



**REPORT OF THE MANAGEMENT BOARD
ON OPERATIONS OF
TAURON POLSKA ENERGIA S.A. CAPITAL GROUP
FOR THE FINANCIAL YEAR 2017**

MARCH 2018

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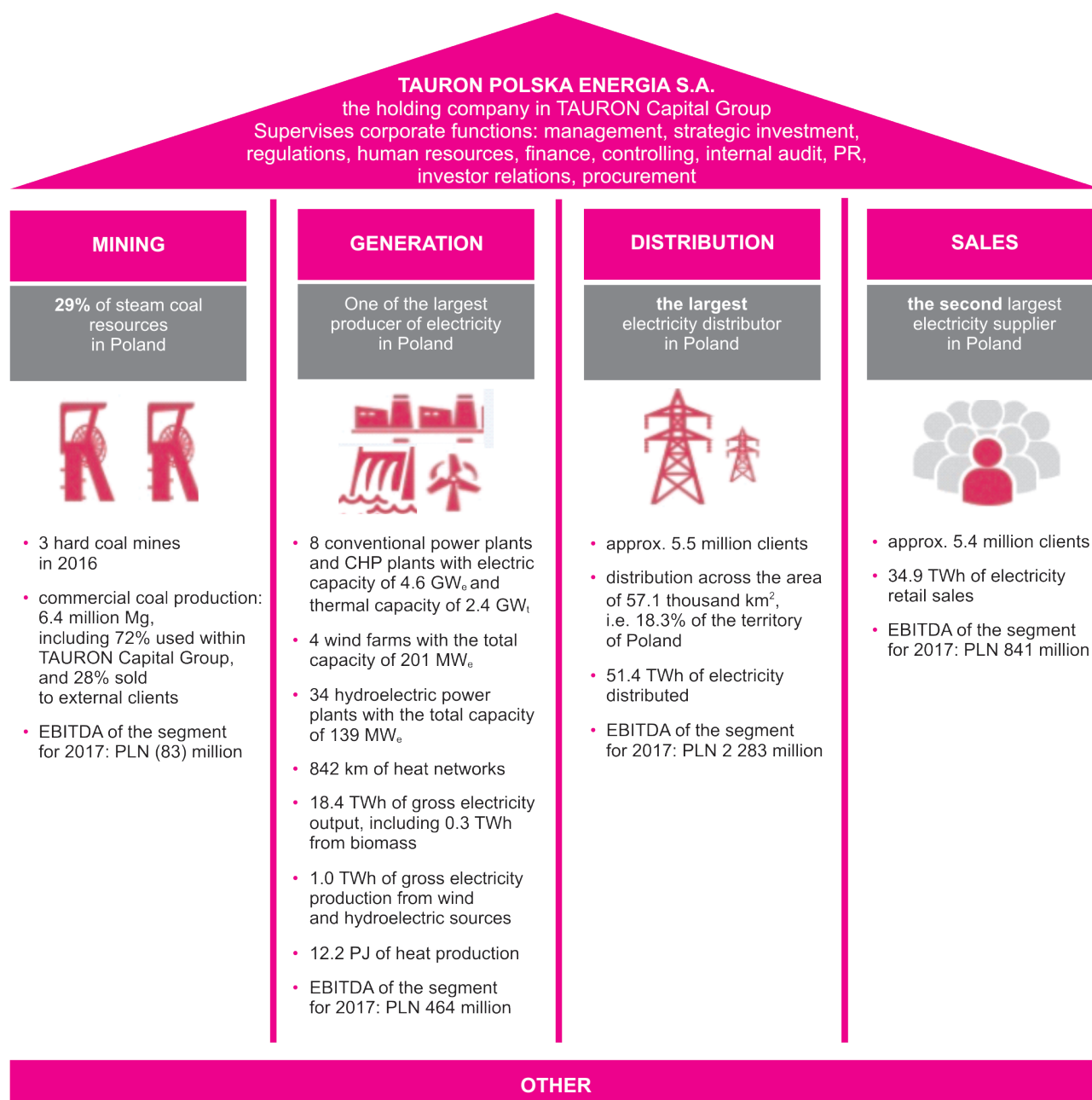
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1. TAURON CAPITAL GROUP

1.1. Basic Information on TAURON Capital Group

TAURON Polska Energia S.A. Capital Group (TAURON Capital Group) is a vertically integrated energy group located in the south of Poland. TAURON Capital Group conducts its operations in all key segments of the energy market (excluding electricity transmission which is the sole responsibility of the Transmission System Operator (TSO)), i.e. hard coal mining as well as electricity and heat generation, distribution and trading.

Figure no. 1. TAURON Capital Group



1.2. Business segments (lines of business)

Business operations, in accordance with TAURON Group's Business and Operational Model (Business Model) in force, are conducted by units defined as: Corporate Center, seven Lines of Business, i.e. Trading, Mining, Generation, Renewable Energy Sources (RES), Heat, Distribution and Supply as well as Shared Services Centers (CUW). The detailed information on the Business Model was concluded in section 8.1. of this report.

For the needs of reporting TAURON Capital Group's results from operations TAURON Capital Group's operations are split into the following five Segments, hereinafter also referred to as Lines of Business:



Mining segment, comprising mainly hard coal mining, enriching and selling in Poland with such operations conducted by TAURON Wydobycie S.A. (TAURON Wydobycie).



Generation segment, comprising mainly electricity generation using conventional sources, including co-generation, as well as electricity generation from renewable energy sources, including biomass burning and co-firing, and hydroelectric power plants and wind farms. The segment also includes heat generation, distribution and supply. This segment's operations are conducted by TAURON Wytwarzanie S.A. (TAURON Wytwarzanie), TAURON Ciepło sp. z o.o. (TAURON Ciepło) and TAURON EKOENERGIA sp. z o.o. (TAURON EKOENERGIA). The segment also includes TAURON Serwis sp. z o.o. (TAURON Serwis) subsidiary, dealing primarily with the generation equipment's overhauls and Nowe Jaworzno Grupa TAURON Sp. z o.o. (Nowe Jaworzno GT) company responsible for the construction of the new power generation unit at Jaworzno.



Distribution segment, comprising electricity distribution using the distribution grids located in southern Poland. The operations are conducted by TAURON Dystrybucja S.A. (TAURON Dystrybucja). This segment also includes the following subsidiaries: TAURON Dystrybucja Serwis S.A. (TAURON Dystrybucja Serwis) and TAURON Dystrybucja Pomiary sp. z o.o. (TAURON Dystrybucja Pomiary).



Supply segment, comprising electricity supply to the final consumers and electricity wholesale trading, as well as trading and management of CO₂ emission allowances and property rights arising from certificates of origin as well as fuels. The operations in this segment are conducted by the following subsidiaries: TAURON Polska Energia S.A. (TAURON or the Company), TAURON Sprzedaż sp. z o.o. (TAURON Sprzedaż), TAURON Sprzedaż GZE sp. z o.o. (TAURON Sprzedaż GZE) and TAURON Czech Energy s.r.o. (TAURON Czech Energy).

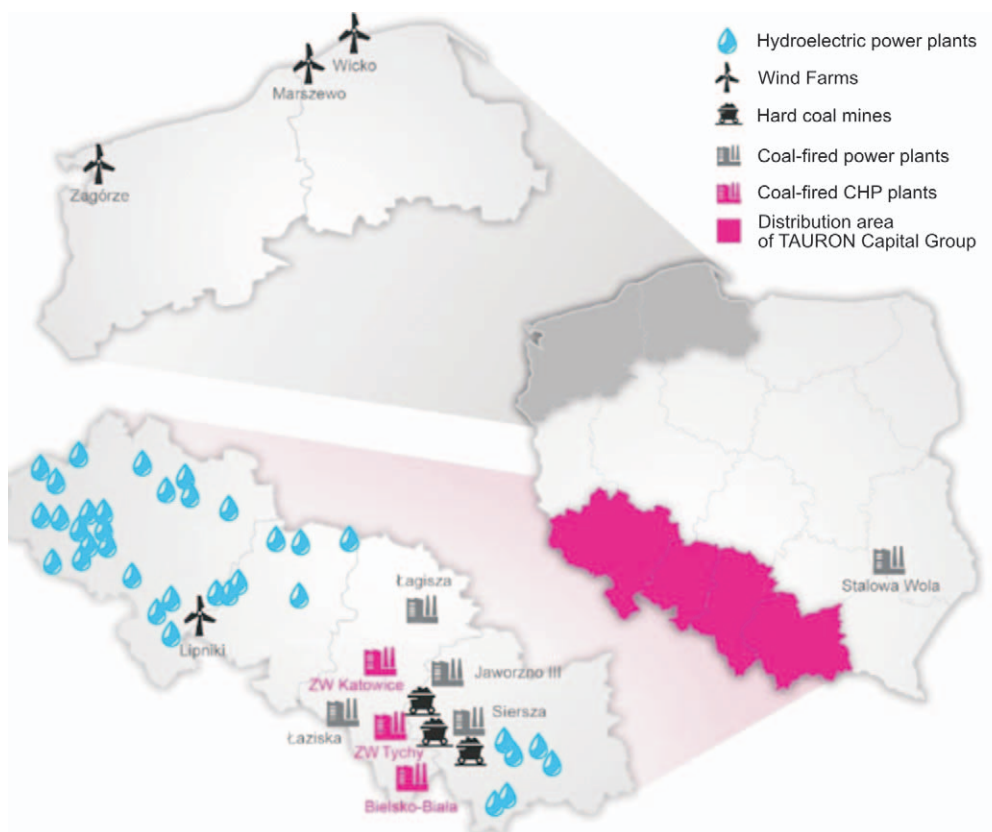


Other operations, comprising, among others, customer service for TAURON Capital Group's customers, provision of support services for TAURON Capital Group's subsidiaries with respect to accounting, HR and ICT, conducted by TAURON Obsługa Klienta sp. z o.o. (TAURON Obsługa Klienta) subsidiary, as well as operations related to extraction of stone, including limestone, for the needs of power generation, steel, construction and road building industries as well as production of sorbing agents for wet flue gas desulphurization installations and for use in fluidized bed boilers, carried out by Kopalnia Wapienia "Czatkowice" sp. z o.o. (KW Czatkowice) subsidiary. This segment also includes the following subsidiaries: TAURON Sweden Energy AB (publ) (TAURON Sweden Energy), dealing with financial operations, Biomasa Grupa TAURON sp. z o.o., (Biomasa Grupa TAURON), dealing mainly with biomass acquisition, transportation and processing, KOMFORT-ZET sp. z o.o. (KOMFORT-ZET) dealing primarily with real estate administration as well as the technical support of vehicles and Polska Energia – Pierwsza Kompania Handlowa sp. z o.o. (PEPKH).

TAURON Capital Group conducts its operations and generates its revenue mainly from electricity and heat supply and distribution, electricity and heat generation, as well as from hard coal sales.

The below figure presents the location of TAURON Capital Group's key assets as well as the distribution area where TAURON Dystrybucja conducts operations as the Distribution System Operator.

Figure no. 2. Location of TAURON Capital Group's key assets



1.3. TAURON Capital Group's organization and structure

TAURON Polska Energia S.A. parent (holding) company was established on December 6, 2006 as part of the *Program for the Power Generation Sector*. The founders of the Company included: State Treasury represented by the Minister of Treasury, EnergiaPro S.A. with its seat in Wrocław (currently: TAURON Dystrybucja), ENION S.A. with its seat in Cracow (currently: TAURON Dystrybucja) and Elektrownia Stalowa Wola S.A. with its seat in Stalowa Wola (currently: TAURON Wytwarzanie). The Company was registered in the National Court Register on January 8, 2007 under the name: Energetyka Południe S.A. The change of the Company's name to its current one, i.e. TAURON Polska Energia S.A., was registered on November 16, 2007.

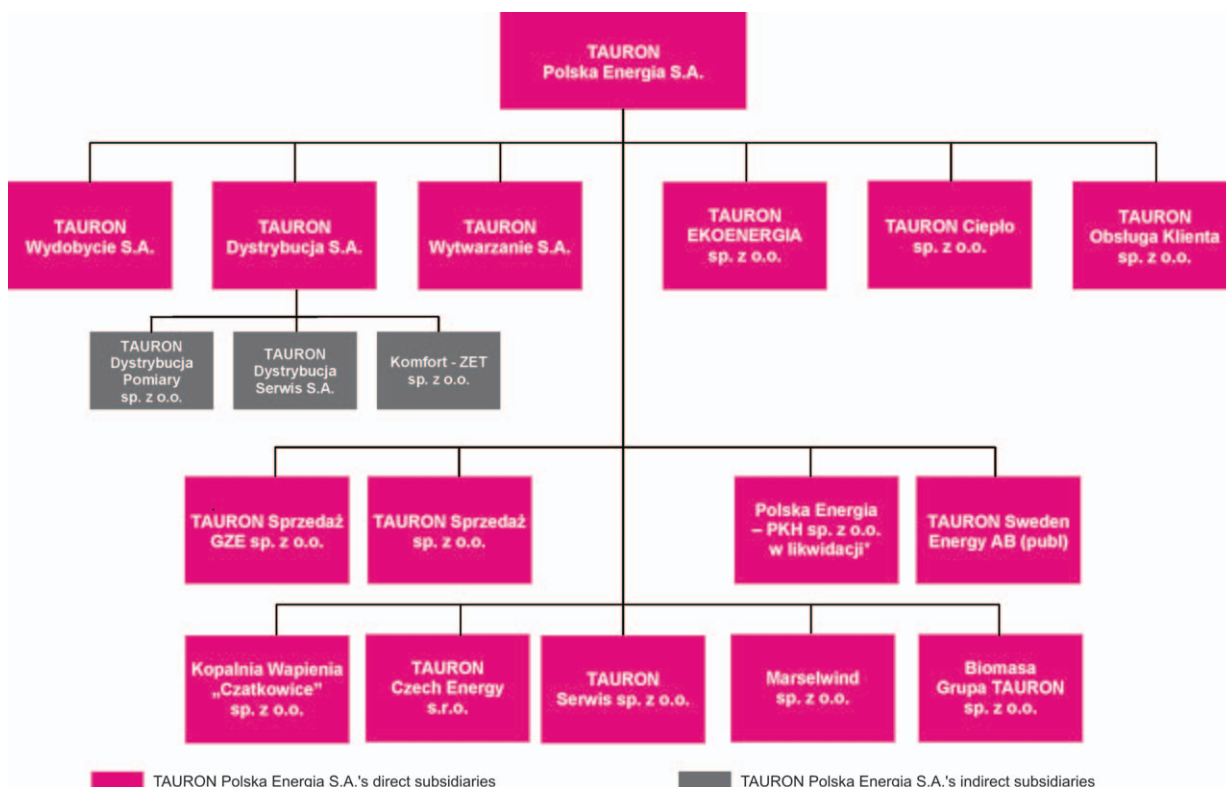
The company does not have any branches (plants).

As of December 31, 2017 TAURON Capital Group's key subsidiaries, besides the TAURON parent company, included 19 subsidiaries subject to consolidation, listed in section 1.3.1. of this report. Furthermore, as of December 31, 2017, the Company held, directly or indirectly, shares in the other 38 subsidiaries.

1.3.1. Units subject to consolidation

The below figure presents TAURON Capital Group's structure, including the subsidiaries subject to consolidation, as of December 31, 2017.

Figure no. 3. TAURON Capital Group's structure, including the subsidiaries subject to consolidation, as of December 31, 2017



TAURON Capital Group also holds stakes in joint ventures: Elektrociepłownia Stalowa Wola S.A. (EC Stalowa Wola) and TAMEH HOLDING sp. z o.o. (TAMEH HOLDING), TAMEH POLSKA sp. z o.o. (TAMEH POLSKA) and TAMEH Czech s.r.o. (TAMEH Czech) that are valued using the equity method in the consolidated financial statements.

Detailed information on subsidiaries subject to consolidation and TAURON's share in their share capital, as well in the parent company, is provided in section 1.3.3. of this report.

1.3.2. Changes to TAURON Capital Group's organization

In 2017 and by the day of drawing up this report the following changes to the organization of TAURON Capital Group had taken place:

Split of TAURON Wytwarzanie by transferring assets to the newly established "Nowe Jaworzno Grupa TAURON sp. z o.o." company

On January 31, 2017 the Extraordinary GM of TAURON Wytwarzanie passed a resolution on the split of TAURON Wytwarzanie subsidiary by way of spinning off under art. 529 § 1 clause 4) of the Commercial Companies Code, i.e. by transferring some assets of TAURON Wytwarzanie in the form of an organized part of the enterprise including the investment process related to the construction of the new 910 MW power generation unit at Jaworzno III Power Plant, carried out by TAURON Wytwarzanie Oddział Elektrownia Jaworzno III in Jaworzno, to the newly established Nowe Jaworzno GT company (in organization) in exchange for 37 000 shares in the Nowe Jaworzno GT company with the nominal value of PLN 50 per share and the total nominal value of PLN 1 850 000 that were taken up by the sole shareholder of the split company – TAURON.

The split process is the result of the implementation of *TAURON Group's 2016–2025 Strategy* according to which the 910 MW unit construction project at Jaworzno III Power Plant will be carried out under a new financing formula, assuming spinning off out of TAURON Wytwarzanie of an organized part of the enterprise and selling a stake therein to external partners.

On April 3, 2017 Nowe Jaworzno GT company was registered in the National Court Register.

Establishing new companies (subsidiaries)

1. On August 1, 2017 Komfort Zarządzanie Aktywami sp. z o.o. (Komfort Zarządzanie Aktywami) company was registered in the National Court Register in organization with its seat in Katowice that had been established on May 25, 2017. Upon registration the company's share capital was PLN 5 000 and was split into 100 shares with the nominal value of PLN 50 per share that were taken up in the following way:

- 1) Wsparcie Grupa TAURON (formerly KOMFORT-ZET sp. z o.o.) with its seat in Tarnów took up 99 shares,
- 2) TAURON Dystrybucja Pomiary with its seat in Tarnów took up 1 share.

The company was established in order to concentrate therein minority shares held by TAURON Capital Group's subsidiaries in commercial law companies that are not subsidiaries, joint subsidiaries and associated companies, including companies undergoing liquidation and bankruptcy proceedings, and then sell the company outside of TAURON Capital Group.

2. On August 1, 2017 TAURON established four limited liability companies with their seats in Katowice under the following names:

- 1) En-Energia I sp. z o.o. (registered in the National Court Register on September 8, 2017),
- 2) En-Energia II sp. z o.o. (registered in the National Court Register on September 30, 2017),
- 3) En-Energia III sp. z o.o. (registered in the National Court Register on September 1, 2017),
- 4) En-Energia IV sp. z o.o. (registered in the National Court Register on September 14, 2017).

In each of the above-mentioned companies TAURON took up all of the 100 shares with the nominal value of PLN 50 per share and the total nominal value of PLN 5 000. The above-mentioned companies were established as special purpose vehicles in conjunction with the reorganization projects underway at TAURON Capital Group.

Purchases of shares in other companies

1. In conjunction with the August 9, 2017 conclusion of the agreement between TAURON and TAURON Dystrybucja on the transfer of shares in TAURON Dystrybucja Serwis in order to release TAURON Dystrybucja from the obligation to pay out a dividend to TAURON (datio in solutum), TAURON became the owner of 5 101 003 shares in TAURON Dystrybucja Serwis, used up to now from TAURON Dystrybucja, representing 100% of shares in its share capital.
2. Under the share purchase agreement of November 16, 2017 TAURON Dystrybucja Pomiary acquired from Wsparcie Grupa TAURON 99 shares in Komfort Zarządzanie Aktywami company. This way TAURON Dystrybucja Pomiary became the owner of 100% shares in Komfort Zarządzanie Aktywami and its sole shareholder. The above action was one of the stages of the initiative implemented by TAURON Capital Group, aimed at concentrating in Komfort Zarządzanie Aktywami company the minority stakes and shares held by TAURON Capital Group's subsidiaries in commercial law companies that are not subsidiaries, joint subsidiaries and associated companies, including ones in the course of liquidation and bankruptcy proceedings, and then a sale of the company outside TAURON Capital Group.
3. Furthermore, as part of the initiative described above in section 2, Komfort Zarządzanie Aktywami company acquired from TAURON Capital Group's subsidiaries minority stakes in the below companies:
 - 1) Huta Batory S.A. in bankruptcy,
 - 2) Concorde Investissement S.A.,
 - 3) Opolskie Zakłady Przemysłu Lniarskiego "Linoptyt" S.A. in liquidation in bankruptcy,
 - 4) LEN S.A. in liquidation,
 - 5) Przędzalnia Czesankowa "ELANEX" S.A. in liquidation,
 - 6) Stilna S.A.,
 - 7) ZMK S.A. in liquidation,
 - 8) Przedsiębiorstwo Budowlane Katowice S.A. in liquidation,
 - 9) CFI Holding S.A.

Increase of the subsidiaries' share capital

1. On April 7, 2017 the District Court for Katowice-Wschód, 8th Commercial Department registered in the National Court Register an increase in the share capital of Tauron Wydobywanie, passed by the Extraordinary GM of TAURON Wydobywanie on March 21, 2017. The subsidiary's share capital was increased from PLN 355 510 780 to PLN 357 110 780, i.e. by PLN 1 600 000, by way of issuance of 160 000 new "K" series registered shares with the nominal value of PLN 10 per share and the total nominal value of PLN 1 600 000. All of the "K" series shares were taken up, by way of a private placement subscription, by the subsidiary's sole shareholder – TAURON, at the price of PLN 1 000 per share, i.e. for the total amount of PLN 160 000 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 990 per each new share, i.e. in the total amount of PLN 158 400 000, was allocated to the company's spare capital.
2. On June 26, 2017 the District Court for Katowice-Wschód, 8th Commercial Department registered in the National Court Register an increase in the share capital of Nowe Jaworzno GT, passed by the Extraordinary GM of the company on May 16, 2017. The subsidiary's share capital was increased from PLN 1 850 000 to PLN 31 850 000, i.e. by PLN 30 000 000, by way of issuance of 600 000 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 30 000 000. All of the new shares were taken up by the subsidiary's existing sole shareholder – TAURON. at the price of PLN 5 000 per share, i.e. for the total amount of PLN 3 000 000 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 2 970 000 000, was allocated to the company's spare capital.

On July 13, 2017 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of Nowe Jaworzno GT, passed by the Extraordinary GM of Nowe Jaworzno GT on June 29, 2017. The subsidiary's share capital was increased from PLN 31 850 000 to PLN 35 850 000, i.e. by PLN 4 000 000, by way of issuance of 80 000 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 400 000 000. All of the new shares were taken up by the subsidiary's existing sole shareholder – TAURON. at the price of PLN 5 000 per share, i.e. for the total amount of PLN 400 000 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 396 000 000, was allocated to the company's spare capital.

3. On June 20, 2017 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of TAURON Ciepło, passed by the Extraordinary GM of TAURON Ciepło on May 11, 2017. The subsidiary's share capital was increased from PLN 1 098 348 500 to PLN 1 104 348 500, i.e. by PLN 6 000 000, by way of issuance of 120 000 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 6 000 000. All of the new shares were taken up by the subsidiary's existing sole shareholder – TAURON. at the price of PLN 5 000 per share, i.e. for the total amount of PLN 600 000 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 594 000 000 was allocated to the company's spare capital.
4. On October 13, 2017 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of Marselwind sp. z o.o. (Marselwind) passed by the Extraordinary GM of the company on June 28, 2017. The subsidiary's share capital was increased from PLN 105 000 to PLN 110 000, i.e. by PLN 5 000, by way of issuance of 100 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 5 000. All of the new shares were taken up by TAURON at the price of PLN 5 000 per share, i.e. for the total amount of PLN 200 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 1 950 per each new share, i.e. in the total amount of PLN 195 000 was allocated to the company's spare capital.
5. On January 11, 2018 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of Magenta Grupa TAURON sp. z o.o. (Magenta GT), passed by the Extraordinary GM of the company on October 24, 2017. The subsidiary's share capital was increased from PLN 500 000 to PLN 1 500 000, i.e. by PLN 1 000 000, by way of issuance of 20 000 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 1 000 000. All of the new shares were taken up by the subsidiary's existing sole shareholder – TAURON at the price of PLN 450 per share, i.e. for the total amount of PLN 9 000 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 400 per each new share, i.e. in the total amount of PLN 8 000 000 was allocated to the company's spare capital.
6. On March 2, 2018, the District Court for Wrocław-Fabryczna in Wrocław, 9th Commercial Department, registered in the National Court Register an increase in the share capital of TAURON EKOENERGIA passed by the Extraordinary GM on October 24, 2017. The share capital was increased by PLN 10 000 000 by way of issuing 10

000 new shares with the nominal value of PLN 1 000 each and the total nominal value of PLN 10 000 000. All the new shares were taken up by the existing sole shareholder of the company – TAURON at the price of PLN 100 000 per share, i.e. for the total amount of PLN 1 000 000 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 99 000 per each new share, i.e. in the total amount of PLN 990 000 000 was allocated to the company's spare capital.

7. On December 29, 2017 the District Court for Kraków-Śródmieście in Kraków, 11th Commercial Department, registered in the National Court Register an increase in the share capital of TAURON Dystrybucja subsidiary, passed by the Extraordinary GM of the company on October 26, 2017. The subsidiary's share capital was increased from PLN 511 925 759.22 to PLN 560 611 250.96, i.e. by PLN 48 685 491.74, by way of issuing 2 434 274 587 new ordinary registered shares with the nominal value of PLN 0.02 each, i.e. with the total amount of PLN 48 685 491.74. All of the shares will be taken up by TAURON at the price of PLN 0.4108 per share, i.e. for the total amount of PLN 1 000 000 000.34, where the surplus of the issuing price of each share above its nominal value in the amount of PLN 0,3908 per each such share, i.e. in the total amount of PLN 951 314 508.60 was allocated to the company's spare capital.

In conjunction with the increase of the share capital TAURON's share in the subsidiary's share capital increased from 99.72% to 99.74%.

8. On January 22, 2018 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of En-Energia II sp. z o.o., passed by the Extraordinary GM of the company on December 15, 2017. The subsidiary's share capital was increased from PLN 5 000 to PLN 5 800, i.e. by PLN 800, by way of issuance of 16 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 800. All of the new shares were taken up by TAURON at the price of PLN 5 000 per share, i.e. for the total amount of PLN 80 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 79 200 was allocated to the company's spare capital.
9. On January 24, 2018 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of En-Energia I sp. z o.o., passed by the Extraordinary GM of the company on December 15, 2017. The subsidiary's share capital was increased from PLN 5 000 to PLN 5 800, i.e. by PLN 800, by way of issuance of 16 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 800. All of the new shares were taken up by TAURON at the price of PLN 5 000 per share, i.e. for the total amount of PLN 80 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 79 200 was allocated to the company's spare capital.
10. On February 26, 2018 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of En-Energia IV sp. z o.o., passed by the Extraordinary GM of the company on December 15, 2017. The subsidiary's share capital was increased from PLN 5 000 to PLN 5 800, i.e. by PLN 800, by way of issuance of 16 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 800. All of the new shares were taken up by TAURON at the price of PLN 5 000 per share, i.e. for the total amount of PLN 80 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 79 200 was allocated to the company's spare capital.
11. On March 8, 2018 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of En-Energia III sp. z o.o. passed by the Extraordinary GM on December 15, 2017. The share capital was increased by from PLN 5 000 to PLN 5 800, i.e. by PLN 800, by way of issuing 10 000 new shares with the nominal value of PLN 1 000 each and the total nominal value of PLN 10 000 000. All of the new shares were taken up by TAURON at the price of PLN 5 000 per share, i.e. for the total amount of PLN 80 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 4 950 per each new share, i.e. in the total amount of PLN 79 200 was allocated to the company's spare capital.
12. On February 15, 2018 the District Court for Katowice-Wschód, 8th Commercial Department, registered in the National Court Register an increase in the share capital of Komfort Zarządzanie Aktywami passed by the Extraordinary GM of the company on December 8, 2017. The subsidiary's share capital was increased from PLN 5 000 to PLN 52 500, i.e. by PLN 47 500, by way of issuance of 950 new shares with the nominal value of PLN 50 per share and the total nominal value of PLN 47 500. All of the new shares were taken up by the existing sole shareholder of the company – TAURON Dystrybucja Pomiary at the price of PLN 100 per share, i.e. for the total amount of PLN 95 000, where the surplus of the price of taking up each new share in the company's increased share capital above its nominal value in the amount of PLN 50 per each new share, i.e. in the total amount of PLN 47 500 was allocated to the company's spare capital.

13. On January 3, 2018 the Extraordinary General Meeting of the Shareholders of ElectroMobility Poland S.A. passed a resolution on increasing the company's share capital from PLN 10 000 000 to PLN 30 000 000, i.e. by PLN 20 000 000, by way of increasing the nominal value of the existing shares from PLN 1 000 per share up to PLN 3 000 per share, as part of which TAURON took up, in proportion to the shares held, the increased nominal value of 2 500 shares held from the total amount of PLN 2 500 000 up to the total amount of PLN 7 500 000, i.e. in the total amount of PLN 5 000 000.

As of the day of drawing up this information the increase of the share capital was not yet registered in the National Court Register.

Revoking of the liquidation of the PEPKH subsidiary

On March 8, 2017 the Extraordinary GM of the PEPKH subsidiary in liquidation, pursuant to art. 273 of the Commercial Companies Code, passed the resolution on the further existence of the company and revoking its liquidation.

The revoking of the company's liquidation was due to the change of the conditions related to the liquidation proceedings underway, indicating the purposefulness of the further existence of the company.

Conversion of Komfort-ZET sp. z o.o. into Wsparcie Grupa TAURON sp. z o.o.

Conversion of Komfort-ZET sp. z o.o. with its seat in Tarnów into Wsparcie Grupa TAURON sp. z o.o. was registered in the National Court Register on September 6, 2017.

Restoring TAURON EKOENERGIA's share capital to the level from before the company's split

On January 30, 2018 the District Court for Wrocław-Fabryczna in Wrocław, 9th Commercial Department, registered in the National Court Register a change in the share capital of TAURON EKOENERGIA restoring its value to the level from before the company's split by spinning off and transferring to the Marselwind company and the decrease of the share capital of TAURON EKOENERGIA passed by the Extraordinary GM of the company on February 9, 2015. Due to the restoration of the share capital from before the company's split the capital was increased from PLN 444 888 000 to PLN 573 423 000, i.e. by PLN 128 535 000, and the number of shares held by the sole shareholder of the company – TAURON increased from 444 888 shares to 573 423 shares.

Contribution of additional payments to the capital of PEPKH

Acting in accordance with the resolution of the Extraordinary GM PEPKH of March 1, 2018 on imposing on TAURON as a sole shareholder an obligation to make additional payments, on March 7, 2018 TAURON contributed additional payments to the share capital of the above mentioned company in the total amount of PLN 6 000 thou. The resolution of the Extraordinary GM as passed in order to ensure financing for the operations of PEPKH.

1.3.3. Organizational or equity ties

The below table presents a list of material direct or indirect subsidiaries subject to consolidation in which the Company held shares as of December 31, 2017.

Table no. 1. List of material subsidiaries subject to consolidation as of December 31, 2017

No.	Company name	Registered Office	Main subject of operations	TAURON's share in the subsidiary's capital	TAURON's share in the subsidiary's parent company
1.	TAURON Wydobycie	Jaworzno	Hard coal mining	100.00%	100.00%
2.	TAURON Wytwarzanie ¹	Jaworzno	Electricity and heat generation, transmission and distribution	100.00%	100.00%
3.	Nowe Jaworzno GT ¹	Jaworzno	Electricity and heat generation, transmission and distribution, as well as electricity trading	100.00%	100.00%
4.	TAURON EKOENERGIA	Jelenia Góra	Electricity generation	100.00%	100.00%
5.	Marselwind	Katowice	Electricity generation, transmission and trading	100.00%	100.00%
6.	TAURON Ciepło	Katowice	Heat production and distribution	100.00%	100.00%
7.	TAURON Serwis	Katowice	Services	95.61%	95.61%

No.	Company name	Registered Office	Main subject of operations	TAURON's share in the subsidiary's capital	TAURON's share in the subsidiary's parent company
8.	TAURON Dystrybucja	Kraków	Electricity distribution	99.74%	99.75%
9.	TAURON Dystrybucja Serwis	Wrocław	Services	100.00%	100.00%
10.	TAURON Dystrybucja Pomiary ²	Tarnów	Services	99.74%	99.75%
11.	TAURON Sprzedaż	Kraków	Electricity trading	100.00%	100.00%
12.	TAURON Sprzedaż GZE	Gliwice	Electricity trading	100.00%	100.00%
13.	TAURON Czech Energy	Ostrava, Czech Republic	Electricity trading	100.00%	100.00%
14.	TAURON Obsługa Klienta	Wrocław	Services	100.00%	100.00%
15.	KW Czatkowice	Krzeszowice	Limestone and rock extraction	100.00%	100.00%
16.	PEPKH ³	Warszawa	Electricity trading	100.00%	100.00%
17.	TAURON Sweden Energy	Stockholm, Sweden	Services	100.00%	100.00%
18.	Biomasa Grupa TAURON	Stalowa Wola	Waste and scrap metal wholesale	100.00%	100.00%
19.	Wsparcie Grupa TAURON ^{2, 4}	Tarnów	Services	99.74%	99.75%

¹ On April 3, 2017 TAURON Wytwarzanie subsidiary was split and an organized part of the enterprise was spun off to Nowe Jaworzno GT subsidiary.

² Share in TAURON Dystrybucja Pomiary and Wsparcie Grupa TAURON (formerly KOMFORT-ZET sp. z o.o.) is held by TAURON indirectly via TAURON Dystrybucja subsidiary. TAURON is a user of TAURON Dystrybucja Pomiary subsidiary's shares.

³ On March 8, 2017 the Extraordinary GM of the PEPKH subsidiary in liquidation passed a resolution on revoking the liquidation of this company.

⁴ On September 6, 2017 KOMFORT-ZET sp. z o.o. changed its name to "Wsparcie Grupa TAURON sp. z o.o.".

The below table presents a list of material joint subsidiaries subject to consolidation in which the Company held shares as of December 31, 2017.

Table no. 2. List of material joint subsidiaries subject to consolidation as of December 31, 2017

No.	Company name	Registered Office	Main subject of operations	TAURON's share in the capital and subsidiary's parent company
1.	EC Stalowa Wola ¹	Stalowa Wola	Electricity generation	50.00%
2.	TAMEH HOLDING ²	Dąbrowa Górnicza	Central companies and holding operations	50.00%
3.	TAMEH POLSKA ²	Dąbrowa Górnicza	Electricity and heat generation, transmission, distribution and trading	50.00%
4.	TAMEH Czech ²	Ostrava, Republika Czeska	Production, trading and services	50.00%

¹ Share in EC Stalowa Wola is held by TAURON indirectly via TAURON Wytwarzanie subsidiary.

² Subsidiaries form a capital group. TAURON holds a diet share in the capital and the parent company of TAMEH HOLDING subsidiary that holds a 100% share in the capital and the parent company of TAMEH POLSKA and TAMEH Czech.

As of the day of drawing up this report TAURON holds, directly or indirectly, shares in 57 subsidiaries of TAURON Capital Group.

The other most important equity investments in financial assets as of December 31, 2017 include involvement in the following entities:

1. SCE Jaworzno III sp. z o.o. worth PLN 36 283 thousand,
2. Przedsiębiorstwo Energetyki Ciepłej Tychy sp. z o.o. worth PLN 32 483 thousand,
3. PGE EJ 1 sp. z o.o. (PGE EJ 1) worth PLN 26 546 thousand,
4. Energetyka Cieszyńska sp. z o.o. worth PLN 15 063 thousand.

1.3.4. Major domestic and foreign investments

Taking up or purchasing share securities

With respect to purchasing or taking up shares in TAURON Capital Group's subsidiaries major investments made by the Company include:

1. Taking up by TAURON of 717 thousand new shares in the share capital of Nowe Jaworzno GT (three times in 2017, i.e.: upon establishing the company and twice increasing the share capital), for the total amount of PLN 3 400 000 thousand.
2. Taking up by TAURON, by way of a private placement, of 2 434 274 587 new shares in the increased share capital of TAURON Dystrybcja at the price of 0.4108 per share, for the total amount of PLN 1 000 000 thousand.
3. Taking up by TAURON of 10 thousand new shares in the increased share capital of TAURON EKOENERGIA at the price of PLN 100 thousand per share, for the total amount of PLN 1 000 000 thousand.
4. Taking up by TAURON of 120 thousand new shares in the increased share capital of TAURON Ciepło at the price of PLN 5 thousand per share, for the total amount of PLN 600 000 thousand.
5. Taking up by TAURON of 160 thousand new shares in the increased share capital of TAURON Wydobycie at the price of PLN 1 thousand per share, for the total amount of PLN 160 000 thousand.
6. Taking up by TAURON of 20 thousand new shares in the increased share capital of Magenta GT at the price of PLN 450 per share, for the total amount of PLN 9 000 thousand.
7. Taking up by TAURON from TAURON Dystrybcja of 5 101 003 shares in TAURON Dystrybcja Serwis, of the total value of PLN 201 045 thousand, representing 100% shares in the share capital of TAURON Dystrybcja Serwis.

Major investments in financial assets

TAURON Capital Group's major investments in financial assets include:

1. Purchasing by TAURON, being the parent company, of participation units in investment funds for the total amount of PLN 75 000 thousand. As of the balance sheet day the value of participation units in investment funds reached PLN 101 358 thousand.
2. Granting by TAURON, being the parent company, of loans to the EC Stalowa Wola joint subsidiary for the total amount of PLN 304 192 thousand. As of the balance sheet day the amount of loans granted to EC Stalowa Wola reached PLN 570 432 thousand.

Investments in financial assets were finance using own funds and the funds obtained as part of the central financing model functioning at TAURON Capital Group. With respect to the above additionally it should be indicated that to finance the transactions: taking up of shares in the increased share capital of TAURON Dystrybcja and taking up of shares in the increased share capital of TAURON EKOENERGIA the funds coming from TAURON Eurobond issue that had taken place on July 5, 2017 were dedicated. Taking up of shares in the above indicated companies represented accomplishing the main goal of the issue stated in the Eurobond issue prospectus, according to which the funds obtained from the issue were to be used, first of all, to refinance the costs of constructing and purchasing wind farms and to finance the investments of TAURON Capital Group in the Distribution segment.

1.4. Strategy and strategic priorities of TAURON Capital Group

TAURON Group's 2016–2025 Strategy (Strategy), adopted by the Management Board of TAURON on September 2, 2016 and positively evaluated by the Supervisory Board, was implemented in 2017. This Strategy is the response to the challenges stemming from the current and forecast situation on the electricity market and in the power sector. In the process of preparing the Strategy a thorough analysis was conducted of the macroeconomic, market and regulatory environment as well as of the forecasts on the directions of the sector's growth, including translating them into opportunities and risks facing TAURON Capital Group over the next ten years. TAURON Capital Group's ability to finance the current and planned investment projects was reviewed in detail with a view that their completion could be achieved using funds generated from operations and debt financing. The above analyses and market trends were the basis for verifying market and macroeconomic assumptions as well as the CAPEX plan.

1.4.1. TAURON Capital Group’s mission, vision and values

Strategy defines the Mission and Vision and defines the key values of TAURON Capital Group:

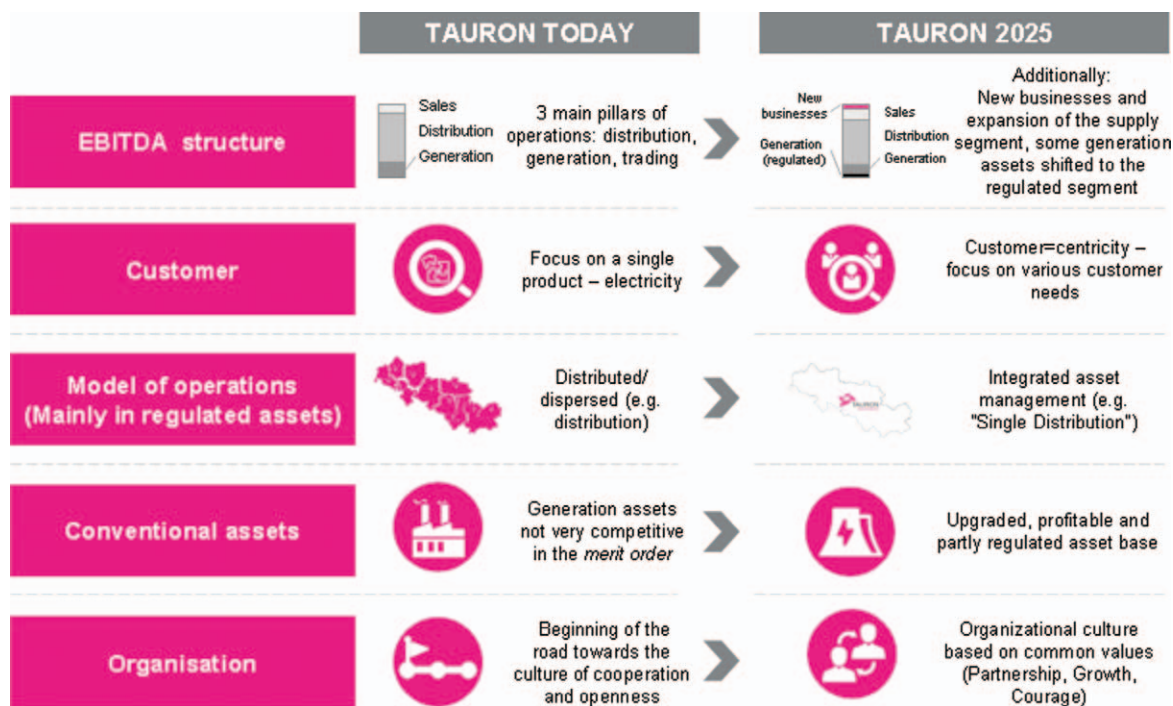
Mission of TAURON Capital Group
“With passion and commitment we are delivering modern solutions that provide energy in the constantly changing world.”

Vision of TAURON Capital Group
“We are a company that best meets customer needs in the Polish energy industry.”

Mission and vision best describe TAURON Capital Group’s strategic intentions. The Supply segment and new products represent the field of operations that TAURON Capital Group is intensely developing. TAURON Capital Group is adjusting its profile in order to ensure full focus on the customer, while appreciating the potential of new products, compatible services, modern contact channels as a way to shape the response to customer needs.

The below figure presents TAURON Capital Group’s 2025 Vision.

Figure no. 4. TAURON Capital Group’s 2025 Vision



The key values that are to support the implementation of the Strategy include “Partnership”, “Development” and “Courage”. The values reflect the way in which TAURON Capital Group wants to achieve its goals. What is important as part of the partnership is customer orientation, development of sustainable relationships and engagement. Development means focus on innovations, developing competences, skills and knowledge and seeking ever better solutions meeting customer needs and raising the quality of services. Courage means boldness and openness, determination as well as engagement and passion in achieving common goals.

Combination of such values is to lead to a better understanding of customer expectations, responding to market challenges and developing TAURON Capital Group’s organizational culture.

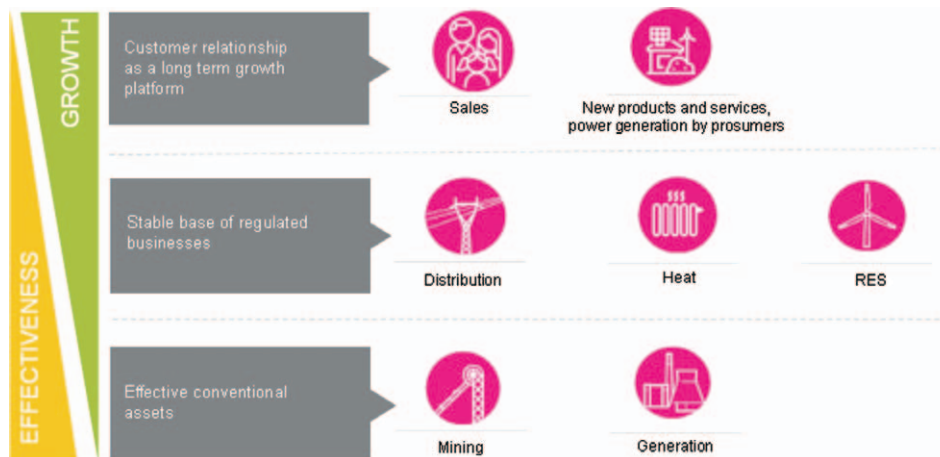
1.4.2. TAURON Capital Group’s 2016–2025 Strategy

2016–2025 Strategy adopted presents an optimal expansion path that will ensure financial stability and growth, while at the same time providing support for ensuring stability of the power system. The long term growth will be driven by solutions based on customer relationships. The adopted mission and vision reflect new management philosophy and are in line with the customer-oriented growth concept.

Strategy describes the approach to developing individual segments of TAURON Capital Group's operations, dividing them into ones that TAURON Capital Group is planning to strongly expand, ones that will constitute the foundation of the financial stability and ones where strong emphasis on cost efficiency is required. The above reflects a new management philosophy and emphasizes a turn towards the customer and his/her needs as well as towards developing an innovative, open to new solutions TAURON Capital Group.

The below figure presents the prospects of TAURON Capital Group's segments.

Figure no. 5. Prospects of TAURON Capital Group's segments



Strategy sets the priorities that will transform TAURON Capital Group into an innovative, aligned to the market and customer needs, growing energy company ultimately providing a return on invested capital for its shareholders.

1. Ensuring TAURON Capital Group's financial stability to be achieved through the following actions:
 - a) TAURON Group's 2016–2018 Efficiency Improvement Program, adopted in March, 2016 and assuming achieving PLN 1.3 bln in savings in 2016–2018. The above savings include actions resulting in the cumulative EBITDA increase by approximately PLN 1 bln and involving CAPEX reduction by approximately PLN 0.3 bln in 2016–2018.
 - b) Strategic Initiatives and CAPEX reduction in 2017–2020 will bring a financial effect of PLN 1.9 bln. It will be achieved as a result of actions leading to the cumulative EBITDA increase by approximately PLN 1.2 bln and the CAPEX reduction by approximately PLN 0.7 bln. These are additional financial outcomes, beside the effects generated by the Efficiency Improvement Program.
 - c) Stopping the investment in the CCGT unit at Łagisza Power Plant, resulting in not incurring PLN 1.5 bln in CAPEX. It will be possible to resume the project in case the regulatory and market environment turns favorable.
2. Building a strong capital group.

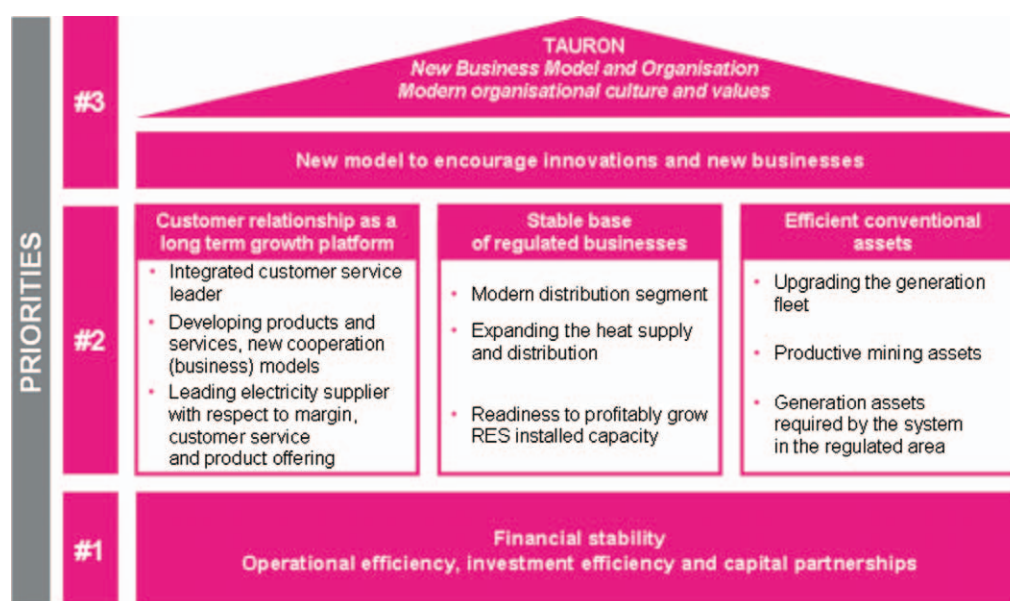
Strategy defines a new approach to the value chain where key tasks are set for each Line of Business. Strategy does not assume balanced growth along each link of the value chain. Sales and development of new products and services are to constitute a strong base for the Group's growth. The Group is planning to rapidly develop its offering for the customers in this segment which will allow for retaining the existing base of customers that purchase TAURON products and increasing profitability. Electricity distribution as well as heat generation and distribution segments are to constitute a stable base of the Group's regulated businesses. Mining and conventional generation segments have tasks related first of all to efficiency improvement. The following three pillars of the strong capital group were defined:

- a) Customer relationships based on integrated high quality service with the use of modern sales and customer service channels as well as developing a product and service offering.
- b) Stable base of regulated assets based on the upgraded electricity distribution and heat segments as well as readiness to grow renewable energy sources in case the regulatory environment turns favorable.
- c) Efficient conventional assets, i.e. mining and conventional generation segments, which as a result of improving cost efficiency and productivity will be competitive on the market or, in case of generation assets, they will be shifted to the regulated segment of the power system.

3. Implementing organizational changes supporting the implementation of the Strategy that will transform TAURON Capital Group into a modern and innovative organization:
 - a) Implementing a new, process-oriented operational model. Five priority process streams have been identified around which TAURON Capital Group's operations will be concentrated, i.e. Strategy, Finance, Asset Management and Development, Customer and Corporate Management and Support. Such approach will allow for placing a greater emphasis on cross-sectional issues that will determine TAURON Capital Group's competitive advantages in the future.
 - b) Expanding research and development as well as innovative activities for which expenditures equal to 0.4% of the consolidated revenue a year are envisaged.
 - c) Developing innovative projects based on the Corporate Venture Capital (CVC) type fund dedicated for this purpose or similar solutions.

The below figure presents implementation of priorities based on the pillars of TAURON Capital Group's Strategy.

Figure no. 6. Implementation of priorities based on the pillars of TAURON Capital Group's Strategy



The implementation of the Strategy will allow for increasing EBITDA from PLN 3.5 bln in 2015 to more than PLN 4 bln in 2020 and to more than PLN 5 bln in 2025. Estimated, recurring effect of implementing the Efficiency Improvement Program in the form of an impact on the Group's EBITDA will be approximately PLN 0.4 bln starting from 2018, while the effect of implementing the Strategic Initiatives in the form of an impact on the Group's EBITDA will be approximately PLN 0.3 bln beyond 2020.

As part of rationalizing CAPEX the expenditures planned for 2016–2020 were reduced from PLN 20.2 bln to approx. PLN 18 bln. It is assumed that the commenced and well advanced investment projects will be continued. The detailed analysis revealed that 75 percent of the CAPEX plan until 2020 are tasks that are either a continuation or are related to keeping the commitments made. Such tasks include the investment in the 910 MW unit at Jaworzno III Power Plant as well as the contracted or resulting from regulatory requirements tasks in the distribution segment. Resigning or delaying these tasks would have a negative impact on the Group's value or is impossible due to legal or safety reasons.

In the Mining segment investments at Janina coal mine and the construction of Grzegorz shaft at Sobieski coal mine will be continued and the planned investments at Brzeszcze coal mine will be carried out. CAPEX in this line of business is approximately PLN 1.3 bln until 2020.

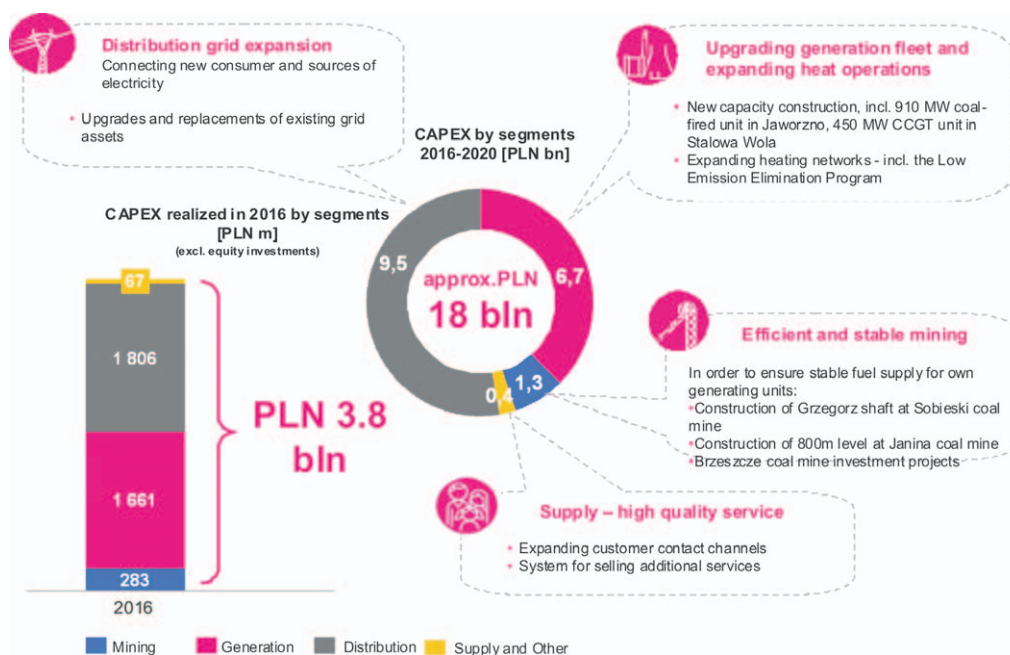
In the Generation segment investments in the construction of the 910 MW unit at Jaworzno III Power Plant and the CCGT unit at Stalowa Wola Combined Heat and Power Plant as well as the investments in the heating networks will be continued. TAURON assumes that the construction of the 910 MW unit at Jaworzno III Power Plant will be carried out under a new financing formula envisaging spinning off of an organized part of the enterprise and selling its shares to third party partners, provided they do not acquire a controlling stake. A change of the way the unit's construction is financed would reduce the net debt/EBITDA ratio, and thus significantly lower the risk of breaching the threshold value of this covenant (3.5x) defined in the financing agreements.

Strategy assumes maintaining financial stability and not breaching the net debt/EBITDA covenant of 3.5x without taking into account selling a minority stake in the construction of the 910 MW unit to third party partners. This means that the planned change of this project's financing formula represents an additional element that would stabilize TAURON Capital Group's financial position. Generation segment's capital expenditures amount to PLN 6.7 bln until 2020.

More than 50 percent of the entire CAPEX, i.e. PLN 9.5 bln by 2020, are investments in the Distribution segment that include connecting new customers and generation sources as well as upgrading and replacing grid assets

The below figure presents capital expenditures by segments in 2016–2020.

Figure no. 7. Capital expenditures by segments in 2016–2020



With respect to innovative as well as research and development activities the Strategy assumes expenditures equal to 0.4% of the consolidated revenue a year.

The overall objective in terms of CAPEX is to align the investment portfolio to the market needs.

In particular the actions to be undertaken will be aimed at:





1. Optimizing the asset structure in all lines of business and achieving compliance with the environmental requirements.
2. Carrying out only those investment projects that guarantee the expected return on capital and are not burdened with material market risks.
3. Using off-balance sheet forms of financing, in particular by engaging third party partners.
4. Reviewing investment projects in the conventional generation segment, provided mechanisms that guarantee revenue are introduced (e.g. capacity market or another form of regulation).
5. Investing in projects in sectors that are related to the power industry (in particular, services) in order to complement the value chain that TAURON is operating in, and also developing a high margin services offering.

Assumed directions of investments beyond 2020 include first of all the regulated segments of the power sector (i.e., among others, electricity distribution, heat generation and distribution, participation in the nuclear power generation and regulated conventional generation) and the new power industry (i.e. e-mobility, distributed heat and electricity generation, power generation by prosumers, Smart Home, Smart City solutions and energy related services). Strategy assumes that in 2020–2025 TAURON Capital Group's estimated investment potential will be more than PLN 6 bln.

1.4.3. Key challenges for TAURON Capital Group

Strategy is TAURON Capital Group’s response to the challenges posed by the business environment and the requirements of the energy sector’s customers that have been changing fast over the last few years.

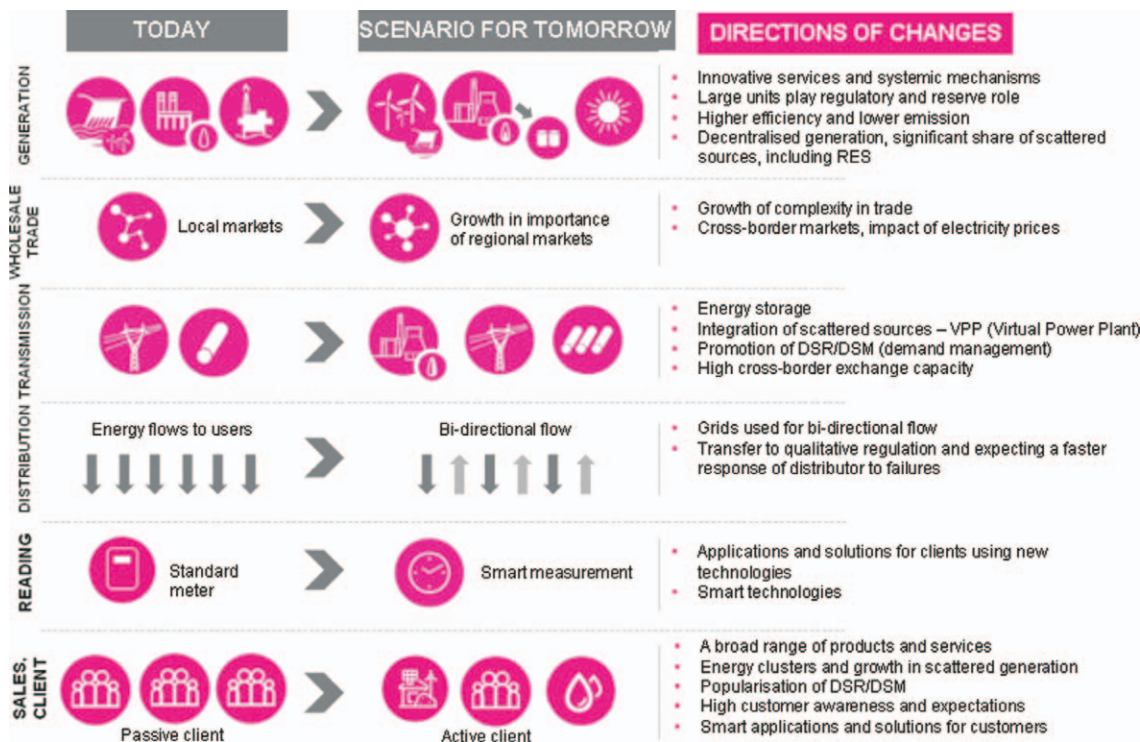
Strategy defines four key challenges facing TAURON Capital Group: regulations, market, customer and technologies.

<p>Regulations</p> 	<p>Introduction of the dual-product market – capacity market, the European Union’s (EU) decarbonization policy and successive regulations aimed at reducing emissions, introduction of the quality based regulation in the distribution segment, changes to the support for RES installations and EU actions aimed at developing a common electricity market.</p>
<p>Market</p> 	<p>Changing forecasts of electricity prices, hard coal oversupply and prices, demand for electricity, demand for capacity, growing competition on the retail market, rising level of RES generation along with the withdrawal of the European players and the reduction of the financing for the conventional power generation.</p>
<p>Client</p> 	<p>Growing awareness of the customers and the requirements with respect to satisfying their needs as well as comprehensiveness of the offering, increased expectations with respect to customer service quality and availability.</p>
<p>Technologies</p> 	<p>Falling prices of renewable and dispersed technologies, rising competitiveness of such sources versus conventional sources, a change of the role of the distribution service due to the expansion of dispersed power generation, advancement of smart technologies, microgeneration and energy storage.</p>

In the long term profound changes of the entire power sector, towards the so-called “power industry of tomorrow”, are important. A transformation of the system power sector towards decentralized generation, increased role of transborder connections, energy storage and new energy services, as for example “virtual power plants”, demand side management, dispersed generation. This also leads to a change of the role of the distribution segment that must deal with smart technologies, electric vehicle charging infrastructure, distributed generation, including prosumers, bi+directional flows, while at the same time raising the quality and security of supplies.

The below figure presents the key challenges facing TAURON Capital Group.

Figure no. 8. Key challenges facing TAURON Capital Group



1.4.4. Opportunities and threats

The defined key challenges facing TAURON Capital Group create both opportunities as well as threats for TAURON Capital Group's operations.

The below table presents opportunities and threats for TAURON Capital Group's operations.

Table no. 3. Opportunities and threats for TAURON Capital Group's operations

Opportunities	Threats
Regulations	
<ul style="list-style-type: none"> • Introduction of the dual-product market – additional revenue for maintaining generation capacity. • Support for electromobility (growing electricity consumption). • Introduction of legal regulations supporting the reduction of low emissions (e.g. system district heating, increasing the share of eco-pea coal in the sales). • Expected support for the cogeneration beyond 2018. 	<ul style="list-style-type: none"> • Rising costs of electricity production from conventional assets, growing environmental costs and further tightening of the decarbonization policy. • Negative impact of the EU regulations related to the common energy market. • Lack of stability and predictability of the regulations for the RES sources, including rising costs of maintaining wind farms and hydro-electric power plants as well as uncertain future of the RES sources based on the biomass burning and co-firing technology (RES directive draft). • Lack of support for the cogeneration beyond 2018.
Market	
<ul style="list-style-type: none"> • Cost effective, own mining assets, competitive on the Polish market, allowing for stabilization and predictability of the fuel cost. • Access to the largest, among Poland's energy companies, customer base. • Entry to the energy related services market segments based on the competences held. • Commercialization of innovative solutions developed as part of research and development operations. 	<ul style="list-style-type: none"> • Declining margins and lower utilization of conventional assets (deteriorating profitability, required outlays for upgrades or the need to shutdown old generating units due to the new high efficiency units entering the system and due to the BAT requirements). • Loss of volume and profitability of the Supply Segment, in particular in the B2B area. • Pressure on electricity prices with the growing transborder exchange volumes. • Rising costs and limited availability of financing. • Increased prices of products and services negatively impacting investment efficiency.
Customer	
<ul style="list-style-type: none"> • Competitive advantage with respect to customer service quality. • Customer segmentation and offering additional products in line with customer expectations. • Greater customer awareness and expectations towards comprehensive, personalized offering of additional services and products (greater customer product saturation). • Expanding an offering of services for customers based on competences held and trust in TAURON brand. • Growth through concentration on a customer that is not generating large capital investments. • Developing modern and integrated sales and customer service channels. • New competences and business models based on research and development operations. • Maintaining an upward trend in electricity consumption trend by final consumers. 	<ul style="list-style-type: none"> • Potential loss of customers due to an increase in the number of competitors offering customers similar products and due to low electricity supply market entry barriers. • Decreasing customer loyalty – growing number of supplier switchings. • Greater customer awareness and requirements with respect to service quality and product offering. • Power independence of consumers (prosumers, energy (power) islands, clusters). • Energy intensive consumers building their own generation sources, as a result of the drive to reduce electricity costs. • “Carbon leakage” – moving business operations to other countries due to the cost of energy.
Technologies	
<ul style="list-style-type: none"> • Falling prices of renewable technologies. • Advancement of storage technologies, smart technologies and technologies related to dispersed (distributed) generation. • Additional services for customers related to new technologies (internet of things, dynamic tariffs, virtual power plants). • Advancement of dispersed (distributed) power generation, including prosumers. • Developing and implementing (commercializing) of own innovative solutions that provide a competitive advantage. 	<ul style="list-style-type: none"> • The need to adapt the grid to the growth of dispersed (distributed) power generation (bi-directional flows). • Arrival of new, cost competitive electricity generation technologies in countries neighboring with Poland.

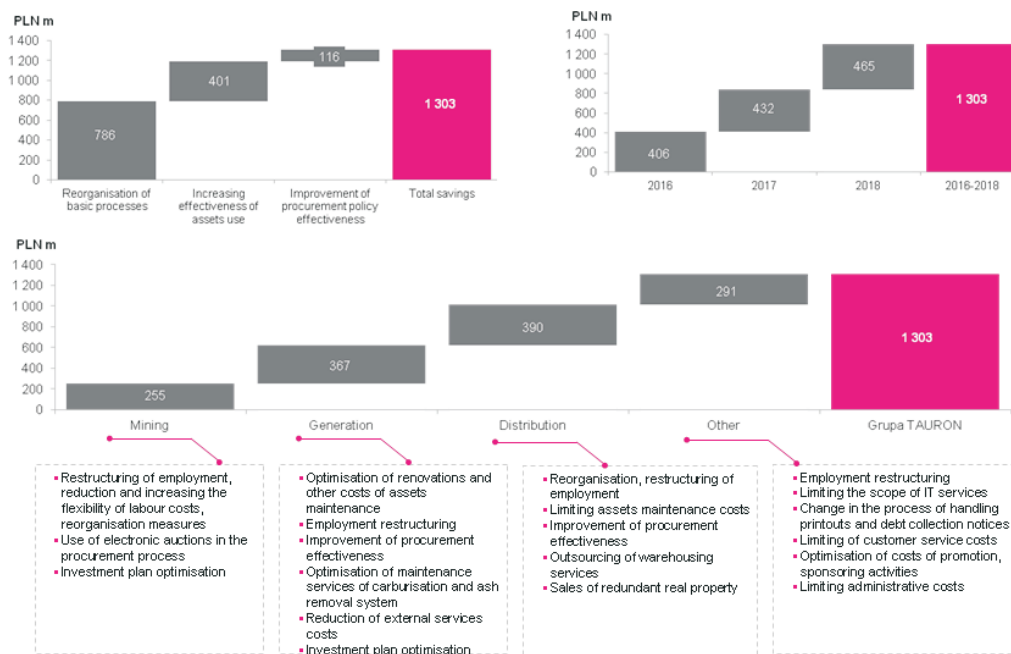
1.4.5. Implementation of the Strategy and priorities of TAURON Capital Group in 2017

2017 was the time when the first effects of the Strategy adopted in September 2016 were achieved. In accordance with the Assumption the most important priority was to ensure financial stability in order to lay down solid foundations for the expansion of TAURON Capital Group. As part of the Strategy actions in the form of Strategic Initiatives were taken and the Efficiency Improvement Program was continued, involving reorganizing core processes throughout TAURON Capital Group and raising asset utilization efficiency. Strategy is implemented by:

- a) Achieving TAURON Capital Group's strategic objectives, which are:
- EBITDA above PLN 4 bln in 2020. The objective is being achieved through actions related to the implementation of the Strategic Initiatives and initiatives carried out as part of the Efficiency Improvement Program the implementation of which in 2017 brought higher returns than planned at the stage of developing the Strategy. In 2017 EBITDA of more than PLN 3.5 bln was achieved, this is a better result than in 2016 when EBITDA of more than PLN 3.3 bln was achieved.
 - Maintaining the net debt/EBITDA covenants below 3.5. One of the priorities of the Strategy is to ensure financial stability. Maintaining the covenants is both an effect of actions leading to improved financial results as well as actions aimed at improving investment efficiency. As part of the Strategy the investment portfolio was optimized and modern financing in the form of a hybrid bond issue was obtained. At the end 2017 the net debt/EBITDA ratio reached 2.3x.
 - Maintaining a high Customer Satisfaction Index (CSI). TAURON Capital Group is an industry leader in customer service quality. Annual customer satisfaction surveys performed by an external company confirm a high satisfaction level of TAURON Capital Group's customers. The overall result of the September 2017 survey proved maintaining a high 2016 index level of 80 points.
 - Power plants generating positive cash flows by 2020. Achievement of this goal will be the result of a number of actions undertaken within TAURON Capital Group, among others: optimizing the costs of the generating units and TAURON Capital Group's trading (commercial) strategy, as well as the impact of the external environment, both the regulatory one, as well as the market one (support for RES and cogeneration, fuel prices, property rights prices, electricity prices).
 - Maintaining the customer base. TAURON Capital Group is Poland's distributor and the second largest electricity supplier. Maintaining the customer base represents for TAURON Capital Group a long term growth platform and is implemented by both, actions improving the quality of services, among others an expansion of customer communications channels, as well as a broad product offering. At the end of 2017 TAURON Capital Group provided services for almost 5.4 mln customers of the Supply Segment and more than 5.5 mln customers of the Distribution Segment.
 - Unit margin leader among Poland's largest 4 electricity suppliers. Maintaining the leader's position is based both on maintaining a high volume of electricity supplied, as well as the ability to generate a positive financial result. TAURON Capital Group, by concentrating on the customer, is developing a broad, profitable base of products and services offered to our customers. Based on the data for 9 months of 2017 TAURON Capital Group maintained the leading position among Poland's largest 4 utilities.
 - New businesses are to represent at least 25% of revenue/margin in 2025. This objective is to be a response to the challenges posed by the competitive environment. Achieving climate improvement targets and building the European energy market will have an impact on the increase of competition in the power sector, therefore actions are undertaken aimed at developing new businesses and we place our bets on innovations.
- b) Efficiency Improvement Program, adopted in March, 2016 and assuming achieving PLN 1.3 bln in savings in 2016–2018. The above savings include actions resulting in the cumulative EBITDA increase by approximately PLN 1 bln and involving CAPEX reduction by approximately PLN 0.3 bln in 2016–2018 within three scopes of operations.

The below figure presents the 2016–2018 Efficiency Improvement Program.

Figure no. 9. 2016–2018 Efficiency Improvement Program

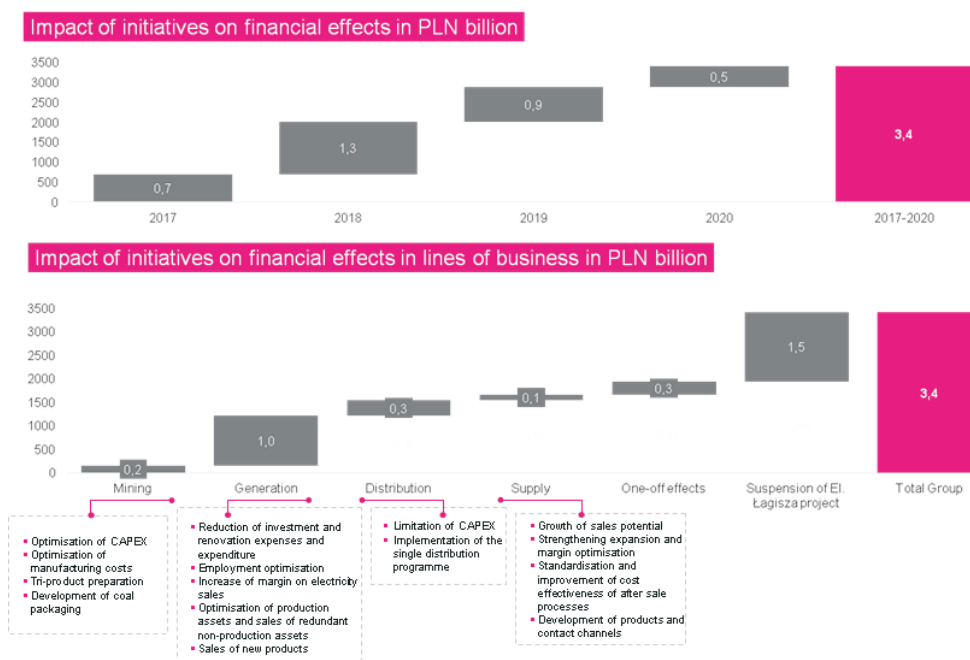


TAURON Capital Group’s Efficiency Improvement Program brought, in 2016–2017, savings of PLN 1 091 mln which represents 84% of the planned savings, out of which PLN 640 mln impacted EBITDA, while PLN 451 mln was applicable to CAPEX savings. The largest contribution to the savings achieved came from the Generation Line of Business.

- c) Strategic Initiatives and CAPEX rationalization in 2017–2020 assuming financial effects of PLN 3.4 bln, including the cumulative EBITDA increase by approximately PLN 1.2 bln, CAPEX reduction by approximately PLN 0.7 bln and stopping the investment in the new unit at Łagisza Power Plant worth PLN 1.5 bln.

The below figure presents Strategic Initiatives and CAPEX rationalization in 2017–2020.

Figure no. 10. Strategic Initiatives and CAPEX rationalization in 2017–2020



In accordance with the objectives set TAURON Capital Group will be expanding the Supply Line of Business and customer service. In this respect a further introduction of coherent, high customer service standards in each area of the value chain and the growth of modern and integrated sales and customer service channels is planned.

In the Distribution Line of Business the “One Distribution” program based on actions related to unifying the processes and systems as well as implementing an optimal and coherent structure of TAURON Dystrybucja so as to improve operational and investment efficiency of this Line of Business will be continued.

In the Mining and Generation Lines of Businesses tasks related to a further improvement of the cost and investment efficiency will be carried out. The introduction of the detailed regulations related to the capacity market in Poland and the planned auctions related thereto will be important for the generation assets.

In 2017 Strategic Initiatives brought a financial effect of PLN 937 mln, out of which PLN 320 mln impacted EBITDA, while PLN 617 mln was applicable to CAPEX savings (including PLN 428 mln due to stopping the Łagisza investment project). The largest contributions to the savings achieved came from the Generation (PLN 314 mln) and Distribution (PLN 103 mln) Lines of Business.

In 2018 TAURON Capital Group’s largest investment projects will be continued in line with the adopted Strategy, including:

- 1) in the Mining Line of Business: construction of the Grzegorz shaft, 800 m level at Janina Coal Mine and investment projects at Brzeszcze Coal Mine,
- 2) in the Generation Line of Business: construction of the 910 MW hard coal-fired unit in Jaworzno, the 450 MW CCGT unit in Stalowa Wola,
- 3) in the Distribution Line of Business: investment tasks related to the grid construction and upgrading.

Furthermore, the Low Emission Elimination Program in the Silesia and Dąbrowa conurbation as well as the project related to implementing heat production at unit no. 10 and construction of peaking and backup boilers at Łagisza Power Plant, as a consequence of planned shutdown of 120 MW units at this site, will be carried out.

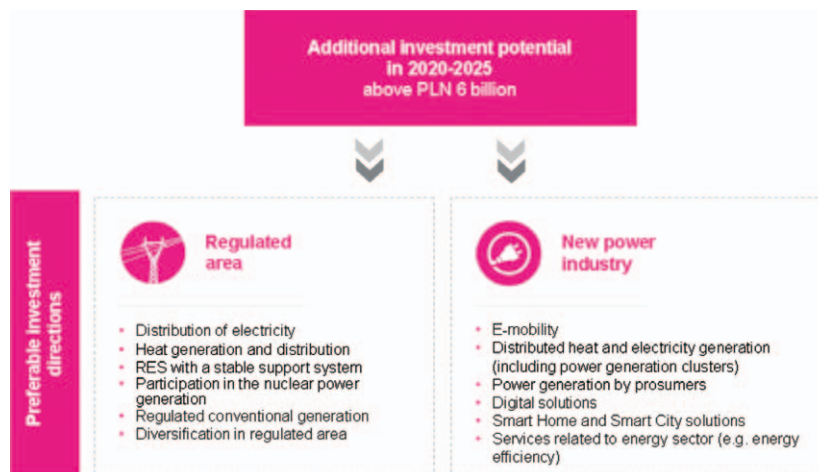
1.5. Description of TAURON Capital Group’s expansion policy and directions

Strategy sets the directions of TAURON Capital Group’s short and long term expansion. The tasks for TAURON Capital Group’s individual Lines of Business were defined in detail until 2020 and the financial effects for such tasks were set. The priority is to maintain stable financial position and lay down solid foundations for growth in a changing environment. This priority is to be achieved through the Efficiency Improvement Program and Strategic Initiatives aimed at the cost and investment optimization. It is planned that by 2020 PLN approximately 18 bln worth of CAPEX will be spent, with more than half on the distribution assets generating TAURON Capital Group’s most stable revenue. Strategy sets the priority directions for the innovations as well as research and development activities that will be the basis for developing new products and services in the longer term. In order to achieve this goal TAURON Capital Group adopted a new model for the innovations as well as research and development activities, setting up a dedicated central organization for managing and coordinating such operations and allocating a budget of 0.4% of revenue thereto.

In the longer term Strategy assumes full utilization of the potential of TAURON Capital Group’s assets, supporting innovations, organizational culture and, first of all, the broad customer base. Strategy assumes that in 2020–2025 TAURON Capital Group will gain an additional CAPEX potential in the region of approximately PLN 6 bln to be used for projects that will generate value for TAURON Capital Group in the longer term. TAURON Capital Group will be investing in the regulated areas such as electricity distribution as well as heat distribution and generation, RES (on the condition of a stable support system), regulated conventional generation and in the new power sector, e.g. electromobility, dispersed (distributed) electricity and heat generation, smart solutions.

The below figure presents the outlook for CAPEX directions beyond 2020.

Figure no. 11. Outlook for CAPEX directions beyond 2020



TAURON Capital Group's main competitive advantage is the base of 5.5 mln customers. The most important actions in the short and long term will be relatively low capital intensive actions related to an expansion of the product and service offering for the consumers and developing new operations based on TAURON Capital Group's competences. Strategy assumes that in 2025 new businesses will be generating approx. 25% of the total margin or revenue from the Supply Segment's sales.

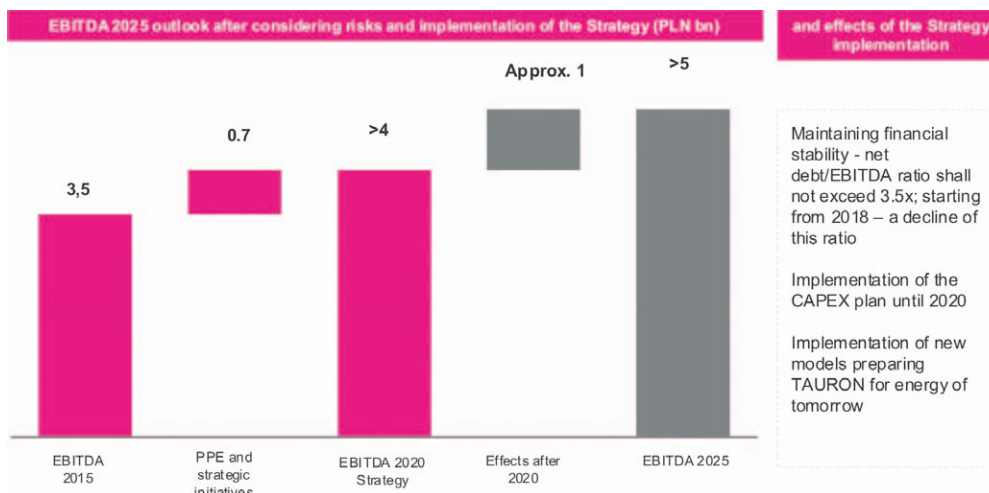
1.5.1. Long term goals and financial assumptions of the Strategy

Actions defined in the Strategy will allow for achieving the set key goals for TAURON Capital Group:

- 1) EBITDA above PLN 4 bln in 2020
- 2) Maintaining the net debt/EBITDA covenants below 3.5x
- 3) Maintaining a high Customer Satisfaction Index (CSI)
- 4) Power plants generating positive cash flows by 2020
- 5) Maintaining the customer base
- 6) Unit margin leader among Poland's largest 4 electricity suppliers
- 7) New businesses will represent at least 25% of revenue/margin in 2025

The below figure presents the 2025 EBITDA outlook taking into account the risks and the implementation of the Strategy as well as the effects of the implementation of the Strategy.

Figure no. 12. 2025 EBITDA outlook taking into account the risks and the implementation of the Strategy as well as the effects of the implementation of the Strategy



Actions planned for the coming years will allow for stopping the profitability decline. This will be achieved by optimizing operations in the Generation and Mining Segments while at the same time maintaining stability in the Distribution Line of Business.

1.5.2. Implementation of strategic investment projects

Key strategic investment projects underway

The below table presents the activities carried out by TAURON Capital Group in 2017 in connection with the implementation of the key strategic investment projects.

Table no. 4. Key strategic investment projects' work progress

No.	Investment project	Work progress
1.	<p>Construction of a 449 MW_e CCGT unit, including a 240 MW_t heat generation component at Stalowa Wola (Project implemented jointly with the strategic partner – Polskie Górnictwo Naftowe i Gazownictwo S.A. (PGNiG)).</p> <p>Contractor: the contract with Abener Energia S.A. was terminated. The Project's completion is envisaged under the EPCM formula (contract manager). EPCM – Energoprojekt Katowice – Energopomiar Gliwice consortium.</p> <p>Planned project completion date: 2019</p> <p>Work progress: 86%</p> <p>Expenditures incurred: PLN 981.9 mln</p>	<p>The installed machines and devices' maintenance works were conducted on an ongoing basis, works related to the startup of the auxiliary devices were conducted, power supply was provided to the unit's switchgear and negotiations with the suppliers and sub-suppliers of the main devices were conducted. The concept of the project's completion under the contract manager – EPCM formula and the contractors' contracting was prepared. The EPCM service agreement with the Energopomiar Gliwice – Energoprojekt Katowice consortium was concluded. EPCM commenced the performance of the services. In December 2017 ECSW with the EPCM support announced the first proceeding aimed at selecting the critical path contractor – startup group.</p> <p>The proceeding aimed at selecting the Contractor to construct the cooling water's duct was completed. IDS-BUD S.A. was selected, preparations to commence the construction works are underway.</p> <p>The decision was taken on expanding the project's scope by adding the construction of the backup heat source. Preparation works are underway. All liabilities under ECSW's loan agreements towards the financing banks (European Investment Bank, European Bank for Reconstruction and Development, Bank Polska Kasa Opieki S.A.) were totally repaid. Upon the crediting of the financing institutions' bank accounts the suspending conditions were met and at the same time the documents came into force, i.e. the agreement on establishing the basic boundary conditions of the project's restructuring among TAURON, PGNiG and ECSW, the amendment to the electricity sale Agreement among TAURON, PGNiG and ECSW and the amendment to the gas supply agreement between PGNiG and ECSW.</p> <p>Talks aimed at acquiring the financing required to complete the investment project are continued.</p>
2.	<p>Construction of a new 910 MW_e power generation unit for supercritical parameters at Jaworzno III Power Plant (TAURON Wytwarzanie).</p> <p>Contractor: RAFAKO S.A. and MOSTOSTAL WARSZAWA S.A. Consortium</p> <p>Planned project completion date: 2019</p> <p>Work progress: 54%</p> <p>Expenditures incurred: PLN 3 330 mln</p>	<p>Construction works and installing of the steel structures were underway. With respect to the machine room building the basic steel structure of the building including the overhead crane was completed. Installation of the generator's stator was completed. The cooling tower's ultimate height was achieved and the absorber's pump station's roof's steel structure was completed.</p> <p>The project works conducted by the selected contractors selected were underway to construct: ignition oil (auxiliary fuel) installation, compressed air system, office building, power discharge system, water supply system as well as water treatment station and wastewater treatment plant were underway. The Contractor for the construction of the flyovers of pipelines was selected. Tender proceedings to select the Contractor for the construction of the track layout system, telecommunications network and the water and sewage network were continued.</p> <p>An amendment with the RAFAKO S.A. – MOSTOSTAL WARSZAWA S.A. consortium was signed under which the agreement's net price was increased by PLN 71.05 mln (i.e. to PLN 4 470 mln), and the deadline for completing the subject of the agreement was extended by 8 months which means that the new date of handing the unit over for operation is November 2019). The amendment did not impact the investment project's total budget.</p> <p>Furthermore, the unit's process parts were installed. The works performed were related to installing boiler pressure elements, furnace installation, boiler fuel supply and electrostatic precipitator installation. Generator's installation was completed, the installation of the turbine and condenser elements as well as feeding water pumps including the GRP pipelines was continued. Also the contractors for the other systems, i.e.: telecommunications network, the water and sewage network as well as track layout system.</p> <p>Works in the area of auxiliary and accompanying systems were continued: carburization, de-ashing, power discharge system, ignition oil (auxiliary fuel) system, compressed air system, raw water supply system, flyovers (bridges), water treatment station, office building, telecommunications network.</p>

No.	Investment project	Work progress
3.	<p>Construction of the "Grzegorz" shaft including the infrastructure (above the ground and underground) and the accompanying headings (TAURON Wydobycie).</p> <p>Contractor: Consortium KOPEX Przedsiębiorstwo Budowy Szybów S.A. FAMUR Pemug Sp. z o.o. (main task – Stage I), LINTER S.A.</p> <p>Planned project completion date: 2023</p> <p>Work progress: 20%</p> <p>Expenditures incurred: PLN 97.2 mln</p>	<p>Works related to excavating the headings to the "Grzegorz" shaft on the 540 m were continued. Currently the excavated heading's length reached 930 m.</p> <p>General Contractor of the construction of the shaft, including the above the ground infrastructure, was selected – KOPEX Przedsiębiorstwo Budowy Szybów S.A. and Famur Pemug Sp. z o.o. The construction site was handed over to the General Contractor.</p>
4.	<p>Construction of the 800 m level at Janina Coal Mine (TAURON Wydobycie).</p> <p>Contractor: Konsorcjum Mostostal Zabrze GPBP S.A. i SIEMAG TECBERG POLSKA S.A. (Construction of the ultimate above the ground and underground infrastructure including the Janina VI shaft Mine Shaft Elevator), KOPEX S.A. i KOPEX Przedsiębiorstwo Budowy Szybów S.A. (zadanie zakończone – drażenie szybu) Tender proceeding aimed at selecting the contractor for the ultimate above the ground and underground infrastructure including the mine shaft elevator is underway (GWSZ), KOPEX</p> <p>Planned project completion date: 2020</p> <p>Work progress: 57%</p> <p>Expenditures incurred: PLN 294.1 mln</p>	<p>Works associated with shaft drilling and furnishing as well as the installation of the shaft pipe to the ultimate depth were completed. The works associated with the horizontal heading drilling on the 800 m level are underway.</p> <p>The contractor to complete the construction of the shaft's above the ground and underground infrastructure, including the mine shaft elevator, was selected.</p>
5.	<p>Brzeszcze CAPEX Program</p> <p>Contractors: TRANS-JAN, FAMUR and KOPEX Machinery Consortium, FAMUR and KPRGiBSz Consortium, MAS and Carbospec Consortium, Elektrometal Cieszyn</p> <p>Planned Program completion date: 2025</p> <p>Work progress: 26%</p> <p>Expenditures incurred: PLN 138,3 mln</p>	<p>Wall 05 was launched. The works related to the alteration of the ventilation excavations are underway. The works related to the construction of the fine coal sales facility, construction of the primary compressors station, construction of the water and ash blending station were conducted. The mine's upgraded mining rescue station was commissioned and the mine dewatering system was upgraded.</p>
6.	<p>Implementing heat production at unit no. 10 and construction of peaking and backup boilers at Łagisza</p> <p>Contractor: proceedings to select General Contractors to carry out individual scopes underway.</p> <p>Planned Program completion date: 2019</p> <p>Work progress: 0.5%</p> <p>Expenditures incurred: PLN 0.5 mln</p>	<p>The project's goal is to adapt unit no. 10 at Łagisza Power Plant to produce heat by upgrading the turbine, installing heat-producing heaters at unit no. 10's turbine, in order to heat heating water using the steam extracted from the turbine's flow section and upgrading the heating station. Securing of the heat supply during the demand peak and/or during the scheduled or emergency shutdown of unit no. 10 from the operation will be carried out as part of the construction of the peaking and backup boilers.</p> <p>Two of the three main tender proceedings to select contractors to carry out individual tasks have been announced. Planned expenditures to be incurred to carry out the project is approx. PLN 114 mln.</p>
7.	<p>Low Emission Elimination Program (PLNE) on the territory of the Silesia and Dąbrowa conurbation</p> <p>Contractors: Contractors selected to carry out individual projects.</p> <p>Planned Program completion date: 2023</p> <p>Work progress: 3%</p> <p>Expenditures incurred: PLN 2.8 mln</p>	<p>The program is carried out on the territory of the following cities: Będzin, Chorzów, Czeladź, Dąbrowa Górnicza, Katowice, Siemianowice Śląskie, Sosnowiec, Świętochłowice. The scope of the project includes construction and alteration of the district heating networks: transmission ones, housing estate ones and connections, as well as construction of heating nodes to the extent required to connect heat consumers. Connecting of 183 MWt of thermal capacity to the district heating network as well as an increase of heat supply and distribution is planned. The program's goal is to reduce smog in the Silesia and Dąbrowa conurbation.</p> <p>TAURON Ciepło signed a funding agreement for the amount of approximately PLN 141 mln. The total funds envisaged to carry out the program amount to approximately PLN 250 mln.</p>

Nuclear power plant construction project

On February 15, 2017 PGE EJ 1's share capital increase was registered in the National Court Register, in line with the resolution passed by the Extraordinary GM of the PGE EJ 1 special purpose vehicle on December 21, 2016. The share capital was increased from PLN 275 859 450 to PLN 310 858 470, i.e. by PLN 34 999 020, by way of issuance of 248 220 new shares with the nominal value of PLN 141 per share and the total nominal value of PLN 34 999 020. TAURON took up 24 822 new shares with the nominal value of PLN 141 per share and the total nominal value of PLN 3 499 902, paid for by cash in the amount of PLN 3 499 902.

On September 3, 2014 TAURON, ENEA S.A. (ENEA) and KGHM Polska Miedź S.A. (Business Partners) concluded the Partners' Agreement governing the rules of cooperation in the implementation of Poland's first nuclear power plant construction project. On April 15, 2015 the above entities concluded the agreement on the purchase of shares in PGE EJ 1 – a special purpose vehicle responsible for preparing and implementing an investment project involving the construction and operation of a nuclear power plant with the capacity of approximately 3 thousand MWe (Project). Each Business Partner acquired from PGE a 10% stake (30% of shares in total) in the PGE EJ 1 special purpose vehicle. TAURON paid PLN 16 044 000 for the acquired stake. This way one of the commitments under the Partners' Agreement, according to which the parties undertook to jointly, in proportion to the stakes held, finance operations as part of a project milestone, was fulfilled

The Partners' Agreement envisages that the successive decisions related to the project, including the decision on the declaration to further continue participation in a subsequent project stage by the individual parties (including TAURON), will be taken following the completion of the preliminary stage.

In 2017 PGE EJ 1 carried out the scope of the works related to conducting environmental and siting research at Żarnowiec and Lubiatowo-Kopalino sites.

Coal gasification project

On April 20, 2017 TAURON signed a letter of intent with Grupa Azoty S.A., defining general rules of commencing cooperation aimed at implementing the coal gasification project.

The product of the technological process system that the letter of intent is applicable to is primarily the synthesis gas (syngas) with the composition that would allow using it directly to produce hydrogen, ammonia, methanol or other chemicals. The parties came to the conclusion that the current natural gas consumption in the nitrogen fertilizers manufacturing industry could partly be replaced with the synthesis gas (syngas) obtained as a result of coal gasification. This opens new prospects for the mining industry, increasing Poland's security of electricity supply by developing low emission technology.

The project is at the preFeed (Preliminary Front End Engineering Design) and accompanying analyses, including market research, stage. As part of the project Grupa Azoty commissioned works related to documentation, in particular a preliminary selection of licensors and updating of the analyses. The Project's estimated value will reach between EUR 400 mln and EUR 600 mln, depending on the selected technology version.

TAURON has declared its participation in the Project's implementation in accordance with the rules that will be defined by the Parties in separate agreements, including assuming selecting and completing an installation that would ensure maximizing the use of hard coal coming from TAURON Capital Group's coal mines. If TAURON is not able to provide appropriate quantity or parameters of coal required by the installation, it shall be permitted to supplement the supply with coal coming from other suppliers.

The letter of intent expresses the readiness of the parties to commence talks and defines the general cooperation framework and does not cause, at the current stage, any financial or management implications for either Party. The Parties declared an intention to cooperate and expressed the will to sign further agreements, including agreements related to establishing a joint special purpose vehicle (SPV) to carry out the project. Either Party shall have the right to terminate the letter of intent at one month's notice.

413 MW_e CCGT unit construction project including the 266 MW_e heat production unit at Łagisza Power Plant

In accordance with the Strategy, as part of the priority to ensure TAURON Capital Group's financial stability, the CCGT unit construction project at Łagisza Power Plant was stopped by TAURON Wytwarzanie due to the loss of its business justification. The project continues to maintain the stopped project status and it will be possible to resume it in case the regulatory and market environment turns favorable.

CCGT unit construction project at Elektrownia Blachownia Nowa sp. z o.o.

On December 19, 2017 the Extraordinary GM of Shareholders of Elektrownia Blachownia Nowa sp. z o.o. in liquidation confirmed, through applicable resolutions, the completion of the company's liquidation process. The remaining assets (funds) were split into two equal parts and transferred to KGHM and TAURON Wytwarzanie. It was the consequence of the agreement signed on July 28, 2016 between: TAURON, KGHM and TAURON Wytwarzanie, under which the companies decided in unison to withdraw from implementing the CCGT unit construction project at Elektrownia Blachownia Nowa sp. z o.o., suspended since 2013, and terminate the Partners' Agreement signed between KGHM and TAURON Wytwarzanie, and also to proceed to the liquidation of Elektrownia Blachownia Nowa sp. z o.o.

Capital expenditures

In 2017 TAURON Capital Group's capital expenditures reached PLN 3 474 mln and were approx. 9% lower than the expenditures incurred in 2016 that reached approx. PLN 3 817 mln. This is primarily due to the decreased capex in the following Lines of Business: Generation, Distribution and Mining.

The below table presents selected capital expenditures incurred in 2017, highest by value, by TAURON Capital Group's Lines of Business.

Table no. 5. Capital expenditures, highest by value, incurred in 2017 by TAURON Capital Group's Lines of Business

Item	Capital expenditures (PLN M)
Distribution	
Grid assets' upgrades (refurbishments) and replacements	865
Construction of new connections	610
Generation	
Construction of new capacity at Jaworzno III Power Plant (910 MW)	1 278
CAPEX on upgrades (refurbishments) and replacements as well as components at TAURON Wytwarzanie	77
Investment projects related to the maintenance and development of district heating networks	16
Connecting new facilities	17
Mining	
Brzeszcze Coal Mine's Investment Program	38
Construction of the 800 m level at Janina Coal Mine	41
Construction of the "Grzegorz" shaft, including the infrastructure and the accompanying headings	13

The detailed information on the capital expenditures incurred in the individual Segments of TAURON Capital Group's operations are provided in section 2.3. of this report.

1.5.3. Evaluation of the capability to complete the intended investment projects

TAURON Capital Group's strategic investment projects and the financing thereof are centrally managed at the Company's level. Based on the analyses completed the Company's Management Board assesses that TAURON Capital Group is able to finance the current and future intended investment projects included in the Strategy using funds generated from operations and obtaining debt financing.

1.5.4. Building TAURON Capital Group's value

TAURON Capital Group is conducting operations in all key segments of the energy market, i.e. hard coal mining as well as electricity and heat generation, distribution and trading. Strategy assumes that each Line of Business will be building TAURON Capital Group's value, but in a manner aligned to the market conditions for the given segment. Supply Line of Business as well as the new products and services represent the field of operations that will be intensely expanded by TAURON Capital Group. TAURON Capital Group is changing its profile towards full concentration on the customer. This is achieved by building sustainable relationships with customers, introducing consistent, high customer service standards in each link of the value chain, modern and integrated sales and customer service channels (omnichannel and e-commerce), adapted to today's highest standards. Supply segment and customer service will be the main drivers for building TAURON Capital Group's value. Electricity Distribution Line of Business is the most stable line of business in terms of contribution to generating TAURON Capital Group's EBITDA. TAURON Capital Group is planning to maintain a stable role of the Distribution Line of Business and continue the up to now investment policy. Through further upgrades and expansion of its distribution grid TAURON Capital Group will be able to meet the requirements in terms of security and quality of supplies. Generation and Mining Lines of Business will continue to improve the cost and operating efficiency, while a potential expansion of the conventional generation will depend on the market situation or favorable regulations for the conventional generation.

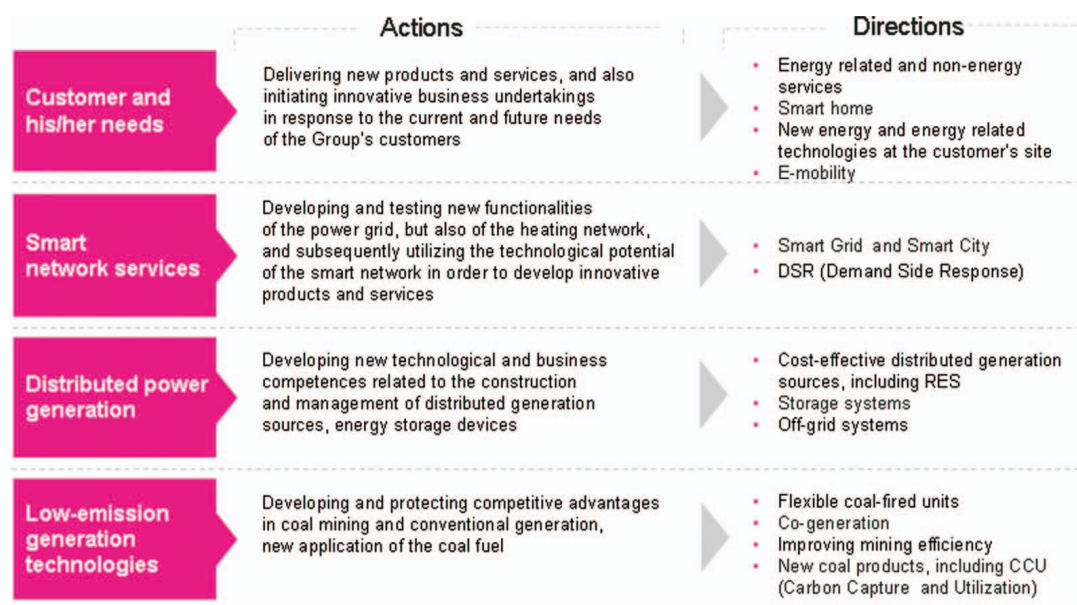
1.5.5. Directions for advancing innovations as well as research and development activities

In its adopted Strategy TAURON Capital Group places its bet on a dynamic expansion of the research and development as well as innovations line of business (R+D+I), viewing it as a way to achieve new revenue in the future. It is assumed that, starting from 2017, minimum 0.4% of consolidated revenue will be spent on R+D+I, as well as on expansion based on, among others, Corporate Venture Capital (CVC) and long term return on the portfolio, and also an annual revision depending on the financial position.

The research and development as well as innovations line of business (R+D+I), in line with the Strategy, introduced portfolio based management of research and development projects in accordance with the priority directions of innovations as well as research and development activities.

The below figure presents the priority directions of innovations as well as research and development activities.

Figure no. 13. Priority directions of innovations as well as research and development activities



The directions of innovations as well as research and development activities were taken into account in the works on developing the Strategic Research Agenda (SRA) conducted in 2017. This document will constitute a conversion of the goals indicated in the Strategy into a "road map" for the R+D+I operations of TAURON Capital Group, accommodating the specifics of the challenges in each of the above four directions and at the same time reaching in the adopted timeframe beyond the timeline of the current Strategy in force.

Additionally, process based management introduced in the R+D+I line of business provided more effective and timely implementation of the R+D portfolio projects by TAURON and TAURON Capital Group's subsidiaries. The change of the line of business operations' organization ensured effective supervision of the Corporate Center over the R+D projects' implementation by TAURON Capital Group's subsidiaries and management of financial and non-financial resources.

1.5.6. Major achievements in the field of research and development

2017 was the first year of the implementation of the Strategy, assuming the R+D+I line of business budget of approx. 0.4% of the consolidated revenue.

Within the dedicated budget a number of research and development projects were launched in all 4 project portfolios, corresponding to the priority directions of the innovations and development activities. At the end of 2017 the R+D project records included 43 projects, including 22 launched and underway, plus 21 at the stage of preparation and acceptance.

The below table presents the most important research and development projects implemented in 2017 by TAURON Capital Group's subsidiaries, co-financed from external sources.

Table no. 6. Selected research and development projects implemented in 2017 by TAURON Capital Group's subsidiaries, co-financed from external sources

No.	Projects/programs/tasks	Co-financing source
1.	<ul style="list-style-type: none"> • CO₂-SNG project, including chemical energy accumulation through production of methane from captured CO₂. • POLYGEN project the concept of which is based on the use of the polygeneration processing system in the process of gasifying the locally available fuels (e.g. selected waste fractions). 	Knowledge and Innovation Community (Wspólnota Wiedzy i Innowacji) KIC InnoEnergy (KIC InnoEnergy)
2.	<ul style="list-style-type: none"> • As part of <i>Power Sector's Research Program</i> the following projects were launched: <ul style="list-style-type: none"> • System for assessing propagation and improvement of the quality of electricity in distribution grids. • Developing a platform allowing for aggregating the generation and regulatory potential of the dispersed (distributed) renewable energy sources and energy storage devices as well as the selected categories of controllable consumers. • Integrated Grid Diagnostics System. 	National Research and Development Center (Narodowe Centrum Badań i Rozwoju – NCBR)

No.	Projects/programs/tasks	Co-financing source
	<ul style="list-style-type: none"> • TENNESSEE – Development of the industrial design of carbonate fuel cells and ceramic electrolyzers enabling integration with the power-to-gas installations. • Flexibility of the existing power generation units with limited capital expenditures. • System for optimizing the operation of conventional generating units aiming to increase their adjustability in order to ensure ongoing stability of the power system and long term conditions for further integration of renewable energy sources. • Platform for managing data from advanced measurement infrastructure. • Dispersed (distributed) power solutions model 2.0 – self-balancing power grid areas. • Applied Research Program under which the project with respect to producing demineralized water to supplement the water and steam circulation using electromembrane methods. 	<p>National Research and Development Center (Narodowe Centrum Badań i Rozwoju – NCBR)</p>
3.	<ul style="list-style-type: none"> • CERES project aimed at introducing a number of technology improvements in order to reduce the risk related to the mining waste produced. 	<p>European Union's Coal and Steel Research Fund</p>
4.	<ul style="list-style-type: none"> • ICP4Life project related to developing integrated collaboration platform for managing the technology and product services life cycle. • MOBISTYLE project related to technology solutions that will allow for positively influencing customer behavior by raising the consumers' awareness and feeling of ownership. • UtilitEE project aimed at implementing a solution that will increase electricity consumption efficiency by actively engaging customers in their behaviors related to electricity consumption with the use of information and communications technologies and DSM mechanisms. 	<p>2020 Horizon: Framework Program with respect to scientific research and innovations</p>

8 projects passed NCBiR's verification in 2017 as part of the 1st competition under the Power Sector's Research Program using the funds of the Smart Development Operational Programme, receiving funding in the amount of PLN 21 mln that represented almost 1/3 of the competition's budget. The project that combines the activities of the subsidiaries: TAURON, TAURON Dystrybucja, TAURON EKOENERGIA and TAURON Sprzedaż is *M-GRID 2.0* – "Dispersed (distributed) power solutions model 2.0" – as part of which we will conduct demonstrations of the self-balancing power grid area. The project's goal is to develop the technology to be used to build local power grids the main advantage of which is to reduce transmission losses, improve reliability and flexibility of the system. Knowledge and experience gained with respect to developing and operating microgrids will allow for offering TAURON services to external customers, and also for applying the solution within TAURON Capital Group.

One of the more important research and development projects implemented in 2017 by TAURON Capital Group is the CO₂-SNG project, related to converting CO₂ into synthetic natural gas using the surplus electricity from RES. The project is carried out by an international consortium grouping Polish and French entities, with TAURON Wytwarzanie as the consortium leader. The scope of the project encompasses converting carbon dioxide produced as a result of burning fuels in industrial installations into synthetic natural gas – SNG. This gas will be produced as result of CO₂ reacting with hydrogen coming from the electrolysis process, powered using cheap electricity coming from RES in the power system's load valleys. The project assumes that this can be the method to store electricity surplus from renewable sources, and at the same time a future-proof solution for utilizing CO₂ produced at TAURON Capital Group's installations. Funding from KIC InnoEnergy was obtained to implement the project. The project constitutes the basis for other projects: POLYGEN and TENNESSEE.

The goal of the POLYGEN project is to develop a technology solution to fill a market niche of environmentally friendly and cost effective thermal waste and alternative fuel processing for small and medium size applications. The project's product will be the development of technology to produce heat, electricity and synthetic natural gas based on gasifying alternative fuels such as municipal waste, dewatered sediments or biomass.

The goal of the TENNESSEE project is to improve energy storage process in the chemical form – natural gas substitute, aimed at improving operating parameters of the ultimate installation, mainly based on the higher efficiency of the high temperature electrolysis and the use of carbonate fuel cells to capture CO₂ from flue gases which does not require supplying electricity from the power plant to the capture system. In particular the project will contribute to lowering the energy intensity per a unit of the SNG produced.

An important accomplishment was also the launching of the UtilitEE project co-financed under the Horizon 2020 program under the name of "Transformation of an electricity supplier's business model with a view to energy efficiency based on changing human behaviors and the use of information and communications technologies". The project activities are aimed at implementing a solution that will increase electricity efficiency consumption by actively engaging customers in their behaviors related to electricity consumption with the use of information and communications technologies and DSM mechanisms.

In the Supply Line of Business the key research and development project is "PROmoc – active management of the energy balance and customer preferences in order to optimize the use of the potential for adjusting (controlling) demand for electricity". The project's task is to generate benefits from efficient capacity management for three market

participants: customer, utility company contracting electricity and the entity managing the national power system's security.

In 2017 TAURON continued activities with respect to building mechanisms for cooperation between industry and science as well as between industry and startups. In this regard the participation in the works of the Technology and Innovations Highway Institute (Instytut Autostrada Technologii i Innowacji), set up in 2014, that is the new platform for cooperation between industry and Polish universities, took place. In the Pilot Maker program, co-financed by the Polish Agency for Enterprise Development (PARP) as part of the Scale Up competition, 3 startup selection processes were carried out. Since the beginning of 2017 in the entire program TAURON reviewed almost 130 solutions prepared by startups. i.e. 46 in the first selection process, 23 in the second selection process and 60 in the third selection process. 30 startups began cooperating with TAURON on preparing solutions in response to the technological challenges defined by TAURON Capital Group. Currently 26 startups are testing their solutions on TAURON's infrastructure or preparing their solutions for such tests (pilots). The program's leader is techBrainers sp. z o.o., the main partner is TAURON, the other partners are well known companies Kross S.A. and Amplus sp. z o.o.

In 2017 TAURON Capital Group was carrying out works as part of KIC InnoEnergy, in particular the Polish node of InnoEnergy Central Europe sp. z o.o. with its seat in Kraków (one of six in the EU). Within the structures of KIC InnoEnergy TAURON holds the Associated Partner status. One of TAURON's areas of interests are the so-called clean coal technologies. At the same time conducting of tests and coordinating of activities in this area are the main tasks of InnoEnergy Central Europe sp. z o.o., of which TAURON is one of the shareholders. In 2017 the Company's representatives were engaged in the works of KIC InnoEnergy, related to evaluating projects/initiatives proposed to be implemented by other partners operating within the structures of KIC InnoEnergy, both on the national, as well as international level. Additionally, two projects were completed as part of the cooperation with KIC:

- 1) Smart Home project, encompassing developing a system of integrated devices allowing for an efficient way to remotely manage operation of electric devices and control safety at home.
- 2) Prointerface project, encompassing developing a system for individually evaluating disruptions of the quality of electricity in the distribution grid along with the power electronic interface for connecting dispersed (distributed) renewable energy sources. In 2017 the first Survey of the Level of Innovations at TAURON Capital Group's subsidiaries that will constitute the basis for monitoring the progress in this area in the subsequent years.

2. TAURON CAPITAL GROUP'S OPERATIONS

2.1. Factors and non-typical events that have a significant impact on earnings achieved

2.1.1. Internal factors and the assessment thereof

TAURON Capital Group's operations and earnings in 2017 were impacted, among others, by the following internal factors:

- 1) actions with respect to optimizing processes taken by all of TAURON Capital Group's subsidiaries,
- 2) first effects of the implementation of the Strategy due to implementing the Strategic Initiatives and optimizing capital expenditures,
- 3) implementation of the Efficiency Improvement Program aimed at reducing TAURON Capital Group's operating expenses in 2016–2018, including the consolidation and restructuring projects, the Voluntary Redundancy Programs for the workforce,
- 4) decisions with respect to the implementation of the key investment projects, in particular with respect to the construction of new generation capacity and refurbishing the existing generation capacity, the construction of new connections and upgrading (refurbishing) the existing distribution grids, district heating networks, the construction of the underground headings,
- 5) loyalty building measures aimed at retaining the existing customers and marketing activities with respect to acquiring new customers,
- 6) centralizing TAURON Capital Group's financial management, supported by the use of such tools as: central model of financing, cash flow (financial liquidity) management policy using the cash pooling mechanism, risk management policy in the financial area, insurance policy,
- 7) ability to obtain debt financing on international markets,
- 8) Tax Capital Group's operations, primarily aimed at optimizing the performance of the obligations associated with the payment of the corporate income tax by TAURON Capital Group's key subsidiaries,
- 9) TAURON's procurement management, in particular, management of fuel purchases for the needs of TAURON Capital Group's generation entities,
- 10) geological and mining conditions of hard coal extraction.

The impact of the above mentioned factors on the financial result achieved in 2017 is described in section 4 of this report. The effects of this impact are visible both in the short term as well as in the long term outlook.

2.1.2. External factors and the assessment thereof

TAURON Capital Group's operations and earnings in 2017 were impacted by the following external factors:

- 1) Macroeconomic environment.
- 2) Market environment.
- 3) Regulatory environment.
- 4) Competitive environment (landscape).

2.1.2.1. Macroeconomic environment

TAURON Capital Group's core business operations are conducted on the Polish market and the Company takes advantage of the positive trends occurring thereupon as well as it is affected by the changes thereof. The macroeconomic situation, both in the individual sectors of the economy as well as on the financial markets, is a significant factor impacting the earnings generated by the Company and TAURON Capital Group.

2017 was generally positive for the Polish economy. The Central Statistics Office (GUS) informed in March 2017 that all economic indicators improved. Registered (official) jobless rate reached 8.5% in February 2017. Additionally, Moody's raised Poland's Gross Domestic Product (GDP) growth rate forecast to 3.2% year on year. All this information allowed for strengthening of the Polish currency both versus EUR as well as USD. In March 2017 the USD/PLN exchange rate declined 2.54% to PLN 3.96, while the EUR/PLN exchange rate dropped 1.74% to PLN 4.23. In April 2017 more positive information on the Polish economy surfaced. In March 2017 the manufacturing industry's sold output rose 11.1% year on year. The actual monthly industrial production growth rate reached 17.6%.

In the subsequent months of 2017 more positive information was published. In June 2017 average wages in the enterprises sector rose to PLN 4 508. Also, employment in the enterprises sector went up, leading to the fall of

the jobless rate to 7.1%. Furthermore, in Poland, similar to the Eurozone, an increase of the manufacturing industry's PMI was observed reaching 53,1 and 56.8, accordingly.

It should be noted that CPI rose 1,5% in the period under review. In November 2017 the consumer products and services price index increased 2.50% on annual basis and 0.50% on monthly basis. GDP growth rate reached 4.9% year on year in Q3 2017, versus 4% in Q2 2017. According to the Central Statistics Office (GUS) data GDP growth rate for the entire 2017 reached 4.6% versus 3.6% expected earlier which undoubtedly proves the strengthening of the country's economy.

According to the data of Polskie Sieci Elektroenergetyczne S.A. (PSE, TSO) 2017 brought a significant increase (2.13% year on year) of the gross national electricity consumption (KZEE), covered mainly by the rise of production from the domestic power plants (1.98% year on year) – and increased imports (14.41% year on year) that reached 2.23 TWh in 2017.

Due to the increased demand for electricity in the National Power System in 2017 TAURON Wytwarzanie's generating units produced approx. 8,8% more gross electricity than in 2016. Increased electricity output had a direct impact on the volume of consumed coal.

2.1.2.2. Market environment

Electricity

Wholesale electricity prices on the Day Ahead Market (RDN) of the Polish Power Exchange (Towarowa Giełda Energii S.A. – TGE) in 2017 in Poland, in spite of rising commodity and CO₂ emission allowance prices, were on an averaged annualized basis lower than in 2016 and reached 157.84 PLN/MWh (-1,38 PLN/MWh in comparison to 2016). The CRO price on the Balancing Market na Rynku (RB) reached 166.65 PLN/MWh (+2,46 PLN/MWh on an annualized basis).

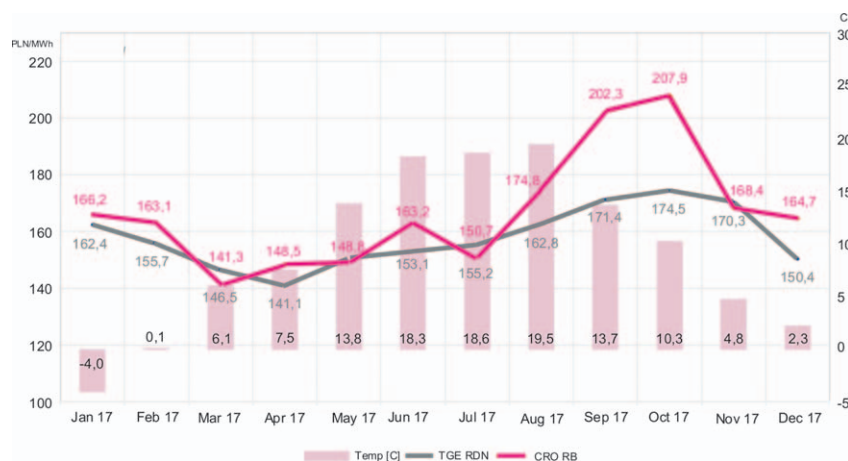
The main reason for a slight price decline on the RDN was a good situation in the National Power System (KSE) and relatively low and very low prices in the 1st half of 2017. The situation improved in the 2nd half of 2017. Rising demand for capacity (year on year increase by 3.99 TWh to 168.4 TWh) in combination with overhaul plans for the centrally dispatched generating units had a significant impact on the increase of CRO prices that were higher, on average, by 8.81 PLN/MWh than the prices on the RDN.

The impact of the rising electricity consumption on the increase of electricity prices was to a certain extent offset by the record volume of electricity produced by the wind sources (14.4 TWh, increase by 2.7 TWh in comparison to 2016). In 2017, in spite of the rising demand, generation output from hard coal fired power plants declined (to 78.7 TWh, i.e. by 1.5 TWh in comparison to 2016). Rising demand was satisfied by increased production at more expensive power plants, for example, the gas-fired ones, the output from which, on an annualized basis, rose 37.8% to 5.8 TWh.

In spite of commissioning approx. 730 MW of new capacity in wind power plants in 2016, a slight increase of the production from RES did not bring the expected output increase in this sub-sector. At the same time a significant, by as much as 4.4%, drop of production from cheap lignite fired power plants was observed in 2017 which had to be offset by the rising production at more expensive power plants, for example, the gas-fired ones, the output from which, on an annualized basis, rose 24.2% to 7.2 TWh. Additionally, KSE was supported by electricity imports in the volume of almost 2.4 TWh.

The below figure presents average monthly electricity prices on the SPOT and RB markets, as well as average temperatures.

Figure no. 14. Average monthly electricity prices on the SPOT and RB markets, as well as average temperatures



The base load contract with the delivery in 2018 was in a clear upward trend on the futures market in 2017. BASE_Y-18 contract prices, after the closing of the BASE_Y-17 contract, began with an up gap in the region of approx. 3 PLN/MWh. However, the gap was quickly closed due to the declining CO₂ prices to the level below 160 PLN/MWh at the end of the first decade of January 2017. In the second half of January 2017 the prices rose and fluctuated in the approx. 160–161 PLN/MWh range. Subsequent months brought stabilization of prices. Only at the end of the summer holidays period rising electricity prices were observed on the energy markets almost all over Europe. The biggest price increases occurred in France, Spain and in Germany (fears of a repeat of the cold 2016/2017 winter and problems with satisfying the demand). In August 2017 the BASE_Q4-17 and BASE_Q1-18 products were particularly high priced, frequently above 50.00 EUR/MWh, i.e. much higher than the reference quarterly product listed on TGE. In September 2017 the average price of the BASE_Y-18 futures contract reached 166.80 PLN/MWh, i.e. it was 3.00 PLN/MWh higher than in August 2017. Forward market electricity prices in October 2017 continued the upward trend commenced in September.

Factors supporting the demand side remained unchanged. A high coal price on the world markets, rising EUA unit prices and a tight situation in the French power system as well as the approaching winter effectively supported reaching new price peaks on the forward products. Additionally, high SPOT price levels also had a clear impact on the wholesale market prices. In October 2017 the average price of the BASE_Y-18 futures contract reached 172.70 PLN/MWh, i.e. it was almost 6.00 PLN/MWh higher than in September. However, the biggest price increase occurred at the beginning of December 2017, when the price of the BASE_Y-18 contract was close to 180 PLN/MWh. The average volume weighted price of the BASE_Y-18 product reached 165.98 PLN/MWh, with the total trading volume reaching 65.2 TWh, i.e. it was more than 10 TWh lower than in 2016.

The below figure presents the BASE Y-18 contracts performance.

Figure no. 15. BASE Y-18 contracts performance



Crude oil and coal

2017 on the crude oil market was characterized by the continuation of the upward trend following the declines that had taken place in 2014–2015. The crude oil prices fluctuated in the 44,35–67.1 USD/bbl range in the period under review.

The beginning of 2017 was characterized by low price volatility. In February crude oil prices fluctuated in the 54.4–57.45 USD/bbl range. At that time investors were analyzing the agreement between the OPEC cartel and Russia, aimed at reducing the crude oil output, and the data on the crude oil production output and inventory levels in the US. It should be noted that a large role in OPEC is played by Saudi Arabia and this country is interested in high oil prices due to the largest IPO in history – the stock market debut of Saudi Aramco.

On March 26, 2017 an OPEC meeting was held in Vienna during which, however, no unequivocal and binding decisions on production levels were taken. Two days later cyclone Debbie hit the northwestern coast of Australia which led to a rise of commodity prices, including also crude oil. In spite of OPEC and Russia's efforts the United States did not join the agreement aimed at reducing oil production, on the contrary, in April 2017 the US observed an increase of its output by almost 0.5 mln bpd, and as a result the worldwide crude oil inventory did not decrease to the expected levels which had a direct impact on the mood on the market.

The second half of 2017 was characterized by a strong anxiety on the market caused by weather related natural disasters and political turmoil. Hurricanes Harvey and Irma had a strong impact on oil prices at the end of August and beginning of September. As a result of the forces of nature a number of US refineries had to stop their operations which led to problems with excessive stockpiles of extracted oil.

Due to increased exports of US oil to other markets the US WTI oil price discount versus the Brent oil widened. Petrol price increased, refining margins rose due to smaller supply of petrol. The strengthening of the crude oil prices in September was due to the “restart” of the US refining industry, but also due to the rising geopolitical tensions. An important factor was also an increase of tension between North Korea and the US and Japan.

Additionally, Kurdistan announced an independence referendum which led to a sharp reaction from Turkey. It threatened to cut off oil supplies from Iraqi oil field in the Kirkuk area to the Ceyhan port in Turkey, which would substantially reduce oil supply.

The situation on the coal market was similar. In Q1 2017 the coal prices were not highly volatile. However, looking at the entire 2017 an upward trend of this commodity should be emphasized. Prices moved in the range between 61.75, and 90.75 USD/Mg. Relative peace on the market was due to investors waiting for the decision of the Chinese National Development and Reform Commission – NDRC, on limiting the number of days in a year when coal may be extracted. Furthermore, safety issues also arose in China – as a result of ad-hoc audits mining was suspended at coal mines that did not meet safety requirements.

On the other hand, due to the beginning of the season characterized by the lower demand for coal, prices on the worldwide market began to drop. Unexpectedly, the aftermath of cyclone Debbie that hit Australia became a factor inhibiting the market declines observed. Particularly strong price hikes during that time were applicable to coke with Australia being one of its main producers, where some mines were closed and the railway infrastructure was destroyed due to difficult conditions as a result of weather related natural disasters. Following the disruptions related to cyclone Debbie coal prices with the delivery in 2018 returned to lower levels. However, Australia was soon hit with flooding rains and finally the price stayed at a relatively high level of 66 USD/Mg.

Additionally, in China, due to overhauls, a very important railway line that connects regions where coal is extracted with the Quindango port was temporarily closed. As a result of these occurrences coal prices with the delivery in 2018 went up by a few dollars – to 68 USD/Mg. Only after a few weeks the situation began to normalize. Finally, the coal at ARA ports with the delivery in 2018 cost 66.50 USD/Mg. In the subsequent months of 2017 temperatures were rising and the precipitation was declining which as a consequence led to the falling water levels. In China the hydroelectric plants' production fell by as much as 70%, and hydro is the second largest source of energy in this country, following coal. Additionally, continued disruptions on the supply side, as a consequence of cyclone Debbie and flooding rains, led to the rising demand on the market.

Coal prices in September at ARA ports with the delivery in 2018 were in an upward trend that began already in March 2017. In the period under review coal prices with the delivery in 2018 reached the maximum level of 84.25 USD/Mg, i.e. the highest value since 2014. Such increases were caused by the strong demand in the Asia region and speculations related to the possibility of a repeat of last year's problems of nuclear plants in France and higher coal consumption in Europe. At the end of the month the prices suffered a correction which was due to the lower demand for coal in China, related to the approaching National Days holidays lasting a full week. Also, a transition period for a ban on coal imports from North Korea was introduced which led to increased supply. Finally, at the end of the year coal prices landed at levels not seen since 2013, reaching 90 USD/Mg.

Natural gas

Year 2017 brought price increases on the gas market following the record low prices in 2016. The average price on the Day Ahead Market for gas on the Polish Power Exchange (TGE) reached 84.69 PLN/MWh in 2017 and it was more than PLN 13 higher than in 2016. Contracts with the delivery on the day ahead were particularly high priced in the first two and the last two months of 2017, i.e. during the gas winter season, when the demand for fuel is the highest. Prices in January and in December topped 100 PLN/MWh a number of times. The maximum value was achieved on December 13, 2017 and it reached 105.10 PLN/MWh. High prices in Q1 2017 were the result of increased demand for gas all over Europe, caused by unavailability of some nuclear plants in France (which led to a larger generation from gas-fired sources) and a relatively long cold period.

In Poland the daily average temperatures on a few January days did not exceed -11°C, while temperatures above 0°C began to appear only in mid-February 2017. Due to increased gas consumption an extension of the cold spell may have led to real problems with availability of gas fuel in Europe. Fears of a repeat of the situation that occurred at the end of 2016 / beginning of 2017 were also the reason for high prices at the end of 2017. The distribution of prices on the spot market in 2017 was characteristic for the gas demand distribution (a clear drop of prices during the period of lower demand in the summer).

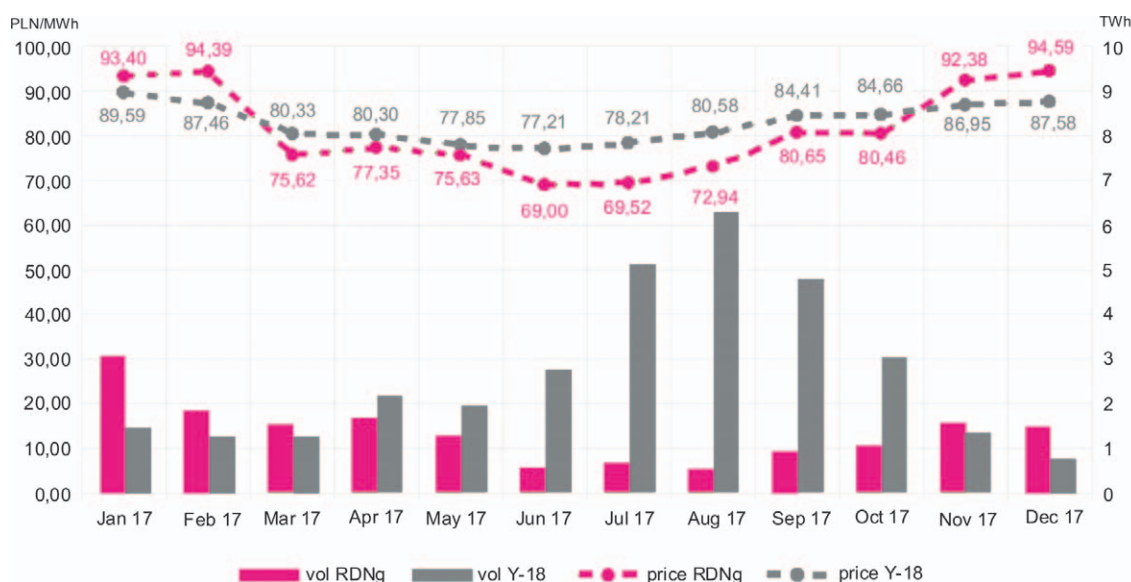
Similar to the markets with a shorter delivery period, on the forward contracts market Q1 and Q3 were characterized by a markedly higher price. The reference one year contract in 2017 was priced within the 76.80–92.27 PLN/MWh range, while upon expiration it was priced at 86.50 PLN/MWh.

The total trading volume on TGE in 2017 reached more than 138.5 TWh. As compared to the previous year an increase by 21% occurred. The forward contracts market had the biggest share in the trading volume, generating a volume at the level close to 115 TWh. On the spot market the total volume of the day ahead contracts and weekend contracts reached more than 19 TWh, which was 0.5 TWh less than in the previous year. A similar slight decline was also observed on the Day Ahead Market for gas where the trading volume reached 4.7 TWh.

The key event for the development of the gas market in Poland was the first historic LNG delivery from the US. A ship carrying liquid gas entered the terminal in Świnoujście on June 7, 2017. While the new rules of maintaining mandatory gas inventory came into force on October 1, 2017. According to these rules importers that want to maintain mandatory gas inventory outside Poland must – in order to ensure their ability to transfer such gas to Poland in case of an energy crisis – reserve the so-called continuous transmission capabilities on the transborder lines (interconnectors). The reserved transmission capabilities are to allow for transmitting the entire inventory to Poland in any conditions within maximum 40 days and additionally they cannot be used for any other purposes, for example commercial (trading) ones.

The below figure presents average monthly SPOT and Y-18 contract prices on TGE in 2017.

Figure no. 16. Average monthly SPOT and Y-18 contract prices on TGE in 2017



CO₂ emission allowances

The CO₂ emission allowances market in 2017 was characterized by high price volatility, caused to a large degree by political factors. During the period under review the prices moved within the 4.29–8.30 EUR/Mg range.

Q1 2017 market should, finally, be deemed as being in the downward trend, in spite of major political events at the EU level, related to the 4th trading period of the European CO₂ Emission Allowances Trading System (EU ETS). The first factor indicating a downward trend were clear declines of electricity contract prices in Germany and France, previously featuring high volatility due to the design problems of the French nuclear plants. Another factor impacting the entire 2017 year was a record high volume offered at the CO₂ emission allowances auctions, Poland's first auction was held on March 29, 2017. It worth noting that the weather conditions in Q1 2017 supported increased utilization of the renewable energy sources. Events that occurred in Q2 2017 resulted in a change of the market mood, and as a consequence a reversal of the downward trend. The main themes attracting the market's attention were:

1. Redemptions of the CO₂ emission allowances – by April 30 every year all industrial installations covered by the EU ETS shall have an obligation to perform the so-called redemptions of the emission allowances the number of which must correspond to the verified emission volume from last year. In case the installation operator does not complete the redemption at the right time, this may lead to an imposition of a financial penalty of 100 EUR/ MgCO₂. For comparison it is worth mentioning that the average EUA price quoted on the market during the period of redemptions fluctuated around 5 EUR/Mg.
2. France's presidential elections.

3. Publishing information on the current oversupply volume on the market – by May 15 every year the European Commission undertook to publish data on the oversupply on the market, and this way it will be possible to estimate what oversupply volume will be allocated to the MSR in the subsequent year.
4. G7 meeting – during which one of the leading themes was the ecological policy, and in particular the theme of the so-called “Paris Agreement”. The climate agreement signed in Paris in 2015 by 195 states from all over the world constitutes an action plan aimed at limiting the rise of temperatures worldwide. During the G7 summit the US President raised his objections against the above mentioned agreement. Finally the US does not respect this document.

July 2017 for the emission allowances market was a month that continued the upward trend commenced in June. The prices fluctuated between 4.99 EUR/Mg and 5.62 EUR/Mg, while the average price for the period under review reached 5.27 EUR/Mg. Continued price increases on the market were to a large degree a consequence of the weather conditions in Europe. Extended period of high temperature and low precipitation led, first of all, to increased demand for electricity (substantial increase of use of cooling devices) and secondly, a difficult hydrological situation in some EU countries. The above mentioned factors of fundamental nature increased the intensity of the use of the hard coal-fired power plants, and thus contributed to an increase of demand for EUAs. In August the ASE Agency ordered a re-checking of all nuclear reactors located in France in order to finally verify the safety of the installations. This information led to a wave of speculations related to the possibility of a repeat of the 2016 situation. The last month of Q3 2017 featured a substantial price volatility. During only 8 session days the price rose by almost 33%. In the beginning of the month market transactions were made at the level of 5.82 EUR/Mg, while a few days later, the CO₂ emission allowances were contracted at the level of 7.72 EUR/Mg. Such large increases were a consequence of rising fears related to the situation of the French nuclear power plants, as well as the German elections. Furthermore, following the takeover of the EU presidency by Estonia, the works related to the legislation of the EU ETS system's phase 4 were accelerated. October 2017 for the emission allowances market was a month of continued strong growth commenced in the previous month. The EUA prices fluctuated between 6.77 EUR/Mg and 8.05 EUR/Mg, which indicates that in the period under review the prices went up by 18.91%, i.e. by 1.28 EUR/Mg. The price increase was caused mainly by the speculative factors, related to the legislation of the EU ETS system's phase 4, surfacing information on the manner of Great Britain exiting the system, as well as related to the problems of the nuclear power plants in France. Additionally, EUA price increases were impacted by the strong upward trend on the coal market. In November 2017 a working group made up of representatives of three main European institutions completed the works on the EU ETS system's phase 4 that will be in force in 2021–2030. In accordance with the agreements reached the reform defined among others:

- 1) Market Stabilization Reserve (MSR),
- 2) Linear Reduction Factor (LRF),
- 3) quantity of emission allowances available at the CO₂ emission allowances auctions,
- 4) quantity of free of charge emission allowances granted during the regulation period,
- 5) modernization and innovation fund.

It is worth noting that the so-called Modernization Fund, and specifically its provisions, prevented the completion of the legislation in October 2017. In its current form the provision on the emission conditions was removed from the provisions setting up the Modernization Fund, however a provision prohibiting the Modernization Fund from subsidizing coal-fired units. In December 2017 the growth trend, developing since Q2, was continued – the prices were moving within the 6.94–8.30 EUR/Mg range.

The below figure presents the impact of the legislative works and the environment on the EUA SPOT product price in 2017.

Figure no. 17. The impact of the legislative works and the environment on the EUA SPOT product price in 2017

Property rights

2017 has brought upon significant changes on the property rights market, mainly related to amendments of legal regulations. Lasting oversupply of PMOZE_A property rights in the market has caused that since June 2017 the average monthly values of the OZEX_A index have been dropping from 37.98 PLN/MWh in January to a historic minimum of 24.38 PLN/MWh in June. In the same period, the surplus on the PMOZE_A register increased by 8.6% to 25.42 TWh. Beginning with July 2017, the prices started to slowly grow back. Compared to 2016, the average weighted price of the OZEX_A index has dropped by nearly 50% to 38.83 PLN/MWh, while the balance on the PMOZE_A register by the end of 2017 was 28.14 TWh that when taking into account the rights blocked for redemption leaves a value of 24.90 TWh at the end of 2017. One should also note the trading volume in “green” certificates in 2017, which amounted to over 10 TWh. So far this was the biggest trade in the history of “green” property rights (higher by as much as 36% than in 2016). According to the *act of 20 July 2017 on amendment of the act on the renewable energy sources*, which came into force on 25 September 2017, the substitution fee in force until September 2017 was 300.03 PLN/MWh, while for the following three months of 2017 this fee dropped to 92.03 PLN/MWh, being 125% of the weighted average price of 2016. The obligation to submit PMOZE_A certificates for redemption increased to 15.40%.

The prices of certificates confirming energy generation from agricultural biogas (called “blue” certificates) for which the obligation rate in 2017 was 0.6% were above the substitution fee that was 300.03 PLN/MWh. From January to May the monthly average prices of the TGEozebio index were dynamically growing, respectively from 301.15 PLN/MWh to as high as 408.08 PLN/MWh. In the following two months this trend has reversed and the prices returned to the substitution fee level. Finally the average weighted value of the index at the end of 2017 was 333.89 PLN/MWh. The total traded volume was 522.5 GWh, and the PMOZE_BIO register balance at the end of 2017 was 309 GWh. Taking into account the certificates blocked for redemption, this value has dropped to 206 GWh.

According to the *act of 10 April 1997, the Energy Law*, amended in 2016, until 30 June of each calendar year the property rights issued to cogeneration units for generation in the previous year may be redeemed. Due to the above, until the end of H1 listings included the property rights for cogeneration both in 2016 and in 2017, while in H2 listings included exclusively the property rights confirming energy generation in 2017.

Until the end of June 2017, the PMEC-2016 (high-efficiency cogeneration) was traded, listed in a narrow price band from 10.76 PLN/MWh in January to 9.27 PLN/MWh in June. However, as of beginning of May 2017, the POLPX started listing PMEC-2017 with opening at 9.68 PLN/MWh. Until the end of 2017, also in case of this instrument the volatility of the KECX index was symbolic and with respect to the monthly values was a mere 0.11 PLN/MWh, while by the end of 2017 the listings ended at 9.79 PLN/MWh. The market prices fluctuated slightly below the substitution fee defined at 10 PLN/MWh.

In gas cogeneration the situation was very much alike. By the end of June 2017, the PMGM-2016 instrument was still listed, closing at 112.21 PLN/MWh. This level, like in case of the coal based cogeneration, was determined by the substitution fee, for 2016 set at 125 PLN/MWh. The PMGM-2017 instrument, concerning generation in 2017,

was listed already in March 2017, with the average KGMX index at 116.00 PLN/MWh. Until the end of 2017 its value was increasing on month to month basis, reaching 117.14 PLN/MWh in December. The average listings in 2017 for PMGM-2017 instrument were 116.48 PLN/MWh and were just c.a. 3.50 PLN/MWh below the substitution fee, which for 2017 has dropped to 120 PLN/MWh.

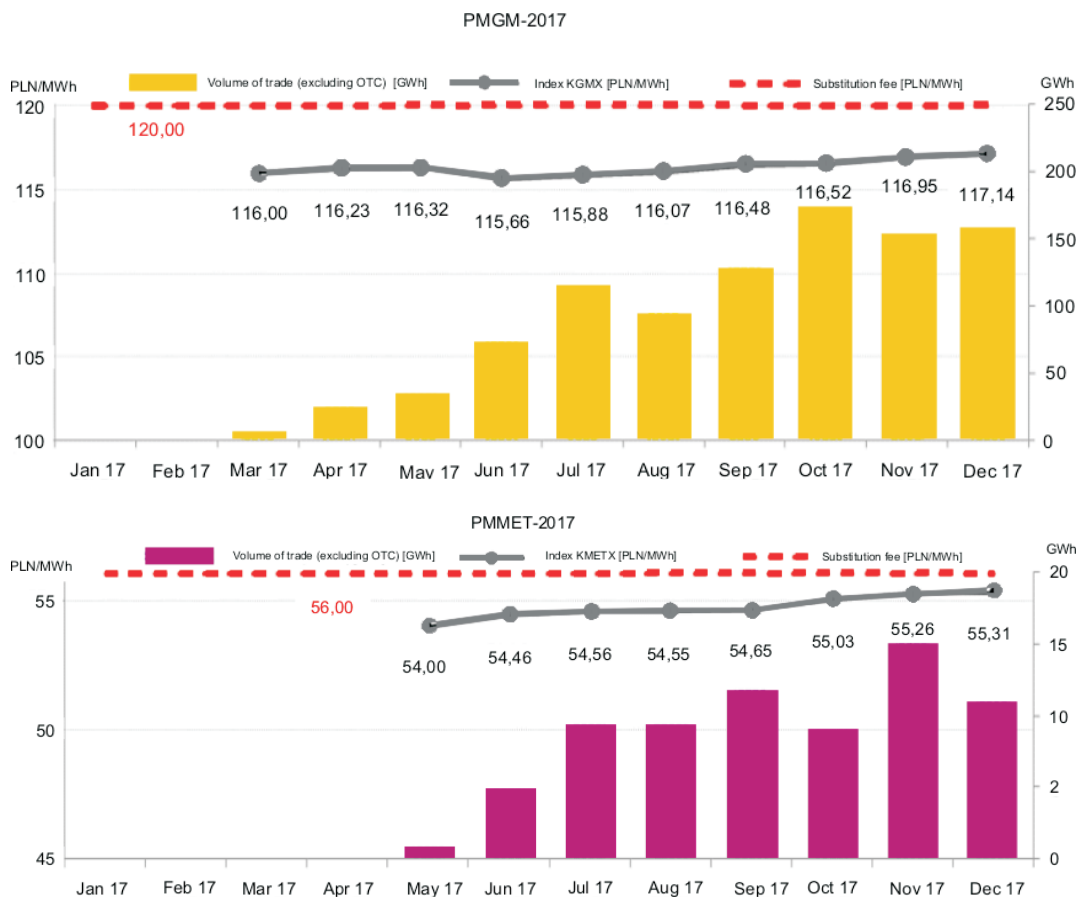
The situation on the market in PMMET property rights confirming energy generation from firing methane was developing similarly to that in case of “yellow” and “red” certificates. Until the end of June 2017 the PMMET-2016 instrument was still listed, with its average value of the KMETX index being 62.19 PLN/MWh. The substitution fee concerning production in 2016 was 63 PLN/MWh, while for 2017 it was lower by 7 PLN/MWh and determined the market prices. The PMMET-2017 instrument for production from the previous year was listed on average at 54.88 PLN/MWh.

The property rights due to the PMEF certificates of energy efficiency (the so-called “white” certificates) continued the downward trend. At the beginning of 2017 the average monthly prices dropped from 1 219,38 PLN/toe in January to the historical lows of 385.86/toe. Finally the weighted average index reached 693.36 PLN/toe and it was as much as 807 PLN/toe lower than the substitution fee set for 2017 at PLN 1 500.00/toe.

The below figure presents the property rights indices, the so-called “green”, “blue”, “red”, “yellow” and “violet” certificates.

Figure no. 18. Property rights indices





2.1.2.3. Regulatory environment

Capacity market law

On December 28, 2017 the President of the Republic of Poland signed the *act of December 8, 2017 on the capacity market*, that came into force on January 18, 2018. This act has a significant impact on the future functioning of the Polish energy sector. The essential goal of the act is to satisfy the deficit of generation capacity due to the foreseen growth of demand for the peak capacity and the simultaneous substantial scope of the planned retirements of generating units from operation. The law defines, among others:

- 1) rules of providing the service of maintaining readiness to deliver electric capacity and defines the principles of compensation for fulfilling the capacity obligation,
- 2) organization of the capacity market,
- 3) rights and obligations of the capacity market participants.

The finally adopted law envisages:

- 1) permitting foreign capacity market units to take part in the auctions,
- 2) liquidating price baskets for the new, refurbished and existing units,
- 3) introducing the possibility of concluding capacity contracts lasting up to 15 or up to 5 years for the new units or up to 5 years for the refurbished or planned units of demand reduction depending on the unit levels of capital expenditures referred to the net achievable capacity,
- 4) introducing, for the new or refurbished units with emission levels below 450 kgCO₂/MWh and cogeneration units feeding the heating systems, the possibility of concluding 2 years longer capacity contracts,
- 5) taking into account the lack of the possibility to comply with the capacity obligation greater than 40% due to a force majeure occurrence.

Furthermore, it was specified in detail that the period of incurring capital expenditures for the needs of the first main auction shall cover the period from January 1, 2014, and for the needs of the second main auction, from January 1, 2017. For the delivery periods falling in 2021–2023 foreign capacities will be taking part in the capacity market solely by participating in additional auctions. Capacity agreements will not be subject to enforcement until the day the European

Commission's decision on their compliance with the internal market or a decision that this solution does not constitute public aid is issued.

Currently the energy sector is awaiting the publishing of the draft capacity market regulations which is to be published in the coming months and for the executive ordinances. The regulations will describe in detail the course of an auction, including the detailed description of the electricity demand curve. The first capacity auctions are to be held in Q4 2018 and they will be applicable to the 2021–2023 time frame.

BAT conclusions

Best Available Technologies (BAT) mean the most efficient and advanced stage of development and methods of conducting the given operations that indicate the possible use of individual techniques as the base when setting the admissible emissions values and other conditions aimed at preventing arising, and if it is not possible, reducing emissions and impact on the environment as a whole.

BAT conclusions is a document drawn up based on the reference document on the best available technologies, the so-called BREF. BAT conclusions for large combustion plants (LCP) as an executive decision to directive 2010/75/EU on industrial emissions (IED Directive) will be directly applicable. They define the new requirements with respect to admissible emissions values and the monitoring obligation. A consequence of their implementation will be the need to adapt the fuel combustion installations to the requirements defined in the BAT Conclusions by constructing or refurbishing generation sources, flue gases cleaning (scrubbing) installations and in certain cases additionally installing the continuous monitoring systems for the pollutants so far not covered by such an obligation which means the need to bear exceptionally high capital expenditures.

On April 28, 2017 the representatives of the member states in the European Commission passed the new standards tightening the emission standards for the manufacturing industry, i.e. the so-called BAT conclusions for large utility scale combustion facilities. On August 17, 2017 the executive decision of the European Commission (EE) 2017/1442 of July 31, 2017, introducing the conclusions related to the best available technologies (BAT) with respect to large utility scale combustion facilities, was published in the Official Journal of the European Union. Upon publishing the BAT conclusions became a part of the legal order in force in Poland and they will be the basis for issuing the integrated permits.

Apart from more stringent restrictions for the SO₂, NO_x and dust emissions the BAT conclusions introduce emission standards for substances not covered thereby so far, namely for mercury, hydrogen chloride, hydrogen fluoride and ammonia, and also in specific cases order installing continuous monitoring for the pollutants not covered by such an obligation so far. The existing installations have 4 years to adapt to the new requirements and they will have to comply therewith after August 17, 2021. BAT conclusions will be applicable to the facilities and installations burning fuels with the capacity not lower than 50 MW in fuel. They are applicable to both the new facilities that will obtain an integrated permit following the publishing of the conclusions, as well as to the facilities already in operation. New, more stringent requirements related to the permitted values of pollutant emissions will have a significant impact on the future of the European coal-fired power plants.

According to the Ministry of the Environment adapting large industrial installations, including the ones generating electricity and heat, to the tighter SO₂, NO_x and dust emission standards and introduced for the first time binding emission levels for mercury, hydrogen chloride, hydrogen fluoride and ammonia will cost at least PLN 10 bln. Both the costs as well as the schedule of the investment projects aimed at adapting the installations covered by the tightening will be an enormous challenge for the energy sector, especially due to the fact that the refurbishing will have to encompass practically all the power generation units currently in operation. Although the IED Directive provides for an option to obtain temporary derogations from meeting the limit emission values defined based on the BAT conclusions, but such derogation may be granted only if achieving the limit emission values were to lead to unproportionally high costs in relation to the benefits for the environment due to the geographical location of the installations, local environmental conditions or the technical features of the installation.

Further tightening of the emission limits is to take place as a result of subsequent revisions of the conclusions that are to be published every 8 years.

Act on Renewable Energy Sources (RES)

In 2017 works were underway on successive amendments of the *Act on Renewable Energy Sources (RES law)* passed on February 20, 2015. A draft amendment of the law was published and sent for public consultations in June 2017, with its main goal being to ensure the compliance of the provisions of the RES law with the regulations on public aid issued by the European Commission. The amendments presented make the provisions of the Act on RES fully compliant with the requirements defined in the guidelines on public aid related to environment protection and energy goals in 2014–2020, that permit, as compliant with the common market principles, such market instruments as auctions or tender procedures in line with the competition principles that are open for all producers generating electricity from RES competing against one another on equal terms that should substantially ensure that subsidies are reduced to the minimum.

The scope of the amendment defined, among others, a rule on cumulating public aid, new split into auction baskets, additional support rules were proposed in the form Feed-in-tariff (FIT) and Feed-in-premium (FIP) tariffs for electricity generators from renewable sources dedicated for micro and small RES installations that use stable and predictable energy sources (hydroelectricity, biogas, agricultural biogas) with an installed capacity lower than 500 kW – FIT and a capacity not lower than 500 kW and lower than 1 MW – FIP;

On 30 August 2017, the *ordinance of the Minister of Energy of 11 August 2017 on amendment of the quantity share of electricity volume resulting out of the redeemed certificates of origin confirming generation of electricity from renewable sources in 2018–2019* came into force, defining the levels of obligations. These levels are 17.5% and 18.5% respectively, while for the “blue” certificates the share for 2018 and 2019 is 0.5%. The new obligations should result in reduction of certificate surplus on the market, and thus increase of their prices that will be capped by a new substitution fee defined for each year.

On 25 September 2017, the act of 20 July 2017, *amending the act on renewable energy sources*, came into force. The key change introduced with this amendment is the discontinuation of the fixed substitution fee in the amount of 300.03 PLN/MWh and relating it to the market prices of certificates of origin of energy from certain RES (“green” and “blue” certificates). This fee is to be equal to 125% annual weighted average price of property rights resulting out of certificates of origin of RES energy, published pursuant to Article 47 (3) 2) of the *act of 20 February 2015 on renewable energy sources*, however not more than 300.03 PLN/MWh.

On 13 December 2017, on power of EU State aid regulations, the European Commission has approved the Polish programme concerning energy from renewable sources. The decision by the European Commission has influenced intensification of work on amendment of the RES act concerning support for RES generators; therefore adoption of another amendment to the RES act is expected in Q1 2018.

In H1 2017, based on the ordinances to the RES act adopted by the Council of Ministers, concerning: the order of conducting the auction sales of electricity from renewable sources in 2017, the maximum volume and value of electricity from renewable sources that may be sold in auctions in 2017 and the reference price of electricity from renewable sources in 2017 and the terms binding the producers who have won auctions in 2017, two RES auctions were conducted for new build and existing producers with installed capacities of up to 1 MW. Subsequent auctions planned to be held in H2 2017 were cancelled by amendment to the previous ordinances.

Amendment to the Water Law Act

The *act of July 20, 2017, the Water Law* was announced on August 23, 2017, however the majority of the new Water law provisions came into force on January 1, 2018.

The act implements into the Polish law, among other, the EU regulations defined in the Water Framework Directive, stating that all water users must incur the costs thereof. The fees shall be applicable to the energy sector, fish growers, farmers and businesses using large quantities of water for their production.

In case of the energy sector the fee for water consumption by hydroelectric power plants is to be borne by the owners of hydroelectric power plants solely for the volume of electricity generated using the reclaimable water and for the intake of non-reclaimable process water.

With respect to the fee for water intake to ensure operation of cooling systems of power plants or combined heat and power plants such fee will be borne solely for the difference between the quantity of water taken for such purposes, and the quantity of water discharged to water streams or to the ground from the cooling systems.

Another fee is the fee for discharging the water from the cooling systems of power plants or combined heat and power plants to water streams or to the ground.

Arrangements concerning the European Union’s CO₂ emissions allowance scheme

The beginning of 2017 saw intensification of work on the EU ETS legislation; however, already in 2016 the EU’s administration bodies received the preliminary decisions on phase 4 of the EU ETS for consultation. On 15 February 2017, the European Parliament has adopted selected legislative proposals submitted by the ENVI and ITRE committees concerning the shape of the EU ETS in 2021–2030. However, on 28 February 2017 a meeting of environment ministers of the Member States of the European Union was held in Belgian’s capital, which adopted the postulates voted at the European Parliament despite objections by nine countries (including Poland), thus demonstrating that EU Member States in majority are for increasing restrictions on greenhouse gas emissions.

Preliminary approval of the resolutions of these institutions has paved the way to further stage of the legislation path adopted in the EU. A working party consisting of representatives of the European Parliament, the European Council and the European Commission (the Trilog) has on 8–9 November 2017 agreed on the compromise text of the draft directive on the reform of the EU ETS in the 4th trading period (2021–2030). The text of the approved reform stipulates, among others:

- 1) Raising the linear reduction factor (LRF) from the current level of 1.74% to 2.2%.
- 2) Introduction of the market stability reserve (MSR) mechanism that in principle is to reduce the number of allowances traded in the market to 800 million. In its first years of operation (2019–2023) the mechanism will be absorbing 24% of allowances from the auctioning share and transfer them into reserve. As of 2024, the CO₂ emissions allowances absorption mechanism will be reduced to 12%. Moreover, as of 2023, the allowances held in the MSR in excess of the auctioning share from the previous year will be eliminated.
- 3) In the fourth trading period the total available auctioning share will constitute 57% with possibility of increase by 3%.
- 4) Establishment of the Innovation and Modernisation Funds. The Innovation Fund in principle is to support modern low emissions technologies with around 400 million allowances. The Modernisation Fund will support the lowest GDP Member States in modernisation of their energy sectors. The Fund may not be used for supporting energy generation using fossil fuels (with the exception of energy sectors of Romania and Bulgaria).
- 5) Sectors at risk of carbon leakage shall be allocated 100% of free of charge allowances.

At present, the reform of the fourth trading period of the EU ETS is at the last stage of the approval path provided for by the EU legislative procedure process.

The exchange obligation

The act of 8 December 2017 on the capacity market announced on 3 January 2018 has amended the act of 10 April 1997 – *the Energy Law*. In the new wording of the energy Law “energy undertakings dealing with electricity generation are required to sell not less than 30% (previously not less than 15%) of electricity generated in a given year at commodity exchanges in understanding of the *act of 26 October 2000 on commodity exchanges*, or on market organised by a leading undertaking operating a regulated market on the territory of the Republic of Poland (...). The obligation for 2018 shall be fulfilled by energy undertakings dealing with electricity generation with respect to electricity generated as of 1 January 2018.

In December 2017, the total volume of electricity traded in the SPOT and futures markets operated by the POLPX was 13.3 TWh, on year on year basis an increase of 51.2%. In December 2017, the volume of electricity traded in the futures market was 10.8 TWh, meaning an increase by 74.4% comparing to the same period of the previous year, and the trade volume on the SPOT market reached 2.5 TWh, meaning a drop by 3.7% year on year.

However, throughout the entire 2017 the total volume of electricity traded in the SPOT and futures markets was 111.7 TWh, meaning a decrease of 11.8% comparing to the volume in 2016. In 2017 the electricity trading volume on the futures market was 86.4 TWh, meaning a drop of 12.7% comparing to 2016, and the trading volume on the SPOT market reached 27.6 TWh, meaning a drop of 8.6% year on year.

Operating reserve (OR)

In 2017, the OR model did not change functionally. However, the model parameters have changed due to the change of the model calculation baseline. The hourly OR budget was increased from PLN 128 758.72 to PLN 144 070.61 and the CRRM reference hourly price changed from PLN 41.20/MWh to PLN 41.79 /MWh. The hourly required operating reserve volume changed from 3 451.09 MW/h to 3 447.49 MW/h. The COR weighted average price in 2017, determined based on the data published by the Polish Power Grid (PSE) was PLN 33.88/MWh.

Amendment of the act on natural gas stocks

On 2 August 2017, the act of 7 July 2017 came into force amending the act on stocks of crude oil, petroleum products and natural gas, the principles of proceeding in circumstances of a threat to the fuel security of the State and disruption on the petroleum market and certain other acts, which amended the act of 16 February 2007 on stocks of crude oil, petroleum products and natural gas, the principles of proceeding in circumstances of a threat to the fuel security of the State and disruption on the petroleum market, the act of 10 April 1997 – *the Energy Law* and the act of 22 July 2016 on amendment of the act – *the Energy Law* and certain other acts.

The key changes introduced by the above amendment notably include:

- 1) supplementing the act of 7 July 2017 came into force amending the act on stocks of crude oil, petroleum products and natural gas, the principles of proceeding in circumstances of a threat to the fuel security of the State and disruption on the petroleum market with a definition of an entity performing imports of natural gas – the definition considers as an entity performing imports a natural person, legal person or organisational entity not having a legal personality, including an energy undertaking being an owner of a gas transmission system, which performs import of natural gas into the territory of the Republic of Poland for its own needs,

- 2) unambiguous resolution of doubts concerning the admissible methods of maintaining the mandatory stocks of natural gas by deciding that stocks of gas may be maintained exclusively physically in storage installations connected to the gas transmission or distribution systems,
- 3) definition of obligations of the operator of a gas storage system and operator of a gas transmission system, aimed at maintaining the mandatory stocks of natural gas at specified level,
- 4) imposition on the gas transmission system operator of the obligation to notify the President of the Energy Regulatory Office about using the transmission capacities reserved for delivery of total volumes of the mandatory stock of natural gas maintained outside the territory of the Republic of Poland to the domestic transmission or distribution network for other purposes, within 7 of becoming aware of this fact,
- 5) imposition on energy undertakings performing economic activities of cross-border trade in natural gas and an entity performing imports of natural gas of the obligation to provide the operator of the transmission system with information about the location of storage of mandatory stocks of gas for the purpose of validation of the technical capabilities of delivery of such stock to the gas system,
- 6) clarification of the rules and procedures in force in the event of activation of the mandatory stock of natural gas for the purpose of balancing the gas system at times of disturbances of gas supply or unforeseen increase of its consumption,
- 7) clarification of issues relating to imposition of fines on entities that fail to meet the specific statutory obligations,
- 8) introduction of a transition period during which an undertaking resigns from operations subject to license and then is relieved from the obligations to maintain mandatory stock of natural gas.

Abolishment of tariff obligation

The act of 30 November 2016 amending the act – the Energy Law and certain other acts a time schedule was introduced for abolishment of the obligation of gaining approval by the President of the Energy Regulatory Office and application of Tariffs for gas fuels, as of:

- 1) 1 January 2017, for trade (sales) of gas at a virtual point, sales of LNG and CNG and sales through tenders, auctions or public procurement,
- 2) 1 October 2017, for final consumers (with exception of household consumers),
- 3) 1 January 2024, for household consumers.

“Winter Package” and Network Codes

In 2017, at the EU level, work has been conducted focused on elaboration of the final provisions of 11 documents constituting the “Winter Package” proposed by the European Commission on 30 November 2016. The key documents include: Regulation on the Governance of the Energy Union, amendment of the Regulation on the Internal Energy Market, amendment of the Directive on the Internal Energy Market, amendment of the Directive on the Use of Energy from Renewable Sources, amendment of the ACER regulation, amendment of the Energy Efficiency Directive and the Regulation on Risk Preparedness in the Electricity Sector. The documents submitted by the European Commission present the vision of changes that would be implemented in the Union’s energy sector.

The entire “Winter Package” in the proposed shape is intended to guarantee the best possible functioning of non-controllable RES by creating broad opportunities for flow of energy they generate between the Member States. At the same time proposals include transferring a range of – so far national – competences from Member States to the regional and the EU levels. Building an energy union is in principle focused on streamlining the reporting obligations imposed on the Member States and supervision over fulfilment of the goals of the EU climate policy (both the 2030 goals and obligations arising out of the Paris Agreement) with particular attention to decreasing the CO₂ emissions and increasing the use of renewable energy sources.

A lot of stress is placed on growing the internal energy market with particular consideration to the infrastructure interconnecting the energy systems of individual Member States and initiatives to increase the flexibility of operation of the systems with a view to significantly increase the share of renewable energy sources. The Member States are also required to report the progress in improving energy efficiency, including presenting plans for renovation and modernisation of buildings, both public and private.

Initially, the proposals presented by the European Commission provided it with authority to act at the EU level if in the opinion of the European Commission the goals of the energy union or the climate goals could not be achieved due to insufficient contributions by the Member States. Such authority would impose, for example, on the Member States the duty of financial contributions when in the opinion of the European Commission the Union’s goal of RES share would not be pursued collectively. The contributions would be paid into the EU financial platform “contributing” towards development of renewable projects, established at the EU level and managed directly or indirectly by

the European Commission. Member States could use as financial contribution their proceeds from greenhouse gas emissions allowances auctions. The European Commission would also be empowered to adopt delegated acts to establish and allow functioning and financing of the aforementioned financial platform. The proposed amendments of the rules governing the functioning of the internal energy market presented the mechanisms limiting the possibilities of use of capacity mechanisms by Member States, by limiting participation in these mechanisms to units with emissions below 550 gr CO₂/kWh, practically unattainable for coal based technologies. The text of the currently amended Renewable Sources Directive presents proposals for limiting the possibility of counting the energy generated from biomass towards achievement of domestic RES goals.

The work on final versions of the texts of regulatory acts constituting the “Winter Package” have been conducted within a “Trilog” of the European Parliament, European Council and the European Commission and at the present stage no agreement has been reached that could gain mutual acceptance.

In 2017, significant part of work was finalised on Network Codes and Guidelines that are the measures used under the EU law for the purpose of construction of Union-wide harmonised market in electricity and gas. The Codes are implemented legally as Regulations of the European Commission that are directly applicable in the Member States without the necessity for their implementation in national legislations. The Codes define common rules for operation and management of energy systems and are intended to eliminate the technical obstacles to further integration of the European electricity and gas markets; they are also intended to foster deregulation and ongoing growth of competition in these markets, as well as to improve service standards and security of supply. The Codes are being developed by ENTSO-E/ENTSO-G and have to comply with the non-binding framework guidelines developed by ACER. Network Codes and Guidelines may be divided into three families:

Market

defines the rules for operation of the electricity balancing market, short term markets – day ahead and intraday, as well as long term markets – forward capacity allocation.

Connection

defines the rules and requirements relating to connection of generators and demand to the electricity networks. It also defines the requirements for high voltage direct current networks and connections.

Operations

defines the requirements and rules for transmission system operators to assure system operation security, effective use of interconnected systems and resources and prevention of propagation or escalation of incidents, to avoid widespread disruptions and blackouts, as well as to allow efficient and quick restoration of electricity systems.

At present all of the eight proceeded Network Codes and Guidelines became effective and the stage of their implementation commences. This process will require further extensive consultations and conducting joint projects, both on the national and the European arenas. Implementation of provisions of the Codes will to a significant extent remodel the principles of operation of the Polish energy market in the upcoming years.

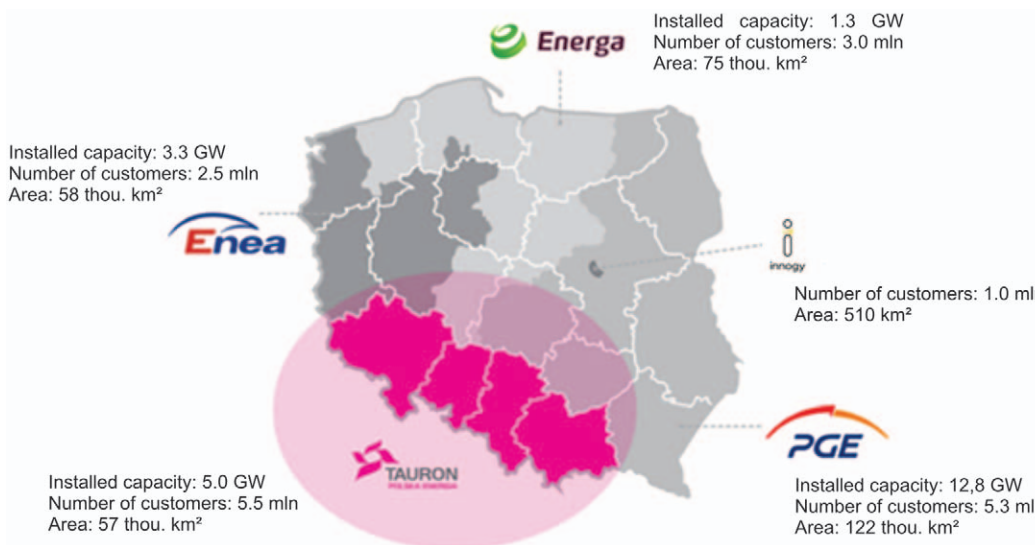
2.1.2.4. Competitive environment (landscape)

Poland's Energy Groups

Apart from TAURON Capital Group currently 3 large, vertically integrated energy groups are operating on the Polish market: PGE, ENEA and ENERGA S.A. (ENERGA).

The below figure presents TAURON Capital Group's competitive environment (landscape) based on the data available, i.e. for 2016.

Figure no. 19. TAURON Capital Group's competitive environment (landscape) (2016 data)



Based on the vertically integrated structure the above entities have a strong position on the domestic market. Furthermore, also foreign energy groups are present on the Polish market.

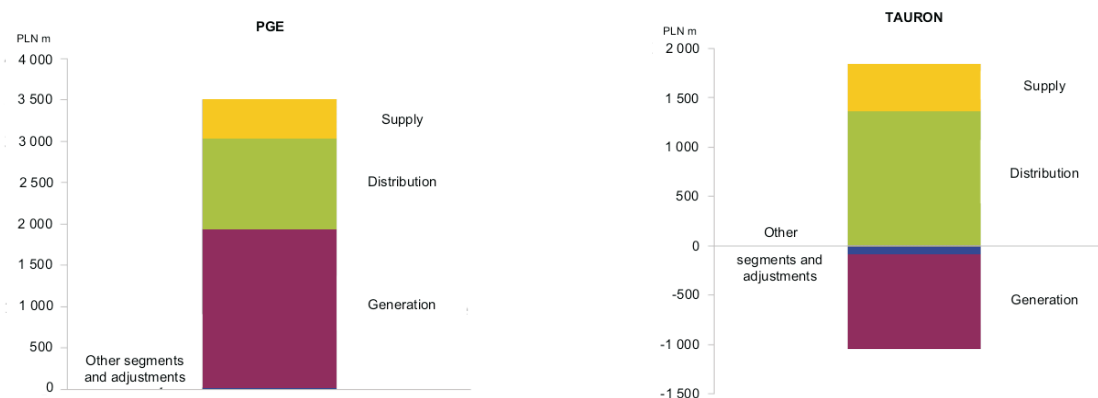
According to the 2016 data the consolidated energy groups (PGE, TAURON, ENEA, ENERGA) held a 56% market share in the electricity generation subsector. Smaller players, although significant in 2016, included: EDF Polska Centrala sp. z o.o. (EDF) (7%), ENGIE Energia Polska S.A. (ENGIE) (7%) and Zespół Elektrowni Pątnów-Adamów-Konin S.A. (ZE PAK) (5%).

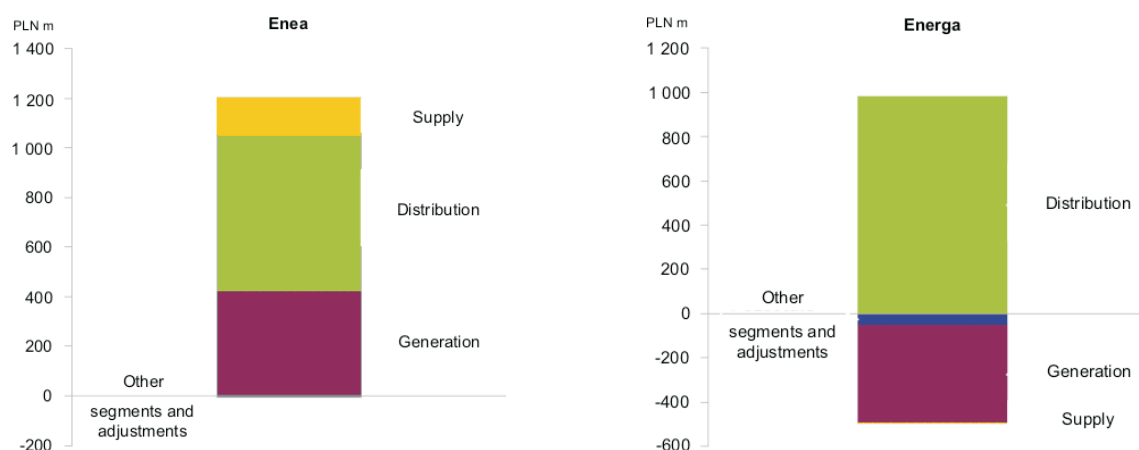
TAURON Capital Group is a fully vertically integrated energy (utility) enterprise that utilizes synergies resulting from the size and scope of the operations conducted.

TAURON Capital Group controls the value chain, from hard coal mining to the delivery of electricity to final consumers. TAURON Capital Group conducts its operations in all key segments of the energy market (excluding electricity transmission), i.e. hard coal mining as well as electricity and heat generation, distribution, supply and trading.

The below figure presents information on EBIT structure by the main segments.

Figure no. 20. EBIT – estimated structure by the main segments in 2016¹





¹ In order to make the segments presented comparable the Generation Segment includes also Mining, RES and Heat; Generation Segment includes impairment charges.

Source: Companies' Annual Reports

Generation

TAURON Capital Group is Poland's second largest electricity generator

TAURON Capital Group's share in the domestic electricity generation market, based on gross electricity production output, reached approx. 10% in 2016, which gave TAURON Capital Group position no. 2 in Poland, behind PGE.

90% of TAURON Capital Group's generation assets are hard coal fired units, 10% of which are modern high efficiency generating units. TAURON Capital Group's total installed capacity reaches almost 5.0 GW. Wind farms' installed capacity represents 3.9%, hydroelectric power plants' installed capacity represents 2.8%, biomass-fired generating units' installed capacity represents 2.3% of TAURON Capital Group's total installed capacity.

Electricity generation market shares changed significantly last year. PGE Group finalized the acquisition of EDF assets and ENEA Group finalized the acquisition of ENGIE assets in 2017. In case of ZE PAK, Adamów Power Plant, a part thereof, was shut down at the beginning of January 2018. The shutdown of the power plant's generating units was due to the European Commission's decision, indicating the need to finish the operation of Adamów Power Plant's generation assets at the beginning of January 2018.

PGE's share in the domestic electricity generation market reached approx. 35% in 2016, with its installed capacity of 12.8 GW. Following the acquisition of EDF's assets (in 2017) PGE's installed capacity rose to almost 16 GW.

ENEA was Poland's third largest electricity generator in 2016, with its market share reaching approx. 8%. ENEA Group's generation assets' capacity rose from 3.3 to 5.8 GW as a result of the 2017 acquisition of Połaniec Power Plant from ENGIE.

Meanwhile ENERGA had the largest, on the Polish market, share of its electricity output coming from RES, reaching more than 30% in 2016. ENERGA Group's total installed capacity reached 1.34 GW.

TAURON Capital Group's generation assets are concentrated in the south of Poland. The hard coal deposits used to fire TAURON Capital Group's power plants and combined heat and power plants are also located in this region. The location of generation assets near the hard coal deposits allows for optimizing the costs related to the transportation of this commodity.

The below table presents information on installed capacity as of December 31, 2016 and on electricity generated in 2016.

Table no. 7. Installed capacity and electricity generation by energy groups in 2016

No.	Group	Installed capacity		Generation ¹	
		Value (GW)	Share (%)	Volume (TWh)	Share (%)
1.	PGE	12.75	31	59	35
2.	TAURON	4.96	12	17	10
3.	ENEA	3.30	8	15	9
4.	EDF	3.30	8	12	7
5.	PAK	2.50	6	9	5
6.	Engie	1.90	5	11	7

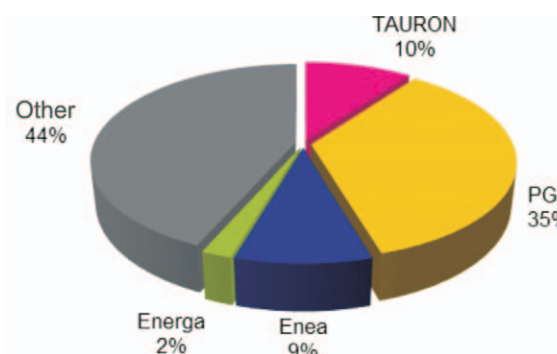
No.	Group	Installed capacity		Generation ¹	
		Value (GW)	Share (%)	Volume (TWh)	Share (%)
7.	ENERGA	1.34	3	4	2
8.	CEZ	0.60	1	3	2
9.	Other	10.60	26	37	22
Total		41.25	100	167	100

¹ Volume of gross electricity generated in 2016.

Source: ARE, information from companies published on their websites, own estimates in case of companies publishing the net production

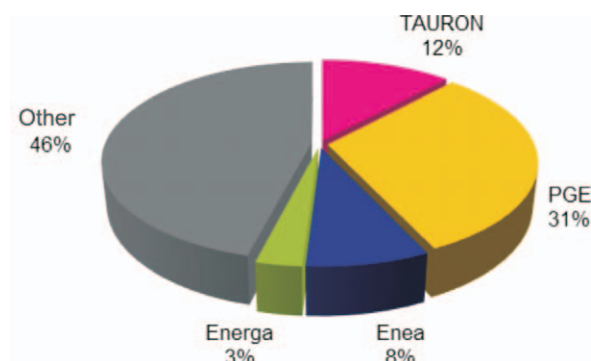
The below figures present information on electricity generated in 2016 and installed capacity as of December 31, 2016.

Figure no. 21. Gross electricity production – estimated market shares in 2016



Source: ARE, information from companies published on their websites

Figure no. 22. Installed capacity – estimated market shares in 2016



Source: ARE, information from companies published on their websites

Distribution

TAURON Capital Group is the Polish market leader in terms of the number of distribution customers and volume of electricity distributed.

TAURON Capital Group is Poland's largest electricity distributor. TAURON Dystrybucja's share in electricity distribution to final consumers reached approx. 38% in 2016 (taking into account top 5 distributors). TAURON Capital Group's distribution grids cover more than 18% of Poland's territory.

TAURON Capital Group is the Polish market leader in terms of the number of distribution customers and volume of electricity distributed.

The below table presents basic information on the share of individual energy groups in terms of electricity distribution based on the 2016 data.

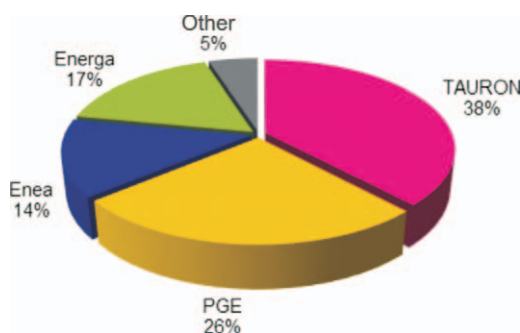
Table no. 8. Electricity distribution to final consumers by energy groups

No.	Group	Distribution	
		Volume (TWh)	Share (%)
1.	TAURON	50	38%
2.	PGE	34	26%
3.	ENERGA	22	17%
4.	ENEA	19	14%
5.	Other	7	5%
Total		132	100%

Source: ARE, information from companies published on their websites

The below figure presents basic information on the share of individual energy groups in terms of electricity distribution based on the 2016 data.

Figure no. 23. Electricity distribution – estimated market shares in 2016



Source: ARE, information from companies published on their websites

Based on the data for recent years TAURON Capital Group was number 1 in terms of volume of electricity delivered, with the volume of electricity delivered by the Distribution Segment to the final customers at the level of almost 50 TWh. In 2017 the volume of electricity delivered to the final consumers reached approx. 51,4 TWh. TAURON Capital Group is Poland’s largest electricity distributor also in terms of revenue from the distribution operations.

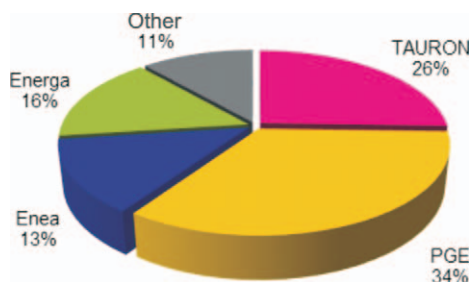
It should be emphasized that TAURON Capital Group’s distribution operations, due to the natural quasi monopoly in the designated area, are a source of stable and predictable revenue, representing a material part of the consolidated revenue of the entire TAURON Capital Group. The electricity distribution geographical area on which the Distribution and Supply Segments subsidiaries are historically operating is a strongly industrialized and densely populated area which impacts the demand for electricity both among households, as well as businesses. The number of the Distribution Segment’s customers is more than 5.5 mln.

Supply

TAURON Capital Group is Poland’s second largest electricity supplier.

The below figure presents basic information on the share of individual energy groups in terms of electricity supply to final consumers based on the 2016 data.

Figure no. 24. Electricity supply to final consumers – estimated market shares in 2016



Source: ARE, information from companies published on their websites

TAURON Capital Group was Poland's second largest electricity supplier behind PGE Capital Group. Electricity retail supply reached 32 TWh in 2016. In 2017 the volume of electricity retail supply reached approx. 34,9 TWh. The number of the Supply Segment's customers is approx. 5.4 mln.

In the electricity supply segment the individual energy groups are geographically tied, first of all, to the areas in which they are performing the DSO function – this is applicable especially to customers classified as households and small enterprises. A broader and more open competition among the groups are limited due to the continued obligation to submit tariffs for households for approval to the President of ERO. The need to apply tariff based prices leads to limited options of positioning prices in the product offerings, and what follows, their attractiveness for customers. These restrictions do not apply to business and institutional customers.

Among the main competitors of TAURON Capital Group in this segment on one hand an upward trend in terms of electricity supply volume is visible, but on the other hand a downward trend in terms of earnings can be observed, which can be the effect of the assumptions adopted in the market strategies of these groups.

The below table presents the main sources of competitiveness.

Table no. 9. Sources of competitiveness

No.	Line of Business	Initiatives	Sources of competitiveness
1.	Mining Generation	1) Reducing the price and fuel supply risk 2) Investments in generating units 3) Operating expenses	1) Own coal resources – security of fuel supply and control over mining costs 2) High efficiency generating units with a competitive unit production cost 3) Improvement of operational efficiency
	RES Heat	1) Operating expenses 2) Investments in district heating networks	1) Improvement of operational efficiency 2) Developing regulated operations
2.	Distribution	1) Operating expenses 2) Investment efficiency 3) Improvement of grid reliability indicators	1) Implementing the ultimate business model 2) Cooperation with the President of ERO with respect to compensation on capex 3) Implemented IT systems, separate processes, clear (transparent) split of responsibilities
3.	Supply	1) Operating expenses 2) Sales margin, developing products tailored to customer needs, growth in new Lines of Business	1) Efficiently allocated operating expenses 2) Brand, current customer base, sales channel held, experience in product and purchasing portfolio management

2.2. Material growth impacting factors

The most material impact on TAURON Capital Group's operations will come, similar as it was in the past, from the following factors:

External factors:

- 1) macroeconomic situation, particularly in Poland, as well as the economic situation of the area on which TAURON Capital Group is conducting operations and at the EU and global economy level, including changes of interest rates, FX rates, etc., impacting valuation of assets and liabilities listed by the Company in the statement of financial position,
- 2) political environment, particularly in Poland and at the EU level, including the positions and decisions of the state administration institutions and offices, e.g.: UOKiK, URE (ERO) and the European Commission,
- 3) changes to the regulations related to the power sector, and also changes in the legal environment, including: tax law, commercial law, environment protection law,
- 4) introduction of the generation capabilities compensation mechanism (the so-called capacity market) and decisions on the future shape of the OCR (ORM) and cold intervention reserve,
- 5) support system for electricity generation using high efficiency cogeneration, resulting, on one hand, in the costs of redeeming "red" and "yellow" certificates with the suppliers of electricity to final consumers, on the other hand, in revenue from the sale of "red" and "yellow" certificates with the generators of electricity using cogeneration. The current support system is in force until the end of 2018; no information on its shape beyond 2018,
- 6) new RES support system, the so-called RES auctions,

- 7) situation in the power sector, including the activities and actions of the competition on the energy market,
- 8) number of CO₂ emission allowances allocated for free, and also prices of allowances purchased – in case of a deficit of free allowances,
- 9) wholesale electricity prices,
- 10) electricity and coal sales prices and distribution tariffs based on the adopted DSO operations regulation model, as factors impacting the revenues level,
- 11) prices of certificates of origin of energy from renewable sources and from cogeneration,
- 12) prices of fuels (energy resources),
- 13) environment protection requirements,
- 14) new non-energy products,
- 15) science (research) and technical progress,
- 16) demand for electricity and the other energy market products, taking into account changes due to seasonality and weather conditions.

Changes of the above mentioned external factors may constitute premises obliging TAURON Capital Group, in accordance with the International Accounting Standard 36, to conduct asset impairment tests. The results of these tests may have an impact on TAURON Capital Group's financial results in the subsequent reporting periods.

Internal factors:

- 1) steadfast implementation of the Strategy and achieving the assumed financial and non-financial effects,
- 2) actions with respect to optimizing processes taken by all of TAURON Capital Group's subsidiaries,
- 3) decisions with respect to the implementation of the key investment projects,
- 4) geological and mining conditions of hard coal extraction,
- 5) potential failures of TAURON Capital Group's equipment, installations and grids.

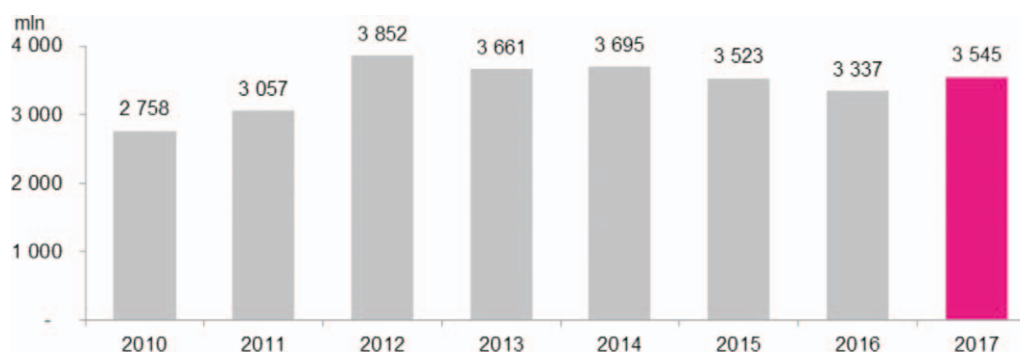
TAURON Capital Group's operations are characterized by seasonality which is applicable, in particular, to heat production, distribution and supply, electricity distribution and supply to individual consumers and hard coal sales to individual consumers for heating purposes. Heat sales depend on weather conditions, in particular, on air temperature, and are higher in the autumn and winter season. Volume of electricity supply to individual consumers depends on the length of day which usually makes electricity supply to this group of consumers lower in the spring and summer season and higher in the autumn and winter season. Hard coal sales to individual consumers is higher in the autumn and winter season. Seasonality of TAURON Capital Group's other lines of business is low.

The impact of the above factors on the financial results achieved in 2017 is described in section 2.3 and in section 4 of this report. The effects of this impact are visible both in the short term, as well as in the long term.

2.3. TAURON Capital Group's financial results

The below figure presents TAURON Capital Group's 2010–2017 EBITDA.

Figure no. 25. TAURON Capital Group's 2010–2017 EBITDA



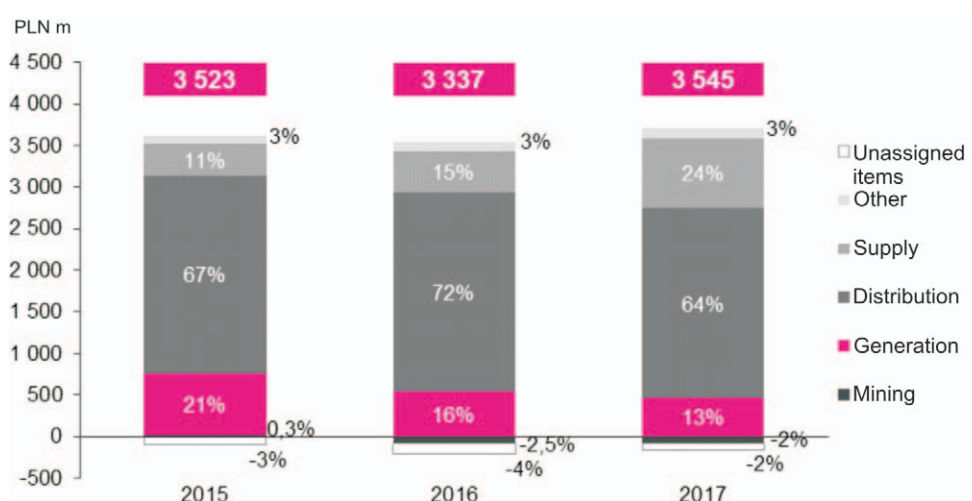
The below table presents TAURON Capital Group's 2015–2017 EBITDA broken down into individual lines of business (segments). Data for the individual segments do not include consolidation exclusions.

Table no. 10. TAURON Capital Group's 2015–2017 EBITDA broken down into individual lines of business (segments)

No.	EBITDA (PLN thous.)	2017	2016	2015	Change in % (2017/2016)	Change (2017–2016)
1.	Mining	(83 036)	(82 130)	9 137	–	(906)
2.	Generation	463 974	545 311	754 751	85%	(81 337)
3.	Distribution	2 282 685	2 394 812	2 372 129	95%	(112 127)
4.	Supply	841 222	490 005	380 405	172%	351 217
5.	Other	118 043	114 570	100 320	103%	3 473
6.	Unassigned items	(78 297)	(125 754)	(93 514)	–	47 457
Total EBITDA		3 544 591	3 336 814	3 523 228	106%	207 777

The below figure presents TAURON Capital Group's 2015–2017 EBITDA structure (composition).

Figure no. 26. TAURON Capital Group's 2015–2017 EBITDA structure (composition)



Distribution, Generation and Supply Segments have the biggest contributions to TAURON Capital Group's EBITDA.

The below figure presents the change in TAURON Capital Group's EBITDA in 2015–2017.

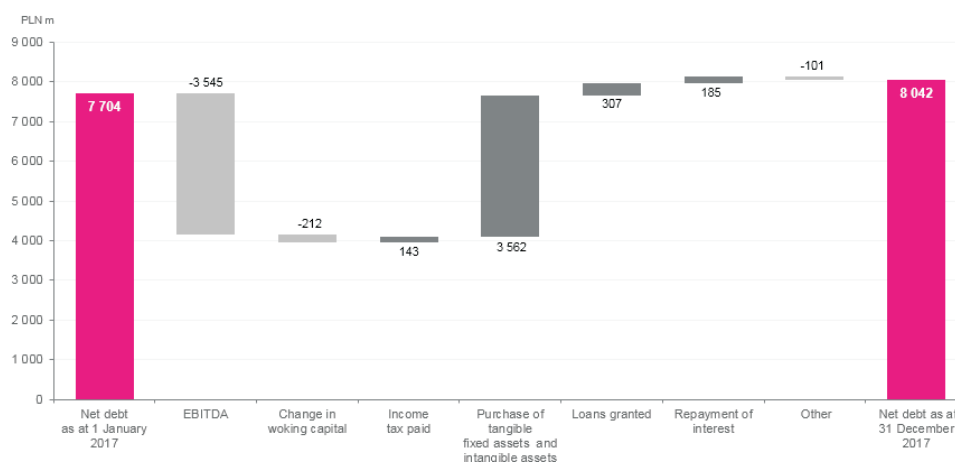
Figure no. 27. Change in TAURON Capital Group's EBITDA in 2015–2017



TAURON Capital Group's 2017 cash flows

The below figure presents TAURON Capital Group's 2017 cash flows.

Figure no. 28. TAURON Capital Group's 2017 cash flows



2.3.1. Mining Segment

The below table presents the Mining Segment's 2015–2017 results.

Table no. 11. Mining Segment's 2015–2017 results

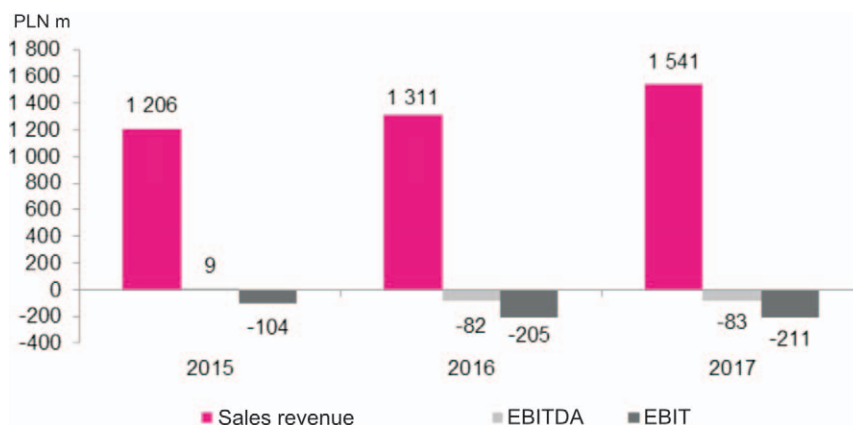
Item (PLN thous.)	2017	2016	2015	Change in % (2017/2016)	Change (2017–2016)
Mining					
Sales revenue	1 541 425	1 311 143	1 205 944	117.6%	230 282
<i>coal – coarse and medium assortments</i>	<i>509 348</i>	<i>346 251</i>	<i>346 778</i>	<i>147.1%</i>	<i>163 097</i>
<i>thermal coal</i>	<i>973 549</i>	<i>918 647</i>	<i>836 772</i>	<i>106.0%</i>	<i>54 902</i>
<i>other revenue</i>	<i>58 528</i>	<i>46 245</i>	<i>22 394</i>	<i>126.6%</i>	<i>12 283</i>
Operating profit	(211 070)	(205 163)	(104 328)	–	(5 907)
Depreciation and write-downs	128 034	123 033	113 465	104.1%	5 001
EBITDA	(83 036)	(82 130)	9 137	–	(906)

Mining Segment's 2017 operating results, EBIT and EBITDA, were at a similar level as the 2016 earnings. This segment's financial results were impacted by the following factors:

- 1) higher sales volumes of each product assortment by 12% on average,
- 2) higher average price of products sold by 6.7%,
- 3) higher unit commercial coal production unit cost due to higher mining services costs, labor costs as a consequence of paying out a one-off bonus, consuming a larger quantity of coal purchased for processing on the market in 2017 and achieving commercial coal production volume slightly higher than in 2016,
- 4) selling a substantial portion of coal inventory in 2017, which resulted in recognising the coal inventory value as own cost in this period. The coal sales surplus over the realized coal production reached 323 thousand Mg in the reporting period. In the same period of 2016 the situation was opposite and some unsold production (304 thou. Mg) was inventoried and sold in the subsequent periods.

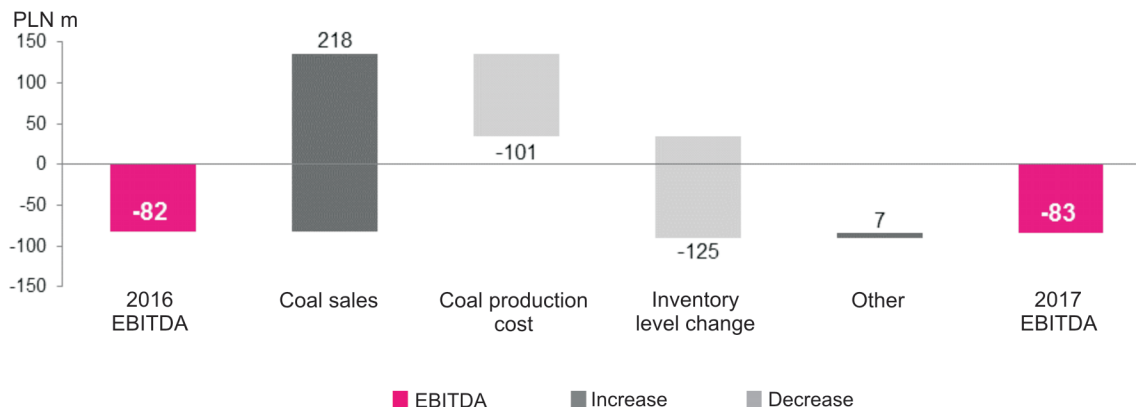
The below figure presents the Mining Segment's 2015–2017 financial data.

Figure no. 29. Mining Segment's 2015–2017 financial data



The below figure presents the Mining Segment's EBITDA, including the material factors affecting the year on year change.

Figure no. 30. Mining Segment's EBITDA



Strategic goals and initiatives

The main goal of the Mining Segment defined in the Strategy is: stable supply of cost competitive and appropriate quality fuel to TAURON Capital Group, as well as development of the product offering and maximizing the margin generated on the sales of the other products.

The goals set out in the Strategy are to be accomplished by implementing the strategic initiatives that include, inter alia: optimizing the costs and capital expenditures, tri-product enrichment at Sobieski Coal Mine and Janina Coal Mine as well as an extension of the line for packaging eco-pea coal.

Major investments

In 2017 the Mining Segment's total capital expenditure reached approximately PLN 166 million, including the following strategic investment projects:

- 1) PLN 13 PLN m on the construction of the "Grzegorz" shaft, including the construction of the infrastructure and the accompanying headings,
- 2) PLN 41 mln on the construction of a 800 m level at Janina Coal Mine,
- 3) PLN 38 PLN m on Brzeszcze Coal Mine's capex program.

Mining Segment's other capital expenditures are spent on coal extraction preparations and operations (mainly the purchase of machines and equipment, drilling of headings, longwall preparation).

Growth outlook

The current situation of the hard coal mining industry in Poland, including the integration of Polska Grupa Górnicza's assets, the logistics problems and the impact of the geological problems brought about the decline of coal extraction

output which led to the low coal inventory levels of the coal mines' stock piles and an increase of the commodity's price. The analysts are forecasting stable demand for coal in 2018 which, with low coal extraction output, may lead to an increase of the coal price on the market and as a consequence a potential rise of electricity prices. In 2017 thermal coal prices rose 8% with the main reason being the low supply due to the price declines in 2014–2016 and thus reducing the capex during that period. The low coal supply on the local market may lead to increased coal imports which will also impact the price level. The upcoming period will be difficult and demanding also due to an unfavorable outlook for this fuel in the EU's energy policy.

The challenges for this line of business will include: the evolution of Poland's fuel and energy policy, development directions indicated in the "Program for the hard coal mining sector in Poland", published in January 2018, and also the ordinance on the quality of fuels.

The Strategy assumes that the planned strategic initiatives and the investment projects underway will enable TAURON Capital Group's Mining Segment to strengthen its position and provide coal fuel to TAURON Capital Group's subsidiaries, thus mitigating the risk of the rising prices of this commodity on the external market.

In accordance with the Strategy the main directions of actions to be taken by the Mining Segment include:

- 1) continuation of the investment projects at Janina Coal Mine and Sobieski Coal Mine,
- 2) implementation of the capex program at Brzeszcze Coal Mine,
- 3) optimizing the costs and expenditures in order to maintain TAURON Wydobycie's position as the second most cost-effective coal producer in Poland (following Lubelski Węgiel "Bogdanka" S.A.'s coal mine),
- 4) construction of the portfolio of products aligned to internal needs, including the provision of coal supplies for the generation units of TAURON Capital Group at a level of 70–80% of demand;
- 5) developing a product offering for the customers outside TAURON Capital Group.

The investment projects implemented by TAURON Capital Group in the Mining Segment are aimed at increasing the productivity and lifting the share of coal from own mines in the structure of TAURON Capital Group's purchasing. The effects of actions aimed at improving the efficiency of this segment will be reflected in its financial and operating results in the subsequent periods.

2.3.2. Generation Segment

The below table presents the Generation Segment's 2015–2017 results.

Table no. 12. Generation Segment's 2015–2017 results

Item (PLN thous.)	2017	2016	2015	Change in % (2017/2016)	Change (2017–2016)
Generation					
Sales revenue	4 528 480	4 356 101	5 376 280	104.0%	172 379
<i>electricity</i>	3 486 458	3 101 505	4 021 274	112.4%	384 953
<i>heat</i>	873 929	861 029	814 045	101.5%	12 900
<i>property rights arising from certificates of electricity origin</i>	114 840	335 673	480 698	34.2%	(220 833)
<i>other revenue</i>	53 253	57 894	60 263	92.0%	(4 641)
Operating profit	16 595	(752 813)	(3 477 076)	–	769 408
Depreciation and write-downs	447 379	1 298 124	4 231 827	34.5%	(850 745)
EBITDA	463 974	545 311	754 751	85.1%	(81 337)

In 2017 the Generation Segment's sales revenue was higher by 4% as compared to 2016 due to higher electricity and heat sales revenue (mainly due to higher sales volumes). Lower revenue from the sales of property rights to the certificates of origin of electricity are the result of the lower sales volume and lower price of PMOZE.

The following factors impacted the results achieved:

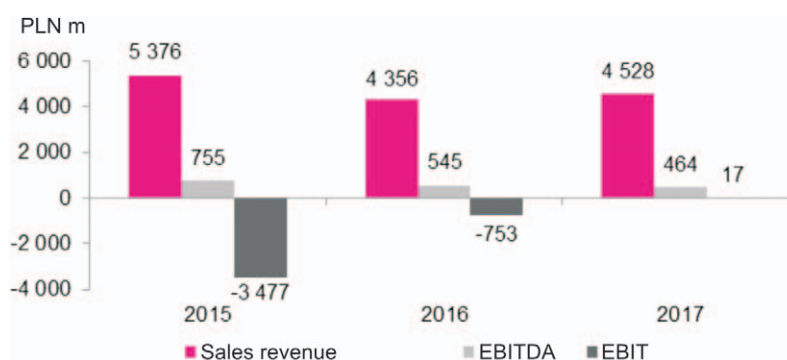
- 1) lower margin on electricity – mainly due to the lower electricity sales price year on year,
- 2) lower price and lower sales volume of the RES related property rights – the result of PMOZE oversupply on the market and the reduction of the biomass fired units' production,

- 3) higher margin on heat – higher heat sales and transmission services volume (the effect of the lower external temperature in the heating season (4.0°C in 2016, 3.6°C in 2017) and a higher rate for the transmission services,
- 4) lower costs of the CO₂ provision – which is the result of: a larger number of free emission allowances, higher CO₂ emission volume (the result of higher electricity and heat production) and lower prices of forward CO₂ contracting year on year,
- 5) other – mainly higher costs of the real estate tax on wind farms, the costs of one-off bonuses for the workforce, higher costs of the provision for the Voluntary Redundancy, larger scope of ongoing maintenance and higher costs of electricity related infrastructure damage.

In the year ended on December 31, 2017 TAURON Capital Group booked impairment charges and the dissolving of the previously set up provisions related to the tangible fixed assets as a result of impairment tests for assets conducted as of December 31, 2017 and June 30, 2017. The results of the tests completed proved that for some assets of the Generation Segment an additional write-down in the amount of PLN 658.7 mln should be booked. The tests completed also demonstrated that the reversal of impairment charges in this Segment for the amount of PLN 628.2 mln is justified.

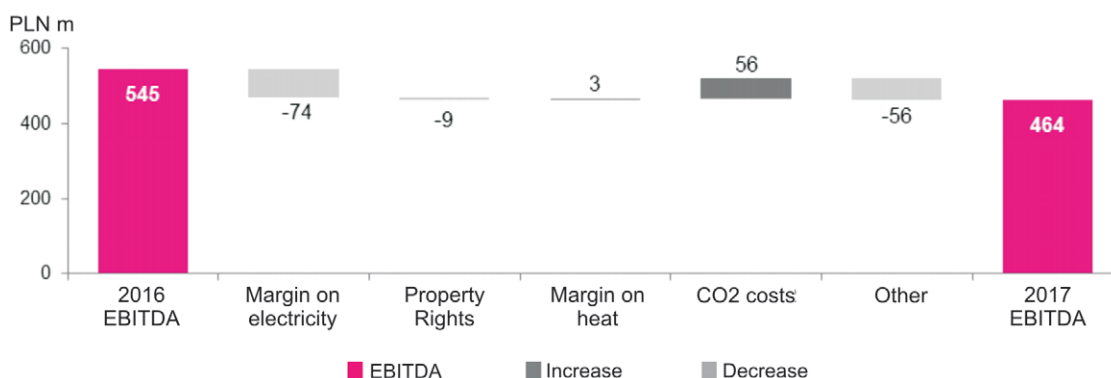
The below figure presents the Generation Segment's 2015–2017 financial data.

Figure no. 31. Generation Segment's 2015–2017 financial data



The below figure presents the Generation Segment's EBITDA, including the material factors impacting the change year on year.

Figure no. 32. Generation Segment's EBITDA



Strategic goals and initiatives

The main goals of the Generation Segment defined in the Strategy include:

- 1) for TAURON Wytwarzanie subsidiary: halting the decline of the assets' value and modernizing the generation fleet,
- 2) for TAURON EKOENERGIA subsidiary: raising the profitability of the generation assets held and developing options for a profitable expansion of the line of business,
- 3) for TAURON Ciepło subsidiary: expanding heat sales and distribution.

The goals set out in the Strategy are to be accomplished by implementing the strategic initiatives that include, inter alia: optimizing the costs and capital expenditures, optimizing employment, optimizing the production assets and selling the redundant non-production assets as well as the investment projects leading to the upgrading of the generation (910 MW unit at Jaworzno Power Plant, 450 MW unit at Stalowa Wola Combined Heat and Power Plant).

The main strategic direction set for the Generation Segment's conventional assets is to achieve economic efficiency or permanent decommissioning (retirement) from operation. The actions taken in this line of business will focus on, among others, completing the construction of the 910 MW hard coal-fired unit at Jaworzno Power Plant, including the project's implementation jointly with a strategic partner as a result of selling some shares while retaining the controlling stake. The general direction concept related to adapting TAURON Capital Group's generating units to the BAT conclusions will be developed in 2018. The analytical works should provide a recommendation for the best action scenario, i.e. the scope of upgrading (adapting) generating units including the required outlays or the possibilities for potentially obtaining derogations with respect to the limit emission values.

With respect to RES, options are being prepared for expanding RES installations assuming a favorable support system is put in place and a profitable model for the operation thereof is developed.

With respect to the heat generation, distribution and trading, material actions include an expansion of the heat generation, distribution and trading, and in particular the implementation of the Low Emission Liquidation Program, seeking solutions in the multi-fuel co-generation area and increasing the level of utilizing the existing infrastructure.

Major investments

In 2017 the Generation Segment's total capital expenditure reached PLN 1 516 million, including the following strategic investment projects:

- 1) PLN 1 278 mln on the construction of the coal-fired 910 MW unit at Jaworzno III Power Plant,
- 2) PLN 16 mln on investment projects related to expanding and maintaining the district heating networks,
- 3) PLN 17 mln on connecting new facilities.

Moreover, approx. PLN 77 million was spent on replacements and repairs (maintenance) by TAURON Wytwarzanie. Apart from the above capex an investment project in Stalowa Wola with the participation of the strategic partner, PGNiG, is underway. TAURON and PGNiG hold a 50% stake each in the special purpose vehicle implementing the project that includes the construction of the 449 MW_e CCGT unit, including the 240 MW_t heat generation component. In January 2016, the contract with the general contractor Abener Energia S.A was terminated. In March 2017, thanks to the repayment of the existing institutions financing the project, the signed amendments to the gas and electricity agreements as well as the agreement on the project's restructuring came into force. The agreement was reached and the decision was taken on the construction of the backup heat source. Talks with the financing institutions on obtaining new, more favorable financing are being finalized. As a result of completing a number of analyses, among others due to the project's advancement level the contract manager formula (EPCM) was chosen. Energopomiar Gliwice – Energoprojekt Katowice consortium was selected to implement the EPCM project. The project's completion is scheduled for 2019. Expected capital expenditures on the project (excluding the financial costs) are to reach approx. PLN 411 mln (with approx. PLN 165 mln planned to be spent in 2018). PLN 984 mln had been spent by the end of 2017.

Growth outlook

The available forecasts and analyses for the upcoming year assume an increase of domestic electricity production, including also production from RES and rising wholesale market contract prices of: electricity, certificates and EUAs. In the near future the generation sector will also have to deal with an unfavorable situation on the labor market. Due to the noticeable generational gap problem there is a shortage of specialists on the market which impacts the operations of electricity and heat producers.

Analysts are forecasting an increase of RES generation capacity and its key role in electricity production on the market (mainly wind farms), which poses a challenge for the grid and the stability of electricity supply. A strong interest in the RES line of business, supported by the EU policy, may have an impact on investments, including acquisition opportunities in the RES segment.

A growing share of intermittent generation sources and decreasing volumes of production from the conventional generating units (due to, inter alia, age and low efficiency) have a significant impact on Poland's security of electricity supply. In the coming years the key issue will continue to be ensuring the security of the operation of KSE, this why the capacity market was introduced in Poland which should allow for obtaining an additional revenue source for the generating units for the required capex and asset refurbishments.

On the heat market Poland's policy, aimed at improving the air quality, may lead to a material increase of investments and an expansion of this line of business.

2.3.3. Distribution Segment

The below table presents the Distribution Segment's 2015–2017 results.

Table no. 13. Distribution Segment's 2015–2017 results

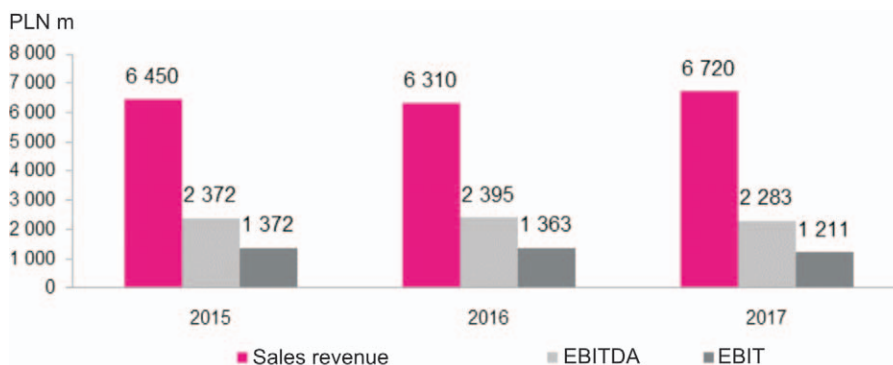
Item (PLN thous.)	2017	2016	2015	Change in % (2017/2016)	Change (2017–2016)
Distribution					
Sales revenue	6 719 943	6 310 216	6 450 274	106.5%	409 727
<i>distribution services</i>	<i>6 311 594</i>	<i>5 892 510</i>	<i>6 022 144</i>	<i>107.1%</i>	<i>419 084</i>
<i>connection fees</i>	<i>114 112</i>	<i>103 636</i>	<i>125 698</i>	<i>110.1%</i>	<i>10 476</i>
<i>maintenance of street lighting</i>	<i>115 265</i>	<i>116 462</i>	<i>116 042</i>	<i>99.0%</i>	<i>(1 197)</i>
<i>other revenue</i>	<i>178 972</i>	<i>197 608</i>	<i>186 389</i>	<i>90.6%</i>	<i>(18 636)</i>
Operating profit	1 210 925	1 363 236	1 371 577	88.8%	(152 311)
Depreciation and write-downs	1 071 760	1 031 576	1 000 552	103.9%	40 184
EBITDA	2 282 685	2 394 812	2 372 129	95.3%	(112 127)

In 2017, as compared to 2016, the Distribution Segment reported a 6.5% revenue increase and a change of results on the EBIT and EBITDA level by (11,2)% and (4,7)%, respectively. The following reasons impacted the results:

- 1) increase of the average rate of the distribution service sales to the final consumers in each tariff group, mainly as a result of an increase of the transition fee and RES fee rates,
- 2) rising supplies to consumers in each group, in particular, among consumers in A and B groups, as a result of favorable economic conditions, rising production, and reducing own generation,
- 3) rising transmission services purchase costs as a result of a higher transition fee and the RES fee (not existing in 2016),
- 4) declining costs of purchasing electricity to cover the balancing difference achieved due to the reduction of the purchase volume,
- 5) lower grid losses indicator year on year as recorded in the books, among others due to conducting the "Program of actions aimed at reducing electricity losses",
- 6) increase of revenue from fees for above-standard passive energy off-take where the main parameter of the positive deviation versus last year is an increase of the electricity price on the competitive market,
- 7) drop of the revenue due to fixing collisions, mainly as a result of shifting the performance of tasks to 2018,
- 8) incurring costs due to the implementation of the Grid Reliability Improvement Program in 2017 and the costs of the one-off bonus,
- 9) actuarial provision – a one-off event in December 2016 involving dissolving of the actuarial provision associated with the harmonisation of the Company Collective Bargaining Agreement in the companies of the Distribution Segment,
- 10) increase of the costs of taxes and fees as a result of the investment projects underway, rising value of the grid assets and the higher provision due to the easement of the transmission lines located on the territory of the State Forest Company (Lasy Państwowe).

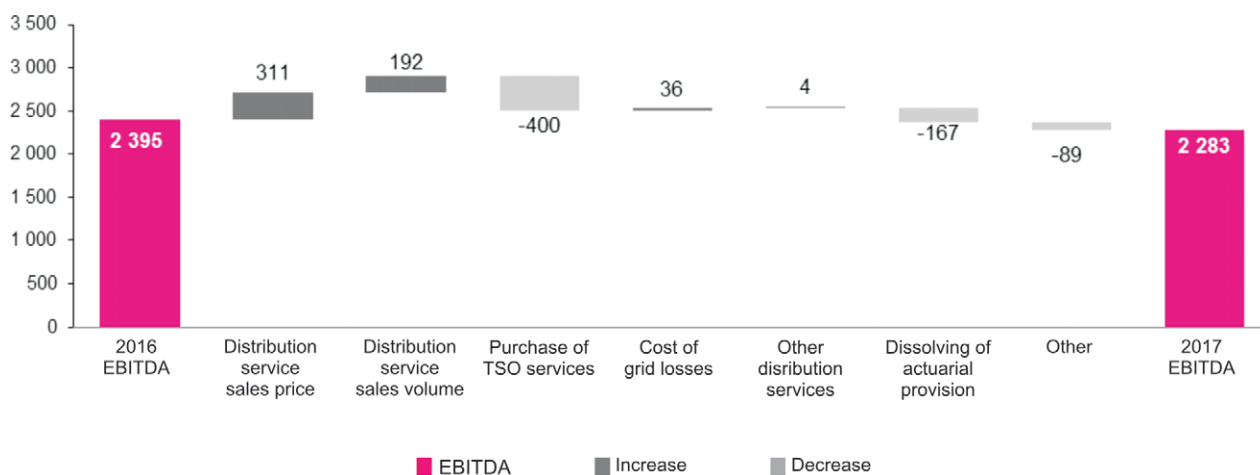
The below figure presents the Distribution Segment's 2015–2017 financial data.

Figure no. 33. Distribution Segment's 2015–2017 financial data



The below figure presents the Distribution Segment's EBITDA, including the material factors impacting the year on year change.

Figure no. 34. Distribution Segment's EBITDA



Strategic goals and initiatives

The main goal of the Distribution Segment defined in the Strategy is to maintain the leading position on the Polish market in terms of the security and efficiency of the grid's operation.

The assumed goal is to be accomplished by implementing the strategic initiatives: "Single Distribution" program comprising projects optimizing the operational processes in the company; actions leading to the improvement of customer satisfaction and simultaneously the improvement of the company's image; electrical mobility program and storage systems. The Distribution Segment is implementing material investment projects related to the upgrading and replacing of the grid.

Major investments

In 2017 the Distribution Segment's total capital expenditures reached PLN 1 693 million. The main capex directions of investment included:

- 1) PLN 610 mln on investments related to connecting new consumers
- 2) PLN 865 mln on investments related to the upgrading and replacing of the grid

Moreover, in 2017 expenditures were spent on implementing the following Strategic Investment Projects: *The Grid Assets Management System* (approx. PLN 16 million), *The Construction of the Grid Management Centre in Kraków* (approx. 31 million). Expenditures in the total amount of approx PLN 150 million were also spent on: communications and IT, buildings and structures, means of transportation, modernisation of street lighting.

Growth outlook

The Distribution Segment must align its capex to URE's requirements related to the quality based regulation. Actions oriented towards ensuring the reliability of electricity supply and simplifying the procedures related to connecting new consumers will be continued. The investment projects implemented must allow for adapting the company's distribution

assets to the growing volume of electricity generated by the renewable sources, and also for preparing the grid to interwork with the infrastructure for charging electric vehicles. The company's expansion in terms of smart grids and meters will allow for introducing additional functionalities, both on the distributor's as well as the customer's side. The segment's expansion will be significantly impacted by the competences with respect to obtaining aid funds, both for improving the security, as well as the conducted research and development works.

It should be noted that these challenges will be dealt with on the regulated market which makes the Segment's actions dependent on the new elements of the DSO regulatory policy introduced by the President of URE and the risks associated therewith, i.e. an updated approach to the weighted average cost of capital, the companies' efficiency improvement correction factors with respect to the operating expenses and the balancing differences level, continuing the quality based regulation. A significant change for the Segment is the introduction of the so-called anti-smog tariff. President of URE approved TAURON Dystrybucja's new tariff in force until December 31, 2018. The tariff change involves setting up a separate tariff group, with a reduced rate for the consumers consuming electricity for household needs in order to stimulate such consumers to consume greater volume of electricity at night, i.e. from 22⁰⁰ to 6⁰⁰.

2.3.4. Supply Segment

The below table presents the Supply Segment's 2015–2017 results.

Table no. 14. Supply Segment's 2015–2017 results

Item (PLN thous.)	2017	2016	2015	Change in % (2017/2016)	Change (2017–2016)
Supply					
Sales revenue	13 567 887	14 016 190	15 873 355	96.8%	(448 303)
<i>electricity, including</i>	8 740 196	8 814 692	10 357 041	99.2%	(74 496)
<i>revenue from retail sales of electricity</i>	7 554 291	7 145 644	8 111 002	105.7%	408 647
<i>greenhouse gas emission allowances</i>	336 566	363 500	94 086	92.6%	(26 934)
<i>fuel</i>	1 024 912	1 583 672	1 972 403	64.7%	(558 759)
<i>distribution service (transferred)</i>	3 400 487	3 183 232	3 377 473	106.8%	217 255
<i>other revenue, including commercial services</i>	65 725	71 094	72 353	92.4%	(5 369)
Operating profit	832 216	479 374	369 529	173.6%	352 842
Depreciation and write-downs	9 006	10 631	10 876	84.7%	(1 625)
EBITDA	841 222	490 005	380 405	171.1%	351 217

Sales revenue was 3.2% lower in 2017 versus 2016, mainly due to the decline of fuel and electricity sales. The lower electricity sales revenue is due to the lower wholesale electricity sales as a result of lower electricity sales volume (by 2.1 TWh), while revenue from retail electricity sales went up by 5.7% due to a rise in the sales volume (by 2.9 TWh). The result of the higher retail sales volume is a higher distribution service sales revenue. Fuel sales revenue decline is due to a change of the coal supply organization model and lower natural gas sales revenue (lower sales volume).

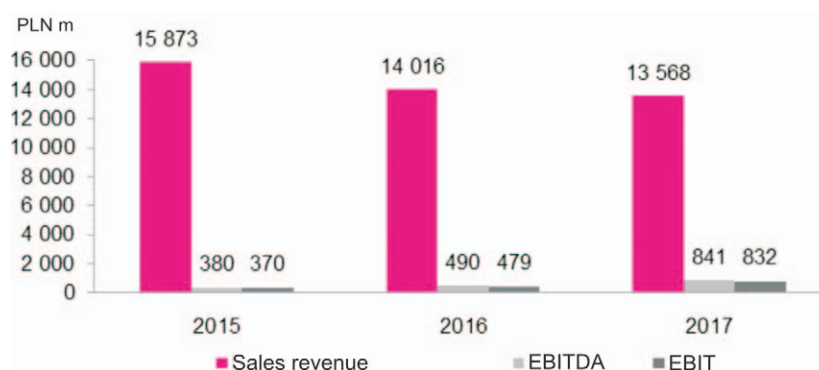
2017 EBIT and EBITDA were higher than in 2016 due, among others, to dissolving of the ECSW related provision and the termination of the long term PMOZE purchase contracts in H1 2017. The results were mainly affected by the following factors:

- 1) Electricity volume and prices – a negative impact on the result is due to the lower electricity sales price with retail electricity sales volume rising at the same time. The stronger sales price decline rate versus the purchase price decline rate is due, among others, to the falling sales prices to business customers because of lower PMOZE market prices. The sales prices drop was also affected by the reduction of the G tariff at TAURON Sprzedaż by 5% year on year.
- 2) Property rights prices – a positive impact on the result due to taking advantage of the favorable market situation, mainly related to the “green” certificates (purchase of PMOZE at lower prices) and a change of the regulations related to the calculation of the property rights related to energy efficiency at the same time,
- 3) Property rights redemption obligation – a negative impact on the result due to an increase of the obligation level year on year: for PMOZE in H1 2017 from 15.00% to 15.40% and in H2 2017 from 14.35% to 15.40%, for PMMET from 1.5% to 1.8%, for PMGM from 6.00% to 7.00% and the introduction of the obligation for PMOZE-BIO in H1 2017: 0.60% (in H1 2016 there was no such obligation), and in H2 2017: a change from 0.65% to 0.60%,

- 4) Dissolving of the provision for the agreements related to the joint venture (ECSW) led to an improvement of the Supply Segment's result by PLN 203 mln due to the coming into force of the Agreement concluded between TAURON i PGNiG on the gas and electricity agreement and the amendments to the long term gas and electricity sale agreements related to the CCGT unit construction project at Stalowa Wola,
- 5) Other commercial products – margins reached on the other commercial products (primarily the declining margin on the natural gas sales due to the lower sales volume),
- 6) Other – higher result on the other operations recorded and higher costs of sales.

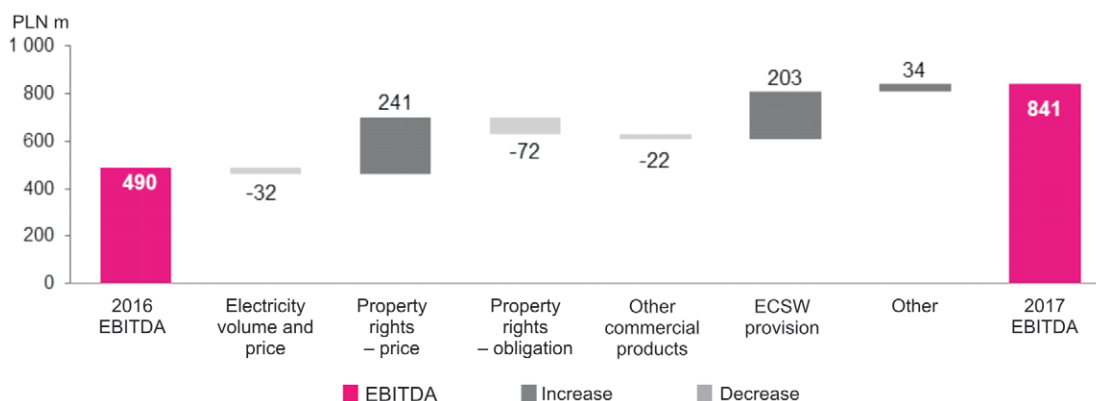
The below figure presents the Supply Segment's 2015–2017 financial data.

Figure no. 35. Supply Segment's 2015–2017 financial data



The below figure presents the Supply Segment's EBITDA, including the material factors impacting the year on year change.

Figure no. 36. Supply Segment's EBITDA



Strategic goals and initiatives

The main goal for the Supply Segment defined in the Strategy is: to achieve the leading position customer relationships based on high quality of service and product leadership.

The goals set in the Strategy are to be accomplished by implementing the strategic initiatives, including, inter alia: increasing the sales potential by transforming service channels into integrated customer contact channels focused on sales and product advice, increasing the value of product and service sales to mass customers by developing the product offering and sales techniques, developing products and building communication channels for specialized products and the partnership offering addressed to the mass customer segment, as well as to the business customers, strengthening of expansion and optimizing the sales margins in the business segments.

Major investments

The Supply Segment's total capital expenditures reached PLN 1 million in 2017.

Growth outlook

Growing competition in the electricity supply segment as well as the demanding situation on the wholesale electricity market leads to the decline of sales volumes and margin erosion. Actions taken by the competition and rising customer expectations are impacting product offering development and maintaining of the highest customer service standards. Growing customer awareness leads to increased requirements, both in terms of the products offered, as well as the customer service speed and quality. TAURON Capital Group is systematically expanding its product offering in this respect, aligning it to the individual and business customers, and it is expanding communications channels, both with respect to digital platforms as well as direct contacts. The upgrading and expanding of the traditional customer service network meets the expectations of that part of the public that is not ready for IT based electronic solutions.

TAURON's competitors are also offering a broad range of products on the market that are often very similar (photovoltaics, air conditioning, professional (handyman), etc.). With price offerings at a similar level customer competition will take place at the level of innovative product and service proposals, win particular with respect to customer communications platforms and customer service quality.

2.3.5. Other operations

The below table presents the Other Operations Segment's 2015–2017 results.

Table no. 15. Other Operations Segment's 2015–2017 results

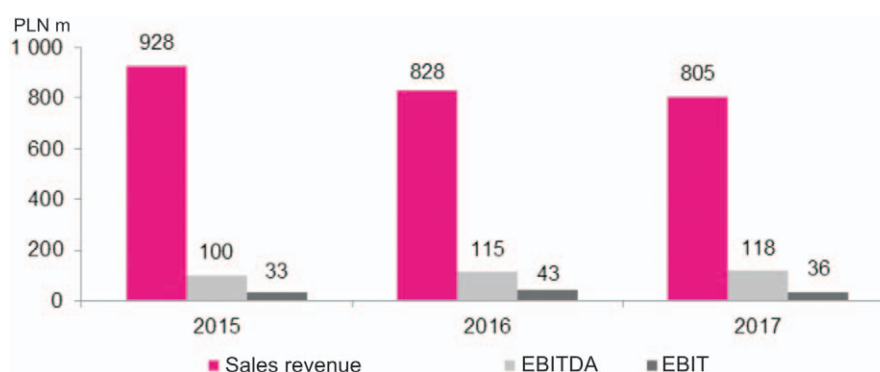
Item (PLN thous.)	2017	2016	2015	Change in % (2017/2016)	Change (2017–2016)
Other					
Sales revenue	804 560	827 928	927 953	97,2%	(23 368)
customer service, accounting and IT services	544 860	558 046	581 050	97,6%	(13 186)
electricity and property rights arising from certificates of electricity origin	15 013	12 827	73 927	117,0%	2 186
biomass	74 248	111 087	171 326	66,8%	(36 839)
aggregates	101 343	90 491	89 102	112,0%	10 852
other revenue	69 096	55 477	12 548	124,5%	13 619
Operating profit	35 902	42 642	32 596	84,2%	(6 740)
Depreciation and write-downs	82 141	71 928	67 724	114,2%	10 213
EBITDA	118 043	114 570	100 320	103,0%	3 473

The Other Operations Segment's revenue was approx. 3% lower in 2017 versus 2016 and the main reasons should be attributed to the loss of biomass sales revenue.

The biggest contribution to this segment's results comes from the customer service, accounting and IT services representing 79% of the segment's EBITDA, 20% margin on aggregates represents 20%, support services provided for TAURON Capital Group's subsidiaries represent 4% and 1% is the margin on biomass. This segment's result is also affected by the negative margin on electricity and property rights sales.

The below figure presents the Other Operations Segment companies' 2015–2017 financial data.

Figure no. 37. Other Operations Segment companies' 2015–2017 financial data



Major investments

The Other Operations Segment companies' total capital expenditures reached PLN 98 million. They include mainly expenditures on the IT systems.

Growth outlook

The Other Operations Segment companies' cost efficiency has a direct impact of the competitiveness of the Segments for which they are providing their services. The operations with respect to customer service, and in particular professional and efficient customer service, as well as tailoring of the IT tools to the business needs, developing both the traditional, as well as electronic customer service channels will have a material impact on the expansion of the Supply and Distribution Segments.

The current market trends clearly show customer service migrating to the alternative channels, aligned with the growing customer expectations and diversity. It is necessary to take actions related to stationary (in person) customer service as well to expand telephone and electronic customer service channels. The efficiency, quality and innovations included in the solutions offered will to a large degree impact on the earnings of the entire TAURON Capital Group.

2.4. What can be expected in 2018

2017 was the year of growth, both for the world economy, as well as for the Polish economy. According to the World Bank's forecasts the world economy will accelerate in 2018 even more than in 2017, and the estimated 2018 GDP growth rate worldwide will reach 3.1%.

With respect to the Polish economy analysts are predicting the 2018 GDP growth rate to continue at the level of approx. 4%¹, the unemployment rate to drop to approx. 6% and the inflation to increase (the annual average inflation rate at the level of approx. 2.3%)². Poland's economy growth rate is to a large extent determined by internal consumption, however foreign investment is also the key factor. Investors TFI and BZ WBK analysts are expecting strong consumption (impacted, among others, by the declining unemployment and rising wages) in 2018, and also investments to increase, including private sector investments. Good economic situation in the eurozone will provide a strong support for the expansion of the Polish manufacturing industry and fuel Poland's exports.

Poland's power sector can expect big challenges related to the industry regulations in 2018. The detailed capacity market regulations (ordinances, regulations) as well as the first certification process and, as a consequence, the first auctions. This will allow for developing detailed plans with respect to the future of many generating units in Poland.

In 2018, in accordance with the public announcements, works on Poland's fuel and energy policy that will set the long term expansion (growth) directions and also works on the new support system for the cogeneration will be conducted. Also, probably the decision on the future of the nuclear energy in Poland will be taken. The above material issues will impact the developing of the detailed expansion (growth) directions for Poland's energy sector. The construction of the Baltic Pipe gas pipeline, with respect to which the final investment decision should be taken by the end of the year, while the completion of its construction is expected at the end of 2022, will have a real impact on the situation of Poland's energy sector and energy security.

For KSE 2018 will be the year of commissioning or launching the full operation in the system of new conventional units with the total capacity of more than 3 GW. Also, numerous projects implemented based on the first RES auction should be commissioned (the volume contracted for 2018 reached close to 70 GWh).

Following the 2017 acquisitions on the power market (the acquisition of EDF assets by PGE Group and ENGIE assets by ENEA Group) these assets will be integrated and the impact of this concentration on the market will be visible, first of all in the generation segment.

The capacity market, and also RES auctions, should stimulate appetite for investments in new capacity. On the other hand, in case of the distribution grids the rising number of dispersed RES sources and microinstallations pose challenges in terms of ensuring the reliability of electricity supplies which will require capital expenditures on grid upgrades and replacements.

As consumption is rising the domestic electricity production is expected to increase, including electricity generated from RES. Wholesale coal prices and EUA prices can be expected to rise, and, as a consequence, also electricity and property rights prices.

¹ 2018 GDP growth rate forecasts: World Bank 4%, OECD 3.5%, government's budget assumptions 3.8%, European Commission 4.2%, NBP 4%.

² NBP's forecasts.

2.5. Core products, goods and services

The below table presents TAURON Capital Group's 2015–2017 production and sales volumes.

Table no. 16. 2015–2017 production and sales volumes

No.	Volumes of production and sales	Unit	2017	2016	2015	Change in % (2017/2016)
1.	Commercial coal production	<i>M Mg</i>	6.45	6.37	4.91	101%
2.	Net production of electric energy	<i>TWh</i>	18.41	16.80	18.56	110%
	<i>including production from RES</i>	<i>TWh</i>	1.30	1.32	1.63	98%
3.	Heat production	<i>PJ</i>	12.20	11.52	11.51	106%
4.	Distribution of electricity	<i>TWh</i>	51.37	49.68	49.20	103%
5.	Retail sales of electricity (in total, by Areas: Sales and Generation)	<i>TWh</i>	34.94	32.04	35.94	109%
6.	Number of customers – Distribution	<i>thou.</i>	5 533	5 474	5 418	101%

2.6. Markets and sources of supply

2.6.1. Markets

Mining Segment

The core operations of the Mining Segment is carried out by TAURON Wydobywanie subsidiary and comprises extraction and production of coal offered for sale on the market in coarse, medium coal assortments and as steam coal dust as well as methane being the accompanying mineral from the Brzeszcze deposit. TAURON Group is operating three coal mines: Sobieski Coal Mine, Janina Coal Mine and Brzeszcze Coal Mine.

Depending on the coal assortment, coal has the following trade parameters:

- 1) calorific value from 19 MJ/kg to 31 MJ/kg,
- 2) ash content from 4.3% to 45.2%,
- 3) sulphur content from 0.23% to 1.68%.

Production of commercial coal in 2017 was slightly higher than in 2016 as a result of increased Brzeszcze Coal Mine's extraction capacity, favorable coal faces distribution at Janina Coal Mine in the January – September 2017 timeframe and adverse mining and geological conditions in Q4 2017.

TAURON Wydobywanie conducts the sales of coal in two directions:

- 1) sales of fine coal and coal sludge to power plants and co-generation plants, mostly within TAURON Capital Group
- 2) sales of coarse, medium and small amount of fine coal assortments through the nationwide organized sales network, primarily on the domestic market.

TAURON Wydobywanie is selling coal mainly in southern and central Poland, in particular in the following regions (provinces): Silesia, Małopolska, Podkarpacie, Świętokrzyskie and Lower Silesia, to enterprises and individual consumers.

In 2017 hard coal sales reached approx. 6.8 mln Mg, including 4.9 mln Mg (approx. 72%) to TAURON Capital Group's Generation Segment companies. It means a 12% increase as compared to 2016 and is due to higher coal production and higher demand for coal on the market.

Generation Segment

Generation Segment's core operations within TAURON Capital Group comprises generation of electricity and heat using:

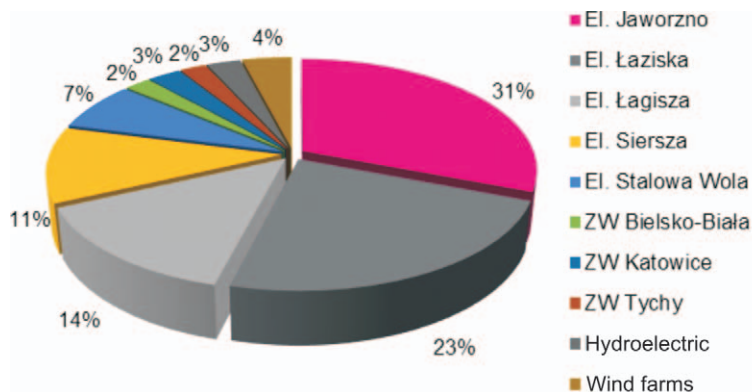
- 1) coal-fired and biomass burning power plants and combined heat and power plants,
- 2) hydroelectric power plants,
- 3) wind farms.

Moreover, the Generation Segment's operations include trading, distribution and transmission of heat.

The total installed electric capacity of generation units of the Generation Segment reached 5.0 GW_e of electric capacity and 2.4 GW_t of heat capacity at the end of 2017.

The below figure presents the structure of installed electric capacity of the Generation Segment as of December 31, 2017 (no material changes versus 2016).

Figure no. 38. Structure of installed electric capacity of the Generation Segment as of December 31, 2017



In 2017 the Generation Segment produced 18.4 TWh of electricity (including 1.3 TWh from RES), i.e. 10% more in relation to 2016 when the production of electricity reached 16.8 TWh (including 1.3 TWh from RES). Higher electricity production is a result of the adopted commercial (trading) strategy, taking into account the changing market conditions and favorable wind and hydrological conditions.

Sales of electricity from own production plus energy purchased for trading purposes reached 19.6 TWh in 2017, which means an increase by 26% in relation to 2016.

In 2017 the electricity produced by the Generation Segment was sold on the domestic market, first of all to TAURON Capital Group's Supply Segment (80%), as well as TGE (power exchange obligation) and to the external consumers. The share of electricity sold on the balancing market was materially lower in 2017 versus 2016.

Heat sales of the Generation Segment reached 16.4 PJ in 2017 and it was higher by 4% in relation to the corresponding period of 2016. The share of heat generated using own sources in the total heat sales reached 62% in 2017. TAURON Wytwarzanie subsidiary's power plants are selling heat in Upper Silesia and Zagłębie, and also in parts of the Podkarpackie region – Stalowa Wola and Nisko supplied by the Stalowa Wola Power Plant and Małopolska region – a part of Trzebinia supplied by the Siersza Power Plant.

Heat is sold mainly via the heat distributors: TAURON Ciepło, Spółka Ciepłowniczo-Energetyczna Jaworzno III sp. z o.o., Przedsiębiorstwo Energetyki Ciepłej Tychy and others, and on the Podkarpackie market – Przedsiębiorstwo Energetyki Ciepłej in Stalowa Wola and ENESTA. Small volumes of heat are sold directly to the consumers located in the vicinity of the generation companies.

On the other hand, TAURON Ciepło's heat sales market, mainly for heating purposes, production of hot water for domestic use, process water, includes diverse consumers: housing cooperatives and communities, private single- and multi-family houses, offices and institutions, shopping centers and industrial plants.

Moreover, due to electricity generation from RES and in co-generation, the Generation Segment acquires certificates of origin, which are subsequently purchased by the Supply Segment companies and submitted to the President of ERO for redemption.

Distribution Segment

TAURON Dystrybucja, as a utility conducting operations with respect to electricity distribution and being at the same time, pursuant to the decision of the President of ERO, a DSO, is operating under the natural monopoly conditions. The regulated market on which the company is operating includes the operations of 5 large distribution system operators that are subject to the full regulatory model. Each DSO is operating on the territory defined in the license. Following changes to the law, also more than a hundred of small distribution system operators are operating on this market serving small portions of the market, with respect to which the President of ERO is applying a simplified regulatory model. Their operations are local, based on the technical infrastructure held. One of the larger entities holding a license for distribution operations nationwide is PKP Energetyka.

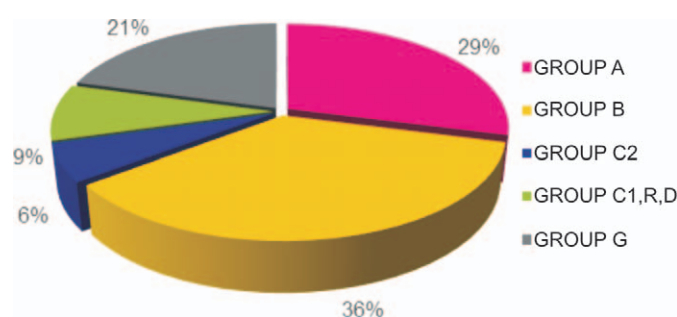
TAURON Capital Group's Distribution Segment serves approx. 5 533 thou. final consumers. It covers with its operations the area of about 57 thousand km², located mainly in the Lower Silesia, Małopolska, Opole and Silesia regions and, in addition, in the Łódź, Podkarpacie and Świętokrzyskie regions. The operational functions are performed by 11 branches located in: Bielsko-Biała, Będzin, Częstochowa, Gliwice, Jelenia Góra, Kraków, Legnica, Opole, Tarnów, Wałbrzych and Wrocław.

In 2017 the sales volume of electricity distribution services reached 51.37 TWh, i.e. it increased in relation to 2016 by approximately 1.69 TWh, i.e. 3.4%.

Sales to the tariff covered consumers on individual voltage levels represent 95.6%: high voltage (A group), medium voltage (B group) and low voltage (C,G,R), of the supply of the distribution services volume. The total electricity volume supplied to the tariff covered consumers connected to the TAURON Dystrybucja grid in 2017, as part of the sales of distribution services, reached 49 TWh (estimated) and it was higher as compared to 2016 by approximately 1.6 GWh, i.e. by 3.38%.

The below figure presents electricity distribution by tariff groups in 2017 (the structure in relation to 2016 did not change).

Figure no. 39. Electricity distribution by tariff groups in 2017 Distribution of electricity according to tariff groups in 2016 (MWh)



Sales of the distribution services are carried out on the basis of comprehensive agreements as well as agreements on the provision of distribution services concluded with consumers. The first type of agreement covers both electricity supply by the companies of the Supply Segment as well as the supply of this energy by the company acting as a DSO. The second type of agreement regulates only supplies of electricity by the company acting as a DSO. In case of this type of agreements, the purchase of electricity is governed by separate electricity supply agreements, concluded by a consumer with the supplier selected thereby.

The share of the distribution services sales under the comprehensive agreements in the total value of the distribution services sales to the final consumers in 2017 reached approximately 53% whereas the volume of supplies in the total volume of supplies to the final consumers reached approximately 35%.

Supply Segment

Supply Segment comprises operations with respect to the wholesale trading of electricity, natural gas and other products of the energy market as well as operations with respect to retail electricity and natural gas sales.

TAURON's wholesale trading operations comprise mainly wholesale of electricity, trading and management of CO₂ emission allowances, property rights arising from the energy certificates of origin and trading in natural gas primarily for the needs of securing the purchase and sale positions of TAURON Capital Group's entities.

The Company's operations are conducted on the wholesale markets both in Poland and abroad, also on the SPOT market and the forward market. The Company is an active participant of TGE and the OTC platform conducted by a London energy broker – Tradition Financial Services.

With respect to gas trading TAURON is expanding its presence on the foreign markets. The agreements signed by the Company with the German transmission system operators: GASCADE Gastransport and ONTRAS Gastransport GmbH as well as Czech NET4GAS s.r.o. enabling purchasing in Germany and selling on the Czech market.

TAURON is a participant of the European transmission capacity trading platform PRISMA European Capacity Platform GmbH, where it is purchasing inter-system (interconnector) transmission capacities. With respect to booking transmission capacity on the Polish market the Company is operating as a participant of the GSA GAZ-SYSTEM Aukcje auction platform. Gas trading on the Czech and Slovak markets and the inter-system (interconnector) gas exchange between Poland and the Czech Republic is performed through the TAURON Czech Energy subsidiary.

On the other hand retail sales operations, conducted by the TAURON Sprzedaż and TAURON Sprzedaż GZE subsidiaries, include electricity and gas sales to the final customers, including also the key accounts.

The Supply Segment was operating in a market environment In 2017 where the level of competitiveness in individual segments did not change significantly as compared to the previous years. In 2017 households market (individual customers) continued to be covered by the obligation to have electricity sales prices approved by the President of ERO.

According to the ERO data, from mid-2007 until December 2017, i.e. since the beginning of the liberalisation process of the energy market, approximately 547 thousand of households and approximately 199 thousand of institutional entities that switched their electricity supplier were recorded.

In the institutions and business entities (business customer) market segment, where competition is strong and companies have already been taking advantage of the liberalisation of electricity prices for several years, the progress of the liberalisation has resulted in the increasing awareness of business customers expecting competitive solutions. The enhanced sales activities of energy companies exert ever increasing price pressure. New entities competing for customers have also appeared, and the transparency of energy market mechanisms is already a necessity when operating on this market, as business customers are more and more willing to switch their supplier. The household segment is considered to offer a a strong potential as the number of supplier switchings in this segment represents a small percentage.

In 2017 over 98 thousand consumers of electricity switched their suppliers (including approximately 14 thousand institutional customers and approximately 84 thousand households). In 2017 the growth rate of changes in case of households reached 18.1%, and in case of institutional entities – 8%.

In 2017 the retail sales of electricity realized by the Supply Segment to approx. 5.4 million customers reached approx. 34.9 TWh, i.e. 109% of the 2016 level when the sales reached approx. 32.0 TWh. Increased sales volume is visible primarily in the Business Customer Segment, which is due to both acquiring new customers (e.g. Polenergia Obrót S.A., ANIMEX FOODS Spółka z o.o.), as well much higher electricity consumption by some customer already served by the Company (e.g. KGHM, Katowicki Holding Węglowy S.A., Arcelor Mittal Poland S.A. or ISD Huta Częstochowa).

The customer segmentation applied by TAURON Capital Group (strategic, business and mass customers), depending on the volume of electricity consumed, is aimed at tailoring the product offering, sales channels and marketing communications to the expectations of the specific customer segment.

The below table presents categories of TAURON Capital Group's final customers, resulting from the market segmentation used and the specific nature of their business:

Table no. 17. Categories of TAURON Capital Group's final customers

No.	Group of customers	Description of customers
1.	Strategic customers	Customers with the annual potential energy consumption at a level not lower than 40 GWh or strategic business partners of TAURON Capital Group, i.e. mainly entities representing the sector of heavy industry, among others: metallurgical industry, chemical industry, mining industry, automotive industry.
2.	Business customers	Customers with the annual potential energy consumption at a level above 250 MWh (other than consumers), or purchasing energy based on the provisions of the <i>Act of 29 January 2004 on Public procurement law</i> , i.e. entities representing other sectors of industry, producers of equipment, consumers from food industry, public sector, construction sector and public utilities sector.
3.	Mass customers – small and medium-sized enterprises	Customers dealing with sales, services, banking, catering and small entrepreneurs.
4.	Mass customers – households	Households.

The below table presents information on the volume of electricity sold by TAURON Capital Group's subsidiaries operating with respect to electricity supply to customers, as well as the number of customers, broken down into individual customer segments, in 2017.

Table no. 18. Volume of retail electricity sold by the Supply Segment and the number of customers in 2017

No.	Customer type	Electricity volume sold (TWh)	Number of customers (thou.)
1.	Strategic customers	7.7	1
2.	Business customers	12.7	185
3.	Mass customers, including:	11.4	5 175
	<i>households</i>	9.5	4 836
4.	Sales to TAURON Dystrybucja to cover balancing differences	2.9	0.001
5.	Other (exports, own needs)	0.2	–
Supply Segment		34.9	5 361

The process of the progressing liberalisation and the customers' rising awareness with respect to mechanisms functioning on the energy market associated therewith is reflected by the degree of loyalty in individual customer segments. This situation results in activities aimed at protecting own customer base against actions undertaken by the competition, through the introduction of loyal customer agreements. Customers from the business segment of TAURON Capital Group are most advanced in this process, where approx. 97% of the volume of the agreements concluded are the results of individually negotiated commercial terms.

In 2017 the sales offering of the TAURON Sprzedaż subsidiary for the business segment covered two media – electricity and gas fuel. Due to the customers' awareness of the energy market mechanisms and the acquired skills of using those mechanisms, TAURON Sprzedaż focused its activities on the protection of its customer base. In particular, activities oriented towards customer loyalty building were continued. It was recognised that particular emphasis would be placed building an offering that would meet customer expectations. Customers were offered a selection of a number of products taking into account their needs and the specific nature of their electricity consumption, including ecological, exchange and technical products.

While expanding the offering in the developing gas fuel sales area, the TAURON Gaz Giełda (TAURON Gas Exchange) product sales were continued, based on market prices determined in relation to quotations of TGE RTT indices. Moreover, in order to intensify electricity and gas contracting, the TAURON Multipakiet (TAURON Multipackage) product was retained in the offering, which provides simultaneous contracting of customers with respect to both media during a single round of business negotiations.

In 2017 the process of migration of mass segment customers (individual customers and small and medium-sized enterprises) from the tariff to the product area was continued. At the end of 2017 TAURON Capital Group sold electricity to approximately 38% of customers in this segment under agreements with a guarantee of commercial terms and conditions for a specific period (loyalty agreements), and 62% of customers bought energy at tariff prices.

The key element of the commercial offering for mass customers in 2017 were the combined products called Elektryk (Electrician) and Serwisant (Service Provider), based on the assistance functionality, used by over 1 million customers. As part of the sales campaigns TAURON Sprzedaż continued sales of gas to mass market customers in 2017.

These products will also constitute the basis of the offering in 2018. Furthermore, in 2017 the range of products addressed to the customers of TAURON Sprzedaż was expanded by the specialist products.

2.6.2. Supply sources – fuel

Coal (domestic market)

TAURON Capital Group purchases coal solely on the domestic market, in 2017 coal purchases were continued by TAURON for the needs of TAURON Wytwarzanie and TAURON Ciepło subsidiaries.

In 2017 the majority of TAURON Capital Group's demand for fuel to produce electricity and heat (approx. 56,5%) was satisfied with hard coal from own coal mines.

The remaining part of the demand was covered from external sources, where Polska Grupa Górnicza sp. z o.o. that took over the mines of Katowicki Holding Węglowy S.A., had the highest share (approx. 36.2% of the demand)

Gas (domestic and foreign market)

TAURON Capital Group purchases fuel gas solely on the domestic and foreign market, via exchanges. The company is an active participant of the gas market managed by TGE, carries out transactions on the SPOT market, as well as on the RTT forward market products.

The Company is also involved in the proprietary trading activity on an international gas exchange POWERNEXT Pegas. The Company is present in the hub: GASPOOL, New Connect Germany i Tittle Transfer Facility. Presence in the New

Connect Germany hub (German market) also allows for, apart from the trading activities, physical gas deliveries to the Czech Republic.

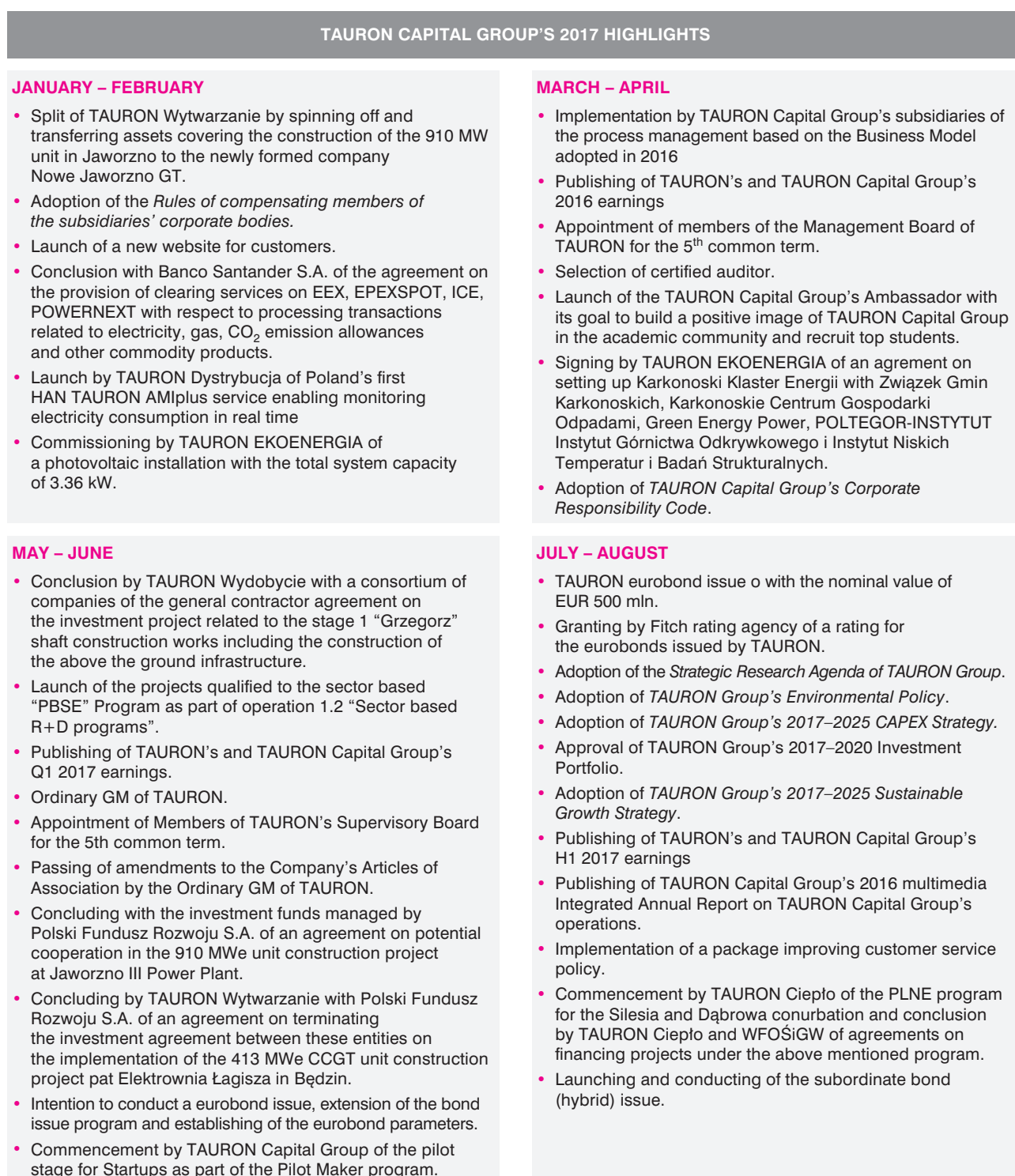
Furthermore, the Company is a participant of the Intercontinental Exchange (ICE) on the National Balancing Point (NBP) hub. It is also systematically increasing the volume of transaction concluded by the Company on the OTC market.

Operating on the gas market the Company is securing gas supplies TAURON Capital Group's entities.

2.7. Timeline

The below figure presents the timeline of selected highlights associated with the operations of TAURON Capital Group that took place in 2017.

Figure no. 40. Timeline



SEPTEMBER – OCTOBER

- Launch of the program to implement the GDPR regulations at TAURON Groups.
- TAURON units' win in a RES auction
- Establishing the Tax Capital Group for 2018-2020.
- Launch of the project with respect to developing and implementing a new IT infrastructure in order to improve customer service.
- Introducing for use by TAURON Capital Group's subsidiaries of a new compensation policy for members of the supervising and managing authorities.
- Adoption of the 2018–2025 TAURON Brand Strategy.
- Inclusion of TAURON in the *The Best of The Best* group and receipt of the top prize for the integrated report in the *The Best Annual Report* competition.
- Change of the name of "KOMFORT-ZET sp. z o. o." subsidiary to "Wsparcie Grupa TAURON sp. z o.o."

NOVEMBER – DECEMBER

- Publishing of TAURON's and TAURON Capital Group's Q3 2017 earnings
- Adoption of *TAURON Group's 2018-2025 Sponsoring Strategy*.
- Launch of the Project aimed at developing a detailed strategic research agenda for TAURON Capital Group with respect to 3 of 4 project portfolios.
- Adoption of a model for the operations of Shared Services Centers at TAURON Obsługa Klienta.
- Pilot implementation of an application automating actions in the customer service process.
- Adoption of policies related to social, personnel, human rights respect and corruption counteraction related issues.
- Introduction of the *PRO Client Social Policy at TAURON Group*.
- Commencement by TAURON Wytwarzanie of the 460 MW turbine refurbishment project at Łagisza Power Plant in order to launch heat production at Łagisza Power Plant.
- Conclusion by TAURON Wydobywanie of the agreement on the construction of the above the ground infrastructure at Janina VI shaft at Janina Coal Mine.
- Affirming by Fitch rating agency and ihc of TAURON's Outlook and granting of the rating for the hybrid bond issue worth PLN 400 mln.
- Extending until February 28, 2018 of the validity term of the agreement on cooperation in the 910 MWe unit construction project at Jaworzno III Power Plant with the investment funds managed by Polski Fundusz Rozwoju S.A.

2.8. Key events and TAURON Capital Group's accomplishments with a significant impact on its operations

The more important events and accomplishments that had a significant impact on TAURON Capital Group's operations that occurred in 2017, as well as until the day of drawing up this report are listed below. Additionally the above events should include concluding agreements significant for TAURON Capital Group's operations, described in detail in section 9.2.1. of this report.

Key business events in 2017

Eurobond issue by TAURON

On June 14, 2017 TAURON, in agreement with a consortium of investment banks, commenced activities aimed at conducting a eurobond issue of a nominal value not higher than EUR 500 mln that included in particular conducting meetings with investors in Europe. Conducting of a eurobond issue was dependent on market conditions, and the issue size, the final issue price and the interest rate of the eurobonds were determined following the meetings with investors in Europe.

The Company's intention was to file for admission of the eurobonds to trading on the regulated market of the London Stock Exchange, as well as to use the proceeds from the eurobonds issue to cover TAURON Capital Group's expenses.

On June 28, 2017 the following parameters of the eurobonds were set:

- 1) Total nominal value: EUR 500 mln,
- 2) Maturity: 10 years,
- 3) Interest periods: annual,
- 4) Coupon: 2.375. per annum,
- 5) Yield as of issue date: 2.439% per annum (i.e. mid-swap + 1.63%),
- 6) Issue price: 99.438% of the nominal value.

The condition for the bond issue was the signature of the documentation of the transaction and the fulfillment of the conditions indicated therein.

On July 5, 2017 the Company issued eurobonds with the above indicated parameters that were admitted to trading on the regulated market of the London Stock Exchange on July 10, 2017.

On the same day Fitch rating agency granted the "BBB" rating for unsecured and unsubordinated debt in the form of the Company's 10-year eurobonds with the total nominal value of EUR 500 mln. The rating reflects the Company's

leading position in the regulated and stable distribution segment that generates a significant part of TAURON Capital Group's EBITDA (72% in 2016).

The Company disclosed information on the above events in the following regulatory filings (current reports): no. 28/2017 of June 14, 2017, no. 30/2017 of June 28, 2017, no. 31/2017 of July 5, 2017 and no. 32/2017 of July 5, 2017.

TAURON ratings and outlooks affirmed; rating assigned to the hybrid bonds program

On December 21, 2017 Fitch rating agency ("Fitch") affirmed long-term foreign and local currency IDRs of TAURON at 'BBB' with a stable outlook and assigned local currency rating of 'BB+' and national rating of 'BBB+(pol)' to the PLN 400 million hybrid bonds program.

Full list of rating actions includes:

- 1) long-term foreign and local currency IDRs affirmed at 'BBB'; stable outlook,
- 2) short-term foreign and local currency IDRs affirmed at 'F3',
- 3) existing hybrid bonds affirmed at 'BB+',
- 4) national long-term rating affirmed at 'A+(pol)'; stable outlook,
- 5) national senior unsecured rating affirmed at 'A+(pol)',
- 6) foreign currency senior unsecured rating of Eurobonds affirmed at 'BBB',
- 7) ratings assigned to PLN400 million hybrid bonds program: local currency rating of 'BB+' and national rating of 'BBB+(pol)'.

Information on the above event was published in the regulatory filing (current report): no. 41/2017 of December 21, 2017.

Termination of the long term agreements on the purchase of the property rights by a subsidiary

On February 28, 2017 TAURON Sprzedaż filed a statement on the termination of the long term agreements on the purchase of the property rights arising from the certificates of origin of electricity from renewable energy sources (the so-called "green" certificates). Parties to the agreements concluded in 2008 are the below listed counterparties that own facilities generating electricity from renewable sources:

- 1) in.ventus limited liability company EW Dobrzyń limited partnership,
- 2) in.ventus limited liability company Ino 1 limited partnership,
- 3) in.ventus limited liability company EW Gołdap limited partnership.

The agreements were terminated effective immediately as a result of the parties failing to achieve an agreement while trying to renegotiate the contracts under the procedure provided for in the agreements. The financial implication of the termination of the agreements will be TAURON Sprzedaż avoiding a loss equal to the difference between the contractual prices and the market price of the "green" certificates. An estimated net value of the above mentioned loss due to the performance of the agreements until the end of the originally assumed agreements' term (i.e. until 2023), based on the current market prices of the "green" certificates is approximately PLN 343 mln. Estimated total net value of the contractual obligations of TAURON Sprzedaż in 2017–2023 is approximately PLN 417 mln. The above figure was calculated based on the pricing formulas assumed in the agreements for the period running from the day of drawing up this report until the end of the originally assumed agreements' term (i.e. until 2023).

The above event was described in detail in the regulatory filing (current report) no. 6/2017 of February 28, 2017.

Signing of the letter of intent on the coal gasification project

On April 20, 2017 a Letter of intent was signed between TAURON and Grupa Azoty S.A. defining the general rules of commencing cooperation aimed at implementing the coal gasification project.

The parties signed the Letter of intent due to the fact that among various coal conversion methods of key importance in the medium and long term are those that are offering efficient utilization of coal resources, in line also with the direction of the European Union's policy. This is due, among others, to the need to reduce the ecological burden (footprint) of the power generation and chemical processes, including to significantly reduce the CO₂ emissions.

The detailed information on the above event is provided in section 1.5.2. of this report.

The Company disclosed information on the signature of the letter of intent in the regulatory filing (current report) no. 12/2017 of April 20, 2017.

Important corporate events in 2017

Dismissal and appointment of members of the Company's Management Board

On March 15, 2017 the Company's Supervisory Board dismissed, effective as of the end of day on March 15, 2017, all members of the Company's Management Board of the 4th common term of office, i.e.: Filip Grzegorzczuk – President of the Management

Board, Jarosław Broda – Vice-President of the Management Board for Asset Management and Development, Kamil Kamiński – Vice-President of the Management Board for Corporate Governance, Marek Wadowski – Vice-President of the Management Board for Finance, Piotr Zawistowski – Vice-President of the Management Board for Customer and Trade.

At the same time the Supervisory Board on March 15, 2017 appointed as of March 16, 2017 the following persons to TAURON's Management Board of the 5th common three-year term of office: Filip Grzegorzczak, as the President of the Management Board, Jarosław Broda, as Vice-President of the Management Board for Asset Management and Development, Kamil Kamiński as Vice-President of the Management Board for Corporate Governance, Marek Wadowski as Vice-President of the Management Board for Finance.

On March 15, 2017 Piotr Zawistowski up to then performing the function of Vice-President of the Management Board for Customer and Trade provided the Supervisory Board with the information on the resignation from applying for being selected to be a member of TAURON's Management Board of the 5th common term of office. Due to the change made to the Company's Organizational Regulations the Supervisory Board made, as of April 14, 2017, a change of the existing position held by Kamil Kamiński to Vice-President of the Management Board for Customer and Corporate Support.

The Company disclosed information on the change to the composition of the Management Board in the regulatory filing (current report) no. 10/2017 of March 15, 2017.

Changes to the Supervisory Board's composition

On May 25, 2017 the Company received Jacek Rawecki a statement on the resignation, as of May 26, 2017, from the function of a member of the Company's Supervisory Board. Jacek Rawecki did not provide the reason for the submitted resignation.

On May 29, 2017 the Minister of Energy, acting pursuant to § 23, clause 1, sections 1) and 3) of the Company's Articles of Association, appointed the following persons to be members of the Company's Supervisory Board of the 5th common term of office as of May 29, 2017:

1. Beata Chłodzińska,
2. Teresa Famulska,
3. Barbara Łasak-Jarszak,
4. Jan Płudowski,
5. Agnieszka Woźniak.

On May 29, 2017 the Ordinary GM of the Company, acting pursuant to § 22, clause 1 of the Company's Articles of Association, appointed the following persons to be members of the Company's Supervisory Board of the 5th common term of office:

1. Radosław Domagalski-Łabędzki,
2. Paweł Pampuszko,
3. Jacek Szyke.

The Company disclosed information on the above events in the regulatory filings (current reports): no. 19/2017 of May 25, 2017 and no. 22/2017 of May 29, 2017. The information on appointed members of the Supervisory Board was disclosed in the regulatory filing (current report) no. 27/2017 of June 5, 2017.

Decision of TAURON's Management Board on the motion filed to the Ordinary GM of the Company to cover the Company's net loss for the financial year 2016 from the Company's spare (supplementary) capital and not recommend the use of the spare (supplementary) capital for the dividend payout

On March 13, 2017 TAURON's Management Board of the Company adopted the resolution on filing a motion to the Ordinary GM of the Company to cover the Company's net loss in the financial year 2016 in the amount of PLN 166 252 898.52 from the Company's spare (supplementary) capital.

At the same time, in reference to the information on the adoption of the 2016–2025 dividend policy, provided in the regulatory filing (current report) no. 35/2016 of September 2, 2016, the Company's Management Board decided not to recommend to the Ordinary GM of the Company taking of the decision on the use of the Company's spare (supplementary) capital for the payout of the dividend for 2016 to the Company's shareholders.

The above decision was dictated by the needs related to the implementation of the investment program worth approx. PLN 18 bln by 2020 and ensuring TAURON Capital Group's financial stability, including in particular maintaining the net debt/EBITDA ratio defined in TAURON's financial agreements at the level not higher than 3.5x.

Additionally, in accordance with the information published by the company in the regulatory filing (current report) no. 41/2016 of November 14, 2016 the planned stopping of the dividend payout until 2019 was one of the factors enabling the Fitch rating agency to maintain TAURON's long term rating at investment grade level and to change the outlook from negative to stable.

The Company disclosed information on the above decision in the regulatory filing (current report) no. 8/2017 of March 13, 2017.

Shareholder's request to include particular items on the agenda of the General Meeting of the Company

On May 5, 2017 the State Treasury of the Republic of Poland, as a shareholder representing more than one twentieth of TAURON's share capital, submitted a request to include on the agenda of the Ordinary General Meeting of the Company convened on May 29, 2017 additional items related to a change of the resolution no. 5 of the Extraordinary GM of December 15, 2016 on the principles of setting the compensation of the members of the Management Board and a change to the Company's Articles of Association the scope of which was indicated in detail in the content of the regulatory filing (current report) no. 16/2017 of May 5, 2017.

State Treasury indicated as a justification for the proposed changes the need to align the principles of setting the compensation of the members of the Management Board and the content of the Company's Articles of Association to the requirements of the *Act of December 16, 2016 on the state assets management principles*.

The introduction of the amendment to the Company's Articles of Association was aimed at implementing a more transparent split of competences of the Company's corporate authorities, transparent asset management principles, investment decision making principles, manner of appointing members of the supervisory and management authorities and setting their compensation, as well as standards related to actions taken by the management boards of companies, among others in such areas as: consulting, marketing, sponsoring or meals and entertainment expenses.

The draft resolutions received from the State Treasury to be the subject of discussions at the Ordinary GM of the Company and the proposed changes to the Company's Articles of Association were published on May 19, 2017. Meanwhile on May 25, 2017 the State Treasury filed a change to the draft resolution on the change of § 20 of TAURON's Articles of Association and withdrew the draft resolution on the change of § 35 of TAURON's Articles of Association.

The Company disclosed information on the above events in the regulatory filings (current reports) no. 16/2017 of May 5, 2017, 17/2017 and 18/2017 of May 19, 2017 and 20/2017 and 21/2017 of May 25, 2017.

Ordinary General Meeting of TAURON

On May 29, 2017 the Ordinary GM of the Company was held which adopted resolutions concerning, inter alia: the approval of the Consolidated financial statements of TAURON Capital Group and the Report of the Management Board on the operations of TAURON Capital Group for the financial year 2016, the Financial statements of TAURON and the Report of the Management Board on the operations of TAURON for the financial year 2016, covering of net loss for the financial year 2016 from the spare (supplementary) capital, acknowledgement of the fulfillment of duties by members of the Company's Management Board and Supervisory Board, determining the number of members of the Company's Supervisory Board and appointing of members of the Supervisory Board, changing resolution no. 5 of the Ordinary GM of December 15, 2016, as well as amending the Company's Articles of Association.

It was decided to cover the net loss of the Company for the financial year 2016 in the amount of PLN 166 252 898,52 from the Company's spare (supplementary) capital.

The Company disclosed information on convening the Ordinary GM and on the content of the draft resolutions in the regulatory filings (current reports) no. 13/2017 and no. 14/2017 of April 27, 2017. The Company disclosed information on the adopted resolutions and the decisions of the Ordinary GM concerning: covering of the net loss, amendments to the Company's Articles of Association and appointment of the Supervisory Board members in the regulatory filings (current reports): no. 22/2017, no. 23/2017, no. 24/2017 of May 29, 2017.

Amendments to TAURON's Articles of Association

On May 29, 2017 the Ordinary GM of the Company adopted the resolutions on the amendments to the Company's Articles of Association.

As part of the passed amendments to the Company's Articles of Association the majority of the provisions of the *Act of December 16, 2016 on the state assets management principles* were implemented directly in the Company's Articles of Association. Also the competences of the Supervisory Board were extended and it shall express its consent for the conclusion of agreements on legal, marketing services, public relations and social communications services and consulting services related to management if the envisaged total net compensation for the services provided exceeds PLN 500 000, on annualized basis, with respect to donations granted or other agreements of similar effect with the value exceeding PLN 20 000 or 0.1. of the total assets, determined based on the last approved financial statements and relieving of debt exceeding PLN 50 000 or 0,1% of the total assets. Furthermore, the competences of the Supervisory Board were extended by including: tasks related to determining the manner of exercising the voting rights at TAURON Capital Group's subsidiaries' GMs on issues regarding setting up companies, amending the Articles of Association or the Agreement, transformations or liquidations, raising or reducing share capital, divesting and leasing out the company's enterprises or its organized part and establishing a limited property right thereupon, redeeming shares, setting the compensation of members of management boards or supervisory boards, claims for redressing damage inflicted upon formation of the company or exercising management or supervision, with respect to issues mentioned in art. 17 of the *Act of December 16, 2016 on the state assets management principles*. Also the principles of divesting fixed asset components were defined and procedures for selecting members of the management board following the qualification proceeding by

the Supervisory Board the goal of which will be to verify and evaluate the candidates' qualifications were introduced, as well as the requirements for candidates for members of management authorities were defined.

On July 12, 2017 the District Court for Katowice-Wschód, the 8th Commercial Department of the National Court Register, entered into the Register of Entrepreneurs of the National Court Register the amendments to the Company's Articles of Association, adopted by the Ordinary GM of the Company by way of resolutions no. 39-45 of May 29, 2017 on amendments to the Company's Articles of Association.

On July 17, 2017 the Supervisory Board of TAURON, acting pursuant to § 20, clause 1, section 13 of the Company's Articles of Association, adopted a consolidated text of the Articles of Association of TAURON that includes the amendment to the Articles of Association entered into the National Court Register by the District Court for Katowice-Wschód in Katowice, the 8th Commercial Division.

The information on the above events was provided in the regulatory filings (current reports): no. 24/2017 of May 29, 2017, 33/2017 of July 12, 2017 and 34/2017 of July 17, 2017.

Other important events in 2017

Appointment of certified auditor

On March 15 2017 the Company's Supervisory Board appointed Ernst & Young Audyt Polska Limited Liability Company Limited Joint-Stock Partnership as the entity authorized to examine TAURON's standalone and consolidated financial statements for the financial year 2017 and review TAURON's standalone and consolidated interim financial statements for the period ending on June 30, 2017. To date the services provided by Ernst & Young for the Company included examinations of the Company's standalone and consolidated financial statements for the years: 2008–2012, as well as reviews of the Company's standalone and consolidated interim financial statements for the periods ending on 30 June in the individual years from 2010 to 2012. The Company also used advisory and training services provided by Ernst & Young to the extent that in no way limited the impartiality and independence of the auditor. The certified auditor was appointed in accordance with the regulations in force, following a non-public order award procedure conducted by way of offer and acceptance. The agreement with Ernst & Young will be concluded by the Management Board of the Company for a period required to perform the contracted services

The Company disclosed information on the above event in the regulatory filing (current report) no. 9/2017 of March 15, 2017.

Submission of the lawsuits in connection with the termination by PEPKH of long-term contracts for the purchase of power and property rights

1. On July 20, 2017 TAURON received the lawsuit of June 29, 2017 of Gorzyca Wind Invest sp. z o.o. with its seat in Warsaw against TAURON for payment of damages in the amount of PLN 39.7 mln and determination of liability for damages that may arise in the future due to torts, including unfair competition acts, estimated by the plaintiff to be worth PLN 465.9 mln. The case is pending before the Regional Court in Katowice. The factual basis for the lawsuit, according to the plaintiff, is the termination by PEPKH – TAURON's subsidiary, of the long term contracts for the purchase of electricity and property rights arising from certificates of origin, and the total amount of the future damages suffered by all of Wind Invest's subsidiaries will reach, according to the plaintiff, PLN 1 212.9 mln. TAURON disclosed information on the termination of the above mentioned agreements in the regulatory filing (current report) no. 7/2015 of March 19, 2015.

The preliminary assessment of the justification for the claims contained in the lawsuit indicates that they are completely groundless.

2. On August 2, 2017 a submission was made to TAURON's power of attorney appointed in the lawsuit conducted before the Regional Court in Cracow, file reference no. IX GC 983/14, filed by Dobiesław Wind Invest sp. z o.o. with its registered office in Warsaw against TAURON and its subsidiary, i.e. PEPKH (to prevent the imminent danger of damage to Dobiesław Wind Invest sp. z o.o., by obligating TAURON and PEPKH and to revoke the liquidation of PEPKH), of a pleading of Dobiesław Wind Invest sp. z o.o. containing a change to the lawsuit.

The plaintiff changed the lawsuit's claim in such a manner that it had withdrawn its original legal action against PEPKH, while it changed the legal action against TAURON from the claim to prevent the imminent danger of damage into the claim for the payment of compensation.

Dobiesław Wind Invest sp. z o.o. was demanding: 1) payment of PLN 34.7 mln including statutory interest accrued from the day the claim was filed until the payment date, 2) determination that TAURON is liable towards Dobiesław Wind Invest sp. z o.o. for damages that may arise in the future, estimated by the plaintiff at PLN 254 mln (and stemming from TAURON's alleged torts), 3) that injunctive relief be granted against TAURON for the amount of PLN 254 mln in case the court does not find TAURON liable for the damages that may arise in the future.

The factual basis for the lawsuit, according to the plaintiff, is the termination by TAURON's subsidiary – PEPKH with its registered office in Warsaw of the long-term contracts for the purchase of electricity and property rights arising from certificates of origin, as described by TAURON in the regulatory filing (current report) no. 7/2015 of March 19, 2015.

The preliminary assessment of the justification for the claims contained in the lawsuit indicates that they are completely groundless.

3. On August 21, 2017 TAURON received the lawsuit of June 30, 2017 of Pełkanino Wind Invest sp. z o. o. with its seat in Warsaw against the Issuer for payment of damages in the amount of PLN 28.5 mln and determination of liability for damages that may arise in the future due to torts, including unfair competition acts, estimated by the plaintiff to be worth PLN 201.6 mln.

The case is pending before the Regional Court in Katowice. The factual basis for the lawsuit, according to the plaintiff, is the termination by PEPKH – the Issuer’s subsidiary, of the long term contracts for the purchase of electricity and property rights arising from certificates of origin. The Issuer disclosed information on the termination of the above mentioned agreements in the regulatory filing (current report) no. 7/2015 of March 19, 2015.

The preliminary assessment of the justification for the claims contained in the lawsuit indicates that they are completely groundless.

4. On October 16, 2017 TAURON received the lawsuit of June 30, 2017 of Nowy Jarosław Wind Invest sp. z o. o. with its seat in Warsaw against the Issuer for payment of damages in the amount of PLN 27 mln and determination of liability for damages that may arise in the future due to torts, including unfair competition acts, estimated by the plaintiff to be worth PLN 197.8 mln. This is the last of four announced lawsuits by Grupa Wind Invest companies in this case.

The case is pending before the Regional Court in Katowice. The factual basis for the lawsuit, according to the plaintiff, is the termination by TAURON’s subsidiary, i.e. PEPKH, of the long term contracts for the purchase of electricity and property rights arising from certificates of origin. TAURON disclosed information on the termination of the above mentioned agreements in the regulatory filing (current report) no. 7/2015 of March 19, 2015.

The preliminary assessment of the justification for the claims contained in the lawsuit indicates that they are completely groundless.

The Company disclosed information on the above events in the regulatory filings (current reports): no. 35/2017 of July 20, 2017, no. 37/2017 of August 3, 2017, no. 38/2017 of August 21, 2017 and no. 39/2017 of October 16, 2017.

Important events after December 31, 2017

Selection of certified auditor

On February 26, 2018 TAURON’s Supervisory Board selected the audit company Ernst & Young Audyt Polska Limited Liability Company Limited Joint-Stock Partnership (“Ernst & Young”) to conduct an audit of the standalone and consolidated financial statements of TAURON for the financial year 2018 and a review of the interim standalone and consolidated financial statements of TAURON for the six months ending on June 30, 2018.

The selection of Ernst & Young to conduct an audit of the standalone and consolidated financial statements of the Company took place in conjunction with the need to bring the agreement concluded with Ernst & Young on auditing the financial statements for the financial year 2017 in line with the requirements of the regulations of art. 66 clause 5 of the law of September 29, 1994 on accounting in the version given thereto by the law of May 11, 2017 on certified auditors, audit companies and public supervision, including with respect to the period for which the first audit agreement should be concluded (i.e. for a period not shorter than 2 years). An amendment to the agreement with Ernst & Young will be concluded for the period required to complete the entrusted activities.

The detailed information was provided in the regulatory filings (current reports): no. 3/2018 of February 26, 2018.

2.9. Prizes and accolades (honorable mentions)

In 2017 TAURON and TAURON Capital Group’s subsidiaries received the following awards and accolades.

Figure no. 41. Prizes and accolades (honorable mentions)

PRIZES AND HONORABLE MENTIONS AWARDED TO TAURON AND TAURON CAPITAL GROUP’S SUBSIDIARIES IN 2017

JANUARY

Awarding of the *Laurel of Skills and Competence 2016* prize to the Opole branch of TAURON Dystrybucja by Opole Chamber of Commerce for supporting the economic development of Opole Silesia particularly taking into account the economic zones, efficient and fast fixing of failures, efficient cooperation with institutions, local governments, entrepreneurs and many other entities associated with the region’s operations, and also efficient completion of investment processes on the territory of the Opole region, positive participation in the life of Opole counties and municipalities and the attitude of a socially responsible enterprise.

MARCH

- Awarding of a special prize to TAURON in the competition for the best investor relations among WIG30 index companies, organized by the Stock Market and Investors Paper “Parkiet” and the Chamber of Brokerage Houses.
- Honorable mention for 12 initiatives conducted by TAURON Capital Group in the field of sustainable growth in the report “Responsible business in Poland. Best practice” authored by Forum Odpowiedzialnego Biznesu.

APRIL

- Awarding of the 2016 *Transparent Company of the Year* title to TAURON by the Stock Market and Investors Paper "Parkiet" for business transparency and quality of the market communications.
- Awarding of the prize to TAURON in the "Leaders of the Energy World" competition for the energy industry's first startup accelerator program PilotMaker.
- Awarding of the "Leader" title to TAURON during the Techno Biznes 2017 Gala for implementing the "Innovation Zone" application, allowing the company's personnel to submit solutions improving the entire organization's operations.

JUNE

- Awarding the Hero of the capital market 2017 title to TAURON in the Individual Investors Association's competition. Individual investors appreciated TAURON's high standards in the investor relations area and applying of the best practices in the communications addressed thereto.
- Awarding the "Platinum MegaWatt" trophy to TAURON by TGE for being most active on the electricity market among electric utilities in 2016.
- Awarding the "Platinum MegaWatt" trophy to TAURON Sprzedaż by TGE for being most active on the Property Rights market among electric utilities in 2016.

SEPTEMBER

Awarding of the *Ceramic Bat 2017* prize to KW Czatkowice by the board of the BAT FESTIVAL for all contributions to the Cracow county, including many years of contributions to environment protection and actions aimed at popularizing culture and national heritage.

OCTOBER

- Including TAURON in *The Best of the Best* group and awarding the top prize for the integrated annual report in the "The Best Annual Report" competition organized by the Institute of Accounting and Taxes. Thus the Company confirmed its position among companies that can boast the highest reporting standards.
- Awarding TAURON the *Golden Laurel of "Super Business"* prize by business section of the "Super Express" daily in the "Corporate Social Responsibility". TAURON was appreciated for the "Houses of Positive Energy" – competition organized for orphanages and educational care facilities.
- Awarding TAURON Dystrybucja the honorable mention in the *New Impulse 2017* competition by the 16th Congress of Nowy Przemysł / Grupa PTWP S.A. for effective introduction of smart solutions in electricity distribution.
- Awarding TAURON the Wprost Innovator 2017 prize in the energy sector category for participating in the Pilot Maker program, one of the most advance accelerator programs on the Polish market dedicated to implementing solutions developed by startUPS at large enterprises.

NOVEMBER

- Awarding TAURON Dystrybucja the *White Tiger Laurel* by the Energy Promotion Agency during the 10th Energetykon 2017 "Energy-Climate-Economy-Society" Conference for the design to build Poland's first digital power station in which fully electronic communications will be applied.
- Awarding TAURON Sprzedaż the *Eagle of Wprost 2017 Business Leader* title by the publisher of the "Wprost" weekly in the "Companies with the highest net profit" category in Małopolska region.

DECEMBER

- TAURON's inclusion, for the fifth time in a row, in the RESPECT Index – a group of listed companies managed in responsible and sustainable manner included in this index.
- Awarding TAURON Ciepło a certificate in the *Personnel Friendly Employer* competition by the National Commission of NSZZ "Solidarność" (competition under the patronage of the President of the Republic of Poland Andrzej Duda. The certification committee took into account labor law compliance, concluding of collective bargaining agreements, employing personnel for an indefinite period of time, unionization and counteracting mobbing.
- Awarding TAURON Wydobycie the Miners Families Foundation Medal "A Friend of the Miners Families Foundation Medal". The medal is awarded to an institution that provides financial support for the Foundation, is its active donor and promotor.
- Awarding ZG Janina TAURON Wydobycie the 1st position in the Miners Professional Solidarity competition by the Miners Families Foundation. The metric is the amount of the contributions collected during a year for the Miners Families Foundation in relation to a company's headcount.

JANUARY – FEBRUARY 2018 (prizes for 2017)

- Awarding TAURON Dystrybucja the *Top Event 2017* prize by Evential sp. z o.o. for the "Light Alchemy" organized in 2017 in Katowice – unique Nationwide multimedia show, combining Visual arts: three dimensional mapping, lights, laser and pyrotechnical displays, music, singing and dance live and diverse elements of the form theatre.
- Awarding TAURON Wydobycie the *Solid Company 2017* prize by the Board of the Economic and Consumers Program certifying a company's credibility and integrity. TAURON Wydobycie is a laureate of the "Bronze Solidarity Trophy", as it has passed the verification process for the seventh time already.

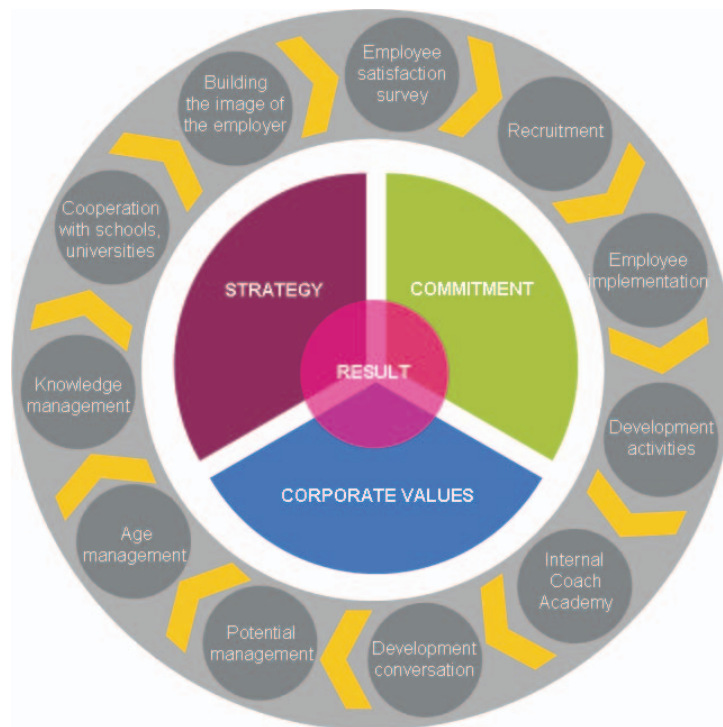
2.10. Information on TAURON Capital Group's employment

2.10.1. Policy of Human Resources Management at TAURON Group

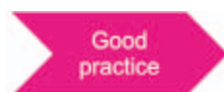
Adoption by TAURON Capital Group of the management by process style of management in 2017 led to updating of the applicable in all companies *Human Resources Management Policy at TAURON Group*, which together with the core values of Partnership, Development and Courage constitute the signposts for management and employees in meeting new challenges and efficiency increasing activities. TAURON Capital Group strives to develop, motivate and win employees capable of attaining the assumed objectives. The overriding purpose is to support the management in effective implementation of changes and promoting new initiatives. TAURON Capital Group seeks to establish conditions fostering development of knowledge and skills, and creating a work environment of cooperation and partnership, where innovativeness and all optimizing initiatives will be the basis for taking actions.

The below figure presents the assumptions of the *Policy of Human Resources Management at TAURON Group*.

Figure no. 42. Assumptions of the Policy of Human Resources Management at TAURON Group



Interdisciplinary teams in the HR area of TAURON Group



Partnership attitudes as one of the core corporate values are being instilled already when developing systemic solutions. Challenges facing the HR function are undertaken in adherence to a principle of establishing workgroups consisting of HR staff from companies of the TAURON Capital Group. Team members are appointed by the HR Management Council of TAURON Capital Group, consisting of top HR manager of the Group. This proven style of HR project management results in standardizing and optimizing HR management processes, improving at the same time task completion quality with consideration of the specific requirements in each of the Group companies. Such participative approach is reflected in effectiveness of solutions and building a consistent image of the HR function.

2.10.2. Development and training

Employees of TAURON Capital Group's subsidiaries are participating various forms of development activities: The below figure presents the forms of development activities of employees of TAURON Capital Group's subsidiaries.

Figure no. 43. Forms of development activities of employees of TAURON Capital Group's subsidiaries



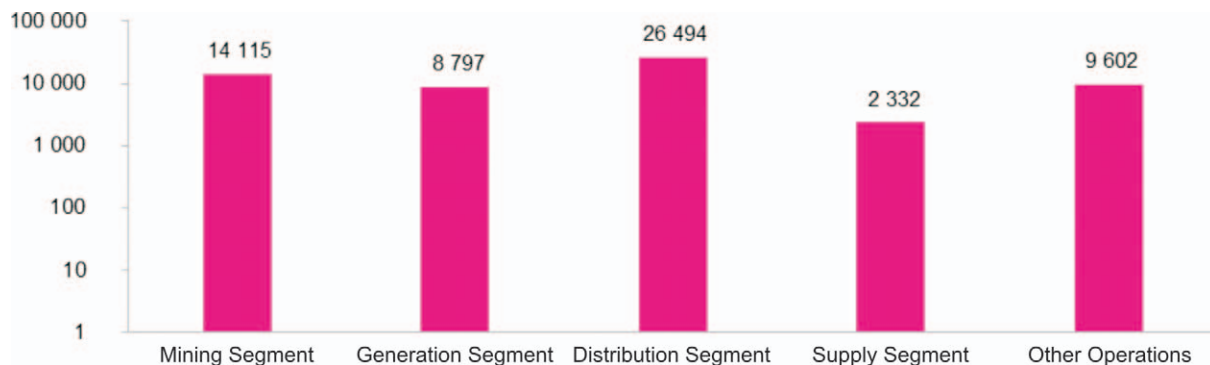
The below figure presents TAURON Capital Group's key 2017 training statistics.

Figure no. 44. TAURON Capital Group's key 2017 training statistics



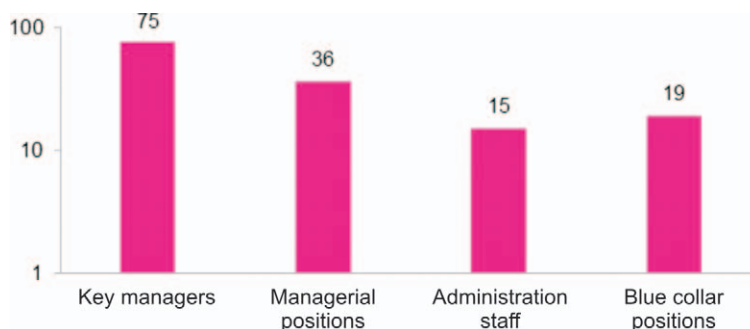
The below figure presents the total number of training days broken down into Segments of operations (lines of business).

Figure no. 45. Total number of training days broken down into Segments of operations (lines of business)



The below figure presents the average number of training hours per employee, broken down into job (work position) groups.

Figure no. 46. The average number of training hours per employee, broken down into job (work position) groups



HR initiatives organized by TAURON Group



Employee satisfaction poll (survey) at TAURON Capital Group. The Employee satisfaction poll at TAURON Capital Group took place between end of April and beginning of May 2017. The questionnaire ensured full anonymity and for the first time in history of the TAURON Capital Group was performed in all companies of the Group. Purpose of the poll was to acquire staff opinions as to the most important issues related with their working environs, including values of the company, communicating with superiors and within the company, team atmosphere and cooperation, work safety and hygiene and availability of training and development opportunities.

46% of TAURON Capital Group employees participated in the poll (3769 used hardcopy questionnaires and 7751 filled-in the electronic forms). Of the participants, 84% declared high levels of commitment to their work, 80% stated satisfaction with employee relationships and 70% expressed satisfaction with working conditions at TAURON Capital Group.



TAURON Group's Competence Model. TAURON Group's Competence Model was developed in mid 2017 as a result of interaction between representatives of individual group companies, coming from a variety of business areas and the HR function. The model reflects strategy, mission, vision and key values, i.e.: Partnership, Development, Courage, and also involves business challenges facing TAURON Capital Group. The model assumes continuing staff development and supporting the attaining of results within TAURON Capital Group. Each employee has awareness of what competences and behaviors are expected of him/her; thus enabling not just performance of assigned tasks, but also developing of own professional capacities. The model affects a multitude of human resources management processes, including recruitment, adaptation, development and employee assessment. Also, individual companies held workshops devoted to the Model, addressed both to managers and employees.



Cooperation with universities. TAURON Capital Group cooperated with almost 50 educational establishments (universities, secondary and vocational schools) all over the country. As part of the cooperation, pupils, students and graduates may apply for internship and training at TAURON Capital Group. 693 persons worked as interns in 2017. Through the cooperation partnership relations with the academic community are built – the scientific (academic) staff (faculty) and students. TAURON as a leader can influence education and gaining professional competence amount future adepts in the industry. Best students and graduates were searched for both at universities, through cooperation with university Career Offices and through participation in the largest national fair – Absolvent Talent Days. Furthermore, TAURON Group's Ambassador program was launched in 2017 with its goal to expand cooperation with universities, build a positive image of TAURON Capital Group and recruit top students from the business needs point of view. The program is announced for the given academic year, and the target group includes students in the 2nd to 5th year of their studies.



The "Join Us" internship program at TAURON. TAURON launched an internship (traineeship) program in 2017, the purpose of which is to prepare most talented students at Polish universities to enter the job market. Participants are offered a versatile professional development program in state-of-the-art energy industry. Trainees are acquainted with the Company's structure, determinants and rules. The program heavily focuses on forming appropriate attitudes to the tasks assigned, attention to quality and timeliness of performing assigned tasks, valid cooperation with other persons and units within the Company, developing own initiative, acquiring teamwork skills. The program is addressed to 4th and 5th year university students.

Initiative

TAURON Group Open University. TAURON Group Open University is a cycle of lectures conducted since 2014 by the most outstanding experts specialising in various disciplines of science, politics, business, culture and personal development. Through participation in the lectures we want to provide Employees with access to current knowledge and information. In addition, this initiative allows to create a platform for the exchange of ideas and experience among employees from various companies and, consequently, to provide even better support for the implementation of TAURON Capital Group's strategic objectives.



TAURON Group Open University was launched in order to offer the following opportunities to employees:

- 1) lifelong learning through exploring new issues and acquiring new skills,
- 2) active participation in the reality surrounding us through learning new phenomena and the skill to face them,
- 3) comprehensive, broadly understood development,
- 4) learning and using the latest technologies,
- 5) development of own personality, values and pro-social attitudes,
- 6) exploring various areas of science, life, culture and arts.

So far, 17 lectures have been provided, attended by over 3 000 employees of all TAURON Capital Group's subsidiaries. 6 lectures were organized in 2017, attended by almost 1 000 employees in total.

Initiative

Values: Partnership, Development, Courage – their implementation within the TAURON Capital Group companies. 2017 was devoted to implementing our core values: Partnership, Development and Courage ("PRO") at TAURON Capital Group's subsidiaries. Workshops introducing staff to the PRO Values program were held throughout the Group. 100% of the lines of business underwent training. Promoting these values within the Group companies proceeded along varying pathways. PRO Values were discussed and refreshed at TAURON Wydobycie and TAURON Wytwarzanie in course of occupational safety and hygiene training courses. TAURON EKOENERGIA organized the "We are PRO" competition, the purpose of which was to promote values by awarding those employees who promote corporate values through their attitude and everyday actions, thus becoming Value Ambassadors within the TAURON Capital Group. Questionnaire based voting led to election of one Ambassador for each of the core values. In turn, TAURON Obsługa Klienta organized workshops at which the importance of PRO Values at work was discussed. A number of involving discussions emerged, during which employees were to respond to issues such as: Why corporations need values? How are values to be understood? What attitudes and behavior support Partnership, Development and Courage?

The PRO Values are a symbol of, and determine TAURON Capital Group's organizational culture; hence it is importance for each employee to be guided by such values in performing his/her everyday duties.



We are partners for clients and for each other in implementation of common goals.
We build sustainable relations: based on trust and mutual respect.
We engage in anything important for our clients and the Group.



We are innovative: we overcome barriers, determine trends and create changes.
We continuously develop competence, skills and knowledge.
We search for increasingly improved solutions: we meet current and future clients' needs, continuously enhancing the quality of our services.



We discuss problems and the boldest ideas openly and courageously.
We are determined in implementing what we believe in with the purpose of reaching common goals.
We face challenges of the changing environment with commitment and passion.

Initiative

E-learning platform. Employees of selected companies of TAURON Capital Group's subsidiaries may use the e-learning platform containing many training courses. They include both specialised training and training courses developing interpersonal skills. In 2017 mandatory training courses were launched for the workforce with respect to "Recruitment and adaptation (induction) of employees – step by step", "Responsible Business Code" and "Counteracting mobbing and discrimination at TAURON Group". In total all users of the platform realized more than 32 000 training courses in 2017.



Initiative

Developing managers. The Managers Development Program comprises a comprehensive growth initiative the purpose of which is to support management level staff in both their business as well as personal efficiency, and to consciously develop model leadership attitudes within the entire TAURON Capital Group. Core values of TAURON Capital Group, i.e. Partnership, Development and Courage, guide individual actions within the program and constitute its second foundation. Developed competence enables the participants to become even more efficient leaders, whereas values determine the areas and objectives where their efficiency attains best results. The Program has been prepared and implemented based on globally proven solutions and expertise of coaches and experts involved in the Program. The development process is practical in nature and at the same time delivers inspiration and nurtures uniqueness. More than 70 key managers at TAURON Capital Group participate in the Program.

Initiative

International Family Day festivities at TAURON Capital Group. 2017 marked the fourth year in which TAURON participated in public festivities associated with the International Family Day, the purpose of which is to strengthen family ties through sincere discussion and by building and strengthening identity of the young generation. All TAURON Capital Group companies participated in the 2017 festivities. On the agreed day, employees were allowed to work 2 hours less on full pay, and free time was to be devoted to their families and friends. The companies also organized competitions promoting leitmotif of the campaign, which this year read "Cooking within the family circle". The festivities continued at TAURON, TAURON Dystrybucja and TAURON Ciepło where visits of children, and even grandchildren, at parent workplaces were organized. Visits were accompanied by entertainment and attractions.

Initiative

The Innovativeness Marathon at TAURON Dystrybucja. November 2017 witnessed the first Innovativeness Marathon organized at TAURON Dystrybucja. Twelve teams of 6 students, each, worked on a project inspired by the slogan: "Energy of the Future: Internet of Things, Big Data and electro-mobility in power grids of the future". Participants came from the AGH University of Science and Technology in Kraków, and from the Silesian, Częstochowa and Wrocław Technology Universities. First 3 days of the Marathon gave participants an opportunity to familiarize with needs of TAURON Dystrybucja clients and principles of working in the service design thinking formula based on workshop based activities using creative techniques. Acquired knowledge was used during the next two days to create innovative solutions for TAURON Dystrybucja. The competition was won by the "Electron" team from the Silesian Technical University in Gliwice, which presented the idea of an algorithm defining optimal locations for electric power loading stations for electric vehicles, taking into account characteristics and loads of the existing power grid.

Initiative

Skills development for employees of TAURON Obsługa Klienta. In implementing its objective to provide high quality services and developing employee skills, TAURON Obsługa Klienta being the Shared Services Center in 2017 organized a number of training course and workshops on communication and cooperation, integration of staff and building team relationships, course oriented towards agility at work, workshops on mediation based operating styles, courses on improving security at the Customer Service Centers (POK), effective communication techniques, cooperation under changing requirements and a set of workshops devoted to leadership skills. Over 1200 employees participated in these initiatives

Initiative

Management by Objectives training for management staff. In 2017 TAURON held a series of workshop course dedicated to management staff, devoted to the Management by Objectives methods, particularly principles of setting and cascading objectives based on the SMART model. The goal of the workshops was to make the participants familiar with the principles of evaluating attaining of objectives and giving constructive return information. Also, tools used to support employees in attaining their objectives and tools for assessment of subordinates were presented. More than 60% of the Company's management staff participated in the two-day workshops.



Policies combating Mobbing and Discrimination at the TAURON Group. The *Policy of combating Mobbing and Discrimination at the TAURON Group* was developed in the second half of 2017. The policy document applies throughout the entire TAURON Capital Group. The policy defines principles for counteracting mobbing and discrimination at the workplace and in relation to performing duties, ensures implementation of labor law provisions and includes internal regulations enforced by the employer. Intervening activities and actions aimed at alleviating abusing mobbing or discrimination behaviors against employees were presented, as well as consequences awaiting perpetrators.

2.10.3. Social dialogue

The Management Board of TAURON conducts a constructive and open dialogue with the workforce (social party), mainly aimed at maintaining high quality and effectiveness of mutual cooperation. During regular meetings and consultations, the workforce representatives are informed about issues associated with:

- 1) TAURON Capital Group’s economic and financial situation of TAURON Capital Group,
- 2) TAURON Group’s 2016–2018 Efficiency Improvement Program and Strategic Initiatives,
- 3) Voluntary Redundancy Programs underway at TAURON Capital Group’s subsidiaries,
- 4) issues related to employee affairs at TAURON Capital Group.

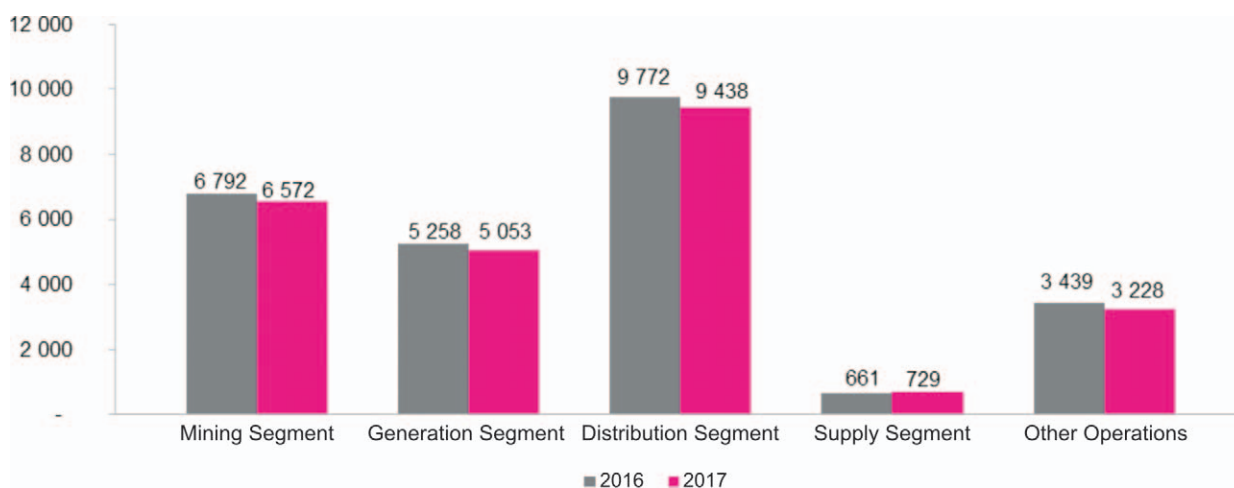
As part of the conducted social dialogue the Management Board of TAURON provided many answers to the correspondence from the trade union organisations and the Ministry of Energy. In parallel, ongoing communication is maintained at TAURON Capital Group’s subsidiaries between Management Boards and trade union organisations operating at the given employer. TAURON takes an active part in meetings at the national level with the representatives of the government, employees and employers (within the activities of the Tri-party Team for the Energy Sector).

2.10.4. Key headcount data

TAURON Capital Group’s average headcount reached 25 020 FTEs in 2017 which means a decrease versus the headcount in 2016, when the average employment was 25 992 FTEs.

The below figure presents TAURON Capital Group’s average headcount in FTEs (rounded up to the full FTE) per line of business (Segment) in 2016 and in 2017.

Figure no. 47. TAURON Capital Group’s average headcount in 2016 and in 2017¹ (FTEs)



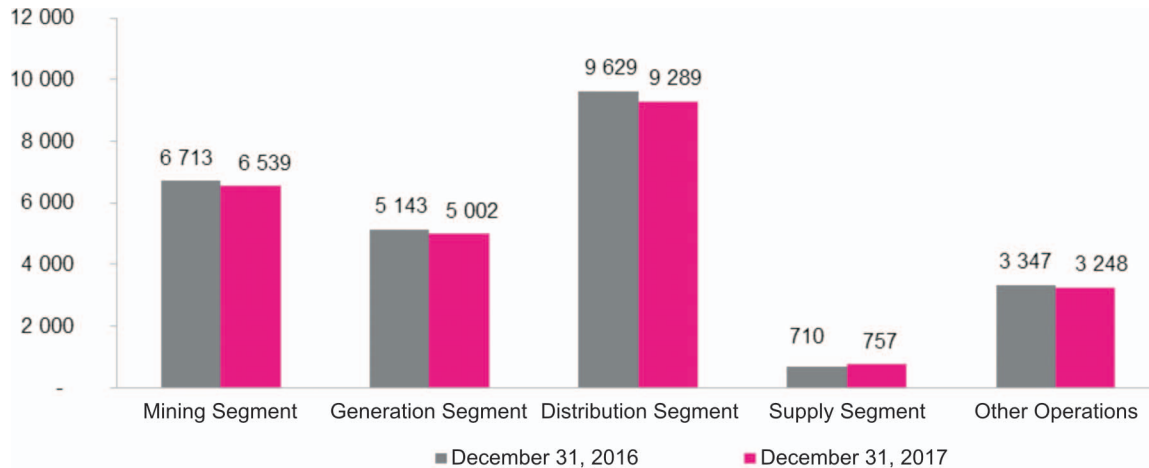
¹ Average headcount includes Nowe Jaworzno GT subsidiary that was covered by the consolidated reporting in H1 2017.

Changes to the average headcount at individual Lines of Business (Segments) in 2017 in relation to the average headcount in 2016 arise, inter alia, from the *Voluntary Redundancy Programs in the Distribution, Generation Segments and the Other Operations* line of business underway, as well as employees leaving TAURON Capital Group.

24 835 persons were employed by TAURON Capital Group’s subsidiaries as of December 31, 2017. The headcount decreased by 707 persons as compared to the headcount as of December 31, 2016 that reached 25 542 persons.

The below figure presents TAURON Capital Group’s headcount in persons as of December 31, 2016 and December 31, 2017.

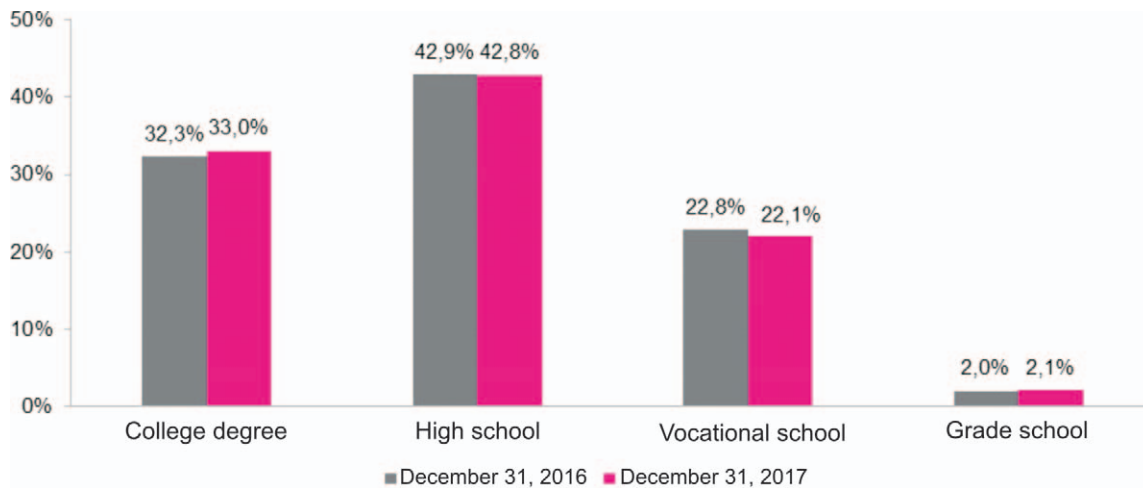
Figure no. 48. TAURON Capital Group's headcount as of December 31, 2016 and December 31, 2017¹ (persons)



¹ Headcount in persons includes Nowe Jaworzno GT subsidiary that was included in the consolidated reporting in H1 2017

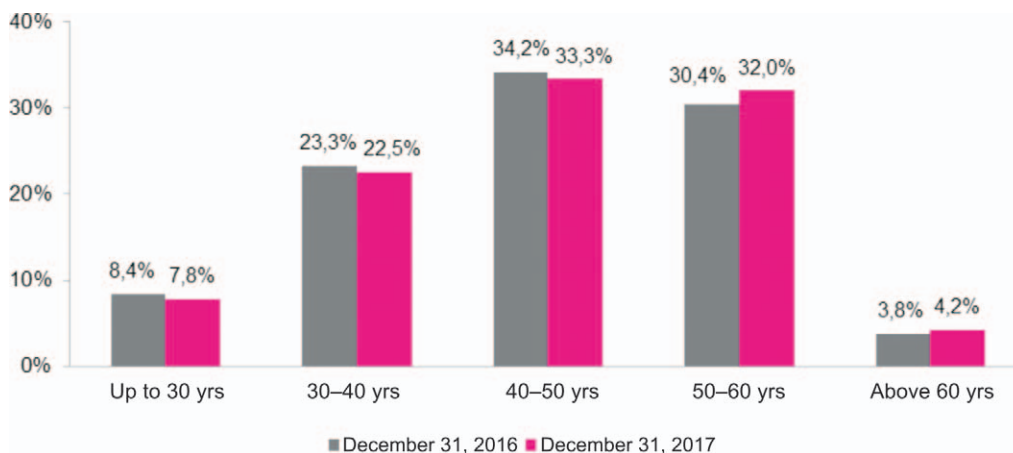
The below figure presents the structure of employment at TAURON Capital Group by education level as of December 31, 2016 and December 31, 2017.

Figure no. 49. Structure of employment at TAURON Capital Group as of December 31, 2016 and December 31, 2017 (by education level)



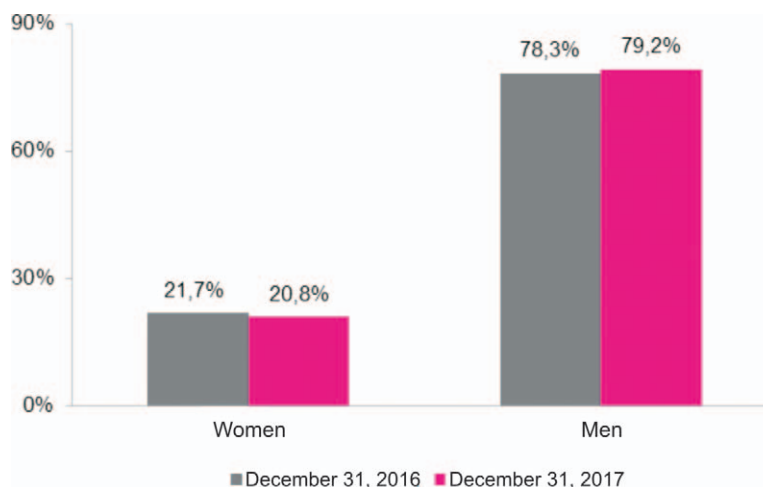
The below figure presents the structure of employment at TAURON Capital Group by age as of December 31, 2016 and December 31, 2017.

Figure no. 50. Structure of employment at TAURON Capital Group as of December 31, 2016 and December 31, 2017 (by age)



The below figure presents the structure of employment at TAURON Capital Group by gender as of December 31, 2016 and December 31, 2017.

Figure no. 51. Structure of employment at TAURON Capital Group as of December 31, 2016 and December 31, 2017 (by gender)



2.11. Corporate Social Responsibility (CSR) Policy

TAURON Group's 2017–2025 Sustainable Development Strategy

Undertakings commenced in 2016 were continued in 2017 in order to strengthen TAURON Capital Group's position as a leading, innovative and modern enterprise that is steadfastly implementing its Strategy and Business Model.

On August 1, 2017 TAURON's Management Board adopted the updated *TAURON Group's 2017–2025 Sustainable Development Strategy* (Sustainable Development Strategy) that was developed based on *TAURON Group's 2016–2025 Strategy*, taking into account feedback of the stakeholders, and also the current challenges facing the energy sector. Sustainable Development Strategy constitutes the framework of actions with respect to TAURON Capital Group's Corporate Social Responsibility.

Sustainable Development Strategy is based on 5 directions. Two of them are of leading nature as they are related to the operations on the market – "Orientation towards the customer and his/her needs" and "Reliability and quality of the supply of products and services for customers". The other three are the supporting directions and they include "Labor safety, ethical culture and employee engagement", "Environment protection" and "Social and business partnership". For each direction obligations (18 in total) that TAURON is intending to fulfill by the end of 2025 were defined. For each obligation key initiatives were formulated that support their implementation and they were assigned to the individual organizational units (business units) of TAURON Capital Group.

Reporting non-financial data

Sustainable Development Strategy is directly associated with all of TAURON Capital Group's lines of business. It streamlines both the approach to the CSR as well as the methodology for assessing the effectiveness of measures undertaken based on Global Reporting Initiative (GRI) indicators.

In 2017 TAURON Capital Group published its integrated report for the second time. Apart from the financial data the document presented the complete view of the company's operations, including its impact on the economy, society and environment.

The integrated formula provided a clear way to show the relationships and dependencies between the financial and non-financial aspects of the operations of all of TAURON Capital Group's subsidiaries and thus constituted a comprehensive and transparent document, presenting the company's operations, its Business Model, Strategy, most important changes, opportunities and risks, and also the results from the point of view of all stakeholder groups. Combining the financial data with the non-financial aspects of the company was also aimed at showing the potential reached due to the synergies between the core operations and the non-business activities.

The report was prepared in accordance with the highest reporting standards – GRI G.4, and it was subjected to external verification by an independent auditor. The Company was also audited in connection with joining the RESPECT Index – the index comprising companies listed on the stock exchange, operating in accordance with the rules of sustainable

development. In 2017, TAURON achieved, for the fifth time, a positive result and was included in this most prestigious ranking of socially responsible companies.

Key CSR projects

One of the directions of the Sustainable Development Strategy is the social and business partnership. The resulting goals are implemented, among others, through the activities of TAURON Foundation which allows for even more effective implementation of CSR goals with respect to taking care of safety of local communities and actions for public benefit.

TAURON Capital Group, operating in the south of Poland, holds the leading position in electricity distribution and its supply on the territory of the Lower Silesia, Opole, Silesia and Małopolska regions. Because of that the range of actions conducted for the benefit of the communities in which TAURON Capital Group's subsidiaries are operating, is very broad. Many projects are supported which are important for the inhabitants of the Upper and Lower Silesia, Opole, Małopolska and Podkarpackie regions. Among others, TAURON is cooperating with the Mountain Voluntary Emergency Service (GOPR), with the goal to improve safety in the mountains.

In 2017 TAURON continued also its cooperation, commenced in 2014, with the SIEMACHA Association – one of the leading NGOs in the country focusing on the implementation of projects in the area of education, sports and therapy, providing systemic assistance to children and teenagers. As part of this cooperation TAURON's patronage covered sports activities of the association, gaining the title of *TAURON – SIEMACHA's sports partner*. In 2017 such projects were supported as *Football Children's Day with TAURON* and *Juliada*.

Activities carried out by TAURON Capital Group's subsidiaries are also worth mentioning. In 2017 the campaign, implemented by TAURON Sprzedaż, called: *TAURON does not go door to door to sell electricity or gas* was continued. Its stage focused on raising awareness of customers on the energy market, in particular, in order to protect them against practices of unfair salesmen. On the other hand, TAURON Dystrybucja has been conducting, since 2013, an educational program for children and teenagers called *TAURON fuses. Switch on for the kid's benefit*. Its main goal is to improve safety by popularizing the rules of safe electricity use.



In 2017 TAURON Foundation, the Company and TAURON Dystrybucja implemented the thirteenth edition of the Houses of Positive Energy campaign, addressed to 24-hour custody and caretaking facilities, aimed at improving the living conditions of children from orphanages and educating, motivating them to act, opening prospects and enabling to set themselves apart in a positive manner. Since refreshing the campaign's formula, i.e. since 2011, 523 orphanages have taken part in the campaign. Young persons taking part in the campaign are competing for a financial prize every year in order to fulfill their youth passions, dreams and wishes.

In 2017 the Foundation also accomplished its goals, in particular, through supporting private individuals and legal entities, institutions and organisations in their activities consistent with the Foundation's goals, transferring by way of donations PLN 3 074 896.41.

TAURON is a signatory of the declaration signed on June 17, 2009 during the national conference as part of the cycle *Responsible Energy*, comprising the principles of sustainable development in the energy sector in Poland.

In 2013, the Company joined a group of signatories of the *Business declaration for the sustainable development*, consequently undertaking to get involved in the implementation of strategic goals of the *Vision of sustainable development for the Polish business 2050*.

Since 2014, TAURON has also been a member of the Responsible Business Forum.

2.11.1. Energy security

Ensuring energy security to customers is the first of the obligations included in the Sustainable Development Strategy. As an essential element of Poland's energy system, TAURON optimizes processes in individual lines of its business operations: generation, distribution and supply of electricity and heat, in order to ensure stable power supplies with high quality parameters to customers. In order to ensure continuity of power supply, TAURON not only implements new investment projects but also conducts ongoing maintenance works and upgrades of its infrastructure held as well as actively searches for new solutions.

In 2017 TAURON Dystrybucja upgraded almost 1 300 km of existing grids and 36 main power supply points. The Company also built 2 500 km of new lines including the connections. Also 4 new main power supply points were built. Investment projects are also conducted by TAURON Ciepło. In 2017 the total capacity under the agreements with customers on new connections to the heating network reached 47.2 MW.

On August 30, 2017 an agreement on financing the Low Emission Elimination Program (Program Likwidacji Niskiej Emisji – PLNE) in 8 cities of the Silesia and Dąbrowa metropolitan area covered by the low emission, i.e.: Będzin, Chorzów, Czeladź, Dąbrowa Górnicza, Katowice, Siemianowice Śląskie, Sosnowiec, Świętochłowice, was signed. TAURON Ciepło is planning to connect, under PLNE, by the end of 2022, approximately 1300 buildings which represents approximately 183 MW of heat capacity in total. Ultimately, as a result of the construction and refurbishment of the heating networks under PLNE, 100 km of modern heating networks (pre-insulated) will be built.

Under PLNE, by the end of 2017 TAURON Ciepło concluded, additionally, agreements with customers on connecting building to the heating networks with the total capacity of 14 MW.

At the same time, in order to guarantee stable supplies, TAURON Dystrybucja conducts ongoing measures minimizing the risk of failure as well as shortening the response time necessary to find the place of failure and to remedy it. It is fostered, inter alia, by the implementation of the modern system of Grid Assets Management or the increase of the grid automation level. For several years, rules of prioritisation of investment needs have been applicable in TAURON. They are aimed at addressing the expenditure to places that have the strongest impact on the improvement of electricity supplies and effectiveness of the distribution grid performance, including the enhancement of the qualitative electricity indicators.

Moreover, taking care for comfort and security of persons having contact with electricity and the equipment supplied by it, TAURON Dystrybucja has been carrying out the educational and information campaign called *TAURON Fuses* addressed to children and teenagers. In 2017 a multimedia educational platform was developed and launched, providing teachers, pupils and parents with access to educational materials. Some of them are adapted to the needs of disabled pupils. The Company is also the initiator and co-organizer of other social campaigns enhancing the level of energy supply reliability (e.g. “Stop the illegal electricity intake” campaign).

Innovative technological solutions represent an important element of the energy supply process. Accordingly, TAURON Capital Group puts strong emphasis on activities in the area of research and development, resulting not only in innovative solutions with respect to, inter alia, reducing the emission of hazardous substances from combustion processes but also innovative products and services for individual customers (e.g. Electricity with an electrician 24 h, offering “Your 300”, Preferential 0 percent interest rate for those buying boilers from TAURON).

Since 2016 the Zone of Innovation has been operating in TAURON Capital Group’s intranet, within which competitions for employees are organised. Its objective is to promote innovative organizational culture and encourage employees to submit innovative solutions optimizing daily work. After the announcement of the competition results, the proposals are archived and available in the Zone of Innovation to all users. The first competition launched in the Zone of Innovation was related to safety at work place. In 2017 all projects that won prizes in the “Safe at work” competition were implemented. They included, e.g. representing a compendium of Occupational Health and Safety, safety boards and books at TAURON Wydobycie’s Janina Coal Mine and the boards promoting the slogan “Always in good form!”, presenting simple exercises dedicated to office workers, placed at all TAURON Capital Group’s subsidiaries’ sites next to network printers. The Research and Development Team was also conducting Works on further initiatives aimed at engaging the workforce to be innovative.

2.11.2. Customer orientation

At the time of intense changes in the market environment, progressing digitization and mobility of the society also a visible change of customer expectations is taking place who are becoming more active and aware, expect a broad and comprehensive offering and modern service channels. Meeting the needs of almost 5.3 mln customers, and also orientation towards their needs is reflected in the Sustainable Development Strategy in which customer related issues represent the two leading directions: “Reliability and quality of the supply of products and services for customers” and “Orientation towards the customer and his/her needs”.

Efforts aimed at accomplishing the assumed obligations in this respect are based on many measures in each of the value chain areas, inter alia, through grid modernisation, searching for solutions enhancing customer satisfaction, ensuring security of customer interests, care for vulnerable customers and disadvantaged groups as well as through continuous education in the area of effective use electricity and its safe utilisation.

TAURON analyses market trends on an on-going basis as well as conducts cyclical customer satisfaction surveys concerning the services and products offered. Owing to such activities the Company endeavors to meet customers’ expectations, satisfying their current and future needs, to the largest extent possible. At the same time, complaint handling procedures are improved, allowing for prompt and efficient response in situations reported by customers.

All measures constituting the customer service process are conducted in compliance with the highest ethical standards.

Seeking not to limit the relations with customers only to the provision of products and services, as well as having the awareness of many threats which may potentially affect a customer in various aspects of electricity purchase or use, TAURON conducts educational campaigns addressed to electricity users.

The educational and informational functions are fulfilled, inter alia, by the action “Energy for the senior”, implemented by the Team of Customer Rights Ombudsman operating within the customer area in TAURON. The initiative is addressed to the elderly who are most exposed to activities of unfair energy vendors (salesmen). Its aim is to educate customers how to move across the energy market. The action is based on the inter-sectoral cooperation of business, public administration represented by consumer rights ombudsmen and non-governmental organisations, i.e. universities of third age, senior clubs as well as associations of retired and pensioners. Within the workshops, both lectures for a broad group of audience and intimate educational meetings are organized.

2.11.3. Customer satisfaction survey

One of key tools of customer satisfaction evaluation at TAURON Capital Group is the CSI survey (poll). This survey is conducted on a regular basis, once a year, at the turn of the 2nd and 3rd quarter, by an independent research agency. The said survey is conducted on a random basis for the selected group of TAURON customers and for a group of customers of other energy companies, such as: ENEA, ENERGA and PGE.

In accordance with the adopted plan the CSI poll, representing one of key tools of customer satisfaction evaluation at TAURON Capital Group, was conducted in June – August 2017 by an independent research agency – TNS Polska S.A.

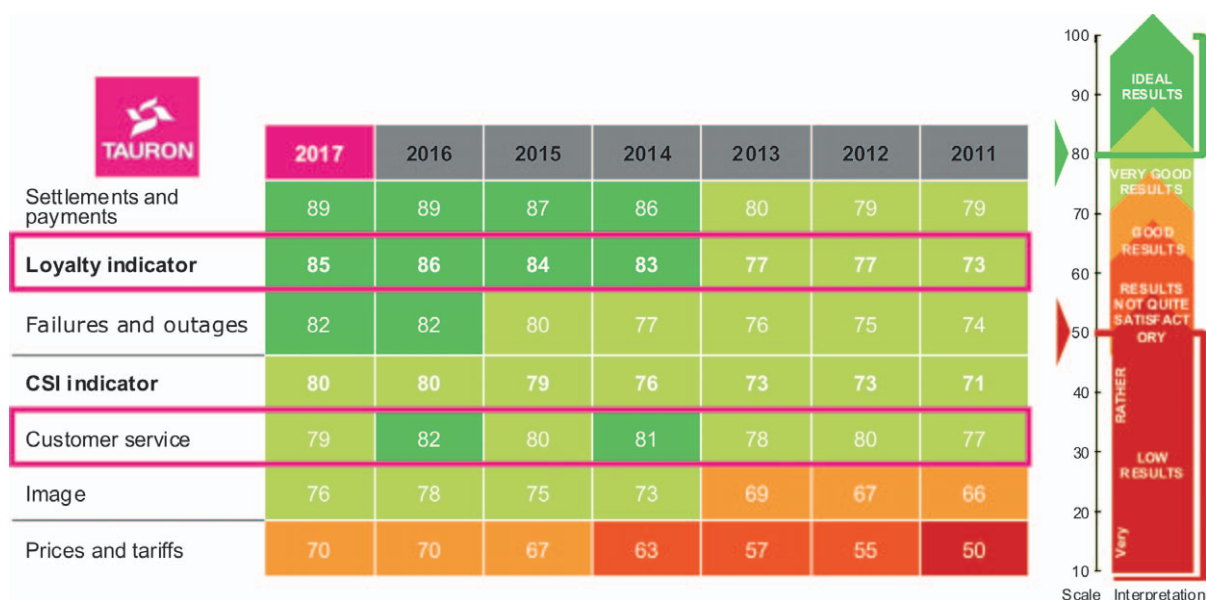
The survey covered randomly selected customers of the Household segment (1 000 customers), Small enterprises (200 customers) and Corporations and large enterprises (300 customers) and a group of customers of other energy companies, such as: ENEA, ENERGA and PGE.

As a result of conducted surveys the CSI was determined to be at the following level:

- 1) Households – 80 points,
- 2) Small enterprises – 71 points,
- 3) Corporations and large enterprises – 77 points.

The below figure presents results of surveys conducted in the Household segment, achieved by TAURON in the period from 2011 to 2017, and the level of the CIS indicator reached in 2017, as compared to other energy groups

Figure no. 52. Results of the survey covering households in 2011–2017



The below figure presents the results of the TAURON survey as compared to other Energy Groups in 2017.

Figure no. 53. Results of the TAURON survey as compared to other Energy Groups in 2017



2.11.4. Impact on natural environment

Environmental protection in the energy sector is the area controlled and regulated by the EU and national legal regulations as well as the local law, therefore, it is strongly associated with the business operations of TAURON Capital Group, in particular, in the context of contemporary challenges related to minimizing the environmental impact throughout the value chain: from mining, through generation and distribution, up to the supply of electricity and heat to final consumers. Considering the sustainable development rules, TAURON Capital Group's subsidiaries are optimizing the processes of management of the resources used (water, raw materials and materials) and are also conducting an active policy of waste management (both process related waste as well as the other waste arising as a result of the operations conducted).

The pro-ecological education conducted by the individual TAURON Capital Group's subsidiaries, addressed both to children and youth as well as to adults, also plays an important role in the area of environmental protection.

TAURON Capital Group's subsidiaries are actively engaging in many information and educational programs concerning environmental protection and energy saving and conservation which are addressed both to employees, local communities and to customers. Such actions include the educational campaign to combat low emission called "Breathe with Air", launched in 2016 and continued in 2017.

A confirmation of the above actions was the adoption in July 2017 of *TAURON Group's Environmental Policy*, in which it was stated that TAURON Capital Group accepts responsibility for taking care of natural environment and the consequences of the use of its resources for the benefit of the current and future generations, recognizing as important the social obligation to ensure environment protection both in its operations, as well as among its customer partners.

The most important actions with respect to environment protection

TAURON Capital Group's subsidiaries are conducting responsible environmental protection policy and apply due diligence to ensure that both the operations conducted as well as the implemented investment projects are compliant with the requirements and include technological advancements with respect to environment protection.

The most important actions with respect to environment protection conducted by TAURON Capital Group in 2017 included:

- 1) continuation of the construction of the 910 MW unit capacity at Jaworzno III Power Plant, whose commissioning will significantly influence the reduction of emissions of NO_x, SO₂, CO₂ and particulate matter (TAURON Wytwarzanie),
- 2) Projects started: Revamping of the mechanical sewage treatment plant with chemicals support at the Jaworzno III Power Plant – Power Plant II (TAURON Wytwarzanie), modernization of the electrofilter of unit no. 5 at Jaworzno III Power Plant in order to reduce dust emission (TAURON Wytwarzanie),

- 3) Projects started at Łaziska Power Plant: revamping of the hydrochloric acid, sodium hydroxide, iron sulphate unloading station to enable unloading of truck takers and commencing with project on protecting the mazut unit area against penetration of hazardous substances into the environment (TAURON Wytwarzanie),
- 4) General overhaul of electrofilter No. 1 and partial upgrade of lighting system to LED technology within the general overhaul of Power Unit No. 1 at Siersza Power Plant (TAURON Wytwarzanie),
- 5) Low Emissions Elimination Program implementation (TAURON Ciepło),
- 6) Revamping of hydroelectric power stations to reduce oils leakage and contamination of natural environment risks caused by installation failures (TAURON EKOENERGIA),
- 7) Launching of project associated with construction of a fish ladder at the Marszowice Hydroelectric power station (TAURON EKOENERGIA),
- 8) Construction and reconstruction of the sanitary and rainwater sewerage system for ZG Sobieski with up-connection to the municipal grid (TAURON Wydobywanie),
- 9) Revamping of transformer stations to protect the water environment (transformer stations equipped with trays) and elimination of intrusive sources of noise (TAURON Dystrybucja),
- 10) Launching of the project associated with heat recuperation at the limestone milling unit (KW Czatkowice),
- 11) Launching of the project associated with automatic road sprinkling using process water supply (KW Czatkowice),
- 12) Thermal revamping of vehicle service station and control room building (KW Czatkowice),
- 13) Revamping of the heating system – laying of external gas supply network by Polska Spółka Gazownictwa sp. z o.o. (PSG) (KW Czatkowice),
- 14) Reconstruction of the Dumping Station with construction of dust removal system for reducing random emissions (KW Czatkowice),
- 15) Pro-ecological initiatives – educational campaign developing ecological awareness of young people: “Clean up of the Pilchowski Reservoir”, where 159 students of partner schools within operating area of TAURON EKOENERGIA together with teachers and employees of TAURON EKOENERGIA completed the 19th campaign of cleaning shores of the Pilchowski Reservoir. Over 400 120-liter bags of refuse were collected (TAURON EKOENERGIA),
- 16) Continuing of the long-lasing “Our Stork” campaign, i.e. construction of successive stork nest poles and performing necessary maintenance of existing nest poles (TAURON Dystrybucja).

The exemplified above actions are aimed at ensuring the compliance of TAURON Capital Group operations with regulations applicable in protection of the environment, with consideration of local circumstances, specific nature of our business, striving at the same time to improve efficiencies.

Minimizing the negative impacts on the environment

Minimizing of the negative impacts on the environment is effectively implemented the specifics of the sector, technology advancements and access to the environmentally friendly technologies.

TAURON Capital Group is monitoring on an ongoing basis the main aspects of the direct and indirect impact on the environment of its operations.

The effects of implementing the capex plan over many years, related to adapting TAURON Wytwarzanie’s conventional sources to comply with the tightened emission requirements allowed, in 2017, for the operations of the generation units at values well below the NO_x, SO₂, dust emission standards currently in force and in many cases close to the values of the future environmental requirements.

The below table presents the estimated levels of NO_x, SO₂, dust and CO₂ emissions from fuel combustion for electricity generation purpose for selected TAURON Capital Group’s subsidiaries in 2017.

Table no. 19. Annual levels of NO_x, SO₂, dust and CO₂ emissions from fuel combustion for electricity generation purpose for 2017

No.	Subsidiary name	SO ₂ emission (Mg)	NO _x emission (Mg)	Dust emission (Mg)	CO ₂ Emissions (Mg)
1.	TAURON Wytwarzanie, including:	13 385	13 701	733	14 654 964
	Oddział Jaworzno III	3 423	5 438	143	6 919 502
	Oddział Łaziska	3 430	3 302	182	3 879 920
	Oddział Łagisza	2 343	2 294	161	1 869 428

No.	Subsidiary name	SO ₂ emission (Mg)	NO _x emission (Mg)	Dust emission (Mg)	CO ₂ Emissions (Mg)
	Oddział Siersza	2 686	1 706	177	1 538 045
	Oddział Stalowa Wola	1 503	961	70	448 069
2.	TAURON Ciepło, including:	3 522	1 610	217	1 913 711
	ZW Bielsko-Biała	979	278	29	500 989
	ZW Kamienna Góra ³	52	17	6	17 208 ³
	ZW Katowice	1 572	660	84	877 950
	ZW Tychy	591	543	18	422 857
	CC Olkusz	143	39	10	40 239
	CC Zawiercie	127	43	9	36 079
	Other (local heating plants) ³	58	30	61	18 38
3.	KW Czatkowice	3	6	14	5 909
	Total	16 910	15 317	964	16 574 584

¹ Total emission of dust from fuel combustion.

² CO₂ emission within the meaning of EU ETS – according to Annual Reports on CO₂ Emission (status in January 2017, the level of emission prior to verification).

³ Installations not covered by EU ETS. Estimated value, prior to verification at the end of the 1st quarter of 2017.

TAURON Capital Group accepts responsibility for taking care of natural environment and the consequences of the use of its resources. In 2017 TAURON Capital Group's subsidiaries accrued fees in the total amount of approximately PLN 38.6 million, i.e. approximately 8% more than in 2016.

The below table presents the level of fees for the use of the environment for business purposes due for 2017 at selected TAURON Capital Group's subsidiaries.

Table no. 20. The level of fees for the use of the environment for business purposes due for 2017

No.	Subsidiary name	Fees for use of the environment for business purposes due for 2017 (PLN thous.)
1.	TAURON Wytwarzanie	21 012
2.	TAURON Wydobywanie	13 372
3.	TAURON Ciepło	4 074
4.	TAURON Dystrybucja	100 ²
5.	KW Czatkowice	50
6.	TAURON Dystrybucja Serwis	12 ²
7.	TAURON Obsługa Klienta	1.9
8.	TAURON EKOENERGIA ¹	< 0.8
9.	TAURON Sprzedaż	1.6
	Total	38 623.5

¹ Total amount below PLN 800 a year is not subject to the statutory exemption from paying fees for the use of the environment for business purposes.

² Estimate data, the annual settlement has not been closed.

Sustainable development

TAURON Capital Group is taking actions aimed at improving energy efficiency in order to reduce or not increase the consumption of fuels and monitoring climate impact.

In 2017 within TAURON Capital Group a number of investment projects were submitted, associated with the improvement of energy efficiency in the Distribution and Mining lines of business, whose direct environmental effect is the reduction of CO₂ emission. This effect was partly confirmed through the allocation of the so-called "white" certificates as a result of the tender, resolved in July 2017, carried out by the President of ERO based on the rules in force before, i.e. 2016 rules. The remaining part of the effect will only be confirmed in 2018 through the allocation of the property rights certificates according to the new principles of the amended energy efficiency law.

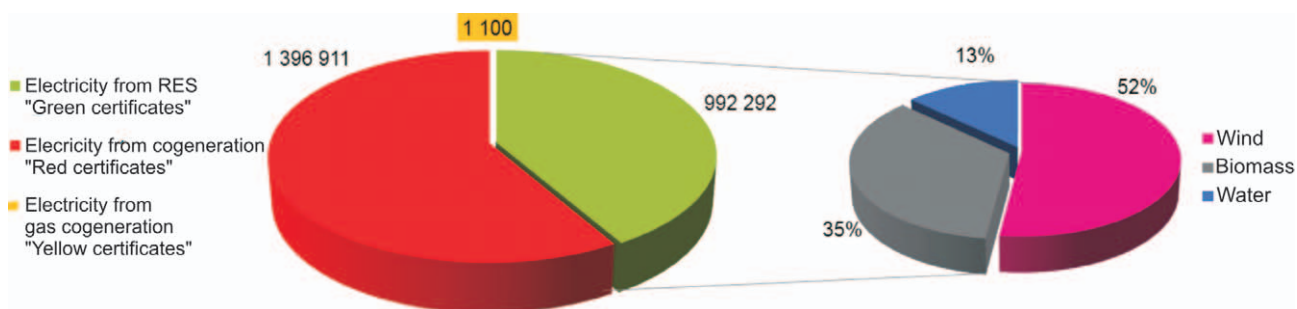
Furthermore, in 2017 an energy efficiency audit was completed for all of TAURON Capital Group's Lines of Business in order to identify optimization areas.

Although the core production of TAURON Capital Group is based on the traditional energy relying on solid fossil fuel, TAURON Capital Group, in its basic volume of production, includes high efficiency generation of electricity and heat in the co-generation system and supplements its offering with electricity generated from renewable sources or in generation based on gas which is reflected in the quantity of property rights to the certificates of origin of electricity generated:

- 992 292 MWh, so-called “green” certificates,
- 1 396 911 MWh, so-called “red” certificates,
- 1 100 MWh, so-called “yellow” certificates.

The below figure presents the structure of the property rights to the certificates of origin obtained by TAURON Capital Group in 2017.

Figure no. 54. Structure of the property rights to the certificates of origin (MWh)



Management of by-products

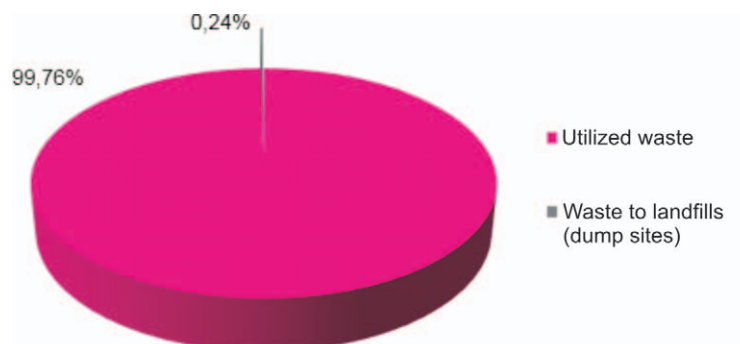
TAURON Capital Group, caring for the natural environment, minimises the quantity of waste deposited in the environment through their introduction to the market, to be used as substitutes for natural materials.

Waste generated by TAURON Capital Group is mainly used in the construction, road building and mining sector. The waste is broadly used by cement and concrete plants. It was also used as the material for reclamation of unfavourably transformed areas.

In 2017 TAURON Capital Group’s conventional power generation segment generated approximately 2.2 million Mg of furnace waste, including 99.76% that was managed on the market and only 0.24% was deposited directly at the dumping sites.

The below figure presents the structure of energy waste management.

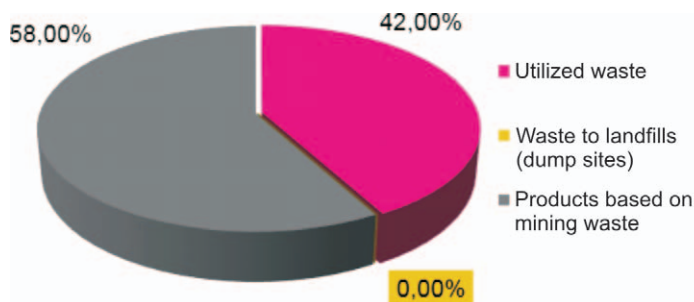
Figure no. 55. Structure of energy waste management



In 2017 hard coal mining at TAURON Capital Group generated 1.1 million Mg of mining waste and 1.4 Mg of full value aggregate products. The products obtained were used in various industries, among others in the construction and mining. waste comprised aggregate and sludge originating from coal processing and preparation. 100% of the waste generated was used for the business purposes.

The below figure presents the structure of mining waste management.

Figure no. 56. Structure of mining waste management



TAURON Capital Group is seeking to implement the model of closed circuit (circular) economy. It is planned that the maximum of generated process waste is used within TAURON Capital Group, consequently reducing the consumption of natural resources and the product's carbon footprint.

2.11.5. Sponsoring activities

In 2017 TAURON introduced significant changes to its internal regulations related to the sponsoring activities. *New Rules of conducting sponsoring activities by TAURON Group* taking into account the *Best practice with respect to conducting the sponsoring activities by companies with the State Treasury shareholding. TAURON Group's 2018–2025 sponsoring strategy* was adopted. The sponsoring activities were conducted based on the *Plan of conducting the sponsoring activities by TAURON Group in 2017*, adopted by the Management Board and granted a positive opinion by the Supervisory Board.

The main objective of TAURON Capital Group's sponsoring activities is to support its business and communications goals in reference to *TAURON Group's 2016–2025*.

The sponsoring activity was carried out based on negotiated agreements, according to standardized provisions. Moreover, this activity was monitored, analysed and reported on an on-going basis, through detailed reports on the implementation of sponsoring agreements, surveys and analyses conducted in quarterly and annual cycles by specialized external entities and the supervision of companies of TAURON Capital Group.

In accordance with the implemented procedures, the assessment of effectiveness of the activities conducted was carried out, through opinion surveys, measurement of the value and size of brand exposure in media, in the context of the activities conducted, measurement of implementation of sales targets, with reporting of the obtained results. As a result of the promotion effectiveness measurement, an independent research entity initially estimated the advertising equivalent in relation to activities completed in 2017. Comparing the summarised value obtained in this way to the sum of all expenditure arising from sponsoring agreements the ROI ratio at a level of approximately PLN 7.2. was obtained. It means that each zloty (PLN) spent for that purpose generated promotional benefits to TAURON Capital Group whose preliminary value is independently estimated at approximately PLN 7.2. The ongoing verification of the aforementioned value should not significantly change the value of this ratio.

The confirmation of the financial effectiveness of the activities conducted is the high positioning of TAURON brand in an independent research report, *Sponsoring Monitor 2017*, which is the only source of this type of information on the Polish market. According to this report, TAURON is ranked seventh in the TOP 10 list of sponsors and it is the most recognized (noticeable) sponsor versus its direct competitors. More than 200 brands were classified in the ranking, which is the result of opinion polls. In spite of relatively lower outlays on sponsoring versus some of its direct competitors, TAURON achieved a better result, being ranked 3 positions higher than the next group and finding itself among the very top group of the most recognized (noticeable) sponsors. Because of a relatively low level of TAURON Capital Group's sponsoring expenditures its position in this ranking can be regarded as truly very high. Taking into account an indicative value of Poland's sponsoring market according to the *Sponsoring Insight* data and the data from the above mentioned ranking it can be extrapolated that the effect achieved gives TAURON Capital Group a 9–11% market share – which in comparison to other power sector entities is a result that puts TAURON in a position of the leader of efficiency and effectiveness of the funds invested in these activities.

In 2017 sponsoring activities were carried out by TAURON and TAURON Sprzedaż. Both companies implemented 24 projects with 16 customers in total. The preliminary data related to accomplished advertising equivalents referring to activities ended in 2017 indicate that the best results were achieved by activities under projects related to professional sports, i.e. KS Vive TAURON Kielce, Lang Team (among others Tour de Pologne) and Polish Ski Association. Among projects underway such activities as sponsoring of TAURON Arena Kraków were characterized by a strong potential.

3. RISK MANAGEMENT AT TAURON CAPITAL GROUP

3.1. Risk management objective and principles

Risk at TAURON Capital Group is understood as an uncertain occurrence or a group of occurrences that, in case of materializing, will have an impact on achieving by TAURON Capital Group of its defined strategic goals, both negatively (threat), as well as positively (opportunity).

In line with its Strategy the Company is implementing the process of managing the risk related to the operations of TAURON Capital Group. The primary goals of risk management include ensuring the broadly understood security of TAURON Capital Group's operations. In particular, risk management is to ensure increased predictability of TAURON Capital Group achieving its strategic goals, including sustainable financial generation of its financial results.

TAURON Capital Group's risk management:

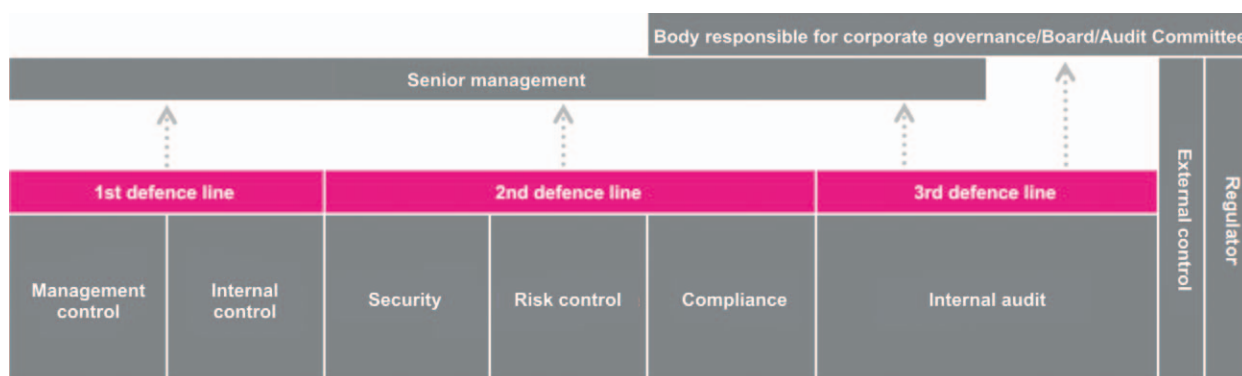
- 1) covers all elements of the value chain,
- 2) provides centralized risk measurement, monitoring and control function, and also ability to evaluate the full risk profile in the organization and coherent risk management principles,
- 3) ensures independence of the risk taking function from its control and monitoring,
- 4) ensures a clear split of competences and responsibilities, in particular by introducing the risk ownership function,
- 5) is an active process, focused on an appropriately early identification of threats, allowing for taking preventive measures,
- 6) is a systematic and continuously improved process which allows for aligning it on an ongoing basis to TAURON Capital Group's specifics and organizational structure, as well as to the changing environment,
- 7) places a strong emphasis on developing awareness, training and encouraging personnel to use the knowledge of risks in daily activities,
- 8) co-creates at TAURON Capital Group the internal audit system, constituting, along with the compliance and security management functions, an element of the three line defense.

3.2. Risk management using the "Three Defense Lines Model"

In order to ensure security of the functioning of the organization the "Three Defense Lines Model" is implemented by TAURON Capital Group, comprising internal control (audit), independent control (audit) within the second defense line and institutional control (audit). In particular, the risk management function co-creates a system of internal control (audit) at TAURON Capital Group, constituting an element of the second defense line, next to the function of ensuring the compliance and security management

The below figure presents the "Three Defense Lines Model".

Figure no. 57. Three Defense Lines Model

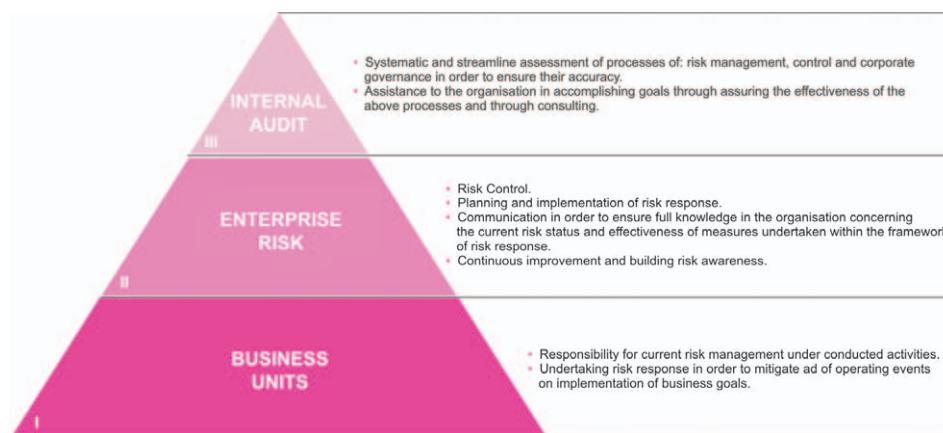


Functions of the individual defense lines:

- First Line of Defence is:** Business units obliged to perform ongoing control embedded in the tasks implemented and the functional control.
- Second Line of Defence is:**
 - a) function of risk management implemented in accordance with the adopted *Corporate risk management strategy at TAURON Group* and detailed policies related to main risk categories,
 - b) function of ensuring compliance understood as adjustment of the organisation to the applicable legal regulations,
 - c) function of ensuring information security and technical safety.
- Third Line of Defence is:** internal audit responsible for creating the internal control system and adequate functioning of the three defense lines model.

The below figure presents risk management as a function of the second defense line.

Figure no. 58. Risk management as a function of the second defense line

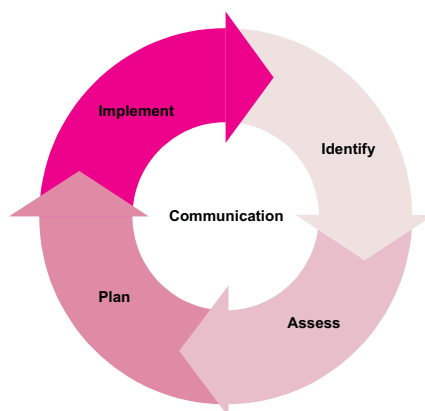


3.3. Risk management process and its participants

The process of enterprise risk management ensures the comprehensive and consistent risk management rules linked with each other in terms of methodology and information. The process of enterprise risk management means continuous measures comprising risk identification, risk assessment, planning of risk response, implementation of the adopted risk response and communication between risk management process participants.

The below figure presents the risk management process.

Figure no. 59. Risk management process



Risk identification – consisting in determining the potential events that may affect the implementation of business goals of TAURON Capital Group.

Risk assessment – consisting in determining of potential financial and non-financial effects of risk materialisation influencing the implementation of specific goals.

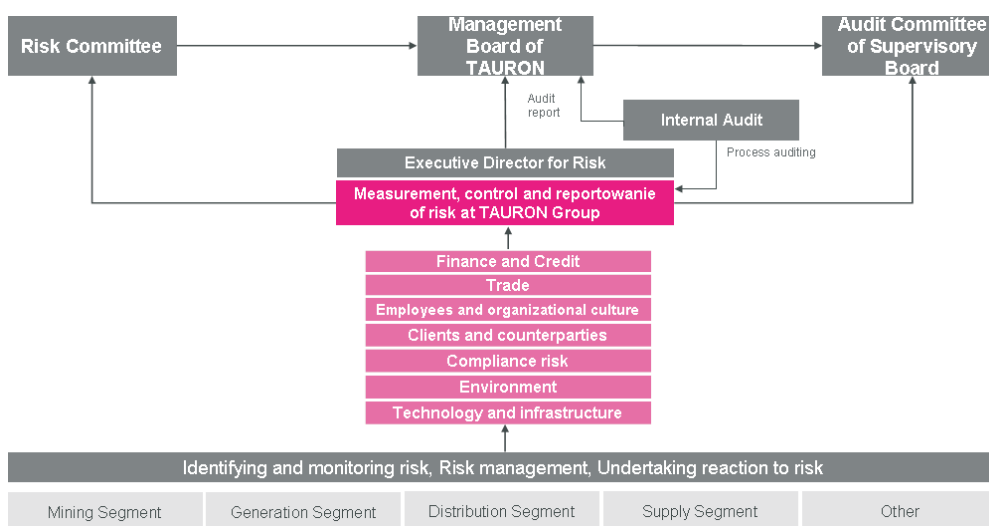
Planning – consisting in preparation of the dedicated response to the risk identified in order to achieve the desirable goals.

Implementation of risk response – consisting in practical implementation of the responses to identified risk prepared in the planning process.

Communication – consisting in continuous information flow among participants of the process which should ensure full knowledge concerning the current risk status and effectiveness of activities conducted within the response to risk. The periodical risk reporting is also an element of this process

The below figure presents the risk management process.

Figure no. 60. Diagram of the management risk communication



3.4. Architecture of the enterprise risk management system (ERM³)

The enterprise risk management system (ERM), implemented at TAURON Capital Group’s level, constitutes a set of rules, standards and tools allowing for implementing the primary goal of risk management which is, broadly understood, ensuring safety (security) of TAURON Capital Group’s operations. This system is governed by the document entitled *Corporate risk management strategy at TAURON Group* that defines TAURON Capital Group’s corporate risk management rules and its goal is to ensure the consistency of managing the individual risk categories that were detailed in separate regulations, aligned with the specifics of the individual threat groups.

The below figure presents the ERM system.

Figure no. 61. ERM system



³ Enterprise Risk Management

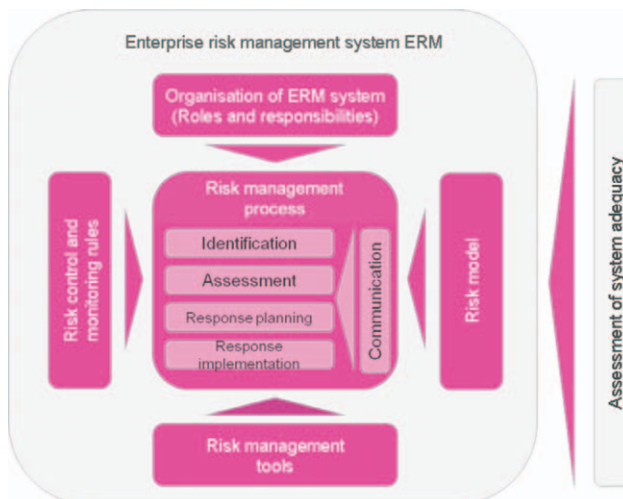
The detailed description of the rules and tools for managing the individual risk categories is provided further on in this section.

The risk management process described in detail in section 3.3 is the center (core) of the system. Moreover, the architecture of the ERM system comprises elements to ensure effective functioning of the process, including:

- 1) risk management tools,
- 2) risk models,
- 3) control and monitoring rules,
- 4) organisation of the ERM system

The below figure presents the architecture of the ERM system.

Figure no. 62. Architecture of the ERM System



Risk management tools comprise elements allowing for effective implementation of individual stages of the process, such as risk identification questionnaire, risk card, risk register, risk model, risk map, risk tolerance

Within the framework of **ERM system organisation**, roles and responsibilities of risk management process at TAURON Capital Group were defined. Participants of the process include, in particular: TAURON Supervisory Board, Audit Committee of TAURON Supervisory Board, Management Board of TAURON, Risk Committee, Executive Director for Risk at TAURON, Executive Director for Audit at TAURON, management boards of subsidiaries, Risk Owners, Risk Management Coordinators and Executors of risk response.

The below figure presents the organizational structure and documentation of the risk management process.

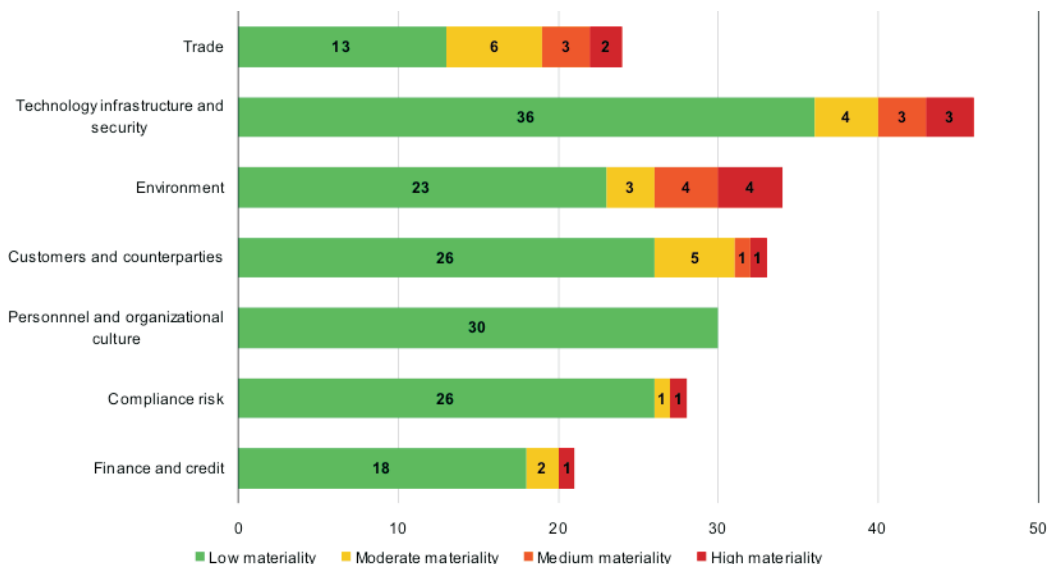
Figure no. 63. Organisational structure and documentation of the risk management process

Supervisory Board							
Audit Committee							
Management Board							
Management	Risk Committee					Internal audit	
	Team for Commercial Risk Management			Team for Financial and Credit Risk Management			
Organisational Regulations/ Bylaws	Strategy of enterprise risk management in TAURON Group					Internal Audit regulations	
	Policy of commercial risk management in TAURON Group	Policy of operating risk management in TAURON Group	Policy of risk management in projects in TAURON Group	Policy of credit risk management in TAURON Group	Policy of management of risk specific in financial area in TAURON Group		
	Market Risk Team	Corporate Risk Team		Credit Risk Team	Executive Director for Finance		
	Executive Director for Risk						Executive Director for Internal Audit
	Reporting to Supervisory Board, Management Board of TAURON, Members of Risk Committees						Reporting to the President of the Board

Risk model defines a consistent risk classification, enabling a consistent and comprehensive capturing of risk across TAURON Capital Group. Each risk identified is assigned to specific categories and sub-categories.

The below figure presents the main risk categories defined by TAURON Capital Group, including the number of key threats:

Figure no. 64. Number of risks monitored, broken down into categories



As part of the implementation of the **risk control and monitoring rules** the Management Board of TAURON approves risk tolerance, taking into consideration the specific nature and scope of operations of TAURON Capital Group. The level of the tolerance defines the value of the maximum permitted risk exposure at TAURON Capital Group and the rules of measurement of individual risks in the organisation ensure the consistency of risk measurement with the applied tolerance definition. The risk tolerance constitutes basis for allocation of its level to the global limits dedicated to a single risk or many key risks. Subsequently global limits are allocated to operating limits within the key risk management.

A supplementary tool used for risk monitoring and control comprises the Early Warning System based on the catalogue of Key Risk Indicators – KRI and Early Warning Indicators – EWI. The system functioning based on the KRI and EWI indicators enables an appropriately early identification of threats by measuring the causes of the individual threats. At the same time this system Allows for an appropriately early taking of remedy actions, before the individual threats actually materialize.

3.4.1. Commercial (trading) risk management

TAURON Capital Group’s commercial (trading) risk management is understood as reducing unplanned volatility of its operating result, due to price fluctuations on the commodity markets and volume deviations in the individual areas of TAURON Capital Group’s commercial (trading) operations. The commercial (trading) risk, due to the specifics of the operations conducted, constitutes one of TAURON Capital Group’s key risks. TAURON Capital Group is made up of subsidiaries operating both in the Mining and the Generation Lines of Business as well as in the Supply Line of Business. Due to the opposing positions in these Lines of Business the risk is, to a certain degree, naturally diversified. However since these Lines of Business do not fully offset each other, and due to the diverse nature of the exposures, TAURON Capital Group is displaying sensitivity to the volatility of the prices of electricity, gas and related products.

In order to efficiently manage this group of risks the commercial (trading) risk management system was established, tied on the organizational and information level to TAURON Capital Group’s process used to develop a commercial (trading) position hedging strategy. In particular *TAURON Group’s commercial (trading) risk management policy* introduces an early warning system and a system used to limit risk exposure in the individual commercial areas. The basic operating measure of TAURON Capital Group’s market risk is Value at Risk, defining the maximum admissible change of the position’s value over the given time horizon and at a specific probability level. Value at Risk represents a dynamic risk measure which in contrast to static measures allows for determining potential negative effects before their factual occurrence. Due to the limitations of the statistical measures the commercial (trading) risk

management system also uses a number of supplementary risk measures enabling a safe operation of the commercial (trading) areas.

The organizational structure of the commercial (trading) risk management system envisages a strict split of competences as part of which risk management is decentralized, where the supervision and risk control are performed centrally at TAURON's level. In particular an element of the organizational structure of the commercial risk management system is the split of TAURON Capital Group's trading operations into: Front Office, Middle Office and Back Office. The goal of such a split of tasks is to guarantee the independence of the operating functions carried out by the Front Office from the risk control carried out by the Risk Area, and it ensures an appropriate level of operational flexibility. For the needs of the risk management process such placement of responsibility is assumed in order to ensure an optimal approach to the given type of threat, especially taking advantage of the economy of scale and the synergy effect. Such approach ensures efficiency of the commercial processes conducted and appropriate supervision over one of the main business processes conducted by TAURON Capital Group.

The below figure presents a breakdown of TAURON Capital Group's trading operations.

Figure no. 65. Breakdown of TAURON Capital Group's trading operations



3.4.2. Financial risk management

As part of financial risk management TAURON Capital Group is managing the FX risk and interest rate risk, based on the rules and standards in line with the best practices in this respect. The main goal of managing these risks is to minimize the sensitivity of TAURON Capital Group's cash flows to the financial risk factors and to minimize the financial costs and the hedging costs as part of a transaction with the use of derivative instruments. In cases when it is possible and economically justified TAURON Capital Group uses the derivative instruments the characteristic of which allows for applying the hedging accounting.

With respect to the financial risks TAURON Capital Group also identifies and actively manages the liquidity risk understood as a potential loss or limitation of the ability to pay current expenses, due to an inadequate value or structure of liquid assets in relation to short term obligations or an insufficient level of the actual net inflows from the operations. TAURON Capital Group's liquidity position is monitored on an ongoing basis for any potential deviations from the assumed plans and the availability of external sources of financing the amount of which substantially exceeds the expected short term demand, mitigates the risk of losing liquidity. For this purpose TAURON applies specific rules of determining the liquidity position, both of the individual subsidiaries, as well of entire TAURON Capital Group, which allows for securing funds to cover a potential liquidity gap, both by allocating funds among subsidiaries (cash pool mechanism), as well as with the use of external financing, including overdrafts.

Risk associated with financing is identified at three levels:

- 1) Risk of failure to raise new financing, understood as a lack of possibility to acquire new funding, which would result in suspension of the investment process or the lack of possibility to re-finance the current debt,
- 2) Risk of cost increase understood as the growth in financing margin,
- 3) Risk of termination of financing in case of breach of covenants and the necessity to repay current financing.

Within the mitigation of risk associated with financing TAURON Capital Group Company conducts a policy of funding acquisition at least 24 months in advance in relation to the planned date of its use. It means that TAURON Capital Group should hold signed programs of guaranteed financing or hedge this financing through collection of funds on TAURON Capital Group's accounts. Such a policy is mainly aimed at ensuring a higher comfort in acquisition of

external financing and reducing the risk of incurring new liabilities under unfavourable market conditions. At the same time, the Company diversifies financing sources by active measures with respect to the acquisition of various debt instruments, also outside the Polish market.

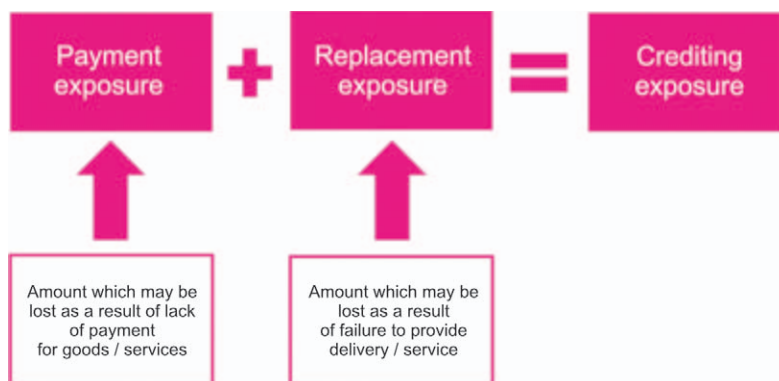
3.4.3. Credit risk management

Credit risk is understood as a possibility to incur a loss due to trade partners (counterparties) failing to fulfill their contractual obligations (default). TAURON Capital Group is using a decentralized credit risk management system, however the control, limiting and reporting of this risk category is carried out centrally, on the parent Company level. TAURON Group's Credit Risk Management Policy in place defines credit risk management principles on TAURON Capital Group's level, aimed at effectively minimizing the impact of this risk on achieving TAURON Capital Group's goals.

Credit risk management is carried out by controlling the credit exposure generated upon the conclusion of contracts by TAURON Capital Group's subsidiaries. The general rule is that prior to concluding a contract every entity is subjected to an examination of its financial standing and receives a credit limit which caps the maximum exposure due to the given trade. Credit exposure is, in this context, understood as an amount that may be lost if a counterparty fails to fulfill its obligations (defaults) within a certain time (taking into account the value of collaterals contributed thereby). Credit exposure is calculated as of the current day and is split into exposure due to payment (payment exposure) and replacement exposure.

The below figure presents credit exposure components.

Figure no. 66. Credit exposure components



Based on the exposure value and the evaluation of the financial standing of specific customers the credit risk value that TAURON Capital Group is exposed to is calculated using the Credit Value at Risk method. It is an analytical method that, based on the mathematical Monte Carlo simulation model, calculates the exposure value based on the total loss probability distribution.

3.4.4. Operational risk management

Operational risk is understood as a possibility to incur a loss due to inappropriate or unreliable internal procedures, human and system errors or as a consequence of external events. It also includes legal risk, reputational risk and non-compliance risk. Operational risk, due to the specific nature of the threats and the ability to manage them, constitutes a separate group of risks affecting TAURON Capital Group's operations. This risk is a complex issue, occurs in every process and type of operations, it is multi-dimensional and applies to various types of activities and operations. In particular, the exposure to the operational risk factors is related to the size and complexity of the organizational structure, the number and complexity of IT systems and to the number of business processes conducted. The operational risk is characterized by the lack of the ability to totally eliminate its sources, and the analysis of its factors and parameters (among others, frequency and severity), and also the evaluation thereof requires the use of complex measurement and analysis methods.

In order to effectively manage the operational risk TAURON Capital Group is using appropriate tools, presented on the below diagram. In particular, they include the operational risk profile, operational events database, global operational risk limit and the related system of operational limits and also the early warning system operating on a large scale.

The below figure presents risk management system tools.

Figure no. 67. Risk management system tools



Global operational risk limit is the basic tool for the operational risk control and represents the allocation of risk tolerance adopted by TAURON Capital Group. The global operational risk limit can be subsequently allocated to TAURON Capital Group's individual lines of business, the operational risk sub-categories as well as to the specific operational risks.

Operational risk profile is aimed at identifying areas, processes or activities with an excessive exposure to threats stemming from specific operational risk factors. Operational risk profile is expressed in particular in the structural dimension that includes types of operational events, TAURON Capital Group's organizational structure and processes, in the scale dimension that includes estimated potential losses, taking into account especially historical values of actual losses, as well as the tools used to mitigate the threats. For the needs of measuring the operational risk and defining the operational risk Profile the individual types of the operational risk are broken down (due to the nature of the occurrence thereof) into continuous and one-off risks.

Early warning system is defined in order to monitor the operational risk level for each identified threat. Early Warning Indicators (EWI) are selected from the Key Risk Indicators (KRI) set as the ones that are subject to continuous control with respect to the caution thresholds set for them, i.e. acceptance, mitigation and escalation thresholds.

Operational events database is created for the needs of identifying new risk factors, and in parallel in order to define the risk profile for TAURON Capital Group. It allows for keeping the records of cases that are characterized by a potential or actual loss for the organization. The goal of maintaining the operational events database is to determine the frequency and severity of the individual operational risk factors, as well as the areas and processes they occur in.

Risk identification questionnaire is a document in the form of a table form that constitutes a tool supporting the performance of the risk management process with respect to risk identification, specifying the detailed information that should be collected in this process.

3.4.5. Project risk management

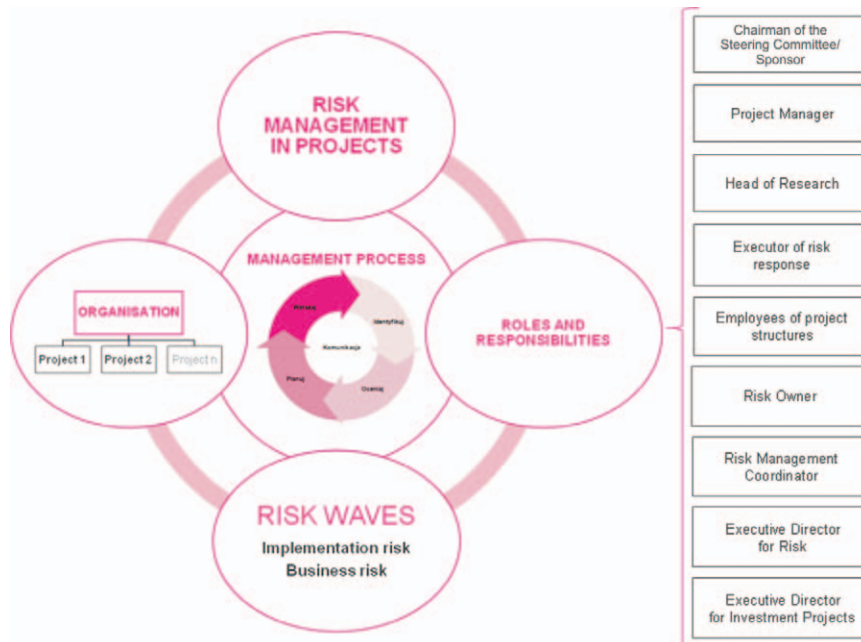
TAURON Capital Group is conducting a number of investment projects in many lines of its business operations. These projects, due to their scale and often very complicated nature of implementation, represent a source of threats that may have an impact on the schedule, budget or quality of the final products. Systematic use of the provisions of *TAURON Group's Project Risk Management Policy* is aimed at mitigating these risks, supporting at the same time the accomplishment of the organization's strategic goals. This regulation, in particular, defines the basic principles of project risk management, ensuring coherence, comprehensive approach and unequivocal understanding in this area. The goal of the actions taken is to achieve the required probability of the project's completion while complying with the defined schedule, budget and quality of the products received. The overall objective is to obtain the expected benefits from the project's completion and to achieve TAURON Capital Group's strategic goals.

Project risk management is also applicable to managing the risk stemming from the projects and having an impact on the organization. The process of managing the risk stemming from the projects includes identification, valuation of such risks, defining and monitoring early warning indicators as well as planning and implementing actions related to managing such risks. In case of risks having an impact on the organization the risk valuation is made as the absolute value of the impact including indicating the impact period broken down into individual accounting periods, in reference to the assumed EBITDA or the assumptions made in the organization for the long term projections. In case of the most important risks having an impact on the organization the Plans of reactions to the risk and back-up

Plans are developed. The evaluation of project risks and risks stemming from the projects for the organization is taken into account when making the key decisions related to launching and implementing such projects.

The below figure presents the project risk management model.

Figure no. 68. Project risk management model



3.5. Description of the most significant risks related to TAURON Capital Group's operations

The below table presents the most significant risks identified for TAURON Capital Group.

Table no. 21. Most significant risks identified for TAURON Capital Group

No.	Risk name	Risk description	Risk trend	Risk response
Finance and credit				
1.	Interest rate and FX rate risk	Risk related to an unfavorable impact of interest rates and FX rates on TAURON Capital Group's financial results.	→	<ul style="list-style-type: none"> Ongoing monitoring of risk exposure in order to minimize negative impact of changes to the market factors, Transfer of risk through the use of derivative instruments
2.	Liquidity / financing risk	Risk related to the manner of financing operations, due to the enterprise's capital structure.	→	<ul style="list-style-type: none"> Diversification of the sources of financing including arranging guaranteed financing programs and securing alternative sources of financing. Implementing the central financing policy. Analyzing the market and the availability of the sources of financing. Monitoring the schedules and the date of announcing the financing program.
3.	Credit risk	Risk related to a potential occurrence of overdue accounts payable or a conclusion of a contract with a counterparty that will turn out to be insolvent.	→	<ul style="list-style-type: none"> Regular monitoring of the counterparties' financial standing. Periodic customer scoring, credit rating of each customer prior to submitting an offer/concluding a contract. Use of protection mechanisms (hedging) in commercial agreements.
Trade				
4.	Market risk	Risk related to an unfavorable change of prices on the electricity market and on the related products markets, having a negative impact on TAURON Capital Group's financial results.	↗	<ul style="list-style-type: none"> Monitoring and updating the hedging strategy. Ongoing monitoring of exposure to the above mentioned risk in order to minimize negative impact of changes to the market factors. Limits (caps) on trade positions within risk mandates.

No.	Risk name	Risk description	Risk trend	Risk response
Workforce and organizational culture				
5.	Social dispute risk	Risk related to collective disputes, strikes, social conflicts being the consequence of a lack of the personnel's satisfaction with the economic and social situation.	→	<ul style="list-style-type: none"> • Conducting social consultations with respect to the planned changes. • Conducting a policy of dialogue with the workforce. • Preparing and implementing motivational solutions for the personnel. • Standardizing the tasks and requirements towards the personnel. • Developing organizational culture based on values. • Conducting active internal communications on personnel matters.
6.	Human resources risk	Risk related to the temporary or permanent loss of specialized staff and difficulties in its restoration.	↘	<ul style="list-style-type: none"> • Taking measures aimed at developing a model that would enhance workforce motivation • Developing competences by training the personnel.
7.	Occupational Health and Safety Risk	Risk related to accidents at work resulting from non-compliance with the Occupational Health and Safety as well as Fire Protection regulations	→	<ul style="list-style-type: none"> • Implementing manuals and rules defining safe organization of work. • Stimulating workforce development by conducting periodic Occupational Health and Safety and additional specialist training. • Analyzing and updating, based on needs, the evaluation of the professional risk at individual work stations (positions). • Maintaining a high standard of equipping the personnel with protection means and enforcing the appropriate use thereof. • Performing measurements of harmful factors in the work environment.
Customers and contractors				
8.	Customer service risk	Risk related to non-compliance with the customer service standards.	→	<ul style="list-style-type: none"> • Monitoring and analyzing external customer satisfaction indicators and indicators related to complaints. • Taking additional measures, e.g. with respect to internal regulations, defining standards of conduct as a result of the analysis of indicators. • Developing key account managers' competences and skills. • Continued raising of customer service standards.
9.	Risk related to performance of agreements by subcontractors	Risk related to improper performance by subcontractors of the works commissioned, termination of the agreement and delays, changes to the budget, scope related thereto	↘	<ul style="list-style-type: none"> • Concluding agreements with subcontractors in accordance with TAURON Capital Group's standards. • Analyzing the performance of the subject of the agreement, examining the quality of services provided by subcontractors. • Evaluating the financial standing and credibility of the subcontractors.
10.	Purchasing process risk	Risk related to the volatility of the situation on the supplies/services market, volatility of demand for the given type of product/supply/service on the market, decline of the availability of supplies/services of appropriate quality, leading to the purchase order value increase risk.	→	<ul style="list-style-type: none"> • Preparing a plan of purchase orders and updating thereof. • Aggregating purchases of selected product groups. • Consolidating purchase orders. • Concluding long term agreements. • Taking into account the price risk related to commodity prices/FX rate fluctuations in contracts with contractors
11.	Volume and margin risk	Unfavorable changes or terminations of commercial agreements by customers, leading to the declining revenue from operations; loss and lack of acquiring new customers.	↗	<ul style="list-style-type: none"> • Conducting marketing campaigns, acquiring new customers. • Taking actions focused on retaining the existing customers and recovering the lost ones. • Ongoing updating of the offering, launching sales of multi-package type products.

No.	Risk name	Risk description	Risk trend	Risk response
Compliance risk				
12.	Internal fraud risk	Appropriation or temporary use of the company's assets, destruction of TAURON Capital Group's property, abuse of work position to derive various types of personal gain by forcing specific behavior of customers while performing work related activities.	↘	<ul style="list-style-type: none"> • Strict adherence to internal procedures aimed at achieving protection against abuse (security procedures, reviews of authorizations). • Conducting compliance type activities. • Promoting best practices, improving procedures, training. • Enforcing and promoting the provisions of <i>TAURON Group's Code of Responsible Business</i> in force.
13.	External fraud risk	Third party actions aimed at, among others, theft, robbery, physical burglary, computer hacking, information theft, forgery.	↘	<ul style="list-style-type: none"> • Monitoring potential and actual security incidents. • Anti-virus protection of workstations. • Physical protection of facilities. • Conducting security tests.
14.	Risk of unethical behaviors	Risk related to the occurrence of behaviors not in line with the generally accepted by the society social coexistence rules, moral standards and lobbying.	↘	<ul style="list-style-type: none"> • Functioning of the whistleblowing system in the organization. • Lack of organizational culture based on TAURON Capital Group's values and principles. • Training, building awareness through meetings, TAURONET, press materials. • Functioning of Ethics Committees in the organization operating based on the adopted regulations.
15.	Legal risk	Risk related to non-compliance with the legal regulations, misinterpretation of the new provisions and regulations, court disputes (litigations), requirements imposed by URE/UOKiK/KNF/GIODO, etc.	→	<ul style="list-style-type: none"> • Continuous monitoring of the legal environment and changes to the legal regulations. • Implementing the required changes to internal regulations. • Appointing working groups tasked with preparing and implementing the required changes stemming from the legal environment. • Continuous cooperation with the authorities overseeing the energy market and the capital market. • Training for the personnel on the changes being introduced.
16.	Risk of breaching contractual provisions (default)	Risk related to the possibility of being in default in performing the obligations under agreements concluded with counterparties.	→	<ul style="list-style-type: none"> • Optimizing the sales and service processes. • Updating and adapting agreement samples to the changes to the law. • Monitoring complaints and proceedings of URE/UOKiK.
Environment				
17.	Reputational risk	Current and future impact on the company's revenue and capital due to the negative public opinion backlash.	→	<ul style="list-style-type: none"> • Continuous monitoring of the Company's external and internal threats. • Media monitoring, developing contacts and relationships with the media within TAURON Capital Group. • Preparing procedures for the Company's communications with the external and internal environment (stakeholders).
18.	Regulatory risk	Unfavorable impact of the domestic and European level legislation due to the need to pass or adapt to the legal regulations and to incur the required financial costs in order to comply therewith.	↗	<ul style="list-style-type: none"> • Continuous monitoring of the legal environment and changes to the regulations. • Analyzing draft legal acts and planning the required adaptation steps. • Implementing the required changes into internal regulations. • Cooperation with the regulator.
19.	License risk	No ability to conduct operations as a result of a prolonged process of obtaining a license or amending the licenses held. Unfavorable legal changes with respect to licensed operations.	→	<ul style="list-style-type: none"> • Ongoing control of the correct performance of licensing obligations. • Monitoring changes to the legal acts with respect to licensing obligations. • Legal support for the license extension and obtaining process.

No.	Risk name	Risk description	Risk trend	Risk response
Technology and infrastructure				
20.	Environmental risk	Potential negative impact of the operations on the environment and of non-alignment to and non-compliance with the environmental requirements of the domestic and community law.	→	<ul style="list-style-type: none"> • Ongoing supervision over compliance with the conditions of the environmental decisions. • Maintaining the required efficiency of the devices reducing the emission of pollutants. • Frequent evaluation of the compliance of actions with the legal requirements with respect to environment protection. • Implementing investment projects in environment protection in order to minimize the adverse impact of the mining and processing operations conducted.
21.	Weather risk	Impact of weather conditions on the operations of the enterprise, both with respect to technological aspects as well as the commercial ones.	→	<ul style="list-style-type: none"> • Upgrading (refurbishing) hydroelectric structures aimed at optimizing the utilization of water resources. • Preparing plans of overhauls, inspections and maintenance activities with flexible provisions on deadlines for completing the works. • Continuous monitoring of wind conditions and icing on the wind farms' blades. • Continuous technical oversight over the operation of individual wind farms, conducted by the companies operating the farms. • Monitoring and analyzing new technological solutions that reduce the impact of adverse weather conditions on the volume of electricity generated. • Increase in acquisitions and takeovers.
22.	Company asset failure risk	Impact of failures of machines and devices, overhauls, upgrades (refurbishments), maintenance and management of production and non-production assets on achieving the company's goals.	→	<ul style="list-style-type: none"> • Optimizing capital expenditures on asset replacements, ongoing monitoring of the condition of machines, devices and installations. • Raising professional qualifications and work culture of the personnel by organizing courses and training. • Responding to an emergency situation by the technical personnel and automatic process safety interlocks. • Insuring assets against fortuitous events (excluding underground assets). • Introducing IT tools with respect to improving the monitoring and managing failure indicators (ratios).
23.	IT risk	Risks related to the IT infrastructure security, failures of the IT infrastructure	↗	<ul style="list-style-type: none"> • Developing and maintaining plans aimed at ensuring continuity of IT infrastructure's operation. • Periodic identifying and categorizing IT resources based on the service restoration targets. • Use of IT solutions with appropriate technical parameters, providing an acceptable level of reliability and efficiency of operation (including also UPS devices, GSM modem, mobile phones). • Planning and conducting training on IT continuity. • Storing and protecting the back-up data.
24.	Asset security and protection risk	Risk related to compromising the integrity of machines/devices and to the security of information, including its improper processing and unauthorized disclosure.	↘	<ul style="list-style-type: none"> • Monitoring the implementation of the developed plans to protect the facilities that are subject to mandatory protection. • Maintaining and updating contingency procedures/plans. • Implementing/updating and oversight over compliance with the information security rules in force. • Regular personnel training with respect to security procedures in force.
25.	Geological risk	Impact of geological factors on the mining operations.	↗	<ul style="list-style-type: none"> • Making test drillings for the better intelligence on the positioning of coal deposits. • Continuing to take preventive measures in areas under threat in order to improve the geological and mining conditions and to provide protection against natural threats (including, among others, long-drilled blasting hole shooting in order to break the rock mass)

4. ANALYSIS OF TAURON CAPITAL GROUP'S FINANCIAL POSITION AND ASSETS

4.1. Overview of economic and financial data disclosed in the consolidated annual financial statements

Consolidated statement of financial position

The below table presents the annual consolidated statement of financial position – **assets**.

Table no. 22. Annual consolidated statement of financial position – assets (material items)¹

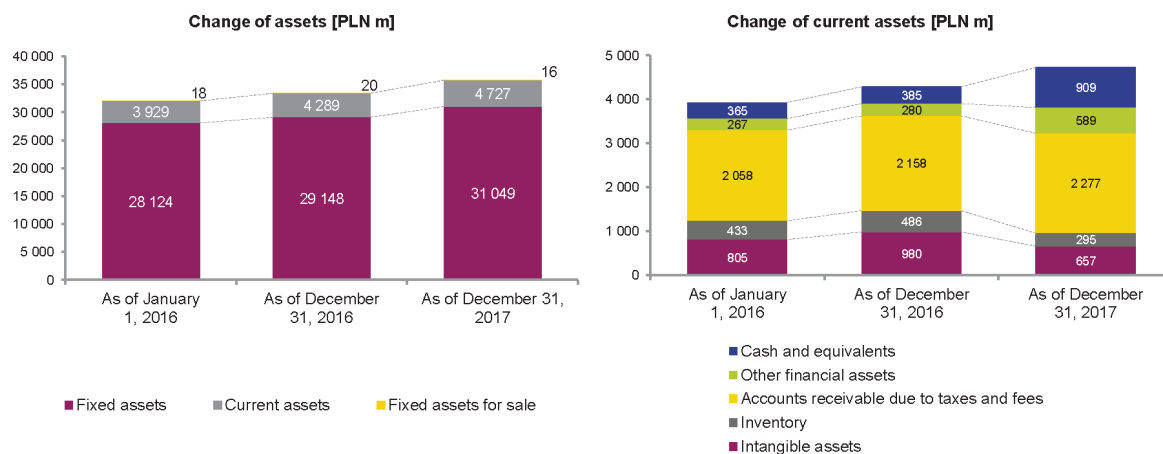
Statement of financial standing (PLN thous.)	As of December 31, 2017	As of December 31, 2016	As of 1 January 2016	Change in % (2017/2016)
ASSETS				
Fixed assets	31 049 127	29 148 253	28 124 185	107%
Tangible fixed assets	28 079 886	26 355 189	24 882 817	107%
Current assets	4 742 894	4 308 641	3 947 248	110%
Cash and equivalents	909 249	384 881	364 912	236%
Fixed assets and assets of TAURON Capital Group for disposal, classified as held for sale	15 910	19 612	17 898	81%
TOTAL ASSETS	35 792 021	33 456 894	32 071 433	107%

¹ Due to the limited comparability of earlier periods, data is presented in a three-year horizon. Data comprising earlier periods are presented in section no. 4.6 of this report.

As of 31 December 2017 the statement of the financial position of TAURON Capital Group indicates the balance sheet total higher by approx. 7%.

The below figure presents the change in the level of assets and current assets.

Figure no. 69. Change in the level of assets and current assets



In the year ended on December 31, 2017 TAURON Capital Group, having taken into account the following premises:

- 1) long-term maintaining of the market value of Company's net assets at a level below the balance sheet carrying amount,
- 2) changes to the commodity prices on the worldwide markets and a change of the situation on the domestic thermal coal market following the consolidation of the mining sector,
- 3) amendments to the RES law and publishing of the RES obligations for 2018 and 2019, that impacted the prices of the certificates of origin for electricity generated from renewable sources,
- 4) passing of the capacity market law and proceeding with the functional solutions described in the draft capacity market regulations,
- 5) continuing unfavourable market conditions in terms of profitability of coal-based power industry,
- 6) increase in risk-free rate,

recognized (booked) impairment write-offs and the reversal of previously booked write-downs related to tangible fixed assets as a result of impairment tests, conducted as of December 31, 2017 and June 30, 2017. Results of the conducted tests indicated that a part of assets of the Generation Segment should be covered by an additional write-down in the amount of PLN 658.7 mln. The conducted test has also confirmed the legitimacy to reverse the write-downs in this Segment in the amount of PLN 628.2 million.

The sensitivity analysis for individual units generating cash flows indicated that the factors most significantly influencing the useful value of the assets tested are related to:

- 1) capacity market with the other market conditions unchanged,
- 2) changes in electricity prices,
- 3) changes in hard coal prices.

The change in the prices of CO₂ emission allowances and changes of the average weighted cost of capital have a lower impact on the valuation.

The value of tangible fixed assets increased by PLN 1 906 million (6.5%), which is the resultant of the following events:

- 1) increase in the value of tangible fixed assets as a result of investments in tangible fixed assets underway at TAURON Capital Group's subsidiaries (mainly at TAURON Dystrybucja, TAURON Wytwarzanie, Nowe Jaworzno GT and TAURON Ciepło) and intangible assets (mainly TAURON Dystrybucja),
- 2) purchase of property rights to the certificates of origin of electricity and greenhouse gases emission allowances in connection with the requirement to fulfil the legal obligation of their redemption.

The following factors had an impact on the increase in the value of current assets by approximately PLN 434 mln (10.1%):

- 1) increase of the level of cash and equivalents by PLN 524 mln which was more extensively described in the section on the cash flow account,
- 2) increase of the value of loans granted for joint ventures by approx. PLN 315 mln, due to the agreement signed between TAURON and ECSW,
- 3) increase of the value of accounts receivable from the consumers by PLN 139 mln,
- 4) increase in the value of other financial assets by PLN 92 mln mainly due to the purchase of investment fund units in 2017,
- 5) decline of the value of certificates of origin of electricity and greenhouse gas emission allowances to be redeemed by PLN 324 mln as a result of the fulfilment of the obligation to redeem certificates of origin of electricity and CO₂ emission allowances and an increase of their level in conjunction with the production and acquisition of the property rights due to the current year's obligation,
- 6) decrease of the inventory value by PLN 191 mln, mainly due to the sale of TAURON Wydobycie's coal inventory and the consumption of coal by the Generation Segment's companies,
- 7) decrease of the value of the other non-financial assets by PLN 98 mln, mainly due to recognizing in 2016 of advance payments towards the supplies by TAURON Capital Group's subsidiaries.

The below table presents the annual consolidated statement of financial position – **liabilities**.

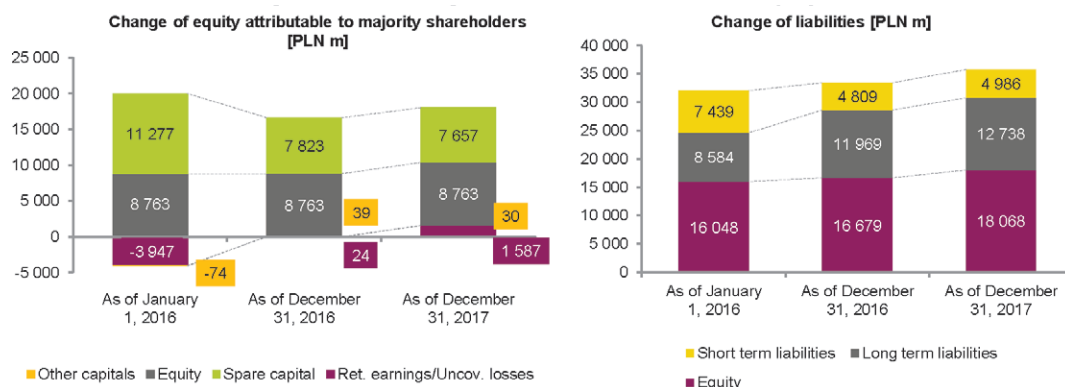
Table no. 23. Annual consolidated statement of financial position – liabilities (material items)¹

Statement of financial standing (PLN thous.)	As of 31 December 2017	As of 31 December 2016	As of 1 January 2016	Change in % (2017/2016)
LIABILITIES				
Equity attributable to shareholders of the parent entity	18 036 446	16 649 266	16 018 328	108%
Non-controlling shares	31 367	30 052	29 829	104%
Long-term liabilities	12 738 005	11 968 719	8 583 950	106%
Loans, credits and debt securities	9 501 414	8 759 789	4 924 127	108%
Short-term liabilities	4 986 203	4 808 857	7 439 326	104%
Current portion of credits, loans and debt securities	351 382	219 740	3 214 520	160%
TOTAL LIABILITIES	35 792 021	33 456 894	32 071 433	107%

¹ Due to the limited comparability of earlier periods, data are presented in a three-year horizon. Data comprising earlier periods are presented in section no. 4.6 of this report.

The below figure presents the change in the level of liabilities and equity

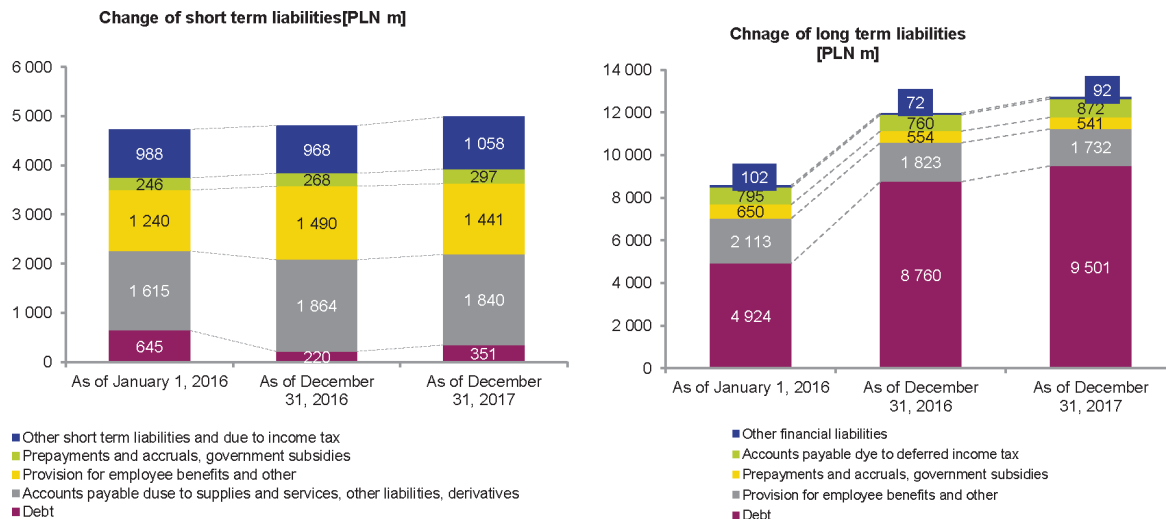
Figure no. 70. Change in the level of liabilities and equity



Similar to the previous years, in 2017 the dominating source of assets financing was equity whose share in the total liabilities reached 50.5%.

The below figure presents the change in the level of liabilities.

Figure no. 71. Change in the status of liabilities



The following factors had an impact on the increase in the value of TAURON Capital Group's long-term liabilities by PLN 769 PLN m (6%):

- 1) increase of the liabilities due to debt by 8% as a result of issue of eurobonds on July 5, 2017 with the total nominal value of EUR 500 million and the issuing price of 99.438% of the nominal value and the maturity of 10 years,
- 2) increase of the liabilities due to the deferred income tax by PLN 112 mln which is the effect of setting up a liability due to a different moment of recognizing for tax purposes of the revenue from products and services sales,
- 3) decrease of the value of provisions due to the costs of dismantling the fixed assets and recultivation of the land and other by PLN 98 mln which is related to dissolving the provision for the costs related to the electricity sale agreement and the provision for the covering of the potential losses in conjunction with the enforcement of the "take or pay" contractual clause, as a result of the fulfilment of the suspending conditions stemming from the contingent agreement signed on October 27, 2016 on establishing the basic boundary conditions of the restructuring of the "Construction of the CCGT unit at Stalowa Wola" project. Meanwhile as a result of updating of the provision for the liquidation of coal mines in conjunction with the change of the discount rate this balance sheet item increased.

The value of short-term liabilities of TAURON Capital Group increased by PLN 177 million (4%), which resulted from the following factors:

- 1) increase due to debt by PLN 132 mln,
- 2) increase of accounts payable towards suppliers by PLN 213 mln and decrease of the value of capex obligations by PLN 237 mln,

- 3) slight drop, by approx. 1%, of the value of provisions, which is the resultant of using the provision set up in 2016 on the account of fulfilling of the obligation to present the certificates of electricity origin for redemption, due to the regulations of the *act of April 10, 1997 Energy law*, and the CO₂ emission allowances, and setting up of the provision on the account of fulfilling of the 2017 obligations.

Consolidated statement of comprehensive income

The below table presents the annual consolidated statement of comprehensive income. Due to the changes in the Segments and in order to maintain the comparability, the results are presented for three years.

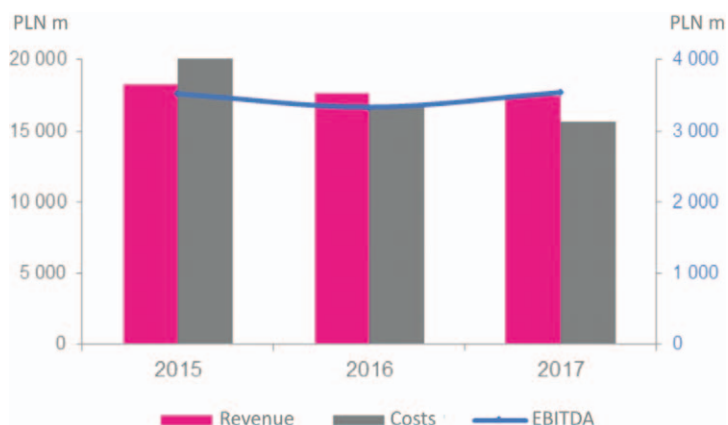
Table no. 24. Annual statement of comprehensive income for 2015–2017¹

Statement of comprehensive income (PLN thous.)	2017	2016	2015	Change in % 2017/2016)
Sales revenue	17 416 029	17 646 489	18 264 440	99%
Own cost of sales (including sales costs and overheads)	(15 605 679)	(16 829 480)	(20 137 894)	93%
Other operating revenues and costs	(4 079)	(15 487)	(27 762)	26%
Operating profit (loss)	1 806 271	801 522	(1 901 216)	225%
<i>Operating profit margin (%)</i>	<i>10,4%</i>	<i>4,5%</i>	<i>(10,4)%</i>	<i>228%</i>
Financial revenue	190 968	65 279	73 185	293%
Financial expenses	(312 637)	(417 980)	(367 673)	75%
Share in the profit (loss) of joint venture	73 050	60 040	7 933	122%
Gross profit (loss)	1 757 652	508 861	(2 187 771)	345%
<i>Gross profit margin (%)</i>	<i>10,1%</i>	<i>2,9%</i>	<i>(12,0)%</i>	<i>350%</i>
Income tax	(374 706)	(138 724)	383 556	270%
Net profit (loss) for financial year	1 382 946	370 137	(1 804 215)	374%
<i>Net profit margin (%)</i>	<i>7,9%</i>	<i>2,1%</i>	<i>(9,9)%</i>	<i>381%</i>
Other comprehensive income for financial year, post tax	6 366	277 748	122 076	2%
Total income for financial year	1 389 312	647 885	(1 682 139)	214%
Profit attributable to:				
Shareholders of the parent entity	1 380 663	367 468	(1 807 317)	376%
Non-controlling shares	2 283	2 669	3 102	86%
EBIT and EBITDA				
EBIT	1 806 271	801 522	(1 901 216)	225%
EBITDA	3 544 591	3 336 814	3 523 228	106%

¹ Due to the limited comparability of earlier periods, data are presented in a three-year horizon. Data comprising earlier periods are presented in section no. 4.6 of this report.

The below figure presents TAURON Capital Group's 2015–2017 financial results.

Figure no. 72. TAURON Capital Group's 2015–2017 financial results

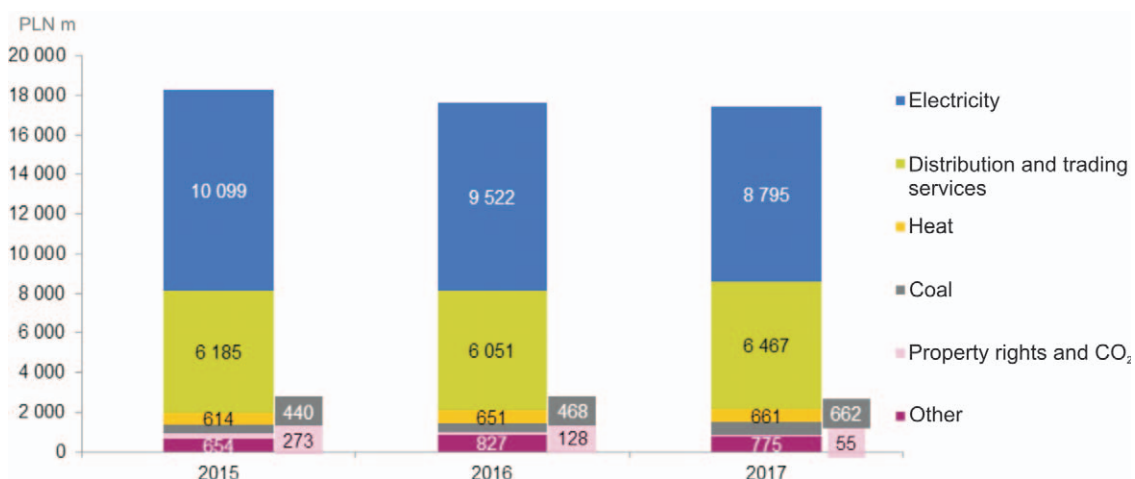


In the reporting period ended on December 31, 2017, TAURON Capital Group generated sales revenue lower by 1.3% as compared to the values achieved in 2016, due to the following factors:

- 1) lower revenue from electricity sales – higher electricity retail sales volume and lower wholesale volume, with lower electricity sales prices,
- 2) higher revenue from heat sales – higher heat sales and transmission services volume and higher rate for the transmission services,
- 3) lower revenue from electricity origin property rights sales, mainly due to a substantial decline of PMOZE market prices,
- 4) higher revenue from distribution services sales, due to an increase of the distribution service sales volume (by 4%) and the rate for the distribution services delivered to the final consumers,
- 5) higher revenue from coal sales due to an increase of coal sales volume (by 34%) – greater demand from the consumers and higher coal sales price.

The below figure presents the structure of TAURON Capital Group's revenue in 2015–2017.

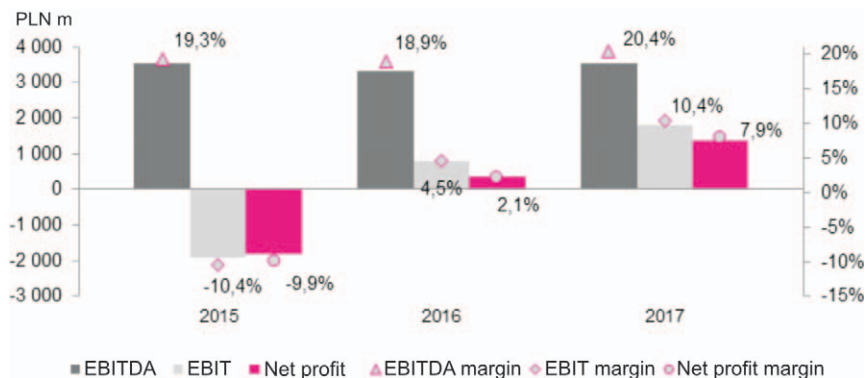
Figure no. 73. Structure of TAURON Capital Group's revenue in 2015–2017¹



¹ The three-year period is presented due to transparency of information. The approximate (due to significant changes in the organisation of Operational Segments, as compared to the period before 2012) results in the five-year period are presented in subsection 4.6. of this report.

The below figure presents TAURON Capital Group's financial results and the level of margins realized.

Figure no. 74. TAURON Capital Group's financial results and the level of margins realized in 2015–2017¹



¹ The three-year period is presented due to transparency of information. The approximate (due to significant changes in the organisation of Operational Segments, as compared to the period before 2012) results in the five-year period are presented in subsection 4.6. of this report.

In 2017 TAURON Capital Group's costs of operations reached PLN 15.6 bln, which meant that they were 7.3% lower than the costs incurred in 2016.

On of the reasons for the cost decline was the booking, in 2016, of the write-downs due to the loss of the carrying amount of the Generation Segment's generating units.

The impairment tests, conducted as of December 31, 2017 and June 30, 2017, for the tangible fixed assets, taking into account the premises related to the assets' net market value, changes of the commodity prices on the worldwide markets, changes of the thermal coal prices on the domestic market, changes of the RES law and publishing of the RES obligations for 2018 and 2019, as well as passing of the capacity market law, proved the legitimacy of booking the impairment charges and of reversing the earlier booked write-downs related to the tangible fixed assets in the amount of PLN 0.03 bln:

- net value of the booked write-downs (i.e. the excess of the reversed write-downs versus the booked write-downs) related to the wind farms and hydroelectric power plants: PLN 0.04 bln,
- net value of the reversed write-downs (i.e. the excess of the reversed write-downs versus the booked write-downs) related to the generation assets in the electricity and heat generation line of business: PLN 0.01 bln.

Apart from the aforementioned one-off events the level of TAURON Capital Group's costs in 2017 was impacted by the following factors:

- 1) decline of the costs of purchasing electricity, mainly due to the lower volume of electricity (wholesale) sold,
- 2) increase of the costs of the distribution service, mainly due to the increase of the volume of electricity transferred,
- 3) increase of the costs of maintenance of devices, overhaul services and the other services,
- 4) increase of the costs of taxes, mainly the real estate tax,
- 5) increase of the labor costs as a result of setting up a provision related to the one-off bonus in conjunction with the agreement signed with the workforce (social party),
- 6) decline of the cost of the redeemed property rights due to the reduction of their price,
- 7) sale of the inventory coal due to the rising demand (increase of the coal sales by 34%).

EBITDA margin achieved in 2017 was 20.4% and it was 7.6% higher than in 2016. As a result of the write-downs booked, the value of which in 2016 was much higher than the write-downs in 2017, EBIT margin and net profit margin were significantly higher in the reporting period than a year ago, reaching 10.4% and 7.9%, respectively. Should the effects of the impairment charges be disregarded, EBIT margin and net profit margin would reach in 2017, respectively, 10.5% and 8.1%, and in 2016, respectively, 9.0% and 5.8%.

In accordance with the presented consolidated statement of comprehensive income, the total comprehensive income of TAURON Capital Group for 2017, taking into account the net profit increased or decreased by the change in the value of hedging instruments, FX differences arising from the conversion of the foreign entity and the other revenue after tax, reached PLN 1 389.3 mln in 2017, versus PLN 647.9 million generated in 2016, while the net profit attributable to the shareholders of the parent entity reached PLN 1 380.7 mln versus PLN 367.5 million posted in 2016.

Statement of cash flows

The below table presents the statement of cash flows

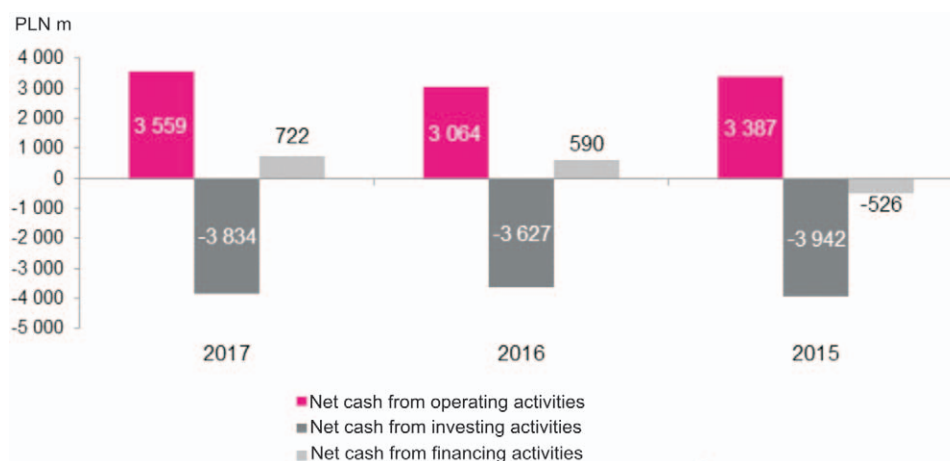
Table no. 25. Statement of cash flows (significant items) in 2015–2017¹

Statement of Cash Flows (PLN thous.)	Year ended 31.12.2017	Year ended 31.12.2016	Year ended 31.12.2015	Change in % (2017/2016)
Cash flows from operating activities				
Gross profit/(loss)	1 757 652	508 861	(2 187 771)	345%
Adjustments	1 801 015	2 555 354	5 575 229	70%
Net cash from operating activities	3 558 667	3 064 215	3 387 458	116%
Cash flows from investing activities				
Purchase of tangible fixed assets and intangible assets	(3 561 758)	(3 516 296)	(3 973 510)	101%
Net cash from investing activities	(3 871 676)	(3 627 458)	(3 942 122)	106%
Cash flows from financing activities				
Cash inflows due to loans/credits	(1)	914	295 000	–
Repayment of loans/credits	(154 918)	(140 331)	(140 585)	110%
Issue of debt securities	2 707 462	4 284 607	310 000	63%
Redemption of debt securities	(1 650 000)	(3 300 000)	(450 000)	50%
Net cash from financing activities	759 629	590 261	(525 692)	122%
Increase/(decrease) in net cash and equivalents	446 620	27 018	(1 080 356)	1 653%
Cash opening balance	354 733	327 715	1 408 071	108%
Cash closing balance	801 353	354 733	327 715	226%

¹ Due to the limited comparability of earlier periods, data are presented in a three-year horizon. Data comprising earlier periods are presented in section no. 4.6 of this report.

The below figure presents the 2017–2015 cash flows.

Figure no. 75. 2017–2015 cash flows



The realized positive value of cash flows from operating activities in 2017 was higher than the cash flow realized in the previous year by PLN 494 million. The following factors had the biggest impact on the change in this item of the cash flow account:

- 1) reduction of the inventory level as a result of higher coal sales, which is related to increased demand for the extracted coal PLN +244 mln,
- 2) income tax payment lower by PLN 252 mln, which is due to advance payments made by the Tax Capital Group in 2017 on the account of the 2017 income tax, in the amount of PLN 216 million, while in 2016 the Tax

Capital Group made advance payments on the account of the income tax in the amount of PLN 301 million and paid the 2015 income tax in the amount of PLN 89 million. In addition, TAURON Capital Group received in the reporting period the refund of the overpaid 2016 income tax in the amount of PLN 79 million,

- 3) negative change of accounts receivable and accounts payable in the amount of PLN 49 million,
- 4) incurring of a lower expenditure in the total amount of PLN 38 million to purchase the certificates of origin and a lower substitution fee in the 2017 reporting period than in 2016.

The biggest impact on cash flows from investing activities came from the expenditures to purchase tangible fixed assets, which in the reporting period were higher by 1% than the expenditures incurred in 2016. The largest expenditures were incurred by the Generation and Distribution Segments.

The positive value of cash flows from financing activities is due to the bond issues completed in 2017 worth PLN 2 707 mln in total, including the EUR 500 mln eurobond issue. At the same time TAURON Capital Group redeemed the bonds issued and repaid credits and loans in the total amount of PLN 1 805 mln.

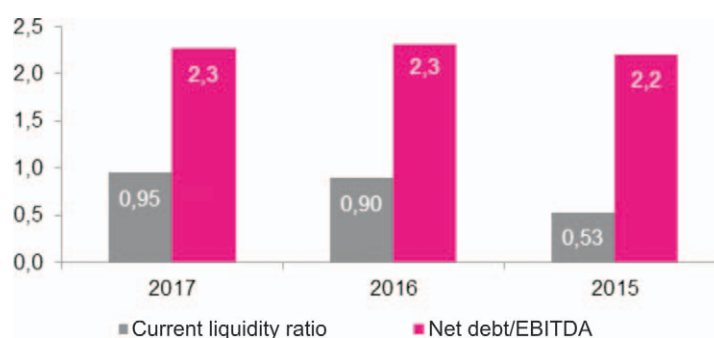
On the other hand in 2016 TAURON Capital Group issued bonds with the total nominal value of PLN 4 285 mln, redeemed the bonds issued in the previous years with the total nominal value of PLN 3 330 mln and repaid credits and loans taken in the previous years in the total amount of PLN 140 mln.

The value of financial expenses due to paid interest on financial liabilities amounted to PLN 185 million in 2017 and it was lower by 28% year on year.

TAURON Capital Group is continuing its expansion process and keeps strengthening its market position. It should be noted that the balance of cash flows from operating activities is positive, consequently enabling TAURON Capital Group to autonomously finance its ongoing operations. The current liquidity ratio and the net debt to EBITDA ratio remain at a safe level.

The below figure presents the current liquidity ratio and the net debt to EBITDA ratio in 2017–2015.

Figure no. 76. The current liquidity ratio and the net debt to EBITDA ratio in 2017–2015



4.2. Characteristics of the structure of assets and liabilities on the consolidated balance sheet

Structure of the annual consolidated statement of financial position

The below table shows the structure of the annual consolidated statement of financial position.

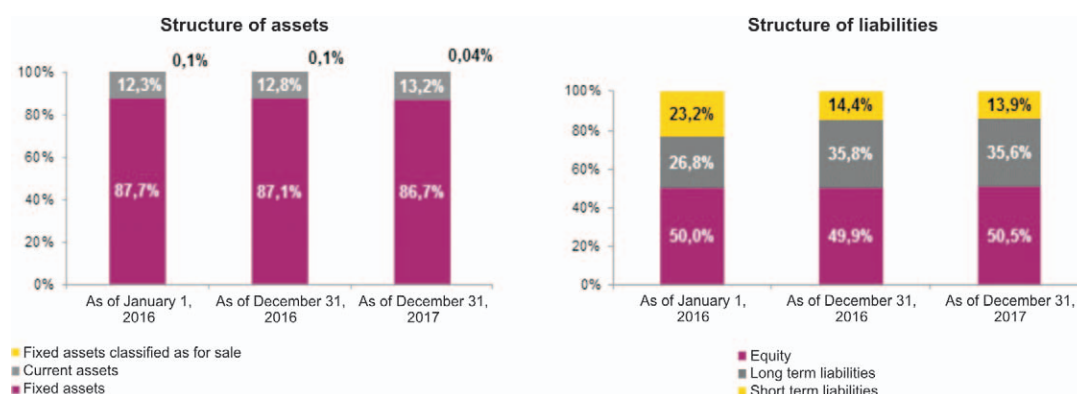
Table no. 26. Structure of the annual consolidated statement of financial position

Consolidated statement of financial position	As of 31 December 2017	As of 31 December 2016	As of 1 January 2016
ASSETS			
Fixed assets	86,7%	87,1%	87,7%
Current assets	13,3%	12,9%	12,3%
TOTAL ASSETS	100,0%	100,0%	100,0%
LIABILITIES			
Equity attributable to shareholders of the parent entity	50,4%	49,8%	49,9%
Non-controlling stakes	0,1%	0,1%	0,1%
Total equity	50,5%	49,9%	50,0%

Consolidated statement of financial position	As of 31 December 2017	As of 31 December 2016	As of 1 January 2016
Long-term liabilities	35,6%	35,8%	26,8%
Short-term liabilities	13,9%	14,4%	23,2%
Total liabilities	49,5%	50,1%	50,0%
TOTAL LIABILITIES	100,0%	100,0%	100,0%
Financial liabilities	9 059 844	8 138 506	8 138 647
Net financial liabilities	8 042 225	7 703 602	7 763 963

The below figure presents the structure of assets and liabilities.

Figure no. 77. Structure of assets and liabilities



As of December 31, 2017, similar as in 2016, the value of fixed assets represents the largest share in the structure of assets. In the structure of fixed assets, the tangible fixed assets of the following Segments represent the largest share: Distribution (57.9%), Generation (31.7%) and Mining (6.2%).

As of December 31, 2017, equity and financial liabilities represent the largest share in the structure of liabilities.

The level of debt of TAURON Capital Group remains at a safe level, which is indicated by the value of the leverage ratio, as compared to the European benchmarks for the sector, and the positive cash flows from operating activities.

4.3. Material off-balance sheet items

As of December 31, 2017, material contingent liabilities of TAURON Capital Group were related to:

- 1) lawsuits against PEPKH, TAURON as well as PEPKH and TAURON associated with the termination of long-term contracts by PEPKH,
- 2) termination of long-term contracts on purchasing property rights by TAURON Sprzedaż,
- 3) potential claims not reported by owners of land with unregulated status due to the lack of detailed records of unregulated land and the resulting inability to reliably estimate the amount of potential claims, and as a consequence, lack of a possibility to create provisions,
- 4) proceedings initiated on September 17, 2013 by the President of UOKiK against TAURON Sprzedaż in connection with the suspected use of practices violating the collective interests of consumers, by providing electricity prices in price lists and information materials without including the value added tax, which constitutes the infringement of the *Act of 23 August 2007 on prevention of unfair market practices*,
- 5) anti-monopoly proceedings initiated by the President of UOKiK pursuant to the decision of October 15, 2015, in connection with suspected use of measures by TAURON Sprzedaż in relation to small hydroelectric power plants, consisting in imposing unfair purchase terms by the entrepreneur in relation to electricity generated in renewable energy sources and making the purchase of this energy dependent on the need to settle the obligation of trade balancing, which may constitute the infringement of the provisions of the *Act of 16 February 2007 on the protection of competition and consumers*,
- 6) proceedings initiated on October 13, 2017 in conjunction with the suspected applying by TAURON Sprzedaż and TAURON Sprzedaż GZE of a practice violating the collective interests of consumers involving hindering a switch of an electricity supplier,

- 7) clarification proceedings conducted by the President of UOKiK against TAURON Sprzedaż and TAURON Sprzedaż GZE,
- 8) administrative proceedings initiated by the President of ERO against TAURON Dystrybucja concerning imposing of a fine due to the failure to maintain facilities, equipment and installations in due technical condition and the violation of the terms defined in the license,
- 9) administrative proceedings initiated by the President of ERO against TAURON Sprzedaż and TAURON Sprzedaż GZE with respect to the following matters: non-compliance with the obligation to obtain and present for redemption to the President of ERO of the energy efficiency certificates and imposing of a fine for a violation involving unjustified halting of the supply of electricity to the final consumers,
- 10) court dispute between TAURON as a legal successor of Górnośląski Zakład Elektroenergetyczny S.A (GZE) and Huta Łaziska S.A. as a result of the failure of Huta Łaziska S.A. to fulfil the obligation to pay the accounts payable for electricity supplies, which consequently caused the halting of electricity supplies to Huta Łaziska S.A. by GZE in 2001; the claim for the payment of damages is PLN 182 060 thou. plus interest,
- 11) lawsuit brought by ENEA against TAURON as well as TAURON Sprzedaż and TAURON Sprzedaż GZE (as third party respondents (defendants)) due to alleged unjustified benefit gained by the Company in connection with the settlements of imbalancing on the Balancing Market, made with PSE (TSO) in the period from January to December 2012; the claim for payment by TAURON amounts to PLN 17 086 thousand, in case the lawsuit against TAURON is dismissed, the claim for payment by TAURON Sprzedaż and TAURON Sprzedaż GZE amounts to PLN 8 414 thou. including interest,
- 12) registered pledge and financial lien on TAMEH HOLDING shares, established by TAURON in favour of RAIFFEISEN BANK INTERNATIONAL AG in order to hedge transactions comprising the agreement for term and working capital loans, concluded between TAMEH Czech and TAMEH POLSKA, TAMEH HOLDING as well as RAIFFEISEN BANK INTERNATIONAL AG,
- 13) value of the real estate tax imposed on devices used for generation and transmission of electricity as well as equipment of underground mining headings,
- 14) claim against TAURON Wydobycie related to the refund of the expenditures incurred to protect a facility against the impact of mining operations in the amount of PLN 22 785 thou.

The detailed information concerning off-balance sheet items is included in notes 47 and 48 of the Consolidated financial statements for the year ended on December 31, 2017.

4.4. Differences between the financial results reported in the annual report and the forecasts of results for the given year published earlier

The Management Board of the Company did not publish any forecasts of the earnings of TAURON Capital Group for 2017. This decision was due to the considerable volatility of the market and a substantial number of factors affecting its predictability.

4.5. Key financial and non-financial ratios

Financial ratios

The below table presents key financial ratios of TAURON Capital Group.

Table no. 27. TAURON Capital Group's key financial ratios¹

Ratios	Definition	2017	2016	2015
PROFITABILITY				
EBIT Margin	Operating profit / Sales revenue	10.4%	4.5%	(10.4)%
EBITDA Margin	EBITDA/ Sales revenue	20.4%	18.9%	19.3%
Net Profitability	Net profit/ Sales revenue	7.9%	2.1%	(9.9)%
Return on Equity (ROE)	Net profit/ Equity at the end of the period	7.7%	2.2%	(11.2)%
LIQUIDITY				
Current liquidity ratio	Current assets (excluding assets held for trade) / Short-term liabilities	0.95	0.90	0.53
DEBT				
Total debt ratio	Total obligations/ total liabilities	0.50	0.50	0.50
Net financial debt/ EBITDA	(Financial liabilities - Cash)/ EBITDA	2.3x	2.3x	2.2x
OTHER RATIOS				
Earnings per share (EPS)	Net result attributable to shareholders of the parent entity / Number of ordinary shares	0.79	0.21	(1.03)

¹ Due to the limited comparability of earlier periods, data are presented in a three-year horizon. Data comprising earlier periods are presented in section no. 4.6 of this report.

In 2017 the net profitability ratio of TAURON Capital Group was higher than last year, as a result of recognising of the balance of impairment charges related to the generation assets of the Generation Segment in 2016 in the amount higher than in 2017. Due to the differences in the values of the write-downs these ratios are not comparable. Disregarding the write-downs, the 2017 net profitability ratio reached 8.1% in 2017 and 5.8% in 2016.

The current liquidity ratio reached, as of December 31, 2017, a value slightly higher than that as of December 31, 2016, which confirms a stable financial position of TAURON Capital Group.

The total debt ratio and the net debt/EBITDA ratio reflect the share of liabilities in TAURON Capital Group's financing. The current level of this ratio enables TAURON Capital Group to acquire external financing required to implement the investment projects planned. The levels of both ratios confirm a stable financial position of TAURON Capital Group, and a slight rise of the net debt was offset by the increase of EBITDA which allowed for maintaining the ratio at the same level as at the end of 2016.

EPS ratio (calculated in relation to net profit attributable to shareholders of the parent entity) is higher in 2017 than in 2016 due to recognizing the balance of the impairment charge related to the tangible fixed assets in the amount higher than the amount recognized in 2017.

Non-financial ratios (indicators)

The non-financial ratios (indicators) in TAURON Capital Group are closely associated with the specific nature of its operations, its resources and the adopted Strategy, including:

- 1) assessment of investment opportunities,
- 2) methods of human resources management,
- 3) risk optimization,
- 4) customer satisfaction surveys (polls),
- 5) centralizing of governance (management) functions at TAURON Capital Group, limiting the non-core operations,
- 6) development of organizational structures and management procedures.
- 7) Process management and implementation of the PRO values (Partnership – Development – Courage).

The description of the monitoring of the implementation (performance) of the above mentioned indicators (ratios) is provided in the individual sections of the report, while the summary of the key non-financial efficiency indicators (ratios) associated with the operations of TAURON Capital Group is provided in section 8.2. of this report.

4.6. Most significant financial and operating data of TAURON Capital Group for the last 5 years

The below table presents the most significant financial data and operating data of TAURON Capital Group for the last 5 years, i.e. for the 2017–2013 period.

Table no. 28. Financial and operating data for 2017–2013¹

Key information	Unit	2017	2016	2015	2014	2013	% change (2017/2016)
Statement of comprehensive income							
Sales revenue	PLN m	17 416	17 646	18 264	18 577	19 131	99%
Operating profit	PLN m	1 806	802	(1 901)	1 830	1 934	225%
Financial revenue (total)	PLN m	264	125	81	86	99	211%
Financial expenses (total)	PLN m	(313)	(418)	(368)	(418)	(347)	75%
Gross profit	PLN m	1 758	509	(2 188)	1 498	1 684	345%
Income Tax	PLN m	(375)	(139)	384	(313)	(337)	270%
Net profit	PLN m	1 383	370	(1 804)	1 186	1 346	374%
attributable to shareholders of the parent entity	PLN m	1 381	367	(1 807)	1 181	1 308	376%
attributable to non-controlling shares	PLN m	2	3	3	5	38	86%
EBITDA	PLN m	3 545	3 337	3 523	3 695	3 661	106%
Statement of financial position							
Fixed assets	PLN m	31 049	29 148	28 124	28 163	27 567	107%
Current assets	PLN m	4 743	4 309	3 947	6 396	4 789	110%
Total equity	PLN m	18 068	16 679	16 048	17 997	17 793	108%
Total liabilities	PLN m	17 724	16 778	16 023	16 563	14 562	106%
Long-term liabilities	PLN m	12 738	11 969	8 584	11 744	9 304	106%
Short-term liabilities	PLN m	4 986	4 809	7 439	4 819	5 258	104%
Net financial debt**	PLN m	8 042	7 704	7 764	6 665	5 227	104%
Net financial debt ²	PLN m	8 944	7 730	7 764	6 665	5 227	116%
Capital expenditures	PLN m	3 474	3 817	4 175	3 090	3 780	91%
Cash flow account							
Net cash from operating activities	PLN m	3 559	3 064	3 387	2 618	4 079	116%
Net cash from investing activities	PLN m	(3 834)	(3 627)	(3 942)	(3 387)	(4 180)	106%
Net cash from financing activities	PLN m	722	590	(526)	1 636	(249)	122%
Cash closing balance	PLN m	801	355	328	1 408	541	226%
Ratios							
EBIT Margin	%	10,4	4,5	(10,4)	9,9	10,1	228%
EBITDA Margin	%	20,4	18,9	19,3	19,9	19,1	108%
Net financial debt/ EBITDA	number	2,27	2,31	2,20	1,80	1,43	98%
Net earnings per share	PLN/ share	0,79	0,21	(1,03)	0,67	0,75	377%
Dividend per share	PLN/ share	–	–	0,15	0,19	0,20	–

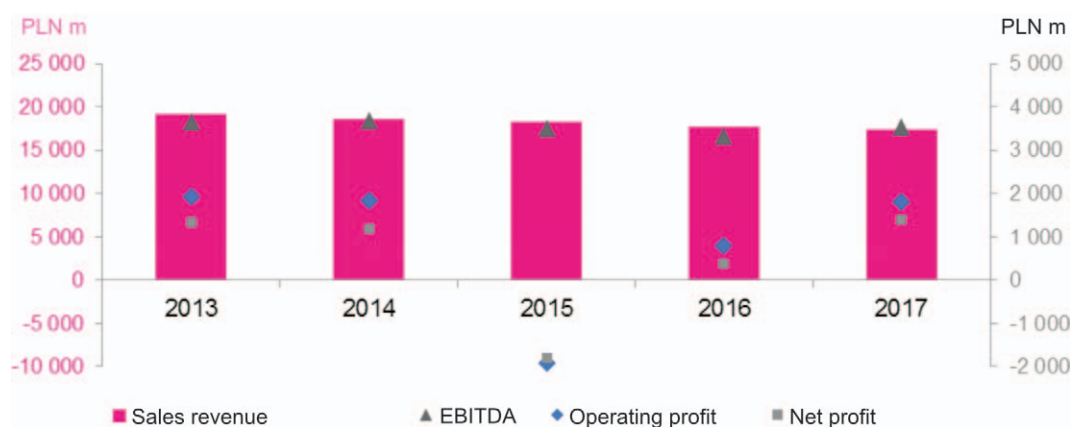
Key information	Unit	2017	2016	2015	2014	2013	% change (2017/2016)
Operating data							
Commercial coal production	<i>mln Mg</i>	6,45	6,37	4,91	5,40	5,45	101%
Gross electricity production	<i>TWh</i>	18,41	16,80	18,56	17,35	21,72	110%
Electricity production from RES	<i>TWh</i>	1,30	1,32	1,63	1,82	1,39	98%
Heat production	<i>PJ</i>	12,20	11,52	11,51	13,41	15,62	106%
Retail sales of electricity	<i>TWh</i>	34,91	32,04	35,94	36,43	41,30	109%
Distribution of electricity	<i>TWh</i>	51,37	49,68	49,20	47,90	47,90	103%
Number of customers (Distribution)	<i>mln</i>	5,53	5,47	5,42	5,38	5,33	101%

¹ The values presented do not reflect the values compliant with the IFRS and are not directly comparable due to the changes in organisation of Segments after 2012.

² Excluding the issue of hybrid bonds.

The below figure presents the financial data of TAURON Capital Group for 2013–2017.

Figure no. 78. Financial data of TAURON Capital Group for 2013–2017



The below table presents TAURON Capital Group's EBITDA, broken down into Segments (Lines of Business) for 2017–2013.

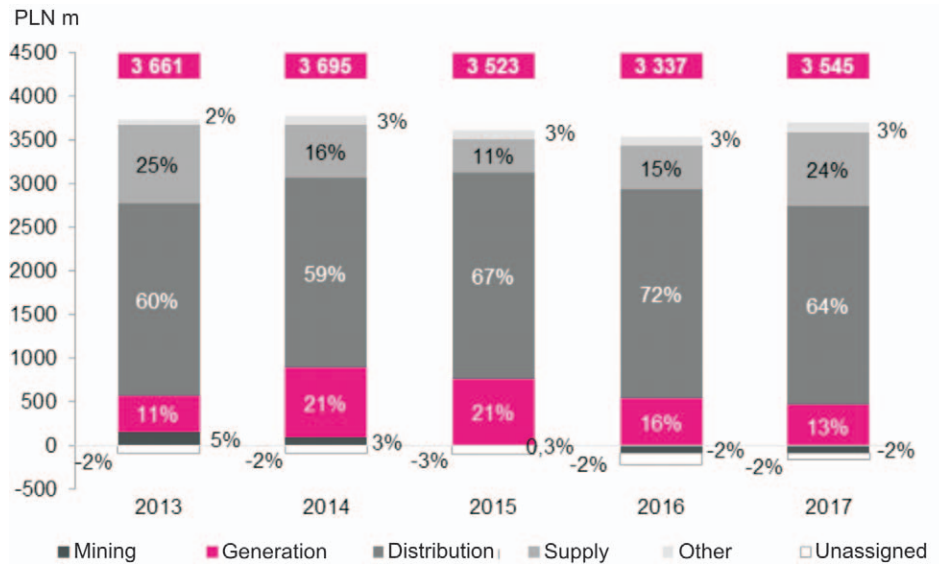
Table no. 29. TAURON Capital Group's EBITDA, broken down into Segments (Lines of Business)¹

No.	EBITDA (PLN m)	2017	2016	2015	2014	2013	Rate of change (2017/2016)	Change (2017–2016)
1.	Mining	(83)	(82)	9	98	166	–	(1)
2.	Generation	464	545	755	793	400	85%	(81)
3.	Distribution	2 283	2 395	2 372	2 172	2 208	95%	(112)
4.	Sales	841	490	380	608	899	172%	351
5.	Other	118	115	100	106	63	103%	3
6.	Unallocated items	(78)	(126)	(94)	(83)	(75)	62%	47
	Total EBITDA	3 545	3 337	3 523	3 695	3 661	95%	208

¹ The values presented do not reflect the values compliant with the IFRS and are not directly comparable due to the changes in organisation of Segments.

The below figure presents the structure of TAURON Capital Group's EBITDA in 2013–2017.

Figure no. 79. Structure of TAURON Capital Group's EBITDA in 2013–2017



Key information for 2013–2017 by Segments

The below figures present the financial data for 2013–2017 by Segments.

Figure no. 80. Data of the Mining Segment for 2013–2017

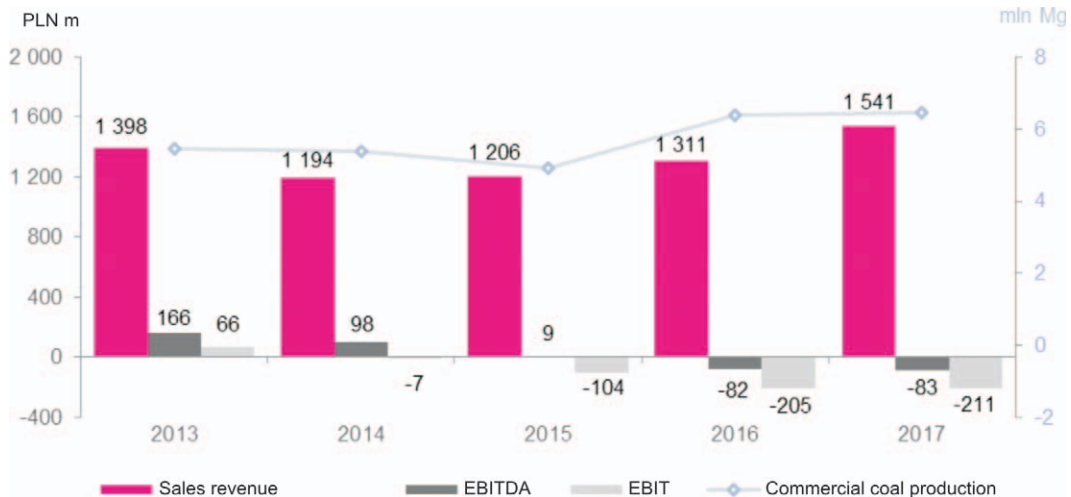


Figure no. 81. Data of the Generation Segment for 2013–2017

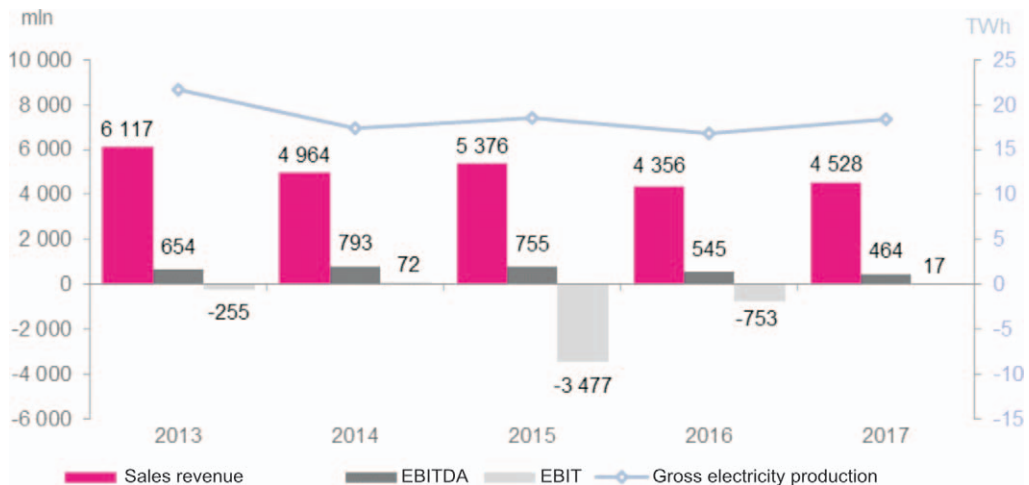


Figure no. 82. Data of the Distribution Segment for 2013–2017

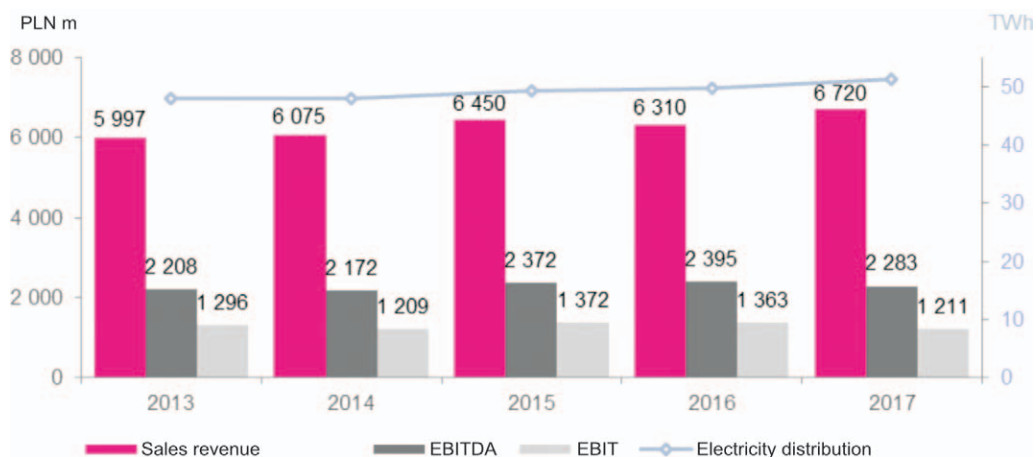


Figure no. 83. Data of the Supply Segment for 2013–2017

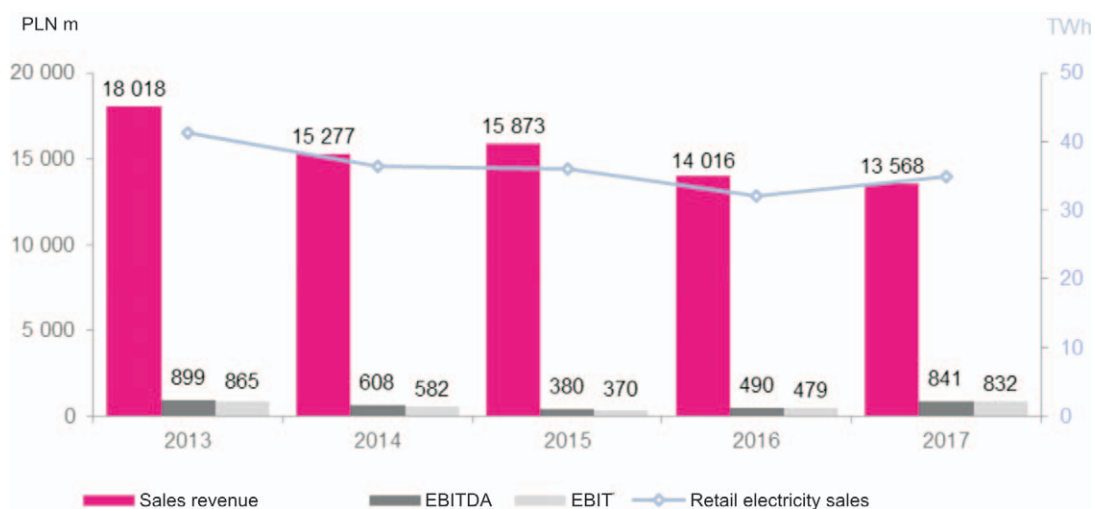
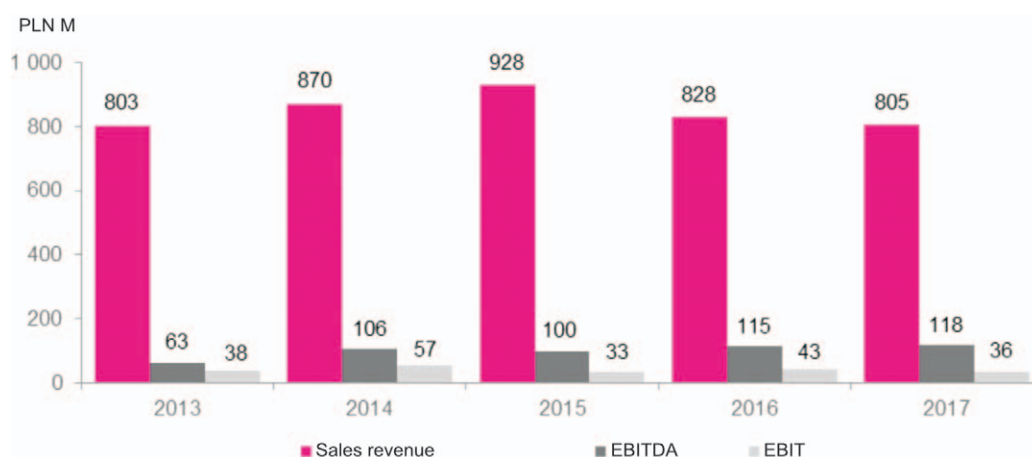


Figure no. 84. Data of the Other Operations for 2013–2017



4.7. Proceeds from securities issues

Under the bond issue programme concluded on 24 November 2015 between the Company and the consortium of banks In 2017 TAURON conducted bond issues and redemptions under the existing program (tj. the bond issue program concluded with the consortium of banks on November 24, 2015), and also completed the eurobond issue.

Eurobond issue

On July 5, 2017 TAURON issued eurobonds with the nominal value of EUR 500 mln. Eurobonds are unsecured, senior, coupon bearing securities. Eurobonds' maturity date is 10 years from the date of issue. The interest rate is based on a fixed rate of 2.375% per annum. The yield as of the date of issuance was 2.439% per annum with the issue price equal to 99.438% of the nominal value. In accordance with the eurobond issue prospectus the proceeds from the issue were to be used to refinance the costs of the construction and acquisition of wind farms by one of TAURON Capital Group's subsidiaries, financing of TAURON Capital Group's investment projects in the distribution segment and for general corporate purposes. Eurobonds were granted BBB rating by Fitch rating agency. Fulfilling this obligation in Q4 2017 TAURON completed the redistribution of the funds obtained from the bond issue by recapitalizing the following subsidiaries: TAURON EKOENERGIA and TAURON Dystrybucja, as a result of which TAURON EKOENERGIA made a repayment of a substantial portion of the debt related to the construction and acquisition of wind farms and TAURON Dystrybucja received funds to cover the expenditures related to the investment projects implemented by this subsidiary.

Eurobonds were admitted to trading on the regulated market of the London Stock Exchange.

Information on the eurobond issue was disclosed in detail in the regulatory filings (current reports) described in section 2.8. of this report.

Bond issues and redemptions in 2017

The bonds issue program signed on 24 November 2015 between TAURON and a consortium of banks led to issue in 2017 by TAURON of bonds having the total part value of PLN 600 Mln, according to the following specification:

- 1) Bonds issue on 30 January 2017 with total par value of PLN 100 Mln – redeemed on 30 July 2017,
- 2) Bonds issue on 01 March 2017 with total par value of PLN 100 Mln – redeemed on 01 September 2017,
- 3) Bonds issue on 31 March 2017 with total par value of PLN 300 Mln – redeemed on 30 June 2017,
- 4) Bonds issue on 30 June 2017 with total par value of PLN 100 Mln – redeemed on 30 July 2017

Funds received from the above bonds issue were used as stated in issue documents, i.e. to cover investment outlays of the TAURON Capital Group and for general corporate purposes.

Also, TAURON redeemed early the following bonds issued within the bonds issue program signed on 24 November 2015:

- 1) Redemption of PLN 100 Mln par value of bonds on 25 September 2017,
- 2) Redemption of PLN 300 Mln par value of bonds on 09 December 2017,
- 3) Redemption of PLN 650 Mln par value of bonds on 29 December 2017.

The below table presents the summary of issued and non-redeemed bonds as of December 31, 2017.

Table no. 30. Summary of issued and non-redeemed bonds as of December 31, 2017

No.	Value of bonds issues (thou.)	Type and level of interest rate	Redemption term of the last series	Balance as of 31 December 2016 (thou.)
1.	1 750 000 PLN	WIBOR 6M + fixed margin	04.11.2019	1 750 000 PLN
2.	1 700 000 PLN	WIBOR 6M + fixed margin	20.12.2029	1 700 000 PLN
3.	1 600 000 PLN	WIBOR 6M + fixed margin	29.12.2020	1 600 000 PLN
4.	190 000 EUR	Fixed interest rate	16.12.2034	190 000 EUR
5.	500 000 EUR	Fixed interest rate	05.07.2027	500 000 EUR

4.8. Financial instruments

4.8.1. Application of financial instruments in order to eliminate price changes, credit risk, material disruptions of cash flows and loss of financial liquidity

The financial risk at TAURON Capital Group is managed by TAURON. The centralizing of the financial risk management function is aimed at optimizing the process, including minimizing TAURON Capital Group's costs in the above mentioned respect. As part of financial risk management in 2017 TAURON Capital Group continued to hedge the risk of volatility in cash flows resulting from its debt based on WIBOR reference rate. Moreover, in 2017 TAURON Capital Group hedged the currency exposure arising from the trading operations (mainly due to the purchase of CO₂ emission allowances) by concluding forward contracts. In 2017 TAURON Capital Group was also implementing the strategy of hedging its foreign currency exposure generated by interest payments on the financing obtained in EUR by concluding forward contracts and CIRS transactions. The goal of these transactions was to hedge against the risk of cash flow volatility resulting from currency rate fluctuations.

The below table presents active forward derivative transactions as of December 31, 2017 (due to the adopted centralized model of financial risk management, the data refers only to TAURON).

Table no. 31. Information on forward transactions and derivatives as of December 31, 2017

No.	Type of transaction concluded	Total denomination of the specific type of transaction (thou.)	Currency			Maturity date of the specific type of transaction		Valuation of transaction of the specific type as of December 31, 2017 (thou.)
			PLN	EUR	other	up to one year	above one year	
1.	IRS	2 100 000	X				X	24 482
2.	CIRS	1 262 120	X				X	- 9 299
2.	Forward	6 610		X		X		- 346

With respect to hedging the risk arising from price volatility and the credit risk TAURON Capital Group did not use financial instruments.

On the other hand, as part of liquidity loss risk management debt instruments referred to in section 4.10 are used.

4.8.2. Objectives and methods of financial risk management

The objectives and methods of financial risk management at TAURON Capital Group are presented in section 3.4.2 of this report.

4.9. Current and forecast financial situation (financial outlook)

Considering the current market situation, it is expected that the results of TAURON Capital Group in the coming years will be affected by both internal factors as well as external factors.

The results of the **Mining Segment** in the coming years will, to a large degree, be dependent on the work progress in the implementation of the investment projects and the technical and organizational changes introduced. The effects of actions aimed at increasing the efficiency of this segment will be reflected in its financial and operating results in the subsequent periods. However it should be indicated that achieving a positive profitability of the segment already in 2018 will be a challenge.

It is expected that the financial situation in the **Generation Segment** in the next few years will not improve in relation to the current situation, due to the macroeconomic and sector related conditions under which electricity producers will be operating. In a longer term the new generation units, currently under construction, demonstrating better production parameters, will have an impact on the improvement of the current status. It is also expected that the changes of the Polish market model being prepared, aimed at implementing the capacity market mechanism, in accordance with the passed and notified capacity market law and the draft capacity market regulations draft, will bring additional revenue that will allow for refurbishing the generating units and extending their lifecycle. The operations related to electricity generation from RES is subject to statutory regulation which, to a large extent, determine the profitability. The segment's cost efficiency improvement measures undertaken will have an impact on the improvement of the results of the entire line of business.

In the **Distribution Segment**, the estimated level of remuneration on the invested capital and the cost efficiency improvement measures undertaken will play a key role impacting the level of the operating result. It is expected that

the estimated level of operating profit in the coming years will be lower than the result reached in 2017. New elements of the regulatory policy and the associated risks will have a significant impact on results in the years to come, i.e. the updated approach to the average weighted cost of capital, enterprise efficiency improvement correction factors with respect to operating expenses and the level of the balancing difference, continuation of the quality based regulation.

Supply Segment – in the coming years the need to incur higher costs has to be taken into account, in connection with conducting expansion activities and measures aimed at minimizing the number of customers leaving as well as recovery of customers lost in the previous years under the circumstances of the increased activities of the competition.

Other Segment is mainly responsible for providing shared services as well as for the implementation and finalization of the projects used mainly to provide services to the Distribution and Supply Lines of Business with respect to contacts and settlements with customers assuring the highest quality. In addition, services for TAURON Capital Group's subsidiaries are provided, inter alia, with respect to financial and accounting as well as IT services. These activities enable achieving synergy effects across TAURON Capital Group and improve cost efficiency.

4.10. Assessment of financial resources management

TAURON Capital Group has a centralized financial management function in place and thus effective management of finance of entire TAURON Capital Group is possible. The main tools enabling effective management include: the implemented central financing model and the appropriate internal corporate regulations as well as the cash pooling implemented by TAURON Capital Group. Additionally, the financial management system is supported by the central policy of managing the financial risk at TAURON Capital Group and the central Insurance policy of TAURON Capital Group. In these areas TAURON plays the role of the management body and decision maker with respect to the directions of measures undertaken, enabling determining the relevant limits of risk exposure.

In accordance with the adopted central model of financing TAURON is responsible for acquiring the financing for TAURON Capital Group's subsidiaries. Funds acquired both internally (from TAURON Capital Group's subsidiaries generating financial surpluses), as well as externally (from the financial market) are subsequently transferred to TAURON Capital Group's subsidiaries, reporting the requirement for financing (for this purpose, besides cash pooling, the intra-group bond issue program is implemented).

Such model of acquiring the funding sources enables, first of all, decreasing of the cost of capital, increasing the possibility to obtain financing, reduces the number and form of hedges established on assets of TAURON Capital Group and covenants required by financial institutions, as well as reduces the administrative costs. The central model of financing also enables acquiring financing sources unavailable for individual subsidiaries, such as, for example, issue of eurobonds.

Another key element influencing the efficiency of financial management is the policy of financial liquidity management. Through implementation of relevant forecasting standards it becomes possible to establish the precise liquidity position allowing for optimizing the moment of fund raising as well as the maturity term and types of deposit instruments as well as the appropriate level of the liquidity reserve. The above factors lead to both, cost reduction as well as liquidity safety improvement. The current liquidity management is supported by the implemented cash pooling mechanism. Its overriding goal is to provide for current financial liquidity at TAURON Capital Group, while at the same time limiting the costs of short term external financing and maximizing the financial revenue due to investing cash surpluses. Owing to the cash pooling structure TAURON Capital Group's subsidiaries facing short term deficits of funds, may use funds of the subsidiaries generating financial surpluses, without the need to acquire external financing.

Moreover, a unified program of bank guarantees was implemented at TAURON Capital Group. Under the agreements concluded by TAURON with banks it is possible to issue guarantees to secure the liabilities of TAURON Capital Group's subsidiaries companies within the centralized limit. The above mentioned measure reduced the cost of guarantees acquired, made their acquisition independent of the individual subsidiaries' financial standing and limited the total number of actions required to obtain a guarantee.

In 2017 TAURON Capital Group demonstrated full capacity to pay its accounts payable with the payment deadlines thereof.

4.11. Principles of preparing annual consolidated financial statements

Consolidated financial statements have been drawn up in accordance with the IFRS approved by the EU.

The IFRS comprise standards and interpretations approved by the International Accounting Standards Board as well as the International Financial Reporting Interpretation Committee.

TAURON Capital Group's subsidiaries and the parent entity keep their accounting books and prepare their financial statements in accordance with the IFRS, excluding TAURON Czech Energy and TAURON Sweden Energy that are

keeping their books and preparing their financial statements in accordance with the accounting principles applicable, respectively, in the Czech Republic and in Sweden.

The consolidated financial statements contain adjustments which are not included in the ledgers of TAURON Capital Group's entities, introduced in order to bring the consolidated statements into compliance with IFRS.

The consolidated financial statements have been prepared with the assumption of the continuation of business operations by TAURON Capital Group's subsidiaries in the foreseeable future. As of the date of approval of the consolidated financial statements for publication, no circumstances have been detected, indicating any risk for business continuity by TAURON Capital Group's subsidiaries.

The accounting principles (policy) adopted for drawing up of the consolidated financial statements are presented in note 9 of the Consolidated financial statements for the year ended on December 31, 2017.

4.12. Information on the entity authorized to audit financial statements

On April 27, 2017 TAURON concluded the agreement with Ernst & Young Audyt Polska Limited Liability Company Limited Joint-Stock Partnership on conducting an audit of:

- 1) financial statements of the Company for 2017, prepared in accordance with the requirements of the IFRS,
- 2) financial statements of selected subsidiaries of TAURON Capital Group for 2017, prepared in accordance with the IFRS,
- 3) consolidated financial statements for 2017, prepared in accordance with the requirements of the IFRS.

The Agreement also covers conducting a review of the interim, half year financial statements of the Company and the consolidated financial statements of TAURON Capital Group, prepared in accordance with the IFRS requirements for the period ending on June 30, 2017.

The above audit company was also selected, on February 26, 2018 by TAURON's Supervisory Board to audit the standalone and consolidated financial statements of TAURON for the financial year 2018 and the review of the interim standalone and consolidated financial statements of TAURON for the period ending on June 30, 2018. The detailed information on the conclusion of the amendment to the agreement with the above audit company is provided in section 2.8. of this report.

The audit of the standalone and consolidated financial statements of TAURON for the financial year 2016, the financial statements of selected TAURON Capital Group's subsidiaries for the financial year 2016 and the review of the interim standalone and consolidated financial statements of TAURON for the period ending on June 30, 2016 were conducted by Deloitte Polska Limited Liability Company Limited Joint-Stock Partnership.

The compensation of the certified auditors for the services provided for TAURON Capital Group's subsidiaries is shown in the below table.

Table no. 32. Compensation of the certified auditors for the services provided for TAURON Capital Group's subsidiaries

No.	Year ended on December 31, 2017 (PLN thous.)	Year ended on December 31, 2016 (PLN thous.)
1. Mandatory audit, including:	1 018	752
<i>consolidated financial statements</i>	124	25
<i>standalone financial statements of the parent entity</i>	54	80
<i>standalone financial statements of the subsidiaries</i>	840	647
2. Other certifying services provided to TAURON Capital Group, including reviews of financial statements	565	438
3. Tax advisory services	0	0
4. Other services (including training) provided for TAURON Capital Group	3	244
Total	1 586	1 434

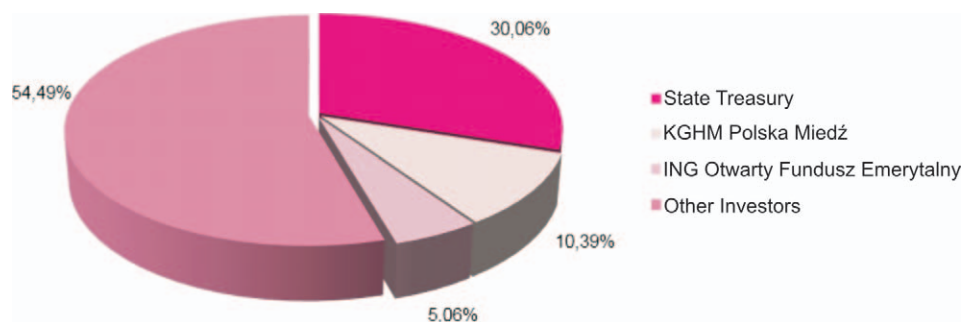
5. SHARES AND SHAREHOLDERS

5.1. Structure of shareholding

As of December 31, 2017 and as of the day of drawing up this report the Company's share capital was, in accordance with an entry in the National Court Register, PLN 8 762 746 970 and was split into 1 752 549 394 shares with a nominal value of PLN 5 per share, including 1 589 438 762 ordinary AA series bearer shares and 163 110 632 registered BB series shares.

The below figure presents the structure of shareholding as of December 31, 2017 and as of the day of drawing up this report.

Figure no. 85. Structure of shareholding as of December 31, 2017 and as of the day of drawing up this report



5.2. Dividend policy

As part of its Strategy adopted on September 2, 2016 the Company adopted its dividend policy. In the long term TAURON is planning to pay out a dividend of minimum 40 percent of the consolidated net profit. The Company's intention is to provide a dividend yield that would be competitive versus the yield offered by long term debt instruments issued on the Polish market by investment grade rated companies. The final recommendation on the dividend will be impacted by additional factors, including in particular

- 1) TAURON Capital Group's liquidity position,
- 2) Market situation,
- 3) Implementation of the investment policy,
- 4) Cost and ability to obtain financing,
- 5) Legal requirements and provisions of the financing agreements, in particular related to not breaching the defined level of the leverage ratio,
- 6) Ensuring investment grade rating.

The forecasts that are the basis for the Strategy indicate that 2020 will be the first year in which the dividend payout will be possible.

The below table presents the dividends paid out in 2010–2014.

Table no. 33. Dividends paid out in 2010–2014

Dividends paid out in 2010–2014						
No.	Financial year for which the dividend was paid out	Dividend amount paid out (PLN)	Net profit %	Dividend per share (PLN)	Dividend record date	Payment date
1.	2010	262 882 409,10	31%	0.15	30.06.2011	20.07.2011
2.	2011	543 290 312,14	44%	0.31	02.07.2012	20.07.2012
3.	2012	350 509 878,80	24%	0.20	03.06.2013	18.06.2013
4.	2013	332 984 384,86	25%	0.19	14.08.2014	04.09.2014
5.	2014	262 882 409,10	23%	0.15	22.07.2015	12.08.2015

5.3. Number and nominal value of the Company's shares, as well as of the shares in units related to the Company, held by members of the Management Board and the Supervisory Board

As of December 31, 2017 and as of the day of drawing up this report members of the Management Board and members of the Supervisory Board did not have any TAURON shares, nor they held any shares in units related to the Company.

5.4. Agreements related to potential changes to the shareholding structure

Management Board has no information on the existence of agreements (including also the ones concluded past the balance sheet date), as a result of which changes in the proportions of shares held by the existing shareholders and bondholders may occur in the future.

5.5. Own shares buybacks

In 2017 and as of the day of drawing up this report the Company did not own any of its shares.

5.6. Employee stock award programs

In 2017 no employee stock award programs were implemented by the Company.

5.7. Shares performance on the Warsaw Stock Exchange (WSE)

TAURON shares have been listed on the Main Market of the Warsaw Stock Exchange since June 30, 2010. In 2017 TAURON share price fluctuated between PLN 2.76 and PLN 4.12 (at closing prices). During the last session of 2016 the share price was PLN 2.85, while a year later the price reached PLN 3.05. This means that the rate of return on the investment in TAURON shares was 7 percent in 2017.

Performance of shares listed on WSE in 2017 was impacted by favorable, both global as well as local factors. Investors were convinced that the government's economic policy allowed for a further strong GDP growth, while PLN was one of the strongest currencies on the market. Also energy sector companies became more attractive for investors, which led to a 15% rise of the WIG-Energia index.

Apart from very good economic conditions and the growing demand for electricity TAURON share price last year was also positively impacted by activities with respect to obtaining financing aimed at ensuring TAURON Capital Group's financial stability, in particular the July 2017 issue of 10-year Eurobonds worth EUR 500 mln.

As of December 31, 2017 TAURON shares were included in the following stock exchange indices:

1. **WIG** – index that includes all companies listed on WSE's Main Market that meet basic criteria for inclusion in indices. TAURON's share in WIG: 0.96%.
2. **WIG-Poland** – national index that groups solely shares of domestic companies listed on WSE's Main Market that meet basic criteria for inclusion in indices. TAURON's share in WIG-Poland index: 1.11%.
3. **WIG20** – index calculated on the basis of the value of the portfolio of shares of 20 largest and most liquid companies listed on WSE's Main Market. TAURON's share in WIG20 index: 1.46%.
4. **WIG30** – index that includes 30 of the largest and most liquid companies listed on WSE's Main Market. TAURON's share in WIG30 index: 1.35%.
5. **WIG-Energia** – sector based index that comprises companies included in WIG index and are also qualified to the energy sector. TAURON's share in WIG-Energia: 15.98%.
6. **Respect Index** – index that groups in its portfolio companies that operate in accordance with the highest corporate social responsibility standards. TAURON's share in RESPECT Index: 2.65%.
7. **MSCI Emerging Markets Europe** – index that includes key companies in 15 developed countries in Europe. TAURON's share in MSCI Emerging Markets Europe Index: 0.02%.
8. **MSCI Poland Index** – index that includes more than 20 key companies listed on WSE. TAURON's share in MSCI Poland Standard Index: 1.26%.

The below table presents key data on the Company's shares in 2011–2017.

Table no. 34. Key data on TAURON shares in 2011–2017

No.	2011	2012	2013	2014	2015	2016	2017
1. Share price high (PLN)	6.81	5.61	5.39	5.69	5.29	3.19	4.12
2. Share price low (PLN)	4.65	4.08	3.85	4.04	2.37	2.31	2.75
3. Last share price (PLN)	5.35	4.75	4.37	5.05	2.88	2.85	3.05
4. Capitalization at the end of the period (PLN m)	9 376	8 325	7 659	8 850	5 047	4 995	5 345
5. Capitalization at the end of the period (%)	2.1	1.59	1.29	1.5	0.98	0.9	0.8
6. Book value (PLN m)	15 922.47	16 839.41	17 675.34	18 106.79	18 837	16 348.99	17 880
7. P/E	8.1	5.5	5.5	7.8	4.2	x	3.02
8. P/BV	0.59	0.49	0.43	0.49	0.27	0.31	0.31
9. Rate of return ytd ¹ (%)	-16.73	-5.03	-3.64	20.07	-40.78	-1.04	7.02
10. Dividend yield (%)	2.8	6.5	4.6	3.8	5.2	–	–
11. Trading volume (PLN m)	5 574.82	3 198.94	3 103.56	3 134.81	3 062.52	3 199.02	2 737.33
12. Trading volume share (%)	2.21	1.7	1.41	1.53	1.5	1.69	1.16
13. Average volume per session	3 721 539	2 667 725	2 793 020	2 489 329	3 190 195	4 662 087	3 261 765
14. Average number of transactions per session	1 373	960	1 022	1 106	1 431	1 465	1 323

Source: WSE Statistical Bulletin

¹ Rate of return calculated taking into account the investor's income from the dividend and assuming that the additional income realized is re-invested. Methodology in accordance with WSE Statistical Bulletin.

The below graphs present historical TAURON share price performance and trading volumes, including against WIG20 and WIG-Energia indices.

Figure no. 86. TAURON share price and trading volumes in 2017

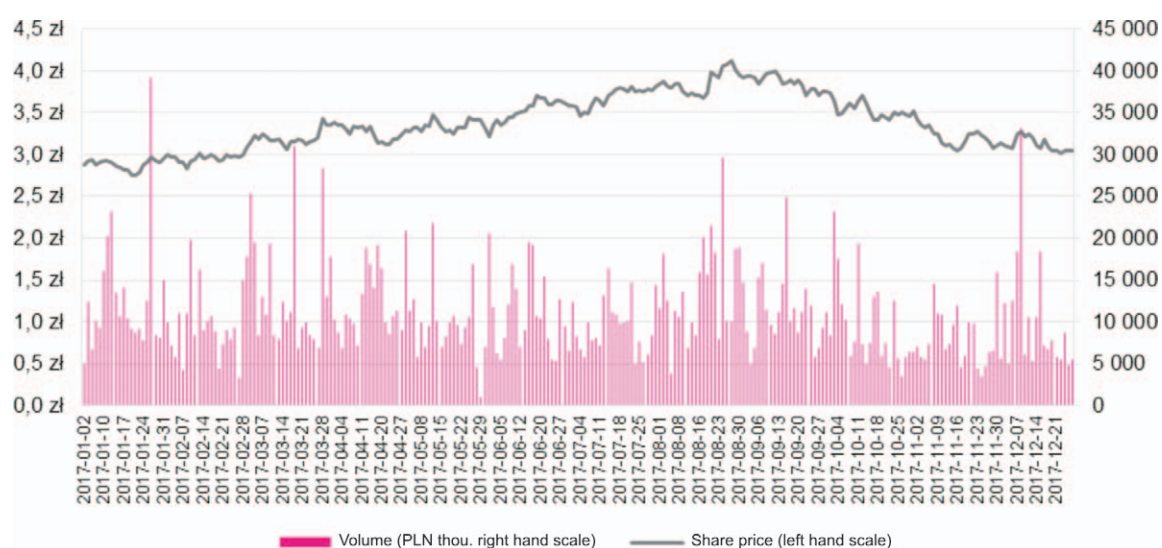
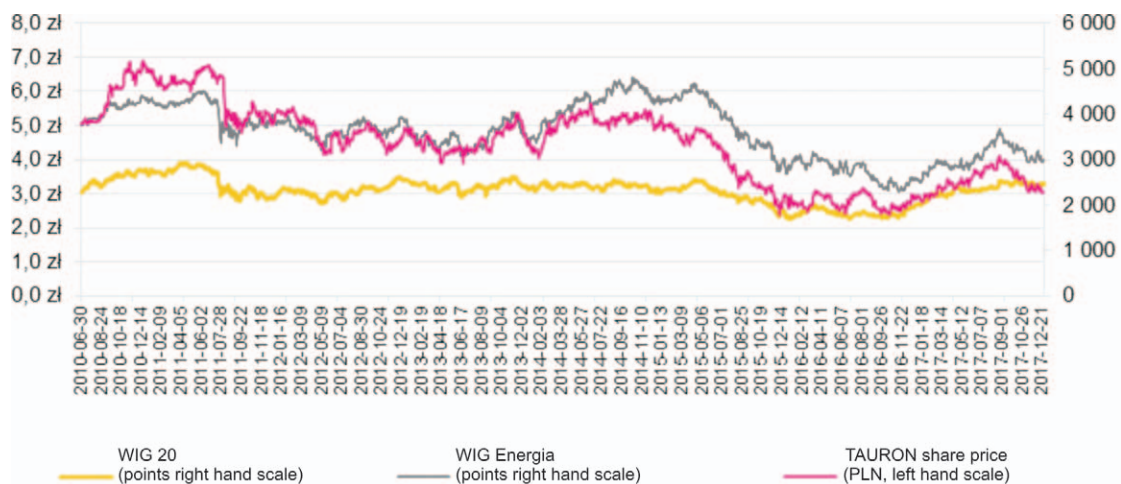


Figure no. 87. TAURON share price and trading volumes since the market debut until December 31, 2017

Figure no. 88. TAURON share price versus WIG20 and WIG-Energia indices since the market debut until December 31, 2017


Recommendations for the shares of TAURON Polska Energia S.A.

In 2017 analysts from brokerage houses and investment banks issued 11 recommendations for TAURON shares in total, including:

- 1) three “Buy” recommendations,
- 2) four “Hold” recommendations,
- 3) four “Sell” recommendations.

The below table presents a list of recommendations issue in 2017.

Table no. 35. Recommendations issued in 2017

Lp.	Data wydania rekomendacji	Recommending institution	Recommendation/target price
1.	15.11.2017	Societe Generale	Buy / PLN 4.50
2.	21.03.2017	Societe Generale	Buy / PLN 4.00
3.	10.01.2017	Pekao Investment Banking	Buy / PLN 4.00
4.	20.11.2017	DM BZ WBK	Hold / PLN 3.40
5.	14.09.2017	Exane BNP Paribas	Hold / PLN 4.00

Lp.	Data wydania rekomendacji	Recommending institution	Recommendation/target price
6.	27.06.2017	mBank	Hold / PLN 3.67
7.	20.03.2017	Raiffeisen Centrobank	Hold / PLN 3.50
8.	08.08.2017	DM PKO BP	Sell / PLN 3.40
9.	26.01.2017	DM BOŚ	Sell / PLN 2.50
10.	08.02.2017	DM Banku Handlowego (Citi)	Sell / PLN 2.50
11.	07.07.2017	DM Banku Handlowego (Citi)	Sell / PLN 2.50

5.8. Investor relations

Accurate and regular communications is one of the key priorities of TAURON with respect to conducting the dialogue with investors. It is provided both in the form of mandatory activities required by law (e.g. by disclosing information in the current and periodic regulatory filings) but also using many additional tools addressed directly to institutional and individual investors. The Company organises itself as well as participates in many investor conferences and roadshows organised by entities operating on the capital market, both in Poland and abroad.

During meetings with investors, the Strategy, the investment projects underway, the financial situation of TAURON Capital Group is presented as well as information on the current standing and outlook of the energy sector.

In connection with the publishing of periodical reports the Company organized conferences for investors and analysts during which members of the Management Board discussed financial results and presented the most important events in the reported periods. The conferences were broadcast on the Internet in Polish and in English. A possibility listening via telephone was also provided. This way all interested investors were able to receive the information at the same time. Separate meetings devoted to discussion of financial results are also regularly arranged for representatives of key media, so that information concerning the standing of TAURON Capital Group could reach all investors via diverse channels.

Besides meetings accompanying the publication of periodical reports, in 2017 members of the Management Board and representatives of the Investor Relations Team took part in 16 conferences and roadshows, during which approximately 100 meetings with managers and capital market analysts were held. Representatives of TAURON met institutional investors not only in Poland, but also in the US, Great Britain, Austria, Germany, Holland, France and Czech Republic.

In connection with the growing role of Internet channels and social media, much emphasis was put on their development with respect to the communications with investors. Via the YouTube service broadcasts of events important for investors are provided: earnings conferences, GMs, Investor Days and comments of the President of the Management Board on the financial results. On the other hand, on Facebook, announcements of significant events are published by the Company, including links to websites where the broadcasts may be followed or participation in an investor chat is possible. TAURON also launched a corporate profile on Twitter where entries related to investor relations appear. Being aware of the fact that the website is a significant source of information for investors, in particular, the *Investor Relations* tab; the Company takes care of its content and validity of the content provided therein. *Investor Relations* section contains a lot of useful information on the current events, financial results or GMs. It also provides presentations and video broadcasts of conferences summarising the financial results.

In 2017, similar to 2016, TAURON participated in events addressed to individual investors. The company was, inter alia, a partner of the "WallStreet" conference in Karpacz, as well as winter and summer sports competitions of the capital market "Capital Market Games". As part of the regular communications with this sizeable group of investors, 4 chats with a representative of the Management Board took place in 2017, in which approximately 100 investors took part each time.

Activities with respect to investor relations are appreciated by participants of the capital market and investors. In 2017 the Company was awarded successive prizes for the high quality of investor relations.

In March 2017, the Company was awarded a special prize in the competition for the best investor relations among WIG30 index companies, organized by the Stock Market and Investors Paper "Parkiet" and the Chamber of Brokerage Houses.

In June 2017 TAURON was awarded the "Hero of the capital market 2017" title in the company category. The winner in the competition organized by the Individual Investors Association was selected based on the vote of the investors who appreciated TAURON's high standards in the field of investor relations and applying the best practice with respect to the communications address to the individual investors.

In the past year TAURON was among the laureates of the “2016 Transparent Company of the Year” ranking for business transparency and quality of the market communications. The ranking, organized by the Stock Market and Investors Paper “Parkiet” and the Institute of Accounting and Taxes (Instytut Rachunkowości i Podatków), was based on a survey in which three most important market communications area were evaluated, i.e. financial statements and reporting, investor relations and corporate governance rules.

TAURON is also regularly awarded prizes in the top annual report competitions. The Company finished first in the previous three editions of “The Best Annual Report” competition organized by the Institute of Accounting and Taxes (Instytut Rachunkowości i Podatków), qualifying, in 2017, to the elite “The Best of the Best” category. In last year’s edition of the competition TAURON was also awarded the top prize for the integrated annual report.

Company is maintaining high quality of reporting to meet the expectations of the broadest possible group of recipients of its communications – customers, shareholders, analysts, as well as media representatives. This is why in 2017 the team working on the design of the integrated annual report focused on the compliance of its structure and content with the international integrated reporting standards. The result of these works is a modern, multimedia online report online presenting the most important information on TAURON Capital Group.

TAURON has been included in the RESPECT Index since 2013, and in December 2017, for the fifth time, the Company found itself in the group of stock market listed entities that apply the highest sustainable growth standards.

2017 investor relations highlights and activities are presented in the below table.

Table no. 36. Highlights and activities performed as part of investor relations in 2017

No.	Date	Event
1.	15.03.2017	Full year 2016 stand-alone and consolidated earnings reports published
2.	16.03.2017	Management Board’s meeting with analysts and fund managers to present FY 2016 earnings, Warsaw
3.	16.03.2017	Chat for individual investors as part of cooperation with the Individual Investors Association
4.	21–22.03.2017	Participation in DM PKO BP CEE Capital Markets Conference, London
5.	27–28.03.2017	Participation in Raiffeisen Centrobank Investor Conference, Austria, Zürs
6.	10.05.2017	Q1 2017 earnings report published
7.	11.05.2017	Management Board’s meeting with analysts and fund managers to present Q1 2017 earnings, Warsaw
8.	11.05.2017	Chat for individual investors as part of cooperation with the Individual Investors Association
9.	25.05.2017	Meetings with fund managers following Q1 2017 earnings, DM Banku Handlowego (Citi), Warsaw
10.	29.05.2017	TAURON’s Ordinary GM
11.	20.06.2017	Eurobond Roadshow, Germany
12.	21.06.2017	Eurobond Roadshow, Netherlands
13.	22.06.2017	Eurobond Roadshow, Great Britain
14.	23.06.2017	Eurobond Roadshow, France
15.	26.06.2017	Eurobond Roadshow, Warsaw
16.	17.08.2017	H1 2017 earnings report published
17.	18.08.2017	Management Board’s meeting with analysts and fund managers to present H1 2017 earnings, Warsaw
18.	18.08.2017	Chat for individual investors as part of cooperation with the Individual Investors Association
19.	24.08.2017	Meetings with fund managers following H1 2017 earnings, Societe Generale, Warsaw
20.	11–12.09.2017	Participation in 14th Annual Emerging Europe Investment Conference, Pekao Investment Banking, Warsaw
21.	26–27.09.2017	Participation in Mining&Energy Conference, DM PKO BP, Katowice
22.	11–12.10.2017	Participation in Erste Group Investor Conference, Austria, Stegersbach
23.	08.11.2017	Q3 2017 earnings report published
24.	09.11.2017	Management Board’s meeting with analysts and fund managers to present Q3 2017 earnings, Warsaw

No.	Date	Event
25.	09.11.2017	Chat for individual investors as part of cooperation with the Individual Investors Association
26.	15.11.2017	Meetings with fund managers following Q3 2017 earnings, DM mBanku, Warsaw
27.	20–21.11.2017	Participation in Poland Investment Forum NY, JP Morgan, New York
28.	01.12.2017	Participation in BZ WBK Energy & Mining Conference, Warsaw
29.	05.12.2017	Participation in Wood's Winter Conference in Prague, Prague

6. STATEMENT ON APPLICATION OF CORPORATE GOVERNANCE

Pursuant to § 91(5)(4) of the Regulation of the Minister of Finance of 19 February 2009 on current and periodical information submitted by issuers of securities and conditions to acknowledge as equivalent information required by legal regulations of a country not being a member state (Journal of Laws no.33 item 259 as amended), and the Best Practice of GPW Listed Companies 2016 (Best Practice 2016), the Company's Management Board submits the statement on application of corporate governance in 2017.

6.1. Indication of applied set of corporate governance rules

In 2017 the Company was subject to the corporate governance rules, described in the document *Best Practice of GPW Listed Companies* (Best Practice 2016), adopted by the Supervisory Board of the GPW Board no. 27/1414/2015 of 13 October 13, 2015, which came into force on January 1, 2016.

The text of the Best Practice 2016 the Company is subject to is published on the GPW website at the address: www.gpw.dobre-praktyki.pl.

6.2. Indication of abandoned rules of corporate governance

In 2017 the Company did not apply the following detailed rules provided in Best Practice 2016:

- 1) IV.Z.2. concerning ensuring of publicly available real-time broadcasts of general meetings, due to the lack of the relevant provisions of the Articles of Association enabling the aforementioned broadcast. In order to enable the application of the rule, the Company Management Board requested the Ordinary GM of the Company to adopt the relevant amendment to the Company Articles of Association ensuring publicly available real-time broadcast of general meetings. However, the Ordinary GM of the Company convened on 8 June 2016 did not adopt the amendment to the Company Articles of Association proposed by the Company Management Board in this respect,
- 2) VI.Z.1. concerning the construction of incentive schemes in a way necessary, among others, to tie the level of compensation of members of the Company's management board and key managers to the actual long-term financial standing of the Company and long-term shareholder value creation as well as the Company's stability. This rule was not applied due to the compensation and bonus system applicable in TAURON in relation to members of the Management Board of the Company and its key managers stipulates that the level of compensation will be tied to the financial situation of the Company within the annual perspective, in conjunction with the implementation of strategic objectives,
- 3) VI.Z.2. stating that in order to tie the compensation of members of the management board and key managers to the Company's long-term business and financial goals, the period between the allocation of options or other instruments linked to the Company's shares under the incentive scheme and their exercisability should be no less than two years. 2 years This rule was not applied due to the compensation and bonus system applicable in TAURON in relation to Members of the Management Board of the Company and its key managers does not provide that compensation should be tied to instruments linked with the Company shares.

In 2017 the following rules did not apply to the Company:

- 1) I.Z.1.10. concerning placing financial projections on the Company website – if the company has decided to publish them – published at least in the last 5 years, including information about the degree of their implementation – due to the fact that financial forecasts are not published,
- 2) III.Z.6. stating that where the Company has no separate internal audit function in its organisation, the audit committee (or the supervisory board if it performs the functions of the audit committee) should review on an annual basis whether such function needs to be separated – due to the fact that the Company has a separate Internal Audit Department in its organisational structure.

Furthermore, the Management Board of the Company, adopting the detailed rules of Best Practice 2016 designated as: I.Z.1.3, I.Z.1.15, I.Z.1.16, II.Z.1, II.Z.6, II.Z.10.1, II.Z.10.2, II.Z.10.3, II.Z.10.4, V.Z.5, V.Z.6, VI.Z.4., indicated the manner of applying them. The detailed description of the manner of applying the above rules is provided in the *Information on the status of applying by the Company of the recommendations and rules provided in Best Practice 2016*, constituting an appendix to the above mentioned report on not applying the detailed rules provided in Best Practice 2016 and provided on the Company's website.

In 2017 the Company developed and introduced into use the document *Diversity Policy at TAURON Group*, that was described in detail in section 6.12. of this report. Before that the Company had not had a single document describing the applied policy of diversity in relation to the authorities of the Company and its key managers, referred to in the rule designated as I.Z.1.15. of Best Practice 2016, in the report published on February 1, 2016 concerning the abandoned

detailed rules of corporate governance contained in Best Practice 2016, the Company indicated the method of applying the diversity policy. It was indicated at then that the rules on diversity management were introduced for application under many documents constituting internal legal acts.

Information concerning abandonment of recommendations provided in Best Practice 2016 for application

In 2017 the Company did not apply only the recommendation provided in Best Practice 2016, designated as IV.R.2 concerning ensuring a possibility to shareholders to participate in the GM using electronic communication means, due to the lack of such shareholders' expectation. This decision is expressed by the failure of the Company GM on 8 June 2016 to adopt the relevant amendments to the Company Articles of Association ensuring publicly available real-time broadcast of general meetings.

The other recommendations provided in Best Practice 2016 were applied by the Company in 2017.

6.3. Description of main characteristics of internal control and risk management systems in relation to the process of generating the financial statements and consolidated financial statements

The internal audit and risk management system with respect to the process of drawing up the financial statements and consolidated financial statements is implemented on three levels:

Level I

General principles of management at the Company and TAURON Capital Group.

TAURON Capital Group's subsidiaries operate based on organizational regulations and possess defined organizational structures based on internal documents adopted for the entire Group. These define the business units responsible for preparing financial statements and consolidated financial statements. Such units have the duty to perform regular control of the tasks vested and functional control of their activities. Business Model of the TAURON Capital Group resulted in implementation of Process Documentation of Megaprocess 3.4 Accounting, containing procedures associated with financial reporting of the Company and the TAURON Capital Group. Process documents define responsibilities of business units within the reporting processes.

Level II

Risk management.

TAURON Capital Group implemented a Risk Area managed by the Executive Director for Risk Management, whose role is to oversee and establish the risk management process for the entire TAURON Capital Group. These functions are implemented within the Company by Corporate, Market and Credit Risk Management Teams. The purpose of risk management is to improve the predictability of attaining strategic objectives by the TAURON Capital Group, including stable creation of the financial result through early identification of threats allowing preventive activities to commence. Risk management standards applicable at the TAURON Capital Group have been defined in the *Strategy for corporate risk management at the TAURON Group* and in policies for managing specific risks. The ERM system encompasses all spheres of TAURON Capital Group business and business processes within the Group, including the process of preparing financial statements. Risks associated with his process are managed, monitored and reported within the ERM system. Standardization aims to ensure coherence in managing the individual risk categories, defining general principles, standards and tools of system architecture. Oversight of the ERM system at the TAURON Capital Group is performed by the Risk Committee.

Level III

Internal Audit.

Internal Audit Department is functioning in the Company. The goal of the Internal Audit is planning and implementing audit tasks, including performance of commissioned ad-hoc inspections, and also activities of advisory and opinion (feedback) providing nature. Methods and rules of implementing the Internal Audit function are defined by the Process Documentation of the Megaprocess 1.5 Audit along with the related document *Regulations of Internal Audit at TAURON Group*. The introduction of Megaprocess 1.5 Audit was a consequence of the adoption of the Business Mode by the Management Board of TAURON. In implementing the internal audit function the Company shall be acting in compliance with the *TAURON Group's Corporate Social Responsibility Code* and the International Standards for the Professional Practice of Internal Auditing.

Key aspects with respect to internal control and risk management in reference to the process of preparing financial statements and consolidated financial statements include:

Supervision over application of consistent accounting rules by TAURON Capital Group's subsidiaries when developing reporting packages for the purpose of preparing TAURON Capital Group's consolidated financial statements

In order to ensure consistent accounting principles based on International Financial Reporting Standards (IFRS) approved by the European Union the Accounting Policy of TAURON Polska Energia S.A. Capital Group (Accounting Policy) was developed and implemented in TAURON Capital Group. This document shall be accordingly updated in case there are changes to the regulations. The rules defined in the Accounting Policy shall be applicable to TAURON's stand-alone financial statements and TAURON Capital Group's consolidated financial statements. TAURON Capital Group's subsidiaries shall be obligated to apply the Accounting Policy when preparing the reporting packages that provide the basis for preparing TAURON Capital Group's consolidated financial statements.

Furthermore, TAURON Capital Group developed and implemented an intra-group regulation that comprehensively regulates issues related to the rules and deadlines for preparing the reporting packages for the purpose of consolidated financial statements. The reporting packages shall be validated by the holding company's Consolidation and Reporting Office and by an independent certified auditor during an audit or review of TAURON Capital Group's consolidated financial statements.

Procedures used to authorize and provide opinions on the Company's financial statements and TAURON Capital Group's consolidated financial statements

The Company has implemented financial statements' authorization procedures. Quarterly, half year and full year financial statements of the Company and TAURON Capital Group's consolidated financial statements shall be approved by the Company's Management Board before being published. Full year financial statements of TAURON and TAURON Capital Group's consolidated financial statements shall be additionally presented for evaluation to the Company's Supervisory Board before being published. Vice President of the Management Board for economic and financial affairs (Chief Financial Officer) shall oversee the preparation of financial statements, while the Management Boards of the subsidiaries included in the consolidation shall be responsible for preparing the reporting packages for TAURON Capital Group's consolidated financial statements.

Supervisory Board's structure includes the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A., whose membership, competence and description of activities are provided in clause 6.11.3 of this report

IT systems as well as financial and accounting processes

TAURON Capital Group's subsidiaries maintain accounting books (ledgers) which constitute the basis for preparing financial statements using ERP financial and accounting computer systems, enabling system audits of the correctness of the document flow and classifying of the business events. Consolidated financial statements are prepared using an IT tool used to consolidate financial statements, providing system control with respect to the coherence (integrity) and timeliness of preparing the consolidation data.

TAURON Capital Group's subsidiaries have implemented IT and organizational solutions that provide control of access to the financial and accounting system and ensure adequate protection and archiving of the accounting books. Access to IT systems is restricted based on applicable access rights assigned to authorized personnel. Control mechanisms are applied in the process of granting and changing access rights to the financial and accounting systems. Granted rights are also subject to periodic verification.

Due to the integration of the accounting functions and the transfer of TAURON Capital Group's material subsidiaries' financial and accounting services to CUW-R (Shared Services Center – Accounting) TAURON Capital Group's financial and accounting processes were gradually unified. The subsidiaries adjusted their own procedures to the flow of the financial and accounting processes, taking into account the specifics of the individual segments.

TAURON Capital Group's Business Model clearly distributes responsibilities with respect to the financial and accounting processes between the Company (indicated as the Corporate Centre) and the subsidiaries and CUW R, indicating that the Corporate Centre is the owner of processes associated with accounting and reporting of TAURON Capital Group. With respect to the tasks of the Corporate Centre, strategic functions associated with the development of the model of operations and standards of TAURON Capital Group were indicated in the area of accounting and supervision of the implementation of standards in the accounting area in the subsidiaries and CUW R. Moreover, it was indicated that the Company as the Corporate Centre is responsible for drawing up the Company's financial statements and the consolidated financial statements of TAURON Capital Group. A clear split of responsibilities and strong emphasis on the fulfillment of the supervisory functions by the Corporate Centre in relation to CUW R and the subsidiaries is, inter alia, aimed at improving the process of preparing the financial statements.

Subjecting the Company's financial statements and TAURON Capital Group's consolidated financial statements to an audit and reviews by an independent certified auditor

Full year financial statements of the Company and full year consolidated financial statements of TAURON Capital Group are subject to an audit by an independent certified auditor. Half year financial statements of the Company and half year consolidated financial statements of TAURON Capital Group are subject to a review by a certified auditor. In 2017 the Company selected an entity authorized to audit and review the financial statements of the material subsidiaries of TAURON Capital Group and the consolidated financial statements. The agreement with the entity authorized to audit financial statements was concluded to conduct an audit and review of the 2017 financial statements. Due to the selection by TAURON's Supervisory Board on February 26, 2018 of an audit company to conduct an audit of the Company's and TAURON Capital Group's 2018 financial statements and a review of the Company's and TAURON Capital Group's 2018 financial statements for the period ended on June 30, 2018 it is planned that an amendment to the agreement with the audit company will be signed.

Due to the coming into force of the law of May 11, 2017 on certified auditors, audit companies and public supervision, the Audit Committee TAURON's Supervisory Board adopted the following regulations on October 16, 2017:

- 1) *Policy of selecting an audit company to conduct an audit and review of the financial statements and consolidated financial statements of TAURON Polska Energia S.A.,*
- 2) *Procedure of selecting an audit company to conduct an audit and review of the financial statements and consolidated financial statements of TAURON Polska Energia S.A., and*
- 3) *Policy of providing at TAURON Group, by an audit company conducting of an audit of the annual financial statements and consolidated financial statements of TAURON Polska Energia S.A., entities related to this audit company and a member of the audit company's network, of the permitted services that are not an audit.*

The above regulations in a clear manner define the principles and rules of the process of selecting an audit company to audit the Company's financial statements, as well as the principles of providing permitted services for the benefit of TAURON Capital Group's, in order to ensure independence of an audit company and certified auditors towards the Company and guarantee for the Company the provision of audit services of high subject matter quality, while meeting the required deadlines that the Company must comply with.

Principle of changing the Company and TAURON Capital Group's audit company

The principle of changing the Company's and TAURON Capital Group's audit company was changed in 2017. The following rule was established in the *Policy of selecting an audit company to conduct an audit and review of the financial statements and consolidated financial statements of TAURON Polska Energia SA*, adopted by the Audit Committee of the Company's Supervisory Board on October 16, 2017:

- 1) maximum period of continuous orders for audits to be conducted by the same audit company or an entity related to that audit company or any member of the network operating in the European Union countries that such audit companies are members of, shall not exceed 5 years,
- 2) after a 5-year duration of the order neither the audit company, nor any member of its network operating within the European Union shall conduct an audit of the Company for the subsequent 4 years,
- 3) a key certified auditor shall not conduct an audit of the Company for a period longer than 5 years,
- 4) a key certified auditor may again conduct an audit of the Company after at least 3 years have elapsed from the completion of the last audit.

Before that the principle adopted by the Supervisory Board of the Company on August 27, 2010 had been in force according to which the rule was adopted concerning changing of the entity authorised to audit the financial statements of the Company and TAURON Capital Group at least once every five 5 financial years. The entity authorized to audit the financial statements of the Company and TAURON Capital Group was able to perform these activities again after the elapse of two financial years.

6.4. Shareholders holding substantial blocks of shares

The below table presents shareholders holding, as of December 31, 2017 and as of the day of drawing up this report, directly or indirectly substantial blocks of the Company's shares.

Table no. 37. Shareholders holding, directly or indirectly, substantial blocks of shares

No.	Shareholders	Number of shares held	Percentage interest in share capital	Number of votes held	Percentage share in the total number of votes
1.	State Treasury	526 848 384	30.06%	526 848 384	30.06%
2.	KGHM Polska Miedź S.A.	182 110 566	10.39%	182 110 566	10.39%
3.	Nationale-Nederlanden Otwarty Fundusz Emerytalny	88 742 929	5.06%	88 742 929	5.06%

Since the day of publishing the previous periodical report, i.e. since November 8, 2017, until the day of publishing this report the Company did not receive any notifications from its shareholders on any changes in the ownership structure of substantial blocks of TAURON shares.

6.5. Holders of securities providing special control rights

The Company did not issue securities that would provide special control rights with respect to the Company.

6.6. Restrictions on exercising the voting right

Restrictions on exercising the right to vote are provided in § 10 of the Company's Articles of Association which are available on the Company's website <http://www.tauron.pl/>.

The above restrictions on exercising the voting right are formulated in the following way:

1. The voting right of shareholders holding over 10% of total votes in the company shall be limited so that none of them can exercise more than 10% of the total votes in the company at the General Meeting of Shareholders.
2. The restriction on exercising the voting right mentioned in clause 1 above shall not apply to the State Treasury and entities controlled thereby in the period during which the State Treasury, together with entities controlled thereby, hold a number of the company's shares that entitle them to exercise at least 25% of the total votes in the company.
3. Votes of shareholders who have a parent/subsidiary relationship in the understanding of § 10 of the Articles of Association (Shareholder Cluster) shall be aggregated; in case the aggregate number of their votes exceeds 10% of total votes in the company it shall be subject to reduction. Rules of votes' aggregation and reduction are defined in clauses 6 and 7 below.
4. A shareholder, in the understanding of § 10 of the Articles of Associations, shall be any party (entity), including its parent and subsidiary company, entitled directly or indirectly to a voting right at the General Meeting of Shareholders on the basis of any legal title; it shall also be applicable to a party (entity) that does not hold the company's shares, and in particular to a user, lien holder, party (entity) entitled on the basis of a depository receipt under regulations of the Act of July 29, 2005 on financial instruments trading, as well as a party (entity) entitled to take part in the General Meeting of Shareholders in spite of disposing of its shares after the date of establishing (registering) the right to take part in the General Meeting of Shareholders.
5. A parent company and subsidiary company, for the purposes of § 10 of the Articles of Association, shall be understood, accordingly, as a party (entity):
 - 1) having the status of a controlling undertaking, controlled undertaking or, at the same time, both the status of a controlling undertaking and controlled undertaking in the understanding of the *Act of February 16, 2007 on the protection of competition and consumers*, or
 - 2) having the status of a parent company, higher level parent company, subsidiary company, lower level subsidiary company, co-controlled company or one that has both the status of a parent company (including a higher level parent company) and the status of a subsidiary (including a lower level subsidiary company and a co-controlled company) in the understanding of the *Act of September 29, 1994 on accounting*, or
 - 3) which has (parent company) or one which is under controlling influence (subsidiary company) in the understanding of the *Act of September 22, 2006 on transparency of financial relationships between public bodies and public undertakings and on financial transparency of some undertakings*, or
 - 4) whose votes due to the company's shares owned directly or indirectly are subject to aggregation with votes of another party (entity) or other parties (entities) on conditions defined in the *Act of July 29, 2005 on a public offering and conditions of introducing financial instruments to an organized trading system and on public companies* in connection with holding, disposing of or acquiring large blocks of the company's shares.
6. Aggregation of votes is based on totaling the number of votes held by individual shareholders that are members of the Shareholders' Cluster.
7. Reduction of votes involves decreasing the total number of votes in the company that shareholders that are members of the Shareholders' Cluster, are entitled to exercise at the General Meeting of Shareholders to the level of 10% of total votes in the company. Reduction of votes shall take place in accordance with the following rules:
 - 1) number of votes of a shareholder who holds the largest number of votes in the company among all shareholders that are members of the Shareholders' Cluster shall be reduced by a number of votes equal to a surplus above 10% of total votes in the company held by all shareholders that are members of the Shareholders' Cluster,
 - 2) if, despite the above mentioned reduction, the total number of votes that shareholders that are members of the Shareholders' Cluster are entitled to exceeds 10% of the total votes in the company, a further reduction of votes held by other shareholders that are members of the Shareholders' Cluster shall be made. The further reduction of individual shareholders' votes shall take place in an order established on the basis of the number of votes that individual shareholders that are members of the Shareholders' Cluster hold (from the highest to the lowest one). The further reduction shall take place until the total number of votes held by shareholders that are members of the Shareholders' Cluster does not exceed 10% of the total votes in the Company,
 - 3) in any case a shareholder whose voting rights have been reduced shall have the right to exercise at least one vote,
 - 4) restriction on exercising the voting right shall also apply to a shareholder absent at the General Meeting of Shareholders.
8. Each shareholder who is going to take part in the General Meeting of Shareholders, in person or through a proxy, shall be obliged to, without a separate notice mentioned in clause 9 below, notify the Management Board or the Chairperson of the General Meeting of Shareholders that she/he holds, directly or indirectly, more than 10% of the total votes in the company.

9. Notwithstanding the provisions of clause 8 above, in order to establish the basis for aggregating and reducing the votes, a Company's shareholder, Management Board, Supervisory Board and individual members of such bodies shall have the right to demand that a shareholder of the Company provide information whether she/he is a party (entity) having the status of a parent or subsidiary company towards another shareholder in the understanding of § 10 of the Articles of Association. The entitlement mentioned in the preceding sentence shall also include the right to demand the revealing of the number of votes that the company's shareholder holds on its own or jointly with other shareholders of the Company.
10. A party (entity) that has failed to fulfill or has fulfilled the information obligation mentioned in clauses 8 and 9 above improperly, shall, until the failure to fulfill the information obligation has been remedied, be able to exercise its voting right with respect to one share only; exercising voting rights with respect to other shares by such party (entity) shall be null and void.

6.7. Restrictions on transfer of securities ownership right

As of December 31, 2017 and as of the day of drawing up this report TAURON's Articles of Association do not envisage limitations on the transfer of the Company's securities ownership right.

However, in accordance with the *law of July 24, 2015 on the control of some investments* an entity intending to purchase or achieve a material shareholding or purchase the dominating control over TAURON, which is an entity subject to protection, shall, each time, be obligated to submit a notification to the control body – Minister of Energy of its intention to do so, unless such obligation rests on other entities.

6.8. Rules on appointing and dismissing managing and supervising persons and their powers

6.8.1. Management Board

Rules on appointing and dismissing members of the Management Board

Management Board of the company shall be composed of one to six persons, including the President and Vice Presidents. Members of the Management Board shall be appointed and dismissed by the Supervisory Board for a common term of office lasting 3 years, except for the 1st term that lasted 2 years.

Each of the Management Board members can be dismissed or suspended in office by the Supervisory Board or the GM.

In order to recruit a person with whom an agreement on performing the management board level function at the Company, Supervisory Board announces the competition and conducts a qualification procedure for the position of the President or Vice President aimed at verifying and assessing the candidates' qualifications and selecting the best candidate. A candidate for a member of the Management Board must meet the requirements set forth in §16 clauses 3 and 4 of the Company's Articles of Association. The announcement of the qualification process is published on the Company's web site and in the Public Information Bulletin of the Ministry of Energy. The Company notifies the shareholders of the results of the qualification procedure.

Management Board's competence

Management Board shall conduct the company's affairs and represent the company in all court and out of court proceedings. Any matters related to conducting the Company's affairs, not assigned, based on the legal regulations or the provisions of the Articles of Association, to the scope of competence of the General Meeting of Shareholders or Supervisory Board, shall be within the scope of competence of the Management Board.

In accordance with the Articles of Association, all issues which go beyond the regular scope of the Company's activities shall require a resolution of the Management Board, in particular, the following issues listed in the below table:

Table no. 38. Management Board's competence

Matters that require a resolution of the Management Board
as of December 31, 2017 and as of the day of drawing up this report
1. Management Board bylaws,
2. company's organizational regulations,
3. establishment and liquidation of branches,
4. appointment of a proxy,
5. taking on credits and loans,
6. approving annual material and financial plans of the company and of the Capital Group as well as the Capital Group's Corporate Strategy,
7. assuming contingent liabilities in the understanding of the Act of September 29, 1994 on accounting, including granting guaranties and sureties by the company as well as issuing bills of exchange, subject to § 20 clause 2 item 4 and 5 of the company's Articles of Association,
8. making donations, cancelling interest or releasing from debt, subject to § 43 clause 3 items 1 and 2 of the company's Articles of Association,

Matters that require a resolution of the Management Board

as of December 31, 2017 and as of the day of drawing up this report

9. purchase of real estate, perpetual usufruct or shares in real estate or in perpetual usufruct, subject to § 20 clause 2 item 1 of the company's Articles of Association,
10. purchase of fixed assets excluding real estate, perpetual usufruct or share in real estate or perpetual usufruct with the value equal to or exceeding the PLN equivalent of EUR 10,000, subject to the provisions of § 20 clause 2 item 2 of the Company's Articles of Association,
11. disposal (control) of fixed assets including real estate, perpetual usufruct or share in real estate or perpetual usufruct with the value equal to or exceeding the PLN equivalent of EUR 10,000, subject to the provisions of § 20 clause 2 item 3 of the company's Articles of Association,
12. defining the way the voting right will be exercised at the General Meeting of Shareholders or the Meeting of Shareholders of companies in which the company holds shares, on matters within the scope of competence of the General Meeting of Shareholders or the Meeting of Shareholders of such companies, subject to the provisions of § 20 clause 3 item 9 of the company's Articles of Association,
13. rules of conducting sponsoring activities,
14. adoption of the annual plan of sponsoring activities,
15. matters which the Management Board refers to the Supervisory Board or the General Meeting of Shareholders for review.

6.8.2. Supervisory Board

Rules on appointing and dismissing members of the Supervisory Board

Supervisory Board shall be composed of five to nine persons, appointed for a common term of office lasting three years, except for the first term that lasted 1 year. In accordance with the Company's Articles of Association members of the Supervisory Board shall be appointed and dismissed by the General Meeting of Shareholders, subject to the following:

- 1) during the time when the State Treasury, together with the State Treasury controlled entities in the understanding of § 10 clause 5 of the Articles of Association, hold a number of the company's shares that entitle them to exercise at least 25% of the total votes in the company, the State Treasury, represented by the minister competent to handle the State Treasury's affairs, shall be entitled to appoint and dismiss members of the Supervisory Board in the number equal to half of the maximum number of members of the Supervisory Board defined in the Articles of Association (in case such number is not integral it shall be rounded down to an integral number, for example 4.5 shall be rounded down to 4) and increased by 1, provided that the State Treasury:
 - a) shall be obliged to vote at the General Meeting of Shareholders on establishing the number of members in the Supervisory Board that would correspond to the maximum number of members of the Supervisory Board defined in the Articles of Association in case such a motion is submitted to the Management Board by a shareholder or shareholders who hold a number of votes that entitle them to exercise at least 5% of the total number of votes in the Company,
 - b) shall be excluded from the voting at the General Meeting of Shareholders on appointing and dismissing other members of the Supervisory Board, including independent members of the Supervisory Board; this shall not, however, apply to the case when the Supervisory Board cannot act due to its membership being smaller than required by the Articles of Association, and the shareholders present at the General Meeting of Shareholders, other than the State Treasury, do not supplement the membership of the Supervisory Board in accordance with the distribution of seats in the Supervisory Board defined in this section;
- 2) during the time when the State Treasury, together with the State Treasury controlled entities in the understanding of § 10 clause 5 of the Articles of Association, hold a number of the company's shares that entitle them to exercise less than 25% of the total number of votes in the company, the State Treasury, represented by the minister competent to handle the State Treasury's affairs, shall be entitled to appoint and dismiss one member of the Supervisory Board.
- 3) appointing and dismissing members of the Supervisory Board by the State Treasury pursuant to the above mentioned clause 1) or 2) shall take place by means of a statement submitted to the Company.

In accordance with the Best Practice at least two members of the Supervisory Board shall meet the criteria of independence. Phrase an "independent member of the Supervisory Board" shall denote an independent member of the Supervisory Board in the understanding of Appendix II to the *European Commission's Recommendation of February 15, 2005 related to the role of non-executive directors or members of a supervisory board of publicly listed companies and a supervisory board's committee* (2005/162/EC).

Members of the Supervisory Board shall submit to the Company, prior to their appointment as members of the Supervisory Board, a written statement on compliance with the independence criteria. In case a situation occurs where the independence criteria are not complied with a member of the Supervisory Board shall be obligated to forthwith inform the company thereof. The company shall inform shareholders of the up to date number of independent members of the Supervisory Board.

Supervisory Board's competence

Supervisory Board shall continuously oversee the Company's activities in all areas of its operations.

According to the Company's Articles of Association the Supervisory Board's tasks and competences shall include in particular the matters listed in the below table.

Table no. 39. Supervisory Board's competence

Matters that require a resolution of the Supervisory Board	
as of December 31, 2017 and as of the day of drawing up this report	
Competences related to providing opinions	
1.	evaluate the Management Board's report on the company's operations (Directors' Report) as well as the financial statements for the last financial year with respect to their compliance with books, documents as well as with the actual status. This shall also apply to the Capital Group's consolidated financial statements, provided they are prepared,
2.	evaluate the Management Board's recommendations on profit distribution or loss coverage,
3.	submit a written report to the General Meeting of Shareholders on the outcome of activities covered in clauses 1 and 2,
4.	prepare once a year and submit to the General Meeting: <ol style="list-style-type: none"> a) evaluation of the company situation, including the assessment of the internal control, risk management systems, compliance and internal audit functions, including all significant control mechanisms, in particular, those related to financial reporting and operations, b) report on activities of the Supervisory Board comprising at least information concerning: <ul style="list-style-type: none"> – the composition of the Supervisory Board and its committees, – fulfilment of independence criteria by Members of the Supervisory Board, – number of meetings of the Supervisory Board and its committees, – self-assessment of the Supervisory Board c) assessment of the method of fulfilment of information obligations by the Company, in relation to the application of corporate governance principles defined in the Regulations of the Exchange and provisions related to current and periodical information submitted by issuers of securities, d) assessment of rationality of sponsoring, charitable policy, or other similar policy pursued by the Company, or information concerning the lack of such policy,
5.	prepare, along with the report on the results of the Company's annual financial statements' evaluation, the Supervisory Board's opinion on the financial viability of the company's capital investments in other commercial law entities made in the given financial year,
6.	provide opinions on the Capital Group's Corporate Strategy,
7.	provide opinions on the rules of conducting sponsoring activities,
8.	provide opinions on the annual plan of conducting sponsoring activities as well as on the annual report on its implementation,
9.	provide opinions on the reports prepared, by the Management Board, on entertainment expenses, expenditures on legal services, marketing services, public relations and social communications service as well as advisory services related to management,
10.	provide opinions on the changes of the rules of divesting fixed assets, defined in § 381 of the Company's Articles of Association.
Competences that include	
1.	selecting a certified auditor to carry out an audit of the company's financial statements and the Capital Group's consolidated financial statements,
2.	defining the scope and deadlines for submitting the company's and the Capital Group's annual material and financial plan by the Management Board,
3.	adopting the consolidated text of the company's Articles of Association, prepared by the company's Management Board,
4.	approving the Management Board's bylaws,
5.	approving the organizational regulations of the company's enterprise,
6.	purchasing real estate, perpetual usufruct or shares in real estate or in perpetual usufruct with the value exceeding the PLN equivalent of EUR 5,000,000, except for real estate, perpetual usufruct or shares in real estate or in perpetual usufruct purchased from the Capital Group's subsidiaries,
7.	purchasing fixed assets, excluding real estate, perpetual usufruct or share in real estate or perpetual usufruct, bonds issued by the Capital Group's subsidiaries and other fixed assets purchased from the Capital Group's subsidiaries of the value exceeding the PLN equivalent of EUR 5,000,000,
8.	disposing of fixed assets, including real estate, perpetual usufruct or share in real estate or perpetual usufruct, of the value equal to or exceeding the PLN equivalent of EUR 5,000,000, except for real estate, perpetual usufruct or shares in real estate or in perpetual usufruct, and also other fixed assets that as a result of disposing will be sold or encumbered in favor of the Capital Group's subsidiaries,
9.	assuming contingent liabilities, including granting guaranties and sureties by the company with the value exceeding the PLN equivalent of EUR 5,000,000,
10.	issuing bills of exchange of the value exceeding the PLN equivalent of EUR 5,000,000,
11.	making an advance payment on account of the expected dividend,
12.	taking over or purchasing shares in other companies than the Capital Group's subsidiaries with the value exceeding the PLN equivalent of EUR 5,000,000, except for situations when taking over shares in such companies takes place in exchange for the company's liabilities as a part of composition or bankruptcy proceedings,

Matters that require a resolution of the Supervisory Board

as of December 31, 2017 and as of the day of drawing up this report

13. selling shares with the value exceeding the PLN equivalent of EUR 5,000,000 along with defining the conditions and procedure to be applied in their sale, except for:
 - a) selling shares which are traded on the regulated market,
 - b) selling shares that the company holds in the amount not exceeding a 10% interest in the share capital of particular companies,
 - c) selling shares in favor of the Capital Group's subsidiaries,
14. concluding a material agreement with a shareholder holding at least 5% of the total number of votes in the Company or a related company, with a proviso, that this obligation shall not cover typical transactions and concluded at arm's length as part of the business operations conducted by the Company with entities that are members of TAURON Capital Group,
15. concluding an agreement on legal services, marketing services, public relations and social communications services as well as advisory services related to management, if the amount of total net compensation for the services provided exceeds PLN 500 000, on a yearly basis,
16. amending an agreement on legal services, marketing services, public relations and social communications services as well as advisory services related to management, increasing the compensation above the amount mentioned in the above clause j,
17. concluding an agreement on legal services, marketing services, public relations and social communications services as well as advisory services related to management, under which the maximum compensation amount is not envisaged,
18. concluding a donation agreement or another agreement with similar consequences of the value exceeding PLN 20 000 or 0.1% of the total assets in the understanding of the *law of September 29, 1994 on accounting*, determined on the basis of the last approved financial statements,
19. relieving from debt *dlugu* or from another agreement with similar consequences of the value exceeding PLN 50 000 or 0.1% of the total assets in the understanding of the *law of September 29, 1994 on accounting*, determined on the basis of the last approved financial statements,
20. granting a permission to establish the company's branches abroad,
21. defining the way of exercising the voting right at the General Meeting of Shareholders or at the Meeting of Shareholders of companies in which the company holds more than 50% of shares, with respect to the following matters:
 - a) selling and leasing out the company's enterprise or its organized part as well as establishing a limited proprietary right on them if their value exceeds the PLN equivalent of EUR 5 000 000,
 - b) dissolving and liquidating the company.
22. defining the manner of exercising the voting right by a representative of TAURON during the GMs of companies (subsidiaries) with respect to which the Company is a dominating entrepreneur in the understating of art. 4 section 3 of the *law of February 16, 2007 on competition and consumer protection*, with respect to the following issues:
 - a) company setting up another company,
 - b) change to the Articles of Association or the shareholders agreement and the subject of the company's operations,
 - c) merging, transforming, splitting, dissolving and liquidating the company,
 - d) increasing or decreasing the company's share capital,
 - e) selling and leasing out the company's enterprises or its organized part and establishing a limited property right thereupon,
 - f) redeeming (retiring) of shares,
 - g) setting the compensation of members of Management Boards and Supervisory Boards,
 - h) provision on claims for remedying damage inflicted when setting up the company or performing management or supervision,
 - i) matters mentioned in art. 17 of the *law of December 16, 2016 on the principles of managing state property*, subject to § 15 clause 4 of the Company's Articles of Association,
23. approving compensation policy for the capital group.

Competences related to the Management Board

1. appoint and dismiss members of the Management Board,
2. establish the rules of compensation and the amounts of compensation for the members of the Management Board, subject to § 18 of the Company's Articles of Association,
3. suspend members of the Management Board from office for important reasons,
4. delegate members of the Supervisory Board to temporarily perform duties of the members of the Management Board who cannot perform their duties and establish their compensation subject to the provision that the total compensation of the delegated person as a Member of the Supervisory Board's as well as on account of being delegated to temporarily perform duties of a Member of the Management Board shall not exceed the compensation established for the Member of the Management Board to replace whom the Member of the Supervisory Board was delegated,
5. conduct a recruitment process for the position of a Member of the Management Board,
6. conduct a competition in order to select a person with whom an agreement to perform the management board functions in the Company shall be concluded and conclude such agreement to perform the management board functions in the Company,
7. grant a permission to Members of the Management Board to take positions in governing bodies of other companies.

Other competences of the Company's Supervisory Board

1. prepare reports on overseeing the implementation of investment projects by the Management Board, including fixed asset purchases, and in particular provide opinions on the correctness and effectiveness of expenditures related thereto,
2. approve the Management Board's annual report on the supervision over the implementation of investment projects,
3. pass regulations describing in detail the Supervisory Board's procedures.

6.9. Description of the procedure of amendment of the Company's Articles of Association

Amendments to the Company's Articles of Association in accordance with the provisions of the Ksh, in particular: amendments to the Company's Articles of Association take place by means of resolution of the GM, at the majority of two thirds of the votes, and then requires issuing a decision by a proper court on entering the change into the register of entrepreneurs. The consolidated text of the Company's Articles of Association, including amendments passed by the General Meeting, shall be adopted by the Supervisory Board by means of a resolution.

In accordance with the Company's Articles of Association, a material amendment to the subject of activities requires two thirds of votes under the presence of persons representing at least a half of the share capital.

Ordinary GM on May 29, 2016 adopted the resolutions concerning amendments to the Company's Articles of Association; the relevant information s provided in section 2.8. of this report.

6.10. Procedures of the General Meeting of Shareholders, its fundamental powers and description of shareholders' rights and the manner of exercising thereof

The Company's General Meeting of Shareholders' procedures and its empowerments are defined in the company's Articles of Association and in the Regulations of the General Meeting of Shareholders of TAURON Polska Energia S.A. which are available on the Company's website <http://www.tauron.pl/>.

Procedures of the General Meeting of Shareholders

General Meeting of Shareholders shall be convened by a notice published on the company's website and in a manner defined for providing current information by public companies. In case the General Meeting is convened by an entity or a body other than the Management Board on the basis of regulations of the Code of Commercial Companies, as convening a General Meeting of Shareholders requires the Management Board's cooperation, the Management Board shall be obligated to perform any activities required by law in order to convene, organize and conduct General Meetings of Shareholders that take place either at the Company's seat or in Warsaw.

General Meeting of Shareholders shall be opened by the Chairperson of the Supervisory Board, and in case he/she is absent the following persons shall be entitled to open the General Meeting of Shareholders in the given order: Vice Chairperson of the Supervisory Board, President of the Management Board, a person designated by the Management Board or the shareholder who registered at the General Meeting of Shareholders such number of shares that provide the right to exercise the highest number of votes. Then, the chairperson of the General Meeting of Shareholders shall be elected from among persons entitled to participate in the General Meeting of Shareholders.

General Meeting of Shareholders shall pass resolutions irrespective of the number of shares represented at the Meeting, unless regulations of the Code of Commercial Companies, as well as provisions of the company's Articles of Association state otherwise. General Meeting of Shareholders may order a break in the meeting by the majority of two thirds of votes. The breaks shall not exceed 30 days in total.

A break in the GM session may take place only in exceptional situations indicated on a case-by-case basis in the justification to the resolution, prepared based on reasons presented by a shareholder requesting the announcement pf the break.

The GM resolution concerning a break shall clearly indicate the date of resumption of the session, however, such a date must not create a barrier for participation of the majority of shareholders in resumed meeting, including minority shareholders.

Competence of the General Meeting of Shareholders

In accordance with the Company's Articles of Association the matters listed in the below table shall require a resolution of the General Meeting of Shareholders.

Table no. 40. Competence of the General Meeting of Shareholders

Matters that require a resolution of the General Meeting of Shareholders	
as of December 31, 2017 and as of the day of drawing up this report	
1.	reviewing and approving the financial statements of the Company and the consolidated financial statements of TAURON Capital Group for the previous financial year for the previous financial year as well as the Management Board's report on the Company's operations (Directors' Report) and the Management Board's report on the operations of TAURON Capital Group
2.	granting the acknowledgement of the fulfillment of duties to the members of the Company's corporate bodies,
3.	profit distribution and coverage of loss,
4.	appointing and dismissing members of the Supervisory Board,
5.	suspending members of the Management Board in performance of their duties,
6.	establishing the amount of compensation for members of the Supervisory Board, subject to § 29 clause 4 of the company's Articles of Association,
7.	establishing the principles of determining compensation and the amount of compensation of members of the Management Board taking into account the provisions of the <i>law of June 9, 2016 on the principles of determining compensation of persons managing some companies</i> ,
8.	selling and leasing out the company's enterprise or its organized part as well as establishing a limited proprietary right on them,

Matters that require a resolution of the General Meeting of Shareholders

as of December 31, 2017 and as of the day of drawing up this report

9. concluding a credit, loan, surety agreement or any other similar agreement by the company with a member of the Management Board, Supervisory Board, proxy, liquidator or for the benefit of any such person. Concluding a credit, loan, surety or any other similar agreement by a subsidiary with a member of the Management Board, Supervisory Board, proxy, liquidator or for the benefit of any such person,
10. increasing and decreasing the company's share capital,
11. issuing convertible bonds or senior bonds as well as registered securities or bearer securities entitling their holder to subscribe or acquire the shares,
12. purchasing of treasury shares in cases required by the regulations of the Code of Commercial Companies,
13. mandatory redemption of shares (squeeze-out) in accordance with the provisions of art. 418 of the Code of Commercial Companies,
14. setting up, using and liquidating reserve capitals,
15. using supplementary capital,
16. provisions related to claims to repair damage caused while establishing the company or serving on the management board or performing supervision,
17. merger, transformation and division of the company,
18. redemptions (retirements) of shares,
19. amendment to the Articles of Association and change of the subject of the Company's operations,
20. dissolving and liquidating the company.

In accordance with the provisions of the CCC the decision on issue and repurchase of shares is included within the competence of the General Meeting.

Description of shareholders' rights and the manner of exercising thereof

Description of the Company's shareholders' rights related to the General Meeting of Shareholders in accordance with the Company's Articles of Association, Code of Commercial Companies and the *Regulations of the General Meeting of Shareholders of TAURON Polska Energia S.A.* is presented in the below table.

Table no. 41. Description of the shareholders' rights related to the General Meeting of Shareholders

No.	Shareholders' rights	Description of shareholders' rights
1.	Convene a General Meeting of Shareholders	Shareholders representing at least one twentieth of the share capital, may request convening of an Extraordinary General Meeting of Shareholders. Such request should include a concise justification. It may be submitted to the Management Board in writing or in an electronic form, to the company's e-mail address, provided by the company on its website under the "Investor Relations" tab. Shareholders representing at least a half of the share capital or at least a half of all votes in the company may convene an Extraordinary General Meeting of Shareholders and appoint a chairperson of such General Meeting.
2.	Include matters (items) in the agenda of the General Meeting of Shareholders	Shareholders representing at least one twentieth of the share capital, may request that certain matters (items) be included in the agenda of the forthcoming General Meeting of Shareholders. Such request, including a justification or a draft resolution related to the proposed item of the agenda, should be submitted to the Management Board not later than 21 days prior to the set date of the General Meeting of Shareholders in electronic form to the company's e-mail address or in writing to the company's address.
3.	Become acquainted with the list of shareholders	Shareholders may become acquainted with the shareholders' list at the company's Management Board's seat for three weekdays preceding directly the General Meeting of Shareholders. Shareholders may also request that the list of shareholders be sent to them free of charge by electronic mail, providing the address to which the list should be sent.
4.	Participate in the General Meeting of Shareholders	Only persons who are Shareholders sixteen days before the date of the General Meeting of Shareholders (date of registering to participate in the General Meeting of Shareholders) shall have the right to take part in the General Meeting of Shareholders. In order to participate in the General Meeting shareholders should submit a request to issue a name bearing affidavit on the right to take part in the General Meeting of Shareholders to an investment (brokerage) company running their securities account. Such request should be submitted not earlier than following the announcement on convening of the General Meeting of Shareholders and not later than on the first weekday following the day of registering the participation in the General Meeting of Shareholders.
5.	Represent a shareholder by a proxy	Shareholders may take part in the General Meeting of Shareholders as well as exercise the voting right in person or through a proxy. Shares' co-owners may take part in the General Meeting of Shareholders and exercise the voting right only through a joint representative (proxy). A proxy may represent more than one shareholder and vote differently based on shares of each shareholder.
6.	Elect the Chairperson of the General Meeting of Shareholders	Shareholders shall elect the Chairperson of the General Meeting of Shareholders from among the persons entitled to take part in the General Meeting of Shareholders. Each of the participants of the General Meeting of Shareholders shall have the right to propose one candidate for the post of the Chairperson. Chairperson shall be elected by a secret ballot, by an absolute majority of votes. In case there is just one candidate for the Chairperson, election can take place by acclamation.
7.	Elect the Returning Committee	Each shareholder may propose no more than three candidates for members of the Returning Committee to be elected by the General Meeting of Shareholders, and vote for three candidates maximum.

No.	Shareholders' rights	Description of shareholders' rights
8.	Submit a draft resolution	During the General Meeting of Shareholders a shareholder shall have the right, until the discussion on a certain item of the agenda is closed, to submit a proposal of changes to the content of a draft resolution proposed for adoption by the General Meeting of Shareholders, as part of the given item of the agenda, or put forward his/her own draft of such resolution. Proposals of changes or draft resolutions, including justifications, may be submitted in writing to the Chairperson or verbally to be recorded in the minutes of the meeting.
9.	Raise an objection	Shareholders who voted against a resolution and, after the General Meeting of Shareholders has adopted it, want to raise their objection, should, immediately after the results of the voting have been announced, raise their objection and request it be included in the minutes of the meetings before proceeding to the next item of the agenda. In case such objection is raised later, which however shall not take place later than by the time the General Meeting of Shareholders is closed, the shareholders shall indicate against which resolution passed by the General Meeting they are raising their objection. Shareholders raising their objection against a resolution of the General Meeting may request their concise justification of the objection be recorded in the minutes of the meeting.

6.11. Composition of the Company's managing and supervising bodies and their committees, its changes, description of operation

6.11.1. Management Board

The current, fifth term of office of the Management Board began its run on March 16, 2017, i.e. on the day of appointing the Management Board of the Company for the fifth common term of office. In accordance with the Company's Articles of Association the common term of office shall last 3 years.

Composition of the Management Board as of December 31, 2017 and as of the day of drawing up this report

1. Filip Grzegorzcyk – President of the Management Board,
2. Jarosław Broda – Vice-President of the Management Board for Asset Management and Development,
3. Kamil Kamiński – Vice-President of the Management Board for Customer and Corporate Support,
4. Marek Wadowski – Vice-President of the Management Board for Finance.

Changes to the Management Board's composition in 2017 and in the period up to the day of drawing up this report

As of January 1, 2017 the Management Board was composed of the following members: Filip Grzegorzcyk (President of the Management Board), Jarosław Broda (Vice-President of the Management Board), Kamil Kamiński (Vice-President of the Management Board), Marek Wadowski (Vice-President of the Management Board) and Piotr Zawistowski (Vice-President of the Management Board).

On March 15, 2017 the Company's Supervisory Board dismissed, effective as of the end of day on March 15, 2017, all members of the Company's Management Board. On the same day Piotr Zawistowski up to then performing the function of Vice-President of the Management Board for Customer and Trade provided the Supervisory Board with the information on the resignation from applying for being selected to be a member of TAURON's Management Board of the 5th common term of office. The other members of the Management Board were appointed as of March 16, 2017 to the Company's Management Board of the 5th common term of office.

There were no other changes to the composition of the Management Board by the day of publishing this report

Experience and competences of members of the Management Board



Filip Grzegorzcyk – President of the Management Board

A graduate of the Faculty of Law and Administration and the Faculty of International and Political Studies of the Jagiellonian University in Cracow where he obtained a PhD degree in the EU law, and then a post-PhD degree in the business law.

He also completed the Summer Advanced Course program in the European Law at the University of London, King's College, Centre of European Law as well as the International Business and Trade Summer School program at Catholic University of America – Columbus School of Law and the Ecole de droit français Université d'Orléans. He holds the position of Professor at the University of Economics in Cracow, where he is a lecturer at the Faculties of Management and Economics and International Relations.

He has broad professional experience in the energy and fuel sector. In 2011–2013 he was associated with Kompania Węglowa as a management board proxy for energy sector development at Kompania Węglowa S.A. In 2007–2008 he was a member of the Management Board of TAURON. From November 2015 he served as the Undersecretary of State at the Ministry of State Treasury. He speaks fluent English and French.

He has been holding the position of the President of the Management Board of TAURON Polska Energia S.A. since November 15, 2016. He is currently overseeing the following areas of the operations: strategic management and regulatory solutions, relationships with the environment (stakeholders), legal support and investor relations, risk management, legal and internal audit, security and compliance as well as human resources development and social dialogue policy.



Jarosław Broda – Vice-President of the Management Board

A graduate of the Warsaw School of Economics, a holder of a postgraduate diploma in project management from the Kozmiński University.

He has experience in the area of consolidation and operation of the energy sector, privatization of state-owned utility groups, developing processes associated with the restructuring and strategy building as well as energy entities' expansion projects.

Since the beginning of his professional career he has been associated with the energy sector's entities, holding senior executive and managerial positions. He gained his professional experience working at the Ministry of State Treasury as well as at TAURON and GDF Suez Energia Polska. Recently associated with GDF Suez Energia Polska – Katowice and GDF Suez (Branch Energy Europe) where he was responsible for market analyses and developing the company's expansion strategy, regulatory management and M&A projects. He was also involved in developing the sales and marketing expansion strategy in Europe. Since mid-2015 he was responsible for developing the commercial strategy and the contract for difference related to the nuclear project in Great Britain.

He has been holding the position of the Vice-President of the Management Board of TAURON Polska Energia S.A. since December 8, 2015. He is currently overseeing the following areas of the operations: asset management, research and innovation, investment projects and programs as well as occupational health and safety.



Kamil Kamiński – Vice-President of the Management Board

A graduate of the Faculty of Management and Social Communications of the Jagiellonian University. A holder of the MBA Executive diploma (Stockholm University School of Business/ Cracow University of Economics) and the Post-MBA Diploma in Strategic Financial Management (Rotterdam School of Management, Erasmus University/ GFKM).

He has experience in the area of building company value, mergers and acquisitions, business integration and strategy operationalization as well as management of comprehensive projects in the public and private sectors. He was involved in complex transformation and restructuring processes of enterprises in the energy and fuel as well as transportations logistics sectors.

He gained his professional experience acting in the capacity of the President or Vice-President of the Management Board and holding senior managerial positions.

From the beginning of 2014 he was associated with Węglokoks Capital Group where, within the structures of Węglokoks Energia, he participated in the consolidation of electricity and heat generation assets of Kompania Węglowa and Węglokoks. At that time he was the head of the Management Committee. Previous professional experience includes, among others, work at the Research and Development Centre of the Refining Industry (OBR) in Płock or Jan Paweł II International Cracow-Balice Airport. He also managed the operations of John Menzies PLC in Poland. For many years he cooperated with Lotos Group where he supported the development of the aviation fuel segment which resulted in the *joint venture* with Air BP Ltd. and the establishment of Lotos Air BP.

He has been holding the position of the Vice-President of the Management Board of TAURON Polska Energia S.A. since December 8, 2015. He is currently overseeing the following areas of the operations: corporate management, human resources, marketing strategy and customer relations, IT systems functioning and management, personal data protection as well as procurement and administration.



Marek Wadowski – Vice President of the Management Board

A graduate of the Faculty of Economics of the University of Economics in Katowice. He also completed post graduate studies at École Supérieure de Commerce Toulouse where he obtained Mastère Spécialisé en Banque et Ingénierie Financière diploma and the Executive MBA studies at the Kozmiński University in Warsaw.

He has professional experience in the field of financial, controlling and accounting process management in industry (power sector, mining, steel industry), as well as in financing of investment projects and international commercial transactions. He was involved in the implementation of the *due diligence* projects and valuations of many enterprises (using income-based, equity and comparison valuation methods).

From the beginning of his professional career he was associated with the energy, mining and steel sector entities, acting in the capacity of the President or the Vice-President of the Management Board and holding senior managerial positions. He gained his professional experience working at BRE Corporate Finance S.A., Huta Cynku Miasteczko Śląskie S.A. and at Jastrzębska Spółka Węglowa S.A. Capital Group's subsidiaries. From 2008, acting in the capacity of the Vice-President of the Management Board in charge of the financial division at Jastrzębska Spółka Węglowa S.A. Capital Group's subsidiaries, he was responsible, inter alia, for structuring commercial transactions, implementing the foreign exchange risk hedging policy, financial costs reduction, liquidity management, acquiring funds from the consortium of banks in the form of a bond issue program. He was also involved in the IPO of JSW S.A. (implementation of the International Accounting Standards, modification of the management information system, preparing the IPO prospectus, talks with investors). He held the position of the President of the Management Board at Towarzystwo Finansowe Silesia where he was involved in the bond issue program for Kompania Węglowa and was dealing with the acquisition of debt financing from the consortium of banks.

He has been holding the position of the Vice-President of the Management Board of TAURON Polska Energia S.A. since January 29, 2016. He is currently overseeing the following areas of the operations: finance and insurance policy, controlling and planning, analyses, accounting and tax policy. Additionally, until the Vice-President of the Management Board for Commercial Affairs is appointed, he also oversees the following areas: electricity and property rights trading, fuel trading, portfolio management and electricity trading, controlling, business analyses, accounting and taxes, risk and IT.

The description of the experience and competences of the members of the Management Board is published on the Company's website <http://www.tauron.pl/>.

Description of the operations

Management Board of the company shall act on the basis of the Code of Commercial Companies and other legal regulations, provisions of the company's Articles of Association and provisions of the *Bylaws of the Management Board of TAURON Polska Energia Spółka Akcyjna with its seat in Katowice* which are available on the company's website <http://www.tauron.pl/>. When performing their duties members of the Management Board shall be acting in accordance with the principles included in Best Practice 2016.

2 members of the Management Board or one member of the Management Board together with a proxy shall be entitled to make valid statements on behalf of the Company. In case the Management Board includes one person, one member of the Management Board or a proxy shall be entitled to make valid statements on behalf of the Company.

Meetings of the Management Board shall be convened by the President of the Management Board or a Vice President of the Management Board designated thereby. Meetings of the Management Board shall also be convened on the motion of the majority of Vice Presidents of the Management Board as well as on the motion of the Chairperson of the Supervisory Board. The meetings shall be held at the company's seat on the date set by the person that convened the meeting. In justified cases the Management Board's meetings may be held outside the company's seat. The President of the Management Board or a Vice President of the Management Board designated thereby shall chair the meetings of the Management Board.

Management Board shall vote in an open ballot. The result of the ballot shall be recorded in the minutes of the meeting. President of the Management Board shall order a secret ballot at the request of any Vice President of the Management Board.

Resolutions of the Management Board shall be passed by an absolute majority of votes in the presence of 3/5 of the members of the Management Board. In case of an equal number of votes the President of the Management Board shall have a casting vote. Management Board may pass resolutions by voting in writing or using means of direct remote communications. Voting in accordance with the above procedures shall be ordered by the President of the Management Board or a Vice President of the Management Board designated thereby, including setting the deadline for casting votes by members of the Management Board. Submission of a dissenting opinion shall be allowed. Such dissenting opinion shall be recorded in the minutes of the meeting, including the justification thereof. Decisions of the Management Board related to ongoing issues that do not require passing of a resolution shall be recorded solely in the minutes of the meeting.

In case there are fewer members of the Management Board than the foreseen number of divisions (areas of responsibility), members of the Management Board may combine performing duties related to managing two divisions or introduce a different split of competences that would not be in conflict with the assignment of competences made by the Supervisory Board.

The internal division, among members of the Management Board, of the tasks and responsibilities for the individual areas of the Company's operations (Divisions) defined in the *Organizational Regulations of TAURON Polska Energia S.A.* and including the independent work positions (jobs) as well as organizational units reporting to the individual Members of the Management Board and supervised thereby, shall be defined by the above Organizational Regulations, while the diagram showing the above mentioned division is published on the Company's website.

The structure of the divisions reporting to the individual Members of the Management Board is defined on the diagram (flowchart) of the Company's organizational structure, described in section 8.1.2. of this report.

6.11.2. Supervisory Board

The current, fifth term of office of the Supervisory Board, began on May 29, 2017, i.e. on the day of holding the Ordinary GM of the Company approving the financial statements for the last full financial year of the tenure of the members of the Supervisory Board of the fourth term, i.e. for the financial year 2016. In accordance with the Company's Articles of Association it shall be a common term of office and it shall last for 3 years.

The composition of the Supervisory Board as of December 31, 2017 and as of the date of drawing up this report

1. Beata Chłodzińska – Chair of the Supervisory Board,
2. Teresa Famulska – Deputy Chair of the Supervisory Board,
3. Jacek Szyke – Secretary of the Supervisory Board,
4. Radosław Domagalski-Łabędzki – Member of the Supervisory Board,
5. Katarzyna Łasak-Jarszak – Member of the Supervisory Board,
6. Paweł Pampuszko – Member of the Supervisory Board,
7. Jan Płudowski – Member of the Supervisory Board,
8. Agnieszka Woźniak – Member of the Supervisory Board.

Changes to the Supervisory Board's membership in 2017

As of January 1, 2017 the Supervisory Board was composed of the following members: Beata Chłodzińska (Chair of the Supervisory Board), Anna Mańk (Vice-Chair of the Supervisory Board), Jacek Szyke (Secretary of the Supervisory Board), Stanisław Bortkiewicz (Member of the Supervisory Board), Leszek Koziorowski (Member of the Supervisory Board), Jan Płudowski (Member of the Supervisory Board), Jacek Rawecki (Member of the Supervisory Board), Stefan Świątkowski (Member of the Supervisory Board) and Agnieszka Woźniak (Member of the Supervisory Board).

On May 25, 2017 Jacek Rawecki submitted a statement on the resignation, as of May 26, 2017, from the function of a member of the Company's Supervisory Board.

On May 29, 2017 the State Treasury, acting within its personal powers defined in § 23, clause 1, sections 1) and 3) of the Company's Articles of Association, appointed the following persons to be the members of the Company's Supervisory Board of the 5th common term of office: Beata Chłodzińska, Teresa Famulska, Barbara Katarzynę Łasak-Jarszak, Jan Płudowski i Agnieszka Woźniak.

On May 29, 2017 the Ordinary GM of the Company appointed the following persons to be the members of the Company's Supervisory Board of the 5th common term of office: Radosław Domagalski-Łabędzki, Paweł Pampuszko and Jacek Szyke.

There were no other changes to the composition of the Supervisory Board by the day of publishing this report.

Information on the independence of members of the Supervisory Board as of December 31, 2017

The independence requirements defined in the Best Practice and Appendix II to the *European Commission's Recommendation of February 15, 2005 related to the role of non-executive directors or members of a supervisory board of publicly listed companies and a supervisory board's committee (2005/162/EC)* are met by the following members of the Supervisory Board:

- 1) Teresa Famulska,
- 2) Barbara Łasak-Jarszak,
- 3) Paweł Pampuszko,
- 4) Jan Płudowski,
- 5) Jacek Szyke.

The other members of the Supervisory Board do not meet the independence requirements defined in the Best Practice.

As of the day of drawing up this report a member of the Supervisory Board, Beata Chłodzińska, met the independence requirements defined in the Best Practice.

Experience and competences of the members of the Supervisory Board

Beata Chłodzińska – Chair of the Supervisory Board

A graduate of the Faculty of Law and Administration of the Warsaw University. She is a licensed legal counsel.

In 2001–2016 she was associated with the Ministry of State Treasury where she was providing legal services, most recently as the Deputy Director at the Legal and Litigation Department. She is currently working at PKN Orlen S.A. in the legal area.

She gained professional experience associated with supervising the operations of the State Treasury owned companies by, among others, holding seats on the supervisory boards of the following companies: Polska Agencja Prasowa S.A. with its seat in Warsaw, Centrum Techniki Okrętowej S.A. with its seat in Gdańsk, Chemia Polska sp. z o.o. with its seat in Warsaw, Międzynarodowa Korporacja Gwarancyjna sp. z o.o. with its seat in Warsaw.

She has been a member of the Supervisory Board of TAURON Polska Energia S.A. since August 12, 2015. In the Supervisory Board of the 5th common term of office she is the Chair of the Supervisory Board, the Head of the Nominations and Compensation Committee of the Supervisory Board, as well as a member of the Audit Committee of the Supervisory Board and a member of the Strategy Committee of the Supervisory Board.

Teresa Famulska – Deputy Chair of the Supervisory Board

A graduate of the University of Economics in Katowice, a Professor of economics appointed by the President of the Republic of Poland at the request of the Board of the Faculty of Finance and Insurance of the University of Economics in Katowice.

She has been associated with the University of Economics in Katowice since 1981. She is currently the Head of the Public Finance Department holding the full Professor's position. In 1998–2013 she was working at the School of Banking and Finance, recently as a dean, holding the full Professor's position.

An author of approximately 150 domestic and foreign publications in the field of finance, mainly public finance (including taxes and tax systems) and corporate finance. Apart from academic work she is continuously involved in business practice, participating, among others, in several dozen science and research projects. She conducts numerous lectures and training courses for the finance and management personnel of enterprises and for the tax authorities staff as part of the post-graduate studies and in cooperation with, among others, the Polish Economic Society (Polskie Towarzystwo Ekonomiczne) and the Accountants Association in Poland (Stowarzyszenie Księgowych w Polsce). Since 2007 she has been working at the State Examination Commission on Tax Advisory Services, where she has been the Head of the Commission since 2010. Since 2007 a member of the Financial Education Committee of the Polish Academy of Science, where she was a member of the Board of the Committee in 2011–2015. Furthermore, she is a member of the Main Board of the Polish Finance and Banking Association (Zarząd Główny Polskiego Stowarzyszenia Finansów i Bankowości), International Fiscal Association, Center for Information and Organization of Public Finance and Tax Law Research of Central and Eastern European Countries (Centrum Informacji i Organizacji Badań Finansów Publicznych i Prawa Podatkowego Krajów Europy Środkowej i Wschodniej) and Polish Economic Society (Polskie Towarzystwo Ekonomiczne).

She was awarded the following orders and accolades: Silver Cross of Merit (Srebrny Krzyż Zasługi), Silver Medal for Long-term Service (Srebrny Medal za Długoletnią Służbę), Medal of the Commission of National Education (Medal Komisji Edukacji Narodowej), awards of the Minister of National Education and of the President of the University of Economics in Katowice.

She has been a member of the Supervisory Board of TAURON Polska Energia S.A. since May 29, 2015. In the Supervisory Board of the 5th common term of office she is the Vice-Chair of the Supervisory Board and the Head of the Audit Committee of the Supervisory Board

Jacek Szyke – Secretary of the Supervisory Board

A graduate of Faculty of Economics of Łódź University and of the Faculty of Electric Engineering of the Technical University in Poznań where he also obtained a PhD in technical science.

He has yearslong professional experience associated with the utility scale power industry where he climbed up all levels of the career ladder, starting with an intern, through foreman, Head of the Safety and Instrumentation and & Control Department (Zakład Energetyczny Kalisz and Łódź), Engineer On Duty Responsible for the Operation (Elektrociepłownia Łódź), up to the position of the Chief Engineer (Zakład Energetyczny Łódź and Płock) and General Manager (Zakład Energetyczny Płock and Elektrociepłownia Siekierki). He also worked as the Contract Manager in Libya. The owner and President of the JES ENERGY consulting company.

State orders awarded: Golden Cross of Merit (Złoty Krzyż Zasługi), Knight's Order (Krzyż Kawalerski). Industry orders awarded: Distinguished for the following sectors: Power, Construction, Communications, Firefighting, Culture and Heat industry.

The author of more than 100 articles, publications and books, including: "Wspomnienia o tradycji i zwyczajach pracy w energetyce" (Memories of traditions and customs related to working in the power utilities sector), "O energetyce z sentymentem" (About electric utilities sector with a sentiment), "Historia Polskiej Elektroenergetyki" (History of Poland's Power Industry), "Złota Księga Elektroenergetyki" (Golden Book of Power Industry), "Grupa TAURON – monografia" (TAURON Group – monograph).

He has been a member of the Supervisory Board of TAURON Polska Energia S.A. since September 14, 2010. In the Supervisory Board of the 5th common term of office he is the Secretary of the Supervisory Board and the Head of the Strategy Committee of the Supervisory Board as well as a member of the Audit Committee of the Supervisory Board.

Radosław Domagalski-Łabędzki – Member of the Supervisory Board

A graduate of Łódź University (master's degree in law). Completed Executive MBA studies at Rutgers University in New Jersey. Visiting fellow at the German Munster and Mannheim Universities.

A manager with a broad practical experience in managing complex international business projects. He prepared and effectively implemented an expansion strategy in Asia for one of Poland's largest capital groups.

In 2006–2013 the President of the Management Board of Magellan Trading Shanghai Co. Ltd in China. Prior to that he worked as a lawyer at GSP Group Sp. z o.o. in Łódź, and also at American Enterprise Institute in Washington – one of the largest American think-thanks.

Between December 2015 and October 2016 the Undersecretary of State at the Ministry of Development, responsible, among others, for promoting the Polish economy, a member of the Financial Supervision Commission (Komisja Nadzoru Finansowego).

Since October 2016 until March 10, 2018 he was the President of the Management Board of KGHM Polska Miedź S.A. Co-founder of the Polish-Chinese Chamber of Industry and Commerce in Shanghai. An author of many business publications.

He has been a member of the Supervisory Board of TAURON Polska Energia S.A. since May 29, 2017. In the Supervisory Board of the 5th common term of office he is a member of the Audit Committee of the Supervisory Board.

Barbara Katarzyna Łasak-Jarszak – Member of the Supervisory Board

A graduate of the Faculty of Law and Administration of the Warsaw University.

Between January 1997 and February 2017 she was working at the Legal Department of the Ministry of State Treasury. Between April 1998 and February 2017 she headed an organizational unit of the Legal Department providing legal services for the Ministry. Since March 1 2017 the Head of the State Property and Finance Division of the State Treasury Department of the Chancellery of the Prime Minister where she is dealing with, among others, with the issues related to the new principles of managing the state owned property.

In 1999–2001 a member of the Disciplinary Commission of the Ministry of State Treasury. In 1999–2005 deputy public finance auditor for the Minister of State Treasury.

He has yearslong professional experience of holding seats on supervisory boards of State Treasury owned companies, including: ZPP “Lenora” sp. z o.o., Koneckie Zakłady Odlewnicze S.A., Uzdrowisko Busko-Zdrój S.A., ŚWWG Polmos S.A., Stocznia Gdynia S.A., Archimedes S.A., PSO “Maskpol” S.A., ZG “Dom Słowa Polskiego” S.A. in liquidation, Fundusz Rozwoju Spółek S.A., Zakłady Mięsne Nisko S.A.

She has been a member of the Supervisory Board of TAURON Polska Energia S.A. since May 29, 2017. In the Supervisory Board of the 5th common term of office she is a member of the Nominations and Compensation Committee of the Supervisory Board.

Paweł Pampuszko – Member of the Supervisory Board

A graduate of the Faculty of Law and Administration of the University of Silesia in Katowice, a lawyer entered on the list of lawyers maintained by the Solicitors Regulation Authority (Izba Adwokacka) in Katowice.

During his yearslong professional career he gained significant experience with respect to negotiating contracts as part of major industrial and business undertakings, and also preparing and conducting significant court disputes where it was necessary to become familiar with non-legal specialist issues and close cooperation with specialists in other fields. He was also actively involved in identifying and eliminating deficiencies in the operations of the corporations' authorities.

He gained professional experience related to providing legal services for business entities by working in 2005–2009, among others, at Kancelaria Biura Prawne Babula i Wspólnicy sp. k., Kancelaria Adwokatów i Radców Prawnych Ślązak, Zapiór & Partnerzy, SILEGE S.C. and Wozym Technologies sp.j. In 2009–2011 he was running his own legal practice. Since 2011 till now he has been a founding partner at law firm Kuś-Zielińska, Pampuszko i Wspólnicy – Adwokaci i Radcy Prawni sp.j.

He was a member of supervisory authorities in the non-government organizations and corporations: CHK S.A. and Medicina Pro Humana Foundation.

He is an author of publications on medical law.

He has been a member of the Supervisory Board of TAURON Polska Energia S.A. since May 29, 2017. In the Supervisory Board of the 5th common term of office he is a member of the Strategy Committee of the Supervisory Board.

Jan Płudowski – Member of the Supervisory Board

A graduate of the Faculty of Electric Engineering of the Silesian University of Technology in Gliwice. He also completed post-graduate studies at the Faculty of Electric Engineering of the Gdańsk University of Technology, at the University of Economics (formerly K. Adamiecki Academy of Economics) in Katowice in the field of corporate finance management and at the Faculty of Management and Services Economics of the University of Szczecin in the field of marketing and corporate management.

Professionally associated with the power sector, he gained professional experience by climbing up all levels of the career ladder. He was working, among others, as the Regional Chief Power Engineer (PKP Śląska Dyrekcja Okręgowa Kolei Państwowych (Polish State Railways' Silesian Regional Board) in Katowice), Director of Zakład Energetyki Kolejowej (Railways' Power Unit) in Katowice and the Head of the Power Management Department (PKP Dyrekcja Energetyki Kolejowej (Polish State Railways' Power Unit Board) in Warsaw), Director of the Cash Flow Office (“PKP Energetyka” sp. z o.o. in Warsaw). He is currently holding the position of the Project Coordinator Director at “PKP Energetyka” S.A. in Warsaw.

In 2007–2008 he was a member of the Supervisory Board of Spółka Energetyczna Jastrzębie S.A.

He has been a member of the Supervisory Board of TAURON Polska Energia S.A. since December 30, 2016. In the Supervisory Board of the 5th common term of office he is a member of the Audit Committee of the Supervisory Board and a member of the Strategy Committee of the Supervisory Board.

Agnieszka Woźniak – Member of the Supervisory Board

A graduate of the Faculty of Law and Administration of the UMCS University in Lublin. A lawyer by education.

In 2001–2015 she worked at the Ministry of Economy where she climbed up all levels of the career ladder, starting from a referendary, through the positions of a specialist, chief specialist, head of division, deputy director and director. Since 2005 an appointed civil servant. She has been associated with the Ministry of Energy since it was formed, i.e. since November 2015, where she is currently holding the position of the Director of the Minister's Office.

She has yearslong experience in personnel management. She was dealing with matters related to audits, organizational affairs of the office, public procurement, personnel issues. She was also holding the position of the Plenipotentiary of the General Director for the Integrated Management System.

She has experience related to supervising the operations of State Treasury owned companies. Between January 2009 and June 2014 a member of the Supervisory Board of Węglokoks S.A. with its seat in Katowice.

She has been a member of the Supervisory Board of TAURON Polska Energia S.A. since December 16, 2016. In the Supervisory Board of the 5th common term of office she is a member of the Nominations and Compensation Committee of the Supervisory Board and a member of the Strategy Committee of the Supervisory Board.

The detailed description of the experience and competences of the members of the Supervisory Board is published on the Company's website <http://www.tauron.pl/>.

Description of the operations

Detailed description of the Supervisory Board's operations is provided in the Code of Commercial Companies, the company's Articles of Association which are available on the company's website <http://www.tauron.pl/> and in the *Regulations of the Supervisory Board of TAURON Polska Energia S.A. with its seat in Katowice*.

The main form of the Supervisory Board overseeing the Company's operations shall be the meetings of the Supervisory Board. Supervisory Board shall perform its obligations collectively. Meetings of the Supervisory Board shall be convened by the Chairperson of the Supervisory Board or Vice Chairperson of the Supervisory Board by presenting a detailed agenda:

- 1) in accordance with the decisions taken by the Supervisory Board,
- 2) of his/her own initiative,
- 3) at a written request of each member of the Supervisory Board,
- 4) at a written request of the Management Board.

Meetings of the Supervisory Board shall be held at the Company's seat. In justified cases a meeting may be convened at a different venue.

In order to convene a meeting all members of the Supervisory Board must be invited in writing at least 7 days before the date of the Supervisory Board's meeting. For important reasons the Chairperson of the Supervisory Board may shorten this period to 2 days, defining the way the invitations should be distributed. Notifications of the Supervisory Board's meeting shall be sent by fax or electronic mail and confirmed by phone. In the notification of the Supervisory Board's meeting the Chairperson shall define the date of the meeting, venue of the meeting and the detailed draft agenda. Supervisory Board shall meet on as needed basis, however not less frequently than once every 2 months. Supervisory Board may hold meetings without convening a formal meeting if all members of the Supervisory Board are present and nobody objects against the fact of holding the meeting or against the agenda.

A change of the proposed agenda may occur when all members of the Supervisory Board are present at the meeting and no one raises an objection against the agenda. An issue not included in the agenda should be included in the agenda of the next meeting.

Participation in a meeting of the Supervisory Board shall be a Supervisory Board member's duty. A member of the Supervisory Board shall provide information on the reason for his/her absence in writing. Excusing an absence of a member of the Supervisory Board shall require a resolution of the Supervisory Board. Members of the company's Management Board may take part in the Supervisory Board's meetings unless the Supervisory Board raises an objection. Participation of the Management Board's members in the Supervisory Board meetings shall be mandatory if they have been invited by the Chairperson of the Supervisory Board. Other persons may also take part in the meetings if they have been invited in the above mentioned way.

Supervisory Board may seek opinions of legal counsels who provide regular legal advice for the company, as well as, in justified cases, it may appoint and invite to meetings of the Supervisory Board appropriate experts in order to seek their opinion and make the right decision. In the above mentioned cases the Supervisory Board shall pass a resolution on commissioning the selected expert (auditing, consulting company) to carry out the work, obligating the Company's Management Board to conclude an applicable agreement.

Meetings of the Supervisory Board shall be chaired by the Chairperson of the Supervisory Board, and in case of his/her absence by the Vice Chairperson. For important reasons, with the consent of the majority of members of the Supervisory Board present at the meeting, the chairperson chairing the meeting shall be obligated to subject to a vote a motion to interrupt the meeting and set the date of resuming the meeting of the Supervisory Board. Supervisory Board shall make decisions in the form of resolutions. Supervisory Board's resolutions shall be passed mainly at its meetings. Supervisory Board shall pass resolutions if at least half of its members are present at the meeting and all its members have been invited in the appropriate way defined in the Regulations. Subject to the mandatory legal regulations in force, including the Code of Commercial Companies and the provisions of the company's Articles of Association, the Supervisory Board shall pass resolutions by an absolute majority of votes of the persons present at the meeting where the absolute majority of votes shall be understood as more votes cast "for" than "against" and "abstain". Resolutions shall not be passed on matters not included in the agenda unless all members of the Supervisory Board are present and nobody raises an objection. This shall not apply to resolutions on excusing a Supervisory Board's member's absence at the meeting. Resolutions shall be voted on in an open ballot. A secret ballot shall be ordered:

- 1) at the request of at least one member of the Supervisory Board,
- 2) in personnel related matters.

In accordance with the company's Articles of Association the Supervisory Board may pass resolutions in writing or using means of direct remote communications. Passing a resolution in such way shall require a prior notification of all members of the Supervisory Board of the content of the draft resolution. Passing resolutions this way shall not apply to appointing the Chairperson, the Vice Chairperson and the Secretary of the Supervisory Board, appointing or suspending from office a member of the Management Board and dismissing these persons, as well as other matters that require a secret ballot vote. When voting on a resolution in the aforementioned way a member of the Supervisory Board shall indicate his/her vote, i.e. "for", "against" or "abstain". In case a member of the Supervisory Board fails to indicate his/her vote by the time defined by the Chairperson the resolution shall not be passed. A resolution with a note that it has been passed in writing or by voting using means of direct remote communications shall be signed by the Chairperson of the Supervisory Board. Resolutions passed this way shall be presented at the forthcoming meeting of the Supervisory Board along with the result of the voting.

Members of the Supervisory Board shall be allowed to take part in the meeting and vote on resolutions during such meeting using means of direct remote communications, i.e. a conference call or a video conference, subject to a proviso that at least half of its members are present at the meeting's venue indicated in the notification of the meeting and a secure communications link is technically possible.

Members of the Supervisory Board shall take part in meetings and exercise their rights and responsibilities in person, and while performing their duties they shall be obliged to act with due diligence. Members of the Supervisory Board shall be obliged to keep confidential information related to the company's activities that they have acquired in connection with holding their seat or on another occasion. Supervisory Board shall perform its activities collectively.

Supervisory Board may, for important reasons, delegate its individual members to perform certain supervision actions on their own for a defined period of time. Supervisory Board may delegate its members, for a period not longer than three months, to temporarily perform duties of members of the Management Board who have been dismissed, submitted their resignation or if for other reasons they cannot perform their functions. The above mentioned delegation shall require obtaining a consent of the member of the Supervisory Board who is to be delegated.

The detailed description of the activities of the Supervisory Board in the last financial year is provided in the Report on the Activities of the Supervisory Board, submitted on annual basis to the General Meeting of Shareholders and then published on the company's website <http://www.tauron.pl/>.

Supervisory Board may appoint from among its members permanent or temporary (ad-hoc) working groups, committees to perform specific actions. Supervisory Board's standing committees shall be:

- 1) Audit Committee of the Supervisory Board of TAURON Polska Energia S.A. (Audit Committee),
- 2) Nominations and Compensation Committee of the Supervisory Board of TAURON Polska Energia S.A. (Nominations and Compensation Committee),
- 3) Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A. (Strategy Committee).

Membership, tasks and rules of operation of the above mentioned committees shall be defined in the regulations thereof passed by the Supervisory Board.

6.11.3. Audit Committee

Due to the changes to the membership of the Supervisory Board of the Company introduced in 2017, the Supervisory Board also made changes to the membership of the Audit Committee.

Members of the Audit Committee as of December 31, 2017 and as of the day of drawing up this report

1. Teresa Famulska – Head of the Audit Committee,
2. Beata Chłodzińska – Member of the Audit Committee,
3. Radosław Domagalski-Łabędzki – Member of the Audit Committee,
4. Jan Płudowski – Member of the Audit Committee,
5. Jacek Szyke – Member of the Audit Committee.

Changes to the Audit Committee's membership

As of January 1, 2017 the Audit Committee was composed of the following members: Beata Chłodzińska (Head of the Audit Committee), Jacek Rawecki and Jacek Szyke.

On January 30, 2017 the Supervisory Board appointed the following members of the Audit Committee: Stanisław Bortkiewicz and Jan Płudowski. On the same day the Audit Committee elected, from among its members, Stanisław Bortkiewicz as the Head of the Audit Committee.

On May 25, 2017 Jacek Rawecki submitted a statement on the resignation, as of May 26, 2017, from the function of a member of the Company's Supervisory Board. Consequently, his membership in the Audit Committee also expired.

On May 29, 2017, due to the end of the 4th term of the Supervisory Board mandates of members of the Supervisory Board expired and consequently their membership in the Audit Committee expired.

On June 20, 2017, due to the appointment, as of May 29, 2017, of members of the Supervisory Board of the 5th term, the Supervisory Board appointed the Audit Committee with the following members: Beata Chłodzińska, Radosław Domagalski-Łabędzki, Teresa Famulska, Jan Płudowski and Jacek Szyke. On the same day the Audit Committee, during the first meeting of the 5th term, elected Teresa Famulska as the Head of the Audit Committee.

No other changes to the membership of the Audit Committee had been made as of the day of disclosing this report.

Information on the independence of members of the Audit Committee as of December 31, 2017

The membership (composition) of the Audit Committee is in compliance with the requirements defined in the *law of May 11, 2017 on certified auditors, audit companies and public supervision*. The evaluation of independence and the statutory requirements with respect to the knowledge and skills of the individual members of the Audit Committee was made by the Supervisory Board Rada based on the relevant statements submitted by the members of the Audit Committee. Three members of the Audit Committee comply with the statutory requirements related to independence, including the Head of the Audit Committee who also has knowledge and skills in the field of accounting and auditing financial statements. Two members of the Audit Committee: Jacek Szyke and Jan Płudowski, knowledge and skills in the field of energy, i.e. the Company's industry.

The independence requirements defined for the members of the Audit Committee by the above law are met by the following members of the Audit Committee:

- 1) Teresa Famulska,
- 2) Jan Płudowski,
- 3) Jacek Szyke.

The other members of the Audit Committee do not meet the independence requirements defined by the above law.

As of the day of drawing up this report a member of the Supervisory Board, Beata Chłodzińska, met the independence requirements defined by the above law.

Tasks and competence of the Audit Committee

The tasks and competence of the Audit Committee with the coming into force on June 21, 2017 of the law of May 11, 2017 on certified auditors, audit companies and public supervision, have been verified and aligned with the current legal regulations in force and adopted by the Supervisory Board at the motion of the Audit Committee in the form of the new Regulations of of the Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.

The tasks and competence of the Audit Committee as of the day of drawing up this report are presented in the below table.

Table no. 42. Competence of the Audit Committee

Competence of the Audit Committee	
as of December 31, 2017 and as of the day of drawing up this report	
1.	monitoring: <ol style="list-style-type: none">1) the Company's financial reporting process,2) the effectiveness of internal control, risk management, compliance and internal audit systems, including with respect to the financial reporting,3) monitoring of performing of financial revisions, in particular performing of an audit by an audit company, taking into account any conclusions (motions) and arrangements of the Audit Supervision Committee stemming from an audit (inspection) performed at an audit company,
2.	controlling and monitoring of independence and impartiality of the chartered accountant (certified auditor) and the entity entitled to examine financial statements, including rendering by them services other than financial audit, monitoring the independence of a certified auditor and audit company, in particular in case other services than an audit are provided for the benefit of the Company,
3.	performing the evaluation of independence of the certified auditor and expressing consent for performing by him of permitted services not constituting the audit within the Company,
4.	developing the policy for selecting the auditing company to perform the audit,
5.	developing a policy of performing by the auditing company performing the audit, entities related with the auditing company and members of the auditing company's corporate network of permitted services not constituting the audit,
6.	defining the procedure for selecting the auditing company by the Company,
7.	presenting to the Supervisory Board of recommendation for selection of the auditing company responsible for performing the statutory audit or review of financial statements, as required under Art. 130 Paras 2 and 3 of the <i>Act of 11 May 2017 on certified auditors, auditing companies and public oversight</i> and in Art. 16.2 <i>Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC</i> , in line with policies referred to above in items 4 and 5,
8.	informing the Supervisory Board of audit results and explaining as to who did the audit contribute to trustworthiness of financial reporting in the Company, and also what was the role of the Audit Committee in course of the audit,
9.	presenting recommendations aimed at ensuring reliability of the financial reporting process within the Company,
10.	performing other activities vested with audit committees pursuant to <i>Act of 11 May 2017 on certified auditors, auditing companies and public oversight, Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC and Act of 29 September 1994 – the Accounting Act</i> .

The detailed description of the activities of the Audit Committee in the last financial year is provided in the report on the activities of the Supervisory Board submitted on annual basis to the General Meeting of Shareholders and published on the Company's website <http://www.tauron.pl/>.

6.11.4. Nominations and Compensation Committee

Due to the changes to the membership of the Supervisory Board of the Company introduced in 2017, the Supervisory Board also made changes to the membership of the Nominations and Compensation Committee

Members of the Nominations and Compensation Committee as of December 31, 2017 and as of the day of drawing up this report

1. Beata Chłodzińska – Head of the Nominations and Compensation Committee,
2. Barbara Łasak-Jarszak – Member of the Nominations and Compensation Committee,
3. Agnieszka Woźniak – Member of the Nominations and Compensation Committee.

Changes to the Nominations and Compensation Committee's membership

As of January 1, 2017 the Nominations and Compensation Committee was composed of the following members: Beata Chłodzińska (Head), Leszek Kozirowski i Agnieszka Woźniak.

On May 29, 2017, due to the end of the 4th term of the Supervisory Board mandates of members of the Supervisory Board expired and consequently their membership in the Nominations and Compensation Committee expired.

On June 20, 2017, due to the appointment, as of May 29, 2017, of members of the Supervisory Board of the 5th term, the Supervisory Board appointed the Nominations and Compensation Committee with the following members: Beata Chłodzińska, Barbara Łasak-Jarszak and Agnieszka Woźniak. On the same day the Nominations and Compensation Committee, during the first meeting of the 5th term, elected Beata Chłodzińska as the Head of Nominations and Compensation Committee.

No other changes to the membership of the Nominations and Compensation Committee had been made as of the day of disclosing this report.

Tasks and competence of the Nominations and Compensation Committee

The tasks and competence of the Nominations and Compensation Committee did not change in 2017.

The tasks and competence of the Nominations and Compensation Committee as of December 31, 2017 and as of the day of drawing up this report are presented in the below table

Table no. 43. Competence of the Nominations and Compensation Committee

Competence of the Nominations and Compensation Committee	
as of December 31, 2017 and as of the day of drawing up this report	
1.	recommending to the Supervisory Board a recruitment procedure for the positions of members of the company's Management Board,
2.	evaluating candidates for members of the Management Board and providing the Supervisory Board with opinions in this respect,
3.	recommending to the Supervisory Board a form and content of agreements to be concluded with members of the Management Board,
4.	recommending to the Supervisory Board a compensation and bonus system for members of the Management Board,
5.	recommending to the Supervisory Board the need to suspend a member of the Management Board for important reasons,
6.	recommending to the Supervisory Board the need to delegate a member of the Supervisory Board to temporarily perform the duties of members of the Management Board who cannot perform their duties, along with a compensation proposal.

The detailed description of the activities of the Nominations and Compensation Committee in the last financial year is provided in the Report on the activities of the Supervisory Board submitted on annual basis to the General Meeting of Shareholders and published on the Company's website <http://www.tauron.pl/>.

6.11.5. Strategy Committee

Due to the changes to the membership of the Supervisory Board of the Company introduced in 2017, the Supervisory Board also made changes to the membership of the Strategy Committee

Members of the Strategy Committee as of December 31, 2017 and as of the day of drawing up this report

1. Jacek Szyke – Head of the Strategy Committee,
2. Beata Chłodzińska – Member of the Strategy Committee,
3. Paweł Pampuszko – Member of the Strategy Committee,
4. Jan Płudowski – Member of the Strategy Committee,
5. Agnieszka Woźniak – Member of the Strategy Committee.

Changes to the Strategy Committee's membership

As of January 1, 2017 the Strategy Committee was composed of the following members: Jacek Szyke (Head), Beata Chłodzińska, Anna Mańk i Stefan Świątkowski.

On March 15, 2017 the Supervisory Board passed a resolution on appointing as members of the Strategy Committee: Stanisław Bortkiewicz and Jan Płudowski.

On May 29, 2017, due to the end of the 4th term of the Supervisory Board mandates of members of the Supervisory Board expired and consequently their membership in the Strategy Committee expired.

On June 20, 2017, due to the appointment, as of May 29, 2017, of members of the Supervisory Board of the 5th term, the Supervisory Board appointed the Strategy Committee with the following members: Jacek Szyke, Beata Chłodzińska, Paweł Pampuszko, Jan Płudowski i Agnieszka Woźniak. On the same day the Strategy Committee, during the first meeting of the 5th term, elected Jacek Szyke as the head of the Strategy Committee.

No other changes to the membership of the Strategy Committee had been made as of the day of disclosing this report.

Tasks and competence of the Strategy Committee

The tasks and competence of the Strategy Committee did not change in 2017. The tasks and competence of the Strategy Committee as of December 31, 2017 and as of the day of drawing up this report are presented in the below table.

Table no. 44. Competence of the Strategy Committee

Competence of the Strategy Committee	
as of December 31, 2017 and as of the day of drawing up this report	
1.	evaluating the Company's and TAURON Capital Group's Strategy and presenting the results of such evaluation to the Supervisory Board,
2.	recommending to the Supervisory Board the scope and deadlines for submitting the long term strategic plans by the Management Board,
3.	evaluating the impact of planned and currently undertaken strategic investment projects on the Company's assets,
4.	monitoring the implementation of strategic investment tasks,
5.	evaluating activities related to the use of material Company's assets,
6.	providing opinions on strategic documents submitted to the Supervisory Board by the Management Board.

The detailed description of the activities of the Strategy Committee in the last financial year is provided in the report on the activities of the Supervisory Board submitted on annual basis to the General Meeting of Shareholders and published on the Company's website <http://www.tauron.pl/>.

6.11.6. Description of activities of the Committees of the Supervisory Board

The detailed description of the operations of the Committees of the Supervisory Board is provided in the Regulations of individual Committees of the Supervisory Board of TAURON Polska Energia S.A.

The Committees of the Supervisory Board are advisory and opinion-making bodies acting collectively as a part of the Supervisory Board and perform support and advisory functions towards the Supervisory Board. The tasks of the Committees of the Supervisory Board are carried out by submitting motions, recommendations, opinions and statements on the scope of its tasks to the Supervisory Board, by means of resolutions. The Committees of the Supervisory Board are independent of the Management Board of the Company. The Management Board may not issue binding orders to the Committees of the Supervisory Board concerning performing their tasks.

The Audit Committee and the Nominations and Compensation Committee of the Supervisory Board are composed of three to five members, while the Strategy Committee is composed of three to seven members. The activities of the individual Committees are managed by their Chairpersons (Heads).

Meetings of the Committees are convened by the Chairperson of the specific Committee on his/her own initiative or upon the motion of a member of the Committee or Chairperson of the Supervisory Board and they are held on as needed basis. In case of the Audit Committee the meetings are convened at least on a quarterly basis. The Chairpersons of the Committees may invite members of the Supervisory Board, who are not members of the specific Committee, members of the Management Board and employees of the Company as well as other persons working or cooperating with the Company to the meetings of the Committees. The Chairperson of the specific Committee or a person appointed by him/her submits motions, recommendations and reports to the Supervisory Board.

The Committees of the Supervisory Board pass resolutions if at least a half of their members were present at the meeting and all their members have been duly invited. The resolutions of the Committees of the Supervisory Board are adopted by an absolute majority of votes present at the meeting, where the absolute majority of votes is understood as more votes given "for" than "against" and "abstain". The Committees of the Supervisory Board may pass resolutions in writing or by using means of direct remote communication.

Members of the Committees of the Supervisory Board may also participate in meetings and vote of the adopted resolutions by using means of direct remote communication, i.e. tele- or videoconferences.

The Company's Management Board shall be informed about recommendations and assessments submitted to the Supervisory Board by the given Committee of the Supervisory Board. Every year, the Committees of the Supervisory Board provide public record information, through the Company, on their memberships, the number of meetings held and participation in the meetings during the year as well as on their main activities. In addition, the Audit Committee performs an assessment of the independence of the certified auditor and expresses its consent for the provision thereby of the permitted services that are not an audit of the Company.

The Company's Management Board provides the possibility to use the services of external advisers by the Committees to the extent required for performing the obligations of the Committees.

6.12. Description of the policy of diversity applied to the governing bodies of the Company

Diversity and openness are an integral part of both, TAURON Capital Group's business operations, as well its management policy. All of TAURON Capital Group's subsidiaries apply the policy of equal treatment and strive to ensure

diversity in terms of gender, educational background, age and professional experience in relation to all employees and key managers.

With respect to the members of the corporate bodies of TAURON, i.e. the Management Board and the Supervisory Board, persons acting as Members of the Management Board are selected by the Supervisory Board, while Members of the Supervisory Board are selected by the Minister of Energy. In 2017, acting within its statutory powers, the State Treasury appointed 5 Members of the Supervisory Board and the Ordinary GM of TAURON on May 29, 2017 elected 3 Members of the Management Board. Information concerning qualifications and professional experience of persons appointed to the Management Board and the Supervisory Board is published in the relevant regulatory filings (current reports) as well as on the Company's website.

Members of the Management Board are appointed by the Supervisory Board after conducting a qualification procedure designed for verifying and assessing their qualifications and selected the best candidates. Announcement of qualification process is published on the Company's web page and in the Public Information Bulletin of the Ministry of Energy. The competition is open for any person meeting requirements set forth in the Company's By-laws and formal requirements specified in the announcement. Candidates are required to possess university level education, at least five years of employment and minimum three years of experience as managers, and have to meet requirements set forth in other legislation. No special requirements are placed on features such as sex, type of education, age and professional expertise, to the Supervisory Board is capable of assessing candidates to the Management Board with consideration of their overall capabilities and diversity requirements.

The *Diversity Policy of the TAURON Group* was implemented in 2017, the purpose of which is to strengthen awareness and organizational culture open to diversity. Implementation of the Diversity Policy enables employees to full realize their individual potential in the job environment.

Also, actions have been undertaken to prevent any discrimination by structuring the appropriate atmosphere and culture at the workplace based on key PRO corporate values – Partnership, Development and Courage, confirmed through the *Policy of combating Mobbing and Discrimination at the TAURON Group*.

7. COMPENSATION POLICY WITH RESPECT TO THE MANAGEMENT AND SUPERVISORY STAFF

7.1. Compensation system for members of the Management Board and key managers

7.1.1. General information on the adopted compensation system for members of the Management Board

In 2017 the principles of compensation of members of the Company's Management Board defined in the Resolution of the Extraordinary GM of TAURON of December 15, 2016 *on the principles for determining compensation of members of the Management Board* (Principles for determining compensation) were in force at the Company, as subsequently amended and detailed by the Supervisory Board of the Company pursuant to the resolution of December 19, 2016 *on the principles for determining compensation of members of the Management Board TAURON Polska Energia S.A.* as subsequently amended. The above principles for determining compensation are in line with the provisions of the *Act of June 9, 2016 on the principles for determining compensation of persons managing certain companies*.

The adopted principles for determining compensation define the compensation system for members of the Management Board in connection with outstanding tasks aimed at the implementation of the adopted Strategy, directions of expansion and financial plans. The overriding objective of the adopted compensation system is to ensure an incentive-based compensation of the senior management staff and to create basis for their development.

Overall objectives of the compensation policy are:

- 1) ensuring a consistent and motivational compensation system for members of the Management Board,
- 2) linking the compensation rules with monitoring of the implementation of adopted strategic plans and implementation of the financial plans,
- 3) setting the level of compensation for the Management Board members in connection with the implementation of the management tasks set,
- 4) increasing the Company's value through the development of the senior management staff,
- 5) improving the compensation systems leading to the implementation of the Company's strategy and expansion directions.

Model of compensation for members of the Management Board is based on a two-component system for determining compensation, composed of a fixed part constituting the monthly base wage and a variable part constituting the supplementary compensation for the Company's financial year, dependent on achieving specific management objectives.

System of compensation for members of the Management Board assumes linking the variable part of the compensation with the outstanding management goals stemming from the provisions of the *Act of June 9, 2016 on the principles for determining compensation of persons managing certain companies* and set, based upon these provisions, by the GM the Supervisory Board of the Company. The goal of adopting in the system of compensation, of the dependence of the compensation's variable part on achieving the management goals set is, in particular, to implement the adopted Strategy, the directions of the Company's expansion and financial plans, it also shapes a new organizational culture of the Company.

Taking into account the applicable regulations, the level of compensation for members of the Management Board is defined by the Supervisory Board, within the brackets determined by the Company's GM.

Members of the Management Board of the Company are neither covered by the bonus program based on the capital of the Company, nor do they receive any compensation or awards due to fulfilment of their functions in governing bodies of TAURON Capital Group's subsidiaries.

In 2017 the Supervisory Board updated the *Policy of compensation for Members of the supervision and management authorities (bodies) including the description of the principles for the determination thereof at TAURON Polska Energia S.A.*, in force since February 24, 2011.

7.1.2. General information on the adopted compensation system for key managers

The rules concerning compensation and bonus system for key managers and other employees are defined in the *Regulations on Compensation of Employees of TAURON Polska Energia S.A.*, adopted for application by the Management Board of the Company.

In 2017 the *Principles of Compensation at TAURON Group* were developed representing the guidelines for TAURON Capital Group's subsidiaries with respect to the personnel compensation systems, particularly taking into account the bonus system for key managers based on the management by objectives system consistent throughout TAURON Capital Group, representing a combination of the planning process, efficiency measurement process and evaluation process.

The compensation and bonus system for key managers stipulates that the level of compensation should be tied to the financial situation of TAURON Capital Group in an annual perspective, in connection with the implementation of strategic goals.

The overriding assumption of the compensation system in force is to ensure the optimum and motivating compensation level, depending on the value and type of work on a given position as well as the quality of work and effects achieved by employees.

The structure of the compensation consists of the following elements:

- 1) fixed part – constituting the base salary determined in accordance with the table of grade categories applicable in the Company and monthly rates of personal grade. The allocated level of basic salary reflects the value and type of work as well as the quality of employee’s work, defined through the assessment of employee’s competence level
- 2) variable part – which depends on performance results, defined through the level of accomplishment of targets and tasks within the MBO bonus system,
- 3) benefits – which are defined in the internal regulations of the Company

The MBO bonusing system based on market principles of awarding bonuses ensures focusing activities of key management staff on attaining objectives defined within the Strategy, as well as individual strategic objectives and development directions of individual companies within the TAURON Capital Group. This system also ensures cascading of objectives defined by the Company’s Management Board at the TAURON Capital Group level and at the Company level, down to concrete, parametric tasks vested with employees of lower structural levels. The MBO bonusing system has been tied with the management by process style of operations at the TAURON Capital Group, *inter alia* by aligning the objectives with Megaprocesses defined within the TAURON Capital Group. Therefore, the introduced culture of Management by Objectives reflects the specific features of each function implemented in the Company and allows use of dialogue mechanisms between the superior and subordinate during the process of setting and assessing objectives, leading to attaining overall efficiency throughout the entire organization.

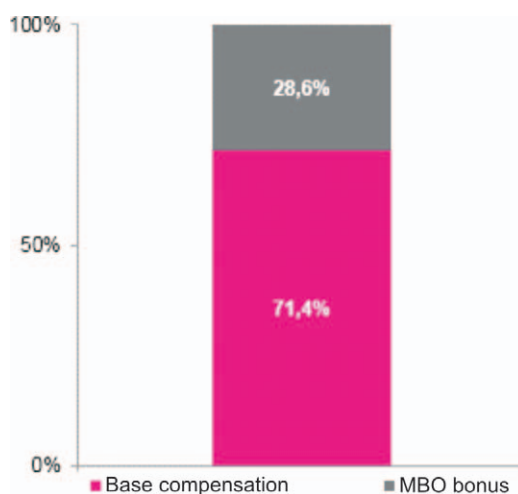
At the same time, this took enables precise correlating of KPIs defined for members of the Management Board with objectives defined for the given year for key managers of the Company. Initial assessment of accomplished objectives takes place after end of the first 6 months and after end of the year, members of the Management Board conduct final assessment of KPI performance by key managers.

Moreover, in March 2017 the bonus system for the trading area aimed at motivating to generate higher revenue for TAURON Capital Group. The trading bonus covered key managers in the trading area, however the bonus system sets an additional bonus for them only once they have topped annual trade plans.

Employees of the Company do not receive any compensation or awards on account of functions fulfilled in governing bodies of TAURON Capital Group’s subsidiaries.

The below figure presents the structure of compensation for key manager positions.

Figure no. 89. Structure of compensation for key manager positions



7.1.3. Rules, terms and conditions as well level of compensation of members of the Management Board

The total amount of compensation understood as the value of salaries, awards and benefits received in cash, in kind or in any other form, due or paid by the Company to the Management Board members in 2017 reached the gross amount of PLN 4 534 thousand.

The compensation of members of the Company's Management Board in 2017, broken down into components, is presented in the below table.

Table no. 45. Compensation of members of the Company's Management Board in 2017 broken down into components

No.	Name	Period of holding the position in 2017	Compensation ¹ (PLN '000)	Bonus ¹ (PLN '000)	Other benefits ¹ (PLN '000)	Total (PLN '000)
1.	Filip Grzegorzczak ²	01.01.2017 – 31.12.2017	793	–	24	817
2.	Jarostaw Broda ³	01.01.2017 – 31.12.2017	803	226	79	1 108
3.	Kamil Kamiński ³	01.01.2017 – 31.12.2017	792	181	77	1 050
4.	Marek Wadowski ³	01.01.2017 – 31.12.2017	863	181	36	1 080
5.	Piotr Zawistowski	01.01.2017 – 15.03.2017	186	226	69	481
Total			3 437	812	285	4 534

¹ Excluding markups (surcharges).

² Compensation in accordance with the agreement on the provision of management services in force.

³ From January 1, 2017 till March 15, 2017 the compensation in accordance with the labor agreement, while from March 16, 2017 till December 31, 2017 the compensation in accordance with the agreement on the provision of management services.

Members of the Management Board did not receive compensation or bonuses for performing functions in the corporate bodies of TAURON Capital Group's subsidiaries in 2017.

From January 1, 2017 till March 15, 2017 members of the Management Board received the compensation in accordance with the labor agreement (except for the President of the Management Board who received the compensation in accordance with the agreement on the provision of management services). From March 16, 2017 all members of the Management Board appointed for the 5th term received the compensation in accordance with the agreement on the provision of management services, prepared in accordance with the law of June 9, 2016 on the principles of determining the compensation of persons managing certain companies.

Model of compensation for members of the Management Board, defined in the agreements on the provision of management services is based on a two-component system for determining compensation, composed of a fixed part (monthly base wage) and a variable part (supplementary compensation for the Company's financial year), dependent on fulfilling specific result-based criteria, i.e. achieving management objectives.

System of compensation for members of the Management Board assumes linking the variable part of the compensation with the outstanding management goals stemming from the provisions of the Act of June 9, 2016 on the principles for determining compensation of persons managing certain companies and set, based upon these provisions, by the GM the Supervisory Board of the Company. The goal of adopting in the system of compensation, of the dependence of the compensation's variable part on achieving the management goals set is, in particular, to implement the adopted Strategy, the directions of the Company's expansion and financial plans, it also shapes a new organizational culture of the Company.

The variable part of the compensation represents up to 60% of the fixed part of the compensation for the financial year, assuming the management goals set by the Supervisory Board for the given financial year have been achieved.

The Supervisory Board determines the percentage level of the variable part of the compensation for each of the following management goals:

- 1) achieving EBITDA at the level approved in the material and financial plan for a given financial year,
- 2) achieving the Net debt/EBITDA ratio at the level approved in the material and financial plan for a given financial year,
- 3) implementation of the "2016–2018 Efficiency Improvement Program" and achieving the total effect at the level approved in the material and financial plan for a given financial year,
- 4) implementation of the non-financial management goals objectives.

The variable part of the compensation for achieving the financial management goals is allocated based on the data derived from the audited consolidated financial statements of the Company for the given financial year.

The variable part of the compensation for achieving the non-financial management goals is allocated based on the achievement of specific objectives in the given financial year, based on the assessment of their performance by the Supervisory Board.

7.1.4. Agreements concluded with managing persons which envisage compensation in case of their resignation or dismissal from the position held, without material reason, or if their dismissal or resignation takes place as a result of the merger of the Company through takeover

According to the agreements on the provision of management services concluded with the members of the Management Board on March 15, 2017 envisage, in case of termination or dissolution of the agreement by the Company for reasons other than defined therein, a payout of the severance payment at a level of three-fold fixed part of the compensation, under the condition of fulfilment of the function by them over a period of at least 12 months prior to the termination of the agreement.

Furthermore, due to the access of members of the Management Board to confidential information the disclosure of which could expose the Company and TAURON Capital Group's subsidiaries to losses, the aforementioned agreements on the provision of management services include non-competition provisions applicable after the expiry of the term of office. Under the aforementioned agreements members of the Management Board undertook to refrain from conducting competitive activities in the specified period in return for compensation.

Members of the Company's Management Board did not hold positions of members of Management Boards of subsidiaries (companies included) in TAURON Capital Group prior to being appointed as members of the Company's Management Board.

7.1.5. Non-financial components of compensation allocated to members of the Management Board and key managers

Non-financial components of the compensation of members of the Management Board

Members of the Management Board, in accordance with the agreements on provision of management services, are entitled to:

- 1) refinancing by the Company of the cost of training up to the net amount of PLN 15 000 in a calendar year,
- 2) use a company car,
- 3) use the technical devices required to perform the obligations under the concluded agreement.

Non-financial components of the compensation of key managers

Staff members employed at key positions by the Company are entitled to use the following benefits and non-financial components of the compensation offered by the Company:

- 1) participate in the Employee Pension Scheme operated by the employer (under the condition of being employed in the Company or one of the subsidiaries of TAURON Capital Group over a period of at least one year),
- 2) use the medical package financed from the Company funds,
- 3) use a company car allocated for sole disposal,
- 4) use company accommodation in case if the availability of the employee is required due to the nature of his/her work and scope of responsibilities.

7.1.6. Information on changes to the compensation policy over the last financial year

On May 29, 2017 the Ordinary GM amended resolution no. 5 of the Extraordinary GM of TAURON of December 15, 2016 *on the principles for determining compensation of members of the Management Board*, by adding an extra management goal to be achieved by members of the Management Board by December 31, 2017, making the payment of the variable part of the compensation contingent, covering the performance of the obligations mentioned in art. 17–20, art. 22 and art. 23 of the law of December 16, 2016 *on the state assets management principles*.

With a view to implement the principles to determine compensation passed by the GM in December 2016 r., on March 15, 2017 agreements on the provision of management services were concluded with the members of the Management Board appointed for the common 5th term in office. The agreement on the provision of management services with the President of the Management Board had been concluded earlier, meanwhile labor contracts had been concluded earlier with the other members of the Management Board.

7.1.7. Assessment of functioning of the compensation policy in terms of fulfilment of its objectives, in particular, the long-term growth in shareholders' value and stability of the undertaking performance

The applied compensation system for members of the Management Board is compliant with the *Act of June 9, 2016 on the principles for determining compensation of persons managing certain companies*. The incentive-based and consistent system is provided, linked with the monitoring of annual financial plans and the adopted Strategy and development (expansion) directions

The form, structure and level of compensation correspond to market conditions and are oriented towards enabling the recruitment and maintaining of individuals fulfilling the criteria required for running the Company in the manner taking into account shareholders' interests (building the Company's value for shareholders), as well as prevent conflicts of interest from arising among members of the Management Board and shareholders. At the same time, they are constructed in the manner which is transparent for investors, so that their trust towards the Company is built and they are able to express their opinions using the applicable procedures.

Information policy on the form, structure and level of compensation of members of the Management Board and the Supervisory Board is conducted by the Company in communication with the Supervisory Board in a manner that is in compliance with the regulations in force and best market practice.

The disbursement of variable components of compensation is linked with the pre-defined, measurable management goals. The set management goals should foster long-term stability of the Company.

The indicators (criteria) determining obtaining and level of variable components of the compensation are defined in accordance with the SMART principle, thus, they also display such features as: precision, measurability, achievability, materiality and defining in time.

The compensation and bonus system for both Members of the Management Board of the Company as well as the key managers in force at TAURON supports the implementation of strategic goals and determines the compensation depending on the financial situation of the Company and TAURON Capital Group in an annual perspective.

7.2. Compensation system for members of the Supervisory Board

In 2017 the system of compensation for members of the Supervisory Board of the Company defined in the Resolution of the Extraordinary GM of TAURON of December 15, 2016 *on the principles for determining compensation for members of the Supervisory Board of TAURON Polska Energia S.A.* was in force, adopted as the implementation of the provisions of the *Act of 9 June 2016 concerning principles for determining compensation of persons managing certain companies* (Journal of Laws of 2016, item 1202).

In accordance with the aforementioned Resolution of the Extraordinary GM a monthly compensation of Supervisory Board members is determined as a product of the average monthly compensation in the enterprise sector, excluding payment of profit distribution bonuses in the fourth quarter of the preceding year, announced by the President of the Central Statistics Office and the multiplier:

- 1) for the chairperson of the Supervisory Board – 1.7
- 2) for other members of the Supervisory Board – 1.5

Members of the Supervisory Board are entitled to receive the compensation irrespective of the frequency of formally convened meetings.

The compensation does not apply for a month in which a member of the Supervisory Board was not present at any of the formally convened meetings, for unjustified reasons. The decision on excusing or failure to excuse the absence of a member of the Supervisory Board at its meeting is taken by the Supervisory Board by means of a resolution.

The compensation is calculated on a pro rata basis, in relation to the number of days when the function was fulfilled in case if the appointment or dismissal occurred during the calendar month.

The Company covers costs incurred in connection with the fulfilment of functions assigned to members of the Supervisory Board, in particular: costs of return transfer between the place of residence and the venue of the Supervisory Board meeting or meeting of the Supervisory Board Committee, costs of individual supervision and costs of accommodation and board.

Compensation of supervising personnel

The compensation of members of the Company's Supervisory Board in 2017 is presented in the below table.

Table no. 46. Compensation of members of the company's Supervisory Board in 2017

No.	Name	Period of holding the position in 2017	Compensation (PLN '000)
1.	Beata Chłodzińska	01.01.2017 – 31.12.2017	89
2.	Teresa Famulska	29.05.2017 – 31.12.2017	47
3.	Jacek Szyke	01.01.2017 – 31.12.2017	79
4.	Radosław Domagalski-Łabędzki	29.05.2017 – 31.12.2017	47
5.	Barbara Łasak-Jarszak	29.05.2017 – 31.12.2017	47

No.	Name	Period of holding the position in 2017	Compensation (PLN '000)
6.	Paweł Pampuszko	29.05.2017 – 31.12.2017	47
7.	Jan Płudowski	01.01.2017 – 31.12.2017	79
8.	Agnieszka Woźniak	01.01.2017 – 31.12.2017	79
9.	Jacek Rawecki	01.01.2017 – 26.05.2017	32
10.	Leszek Koziorowski	01.01.2017 – 29.05.2017	33
11.	Stefan Świątkowski	01.01.2017 – 29.05.2017	33
12.	Anna Mańk	01.01.2017 – 29.05.2017	33
13.	Stanisław Bortkiewicz	01.01.2017 – 29.05.2017	33
Total			677

7.3. Liabilities arising from pensions and similar benefits for former the Members of the Management Board and the Supervisory Board

The Company does not have any liabilities towards former the Members of the Management Board and the Supervisory Board arising from pensions and similar benefits.

At the same time, it is indicated that due to the Company's liabilities towards former members of TAURON Management Board, in 2017 the total amount of PLN 2 258 thousand was paid due to bonuses for the accomplishment of KPIs in 2016 and compensations for compliance with the non-competition clause.

8. STATEMENT ON NON-FINANCIAL INFORMATION

8.1. TAURON Group's Business and Operational Model

TAURON Capital Group comprises selected companies managed jointly as a uniform economic body consisting of independent commercial law companies, led by TAURON as the parent entity.

In 2017 the *Business Model of TAURON Group* adopted by the Management Board of the Company on May 4, 2016 was in force. In order for TAURON Capital Group to effectively carry out the tasks the above document was updated by the Management Board of TAURON. A document called *Business and Operational Model of TAURON Group* (Business Model) adopted on January 23, 2018 defines TAURON Capital Group's management model, defines the high-level architecture of processes and contains guidelines concerning key performance indicators of units constituting TAURON Capital Group.

8.1.1. Assumptions of the Business Model

The key assumptions of the Business Model include building of TAURON Capital Group value, focusing on customers, transparent distribution of duties and responsibilities, effective information exchange, use of employees' knowledge, volatility of the Business Model, organisational integrity of TAURON Capital Group.

8.1.2. Company management principles

In accordance with the provisions of the *By-laws of the Management Board of TAURON Polska Energia Spółka Akcyjna with its seat in Katowice*, the Management Board conducts the affairs of the Company and represents it in all judicial and extra-judicial proceedings. All issues connected with managing the Company, which are not restricted by legal regulations and provisions of the Company's Articles of Association to the competence of the General Meeting or the Supervisory Board lie within the competence of the Company's Management Board. Cooperation of two members of the Management Board or one member of the Management Board together with a proxy is required for submitting statements on behalf of the Company.

Issues covered within the competence of the Management Board as a collective body are described in detail in section 6.8.1. of this report.

In accordance with the *Organisational Regulations of TAURON Polska Energia S.A.* (Organisational Regulations), the Company is managed directly by the Management Board of the Company as well as through proxies, Executive Directors, Managing Directors or power of attorneys.

The Company implements its tasks through:

- 1) separate organizational units (business units):
 - Divisions comprising independent positions and business units reporting to individual members of the Management Board and supervised by them,
 - Teams, constituting business units reporting directly to Executive Directors or Managing Directors. The activities of the team are managed by the Team Leader (Manager),
- 2) independent positions:
 - Managing Director manages and leads the work of subordinated Executive Directors and Teams,
 - Executive Director manages and leads the work of subordinated Teams,
 - Other independent positions which may be entrusted to Power of Attorneys, Coordinators, Consultants or Specialists,
- 3) temporary organisations – Project Teams established with the aim to implement tasks and projects of the Company.

8.1.3. TAURON Capital Group management principles

The main regulatory act of TAURON Group is the *Code of TAURON Group* adopted by the Management Board of the Company which regulates its operations, ensuring the implementation of the goals through tailored solutions in the area of management of TAURON Capital Group's entities, including, in particular, setting the operating objectives of companies, enabling the achievement of effects assumed in the new Strategy.

Regulations implemented in 2016 together with the Business Model led to introduction of the management by processes structure within the entire TAURON Capital Group, consisting in establishing of process subordination running horizontally within all companies of the Group. Members of the Management Board are responsible for the allocated to them process streams which are subsequently divided into Megaprocesses. Megaprocesses are owned by named managing and executive directors at TAURON. Process documentation (maps, diagrams and process sheets) defines and describes decision authorities and actions to be undertaken by individual organizational units within companies of

the TAURON Capital Group. Owners of Megaprocesses decompose these into lower level processes and appoint their owners. Each process has its owner and process metrics defined by the higher level process owner. Process documentation defines the decision dependences and authorities for repeatable processes.

Management by processes model has been implemented to benefit from operating synergies between companies of the TAURON Capital Group, share and use best practices, standardize and automate processes, and to ensure coherence of actions taken within Group companies to support implementation of Group Strategy.

The essence of management by processes lies in unending search for and implementation of efficiencies along with clear and transparent division of authorities and responsibilities. Processes are modified to improve their efficiencies. Process documentation is published in the Intranet and available to all employees.

Authorities and process dependences described in process documentation supplement authorities set forth in the organizational structure of individual companies and support operations of TAURON Capital Group companies as a single organism.

Within TAURON Capital Group the Standing Committees of TAURON Capital Group are operating, including:

- 1) Investment Committee,
- 2) Risk Committee.

The aforementioned Committees were established in order to enable performing of operations in accordance with the principles of operating consistency, in compliance with the law and interests of TAURON Capital Group and its stakeholders.

The below figure presents process streams cutting across TAURON Capital Group's Lines of Business.

Figure no. 90. Process streams



Business Model identifies 23 mega processes cutting across all units of TAURON Capital Group.

The below figure presents the structure of TAURON Capital Group's processes (mega processes).

Figure no. 91. Structure of TAURON Capital Group’s processes (megaprocesses)

Management processes	
1.1 Strategy	1.5 Audit
1.2 Controlling	1.6 Asset management
1.3 Corporate communication	1.7 Research and innovation
1.4 Risk management	
Operating processes	
2.1 Mining	2.4 Distribution of electricity and heat
2.2 Production of electricity and heat	2.5 Sales and Customer Service
2.3 Trade	
Support processes	
3.1 Corporate management	3.7 IT support
3.2 Mergers and acquisitions	3.8 Legal service
3.3 Finance management	3.9 Purchases
3.4 Accounting	3.10 Ensuring security
3.5 Tax management	3.11 Project implementation
3.6 Human capital management	

8.1.4. TAURON Capital Group’s Lines of Business

In accordance with the Business Model in force activities are underway aimed at fully implementing the distribution of roles and responsibilities base on assigning the process competences, among:

- Corporate Centre** superior business unit responsible for management of TAURON Capital Group’s operations and taking the most important decisions affecting TAURON Capital Group, Lines of Business, Shared Services Centers and TAURON Capital Group’s subsidiaries.
- Lines of Business** seven lines of TAURON Capital Group’s core operations, defined in accordance with the links of the electricity and heat production value chain, i.e.: Trading, Mining, Generation, Renewable Energy Sources (RES), Heat, Distribution and Supply.
- Shared Services Centers** units responsible for the provision of specific support services (e.g. Accounting, IT, HR and payroll, insurance, customer service) in favour of other entities of TAURON Capital Group.

TAURON Capital Group’s business operations are conducted based on seven Lines of Business defined in accordance with the links of the electricity and heat production value chain: Mining, Generation, Renewable Energy Sources (RES), Heat, Trading, Distribution and Supply.

The below figure presents the structure of TAURON Capital Group’s Lines of Business.

Figure no. 92. Structure of TAURON Capital Group’s Lines of Business



TAURON Capital Group's Shared Services Centers (CUW)

Centralizing of the support services is aimed at relieving the Corporate Centre and Lines of Business from execution of processes which are not directly associated with the conducted business operations (so-called support processes) as well as at reducing costs of the implementation of such processes due to the economy of scale and increase of the operational efficiency. Within the formal structure of TAURON Capital Group, CUWs were placed in TAURON Obsługa Klienta, TAURON Ubezpieczenia sp. z o.o. and Wsparcie Grupa TAURON subsidiaries.

8.1.5. Changes in the principles of managing TAURON Capital Group

Changes in the principles of managing the Company

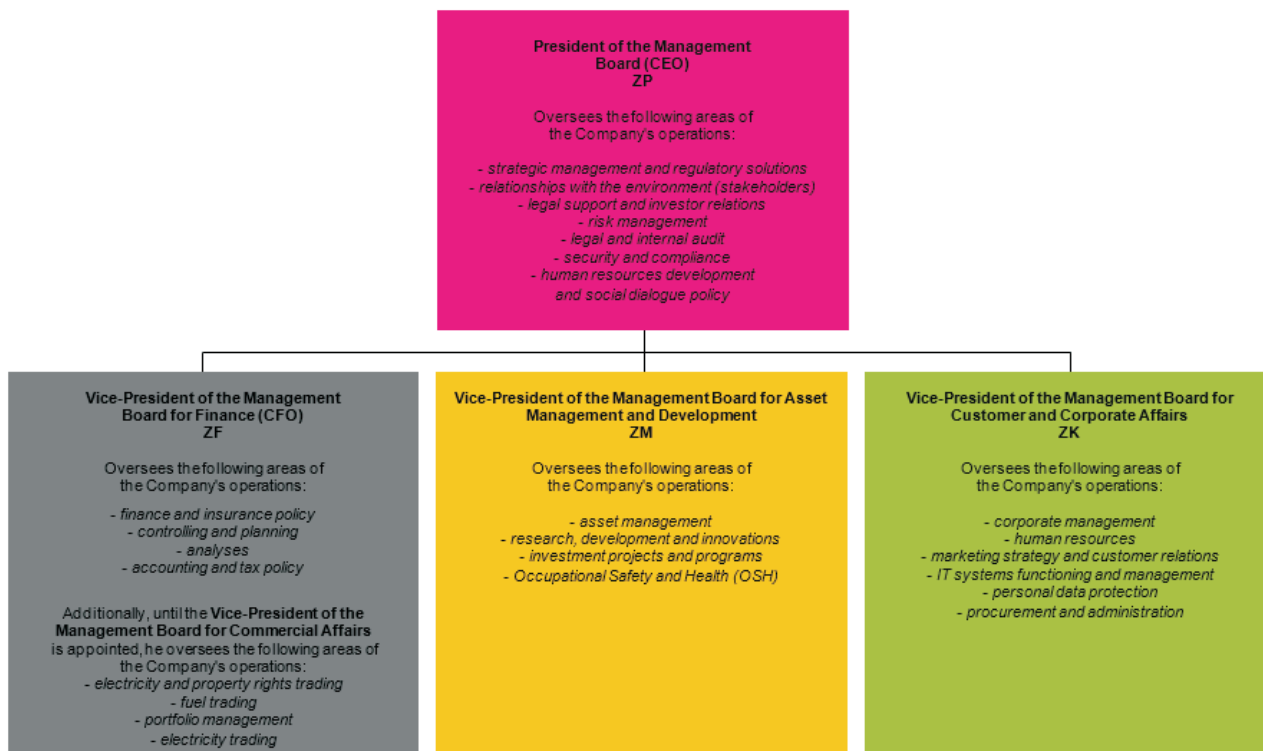
Three amendments were introduced in 2017 in the Organizational By-laws at TAURON aimed to optimize management processes, i.e.:

1. The following key amendments to the Organizational By-laws were enforced on 14 April 2017:
 - 1) Vice-President of the Management Board for Finance was vested with oversight of the development of forecasting s and tools necessary for analyzing the wholesale and retail markets by subordinating to him the activities of the Executive Director for Business Analyses,
 - 2) The following positions were changed: Vice-President of the Management Board for Corporate Management to Vice-President of the Management Board for Clients and Corporate Support, and Vice-President of the Management Board for Clients and Trade to Vice-President of the Management Board for Trade,
 - 3) The Vice-President of the Management Board for Clients and Corporate Support was vested with oversight of representing client interest inside and outside the organization by subordinating to him the Executive Director for Client Affairs,
 - 4) The sphere of project analysis and assessment was subordinated to the Executive Director for Investment Projects at the Division of the Vice-President of the Management Board for Asset Management and Development,
2. The following key amendments to the Organizational By-laws were enforced on 17 July 2017:
 - 1) The sphere of the Executive Director for External Relations at the Division of the President of the Management Board was integrated with the sphere of Executive Director for Strategy and Regulations by creating a single sphere of Executive Director for Strategic Management. Integration of both these spheres of activities was justified in light of the operational synergies existing in several planes of operations, particularly in light of the correlation between external communications and building relationships, including relationships with public administration and international authorities as well as with professional industrial organizations,
 - 2) The sphere of investor relations previously subordinated in the Division of the President of the Management Board to the Executive Director for External Relations was transferred to the Executive Director for Legal Issues. The purpose of this change was to concentrate in the legal area all tasks related with ensuring adherence by the Company to principles of corporate governance and information duties of a securities issuer.
3. The following key amendments to the Organizational By-laws were enforced on 25 October 2017:
 - 1) The President of the Management Board was vested with:
 - a) oversight over functioning of the risk management system of the TAURON Capital Group by subordinating to him the activities sphere of the Executive Director for Risk Management, who was subordinated previously to the Vice-president of the Management Board for Finance,
 - b) creating and overseeing the Company's and TAURON Capital Group system of legal compliance by subordinating the sphere of the Attorney for Compliance to the Executive Director for Security and Compliance,
 - c) coordinating and overseeing security activities, including IT security, technical infrastructure security, protection of confidential information and physical security by subordinating to him the sphere of the Executive Director for Security and Compliance, who was previously subordinated to the Vice-president of the Management Board for Clients and Corporate Support.
 - 2) Vice-president of the Management Board for Clients and Corporate Support was vested with:
 - a) overseeing the formulation of the IT area functioning and management model by subordinating to him the sphere of the Executive Director for IT, who was previously subordinated to the Vice-president of the Management Board for Finance,

- b) overseeing the formulation of strategy as well as standard and guidelines for protection of personal data in the Company and in the TAURON Capital Group, now subordinated to the Executive Director for IT.

At the time, due to the vacancy on position of Vice-president of the Management Board for Trade, these functions were temporarily vested as from 14 April 2017 to the Vice-president of the Management Board for Assets Management and Development, and as from 25 October 2017 temporarily to the Vice-president of the Management Board for Finance. The below figure presents the diagram of the split of responsibilities of members of the Management Board.

Figure no. 93. Diagram of the split of responsibilities of members of the Management Board



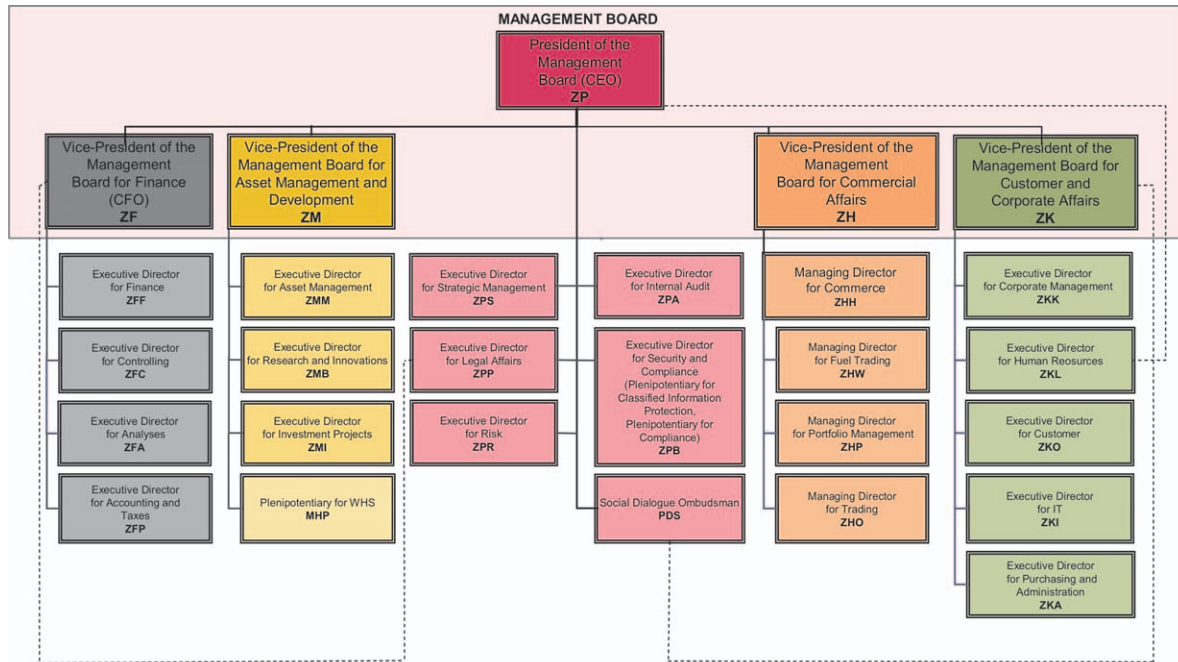
Introducing the above changes to the Organizational By-laws the required modifications of the scopes of the individual business units in the Company's structure were made.

In the general part of the Organizational By-laws provisions on establishing additional reporting lines and principles of proceeding in case of conflicting instructions were modified. Furthermore, the power to issue intra corporate regulatory acts was also granted to the Vice President of the Management Board empowered by the Management Board.

Changes to the organisational structure of the Company were aimed at optimizing the operations of the Company and TAURON Capital Group. Areas assigned to the individual divisions managed by members of the Management Board of the Company were revised.

The below figure presents the divisions assigned to the individual members of the Management Board, down to the level of business units and independent work positions reporting directly to members of the Management Board, as of the day of drawing up this report.

Figure no. 94. TAURON's organizational diagram (flowchart) as of the day of drawing up this report



Changes in the principles of managing the TAURON Capital Group

Activities undertaken in implementing the management by processes structure resulted in updating of the Business Model. Scope of authorities and functions attributed to individual Megaprocesses were specified in further detail and supplemented to fully reflect the performed activities in the documents and to ensure possibly high effectiveness. Most important changes include allocation of activities in occupational safety, hygiene and environmental protection to the assets management Megaprocess, transfer of activities related with market forecasting from the trade Megaprocess to the controlling Megaprocess and including public aid activities into the controlling Megaprocess. Some other minor modifications and changes were made in line with the Business Model Structure.

Owners of the Megaprocesses were defined in course of 2017 implementation processes of the Business Model and the Megaprocesses devolved to lower level processes being implemented in their entirety in all companies of the TAURON Capital Group. Full documentation of processes active within TAURON was prepared and published.

Process documentation (maps, diagrams and sheets) were developed, implemented and published in H2 2017 in key companies of the TAURON Capital Group, i.e. at TAURON Wydobycie S.A., TAURON Wytwarzanie S.A., TAURON EKOENERGIA sp. z o.o., TAURON Ciepło sp. z o.o., TAURON Dystrybucja S.A., TAURON Sprzedaż sp. z o.o. and TAURON Obsługa Klienta sp. z o.o.

Process design activities led to identification and elimination of much inefficiency and products of processes not generating added value, as well as added were actions necessary and required for effective implementation of objectives and assumptions resulting from the Strategy. These activities were supported through workshops and training courses for employees participating in process modeling and creating process documentation.

New statutes and company deeds were adopted in 2017 within the TAURON Capital Group companies, implementing principles of management set forth in the *Act of 16 December 2016 on principles of managing State-owned assets*. Provisions defining scope of authorities of corporate bodies that were described in process documents were removed forth the deeds. This served to avoid overlaps and prolonging of decision processes in the scope that has been allocated in process documents to other units and persons.

Implementation of the Business Model redefined, redesigned all repeatable processes unifying descriptions that were published in implemented through process documentation. Implemented process documents and tool as well as acquired within the TAURON Capital Group competences in process management and process optimization throughout the Group have become a starting point for attaining further efficiencies and operating effectiveness.

Activities associated with design and implementing of key processes in remaining operating companies of the TAURON Capital Group shall be continued in 2018.

8.2. Key non-financial performance indicators in operations of TAURON Capital Group

Being among the biggest energy sector holdings in Central and Eastern Europe, with operations along the entire energy value chain, the TAURON Capital Group is aware of the influence it has on its broad surroundings – natural environment, stakeholders (employees, customers, shareholders, local communities, suppliers, representatives of authorities and institutions), the micro- and macroeconomic situation and the industry it operates in. While studying its social influence and impacts on the economy, lives of employees, customers, natural environment and communities, the TAURON Capital group is continuously monitoring the non-financial indicators of its operations and presents the results annually in its integrated report.

The integrated formula allows a clear presentation of relations and dependencies between the financial and non-financial aspects of the operations of all companies of the TAURON Capital Group. This makes it a comprehensive and transparent document presenting the company operations, its business model, strategy, key changes, opportunities and risks as well as results from the point of view of all stakeholder groups. Combining the financial data with the non-financial aspects of the TAURON Capital Group is also intended to demonstrate the potential achieved through synergy of the core business with non-business operations, based on the Strategy.

Within the 5 directions set by the Strategy, 18 commitments were made, and due to the need to monitor the extent of their achievement, each commitment was assigned a metric and initiatives.

The key non-financial performance metrics of the TAURON Capital Group include, in line with the Sustainable Development Strategy, the system average interruption frequency index (SAIDI), number of innovative R&D initiatives submitted in employee competitions, the level and monitoring of the Customer Satisfaction Index (CSI), the complaints index as well as offering match indicator.

Striving for the customer relations not to be limited only to providing products and services, while being aware of the numerous threats that may be encountered by customers in various aspects of using or purchasing electricity, TAURON is conducting educational campaigns targeted at electricity consumers, while the performance indicator of these activities is, e.g., the number of delivered initiatives such as “Energy for Seniors”.

The non-financial indicators also concern TAURON Capital Group’s impact on natural environment. Having in mind the sustainable development principles, the companies of the TAURON Capital Group are optimising their resource management processes (water, raw materials and materials) and are executing active waste management policies (with respect to process and communal waste). Important role in environment protection is also played by the pro-environmental education conducted by individual companies of the TAURON Capital Group, addressed to children as well as to adults.

The non-financial performance metrics of environmental operations of the companies of the TAURON Capital Group also include the number and reach of information and education programmes about environment protection addressed to the customers, employees and the local communities.

The non-financial performance metrics of the TAURON Capital Group operations in employee dimension are, for example, indices of injuries, vocational diseases, days lost and absences, as well as fatal work accidents according to regions and gender, as well as the average number of training hours per year per employee according to gender and job category.

The non-financial performance indicators included in the integrated report of the TAURON Capital Group also presented the dual benefits indicators (dual indicators), i.e. non-financial indicators that are clearly related to financial indicators. An example here is energy consumption dynamics. Reduction of electricity consumption is good for the environment (first benefit) and at the same time reduces costs and improves the results of an entity.

The use of non-financial performance indicators allows the TAURON Capital Group a more comprehensive company mapping in the annual integrated reports, presenting processes and events taking place, as well as including in the analyses the factors impacting its success in a longer time horizon.

Non-financial indicators presented in the annual report of the TAURON Capital Group comprehensively present the social impact, characterise the way in which TAURON intends to remedy its negative impact on the natural and social environment and the ways it contributed to its improvement.

8.3. Description of TAURON's policies

For the purpose of implementation in the national legislation of the Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (Non-financial Information Disclosure Directive), the Polish act of 29 September 1994 on accounting (the Accounting Law) was amended.

According to Article 49 b (2) and (3) of the Accounting Law, the scope of information contained in a non-financial report was extended with the description of policies applied with respect to social, employee, natural environment, respect for human rights and corruption countering issues, as well as with description of due diligence procedures applied under these policies and their results.

To assure compliance of the operations of the TAURON Capital Group with the new regulatory requirements, the Management Board of TAURON has in 2017 adopted for use throughout the TAURON Group the following regulations:

- 1) Customer Oriented Social Policy of the TAURON Group (the Customer Oriented Social Policy),
- 2) Diversity Policy of the TAURON Group (the Diversity Policy),
- 3) Environmental Policy of the TAURON Group (the Environmental Policy),
- 4) Human Rights Respect Policy of the TAURON Group along with Code of Conduct of Business Partners of the TAURON Group Companies (the Human Rights Respect Policy or the Code of Conduct of Business Partners),
- 5) Work Health and Safety Policy of the TAURON Group (the WHS Policy),
- 6) Anticorruption Policy of the TAURON Group (the Anticorruption Policy).

Each of the above documents comprehensively presents its subject matter along with an exhaustive description of measures taken by TAURON Capital Group's subsidiaries to achieve the targets adopted in the relevant areas.

8.3.1. Social issues

The responsibilities taken on by the TAURON Capital Group in the area of social issues are governed by the adopted Customer Oriented Social Policy (PRO), aimed at assuring appropriate organisational and business conditions required for achievement of the strategic goals of the TAURON Capital Group concerning its customer and market environment relations. The Customer Oriented Social Policy defines the measures taken by TAURON under a customer dialogue, stresses the importance of building lasting relations both with the customers and the market environment.

8.3.2. Employee issues

Diversity and openness constitute an integral part of both the business operations of the TAURON Capital Group as well as of its *Human Resources Management Policy of the TAURON Group*. The companies of the TAURON Capital Group observe the equal treatment policy and strive to assure diversity with respect to gender, education type, age and professional experience with respect to all employees, and in particular Company authorities and its key managers.

Streamlining of the above measures is supported by the Diversity Policy implemented at the TAURON Capital Group with the key objective of strengthening organisational awareness and culture welcoming diversity.

In employee related matters the TAURON Capital Group also takes measures to prevent discrimination by creating appropriate working atmosphere and culture based on corporate values (Partnership, Development and Courage), as confirmed by implementation of the *Counter Mobbing and Counter Discrimination Policy at the TAURON Group*.

8.3.3. Natural environment

TAURON Capital Group takes on responsibility for caring for the natural environment and the consequences of using its resources. Considering it an important social responsibility, since many years TAURON has been commencing a range of measures aimed at minimising the negative impact of its operations on natural environment.

All companies of TAURON Capital Group have adopted the Environmental Policy that defines the approach to environmental management, including the general direction of environmental operations of the organisation and the principles it follows in environment related matters. The environmental policy is the benchmark for assessing the operation of all companies in the area of environment protection and environmental management; it also documents the values and the vision followed by TAURON Capital Group in its influence on the natural environment.

8.3.4. Respect of human rights

The principles followed by the TAURON Capital Group in the context of respect for human rights and measures taken to prevent their violation as well as support for a climate of dignity and mutual respect are expressed in the Human Rights Respect Policy. This document defines the rules for actions and conduct with respect to human rights that are dedicated to all stakeholders of the TAURON Capital Group, in particular the employees, trading partners and business partners, and include: prohibition of mobbing and discrimination, observing employment and remuneration conditions, work health and safety (WHS).

Due to the nature of operations of the TAURON Capital Group, the area of respect for human rights gives prominent place to aspects relating to work safety assurance. For this reason a separate document was developed that defines the values, rules of conduct and principles of actions concerning the WHS. The goal of the WHS Policy is to achieve the four fundamental goals of work health and safety, being:

- 1) Assuring optimal working conditions to everyone employed by and working for the TAURON Capital Group.
- 2) Raising the qualifications of employees of the TAURON Capital Group aimed at building knowledge, commitment and competences of all employees in the area of improvement of their safety and safety of co-workers and persons present at their places of work.
- 3) Implementing and improving an effective WHS management system, closely related to ongoing operations of the TAURON Capital Group.
- 4) Eliminating of work related accidents to everyone employed by and working for the TAURON Capital Group and other persons present at the premises of business operations of the companies of the TAURON Capital Group.

Provisions contained in the WHS Policy bind all employees of the TAURON Capital Group as well as all contractors and suppliers of products and services, and any other persons present at the premises of the TAURON Capital Group. The WHS reporting procedures at the TAURON Capital Group are compliant with the Labour Law regulations governing the operation of work place accidents register and informing external authorities about work related accidents and vocational diseases.

Without a business based on respect for human rights there is no possibility to collaborate with the market at the top level. The TAURON Capital Group also expects its business partners to observe the rules and respect human rights of their own employees and to abstain from any forms of breach. As a consequence of supporting the responsible and ethical business conduct, the Code of Conduct of Business Partners was implemented.

8.3.5. Countering corruption

The goal of the Anticorruption Policy in force is to define uniform rules and standards of conduct that allow identifying, countering and mitigating the risk of occurrence of corrupt practices and other kinds of fraud at the companies of the TAURON Capital Group. TAURON has a zero tolerance policy towards corruption and other fraud with respect to all aspects of business and non-business operations of the TAURON Capital Group.

The Anticorruption Policy defines acts of corruption and other practices contrary to the legal regulations in force, internal regulations and corporate regulations of the TAURON Capital Group or ethics. The document defines the obligations relating to countering corruption, potential areas of corruption risk as well as the warning signals the employees should be paying attention to in their daily work. According to the provisions of the Anticorruption Policy, the TAURON Capital Group operates appropriate communication channels allowing the employees to immediately and securely (including anonymous) report potential cases of breach.

8.4. Description of the results of application of policies by TAURON

The basic premise of the Customer Oriented Social Policy is an ongoing survey of general customer satisfaction. At the TAURON Capital Group, one of the key tools for their satisfaction evaluation is the Customer Satisfaction Index (CSI). The survey is performed every Q2/Q3 by an independent research agency. It includes a randomly selected group of customers of TAURON and a group of customers of other energy utilities, such as: ENEA, ENERGA and PGE.

The effects of application of the Customer Oriented Social Policy also include educational initiatives oriented at disadvantaged groups, primarily energy sensitive customers and seniors. The range of topics of these initiatives includes the commercial dangers on the energy market, consumer rights, ways to overcome difficulties with paying the electricity bills, assistance in understanding the bill, etc. In this way TAURON is helping the disadvantaged groups in informed and safe use of the energy market. Educational activities take the form of:

- 1) information campaigns (e.g. Strangers? Do not answer the door!, i.e. *TAURON is not knocking on doors to sell electricity or gas*),

- 2) organising educational meetings addressed to senior citizens “Energy for Seniors” (in 2017, five meetings were held – in Limanowa, Nowy Targ, Cieszyn, Wałbrzych and in Bytom),
- 3) organisation of educational workshops addressed to social assistance workers: “Customer on the horizon” (in 2017, four meetings were held – in Siemianowice Śląskie, Wałbrzych, Kraków and in Wrocław).

The results of implementation of the assumptions of the Customer Oriented Social Policy also include simplification of the marketing communication of products and services as well as providing the customers with an option to pay their distribution service fees and connection charges using electronic payments. Moreover, the partners TAURON collaborates with in the offerings (suppliers of specialised equipment) and in expanding the sales channels (at present, sales through real estate agencies – over 10 partners in total) are selected according to the procedures for establishing collaboration.

Presently the TAURON Capital Group is working on operationalisation of the principles of the implemented employee related policies. The measures taken are targeted at creating a culture based on corporate values of Partnership, Development and Courage that support dialogue, openness, mutual tolerance and teamwork.

Moreover, in 2017 an e-learning training was launched on countering mobbing and discrimination at the TAURON Capital Group, which supports the procedures of reporting incidents that may indicate occurrence of mobbing or discrimination.

The result of application of the Environmental Policy by the TAURON Capital Group is a gradual reduction of both the direct and indirect influence on the environment and conducting relevant communication assuring understanding of the operations of the TAURON Capital Group that may be impacting the environment.

The TAURON Capital Group observes all the internationally recognised human rights and supports their protection, while at the same time preventing situations where these rights would be directly or indirectly violated. The Human Rights Respect Policy is binding on all employees, and with the implementation of the Code of Conduct of Business Partners – also on TAURON’s business partners. Currently the process of operationalisation of the document is under way. Due to the above it is not possible to comprehensively present the results of application of the above policy at present.

The WHS Policy streamlines the rules on the WHS that the TAURON Capital Group has been observing long before the development of this document. The expected result of operationalisation of the WHS Policy is a continuing improvement of work health and safety standards that is to result in, among others, elimination of work related accidents and minimisation of occurrence of vocational diseases and potentially accident prone incidents.

Each and every employee of the TAURON Capital Group is required to study the content of the Anticorruption Policy, respect it unconditionally and sign a statement on having studied its content. Introduction of the Anticorruption Policy at the TAURON Capital Group contributes towards continued improvement of awareness concerning identification of corrupt practices and promotion of honesty and transparent conduct.

8.5. Description of due diligence procedures in operation under the policies applied by TAURON

One of the key metrics of due diligence used in the Customer Oriented Social Policy are the cyclically determined Key Performance Indicators (KPIs) concerning, for example, the number of complaints submitted to the TAURON Capital Group. In its operations TAURON pays particular attention to the procedures aimed at raising customer awareness, thus preventive measures are developed and implemented after post-collection reconnection of electricity supply, i.e. the customers are informed about the need to prepare their premises for renewed electricity supply so as to prevent occurrence of hazards to people and property.

TAURON is planning further delivery of information campaigns, trainings and other initiatives facilitating understanding of the Customer Oriented Social Policy by the employees and developing customer oriented attitudes with:

- 1) e-learning on products and services offered, increasing the level of knowledge about the customers, primarily addressed to all employees of the TAURON Capital Group,
- 2) an educational programme building customer oriented awareness for all employees of the TAURON Capital Group,
- 3) development of a knowledge base available to all employees of the TAURON Capital Group (it will provide the employees with the knowledge on current customer oriented initiatives and with the content deepening the knowledge and awareness of employees about customer focus, consumer rights, good practices in customer relations and building positive customer experience in contacts with the TAURON brand).

With respect to employee issues under the policies applied at the TAURON Capital Group, regulations are in force on remuneration and labour law, as well as a standardised *Human Resources Management Policy at the TAURON Group* and *Rules of Remuneration at the TAURON Group*.

Moreover, respecting the freedom of association, the TAURON Capital Group has a Social Council and dozens of trade union organisations.

The general direction of environmental measures at the TAURON Capital Group includes minimising the negative impact on the environment taking into account the specifics of the sector, technical progress and access to environmentally friendly technologies, achieved by:

- 1) assuring compliance of operation of all companies of the TAURON Capital Group with the environment protection regulations, taking into account the local conditions and specifics of business operations,
- 2) collaborating with all parties to and participants in the processes,
- 3) monitoring and exchange of “industry good environmental practices”,
- 4) ongoing monitoring of the main aspects of direct and indirect environmental impact of operations.

The TAURON Capital Group strives to respect human rights and to understand the values of local communities by holding open dialogues with those affected by the company operations. When making business decisions, TAURON analyses the extent of their potential impact on the local communities of the region and seeks to balance its impact on the environment, which is reflected in its *Human Rights Respect Policy*, with its provisions also defining the path for reporting violation of its rules.

Under the due diligence procedures in operation under the human rights respect policies, changes were introduced to the template TOR and detailed TOR documents that constitute attachments to the *Rules for Awarding Contracts at the TAURON Group*, resulting in the requirement on every business partner of the companies of the TAURON Capital Group to submit the statement on having reviewed the Code of Conduct of Business Partners.

Under the due diligence procedures aimed at improving the WHS standards, the TAURON Capital Group measures and benchmarks its results with respect to the WHS both internally and externally, and uses the best identified practices. Moreover it seeks to develop its own best practices in the WHS and conducts internal and external audits with participation of the management staff, employees and their representatives, WHS services and contractors. TAURON also works on initiatives raising the awareness of the WHS among employees, including information and training activities, as well as campaigns oriented at increasing the employee engagement in shaping the work health and safety system at the TAURON Capital Group.

The TAURON Capital Group encourages its employees and third parties to come forward with any information on breaches of the Anticorruption Policy and other violations using the dedicated communications channels. The employees and third parties may submit their doubts or request the assistance of the Compliance Officer in case of doubt as to whether a justified suspicion arises in specific situation of breach of provisions of the Anticorruption Policy or other legal regulations, internal company regulations or corporate regulations of the TAURON Capital Group or of ethical standards. All submissions are treated with confidence and studied with due diligence.

TAURON is taking measures to raise employee knowledge and awareness of combating corruption. In 2017, TAURON has organised workshops for the members of the management staff on topics of corruption. Similar trainings particularly dedicated to the staff from procurement and investments areas took place also at the other companies of the TAURON Capital Group. In 2018, TAURON is planning to deliver information initiatives, trainings and other measures facilitating correct understanding of the Anticorruption Policy by the employees and following its principles in their daily work.

8.6. Description of significant risks related to operations of TAURON that may exert adverse impact on the policies applied by TAURON, as well as description of management of these risks

Under the risk management process employed by the TAURON Capital Group, risks related to operations of the companies were identified that could exert adverse impact on the social, employee, natural environment, respect for human rights and anticorruption issues as well as on policies employed by TAURON.

According to regulations in force, for every identified risk its Risk Owner is appointed and made responsible for this risk management, risk records are developed containing descriptions of mitigation measures conducted, risk measurement parameters and early warning indicators are defined and in particular cases separate risk response and backup plans are developed. These risks are included in the risk model that defines the categories of risks present in the operations of TAURON.

The key risks include: social risk, human capital management risk, WHS risk, internal communication risk, environmental risk, procurement process risk, legal risk and compliance risk.

The below table below characterises the risks related to the operations of TAURON that could exert adverse impact on the policies employed by TAURON.

Table no. 47. Risks related to the operations of TAURON that could exert adverse impact on the policies employed by TAURON

No.	Risk name	Risk description	Risk response
1.	Social risk	The risk includes failing to meet customer service standards, to deliver on sales agreements, external communications and marketing activities and the personal data protection related risk. Risk materialisation could result in loss of reputation and customer trust, customer disputes, non-achievement of goals including sales targets and possible penalties for legal noncompliance concerning personal data protection.	<ul style="list-style-type: none"> • Adoption and execution of Customer Oriented Social Policy. • Holding a dialogue with customers, including customer satisfaction surveys, tailoring the product offering to their needs, looking after high customer service levels. • Building relations with the customers and market environment. • Responsibility for the product including quality and security of supply, tailoring the product offering to customer needs. • Customer personal data privacy and security protection. • Implementing tools supporting execution of customer focused social policy. • Standardisation of customer agreement templates and their adaptation to legislation changes and optimisation of sales and service processes. • Delivery of promotional activities in line with the adopted <i>TAURON brand strategy</i> and <i>TAURON Group sponsoring strategy for 2018–2025</i>, taking into account respect for human rights and conducting responsible marketing.
2.	Human capital management risk	Risk relating to employee issues including diversity, inclusion, employment conditions and respect of right of association, capital management, career paths and recruitment management, training system, work health and safety management. Risk materialisation results in employee complaints, collective disputes, strikes, loss of specialised staff and problems with its restoration.	<ul style="list-style-type: none"> • Adoption and execution of the Employee Recruitment, Selection and Adaptation Policy. • Adoption and execution Counter Mobbing and Counter Discrimination Policy. • Looking after development of employee competences, including through participation in trainings. • Holding consultations with social organisations within the TAURON Capital Group. • Execution of the staffing policy based on the Competence Model and Rules of Compensation, and Rules of Work. • Adoption and implementation of the Diversity Policy. • Adoption and implementation the Human Rights Respect Policy.
3.	Work Health and Safety (WHS) risk	Risk relating to ensuring health and safety at work. Risk materialisation result is employee injury, health loss or excessive employee exposure to hazards.	<ul style="list-style-type: none"> • Prioritisation of employee, customer, contractor and stakeholder safety in the business activities performed. • Adoption and execution of the <i>Work Health and Safety Policy of the TAURON Group</i>. • Assuring optimal working conditions. • Raising employee qualifications with respect to work safety improvements. • Conducting trainings, implementation and improvement of WHS management system.
4.	Internal communication risk	Risk relating to assuring optimal and effective communication within the TAURON Group and transmission of honest information to employees of the TAURON Capital Group while observing confidentiality of sensitive information. Risk materialisation result is a loss of trust in the employer, increased social unrests, loss of reputation and negative impact on the TAURON brand.	<ul style="list-style-type: none"> • Building relations with the social side at the TAURON Capital Group and close cooperation with the Social Dialogue Spokesperson. • Use and development of available communications tools to provide significant information to the employees of the TAURON Capital Group. • When providing significant information – organisation of fact to face meetings of the management staff with the employees. • Ongoing monitoring of situation and events at companies of the TAURON Capital Group that could result in social unrests. • Regular meetings with the representatives of companies dealing with internal communication to exchange information. • Developing the Communication Strategy for the TAURON Group.

No.	Risk name	Risk description	Risk response
5.	Environmental risk	Risk relating to impact of business operations on natural environment and the use of its resources, pollution control and prevention, protection of water sources and waste management. Risk materialisation result is a degradation of natural environment and penalties for failing to meet environmental requirements, the need to remedy them, to limit production, possibility of benefiting from subsidy programmes and loss of image of the TAURON Capital Group.	<ul style="list-style-type: none"> • Adoption and implementation of <i>Environmental Policy of the TAURON Group</i>. • Conducting business operations impacting the natural environment according to sustainable development principles. • Identification of areas of environmental impact and assuring the operation of the TAURON Capital Group in compliance with the environment protection laws. • Continuing development of knowledge and environmental responsibility culture among the employees, customers and business partners of the TAURON Capital Group. • Seeking solutions aimed at implementing circular economy principles at the TAURON Capital Group and actively seeking technical and organisational solutions that minimise the negative impact of operations on the environment. • Improvement of energy efficiency and efficient water management. • Offering products / services that take into account the aspect of limiting the negative environmental impact. • Promoting conservation of nature and relevant collaboration with local government and central government administration bodies.
6.	Procurement process risk	Risk relating to the exercised procurement procedures, taking into account prevention of violation of human rights by business partners, countering corruption and fraud in procurement processes and observing ethical and moral standards in their progress. Risk materialisation result are non-optimal purchase contracts, need to annul tendering procedures, loss of image of the TAURON Capital Group and credibility to stakeholders.	<ul style="list-style-type: none"> • Adoption and implementation of the Code of Conduct of Business Partners of the TAURON Group. • Adoption and execution of the <i>Anticorruption Policy of the TAURON Group</i>. • Adoption and execution of the <i>Human Rights Respect Policy</i>. • Standardisation of conducting procurement processes and their transparency. • Building lasting business partner relationships based on trust and mutual respect. • Expecting the business partners to observe the legal regulations, ethics standards and fair trading practices, including work health and safety, prevention of discrimination and unequal treatment, respecting employee human rights and dignity, transparent HR policy, environment protection, fair competition, fraud prevention and combating, as well as information security and protection. • Use of standard template agreements and standard clauses in contracts providing for respect for human rights by the business partners of the TAURON Capital Group.
7.	Legal risk	Risk relating to non-observance of legal regulations, misinterpretation of new rules and regulations, requirements imposed by the regulator and the supervisory bodies.	<ul style="list-style-type: none"> • Ongoing monitoring of the legal environment and amendments to legal regulations, including in scope of social issues, respect for human rights, countering corruption, environment protection and employee issues. • Implementation of the required amendments to the in-house regulations. • Appointing working parties tasked with developing and implementing the required changes resulting from the legal environment. • Ongoing cooperation with the bodies supervising the energy market and the capital market. • Training the employees in legal regulations and in-house regulations.

No.	Risk name	Risk description	Risk response
8.	Compliance risk	<p>Compliance risk includes the risk of internal fraud, external fraud and non-ethical conduct.</p> <p>Risk relating to misappropriation or improper use of Company assets, their devastation, abuse of official position for personal gains, acts by third parties aimed at theft, burglary, counterfeiting and related to occurrence of conduct violating generally accepted social coexistence standards, moral standards and mobbing.</p>	<ul style="list-style-type: none"> • Adoption and implementation of <i>Code of Conduct of Business Partners of the TAURON Group</i>. • Adoption and execution of the <i>Anticorruption Policy of the TAURON Group</i>. • Adoption and execution of the <i>Human Rights Respect Policy</i>. • Adoption and execution of the <i>Counter Mobbing and Counter Discrimination Policy</i>. • Adoption and implementation of the <i>Diversity Policy</i>. • Use of internal procedures aimed at fraud prevention (security procedures, reviews of authorisations), their testing and improvement. • Promoting best practices, improvement of procedures, conducting trainings and observing the Code of Business Ethics of the TAURON Group and operation of a fraud reporting system. • Building an organisational culture based on values and principles of the TAURON Group.

9. OTHER MATERIAL INFORMATION AND EVENTS

9.1. Proceedings pending before the court, competent arbitration authority or public administration authority

During the reporting period no proceedings were pending before any court, competent arbitration authority or public administration authority, related to the Company, the standalone or aggregate value of which would represent at least 10% of TAURON's equity.

Furthermore, during the reporting period no proceedings were pending before any court, competent arbitration authority or public authority body, related to the subsidiaries of TAURON Group, the standalone or aggregate value of which would represent at least 10% of TAURON's equity.

9.2. Information on agreements concluded by TAURON Capital Group's subsidiaries

9.2.1. Agreements significant for TAURON Capital Group's operations

In the financial year 2017 and until the day of drawing up this report TAURON Capital Group's subsidiaries concluded the following agreements significant for the operations of TAURON Capital Group:

Concluding of the amendment to the agreement with the RAFAKO S.A. – MOSTOSTAL WARSZAWA S.A. consortium on the construction of a power generation unit at Jaworzno III Power Plant

On March 1, 2017 the Management Board of TAURON's subsidiary – TAURON Wytwarzanie (Ordering Party) signed with the RAFAKO S.A. – MOSTOSTAL WARSZAWA S.A. consortium (Contractor) an amendment to the agreement on the construction of a 910 MWe power generation unit for super critical parameters at Jaworzno III Power Plant – Elektrownia II, currently carried out by the Ordering Party's spun off branch – Oddział Jaworzno 910 MW in Jaworzno, with respect to: steam boiler, turbine set, main building, electric part and the unit's instrumentation and control (I&C).

Under the amendment the agreement's net price was increased by PLN 71.05 mln, i.e. to PLN 4 470 mln, and the deadline for completing the subject of the agreement was extended by 8 months, i.e. until the 67th month from the date of concluding the agreement at the latest which means that the new assumed date of handing over the unit for operation is November 2019.

The decision to sign by TAURON Wytwarzanie of the above mentioned amendment was taken on February 28, 2017. On the same day also the Management Board of TAURON issued a positive opinion on the conclusion of the amendment on the above mentioned terms.

Amendments to the agreement were due to the need to change the unit's facilities' foundations to the deep foundations, and also due to the parties to the agreement agreeing on additional works beneficial to the Ordering Party for technical and economic reasons (erecting the foundation for the fifth electrofilter (EF) zone and extending the EF switchgear building). The additional works will allow the Ordering Party to achieve savings during the planned outage of the unit in 2021 in order to partly adapt the unit to comply with the future BAT conclusions requirements. The Ordering Party partly accepted the Contractor's claims related to the above circumstances and the change necessity protocols as justified. The claims due the change of the design standards – EUROKODY, were not accepted as justified by the Ordering Party.

Due to the above the warranties granted by the Contractor were extended:

- 1) by 6 months with respect to the Unit's availability for the direct shipments carried out by RAFAKO S.A., boiler maximum continuous rating, unit's technical minimum and flue gas water content behind FGD, vibration level for a structure,
- 2) by 12 months with respect to the unit's design and construction.

The Contractor will also ensure an appropriate extension of the agreement's performance bond.

Signing of the amendment changed the terms of the agreement with the Contractor, however it had no impact on the change of the entire investment project's budget.

The Company provided information on the amendment to the above mentioned agreement in the regulatory filings (current reports): no. 5/2017 of February 28, 2017 and no. 7/2017 of March 1, 2017.

Coming into force of the agreement and amendments on the terms of further implementation of the "CCGT unit's construction at Stalowa Wola" project

On March 31, 2017, in reference to the earlier concluded agreements and amendments on the terms of further implementation of the "CCGT unit's construction at Stalowa Wola" project (Project), as described in the regulatory filing (current report) no. 36/2016 of October 27, 2016 ECSW issued an instruction to make the payment to the

institutions so far providing the financing for ECSW, i.e. European Investment Bank, European Bank for Reconstruction and Development, Bank Polska Kasa Opieki S.A. (Financing Institutions) of PLN 581.4 mln as the repayment of all of ECSW's liabilities towards the Financing Institutions. Upon the crediting of the Financing Institutions' bank accounts the suspending conditions were met and at the same time the documents described in the above mentioned report (filing) came into force, i.e.:

- 1) agreement on establishing the basic boundary conditions of the Project's restructuring among TAURON, PGNiG and ECSW,
- 2) amendment to the electricity sale Agreement of March 11, 2011 (Electricity Sale Agreement) among TAURON, PGNiG and ECSW,
- 3) amendment to the gas supply Agreement of March 11, 2011 (Gas Agreement) between PGNiG and ECSW.

The agreement governs, first of all, the conditions of settling the liquidated damages, making the so far used pricing formulas market based and the Project's financial restructuring issues and it constitutes a reflection of the will of the Project's sponsors, i.e.: TAURON and PGNiG (Sponsors) with respect to the continuation of the CCGT unit's construction, making changes to the Gas Agreement and the Electricity Sale Agreement and changing Project's financing formula from project finance to corporate finance.

Changes to the Gas Agreement and the Electricity Sale Agreement envisage in particular making the pricing formulas used in these agreements market based. Furthermore, due to the delay in the Project's implementation, the amendment to the Gas Agreement envisages a change with respect to amounts, deadlines and methodology used to assess liquidated damages.

ECSW acquired the funds for the bank loans' repayment under loan agreements according to which each of the Sponsors granted ECSW a PLN 290.7 mln loan.

In accordance with the provisions of the standstill agreement mentioned in the regulatory filing (current report) no. 36/2016 the Financing Institutions were obligated to return the bank guarantees received from the Sponsors for the total amount of approx. PLN 629m, where the total amount of bank guarantees provided by TAURON was PLN 314.5 mln.

Irrespective of the above the Sponsors, along with ECSW, are continuing joint works aimed at acquiring new financing for the CCGT unit's construction project at Stalowa Wola the terms and the structure of which would be more favorable than the existing agreements.

The Company disclosed information on the above event in the regulatory filing (current report) no. 11/2017 of March 31, 2017.

The bank guarantees for PLN 314.5 mln issued at TAURON's instruction in order to guarantee the banks' liabilities under the loans granted to ECSW mentioned in the above regulatory filing (current report) expired in April 2017.

Signing of the agreement on potential cooperation in the implementation of the construction of a 910 MW power generation unit project at Jaworzno III Power Plant and the termination of the investment agreement related to the CCGT unit at Łagisza Power Plant

In reference to the Strategy that assumes an implementation of the construction of a 910 MW power generation unit project at Jaworzno (Project) under the new financing formula, envisaging spinning off of an organized part of an enterprise including the above mentioned investment project into a new special purpose vehicle, and then external partners joining the company, on June 1, 2017 TAURON signed the Agreement on the preliminary terms of potential cooperation as part of the Project with Fundusz Inwestycji Infrastrukturalnych – Kapitałowy Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych and Fundusz Inwestycji Infrastrukturalnych – Dłużny Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych (Funds), managed by Towarzystwo Funduszy Inwestycyjnych BGK S.A. A part of the investment portfolio of the above mentioned Funds is managed by Polski Fundusz Rozwoju S.A.

Under the Agreement the Funds expressed a preliminary interest in investing in the Project PLN 880 mln in total, by way of the Funds taking up new shares in the Nowe Jaworzno GT special purpose vehicle, that is currently TAURON's wholly owned company currently implementing the Project. The Funds' share in the share capital of Nowe Jaworzno GT cannot be higher than 50% minus one share. The other shares in Nowe Jaworzno GT will be held by the Company or by the Company and an additional Investor (Investors), where the Company will own at least 50% plus one share in Nowe Jaworzno GT. The Agreement expresses the will of the parties to conduct, in good faith, negotiations aimed at defining the rules of potential cooperation in implementing the Project. The joining of the Project by the Funds will be dependent on the results of the detailed analysis of the Project by the Funds, the parties agreeing and fulfilling the conditions defined in the documentation of the transaction and the Funds obtaining the required investment consents to take part in the Project. The Agreement shall be valid until December 31, 2017.

At the same time on June 1, 2017 an agreement was signed between TAURON Wytwarzanie and PFR under which the investment agreement concluded between the above mentioned entities aimed at the joint implementation of the project "Construction of a 413 MWe CCGT unit at TAURON Wytwarzanie Spółka Akcyjna Oddział Elektrownia Łagisza in Będzin" was terminated. The Company provided information on the conclusion of the investment agreement in the regulatory filing (current report) no. 17/2015 of July 13, 2015. The termination of the investment agreement is in line with the assumptions of the Strategy envisaging stopping of the investment in the CCGT unit at Łagisza Power Plant which translates into the reduction of capital expenditures for this purpose by approximately PLN 1.5 bln.

In reference to the term (expiration date) of the above mentioned Agreement, on December 29, 2017 TAURON signed an amendment under which the Agreement on potential cooperation in the implementation of the 910 MW power generation unit construction project in Jaworzno was extended until February 28, 2018.

The other provisions of the above mentioned Agreement were not changed.

On February 28, 2018 TAURON informed of the will, expressed by the parties to the Agreement, to continue activities aimed at signing agreements that will define the terms of the Funds' equity investment in the Special Purpose Vehicle.

The intention of the parties is to have the Funds join the Special Purpose Vehicle and participate in the successive recapitalizations of the Special Purpose Vehicle, by taking up the newly created shares in exchange for financial contributions up to the total maximum amount of PLN 880 mln.

The Funds' share in the Special Purpose Vehicle's share capital, as of the day the Unit is commissioned, should reach approx. 14%, while TAURON's share should reach at least 50% + 1 share. Joining the Special Purpose Vehicle by the Funds will be contingent on the fulfillment of the conditions that will be defined in the agreements.

The Company disclosed information on the above events in the regulatory filings (current reports): no. 25/2017 of June 1, 2017, no. 43/2017 of December 29, 2017 and no. 4/2018 of February 28, 2018.

Extension of the bond issue program

On June 20, 2017 amendments were signed to the agreements related to the bond issue program (Program), i.e. agency and custody agreement and underwriting agreement of the conclusion of which the Company provided information in the regulatory filing (current report) no. 49/2015 of November 20, 2015. Under the above amendments the following extension of the Program was made:

- a) one year, i.e. until December 31, 2021 ("Extension Period I"). Program amount in Extension Period I will be PLN 5.32 bln maximum, and the following banks joined the extension: MUFG Bank (Europe) N.V., MUFG Bank (Europe) N.V. S.A. Branch in Poland, Bank Zachodni WBK S.A., CaixaBank S.A. (Joint Stock Company) Branch in Poland, Industrial and Commercial Bank of China (Europe) S.A. Branch in Poland, ING Bank Śląski S.A., Powszechna Kasa Oszczędności Bank Polski S.A. and mBank S.A.,
- b) by two years, i.e. until December 31, 2022 ("Extension Period II"). Program amount in Extension Period II will be PLN 2.45 bln maximum, and the following banks joined the extension: MUFG Bank (Europe) N.V., MUFG Bank (Europe) N.V. S.A. Branch in Poland and Powszechna Kasa Oszczędności Bank Polski S.A.

Until December 31, 2020 the Program amount will not change and will be PLN 6.27 bln maximum. The margin of the financing under the Program did not change due to the extension made.

On the other hand on March 9, 2018 amendments to the agency and custody agreement as well as the underwriting agreement were signed, the result of which is an extension by some banks of the period of availability of the funds under the Program.

This means that the maximum value of the Program:

- a) is PLN 6.27 bln until December 31, 2020 (this amount did not change as a result of signing the amendments),
- b) is PLN 6.07 bln until December 31, 2021 (it had been PLN 5.32 bln before the amendments were signed),
- c) is PLN 5.82 bln until December 31, 2022 (it had been PLN 2.45 bln before the amendments were signed).

The amendments were signed with the following banks taking part in the Program: Bank Handlowy in Warsaw S.A., Bank BGŻ BNP Paribas S.A., Bank Zachodni WBK S.A., CaixaBank S.A. (Joint Stock Company) Branch in Poland, Industrial and Commercial Bank of China (Europe) S.A. Branch in Poland, ING Bank Śląski S.A., mBank S.A., MUFG Bank (Europe) N.V., MUFG Bank (Europe) N.V. S.A. Branch in Poland and Powszechna Kasa Oszczędności Bank Polski S.A.

The information on the above events was disclosed by the Company in the regulatory filings (current reports) no. 29/2017 of June 20, 2017 and no. 6/2018 of March 9, 2018.

Conclusion of the coal purchase agreement with Polska Grupa Górnicza S.A.

On January 18, 2018 a coal purchase agreement was signed between TAURON and Polska Grupa Górnicza S.A. with the subject of the agreement being the purchase of thermal coal for the production needs of TAURON Capital Group's

power generating units. The estimated value of coal supplies in the 2018–2021 time frame, based on the coal price agreed for 2018, will reach the net amount of approximately PLN 2.15 bln. The coal price was agreed for the first year of the agreement's term, while in the subsequent years the coal price will be indexed based on the formula included in the agreement, taking into account changes of the market conditions. The above agreement was concluded for an indefinite period of time and it provides for liquidated damages in the amount of 10 percent of the value of unrealized deliveries in the given year.

The information on the above event was disclosed by the Company in the regulatory filing (current report) no. 1/2018 of January 18, 2018.

Financing for EC Stalowa Wola subsidiary

On March 8, 2018 in reference to the current report no. 11/2017 of March 31, 2017 with respect to the information on actions related to obtaining new financing for the CCGT unit construction project at Stalowa Wola, EC Stalowa Wola (Loan Taker), i.e. entity in which the TAURON holds indirectly, via its TAURON Wytwarzanie S.A. subsidiary, a 50% stake in the share capital; signed a loan agreement with BGK and PGNiG.

Under the above mentioned agreement BGK and PGNiG will grant the Loan Taker a loan in the amount of PLN 450 mln each, to be used to refinance the Loan Taker's debt towards the Issuer and PGNiG (PLN 600 mln) and to cover the Loan Taker's further capital expenditures (PLN 300 mln). The agreement was concluded for the period lasting until June 14, 2030.

As of March 8, 2018 the Loan Taker's current loan liabilities towards the Issuer were approximately PLN 610 mln.

The loan agreement provides for the funds to be paid out to the Loan Taker after the suspending conditions have been met, with one of them being presenting to BGK of a bank guarantee issued at the Issuer's instruction and securing the Loan Taker's debt towards BGK. The bank guarantee will be renewed annually, and its value will not exceed PLN 517.5 mln.

The information on the above event was disclosed by the Company in the regulatory filing (current report) no. 5/2018 of March 8, 2018.

9.2.2. Transactions with related entities on terms other than at arm's length

All transactions with related entities are concluded at arm's length.

The detailed information on the transactions with related entities is provided in note 49 of the consolidated financial statements for the year ended on December 31, 2017.

9.2.3. Signed and terminated credit and loan agreements

Working capital credits and short term loans

In accordance with the financing model adopted by TAURON Capital Group, only TAURON may act as a party to working capital credits and short-term loans raised with external institutions.

TAURON Capital Group is using a true cash pooling structure, implemented under the cash management agreement concluded with PKO BP (the former agreement expired on December 17, 2017, while the new agreement came into force on December 18, 2017, valid until December 17, 2020). The cash pooling structure is based on daily limits granted to individual participants by the agent managing the service, i.e. TAURON. As a result of implementing the cash pooling mechanism, cash transfers are performed between accounts of participants of the service and the agent's account. Within the cash pooling structure TAURON uses at PKO BP:

- 1) overdraft limit in the amount of PLN 300,000 thousand, based on the overdraft agreement concluded with the bank in October 2017, with the repayment date falling on December 29, 2017 (the former overdraft limit agreement of December 2014 expired on December 29, 2017), and
- 2) intraday limit in the amount of PLN 500,000 thousand, effective until December 17, 2020 (the effective date was extended under the amendment to the bank account concluded in October 2017). The intraday limit is a daily limit which must be fully repaid by the end of each day on which it was used).

As part of financing its ongoing operations following agreements were also in force:

- 1) overdraft agreement with BGK, up to the amount of EUR 45,000 thousand with the repayment date of December 31, 2017. The overdrawn amount is used for financing of the transactions of purchase/ sale/ exchange of CO₂ emission allowances, trading in electricity and gas made on the European exchanges, (accordingly, under amendments no. 1 and no. 2 to the overdraft agreement, concluded in May and December 2017, its amount was raised from EUR 25 000 thou. to EUR 45 000 thou. and the effective date was extended until December 31, 2018).

- 2) overdraft agreement concluded with mBank for the amount not exceeding of USD 2,000 thousand, to be used for financing the ongoing operations, in particular, for financing the collateral margin and commodity products transactions. The repayment deadline of the loan, pursuant to the amendment of January 12, 2017, falls on March 31, 2018.

The use of above described foreign currency loans is aimed at mitigating the FX risk related to the trade transactions concluded.

The below table presents a detailed summary of working capital loan and credit agreements effective as of December 31, 2017.

Table no. 48. Summary of TAURON Capital Group's working capital loan and credit agreements as of December 31, 2017

No.	Type of agreement	Interest rate	Amount of credit/loan (thou.)	Period of financing	Balance as of December 31, 2017 (thou.)
1.	Overdraft facility	LIBOR 1M + fixed margin	2 000 USD	16.04.2015 – 30.03.2018	417 USD
2.	Overdraft facility	EURIBOR 1M + fixed margin	45 000 EUR	09.05.2017 – 31.12.2018	22 060 EUR
3.	Overdraft facility	WIBOR O/N + fixed margin	300 000 PLN	30.12.2017 – 29.12.2020	0 PLN
4.	Intraday limit	None	500 000 PLN	18.12.2017 – 17.12.2020	0 PLN

Investment credits and loans

The below table presents a detailed summary of investment credit and loan agreements effective at TAURON Capital Group as of December 31, 2017.

Table no. 49. Summary of TAURON Capital Group's investment credit and loan agreements as of December 31, 2017

No.	Parties to the agreement	Type of agreement and interest rate	Amount of credit/loan (thou.)	Repayment date	Balance as of December 31, 2017 (thou.)
1.	TAURON – EBI	fixed margin	210 000 PLN	15.12.2021	84 000 PLN
2.	TAURON – EBI	fixed margin	300 000 PLN	15.12.2021	120 000 PLN
3.	TAURON – EBI	fixed margin	450 000 PLN	15.06.2024	265 909 PLN
4.	TAURON – EBI	fixed margin	200 000 PLN	15.09.2024	127 273 PLN
5.	TAURON – EBI	fixed margin	250 000 PLN	15.09.2024	159 091 PLN
6.	TAURON – EBI	fixed margin	295 000 PLN	15.03.2027	280 250 PLN
7.	TAURON Wytwarzanie – WFOŚiGW	base rate + fixed margin	40 000 PLN	15.12.2022	20 000 PLN
8.	TAURON Ciepło – WFOŚiGW	floating	30 000 PLN	15.12.2022	15 000 PLN
10.	KW Czatkowice – WFOŚiGW	floating	914 PLN	31.05.2021	627 PLN

In 2017 TAURON Capital Group's subsidiaries did not terminate any credit and loan agreements.

9.2.4. Loans and sureties granted as well as sureties and guarantees received

Loans granted

Besides its subsidiaries included in the consolidation, In 2017 TAURON granted financing to its co-subsidiary, EC Stalowa Wola, in the form of loans to be used for the current operations of EC Stalowa Wola and the repayment of loan installments of this subsidiary towards the European Investment Bank, European Bank for Reconstruction and Development and Pekao S.A. Furthermore, the agreement consolidating ECSW's debt due to the loans granted to the company before was signed in 2017.

Moreover, on November 8, 2017 the Company concluded, with PGE EJ 1 sp. z o.o., an agreement on a PLN 2 940 thou. loan for the period of 3 years from the date of concluding the agreement, i.e. until November 6, 2020.

The below table presents a summary of loans granted and effective as of December 31, 2017.

Table no. 50. Summary of loans granted by TAURON, effective as of December 31, 2017

No.	Type of agreement/Beneficiary	Interest rate type	Loan amount under the agreement (thou.)	Effective term	Balance as of December 31, 2017 (thou.)
1.	Loan EC Stalowa Wola	WIBOR 3M + fixed margin	177 000 PLN	20.06.2012 – 31.12.2032	177 000 PLN
2.	Loan EC Stalowa Wola	WIBOR 3M + fixed margin	15 850 PLN	14.12.2015 – 31.12.2027	15 850 PLN
3.	Loan EC Stalowa Wola	WIBOR 6M + fixed margin	15 300 PLN	15.12.2016 – 31.12.2027	11 000 PLN
4.	Loan EC Stalowa Wola	WIBOR 6M + fixed margin	150 000 PLN	30.06.2017 – 28.02.2018	150 000 PLN
5.	Loan EC Stalowa Wola	WIBOR 6M + fixed margin	175 157 PLN	01.11.2017 – 28.02.2018	175 157 PLN
6.	Loan PGE EJ 1	Fixed	2 940 PLN	08.11.2017 – 06.11.2020	2 940 PLN

Sureties and guarantees granted

TAURON Capital Group's principles of granting collaterals are based on TAURON Capital Group's regulation in force. The below table presents a summary of collaterals granted by TAURON effective as of December 31, 2017.

Table no. 51. Summary of collaterals granted by TAURON, effective as of December 31, 2017

No.	Beneficiary	Agreement/Collateral	Entity whose liabilities constitute the subject of collateral	Amount (thou.)	Effective date
1.	WFOŚiGW	Bills of exchange with a promissory note	TAURON Wytwarzanie	40 000 PLN	15.12.2022
2.	WFOŚiGW	Bills of exchange with a promissory note	TAURON Ciepło	30 000 PLN	15.12.2022
3.	WFOŚiGW	Surety agreement	KW Czatkowice	914 PLN	15.06.2021
4.	PSG	Surety agreement	TAURON Sprzedaż	15 000 PLN	31.03.2018
5.	PSE	Surety agreement	TAURON Wytwarzanie	5 000 PLN	04.08.2019
6.	GAZ-SYSTEM	Surety agreement	EC Stalowa Wola	1 667 PLN	30.07.2020
7.	Doradcy Funduszu (Fund Advisors)	Surety agreement	Nowe Jaworzno GT	2 350 PLN	28.09.2025
8.	Businesses and consumers that concluded an agreement TAURON Ekoenergia based on the electricity trading license granted by the President of ERO	Corporate guarantee	TAURON EKOENERGIA	16 400 PLN	31.12.2030
9.	NCBiR	Bills of exchange with a promissory note	TAURON	1 869 PLN	31.03.2026
10.	NCBiR	Bills of exchange with a promissory note	TAURON	2 375 PLN	31.07.2024
11.	Bondholders	Corporate guarantee	TAURON Sweden Energy	168 000 EUR	03.12.2029

The following framework (master) agreements, under which bank guarantees were issued, were in force in 2017:

- 1) Framework (master) agreement of June 8, 2015 on a limit on bank guarantees, concluded with BZ WBK, with the effective date of June 7, 2018 and an extension option by another 12 months. The limit amount of PLN 150 000 thou. to be used by TAURON and its subsidiaries in favor of the beneficiary – Izba Rozliczeniowa Giełd Towarowych S.A. (IRGIT).
- 2) Framework (master) Agreement of July 12, 2016 on a limit on bank guarantees, concluded with CaixaBank S.A. (Joint Stock Company) Branch in Poland (CaixaBank), under which a limit was granted for the period of 36 months, i.e. until July 11, 2019. The maximum effective term of the bank guarantees issued within the limit shall not exceed July 11, 2020. The limit to be used by TAURON and its subsidiaries in conjunction with their operations.

Within the bank guarantee limit obtained from BZ WBK in 2017 TAURON was ordering issuing of bank guarantees for the benefit of IRGIT as a security for the transactions made on TGE, with the effective term of less than one year.

The below table presents a summary of bank guaranties granted under the agreements effective as of December 31, 2017.

Table no. 52. Summary of bank guaranties granted under the agreements effective as of December 31, 2017

No.	Bank	Company	Beneficiary	Type of guarantee	Amount (thou.)	Launch date	Effective date
1.	BZ WBK	TAURON	IRGIT	payment	30 000 PLN	11.08.2016	31.03.2018
2.	BZ WBK	TAURON	IRGIT	payment	20 000 PLN	14.12.2016	31.03.2018
3.	CaixaBank	TAURON	PSE	performance bond	4 041 PLN	01.01.2017	11.02.2018
4.	CaixaBank	TAURON	GAZ-SYSTEM	performance bond	2 661 PLN	01.12.2017	30.11.2018
5.	CaixaBank	KW Czatkowice	PGE	performance bond	147 PLN	09.09.2016	31.01.2018
6.	CaixaBank	TAURON Dystrybucja Serwis	Strabag Infrastruktura Południe	performance bond	116 PLN	09.09.2016	15.06.2019
7.	CaixaBank	TAURON Wydobycie	Polskie Koleje Państwowe	performance bond	103 PLN	01.01.2017	31.12.2018
8.	CaixaBank	TAURON Ciepło	Elektrobudowa	payment	12 300 PLN	02.01.2017	31.12.2018
9.	CaixaBank	KW Czatkowice	PGE Paliwa (formerly EDF Paliwa)	performance bond	187 PLN	12.01.2017	30.01.2018
10.	CaixaBank	KW Czatkowice	PGE Paliwa (formerly EDF Paliwa)	performance bond	412 PLN	01.07.2017	30.01.2018 ¹
11.	CaixaBank	TAURON Dystrybucja	Gmina Sosnowiec	performance bond	53 PLN	06.10.2017	06.10.2018
12.	CaixaBank	KW Czatkowice	PGE Górnictwo i Energetyka Konwencjonalna	performance bond	515 PLN	24.10.2017	30.01.2020

¹ As of January 1, 2018 by way of amendment no. 1 to the guarantee the guarantee value was increased to PLN 761 thou. and the term was extended to January 31, 2019.

Sureties and guarantees received

The below table presents a summary of collaterals received by TAURON effective as of December 31, 2017.

Table no. 53. Summary of collaterals received by TAURON, effective as of December 31, 2017

No.	Entity whose liabilities constitute the subject of collateral	Entity issuing collateral	Type of collateral	Amount in currency (thou.)	Effective date
1.	Polenergia Obrót S.A.	PKO BP	Bank guarantee	750 EUR	28.02.2019
2.	Ezpada s.r.o.	Ezpada A.G.	Corporate guarantee	1 000 EUR	28.02.2018
3.	Interenergia S.A.	NDI S.A.	Corporate guarantee	10 000 PLN	06.11.2019

9.3. Information on other agreements and events

Concluding of the agreement with TAURON Wydobycie on coal sales

On February 1, 2017 a multi-year agreement on coal sales for electricity generation purposes was concluded between TAURON and TAURON Wydobycie the subject of which was the purchase of coal by the Company for the needs of the generation units of TAURON Wytwarzanie and TAURON Ciepło. The agreement was concluded for the period until 31 December 31, 2019.

New coal trading model within TAURON Capital Group

On April 1, 2017 a new coal trading model within TAURON Capital Group, i.e. between TAURON Wydobycie and TAURON Wytwarzanie and TAURON Ciepło came into force. In accordance with the new model coal sales by TAURON Wydobycie to TAURON Wytwarzanie and TAURON Ciepło take place directly, bypassing TAURON as an intermediary. TAURON provides an agency service for the above mentioned entities. In accordance with the agreements concluded between TAURON and TAURON Wytwarzanie and TAURON Ciepło on the provision of services (agency agreements), TAURON was granted the power of attorney, among others, to:

- 1) agree and negotiate coal purchase terms,
- 2) draw up draft agreements,
- 3) conclude, make changes (amend) and terminate on behalf of TAURON Wytwarzanie and TAURON Ciepło agreements concluded with TAURON Wydobycie related to coal sales,
- 4) perform on behalf of TAURON Wytwarzanie and TAURON Ciepło actions related to the performance of the agreements,
- 5) draw up for TAURON Wytwarzanie and TAURON Ciepło monthly reports on the size of shipments, quality parameters, volumes of coal products transferred (for the needs of the excise tax related record keeping).

The above described model change led, among others, to the reduction of the number of invoices issued between TAURON Wydobycie and TAURON Wytwarzanie and TAURON Ciepło and to an improvement of the profitability ratio of the companies included within the Tax Capital Group.

Allocations of free CO₂ emission allowances and free allowances for heat production

In accordance with Directive 2003/87/EC of the European Parliament and of the Council of October 13, 2003 establishing a scheme for greenhouse gas emission allowances trading within the Community and amending the Council's Directive 96/61/EC, TAURON Capital Group is entitled to obtain free emission allowances pursuant to Article 10c of the above mentioned Directive ("derogation allowances"),

In order to obtain free allowances for electricity generation for 2016 TAURON Capital Group, on September 29, 2016, submitted to the National Emissions Balancing and Management Center (Krajowy Ośrodek Bilansowania i Zarządzania Emisjami) reports on works and expenditures related to the settlement of capital expenditures incurred to carry out investment tasks included in the National Investment Plan for the reporting period: July 1, 2015 – June 30, 2016.

Based on the reports submitted on April 21, 2017 the accounts of TAURON Capital Group's installations were credited with free CO₂ emission allowances in the number stemming from the incurred investment expenditures, i.e. 1 680 838 EUAs.

Additionally, in February 2017 the accounts of TAURON Capital Group's installations were credited with free allowances for heat production for 2017 in the total number of 469 945 EUAs.

Determining of the level of substitution fees by the ERO President

The binding Act of April 10, 1997 the Energy Law defines the rules of the support system for high efficiency coal co-generation and gas co-generation in the years 2014–2018. The Act defines the obligation to purchase and redeem certificates of electricity origin (the so-called "yellow" certificates – for gas co-generation, the so-called "red" certificates – for coal co-generation) or pay the substitution fee by electricity suppliers to the final consumers. For the "red"

certificates the redemption obligation is 23.3% of the volume of electricity sold. In case of the “yellow” certificates this obligation shall increase from 3.9% in 2014 to 8% in 2018, in 2016 it was 6.0%, which is to contribute to the expansion of the co-generation sources operating on the gas fuel,

In accordance with the said Act the ERO President set and announced in Q2 2016 the following substitution fees in force in 2017:

- 1) for “red” certificates: PLN 10/MWh in 2017 (PLN 11/MWh in 2016),
- 2) for “yellow” certificates: PLN 120/MWh in 2017 (PLN 125/MWh in 2016),
- 3) for “violet” certificates: PLN 56/MWh in 2017 (PLN 63/MWh in 2016).

The substitution fees for the subsequent years shall be defined by the ERO President according to the following rules:

- 1) in case of coal-fired co-generation the substitution fee which in the system of certificates represents the benchmark for their prices, may not have a value lower than 5% and higher than 40% of the average electricity sales price on the competitive market in the preceding year,
- 2) in case of gas-fired co-generation the substitution fee may not be lower than 15% and higher than 110% of the average electricity sales price on the competitive market.

It will be possible to redeem the certificates originating from production in co-generation in individual years only within the settlement for the given year, i.e. until June of the subsequent year, which is a significant difference in relation to the previously used mechanisms when the possibility of “banking” the certificates from the previous years led to the disruption of the relationship between supply and demand and instability of the prices of certificates.

For certificates of origin obtained for electricity generation from renewable energy sources the unit substitution fee was set in the *Act of February 20, 2015 on renewable energy sources* at a fixed level of PLN 300.03/MWh in force for the entire duration of the support period.

The value of the announced unit substitution fees has a direct impact on TAURON Capital Group’s results. The costs of electricity for consumers purchasing electricity for own use are additionally burdened with the costs of purchasing and submitting for redemption to the ERO President of the relevant certificates and should be classified as justified costs in the process of updating the electricity tariff.

TAURON units’ win in a RES auction

On June 30, 2017 Ordinary Auction no. AZ/2/2017 was held for installations with total installed electric capacity not greater than 1 MW at which CO₂ emission is not greater than 100 kg/MWh with the factor of utilizing the installed electric capacity greater than 3 504 MWh/MW/year. As part of the preparation TAURON Capital Group selected for participation in the RES auction three hydroelectric power plants owned by TAURON EKOENERGIA: EW Brzeg, EW Kraszewice and EW Wrocław II. All the bids submitted by TAURON won the auctions and thus these power plants guaranteed for themselves the sale of electricity until the end of the support period (i.e. 2020 for EW Kraszewice and EW Wrocław II, and 2026 for EW Brzeg), at the bid price much higher than the prices obtained under the existing support system.

Signing of the hybrid financing agreements with BGK

On September 6, 2017 the Company and Bank Gospodarstwa Krajowego (BGK) signed the documentation of the subordinate bond issue program, constituting the basis for conducting a hybrid bond issue worth up to PLN 400 000 thousand.

The Company may carry out the hybrid bond issue in several series, and the period of the availability of funds was set as up to June 30, 2019. The financing period is 12 years from the issue date, however in accordance with the characteristic of the hybrid financing the first period of financing was defined as 7 years (the so-called *non-call period*), during which an early redemption of the hybrid bonds by TAURON will not be possible BGK will not be able to sell them to third parties (in both cases subject to the exceptions defined in the documentation). The agreement also provides for an option to defer payment of interest on the hybrid bonds, until the hybrid bonds’ redemption day as a maximum. Due to the subordinate nature of the hybrid bonds, in case of TAURON’s bankruptcy or liquidation the obligations under the hybrid bonds will have a priority of being satisfied only ahead of TAURON’s shareholders’ liabilities. A potential hybrid bond issue will have a positive impact on TAURON’s financial stability because the bonds are excluded from calculating the leverage ratio (net debt/EBITDA ratio) which constitutes a covenant in some of TAURON’s financing programs. Furthermore, 50% of the hybrid bonds amount will be classified by Fitch rating agency as equity in the rating model, which will have a positive impact on TAURON’s rating. The hybrid bonds were granted BB+ rating by Fitch rating agency. In 2017 the Company did not conduct a bond issue under the above mentioned program, and the hybrid financing, due to its cost, is treated as an option in case of potential implementation of new investment projects and represents a financial security for the Group.

Tax Capital Group (Podatkowa Grupa Kapitałowa – PGK)

Due to the elapse, on December 31, 2017, of the three-year period of PGK's operation, on September 26, 2017 selected TAURON Capital Group's subsidiaries concluded the PGK agreement in the form of a notary authenticated deed. On October 30, 2017 the Head of the First Silesian Tax Office in Sosnowiec issued a decision on PGK's registration for the period of subsequent tax years 3, i.e. from January 1, 2018 until December 31, 2020. The new PGK includes the following subsidiaries: TAURON, TAURON Wytwarzanie, TAURON Dystrybucja, TAURON Sprzedaż, TAURON Sprzedaż GZE, TAURON Ciepło, TAURON Wydobywanie, TAURON EKOENERGIA, TAURON Obsługa Klienta, TAURON Serwis, KW Czatkowice, Biomasa GT, TAURON Dystrybucja Serwis, Marselwind, Magenta GT, TAURON Ubezpieczenia sp. z o.o., En-Energia I sp. z o.o., En-Energia II sp. z o.o., En-Energia III sp. z o.o. and En-Energia IV sp. z o.o. Setting up of a new PGK will allow for taking advantage of the tax settlements synergy effect, i.e. deducting the tax loss of the subsidiaries that are members of the PGK from the income of the other subsidiaries. At the same time it will allow for continuing a unified system of settlements and for ensuring consistent interpretation of the tax regulations at the PGK level.

Revoking of the license for trading of natural gas abroad

As of September 30, 2017, at TAURON's request the President of the Energy Regulatory Office (ERO-URE), by way of the decision no. DRG.DRG-1.4112.38.2017.KL, revoked TAURON'S license for trading of natural gas abroad.

The revoking of the license involves obtaining an exemption from the need to maintain mandatory natural gas inventory (stock), beginning as of October 1, 2017, in connection with the coming into force of the amendment to the *law of February 16, 2007 on the inventory (stock) of oil products and natural gas*.

At the same time, taking into account the nature of its operations related to supplying TAURON Capital Group's subsidiaries with gas and the active participation in wholesale trading, TAURON has an option to purchase gas on the domestic market under its license for trading gas fuels. Gas contracting is conducted directly on the Polish Power Exchange (Towarowa Giełda Energii S.A.), both by way of futures market contracts, as well as SPOT market transactions. Furthermore, the Company contracts gas purchases and sales on the OTC market, based on commercial agreements concluded. Therefore, it should be pointed out that purchasing of gas fuel for the wholesale trading purpose as well as the security of supply and securing of the gas needs of TAURON Capital Group's subsidiaries are not in jeopardy.

Management Board of the Company

Katowice, March 12, 2018

Filip Grzegorzczak – President of the Management Board

Jarosław Broda – Vice-President of the Management Board

Kamil Kamiński – Vice-President of the Management Board

Marek Wadowski – Vice-President of the Management Board

Appendix A: GLOSSARY OF TERMS AND LIST OF ABBREVIATIONS

The glossary of trade terms and the list of abbreviations and acronyms most commonly used in this report is presented below.

Table no. 54. Explanation of abbreviations and acronyms and trade terms used in the report

No.	Abbreviation and trade term	Full name/explanation
1.	ARE	Agencja Rynku Energii S.A. with its seat in Warsaw
2.	BGK	Bank Gospodarstwa Krajowego with its seat in Warsaw
3.	Biomasa Grupa TAURON	Biomasa Grupa TAURON sp. z o.o. with its seat in Stalowa Wola
4.	BZ WBK	Bank Zachodni WBK S.A. with its seat in Wrocław
5.	B2B	B2B (business-to-business) an acronym denoting transactions between two or more business entities
6.	CC	Central heating plant (Centralna Ciepłownia) in Olkusz lub Zawiercie
7.	Cash pooling	Cash pooling used by the Company – the consolidation of balances of bank accounts through physical transferring of cash from the accounts of TAURON Capital Group's subsidiaries in the bank in which cash pooling is operated to the bank account of the Pool Leader whose function is performed by the Company. At the end of each working day, cash is transferred from the bank accounts of TAURON Capital Group's subsidiaries which show positive balance to the bank account of the pool leader. At the beginning of each working day the bank accounts of TAURON Capital Group's subsidiaries are credited from the bank account of the pool leader with the amount required to maintain the financial liquidity of the TAURON Capital Group's subsidiary on the given working day.
8.	Color certificates	Property rights resulting from the certificates of origin of electricity generated in the way subject to support, the so-called colored certificates: <ol style="list-style-type: none"> 1) green – certificates of origin of electricity from RES, 2) violet – certificates of origin of electricity generated in co-generation fired using methane released and captured during underground mining works in active, in liquidation or liquidated hard coal mines, or using gas obtained from biomass processing, 3) red – certificates of origin of electricity from co-generation (CHP certificates – Combined Heat and Power), 4) yellow – certificates of origin of electricity generated in co-generation from gas-fired sources or with the total installed capacity below 1 MW, 5) blue – certificates of origin of electricity generated from agricultural biogas. White – energy efficiency certificates (mechanism stimulating and forcing pro-savings behaviors).
9.	CIRS	Transaction involving a swap between counterparties of interest payments assessed on amounts denominated in various currencies and determined according to various interest rates
10.	CSI	Customer Satisfaction Index – index used in marketing to determine the level of customer satisfaction with the products or services offered by a company
11.	CSR	Corporate Social Responsibility
12.	CUW	Shared Services Center (Centrum Usług Wspólnych), np. CUW R – accounting services
13.	DM	Brokerage House (Dom Maklerski)
14.	Good Practices 2016	Good Practices of WSE Listed Companies 2016, in force as of January 1, 2016
15.	EIB	European Investment Bank with its seat in Luxembourg
16.	EBIT	Earnings Before Interest and Taxes
17.	EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortization
18.	EC Stalowa Wola/ECSW	Elektrociepłownia (Combined Heat and Power Plant – CHP) Stalowa Wola S.A. with its seat in Stalowa Wola
19.	ENEA	ENEA S.A. with its seat in Poznań
20.	ENERGA	ENERGA S.A. with its seat in Gdańsk
21.	ERM	Enterprise Risk Management system

No.	Abbreviation and trade term	Full name/explanation
22.	EU ETS	European Union CO ₂ Emission Allowances Trading System
23.	EUA	European Union Allowance – an allowance to introduce the carbon dioxide (CO ₂) equivalent to the air, within the meaning of Article 2 section 4 of the <i>Act of July 17, 2009 on the management system of emissions of greenhouse gases and other substances</i> , which is used for settlements of emission level within the system and which can be managed under the rules provided in the <i>Act of April 28, 2011 on the system of greenhouse gases emission allowances trading (Journal of Laws No. 122, item 695)</i>
24.	EUR	Euro – a common European currency introduced in some EU member states
25.	GAZ-SYSTEM	Transmission Pipelines Operator GAZ-SYSTEM S.A. with its seat in Warsaw
26.	GPW	Warsaw Stock Exchange (Giełda Papierów Wartościowych w Warszawie S.A.) with its seat in Warsaw
27.	GRI	Global Reporting Initiative
28.	TAURON Capital Group	TAURON Capital Group Polska Energia S.A.
29.	GZE	Górnośląski Zakład Elektroenergetyczny
30.	IRGIT	Izba Rozliczeniowa Giełd Towarowych S.A. with its seat in Warsaw
31.	IRS	Interest Rate Swap, one of basic derivatives that is the subject of trading on the interbank market
32.	KGHM	KGHM Polska Miedź S.A. with its seat in Lubin
33.	KIC InnoEnergy	Knowledge and Innovations Community KIC InnoEnergy with its seat in Kraków
34.	Komfort Zarządzanie Aktywami	Komfort Zarządzanie Aktywami sp. z o.o. with its seat in Katowice
35.	Audit Committee	Audit Committee of the Supervisory Board of TAURON Polska Energia S.A.
36.	Nominations and Compensation Committee	Nominations and Compensation Committee of the Supervisory Board of TAURON Polska Energia S.A.
37.	Strategy Committee	Strategy Committee of the Supervisory Board of TAURON Polska Energia S.A.
38.	KPI	Key Performance Indicators, financial and non-financial indicators used as ways to measure progress of achieving goals of an organization
39.	KSE	National Power System (Krajowy System Elektroenergetyczny)
40.	Commercial companies code	
41.	KW Czatkowice	Kopalnia Wapienia (Limestone Mine) "Czatkowice" sp. z o.o. with its seat in Krzeszowice
42.	KZEE	National electricity consumption
43.	Model Biznesowy	Document entitled <i>TAURON Group's Business and Operational Model</i> (which is an update of <i>TAURON Group's Business Model</i> adopted by the Management Board on May 4, 2016)
44.	mBank	mBank S.A. with its seat in Warsaw
45.	Magenta GT	Magenta Grupa TAURON sp. z o.o. with its seat in Katowice
46.	Marselwind	Marselwind sp. z o.o. with its seat in Katowice
47.	Mg	Mega gram – million grams (1 000 000 g) i.e. a ton
48.	MSR	CO ₂ Emission Allowances Market Stability Reserve
49.	ISSR	International Financial Reporting Standards
50.	Nowe Jaworzno GT	Nowe Jaworzno Grupa TAURON sp. z o.o. with its seat in Jaworzno
51.	Line of Business	Seven areas of TAURON Capital Group's core operations set up by the Company: Trading, Mining, Generation, RES, Heat, Distribution and Supply
52.	OPEC	Organization of the Petroleum Exporting Countries with its seat in Vienna
53.	ORM	Operational Capacity Reserve (OCR)
54.	OSD	Distribution System Operator (DSO)

No.	Abbreviation and trade term	Full name/explanation
55.	OSP	Transmission System Operator (TSO)
56.	OTC (OTC market)	Over The Counter Market
57.	OZE	Renewable Energy Sources (RES)
58.	OZEX_A	Green certificates index price
59.	Efficiency Improvement Program	TAURON Group's 2016–2018 Efficiency Improvement Program
60.	PEPKH	Polska Energia – Pierwsza Kompania Handlowa sp. z o.o. with its seat in Warsaw
61.	PGE	PGE Polska Grupa Energetyczna S.A. with its seat in Warsaw
62.	PGE EJ 1	PGE EJ 1 sp. z o.o. with its seat in Warsaw
63.	PGNiG	Polskie Górnictwo Naftowe i Gazownictwo S.A. with its seat in Warsaw
64.	PKB	Gross Domestic Product (GDP)
65.	PKO BP	Powszechna Kasa Oszczędności Bank Polski S.A. with its seat in Warszawie
66.	PLN	Polish zoty currency symbol – zł
67.	PMEC	Property rights for certificates of origin confirming generation of electricity in the other co-generation sources
68.	PMEF	Property rights for energy efficiency certificates
69.	PMGM	Property rights for certificates of origin confirming generation of electricity in co-generation, from gas-fired sources or sources with the total installed capacity below 1 MW
70.	PMMET	Property rights for certificates of origin confirming generation of electricity in co-generation fired using methane released and captured during underground mining works in active, in liquidation or liquidated hard coal mines, or using gas obtained from biomass processing
71.	PMOZE	Property rights for certificates of origin confirming generation of electricity in RES before March 1, 2009
72.	PMOZE_A	Property rights for certificates of origin confirming generation of electricity in RES after March 1, 2009
73.	PMOZE-BIO	Property rights for certificates of origin confirming generation of electricity from agricultural biogas from July 1, 2016
74.	PSE	Polskie Sieci Elektroenergetyczne S.A. with its seat in Konstancin-Jeziorna
75.	PSG	Polska Spółka Gazownictwa sp. z o.o. with its seat in Warsaw
76.	RB	Balancing Market (Rynek Bilansujący)
77.	RDN	Day Ahead Market (Rynek Dnia Następnego)
78.	RESPECT Index	Stock market index grouping stock market companies operating in accordance with the sustainable growth principles
79.	RTT	Futures Commodity Market (Rynek Terminowy Towarowy)
80.	Segment	TAURON Capital Group's segments of operations used in the statutory reporting process. TAURON Capital Group's results from operations are allocated to the following five Segments (also called Line of Business or Areas in this report): Mining, Generation, Distribution, Supply and Other.
81.	SPOT (SPOT market)	With respect to electricity, it is the place where trade transactions for electricity are concluded for which the period of delivery falls, at the latest, three days after the date of the transaction's conclusion (usually it is one day before the date of delivery). Operation of the SPOT market for electricity is strongly tied to the operation of the balancing market run by the TSO
82.	Company/TAURON	TAURON Polska Energia S.A. with its seat in Katowicach
83.	Strategy	Document entitled <i>TAURON Group's 2016–2025 Strategy</i> adopted by the Management Board on September 2, 2016

No.	Abbreviation and trade term	Full name/explanation
84.	Sustainable development strategy	Document entitled <i>TAURON Group's 2017–2025 Sustainable development strategy</i> adopted by the Management Board on August 1, 2017, which is an update of the document entitled <i>TAURON Group's 2016–2018 Sustainable development strategy with an outlook until 2020</i> .
85.	TAMEH Czech	TAMEH Czech s.r.o. with its seat in Ostrava, Czech Republic
86.	TAMEH HOLDING	TAMEH HOLDING sp. z o.o. with its seat in Dąbrowa Górnicza
87.	TAMEH POLSKA	TAMEH POLSKA sp. z o.o. with its seat in Dąbrowa Górnicza
88.	TAURON/Company	TAURON Polska Energia S.A. with its seat in Katowice
89.	TAURON Ciepło	TAURON Ciepło sp. z o.o. with its seat in Katowice
90.	TAURON Czech Energy	TAURON Czech Energy s.r.o. with its seat in Ostrava, Czech Republic
91.	TAURON Dystrybucja	TAURON Dystrybucja S.A. with its seat in Kraków
92.	TAURON Dystrybucja Pomiary	TAURON Dystrybucja Pomiary sp. z o.o. with its seat in Tarnów
93.	TAURON Dystrybucja Serwis	TAURON Dystrybucja Serwis S.A. with its seat in Wrocław
94.	TAURON EKOENERGIA	TAURON EKOENERGIA sp. z o.o. with its seat in Jelena Góra
95.	TAURON Obsługa Klienta	TAURON Obsługa Klienta sp. z o.o. with its seat in Wrocław
96.	TAURON Serwis	TAURON Serwis sp. z o.o. with its seat in Katowice
97.	TAURON Sprzedaż	TAURON Sprzedaż sp. z o.o. with its seat in Kraków
98.	TAURON Sprzedaż GZE	TAURON Sprzedaż GZE sp. z o.o. with its seat in Gliwice
99.	TAURON Sweden Energy	TAURON Sweden Energy AB (publ) with its seat in Stockholm, Sweden
100.	TAURON Ubezpieczenia	TAURON Ubezpieczenia sp. z o.o. with its seat in Katowice
101.	TAURON Wydobywanie	TAURON Wydobywanie S.A. with its seat in Jaworzno
102.	TAURON Wytwarzanie	TAURON Wytwarzanie S.A. with its seat in Jaworzno
103.	TAURON Wytwarzanie Serwis	TAURON Wytwarzanie Serwis sp. z o.o. with its seat in Jaworzno
104.	TGE	Towarowa Giełda Energii S.A. with its seat in Warsaw
105.	EU	European Union
106.	UOKiK	Office of Competition and Consumer Protection (Urząd Ochrony Konkurencji i Konsumentów)
107.	USD	United States Dollar – US dollar's international acronym
108.	ERO (URE)	Energy Regulatory Office (Urząd Regulacji Energetyki)
109.	WFOŚiGW	Regional Environment Protection and Water Management Fund (Wojewódzki Fundusz Ochrony Środowiska i Gospodarki Wodnej) in Katowice or in Kraków
110.	Wsparcie Grupa TAURON	Wsparcie Grupa TAURON sp. z o.o. with its seat in Tarnów (formerly KOMFORT-ZET sp. z o.o.)
111.	WZ/ZW	General Meeting (GM) / Shareholders' Meeting
112.	ZG	Coal Mine (Zakład Górniczy) (Sobieski, Janina or Brzeszcze)
113.	ZW	Generation Plants (Zakłady Wytwarzania) in Bielsko-Biała, Kamienna Góra, Katowice or Tychy

Appendix B: INDEX OF TABLES AND FIGURES

The list of tables and figures presented in this report is provided below.

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