PWE Gubin sp. z o.o.	Cezary Bujak	Member of the Management Board	299

1.6. Changes in organisation of the Capital Group

The changes, which occurred in the Group's structure during 12-month period ended December 31, 2011 are presented in Note 2 to consolidated financial statements and described below.

Shares in subsidiaries and associates

In 2011 PGE S.A. changed its equity interest in the following entities:

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

– on February 24, 2011 PGE Polska Grupa Energetyczna S.A. purchased 17 inscribed shares of PGE Obrót S.A. from its minority shareholders (constituting 0.0003% of the share capital of the company),

– on May 30, 2011 PGE Polska Grupa Energetyczna S.A. purchased 17 inscribed shares of PGE Obrót S.A. from its minority shareholder (constituting 0.0003% of the share capital of the company),

– on June 6, 2011 Polska Grupa Energetyczna S.A. purchased 17 inscribed shares of PGE Obrót S.A. from its minority shareholder (constituting 0.0003% of the share capital of the company),

– on July 29, 2011, the General Meeting of Shareholders decided to increase the share capital of PGE Systemy S.A. from PLN 1,500,000 to PLN 5,000,000 PLN i.e. by PLN 3,500,000. 350,000 newly created series C shares with a nominal value of PLN 10 each, were acquired by the sole shareholder of the company i.e. PGE Polska Grupa Energetyczna S.A. The increase of the share capital was registered on October 10, 2011.

– on September 8, 2011, the General Meeting of Shareholders decided to increase the share capital of PGE Energia Jądrowa S.A. from PLN 62,500,000 to PLN 87,500,000 PLN i.e. by PLN 25,000,000 PLN. 1,000,000 newly created series B shares with a nominal value of PLN 25 each, were acquired by the sole shareholder of the company i.e. by PGE Polska Grupa Energetyczna S.A. The increase of the share capital was registered on October 10, 2011.

– on September 8, 2011, the General Meeting of Shareholders decided to increase the share capital of PGE EJ1 sp. z o.o. (in which PGE Energia Jądrowa S.A. holds 51% of shares, and PGE S.A. holds 49%) from PLN 38,000,000 to PLN 73,000,000 PLN, i.e. by PLN 35,000,000. PGE Energia Jądrowa S.A. acquired 357,000 newly created shares with a nominal value of PLN 50 each, and PGE Polska Grupa Energetyczna S.A. acquired 343,000 newly created shares with a nominal value of PLN 50 each. The increase of the share capital was registered on October 20, 2011.

– in the third quarter of 2011 PGE Polska Grupa Energetyczna S.A. acquired from the minority shareholders a total number of 9,170 inscribed shares of PGE Górnictwo i Energetyka Konwencjonalna S.A. (constituting in total 0.0014% share in the share capital of the company). The purchase of inscribed shares by PGE S.A. resulted from the Privatisation agreement, upon which the employees of PGE Elektrociepłownia Bydgoszcz S.A. (currently PGE GiEK S.A.) are entitled to sell the allotted block of shares to the majority shareholder.

- on October 27, 2011 PGE Polska Grupa Energetyczna S.A. purchased from the State Treasury:
  - 82,479 shares of PGE Elektrownia Opole S.A., constituting 8.25% of the company's share capital;
  - 44,087 shares of PGE Górnictwo i Energetyka Konwencjonalna S.A., constituting 0.0068% of the company's share capital;
  - 24,423 shares of PGE Dystrybucja S.A., constituting 0.0025% of the company's share capital;
  - 96 shares of PGE Obrót S.A., constituting 0.0019% of the company's share capital.
- on November 3, 2011 PGE Polska Grupa Energetyczna S.A. purchased from the State Treasury stake in Zakłady Pomiarowo-Badawcze Energetyki "Energopomiar" sp. z o.o. with nominal value of PLN 481,881.26, constituting 8.95% of the company's share capital.
- on November 9, 2011 PGE Polska Grupa Energetyczna S.A. sold 4,479,191 ordinary registered shares of Polkomtel S.A with a nominal value of PLN 100 per share, representing 21.85% of the total number of votes at Polkomtel S.A.'s general meeting. The transfer of shares took place on the basis of the agreement or the sale of Polkomtel S.A.'s shares, which was in performance of the preliminary agreement for the sale of 100% of Polkomtel S.A.'s shares signed on June 30, 2011 between PGE, Polski Koncern Naftowy ORLEN S.A., KGHM Polska Miedź S.A., Vodafone Americas Inc, Vodafone International Holdings B.V. and Węglokoks S.A. as the sellers and Spartan Capital Holdings Sp. z o.o. as the purchaser.

On March 30, 2011 the register court registered the liquidation of PGE Inwest Spółka z ograniczoną odpowiedzialnością II spółka komandytowo-akcyjna (in connection with the resolution of the Assembly of Partners dated March 18, 2011).

On October 27, 2011 the Extraordinary Meeting of Shareholders of PGE Serwis Sp. z o.o. with its registered office in Warsaw decided to dissolve the company and appointed a liquidator.

On December 30, 2011 datio in solutum agreement was signed between PGE Polska Grupa Energetyczna S.A. and PGE Energia Odnawialna S.A., that settles the dividend liability of PGE Energia Odnawialna S.A. towards PGE Polska Grupa Energetyczna S.A. On the ground of the above agreement, after fulfilment of its provisions, the ownership right of 103,196 ordinary registered shares of PGE Górnictwo i Energetyka Konwencjonalna S.A. (representing 0.016% of the share capital) will be transferred to PGE Polska Grupa Energetyczna S.A. in order to release PGE Energia Odnawialna S.A. from the commitment to pay part of the due dividend.

In 12-month period ended December 31, 2011 PGE Group companies increased their capital exposure in the following entities:

- on January 19, 2011 a share capital increase was registered for Energetyczne Towarzystwo Finansowo-Leasingowe Energo-Utech S.A. (a company in which PGE Energia Odnawialna S.A. holds 50% in the share capital) by PLN 10,000,000 (PLN 5,000,000 by each shareholder) by issue of 1,000 inscribed series C shares with a nominal value of PLN 10,000 (current value of the share capital amounts to PLN 22,400,000).
- on January 26, 2011 NOM Sp. z o.o. bought the minority stake in Energo-Tel S.A. (buyout of the minority shareholder who held 0.1% in the share capital). As a result of the transaction the share of NOM Sp. z o.o. in the share capital of Energo-Tel S.A. increased to 48.9%.
- on February 11, 2011 a share capital increase was registered for Eolica Wojciechowo Sp. z o.o. The company's share capital was increased from PLN 3,550,000 to PLN 9,550,000 i.e. by PLN 6,000,000 through creation of 12,000 new shares with a nominal value of PLN 500 each. New shares from the increased capital were acquired in half by partners: PGE Energia Odnawialna S.A. and Greentech Energy Systems A/S.
- on February 18, 2011 a share capital increase was registered for Biogazownia Wożuczyn Sp. z o.o. from PLN 250,000 to PLN 3,700,000, i.e. by PLN 3,450,000. Newly created shares were acquired by PGE Energia Odnawialna S.A.

- on February 18, 2011 a share capital increase was registered for Biogazownia Łapy Sp. z o.o. from PLN 250,000 to PLN 3,700,000, i.e. by PLN 3,450,000. Newly created shares were acquired by PGE Energia Odnawialna S.A.
- on March 31, 2011 the merger of Przedsiębiorstwo Transportowo Sprzętowe Betrans Sp. z o.o. with its registered office in Rogowiec (acquiring company) with Przedsiębiorstwo Transportowe ELTUR-TRANS Sp. z o.o. with its registered office in Bogatynia (acquired company) was registered. The merger took place by way of transferring all assets of the acquired company to the acquiring company in exchange for the shares in the increased share capital of the acquiring company. The shares were assigned to the partner of the acquired company. As a result of the merger the share capital of „Betrans" Sp. z o.o. amounting to PLN 8,773,000 was increased by PLN 6,096,500 i.e. to PLN 14,869,500 through creation of 12,193 new shares with a nominal value of PLN 500 each (merger shares).
- on April 26, 2011 Energetyczne Towarzystwo Finansowo-Leasingowe Energo-Utech S.A. signed share purchase agreement to buy 50 shares of ENERGOUTECH 2 Sp. z o.o. with nominal value of PLN 100 each for total consideration of PLN 5,000 for all stakes. On April 26, 2011 the company acquired 450 new shares with nominal value of PLN 100 each, i.e. with total value of PLN 45,000, in share capital of ENERGOUTECH 2 sp. z o.o. that was increased to PLN 50,000. Currently the company owns 100% stake in share capital of ENERGOUTECH 2 Sp. z o.o.
- on April 29, 2011 the merger of Elbest Sp. z o.o. with registered office in Rogowiec (acquiring company) with: BESTUR Sp. z o.o. with registered office in Bełchatów, PHU Global-Tur Sp. z o.o. with registered office in Bogatynia, Energetyk SPA Sp. z o.o. with registered office in Iwonicz-Zdrój, Centrum Szkolenia i Rekreacji Energetyk Sp. z o.o. with registered office in Krasnobród, Media-Serwis Dychów Sp. z o.o. with registered office in Dychów (acquired companies), realised pursuant to art. 492 sec. 1 p. 1 of the CCC, was registered. As a result of the merger, which is a consequence of reorganization of hotel- security- services area within PGE capital group, share capital of Elbest sp. z o.o. was increased to PLN 123,895,000. Shareholding structure of Elbest sp. z o.o. is as follows: PGE Górnictwo i Energetyka Konwencjonalna S.A. – 91.19%, PGE Dystrybucja S.A. – 7.60%, PGE Obrót – 1.12% and PGE Energia Odnawialna S.A. – 0.09%.
- on June 13, 2011 companies EO Baltica Sp. z o.o. and Elektrownia Wiatrowa Resko Sp. z o.o. established 3 SPVs: Elektrownia Wiatrowa Baltica 1 Sp. z o.o., Elektrownia Wiatrowa Baltica 2 Sp. z o.o. and Elektrownia Wiatrowa Baltica 3 Sp. z o.o. Elektrownia Wiatrowa Resko Sp. z o.o. acquired 5% of shares in each of 3 companies (i.e. 80 shares with nominal value of PLN 500 each, with total value of PLN 40,000 in each of abovementioned companies). The companies were registered in National Court Register respectively on July 22, 2011, August 9, 2011 and August 4, 2011.
- on July 4, 2011 the General Meeting of Shareholders decided to increase the share capital of Elektrownia Wiatrowa Resko sp. z o.o. from PLN 8,640,000 to PLN 30,140,000 i.e. by PLN 21,500,000. 21,500 shares with a nominal value of PLN 1,000 each were acquired by the sole shareholder of the company i.e. PGE Energia Odnawialna S.A. The increase of the share capital was registered on October 24, 2011.
- on September 12, 2011 PGE Energia Odnawialna S.A. acquired, by way of compulsory buyout, a block of 200 series A inscribed shares of Bio-Energia S.A. with a nominal value of PLN 20,000 PLN (owned by of Zakład Innowacyjny Technik Energetycznych „PROMAT" Sp. z o.o.) at a price of PLN 85 per one share (i.e. PLN 17,000 for the whole block of shares). On September 14, 2011, due to completion of compulsory buyout and in connection with the payment for shares to the shareholders not participating in the conversion of „BIO-ENERGIA ESP" sp. z o.o. into a joint stock company, the Management Board of Bio-Energia S.A. proposed to PGE Energia Odnawialna S.A. to buy 340 company's shares not taken up during the conversion process. These shares were not taken up by the former partners, who did not join the transformed company. According to the conversion plan Bio-Energia S.A. paid out PLN 29,954.00 for the shares (i.e. PLN 88.10 per share). On October 25, 2011 the transfer of the ownership (purchase from Bio-Energia S.A.) of 340 shares not taken up during the above mentioned process of conversion into the joint stock company. On November 14, 2011 PGE Energia Odnawialna S.A. was filed in National Court Register as the shareholder with 100% share in the company's share capital.
- on December 12, 2011 a share capital increase was registered in National Court Register for MEGA Sp. z o.o. from PLN 3,395,600 to PLN 11,585,600 i.e. by PLN 8,190,000, resulting from

the provisions of the settlement proceeding (conversion of receivables into shares). After the share capital increase PGE Energia Odnawialna S.A. holds 75.01% in the company's share capital.

In 12-month period ended December 31, 2011 PGE Group companies reduced their capital exposure in the following entities:

- on March 22, 2011 PGE Elektrownia Opole S.A. concluded an agreement, according to which it agreed for redemption and sold to Eltrans Sp. z o.o. with its registered office in Brzezie all shares possessed in that company, i.e. 384 shares, constituting 40% of the share capital and the company purchased these shares for redemption. After the transaction PGE Elektrownia Opole S.A. is no longer a partner in the company.
- on March 22, 2011 PGE Elektrownia Opole S.A. concluded an agreement, according to which it agreed for redemption and sold to Energotest-Diagnostyka Sp. z o.o. with its registered office in Brzezie all shares possessed in that company, i.e. 26 shares, constituting 26% of the share capital and the company purchased these shares for redemption. After the transaction PGE Elektrownia Opole S.A. is no longer a partner in the company.
- on April 15, 2011 PGE Obrót S.A. concluded an agreement to sell all the shares owned by the company in Zamojskie Przedsiębiorstwo Usługowo-Produkcyjne "Energozam" Sp. z o.o. with registered office in Zamość, constituting 42.59% in share capital of this company.
- on July 4, 2011 the Supervisory Board of PGE Obrót S.A. issued its approval for sale of the whole, owned by PGE Obrót S.A., block of shares in Przedsiębiorstwo Wielobranżowe ATEX sp. z o.o. with its registered office in Zamość, i.e. 171,125 shares constituting 43.83% in the share capital of the abovementioned company, to Dalkia Term S.A. with its registered office in Warsaw (majority shareholder in Przedsiębiorstwo Wielobranżowe ATEX sp. z o.o.). On October 6, 2011 the conditional agreement for the sale of shares owned by PGE Obrót S.A. to Dalkia Term S.A. (majority shareholder in Przedsiębiorstwo Wielobranżowe ATEX sp. z o.o.) was signed for the price of PLN 14,000,000. On December 1, 2011 all shares in PW ATEX Sp. z o.o. were sold to Dalkia Term S.A.
- on December 29, 2011, on the ground of the sale agreement, PGE Dystrybucja S.A. sold 100% shares of Pracownia Projektowa ENSPRO Sp. z o.o. to Elektromontaż Wschód sp. z o.o. with its registered office in Białystok.

On December 15, 2010 the General Meeting of Shareholders of Electra Slovakia s.r.o. adopted a resolution on liquidation of the company. On January 25, 2011 the liquidation was entered into commercial register and from that date company has been using a firm Electra Slovakia s.r.o. in liquidation.

On February 23, 2011 the Extraordinary Assembly of Partners of Pensjonat Dychów sp. z o.o. (100% owned by PGE Energia Odnawialna S.A.) decided to liquidate the company. The application for liquidation was submitted at the Regional Court in Zielona Góra on March 11, 2011. On May 10, 2011 the court dismissed the application.

On March 14, 2011 the Extraordinary Assembly of Partners of ESP-Usługi sp. z o.o. (100% owned by PGE Energia Odnawialna S.A.) decided to dissolve and liquidate the company. On April 21, 2011 the resolution was registered in National Court Register.

On March 31, 2011 the conversion of Bio-Energia ESP sp. z o.o. into the joint stock company was registered – current name is Bio-Energia S.A. PGE Energia Odnawialna S.A., in way of compulsory buyout, made payment for buyout price of 200 registered series A shares of BIO-ENERGIA S.A. with nominal value of PLN 20,000.00 (property of Zakład Innowacyjny Technik Energetycznych „PROMAT" Sp. z o.o.) at price of PLN 85.00 per share (i.e. PLN 17,000 PLN for the whole package). On October 25, 2011 the transfer of the ownership (purchase from Bio-Energia S.A.) of 340 shares not taken up during the above mentioned process of conversion into the joint stock company. On November 14, 2011 PGE Energia Odnawialna S.A. was filed in National Court Register as the shareholder with 100% share in the company's share capital.

On March 31, 2011 the change of names of the branches of PGE Energia Odnawialna S.A. was registered:

- PGE Energia Odnawialna S.A. Branch in Solina changed to PGE Energia Odnawialna S.A. Branch ZEW Solina – Myczkowce in Solina,
- PGE Energia Odnawialna S.A. Branch in Międzybrodzie Bialskie changed to PGE Energia Odnawialna S.A. Branch ZEW Porąbka – Żar in Międzybrodzie Bialskie,
- PGE Energia Odnawialna S.A. Branch in Czymanowo changed to PGE Energia Odnawialna S.A. Branch EW Żarnowiec in Czymanowo,
- PGE Energia Odnawialna S.A. Branch in Dychów changed to PGE Energia Odnawialna S.A. Branch ZEW Dychów in Dychów.

On November 30, 2011 Branch Dębe in Dębe, owned by PGE Energia Odnawialna S.A., was registered in National Court Register.

On May 9, 2011 the bankruptcy proceedings of Wind 1 Koszalin sp. z o.o. were completed (the bankruptcy court's decision was validated on June 4, 2011). On June 14, 2011, the company was deleted from National Court Register.

A division plan, involving the transfer of Zakład Transportu, an organised part of enterprise ELBEST sp. z o.o. to PTS BETRANS sp. z o.o., was signed on June 22, 2011. On June 27, 2011 abovementioned division plan was submitted to the Regional Court for Łódź-Śródmieście in Łódź. On August 31, 2011, as a result of the court's decision, the split of Elbest sp. z o.o. was completed. The split of Elbest sp. z o.o. (split company) was carried out by way of transferring of the organized part of enterprise (transportation enterprise) to PTS BETRANS sp. z o.o. (acquiring company) through separation pursuant to art. 529 § 1 p. 4 of the Commercial Companies Code, based on the resolutions of the General Meetings of both companies dated August 23, 2011. As a result of the acquisition of the transportation enterprise, the share capital of PTS BETRANS sp. z o.o. was increased by contribution in kind in amount of PLN 2,691,000 and it amounts to PLN 17,560,500. The share capital of Elbest sp. z o.o. was decreased to PLN 119,904,000 i.e. by PLN 3,991,000. The current ownership structure in PTS BETRANS sp. z o.o. is as follows: PGE GiEK S.A. – 98.65%, PGE Dystrybucja S.A. – 1.16%, PGE Obrót S.A. – 0.17% and PGE Energia Odnawialna S.A. – 0.01%, and in Elbest sp. z o.o.: PGE GiEK S.A. – 91.19%, PGE Dystrybucja S.A. – 7.60%, PGE Obrót S.A. – 1.12% and PGE Energia Odnawialna S.A. – 0.09%.

On September 30, 2011 the merger plan of PGE Energia Odnawialna S.A. (acquring company) and Elektrownia Wiatrowa Kamieńsk sp. z o.o. and Dychowskie Przedsiębiorstwo Eksploatacji Elektrowni „ELDEKS" sp. z o.o. (acquired companies) was submitted to the court. The merger was carried out by way of acquisition of the acquired companies pursuant to article 492 § 1 of the Commercial Companies Code in connection with art. 515 and 516 of the Commercial Companies Code, i.e. by way of transferring all assets of the acquired companies to the acquiring company without any issue of new shares in the acquiring company in return for shares in the acquired companies, in accordance with the provisions of art. 514 of the the Commercial Companies Code. On December 7, 2011 the meetings of the companies took decisions on merger of PGE Energia Odnawialna S.A. with the acquired companies. On January 2, 2012 the merger of Dychowskie Przedsiębiorstwo Eksploatacji Elektrowni „Eldeks" sp. z o.o. and Elektrownia Wiatrowa Kamieńsk sp. z o.o. with PGE Energia Odnawialna S.A. was registered.

On October 11, 2011 the Extraordinary Meeting of Shareholders of Elektrownia Wiatrowa Gniewino sp. z o.o. and EO Baltica sp. z o.o. adopted resolutions on merger of Elektrownia Wiatrowa Gniewino sp. z o.o (acquiring company) with EO Baltica sp. z o.o. (acquired company). The merger was registered on November 2, 2011.

On October 31, 2011 the Extraordinary Meeting of Shareholders of EnBud sp. z o.o., with registered office in Czymanowo, adopted resolutions on dissolving and liquidation of the company and on appointment of a liquidator. PGE Energia Odnawialna S.A. is the only shareholder of the company. On November 22, 2011 the liquidation of EnBud sp. z o.o. was registered in National Court Register.

On December 20, 2011 the Extraordinary Meeting of Shareholders of PTS Betrans sp. z o.o. i Elbest sp. z o.o. took decisions on division of PTS Betrans sp. z o.o. (divided company) by way of transfer of the organized part of divided company – Greenery Keeping Unit (ZCP) to Elbest sp. z o.o. (acquiring company) pursuant to art. 529 § 1 p. 4 of the Commercial Companies Code. In connection with the division a share capital of the acquiring company was increased and the shareholders of the divided company were given shares in the acquiring company in exchange for their shares in ZCP and the share capital of the divided company was decreased by the value resulting from the transfer of ZCP to the acquiring company. As a result of the division, the share capital of the divided company was decreased by PLN 1,482,000 i.e. to PLN 16,078,500 through redemption of 2,964 share with a nominal value of PLN 500 each, proportionally to the shares held by the particular shareholders in the divided company. The share capital of the acquiring company was increased by PLN 1,952,000 i.e. to PLN 121,856,000 as a result of the shares exchange parity in compliance with status of the shareholders of the divided company as at the date of the resolution on division and was accomplished through issue of 1,952 shares with a nominal value of PLN 1,000 each, which were granted to the shareholders of the divided company as follows: PGE GiEK S.A. – 1,927 shares with value of PLN 1,927,000, PGE Dystrybucja S.A. - 22 shares with value of PLN 22,000, PGE Obrót S.A. - 3 shares with value of PLN 3,000. Changes in the share capital of Elbest sp. z o.o. and PTS Betrans sp. z o.o. were registered on January 2, 2012.

During 12-month period ended December 31, 2011 PGE Capital Group did not discontinue any significant operations. The consolidated financial statements specify discontinued operations for companies, discussed in Note 19 to the consolidated financial statements

1.6.1. Control system of employees share scheme

In 2011, PGE S.A. did not maintain any employees share schemes.

1.6.2. Use of proceeds from issues

In 2011 PGE S.A. did not issue any shares.

Proceeds from the issue of bonds under the bond programs described in p. 4.3 were used for financing of the on-going activities of PGE S.A. as well as for financing of the investments conducted by PGE S.A. and PGE Group companies.

1.7. Remuneration for PGE S.A. authorities

1.7.1. Rules for determining and amount of remuneration paid out to Management Board members in 2011

In the whole reporting period, i.e. from January 1, 2011 till December 31, 2011 the members of the Management Board were remunerated on the ground of the agreements for rendering of management services concluded with the Company. These agreements were concluded pursuant to provisions defined in art. 3 sec. 2 of the Act on salaries of persons managing certain legal entities (the "Salary Cap Act"). The provisions of the agreements referring to the remuneration result from the remuneration rules set out by the Supervisory Board. The agreements for rendering of management services include clauses relating to no-competition during the contractual period and after the termination of the agreement. The Management Board members purchased, at their own expense, the liability insurance with regard to the managing of the Company.

Table: Remuneration paid by PGE S.A., Group entities other than PGE S.A. in 2011 to the Management Board members of PGE S.A., who performed their functions in 2011, by person.

Full name of a Management Board member	Position	Remuneration paid by PGE S.A. in 2011*	Remuneration paid by Group entities other than PGE S.A. in 2011*
Paweł Skowroński	Acting CEO	PLN 182,402.84	PLN 347,622.88
Wojciech Ostrowski	Vice-President of the Management Board	PLN 182,402.84	PLN 436,145.22
Piotr Szymanek	Vice-President of the Management Board	PLN 483,644.28	PLN 765,496.38
Tomasz Zadroga	President of the Management Board *till December 14, 2011*	PLN 693,737.72	PLN 959,776.20
Marek Szostek	Vice-President of the Management Board *till December 14, 2011*	PLN 493,737.72	PLN 760,212.55
Marek Trawiński	Vice-President of the Management Board *till March 16, 2011*	PLN 258,644.28	PLN 470,105.91
Wojciech Topolnicki	Vice-President of the Management Board *till January 5, 2011*	PLN 258,644.28	PLN 251,993.11

** includes remuneration for the period of the position held in the Management Board, remuneration for the termination period (after recall/resignation from the Management Board) and payments due to provisions of the agreements regarding no-competition*

The remuneration paid by the Company to all persons that acted as Management Board members jointly with the post-employment benefits, amounted to PLN 2.55 million in 2011.

In cost perspective, the remuneration of all persons that acted as Management Board members jointly with the post-employment benefits, amounted to PLN 2.66 million (see Note 41.3. to the consolidated financial statements).

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

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

Table: Remuneration paid by PGE S.A. and Group entities other than PGE S.A. in 2011 to the members of the Supervisory Board of PGE S.A. who performed their functions in 2011, by person.

Full name of a Supervisory Board member	Position	Remuneration paid by the Company in 2011	Remuneration paid by Group entities other than PGE S.A. in 2011
Marcin Zieliński	Chairman of the Supervisory Board	PLN 41,454.96	EUR 42,000.00
Maciej Bałtowski	Vice-Chairman of the Supervisory Board	PLN 41,454.96	-
Jacek Barylski	Supervisory Board Member	PLN 41,454.96	-
Małgorzata Dec	Supervisory Board Member	PLN 41,454.96	-
Czesław Grzesiak	Supervisory Board Member	PLN 41,454.96	-
Grzegorz Krystek	Supervisory Board Member	PLN 41,454.96	-
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 41,454.96	-

Total remuneration paid out by the Company for performing the functions in the Supervisory Board amounted to PLN 373.1 thousand in 2011.

2. Characteristics of the activity of PGE Capital Group

2.1. Supply markets

Supply of raw materials

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

Until the consolidation the supplies of lignite to PGE Elektrownia Bełchatów S.A. and PGE Elektrownia Turów S.A. (currently branches of PGE Górnictwo i Energetyka Konwencjonalna S.A.) were performed on the ground of long-term agreements concluded with PGE KWB Bełchatów S.A. (agreement for approximately 20 years) and PGE KWB Turów S.A. (agreement for approximately 40 years). In connection with the long-term agreements, the additional agreements were also concluded between the parties in order to determine the rules of supplies in mid-term. PGE KWB Bełchatów S.A. and PGE KWB Turów S.A. currently are branches of PGE Górnictwo i Energetyka Konwencjonalna S.A. The internal regulations on performance and settlements of the lignite supplies between the branches were introduced after the consolidation. These regulations were introduced as internal instructions for rules of cooperation between the branches with regard to realisation and supplies settlement methods and with regard to provision of lignite reserves, separate for localisations, to which agreements related before the consolidation.

In 2011, PGE purchased hard coal for the needs of Group's power plants and CHPs. Coal was being bought from Kompania Węglowa S.A., Jastrzębska Spółka Węglowa S.A, Katowicki Holding Węglowy S.A., SUEK Polska sp. z o.o., PHU Energokrak sp. z o.o. and Carbo Proces Recykling sp. z o.o. and then was being sold it to particular producers from the PGE Group. Given the valid agreement with Kompania Węglowa S.A., PGE Capital Group is - to some extent - dependent on this supplier.

situation in the hard coal market and accessibility to imported coal, the PGE Group is not.

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

In 2011 biomass supplies to the generators from PGE Group were mainly carried out by the PGE Group companies and companies from outside of PGE (acting as agents) and directly from biomass producers. Due to large dispersion of the suppliers, PGE Capital Group is not dependent on any of the current suppliers. The works on centralization of biomass supplies in one PGE Group company, i.e. Elbis sp. z o.o., are currently carried out. Ultimately, this company is to provide biomass supplies to all generators from PGE Capital Group.

Purchase of services from PSE Operator S.A.

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

Given the above, companies operating in the electricity generation, trading and distribution areas in Poland (including PGE Group companies) are dependant, indirectly or directly, on transmission service agreements, with regard to the balancing of the power market as well, which is a typical situation in the electro energy sector. Such agreements are concluded with PSE Operator S.A., which is responsible for the operation of the electro energy transmission system, including connections with other electro energy systems, and provides electricity transmission services. Pursuant to the Energy Law, such services are provided only by the transmission system operator and transmission service agreements are obligatory. Such an obligation creates a system dependency. Power companies within the PGE Group are also subject to such dependency to an extent defined by law and determined by the scope and character of their activity. The termination or expiry of such an agreement in the case there is no agreement concerning a new transmission contract between a power company and a transmission system operator results, in practice, in one party filing an application with the President of the Energy Regulatory Office to define terms and conditions for such a contract.

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

In 2011, services purchased from PSE Operator S.A. constituted approximately 8% of total operating expenses incurred by the Group. PSE Operator S.A. is a related party to PGE S.A., as both companies are controlled by the State Treasury.

Purchase of electricity

Pursuant to the applicable electricity trading model in the PGE Group, in 2011, generators from PGE Group sold electricity to PGE S.A., on power exchanges (in scope regulated by art. 49a section 1 and 2 of the Energy Law, i.e. so called "power exchange obligation") and to external customers. Energy bought by PGE S.A. was sold to PGE Group companies, i.a. to retail sales company and distribution company, to contractors outside of PGE Group, on domestic and international market, which sold the acquired electricity to its business partners (trading companies) outside the PGE Group, in the domestic or international market. PGE retail sales company also bought energy from local sources located in the area where this company acts as a supplier of last resort.

2.2. Description of significant agreements

2.2.1. Agreement for performance of electricity transmission services concluded between PGE Dystrybucja S.A. and PSE Operator S.A.

On January 13, 2011 PGE Dystrybucja S.A. and PSE Operator S.A. concluded an agreement for provision of the electricity transmission services ("Agreement"). Agreement was concluded for indefinite period and will be performed on the whole operation area of PGE Dystrybucja S.A. As at effective date of the Agreement, the agreements existing between PSE Operator S.A. and the companies, which as from consolidation date were incorporated into PGE Dystrybucja S.A., were dissolved. As a result of concluding of above Agreement, centralization of settlements of services provided by Transmission System Operator ("TSO"), that are subject matter of the agreement, took place in PGE Dystrybucja S.A.

The subject matter of the Agreement is the provision of the services of electricity transmission, comprising both domestic and international transmission services provided by TSO for PGE Dystrybucja S.A. The Agreement also comprises the National Power System accessibility services provided by TSO to PGE Dystrybucja S.A. The settlements are conducted on the ground of tariff of PSE Operator. Total value of the Agreement for 5-year period is estimated at PLN 6.1 billion.

2.2.2. Establishment of PGE Polska Grupa Energetyczna S.A. bond issue program

On August 29, 2011 the Company concluded an agreement for indefinite period with Bank Polska Kasa Opieki S.A. (acting as Agent, Paying Agent and Depository) and ING Bank Śląski S.A. (acting as Sub-Agent, Paying Sub-Agent and Sub-Depository). The bond issue program (the "Programme") was established on the ground of the above agreement.

The maximum indebtedness amount from the bonds issued (representing a maximum aggregate nominal value of bonds issued and outstanding) under the Programme cannot exceed PLN 5 billion.

Under the Programme, the company is entitled to issue bearer bonds ("Bonds") in dematerialized form in accordance with the Act on Bonds dated June 29, 1995 (Journal of Laws of 1995 No. 83, item 420 as amended) (the "Act on Bonds") with projected maturity – depending on the type of Bonds – for zero-coupon Bonds not longer than 1 year, and for coupon Bonds not shorter than 1 year and not longer than 10 years, according to the terms of issue of the given Bonds series. The Bonds will be issued pursuant to Article 9, section 3 of the Act on Bonds and the issues will be non-public. The Bonds may be dematerialized at the National Depository for Securities and quoted on the Alternative Trading System ("ASO") organized by the Warsaw Stock Exchange or Bondspot S.A. within the Catalyst.

Bonds under the Programme will be denominated in Polish zlotys (PLN) and the nominal value of one bond will amount to PLN 10,000 or multiple of that amount. The price terms of the Bonds – discount for zero-coupon bonds and interest rate/coupon for the coupon bonds – are determined during the Bonds offering. 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.

2.2.3. Sale of 100% of Polkomtel S.A. shares to Spartan Capital Holdings sp. z o.o.

On October 24, 2011 Polish Office of Competition and Consumer Protection approved the transaction of sale of 100% of Polkomtel shares to Spartan Capital Holdings Sp. z o.o. Consequently, a condition of the preliminary agreement signed on June 30, 2011 between PGE, PKN ORLEN S.A., KGHM Polska Miedz S.A., Vodafone Americas Inc, Vodafone International Holdings B.V. and Weglokoks S.A. as the sellers ("Sellers"), and Spartan Capital Holdings Sp. z o.o., the special purpose vehicle controlled by Mr. Zygmunt Solorz-Żak, as the purchaser ("Purchaser") for the sale of 100% of shares in Polkomtel S.A. (the "Agreement"), has been fulfilled (information on the Agreement was provided by the Company in the regulatory announcement no 29/2011 dated June 30, 2011).

The transfer of the shares and payment for the shares were completed on November 9, 2011. After taking the income tax into account, the PGE Capital Group achieved a profit from the sale transaction in amount of PLN 1.66 billion, recognised in November 2011.

Following the completion of the transaction and acquisition of 100% shares in Polkomtel S.A. by Spartan Capital Holdings Sp. z o.o., PGE holds no shares in Polkomtel S.A.

2.3. Transactions with related entities

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

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

As at December 31, 2011 PGE S.A. and its subsidiaries were not a party of any proceedings concerning payables or debts whose total value would constitute at least 10% of the Company's equity, except for applications filed by generators from PGE Group to confirm excise tax overpayment and tax return together with interest for the years 2006-2008 and the first two months of 2009. Total overpaid tax to be returned to the PGE Group companies may amount to approximately PLN 3.4 billion, excluding interest (the generators are entitled to interest on overpaid excise tax, accrued from the date of payment of the overstated tax). Such proceedings are described in Note 45.4 to the consolidated financial statements

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

2.5. Key R&D achievements

The PGE Group carried out a number of actions in this area, mainly in order to: (i) implement new electricity production technologies, (ii) fulfil environmental requirements, (iii) reduce production costs. The most important R&D projects in particular business segments are as follows:

2.5.1. Activities related to mining and conventional generation

Construction of CCS installation at PGE GiEK S.A. Branch Elektrownia Bełchatów

The subject of the undertaking is to demonstrate on industrial scale a feasibility of technology of CO2 capture from the combustion gases emitted during the electricity generation process, compression of captured CO2 in order to transport it to the safe storage locations, i.e. in order to pump it to the deep geological structures – saline layers.

The most significant works within this task in 2011 included:

- works on optimal structure of CO2 storage and preparation works on CO2 transport component;
- works connected with the public consultation on transport and storage of CO2;
- submission of the application to the Ministry of Economy for the additional financing of the project within the NER 300 program.

In addition, the works on project structure financing are on-going, the obligations resulting from the Grant agreement under the European Economic Plan for Recovery (EEPR) has been fulfilled as well as the obligations resulting from the agreement for the participation in CCS Demonstration Projects Network (CCS Network). It is connected with the periodical reporting of the development of the project to the European Commission, as well as with the participation in workshops and exchange of the knowledge with the representatives of the project teams implementing CCS Projects, that are associated within CCS Network. One of the workshop meetings took place on September 28-29, 2011 in Łódź and was organised by PGE GiEK SA.

Mercury program

The implementation of the program is a necessary element of the outpacing activities, which are to prepare PGE GiEK S.A. to meet future environmental requirements and simultaneously will allow to comply with the obligation imposed by the existing law (balancing of the emissions, fees, PRTR reporting).

Program was divided into three packets:

Packet 1 – determination of mercury level in coals and other combusted fuels;

Packet 2 – performance of mercury balancing research in combustion process;

Packet 3 – tests of mercury removal by using the chemical preparations.

The implementation of the program should:

- deliver precise diagnosis of the actual situation, detailed measuring allowing for reliable assessment of the condition of installations of PGE GiEK S.A (Packet 1 and 2);
- deliver complete knowledge and information on circulation of mercury in the technological chain from coal extraction to electricity and heat generation, on research of possible emissions reduction, on proposals of specific actions to be taken at the branches of and preparation of data for the National Team for Mercury Convention at the Ministry of Economy in order to support the Ministry of Economy at development of Polish negotiation standpoint in the negotiations process of the international mercury convention and towards he European Union.
- compose a formula for reaching the reduction goal and usage in new installations and modernisation programs (Packet 3);

In 2011 Packet 1 was implemented. The preparations for the implementation of Packet 2 have begun.

Elaboration of oxygen combustion technology for the pulverised-fuel boilers and steam boilers integrated with the CO2 capture, in PGE GiEK S.A. Branch Elektrownia Turów.

The task is implemented under the strategic program "Advanced Technologies of Energy Acquirement", research task no. 2, announced and co-financed by the National Centre for Research and Development (NCBiR).

The Częstochowa Technical University is the leader of the scientific-industrial consortium. PGE Górnictwo i Energetyka Konwencjonalna S.A. Branch Elektrownia Turów is an industrial partner responsible for the stage „CO2 capture and storage – study case for PGE Elektrownia Turów".

2.5.2. Activities related to renewable energy

In renewables area, projects were carried out mainly in order to utilise innovative technologies in planned modernisation works for existing hydroelectric power plants and pumped storage power plants.

2.5.3. Activities related to distribution

„Construction and implementation of Advanced Metering Infrastructure system" was carried out within the innovative tasks in distribution. The technical, economical and organizational analyses for implementation of particular elements of the system and system architecture concept were developed during that project.

2.5.4. Other R&D projects

Apart from the aforementioned R&D project, PGE S.A. carries out many works, including, inter alia (i) participation in the Polish Platform of Clean Coal Technologies dealing with clean coal technologies from the technical, economic, financial, legislative and social point of view; (ii) works in the scientific-industrial consortium "Carbon Fuel Cells", which aims at construction and demonstration of work of a carbon fuel cell in size allowing for accomplishment of technical and economic analysis of the undertaking and determining the implementation potential; (iii) participation in the project of Polish Power Plants Economic Society regarding hard coal enrichment; (iv) elaboration of possibilities of co-combustion of raw and dried lignite in chosen PGE power plants; preparation of coal drying project; (v) construction of prototype allowing for compensation of brief decays of voltage in energy grid with energy repository in form of HV supercondensators battery; (vi) elaboration of concept, and ultimately creation of training system for operators on the base of simulators of units work and of e-learning system.

2.6. Issues relating to the natural environment

The conventional power plants and CHP plants in the PGE Group hold integrated permits that specify the type and parameters of the system, conditions for introducing chemical substances and energy to the environment, specification of permitted types and quantities of gases and dusts. Permits also contain guideline relating to water management, waste management, specification of the permitted level of noise and improvement of standards of environment protection. In addition they specify the methods of preventing failures and limiting the effects of such failures, as well as an obligation to inform of the failures, and specify obligations with respect to the monitoring of water, sewage and air. The PGE Group electricity generating companies also hold applicable sector permits.

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

The characteristics of the business activities of PGE Dystrybucja S.A. have direct influence on the environment and require a number of permits for the use of the environment. Branches of PGE Dystrybucja S.A. hold permits and consents required by law to conduct their basic activity. In particular, they hold permits for the production of dangerous and non-dangerous waste. Water consumption from own water intakes was carried with respect to the provisions determined in the obtained permits. Other water intakes, due to exemption from this obligation, were exploited without water law permits. In 2011 company pumped sewage into water and land with the quality standards determined in the water law permits.

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

Environmental actions carried out by the PGE Capital Group

In 2011, the PGE Capital Group carried out environmental actions, including in particular:

– the fulfilment of all duties imposed on the Group companies by environmental regulations and administrative decisions, including relevant reporting and measurements, on the current basis;

– settlement of emissions and rights to emissions for 2010 and purchase of rights to emissions in order to balance the rights in 2011 and partly in 2012; the purchases included EUA as well as CER and ERU;

– continuation of the programme of reduction of noise emission to the environment, including, inter alia, in Turów mine and Turów power plant. The investments related to modernisation of technology system of coal transporters and to sound-proofness of plants' installations in order to improve acoustics and lower the noise level below the binding norms;

– usage of the best available technical solutions and expert installations in PGE Capital in order to limit the pollution emissions to the air. Comparing the results of measurement of pollution with the requirements of the Ministry of Environment Decree, no violation of limits for polluting substances were recorded in emissions from power plants and CHPs in 2011;

– a series of activities heading for reduction of water pollution, including i.a. limitation of leakages and pollution in the reservoir of the plants by renovation and protection works (ESP Porąbka – Żar, EW Żagań II on Bóbr river), works improving the separation of oils from leak waters (EW Żarnowiec) and implementation of non-grease bearing system (EW Dębe);

– participation in programs of development of water management in cooperation with the Ministry of Environment, Regional Water Management Authorities, National Fund for Environmental Protection and Water Management and other entities, covering regulation of rivers and construction of retention reservoirs, protections against riverside washing out, including, stabilization of flow in canal of San river (EW Myczkowce), performance of repairs of drain pipe (ESP Solina – Myczkowce) and construction of fish ladders on rivers: Nysa Łużycka, Bóbr and Kwisa;

– actions relating to waste management i.e. the reduction of quantities of wastes, the recovery of recyclable wastes, and then the neutralisation thereof in accordance with legal requirements. PGE Capital Group actively participates in works of the Consortium for Side Products of Combustion and in works of Eurogypsum Consortium;

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

3.1. Factors and events influencing financial results

3.1.1. 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 sustaining relatively good macroeconomic situation of Poland has an impact on financial results achieved by the PGE Group. Particularly, favourable economic conditions triggered an increase in demand for electricity in the National Power System in this period by approximately 1.9% in comparison to 2010.

Table: Key economic ratios connected with the Polish economy.

Key data	2011	2010
Real GDP growth (% of growth)[1]	4.3*	3.9
Annual CPI rate (% of growth) [2]	4.3	2.6
Domestic electricity consumption(% of growth) [3]	1.9	4.2
Domestic electricity consumption (TWh) [3]	157.9	155.0

* 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.

3.1.2. Termination of long-term contracts (LTC)

Due to the termination of LTCs in accordance with The Act on coverage of stranded costs resulting at generators in relation to accelerated termination of long-term contracts ("LTC Act"), the producers being earlier the parties to such contracts obtained a right to receive compensations for the coverage of so called stranded costs (capital expenditures resulting from investments in generating assets made by the generator before May 1, 2004 that a generator is not able to recoup from revenues obtained from sales of generated electricity, spare capacity and ancillary services in a competitive environment after early termination of LTC). The LTC Act limits the total amount of funds that may be paid to all generators to cover stranded costs, discounted as at January 1, 2007, to PLN 11.6 billion.

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

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

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

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

3.1.3. Balance of energy of PGE Capital Group

Sales of electricity

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

	2011	2010	% change
Sales in TWh, including:	**90.60**	**56.31**	**_61%_**
Sales to end-users*	31.63	29.99**	_5%_
Sales on the wholesale market:	57.01	22.82	_150%_
Sales on the domestic wholesale market – power exchange	_51.54_	_6.90_	_647%_
Other sales on the domestic wholesale market	_4.55_	_14.85_	_-69%_
Sales to foreign customers	_0.92_	_1.07_	_-14%_
Sales on the Balancing Market	1.96	3.50	_-44%_

* after elimination of intra-group sales in PGE Group
** data restated for comparability regarding the elimination of sales to the consolidated entities

In 2011 and in 2010 the Group sold 90.60 TWh and 56.31 TWh of electricity, respectively. Changes in 2011 as compared to 2010 resulted mainly from the increase of sales on the wholesale market connected with the increased sale of electricity by the generators on the power exchange (change of the trading model in PGE Capital Group and introduction of so called "power exchange obligation"). "). The increase of sales of electricity to the end users was also recorded. The decrease in sales occurred in other sales on the wholesale market (mainly as a result of shift of the volumes of energy sold to the power exchange), in sales to foreign customers and in sales on the balancing market.

Purchases of electricity

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

	2011	2010	% change
Purchases in TWh, including:	**39.33**	**9.22**	***327%***
Purchases on the domestic wholesale market, power exchange	33.28	0.02	-
Purchases on the domestic wholesale market, other	1.28	0.78	*64%*
Purchases from abroad	0.36	1.04	*-65%*
Purchase from the Balancing Market..	4.41	7.38	*-40%*

In 2011 and 2010 the companies from the Group purchased respectively 39.33 TWh and 9.22 TWh of electricity from outside the PGE Group. Changes in 2011 as compared to 2010 resulted mainly from the increased energy purchase on the power exchange. The purchase from abroad decreased by 65% in 2011 as compared to 2010 in connection with the unfavourable situation on foreign markets; additionally the trade agreement with Vattenfall Aktiebolag on exchange of energy on link between Poland and Sweden expired in August 2010. The decrease of the purchase from the balancing market also occurred.

Production of electricity

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

	2011	2010	% change
Total energy generation (in TWh), including:	**56.52**	**52.73**	***7%***
Lignite-fired power plants	38.69	35.31	*10%*
Coal-fired power plants..	13.29	12.94	*3%*
Coal-fired CHP plants..	1.42	1.38	*3%*
Gas-fired CHP plants...	2.21	1.92	*15%*
Pumped storage power plants...	0.40	0.53	*-25%*
Hydroelectric plants...	0.44	0.59	*-25%*
Wind power plants...	0.07	0.06	*17%*

In 2011 and 2010, the Group produced 56.52 TWh and 52.73 TWh of electric power, respectively, what means growth by 3.79 TWh i.e. by 7%. The production in lignite-fired power plants increased by 3.38 TWh i.e. by 10% and in coal-fired power plants increased by 0.35 TWh i.e. by 3%. There was also growth of production in coal-fired CHP plants and gas-fired CHP plants, as well as in wind power plants. The pumped storage power plants and hydroelectric plants decreased their production.

The increase in electricity production in lignite-fired power plants is mainly a result of electricity production in new 858 MW unit in Bełchatów Power Plant. The increase in electricity production in coal-fired power plants, coal-fired CHP plants and gas-fired CHP plants is mainly related to lower failure rate than in 2010.

3.1.4. Production and sales of heat

In 2011 the net heat production and sales in PGE Group totalled respectively 22.75 GJ million and 21.34 GJ million and were lower by approximately 11% and 12% as compared to 2010. The divergence was mainly a result of weather conditions.

3.1.5. 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

On the energy market year 2011 was the first full year of so called power exchange obligation resulting from art. 49a section 1 and 2 of the Energy Law. It resulted in increased role of Towarowa Giełda Energii ("TGE", Polish power exchange) in electricity trading on spot as well as on futures and forward market. Along with the increased transaction number and increased volumes traded on the market, the share of TGE in volumes grew on the whole organized market, represented also by TFS, GFI and WSE's POEE. Through most of 2011, TGE was the only exchange that fulfilled the requirements of the Energy Law, not until the amendment to the Energy Law and statement of the ERO President since October 30, 2011, the market participants obliged to public sale of electricity may fulfil that requirement also through the WSE's POEE market. It resulted in slight growth in volumes traded on spot market on POEE. For the whole previous year POEE achieved less than 9% share in the spot market.

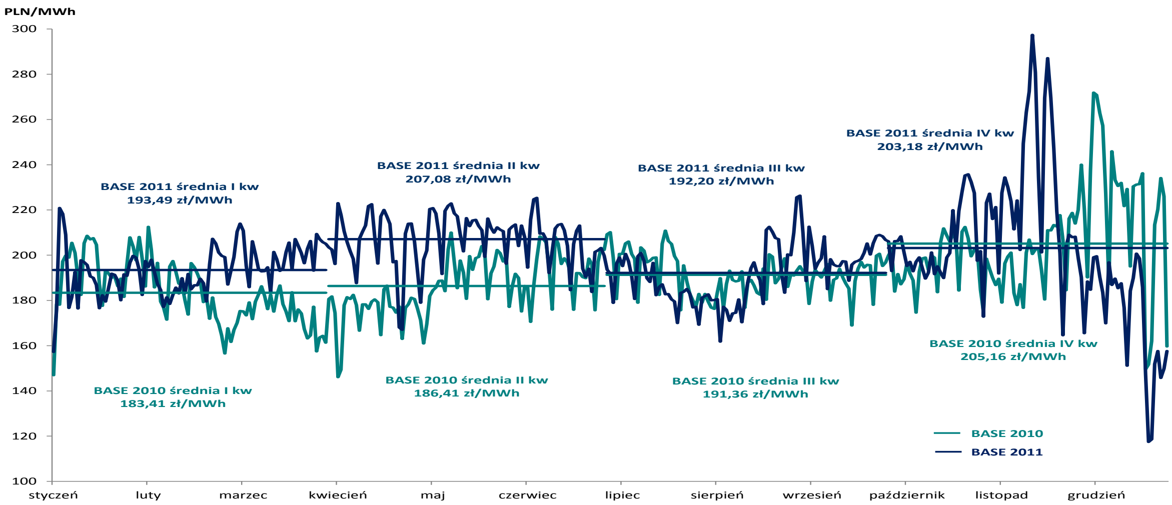
Domestic electricity consumption in 2011 amounted to 157.9 TWh and grew by 1.9% as compared to the previous year. Total generation volume in 2011 in Poland amounted to 163.2 TWh and increased by 4.4%.

Spot market

The growth of electricity spot prices was observed in 2011. Average spot price indexed by IRDN24 (arithmetic average of hourly prices) amounted to 198.99 PLN/MWh, what means growth by 7.35 PLN/MWh in comparison to the previous year. This growth mainly resulted from the increase of prices in the second quarter of 2011, when average prices at all hours amounted to 207.08 PLN/MWh. The international situation regarding the consequences of the Fukushima breakdown and the growth of energy prices in Germany due to the decommissioning of some nuclear power plant had impact on the Polish electricity prices. Volume of transmission capacities on interconnectors facilitated by PSE-Operator during that time increased the export possibilities, what resulted in growth of prices in Poland. The high spot prices in November resulted from unplanned switch offs of generating units in some power plants. The record-breaking prices were observed and average monthly price reached 229.47 PLN/MWh.

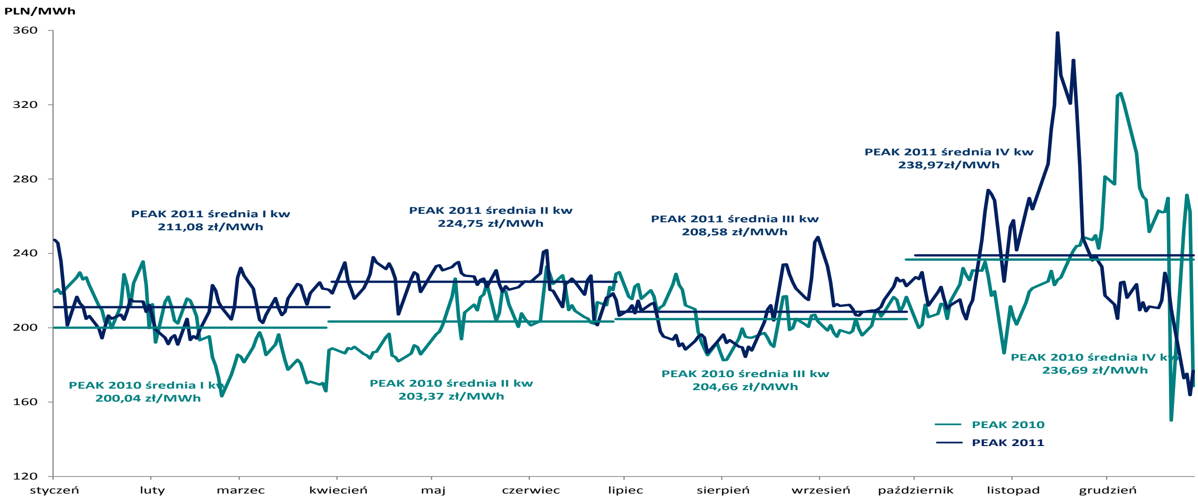
Total trading volumes of electricity on spot market, both on TGE and WSE's POEE, amounted to over 21.6 TWh in 2011 and were by approximately 8.3 TWh higher than in 2010. Majority of the volume – 19.7 TWh - was performed on TGE due to the fulfilment of the power exchange obligation imposed on the generators.

Chart. Daily and quarterly base prices in spot transactions in 2010–2011 (TGE)*.



** Arithmetic average of all power exchange transactions concluded during the session, calculated for the whole day by delivery date (index IRDN24)*

Chart. Daily and quarterly peak prices in SPOT transactions in 2010–2011 (TGE) *.



** Arithmetic average of all power exchange transactions concluded during the session, calculated for the whole day by delivery date (index IRDN24)*

The balancing market, although it is assumed to be the technical market, was the seller's market in 2011, and the unbalancing of its participants amounted to 1.7 TWh. Prices on the balancing market were on the similar levels as on TGE, with the exception that in situation of reduced capacity margin in the system, the settlement price of divergence was significantly higher than TGE prices.

Futures and forward market

The futures and forwards market, regardless of the delivery date, totalled approximately 154.5 TWh in 2011 (i.e. approximately 50 TWh more than in 2010). The organized energy market in Poland is just a part of energy supplies. The other part of traded volume was accomplished in bilateral contacts and also through the balancing market. The organized energy market in Poland is formed by power exchanges: TGE and WSE's POEE, and brokerage platforms: TFS and GFI. TGE is a dominant trading place of futures and forwards with regard to the volume of the concluded transactions. More than 106.0 TWh was traded through TGE in 2011, what means almost 69% share in the futures and forwards market. The majority (79%) of the total sales related to the yearly contracts. Yearly contracts for 2012 had the highest share in the contracts concluded during 2011. Their volume amounted to 107.2 TWh, with base products totalling 93.2 TWh at an average price of 202.82 PLN/MWh. Trading volume of the yearly peak products amounted to 13.0 TWh and average price amounted to 227.7 PLN/MWh. More active trading of contract with a remote delivery year indicates the development of the futures and forward market.

Contracts for 2013-2014 were also realised on the market in 2011.Their volume amounted to 760 MW (including 20 MW in peak) and 45 MW respectively. Weekly, monthly and quarterly contracts were becoming more popular.

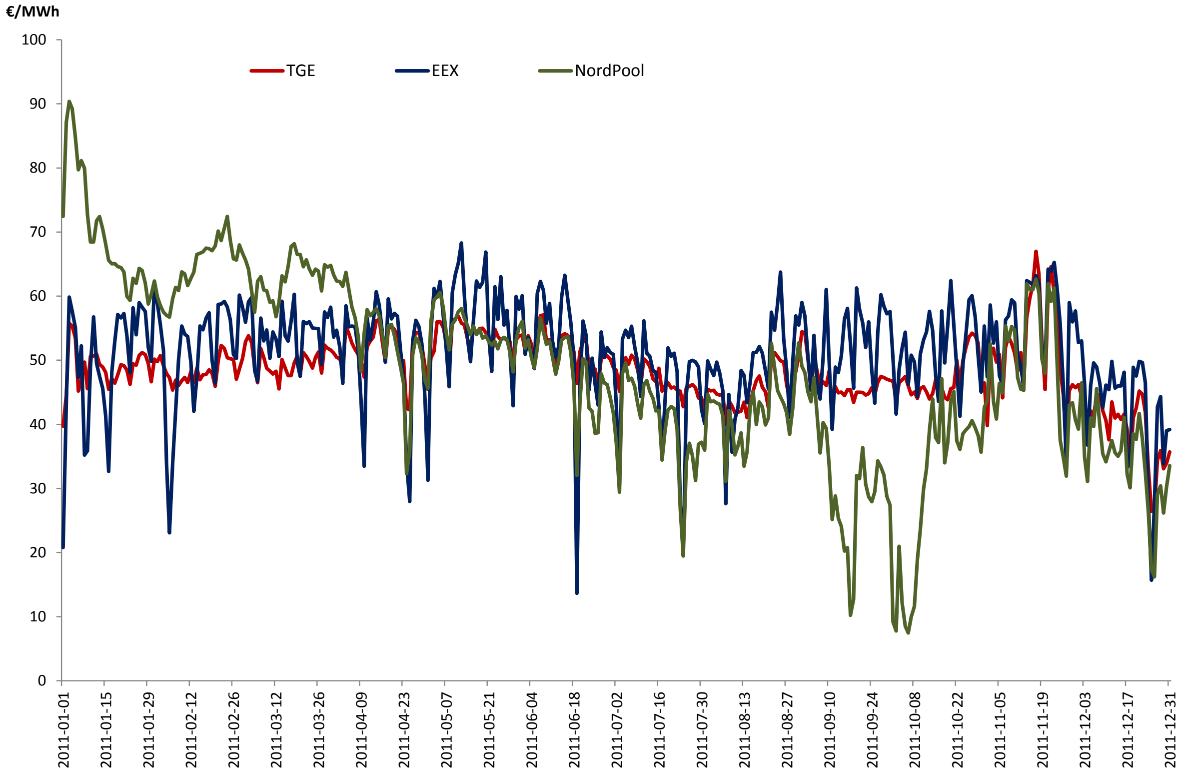
International market

The prices on the Polish and German market dropped at the beginning of 2011. Then the growing trend was observed till the end of May. The growth of prices on the German market mainly resulted from the limitation of the nuclear capacities following the decision by the German government. The decision was taken in connection with the public and political opinion after the breakdown of the Fukushima nuclear power plant in Japan. In the later periods the German prices were quoted on the lower levels and resulted from the decrease of prices of the CO2 emission rights. In the whole previous year the EEX prices were on significantly higher levels than on TGE. Lower generation from nuclear sources in Germany resulted in the need of import of the energy, both from Poland and from other countries neighbouring with German system. The increased export from Poland was also thanks to facilitation of more commercial capacities on interconnectors by PSE Operator.

High level of prices of the Scandinavian market in the first half of 2011 was a result of low level of water reservoirs that plays a significant role in price setting due to the existing generation structure. Along with the growing levels of the water reservoirs and the drop of prices of CO2 emission rights, the electricity prices decreased, reaching the lowest level at the beginning of October.

Total volume of energy exported from Poland in 2011 amounted to 6.2 TWh, including 2.4 TWh on connection PSE-O HzT50 (with Germany). The level of import in 2011 was lower. Import volume amounted to almost 1.9 TWh, including 1.4 TWh DC connection between Poland and Sweden (SwePol Link).

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



3.1.6. Tariffs

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

<u>Sales of electricity</u>

Sales of electricity to recipients from the G tariff group, connected to the distribution network of PGE Dystrybucja S.A. in 2011 took place on the basis of electricity tariffs approved by the President of the Energy Regulatory Office. The proceedings on the approval of the tariffs for 2011 were started on October 18, 2010 and were finalized on December 16, 2010. The approved tariff came into force on January 1, 2011. In 2011 sales of energy to the corporate customers (key and business) and to individuals other than from G tariff group connected to the distribution network of PGE Dystrybucja S.A. took place on the basis of Tariff for customers from A, B, C and R tariff groups, approved by the resolution of the Management Board of PGE Obrót S.A. and effective from January 1, 2011, as well as on the basis of individually negotiated offers.

<u>Distribution of electricity</u>

Methodology of and assumptions for tariffs determination were published in the document "Tariffs for the DSO for the year 2011", which were prepared by the President of the Energy Regulatory Office and provided to distribution system operators.

First consolidated tariff of PGE Dystrybucja S.A. for 2011 was approved by the President of the Energy Regulatory Office on December 17, 2010 in the part concerning the transition fee and on December 21, 2010 in other part. Tariffs for 2011, according to resolution of the Management Board of PGE Dystrybucja S.A, dated December 24, 2010, came into force on January 5, 2011 (according to the decision of the President of the Energy Regulatory Office, the transition fee has been in force since January 1, 2011).

Distribution tariffs for 2011 approved by the President of the Energy Regulatory Office, contributed to changes in average payments for customers in particular tariff groups in comparison to year 2010:

- A tariff group – decrease by 1.25 %,
- B tariff group – decrease by 2.35 %,
- C+R tariff group – increase by 2.61 %,
- G tariff group – increase by 3.34 %.

An average price of energy distribution services in comparison to last tariffs binding in 2010 increased by approximately 1.05%.

During the reporting period the approved tariffs for distribution services were not subject to any changes.

Tariff for heat

Pursuant to Art. 47 sections 1 and 2 of the Energy Law energy, companies, which hold licences, set tariffs for heat and propose their duration. Submitted tariff is subject to the approval by the President of the Energy Regulatory Office, provided that it is consistent with rules and regulations referred to in Art. 44-46 of the Energy Law. Conduction of proceedings concerning heat tariffs approval lies within the competence of regional Branches of Energy Regulatory Office.

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

3.1.7. Prices of fuel

Table: Volume and cost of purchase of fuels from third party suppliers in the 12-month period ended December 31, 2011 and December 31, 2010.

	12-month period ended December 31, 2011		12-month period ended December 31, 2010	
	Volume ('000 tonnes)	**Cost (PLN million)**	**Volume ('000 tonnes)**	**Cost (PLN million)**
Hard coal	7,316	1,966	6,467	1,661
Gas ('000 m^3)	611,987	501	553,478	401
Biomass	731	254	509	165
Fuel oil	78	174	55	88
TOTAL		**2,895**		**2,315**

** data for 2010 – adjusted for comparability*

In the 12-month period ended December 31, 2011 the costs of purchasing primary fuels from providers outside the Group amounted to PLN 2,895.0 million and were higher by approximately 25% as compared to the period ended December 31, 2010. It is mainly connected with: (i) higher volume of hard coal supplies in connection with necessity of reserves replenishment (ii) higher volume of electricity and heat production in gas-fired power plants with the simultaneous growth of gas prices by approximately 13%, (iii) increase of prices of fuel oil and the increase of its usage, mainly in connection with the trial run of 858 MW unit in Bełchatów Power Plant, (iv) increase of electricity production from biomass co-combustion by approximately 35%

In the period ended December 31, 2011 approximately 68% of the electricity produced was obtained from internally sourced lignite, whose price is less susceptible to fluctuations than fuel sourced externally. However, certain factors including the aggregate amount of lignite extracted, costs of overburden removal, labour costs and environmental provisioning affect mining costs incurred by the Group and thus PGE Group's generation costs

3.1.8. National Allocation Plan for the years 2008-2012 ("NAP II")

The National Allocation Plan on CO_2 emission ("NAP") is subject to the notification to the European Commission, under the EU emission rights trading system. In connection with the fact that the European Commission reduced the quantity of CO_2 emission rights for Poland in both settlement periods in relation to quantities applied by Poland in the NAP, the granted limits constitute a material limitation for the electro energy sector.

As regards the second settlement period, which covers the years 2008-2012, Poland applied for average yearly emission caps of 284 million tonnes of CO_2. The European Commission reduced the average free CO_2 emission allowances per year for Poland to 208.5 million tonnes. According to the present NAP II, utility power plants would only be authorized to emit 110.8 million tonnes of CO_2, whereas Polish CO_2 emissions in normal circumstances are estimated at approximately 120 million tonnes per year.

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

Sector	Average rights - Mg of CO_2 per year
Utility power plants	110,791,200
Utility CHP plants	25,391,008

The following table presents data concerning CO_2 emission from major Group installations in 2011 (as compared to the number of rights granted under free allocations).

Table: Emission of CO_2 (in Mg) from major Group installations in 2011 in comparison to the average yearly allocation of CO_2 emission rights.

Operator	CO_2 emissions in 2011*	Average yearly allocation for 2011 based on the NAP II
PGE GiEK Branch Elektrownia Bełchatów	32,823,140	27,766,940
PGE GiEK Branch Elektrownia Turów	10,776,551	11,158,636
PGE GiEK Branch Zespół Elektrowni Dolna Odra	6,712,435	5,680,137
PGE GiEK Branch Zespół Elektrociepłowni Bydgoszcz	1,022,987	1,155,252
PGE GiEK Branch Elektrociepłownia Gorzów	444,287	479,305
PGE GiEK Branch Elektrociepłownia Lublin-Wrotków	583,966	570,840
PGE GiEK Branch Elektrociepłownia Rzeszów	308,264	303,155
PGE GiEK Branch Elektrociepłownia Kielce	165,626	194,547
PGE GiEK Branch Elektrociepłownia Zgierz	83,823	104,988
PGE Elektrownia Opole S.A.	6,872,050	6,475,340
TOTAL	**59,793,129**	**53,889,140**

** estimates, the data will be verified in the annual report of the verifier*

In connection with the commissioning of new 858 MW unit PGE GiEK S.A. Branch Elektrownia Bełchatów received, in compliance with the decision of December 20, 2011 by the Łódź Voivodship Marshal, additional CO_2 emission right in amount of 4,812,746 tonnes until the end of the settlement period 2008-2012. These allowances were recorded on the installation's account on February 24, 2012. Additional allowances in amount of 829,785 tonnes were enclosed as the allocation for 2011.

PGE GiEK S.A. Branch Elektrociepłownia Kielce received additional rights for 5,190 tonnes per annum for the years 2009-2012 from a reserve for new facilities. The decision to grant the additional rights was issued on December 18, 2009 and on January 5, 2011; the rights were submitted to the generator's account (a total of 10,380 tonnes). The right for 2011 were submitted on February 26, 2011.

In 2011, i.e. in the fourth year of the second settlement period of the EU emission trading system, the Group recorded the shortage of rights of approximately 5.9 million tons of CO_2.

3.2. Financial results of the Group

Consolidated statement of comprehensive income

Total sales revenues of the Group in 2011 amounted to PLN 28,111.4 million, as compared to PLN 20,471.4 million in 2010. The biggest increase of revenues was reported in the revenues from sales of finished goods and merchandise which grew by PLN 7,626.6 million mainly as a result of: (i) increased revenues from sales of electricity on the wholesale market in connection with the change of the trading model, including implementation of the power exchange obligation (see Note 45.7 to the consolidated financial statements), (ii) increase in revenues from sales of electricity to end-users, (iii) increase in revenues from distribution services. The decline of sales to the balancing market had negative impact on the divergence of the revenues from sales of finished goods and merchandise. The revenues from LTC compensations, which were higher by PLN 105.3 million, also affected the sales revenues.

Cost of goods sold in 2011 amounted to PLN 20,620.8 million i.e. it grew by ca. 45% as compared to 2010. The increase of the cost of goods sold was caused by increase in value of cost of merchandise and materials sold by PLN 6,122.1 million, in connection with change of the trading model and the realisation of the "power exchange obligation".

Gross profit on sales in 2011 amounted to PLN 7,490.6 million as compared to PLN 6,219.1 million in 2010, what means growth by ca. 20%.

In the third quarter of 2011 total distribution and selling expenses of PGE Group amounted to PLN 1,638.1 million, what means approximately 7% increase as compared to 2010. The growth of selling and distribution expenses was mainly associated with higher costs of redemption of property rights incurred by PGE Obrót S.A.

In 2011 general and administrative expenses amounted to PLN 819.3 million, what means approximately 3% growth as compared to 2010.

Net income from other operating activities in 2011 was negative and amounted to PLN (-) 888.7 million as compared to positive result in amount of PLN 258.8 million in 2010.

Other operating revenues of the Group in 2011 amounted to PLN 624.0 million, which means approximately 6% decline in relation to PLN 666.4 million achieved in 2010. The decrease in other operating revenues is mainly related to level of reversed balance sheet provisions lower by PLN 315.5 million and income from the sale of subsidiaries lower by PLN 27.5 million.

The decline of above mentioned revenues items was partly compensated by received compensations, penalties and fines (mainly the compensation for delayed construction of 858MW unit in Bełchatów power plant) higher by PLN 287.6 million and level of reversed revaluation write-offs on receivables higher by PLN 29.6 million.

The increase in other operating expenses by PLN 1,105.1 million in 2011 as compared to 2010 is a result of adjustment of LTC compensations settlements by 1,037.6 million made in 2011 and level of created balance sheet provisions higher by PLN 100.9 million.

In 2011 the net result on financial activities was positive and totalled PLN 1,846.5 million as compared to the negative result in 2010, which amounted to PLN 136.1 million.

The Group's financial revenues in 2011 amounted to PLN 2,304.4 million, what means increase by approximately 483% in relation to PLN 395.1 million achieved in 2010. Increase of financial revenues is mainly connected with sale of shares in Polkomtel S.A. After deduction of the profit from this transaction (PLN 1.99 billion) financial revenues amounted to PLN 311.6 million and were lower by PLN 83.4 million as compared to 2010. This change is mainly connected with the decline of revenues from interest on financial instruments by PLN 98.0 million.

The decrease of financial expenses by PLN 73.3 million in 2011 as compared to 2010 is mainly related to decrease in interest expenses from financial instruments by PLN 121.7 million and decline by PLN 23.0 million of expenses related to creation of revaluation write-offs (high level of this item in 2010 was connected mainly with creation of revaluation write-off for investments in associates). The decline of above items was partly compensated by negative foreign exchange difference higher by PLN 64.6 million and interest expenses higher by PLN 2.7 million as a result of discount unwinding.

Share in the profit of associates amounted to PLN 174.4 million and was lower by PLN 52.6 million as compared to 2010. Share in the profit of associates mainly resulted from share of PGE S.A. in the profit of Polkomtel S.A.

The gross profit of the Group amounted to PLN 6,165.4 million in 2011 as compared to PLN 4,240.2 million in 2010. The growth of the gross profit was mainly caused by the sale of shares in Polkomtel S.A. In addition, in 2011 gross profit margin of the Group (gross profit to total sales revenues) increased to 21.9% from 20.7% in 2010.

As a result of the factors discussed above the net profit amounted to PLN 4,972.6 million in 2011 as compared to PLN 3,597.8 million in 2010.

In 2011 the Group identified PLN 1.7 million of profit from discontinued operations, in relation to implementation of the "Non-Core" Programme in the Group. In 2011 the Group identified two subsidiaries, which complies with the definition of the discontinued operations: ENSPRO sp. z o.o. and Budownictwo Hydro-Energetyka Dychów sp. z o.o.

Total comprehensive income of the Group in 2011 amounted to PLN 4,978.3 million as compared to PLN 3,599.7 million in 2010.

Consolidated statement of financial position

As at December 31, 2011 and December 31, 2010, non-current assets of the Group were PLN 44,444.9 million and PLN 44,137.4 million and represented 76% and 82% of total assets, respectively.

The increase in the value of non-current assets by PLN 307.5 million in the period ended December 31, 2011 as compared to the year ended December 31, 2010 was relate mainly to growth in property, plant and equipment by PLN 1,532.6 million as a result of capital expenditures incurred for reconstruction and modernization of units 5-12 and construction of new 858 MW in Bełchatów power plant and for construction of desulphurization installation in in Bełchatów power plant and for other direct purchase. In addition, other long-term assets increased by PLN 175.7 million (mainly related to increase of prepayments shown by PGE Energia Odnawialna S.A. for purchase of shares in Żuromin sp. z o.o. i Pelplin sp. z o.o.). The growth was partly compensated by decrease shares in associates and joint ventures accounted for under the equity method by PLN 1,353.4 million what was caused mainly by sale of shares in Polkomtel S.A.

Current assets of the Group as at December 31, 2011 and as at December 31, 2010 amounted to PLN 14,317.7 million and PLN 9,742.6 million.

The increase in the value of the Group's current assets by PLN 4,575.1 million in the period ended December 31, 2011 as compared to the year ended December 31, 2010 was mainly attributable to the increase in other loans and financial assets by PLN 1,987.3 million, increase in cash and cash equivalents by PLN 1,321.8 million, increase in rights to emissions of greenhouse gases by PLN 741.5 million.

The increase in other loans and financial assets in the period ended December 31, 2011 as compared to the year ended December 31, 2010 mainly resulted from deposits with maturity over 3-months higher by PLN 2,107.3 million and the decrease in amounts receivable from LTC compensations by PLN 405.8 million.

Cash and cash equivalents were described in the part relating to cash flow statement.

As at December 31, 2011 and as at December 31, 2010 total equity of the Group amounted to PLN 41,173.3 million and PLN 37,554.7 million, respectively, i.e. it represented approximately 70% of total equity and liabilities in 2011 and 2010. Non-controlling interest as at December 31, 2011 and as at December 31, 2010 amounted to PLN 414.4 million and PLN 596.0 million, respectively.

The increase in total equity by PLN 3,618.6 million results mainly from the net profit for the period ended December 31, 2011 in amount of PLN 4,972.6 million. The distribution of profit for 2010 and allocation of part of the net profit, i.e. PLN 1,215.3 million, for the dividend payment and recognition of adjustment for payments from the profit for the previous periods in amount of PLN 0.4 million had the negative impact on the total equity. In addition, the settlement of purchase of additional shares in subsidiaries of the Capital Group affected the level of total equity (decrease by PLN 105.2 million).

The long-term liabilities as at December 31, 2011 amounted to PLN 7,216.0 million and were lower by PLN 255.6 million than as at December 31, 2010. The change in long-term liabilities mainly reflected lower debt due to bank loans, borrowings, bonds and lease by PLN 463.1 million and lower level of created provisions. Lower level of provisions results from decline in long-term provision for CO_2 emission costs with the simultaneous increase of provision for rehabilitation expenses. The decline was in large part compensated by provision for deferred tax higher by PLN 207.9 million and deferred income and government grants higher by PLN 142.7 million mainly as a result of increased grant received by PGE GiEK S.A. for the construction of CCS installation.

Short-term liabilities increased from PLN 8,853.7 million as at December 31, 2010 to PLN 10,373.4 million as at December 31, 2011 mainly due to increase in short-term provisions by PLN 703.4 million (mainly as a result of increase of the short-term part of provision for costs of CO_2 emission by PLN 567.7 million and provision for value of property rights for redemption by PLN 70 million), increase in other financial liabilities by PLN by 561.1 million (mainly as a result of increase of liabilities related to LTC compensations by PLN 847.0 million), income tax liabilities higher by PLN 196.5 million, increase in trade liabilities by PLN 136.9 million. On the other hand, debt from the interest bearing loans and credits decreased by PLN 217.3 million.

Consolidated cash flow statement

Cash and cash equivalents as at December 31, 2011 amounted to PLN 4,040.9 million and were higher by PLN 1,304.0 million than at the end of the corresponding period of 2010.

Total net cash flows from operating activities for the 12-month period ended December 31, 2011 amounted to PLN 6,942.0 million as compared to PLN 6,611.0 million for the 12-month period ended December 31, 2010. The increase of cash flows from operating activities in the 12-month period ended December 31, 2011 as compared to the 12-month period ended December 31, 2010 was mainly caused by change in provisions (cash flow higher by PLN 1,200.1 million) and change in liabilities other than loans and credits (cash flow higher by PLN 998.6 million). The increase of cash flow resulting from above factors was partly compensated by change in prepayments and accruals (cash flow lower by PLN 1,298.6 million) and change in inventory (cash flow lower by PLN 395.4 million).

Negative net cash flow from investing activities for the 12-month period ended December 31, 2011 amounted to PLN 3,326.7 million and were lower by PLN 4,141.6 million as compared to the 12-month period ended December 31, 2010. The balance of net cash flows from investing activities for the 12-month period ended December 31, 2011 mainly consisted of expenses related to acquisition of property, plant and equipment and intangible assets in amount of PLN (-) 4,519.0 million and to financial assets in amount of PLN (-) 2,438.7 million. Sale of other financial assets in amount of PLN (+) 3,334.2 million also had significant effect on the balance of cash flow from investing activities for the period ended December 31, 2011.

Negative net cash flow from financial activities for the 12-month period ended December 31, 2011 amounted to PLN 2,311.3 million as compared to negative net cash flow from financial activities in amount of PLN 4,111.8 million for the 12-month period ended December 31, 2010. The balance of net cash flows from financial activities for the 12-month period ended December 31, 2011 mainly consisted of: (i) balance of inflows/ payments from loans, borrowings, bonds issues and financial lease amounting to PLN (-) 851.0 million, (ii) dividends paid to shareholders in amount of PLN (-) 1,410.5 million and (iii) interest paid in amount of PLN (-) 72.7 million.

3.3. Geographical areas

Table: Breakdown of Group's net income from continuing operations, by geographic area, for years ended December 31, 2011 and 2010

PLN million	**Total net income**				
	2011	_(%) share_	**2010**	_(%) share_	**_change%_**
Domestic market	27,590.6	_98%_	19,882.2	97%	_39%_
EU member states	505.2	_2%_	572.1	3%	_-12%_
Other countries	15.6	_0%_	17.1	0%	_-9%_
Total	**28,111.4**	**_100%_**	**20,471.4**	**100%**	**_37%_**

In the years ended December 31, 2011 and 2010, the Group earned income mainly in the domestic market.

In the financial year ended December 31, 2011, income from operations generated in the EU member states amounted to PLN 505.2 million and was lower than income from operations in the financial year ended December 31, 2010 by approximately 12%. The decrease of sales to the EU member states was mainly connected with the lower sales of CO_2 allowances by PGE S.A. in 2011. This decrease was partly compensated by higher sales achieved by ELECTRA Deutschland GmbH on foreign markets. In the financial year ended December 31, 2011, income obtained in other countries amounted to PLN 15.6 million in comparison to PLN 17.1 million in the financial year ended 31 December 2010 and was mainly related to the sales by Exatel S.A.

3.4. Business segments

In 2011 the Group changed the presentation of results achieved by the particular segments, presentation of ascribed assets and liabilities and capital expenditures. In compliance with the changed presentation rules, the consolidation adjustments introduced at the parent company level are not attributed to the particular business segments but they are presented as separate item and they adjust segmental information to the consolidated values for the Capital Group.

Table: Key operational figures.

Key figures	Unit	2011	2010	% change
Lignite extraction	Tons mln	48.94	43.17	*13%*
Net electricity production*, including:	TWh	56.52	52.73	*7%*
Power plants - lignite	*TWh*	*38.69*	*35.31*	*10%*
Power plants – hard coal	*TWh*	*13.29*	*12.94*	*3%*
CHPs – hard coal	*TWh*	*1.42*	*1.38*	*3%*
CHPs – gas	*TWh*	*2.21*	*1.92*	*15%*
Pumped storage power plants	*TWh*	*0.40*	*0.53*	*-25%*
Hydro power plants	*TWh*	*0.44*	*0.59*	*-25%*
Wind power plants	*TWh*	*0.07*	*0.06*	*17%*
Heat sales	GJ mln	21.34	24.30	*-12%*
Sales to Final Customers **	TWh	32.22	31.02	*4%*
Sales to Final Customers outside PGE Group ***, including:	TWh	31.53	29.88	*6%*
Tariff G	*TWh*	*9.14*	*9.22*	*-1%*
Distribution of electricity ****	TWh	31.08	30.61	*2%*

** including productions from biomass in period January-December 2011 – 0.93 TWh, in period January-December 2010 – 0.69 TWh,*
*** sales by PGE Obrót S.A. with additional estimation and with taking into account the sales within PGE Group*
**** sales by PGE Obrót S.A. with additional estimation*
***** with additional estimation*

Table: Breakdown of the Group's gross income (including flows between segments), by business segments for financial years ended December 31, 2011 and December 31, 2010.

in PLN million	**Total gross income**				
	2011	*(%) share*	**2010**	*(%) share*	**% change**
Conventional Generation	13,551.8	*31%*	12,290.7	*28%*	*10%*
Renewable Energy	534.0	*1%*	648.3	*1%*	*-18%*
Wholesale Trading	10,356.2	*24%*	11,828.9	*27%*	*-12%*
Distribution	5,253.0	*12%*	5,031.7	*12%*	*4%*
Retail Sale	12,501.4	*28%*	12,464.6	*28%*	*0%*
Other activity	1,878.4	*4%*	1,804.6	*4%*	*4%*
Total	**44,074.8**	*100%*	**44,068.8**	*100%*	*0%*
Consolidation adjustments	**(15,963.4)**		**(23,597.4)**		*-32%*
Net income	**28,111.4**		**20,471.4**		*37%*

Table: Key financial indicators for each business segment for the financial year ended December 31, 2011 (after eliminations).

in PLN million	**EBITDA**	**EBIT**	**Capital expenditures**	**Assets of the segment**
		2011		
Conventional Generation	4,526.8	2,989.0	2,922.9	32,115.5
Renewable Energy	214.4	87.0	148.5	1,939.7
Wholesale Trading	204.4	180.9	10.0	992.2
Distribution	1,619.3	705.3	1,254.6	14,556.0
Retail Sale	133.8	124.2	5.1	1,930.4
Other activity	150.1	35.3	123.8	1,440.1
Total	**6,848.8**	**4,121.7**	**4,464.9**	**52,973.9**
Consolidation adjustments	**6.3**	**22.8**	**(151.3)**	**(1,921.6)**
Total after adjustments	**6,855.0**	**4,144.5**	**4,313.6**	**51,052.3**

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

in PLN million	**EBITDA**	**EBIT**	**Capital expenditures**	**Assets of the segment***
		2010*		
Conventional Generation	4,426.0	2,925.4	3,901.1	30,251.7
Renewable Energy	265.0	135.3	191.8	1,753.0
Wholesale Trading	228.9	199.9	20.7	1,817.6
Distribution	1,407.9	533.5	1,054.0	14,117.0
Retail Sale	213.5	204.5	24.6	1,718.4
Other activity	213.4	93.2	178.4	1,324.3
Total	**6,754.7**	**4,091.8**	**5,370.6**	**50,982.0**
Consolidation adjustments	**43.2**	**57.4**	**(47.6)**	**(2,960.2)**
Total after adjustments	**6,797.9**	**4,149.2**	**5,323.0**	**48,021.8**

* see Note 14 to the consolidated financial statements
** data restated

Key operational figures were described in p. 3.1. Factors and events influencing financial results

3.4.1. Conventional Generation

In 2011 total sales revenues for Conventional Generation amounted to PLN 13,551.8 million, which means 10% growth as compared to 2010. EBIT of the segment in 2011 amounted to PLN 2,989.0 million, and EBITDA amounted to PLN 4,526.8 million. In the previous year EBIT amounted to PLN 2,925.4 million, and EBITDA amounted to PLN 4,426.0 million. Change in EBIT in 2011, as compared to 2010, was mainly due to higher revenues from sales of electricity and to higher revenues from LTC compensations and adjustment of settlements regarding LTC compensations in amount of PLN (-) 1,037.6 million, which was recognised in other operating expenses and lowered the result. Higher revenues from sales of electricity were mainly due to growth of electricity prices and higher volume of energy sold (commissioning of the 858 MW unit and completion of modernization of units 5 in Bełchatów power plant in February 2011). The details on recognition of adjustment of settlements regarding LTC compensations are presented in Note 45.1 to the consolidated financial statements.

In 2011 capital expenditures in Conventional Generation amounted to PLN 2,922.9 million as compared to 3,901.1 million in 2010.

Table: Capital expenditures incurred in Conventional Generation segment in 2011 and 2010, by particular investment tasks.

in PLN million	Capital expenditures		
	2011	**2010***	**% change**
Investments in generating capacities, including:	2,637.4	3,591.5	*-27%*
Development	1,825.8	2,972.1	*-39%*
Modernization and replacement	811.6	619.4	*31%*
Purchases of finished capital goods	62.3	64.2	*-3%*
IT	14.8	36.1	*-59%*
Vehicles	7.5	7.4	*1%*
Other	200.9	201.9	*0%*
TOTAL	**2,922.9**	**3,901.1**	***-25%***

** data restated*

In 2011 highest capital expenditures were incurred for the following projects: (i) modernization of units 5-12 in Bełchatów power plant (PLN 698.9 million), (ii) construction of a 858 MW power unit in Bełchatów power plant (PLN 518.3 million), (iii) construction of steam boiler producing electricity from biomass in Szczecin power plant (PLN 185.7 million), (iv) construction of desulphurization installation on units 1-2 in Bełchatów power plant (PLN 183.2 million) and (v) construction of desulphurization installation on units 5-6 in Dolna Odra power plant (PLN 110.3 million).

3.4.2. Renewable energy

In 2011 total sales revenues in the Renewable Energy segment amounted to PLN 534.0 million as compared to PLN 648.3 million in 2010. EBIT of the segment in 2011 amounted to PLN 87.0 million, and EBITDA amounted to PLN 214.4 million. In the previous year EBIT amounted to PLN 135.3 million, and EBITDA amounted to PLN 265.0 million. The decline of EBIT in 2011 as compared to 2010 mainly related to lower revenues from sales of electricity and certificates of origin, what resulted from lower production volume due to unfavourable hydrological situation.

In 2011 capital expenditures in the Renewable Energy segment amounted to PLN 148.5 million as compared to PLN 191.8 million in 2010.

Table: Capital expenditures incurred in the Renewable Energy segment in 2011 and 2010, by particular investment tasks.

in PLN million	Capital expenditures		
	2011	**2010**	**% change**
Investments in generating capacities, including:	141.9	182.8	*-22%*
Development	22.5	27.2	*-17%*
Modernization and replacement	119.4	155.6	*-23%*
Purchases of finished capital goods	0.4	1.2	*-67%*
IT	2.6	2.4	*8%*
Vehicles	1.5	1.3	*15%*
Other	2.1	4.1	*-49%*
TOTAL	**148.5**	**191.8**	***-23%***

In 2011 highest capital expenditures were incurred for the following projects: (i) modernization of derivative canal at Dychów hydroelectric power plant (PLN 61.4 million) and (ii) modernization of Żarnowiec hydroelectric power plant (PLN 39.8 million).

3.4.3. Wholesale trading

In 2011 total sales revenues in the Wholesale Trading amounted to PLN 10,356.2 million, which means an approximately 12% decrease as compared to 2010. The decline of sales revenues is mainly related to change of the trading model in PGE Capital Group. EBIT of the segment in 2011 amounted to PLN 180.9 million, and EBITDA amounted to PLN 204.4 million. In the previous year EBIT amounted to PLN 199.9 million, and EBITDA amounted to PLN 228.9 million. The lower EBIT in 2011 as compared to 2010 resulted mainly from lower result on other operating activities (mainly as a result of creation in 2011 of provision for claims related to reservation of interconnector capacities).

In 2011 capital expenditures in the Wholesale Trading amounted to PLN 10.0 million as compared to PLN 20.7 million in 2010. The incurred capital expenditures related mainly modernization of the building of PGE and to IT management support systems.

3.4.4. Distribution

In 2011 total sales revenues in the Distribution segment amounted to PLN 5,253.0 million, as compared to PLN 5,031.7 million in 2010. EBIT of the segment in 2011 amounted to PLN 705.3 million, and EBITDA amounted to PLN 1,619.3 million. In the previous year EBIT amounted to PLN 533.5 million, while EBITDA amounted to PLN 1,407.9 million. The growth of EBIT by approximately 32% was mainly due to higher volume of distributed energy, change in average distribution tariffs in particular groups and increased revenues from connection to the grid.

In 2011 capital expenditures in the Distribution segment amounted to PLN 1,254.6 million as compared to PLN 1,054.0 million in 2010. In 2011 highest capital expenditures were incurred for the following (i) connection of new customers to the distribution network (PLN 536.7 million) and (ii) construction and modernisation of the grid, stations and electro energy lines (PLN 435.4 million).

Table: Capital expenditures incurred in the Distribution segment in 2011 and 2010, by particular investment tasks.

in PLN million	Capital expenditures		
	2011	**2010**	**% change**
HV, MV and LV power networks................................	435.4	351.9	*24%*
Communication, telemechanics and metering equipment	108.0	76.1	*42%*
IT	32.3	47.7	*-32%*
Connection of off-takers	536.7	456.8	*17%*
Purchases of finished capital goods	71.8	41.8	*72%*
Other	70.4	79.7	*-12%*
TOTAL...	**1,254.6**	**1,054.0**	***19%***

3.4.5. Retail Sales

In 2011 total sales revenues in the retail Sales amounted to PLN 12,501.4 million, what means that they were at a similar level as in 2010. EBIT of the segment in 2011 amounted to PLN 124.2 million, and EBITDA amounted to PLN 133.8 million. In the previous year EBIT amounted to PLN 204.5 million, while EBITDA amounted to PLN 213.5 million. Decline of EBIT in Retail Sales segment by approximately 39% in 2011 in comparison to 2010 was chiefly due to lower margin achieved on sales to final off-takers what was caused by higher expenses related to purchase of electricity, property rights and lower pace of retail price growth.

In 2011 capital expenditures in the retail Sales amounted to PLN 5.1 million as compared to PLN 24.6 million in 2010 and were mainly related to expenditures for customer support systems, modernisations of small hydroelectric power plants and purchase of finished capital goods.

3.4.6. Other operations

In 2011 total sales revenues for Other operations amounted to PLN 1,878.4 million, as compared to PLN 1,804.6 million in 2010. EBIT of the segment in 2011 amounted to PLN 35.3 million, and EBITDA amounted to PLN 150.1 million. In the previous year EBIT amounted to PLN 93.2 million, while EBITDA amounted to PLN 213.4 million. Decline of EBIT in 2011 in comparison to 2010 mainly resulted mainly from sales of non-core companies and lower results of other companies from this segment, i.a. Exatel S.A. Lower EBIT in case of Exatel results from lower revenues from voice services with the simultaneous increase of variable costs of these services. Additionally, the lower revenues from other operating activities (due to lower reversal of balance sheet provisions in 2011 as compared to 2010) and lower profit from sale of non-current assets had significant negative impact on EBIT.

Capital expenditures for property, plant and equipment in Other operations in 2011 amounted to PLN 123.8 million. Within the above amount PLN 36.2 million were spent by Exatel S.A. for IT development, while the rest of the capital expenditures were mostly related to expenses for development and modernization of fixed assets required to render services under ancillary activities.

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

3.5. Publication of financial forecasts

PGE S.A. did not publish forecasts of the Company's and Group's financial results for the year 2011.

4. Management of financial resources and financial liquidity

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

4.1. Net debt of the Group and main financial ratios

Table: Group's net debt as at December 31, 2011 and 2010.

in PLN million	**December 31, 2011**	**December 31, 2010**
A. Cash [1]	240.9	546.5
B. Cash equivalents	3,622.8	2,078.0
C. Securities held for trading and available for sale [2]	5.4	8.6
D. Liquidity (A) + (B) + (C)	**3,869.1**	**2,633.1**
E. Investments held to maturity and loans and receivables [3]	**2,298.4**	**32.7**
F. Short-term debt with banks and current part of long-term debt [4]	693.8	915.0
G. Other short-term financial debt [6]	3.9	3.9
H. Short-term financial debt (F) + (G) [5]	**697.7**	**918.8**
I. Short-term financial debt, net (H) - (D) - (E)	**(5,469.9)**	**(1,746.9)**
J. Long-term bank loans and advances	1,335.6	1,804.4
K. Bonds issued	0.0	0.0
L. Other long-term loans and advances or other commitments [6]	5.8	6.5
M. Long-term financial debt (J) + (K) + (L) [5]	**1,341.4**	**1,810.9**
N. Net financial debt (I) + (M)	**(4,128.5)**	**64.0**

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

As at December 31, 2011 net financial debt amounted to PLN (-) 4,128.5 million compared to PLN 64.0 million as at December 31, 2010. The significant difference in net financial debt mainly resulted from completion of sale of Polkomtel shares (income in amount of PLN 3.3 billion), balance of settlements relating to the LTC compensations, income from dividends and grants (for CCS installation, inter alia), which were partly compensated by the payment of dividend to the shareholders.

Table: Selected financial ratios.

	For the year ended December 31,	
	2011	**2010***
Return on sales ROS (in %) Net profit x 100% / net revenues	17.7%	17.6%
Return on equity ROE (in %) Net profit x 100% / (equity – net profit)	13.7%	10.6%
Debtor's days Average trade receivables (gross) x 365 days / net revenues	24.9	33.1
Debt ratio (in %) Liabilities x 100% / total equity and liabilities	29.9%	30.3%
Current ratio Current assets / short-term liabilities	1.4	1.1

** data restated*

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

4.2. Rating

On August 4, 2011 Fitch Ratings affirmed the PGE's Issuer Default Rating ("IDR") at BBB+ with stable outlook and changed PGE's senior unsecured rating to BBB+, as a result of implementation of new methodology.

The change of senior unsecured rating to BBB+ from A- is connected with the implementation of new, more restrictive methodology of utilities assessment, introduced by Fitch Ratings, according to which the issuer of instruments may obtain rating by 1 notch higher that its IDR, when around or more than 50% of its cash flows come from regulated activities.

On December 16, 2011 Moody's Investors Service affirmed the PGE's issuer rating at A3 with stable outlook.

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

4.3. Bonds issued

As at December 31, 2011 PGE Górnictwo i Energetyka Konwencjonalna S.A. and PGE Energia Odnawialna S.A. had bonds issued. Bonds with a total nominal value of PLN 5,562 million were purchased by PGE S.A. under the following programs:

- the Agency agreement with ING Bank Śląski S.A. concluded on September 13, 2010 (agreement consolidated programs of the companies comprising PGE GiEK S.A., with ING Bank Śląski S.A. as Agent) allowing for issue of bonds of up to PLN 4,091 million. The maturity date of the agreement is December 31, 2013. As at December 31, 2011, the nominal value of the bonds acquired by PGE S.A. under this agreement amounted to PLN 3,129.0 million.
- the Agency agreement for the issue of bonds of up to PLN 3.7 billion concluded on November 30, 2009 between PGE Elektrownia Bełchatów S.A. and PKO Bank Polski S.A. The maturity date is on December 1, 2014. As at December 31, 2011, the nominal value of the bonds issued under this agreement amounted to PLN 2,153 million.
- the Agency agreement for the issue of bonds of up to PLN 500 million concluded on June 20, 2011 between PGE Energia Odnawialna S.A. and ING Bank Śląski S.A. The maturity date is on December 31, 2016. As at December 31, 2011, the nominal value of the bonds issued under this agreement amounted to PLN 280 million. On March 1, 2012 the parties signed an Appendix to the Agency agreement, that changes the maximum amount of the program to PLN 1.2 billion.

As at December 31, 2011 the balance sheet value of the issued bonds amounted to PLN 5,488 million.

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

During 2011, 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, 2011 the Company did not have any bonds issued under the programme.

PGE market Bond issue program of up to PLN 5 billion

On August 29, 2011 the Company concluded an agreement for indefinite period with Bank Polska Kasa Opieki S.A. and ING Bank Śląski S.A. The bond issue program (the "Programme") was established on the ground of the above agreement. Detailed description of the Programme is presented in p. 2.2.2 Establishment of PGE Polska Grupa Energetyczna S.A. bond issue program.

The maximum indebtedness amount from the bonds issued (representing a maximum aggregate nominal value of bonds issued and outstanding) under the Programme cannot exceed PLN 5 billion.

As at December 31, 2011 the Company did not have any bonds issued under the Programme.

PGE Bond issue program of up to PLN 10 billion

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

- Bond Purchase Commitment Agreement ("Commitment Agreement"),
- Bond Issue Programme Agreement ("Programme Agreement"),

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, 2011 the bonds were subject to underwriting of up to PLN 1.5 billion (for details see Note 42.4.4.2 to the consolidated financial statements).

As at December 31, 2011 the Company did not have any debt related to bonds under the programme.

PGE Elektrownia Opole S.A. Bond Issue programme of up to PLN 11.03 billion, for PGE

On June 20, 2011 PGE Elektrownia Opole S.A. concluded an agreement with ING Bank Śląski S.A. allowing for issue of bonds directed to PGE S.A. of up to PLN 11,027 million. The maturity date is on December 31, 2025.

As at December 31, 2011 the PGE Elektrownia Opole S.A. did not have any debt related to bonds under the programme.

4.4. Bank loans and advances

Bank loans and advances as at December 31, 2011 amounted to PLN 2,029.3 million and was lower by PLN 690.1 million, i.e. by approximately 25% as compared to the level as at December 31, 2010.

Table: Loans and advances taken by PGE S.A. and PGE Capital Group companies in 2011.

Company	Branch	Bank	Type of financing	Agreement signing date (yyyy-mm-dd)	Maturity date (yyyy-mm-dd)	Amount	Currency code	Reference rate
PGE Elektrownia Opole S.A.		Millennium S.A.	Current account credit	2011-08-24	2014-08-23	100,000,000	PLN	WIBOR 1M
PGE Elektrownia Opole S.A.		Pekao S.A.	Current account credit	2011-10-14	2013-10-13	200,000,000	PLN	WIBOR 1M
PGE Elektrownia Opole S.A.		WFOŚiGW in Opole	Loan	2011-11-04	2015-12-15	13,200,000	PLN	Rediscount rate
PGE Elektrownia Opole S.A.		WFOŚiGW in Opole	Loan	2011-11-04	2014-12-15	1,800,000	PLN	Rediscount rate
PGE Energia Odnawialna S.A.	Headquarters	BRE Bank S.A.	Current account credit	2011-11-04	2014-10-21	50,000,000	PLN	WIBOR 1M
PGE GiEK S.A.	Headquarters	PKO BP S.A.	Current account credit	2011-01-21	2012-01-20	95,000,000	PLN	WIBOR 1M
PGE GiEK S.A.	Headquarters	BRE Bank S.A.	Current account credit	2011-01-31	2012-01-30	50,000,000	PLN	WIBOR 1M

Table: Loans by PGE Group companies amortised in 2011.

Company	Branch	Bank	Type of financing	Agreement signing date (yyyy-mm-dd)	Amortisation date (yyyy-mm-dd)	Amount	Currency code	Reference rate
PGE GiEK S.A.	Elektrownia Turów	NFOŚiGW	Partial amortisation of loan	2009-12-14	2011-10-25	2,913,392	PLN	Rediscount rate
PGE GiEK S.A.	Elektrociepłownia Rzeszów	NFOŚiGW	Partial amortisation of loan	2010-06-28	2011-10-25	14,042,777	PLN	Rediscount rate
PGE GiEK S.A.	KWB Turów	NFOŚiGW	Partial amortisation of loan	2009-06-18	2011-10-25	2,657,000	PLN	Rediscount rate

In 2011 PGE S.A. and PGE Group companies did not terminate any credit agreements.

In 2011, PGE Polska Grupa Energetyczna S.A. granted following advances.

Table: Advances granted by PGE S.A.

Company	Counterparty	Agreement date	Expiry date	Amount	Currency	Interest rate type	Interest rate
PGE S.A.	PGE Systemy S.A.	2011-12-22	2014-12-22	4,000,000	PLN	fixed	Fixed, based on market terms
PGE S.A.	PGE Inwest sp. z o.o.	2011-06-30*	2012-06-30	2,266,747.4	PLN	fixed	

* On July 5, 2011 the additional agreement was signed to the Advance Agreement of December 14, 2010 with PGE Inwest sp. z o.o. The additional agreement came into force on June 30, 2011- according to its provisions - and increased the amount of the advance - in relation to the amount resulting from the initial Advance Agreement - by the value of capitalised interests and prolongs the Advance Agreement till June 30, 2012.

In addition, as described in the Note 43.12 to the consolidated financial statement, in the periods before the balance sheet date PGE S.A. made prepayments for transmission services to Vattenfall Aktiebolag. Based on the character of those transactions, in the consolidated financial statements prepared in accordance with IFRS, part of the prepayments is classified as a cost of purchase of shares in affiliates, and the other part is presented as a loan granted. As at December 31, 2011 the amount of prepayments presented as a loan granted amounted to PLN 189 million.

4.5. Guarantees

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

4.6. Significant off-balance sheet items

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

4.7. 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 2011 confirm that the Group owns sufficient resources to achieve its investment goals, including capital investments.

5. Financial and market risk management

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

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

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

The Group identifies interest rate risk connected with reference rates of WIBOR, EURIBOR and LIBOR.

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

The PGE Group is mainly exposed to currency risk connected with foreign exchange rates of EUR/PLN, USD/PLN, CHF/PLN and SEK/PLN. Major sources of exposure to currency risks are as follows: capital expenditures denominated or indexed in foreign currencies, loans and advances of Group companies denominated in foreign currencies, the purchase or sale of electricity under export contracts expressed in foreign currencies, purchase of electricity denominated in foreign currencies and electricity purchase for which part of the price is indexed to the exchange rates, fees on the purchase of transmission services expressed or indexed in foreign currencies, the purchase or sale of CO_2 emission allowances denominated or indexed to the exchange rates, expenses connected with the current exploitation of production assets denominated or indexed to the exchange rates, , capital investments (deposits) denominated in foreign currencies.

Price risk - because of their business activity, PGE Group companies are exposed to the volatility of cash flows and financial results in the domestic currency due to changes in prices of electricity, heat, hard coal, natural gas, CO_2 emission allowances, and energy certificates of origin.

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

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

Transactions that may involve credit risk for the Group include short term investments (deposits, participation units in investment funds and bonds) and trade receivables.

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

The Group has Credit Risk Management Policy, which is used in management of credit risk mainly by using the following mechanisms: the evaluation of customers' financial standing and the setting up credit limits; requiring credit collaterals from customers with lower financial standing; covenants for credit risk and standardisation of credit collaterals; system of current monitoring of payments and early debt collection system; cooperation with business intelligence agencies and debt collection companies.

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

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

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

6. Risks and threats of the PGE Capital Group

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

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

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

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

The operations of PGE Group are affected mainly by macroeconomic factors related to Polish economy, such as interest rates, PLN exchange rate, inflation rate, unemployment rate, Polish GDP, changes in directions of the economic and tax policy of the state, and also volatility of prices of electricity, fuel, CO_2 emission rights, and availability of materials used for production of electric power and heat. Other than factors associated with Polish economy, our operations are also affected by macroeconomic conditions in other countries, particularly other Member States of the European Union. Any deterioration of the general economic conditions in Poland or in the world may considerably and negatively impact the operations, performance or financial standing of the Group.

6.1.2. Risk relating to an increase in competition (right to choose an energy supplier)

Given the on-going development of the retail market, increasing activity of energy sellers and growing number of customers that change the energy supplier, the PGE Group is exposed to the risk of losing its existing customers in the retail market and the risk of decreasing margin on sale to the existing customers. It is, however, necessary to point out that market development is also an opportunity for the retail sales segment of the PGE Group to acquire new customers from outside the historic operating area of the Retail Sales companies of the PGE Group and increase both sales volume and profit.

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

The PGE Capital Group's income is substantially dependant on the consumption of power and heat by the end users. In a long run, power consumption is expected to grow. However, there is no guarantee that such a growth will occur and that the rate of growth will achieve an assumed level. Demand for electricity may decline, in particular, as a result of: (i) economic slowdown, (ii) possible reduction of power consumption level by recipients of low economic standing, (iii) development of new energy saving technologies, (iv) weather conditions. Decreasing growth rate of demand for electricity and limited access to interconnectors limiting opportunities for exporting electricity produced by the Group may have a significant adverse impact on the activity and financial results of Group companies.

6.2. Risk factors connected with regulatory and legal environment

6.2.1. Political risk

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

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

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

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

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

The Group's activity is also significantly dependant on decisions, positions, opinions and other actions of Polish authorities, authorities of the European Communities and the European Union, and authorities of other states, and although certain decisions, positions, opinions and other actions of such authorities may not take the form of laws, but must be, in practice, applied by the Group companies. In particular, in the energy sector, an authority regulating the Polish fuel and energy market is the President of the Energy Regulatory Office, who is competent, for example, to grant and withdraw concessions based on which we run our activity, and approve (to a defined extent) and control the application of electricity and heat tariffs in terms of their compliance with the provisions of the Energy Law, including the analysis and verification of costs applied by power companies as reasonable to calculate prices and rates under tariffs. Therefore there is a risk that the tariffs subject to approval by the President of the Energy Regulatory Office, are not approved or are approved with delay or are approved in different form than applied for. Additionally, for the violation of obligations set forth in the Energy Law, the President of the Energy Regulatory Office may impose pecuniary fines of up to 15% of income earned by the entity subject to the fine (PGE S.A. or a Group company) in a previous tax year and, and if the fine is related to the licensed activity, the fine may amount up to 15% of income earned on the licensed activity by the fined entity in the previous fiscal year.

6.2.3. Risk relating to projected law on renewable energy sources

In December 2011, the Ministry of Economy sent the draft Law on renewable energy sources for public consultation. If the proposed document will come into force in current shape (initial date was set for July 1, 2012), it will have a significant impact on the profitability of planned, as well as existing, renewable installations in PGE Group.

The given draft Law particularly modifies the current support system within mechanism of certificates of origin in such way that it fixes different minimal guaranteed financial support for each technology. The draft assumes introduction of so called support adjustment ratios. They differentiate the allocation of green certificates depending on type of generation source (so far each 1 MWh of renewable energy generated 1 green certificate). Value of the adjustment ratios is to be announced in a decree. Initial proposals of the ratios are presented in documents sent for public consultations. They show that lower support is projected for the technologies which are currently generating the most renewable energy (co-combustion, wind farms and older, amortised hydroelectric power plants). The new regulations assume that the adjustment ratio will amount to 70% for biomass co-combustion, 75% for the energy from onshore wind farms, 95% for the typical biomass boilers and 105% for the hydroelectric power plants with capacity more than 20 MW. The renewable installation older than 15 years will lose their rights for certificates.

The key change is also lack of provision relating to obligation to buy renewable energy and cancellation of the guarantee for the renewable energy sale price, what may be significant for less stable sources like wind plants – sales outside of peak periods at night may translate into lower income.

In light of the projected changes, in case of PGE Group the biggest decline in income/profit will appear as a result of loss of support (green certificates) for the hydroelectric power plants older than 15 years. Material negative impact is also expected as a result of introduction of adjustment ratios for wind and biomass co-combustion.

6.2.4. Risk relating to the requirement for licenses

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

6.2.5. 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 the PGE Group is the main electricity producer in Poland (approximately 40% share in the electricity generation market) and is one of the biggest electricity sellers in Poland. Given its monopolist or dominant position in relevant markets, the PGE Group is subject to limitations in the form of a ban on overusing its dominant position based on antitrust regulations of the Polish law and the law of the European Union. In the case of any violation thereof, antitrust authorities (the President of the Office for Consumer and Competition Protection, European Commission) may order to take up defined actions or enforce sanctions in the form of financial penalties.

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

PGE Group companies active in electricity trading must obtain and present for redemption to the President of the Energy Regulatory Office with certificates of origin for electricity coming from renewable sources (green certificates). Alternatively, such companies may pay a substitute fee. In the case an obligation to obtain and present for redemption to the President of the Energy Regulatory Office with certificates of origin of energy from renewable sources is not fulfilled or a substitute fee is not paid, a company may be charged with a financial penalty. Similar rules apply to energy produced in the cogeneration (yellow, red and violet certificates).

The green certificates system, supporting the development of the renewable energy, was introduced in Poland in 2005 in connection with the necessary implementation of provisions of the „green" Directive no. 2001/77/WE. The certificates of origin for cogeneration was introduced two years later, this time in connection with the implementation of so called CHP Directive (no. 2004/8/WE) promoting the production of electricity in cogeneration with heat. Current support system guarantees the effectiveness of green and violet certificates for few years ahead, while effectiveness of yellow and red certificates is guaranteed till the end of 2012, then the cogeneration support system, based on these certificates, expires. The works on amendments to the Energy Law, that are currently carried out, assume the extension of the support period for energy produced in cogeneration, however there is uncertainty with regard to settlement methods, and is unknown yet how long will be the period when amended rules of the support system will be valid.

Additionally, prices of certificates of origin are determined by current regulations, decisions of regulatory or other authorities, including in particular those relating to the definition of relevant substitute fees. Therefore, income earned by PGE Group companies from the sale of certificates of origin of energy produced thereby depends on administrative decision and legal regulations.

6.2.7. Risk connected with the programme of CO_2 emissions reduction

The electricity and heat generation at power plants and CHP plants fuelled with fossil fuels is connected with relatively high CO_2 emissions. Therefore, any regulations on the reduction of emission of CO_2 to the environment, including regulations coming within the so called power and climate package of the European Union, will have a significant impact on the Group's activity. In particular limited number of free CO_2 emission allowances under NAP II for 2008-2012 as compared to NAP I for 2005-2007 meant that CO_2 emissions outside the scope of free allowances allocated to Polish installations under NAP required the purchase of EUA emission allowances or CER or ERU units, the prices of which fluctuate. In addition, current low quotations of allowances may pose a threat to the free allocations for the next NAP. Too low prices do not guarantee the achievement of the assumptions of the existing system i.e. the promotion of pro-ecological investments. In order to remedy the system, the European Commission may stimulate the prices by limiting the supply of free allowances. The Polish derogation request for NAP III was submitted to the European Commission at the end of September 2011. The commission has 6 months for the approval or rejection of the request. However this period may be extended by time necessary for examination of compliance of the request with the EU law (inter alia if the derogation does not violate the competition principles). As a result the deadline of March 30, 2012 may not be kept and the final decision on allocation of free emission rights for Poland may not be known until autumn 2012.

The EU has recently announced that in NAP III it plans to withdraw 1,400 million of allowances form the EU emission rights trading system due to their expected excess in the next settlement period. Currently it is not known what will be the needs and what will be the impact of the economic slowdown on the amount of emissions. As a result of economic slowdown, part of the EU enterprises reduced their production and postponed their development plans, what hinders the estimation of the emission rights needed for the balancing of the system. There is threat that newly commissioned generating units from PGE Group will not receive the assumed amount of free allowances or that the actually received amount will be lower than earlier assumptions.

Resolutions, which will be taken in 2012, likely will decide what derogations Poland will obtain with regard to free CO_2 emission allowances for generators for 2013-2020. Moreover on the European forum there's a strong lobby postulating the rise of EU's CO_2 reduction target from 20% to 30% till 2020, however it does not seem that this voting will close the discussion on that matter (for example in light of the current prices of CO_2 emission allowances). Additionally, according to the assumptions of the third settlement period, from 2020 free CO_2 emission allowances will not be granted. The above issues may lead to significant growth of electricity prices, what could result in decline of electricity demand and negatively affect the financial situation of the Group.

6.2.8. Risk of restrictions on emissions of substances other than CO_2 to the environment and the enforcement of more restrictive BAT standards

The activity of Group companies, including in particular the electricity and heat generation, is connected with the emission of not only CO_2, but NO_x, SO_2, 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.

Directive of European Parliament and Council of Europe no 2010/75/UE of November 24, 2010 on industrial emissions (integrated prevention of pollution and its control), called IED, introduces more strict requirements with regard to limits of pollution emissions with reference to previously binding (inter alia, LCP directive). IED Directive must be implemented to the domestic laws by January 7, 2013. IED Directive introduces increased role of the BAT reference documents (so called BREFs). More restrictive emission standards may force PGE Group to make substantial expenses to adapt to new requirements. Therefore, there is a risk that certain of our equipment or installations will not be adjusted to applicable requirements by the imposed deadline, which may reduce electricity output.

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

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

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

6.3.2. Risk of insufficient stocks of fuel

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

6.3.3. Risk connected with mining site rehabilitation expenses

Mining companies representing the Conventional Generation segment must rehabilitate sites where they carry out their mining works. The Geological and Mining Act, as well as implementing regulations thereto, obligate mining companies to make contributions to the mine liquidation fund constituting 10% of a maintenance fee. Such funds may be used only to cover costs of mine liquidation, including rehabilitation costs. It may happen that funds and reserves of mining companies allocated to such a purpose will not cover actual rehabilitation expenses that the companies will have to bear in future. This may result in a need to increase amounts payable to the rehabilitation fund, create other reserves, and finance site rehabilitation from external sources.

6.3.4. Risk connected with weather conditions

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

6.3.5. Risk relating to maintenance, repairs, modernisations and investments

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

6.3.6. Risk of unsettled legal status of the real estates

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

6.3.7. Risk relating to obtaining debt financing

A part of the Group's activities is financed from external sources (bank loans, bonds, etc.). PGE S.A. and Group companies are parties to many financial agreements of the complex legal structure. It is possible that in future it will be difficult to obtain new finance at an amount and terms desired by the Group. This may be caused by still unstable situation in the financial and capital markets in Poland and abroad, poor general economic situation in Poland and abroad, or other reasons that are unpredictable now. Such circumstances may negatively affect the terms of financing, in particular may lead to the growth of costs of such financing (higher interest rates, commissions, etc.). Higher costs of financing may affect the Group's results.

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

PGE S.A. has received positive evaluations from rating agencies confirming its high reliability connected with investment in its debt securities. Nonetheless, rating agencies may at any time downgrade or inform PGE S.A. of their intention to downgrade the rating. The rating agencies may also completely withdraw their ratings which may have the same consequences as a downgrade in PGE's ratings. Any decrease in PGE's rating may increase the costs of external financing, limit access to capital markets and adversely affect the capacity of PGE Group companies to sell their products or contract economic transaction, especially long-term ones. This may in turn decrease the liquidity of PGE S.A. and adversely affect the operating results and financial condition of PGE Group (see p. 4.2 Rating).

6.3.9. Risk associated with the decisions of the President of the Energy Regulatory Office regarding the implementation of LTC Act

PGE S.A. and certain Group generators ware 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.

Up till now, the decisions on determining the annual adjustment of stranded costs and the annual adjustment of costs generated in gas-fuelled units were issued the President of the Energy Regulatory Office three times. The first decisions were issued on July 31, 2009 and were related to the settlement of year 2008, which was the first, not full year of execution of LTC Act. The further decisions were issued in dates determined by the LTC Act.

The aggregate value of stranded costs and the annual adjustment of costs generated in gas-fuelled units for years 2008-2010 for the entitled generators from PGE Group, resulting from the decisions of the President of the Energy Regulatory Office, amounts to PLN (-) 941.1 million. The Management Board of PGE, as well as the Management Boards of the generators from PGE Group, that are subject to LTC compensations scheme, disagree with the decisions of the ERO President and the appeals were filed to the District Court in Warsaw, Court of Competition and Consumer Protection ("CCCP") Legal proceedings are on a different stage of advancement. In previous years CCCP announced judgments with an allowance of the appeal by generators. Judgements were not valid and the ERO President appealed against these decisions.

In February and March 2012 Court of Appeal announced three different verdicts regarding the annual adjustment for the year 2008 for Branch Elektrociepłownia Rzeszów, Branch Elektrociepłownia Lublin – Wrotków and Branch ZEDO.

On February 2, 2012 the Court of Appeal in Warsaw announced a judgments regarding the settlement of value of annual adjustment of the stranded costs for 2008 for PGE GiEK S.A. Branch Elektrociepłownia Rzeszów and dismissed the appeal of the President of the Energy Regulatory Office against a judgement as a groundless and changed the ERO's decisions in accordance with the compan's request. The claim value was PLN 14.6 million. The judgement is final and binding, however the ERO President is entitled to appeal to the Supreme Court.

On March 7, 2012, in a similar case, the Court of Appeal in Warsaw allowed the appeal of the ERO President against a judgement of the CCCP regarding the settlement of value of annual adjustment of the stranded costs for 2008 for Lublin-Wrotków CHP and changed the CCCP judgement by dismissing the appeal of the generator. The claim value was PLN 126.7 million. The judgement is final and binding, however PGE GiEK S.A. is entitled to file a cassation appeal with the Supreme Court.

On March 12, 2012, in a similar case, the Court of Appeal in Warsaw repealed the verdict of the CCCP in the case regarding the settlement of value of annual adjustment of the LTC compensations for 2008 for ZEDO and remitted the case for re-examination by the CCCP. The claim value in the ZEDO case for 2008 is PLN 42.4 million (the details of the on-going proceedings are presented in Note 45.1 to the consolidated financial statements).

6.3.10. Risk of transfer prices

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

6.3.11. Risk of insufficient insurance protection

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

6.3.12. Risk relating to court, arbitration and administrative proceedings

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

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

Over 100 company and inter-company trade unions are present in the PGE S.A. and PGE Group companies and approximately 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.

7. Other significant events of the reporting period and subsequent events

Other significant events of the reporting period and the significant event having impact on the Group's activities, that occurred after the end of the reporting period until the date of approval of the financial statements, were described in detail below (additionally see Note 45 to the consolidated financial statements).

7.1. Activities related to nuclear energy

Determination of site localization for the nuclear power plant

The first stage of works, i.e. "Search and assessment of localization – determination of 3 localisations for environmental and site characterization" was completed in November 2011. The information on three localization chosen for further research was published (alphabetically):

- Choczewo (Choczewo municipality, Wejherowo district, Pomorze voivodship),
- Gąski (Mielno municipality, Koszalin district, Western Pomorze voivodship),
- Żarnowiec (Krokowa municipality, Puck district, Pomorze voivodship).

The necessary legal actions have been taken in order to begin environmental and site characterisation for the above localisations.

Simultaneously, as a part of communication campaign, in December 2011 the representatives of PGE Energia Jądrowa S.A. and PGE EJ1 sp z o.o. ("PGE EJ1") participated in meetings with the representatives of the local authorities and communities in area of Mielno, Choczewa and Krokowa municipalities.

Tender for performer of environmental and site characterisation

Conducting a site characterisation of area intended for a nuclear power plant requires a specialist knowledge, experience, equipment and keeping strict requirements with regard to safety, quality and auditability of conducted works and their results. Within the public contract awards conducted in course of negotiations with announcement (according to Public Procurement Law), the initial bids were submitted by all performers from the "short list":

- Enercon Services Inc.;
- Consortium: Tractebel Engineering S.A., POYRY Finland Oy, Scott Wilson Polska sp. z o.o.;
- Consortium: WorleyParsons Nuclear Services JSC, WorleyParsons International Inc., WorleyParsons Group Inc.

According to the approved course of proceeding, the meetings were held in October and November 2011. As a result of the meetings the main elements of the offers and the subject matter of the proceeding were explained and precisely defined. In December 2011 the representatives of potential contractors participated in visits organised by PGE EJ1 in the area of three potential localisations, which will be subject to environmental and site characterisation, in order to get acquainted with the specific characteristics of each localisation.

Selection of Owner's Engineer

Owner's Engineer will be an integrated part of the Investor's (PGE EJ1) organisation, providing support on every stage of project's realization. Owner's Engineer is to act as a entity PGE EJ1 in realization of Investor's duties towards the technology provider/ general contractor and other contractors of key works.

Within the contract awards conducted in course of negotiations with announcement (according to Public Procurement Law) for Owner's Engineer, three contractors has been put on the "short list":

- Consortium: Scott Wilson Polska sp. z o.o. and Tractebel Engineering S.A.;
- Exelon Generation Company, LLC;
- AMEC Nuclear UK Ltd.

Finalisation of the tender and selection of Owner's Engineer is planned for the first half of 2012.

On October 28, 2011 the District Court in Warsaw brought back consortium Mott MacDonald Limited and AF – Colenco Ltd. (UK/Switzerland) to proceeding. The consortium was earlier rejected as a result of the verdict of National Chamber of Appeal, issued on the ground of appeal submitted by Electricite de France.

According to the approved course of proceedings, invitations to submit initial bids were sent to four qualified contractors.

<u>Selection of technology</u>

In the fourth quarter of 2011 further works on tender documentation concerning selection of the technology provider and general contractor were conducted. Publication of the announcement and formal opening of the tender (in course of negotiations with announcement) is planned for 2012.

<u>Participation in legislative works</u>

In 2011 PGE EJ S.A. and PGE EJ 1 sp. z o.o. participated in public and inter-ministerial consultations of drafts of implementing decrees to the Nuclear Act. It is expected that first drafts of key decrees will be approved by the Ministerial Council Committee in 2012.

<u>Project financing</u>

A research was carried out with regard to the requirements for potential technology providers concerning potential capital engagement and arrangement of financing. Within the analyses, workshops with external advisers and meetings with leading suppliers/contractors were conducted in order to collect necessary information to work out optimal level of their engagement in project financing. Additionally, analysis was undertaken regarding activities of export credit agencies (ECA) and possibilities of acquiring financing through ECA. Tender proceeding for financial adviser of the project was also launched. KPMG was selected as financial adviser in December 2011.

<u>Creation of competences and development of resources</u>

The works relating to organisational processes and procedures for HR management are carried out in order to prepare competences and create human capital for the nuclear project. In addition, the obligatory trainings for all employees with regard to nuclear technology basis and nuclear safety – in order to raise qualifications - are being prepared for implementation. Apart from the agreement with the Gdańsk Technical University, the cooperation agreement on training of future staff and creation of potential in nuclear energy area was also concluded with the Mechanical Faculty of Energy and Aviation of the Warsaw Technical University. The next postgraduate studies on Nuclear Energy were launched at the Warsaw Technical University. The works on the cooperation with the Mining and Metallurgic Academy are on-going.

<u>Information campaign</u>

The contract for preparing and conducting a first stage of information campaign dedicated to nuclear energy was signed in August 2011. Decision about launching and financing by PGE Energia Jądrowa S.A. and PGE EJ1 sp. z o.o. of the first stage of communication activities directed to a wide group of recipients was caused by increasing negative attitude to nuclear energy (as a result of failure in Fukushima power plant, among others). Prepared program entitled „Nuclear Awareness" (Polish "Świadomie o atomie") was inaugurated on October 13, 2011. On this stage, basic communication tools are being built (website, expert's reports), educational and informational activities are being conducted - their purpose is to explain myths and distortions concerning nuclear energy.

Simultaneously, public contract awards for "Preparation and realization of communication and promotional activities regarding project of construction of the first nuclear power plant in Poland for 2012-2013", i.e. for another stage of the communication of the project, was prepared and announced.

On November 25, 2011 the short list of potential localisation of nuclear power plants was publicly announces. The nuclear companies began communication operations directed to the local communities. Directly after the announcement, the informational meetings were held with the authorities of Mielno municipality and residents of Gąski and Sarbinowo. The meetings with the residents of Choczewo and Krokowa municipalities took place on December 6-7, 2011. WDuring these meetings the inwestor presented complex information on planned investment, answered the questions and declared full willingness to present additional information, clarifications or analysed on next, systematically organised meetings.

Safety

The works on preparation of the text of the cooperation agreement with the Internal Security Agency (ABW) with regard to safety issues were conducted in the second half of 2011. The proper agreement was signed in October 2011. Moreover, the works on preparation of terms of reference in the scope of integrated architecture of the information safety management, including certification according to ISO 27001 and business continuity procedures.

7.2. Consolidation Programme

On January 2, 2012 the merger of Dychowskie Przedsiębiorstwo Eksploatacji Elektrowni „Eldeks" sp. z o.o. and Elektrownia Wiatrowa Kamieńsk sp. z o.o. with PGE Energia Odnawialna S.A. was registered (see p. 1.6. Changes in organisation of the Capital Group).

Merger of PGE Elektrownia Opole S.A. with PGE Górnictwo i Energetyka Konwencjonalna S.A. is currently on-going (for detailed description of the legal issues see Note 38.4 to the consolidated financial statements)

The above mentioned changes are a continuation of the Consolidation Programme, which was carried out in PGE Capital Group in 2009-2010. As a result of the execution of the Consolidation Programme in 2010, the following formal and legal mergers took place in the given segments: (i) mining and conventional generation; (ii) renewables; (iii) distribution of the electric energy; (iv) retail sale of electric energy; as well as the merger of PGE Górnictwo i Energetyka S.A., PGE Energia S.A. and PGE Electra S.A. with PGE Polska Grupa Energetyczna S.A.

7.3. Non-core asset management concept within the PGE Capital Group

In 2011, 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.

In 2009-2011, under the programme, shares/stocks of 29 companies were sold, liquidation of 7 companies and bankruptcy proceedings in 5 companies were completed, shares in 1 company were redeemed, 9 holiday resorts and 4 other assets were sold. Sale of shares in one of the listed companies (Bank Ochrony Środowiska S.A.) began in December 2009 and has been continued in 2011.

Sale agreements concluded/completed in 2012

On November 8, 2011 PGE Polska Grupa Energetyczna S.A., PGE Elektrownia Opole S.A. and PGE Górnictwo i Energetyka Konwencjonalna S.A. concluded the conditional agreement with Giełda Papierów Wartościowych S.A. for the sale of 304,750 ordinary registered shares of Towarowa Giełda Energii S.A. with a nominal value of PLN 10 PLN each, representing 21.0172 % of the share capital of Towarowa Giełda Energii S.A. for PLN 46.9 million. The agreement was completed on February 24, 2012 after fulfilment of conditions precedent.

The agreement for sale of 28,000 shares of „WIRBET" S.A. held by PGE Obrót S.A. was signed on February 16, 2012. The value of the agreement is PLN 1.3 million and the shares were purchased by Cypriot fund Tag Heer Capital Fund Management Ltd.

In 2012 the sales of next shares/stocks of non-core companies, qualified to particular portfolios assigned for sale, will be continued. Plans include a sale of consolidated companies MegaMed sp. z o.o. and Elbest Sp. z o.o. The works on preparation for sale of the other non-core assets will be carried out. The liquidation and bankruptcy proceedings of the non-core companies will also be monitored.

7.4. Decisions of the President of the Energy Regulatory Office regarding the annual adjustments of the stranded costs for 2010

In letters dated July 29, 2011 and July 31, 2011 the President of the Energy Regulatory Office (the "ERO President") handed over his decisions concerning the annual adjustment of the stranded costs and annual adjustment of the costs generated in gas-fired units for the year 2010, which are due to five generators from PGE Capital Group according to the Act of June 29, 2007 on coverage of stranded costs resulting at generators in relation to accelerated termination of long-term contracts.

According to the mentioned decisions, generators from PGE Capital Group are obliged to return approximately PLN 317 million in total to Zarządca Rozliczeń S.A.

The Management Board of the Company, as well as the Management Boards of PGE Górnictwo i Energetyka Konwencjonalna S.A. and PGE Elektrownia Opole S.A., disagree with the decisions of the ERO President and the appeals were filed to the District Court in Warsaw, Court of Competition and Consumer Protection ("CCCP") between August 16-18, 2011.

7.5. Creation of a mortgage on the assets of material value by PGE Górnictwo i Energetyka Konwencjonalna S.A.

On August 9, 2011 PGE Górnictwo i Energetyka Konwencjonalna S.A. (PGE GiEK S.A.) created a mortgage up to the amount of EUR 195 million, in favour of the Nordic Investment Bank ("NIB") with its registered office in Helsinki, on perpetual usufruct of the property and on the ownership right concerning the buildings and all of their parts (the "Mortgage"). The Mortgage was created in order to secure the repayment of liabilities resulting from the loan granted by NIB to PGE GiEK S.A. The Mortgage was created on the property, on which the new 858 MW unit is located. The book value of the assets, on which the Mortgage was created, amounts to approximately PLN 4.66 billion in the accounts of PGE GiEK S.A., what constitutes more than 10% of the Company's equity and thereby meets the criteria of the assets of material value. As at December 31, 2011 the liability resulting from the loan secured by the Mortgage amounted to EUR 150 million.

7.6. Establishment of PGE Dom Maklerski S.A.

On February 1, 2012 PGE Polska Grupa Energetyczna S.A. established PGE Dom Maklerski S.A. with the registered office in Warsaw and is a 100% shareholder. Until the date of this report, the company has not been registered in the National Court Register.

7.7. Adoption of the PGE Group Efficiency Improvement Programme for 2012-2016

On January 10, 2012 PGE Group Efficiency Improvement Programme for 2012-2016 (the "Programme") was approved by the Supervisory Board of PGE.

Total expected sustainable result of the Programme on consolidated EBIT of the PGE Capital Group is to amount approximately PLN 1.53 billion p.a. starting from 2016, as compared to 2010 (a base year for the Programme).

The Programme will be implemented in period 2012-2016 and will consist of two elements: cost reduction programme in PGE Group and increase of revenues from existing activities. Initiatives will be implemented gradually, starting from 2012, to reach the ultimate effect in 2016.

As compared to 2010, the cost-related initiatives will provide for approximately PLN 987 million of savings in 2016 and in subsequent years. The initiatives related to cost reduction include:

- increase of organizational structure effectiveness
- optimization of repair and maintenance costs
- increase of effectiveness of power consumption and reduced network losses
- purchases centralization

Revenues-related initiatives, as compared to 2010, will provide for additional revenues of approximately PLN 541 million in 2016 and in subsequent years. Initiatives related to increase of revenues include:

- increase of power generation from biomass
- increase of sales effectiveness and improvement of customer care services

The costs of the Programme will be carried mostly in 2012-2013. As of 2014, the Programme will have a positive impact on financial results, reaching its full potential in 2016.

7.8. Signing of the agreement between PGE Elektrownia Opole S.A. and Rafako S.A., Polimex-Mostostal S.A. and Mostostal Warszawa S.A.

On February 15, 2012 PGE Elektrownia Opole S.A., concluded an agreement with Rafako S.A., Polimex-Mostostal S.A. and Mostostal Warszawa S.A. (the „Agreement"), forming a syndicate: Rafako S.A., Polimex-Mostostal S.A. and Mostostal Warszawa S.A. (later referred to as the „General Contractor"). Subject matter of the agreement is construction of two hard coal fired 900 MW supercritical power units no 5&6 at PGE Elektrownia Opole S.A. by the General Contractor. The project will be executed in EPC formula (Engineering, Procurement, Construction). According to the Agreement, the General Contractor is obliged to execute the order within 54 months from the date of the Notice To Proceed ("NTP") with reference to unit no 5 and within 62 months from the date of the NTP with reference to unit no 6. In order to issue the NTP, PGE Elektrownia Opole S.A. is obliged i.a. to deliver the construction permit. The net value of the Agreement amounts to PLN 9.4 billion, while gross value of the Agreement amounts to PLN 11.6 billion.

7.9. Appointment of the President and Vice-President of the Management Board

On March 1, 2012 the Supervisory Board adopted a resolution on appointment of:

- Mr. Krzysztof Kilian to the Management Board of the eighth term as from March 5, 2012 and entrusting him the duties of President of the Management Board/Chief Executive Officer;
- Ms. Bogusława Matuszewska to the Management Board of the eighth term as from March 5, 2012 and entrusting her the duties of Vice-President of the Management Board.

8. PGE Capital Group's development perspectives

8.1. 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 results and performance within at least next year:

- demand for electricity and heat;
- electricity prices on wholesale market;
- prices of property rights;
- availability and prices of fuels used in generation of electricity and heat, in particular prices of hard coal, fuel gas and oil;
- availability and costs of CO_2 emission rights;
- availability of cross-border transmission capacities;
- 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;
- the tariff process for 2013, including in particular costs recognised by the President of the Energy Regulatory Office as reasonable and the amount of reasonable return on equity, as well as tariff approval date;
- decisions of the ERO President related to realisation of LTC Act;
- amendments to the Energy Law and others acts;
- court's ruling on the disputes between the President of the Energy Regulatory Office and generators from the PGE Group entitled to receive compensations under LTC Act with regard to the annual adjustments of the stranded costs for 2008 and annual adjustments of the stranded costs and annual adjustments of costs generated in gas-fuelled units for 2009 and 2010;
- ruling on the dispute with Alstom consortium regarding the selection of the general contractor of the construction of units 5&6 in PGE Elektrownia Opole S.A.;
- decision on the environmental permit for units 5&6 in PGE Elektrownia Opole S.A.;
- 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.;

– planned sale of Exatel S.A. shares;

– possible different decision in law, tax and other contingent liabilities disputes, from which most relevant were presented in Note 38 to the consolidated financial statements.

8.2. Realisation of PGE Capital Group's strategy in 2011

The primary goal of the PGE Group was 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.

The following activities were executed under the strategy in 2011: a new 858 MW unit in Bełchatów power plant was commissioned, efficiency improvement programs were launched in all business segments, establishing of shared services centres has begun and the sale of non-core assets has been continued.

According to the updated PGE Group strategy for 2012-2035, creating economic value for shareholders remains a main strategic objective of the company. PGE will continue its operations in existing business segments i.e. electricity generation form conventional and renewable sources, lignite mining, retail sale and distribution of electricity to the final customers, generation and sale of heat, electricity wholesale trading on the domestic market and construction of the nuclear power plants. Given the strong market position of PGE Group in current business segments, the company will seek the opportunities for development also on new markets, though, inter alia, development of activities on foreign markets mainly in renewables segment, co-generation and electricity, heat and gas distribution, as well as through development of wholesale trading of electricity, gas and CO_2 emission rights in Poland and internationally, and development of activities on domestic heat market.

In 2012 the Group will continue the Group's key investment projects:

– construction of 2 new coal-fired 900 MW units in Opole power plant;

– preparation for construction of new lignite-fired 460 MW unit in Turów power plant;

– preparation program for construction of steam-gas units at Elektrownia Pomorzany (240MW), Elektrociepłownia Gorzów (135MW), Zespół Elektrociepłowni Bydgoszcz (240MW) and Elektrociepłownia Puławy (600 – 840MW);

– preparation for construction of nuclear power plant;

– program for construction of on-shore wind farms;

– preparation for construction of off-shore wind farms on the Baltic Sea;

– examination of possibilities of commitment into the extraction of unconventional gas.

9. Entity authorised to audit of financial statements

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

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

PLN thousand	**2011**	**2010**
Fee of KPMG Audyt Sp. z o.o., including:	**296.6**	**327.8**
Audit and reviews of the financial statements	296.6	327.8

In 2011 roku KPMG Audyt Sp. z o.o. also audited financial statements of other PGE Capital Group companies, i.e.: PGE Górnictwo i Energetyka Konwencjonalna S.A. (holding with self-balancing branches), PGE Elektrownia Opole S.A., PGE Energia Jądrowa S.A., PGE EJ 1 sp. z o.o., Exatel S.A., PGE Systemy S.A., Elbis sp. z o.o. and Przedsiębiorstwo Transportowe ELTUR-TRANS sp. z o.o. The fees payable from the above audits amounted to PLN 749.9 thousand.

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

10. Statement on implementation of Corporate Governance

This Statement on implementation of corporate governance in PGE Polska Grupa Energetyczna S.A. in 2011 was prepared on the basis of art. 91 section 5 point 4 of the Regulation of the Minister of Finance dated February 19, 2009 on current and periodic information published by issuers of securities and on conditions under which such information may be recognized as being equivalent to information required by the regulations of law of a state which is not a member state (Dziennik Ustaw of 2009, no. 33, item 259 as amended) and the resolution of the Management Board of the Warsaw Stock Exchange no. 718/2009 of December 16, 2009.

10.1. Corporate governance principles which the Company was obliged to follow in 2011

In 2011 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 WSE no. 17/1249/2010, that came into force on July 1, 2010, and later amended by the Resolution of the Board of the WSE no. 15/1282/2011 of August 31, 2011 and by the Resolution of the Board of the WSE no. 20/1287/2011 of October 19, 2011, which both came into force on January 1, 2012. 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.

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

In 2011 the Company applied the corporate governance principles with the exception of principle no. 5 included in 'Recommendations for Best Practice for Listed Companies' described in point 1 of the Best Practices.

This principle constitutes that "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" 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

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 they perform the services for the Company on the ground of the agreements for rendering of the management services (members of the Management Board purchase, at their own expense, the liability insurance with regard to the managing of the Company).

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

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

Basic regulations applicable to preparation of financial statements include: International Financial Reporting Standards ("IFRS") approved by the European Union, IFRS-compliant accounting policy of the PGE Capital Group, the Accounting Act of September 29, 1994 (as amended) (in the areas not regulated by IFRS), the procedure of closing accounting books in PGE Capital Group, and requirements for preparing financial statements and consolidated financial statements imposed by the Warsaw Stock Exchange. IFRS-compliant accounting policy of the PGE Capital Group is binding for the companies using IFRS for preparation of their statutory financial statements and at preparation of the IFRS-compliant reporting packages for the consolidation.

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 2011 financial statements of key companies in the PGE Group. Their duties include review of the half-year financial statements and initial and essential audit of the annual statements. The PGE Group has implemented a multi-stage process of approving financial statements with the participation of Supervisory Boards. Stand-alone and consolidated financial statements of PGE S.A. are evaluated by the Supervisory Board. The Audit Committee operates within the Supervisory Board and is responsible, among others, for reviewing interim and annual financial statements of the Company. Stand-alone financial statements of the companies subject to consolidation are evaluated by the Supervisory Boards of such companies. The financial statements are approved by the General Meetings of the companies.

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

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

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

10.4. Shareholders with a significant stake

According to the company's knowledge, as at December 31, 2011, the sole shareholder with a significant 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 State Treasury, about which the Company informed in the current report no. 78/2010 dated December 22, 2010).

At the same time, the Management Board of PGE informs that on March 1, 2012, it received a notification from the Minister of the State Treasury about a change in the number of shares held by the State Treasury in the Company. On February 29, 2012, the State Treasury, after the accelerated book building, sold 131,000,000 ordinary shares, representing 7.01% of the Company's share capital.

prior to the Sale, the State Treasury held 1,288,124,546 shares of the Company, representing 68.89% of the Company's share capital and entitling to 1,288,124,546 votes at general meeting of the Company, representing 68.89% of the total number of votes at general meeting of the Company.

Following the Sale, the State Treasury holds 1,157,124,546 shares of the Company, representing 61.89% of the Company's share capital and entitling to 1,157,124,546 votes at general meeting of the Company, constituting 61.89% of the total number of votes.

10.5. Shareholders with special control powers

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

Despite the fact that the Company 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.

On the ground of the Statutes, the State Treasury holds special right with regard to selection of the Supervisory Board members. Selection of half of members of the Supervisory Board, including Chairperson of the Supervisory Board, appointed by the General Meeting shall be elected from among persons indicated by the State Treasury. This State Treasury's right is valid until its stake in the Company falls below 20%.

10.6. Limitations regarding exercise of the voting rights in shares

Until June 29, 2011 there were no limitations regarding exercise of the voting rights in shares of the Company.

On June 29, 2011 the General Meeting adopted the changes to the Company Statutes, introducing modifications regarding the limitations regarding exercise of the voting rights in shares. The voting right of shareholders shall be limited in such manner that at the General Meeting, none of them may exercise more than 10% of the total number of votes existing in the Company as at the date of holding the General Meeting, subject to the provision that for the purposes of determining the obligations of entities acquiring considerable blocks of shares as provided for in the Act on public offerings, conditions for introducing financial instruments to an organised trading system and public companies of July 29, 2005, such limitation of the voting right shall be regarded as non-existent.

The above limitation does not apply to the State Treasury and shareholders acting with the State Treasury on the basis of agreements concerning the joint exercise of the voting right related to shares.

In addition, for the purposes of limiting the voting right, votes belonging to shareholders between whom there exists a relationship of domination or dependence (Shareholders Group) shall be cumulated; in the event that the cumulated number of votes exceeds 10% (ten per cent) of the total number of votes in the Company, it shall be subject to reduction.

The cumulation of votes shall consist in the summing of the number of votes remaining at the disposal of shareholders belonging to a Shareholders Group.

The reduction of votes shall consist in decreasing the total number of votes in the Company to which shareholders belonging to a Shareholders Group are entitled at the General Meeting to the threshold of 10% (ten per cent) of the total number of votes in the Company.

The cumulation and reduction of votes together with the detailed description of the shareholders between whom there exists a relationship of domination or dependence are governed by the principles included in the Company's Statutes.

Moreover, each shareholder who intends to participate in the General Meeting, directly or by proxy, shall be obliged, without a separate call, to notify the Management Board or the Chairperson of the General Meeting of the fact that he holds, directly or indirectly more than 10% (ten per cent) of the total number of votes in the Company. A person who has failed to comply or has complied improperly with that obligation to provide information may exercise the voting right exclusively from one share until the remedy of such failure to; the exercise of the voting right from the other shares by such person shall be ineffective.

Irrespective of the above provision, in order to establish a basis for the cumulation and reduction of votes, a shareholder, the Management Board, the Supervisory Board and the particular members of these bodies may demand that a shareholder provide information whether he is a person having the status of a dominant or dependent entity with respect to another shareholder. The right referred to in the preceding sentence shall also cover the right to demand that a shareholder disclose the number of votes that such shareholder holds independently or together with other shareholders.

Resolutions of the General Meeting concerning the preferential status of shares or a merger of the Company by way of a transfer of all its assets to another company or a merger by way of an establishment or another company, a dissolution of the Company (including in consequence of a transfer of the Company's registered office or major enterprise abroad), its liquidation, transformation or decrease of the share capital by way of redemption of a part of shares without its simultaneous increase shall require a majority of 90% of all votes cast.

At the time when the share of the Company's share capital held by the State Treasury falls below 5% the limitation of the above voting right shall expire.

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

There are no limitations regarding the transfer of ownership of the Company's securities, that the Company is aware of.

10.8. Amendments to the Company's Statutes

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

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

Activities of the General Meeting are described in the Code of Commercial Companies and the Company's Statutes. The additional issues related to the activities of the General Meeting are regulated by the Rules of the General Meeting approved on March 30, 2010 by the Extraordinary General Meeting.

The Company's Statutes and the Rules of the General Meeting are available on the PGE's website at www.pgesa.pl.

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.

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 takes place at the Company's registered office.

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). Lienors and users, who have the voting right, may participate in the General Meeting, if they are registered in the stockholders' ledger as at the 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 the Company.

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

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

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

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

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

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

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

A. Management Board

a) Members of the Management Board.

In 2011, 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 until December 14, 2011
Paweł Skowroński	Vice-President of the Management Board responsible for Operations since March 17, 2011; Acting CEO from December 15, 2011 until March 4, 2012
Wojciech Ostrowski	Vice-President of the Management Board responsible for Finance since March 17, 2011
Marek Szostek	Vice-President of the Management Board responsible for Trading from June 29, 2011 until December 14, 2011; Vice-President of the Management Board responsible for Development until June 28, 2011
Piotr Szymanek	Vice-President of the Management Board responsible for Corporate Affairs
Wojciech Topolnicki	Vice-President of the Management Board responsible for Finance until January 5, 2011
Marek Trawiński	Vice-President of the Management Board responsible for Operations until March 16, 2011

Till July 1, 2011 the Management Board acted as the Board of the seventh term. On July 2, 2011 the eighth term of the Management Board has begun.

On March 1, 2012 the Supervisory Board adopted a resolution on appointment of Mr. Krzysztof Kilian as the President of the Management Board/Chief Executive Officer and Ms. Bogusława Matuszewska as the Vice-President of the Management Board. In connection with the above the following persons were the members of the Management Board as at the date of the publication of this report:

- Krzysztof Kilian – President of the Management Board,
- Bogusława Matuszewska – Vice-President of the Management Board,
- Wojciech Ostrowski – Vice-President of the Management Board,
- Paweł Skowroński – Vice-President of the Management Board,
- Piotr Szymanek – Vice-President of the Management Board.

b) 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.

c) 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.

d) 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

a) Members of the Supervisory Board

In 2011 the Supervisory Board consisted of:

Name and surname of the member of the Supervisory Board	Position
Marcin Zieliński	Chairman of the Supervisory Board
Maciej Bałtowski	Vice-Chairman of the Supervisory Board
Jacek Barylski	Supervisory Board Member
Małgorzata Dec	Supervisory Board Member
Czesław Grzesiak	Supervisory Board Member
Grzegorz Krystek	Supervisory Board Member
Katarzyna Prus	Secretary of the Supervisory Board
Zbigniew Szmuniewski	Supervisory Board Member
Krzysztof Żuk	Supervisory Board Member

b) Rules of appointing and recalling of the supervisory personnel

Until June 29, 2011 the following rules were binding with regard to appointment and recall of the members of the Supervisory Board of the Company:

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.

On June 29, 2011 the General Meeting adopted the changes to the Company Statutes, introducing modifications regarding the appointment and recalling of the members of the Supervisory Board of the Company.

According to the valid Statutes, Members of the Supervisory Board are appointed for a joint term of office of three years. The Supervisory Board consists of five to nine members appointed and recalled by the General Meeting. The number of members of the Supervisory Board shall always be an odd number. The Supervisory Board elected by way of group voting shall consist of five members. The number of members of the Supervisory Board shall be determined by the General Meeting in a separate resolution. Member of the Supervisory Board may be appointed and dismissed by the General Meeting at all Times, with the exception of the Supervisory Board member appointed by the State Treasury by way of a written declaration submitted to the Management Board. Moreover, a half of members of the Supervisory Board (except the Supervisory Board member mentioned in the previous sentence), including Chairperson of the Supervisory Board, shall be elected from among persons identified by the State Treasury, until its stake in the share capital falls below 20%. At the time when this right of the State Treasury expires, another shareholder with the highest stake in the Company's share capital acquires that right, provided that he holds at least 20% in the Company's share capital.

The State Treasury is entitled to appoint and dismiss one Supervisory Board member by way of a written declaration submitted to the Management Board. Such appointment or dismissal shall become effective as at the time of a relevant declaration to the Management Board and shall not require a resolution of the General Meeting. This right of the State Treasury shall expire at the time when the State Treasury ceases to be a shareholder in the Company. According to the provisions of the Statutes, the Supervisory Board shall include at least one person appointed by the General Meeting from among persons meeting the criteria of independence specified in the principles of corporate governance adopted by the Board of the WSE. Proposing a candidate for this position a shareholder nominating such candidate shall be obliged to submit to the minutes of the General Meeting such candidate's written declaration confirming his/her independence.

The State Treasury's failure to appoint one member of the Supervisory Board or the General Meeting's failure to elect members of the Management Board meeting the criteria of independence or the absence of such persons in the composition of the Supervisory Board shall not prevent the Supervisory Board from adopting valid resolutions.

At the same time, if the entitled shareholder fails to exercise the right to appoint one member of the Supervisory Board by way of a written declaration submitted to the Management Board, the Supervisory Board may act in the composition appointed by the General Meeting.

According to the provisions of the Statutes in the event that, in consequence of the expiry of a mandate of a member of the Supervisory Board, the number of members of the Supervisory Board falls below the minimum specified in the Statutes, the Management Board shall convene the General Meeting immediately in order to supplement the composition of the Supervisory Board. In the event of the expiry of a mandate of at least one member of the Supervisory Board elected by way of group voting, the State Treasury shall recover its individual right to appoint one Supervisory Board member by way of a written declaration.

c) 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.

d) 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 EUR 100,000,000 with the following exceptions:
  a. entering into contracts with direct or indirect subsidiaries (as defined by the Code of Commercial Companies),
  b. entering into contracts or incurring of obligations consisting in trading of electricity, related products and rights connected with them, and fuels,
- 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 appointment and 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 2011, the Audit Committee consisted of:

Name and surname	Position
Małgorzata Dec	Chairman
Maciej Bałtowski	Committee Member
Grzegorz Krystek	Committee Member
Zbigniew Szmuniewski	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 2011 the Corporate Governance Committee consisted of:

Name and surname	Position
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	Position
Grzegorz Krystek	Chairman (till September 6, 2011 - Committee Member)
Małgorzata Dec	Committee Member
Zbigniew Szmuniewski	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 2011 the Appointment and Remuneration Committee consisted of:

Name and surname	Position
Maciej Bałtowski	Chairman
Jacek Barylski	Committee Member
Czesław Grzesiak	Committee Member
Katarzyna Prus	Committee Member
Marcin Zieliński	Committee Member

11. Statements of the Management Board

11.1. Statement on the reliable preparation of the financial statements

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

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

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

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

Warsaw, March 12, 2012

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

Krzysztof Kilian

President of the Management Board

Bogusława Matuszewska	*Wojciech Ostrowski*
Vice-president of the Management Board	*Vice-president of the Management Board*
Paweł Skowroński	*Piotr Szymanek*
Vice-president of the Management Board	*Vice-president of the Management Board*