Polskie Górnictwo Naftowe i Gazownictwo SA

Consolidated Full-Year Report of the PGNiG Group

for the period January 1st 2016 – December 31st 2016

THE CONSOLIDATED FULL-YEAR REPORT OF THE PGNiG GROUP

FOR THE YEAR ENDED DECEMBER 31ST 2016 COMPRISES:

Letter from President of the Management Board

Ladies and Gentlemen,

I am pleased to present the Annual Report of PGNiG SA and its Group for 2016.

Last year it was the PGNiG Group's revised strategy that provided a direction and focus to all our efforts. In revising the strategy, not only did we modify the existing strategic initiatives in key business areas, but we also added several new projects.

This led to solid financial performance at the consolidated level – we delivered revenue of PLN 33.2bn, and operating profit of PLN 3.4bn. Despite the persistently low prices of hydrocarbons globally, the Group's EBITDA came in at PLN 6bn, on a par with the previous year. The effect of the macroeconomic backdrop was a lower contribution to overall performance of the Exploration and Production segment. This, however, was offset by the strong performance in Trade and Storage, which doubled its previous year's operating profit following – a result of the effective sales policy based on expanding customer relations. In 2016, we concluded a number of new contracts with both wholesale and SME accounts. We also rolled out attractively priced dual fuel plans for retail customers, with gas and electricity supplies bundled in a single contract. During 2016, we sold almost 1.4 bcm more of natural gas than in 2015. We also launched gas exports to Ukraine.

The Distribution and Generation segments saw sustained year-on-year growth of about 10% each. The financial health and business reliability of the PGNiG Group are also confirmed by our investment grade rating.

In view of the need to develop a new gas procurement strategy beyond 2022, we decided to go ahead with projects designed to further diversify our supply sources, connected primarily with the 'Norwegian Corridor'. We see strong prospects for the future in our operations on the Norwegian Continental Shelf. Last year, our Norwegian assets yielded 0.5 bcm of natural gas, but we have plans to ramp up the annual gas production to 2.5 bcm by 2025. In 2016, we received the first deliveries of liquefied natural gas at the Lech Kaczyński Terminal in Świnoujście – seven shipments under the Qatar contract and one spot delivery from Statoil. We opened an office in London, the world's LNG trading hub, which will permit us to trade in LNG on international markets.

We launched a multi-year upstream project that will make use of innovative technologies to extract coal bed methane. Work is also under way on a new extended 'R+D+I' (research, development and innovation) strategy to create new innovation support tools. We embarked on a project to develop framework and tools for establishing partnership relations with start-ups, to be used in the delivery of our strategy.

In 2016, we also worked on streamlining the Group's organisation, which included adoption of a new strategy by Polska Spółka Gazownictwa Sp. z o.o., and acquisition of Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie Zdrój and Spółka Energetyczna Jastrzębie S.A. by PGNiG TERMIKA S.A. Our projects in the coal mining sector are moving forward in line with the business plan adopted in April.

In 2017, we aim to solidify our position in the domestic and European energy markets. I would like to thank our Customers and Shareholders for the trust they place in us.

Kind regards,

Piotr Woźniak

President of the PGNiG Management Board

Financial highlights of the PGNiG Group

Consolidated financial data	PLNm		EURm	
	2016	2015	2016	2015
Revenue	33,196	36,464	7,586	8,713
Operating profit before depreciation and amortisation (EBITDA)*	5,974	6,080	1,365	1,453
Operating profit (EBIT)	3,360	3,290	768	786
Profit before tax	3,210	3,014	734	720
Net profit attributable to owners of the parent	2,351	2,134	537	510
Net profit	2,349	2,136	537	510
Total comprehensive income attributable to owners of the parent	2,984	1,767	682	422
Total comprehensive income	2,982	1,769	681	423
Net cash from operating activities	5,922	7,271	1,353	1,737
Net cash from investing activities	(3,842)	(3,147)	(878)	(752)
Net cash from financing activities	(2,269)	(829)	(519)	(198)
Net cash flows	(189)	3,295	(43)	787
Basic and diluted earnings per share (PLN)	0.40	0.36	0.09	0.09
	2016	2015	2016	2015
Total assets	49,672	48,292	11,228	11,333
Total liabilities	17,656	17,551	3,991	4,119
Total non-current liabilities	7,303	11,262	1,651	2,643
Total current liabilities	10,353	6,289	2,340	1,476
Total equity	32,016	30,741	7,237	7,214
Share capital	5,778	5,900	1,306	1,384
Weighted average number of ordinary shares (million)	5,867	5,900	5,867	5,900
Book value per share and diluted book value per share (in PLN and EUR)	5.46	5.21	1.23	1.22
Dividend per share declared or paid (in PLN and EUR)**	0.18	0.20	0.04	0.05

* Alternative performance measures – for more information, see Note 2.2.
** Dividend paid

Rules followed in the preparation of the consolidated financial statements

Items of the statement of profit or loss, statement of comprehensive income and statement of cash flows were translated at the EUR/PLN exchange rate computed as the arithmetic mean of mid rates quoted by the National Bank of Poland (NBP) for the last day of each calendar month in the reporting period.

Items of the statement of financial position were translated at the mid rate for EUR/PLN quoted by the NBP at the end of the reporting period.

MID RATES FOR PLN/EUR QUOTED BY THE NBP	2016	2015
Average exchange rate in period	4.3757	4.1848
Exchange rate at end of period	4.4240	4.2615

PGNiG CAPITAL GROUP

WARSAW, UL. MARCINA KASPRZAKA 25

CONSOLIDATED FINANCIAL STATEMENTS FOR THE 2016 FINANCIAL YEAR

WITH

AUDITOR'S OPINION

AND

AUDIT REPORT

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Deloitte Polska
Spółka z ograniczoną odpowiedzialnością sp. k.
z siedzibą w Warszawie
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AUDITOR'S OPINION

To the Shareholders' Meeting and Supervisory Board of Polskie Górnictwo Naftowe i Gazownictwo S.A.

Auditor's report

We have audited the attached consolidated financial statements of the PGNiG Capital Group (hereinafter: the "Capital Group"), for which Polskie Górnictwo Naftowe i Gazownictwo S.A. with its registered office in Warsaw at ul. Marcina Kasprzaka 25 is the Parent (hereinafter: the "Parent"). These consolidated financial statements include: the consolidated statement of financial position prepared as at 31 December 2016, consolidated income statement and consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows for the financial year from 1 January 2016 to 31 December 2016 and notes.

Responsibility of the Parent's manager and those charged with governance for the consolidated financial statements

The Management Board of the Parent is responsible for the preparation of the consolidated financial statements and their fair presentation in accordance with the International Accounting Standards, International Financial Reporting Standards, related interpretations published as European Commission regulations and applicable laws. It is also obliged to ensure internal control as it determines necessary for the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Under the Accounting Act of 29 September 1994 (Journal of Laws of 2016 item 1047 as amended), hereinafter referred to as the "Accounting Act", the Management Board of the Parent and members of its Supervisory Board are obliged to ensure that the consolidated financial statements meet the requirements of the Accounting Act.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit works.

We conducted our audit in accordance with Section 7 of the Accounting Act and the National Auditing Standards in line with the wording of the International Standards on Auditing adopted by Resolution No. 2783/52/2015 of the National Council of Statutory Auditors of 10 February 2015 as amended. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

Sąd Rejonowy dla m. st. Warszawy KRS 0000446833, NIP: 527-020-07-86, REGON: 010076870

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Parent's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Parent's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management Board of Parent, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the attached consolidated financial statements:

- give a true and fair view of the economic and financial position of the Capital Group as at 31 December 2016 and its financial performance and cash flows for the financial year from 1 January 2016 to 31 December 2016 in accordance with the International Accounting Standards, International Financial Reporting Standards, related interpretations published as European Commission regulations, other applicable laws and the adopted accounting principles (policies) of the Parent;
- comply, with respect to their form and content, with the applicable provisions of law and the articles of association of the Parent.

The consolidated financial statements for the prior financial year ended 31 December 2015 were audited by another certified auditor, who issued an unqualified opinion on those consolidated financial statements on 19 February 2016.

Report on other legal and regulatory requirements

Opinion on the report on the activities

We do not express an opinion on the report on the activities.

It is the responsibility of the Management Board of the Parent to prepare the report on the activities in accordance with the Accounting Act and other applicable laws. Moreover, the Management Board of the Parent and members of the Supervisory Board are obliged to ensure that the report on the activities meets the requirements of the Accounting Act.

When auditing the consolidated financial statements we were obliged to examine the report on the activities and indicate whether the information contained therein complies with Article 49 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended) and is consistent with underlying information disclosed in the attached consolidated financial statements. Additionally, it was our responsibility to indicate whether we have detected any material misstatement in the report on the activities based on our knowledge of the Capital Group and its business environment obtained in the course of the audit.

In our opinion, the information contained in the report on the activities complies with Article 49 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended) and is consistent with underlying information disclosed in the attached consolidated financial statements. Moreover, based on our knowledge of the Capital Group and its business environment obtained in the course of the audit, we have not detected any material misstatement in the report on the activities.

Statement of compliance with corporate governance principles

In relation to our audit of the consolidated financial statements, it was our responsibility to examine the Parent's statement of compliance with corporate governance principles, which constitutes a separate part of the report on the activities of the Capital Group. In our opinion, the Parent's statement provides all information required by the secondary legislation issued under Article 60.2 of the Act on public offering, conditions governing the introduction of financial instruments to organized trading, and public companies of 29 July 2005 (Journal of Laws of 2016 item 1639 as amended) and regulations issued under Article 61 thereof. The information is compliant with the applicable laws and information presented in the consolidated financial statements.

Piotr Sokołowski
Key certified auditor
conducting the audit
No. 9752

On behalf of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. – entity authorized to audit financial statements entered under number 73 on the list kept by the National Council of Statutory Auditors:

Piotr Sokołowski – Vice-President of the Management Board of Deloitte Polska Sp. z o.o. – which is the General Partner of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k.

Warsaw, 6 March 2017

The above audit opinion together with audit report is a translation from the original Polish version. In case of any discrepancies between the Polish and English version, the Polish version shall prevail.

REPORT ON THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS OF THE PGNIG CAPITAL GROUP FOR THE 2016 FINANCIAL YEAR

I. GENERAL INFORMATION

1. Details of the audited Parent

The Parent of the Capital Group operates under the name Polskie Górnictwo Naftowe i Gazownictwo S.A. (hereinafter: the "Parent"). Its registered office is located in Warsaw, ul. Marcina Kasprzaka 25.

It is a joint-stock company and has been entered in the Register of Entrepreneurs kept by the District Court for the capital city of Warsaw in Warsaw, 12th Commercial Division of the National Court Register under KRS number 0000059492. The Parent's tax identification number NIP assigned by the Second Tax Office for Warszawa-Śródmieście on 22 November 1996 is: 5250008028. The Parent's REGON number assigned by the Statistical Office on 14 November 1996 is: 012216736.

The Parent operates based on the provisions of the Code of Commercial Companies.

As at 31 December 2016, the Parent's share capital equaled PLN 5 778 314 857 and was divided into 5 778 314 857 shares with a face value of PLN 1.00 each. On 24 November 2016, the Extraordinary Shareholders' Meeting of PGNiG S.A. adopted a Resolution to redeem 121 685 143 ordinary bearer shares with a face value of PLN 1.00 and a Resolution to reduce the share capital and create reserve capital. On 2 March 2017 the share capital reduction had been recorded in the National Court Register.

Composition of the Management Board of the Parent as at the date of the opinion:
- Piotr Grzegorz Woźniak – President of the Management Board;
- Maciej Woźniak – Vice-President of the Management Board;
- Michał Władysław Pietrzyk – Vice-President of the Management Board;
- Łukasz Józef Kroplewski – Vice-President of the Management Board;
- Radosław Bartosik – Vice-President of the Management Board;
- Magdalena Zegarska – Vice-President of the Management Board.

Changes in the composition of the Management Board of the Parent during the audited period and until the date of the opinion:
- on 10 February 2016, the Supervisory Board appointed Piotr Woźniak to hold the position of President of the Management Board, Bogusław Marzec to hold the position of Vice-President of the Management Board in charge of Finance, Janusz Kowalski to hold the position of Vice-President of the Management Board in charge of Corporate Affairs, Łukasz Kroplewski to hold the position of Vice-President of the Management Board in charge of Development, and Maciej Woźniak to hold the position of Vice-President of the Management Board in charge of Trade, as from 11 February 2016 for a joint term of office ending 30 December 2016;
- on 19 December 2016, the Supervisory Board removed Piotr Woźniak from the position of President of the Management Board, Maciej Woźniak from the position of Vice-President of the Management Board in charge of Trade, Janusz Kowalski from the position of Vice-President of the Management Board in charge of Corporate Affairs, Łukasz Kroplewski from the position of Vice-President of the Management Board in charge of Development, and Bogusław Marzec from the position of Vice-President of the Management Board in charge of Finance, as from 30 December 2016;
- on 19 December 2016, the Supervisory Board appointed Piotr Woźniak to hold the position of President of the Management Board, Maciej Woźniak to hold the position of Vice-President of the Management Board in charge of Trade, Łukasz Kroplewski to hold the position of Vice-

President of the Management Board in charge of Development, Michał Pietrzyk to hold the position of Vice-President of the Management Board in charge of Finance, and Radosław Bartosik to hold the position of Vice-President of the Management Board in charge of Operations, as from 31 December 2016 for a joint term of office ending 31 December 2019;

- on 6 March 2017, the Supervisory Board removed Waldemar Wójcik from the position of Vice-President of the Management Board and appointed Magdalena Zegarska to hold the position of Vice-President of the Management Board for a joint term of office ending 31 December 2019.

As at 24 November 2016 (the date of the last Shareholders' Meeting) the Parent's shareholders included:

- the State Treasury: 71% of shares;
- other shareholders: 29% of shares.

On 24 November 2016, the Extraordinary Shareholders' Meeting of PGNiG S.A. adopted a Resolution to redeem 121 685 143 ordinary bearer shares with a face value of PLN 1.00 each and a Resolution to reduce the share capital and create reserve capital. The share capital reduction had not been recorded in the National Court Register by the opinion date.

During the audited period, the shareholding structure of the Parent's share capital did not undergo any changes.

There were no changes in the share capital of the Parent after the balance sheet date.

As at 31 December 2016, the Parent's equity amounted to PLN 25 228 million.

2. Structure of the Capital Group

Information about subsidiaries in the PGNiG Capital Group as at 31 December 2016 has been provided in Note 2.1 to the Consolidated Financial Statements of the PGNiG Capital Group.

The consolidated financial statements as at 31 December 2016 included the following entities:

a) Parent – Polskie Górnictwo Naftowe i Gazownictwo S.A.

We have audited the financial statements of the Parent for the period from 1 January to 31 December 2016. As a result of our audit, on 6 March 2017 we issued an unqualified opinion.

b) Companies subject to full consolidation:

Name and address of the Company	Interest in the share capital (%)	Name of entity that audited the financial statements and type of opinion issued	Balance sheet date of the consolidated entity
Exalo Drilling S.A., Piła (Capital Group)	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k.*	31.12.2016
Geofizyka Kraków S.A. in liquidation, Kraków	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion with the emphasis of matter	31.12.2016
Geofizyka Toruń S.A., Toruń	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
Gas Storage Poland Sp. z o.o., Dębogórze	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016

PGNiG Obrót Detaliczny Sp. z o.o., Warszawa	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
PGNiG Termika S.A., Warszawa	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion with the emphasis of matter	31.12.2016
PGNiG Serwis Sp. z o.o., Lublin	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
Geovita S.A., Warszawa	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k.*	31.12.2016
PGNiG Technologie S.A., Krosno	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion with the emphasis of matter	31.12.2016
Polska Spółka Gazownictwa Sp. z o.o., Warszawa	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
PGNiG Upstream International AS, Sandnes, Norway	100%	PricewaterhouseCoopers, unqualified opinion	31.12.2016
PGNiG Finance AB, Stockholm, Sweden	100%	Deloitte AB, unqualified opinion	31.12.2016
Polish Oil and Gas Company – Libya B.V., Amsterdam, Netherlands	100%	Deloitte Accountants B.V.*	31.12.2016
PGNiG Supply & Trading GmbH, Munich, Germany (Capital Group)	100%	BAKER TILLY ROELFS AG*	31.12.2016
Przedsiębiorstwo Energetyki Cieplnej S.A., Jastrzębie Zdrój	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
Spółka Energetyczna "Jastrzębie" S.A., Jastrzębie Zdrój	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
BSiPG Gazoprojekt S.A., Wrocław	75%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
Powiśle Park Sp. z o.o., Warszawa	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016
GAZ Sp. z o.o., Błonie	100%	Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp.k., unqualified opinion	31.12.2016

* Opinion is not delivered to the date of the audit opinion on the consolidated financial statements of the PGNiG Capital Group.

In the audited financial year, following an acquisition, the Parent consolidated the following subsidiaries for the first time as at 31 December 2016:

- Przedsiębiorstwo Energetyki Cieplnej S.A., Jastrzębie-Zdrój
- Spółka Energetyczna "Jastrzębie" S.A.

3. Information about the consolidated financial statements for the prior financial year

In 2015, the Capital Group reported a net profit of PLN 2 136 million. The consolidated financial statements of the Capital Group for the 2015 financial year were audited by a certified auditor. The audit was performed by an authorized entity, PKF Consult Spółka z ograniczoną odpowiedzialnością Sp. k. The certified auditor issued an unqualified opinion on those financial statements.

The General Shareholders' Meeting which approved the consolidated financial statements for the 2015 financial year was held on 28 June 2016.

The consolidated financial statements for the 2015 financial year were submitted to the National Court Register (KRS) on 5 July 2016.

4. Details of the authorized entity and the key certified auditor acting on its behalf

The entity authorized to audit the financial statements was appointed by the Supervisory Board. The audit of the consolidated financial statements was performed based on the agreement of 5 May 2016 concluded between the Parent and Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. with its registered office in Warsaw, al. Jana Pawła II 22, recorded under number 73 on the list of entities authorized to provide audit services kept by the National Council of Statutory Auditors. On behalf of the authorized entity, the audit of the consolidated financial statements was conducted under the supervision of Piotr Sokołowski, key certified auditor (No. 9752) in the registered office of the Parent from 21 November to 2 December 2016, from 23 January to 24 February 2017 as well as outside the Parent's premises until the date of this opinion.

Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. and the key certified auditor conducting the audit confirm that they are authorized to carry out audits and meet the requirements of Article 56 of the Act on certified auditors and their self-government, entities authorized to audit financial statements and public supervision (Journal of Laws of 2016 item 1000 as amended) to express an unbiased and independent opinion on the consolidated financial statements of the Capital Group.

5. Availability of data and management's representations

The scope of our audit was not limited.

During the audit, necessary documents and data as well as detailed information and explanations were provided to the authorized entity and the key certified auditor, as confirmed e.g. in the written representation of the Management Board of the Parent of 6 March 2017.

II. ECONOMIC AND FINANCIAL POSITION OF THE PGNiG CAPITAL GROUP

Presented below are the main items from the consolidated income statement, consolidated statement of financial position as well as financial ratios describing the financial performance of the Capital Group and its economic and financial position compared to the prior year.

Main items from the consolidated income statement (PLN million)	2016	2015
Sales revenue	33 196	36 464
Operating expenses	30 372	33 612
Operating profit (loss)	3 360	3 290
Net profit (loss)	2 349	2 136

Main items from the consolidated statement of financial position (PLN million)		
Inventories	2 510	2 229
Receivables	3 516	2 541
Current assets	13 436	12 649
Total assets	49 672	48 292
Equity	32 016	30 741
Current liabilities (including short-term provisions and accruals)	10 353	6 289
Trade and tax liabilities	1 290	956
Total liabilities and provisions	17 656	17 551

Profitability and efficiency ratios	2016	2015
– return on sales	10%	9%
– net return on equity	8%	7%
– assets turnover ratio	0.67	0.76
– receivables turnover in days	33	30
– liabilities turnover in days	13	12
– inventory turnover in days	28	29

Liquidity/Net working capital		
– debt ratio	36%	36%
– equity to fixed assets ratio	64%	64%
– net working capital (PLN million)	3 083	6 360
– current ratio	1.30	2.01
– quick ratio	1.06	1.66

An analysis of the above figures and ratios indicated the following trends in 2016:

- an increase in the return on sales and the net return on equity;
- a decrease in the assets turnover ratio;
- an increase in the receivables and liabilities turnover in days;
- the debt ratio and the equity to fixed assets ratio remained at the same level;
- a decrease in the net working capital;
- a decrease in liquidity ratios.

III. DETAILED INFORMATION

1. Information about the audited consolidated financial statements

The audited consolidated financial statements were prepared as at 31 December 2016 and include:

- consolidated statement of financial position prepared as at 31 December 2016, with total assets, equity and liabilities of PLN 49 672 million;
- consolidated income statement for the period from 1 January 2016 to 31 December 2016, with a net profit of PLN 2 349 million;
- consolidated statement of comprehensive income for the period from 1 January 2016 to 31 December 2016 with total comprehensive income of PLN 2 982 million;
- consolidated statement of changes in equity for the period from 1 January 2016 to 31 December 2016, disclosing an increase in equity of PLN 1 275 million;
- consolidated statement of cash flows for the period from 1 January 2016 to 31 December 2016, showing a cash outflow of PLN 189 million;
- notes, comprising a summary of significant accounting policies and other explanatory information.

The audit covered the period from 1 January 2016 to 31 December 2016 and focused mainly on:

- verification of the correctness and fairness of the consolidated financial statements prepared by the Management Board of the Parent;
- verification of the consolidation documentation;
- evaluation of the correctness of the consolidation methods and procedures applied during consolidation;
- review of opinions and reports on audits of financial statements of subsidiaries and associated entities included in consolidation, prepared by other certified auditors.

2. Consolidation documentation

The Parent presented the consolidation documentation including:

- financial statements of entities included in the consolidated financial statements;
- financial statements of controlled entities, adjusted to the accounting principles (policy) applied during consolidation;
- financial statements of controlled entities translated into the Polish currency;
- consolidation adjustments and eliminations necessary for preparation of the consolidated financial statements;
- calculation of the fair value of the net assets of controlled entities;
- calculation of goodwill and gain from a bargain purchase as well as impairment losses for goodwill;
- calculation of non-controlling interests;
- calculation of exchange differences arising from translation of the financial statements of controlled entities denominated in foreign currencies.

The financial statements of the subsidiaries were consolidated using the full method, i.e. full amounts of all relevant items of the financial statements of the Parent and the subsidiaries included in consolidation were summed up.

The equity method was applied with respect to associated entities. The value of the Parent's interest in the associated entity was adjusted by increases or decreases in the equity of the associated entity attributable to the Parent, which occurred in the period covered by consolidation, and decreased by dividends due from such entities.

The Parent preparing the consolidated financial statements has not applied any material simplifications and exceptions to the consolidation principles with respect to the controlled entities.

3. Completeness and correctness of notes and explanations, the consolidated statement of cash flows, consolidated statement of changes in equity, and the report on the activities

The Parent confirmed the validity of the going concern basis in preparation of the consolidated financial statements. The notes and explanations to the consolidated financial statements give a description of material measurement principles regarding assets, equity, liabilities, financial performance and principles of preparation of the consolidated financial statements.

The Parent prepared notes in the form of tables to individual items of the consolidated statement of financial position, consolidated income statement and consolidated statement of comprehensive income as well as narrative descriptions in line with the requirements of IFRS.

The Parent prepared the consolidated statement of cash flows and consolidated statement of changes in equity in accordance with the requirements of IFRS.

The financial statements have been supplemented with the Directors' Report on the Operations of PGNiG S.A. and the PGNiG Group in the 2016 financial year, prepared as one document in accordance with Article 55.2a of the Accounting Act. The report contains information required by Article 49.2 of the Accounting Act and the Ordinance of the Minister of Finance of 19 February 2009 on current and periodic information published by issuers of securities and the rules of equal treatment of the information required by the laws of non-member states (Journal of Laws of 2014 item 133 as amended). We have audited the report with respect to the disclosed information derived directly from the audited consolidated financial statements.

IV. FINAL NOTES

Management Board's Representations

Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. and the key certified auditor received a representation letter from the Parent's Management Board, in which the Board stated that the Capital Group complied with the laws in force.

Piotr Sokołowski
Key certified auditor
conducting the audit
No. 9752

On behalf of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k. - entity authorized to audit financial statements entered under number 73 on the list kept by the National Council of Statutory Auditors:

Piotr Sokołowski - Vice-President of the Management Board of Deloitte Polska Sp. z o.o. - which is the General Partner of Deloitte Polska Spółka z ograniczoną odpowiedzialnością Sp. k.

Warsaw, 6 March 2017

Representation of the Management Board on reliability of the consolidated full-year financial statements of the PGNiG Group for 2016

We represent that, to the best of our knowledge, the full-year consolidated financial statements of the PGNiG Group as at December 31st 2016 and the comparative data have been prepared in compliance with the applicable accounting policies and give a true, clear and fair view of the assets, financial standing and financial performance of the PGNiG Group.

We further represent that, to the best of our knowledge, the Directors' Report on the operations of PGNiG SA and the PGNiG Group gives a fair view of the Group's development, achievements and standing, and includes a description of key risks and threats.

The Management Board of PGNiG SA:

President of the Management Board	Piotr Woźniak	....
Vice President of the Management Board	Radosław Bartosik	....
Vice President of the Management Board	Łukasz Kroplewski	....
Vice President of the Management Board	Michał Pietrzyk	....
Vice President of the Management Board	Maciej Woźniak	....
Vice President of the Management Board	Magdalena Zegarska	....

Representation of the Management Board on appointment of the auditor to audit the consolidated full-year financial statements of the PGNiG Group for 2016

We represent that the qualified auditor of financial statements that audited the consolidated full-year financial statements of the PGNiG Group as at December 31st 2016 had been appointed in accordance with the applicable laws.

Both the auditing firm and the auditors who performed the audit met the conditions required to issue an impartial and independent opinion on the audited consolidated full-year financial statements, in accordance with the applicable laws and professional standards.

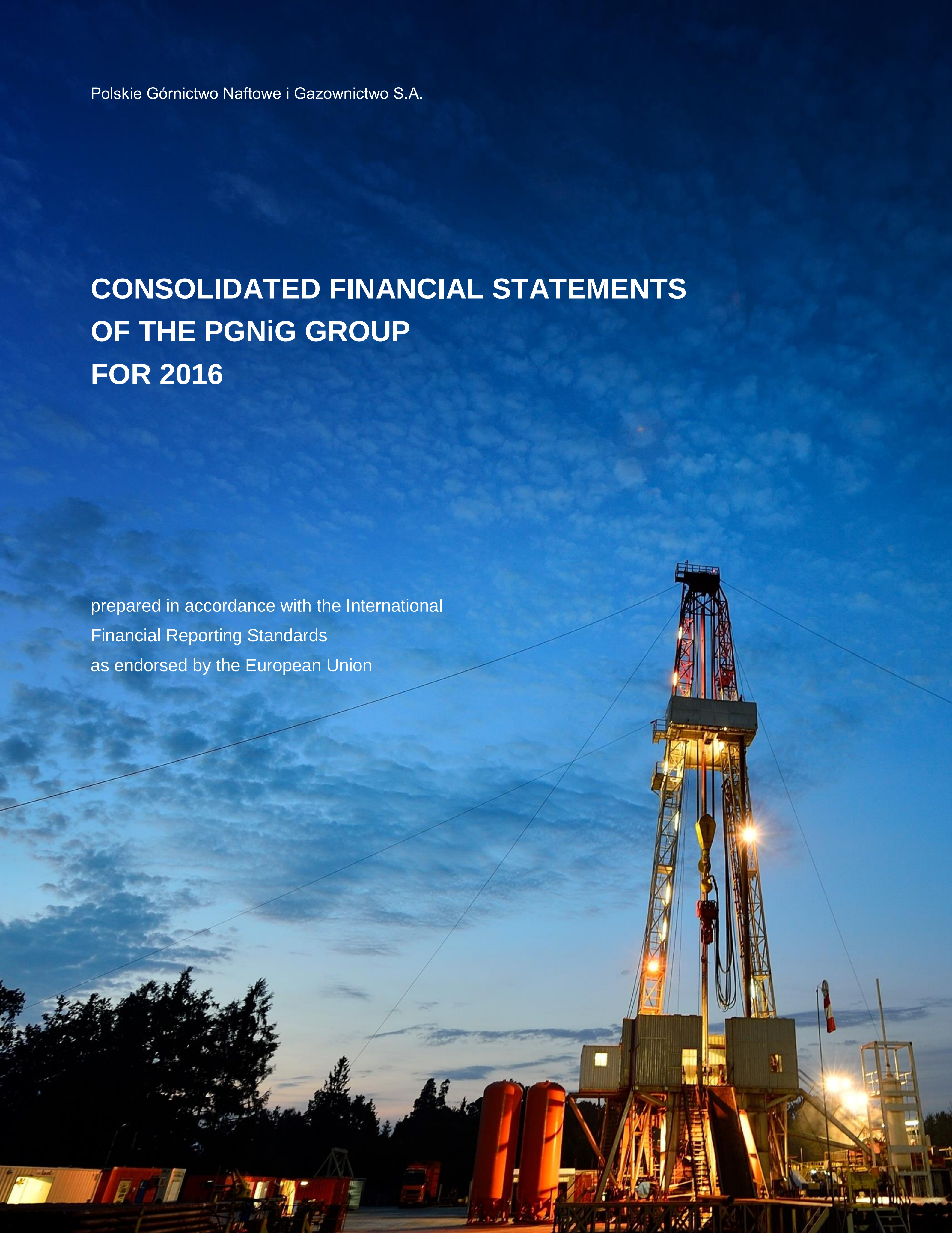
The Management Board of PGNiG SA:

President of the Management Board	Piotr Woźniak	....
Vice President of the Management Board	Radosław Bartosik	....
Vice President of the Management Board	Łukasz Kroplewski	....
Vice President of the Management Board	Michał Pietrzyk	....
Vice President of the Management Board	Maciej Woźniak	....
Vice President of the Management Board	Magdalena Zegarska	....

Polskie Górnictwo Naftowe i Gazownictwo S.A.

CONSOLIDATED FINANCIAL STATEMENTS OF THE PGNiG GROUP FOR 2016

prepared in accordance with the International Financial Reporting Standards as endorsed by the European Union



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Basic financial statements

Consolidated statement of profit or loss	2016	2015	
Revenue from sale of gas	26,429	30,263	*Note 3.1.*
Other revenue	6,767	6,201	*Note 3.1.*
Revenue	**33,196**	**36,464**	
Cost of gas sold	(18,320)	(22,005)	*Note 3.2.*
Other raw materials and consumables used	(2,427)	(2,211)	*Note 3.2.*
Employee benefits expense	(2,573)	(2,714)	*Note 3.2.*
Transmission services	(1,106)	(1,156)	
Other services	(1,412)	(1,235)	*Note 3.2.*
Taxes and charges	(765)	(628)	
Other income and expenses	(332)	(515)	*Note 3.3.*
Work performed by the entity and capitalised	868	953	
Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	(1,155)	(873)	*Note 3.2.*
Operating profit before depreciation and amortisation (EBITDA)	**5,974**	**6,080**	*Note 2.2.*
Depreciation and amortisation	(2,614)	(2,790)	*Note 2.2.*
Operating profit (EBIT)	**3,360**	**3,290**	*Note 2.2.*
Net finance costs	(76)	(225)	*Note 3.4.*
Profit/(loss) from equity-accounted investees	(74)	(51)	*Note 2.4.*
Profit before tax	**3,210**	**3,014**	
Income tax	(861)	(878)	*Note 4.1.*
Net profit	**2,349**	**2,136**	
Net profit attributable to:			
Owners of the parent	2,351	2,134	
Non-controlling interests	(2)	2	
Weighted average number of ordinary shares (million)	5,867	5,900	
Basic and diluted earnings per share (PLN)	0.40	0.36	

Consolidated statement of comprehensive income	2016	2015	
Net profit	**2,349**	**2,136**	
Exchange differences on translating foreign operations	23	15	
Hedge accounting	783	(431)	*Note 7.1.3*
Revaluation of financial assets available for sale	2	-	
Deferred tax	(149)	82	
Other comprehensive income subject to reclassification to profit or loss	**659**	**(334)**	
Actuarial losses on employee benefits	(29)	(35)	
Deferred tax	5	2	
Share of other comprehensive income of equity-accounted investees	(2)	-	
Other comprehensive income not subject to reclassification to profit or loss	**(26)**	**(33)**	
Other comprehensive income, net	633	(367)	
Total comprehensive income	**2,982**	**1,769**	
Total comprehensive income attributable to:			
Owners of the parent	2,984	1,767	
Non-controlling interests	(2)	2	

(in PLN million, unless stated otherwise)

Consolidated statement of cash flows	2016	2015	
Cash flows from operating activities			
Net profit	2,349	2,136	
Depreciation and amortisation	2,614	2,790	
Current tax expense	861	878	
Net gain/(loss) on investing activities	884	578	
Other non-monetary adjustments	368	430	*Note 5.5.2.*
Income tax paid	(611)	(833)	
Movements in working capital	(543)	1,292	*Note 5.5.*
Net cash from operating activities	**5,922**	**7,271**	
Cash flows from investing activities			
Payments for acquisition of tangible exploration and evaluation assets under construction	(713)	(986)	*Note 2.2.*
Payments for other property, plant and equipment and intangible assets	(2,255)	(2,168)	*Note 2.2.*
Payments for shares in related entities	(1,027)	(59)	
Other items, net	153	66	
Net cash from investing activities	**(3,842)**	**(3,147)**	
Cash flows from financing activities			
Payment for treasury shares	(645)	-	
Increase in debt	451	1,948	*Note 5.1.*
Proceeds from derivative financial instruments	89	84	
Decrease in debt	(1,021)	(1,578)	*Note 5.1.*
Dividends paid	(1,062)	(1,180)	*Note 3.5.*
Payment for derivative financial instruments	(78)	(81)	
Other items, net	(3)	(22)	
Net cash from financing activities	**(2,269)**	**(829)**	
Net cash flows	**(189)**	**3,295**	
Cash and cash equivalents at beginning of period	6,021	2,726	
Foreign exchange differences on cash and cash equivalents	(4)	(1)	
Cash and cash equivalents at end of period	**5,832**	**6,021**	*Note 5.5.3.*

(in PLN million, unless stated otherwise)

Consolidated statement of financial position	2016	2015*	2014*	
ASSETS				
Property, plant and equipment	33,149	32,967	33,528	*Note 6.1.1.*
Intangible assets	1,079	1,138	1,113	*Note 6.1.2.*
Deferred tax assets	100	42	58	*Note 4.1.2.*
Equity-accounted investees	1,229	840	856	*Note 2.4.*
Other assets	679	656	642	*Note 8.4.*
Non-current assets	**36,236**	**35,643**	**36,197**	
Inventories	2,510	2,229	3,189	*Note 6.2.1.*
Receivables	4,288	3,379	4,241	*Note 6.2.2.*
Derivative financial instruments	623	709	567	*Note 7.2.*
Other assets	129	146	132	*Note 8.4.*
Cash and cash equivalents	5,829	6,022	2,728	*Note 5.4.*
Assets held for sale	57	164	147	*Note 8.3.*
Current assets	**13,436**	**12,649**	**11,004**	
TOTAL ASSETS	**49,672**	**48,292**	**47,201**	
EQUITY AND LIABILITIES				
Share capital and share premium	7,518	7,640	7,640	
Accumulated other comprehensive income	(4)	(637)	(270)	
Retained earnings	24,499	23,733	22,794	
Equity attributable to owners of the parent	32,013	30,736	30,164	
Equity attributable to non-controlling interests	3	5	5	
TOTAL EQUITY	**32,016**	**30,741**	**30,169**	
Financing liabilities	1,346	5,799	5,069	*Note 5.1.*
Employee benefit obligations	702	565	604	*Note 6.3.1.*
Provision for well decommissioning costs	1,641	1,540	1,580	*Note 6.1.1.1.*
Other provisions	198	188	223	*Note 6.3.2.*
Grants	815	843	843	*Note 6.3.3.*
Deferred tax liabilities	1,932	1,557	1,525	*Note 4.1.2.*
Other liabilities	669	770	815	*Note 6.3.4.*
Non-current liabilities	**7,303**	**11,262**	**10,659**	
Financing liabilities	5,006	583	769	*Note 5.1.*
Derivative financial instruments	346	1,165	593	*Note 7.2.*
Trade and tax payables [A]	3,179	2,765	3,306	*Note 6.2.3.*
Employee benefit obligations	334	352	284	*Note 6.3.1.*
Provision for well decommissioning costs	20	33	28	*Note 6.1.1.1.*
Other provisions	560	661	692	*Note 6.3.2.*
Other liabilities	908	730	701	*Note 6.3.4.*
Current liabilities	**10,353**	**6,289**	**6,373**	
TOTAL LIABILITIES	**17,656**	**17,551**	**17,032**	
TOTAL EQUITY AND LIABILITIES	**49,672**	**48,292**	**47,201**	

[A] Including income tax of PLN 180m (2015: PLN 53m)

* Restated.

(in PLN million, unless stated otherwise)

Consolidated statement of changes in equity

	Equity attributable to owners of the parent												
	Share capital and share premium, including:			Accumulated other comprehensive income:									
	Share capital	Share premium	Treasury shares	Exchange differences on translating foreign operations	Hedging reserve	Revaluation of financial assets available for sale	Actuarial gains/(losses) on employee benefits	Share of other comprehensive income of equity-accounted investees	Retained earnings	Total	Equity attributable to non-controlling interests	Total equity	
As at Jan 1 2015	**5,900**	**1,740**	**-**	**(66)**	**(216)**	**-**	**12**	**-**	**22,794**	**30,164**	**5**	**30,169**	
Net profit	-	-	-	-	-	-	-	-	2,134	**2,134**	2	**2,136**	
Other comprehensive income, net	-	-	-	15	(349)	-	(33)	-	-	**(367)**	-	**(367)**	
Total comprehensive income	**-**	**-**	**-**	**15**	**(349)**	**-**	**(33)**	**-**	**2,134**	**1,767**	**2**	**1,769**	
Dividend	-	-	-	-	-	-	-	-	(1,180)	**(1,180)**	-	**(1,180)**	*Note 3.5.*
Changes in the Group	-	-	-	-	-	-	-	-	(15)	**(15)**	(2)	**(17)**	
As at Dec 31 2015	**5,900**	**1,740**	**-**	**(51)**	**(565)**	**-**	**(21)**	**-**	**23,733**	**30,736**	**5**	**30,741**	
Net profit	-	-	-	-	-	-	-	-	2,351	**2,351**	(2)	**2,349**	
Other comprehensive income, net	-	-	-	23	634	2	(24)	(2)	-	**633**	-	**633**	
Total comprehensive income	**-**	**-**	**-**	**23**	**634**	**2**	**(24)**	**(2)**	**2,351**	**2,984**	**(2)**	**2,982**	
Dividend	-	-	-	-	-	-	-	-	(1,062)	**(1,062)**	-	**(1,062)**	*Note 3.5.*
Acquisition of treasury shares	-	-	(645)	-	-	-	-	-	-	**(645)**	-	**(645)**	
Cancellation of treasury shares	(122)	-	645	-	-	-	-	-	(523)	**-**	-	**-**	
As at Dec 31 2016	**5,778**	**1,740**	**-**	**(28)**	**69**	**2**	**(45)**	**(2)**	**24,499**	**32,013**	**3**	**32,016**	
	Note 8.1.												

(in PLN million, unless stated otherwise)

1. General information

1.1. Key information about the Group and basis of preparation of the financial statements

1.1.1. Key information about the Group

Name	Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna
Registered office	ul. Marcina Kasprzaka 25, 01-224 Warsaw, Poland
Court of registration	District Court for the Capital City of Warsaw, 16th Commercial Division
National Court Register (KRS) No.	0000059492
Industry Identification Number (REGON)	012216736
Tax Identification Number (NIP)	525-000-80-28
Business	The Company's principal business activity includes exploration for and production of crude oil and natural gas, import, storage and sale of gas fuels, as well as trade in electricity.

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna is the Parent of the PGNiG Group (the "PGNiG Group", the "Group"). PGNiG shares are listed on the Warsaw Stock Exchange ("WSE"). As at the date of issue of these consolidated financial statements for 2016, the State Treasury was the only shareholder holding 5% or more of total voting rights at the General Meeting of PGNiG S.A.

The PGNiG Group is the only vertically integrated company in the Polish gas sector, holding the leading position in all segments of the country's gas industry. It is also a significant domestic producer of heat and electricity. The scope of the PGNiG Group's business comprises exploration for mineral deposits, oil and gas exploration and production, import, storage and distribution of and trade in gas fuels. The PGNiG Group imports gas fuel from Russia and Germany, and is the main producer of natural gas from Polish deposits. The Group's upstream operations are one of the key contributors to PGNiG's competitive position on the liberalised gas market in Poland.

For detailed information on the business segments and consolidated entities, see **Note 2**.

1.1.2. Basis of preparation

These consolidated financial statements of the PGNiG Group have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed for application in the European Union (EU).

Basis of consolidation

These consolidated financial statements include data of the Parent, its subsidiaries and joint arrangements (joint ventures and joint operations).

Financial statements of entities which are consolidated or accounted for with the equity method are prepared for the same reporting period as those of the Parent, based on consistent accounting policies. If necessary, adjustments are made to the financial statements of subsidiaries or joint ventures to ensure consistency between the accounting policies applied by a given entity and those applied by the Group.

Joint arrangements are accounted for in accordance with the policies presented in **Notes 2.4** and **8.7.**

Subsidiaries are consolidated with the full method from their acquisition date (the date of assuming control of the company) until the date the control is lost. Control is exercised when the Parent is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over that entity.

Acquisition of control of an entity representing a business is accounted for with the acquisition method. Identifiable acquired assets and assumed liabilities of an acquiree which is a business within the meaning of IFRS 3 are recognised as at the acquisition date and are measured at fair value. The excess of the acquisition cost (the consideration transferred (at fair value), any non-controlling interest in the acquiree measured in accordance with IFRS 3, and − in a business combination achieved in stages − the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree) over the net of the acquisition-date fair value of the identifiable assets acquired and the liabilities assumed, is recognised as goodwill. If the acquisition cost is lower than the net of the acquisition-date fair value of the identifiable assets acquired and the liabilities assumed, the difference is recognised as gain in profit or loss as at the acquisition date (gain on bargain purchase). The transaction costs are recognised in profit or loss when incurred. Non-controlling interests are initially measured at the non-controlling interest's proportionate share of net assets of the acquiree or at fair value.

If the Parent loses control of a subsidiary in a reporting period, the consolidated financial statements account for the subsidiary's results for such part of the reporting year in which control was held by the Parent.

These consolidated financial statements have been prepared based on the assumption that the Group will continue as a going concern in the foreseeable future. As at the date of authorisation of these financial statements for issue, no circumstances were identified which would indicate any threat to the Group's continuing as a going concern.

These consolidated financial statements have been prepared in accordance with the historical cost convention, except with respect to financial derivatives measured at fair value and financial assets available for sale.

The reporting currency of these consolidated financial statements is the Polish złoty (PLN).

The functional currency of PGNiG S.A. and the presentation currency of these consolidated financial statements is the Polish złoty (PLN).

Items denominated in foreign currencies

Transactions denominated in foreign currencies are **initially recognised** at the exchange rate of the functional currency as at the transaction date.

At the **end of a reporting period**:

- Monetary items denominated in foreign currencies are translated at the exchange rate of the functional currency quoted by the National Bank of Poland for the reporting date.
- Non-monetary items measured at historical cost in a foreign currency are translated at the exchange rate as at the date of the transaction.

Exchange differences arising on settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition, are taken to profit or loss. Exchange differences which are part of a gain/(loss) on measurement of a hedging instrument in hedge accounting are recognised in other comprehensive income.

The financial data of all foreign operations and branches which are accounted for in consolidated financial statements must be translated into the Group's presentation currency, i.e. into PLN. For this purpose, their data from the statement of financial position is translated at the mid rate quoted for the given currency by the National Bank of Poland for the end of the reporting period, and data from the statement of profit or loss – at the rate equal to the arithmetic mean of mid rates quoted for the given currency by the National Bank of Poland for the last day of each month of the financial year.

Foreign currency differences arising on translation of assets and liabilities of foreign operations are recognised in other comprehensive income and accumulated as a separate item of equity. Upon disposal of a foreign operation, the foreign exchange differences accumulated in equity are transferred to the statement of profit or loss and disclosed as part of the overall net gain/(loss) on the disposal.

To hedge against foreign currency risk, the Group enters into currency derivative contracts (for description of the accounting policies applied by the Group to derivative financial instruments see **Note 7.2**).

These financial statements were signed and authorised for issue by the Parent's Management Board on March 8th 2017.

1.2. Effect of new standards on the financial statements of the PGNiG Group

1.2.1. New and amended standards and interpretations

The following new and amended standards and interpretations effective as of January 1st 2016 had an effect on these consolidated financial statements:

Standard	Description	Estimated effect
Amendments to IAS 1	In December 2014, as part of its disclosure initiative, the International Accounting Standards Board published an amendment to IAS 1 whose objective was to clarify the concept of materiality and explain that information which the reporting entity deems immaterial should not be presented even if its disclosure is generally required under another IFRS. The amended IAS 1 clarifies that items presented in the statement of financial position and the statement of profit or loss and other comprehensive income may be aggregated or disaggregated depending on materiality. Additional guidelines were also introduced for presentation of subtotals in those statements.	The Group optimised disclosures in its financial statements by introducing presentation changes and modifying the scope and amount of disclosures (taking into account their materiality) as well as the manner of aggregation of financial data.

Amendments other than those referred to above were either not applicable or irrelevant to the Group's consolidated financial statements.

1.2.2. Issued standards and interpretations which are not yet effective and have not been adopted by the Group early

In these consolidated financial statements, the Group did not opt for early application of the following standards, interpretations or amendments to existing standards which have been issued and are relevant to the Group's business:

Standard	Description	Estimated effect	Effective date
IFRS 9 *Financial Instruments*	The standard introduces a model based on the following classification categories for financial assets: measured at fair value through profit or loss (FVTPL), at fair value through other comprehensive income (FVTOCI), and at amortised cost. Assets are classified on initial recognition depending on an entity's financial instrument management model and the characteristics of contractual cash flows from such instruments. IFRS 9 introduces a new impairment recognition model based on expected credit losses. The majority of the requirements under IAS 39 concerning classification and measurement of financial liabilities were incorporated into IFRS 9 unchanged. The key change is the new requirement that entities present in other comprehensive income the effect of changes in their own credit risk related to financial liabilities designated as at fair value through profit or loss. Changes were also made to the hedge accounting model to factor in risk management.	The Group is currently analysing the effects of IFRS 9 on its consolidated financial statements. Based on a preliminarily analysis, it has been assumed that IFRS 9 may have an effect on the consolidated financial statements with respect to hedge accounting and recognition of impairment losses on receivables based on expected credit losses; the latter is expected to have an effect on the Group's statement of financial position by increasing the opening balance of impairment losses. However, the amount of impairment losses on receivables is not expected to change considerably. The Group assumes that the hedging instruments currently designated for hedge accounting will not change. The Group does not expect any changes with respect to fair value measurement. A detailed analysis of the impact of the adoption of the new standard is planned to be made in 2017.	January 1st 2018 As at the date of these consolidated financial statements, IFRS 9 had not yet been endorsed by the European Union. The Group will apply IFRS 9 after it is endorsed by the EU.

(in PLN million, unless stated otherwise)

Standard	Description	Estimated effect	Effective date
IFRS 15 ***Revenue from Contracts with Customers***	IFRS 15 will apply to all contracts giving rise to revenue. The core principle of the new standard is that revenue is to be recognised upon transfer of goods or services to a customer, at the transaction price. Any goods or services that are sold in bundles and are separately identifiable as part of the bundle should be recognised separately, and any discounts and rebates on the transaction price should be allocated to the specific bundle items. Where a contract contains elements of variable consideration, under the new standard such variable consideration is recognised as revenue only if it is highly probable that its remeasurement will not result in a revenue reversal in the future. Furthermore, in accordance with IFRS 15, the cost of obtaining and securing a contract with a customer should be capitalised and amortised over the period in which the contract's benefits are consumed.	The Group has analysed the impact of IFRS 15 on its consolidated financial statements and found that the amendments will have no significant effect on the consolidated financial statements when first adopted.	January 1st 2018 As at the date of these consolidated financial statements, IFRS 15 had not yet been endorsed by the European Union. The Group will apply IFRS 15 as of January 1st 2018.
IFRS 16 ***Leases***	The new standard establishes principles for the recognition, measurement, presentation and disclosure of leases. All lease transactions result in the lessee acquiring a right-of-use asset and incurring a lease liability. Thus, IFRS 16 abolishes the operating and finance lease classification under IFRS 17 and provides a single lessee accounting model, requiring lessees to recognise (a) assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value and (b) amortisation of the leased asset separately from interest on lease liability in the statement of profit or loss. IFRS 16's approach to lessor accounting is substantially unchanged from its predecessor, IAS 17. Lessors continue to classify leases as operating or finance leases, with each of them subject to different accounting treatment.	Based on preliminary assessment, IFRS 16 may potentially have an effect on the Company's financial statements mainly due to the fact that the Company is a holder of perpetual usufruct rights to land. The Group has not yet analysed the potential effect of the new standard on its financial statements. A detailed analysis will be carried out in 2018–2019.	January 1st 2019 As at the date of these consolidated financial statements, this amendment had not yet been endorsed by the European Union. The Group will apply IFRS 16 after it is endorsed by the European Union.
Amendments to IAS 7 ***Disclosure Initiative***	Entities will be required to disclose a reconciliation of changes in liabilities arising from financing activities.	The amendments had an effect on the consolidated financial statements for 2016. Reconciliation of net debt is presented in Note 5.1.	January 1st 2017

The other standards and interpretations that have been issued but are not yet effective are not relevant to the Group's business.

(in PLN million, unless stated otherwise)

1.3. Presentation changes in the financial statements

In the consolidated financial statements for 2016, the Group made presentation changes with respect to the following items of the statement of financial position:

- Deferred tax assets and liabilities – in accordance with IAS 12, deferred tax assets and liabilities were presented on a net basis; and
- Gas Facility Decommissioning Fund cash – following a detailed analysis, it was transferred from cash and cash equivalents to other assets (under non-current assets).

As the amendments discussed above were applied retrospectively, the data as at January 1st 2015 and December 31st 2015 presented in the statement of financial position is restated.

Consolidated statement of financial position	As at Dec 31 2015 – before restatement	Presentation of deferred tax on a net basis	Reclassification of non-current restricted cash	As at Dec 31 2015 – after restatement
ASSETS				
Non-current assets	**36,959**	**(1,533)**	**217**	**35,643**
including:				
Deferred tax assets	1,575	(1,533)	-	42
Other assets	439	-	217	656
Current assets	**12,866**	**-**	**(217)**	**12,649**
including:				
Cash and cash equivalents	6,239	-	(217)	6,022
TOTAL ASSETS	**49,825**	**(1,533)**	**-**	**48,292**
EQUITY AND LIABILITIES				
TOTAL EQUITY	**30,741**	**-**	**-**	**30,741**
Non-current liabilities	**12,795**	**(1,533)**	**-**	**11,262**
including:				
Deferred tax liabilities	3,090	(1,533)	-	1,557
Current liabilities	**6,289**	**-**	**-**	**6,289**
TOTAL LIABILITIES	**19,084**	**(1,533)**	**-**	**17,551**
TOTAL EQUITY AND LIABILITIES	**49,825**	**(1,533)**	**-**	**48,292**

(in PLN million, unless stated otherwise)

Consolidated statement of financial position	As at Jan 1 2015 – before restatement	Presentation of deferred tax on a net basis	Reclassification of non-current restricted cash	As at Jan 1 2015 – after restatement
ASSETS				
Non-current assets including:	**37,692**	**(1,725)**	**230**	**36,197**
Deferred tax assets	1,783	(1,725)	-	58
Other assets	412	-	230	642
Current assets including:	**11,234**	**-**	**(230)**	**11,004**
Cash and cash equivalents	2,958	-	(230)	2,728
TOTAL ASSETS	**48,926**	**(1,725)**	**-**	**47,201**
EQUITY AND LIABILITIES				
TOTAL EQUITY	**30,169**	**-**	**-**	**30,169**
Non-current liabilities including:	**12,384**	**(1,725)**	**-**	**10,659**
Deferred tax liabilities	3,250	(1,725)	-	1,525
Current liabilities	**6,373**	**-**	**-**	**6,373**
TOTAL LIABILITIES	**18,757**	**(1,725)**	**-**	**17,032**
TOTAL EQUITY AND LIABILITIES	**48,926**	**(1,725)**	**-**	**47,201**

Consolidated statement of cash flows	As at Dec 31 2015 – before restatement	Reclassification of non-current restricted cash	As at Dec 31 2015 – after restatement
Net cash from operating activities including:	**7,258**	**13**	**7,271**
Movements in working capital	1,279	13	1,292
Net cash from investing activities	**(3,147)**	**-**	**(3,147)**
Net cash from financing activities	**(829)**	**-**	**(829)**
Net cash flows	**3,282**	**13**	**3,295**
Cash and cash equivalents at beginning of period	**2,956**	**(230)**	**2,726**
Cash and cash equivalents at end of period	**6,238**	**(217)**	**6,021**

2. Description of the Group and reporting segments

2.1. Key information on the Group and its reporting segments.

These consolidated financial statements include financial information of the Parent and of:

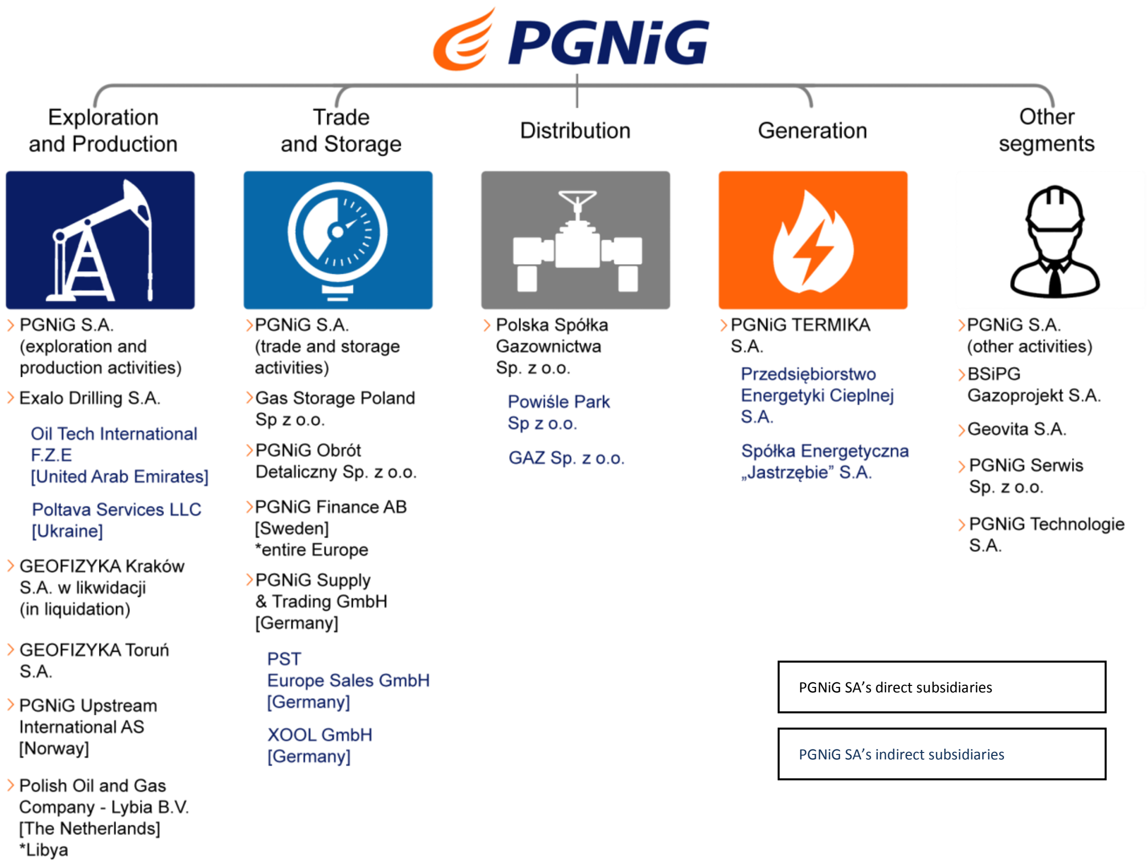
- 15 direct subsidiaries of PGNiG, and
- 8 indirect subsidiaries of PGNiG.

The Parent holds 100% equity interests in all its consolidated subsidiaries except for BSiPG Gazoprojekt S.A., in which PGNiG S.A. holds an aggregate interest of 75% (including a direct holding of 22.5% and 52.5% held indirectly through PGNiG Technologie S.A.).

The assets and liabilities of companies in which the Group holds non-controlling interests are not material.

The Group identifies five reporting segments.

Below is presented a classification of the Group's fully-consolidated entities by reporting segment. For more information on the Group structure, see Section 6.1. of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2016.



[ ] - Country of registration (if different from Poland).

***** Principal place of business (if different from the country of registration).

Figure 1 ***Group structure by operating segment***

The reporting segments have been identified based on the type of business conducted by the Group companies. The individual operating segments have been aggregated into reporting segments according to the aggregation criteria given in the table below. The Management Board of the Parent is the chief operating decision maker (CODM).

Segment	Description of the segment	Operating segments and aggregation criteria
Exploration and Production 	The segment's business focuses on extracting hydrocarbons from deposits and preparing products for sale. The segment covers the process of exploring for and extracting natural gas and crude oil from deposits, including geological surveys, geophysical research, drilling, and development of and production from gas and oil fields. The segment's operations include sale of gas directly from the fields, sale of crude oil and other products in Poland and abroad.	The operating segments included in this reporting segment are the operations of PGNiG S.A. related to the hydrocarbon exploration and production business, as well as the Group companies listed under Exploration and Production in ***Figure 1***. None of the operating segments is significant, therefore the segments were aggregated as they have similar economic characteristics and meet most of the aggregation criteria. The key criteria for aggregation of the operating segments into the reporting segment included similarity of products and services, similar characteristics of the production process and of the target customer base, as well as economic similarities (exposure to the same market risks, as reflected in the correlation of performance (margins) generated by the individual operating segments included in the reporting segment).
Trade and Storage 	The segment's activities consist in sale of natural gas (imported, produced or purchased on natural gas exchanges), operation of underground gas storage facilities for trading purposes (including the UGSFs located in Mogilno, Wierzchowice, Husów, Brzeźnica, Strachocina and Swarzów), and electricity trading.	The operating segments included in this reporting segment are the operations of PGNiG S.A. related to the gas fuel and electricity trading business, as well as the Group companies listed under Trade and Storage in ***Figure 1.*** The key criteria for aggregation of the operating segments into the reporting segment included similarity of products and services, similarity of target customer groups purchasing the segment's products/services, and similar economic characteristics.
Distribution 	The segment's principal business activity consists in distribution of natural gas via distribution networks to retail, industrial and wholesale customers, as well as operation, maintenance (repairs) and expansion of gas distribution networks.	In this case, the operating segment is also a reporting segment, comprising only Polska Spółka Gazownictwa Sp. z o.o.
Generation 	The segment's activities consist in generation and sale of electricity and heat.	The operating segments making up this reporting segment include PGNiG TERMIKA S.A. and its subsidiaries shown in ***Figure 1***. The key criteria for aggregation of the operating segments into the reporting segment included similarity of products and services, similarity of target customer groups purchasing the segment's products/services, and similar economic characteristics.
Other Segments 	This segment comprises operations which cannot be classified into any of the segments listed above, i.e. engineering design and construction of structures, machinery and equipment for the extraction and energy sectors, as well as catering and hospitality services.	In this reporting segment, the operating segments are represented by the individual Group companies which do not qualify for inclusion in any of the other reporting segments, as listed under Other Segments in ***Figure 1***.

(in PLN million, unless stated otherwise)

2.2. Reporting segments in figures

2016	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Profit/(loss) from equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce*
Exploration and Production	2,776	1,515	4,291	1,285	(1,066)	219	(1,089)	(53)	(1,314)	12,881	7,720
Trade and Storage	27,740	440	28,180	1,410	(252)	1,158	(28)	-	(121)	4,227	3,520
Distribution	1,078	3,837	4,915	2,559	(924)	1,635	(4)	-	(1,123)	12,765	10,846
Generation	1,472	723	2,195	759	(360)	399	(16)	(21)	(391)	3,378	1,870
Other Segments	130	110	240	(61)	(14)	(75)	(18)	-	(9)	110	1,315
Total	**33,196**	**6,625**	**39,821**	**5,952**	**(2,616)**	**3,336**	**(1,155)**	**(74)**	**(2,958)**	**33,361**	**25,271**
Reconciliation with consolidated data			(6,625)	22	2	24	-	-	(10)	(212)	
Total			**33,196**	**5,974**	**(2,614)**	**3,360**	**(1,155)**	**(74)**	**(2,968)**	**33,149**	

*Excluding the workforce of equity-accounted investees.

2015	Sales to external customers	Inter-segment sales	Total revenue	EBITDA	Depreciation and amortisation	EBIT (operating profit)	Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	Profit/(loss) from equity-accounted investees	Expenditure on acquisition of property, plant and equipment and intangible assets	Property, plant and equipment	Workforce*
Exploration and Production	3,148	1,707	4,855	2,426	(1,331)	1,095	(839)	-	(1,460)	13,378	8,903
Trade and Storage	31,274	468	31,742	623	(242)	381	(3)	(51)	(171)	4,290	3,462
Distribution	654	3,931	4,585	2,339	(889)	1,450	(2)	-	(1,180)	12,573	10,678
Generation	1,215	672	1,887	679	(312)	367	(30)	-	(353)	2,840	1,071
Other Segments	173	152	325	12	(18)	(6)	1	-	(7)	133	1,305
Total	**36,464**	**6,930**	**43,394**	**6,079**	**(2,792)**	**3,287**	**(873)**	**(51)**	**(3,171)**	**33,214**	**25,419**
Reconciliation with consolidated data			(6,930)	1	2	3	-	-	17	(247)	
Total			**36,464**	**6,080**	**(2,790)**	**3,290**	**(873)**	**(51)**	**(3,154)**	**32,967**	

*Excluding the workforce of equity-accounted investees.

The segment information has been prepared in accordance with the accounting policies applied in these consolidated financial statements.

The Management Board analyses the segments' results using basic performance measures, such as segment's net profit, as well as key efficiency indicators such as EBITDA, which is not a standardised measure.

The definition of EBITDA and how it is calculated by the Group are presented below.

Definition adopted by the Group:

EBITDA – *profit before tax, net finance costs, share of profit/(loss) of equity-accounted investees, and depreciation and amortisation.*

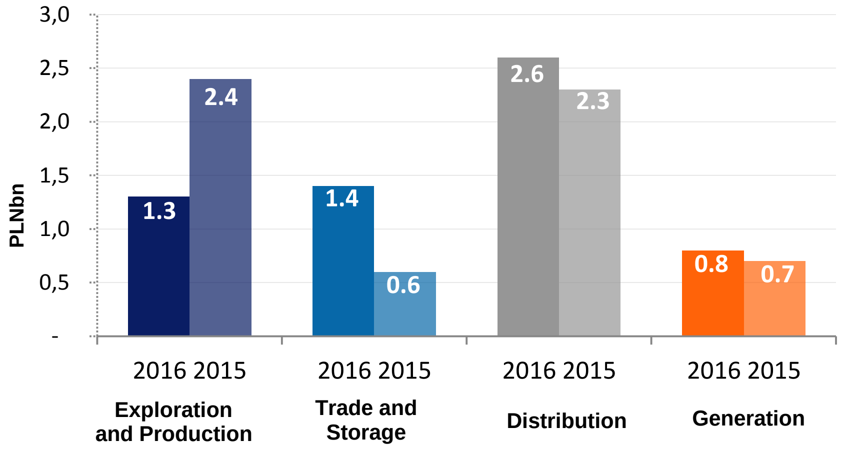


Chart 1 ***Segments' contributions to the Group's EBITDA (PLNbn)***

For more information on the operations of each segment, see the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group.

(in PLN million, unless stated otherwise)

2.3. Related-party transactions

The Group's related parties include entities jointly controlled by the Group, the Group's associates, the Group's subsidiaries which are not consolidated due to immateriality of their data, companies in which the State Treasury holds an equity interest (subsidiaries, jointly controlled entities and associates), as well as the Group's key management personnel (i.e. members of the Management and Supervisory Boards of the Parent and its subsidiaries).

The State Treasury is the entity having control of the Group.

	2016			2015		
	Joint ventures	Other related parties	Total	Joint ventures	Other related parties	Total
Revenue and income/expenses for the period						
Sale of products and services	28	5	33	31	4	35
Interest income from loans advanced	11	7	18	-	13	13
Total	**39**	**12**	**51**	**31**	**17**	**48**
Purchase of services, merchandise and materials	-	(4)	(4)	-	(2)	(2)
Purchase of tangible assets under construction	-	(24)	(24)	-	(17)	(17)
Other purchases	-	(1)	(1)	-	-	-
Total	**-**	**(29)**	**(29)**	**-**	**(19)**	**(19)**
Balance at end of period						
Trade receivables	4	1	5	1	1	2
Including impairment losses	-	-	-	-	-	-
Loans advanced	250	-	250	-	215	215
Including impairment losses	-	(56)	(56)	-	(48)	(48)
Total	254	1	255	**1**	**216**	**217**
Trade payables	23	5	28	7	2	9
Total	**23**	**5**	**28**	**7**	**2**	**9**

In 2016, neither the Parent nor its subsidiaries entered into any material related-party transactions other than on arm's length terms.

(in PLN million, unless stated otherwise)

2.3.1. Transactions with entities in which the State Treasury holds equity interests

Transactions with entities in which the State Treasury holds equity interests (and has control or joint control of, or significant influence on, such entities) are mainly transactions executed in the course of the Group's day-to-day operations, i.e. natural gas trading, sale of crude oil, and sale of electricity.

	2016	2015
Revenue	3,855	4,907
Expenses	(888)	(880)
Receivables	631	429
Liabilities	78	44

The data above includes transactions with the following companies: Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A., Polski Koncern Naftowy ORLEN S.A., ORLEN Południe S.A., PGE Górnictwo i Energetyka Konwencjonalna S.A., Grupa LOTOS S.A., Grupa Azoty Zakłady Azotowe PUŁAWY S.A., Zakłady Azotowe w Tarnowie - Mościcach S.A., Grupa Azoty Zakłady Azotowe Kędzierzyn S.A., Grupa Azoty Zakłady Chemiczne POLICE S.A., Anwil S.A., Energa Obrót S.A., Polskie Sieci Elektroenergetyczne S.A., and KGHM Polska Miedź S.A.

2.3.2. Information on benefits to the Group's key personnel

	2016			2015		
	Management Board	Supervisory Board	Total	Management Board	Supervisory Board	Total
of the Parent	**7.1**	**0.5**	**7.6**	**7.7**	**0.4**	**8.1**
Short-term employee benefits	5.9	0.5	6.4	7.3	0.4	7.7
Termination benefits	1.2	-	1.2	0.4	-	0.4
of the subsidiaries	**21.5**	**5.3**	**26.8**	**19.5**	**4.1**	**23.6**
Short-term employee benefits	18.7	5.3	24.0	18.6	4.1	22.7
Termination benefits	2.8	-	2.8	0.9	-	0.9
Total	**28.6**	**5.8**	**34.4**	**27.2**	**4.5**	**31.7**

For more information on remuneration of the key management personnel and remuneration policy applied at the Group, see Section 10.3. of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2016.

2.3.3. Loans granted to the management and supervisory personnel of the Group companies

	2016	2015
Management personnel		
Interest rate (%)	-	5.99%
Maturing in	-	3 months
Outstanding amount	-	0,01
Supervisory personnel		
Interest rate (%)	0% - 3,5%	1%
Maturing in	2–3 years	3 years
Outstanding amount	0.01	0.01
Total outstanding amount	**0.01**	**0.02**

2.4. Equity-accounted investees

Accounting policies

Joint arrangements

Joint arrangements include:

- Joint operations (see **Note 8.7**),
- Joint ventures.

As a partner in a **joint venture**, in the consolidated financial statements the Group recognises its interest in the joint venture as an investment and accounts for that investment with the equity method.

According to the equity method, investments are initially recognised at cost, and subsequently adjusted for the Group's share in changes of their net assets which occurred in the period from the date joint control was assumed to the reporting date, less impairment. When the Group's share of losses of a jointly controlled entity exceeds the Group's interest in that entity, the Group discontinues recognising its share of further losses. Unrealised gains and losses on transactions between the Group and a jointly controlled entity are eliminated on consolidation proportionately to the Group's interest in the jointly controlled entity.

Material estimates

Impairment of the investment in SGT EUROPOL GAZ S.A., a joint venture

As at the end of each reporting period, the Parent tests its investment in SGT EUROPOL GAZ S.A. (a jointly controlled entity accounted for with the equity method) for impairment and measures its value in use using the DCF method. The valuation was based on the Inter-Governmental Protocol of October 29th 2010, which specified the company's expected net profit.

The company's value estimated as at the same date with the discounted cash flow method was PLN 840m.

The calculations were based on the assumption that in each year in 2011−2021 net profit earned by SGT EUROPOL GAZ S.A. (EUROPOL GAZ) will be PLN 21m. The discounted cash flows include all cash flows generated by EUROPOL GAZ, including cash flows related to the servicing of interest-bearing borrowings (interest expense and principal repayments) and other risks known to the issuer. The cash flows were discounted using a discount rate of 7.69% (in real terms).

As at the end of 2016, the value of the Parent's interest in EUROPOL GAZ determined using the equity method was PLN 902m. Therefore, an impairment loss of PLN 62m was recognised in the current reporting period to align the equity method valuation of the interest with its valuation obtained using the DCF method.

The impairment test result is sensitive to the adopted assumptions regarding future cash flows (which depend on whether the provisions of the Inter-Governmental Protocol with respect to net profit to be earned in each of the years are implemented by the company) and discount rate. Changes in those assumptions following from updates of the company's financial forecasts and changes in the discount rate due to general or company-specific factors, may have a material effect on the company's future value.

2.4.1. Material restrictions of the ability to transfer earnings from interests in joint ventures to the Group

Polska Grupa Górnicza Sp. z o.o. (PGG)

Under PGG's note issue programme agreement dividends may be paid only when all of the following conditions are met:

- A part of notes of individual tranches maturing in the period for which the dividend is to be paid are redeemed before dividend can be distributed;
- The following ratios are maintained within the permitted limits: net debt/EBITDA less replacement capital expenditure (for the last quarter), DSCR (ratio of cash available for debt servicing to mature debt – for the last year) and the Future Cash Flow Ratio (for the last quarter);
- The forecast values of the ratios will not exceed the permitted limits by the note redemption date as a result of the payment;
- The dividend will be paid to the shareholders and to the holders of participation notes in the proportion defined in the terms and conditions of participation notes.

(in PLN million, unless stated otherwise)

Elektrociepłownia Stalowa Wola S.A. (ECSW)

Under ECSW's financing agreement distribution of dividends and payments under subordinated loans are permitted only when there has been no default under the financing agreement, the financial ratios have been maintained within the permitted limits and the planned payments will not result in exceeding those limits, and the company maintains a certain contractually defined minimum reserve of cash available for the servicing of its debt.

As at the date of the consolidated financial statements of the PGNiG Group for 2016, ECSW's construction project was in progress, and according to a directional decision of the Project sponsors (PGNiG and Tauron PE), it will be continued. Advanced negotiations with potential ldeners are under way to agree on details of a new credit facility agreement for refinancing of ECSW's existing debt and further execution of the investment project. For more information on activities relating to ECSW's operations, see Section 5.4.4. the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2016.

SGT EUROPOL GAZ S.A. (EUROPOL GAZ)

In accordance with the agreement of May 20th 1997 between EUROPOL GAZ and its shareholders, which continued in force as at December 31st 2015, no decision on payment of dividend by EUROPOL GAZ could be made until EUROPOL GAZ fully discharged its liabilities under borrowings incurred in connection with construction of the gas pipeline.

As at December 31st 2016, there were no such restrictions at EUROPOL GAZ with respect to payment of dividend, repayment of borrowings, or payment of advances by the company.

The table below contains financial information relating to equity accounted investees.

	2016			2015	
	Joint ventures			Joint venture	Associate
	SGT EUROPOL GAZ S.A.	Polska Grupa Górnicza Sp. z o.o.	Elektrociepłownia Stalowa Wola S.A.	SGT EUROPOL GAZ S.A.	GAS-TRADING S.A.
At beginning of period	**840**	**-**	**-**	**840**	**16**
Acquisition of shares	-	444	-	-	-
Acquisition of additional equity interest in SGT EUROPOL GAZ S.A. (1.44%)	-	-	-	51	-
Deconsolidation	-	-	-	-	(16)
Consolidation	-	-	21	-	-
Changes accounted for in profit/(loss) from equity-accounted investees, including:					
Share of net profit/(loss)	64	(55)	(47)	44	-
Elimination of unrealised profits between the Group and the joint venture	(2)	2	-	(1)	-
Write-off of goodwill from acquisition of additional equity interest in SGT EUROPOL GAZ S.A.	-	-	-	(6)	-
Reversal of negative value of shares accounted for with the equity method	-	-	26	-	-
Impairment losses	(62)	-	-	(88)	-
Changes accounted for in other comprehensive income from equity-accounted investees	-	(2)	-	-	-
At end of period	**840**	**389**	**-**	**840**	**-**

(in PLN million, unless stated otherwise)

	2016		2015
	SGT EUROPOL GAZ S.A.*	Polska Grupa Górnicza Sp. z o.o.**	SGT EUROPOL GAZ S.A.*
PGNiG Group's ownership interest	**51.18%**	**16.63%**	**51.18%**
Description of business	Transmission of natural gas	Production of coal	Transmission of natural gas
Key financial data			
Non-current assets	2,201	6,277	2,465
Current assets	2,125	1,008	1,970
including cash and cash equivalents	1,900	310	-
Non-current liabilities	198	2,442	401
including non-current financial liabilities	115	1,148	-
Current liabilities	322	2,516	329
including current financial liabilities	229	92	-
Net assets	**3,806**	**2,327**	**3,705**
Revenue	1,120	3,828	1,225
Depreciation and amortisation	281	910	305
Interest income	23	9	27
Interest expense	18	48	22
Income tax	29	55	20
Net profit/(loss)	117	(332)	78
Other comprehensive income	-	(11)	-
Carrying amount of the investment			
Share of net assets	**1,948**	**387**	**1,896**
Adjustment to ensure consistency of accounting policies with those of the Group	(45)	-	(57)
Elimination of unrealised profits between the Group and the joint venture	(182)	2	(180)
Goodwill write-off	(6)	-	(6)
Impairment losses	(875)	-	(813)
Carrying amount of the investment in the consolidated statement of financial position	**840**	**389**	**840**

*Resolutions are passed by a majority of three quarters of votes represented at the General Meeting. Resolutions may be passed if the General Meeting is attended by all founding shareholders, each of them holding 30% or more shares.

**Indirect interest held through PGNiG TERMIKA S.A., which is entitled to appoint one member of the Supervisory Board and can block material decisions.

3. Notes to the statement of profit or loss

3.1. Revenue

Accounting policies

Revenue

The Group's revenue comes primarily from trade in high-methane and nitrogen-rich natural gas, generation and sale of electricity and heat, as well as sale of produced crude oil.

The Group's business includes services, such as distribution of gas fuels, storage of gas fuels, geophysical and geological services, gas service connection, drilling and oilfield services, real estate rental and other services.

The Group also generates revenue from construction contracts.

Revenue is measured at fair value of the consideration received or receivable, less any discounts, sales taxes (VAT, excise duty) and other charges.

Material estimates

Estimating natural gas sales

In order to correctly recognise revenue from gas sales in appropriate reporting periods, at the end of each reporting period the Group estimates the quantity and value of gas delivered to retail customers but not invoiced.

The value of natural gas supplied to retail customers but not invoiced is estimated on the basis of the customers' historical consumption patterns in comparable reporting periods. The value of estimated gas sales is calculated as the product of quantities assigned to the individual tariff groups and the rates defined in the applicable tariff. There is a risk that the actual final volume of gas fuel sold might differ from the estimate. Accordingly, profit or loss for a given period may account for a portion of the estimated sales volume which will never be realised.

At the end of 2016, an estimated amount of PLN 103m was included in gas sales revenue (adjustment increasing the invoiced revenue), while gas sales revenue for 2015 was reduced by PLN 183m relative to the invoiced amounts.

Revenue from sale of crude oil

With regard to sales of crude oil produced from the Norwegian Continental Shelf, where the Group holds interests in licences together with other entities, the revenue from sale of crude oil is recognised based on crude volumes produced and sold to customers. However, the volume of crude oil sold to customers may differ from the volume of crude which is attributable to the Group in a given period based on its interest in a given licence. If the production volume attributable to the Group is higher than the sales volume, an asset (underlift) is recognised in the consolidated financial statements. Conversely, if in a given reporting period the volume of crude oil sold exceeds the production volume the Group is entitled to, a liability (overlift) is recognised in the consolidated financial statements.

At the end of 2015 and 2016 the volume of crude oil sold was lower than the Group's share of production. Therefore, an asset of PLN 18.1m and PLN 7m, respectively, was recognised under receivables in the consolidated statement of financial position.

Revenue from construction contracts

If the outcome of a construction contract can be estimated reliably, revenue and costs should be recognised in proportion to the stage of completion of contract activity at the end of the reporting period. If the outcome cannot be estimated reliably, contract revenue should be recognised only to the extent that contract costs incurred are expected to be recoverable.

(in PLN million, unless stated otherwise)

	2016			2015		
	Domestic sales	Export sales*	Total	Domestic sales	Export sales*	Total
Revenue from sale of gas, including:	**24,323**	**2,106**	**26,429**	**28,262**	**2,001**	**30,263**
High-methane gas	22,707	2,095	24,802	26,576	1,965	28,541
Nitrogen-rich gas	1,348	11	1,359	1,389	36	1,425
LNG	185	-	185	207	-	207
CNG	34	-	34	36	-	36
Propane-butane gas	49	-	49	54	-	54
Other revenue, including:	**4,946**	**1,821**	**6,767**	**4,021**	**2,180**	**6,201**
Crude oil and natural gasoline	646	875	1,521	703	1,174	1,877
NGL	-	86	86	-	68	68
Sales of heat	1,264	-	1,264	1,127	-	1,127
Sales of electricity	1,410	442	1,852	990	580	1,570
Revenue from rendering of services:						
- drilling and oilfield services	45	167	212	53	214	267
- geophysical and geological services	50	167	217	53	62	115
- construction and assembly services	90	-	90	129	-	129
- distribution services	762	-	762	363	-	363
- connection charge	130	-	130	120	-	120
- other	208	11	219	248	4	252
Other	341	73	414	235	78	313
Total revenue	**29,269**	**3,927**	**33,196**	**32,283**	**4,181**	**36,464**

*By customer's country.

The Group does not have any single external customer accounting for 10% or more of total revenue earned by the Group.

On foreign markets the Group sells its products mainly to customers in Germany (41.6% of export sales), Norway and Switzerland.

	2016	2015
Value of non-current assets other than financial instruments located in Poland	29,734	29,854
Value of non-current assets other than financial instruments located abroad*	4,513	4,263
Total	**34,247**	**34,117**
% share of assets located outside of Poland in total assets	**13.18%**	**12.50%**
* Including PGNiG Upstream International AS (Norway).	3,929	3,646

(in PLN million, unless stated otherwise)

3.2. Operating expenses

Accounting policies

Cost of gas sold

This item comprises the cost of gas purchased on gas exchanges and from trading partners. The cost of gas purchased includes an appropriate portion of costs of system and transaction charges, costs of domestically produced gas, costs of nitrogen removal and regasification. For details of the valuation of those items, see **Note 6.2.1.**

Raw materials and consumables used

This item comprises the costs of raw materials and consumables used in core activities, in particular fuels for electricity and heat generation. Another material item in this cost group is the cost of electricity for trading.

Employee benefits expense

Employee benefits expense includes in particular salaries, wages and social security contributions. For details of employee benefits expense, see **Note 6.3.1.**

Transmission services

In providing transmission services, the Group pays the costs of gas fuel and heat transmission.

Other services

This item comprises the cost of third-party services required for the core activities of the Group companies, other than transmission services. Other services include in particular:

- Repair and construction services and services related to repairs of production machinery and equipment, in particular equipment associated with heat generation;
- Mineral resources production services related to hydrocarbon production;
- Rental services (mainly rental of real estate).

Taxes and charges

This item includes in particular costs incurred by the Group in relation to property tax and charges for perpetual usufruct of land.

Recognition and reversal of impairment losses on property, plant and equipment and intangible assets

For details of impairment of non-financial assets, see **Note 6.1.3**

Depreciation and amortisation

This item comprises costs of depreciation/amortisation charges on property, plant and equipment and intangible assets, calculated based on the adopted depreciation/amortisation rates (for details, see **Note 6.1.1.** and **Note 6.1.2.**).

	2016	2015
Cost of gas sold	**(18,320)**	**(22,005)**
Gas fuel	(17,624)	(21,731)
Cost of transactions hedging gas prices	(696)	(274)
Other raw materials and consumables used	**(2,427)**	**(2,211)**
Fuels for electricity and heat generation	(715)	(695)
Electricity for trading	(1,190)	(917)
Other raw materials and consumables used	(522)	(599)
Employee benefits expense	**(2,573)**	**(2,714)**
Salaries and wages	(1,910)	(1,839)
Social security contributions	(403)	(423)
Cost of long-term employee benefits	(40)	(72)
Other employee benefits expense	(220)	(380)
Transmission services	**(1,106)**	**(1,156)**
Other services	**(1,412)**	**(1,235)**
Repair and construction services	(203)	(232)
Mineral resources production services	(165)	(168)
Rental services	(98)	(80)
Other services	(946)	(755)
Taxes and charges	**(765)**	**(628)**
Recognition and reversal of impairment losses on property, plant and equipment and intangible assets	**(1,155)**	**(873)**
Cost of exploration and evaluation assets written-off	(319)	(283)
Impairment losses on property, plant and equipment	(825)	(567)
Impairment losses on intangible assets	(11)	(23)
Depreciation and amortisation	**(2,614)**	**(2,790)**
Total	**(30,372)**	**(33,612)**

(in PLN million, unless stated otherwise)

3.3. Other income and expenses

	2016	2015
Compensations, penalties, and fines received	45	36
Exchange differences related to operating activities	128	(94)
Valuation and realisation of derivative financial instruments	(165)	43
Change in inventory write-downs	182	(194)
Change in impairment losses on trade and other receivables	(20)	37
Change in provision for well decommissioning costs	(14)	134
Change in provision for certificates of origin and energy efficiency certificates	(112)	(184)
Change in other provisions	(2)	18
Other income and costs	(374)	(311)
Total other income and expenses	**(332)**	**(515)**

3.4. Net finance costs

	2016	2015
Interest on debt [including fees]	(209)	(156)
Foreign exchange differences	(26)	(86)
Valuation and realisation of derivative financial instruments not covered by hedge accounting	59	(39)
Other net finance costs	100	56
Total net finance costs	**(76)**	**(225)**

3.5. Dividend paid and proposed

	2016	2015
Dividends declared and paid in period		
Dividend per share paid (PLN)	0.18	0.20
Number of shares	5,778	5,900
Dividend paid	**1,062**	**1,180**
dividend paid to owners of the parent	1,062	1,180

4. Notes on taxation

4.1. Income tax

Accounting policies

Mandatory increases in loss/decreases in profit include current income tax (CIT) and deferred tax.

Deferred tax is determined using the balance-sheet method, based on temporary differences between the carrying amounts of assets and liabilities for accounting purposes and their tax base, except where temporary differences arise from the initial recognition of an asset or liability in a transaction which is not a business combination and, at the time of the transaction, affected neither profit before tax nor taxable income (tax loss).

Deferred tax assets and liabilities are measured at tax rates that are expected to apply to the period when the asset will be realised or the liability will be settled.

A deferred tax asset is recognised to the extent it is probable that taxable profit will be available against which deductible temporary differences, including tax losses and tax credit, can be utilised. For more information on tax credit, see **Note 4.1.1.**

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries, joint ventures and associates, unless the Group company controls the timing of the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are offset if and only if the Group:

- Has a legally enforceable right to set off current tax assets against current tax liabilities; and
- The deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on the same taxable entity.

Deferred and current tax is recognised as income or expense, except to the extent that the tax arises from a transaction or event that is credited or charged directly to other comprehensive income or to equity (deferred tax is then recognised in other comprehensive income or charged directly to equity).

Tax group

PGNiG SA was a representative of the PGNiG Tax Group under the agreement concluded in 2014, which expired on December 31st 2016. On September 19th 2016, a new agreement was signed to establish the PGNiG Tax Group for the tax years 2017–2020.

In the current reporting period the PGNiG Tax Group comprises: PGNiG S.A., PGNiG Obrót Detaliczny Sp. z o.o., PSG Sp. z o.o., PGNiG TERMIKA S.A., OSM Sp. z o.o., PGNiG SPV 5 Sp. z o.o., PGNiG SPV 6 Sp. z o.o., PGNiG SPV 7 Sp. z o.o.

The agreement to establish the PGNiG Tax Group for 2017–2020 was signed by the above companies and also by GEOFIZYKA Toruń S.A., PGNiG Technologie S.A. and PGNiG Serwis Sp. z o.o.

The other Group companies are separate CIT taxpayers. In accordance with applicable tax regulations, the companies included in the PGNiG Tax Group lost their separate status as CIT payers and such status was acquired by the PGNiG Tax Group, which allows CIT to be calculated jointly for the PGNiG Tax Group members.

The PGNiG Tax Group is a separate entity exclusively for the purposes of corporate income tax, and it should not be viewed as a separate legal person. Also, its separate tax status does not extend to other taxes; in particular, each of the PGNiG Tax Group member companies is a separate payer of VAT and of tax on civil-law transactions, and a separate remitter of personal income tax withholdings.

(in PLN million, unless stated otherwise)

4.1.1. Income tax expense disclosed in the statement of profit or loss

Reconciliation of effective tax rate	2016	2015	
Profit before tax	3,210	3,014	
Corporate income tax at the 19% statutory rate applicable in Poland	(610)	(573)	
Differences in tax rates of the Group companies (from 24% to 78% for Norway, 33% for Germany, from 12% to 40% for other)	(135)	(173)	
Deductible temporary differences in respect of which no deferred tax was recognised	(116)	(132)	
Income tax expense disclosed in the statement of profit or loss	**(861)**	**(878)**	
Including:			
Current tax expense	(712)	(697)	
Deferred tax expense	(149)	(181)	*Note 4.1.2.*
Effective tax rate	27%	29%	

In the case of PGNiG Upstream International AS (“PUI”), the tax rate is 78%. PUI’s activities in the Norwegian Continental Shelf in 2016 were subject to taxation under two separate tax systems:

- The corporate income tax system (tax rate of 25%; in 2015: 27%), and
- The petroleum tax system (additional tax rate of 53%; in 2015: 51%).

The high tax rate in Norway comes with a wide range of investment incentives and additional deductions.

- For instance, the company may apply a high depreciation/amortisation rate (the annual depreciation/amortisation rate is 16.67%) and commence depreciation/amortisation immediately after capital expenditure is incurred. In the year in which capital expenditure is incurred, the company is entitled to charge depreciation/amortisation for the full year, regardless of the date when it was actually incurred.
- The company may benefit from an investment incentive of 5.5% per annum for four years under the petroleum tax regime. The incentive relates to capital expenditure made in the Norwegian Continental Shelf (excluding exploration expenditure) and amounts to 22% of depreciable expenditure (5.5% over four years; however, for projects commenced before May 2013 the incentive is 30%, i.e. 7.5% over four years). The incentive is deducted only from income taxable with the petroleum tax (53% rate; in 2015: 51%) and does not apply to income tax. If the incentive amount exceeds income generated in a given year, it becomes deductible in subsequent years.
- Total expenditure on exploration activities may be deducted from revenue. If a company does not generate income from which expenditure on exploration could be deducted, it is entitled to reimbursement of 78% of the exploration expenditure. The funds are returned in cash by the end of the year following the year covered by the tax return.
- Finance costs may be deducted under both taxation systems.

Under the Norwegian tax system there is no time limit within which tax losses should be used, and interest accrues on losses carried forward. The interest rate applicable to such losses is calculated as a risk-free interest rate, net of income tax (25%; in 2015: 27%). Tax losses incurred by PUI in earlier years (until 2012), increased by the accrued interest, reduce its current tax expense. Therefore, throughout the entire period of its existence, i.e. starting from its establishment until the end of 2016, the company paid no income tax in Norway.

Current income tax	2016	2015
At beginning of period (tax receivables and payables, net)	(46)	(186)
Income tax expense recognised in profit or loss of the period	(712)	(697)
Tax paid in the period	611	833
Other changes	5	4
At end of period (tax receivables and payables, net)	**(142)**	**(46)**
including:		
- receivables	38	7
- payables	(180)	(53)
	(142)	**(46)**

(in PLN million, unless stated otherwise)

4.1.2. Deferred tax expense

		CREDITED/(CHARGED)					CREDITED/(CHARGED)				
	Jan 1 2015	Net profit/(loss)	Other comprehensive income	Currency translation differences	Other changes	Dec 31 2015	Net profit/(loss)	Other comprehensive income	Currency translation differences	Other changes	Dec 31 2016
Deferred tax assets											
Employee benefit obligations	120	(6)	1	-	-	115	5	8	-	4	132
Provision for well decommissioning costs	141	(14)	-	-	-	127	10	-	-	-	137
Other provisions	157	31	1	-	(11)	178	(71)	(3)	-	3	107
Investment tax credit (Norway)	305	4	-	(20)	-	289	(73)	-	26	-	242
Valuation of derivatives	136	137	-	1	-	274	(140)	-	4	-	138
Impairment of property, plant and equipment	144	59	-	-	-	203	38	-	-	(1)	240
Tax loss	602	(350)	-	(18)	(17)	217	(120)	-	16	-	113
Other	177	8	-	-	(13)	172	(47)	-	-	47	172
Total	**1,782**	**(131)**	**2**	**(37)**	**(41)**	**1,575**	**(398)**	**5**	**46**	**53**	**1,281**
Deferred tax liabilities											
Difference between tax and accounting value of non-current assets	2,985	(79)	-	(77)	-	2,829	(965)	-	84	6	1,954
Valuation of derivative financial instruments	120	141	(82)	2	-	181	(144)	149	4	-	190
Other	144	(12)	-	-	(52)	80	860	-	27	2	969
Total	**3,249**	**50**	**(82)**	**(75)**	**(52)**	**3,090**	**(249)**	**149**	**115**	**8**	**3,113**
Set-off of assets and liabilities	**(1,724)**					**(1,533)**	**-**				**(1,181)**
After set-off											
Assets	**58**					**42**	**(398)**				**100**
Liabilities	**1,525**					**1,557**	**(249)**				**1,932**
Net effect of changes in the period		**(181)**	**84**	**38**	**11**		**(149)**	**(144)**	**(69)**	**45**	

(in PLN million, unless stated otherwise)

5. Notes to the statement of cash flows and information on debt

5.1. Reconciliation of debt

Accounting policies

The Group defines **net debt** as the total of existing bank borrowings (both current and non-current), debt securities, lease liabilities and liabilities under non-bank borrowings, less cash and cash equivalents and cash classified as non-current assets. The Group presents net debt to EBITDA as a measure of its debt.

Net debt	2016	2015	
Bank borrowings	1,180	1,241	
Debt securities	143	4,514	
Other	23	44	
Total liabilities under non-current debt	**1,346**	**5,799**	
Bank borrowings	143	283	
Debt securities	4,841	258	
Other	22	42	
Total liabilities under current debt	**5,006**	**583**	
Total debt	**6,352**	**6,382**	
Cash and cash equivalents	5,829	6,022	*Note 5.4.*
Net debt	**523**	**360**	
EBITDA	**5,974**	**6,080**	*Note 2.2.*
Net debt / EBITDA	**0.09**	**0.06**	

Change in debt	Bank borrowings	Debt securities	Other	Total
As at Jan 1 2015	**814**	**4,894**	**130**	**5,838**
Increase in debt	1,597	362	-	1,959
financing received	1,586	362	-	1,948
transaction costs	11	-	-	11
Interest accrued	72	109	5	186
Debt-related payments	(1,023)	(501)	(54)	(1,578)
principal repayments	(927)	(390)	(49)	(1,366)
interest paid	(71)	(111)	(5)	(187)
commission fees paid	(25)	-	-	(25)
Exchange differences on debt in foreign currencies	64	(92)	2	(26)
Finance lease	-	-	3	3
As at Dec 31 2015	**1,524**	**4,772**	**86**	**6,382**
Increase in debt	317	147	-	464
financing received	304	147	-	451
transaction costs	13	-	-	13
Interest accrued	67	17	4	88
Debt-related payments	(554)	(408)	(59)	(1,021)
principal repayments	(478)	(270)	(55)	(803)
interest paid	(68)	(138)	(4)	(210)
commission fees paid	(8)	-	-	(8)
Exchange differences on debt in foreign currencies	(56)	261	(1)	204
Finance lease	-	-	2	2
Changes in the Group	25	195	13	233
As at Dec 31 2016	**1,323**	**4,984**	**45**	**6,352**

(in PLN million, unless stated otherwise)

5.2. Financing liabilities

Accounting policies

The Group's financing liabilities are classified under three main categories: bank borrowings, debt securities and other financing liabilities (including chiefly finance lease liabilities and non-bank borrowings). On initial recognition, all financing liability categories are measured at fair value less transaction costs. As at the reporting date, financing liabilities are measured at amortised cost with the use of the effective interest rate method.

2016	In functional currency – PLN	In foreign currency	
		EUR	USD
Bank borrowings	36	715	572
Debt securities	2,698	2,286	-
Other	9	-	36
Total, including:	**2,743**	**3,001**	**608**
floating-rate	2,739	715	608
fixed-rate	4	2,286	-

2015	In functional currency – PLN	In foreign currency	
		EUR	USD
Bank borrowings	203	747	574
Debt securities	2,579	2,193	-
Other	33	1	52
Total, including:	**2,815**	**2,941**	**626**
floating-rate	2,813	748	626
fixed-rate	2	2,193	-

Interest on floating-rate debt denominated in the Polish złoty is calculated based on 1M WIBOR, 3M WIBOR or 6M WIBOR rates; USD-denominated debt: 1M LIBOR and 3M LIBOR rates; EUR-denominated debt: EONIA, 1M EURIBOR and 3M EURIBOR rates. Fixed interest rate is applicable only to EUR-denominated debt securities and stands at 4%. The Group's debt is subject to interest rate risk, currency risk and liquidity risk. For detailed information on these risks, see **Note 7.3**.

As at December 31st 2016, the Company operated the following debt security issue programmes:

Issue agreement date	Agreement valid until	Subject matter	Banks participating in the issue as at the reporting date	Issue limit	Utilisation (%) as at Dec 31 2016	Outstanding debt (PLNbn) 2016	Outstanding debt (PLNbn) 2015
Authorised issuer: **PGNiG S.A.**							
Jun 10 2010	Jul 31 2020	Note issuance programme for short-term discount notes and coupon-bearing notes with maturities from one to twelve months	Bank Pekao S.A., ING Bank Śląski S.A., PKO BP S.A., Bank Handlowy w Warszawie S.A., Societe Generale S.A., BGŻ BNP Paribas S.A. Polish Branch, mBank S.A. and Bank Zachodni WBK S.A.	PLN 7bn	-	-	-
May 22 2012	May 22 2027	Note issuance programme	Bank Pekao S.A. and ING Bank Śląski S.A.	PLN 4.5bn	55.6 %	2.5	2.5
Oct 2 2014	Sep 30 2024	Note issuance programme for notes with maturities of at least 12 months[1]	Bank Gospodarstwa Krajowego	PLN 1bn	-	-	-
Authorised issuers: **PGNiG S.A.** and **PGNiG Finance AB**							
Aug 25 2011	Feb 14 2017	Euro medium-term note programme (notes with maturities of up to ten years)	Societe Generale S.A., BGŻ BNP Paribas S.A. and Unicredit Bank AG	EUR 1.2bn	41.6 %	2.2	2.1
Authorised issuer: **PGNiG TERMIKA S.A.**							
Jul 4 2012	Dec 29 2019 [2]	Note issuance programme for coupon-bearing notes or discount notes	ING Bank Śląski S.A., PKO Bank Polski S.A., Nordea Bank Polska S.A. and Bank Zachodni WBK S.A.	PLN 1.5bn	-	-	0.1
Authorised issuer: **Spółka Energetyczna Jastrzębie S.A.**							
Oct 17 2013	Dec 20 2017[3] Sep 20 2017[3]	Note issuance programme	Bank Gospodarstwa Krajowego, Alior Bank S.A.	PLN 0.42bn	4.8 %	0.2	-

1. In accordance with the agreement, the note issue proceeds may only be used to finance capital expenditure, including on maintaining producing capacities, diversification of gas supply sources, oil and gas exploration and appraisal, development of the power segment and ongoing projects involving the construction of storage infrastructure.
2. May be extended until December 29th 2021
3. The Programme provides for multiple note issues in two tranches:
   - Tranche A, worth up to PLN 369m, with proceeds allocated to the financing of the Investment Programme, including by transferring the proceeds to the issuer's group companies carrying out the Investment Programme, and to the refinancing of capital expenditure incurred by the issuer or its group companies to carry out the Investment Programme;
   - Tranche B, worth up to PLN 51m, with proceeds allocated to the financing of the objectives of Tranche A and working capital needs (including redemption of Tranche B notes).

As at December 31st 2016, fair value of the liability under Eurobonds issued by PGNiG Finance A.B. was PLN 2,224.8m, and its carrying amount was PLN 2,286.4m (December 31st 2015: PLN 2,204m, carrying amount at PLN 2,193.2m). The fair value was classified as Level 1 of the fair value hierarchy, and was determined based on market prices of the Eurobonds.

As at December 31st 2016 and December 31st 2015, the fair value of the Company's other financial assets and liabilities measured at amortised cost did not materially differ from their carrying amounts.

Financing liabilities of PLN 3,029m (2015: PLN 1,390m) are secured with property, plant and equipment with a carrying amount of PLN 6,965m (2015: PLN 3,994m).

In the current and comparative periods, the Group repaid its financing liabilities in a timely manner. In the reporting period and as at the date of authorisation of these financial statements for issue, there were no instances of default under material provisions of any credit facility, loan, or debt securities issue agreement that could trigger accelerated repayment.

(in PLN million, unless stated otherwise)

5.2.1. Financing available but not drawn

	2016			2015		
	Obtained limit	Drawn	Undrawn	Obtained limit	Drawn	Undrawn
Credit facilities	2,064	(1,272)	792	2,350	(1,487)	863
Debt securities	19,723	(4,904)	14,819	19,093	(4,732)	14,361
Total	**21,787**	**(6,176)**	**15,611**	**21,443**	**(6,219)**	**15,224**

5.3. Equity and capital management policy

Accounting policies

Share capital is disclosed at par value, in the amount specified in the Parent's Articles of Association and the entry in the court register.

Share premium comprises the positive difference between the issue price of shares and the par value of the shares which remains after covering issue costs.

Accumulated other comprehensive income includes exchange differences on translating foreign operations, effects of the application of cash-flow hedge accounting which are taken to equity, actuarial gains and losses on employee benefits, and valuation of financial assets available for sale.

Retained earnings are the aggregate of the profit for the reporting period and accumulated profits brought forward which were not distributed as dividend but were transferred to reserve funds or remained undistributed.

PGNiG SA's largest shareholder is the State Treasury, which as at December 31st 2016 held 71.88% of the Company's shares, and is the entity having control of the Group. For detailed information on the shareholding structure, see Section 9.1 of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group.

As at the end of the previous reporting period, the share capital comprised 5,900m shares with a par value of PLN 1 per share; the total value of the share capital was PLN 5,900m. In 2016, the Parent bought back 121,685,143 shares for cancellation. On November 24th 2016, the Parent's Extraordinary General Meeting resolved on cancellation of 121,685,143 ordinary bearer shares with a par value of PLN 1 per share as well as reduction of the share capital and creation of a capital reserve.

As at the end of 2016, the share capital comprised 5,778,314,857 shares with a par value of PLN 1 per share.

In the reporting period, the Annual General Meeting of PGNiG S.A. decided to allocate PLN 1,062m to dividend payment (which translated into dividend of PLN 0.18 per share) (2015: PLN 1,180m, i.e. PLN 0.20 per share). The dividend was approved on June 28th 2016, and the dividend record date was set for July 20th 2016.

For detailed information on the dividend policy, see Directors' Report on the operations of PGNiG S.A. and the PGNiG Group.

The key objective of the Group's capital management is to maintain the ability to continue its operations, taking into account investment plans, while increasing the Group's shareholder value. Furthermore, the PGNiG Group monitors its ability to pay liabilities based on the net debt to EBITDA ratio.

(in PLN million, unless stated otherwise)

5.4. Cash and cash equivalents

Accounting policies

Cash and cash equivalents include cash at bank and in hand as well as highly liquid short-term financial assets with the original maturity of up to three months, which are readily convertible into specific cash amounts and subject to an insignificant risk of fluctuation in value.

In the statement of cash flows, cash and cash equivalents are presented net of outstanding current account debt.

	2016	2015
Cash in hand	1	1
Cash at banks	875	507
Bank deposits	4,593	5,285
Other cash	360	229
Total	**5,829**	**6,022**
including restricted cash	742	495

The Group classifies the following as cash equivalents: commercial bills, treasury bills, NBP bills, certificates of deposit, cash in transit, cheques and third-party notes maturing in less than three months.

For details of changes in cash in the period, see **Note 5.4**.

Risks associated with cash and cash equivalents include the credit risk, foreign exchange risk, and interest rate risk. For detailed information on these risks, see **Note 7.3**.

Based on agency ratings	**2016**	**2015**
A+ rated banks according to Fitch	532	656
A rated banks according to Fitch	1,289	-
A- rated banks according to Fitch	2,314	3,203
A2 rated banks according to Moody's	321	799
BB rated banks according to Fitch	24	-
BB- rated banks according to Fitch	16	32
BBB rated banks according to Fitch	92	592
BBB+ rated banks according to Fitch	5	3
Total cash deposits at banks	**4,593**	**5,285**

(in PLN million, unless stated otherwise)

5.5. Additional information on consolidated statement of cash flows

5.5.1. Reconciliation of movements in working capital with the statement of cash flows

2016	Difference resulting from the statement of financial position	Change in current tax receivable/payable	Net cash from investing activities	Net cash from financing activities	Changes in the Group	Non-monetary transactions	Net cash from operating activities (movements in working capital)
Inventories	(281)	-	-	-	16	-	(265)
Receivables	(909)	31	149	-	131	17	(581)
Other assets	17	-	(4)	(5)	10	-	18
Trade and tax payables	414	(127)	67	-	(105)	(15)	234
Employee benefit obligations	(18)	-	-	-	(31)	136	87
Provision for well decommissioning costs	(13)	-	(62)	-	-	101	26
Other provisions	(101)	-	-	-	(8)	10	(99)
Other liabilities	178	-	(25)	-	(3)	(113)	37
Total working capital	**(713)**	**(96)**	**125**	**(5)**	**10**	**136**	**(543)**

2015	Difference resulting from the statement of financial position	Change in current tax receivable/payable	Net cash from investing activities	Net cash from financing activities	Changes in the Group	Non-monetary transactions	Net cash from operating activities (movements in working capital)
Inventories	960	-	-	-	-	-	960
Receivables	862	2	(9)	-	-	(19)	836
Other assets	(14)	-	-	(8)	-	8	(14)
Trade and tax payables	(541)	138	21	-	-	25	(357)
Employee benefit obligations	68	-	-	-	-	(39)	29
Provision for well decommissioning costs	5	-	17	-	-	(40)	(18)
Other provisions	(31)	-	-	-	-	(35)	(66)
Other liabilities	29	-	(37)	-	-	(70)	(78)
Total working capital	**1,338**	**140**	**(8)**	**(8)**	**-**	**(170)**	**1,292**

5.5.2. Other non-monetary adjustments to the statement of cash flows

	2016	2015
Net interest and dividend	27	127
Net foreign exchange gains/(losses)	208	(24)
Profit/(loss) from equity-accounted investees	74	51
Derivative financial instruments	71	28
Written-off expenditure on non-financial non-current assets	322	284
Acquired CO_2 emission allowances	(95)	(90)
Other items, net	(239)	54
Other non-monetary adjustments	**368**	**430**

(in PLN million, unless stated otherwise)

5.5.3. Reconciliation of cash as presented in the statement of cash flows with the statement of financial position

	2016	2015
1) Cash in the statement of financial position at beginning of period	6,022	2,728
a) Net exchange differences on cash at beginning of period	1	2
Cash and cash equivalents in the statement of cash flows at beginning of period (1-a)	**6,021**	**2,726**
2) Cash in the statement of financial position at end of period	5,829	6,022
b) Net exchange differences on cash at end of period	(3)	1
Cash and cash equivalents in the statement of cash flows at end of period (2-b)	**5,832**	**6,021**
I. Change in cash in the statement of financial position (2-1)	(193)	3,294
II. Change in net exchange differences on cash (b-a)	(4)	(1)
Change in cash in the statement of cash flows (I. - II.)	**(189)**	**3,295**

(in PLN million, unless stated otherwise)

6. Notes to the statement of financial position

6.1. Non-current property, plant and equipment and intangible assets

6.1.1. Property, plant and equipment and related provisions

Accounting policies

Property, plant and equipment

The most material items of property, plant and equipment are buildings and structures, and plant and equipment, mostly associated with exploration for and production of natural gas and crude oil, as well as with gas trading, storage and distribution. The Group also holds vehicles and land. Tangible assets under construction include mostly capitalised expenditure on exploration for and evaluation of oil and gas deposits incurred until production commences or the assets are written off (for detailed accounting policies, see 'Exploration and evaluation assets').

Material spare parts and maintenance equipment are disclosed as property, plant and equipment if the Group expects to use such spare parts or equipment for a period longer than one year and they may be assigned to specific items of property, plant and equipment.

Property, plant and equipment are carried at cost less accumulated depreciation and impairment (for information on policies governing the recognition of impairment, see **Note 6.1.3**.).

The initially recognised cost of gas pipelines and gas storage facilities (classified in buildings and structures) includes the value of gas used to fill the pipelines or facilities for the first time. The amount of gas required to fill a pipeline or a storage chamber for the first time equals the amount required to obtain the minimum operating pressure in the pipeline or chamber.

The cost of property, plant and equipment includes also borrowing costs.

Costs of day-to-day maintenance and repairs of property, plant and equipment are expensed as incurred. In the event of a leak, the costs of pipeline refilling or replacing lost fuel are charged to profit or loss in the period when they were incurred.

The Group uses the following depreciation methods and periods:

Category	Depreciation method	Useful life	Average remaining useful life as at the reporting date
Buildings and structures	Straight-line method	1−50 years	29
Plant and equipment	Straight-line method	1−41 years	15
Vehicles	Straight-line method	1−35 years	13
Other property, plant and equipment	Straight-line method	1−35 years	13
Reserves in the Norwegian Continental Shelf	Units of production method*	more than 10 years	more than 10 years
Land		Not depreciated	
Tangible assets under construction		Not depreciated	

*The amounts of production and products sold are strongly correlated, and contracts on sale of hydrocarbons from the Norwegian Continental Shelf preclude major discrepancies between the production volumes and sales volumes, which justifies the applied amortisation method.

Exploration and evaluation assets

Natural gas and crude oil exploration and evaluation expenditure covers geological work performed to discover and document deposits and is accounted for with the successful efforts method.

Natural gas and/or crude oil (mineral) deposits can be evaluated once the Group obtains:

- A licence for appraisal of mineral deposits,
- A licence for exploration for and appraisal of mineral deposits,
- A signed agreement establishing mining rights.

The cost of a licence for appraisal of natural gas and/or crude oil deposits and the cost of its extension is equal to the fees charged for conducting the licensed operations. The Group recognises the costs of such appraisal licences as intangible assets.

Expenditure on seismic surveys is capitalised in exploration and evaluation assets.

Expenditure incurred on individual wells is initially capitalised in tangible exploration and evaluation assets under construction. If exploration activities are successful and lead to a discovery of recoverable reserves, the Group analyses the areas and prospects to determine whether production would be economically viable. If following the appraisal process a decision is made to launch commercial production of hydrocarbons, the Group reclassifies the tangible exploration and evaluation assets under construction to property, plant and equipment after the production launch. If exploration is unsuccessful or the Group entity does not file for a licence for appraisal of natural gas and/or crude oil reserves following an analysis of the areas and prospects in terms of economic viability of commercial production, the full amount of capitalised expenditure incurred on the wells drilled in the exploration phase is expensed to profit or loss in the period in which the decision to discontinue exploration was made. Capitalised seismic survey expenses related to a given prospect are also recognised in profit or loss.

(in PLN million, unless stated otherwise)

The Group recognises provisions for costs of decommissioning of exploration, production and storage wells (for details, see **Note 6.1.1.1.**). Discounted amounts of such provisions are added to the initial cost of wells recognised in exploration and evaluation assets or in property, plant and equipment, and in the latter case are depreciated over the useful lives of the items to which they relate.

Material estimates

Useful lives of property, plant and equipment

The useful lives of the property, plant and equipment were determined on the basis of assessments made by the engineering personnel responsible for their operation. Any such assessment is connected with uncertainty as to the future business environment, technology changes and market competition, which could lead to a different assessment of the economic usefulness of the assets and their remaining useful lives, and ultimately have a material effect on the value of the property, plant and equipment and the future depreciation charges.

The Group reviews the useful lives of property, plant and equipment on an annual basis. As a result of the most recent review, made as at December 31st 2016, depreciation was reduced by about PLN 118m.

	2016			2015		
	Gross carrying amount	Accumulated depreciation and impairment	Net carrying amount	Gross carrying amount	Accumulated depreciation and impairment	Net carrying amount
Land	93	(13)	80	78	(11)	67
Buildings and structures	32,351	(14,217)	18,134	30,570	(12,515)	18,055
Plant and equipment	16,188	(7,587)	8,601	14,552	(6,034)	8,518
Vehicles and other	2,817	(1,678)	1,139	2,704	(1,523)	1,181
Total tangible assets	**51,449**	**(23,495)**	**27,954**	**47,904**	**(20,083)**	**27,821**
Tangible exploration and evaluation assets under construction	3,761	(1,609)	2,152	3,637	(1,400)	2,237
Other tangible assets under construction	3,099	(56)	3,043	2,961	(52)	2,909
Total property, plant and equipment	**58,309**	**(25,160)**	**33,149**	**54,502**	**(21,535)**	**32,967**

The Group has off-balance-sheet liabilities under executed agreements on acquisition of property, plant and equipment which have not yet been disclosed in the statement of financial position.

	2016	2015
Obligations assumed under agreements on acquisition of property, plant and equipment	6,683	6,532
Portion discharged as at the reporting date	(2,289)	(2,767)
Contractual obligations to be met after the reporting date	**4,394**	**3,765**

(in PLN million, unless stated otherwise)

For information on property, plant and equipment serving as collateral for the repayment of financing liabilities, see Note 5.2.

	Land	Buildings and structures	Plant and equipment	Vehicles and other	Total tangible assets	Tangible assets under construction		Total property, plant and equipment	
						Tangible exploration and evaluation assets	Other		
Gross carrying amount as at Jan 1 2015	**78**	**28,536**	**13,467**	**2,583**	**44,664**	**3,183**	**4,405**	**52,252**	
Accumulated depreciation	-	(10,334)	(4,632)	(1,352)	**(16,318)**	-	-	**(16,318)**	
Impairment losses	(7)	(1,030)	(233)	(20)	**(1,290)**	(1,035)	(81)	**(2,406)**	
Net carrying amount as at Jan 1 2015	**71**	**17,172**	**8,602**	**1,211**	**27,056**	**2,148**	**4,324**	**33,528**	
Exchange differences on translating foreign operations	-	6	(199)	-	**(193)**	38	(38)	**(193)**	
Purchase	-	-	-	-	**-**	769	2,385	**3,154**	
Disposal	(1)	(14)	(2)	(3)	**(20)**	-	-	**(20)**	
Provision for well decommissioning costs	-	36	-	-	**36**	24	72	**132**	*Note 6.1.1.1.*
Transfers from tangible assets under construction	1	2,200	1,425	192	**3,818**	(300)	(3,682)	**(164)**	
Transfers between asset groups and between items of the statement of financial position	-	(48)	20	-	**(28)**	186	(186)	**(28)**	
Depreciation	-	(1,111)	(1,268)	(214)	**(2,593)**	-	-	**(2,593)**	
Impairment losses	(4)	(148)	(44)	(4)	**(200)**	(365)	29	**(536)**	
Capitalised interest	-	-	-	-	**-**	16	46	**62**	
Retirement	-	(36)	(12)	(1)	**(49)**	-	-	**(49)**	
Tangible assets under construction written off without bringing economic effects	-	-	-	-	**-**	(283)	(2)	**(285)**	
Other changes	-	(2)	(4)	-	**(6)**	4	(39)	**(41)**	
Gross carrying amount as at Dec 31 2015	**78**	**30,570**	**14,552**	**2,704**	**47,904**	**3,637**	**2,961**	**54,502**	
Accumulated depreciation	-	(11,337)	(5,757)	(1,499)	**(18,593)**	-	-	**(18,593)**	
Impairment losses	(11)	(1,178)	(277)	(24)	**(1,490)**	(1,400)	(52)	**(2,942)**	
Net carrying amount as at Dec 31 2015	**67**	**18,055**	**8,518**	**1,181**	**27,821**	**2,237**	**2,909**	**32,967**	

	Land	Buildings and structures	Plant and equipment	Vehicles and other	Total tangible assets	Tangible assets under construction		Total property, plant and equipment	
						Tangible exploration and evaluation assets	Other		
Gross carrying amount as at Dec 31 2015	**78**	**30,570**	**14,552**	**2,704**	**47,904**	**3,637**	**2,961**	**54,502**	
Accumulated depreciation	-	(11,337)	(5,757)	(1,499)	**(18,593)**	-	-	**(18,593)**	
Impairment losses	(11)	(1,178)	(277)	(24)	**(1,490)**	(1,400)	(52)	**(2,942)**	
Net carrying amount as at Dec 31 2015	**67**	**18,055**	**8,518**	**1,181**	**27,821**	**2,237**	**2,909**	**32,967**	
Exchange differences on translating foreign operations	**-**	**(1)**	**269**	**-**	**268**	**36**	**80**	**384**	
Purchase	-	-	-	-	**-**	675	2,243	**2,918**	
Disposal	-	(2)	-	(2)	**(4)**	-	-	**(4)**	
Provision for well decommissioning costs	-	(19)	-	-	**(19)**	14	67	**62**	*Note 6.1.1.1.*
Transfers from tangible assets under construction	2	1,617	904	198	**2,721**	(286)	(2,490)	**(55)**	
Transfers between asset groups and between items of the statement of financial position	-	(55)	14	1	**(40)**	(11)	11	**(40)**	
Depreciation	-	(1,116)	(1,080)	(212)	**(2,408)**	-	-	**(2,408)**	
Impairment losses	(2)	(458)	(124)	(19)	**(603)**	(209)	(4)	**(816)**	
Changes in the Group	14	154	148	4	**320**	-	192	**512**	
Capitalised interest	-	-	-	-	**-**	16	45	**61**	
Retirement	-	(36)	(30)	(7)	**(73)**	-	-	**(73)**	
Tangible assets under construction written off without bringing economic effects	-	-	-	-	**-**	(318)	(3)	**(321)**	
Other changes	(1)	(5)	(18)	(5)	**(29)**	(2)	(7)	**(38)**	
Gross carrying amount as at Dec 31 2016	**93**	**32,351**	**16,188**	**2,817**	**51,449**	**3,761**	**3,099**	**58,309**	
Accumulated depreciation	-	(12,581)	(7,186)	(1,635)	**(21,402)**	-	-	**(21,402)**	
Impairment losses	(13)	(1,636)	(401)	(43)	**(2,093)**	(1,609)	(56)	**(3,758)**	
Net carrying amount as at Dec 31 2016	**80**	**18,134**	**8,601**	**1,139**	**27,954**	**2,152**	**3,043**	**33,149**	

(in PLN million, unless stated otherwise)

6.1.1.1. Provisions related to property, plant and equipment (including the provision for well decommissioning costs)

Accounting policies

Provision for future well decommissioning costs and contributions to the Extraction Facilities Decommissioning Fund.

The Group recognises a provision for future well decommissioning costs and makes contributions to the Extraction Facilities Decommissioning Fund.

The provision for well decommissioning costs is recognised when the Group has the obligation to properly decommission and abandon wells after production is discontinued. When the provision for well decommissioning costs is recognised with respect to wells classified as tangible exploration and evaluation assets, the discounted amount of the provision is added to the amount of those assets, and after the production phase starts, it is depreciated over the expected useful life of the wells (accounting policies in **Note 6.1.1**). Any subsequent adjustments to the provision due to changes in estimates are also recognised as an adjustment to the value of the relevant item of property, plant and equipment. Adjustments to provisions resulting from changes of discount rates are taken to profit or loss. The amount of the provision for future costs of decommissioning of production and storage wells is adjusted for any unused contributions to the Extraction Facilities Decommissioning Fund.

The Extraction Facilities Decommissioning Fund is created on the basis of the Mining and Geological Law, which requires the Group to decommission extraction facilities once their operation is discontinued. Contributions to the Extraction Facilities Decommissioning Fund are recognised in correspondence with other expenses. The assets accumulated in the Extraction Facilities Decommissioning Fund are kept in a separate bank account and may be used only to cover the costs of decommissioning of an extraction facility or its specific part, in particular the costs of:

- Abandonment of and securing production, storage, discharge, observation and monitoring wells;
- Liquidation of redundant facilities and disassembly of machinery and equipment;
- Reclamation of land and development of areas after completion of extraction activities;
- Maintenance of facilities intended for decommissioning in an order ensuring safety of extraction facility operations.

The Fund assets are presented under non-current assets in the statement of financial position, as other assets.

Material estimates

Provision for well decommissioning costs

The amount of the provision for well decommissioning costs is based on the estimates of future asset decommissioning and land reclamation costs, which largely depend on the applied discount rate and the estimate of time when the outflow of cash is expected to take place.

The provision for well decommissioning costs is calculated based on the average cost of well decommissioning at the individual extraction facilities over the last three full years preceding the reporting period, adjusted for the projected consumer price index (CPI) and changes in the time value of money. The adoption of a three-year time horizon was due to the varied number of decommissioned wells and their decommissioning costs in the individual years.

Extraction Facilities Decommissioning Fund

Contributions to the Extraction Facilities Decommissioning Fund are made in the amount of 3% to 10% of the value of the annual tax depreciation of extraction property, plant and equipment (determined in accordance with income tax laws).

Provision for well decommissioning costs	**2016**	**2015**	
At beginning of reporting period	**1,573**	**1,608**	
Recognised provision capitalised in the cost of property, plant and equipment	62	143	*Note 6.1.1.*
Recognised provision taken to profit or loss	37	39	*Note 3.3.*
Other increases – Extraction Facilities Decommissioning Fund	2	3	
Used	(20)	(29)	
Provision reversal taken to profit or loss	(23)	(173)	*Note 3.3.*
Exchange differences on translating foreign operations	30	(18)	
At end of reporting period	**1,661**	**1,573**	
- non-current	1,641	1,540	
- current	20	33	

With respect to the costs of decommissioning of wells and site infrastructure in Poland, in 2016 the discount rate applied to calculate the provision for well decommissioning was 1.04%, and resulted from a 3.57% rate of return on assets and an inflation rate assumed at the NBP's continuous inflation target of 2.5% (as at the end of 2015, the discount rate was 0.48%, and resulted from the rates of 2.99% and 2.5%, respectively).

6.1.2. Intangible assets

Accounting policies

Intangible assets

The Group identifies the following main categories of intangible assets:

- Perpetual usufruct rights to land,
- Software,
- CO_2 emission allowances,
- Licences obtained under the Polish Geological and Mining Law, mining rights and geological information (“Licences”).

Perpetual usufruct rights to land

The Group uses perpetual usufruct rights to land which it has acquired in the market against consideration or obtained from the State Treasury or a local government unit.

Perpetual usufruct rights to land acquired for consideration (from other entities) are presented as intangible assets and amortised over their useful lives. The useful life of a perpetual usufruct right to land acquired for consideration from an entity other than the State Treasury or local government unit is equal to the period from the acquisition date of the perpetual usufruct right to the last day of the perpetual usufruct period set out in the perpetual usufruct agreement. Useful lives of perpetual usufruct rights acquired against consideration range from 40 to 99 years. As at December 31st 2016, the average remaining useful life of perpetual usufruct rights held by the Group was 55 years.

In the case of perpetual usufruct rights obtained under perpetual usufruct agreements made with the State Treasury or a local government unit, the Group discloses in intangible assets the excess of the first payment over the annual perpetual usufruct charge. The useful life of the excess of the first payment over the annual perpetual usufruct charge is equal to the perpetual usufruct period specified in the perpetual usufruct agreement.

Perpetual usufruct rights to land acquired free of charge pursuant to an administrative decision issued under the Amendment to the Act on Land Management and Expropriation of Real Estate of September 20th 1990 are presented only in off-balance-sheet records.

CO_2 emission allowances

Pursuant to the Act on Trading in Greenhouse Gas Emission Allowances, the Group holds CO_2 emission allowances allocated for individual installations.

The Group classifies emission allowances as:

- Acquired for redemption – recognised as intangible assets and measured in accordance with the policies discussed below,
- Acquired for resale – recognised as inventory (**Note 6.2.1**) and measured initially at cost; at the end of each reporting period they are measured at the lower of cost or net realisable value,
- Received free of charge under the National Allocation Plan – recognised as off-balance-sheet items at nominal value (equal to zero).

Licences, mining rights and rights to geological information

In its exploration and production operations, the Group uses licences obtained under the Polish Geological and Mining Law, rights to geological information, and mining rights.

Costs of licences for exploration for and production of natural gas and/or crude oil and charges for the grant of mining rights payable to the State Treasury are disclosed as capitalised expenditure.

Measurement

The Group initially recognises intangible assets at cost. In the case of granted mining rights, the initial value is equal to the charges paid to the State Treasury for the grant of the mining rights.

Subsequent to initial recognition, intangible assets are carried at cost less accumulated amortisation and impairment (for accounting policies relating to impairment, see **Note 6.1.3**.).

Intangible assets are amortised using the straight-line method based on amortisation rates that reflect the expected useful lives of the assets. Acquired CO_2 emission allowances are amortised depending on the actual emission volumes.

(in PLN million, unless stated otherwise)

Material estimates

Useful lives of intangible assets

The useful lives of intangible assets were determined on the basis of assessments made by the engineering personnel responsible for their use. Any such assessment is connected with uncertainty as to the future business environment, technology changes and market competition, which could lead to a different assessment of the economic usefulness of the assets and their remaining useful lives, and ultimately have a material effect on the value of intangible assets and the future amortisation charges.

The estimated amortisation period and amortisation method are reviewed at the end of each financial year. If the forecast useful life of an asset is significantly different from previous estimates, the amortisation period is changed. Such transactions are recognised by the Group as revision of estimates and are recognised in profit or loss in the period in which such estimates are revised.

The most recent review was carried out as at December 31st 2016. As a result of the review, annual amortisation charges were reduced by about PLN 5m.

	Perpetual usufruct rights to land	CO_2 emission allowances	Software	Licences	Other intangible assets	Total
Gross carrying amount as at Jan 1 2015	**682**	**338**	**387**	**279**	**399**	**2,085**
Accumulated amortisation	(15)	(291)	(271)	(104)	(234)	**(915)**
Impairment losses	(4)	-	(2)	(50)	(1)	**(57)**
Net carrying amount as at Jan 1 2015	**663**	**47**	**114**	**125**	**164**	**1,113**
Exchange differences on translating foreign operations	-	-	1	4	-	**5**
Transfer from tangible assets under construction	-	3	122	20	19	**164**
Transfers between asset groups and between items of the statement of financial position	(5)	-	(4)	-	4	**(5)**
Acquisition	-	90	-	-	-	**90**
Disposal	(3)	-	-	-	-	**(3)**
Amortisation	(2)	(59)	(60)	(15)	(61)	**(197)**
Impairment losses	(18)	-	(1)	2	-	**(17)**
Retirement	(1)	-	-	-	(14)	**(15)**
Other changes	5	-	-	(35)	33	**3**
Gross carrying amount as at Dec 31 2015	**677**	**430**	**499**	**243**	**423**	**2,272**
Accumulated amortisation	(16)	(349)	(324)	(94)	(277)	**(1,060)**
Impairment losses	(22)	-	(3)	(48)	(1)	**(74)**
Net carrying amount as at Dec 31 2015	**639**	**81**	**172**	**101**	**145**	**1,138**
Exchange differences on translating foreign operations	-	-	-	2	-	**2**
Transfer from tangible assets under construction	1	2	28	5	19	**55**
Transfers between asset groups and between items of the statement of financial position	(3)	-	-	-	-	**(3)**
Acquisition	-	94	-	-	-	**94**
Disposal	(2)	-	-	-	-	**(2)**
Amortisation	(2)	(89)	(59)	(20)	(35)	**(205)**
Impairment losses	(7)	-	(1)	(5)	(1)	**(14)**
Changes in the Group	8	11	2	-	20	**41**
Retirement	-	-	(1)	(2)	-	**(3)**
Other changes	3	-	-	(27)	-	**(24)**
Gross carrying amount as at Dec 31 2016	**676**	**538**	**529**	**203**	**460**	**2,406**
Accumulated amortisation	(10)	(439)	(384)	(96)	(310)	**(1,239)**
Impairment losses	(29)	-	(4)	(53)	(2)	**(88)**
Net carrying amount as at Dec 31 2016	**637**	**99**	**141**	**54**	**148**	**1,079**

(in PLN million, unless stated otherwise)

6.1.3. Impairment of non-financial assets

Material estimates

Impairment of non-financial assets

Property, plant and equipment and intangible assets are tested for impairment when there are indications of impairment. Impairment tests are based on the comparison of the carrying amount of an asset (or cash-generating unit if the asset does not independently generate separate cash inflows) with its recoverable amount, equal to the higher of its fair value less cost to sell and value in use.

If the recoverable amount is lower than the carrying amount of an asset (or cash-generating unit), the carrying amount is decreased to the recoverable amount of the asset (or cash-generating unit). An impairment loss is recognised as cost of the period in which the impairment loss arose.

Impairment losses recognised in respect of property, plant and equipment as at the end of 2016 are presented in the table below:

	2016		2015	
	Extraction business	Other	Extraction business	Other
Land	(4)	(9)	(3)	(8)
Buildings and structures	(1,429)	(207)	(1,011)	(166)
Plant and equipment	(324)	(77)	(229)	(49)
Vehicles and other	(39)	(4)	(20)	(4)
Tangible assets under construction:				
Tangible exploration and evaluation assets under construction	(1,609)	-	(1,400)	-
Other	(1)	(55)	-	(52)
Total	**(3,406)**	**(352)**	**(2,663)**	**(279)**

In the reporting year, an impairment test was performed for the Group's main operating assets, including oil and gas production assets and tangible assets under construction (wells). Below is presented basic information on the performed tests, relating to those areas where the largest amounts of impairment losses were recognised.

(in PLN million, unless stated otherwise)

Description of cash generating unit: *In the case of assets classified as assets of oil and gas production units, impairment tests were performed for the individual CGUs, represented by specific production units in Poland and in Pakistan*

	2016		2015	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit:	CGU - 158 production units		CGU - 152 production units	
Reasons for impairment / value increase	* Change in macroeconomic assumptions – higher forecast exchange rates in 2016 and increase in hydrocarbon prices as at December 31st 2016. *Update of production forecast to account for new wells coming on stream.	*Change of forecast prices – a drop in hydrocarbon prices as at June 30th 2016. *Update of production forecast to account for deterioration of reservoir conditions experienced by certain production units. *Change of the discount rate in 2016.	*Update of production forecast to account for increased volumes at specific production units following well workovers and other investments. *Change of the discount rate as at December 31st 2015.	*Change of forecast prices – a drop in hydrocarbon prices in 2015. *Update of production forecast to account for deterioration of reservoir conditions experienced by certain production units.
Value in use	18 849		25 103	
Nominal pre-tax discount rate	Poland: 12.12% - 12.28%		Poland: 11.55% - 12.22%	
	Pakistan: 22.09% - 24.18%		Pakistan: no test was performed	
Amount of recognised impairment loss	**128**	**684**	**104**	**400**

Description of cash generating unit: *Impairment tests were performed for individual CGUs, represented by specific wells in Poland*

	2016		2015	
	impairment loss reversal	impairment loss recognition	impairment loss reversal	impairment loss recognition
Description of cash generating unit:	*CGU - 121 wells*		*CGU - 105 wells*	
Reasons for impairment / value increase	* Change in macroeconomic assumptions – higher forecast exchange rates in 2016 and increase in hydrocarbon prices as at December 31st 2016. *Update of production forecast and reduction of planned capex.	*Change in forecast prices – a drop in hydrocarbon prices as at June 30th 2016. *Decision not to proceed to drilling wells following unsatisfactory results of geological work. *Change of discount rate in 2016.	*High forecast production volumes in a long-term horizon. *Change of discount rate as at December 31st 2015.	*Change in forecast prices – a drop in hydrocarbon prices in 2015. *Decision not to proceed to drilling wells following unsatisfactory results of geological work.
Value in use	3 004		3 111	
Nominal pre-tax discount rate	Poland: 13.17% - 13.33%		Poland: 12.60% - 13.16%	
Amount of recognised impairment loss	**24**	**350**	**19**	**461**

(in PLN million, unless stated otherwise)

6.2. Working capital

6.2.1. Inventories

Accounting policies

The Group's most material **inventory items** include:

- Gas fuel and fuels for electricity and heat generation,
- Certificates of origin for electricity obtained in connection with electricity production and certificates of origin for electricity purchased in order to be surrendered for cancellation,
- Energy efficiency certificates,
- Spare parts that do not qualify as property, plant and equipment (**Note 6.1.1.**) and are used or may be used in different facilities.

Inventories are initially measured at cost. As at the reporting date, inventories are measured at the lower of cost and net realisable value.

Gas fuel at storage facilities is measured jointly for all storage units, at the average weighted cost. Changes in the inventories of gas fuel stored in the Underground Gas Storage Facilities for sale and own consumption, as well as balance differences, are measured at the average actual cost, which comprises costs of purchase of gas fuel from all sources, together with an appropriate portion of costs of system and transaction charges, actual costs of production from domestic sources, and costs of nitrogen removal and regasification.

Changes in the inventories of spare parts are measured using the weighted average method. Spare parts are recognised in profit or loss as at the date of their use.

The Group is obliged to obtain and surrender for cancellation certificates of origin for electricity and energy efficiency certificates corresponding to the volume of electricity sold to end customers. Property rights granted to the Group in connection with the production of electricity as well as energy efficiency certificates are disclosed as inventories at market value (in correspondence with revenue) when their receipt becomes probable. Purchased certificates of origin and energy efficiency certificates are recognised at cost. Changes in the certificates are measured using the weighted average method. Certificates of origin for electricity and energy efficiency certificates are accounted for at the time of their cancellation in correspondence with the relevant provision (**Note 6.3.2.**).

Material estimates

Inventory write-downs

If the cost of inventories is not recoverable, the Group recognises a write down to net realisable value.

An exception is spare parts, which are not written down to net realisable value if they are planned to be used.

Certificates of origin for electricity and energy efficiency certificates are written down based on a comparison between their carrying amounts and their net realisable values derived from an active market.

Write-downs of non-moving inventories are determined by way of a case-by-case assessment of their usefulness, based on the following assumptions:

Inventories of purchased materials which are idle for a period of:	Write-down rate
1–5 years	Generally, a write-down of 20% is recognised; where the case-by-case assessment of usefulness, the possibility of using a category of materials, and their cycle structure, is taken into account, the Group may recognise write-downs of 5% and 10% of the value of the materials
5–10 years	20%−100%
More than 10 years	100% for materials which are useless and intended for sale or scrapping

(in PLN million, unless stated otherwise)

Inventories	2016			2015		
	Initial value	Write-downs	Net carrying amount	Initial value	Write-downs	Net carrying amount
Materials, including:	2,463	(119)	2,344	2,407	(306)	2,101
gas fuel	1,788	(53)	1,735	1,748	(257)	1,491
fuels for electricity and heat generation	255	-	255	278	-	278
crude oil	17	-	17	14	-	14
spare parts	66	-	66	73	-	73
other materials	337	(66)	271	294	(49)	245
Certificates of origin for electricity	157	(5)	152	79	(3)	76
Other inventories	18	(4)	14	52	-	52
Total	**2,638**	**(128)**	**2,510**	**2,538**	**(309)**	**2,229**

Changes in write-downs	2016	2015
Write-downs at beginning of period	**(309)**	**(113)**
Taken to profit or loss, including:		
Recognised write-downs taken to profit or loss	(82)	(267)
Write-down reversal taken to profit or loss	264	73
Used write-downs	1	-
Currency translation differences	(2)	-
Other changes	-	(2)
Write-downs at end of period	**(128)**	**(309)**

(in PLN million, unless stated otherwise)

6.2.2. Receivables

Accounting policies

Receivables include chiefly current trade receivables (mainly in connection with sale of gas fuel), taxes, customs duties and social security.

Current trade receivables are initially recognised at fair value, equal to their nominal value. Following initial recognition, receivables are measured at amortised cost, taking into account impairment losses, if any.

Taxes, customs duties and social security receivable by the Group are determined in accordance with applicable laws and regulations.

Material estimates

The amount of impairment loss on receivables equals the difference between the carrying amount of an asset and the present value of estimated future cash flows discounted at the asset's original effective interest rate.

Depending on the type of receivables, impairment losses are determined using the statistical or individual method.

The Group recognises impairment losses on receivables using the **individual method** if the receivable is past due by more than 90 days or if the receivable is at risk (e.g. the debtor has filed for bankruptcy). Impairment loss is recognised for 100% of the amount of such a receivable.

Impairment losses on receivables for gas deliveries to customers from tariff groups 1−4 (chiefly retail customers and SMEs) are determined using the **statistical method**. The impairment losses are determined based on the analysis of historical data on payment of past due receivables in particular maturity groups. The results of the analysis are then used to calculate recovery ratios on the basis of which the amounts of impairment losses on receivables in each ageing group are determined.

Impairment losses are charged to other expenses or finance costs, as appropriate, depending on the type of receivables for which an impairment loss is recognised.

Receivables	2016			2015		
	Gross carrying amount	Impairment losses	Net carrying amount	Gross carrying amount	Impairment losses	Net carrying amount
Trade receivables (mainly in connection with sale of gas fuel)	3,834	(318)	3,516	2,899	(358)	2,541
VAT receivable	375	(1)	374	431	-	431
Corporate income tax receivable	39	(1)	38	7	-	7
Other taxes, customs duties and social security receivable	28	(6)	22	150	(3)	147
Other receivables	784	(446)	338	682	(429)	253
Total, including:	**5,060**	**(772)**	**4,288**	**4,169**	**(790)**	**3,379**
not past due	3,848	(4)	3,844	2,940	(44)	2,896
past due and impaired	768	(768)	-	746	(746)	-
past due but unimpaired	444	-	444	483	-	483

Ageing structure of trade receivables past due but unimpaired:

Delay	2016	2015
Up to 1 month	290	328
From 1 to 3 months	60	59
From 3 months to 1 year	53	14
from 1 to 5 years	9	17
over 5 years	2	-
Total net past due receivables	**414**	**418**

(in PLN million, unless stated otherwise)

Trade receivables are the source of the Group's credit and currency risk exposure. For information on credit risk management (including assessment of the credit quality of receivables and credit risk concentration), see **Note 7.3.1**. For information on currency risk related to receivables, see **Note 7.3.2.2**.

6.2.3. Trade and tax payables

Accounting policies

Current trade payables and liabilities under purchase of property, plant and equipment and intangible assets are initially recognised at fair value, which is equal to their nominal value, and as at the reporting date are measured at amortised cost.

Taxes, customs duties and social security payable are determined in amounts due to Group companies in accordance with applicable laws and regulations.

Trade and tax payables	2016	2015
Trade payables	1,290	956
Liabilities under purchase of property, plant and equipment and intangible assets	425	383
VAT payable	1,032	1,115
Other taxes, customs duties and social security payable	252	258
Current income tax liabilities	180	53
Total	**3,179**	**2,765**

The Group is exposed to currency risk and liquidity risk in relation to trade payables and liabilities under purchase of property, plant and equipment and intangible assets. For information on those risks, see **Note 7.3.2.2** and Note **7.3.3**, respectively.

6.3. Provisions and liabilities

6.3.1. Employee benefit obligations

Accounting policies

Short-term benefits

Short-term employee benefits are benefits (other than termination benefits) which fall due wholly within twelve months after the end of the annual reporting period in which the employees render the related service. Short-term employee benefits require no actuarial assumptions. The Group recognises the anticipated undiscounted amount of short-term benefits to be paid out. Expenses on benefits paid during employment are charged to profit or loss of the current reporting period.

Short-term employee benefits paid by the Group include:

- Salaries, wages and social security contributions,
- Short-term compensated absences,
- Profit-sharing and bonuses payable within 12 months after the end of the period in which the employees acquired the related entitlements,
- Non-cash benefits for current employees.

Short-term employee benefits, including payments towards defined contribution plans, are recognised in the periods in which the employee provided the services to a Group entity, and in the case of profit-sharing and bonus payments – when the following conditions are met:

- A Group entity has a legal or constructive obligation to make such payments as a result of past events, and
- A reliable estimate of the expected cost can be made.

The Group recognises expected short-term employee benefits expense related to compensated absences in the case of accumulated compensated absences (that is absences to which the entitlement is transferred to the future periods and can be used in the future if the absences were not fully used in the current period).

(in PLN million, unless stated otherwise)

Long-term benefits

Long-term employee benefits are all benefits which are payable after 12 months from the reporting date. They include:

- Post-employment benefits,
- Other long-term employee benefits.

Post-employment benefits include termination benefits, retirement severance payments, and benefits from the Company Social Benefits Fund.

Provision for long-term employee benefits is determined using the projected unit credit method, with the actuarial valuation made as at the end of the reporting period.

Actuarial gains and losses related to defined post-employment benefits are presented in other comprehensive income, whereas gains and losses related to other benefits paid during employment are charged to profit or loss of the current reporting period.

Employee benefit obligations	2016		2015	
	Non-current	Current	Non-current	Current
Liabilities under length-of-service awards	473	45	439	42
Liabilities under severance payments	178	4	113	2
Wages and salaries payable	-	72	-	56
Amounts payable for unused holiday entitlements	-	54	-	47
Termination benefits	-	20	-	36
Other employee benefit obligations	51	139	13	169
Total	**702**	**334**	**565**	**352**

Changes in obligations under retirement severance payments and length-of-service awards were as follows:

	Length-of-service awards		Retirement severance payments	
	2016	2015	2016	2015
Obligations at beginning of period	481	491	115	100
Interest expense	17	5	4	1
Current service cost	24	23	7	4
Past service cost	-	(25)	-	(10)
Benefits paid	(51)	(53)	(16)	(15)
Actuarial gain/(loss) − changes in financial assumptions	9	(14)	4	(6)
Actuarial gain/(loss) − changes in demographic assumptions	87	55	38	41
Gain/(loss) due to curtailments or settlements	(63)	(1)	24	-
Changes in the Group	14	-	6	-
Obligations at end of period	**518**	**481**	**182**	**115**

The technical rate applied to calculate the discounted value of future retirement severance obligations was 1.1%, and resulted from a 3.6% annual return on long-term Treasury bonds and a 2.5% forecast annual salary growth (at the end of 2015 the applied technical rate was 1.4%, and resulted from the rates of 2.9% and 1.5%, respectively).

(in PLN million, unless stated otherwise)

6.3.1.1. Workforce streamlining within the Group

In accordance with the PGNiG Group Efficiency Improvement Programme, PGNiG Group companies are implementing programmes related to workforce streamlining. The Programme is part of initiatives designed to improve the Group's cost effectiveness and organisational efficiency pursued under the PGNiG Group's Strategy for 2014–2022, adopted in December 2014.

Key workforce streamlining initiatives implemented by Group companies in 2016 are presented below.

Company	Workforce restructuring/streamlining process
GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)	In connection with the ongoing liquidation process at GEOFIZYKA Kraków S.A. w likwidacji (in liquidation), on August 4th 2016, a collective redundancies programme was announced under the Act on Special Rules Governing Termination of Employment for Reasons Not Attributable to Employees (Dz.U. of 2015, item 192). The company expects the severance payments under the collective redundancies programme to total PLN 4.7m. During the notice period, the employer may release an employee from the duty to work, provided that the employee retains the right to remuneration. The cost of remuneration for reduced notice period without the duty to work will amount to PLN 0.5m.
EXALO Drilling S.A.	Given the deteriorating market environment, the company launched a comprehensive turnaround plan covering all key areas of its operations. As part of the plan implementation, the company succeeded in optimising its workforce number, adapting it to the market situation. In 2016, employment contracts were terminated with 896 persons. Under the Voluntary Redundancy Programme, 157 employees departed from the company, while notice periods are running with respect to additional 9 persons. Workforce reduction cost incurred in 2016 totalled PLN 14.6m.
PGNiG S.A.	In 2016, the Company launched a new edition of the Voluntary Redundancy Programme as part of the employment restructuring and streamlining process implemented at PGNiG for a few years. Access to the Programme was voluntary. An employee who joined the Programme and obtained the employer's consent had the right to terminate their employment by mutual agreement, on favourable conditions (retaining the right to benefits and compensation defined in the Rules of the Voluntary Redundancy Programme). While the Programme was addressed to all employee groups, it was employees of pre-retirement age who were offered an especially attractive benefit package. In 2016, 164 employees departed under the Programme. The related costs were estimated at PLN 14.6m.

6.3.2. Other provisions

Accounting policies	Material estimates
Provision for certificates of origin and energy efficiency certificates	
If at a reporting date the number of certificates in not sufficient to meet the requirements stipulated in the Energy Law and the Energy Efficiency Act, the Group recognises a provision for cancellation of certificates of origin and energy efficiency certificates or for the payment of emission charge, whichever of the two is lower. The provision is measured based on the carrying amount of the certificates held and the then current price (on the Polish Power Exchange) of certificates which should be additionally purchased to meet the cancellation requirement resulting from the volume of electricity sales to end users. The provision and the registered certificates of origin disclosed under inventories (see **Note 6.2.1**) are accounted for at the time of registering their cancellation in the Register of Certificates of Origin maintained by the Polish Power Exchange (PPE).	The provision is recognised as at the end of reporting period, based on the amounts of electricity, heat and gas fuel sold to end users, and the amount of electricity generated and used for company's own purposes, taking into consideration the applicable unit emission charge or price of a certificate on the PPE.
Provision for liabilities associated with exploration work abroad	
In 2013, the Parent recognised a provision for liabilities associated with the exploration work carried out by POGC Libya B.V., PGNiG's subsidiary. Owing to the Force Majeure risk present in Libya, POGC Libya B.V. has suspended its operating activities. Therefore, the Parent has been maintaining a provision for licence obligations under licence agreements concluded with the Libyan government.	The amount of the provision is based on the obligations contracted under the licence agreements, but not met.
Provision for environmental liabilities	
The Group recognises a provision for the cost of identification and reclamation of ground and water contamination, required under the applicable laws. The provision recognised for such liabilities reflects estimated costs projected to be incurred, which are estimated and reviewed periodically based on current prices.	The amount of the provision is based on the estimates of future reclamation costs, which largely depend on the applied discount rate and the estimate of time when the cash flows are expected to take place.
Provision for claims under extra-contractual use of land	
In the ordinary course of business, the Group installs technical equipment used for transmission and distribution of gas on land owned by third parties, which are often natural persons. Where possible, at the time of installing the elements of the infrastructure, the Group enters into agreements establishing standard land easements and transmission easements. The Group recognises a provision for claims under extra-contractual use of land. The provision for claims under extra-contractual use of land is estimated in respect of those claims which have been confirmed to be valid (the claimant presented a legal title to land) and in the case of which correspondence has been exchanged with the claimant in the last three years.	The Group estimates the provision for claims under extra-contractual use of land based on an estimate survey made by an expert appraiser, or its own valuation, taking into account the size of the controlled area in square meters, the amount of annual rent per square meter for similar land in a given municipality, and the period of extra-contractual use of land (not more than ten years). If it is not possible to obtain reliable data required to apply the method described above, the Group analyses submitted claims on a case-by-case basis. As the amounts used in the above calculations are arrived at based on a number of variables, the actual amounts of compensation for extra-contractual use of land that the Group will be required to pay may differ from amounts of the related provisions.

(in PLN million, unless stated otherwise)

	Provision for certificates of origin and energy efficiency certificates	Provision for liabilities associated with exploration work abroad	Provision for environmental liabilities	Provision for UOKiK fine*	Provision for claims under extra-contractual use of land	Other provisions	Total	
As at Jan 1 2015	**228**	**164**	**94**	**60**	**87**	**282**	**915**	
Recognised provision taken to profit or loss	214	18	4	11	18	47	312	*Note 3.3.*
Provision reversal taken to profit or loss	(30)	-	-	-	(59)	(57)	(146)	*Note 3.3.*
Used provisions	(197)	-	-	(6)	-	(26)	(229)	
Other changes	-	-	-	-	-	(3)	(3)	
As at Dec 31 2015	**215**	**182**	**98**	**65**	**46**	**243**	**849**	
non-current	-	4	90	-	25	69	188	
current	215	178	8	65	21	174	661	
As at Jan 1 2016	**215**	**182**	**98**	**65**	**46**	**243**	**849**	
Recognised provision taken to profit or loss	150	12	31	-	8	119	320	*Note 3.3.*
Provision reversal taken to profit or loss	(38)	-	(18)	(55)	(19)	(76)	(206)	*Note 3.3.*
Used provisions	(184)	-	-	-	-	(33)	(217)	
Changes in the Group	-	-	-	-	-	8	8	
Other changes	-	-	6	-	1	(3)	4	
As at Dec 31 2016	**143**	**194**	**117**	**10**	**36**	**258**	**758**	
non-current	-	4	95	-	24	75	198	
current	143	190	22	10	12	183	560	

*For more information, see Section 6.4.2 of the Directors' Report on the operations of PGNiG S.A. the PGNiG Group.

(in PLN million, unless stated otherwise)

6.3.3. Grants

Accounting policies

Grants

The Group receives grants related to assets, receivable on condition that the Group purchases, produces, or otherwise obtains non-current assets.

Grants related to assets are recognised in the statement of financial position under grants (non-current portion) and other liabilities (current portion), and subsequently taken – through equal annual charges – to profit or loss throughout the expected useful life of the assets.

Grants	2016	2015
Grants related to assets, including:	856	882
Kosakowo UGSC construction	89	98
Wierzchowice UGS extension	443	464
Strachocina UGS extension	57	60
Husów UGS extension	31	33
Construction of gas distribution systems in new areas and upgrades of existing distribution networks	164	147
Other	72	80
Total	**856**	**882**
Including non-current	815	843

Grants related to assets

Group companies are executing projects for which EU co-financing has been obtained.

The largest projects are carried out by the Parent and involve extension of the gas storage capacities to ensure proper operation of the gas distribution system. In the current reporting period, no new co-financing was granted to PGNiG S.A. for those projects. In 2016, PGNiG S.A. received PLN 1.8m under a grant for the financing of the 'LNG-based conversion of Ełk and Olecko from propane-butane to E-gas' project.

In the current period, Polska Spółka Gazownictwa Sp. z o.o. received a grant of PLN 22m from the European Regional Development Fund (ERDF) under a programme involving construction of gas distribution systems in areas where no such infrastructure had existed before, and upgrades of existing distribution networks.

6.3.4. Other liabilities

Accounting policies

Other liabilities

A subsidiary of the Group, Polska Spółka Gazownictwa Sp. z o.o., as a distribution system operator, recognises as deferred revenue connection charges (received for the provision of the connection service before June 30th 2009).

This income is amortised over time, proportionately to depreciation charges on those connections disclosed under property, plant and equipment.

Other liabilities	2016		2015	
	Non-current	Current	Non-current	Current
Connection charges received in cash	339	20	360	20
Non-depreciable portion of the value of gas service lines provided by gas buyers	238	47	288	47
Prepaid deliveries	-	212	-	160
Accruals and deferred revenue	-	132	-	151
Liabilities under licences, rights to geological information and mining rights	24	-	47	-
Other deferred revenue	2	121	20	87
Other	66	376	55	265
Total	**669**	**908**	**770**	**730**

7. Notes on financial instruments and financial risk management

7.1. Financial instruments

Accounting policies

The Group holds the following categories of financial instruments:

- Loans and receivables at amortised cost,
- Financial liabilities at amortised cost,
- Financial assets and liabilities at fair value through profit or loss,
- Assets and liabilities hedging specific risks under hedge accounting

Loans and receivables

The Group classifies mainly the following financial assets as loans and receivables:

- Trade receivables (**Note 6.2.2.**),
- Cash and cash equivalents (**Note 5.4.**).

Financial liabilities at amortised cost

This item comprises mainly:

- Trade payables (**Note 6.2.3.**),
- Financing liabilities (**Note 5.2.**).

Financial assets and liabilities at fair value through profit or loss

Derivative financial instruments which are not hedging instruments are classified by the Group as financial assets/liabilities at fair value through profit or loss. For information on accounting policies, see **Note 7.2.**

Assets and liabilities hedging specific risks under hedge accounting

This category comprises derivative instruments to which the Group applies hedge accounting. For description of the applied hedge accounting policies, see **Note 7.2**.

(in PLN million, unless stated otherwise)

7.1.1. Reconciliation of key balance-sheet items of financial assets to groups required under IAS 39

Reconciliation of key balance-sheet items of financial assets to groups required under IAS 39

			2016				2015			
Balance-sheet item	Item referenced in Note	Notes	Loans and receivables at amortised cost	Financial assets at fair value through profit or loss	Financial instruments designated for hedge accounting	Total	Loans and receivables at amortised cost	Financial assets at fair value through profit or loss	Financial instruments designated for hedge accounting	Total
Receivables	Trade receivables	*Note 6.2.2.*	3,516	-	-	3,516	2,541	-	-	2,541
Derivative financial instruments		*Note 7.2.*	-	483	140	623	-	685	24	709
Cash and cash equivalents		*Note 5.4.*	5 829	-	-	5,829	6,022	-	-	6,022
Total			**9,345**	**483**	**140**	**9,968**	**8,563**	**685**	**24**	**9,272**

7.1.2. Reconciliation of key balance-sheet items of liabilities to groups required under IAS 39

Reconciliation of key balance-sheet items of financial liabilities to groups required under IAS 39

			2016				2015			
Balance-sheet item	Item referenced in Note	Notes	Financial liabilities at amortised cost	Financial liabilities at fair value through profit or loss	Financial instruments designated for hedge accounting	Total	Financial liabilities at amortised cost	Financial liabilities at fair value through profit or loss	Financial instruments designated for hedge accounting	Total
Financing liabilities	Bank borrowings	*Note 5.2.*	1,323	-	-	1,323	1,524	-	-	1,524
	Debt securities	*Note 5.2.*	4,984	-	-	4,984	4,772	-	-	4,772
Trade and tax payables	Trade payables	*Note 6.2.3.*	1,290	-	-	1,290	956	-	-	956
Derivative financial instruments		*Note 7.2.*	-	254	92	346	-	371	794	1,165
Total			**7,597**	**254**	**92**	**7,943**	**7,252**	**371**	**794**	**8,417**

(in PLN million, unless stated otherwise)

7.1.3. Items of income and expenses related to financial assets and liabilities

Item of statement of profit or loss and statement of comprehensive income	Item referenced in Note / supplementary clarifications	Notes	2016 Loans, receivables and liabilities at amortised cost	2016 Derivative financial instruments not designated for hedge accounting	2016 Derivative financial instruments designated cash flow hedge accounting	2015 Loans, receivables and liabilities at amortised cost	2015 Derivative financial instruments not designated for hedge accounting	2015 Derivative financial instruments designated cash flow hedge accounting
Effect on statement of profit or loss								
Net finance costs	Interest on debt	*Note 3.4.*	(204)	-	-	(150)	-	-
	Foreign exchange differences	*Note 3.4.*	(29)	-	-	(83)	-	-
	Measurement and exercise of derivative financial instruments not designated for hedge accounting	*Note 3.4.*	-	59	-	-	(39)	-
Other income and expenses	Foreign exchange differences	*Note 3.3.*	128	-	-	(94)	-	-
	Impairment losses	*Note 3.3.*	(17)	-	-	37	-	-
	Measurement and exercise of derivative financial instruments not designated for hedge accounting	*Note 3.3.*	-	(202)	-	-	27	-
	Reclassification from other comprehensive income	*Note 3.3.*	-	-	37	-	-	16
Raw materials and consumables used	Reclassification from other comprehensive income	*Note 3.2.*	-	-	(696)	-	-	(274)
			(122)	**(143)**	**(659)**	**(290)**	**(12)**	**(258)**
Effect on other comprehensive income								
Gains/(losses) on measurement of derivative instruments in cash flow hedge accounting [effective portion]					124			(689)
Reclassification of derivative instruments valuation to profit or loss upon exercise (cash flow hedges)					659			258
					783			**(431)**
Effect on comprehensive income			**(122)**	**(143)**	**124**	**(290)**	**(12)**	**(689)**

7.2. Derivative financial instruments

Accounting policies

Derivative financial instruments not designated for hedge accounting

Derivative financial instruments which are not hedging instruments in hedge accounting are classified as financial assets/liabilities at fair value through profit or loss. The instruments are economic hedges.

Derivative instruments at fair value include also derivatives with hedging relationship terminated.

Derivative instruments are initially recognised at fair value and as at each reporting date they are measured at fair value with gains or losses from the measurement recognised in statement of profit or loss under net finance costs (e.g. measurement of instruments hedging financing activity, such as debt liabilities) and other income and expenses (hedging transactions not designated for hedge accounting, e.g. forward contracts).

Hedge accounting

The Group applies hedge accounting to hedge against the risk of movements in gas prices and exchange rates (EUR/PLN and USD/PLN) for future gas purchases. The gas price risk is related to the highly probable future gas purchase transactions. The Group applies cash flow hedge accounting to these transactions.

Derivatives are designated as hedging instruments.

The portion of gains or losses on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive income. The ineffective portion is charged to net finance costs in the statement of profit or loss. Amounts previously recognised in other comprehensive income are reclassified to profit or loss (line item 'raw materials and consumables used') in the period when the hedged item affects profit or loss.

The Group ceases to classify an instrument as a hedge if the derivative expires or is sold, terminated or exercised, if the Group revokes its designation as a hedge, the hedge no longer meets the criteria of hedge accounting, or if the hedged transaction is no longer expected to be executed.

The Group enters into transactions involving the following derivative instruments:

Derivative instruments designated for hedge accounting

Description and purpose of instrument	
Currency forwards	A currency forward is a contract for the purchase or sale of a currency for a specified exercise price, with delivery date falling no earlier than after two business days from the date when the forward terms have been agreed. The Group uses currency forwards to hedge against currency risk of USD, NOK, and EUR exchange rates in future gas purchase contracts.
Currency call options	A currency call option gives the holder the right to purchase a set amount of a currency at a specified price (exercise price). The right may be exercised at the option expiration date (European option). For the right represented by the option the seller receives option premium. The Group buys call options to hedge against adverse movements in USD and EUR exchange rates in future gas purchase contracts.
Commodity call options	A call option gives the holder the right to receive specified payment. The payment amount depends on the arithmetic mean of the value of the underlying instrument computed for the period when the instrument is valid. For the right represented by the option the seller receives option premium. The Group purchases call options to hedge against movements in prices of TTF gas [A], GO [B] and FO [C].
Commodity put options	The Group uses put options exclusively under zero-cost collar strategies. The instrument gives the right to receive a specified amount upon exercise. The amount depends on the arithmetic mean of the value of the underlying instrument computed for the period when the instrument is valid. For the right represented by the option the seller receives option premium. The Group sells put options to hedge against movements in prices of TTF gas [A], GO [B] and FO [C].
Commodity swap	A commodity swap is a contract where two parties agree to exchange payments on a specified date. The payments are calculated based on agreed amounts of a specified commodity and its price. In the transaction, one party agrees to pay a fixed price, and the other party pays a floating price. However, no physical exchange of the underlying commodities takes place. The Group uses the instrument to hedge against movements in prices of TTF gas [A], GO [B] and FO [C].
IRS	An interest rate swap is an instrument exchanging fixed rate interest payments denominated in PLN for variable rate interest payments on a specified principal amount.

(in PLN million, unless stated otherwise)

Derivative instruments not designated for hedge accounting

Description and purpose of instrument	
CCIRS	A cross currency interest rate swap is an instrument which exchanges cash flows associated with an interest rate and a currency in respect of an agreed base amount at a fixed pre-agreed exchange rate. The Group uses CCIRS to exchange variable rate interest payments denominated in NOK into variable rate interest payments denominated in PLN or fixed rate interest payments denominated in EUR into variable rate interest payments denominated in PLN.
Currency forwards	For instrument description see the previous table.
Electricity futures contracts[D]	A futures contract (futures) is a standard contract enabling the sale or purchase of a commodity in a regulated market for a set exercise price, with a delivery date falling no earlier than after two business days from the date when the terms of the futures contract have been agreed. The Group uses this instrument as economic hedge against price changes in future purchases of electricity and gas.
CO_2 futures contracts	A futures contract is standard contract enabling the sale or purchase of CO_2 emission allowances in a regulated market for a set exercise price, with a delivery date falling no earlier than after two business days from the date when the terms of the futures contract have been agreed. The Group uses this instrument as economic hedge against price changes in future purchases of CO_2 emission allowances.
Electricity and gas forward contracts	A commodity forward is a contract for the purchase or sale of a commodity for a set exercise price, with delivery date falling no earlier than after two business days from the date when the forward terms have been agreed. The Group uses this instrument as economic hedge against price changes in future purchases of electricity and gas. [E]

[A] Natural Gas at the Title Transfer Facility (TTF) – an exchange index for natural gas, used in connection with the virtual trading activity conducted by the transmission system operator in the Netherlands

[B] Gas Oil (GO) – the Gasoil 0,1% Barges FOB Rotterdam index

[C] Fuel Oil (FO) – the Fuel Oil 1% Barges FOB Rotterdam index

[D] EE – Phelix power futures contracts traded at the EEX

[E] electricity and gas forward contracts traded at the Polish Power Exchange

	2016		2015	
	Assets	Liabilities	Assets	Liabilities
Derivative instruments covered by hedge accounting	140	92	24	794
Derivative instruments not covered by hedge accounting	483	254	685	371
Total	**623**	**346**	**709**	**1,165**

(in PLN million, unless stated otherwise)

Hedging derivatives covered by hedge accounting

Type of derivative instrument	2016 Notional amount	2016 Period over which cash flow will occur and affect the financial result	2016 Exercise price (exercise price range)	2016 Weighted average exercise price	2016 Fair value of instruments covered by cash flow hedge accounting	2015 Notional amount	2015 Period over which cash flow will occur and affect the financial result	2015 Fair value of instruments covered by cash flow hedge accounting
Derivatives used to hedge currency risk in gas purchase contracts								
Forwards								
USD	-	-	-	-	-	USD 110	1-12 months	16
NOK	-	-	-	-	-	-	-	-
EUR	-	-	-	-	-	EUR 10	1-3 months	-
Call options								
EUR	-	-	-	-	-	EUR 45	1-12 months	1
USD	USD 70	1-3 months	3.96-3.99	3.98	15	USD 110	1-12 months	7
					15			**24**
Derivatives used as hedges of gas purchase prices								
TTF call options	8 MWh	up to 3 years	15.80-25.00	16.73	83	8 MWh	1 month - 3 years	-
TTF put options	0 MWh	up to 3 years	19	19.00	(2)	0.26 MWh	1-3 years	(6)
FO put options	-	-	-	-	-	-	-	-
GO put options	-	-	-	-	-	-	-	-
TTF swap	4 MWh	up to 3 years	13.58-21.82	16.10	42	30 MWh	1 month - 3 years	(629)
TTF swap	5 MWh	up to 3 years	15.87-21.82	20.33	(44)	-	-	-
FO swap	-	-	-	-	-	0.15 MT	1-12 months	(58)
GO swap	-	-	-	-	-	0.04 MT	1-12 months	(18)
					79			**(711)**
Derivative instruments hedging interest rate risk								
IRS	143 PLN	from 6 months to 3.5 years	1.84-2.46	2.06	-	-	-	-
IRS	PLN 1.500	1-3 years	3.65%-4.07%	0.04	(46)	PLN 1.500	1-3 years	(83)
				Total	**48**		**Total**	**(770)**
			Including:	Assets	140	Including:	Assets	24
				Liabilities	92		Liabilities	794

(in PLN million, unless stated otherwise)

Derivative instruments not designated for hedge accounting

Type of derivative instrument	2016 Notional amount	2016 Fair value of instruments not covered by hedge accounting	2015 Notional amount	2015 Fair value of instruments not covered by hedge accounting
Derivative instruments hedging interest rate risk and currency risk				
CCIRS				
EUR	EUR 500	204	EUR 500	159
NOK	NOK 2.318	14	NOK 2.940	144
		218		**303**
Derivative instruments used as economic hedges of electricity purchase prices				
Forwards				
electricity – PPX	3 MWh	12	1.335 MWh	19
electricity – PPX	7 MWh	(7)	1.135 MWh	(18)
electricity – OTC	1 MWh	22	1 MWh	30
electricity – OTC	1 MWh	(39)	1 MWh	(19)
Futures				
electricity – EEX AG	2 MWh	67	0.25 MWh	4
electricity – EEX AG	1 MWh	(48)	1 MWh	(15)
		7		**1**
Derivatives used as hedges of gas purchase prices				
Forwards				
gas – OTC	11 MWh	130	12 MWh	282
gas – OTC	11 MWh	(133)	11 MWh	(257)
Futures				
gas – EEX AG	-	-	0.053 MWh	1
gas – EEX AG	-	-	0.151 MWh	(4)
gas – ICE ENDEX B.V.	1 MWh	13	1 MWh	24
gas – ICE ENDEX B.V.	1 MWh	(12)	2 MWh	(26)
gas – POWERNEXT SA	1 MWh	16	1 MWh	22
gas – POWERNEXT SA	1 MWh	(15)	2 MWh	(31)
		(1)		**11**
Derivatives used as hedges of purchase prices of CO_2 emission allowances				
Forwards	EUR 3	-	EUR 10	(1)
Futures	2 t	5	26 t	1
Futures	-	-	26 t	(1)
	Total	**229**	**Total**	**314**
	Including:		Including:	
	Assets	483	Assets	685
	Liabilities	254	Liabilities	371

(in PLN million, unless stated otherwise)

Measurement of derivative financial assets and derivative financial liabilities is classified as level 2 in the fair value hierarchy (level 2: valuation based on observable inputs other than quoted prices).

Instrument	Valuation method	Key inputs
Currency call options	Garman Kohlhagen model	Market data such as interest rates, foreign-exchange rates, basis spreads, commodity prices and volatility of commodity prices
Asian commodity call and put options	Espen Levy model	
Forwards, average rate forwards, swaps, CCIRS and IRS	Discount method	

7.3. Financial risk management policies

In its business activities, the Group is exposed in particular to the following types of financial risk:

- Credit risk **(Note 7.3.1.)**
- Market risk, including:
  - Commodity price risk **(Note 7.3.2.1.)**
  - Currency risk **(Note 7.3.2.2.)**
  - Interest rate risk **(Note 7.3.2.3.)**
- Liquidity risk **(Note 7.3.3.)**

In order to manage financial risk effectively, the Parent operates 'Policy of Financial Risk Management at PGNiG S.A.', (the "Policy"), which defines the division of competencies and tasks among the Company's organisational units in the process of financial risk management and control. The body responsible for ensuring compliance with the Policy and its periodic updates is the Risk Committee, which proposes risk management procedures, monitors the Policy implementation and revises the Policy as needed.

7.3.1. Credit risk

Credit risk is defined as the probability of failure by a Group's trading partner to meet its obligations on time or failure to meet such obligations at all, or the probability that the Group may be unable to recover any monies that have been deposited at a bank or otherwise invested.

The PGNiG Group's credit exposure arises mostly in connection with the following items:

Maximum risk exposure, equal to the carrying amount of the item	2016	2015
Cash and cash equivalents (cash at banks and bank deposits)	5,829	6,022
Non-current restricted cash	190	217
Trade receivables	3,516	2,541
Loans advanced	249	215
Positive value of derivative financial instruments	623	709
Total	**10,407**	**9,704**

As a rule, the Group concludes transactions in financial instruments with multiple entities with high creditworthiness. The key criteria applied by the Group in the selection of trading partners include their financial standing as confirmed by rating agencies, as well as their respective market shares and reputation.

Credit risk exposure associated with the individual items specified above is determined by reference to the carrying amounts of those items.

(in PLN million, unless stated otherwise)

7.3.1.1. Credit risk related to cash and bank deposits

The Group seeks to minimize its credit exposure mainly by diversifying the portfolio of the institutions (mostly banks) with which the Group companies place their funds.

As at the reporting date, there was no concentration of credit risk within the Group. As at the end of 2016, the three banks with which the Group deposited the largest amounts of their funds accounted for 38%, 28% and 12% of the Group's total cash, respectively (2015: 36%, 15% and 12%, respectively).

Moreover, the parent has concluded Framework Agreements with all its relationship banks. The Framework Agreements stipulate detailed terms of execution and settlement of financial transactions between the parties.

The Group assesses the credit risk by reviewing the banks' financial standings on a regular basis, as reflected in ratings assigned to the banks by rating agencies.

The Group places its funds in a diversified portfolio of deposits held with reputable banks – the breakdown of the portfolio is presented below (the table also provides information on any derivatives contracts entered into with the financial institutions (where the Group carries assets in connection with such contracts)).

	Rating assigned by		2016		2015	
	Fitch	Moody's	Bank deposits	Derivative instruments (assets)	Bank deposits	Derivative instruments (assets)
Bank\Financial Institution	A-	-	38%	0%	15%	0%
Bank\Financial Institution	A	Ba1	28%	0%	0%	0%
Bank\Financial Institution	A+	A1	12%	6%	12%	16%
Bank\Financial Institution	A-	A3	8%	4%	9%	1%
Bank\Financial Institution	A2	A2	7%	18%	6%	9%
Bank\Financial Institution	A-	A2	5%	3%	36%	2%
Bank\Financial Institution	BBB	-	2%	0%	11%	0%
Bank\Financial Institution	A2	A2	0%	8%	9%	11%
Bank\Financial Institution	BBB+	A3	0%	7%	0%	5%
Bank\Financial Institution	-	A2	0%	3%	0%	0%
Bank\Financial Institution	AA-	A1	0%	3%	0%	0%
Bank\Financial Institution	-	A3	0%	2%	0%	0%
Bank\Financial Institution	-	A1	0%	2%	0%	0%
Exchanges	-	-	0%	16%	0%	8%
OTC market	-	-	0%	26%	0%	46%
Bank\Financial Institution, other	-	-	1%	1%	1%	1%
Total			**100%**	**100%**	**100%**	**100%**

7.3.1.2. Credit risk related to receivables

The Group is exposed to credit risk of material value in connection with its trade receivables (i.e. amounts it is owed for any natural gas, LNG, crude oil or electricity the Group has sold) and other receivables (i.e. amounts owed to the Group for sold CO_2 emission allowances and certificates of origin for electricity).

Some of the Group's gas sales transactions are effected via the Polish Power Exchange ("PPX"). Transactions made at the Polish Power Exchange do not generate exposure to credit risk, as the system of guaranteed settlements operated by the Commodity Exchange Clearing House protects Clearing House members against insolvency of individual market participants. These transactions account for about 55% of the Group's annual revenue. As at the reporting date, outstanding balances from settlement of transactions effected via the PPX were not material.

In order to minimise the risk of uncollectible receivables arising in connection with sale transactions executed outside of the PPE, uniform rules designed to secure trade receivables are in place.

In line with the procedures operated by the Group, each trading partner's ability to meet current and future contractual obligations is assessed on a regular basis. Results of such assessment are used to determine individual credit limits granted to trading partners and/or security to be provided by the trading partners. The Group also minimizes its trade receivables credit risk by continuously monitoring the financial standing of each of its trading partners and taking appropriate measures to collect any debt in compliance with the procedures operated by the Group.

With respect to private customers, the Group's debt collection teams continuously monitor the balance of a customer's past-due receivables from the day when such arrears first arise. As part of an internally conducted pre-litigation process, customers are automatically notified of any outstanding overdue payments; with respect to those who fail to pay their overdue debt, decisions are made to discontinue supply of gas as permitted by the Energy Law. Any debt that has not been recovered by the Group as part of its internal procedures is sold.

There is no credit risk concentration within the Group. As at December 31st 2016, trade receivables from the Group's three largest customers accounted for 4.6%, 2.8%, and 2.7% of the total balance of trade receivables, respectively (December 31st 2015: 3.7%, 1.8%, and 0.7%, respectively).

7.3.1.3. Credit risk related to derivative transactions

Transactions in financial derivatives are executed with most reputable banks with high credit ratings. The Group has also concluded either Framework Agreements or ISDA Agreements with each of their relationship banks, stipulating detailed terms of service and limits of maximum exposure arising from the fair value of derivatives. The Group believes that all the measures described above protect it against any material credit-risk-related losses.

The relationship banks' credit ratings are presented in **Note 7.3.1.1**.

The shares of the three counterparty banks which accounted the largest proportion (in value terms) of transactions in derivative instruments with positive valuations were 18%, 8%, and 7% (2015: 16%, 11%, and 9%).

7.3.2. Market risk

Market risk is defined as the risk of the Group's financial results or economic value being adversely affected by changes in the financial and commodity markets.

In line with the adopted policy, the purpose of the market risk management process in place at the Group is to:

- Reduce the volatility of cash flows related to the Group's operations to acceptable levels in the short- and medium term
- Build company value in the long term.

Considering potential impacts on its financial results, the Group has identified the following market risks:

Impact on financial results

Market risk	Approach to risk management
Natural gas and oil product prices	The Group manages the risk by purchasing derivatives to hedge natural gas prices.
EUR/PLN, USD/PLN and NOK/PLN exchange rates	[see above] The risk is mainly related to trade payables and debt instruments in issue. The Group hedges the risk by making purchases in the same currency.
Interest rates	The Group hedges the risk by purchasing derivatives.
Other commodity prices	The risk considered immaterial.

7.3.2.1. Commodity price risk

Commodity price risk is defined as the risk of the Group's financial results being adversely affected by changes in commodity prices.

The Group's exposure to commodity price risk arises mainly in connection with its gas fuel purchase and sale contracts entered into as part of daily trading activities on the PPX. It stems from volatility of prices of gas and oil products quoted on global markets. Under some of the contracts for gas fuel supply, the pricing formula relies on a weighted average of the prices recorded in previous months, which mitigates the volatility risk.

Commodity risk is also related to electricity trading, certificates of origin, and carbon credits. Trade in electricity is carried out on regulated exchange markets in Poland and abroad. The Group also executes transactions outside of regulated markets, under framework agreements. Commodity risk exposure is managed by mechanisms for identifying, calculating and monitoring exposure levels, as well as by valuation of open positions, value-at-risk measurement, and market risk limits.

In 2016 and 2015, the Group applied cash flow hedge accounting to hedge against fluctuations in natural gas prices. For details on hedge accounting, see **Note 7.2**.

For prices of electricity, carbon credits and certificates of origin, the Group applies economic hedges but does not apply hedge accounting. For more information on derivatives not designated for hedge accounting, see **Note 7.2**.

The tables below present an analysis of sensitivity of material energy commodity derivatives (TTF) to price changes in 2016 and 2015.

(in PLN million, unless stated otherwise)

2016	Carrying amount	TTF, EE, GO, FO price change: +25% Profit/(loss)	+25% Other comprehensive income	-25% Profit/(loss)	-25% Other comprehensive income
Energy commodity derivative assets	389	31	248	2	-
Energy commodity derivative liabilities	299	(7)	-	(34)	(164)
Effect of TTF, EE, GO, FO* price changes		**24**	**248**	**(32)**	**(164)**

* The abbreviations TTF, EE, GO and FO are explained in Note 7.2.

2015	Carrying amount	TTF, EE, GO, FO price change: +30% Profit/(loss)	+30% Other comprehensive income	-30% Profit/(loss)	-30% Other comprehensive income
Energy commodity derivative assets	382	5	402	13	4
Energy commodity derivative liabilities	1 081	(12)	(3)	(1)	(320)
Effect of TTF, EE, GO, FO* price changes		**(7)**	**399**	**12**	**(316)**

* The abbreviations TTF, EE, GO and FO are explained in Note 7.2.

7.3.2.2. Currency risk

Currency risk is defined as the risk of the Group's financial results being adversely affected by changes in the price of one currency against another.

Currency risk largely arises on account of fluctuations in the EUR/PLN, USD/PLN and NOK/PLN exchange rates, and it mainly affects the Parent. The key sources of exposure include:

- Trade payables (mainly in respect of natural gas purchased by the Group (**Note 6.2.3**.),
- EUR-denominated debt securities in issue (**Note 5.2**.),
- CCIRS hedging a NOK-denominated loan to PGNiG Upstream International AS (the loan is eliminated in the consolidated financial statements) (**Note 7.2.**), and
- Cash and cash equivalents (**Note 5.4.**).

The hedging measures implemented by the Group are mainly intended to provide protection against currency risk. For details of the hedging transactions, see **Note 7.2**.

Derivative instruments used to hedge against currency risk associated with trade payables denominated in foreign currencies (chiefly USD and EUR) include call options, option strategies, swaps, and forwards. For detailed information on derivative transactions executed by the Group (derivatives designated for hedge accounting and economic hedges not designated for hedge accounting), see **Note 7.2**.

The table below presents the Group's exposure to currency risk arising in connection with material items denominated in foreign currencies, and an analysis of the Group's sensitivity to the risk of movements in foreign exchange rates that the Group considers to be reasonably possible as at the reporting date (December 31st 2016).

(in PLN million, unless stated otherwise)

2016	Carrying amount	Value at risk	EUR/PLN				USD/PLN				NOK/PLN				
			Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		
			Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	
Financial assets															
Trade receivables	3,516	686	32	-	(32)	-	19	-	(19)	-	1	-	(1)	-	*Note 6.2.2.*
Derivative financial instruments (assets)	623	233	187	-	-	-	-	24	-	-	-	-	94	-	*Note 7.2.*
Cash and cash equivalents	5,829	640	18	-	(18)	-	32	-	(32)	-	-	-	-	-	*Note 5.4.*
Financial liabilities															
Financing liability	6,352	3,609	(243)	-	243	-	(49)	-	49	-	-	-	-	-	*Note 5.2.*
Trade payables	1,290	939	(23)	-	23	-	(48)	-	48	-	(2)	-	2	-	*Note 6.2.3.*
Derivative financial instruments (liabilities)	346	-	-	-	(187)	-	-	-	-	(12)	(94)	-	-	-	*Note 7.2.*
Effect of exchange rate movements			**(29)**	**-**	**29**	**-**	**(46)**	**24**	**46**	**(12)**	**(95)**	**-**	**95**	**-**	

2015	Carrying amount	Value at risk	EUR/PLN				USD/PLN				NOK/PLN				
			Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		Exchange rate change: +10%		Exchange rate change: -10%		
			Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	Profit/ (loss)	Other compre-hensive income	
Financial assets															
Trade receivables	2,54[illegible]	391	16	-	(16)	-	14	-	(14)	-	1	-	(1)	-	*Note 6.2.2.*
Derivative financial instruments (assets)	70[illegible]	326	190	8	-	-	-	46	10	-	-	-	112	-	*Note 7.2.*
Cash and cash equivalents	6,02[illegible]	834	18	-	(18)	-	47	-	(47)	-	1	-	(1)	-	*Note 5.4.*
Financial liabilities															
Financing liability	6,38[illegible]	3,567	(238)	-	238	-	(51)	-	51	-	-	-	-	-	*Note 5.2.*
Trade payables	95[illegible]	600	(14)	-	14	-	(24)	-	24	-	(9)	-	9	-	*Note 6.2.3.*
Derivative financial instruments (liabilities)	1,16[illegible]	1	-	-	(190)	-	(13)	-	-	(24)	(112)	-	-	-	*Note 7.2.*
Effect of exchange rate movements			**(28)**	**8**	**28**	**-**	**(27)**	**46**	**24**	**(24)**	**(119)**	**-**	**119**	**-**	

(in PLN million, unless stated otherwise)

7.3.2.3. Interest rate risk

Interest rate risk is defined as the risk of the Group's financial results being adversely affected by changes in interest rates.

The Group is exposed to interest rate risk primarily in connection with its:

- Cash and cash equivalents (bank deposits) (**Note 5.4.**).
- Financing liabilities (**Note 5.2**.),
- CIRS and IRS not designated for hedge accounting (**Note 7.2**.).

Market risk (including currency and interest rate risk) is monitored by the Group through sensitivity analyses and VaR measurement. VaR (value at risk) means that the maximum loss arising from a change in the market (fair) value will not exceed that value over the next n business days, given a specified probability level (e.g. 99%). VaR is estimated using the variance-covariance method. VaR is estimated using the variance-covariance method.

Items bearing variable-rate interest expose the Group to the risk of interest rate movements causing changes in cash flows associated with a given item by affecting interest income/expense recognised in profit or loss. Items bearing fixed-rate interest expose the Group to the risk of fair value changes. However, since the items are measured at amortised cost (save for derivatives), any such change has no impact on their carrying amounts or on profit or loss.

The table below presents key items exposed to interest rate risk, and an analysis of the Group's sensitivity to interest rate movements affecting items bearing variable-rate interest, which the Group considers reasonably possible as at the reporting date.

	2016				2015				
	Carrying amount	Balances bearing interest at variable rate	Interest rate movement: +40 bp	Interest rate movement: - 40 bp	Carrying amount	Balances bearing interest at variable rate	Interest rate movement: +50 bp	Interest rate movement: - 50 bp	
Cash and cash equivalents	5,829	4,593	18	(18)	6,022	5,502	28	(28)	*Note 5.4.*
CIRS not designated for hedge accounting (assets)	218	3,340	(9)	9	303	3,433	(17)	17	*Note 7.2.*
Financing liabilities	6,352	4,062	(16)	16	6,382	4,187	(21)	21	*Note 5.2.*
IRS designated for hedge accounting (liabilities)	46	1,500	6	(6)	83	1,500	8	(8)	*Note 7.2.*
Effect after hedge accounting			**(1)**	**1**			**(2)**	**2**	

7.3.3. Liquidity risk

Liquidity risk is defined as the risk of inadequate liquidity restricting the Group's ability to finance its capital requirements or the risk of structural excess liquidity adversely affecting profitability of the Group's business.

The main objective of the liquidity risk management is to monitor and plan the Group's liquidity on a continuous basis. Liquidity is monitored through at least 12-month projections of future cash flows, which are updated once a month. The Group reviews the actual cash flows against projections at regular intervals, which comprises an analysis of unmet cash-flow targets, as well as the related causes and effects.

The liquidity risk should not be associated exclusively with the risk of loss of liquidity by the Group. An equally serious threat is that of having excess structural liquidity, which could adversely affect the Group's profitability. The Group monitors and plans its liquidity levels on a continuous basis. As at December 31st 2016, the Group did not carry any amounts outstanding under overdraft facilities.

(in PLN million, unless stated otherwise)

To enhance its liquidity position, the Group has launched several note issuance programmes. For details on note issue, see Note 7.2.

The Group companies have also contracted lines of credit, as set out in Note 5.2.1.

The liquidity risk at the Parent is significantly mitigated through the application of the "PGNiG S.A. Liquidity Management Procedure". which ensures proper financial liquidity management through:

- Settlement of payments,
- Cash flow forecasting,
- Optimal free cash management,
- Raising and restructuring funds used to finance day-to-day operations and investment projects,
- Providing protection against temporary liquidity constraints resulting from unforeseen disruptions, and servicing contracted bank loans.

Measurement of the liquidity risk is based on ongoing detailed monitoring of cash flows, which takes into account the probability that specific flows will materialise, as well as the planned net cash position.

The tables below present maturities of financial liabilities at contractual undiscounted amounts.

2016	Time to contractual maturity at the reporting date					Total	Carrying amount
	Up to 3 months	3-12 months	1-3 years	3-5 years	over 5 years		
Financing liabilities							
Bank borrowings	23	120	256	504	420	**1,323**	**1,323**
Debt securities	2,338	2,500	103	41	-	**4,982**	**4,984**
Other	8	18	27	-	-	**53**	**45**
Trade payables	2,168	53	34	11	45	**2,311**	**2,311**
Derivative financial liabilities							
IRS designated for hedge accounting							
- inflows	15	46	91	-	-	**152**	**-**
- outflows	(15)	(45)	(88)	-	-	**(148)**	**46**
Forwards							
- inflows	405	639	200	-	-	**1,244**	**-**
- outflows	(408)	(614)	(114)	(1)	-	**(1,137)**	**179**
Other derivative instruments							
- inflows	-	-	-	40	-	**40**	**-**
- outflows	(16)	(47)	(20)	-	-	**(83)**	**121**
Financial liabilities (outflows)	**4,976**	**3,397**	**642**	**557**	**465**	**10,037**	**-**
Financial liabilities, including inflows from derivatives	**4,556**	**2,712**	**351**	**517**	**465**	**8,601**	**9,009**

2015	Time to contractual maturity at the reporting date					Total	Carrying amount
	Up to 3 months	3-12 months	1-3 years	3-5 years	over 5 years		
Financing liabilities							
Bank borrowings	48	235	691	-	550	**1,524**	**1,524**
Debt securities	184	-	4,619	-	-	**4,803**	**4,772**
Other	10	34	49	-	-	**93**	**86**
Trade payables	1,728	25	62	6	34	**1,855**	**1,855**
Derivative financial liabilities							
IRS designated for hedge accounting							
- inflows	15	46	91	-	-	**152**	**-**
- outflows	(15)	(44)	(88)	-	-	**(147)**	**83**
Forwards							
- inflows	406	610	114	-	-	**1,130**	**-**
- outflows	(408)	(621)	(237)	(1)	-	**(1,267)**	**295**
Other derivative instruments							
- inflows	-	-	-	-	-	**-**	**-**
- outflows	(17)	(52)	(28)	-	-	**(97)**	**787**
Financial liabilities (outflows)	**2,410**	**1,011**	**5,774**	**7**	**584**	**9,786**	**-**
Financial liabilities, including inflows from derivatives	**1,989**	**355**	**5,569**	**7**	**584**	**8,504**	**9,402**

(in PLN million, unless stated otherwise)

8. Other notes

8.1. Share capital and share premium

2016	Number of shares	Total par value	% of share capital / total voting rights held
Shareholder			
State Treasury	4,153,706,157	4,153,706,157	71.88%
Other shareholders	1,624,608,700	1,624,608,700	28.12%
Total	**5,778,314,857**	**5,778,314,857**	**100.00%**

2015	Number of shares	Total par value	% of share capital / total voting rights held
Shareholder			
State Treasury	4,178,771,608	4,178,771,608	70.83%
Other shareholders	1,721,228,392	1,721,228,392	29.17%
Total	**5,900,000,000**	**5,900,000,000**	**100.00%**

8.2. Earnings per share

Accounting policies

Basic earnings per share are calculated by dividing net profit/(loss) attributable to holders of the Parent's ordinary shares for a given reporting period by the weighted average number of outstanding ordinary shares in the reporting period.

Diluted earnings per share are calculated by dividing net profit/(loss) attributable to holders of the ordinary shares for a given reporting period (less interest on redeemable preference shares convertible into ordinary shares) by the weighted average number of outstanding ordinary shares in the reporting period (adjusted for the effect of dilutive options and dilutive redeemable preference shares convertible into ordinary shares).

The Group's diluted earnings per share are equal to basic earnings per share because the Group has no instruments with a dilutive effect.

Earnings per share and the weighted average number of ordinary shares are presented in the consolidated statement of profit or loss. Computation of the weighted average number of shares in 2016, taking into account the share buy-back performed in 2016, is presented below.

Beginning of period	End of the period	Number of outstanding ordinary shares	Number of days	Weighted average number of shares
2015-12-31	2016-09-07	5,900	251	4,046
2016-09-07	2016-11-14	5,807	68	1,079
2016-11-14	2016-12-31	5,778	47	742
			366	**5,867**

(in PLN million, unless stated otherwise)

8.3. Assets held for sale

Accounting policies

The Group classifies a non-current asset (or disposal group) as held for sale if its carrying amount is to be recovered principally through a sale transaction rather than through continuing use. Non-current assets held for sale are measured at the lower of their net carrying amount and fair value less cost to sell. If the fair value is lower than the net carrying amount, the difference is charged to profit or loss as an impairment loss.

Asset (disposal group) held for sale	Terms and expected date of disposal	Carrying amount	
		2016	2015
Shares in held-for-sale companies	Inviting other shareholders and potential investors to buy the shares or voluntary cancellation of the shares	3	3
Office building at ul. Kruczkowskiego in Warsaw	No-tender procedure	-	129
Other non-current assets held for sale	Tender	54	32
Total		**57**	**164**

8.4. Other assets

Accounting policies

Loans advanced are initially recognised at fair value and as at each reporting date are measured at amortised cost, using the effective interest rate method.

Non-current restricted cash represents cash of the Extraction Facilities Decommissioning Fund, accumulated by the Parent in a separate bank account from the first day of operation to the start of decommissioning of extraction facilities. The Fund's cash is increased by the amount of interest accruing on the Fund's assets. Due to formal and legal limitations on the use of this cash (it may only be applied towards specific long-term objectives), the assets accumulated in the Extraction Facilities Decommissioning Fund are recognised in the Group's statement of financial position as other assets under non-current assets. The amount of the provision for decommissioning of production and storage wells is adjusted for any unused contributions to the Extraction Facilities Decommissioning Fund (**Note 6.1.1.1**).

Connection charge is disclosed under prepayments. The charge amount is accounted for throughout the average useful lives of the relevant assets.

Unlisted shares are measured at cost (less impairment losses, if any) because their fair value cannot be measured reliably.

Amounts receivable under long-term contracts are the excess of recognised income (measured using the percentage of completion method) over progress billings.

Other non-current assets and other current assets include mainly prepayments.

	2016	2015
Other non-current assets	**679**	**656**
Loans advanced	235	213
Non-current restricted cash	190	217
Connection charge	125	127
Unlisted shares	82	46
Other non-current assets	47	53
Other current assets	**129**	**146**
Amounts receivable under long-term contracts	27	64
Other current assets	102	82

(in PLN million, unless stated otherwise)

8.5. Contingent assets and liabilities

Contingent liability	2016	2015
	Estimated amount	
Guarantees and sureties	8,006	7,711
Promissory notes	708	1,435
Other	28	27
Total	**8,742**	**9,173**

The increase in contingent liabilities under guarantees and sureties at the end of 2016 followed mainly from the weakening of the Polish złoty against the currencies of denomination of most of the guarantees and sureties (USD, EUR, NOK). The decrease in contingent liabilities under promissory notes was caused by termination of co-financing agreements which had been secured with the promissory notes.
An analysis of the probability of consumption of economic benefits as at the reporting date showed that as at the end of 2016 the PGNiG Group's contingent assets did not represent a material item.

8.6. Joint operations

Accounting policies

In relation to its interest in **joint operations**, the Group, as a joint operator, recognises in its financial statements:

- its assets, including its share of any assets held jointly,
- its liabilities, including its share of any liabilities incurred jointly,
- its revenue from the sale of its share of the output arising from the joint operation;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

As assets, liabilities, revenues and costs relating to the joint operation are also disclosed in the separate financial statements of the party, these items are not subject to adjustment or other consolidation procedures when preparing consolidated financial statements of that party.

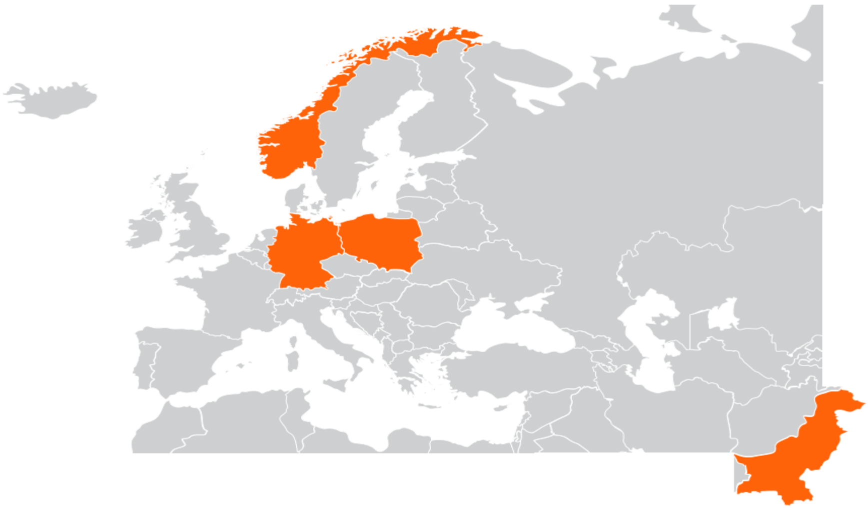


Figure 2 Countries where the Group conducts joint operations

The Group is involved in joint operations mainly in Poland, and also in Germany, Norway, and Pakistan. Joint operations comprise mainly exploration for and production of natural gas and crude oil, except for operations conducted in south-east Poland, where they involve an initial stage of exploration for unconventional deposits of gas.

(in PLN million, unless stated otherwise)

Material estimates

As at the end of the reporting period, the Group was involved in joint ventures, as defined in IFRS 11, as part of projects carried out in Norway in the PL703 and PL856 exploration licence areas, of which, considering all facts and circumstances, it had joint control.

As at December 31st 2015, the Group also held interests in other licences on the Norwegian Continental Shelf, covering, among others, the Skarv, Gina Krog, Morvin, Vilje, and Vale fields. Considering the IFRS 11 criteria, the Group's operations in the above fields do not represent joint arrangements as defined in the standard and the Group does not have joint control of the operations as there is more than one combination of parties that can agree to make significant decisions. Therefore, for the purpose of correct recognition and measurement of transactions related to the operations in those fields, the Group applies other relevant IFRSs taking into account its interest in the fields, which ensures that there are no material differences in the accounting recognition and measurement of transactions related to these operations and the manner of recognising operations which are carried out jointly with the PL703 and PL856 licence interest holders and meet the definition of joint operations within the meaning of IFRS 11.

For more information on joint operations, see Sections 5.1.3. and 5.1.4. of the Directors' Report on the operations of PGNiG S.A. and the PGNiG Group in 2016.

A detailed list of joint operations in which the Group is involved is presented in the tables below.

2016

Name of joint contractual arrangement	Country where joint operation is conducted	Interests in joint operations	Business of joint operations
Joint operation in the Sieraków licence area	Poland	PGNiG S.A. 51%; Orlen Upstream Sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Płotki-PTZ (the Extended Zaniemyśl Area) licence area	Poland	PGNiG S.A. 51%; FX Energy 24.5%; Cal Energy 24.5%	Oil and gas exploration and production
Joint operation in the Kamień Pomorski licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in the Górowo Iławieckie licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in a subdivision of the Lubben licence area in east Germany (Brandenburg)	Germany	PGNiG S.A. 36%; Central European Petroleum Gmbh 39%; Rohöl-Aufsuchungs AG 25%	Oil and gas exploration and production
Joint operation in the Poznań licence area	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Płotki licence area	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Bieszczady licence area	Poland	PGNiG S.A. 51%; ORLEN Upstream sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Warszawa-Południe licence area (blocks 254 and 255)	Poland	PGNiG S.A. 49%; FX Energy 51%	Oil and gas exploration and production
Joint operation covering part of Przedsudecka Monocline	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Kirthar licence area	Pakistan	PGNiG S.A. 70%; Pakistan Petroleum Ltd. 30%	Oil and gas exploration and production
Joint operation in the PL703 licence area	Norway	PGNiG UI 40%, OMV 60%	Oil and gas exploration and production
Joint operation in the PL856 licence area	Norway	PGNiG UI 25%, Capricorn 75%	Oil and gas exploration and production

2015

Name of joint contractual arrangement	Country where joint operation is conducted	Interests in joint operations	Business of joint operations
Joint operation in the Płotki licence area	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Płotki-PTZ (the Extended Zaniemyśl Area) licence area	Poland	PGNiG S.A. 51%; FX Energy 24.5%; Calenergy Resources Poland 24.5%	Oil and gas exploration and production
Joint operation in the Poznań licence area	Poland	PGNiG S.A. 51%; FX Energy 49%	Oil and gas exploration and production
Joint operation in the Bieszczady licence area	Poland	PGNiG S.A. 51%; ORLEN Upstream sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Sieraków licence area	Poland	PGNiG S.A. 51%; Orlen Upstream Sp. z o.o. 49%	Oil and gas exploration and production
Joint operation in the Kamień Pomorski licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in the Górowo Iławieckie licence area	Poland	PGNiG S.A. 51%; LOTOS Petrobaltic S.A. 49%	Oil and gas exploration and production
Joint operation in the Warszawa-Południe licence area (blocks 254 and 255)	Poland	PGNiG S.A. 49%; FX Energy 51%	Oil and gas exploration and production
Joint operation in a subdivision of the Lubben licence area in east Germany (Brandenburg)	Germany	PGNiG S.A. 36%; Central European Petroleum Gmbh 39%; Rohöl-Aufsuchungs AG 25%	Oil and gas exploration and production
Joint operation in the Kirthar licence area	Pakistan	PGNiG S.A. 70%; Pakistan Petroleum Ltd. 30%	Oil and gas exploration and production
Joint operation in the PL702 licence area	Norway	PGNiG UI 40%, OMV 60%	Oil and gas exploration and production
Joint operation in the PL703 licence area	Norway	PGNiG UI 40%, OMV 60%	Oil and gas exploration and production

(in PLN million, unless stated otherwise)

8.7. Changes in the Group structure in the reporting period

Date	Company	Event
August 1st 2016	GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)	The Extraordinary General Meeting of GEOFIZYKA Kraków S.A. passed a resolution to dissolve the company, thus commencing its liquidation.
October 4th 2016	Gas Storage Poland Sp. z o.o.	On October 4th 2016, the change of name of Operator Systemu Magazynowania Sp. z o.o. to Gas Storage Poland Sp. z o.o. (in accordance with a resolution of the company's Extraordinary General Meeting of September 20th 2016) was registered with the National Court Register.

8.8. Business combinations

Acquisition of PEC shares

On April 28th 2016, PGNiG TERMIKA S.A. ("PGNiG TERMIKA") purchased from Spółka Energetyczna Jastrzębie S.A. ("SEJ") 100% of shares in Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie-Zdrój ("PEC"), together with all rights attached thereto, including the right to exercise 100% of the voting rights at the General Meeting of PEC. The fair value of the payment made (representing the purchase price for the shares) was PLN 190.4m and was paid with cash.

In the share purchase agreement, PGNiG TERMIKA undertook not to dispose of or otherwise convey the title to PEC shares (in whole or in part) from the date of the agreement to the date on which the banks are provided with the technical advisor's closure report on the construction of an FBC unit, to be prepared following project completion. The undertaking was reflected in the sale price. However, the restricted right to dispose of or otherwise convey the title to PEC shares does not the affect right to exercise control of PEC, and thus to determine the acquisition date. Accordingly, the date of acquisition of PEC by PGNiG TERMIKA was set as April 28th 2016. For the purposes of accounting for the transaction, April 30th 2016 was adopted as the transaction accounting date.

PEC is involved in the distribution and generation of heat in the municipalities of Jastrzębie-Zdrój, Czerwionka-Leszczyny, Knurów, Racibórz, Kuźnia Raciborska, Pawłowice, Rybnik, Wodzisław-Śląski and Żory. The company operates 288 km of heating networks and 14 local heating plants, which produce 40% of all heat sold by PEC. In 2015, the total sales of heat generated by the company were 2.6 PJ.

The key reasons for the PEC acquisition were:

- to enter new markets and expand the PGNiG Group's geographical reach;
- to strengthen the PGNiG Group's market position;
- to increase the PGNiG Group's value growth on the back of higher total revenue and EBITDA generated by PGNiG TERMIKA and its subsidiaries;
- to increase PEC's value through employment restructuring and operational integration.

As at the date of the transaction, the goodwill on acquisition of PEC shares as disclosed in the interim condensed consolidated financial statements of the PGNiG Group for the six months ended June 30th 2016 and in the interim condensed consolidated financial statements of the PGNiG Group for three months ended September 30th 2016, recognised at fair value of the payment made (PLN 190.4m), less the then initially determined fair value of the identifiable assets and liabilities assumed (PLN 150.9m), was PLN 39.5m.

Measurement of the fair value of net assets for the purposes of the Group's interim consolidated financial statements was provisional as measurement of the fair value of identifiable assets and liabilities for the purposes of these consolidated financial statements was not completed until December 2016.

As a result of the final accounting for the transaction, which included in particular reassessment of completeness and correctness of all the identifiable assets and liabilities assumed in the transaction and their fair value measurement, the fair value of net assets as at the acquisition date was determined at PLN 174.5m, i.e. PLN 23.6m more than the provisional valuation. In consequence, goodwill recognised in the PGNiG Group's consolidated statement of financial position as at December 31st 2016 was PLN 16m.
The goodwill was entirely allocated to the cash-generating unit identified at PEC within to the Generation Segment.

Acquisition of SEJ shares

On August 11th 2016 (acquisition date) PGNiG TERMIKA purchased from Jastrzębska Spółka Węglowa S.A. ("JSW") 100% of shares in Spółka Energetyczna Jastrzębie S.A. of Jastrzębie-Zdrój ("SEJ"), together with all rights attached thereto, including the right to exercise 100% of the voting rights at the General Meeting of SEJ. The shares were purchased for a total of PLN 371.8m, including the amount received by SEJ for sale of PEC shares on April 28th 2016. As at the date of these consolidated financial statements the shares had been paid for in cash. For the purposes of accounting for the transaction, July 31 2016 was adopted as the transaction accounting date, with SEJ data adjusted to account for material events which occurred between July 31st 2016 and August 11th 2016.

SEJ's business consists in generation of electricity and heat for JSW mines and other industrial customers, and generation of heat for households, which is then distributed by PEC. The amount of heat delivered by SEJ to PEC is about 0.9 PJ per year, which represents approximately 60% of SEJ's total heat output. SEJ is also produces compressed air and cold for JSW mines.

As part of the transaction, the parties agreed on long-term conditions of purchases of coal and methane by SEJ from JSW, and sales of heat, electricity, cold and compressed air to JSW.

By acquiring SEJ shares, PGNiG TERMIKA indirectly acquired also 55% of the shares in SEJ-SERWIS Sp. z o.o., and thus the PGNIG Group's overall indirect interest in that company increased to 100% of the share capital (45% of SEJ-SERWIS shares were purchased as part of the acquisition of PEC).

The key reasons for the SEJ acquisition were:

- to enter new markets and expand the PGNiG Group's geographical reach;
- to strengthen the PGNiG Group's market position;
- to increase the PGNiG Group's value growth on the back of higher total revenue and EBITDA generated by PGNiG TERMIKA and its subsidiaries;
- to increase SEJ's value through employment restructuring and operational integration.

The transaction was initially accounted for as at September 30th 2016, and a PLN 72.8m gain from bargain purchase was disclosed under 'Other income and expenses' in the quarterly consolidated statement of profit or loss of the PGNiG Group. This amount was calculated as the excess of fair value, initially determined on that date, of the company's identifiable assets and assumed liabilities (PLN 444.6m) over the fair value of the paid consideration (PLN 371.8m).

Measurement of the fair value of net assets for the purposes of the Group's interim consolidated financial statements was provisional as measurement of the fair value of identifiable assets and liabilities for the purposes of these consolidated financial statements was not completed until December 2016.

As a result of the final accounting for the transaction, which included in particular reassessment of completeness and correctness of all the identifiable assets and liabilities assumed in the transaction and their fair value measurement, the fair value of net assets as at the acquisition date was determined at PLN 368.3m, i.e. PLN 76.4m less than the provisional valuation. In consequence, goodwill recognised in the Group's consolidated statement of financial position as at December 31st 2016 was PLN 3.6m.

Goodwill arose both on the acquisition of PEC and SEJ, and includes mainly the fair value of expected synergies arising from the acquisition, which cannot be separately disclosed in the statement of financial position. Goodwill comprises the expected synergies arising from the combination of the acquirer's and acquiree's businesses, driven by future economic benefits derived from anticipated increase in revenue and employment by PEC and SEJ of highly-qualified staff. Goodwill also comprises future economic benefits derived from the market position of PEC and SEJ, their relationship with Jastrzębska Spółka Węglowa, agreements executed by JSW with heat users, and the possibility to optimise coal procurement for larger groups of customers in order to create added value for the entire PGNiG Group.

The goodwill was entirely allocated to the cash-generating unit identified at SEJ within to the Generation Segment.

(in PLN million, unless stated otherwise)

Fair values of the identified assets and liabilities of PEC and SEJ as at the transaction accounting date:

	Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie-Zdrój	Spółka Energetyczna Jastrzębie S.A.
Acquisition date	**April 28th 2016**	**August 11th 2016**
Cash	190	372
Total consideration paid	**190**	**372**
Total consideration paid as disclosed in the cash flow statement	**190**	**372**

	Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie-Zdrój	Spółka Energetyczna Jastrzębie S.A.
Property, plant and equipment	155	335
Intangible assets	5	16
Inventories	3	13
Receivables	15	116
Cash and cash equivalents	33	186
Other assets	-	10
Deferred tax assets	5	48
Financing liabilities	(3)	(231)
Derivative financial instruments	-	(1)
Trade and tax payables	(12)	(99)
Employee benefit obligations	(17)	(14)
Provisions	(1)	(7)
Other liabilities	(2)	(1)
Deferred tax liability	(6)	(2)
Total identifiable net assets	**175**	**369**

	Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie-Zdrój	Spółka Energetyczna Jastrzębie S.A.
Total acquisition price	190	372
Fair value of identifiable net assets	(174)	(368)
Goodwill	**16**	**4**

Fair value of PEC's trade receivables as the transaction accounting date was PLN 15m. Trade receivables (gross) stood at PLN 15m. As none of the items of trade receivables was impaired, it is expected that recovery of full amounts receivable under the agreements and invoiced supplies and services will be possible.

In the case of SEJ, the fair value of trade receivables as the transaction accounting date was PLN 69m. Trade receivables (gross) stood at PLN 69m. As none of the items of trade receivables was impaired, it is expected that recovery of full amounts receivable under the agreements and invoiced supplies and services will be possible.

In the period from the acquisition date to the reporting date, PEC's contribution to the PGNiG Group's net profit was PLN 1m, while its revenue from continuing operations contributed PLN 97m. Had the acquisition taken place at the beginning of 2016, PEC's contribution to the PGNiG Group's net profit would have been PLN 7m, while its revenue from continuing operations would have contributed PLN 178m.

In the case of SEJ, in the period from the acquisition date to the reporting date, SEJ's contribution to the PGNiG Group's net profit was PLN 6m, while its revenue from continuing operations contributed PLN 84m. Had the acquisition taken place at the beginning of 2016, SEJ's contribution to the PGNiG Group's net profit would have been PLN 46m, while its revenue from continuing operations would have contributed PLN 191m.

Costs directly associated with the transaction and allocated as relating to the acquisition of PEC amounted to PLN 2.4m (of which PLN 0.5m was disclosed under “Other services” in the PGNiG Group's consolidated statement of profit or loss for 2016, while the balance of PLN 1.9m was disclosed under “Taxes and charges” of the PGNiG Group's consolidated statement of profit or loss for 2016). Costs directly associated with the transaction and allocated as relating to the acquisition of SEJ amounted to PLN 4.3m (of which PLN 0.6m was disclosed under “Other services” of the PGNiG Group's consolidated statement of profit or loss for 2016, while the balance of PLN 3.7m was disclosed under “Taxes and charges” of the PGNiG Group's consolidated statement of profit or loss for 2016).

(in PLN million, unless stated otherwise)

8.9. Other important information

8.9.1. Auditor fees

	2016	2015
Audit of the annual consolidated financial statements	0.06	0.06
Audit of the annual separate financial statements	0.06	0.06
Other assurance services, including review of financial statements	0.22	0.47
Total	**0.34**	**0.59**

8.9.2. Other information

Execution of gas fuel supply contract and Individual Contracts with Grupa Azoty S.A.

On April 13th 2016, PGNiG S.A. concluded a Framework Agreement for the sale of gas fuel and bilateral Individual Contracts with Grupa Azoty S.A. and its subsidiaries: Grupa Azoty Zakłady Azotowe Puławy S.A., Grupa Azoty Zakłady Chemiczne Police S.A., Grupa Azoty Zakłady Azotowe Kędzierzyn S.A., Grupa Azoty Kopalnie and Zakłady Chemiczne Siarki Siarkopol S.A. (Customers).

The Framework Agreement provides for a uniform procedure for the conclusion and termination of Individual Contracts to be followed by all Customers, and describes the procedures for order placement, payments, suspension and limitation of supplies, renegotiation clauses, and rules for joint settlement of supplies.

An Individual Contract is a contract for specific supplies under the Framework Agreement, concluded for a definite time, in the form of a sale contract or comprehensive contract, specifying the quantities, timetable, index-linked price formulae, and detailed commercial terms of gas fuel supplies to a Customer.

The Framework Agreement was concluded for an indefinite term and its provisions apply to supplies made since April 1st 2016, while Individual Contracts provide for various supply periods, with the longest period ending on September 30th 2019.

The estimated aggregate value of the Framework Agreement and Individual Contracts is approximately PLN 3.3bn, and the maximum volume of supplies over the entire term of the agreement is 4.5 bcm.

Execution of investment agreement concerning operations of Polska Grupa Górnicza

On April 26th 2016, PGNiG TERMIKA S.A. signed an agreement to launch operations of Polska Grupa Górnicza Sp. z o.o. (the "Agreement").

The parties to the Agreement are Kompania Węglowa S.A., Polska Grupa Górnicza Sp. z o.o. (“PGG”), Węglokoks S.A., Towarzystwo Finansowe Silesia Sp. z o.o. (“TFS”), Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych (“FIPP”), PGNiG TERMIKA S.A., Energa Kogeneracja Sp. z o.o., PGE Górnictwo i Energetyka Konwencjonalna S.A. (“PGE GiEK”) (TFS, FIPP, PGNiG TERMIKA S.A., Energa Kogeneracja Sp. z o.o. and PGE GiEK are jointly referred to as the “Investors”), Alior Bank S.A., Bank BGŻ BNP Paribas S.A., Powszechna Kasa Oszczędności Bank Polski S.A., Bank Zachodni WBK S.A., Bank Gospodarstwa Krajowego S.A. and trade unions operating at Kompania Węglowa S.A. (all jointly referred to as the “Parties”).

In the Agreement, the Parties confirmed the rationale for establishing PGG, whose operations will be based on selected mining assets to be acquired from Kompania Węglowa S.A. (11 mines, four plants, and mine and plant support functions).

In the Agreement, the Investors undertook to purchase PGG shares for a total of PLN 2.4bn, of which PLN 1.8bn is to be contributed in cash and the balance in the form of conversion of TFS's and Węglokoks S.A.'s claims into equity.

PGNiG TERMIKA S.A., as one of the Investors, undertook to purchase PGG shares for PLN 500m.

On April 28th 2016, PGNiG TERMIKA signed an agreement setting out the terms of financial investment in PGG, particularly the terms of acquisition of 5,000,000 shares in PGG for a total amount of PLN 500m (the “Investment Agreement”).

For more information, see **Note 5.1.3**. and **Note 6.1**. of the Directors’ Report on the operations of PGNiG S.A. and the PGNiG Group.

In the consolidated financial statements of the PGNiG Group, the interest in PGG is accounted for with the equity method.

(in PLN million, unless stated otherwise)

8.10. Events subsequent to the end of the reporting period

Date	Company	Event
January 4th 2017	PGNiG Obrót Detaliczny Sp. z o.o.	The President of the Energy Regulatory Office approved the new gas fuel trading tariff (Retail Tariff). The amended Retail Tariff provides for a 7.0% average reduction in gas fuel prices for all tariff groups relative to the previous Tariff of PGNiG Obrót Detaliczny Sp. z o.o. Term of the new Tariff: from February 18th to March 31st 2017.
January 18th 2017	PGNiG Technologie S.A.	Investment agreement with respect to investment in Polimex-Mostostal S.A. and other agreements under the same transaction was executed. The President of Polish Office for Competition and Consumer Protection's approved the business concentration involving the acquisition of joint control of Polimex by the Investors.
January 20th 2017	PGNiG Technologie S.A.	Following the fulfilment of conditions precedent stipulated in the Investment Agreement of January 18th 2017 (“Investment Agreement”), PGNiG Technologie S.A., PGNiG's subsidiary, accepted the Polimex-Mostostal S.A. Management Board's invitation to acquire, in a private subscription, 37,500,000 Series T ordinary bearer shares in Polimex, with a par value of PLN 2 per share, for the issue price of PLN 2 per share and aggregate issue price of PLN 75,000,000. In addition, in the performance of the agreement concluded with SPV Operator Sp. z o.o. (“SPV Operator”), PGNiG Technologie S.A. acquired 1,500,000 Polimex shares from SPV Operator in OTC block transactions.
January 27th 2017	PGNiG TERMIKA S.A.	PGNiG Termika S.A., together with PGE Polska Grupa Energetyczna S.A., ENEA S.A. and Energa S.A. (“Business Partners”) signed a Memorandum of Understanding with EDF, relating to negotiations on the purchase of EDF's assets in Poland (“Transaction”) and the related due diligence. The binding offer may be made after completion of the due diligence, the results of which will be the basis for taking further decisions concerning the Transaction.
February 14th 2017	PGNiG Finance AB	PGNiG Finance AB repaid Eurobonds with a par value of EUR 500 m together with accrued interest.
March 2nd 2017	PGNiG S.A.	District Court for the Capital City of Warsaw in Warsaw, 12th Commercial Division of the National Court Register, approved the cancellation of PGNiG shares and registration of its share capital reduction, as well as registration of the amendments to PGNiG’s Articles of Association in line with EGM resolutions of November 24th 2016 (see Note 5.3).
March 3rd 2017	PGNiG S.A.	Resignation of Magdalena Zegarska from the position of PGNiG Supervisory Board Member, with effect from March 5th 2017. The reason for the resignation is that Magdalena Zegarska is running as a candidate for the position of PGNiG Management Board Member elected by employees.
March 6th 2017	PGNiG S.A.	The PGNiG S.A. Supervisory Board removed Mr Waldemar Wójcik from the Management Board and appointed Ms Magdalena Zegarska as a Management Board member elected by voting by PGNiG S.A. employees.

PGNiG

PGNiG SA Management Board:

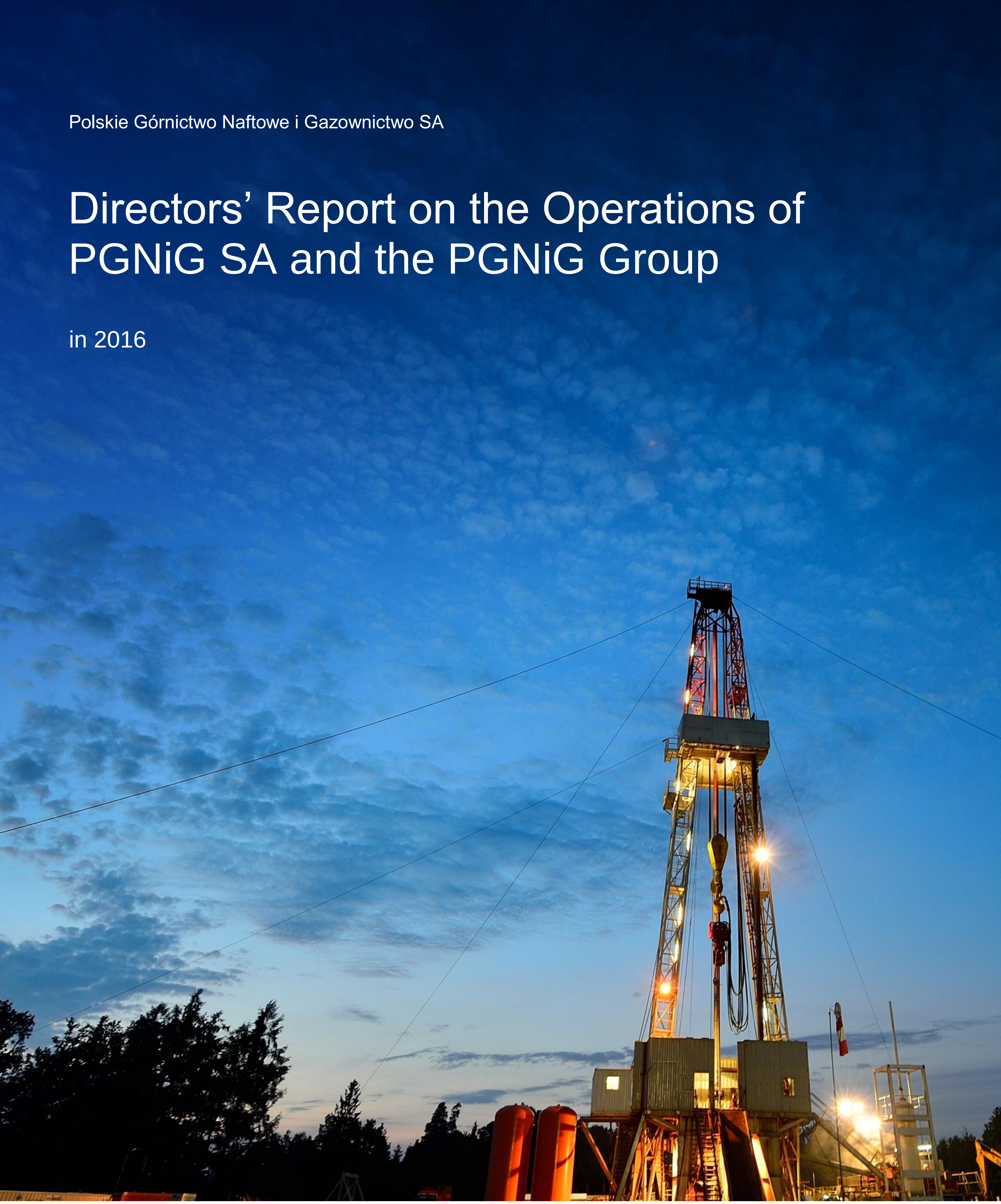
President of the Management Board	Piotr Woźniak	....
Vice President of the Management Board	Radosław Bartosik	....
Vice President of the Management Board	Łukasz Kroplewski	....
Vice President of the Management Board	Michał Pietrzyk	....
Vice President of the Management Board	Maciej Woźniak	....
Vice President of the Management Board	Magdalena Zegarska	....

Warsaw, March 6th 2017

Polskie Górnictwo Naftowe i Gazownictwo SA

Directors' Report on the Operations of PGNiG SA and the PGNiG Group

in 2016



(in PLN million, unless stated otherwise)

Defined Terms

Whenever any of the following acronyms and terms appear in this Directors' Report on the Operations of the PGNiG Group in 2016 and nothing to the contrary is stated herein, these acronyms and terms should be interpreted as follows: **PGNiG, the Company** or the **Issuer** − PGNiG SA as the Parent of its Group; **PGNiG Group** − the PGNiG Group, comprising PGNiG SA as the Parent and its subsidiaries; **PGNiG UI** − PGNiG Upstream International AS; **POGC Libya** − Polish Oil and Gas Company – Libya B.V.; **PSG** − Polska Spółka Gazownictwa Sp. z o.o.; **PST** − PGNiG Supply & Trading GmbH; **PGNiG OD** − PGNiG Obrót Detaliczny Sp. z o.o.; **GSP** − Gas Storage Poland Sp. z o.o.; **PGNiG TERMIKA** − PGNiG TERMIKA S.A.; **PGNiG Technologie** − PGNiG Technologie Sp. z o.o.; **GEOFIZYKA Kraków** − GEOFIZYKA Kraków Sp. z o.o. w likwidacji (in liquidation); **GEOFIZYKA Toruń** − GEOFIZYKA Toruń Sp. z o.o.; **GEOVITA** − GEOVITA S.A.; **Gazoprojekt** − Biuro Studiów i Projektów Gazownictwa Gazoprojekt S.A.; **EXALO** − EXALO Drilling S.A.; **PEC** − Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie Zdrój; **SEJ** − Spółka Energetyczna Jastrzębie S.A.; **CLPB** − Oddział Centralne Laboratorium Pomiarowo-Badawcze PGNiG SA (the Central Measurement and Testing Laboratory Branch of PGNiG SA); **PGG** − Polska Grupa Górnicza Sp. z o.o.; **ECSW** − Elektrociepłownia Stalowa Wola S.A.; **URE** − Urząd Regulacji Energetyki (Energy Regulatory Office); **TTF** − Title Transfer Facility; **PPX** − the Polish Power Exchange (Towarowa Giełda Energii S.A.); **UGSF** − underground gas storage facility; **CUSGF** − cavern underground gas storage facility; **CHPP** − combined heat and power plant; **HP** − heat plant; **SF** − storage facilities; **GSF** − group of storage facilities; **EGM** − Extraordinary General Meeting; **GM** − General Meeting; **KRS** − Krajowy Rejestr Sądowy (National Court Register). With respect to currency and other units: amounts expressed in the **złoty** are designated with the acronym **PLN**; amounts expressed in the **euro** are designated with the acronym **EUR**; amounts expressed in the **US dollars** are designated with the acronym **USD**; amounts expressed in the Norwegian crown are designated with the acronym **NOK**; amounts expressed in the Swedish crown are designated with the acronym **SEK**; and the acronym **boe** is used to designate barrel of oil equivalent.

Converters

Converters	1 bcm of natural gas	1m tonnes of crude oil	1m tonnes of LNG	1 PJ	1mm boe	1 TWh
1 bcm of natural gas	1	0.90	0.73	38	6.45	10.97
1m tonnes of crude oil	1.113	1	0.81	42.7	7.33	11.65
1m tonnes of LNG	1.38	1.23	1	55	8.68	14.34
1 PJ	0.026	0.23	0.019	1	0.17	0.28
1mm boe	0.16	0.14	0.12	6.04	1	1.70
1 TWh	0.091	0.086	0.07	3.6	0.59	1

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1. The PGNiG Group in 2016

1.1. Key financial and operating metrics

PLN 33.2bn
Revenue

PLN 6.0bn
EBITDA

PLN 3.4bn
EBIT

PLN 2.3bn
Net profit

PLN 49.7bn
Total assets

4th
largest company listed on the WSE

PLN 32.5bn
Market capitalisation

25.3 thousand
Number of employees

7.3%
ROE

4.7%
ROA

5.5
EV/EBITDA

13.8
P/E

1.0
P/BV

PLN 25.5m
Average daily trading value

1.3 million tonnes
Production of crude oil, condensate, and NGL

4.5 bcm
Production of natural gas

54
Number of oil and gas production facilities in Poland

225
Number of production licences

over 2 thousand
Number of producing wells

48
Number of hydrocarbon exploration and appraisal licences

770 mm boe
Oil and gas reserves

24.3 bcm
Volume of gas sold

2.9 bcm
Gas storage capacities

9.1 bcm
Volume of gas sold via the PPX

11.5 bcm
Volume of imported gas

6.9 million
Number of customers

396.9 km
Length of heat distribution network

1,482
Number of municipalities/communes connected to the gas grid

10.9 bcm
Volume of distributed gas

40.0 PJ
Heat output

1.1 GW
Electric power

5.4 GW
Thermal power

3.6 TWh
Electricity output

1.2. Calendar of corporate events

January 2016

- Elektrociepłownia Stalowa Wola S.A., a special purpose vehicle of PGNiG TERMIKA and TAURON Wytwarzanie S.A., terminates its contract with Abener Energia, the general contractor for the 450 MW CCGT unit construction project.
- PGNiG terminates its agreement with Standard&Poors Rating Services Ltd (S&P) for credit rating of the Company and of the bonds issued by its subsidiary PGNiG Finance AB.

February 2016

- A claim is brought against OAO Gazprom and OOO Gazprom Export as part of the arbitration proceedings initiated by PGNiG on May 13th 2015 to change the price terms of the long-term gas supply contract.

March 2016

- The President of URE approves the PGNiG Gas Fuel Supply Tariff No. 10/2016 (wholesale tariff) and the PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 3 (retail tariff). › For more information, see Section 4.1.1.

April 2016

- The PGNiG Group's strategy for 2014-2022 is revised and updated. › For more information, see Section 3.
- PGNiG TERMIKA purchases 100% of shares in Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie Zdrój for PLN 190.4m.
- PGNiG signs a gas fuel supply contract with Grupa Azoty S.A. › For more information, see Section 5.2.3.
- PGNiG TERMIKA and a group other investors sign a memorandum of understanding to establish Polska Grupa Górnicza Sp. z o.o. (PGG). PGNiG TERMIKA declares that it would acquire PGG shares worth PLN 500m, with the price payable in three stages. › For more information, see Section 5.1.3.

June 2016

- The President of URE approves the PGNiG Gas Fuel Supply Tariff No. 11/2016 (wholesale tariff) and the PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 4 (retail tariff). › For more information, see Section 4.1.1.
- A new strategy for Polska Spółka Gazownictwa Sp. z o.o. is approved. › For more information, see Section 5.3.2.
- The first shipment of LNG under the long-term contract with Qatargas and the first shipment of LNG purchased in a spot transaction from Statoil arrive at the LNG Terminal in Świnoujście.

August 2016

- PGNiG TERMIKA purchases the entire share capital in Spółka Energetyczna Jastrzębie S.A. for about PLN 372m.
- PGNiG distributes a dividend of PLN 1,062m (PLN 0.18 per share).
- Start of gas supplies to Ukraine, as part of cooperation with ERU TRADING.

September 2016

- PGNiG TERMIKA and its partners (ENEA S.A., ENERGA S.A. and PGE Polska Grupa Energetyczna S.A.) submit a preliminary, non-binding offer to purchase shares in companies owned by EDF Investment SAS in Poland.
- PGNiG enters into a five-year gas fuel supply contract with PKN ORLEN S.A. and its subsidiaries. The contract is worth over PLN 7bn.
- PGNiG signs four gas fuel supply contracts with PGE Górnictwo i Energetyka Konwencjonalna S.A., a PGE Group company. The estimated value of the contracts, which provide for the supply of about 2.2 bcm of gas, exceeds PLN 2bn.
- PGNiG buys back 92,764,327 of its shares. › For more information, see Section 9.2.

October 2016

- The President of URE approves the PGNiG Gas Fuel Supply Tariff No. 12/2016 (largest customers tariff). › For more information, see Section 4.1.1.
- PGNiG, TAURON Polska Energia S.A. and Elektrociepłownia Stalowa Wola S.A. enter into an agreement defining terms of further joint work on the CCGT project in Stalowa Wola.

November 2016

- PGNiG buys back 28,920,816 of its shares. › For more information, see Section 9.2.
- PGNiG and National Iranian Oil Company (NIOC) sign a letter of intent for their collaboration on the Soumar oil field.

December 2016

- PGNiG Supply & Trading GmbH presents charges against the European Commission concerning its decision on the OPAL gas pipeline in an urgent action brought before the European Court of Justice. › For more information, see Section 6.3.3.
- The President of URE approves the PGNiG Gas Fuel Supply Tariff No. 13/2016 (largest customers tariff). › For more information, see Section 4.1.1.
- PGNiG and its partners (ENEA S.A., ENERGA S.A. and PGE Polska Grupa Energetyczna S.A.) submit their letter of intent to consider potential investment in Polimex-Mostostal S.A.

1.3. Events subsequent to the reporting date

January 2017

- On January 20th 2017, PGNiG Technologie S.A. accepted the Polimex-Mostostal S.A. Management Board's invitation to participate in a private placement and subscribe for 37,500,000 Series T ordinary bearer shares with a par value of PLN 2 per share, issued by Polimex at the issue price of PLN 2 per share and aggregate issue price of PLN 75,000,000. Furthermore, in the performance of an agreement with SPV Operator sp. z o.o., PGNiG Technologie S.A. acquired 1,500,000 Polimex shares from SPV Operator in OTC block transactions following satisfaction of the conditions precedent set out in the investment agreement of January 18th 2017. › For more information, see Section 6.1.
- On January 27th 2017, PGNiG Termika S.A., PGE Polska Grupa Energetyczna S.A., ENEA S.A. and Energa S.A. signed a Memorandum of Understanding with EDF providing for negotiations on the potential acquisition of EDF's Polish assets and related due diligence. The transaction would comprise the acquisition of EDF's entire shareholding in EDF Polska S.A., the owner of four CHP plants (in Kraków, Gdańsk, Gdynia, and Toruń), a heat distribution network in Toruń, the Rybnik Power Plant, and other assets, and the acquisition of EDF's entire shareholding in ZEC Kogeneracja S.A., the owner of four CHP plants (in Wrocław, Zielona Góra, Czechnica, and Zawidawie) and heat distribution networks in Zielona Góra, Siechnice, and Zawidawie. The business partners agreed that a firm offer could be made after completion of the due diligence, the results of which would be the basis for further decisions concerning the transaction.

February 2017

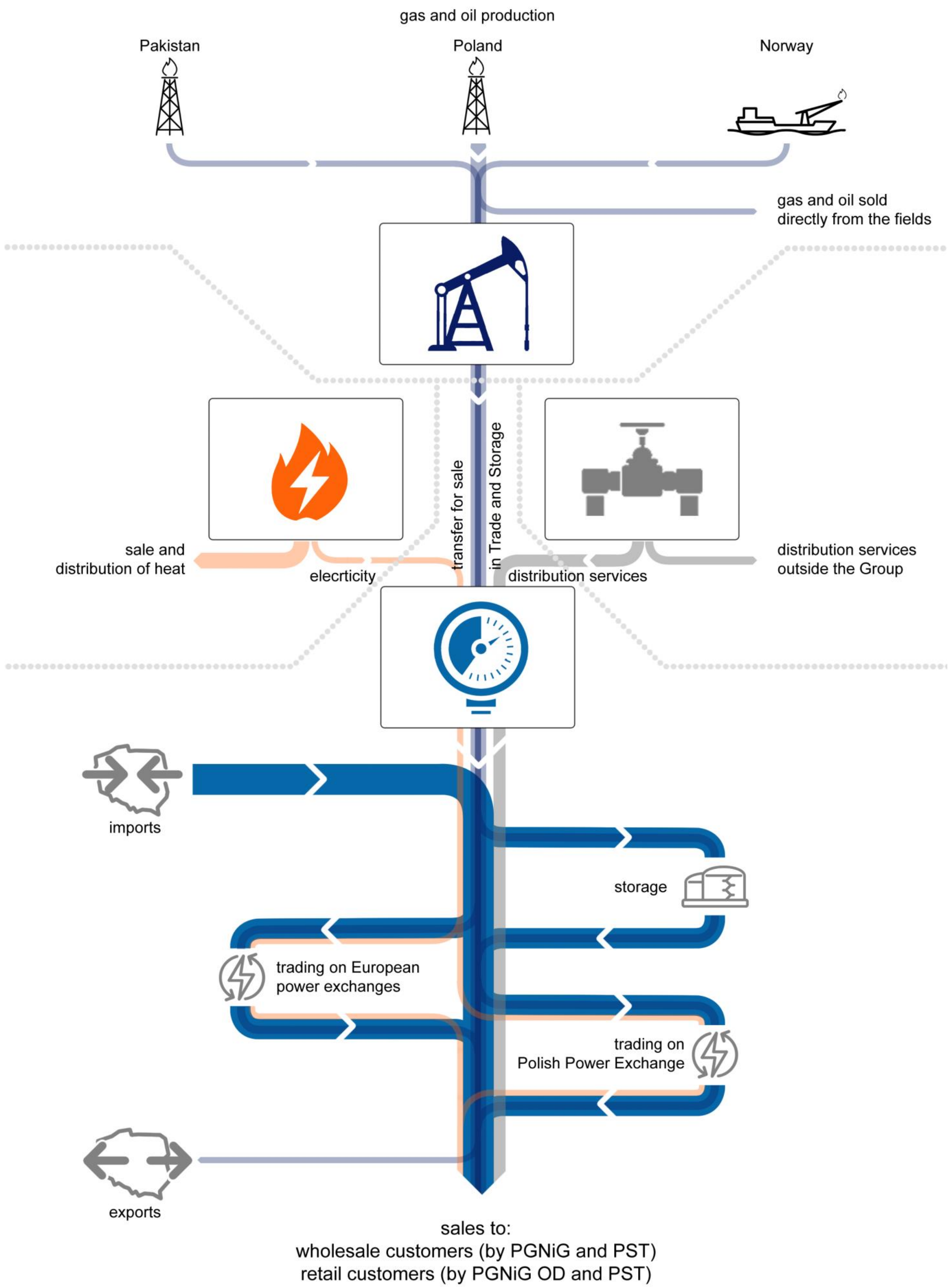
- On February 13th 2017, PGNiG made a timely repayment of a loan from PGNiG Finance AB of EUR 500m along with interest. On February 14th 2017, PGNiG Finance AB redeemed Eurobonds assigned ISIN code XS0746259323, with a nominal value of EUR 500m, and paid due interest.

March 2017

- On March 2nd 2017, the District Court for the Capital City of Warsaw in Warsaw, 12th Commercial Division of the National Court Register, decided to approve the share cancellation, register the reduction of PGNiG's share capital, and register the amendments to the PGNiG Articles of Association introduced by Resolutions No. 6/XI/2016, 7/XI/2016 and 8/XI/2016 of the Extraordinary General Meeting of PGNiG of November 24th 2016. › For more information, see Section 9.2.
- At its meeting held on March 6th 2017, the PGNiG Supervisory Board removed Mr Waldemar Wójcik from the Management Board and appointed Ms Magdalena Zegarska as the Management Board Member elected by PGNiG's employees.

2. PGNiG Group's business model

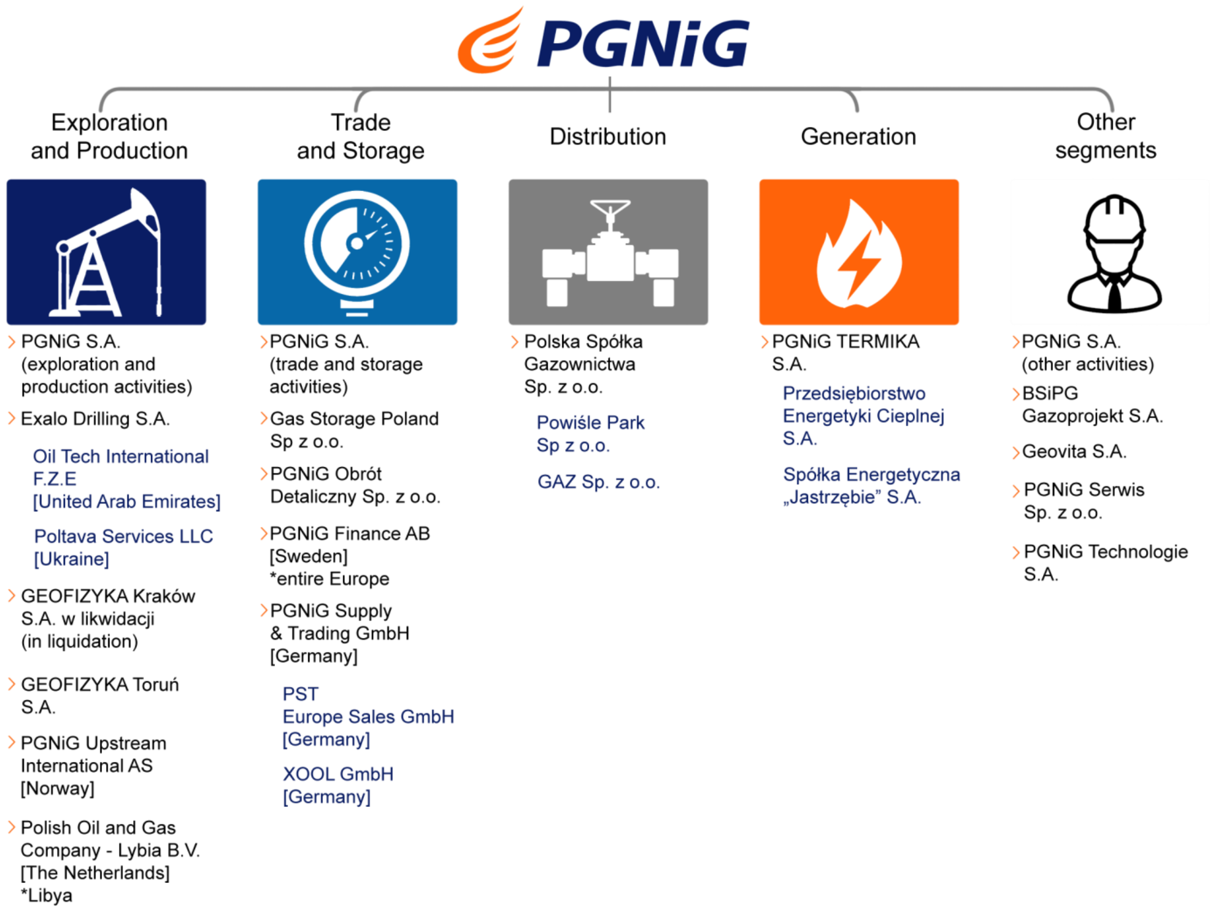
2.1. PGNiG Group's business and the business model



2.2. Companies of the PGNiG Group

As at December 31st 2016, the consolidated companies were PGNiG (the Parent) and 23 subsidiaries.

Consolidated PGNiG Group companies



Company name – PGNiG's indirect subsidiary
[country] – country of registration (if different from Poland)
** Principal place of business (if different from the country of registration)*

3. PGNiG Group strategy

3.1. Mission statement

'By developing oil and gas production, making efficient use of infrastructure, and diversifying natural gas supplies, we provide our customers with environmentally-friendly energy and build the Company's value for our shareholders and employees.'

3.2. Challenges

The PGNiG Group's activities depend strongly on external factors. Key challenges facing the Group in 2016:

- **Developments in the global fuel and energy markets**, notably the slump in oil and gas prices and rapid expansion of the LNG market

  The changes on the Polish gas market were accompanied by steep price declines elsewhere in Europe. Moreover, gas prices on European markets are becoming increasingly decoupled from petroleum product prices − a trend observed for the past several years. Spot prices of gas in Germany and other European markets having declined by over 40%, the cost of gas imports to Poland became much more attractive versus the PGNiG tariff.

  The falling oil prices also had major implications for the Group − the flip side of lower gas procurement costs under long-term contracts, which made imports a more attractive source of supply, were deteriorated economics of foreign upstream projects with a predominant share of oil in total reserves, leading to a downward revaluation of the foreign exploration and production segment.

  Global LNG infrastructure has been expanding rapidly in recent years, with new projects built to increase both export capacities (liquefaction terminals), mainly in North America and Australia, and import capacities (regasification terminals), mainly in Europe. This has also created an oversupply in global LNG markets, leading to price declines and global price convergence.

  As a participant of the global LNG market, PGNiG will be able to take advantage of favourable pricing terms and secure additional gas supplies for Poland. With the abundant LNG supply, trading in gas under spot, short-term and medium-term contracts has gained in importance, as the destination clause is being increasingly departed from, market participants are growing in number, and the global LNG fleet is becoming more available.

- **Progressing market deregulation**
  As the requirement to sell a specific portion of gas volumes on the exchange market has come into force, PGNiG is required to sell high-methane gas on commodity exchanges or other regulated markets. The deregulation process coupled with the exchange sale requirement pose a risk of significant customer loss and reduced revenue from the storage segment.

  PGNiG has also had to align its contracts with customers to the liberalised market in terms of contracted capacity, volumes contracted per gas year, and the supplier switching process.

- **Need to change the mix of imported gas sources**
  The Group's current mix of gas supply sources was structured to cover the entire demand for natural gas in Poland. However, considering the risk of losing a part of the Group's market share and given the insufficient diversification of supplies, there was a risk of imbalance in the Group's gas portfolio. Currently, the PGNiG Group's gas supply mix is largely made up of contracts priced partly by reference to the prices of oil products (Yamal and Qatar Contracts), and differences in the pricing formulas between PGNiG and its competitors entail a risk of pricing pressures.

  Therefore, it has become imperative for the Group to explore opportunities for diversifying its gas supply sources and analyse the feasibility of related projects. With the Yamal Contract nearing expiry, a need arises to build a flexible portfolio of supply sources for Poland beyond 2022.

- **Policy and regulatory changes**

  There are significant changes in PGNiG's regulatory environment, particularly as regards taxation of hydrocarbon production, the exchange sale requirement, and uncertainty surrounding the support model for gas-fired cogeneration, which adversely affect the Group's segment revenues.

3.3. PGNiG Group Strategy

In order to adjust the Strategy to the challenges facing the PGNiG Group in the coming years, in early 2016 the strategy was revised and updated. On April 4th 2016, the PGNiG Supervisory Board approved the PGNiG Group's updated Strategy for 2014–2022. Following a review and verification of the Strategy, its macroeconomic, market and business framework was updated and the strategic ambitions were redefined. As a result, the existing strategic initiatives were modified and new ones were added to the Strategy.

The updated Strategy continues to focus on the following four key business areas:

- Maintaining stable trading volumes (both retail and wholesale) › For more information, see Section 5.2.2;
- Maximising cash flows from the infrastructure and generation area › For more information, see Sections 5.3.2. and 5.4.2;
- Strengthening and transforming the exploration and production area › For more information, see Section 5.1.2;
- Laying foundations for growth along the value chain.

The updated Strategy provides for a slight increase in the Group's EBITDA, the principal performance measure, to over PLN 7bn in 2022. This objective is to be achieved through implementation of strategic initiatives, the number of which was increased from 10 to 16 as part of the Strategy review. The higher EBITDA target is underpinned by larger ambitions in the area of (i) transmission infrastructure (gas and heat distribution), (ii) acquisition of foreign exploration and production assets, and (iii) the Efficiency Improvement Programme.

In the period covered by the Strategy, capital expenditure on organic growth and acquisitions was maintained at PLN 40bn−50bn, with the net debt to EBITDA ratio comfortably below 2.0 in 2022 and the current dividend policy upheld.

In terms of operational objectives, it is of key importance that the planned rates of hydrocarbon production in Poland and abroad be increased to approx. 55−60 million boe in 2022 (by taking advantage of the market conditions conducive to cost-effective acquisitions) and that the annual production targets in Poland be maintained at approximately 33 million boe.

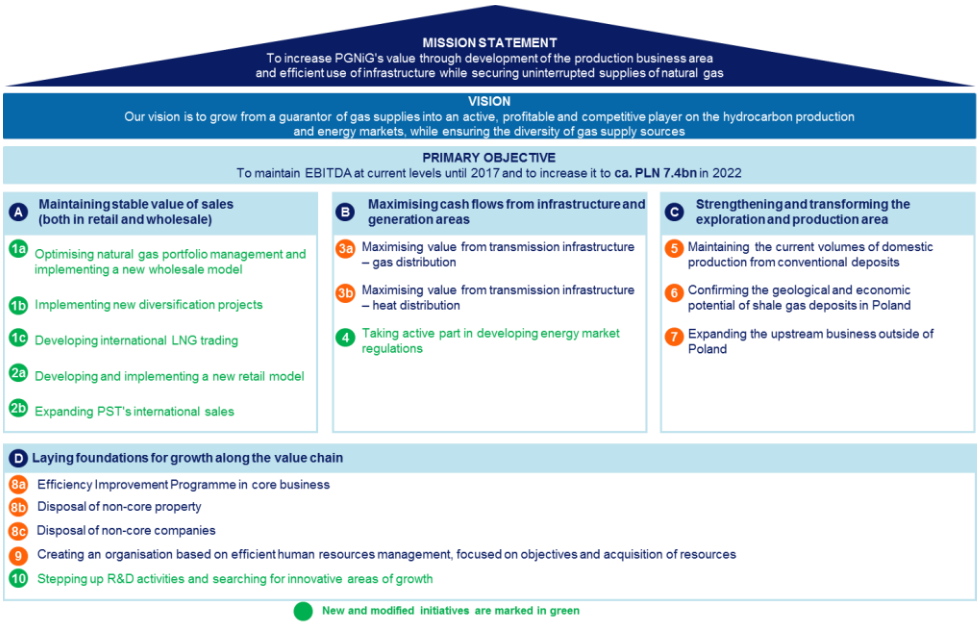
The modified strategic initiatives include:

- Initiative 1a: Optimisation of the natural gas portfolio management and implementation of a new wholesale model − updated negotiation objectives for the long-term contracts (due to changes in the macroeconomic environment),
- Initiative 2a: Developing and implementing a new retail model − to actively defend the market position of PGNiG Obrót Detaliczny,
- Initiative 3b: Maximising value from transmission infrastructure − heat distribution − to achieve higher EBITDA from the acquired heating systems,
- Initiative 4: Taking active part in creating energy market regulations − new stream of work including development of mechanisms to improve the economics of fields with declining hydrocarbon production profiles,
- Initiative 7: Expanding the upstream business outside of Poland − higher production targets and cost efficiency of planned acquisitions following decline of the crude oil prices,
- Initiative 8a: Efficiency Improvement Programme − achieving higher sustainable savings,
- Initiative 8b: Matrix Project − divided into initiative 8b (Disposal of non-core property) and 8c (Disposal of non-core companies),
- Initiative 10: Stepping up R&D activities and searching for innovative areas for growth − innovative technologies developed in the upstream business to be applied in other areas, particularly in order to obtain coal bed methane.

As part of the review, three new initiatives were also added to the Strategy:

- Initiative 1b − analysis of new diversification projects,
- Initiative 1c − assessment of feasibility of developing international LNG trading,
- Initiative 2b − expansion of international sales activities of PGNiG Supply & Trading

(in PLN million, unless stated otherwise)



Operating in a fully competitive market, the PGNiG Group will pursue its strategy, seeking to remain a leader in hydrocarbon exploration and production and the main supplier of natural gas, offering also heat and electricity.

3.4. Capital expenditure in 2016

In 2016, capital expenditure incurred by the PGNiG Group on property, plant and equipment and intangible assets was PLN 3.0bn, having gone down by ca. 10% year on year. The tables below present the Company's and the Group's expenditure in each segment.

Capital expenditure on property, plant and equipment made by PGNiG in 2016

				Performance vs CAPEX plan
		2016	**2015**	**2016**
I.	Exploration and Production, including:	830	983	59%
1	Exploration*	398	526	
	including expenditure on dry wells	*77*	*109*	
2	Production	432	457	
II.	Trade and Storage	183	228	80%
1	Trade	111	45	
2	Storage facilities used by the Trade and Storage segment	72	183	
III.	Other segments	1	-	67%
IV.	Total capital expenditure (I+II+III)	1,014	1,211	60%

** capital expenditure includes expenditure on geophysical surveys and drilling campaigns, as well as capitalised borrowing costs*

Capital expenditure on property, plant and equipment made by the PGNiG Group in 2016

				Performance vs CAPEX plan
		2016	**2015**	**2016**
I.	Exploration* and Production, including:	1,254	1,437	58%
1	Norway	343	395	
2	Pakistan	98	54	
3	Libya	6	10	
II.	Trade and Storage	192	233	85%
III.	Distribution	1,109	1,193	92%
IV.	Generation	438	454	84%
V.	Other segments	9	7	67%
VI.	Total capital expenditure (I-V)	3,003	3,324	73%

** capital expenditure includes expenditure on geophysical surveys and drilling campaigns, as well as capitalised borrowing costs*

Key investment projects and CAPEX in each segment:

- Exploration and Production › For more information, see Section 5.1.5
- Trade and Storage › For more information, see Section 5.2.5
- Distribution › For more information, see Section 5.3.5
- Generation › For more information, see Section 5.4.5

3.5. Research and development

In 2016, the Group significantly intensified its research, development, and innovation activities. Its R&D&I efforts brought the following results:

- Formulation of a new R&D&I strategy for the entire PGNiG Group;
- Implementation of 14 R&D&I initiatives focused mainly on streamlining the processes of selecting innovative projects, but also on improving project assessment, innovation-related decision making, and implementations;
- Conclusion of an agreement, in October 2016, between PGNiG, OGP GAZ-SYSTEM S.A. and the National Centre for Research and Development to create INGA (Innovative Gas), a joint venture. The formula of the joint venture involves a dedicated mechanism for financing R&D efforts, whereby the National Centre for Research and Development and selected industrial partners support pursuit of the country's so-called Research Agenda. The Research Agenda includes R&D themes that are most relevant for the PGNiG Group in the areas of hydrocarbon exploration and production, gas storage, gas networks, use and new applications of gaseous fuels, and environmental protection. The budget of the project's pilot phase (2017–2019) is PLN 400m, half of which will be covered by the National Centre for Research and Development, and the other half will be provided by industry partners. The first contest will be announced in mid-2017;
- Joining the International Centre for Excellence on Coal Mine Methan by PGNiG and launch of the GEO-METAN R&D project on pre-mining coal bed methane extraction. The estimated budget of the project in its initial phase is PLN 360m, of which PLN 210m is expected to be obtained from external sources;
- Organisation of three sessions with micro- and small-sized enterprises and startups as part of the Innovative Thinking Workshop (ITW) initiative aimed to spur new solutions for the PGNiG Group companies (PGNiG TERMIKA, PGNiG OD, and PSG). The ITW project is pursued in cooperation with Agencja Rozwoju Przemysłu and the Chamber of the Natural Gas Industry;
- Launch of a series of Innovation Competitions by PGNiG to foster innovation among employees;
- Second edition of the 'Innovative Youth for PGNiG' competition for young scientists as well as graduate and post-graduate students, to find and attract innovative R&D projects relevant for PGNiG's business; launch of the InnVento.pl startup incubator in December 2016;
- Joining the MIT Enterprise Forum Poland startup accelerator by PGNiG; and
- Start of the 'PGNiG Polish Innovations' project at universities, involving visits of PGNiG representatives at universities and presentation of both our potential and opportunities for expected cooperation in the R&D&I area.

In 2017, we will further intensify the R&D&I efforts as part of the so-called Innovation Factory which comprises a system of practices and activities enabling efficient selection, pursuit and implementation of R&D&I projects. In order to maintain a balanced portfolio of innovative projects, the PGNiG Group intends to carry out several dozen such projects in 2017.

As part of its research, development and innovation activities, the Group pursues also projects focused on power efficiency management. While R&D&I efforts in this specific area are to be intensified in 2017, our achievements and initiatives in 2016 included:

- Launch of a pilot project to implement the Energy Management System in selected facilities: the Wierzchowice UGS, the Tarnów II Gas Production Site, and the PGNiG Head Office;
- Application was filed for co-financing of the construction of a co-generation source system at the Dębno Oil and Gas Production Facility (grant of PLN 5.1m, project value of PLN 37.4m) as part of the National Fund for Environmental Protection and Water Management Operational Programme for 2014–2020;
- Tender declarations were submitted in a tender for energy efficiency certificates.

In 2016 the PGNiG Group initiated and carried out a number of R&D&I activities, including:

- Identification of innovative areas to extend the product range and improve the service quality at PGNiG OD;
- Eight projects within PSG, including LNG metering systems at regasification stations; development of the gas distribution system functionality by application of the Power to Gas (P2G) technology involving conversion of surplus electricity into hydrogen; and preparation of technical documentation, construction and experimental testing of a gas station equipped with a glycol-based natural gas dehydration unit powered from own energy sources;
- development by GSP and CHEMKOP Sp. z o.o. of design for well sampling equipment (borehole caliper, inclinometer, gamma-ray probe), used to examine storage caverns (worked-out salt caverns).

4. Regulatory and market environment

4.1. Regulatory environment

4.1.1. Regulatory environment in Poland

Energy Law

The Energy Law of April 10th 1997 (consolidated text: Dz. U. of 2012, item 1059, as amended; the 'Energy Law') is the main legal act governing the operation of the energy sector. In particular, it specifies the rules of development of the national energy policy, matters concerning the supply and use of fuels, energy and heat, and lays downs rules of operation applicable to energy companies. The Energy Law also defines the bodies competent for matters of fuel and energy management.

As at December 31st 2016, the PGNiG Group held the following licences granted by the President of Energy Regulatory Office under the Energy Law:

- three licences to trade in gas fuels (PGNiG, PGNiG OD, PST),
- one licence to trade in natural gas with foreign partners (PGNiG),
- one licence to trade in liquid fuels (PGNiG; the licence expired in January 2017 by operation of law),
- three licences to produce electricity (PGNiG, PGNiG Termika, PEC),
- four licences to trade in electricity (PGNiG, PGNiG OD, PGNiG Termika, SEJ),
- three licences to produce heat (PGNiG Termika, SEJ, PEC),
- two licences to trade in heat (SEJ, PEC),
- three licences to transmit heat (PGNiG Termika, SEJ, PEC),
- two licences to liquefy natural gas and regasify LNG at LNG regasification plants (PGNiG, PSG),
- one licence to store gas fuel in storage facilities (GSP),
- one licence to distribute gas fuels (PSG).

In 2016, the Energy Law was amended, and the key legislative changes included:

- The Act Amending the Energy Law and Certain Other Acts of July 22nd 2016 (Dz.U. of 2016, item 1065). The main objective of the amendment was to improve the organisation of the liquid fuels and natural gas markets; to enhance Poland's energy security by introducing changes to the system of crude oil and fuels emergency stocks; and to enhance security of natural gas supplies.
- The Act Amending the Energy Law and Certain Other Acts of November 30th 2016 (Dz.U. of 2016, item 1986). The main objective of the amendment was to abolish the system of administrative regulation of natural gas prices. The adopted schedule provides for exemptions from the obligation to submit gas tariffs for approval for:
  - wholesalers and end customers purchasing gas fuel (i) at a virtual gas trading point, (ii) in the form of LNG or CNG, and (iii) under tender, auction or public procurement procedures pursuant to the provisions of the Public Procurement Law as of January 1st 2017,
  - other end customers (businesses) as of October 1st 2017,
  - households as of January 1st 2024.

The Act Amending the Energy Law and Certain Other Acts of July 22nd 2016 was also amended on November 30th 2016. Pursuant to the amendment, no proceedings will be initiated, and any pending proceedings will be discontinued, in matters concerning non-compliance with the obligation to diversify natural gas supply sources prior to the coming into force of the new diversification regulation. Accordingly, on January 4th 2017, the President of URE discontinued proceedings into PGNiG's failure to comply with the obligation to diversify natural gas supply sources in 2011−2013.

PGNiG actively participated all key initiatives to amend the Energy Law, presenting its positions and proposals how to protect the interests of the PGNiG Group and its customers.

Act on Emergency Stocks

Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market of February 16th 2007 (consolidated text: Dz.U. of 2016, item 1899, as amended; 'Act on Emergency Stocks') lays down the rules of creating and maintaining emergency stocks of natural gas, and procedures for monitoring and proper enforcement of the act. The act also sets out the rules to be followed in the event of threat to Poland's energy security.

On July 22nd 2016, the Act Amending the Energy Law and Certain Other Acts was passed. With respect to emergency stocks of natural gas, the amendment extends the list of obligated entities to include gas importers, and removes exemptions from the obligation enjoyed by utilities with fewer than 100 thousand customers and importing less than 100m m^3 of natural gas in a calendar year. Until the amendment of July 22nd 2016, the obligation to maintain mandatory stocks of natural gas applied only to energy companies engaged in the business of importing natural gas for its resale to customers. The obligation therefore applied only to trading companies. Under the amendment however, the obligation was extended to cover companies importing natural gas for their own consumption.

The Act on Emergency Stocks also allows those of the obligated entities which have no reserved storage capacities of their own to cover the obligation by contracting ticketing services from third parties. The Company supported the above solutions and actively participated in legislative work on the amendments to the Act on Emergency Stocks. The developed solutions contribute to Poland's energy security and provide a more level playing field for competitors on the Polish gas market.

Energy Efficiency Act

The Energy Efficiency Act of May 20th 2016 (Dz.U. of 2016, item 831; 'Energy Efficiency Act') establishes an energy efficiency obligation scheme, which implements into the Polish legal system the provisions of Directive 2012/27/EU of the European Parliament and of the Council of 25 October 2012 on energy efficiency, amending Directives 2009/125/EC and 2010/30/EU and repealing Directives 2004/8/EC and 2006/32/EC (OJ EU L 315 of November 14th 2012). Pursuant to the act, obligated entities are required to generate savings in final energy consumption of 1.5% each year. The Energy Efficiency Act references two principal ways to fulfil this obligation:

- to implement a project or projects designed to improve end customers' energy efficiency,
- to obtain an energy efficiency certificate and to submit the certificate to the President of URE for redemption.

The act provides for the option to fulfil the obligation by paying a substitution fee. However, as a rule this option cannot be exercised to cover more than 30% of the obligation for 2016, 20% for 2017, and 10% for 2018. The act significantly increases the substitution fee and provides for its annual indexation. It also imposes an obligation to conduct an energy efficiency audit every four years.

In 2016, PGNiG was actively involved in the legislative process seeking to adopt the new Energy Efficiency Act. The Company's proposals concerned abolishing the preferences given to natural gas purchases with delivery at the border, and reinstatement of deductions from the basis used for calculation of the obligation. The legislator fully complied with the above proposals.

Act on Special Hydrocarbon Tax

Act on Special Hydrocarbon Tax of July 25th 2015 (consolidated text: Dz.U. of 2016, item 979; 'Act on Special Hydrocarbon Tax', 'SHT'), stipulates a special tax regime, where the tax base is the surplus of revenue generated from hydrocarbon extraction activities in a given year over the qualifying expense incurred in a given tax year. The date of receipt of receivables is deemed the date on which revenue from hydrocarbon production is generated. The date of making payment is deemed the date on which qualified expenditure is incurred.

The obligation to pay special hydrocarbon tax will only apply in respect of revenue generated after January 1st 2020. Nevertheless, the obligations to keep appropriate tax records and to file relevant tax returns with the competent tax authority have been discharged since January 1st 2016.

In the first tax year, i.e. the year from January 1st 2016, SHT payers may include in their eligible expenses the expenses they incurred in the four calendar years preceding January 1st 2016, and also – to a specified extent – the value of property, plant and equipment associated with the hydrocarbon production business which they acquired or generated internally in earlier periods, as well as the value of tangible assets under construction in the amount determined as at January 1st 2012.

Geological and Mining Law

The Geological and Mining Law of June 9th 2011 specifies, among others, the rules, terms and conditions for performing geological work, extraction of minerals from deposits, storage of waste matter in rock mass (including in worked-out caverns), protection of mineral deposits, underground waters and other components of the environment in connection with geological works and extraction of minerals.

Business activities involving exploration for and appraisal of mineral deposits, extraction of minerals from deposits, tankless storage of substances and storage of waste matter in rock mass, including in worked-out caverns, require a licence.

The deadline for submitting applications for conversion of existing licenses for exploration and appraisal of hydrocarbons into combined licenses for exploration, appraisal, and extraction of hydrocarbons expired at the end of 2016. Unconverted license remain valid and may be extended only once if specific conditions are met. The obligation to provide security for non-performance or improper performance of the conditions specified in the license in an amount no exceeding the equivalent of up to 20% of the cost of geological work represents an additional and considerable financial burden for the industry.

On December 15th 2016, additional secondary legislation to the act was announced:

- Regulation of the Minister of Environment of December 15th 2011 on specific requirements to be met by other geological documentation;
- Regulation of the Minister of Environment of December 6th 2011 on specific requirements to be met by other geological documentation.

In 2016, the Minister of Environment commenced work on a new amendment to the Geological and Mining Law. One of the purposes of the new regulations is to simplify provisions applicable to administrative proceedings. The main changes are expected to cover:

- imposing an obligation to submit opinions to a qualified entity in the form of decisions by bodies participating in the qualification procedure, not only to the minister competent for the environment;
- allowing for the issue of a partially positive assessment in the qualification procedure (as regards safety), if in the course of the procedure it is found that the qualified entity does not have the required experience;
- waiver of security for non-performance or improper performance of the licence conditions;
- introduction of a second, open-door procedure for granting hydrocarbon licenses, which allows for tender proceedings to be carried out at a request of an undertaking.

Diversification Regulation

The Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies (Dz.U. of 2000, No. 94, item 1042; 'Diversification Regulation) prescribes the maximum share of gas imported from a single country in total gas imports in a given year. In 2015–2018, this share may not exceed 59%.

Work on an amendment to the Diversification Regulation is expected to conclude in 2017. PGNiG is actively involved in the legislative process to ensure that the Company is able to perform long-term import contracts.

System Regulation

Regulation of the Minister of Economy of July 2nd 2010 on specific conditions for the operation of the gas system (consolidated text: Dz.U. of 2014, item 1059, as amended; 'System Regulation') specifies the rules of operation of the gas system set forth in the Energy Law. In particular, it lays down the rules and conditions for applying for grid connection, procedure for trading in gas fuel and ability to provide services in the gas system, including the manner of handling complaints, balancing and transmission constraints management; it also outlines the terms of cooperation between market participants.

According to the Minister of Energy's Regulation of January 10th 2017 amending the Regulation on specific conditions for the operation of the gas system (Dz.U. item 150), only equipment and installations used for gas fuel transmission operations may be connected to gas transmission networks with diameters of DN 1,300 or higher. The Regulation has also raised the capacity threshold for customers authorised to be connected to the transmission network from 5,000 to 45,000 cm/h. It thus expands the operating reach of distribution companies and stabilises the gas fuel transmission and distribution market.

Tariff Regulation

Regulation of the Minister of Economy of June 28th 2013 on detailed rules for determining and calculating tariffs for gas fuels and on settlement of transactions in gas fuels trade (Dz. U. of 2013, item 820; 'Tariff Regulation') sets out the principles for determining tariffs for gas fuels, in particular the calculation of prices and rates, as well as the rules of settlements between market participants.

In 2016, PGNiG applied the following tariffs:

- from January 1st 2016 to March 31st 2016 – PGNiG Gas Fuel Supply Tariff No. 9/2016, approved on December 16th 2015; in the tariff reduced the average prices of high-methane gas and nitrogen-rich gas by 6.6% and 6.1%, respectively,
- from April 1st 2016 to June 30th 2016 – PGNiG Gas Fuel Supply Tariff No. 10/2016, approved on March 15th 2016; in the tariff reduced the average prices of high-methane gas and nitrogen-rich gas by 9.5% and 8.3%, respectively,
- from July 1st 2016 to October 31st 2016 – PGNiG Gas Fuel Supply Tariff No. 11/2016, approved on June 14th 2016; in the tariff reduced the average prices of high-methane gas and nitrogen-rich gas by 8.4% and 8.5%, respectively,
- from November 1st 2016 to December 31st 2016 – PGNiG Gas Fuel Supply Tariff No. 12/2016, approved on October 17th 2016; the tariff increased the average prices of high-methane gas and nitrogen-rich gas by 4% and 3.9%, respectively.

In 2016, PGNiG OD applied the following tariffs:

- from January 1st 2016 to March 31st 2016 – PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 2, approved by the President of URE on December 17th 2015; the average price of high-methane gas was reduced by 3.3%, including for household customers (tariff groups W-1 to W-4) by 3.5%, and for business customers (other tariff groups) by 2%; the average price of nitrogen-rich gas (subgroup Lw) was reduced by 2.8% and the price of nitrogen-rich gas (subgroup Ls) was reduced by 2.1%; subscription fees for households, with the exception of 12T tariff groups, were reduced by 10%, and subscription fees for other customers remained unchanged,
- from April 1st 2016 to June 30th 2016 – PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 3, approved by the President of URE on March 15th 2016; the average price of high-methane gas was reduced by 5.4%, including for household customers (tariff groups W-1 to W-4) by 5.3%, and for business customers (other tariff groups) by 6.8%; the average price of nitrogen-rich gas (subgroup Lw) was reduced by 6.1% and the price of nitrogen-rich gas (subgroup Ls) was reduced by 5.8%; and subscription fees remained unchanged,
- from July 1st 2016 to December 31st 2016 – PGNiG Obrót Detaliczny Gas Fuel Trading Tariff No. 4, approved by the President of URE on June 16th 2016; the average price of gas fuels for all tariff groups was reduced by 1%, and subscription fees remained unchanged.

In 2016, GSP applied the following tariffs:

- from January 1st 2016 to March 31st 2016 – Gas Fuel Storage Tariff No. 1/2015, approved on May 21st 2015
- from April 1st 2016 to December 31st 2016 – Gas Fuel Storage Tariff No. 1/2016, approved on April 22nd 2016

In 2016, PSG applied Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, approved on December 17th 2014.

In 2016, PGNiG TERMIKA applied the following tariffs (among other rates):

- Tariff applicable to PGNiG TERMIKA S.A.'s sales of heat generated at the Żerań CHP, Siekierki CHP, Pruszków CHP, Wola heating plant, and Kawęczyn heating plant, and to the transmission and distribution of heat via the heating network supplied from the Pruszków CHP plant, approved on July 29th 2015,
- Tariff for the Regaty heat plant, effective until the disposal of that heating system to NYSAGAZ, approved on May 13th 2015,
- Tariffs for the transmission of heat via heating networks by PGNiG TERMIKA S.A. in the areas of Marsa Park, Annopol, Marynarska, Chełmżyńska and Jana Kazimierza, approved on November 18th 2014.

In 2016, PEC applied the following tariffs:

- heat tariff approved on June 10th 2015,
- heat tariff approved on November 15th 2016.

In 2016, SEJ applied the following tariffs:

- heat tariff approved on September 25th 2015,
- heat tariff approved on October 14th 2016,
- electricity tariff No. 17/16 approved on December 22nd 2015.

Pursuant to the transitional provisions to the Energy Efficiency Act, the current Tariff Regulation will expire by March 31st 2018. Therefore, legislative work on the new regulation is expected to commence in 2017.

<u>Applications for exemption from the obligation to seek tariff approval</u>

On February 19th 2013, the President of URE issued Communication No. 2/2013 on the exemption of energy utilities holding gas fuel trading licences from the obligation to seek approval of wholesale gas trading tariffs.

On August 30th 2013, PGNiG applied to the President of URE for exemption from the obligation to seek approval for tariffs for the sale of natural gas to energy utilities which purchase gas as part of their gas fuel trading business. By way of decision of August

4th 2016, the President of URE exempted PGNiG from this obligation in relation to high-methane gas, but refused to grant the exemption in relation to nitrogen-rich gas.

In addition, in 2013 PGNiG applied to the President of URE for exemption from the obligation to seek approval for tariffs for high-methane natural gas traded at a virtual gas trading point (OTC market). As the virtual trading point is exempt from the obligation to seek approval for tariffs by law, the President of URE discontinued the proceedings.

On August 10th 2015, PGNiG applied to the President of URE for exemption from the obligation to seek approval for tariffs for the sale of natural gas to energy utilities purchasing it for the purpose of gas transmission, distribution, storage, liquefaction or regasification activities. By way of decision of August 4th 2016, the President of URE exempted the Company from this obligation.

On January 26th 2016, PGNiG applied to the President of URE for exemption from the obligation to seek approval for tariffs for liquefied natural gas (LNG). By way of decision of February 3rd 2016, the President of URE exempted PGNiG from this obligation.

4.1.2. European regulatory environment

Third Energy Package

In 2016, the so-called Third Energy Package was adopted as the all-inclusive regulation for the European gas market. The Package included five acts of law drawn up by EU institutions in 2009:

- Directive 2009/72/EC of the European Parliament and of the Council of July 13th 2009 concerning common rules for the internal market in electricity and repealing Directive 2003/54/EC;
- Directive 2009/73/EC of the European Parliament and of the Council of July 13th 2009 concerning common rules for the internal market in natural gas and repealing Directive 2003/55/EC;
- Regulation (EC) No 714/2009 of the European Parliament and of the Council of July 13th 2009 on conditions for access to the network for cross-border exchanges in electricity and repealing Regulation (EC) No 1228/2003;
- Regulation (EC) No 715/2009 of the European Parliament and of the Council of July 13th 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No 1775/2005;
- Regulation (EC) No 713/2009 of the European Parliament and of the Council of July 13th 2009 establishing an Agency for the Cooperation of Energy Regulators (ACER).

The objective of the Package is to boost competition on the European energy market and create the internal energy market based on mechanisms such as ownership unbundling, organisation of cooperation between regulators and energy companies (ACER, ENTSO-E and ENTSO-G), or introduction of network codes.

In November 2016, invitations were sent to market participants to submit comments on the regulatory changes envisaged for the gas market. The EC commissioned a number of analyses to determine the desired directions of development of the internal gas market. On January 16th 2016, PGNiG submitted its proposals and comments, indicating the key risks identified in the analyses. The work on the legal framework for the internal gas market is expected to continue in 2017, including the publication by the European Commission of the proposals for legislative changes in late 2017.

SoS Regulation

Regulation (EU) No. 994/2010 of the European Parliament and of the Council of October 20th 2010 concerning measures to safeguard security of gas supply and repealing Council Directive 2004/67/EC ('SoS Regulation') is aimed at preventing disruptions in the supply of natural gas to Member States, or mitigating their effects if they occur.

To that end, in the case of a shortage in gas supply, Member States may announce one of the three crisis levels in their territory: early warning level, alert level, and emergency level. Each subsequent crisis level allows the Member State to take specific measures to minimise related risks. The regulation defines a group of 'protected customers', which includes all households connected to the distribution network. In addition, each Member State may extend the 'protected customer' definition to include also small and medium-sized enterprises (provided that they do not represent more than 20% of the final use of gas) and district heating installations (to the extent they deliver heat to household customers and to small and medium-sized enterprises).

The mechanisms for securing the supply of gas to customers are set out in Preventive Action Plans and Emergency Plans adopted by the Member States.

On February 16th 2016, the European Commission published a draft of the new SoS Regulation, which is to supersede the current version. In the new draft, the role of regional cooperation in the event of gas supply disruptions was given a greater priority, and a new solidarity mechanism was introduced. Main risks associated with this draft are related to:

- the proposed information exchange model (transparency mechanism),
- withdrawal of country-level plans and replacing them with regional plans.

Ever since the publication of the new draft SoS Regulation, PGNiG has informed competent public authorities of the related risks to PGNiG's activities, and has presented the position of the PGNiG Group to representatives of the European Commission and the European Parliament.

In the course of the work at the EU Council and the European Parliament, the risks identified by PGNiG were discussed. It seems that the EU Council and the European Parliament intend to address at least some of those risks, and PGNIG will continue to keep monitor the legislative process.

TAR NC Regulation

On September 30th 2016, Commission Regulation (EU) was adopted establishing a network code on rules regarding harmonised gas transmission tariff structures. According to ACER, the regulation is planned to be published in spring 2017. Work on adoption of this regulation began in 2011.

The objective of this regulation is to gradually reduce discrepancies between tariff models applied in individual Member States. Legislation work carried out by the European Commission, aiming to unify the tariff structures in the EU, is designed to facilitate cross-border trade conducted by participants of the European gas market.

The PGNiG Group participated in public consultations organised by the European Commission and devoted to discussing the extent of effect of the new regulation on the tariff systems applicable in member states. The main objective was to ensure that the new regulatory environment will have no adverse effect on the costs of operations of the PGNiG Group.

NC CAM Regulation

Commission Regulation (EU) No 984/2013 of 14 October 2013 establishing a Network Code on Capacity Allocation Mechanisms in Gas Transmission Systems and supplementing Regulation (EC) No 715/2009 of the European Parliament and of the Council (the 'NC CAM Regulation') has been designed to promote the building of correctly operating interconnected transmission network systems, which would provide the foundation for further development of the EU internal energy market through harmonisation of mechanisms that ensure transparent and non-discriminating rules for transmission capacity allocation.

The provisions of the NC CAM Regulation apply to the interconnections between the transmission systems of member states. In order to ensure that all parties can gain access to interconnector transmission capacities on equal and non-discriminatory terms, the allocation of capacity is made through auctions organised by transmission system operators, at which intraday, daily, monthly, quarterly and annual products are offered.

One of the proposals brought forward by the PGNiG Group as part of consultations organised by the European Commission was that appropriate mechanisms be put in place to provide for auctions for quarterly capacity allocation to be held four times a year (previously they were held once a year).

EU ETS

The EU Emission Trading Scheme ('EU ETS'), imposes the obligation to account for CO_2 emissions and regulates the allocation of free emission allowances for heat and electricity. Under the ETS Directive, emitters of greenhouse gases (including CO_2) are under the obligation to account for their emissions by surrendering their CO_2 emission allowances by April 30th each year for the preceding year. If the number of emission allowances is too small, the excess emissions penalty of EUR 100 per tonne of CO_2 is imposed, and the operator must acquire and surrender the necessary number of emission allowances.

Pursuant to the EU ETS Directive, industrial installations, including heat plants and combined heat and power (CHP) plants, may apply for free emission allowances. In the case of power systems, only eight Member States meeting the criteria set out in the EU ETS Directive could apply for the allocation of free emission allowances.

In the case of heat, emission allowances are granted on the basis of historical production data. Power generation installations may receive free allowances in exchange for execution of projects reducing CO_2 emissions. The PGNiG Group submitted ten investment projects to the National Investment Plan and may receive free emission allowances in exchange for their implementation.

Work on draft amendments to the EU ETS Directive, which were presented on July 15th 2015, was continued in 2016. The amendments proposed by the European Commission would affect coal-fired installations and pose a risk to the activities of the PGNiG Group, in particular in the heating sector. In order to PGNiG's best interest, the Group submitted a number of comments, including:

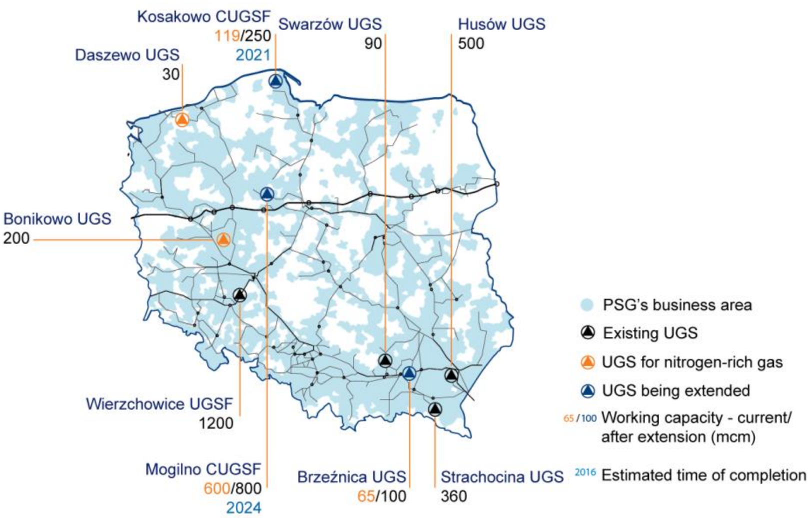
- a proposal to use fuel benchmarks as the basis for the allocation of free emission allowances – this would be to the benefit of the PGNiG Group, especially for its heating business where coal is used as primary fuel. At present, free emission allowances are allocated on the basis of the gas benchmark referenced to the lowest-emission installations in the EU;
- a proposal to include the heating sector in the group of sectors exposed to the risk of carbon leakage, which would enable the implementation of special solutions to reduce the sector's burden – the PGNiG Group emphasised the risk of the local leakage of heat from centralised units covered by the EU ETS system to non-ETS area where no CO_2 emission charges presently apply.

If the proposed solutions are adopted, prices of emission allowances may rise, which may have a negative impact on the PGNiG Group's power and heat business.

4.2. Polish gas market

The PGNiG Group plays a key role on the Polish gas market and, as its leader, is responsible for preserving Poland's energy security. To this end, it takes measures necessary to satisfy the steadily growing demand for gas fuel. The PGNiG Group ensures supply diversification by developing domestic deposits and sourcing gas from abroad, as the largest importer and supplier of natural gas in Poland. Gas is transported to Poland via an extensive transmission network, with LNG fed into the network as of 2016. Gas is supplied to end users via distribution networks. The national gas system is complete with gas fuel storage facilities whose purpose is to cover seasonal and daily shortages of gas fuel. In gas fuel trading itself, the key role is played by the Polish Power Exchange where PGNiG has been the Gas Market Maker since 2013.

Transmission system



The management of the transmission network and transport of natural gas via the national transmission network to deliver it to distribution networks (in which the PGNiG Group has a 99% interest) and end users connected to the transmission system is the responsibility of Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A., a state-owned company (OGP GAZ-SYSTEM S.A.). The existing transmission network comprises two operationally interlinked systems, the Transit Gas Pipeline System and the National Transmission System (high-methane gas [E group] and nitrogen-rich gas [Lw subgroup]). As at the end of Q3 2016, the length of Poland's gas-grid pipelines totalled almost 12 thousand km. In 2016, the domestic transmission networks and inter-system connections continued to be developed.

With respect to interconnectors, in 2016 activities were taken to:

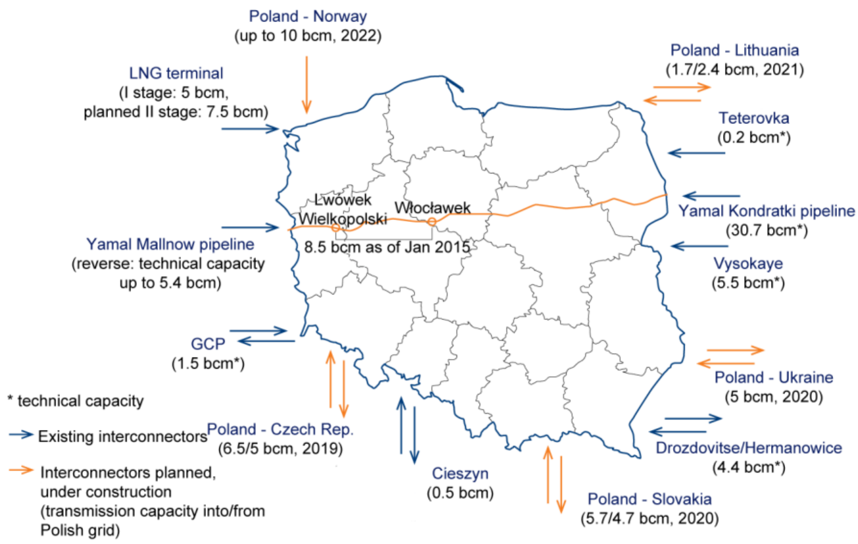
- Test and commission for commercial purposes the LNG Terminal in Świnoujście managed by Polskie LNG S.A., a subsidiary of OGP GAZ SYSTEM S.A.;

(in PLN million, unless stated otherwise)

- Continue work on projects involving construction of interconnectors at the border with Lithuania, Ukraine, Slovakia and the Czech Republic;
- Carry out market consultations regarding the Norwegian Corridor.

From the perspective of the PGNiG Group, a noteworthy development was the execution of a memorandum of understanding between PSG and OGP GAZ-SYSTEM S.A. concerning assessment of the potential cross-acquisition of system facilities. Signed on June 29th 2016, the memorandum seeks to regulate the status of gas networks in Poland. Ultimately, the distribution networks, including high-, medium- and low-pressure gas pipelines, will be managed by distribution system operator PSG, while OGP GAZ-SYSTEM S.A., as the only transmission system operator in Poland, will have sole responsibility for the transmission networks. As per the relevant schedule, the memorandum should be implemented by 2017.

Map of existing and planned strategically important cross-border entry points into the transmission system



Source: OGP GAZ-SYSTEM S.A. and ENTSOG.

Gas flow

In 2016, imports of gas fuel into Poland rose to 150.1 TWh (up by 13%, or 16.8 TWh), with a 24% year-on-year increase in supply from countries east of Poland and a 37% decline in supply from the EU. A vast majority of imported gas, nearly 75% of total flows, originated from countries east of Poland. According to ENTSOG (the European Network of Transmission System Operators for Gas), the Drozdovitse point saw the largest volumes of gas flowing into Poland. As regards imports from the west, the largest flows were recorded at the Mallnow point. The existing cross-border connections at Lasów, Gubin and Kamminke were replaced with a single point called GCP GAZ-SYSTEM/Ontrans. In addition, 2016 saw the first deliveries of liquefied natural gas by sea to the LNG Terminal in Świnoujście. The highest year-on-year growth was recorded at the Hermanowice exit point (Polish-Ukrainian border), where gas exports went up by 557%.

Gas flows at Poland's gas grid entry/exit points

Entry/exit point (in TWh)	2016	2015	Change y/y
Supplies from EU	26.92	42.67	-37%
including Lasów, Gubin (GCP)	4.85	8.03	-40%
including Cieszyn	0.06	0.18	-66%
including Mallnow	22.01	34.45	-36%
Supplies from across Poland's eastern border	112.08	90.65	24%
including Drozdovitse	48.09	39.03	23%
including Teterovka	0.80	0.79	2%
including Kondratki	28.15	23.70	19%
including Vysokoye	35.04	27.14	29%
LNG regasification	11.14	-	-
Exports to Ukraine (mainly Hermanowice)	10.24	1.56	557%
Total flow	150.14	133.32	13%

Source: ENTSOG

LNG in Poland

In 2016, the Lech Kaczyński LNG Terminal in Świnoujście commenced commercial operations. The LNG Terminal and its infrastructure were built with the involvement of four main partners: OGP GAZ-SYSTEM S.A., Polskie LNG S.A. (a wholly-owned subsidiary of OGP GAZ-SYSTEM S.A.), the Maritime Office of Szczecin, and the Harbour Authority of Szczecin and Świnoujście. Following completion of the first stage of the project, the terminal can handle annual gas imports of 5 bcm. Should demand for this type of gas fuel grow, the terminal's capacity may be extended to 7.5 bcm without expanding the project's site.

A single shipment of LNG by sea may supply approximately 210,000 cm of LNG, equivalent to about 126 mcm of natural gas. The end product of gas regasification is fed into the national transmission grid via the Goleniów gas compression station, located over 80 km away from the LNG Terminal. LNG is also transported by tankers to regasification plants or stations located throughout Poland.

PGNiG considers LNG deliveries as a means to ensure gas supply security and diversification. The Company has reserved some 60% of the terminal's capacity to receive and regasify approximately 2.5 million tonnes (slightly more than 3 bcm) of LNG annually over the next 20 years.

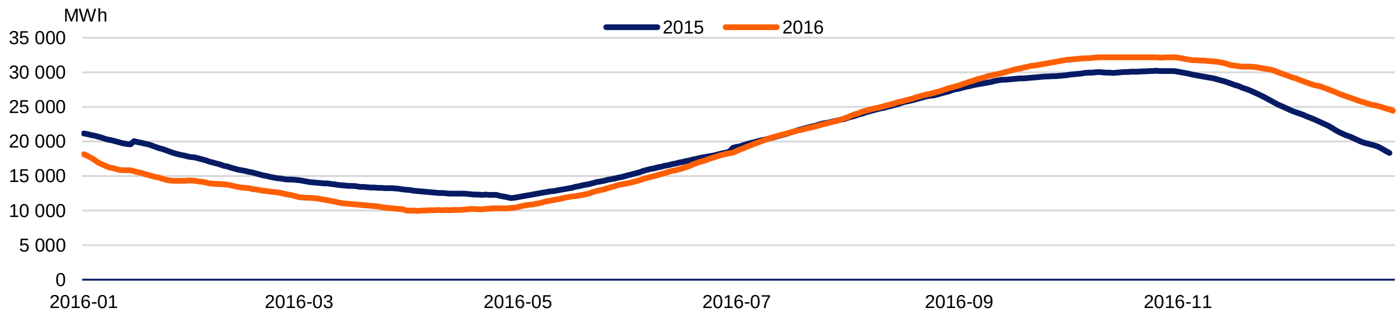
Distribution system

Distribution services are provided by one major distribution system operator – PSG (entity of the PGNiG Group) and several dozen smaller DSOs operating locally, whose networks are connected to the system operated by PSG or OGP GAZ-SYSTEM S.A., the transmission system operator.

Gas storage

PGNiG owns all of Poland's underground gas storage facilities. The average daily volume of gas withdrawal from Polish storage sites in Q1 2016 amounted to 90 GWh/day, more or less unchanged from the previous year. As at March 31st 2016, Polish storage sites were filled to 30% of capacity, which means they held approximately 10 TWh of gas. In 2016, gas was injected into storage at an average rate of 135 GWh/day, a 22 GWh/day increase on 2015. Before the beginning of the winter season, storage facilities in Poland were filled to over 98% of capacity.

Levels of gas in storage in Poland in 2015–2016.



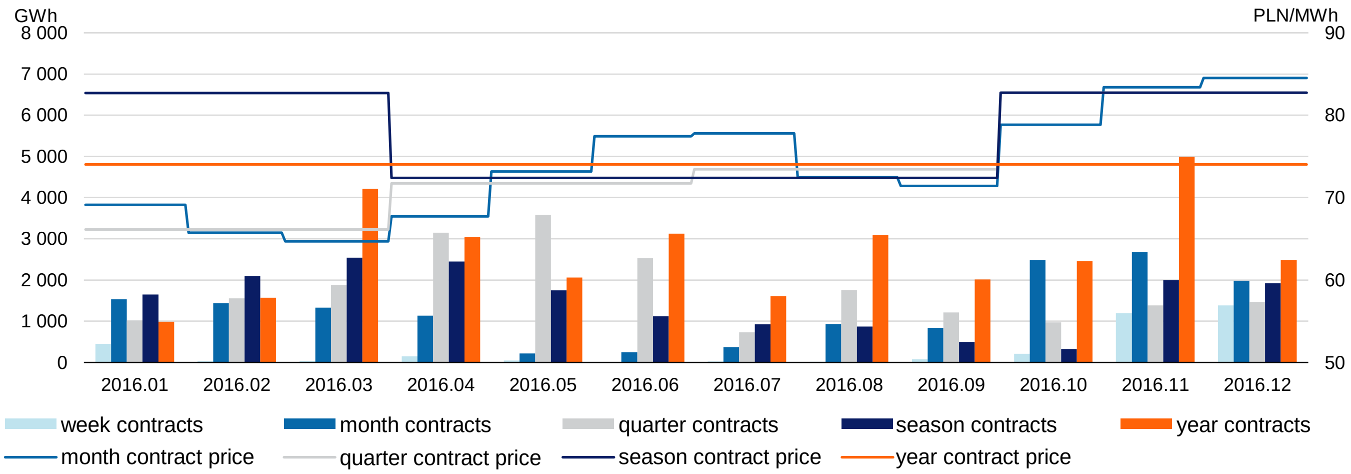
Source: GIE - Gas Infrastructure Europe

Polish Power Exchange

PGNiG is the leader of gas trading at the PPX.

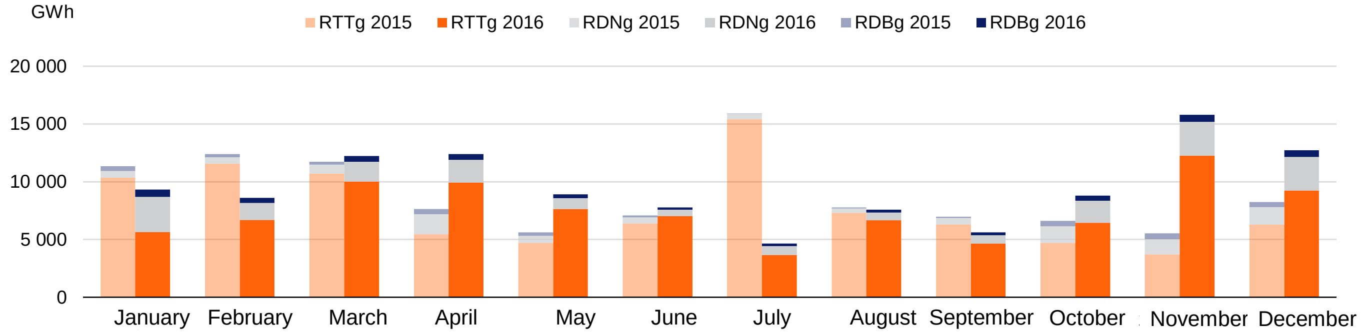
2016 was a record year in terms of gas trading volume at the PPX, which reached 114.5 TWh, up 7.1% relative to 2015. The trading volume on the Day-Ahead Market (DAM) and Intraday Market (IDM) for gas was 24.6 TWh, an increase of 76.5% year on year. The Day-Ahead Market saw the strongest growth − of 87.4% to 19.6 TWh. The trading volume on the Commodity Futures Instruments Market (CFIM) totalled 89.9 TWh in 2016, a 3.3% decline year on year. It is worth noting that the share of futures in total trading on the natural gas market came close to 78.5%. The growth in spot trading (IDM) attests to the ongoing deregulation of the market and increased activity from new entrants, who use spot transactions to balance their gas portfolios in the short term.

Volumes and prices of gas futures contracts traded on the PPX in 2016.



In-house analysis based on PPX data. CFIMg prices are calculated on the basis of the average volume-weighted price of the futures instrument.

Natural gas trading volume at PPX in 2015 and 2016.

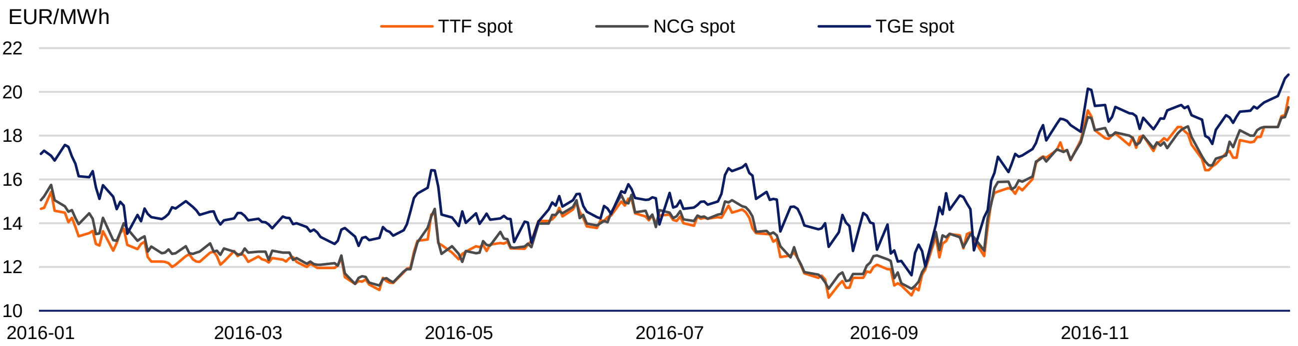


In-house analysis based on PPX data

As at the end of 2016, there were 127 active participants in natural gas trading, a nearly two-fold increase on 2015, with 197 companies holding licences to trade in gas fuels, 20 more than the year before.

In 2016, the average spot price of gas was PLN 67.37/MWh, 24% less relative to 2015. Gas prices in Poland were strongly correlated with gas prices in Germany and on other Western European gas markets. The difference between spot prices at the PPX and Germany's Gaspool market shrank from EUR 1.39/MWh to EUR 1.34/MWh year on year. The most significant differences in prices between these markets were observed in Q1 2016.

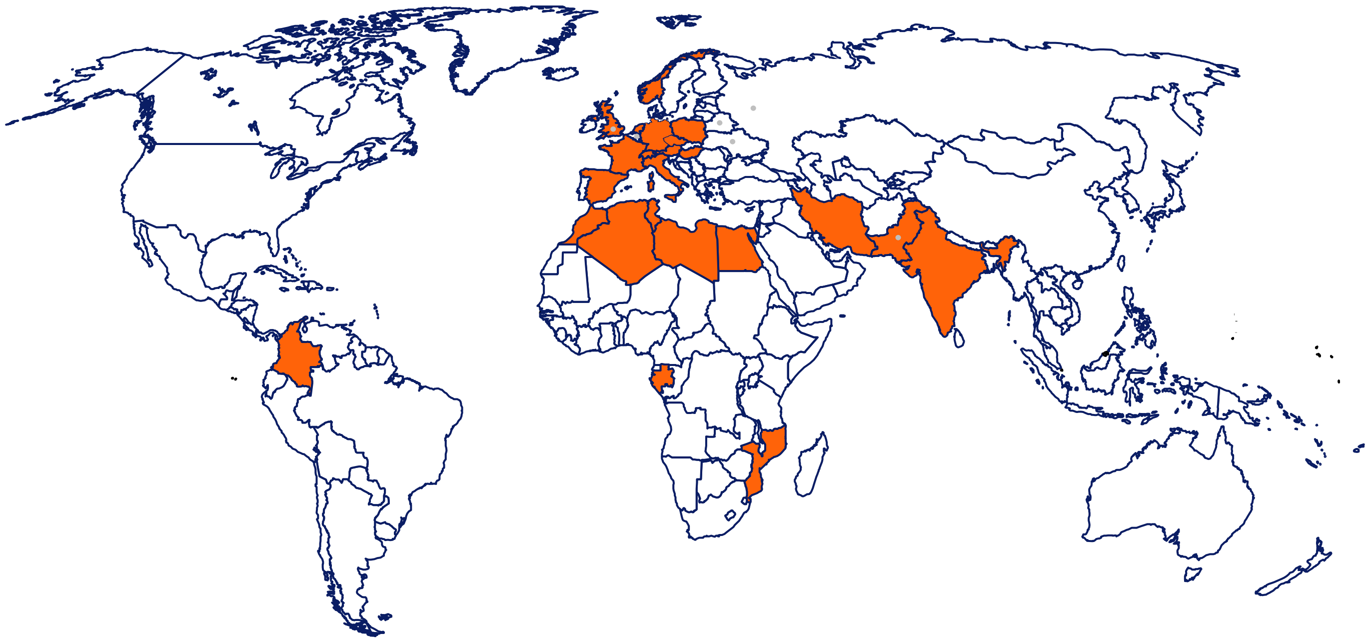
Spot price of gas at PPX, TTF and NCG in 2016.



Source: Bloomberg

(in PLN million, unless stated otherwise)

5. Operations in 2016



PGNiG Group's presence

PGNiG foreign branches and representative offices

Total gas sales outside the PGNiG Group mcm	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	22,899	13,580	21,653	12,276	17,322	14,970	13,723
Nitrogen-rich gas (Ls/Lw as E equivalent)	1,373	909	1,295	875	1,252	1,202	1,156
TOTAL (as E equivalent)	24,273	14,489	22,948	13,151	18,574	16,173	14,879

5.1. Exploration and Production

The segment's business focuses on extracting hydrocarbons from deposits and preparing them for sale. It comprises the entire process of oil and gas exploration and production, from geological analyses, to geophysical surveys and drilling work, to field development and hydrocarbon production. The work is conducted by the segment on its own or jointly with partners, under joint operations agreements.

5.1.1. Segment's figures

Segment's financial highlights	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Total revenue	4,291	2,765	4,855	3,011	6,071	6,185	4,325
Revenue from outside the PGNiG Group, including from sale of:	2,776	1,601	3,148	1,844	4,346	4,580	3,121
- high-methane and nitrogen-rich gas,	517	501	553	561	573	577	550
- crude oil, condensate, and NGL	1,606	907	1,945	1,057	2,654	2,757	1,263
- geophysical, geological and drilling services	429	-	382	-	761	833	915
Intersegment revenue	1,515	1,164	1,707	1,167	1,725	1,605	1,204
EBITDA	1,285	657	2,426	1,242	3,143	3,381	1,966
EBITDA adjusted for impairment losses on assets	2,056	1,374	2,980	1,788	3,812	3,908	2,161

(in PLN million, unless stated otherwise)

Natural gas production by the PGNiG Group mcm	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	1,918	1,401	2,027	1,454	1,876	1,890	1,608
in Poland	1,401	1,401	1,454	1,454	1,457	1,550	1,608
PGNiG Zielona Góra Branch	-	-	-	-	-	-	-
PGNiG Sanok Branch	*1,401*	*1,401*	*1,454*	*1,454*	*1,457*	*1,550*	*1,608*
in Norway	517	-	573	-	419	340	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	2,540	2,540	2,564	2,564	2,627	2,692	2,710
in Poland	2,481	2,481	2,513	2,513	2,569	2,667	2,710
PGNiG Zielona Góra Branch	*2,422*	*2,422*	*2,441*	*2,441*	*2,490*	*2,574*	*2,626*
PGNiG Sanok Branch	*59*	*59*	*72*	*72*	*80*	*87*	*84*
in Pakistan – PGNiG Pakistan Branch	59	59	52	52	58	25	-
TOTAL (measured as E equivalent)	4,458	3,941	4,591	4,018	4,503	4,582	4,317

Sale of natural gas produced by the segment outside the PGNiG Group mcm	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	77	53	54	52	33	36	39
in Poland	53	53	52	52	33	36	39
in Norway	24	-	1	-	-	-	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	703	703	684	684	738	683	651
in Poland	645	645	633	633	682	658	651
in Pakistan	58	58	51	51	56	25	
TOTAL (measured as E equivalent)	780	756	737	736	771	719	690

Crude oil*, PGNiG Group (000' tonnes)	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Crude oil production*	1,318	763	1,428	765	1,207	1,099	492
in Poland	763	763	765	765	789	815	492
PGNiG Zielona Góra Branch	*719*	*719*	*719*	*719*	*742*	*766*	*442*
PGNiG Sanok Branch	*44*	*44*	*46*	*46*	*47*	*49*	*50*
in Norway	555	-	664	-	418	283	-
Sales of crude oil*	1,347	754	1,391	772	1,169	1,106	485
including oil produced in Poland	754	754	772	772	780	809	485
including oil produced in Norway	593	-	619	-	389	297	-

** including condensate and NGL*

5.1.2. Segment's strategy

Strengthening and transforming the exploration and production area

The main objective in this segment is to maintain stable production of natural gas and crude oil in Poland and achieve an increase of approximately 50−55 million boe in hydrocarbon production from Polish and foreign sources by 2022. In 2016, the PGNiG Group produced a total of 4,458 mcm of natural gas (high-methane gas equivalent), including 3,882 mcm from fields in Poland and 576 mcm from fields abroad. Crude oil production (including condensate and NGL) was 1,318 thousand tonnes, of which 763 thousand tonnes was produced in Poland and 555 thousand tonnes was produced abroad.

In Poland, PGNiG worked intensively to discover and assign reserves to new deposits of hydrocarbons. 13.3 mm boe of reserves were documented in 2016, based on discoveries made in previous years. Furthermore, 10 new deposits were discovered, with reserves to be assigned in the following years.

As at the end of 2016, the PGNiG Group had total gas reserves of 609 million boe, of which 498 million boe were reserves in Poland and 111 million boe were foreign reserves. The Group's oil and NGL condensate reserves were 161 million boe, including 126 million boe in Poland and 35 million boe abroad.

In Poland, the PGNiG Group continued the exploration for and appraisal of shale gas deposits in its most promising licence areas (the Pomeranian region). However, work carried out so far did not confirm the initial estimates and forecasts for shale gas potential.

Therefore, the work was discontinued in late 2016. However, the experience gained by PGNiG from shale gas projects will be used in work on deeper wells and in more demanding geological settings.

Together with the Polish Geological Institute − National Research Institute, PGNiG continued a research project into the application of fracturing technology for pre-mining extraction of coal bed methane. › For more information, see Section 3.5.

The Group was also involved in exploration and production within its foreign licence areas in Norway and Pakistan.

Following the lifting of economic and financial sanctions imposed on Iran by the US and the European Union, the PGNiG Group monitors and analyses new opportunities in that region. The Iranian market may offer enormous potential, not only with respect to PGNiG's own exploration and production activity, but also with respect to specialist well services provided by the PGNiG Group.

On November 5th 2016, in Teheran PGNiG SA and National Iranian Oil Company signed a letter of intent concerning their collaboration on the Soumar oil field, with in-place resources put at approximately 475 mm boe. The geological logging and formation tests will take about six months. Only after their completion will PGNiG decide whether to go ahead with the project.

The Group also analysed a range of acquisition targets outside of Poland, but none of them met the asset quality and price expectations.

5.1.3. Operations in Poland

Licences for exploration and appraisal of crude oil and natural gas deposits in Poland

As at January 1st 2016, PGNiG held 59 licences for exploration and appraisal of crude oil and natural gas deposits. As at December 31st 2016, it had 48 licences. During 2016, PGNiG obtained four decisions converting its existing licences into licences for crude oil and natural gas exploration, appraisal and production. By December 31st 2016, PGNiG submitted a total of 27 applications for licence conversion. Additionally, there were 16 proceedings pending for licence conversion and 47 proceedings for approval of geological operations plans/plan supplements. At the same time, licences for seven areas were either not extended or relinquished.

Work performed

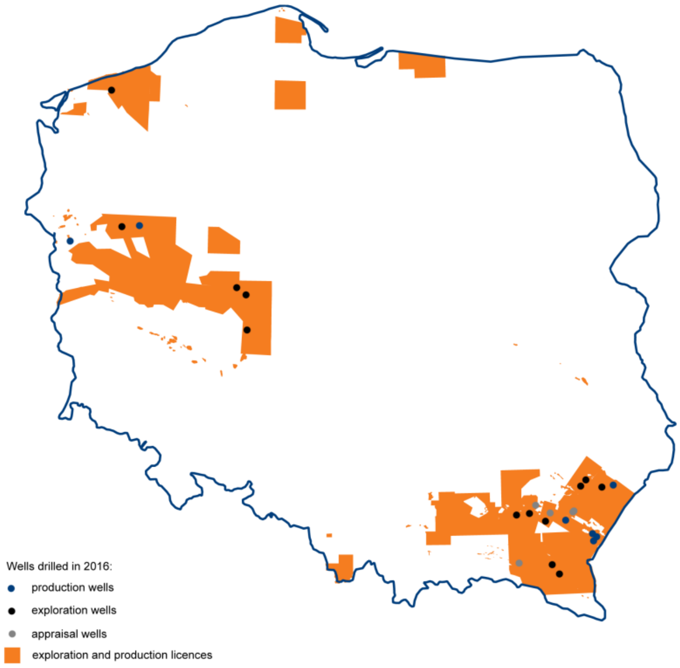
In 2016, PGNiG was involved in crude oil and natural gas exploration and appraisal projects in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands, both on its own and jointly with partners. Drilling work in areas covered by licences awarded to PGNiG was performed on 19 boreholes, including 12 exploration and 7 appraisal wells.

Out of the 19 boreholes, 17 (10 exploration and 7 appraisal wells) reached their target depth.

As at the end of December 2016, formation test results were obtained from 14 boreholes (10 exploration and 4 appraisal wells), including 2 where drilling was completed in 2015.

(in PLN million, unless stated otherwise)

Map of licences and boreholes



In 2016, 12 wells, including 8 exploration and 4 appraisal wells, were drilled with positive results. 2 exploration wells failed to yield a commercial flow of hydrocarbons and were abandoned.

In 2016, 9 production wells were classified as positive. At the same time, 3 wells were abandoned.

In 2016, workovers, enhanced recovery treatments and tests were performed on 4 research (core) boreholes, 3 exploration wells, 2 appraisal wells and 4 production wells.

New fields in the Sanok area brought on stream in 2016 include Draganowa (Draganowa-1 well), Siedleczka section of the Husów-Albigowa-Krasne field (test production) − Siedleczka-2, Siedleczka-3 and Siedleczka-7K wells, and Markowice (Markowice-3K, Markowice-4, and Markowice-5 wells).

In the Zielona Góra area, new fields brought on stream in 2016 were Gajewo (Gajewo-1 well), Połęcko (test production), and Karmin (test production).

Six new wells were brought on stream in already producing fields: 5 in the Sanok area (Lubliniec-13, Rzeszów-20K, Pruchnik-27, Przemyśl-281K, Smolarzyny-7) and 1 in the Zielona Góra area (Brońsko-26H). Production from 2 fields was discontinued.

No. of production facilities	Sanok	Zielona Góra
Gas production facilities	18	11
Oil production facilities	5	2
Oil and gas production facilities	13	5
Total	36	18

Refineries in Poland process approximately 26 million tonnes of crude oil per year. With its oil production volume of 750,000 tonnes in 2016, PGNiG accounts for 20% of total oil production in Poland. As regards domestic gas production, PGNiG's share is approximately 90%.

Production of natural gas in Poland

Production of natural gas in Poland mcm	**2016** PGNiG Group	**2016** PGNiG	**2015** PGNiG Group	**2015** PGNiG	**2014** PGNiG Group	**2013** PGNiG Group	**2012** PGNiG Group
High-methane gas (E)	1,401	1,401	1,454	1,454	1,457	1,550	1,608
PGNiG Zielona Góra Branch	-	-	-	-	-	-	-
PGNiG Sanok Branch	1,401	1,401	1,454	1,454	1,457	1,550	1,608
Nitrogen-rich gas (Ls/Lw as E equivalent)	2,481	2,481	2,513	2,513	2,570	2,661	2,710
PGNiG Zielona Góra Branch	2,422	2,422	2,441	2,441	2,490	2,574	2,626
PGNiG Sanok Branch	59	59	72	72	80	87	84
Total (measured as E equivalent)	3,882	3,882	3,967	3,967	4,027	4,211	4,317

Production of crude oil in Poland (including condensate and NGL)

Crude oil production* in Poland '000 tonnes	**2016** PGNiG Group	**2016** PGNiG	**2015** PGNiG Group	**2015** PGNiG	**2014** PGNiG Group	**2013** PGNiG Group	**2012** PGNiG Group
PGNiG Zielona Góra Branch	719	719	719	719	742	766	442
PGNiG Sanok Branch	44	44	46	46	47	49	50
Total	763	763	765	765	789	815	492

** including condensate and NGL*

Production of other products

'000 tonnes	**2016** PGNiG Group	**2016** PGNiG	**2015** PGNiG Group	**2015** PGNiG	**2014** PGNiG Group	**2013** PGNiG Group	**2012** PGNiG Group
Propane-butane	37	37	35	35	32	30	23
LNG	26	26	25	25	30	32	28
mcm							
Helium	3	3	3	3	3	3	3

Collaboration with other entities

In 2016, PGNiG conducted joint operations with other entities in licence areas awarded to PGNiG, FX Energy Poland Sp. z o.o., LOTOS Petrobaltic S.A., and ORLEN Upstream Sp. z o.o. Furthermore, PGNiG collaborated with other entities in exploration work carried out in Pakistan and Norway.

Collaboration in Poland

Under licences held by PGNiG, work was continued in the following areas:

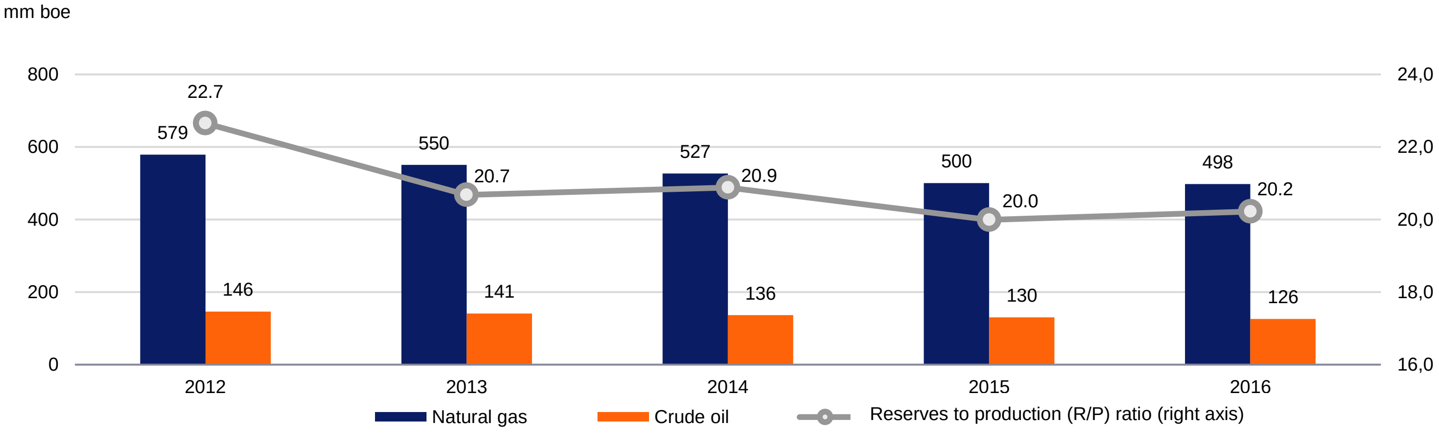
- 'Płotki' – under the joint operations agreement dated May 12th 2000; licence interests: PGNiG (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- 'Płotki' – 'PTZ' (the Extended Zaniemyśl Area) – under the joint operations agreement dated October 26th 2005; licence interests: PGNiG (operator) – 51%, FX Energy Poland Sp. z o.o. – 24.5%, Calenergy Resources Poland Sp. z o.o. – 24.5%. In the PTZ area, work was continued on decommissioning of the Zaniemyśl gas production facility;
- 'Poznań' – under the joint operations agreement dated June 1st 2004; licence interests: PGNiG (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%. In the 'Poznań' area, construction of the Karmin gas production facility was completed, while construction of the Miłosław gas production facility was under way. Drilling of the Miłosław-5K/H exploratory well commenced, while drilling of the Paruchów-1K exploratory well was discontinued as no hydrocarbon flow was recorded, and the well was abandoned.
- 'Bieszczady' – under the joint operations agreement dated June 1st 2007; licence interests: PGNiG (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%; on July 20th 2015 ORLEN Upstream Sp. z o.o. acquired a 49% interest in licence blocks 437, 438, 456, 457, 458 and in parts of licence blocks 416, 417 and 436 held by Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o., thus becoming a party to the joint operations agreement. The processing and interpretation of 2D seismic data (Hoczew-Lutowiska) was completed in the area. 3D seismic survey under the Wańkowa-Bandrów project and drilling of the Pisarowce-1 exploratory well commenced. In 2016,

drilling of the Poraż Południe-1 exploratory well and 2D seismic acquisition under the Barycz-Paszowa project were also started;

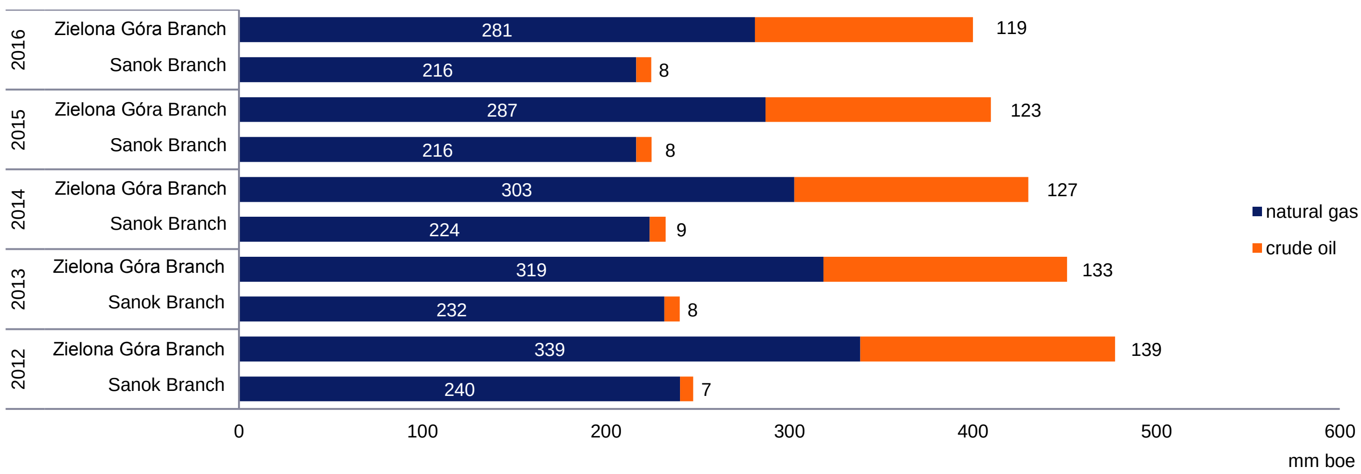
- 'Sieraków' – under the joint operations agreement dated June 22nd 2009; licence interests: PGNiG (operator) – 51%, ORLEN Upstream Sp. z o.o. – 49%. Work to comply with formal and legal requirements is under way in the area, and alternative locations of the Sieraków H1 and Sieraków H2 wells have been determined;
- 'Kamień Pomorski' – under the agreement of August 14th 2013; licence interests: PGNiG (operator) – 51%, LOTOS Petrobaltic S.A. – 49%. An application was submitted for converting the existing licence into an exploration, appraisal and production licence. Site preparation work for the Stawno 1 well commenced;
- 'Górowo Iławieckie' – under the agreement on joint operations of December 31st 2014; licence interests: PGNiG (operator) – 51%, LOTOS Petrobaltic S.A. – 49%. In 2016, analyses were continued.
- Under licences held by FX Energy Poland Sp. z o.o., work was conducted in the 'Warszawa-Południe' area (block 255), under the joint operations agreement dated May 26th 2011. The licence interests are as follows: FX Energy Poland Sp. z o.o. (operator) – 51%, and PGNiG – 49%.

Collaboration abroad › For more information, see Section 5.1.4

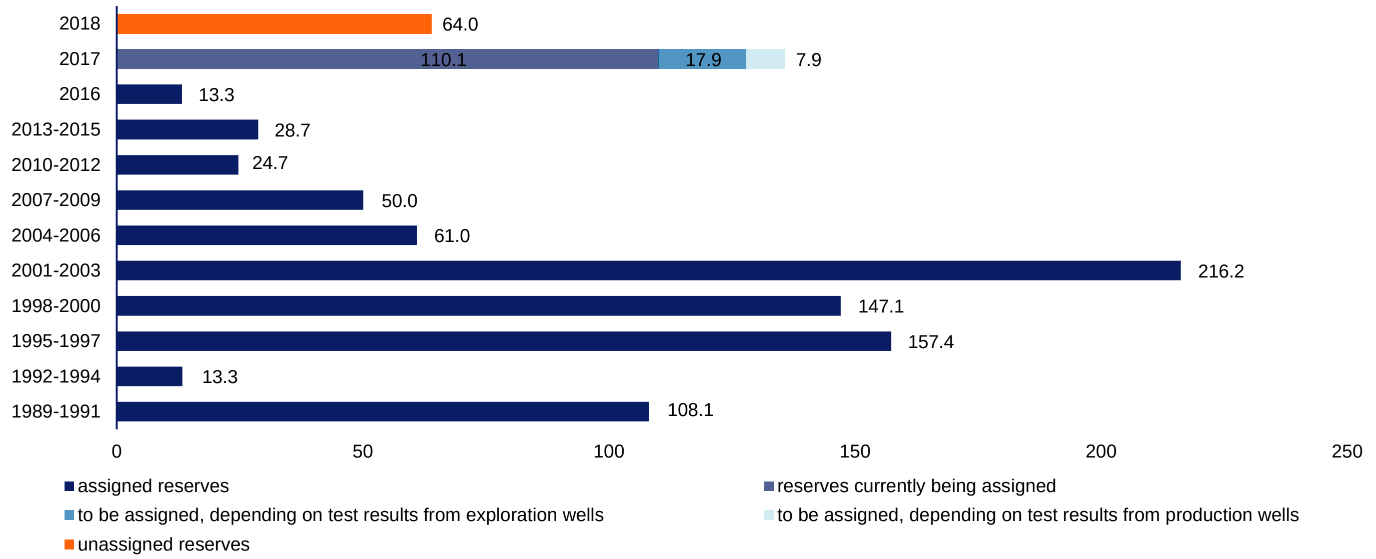
Recoverable reserves in Poland in 2012−2016



PGNiG − recoverable reserves



(in PLN million, unless stated otherwise)



Sales of key products

The main products sold by the Trade and Storage segment are crude oil, high-methane gas and nitrogen-rich gas. Other products, obtained in the process of crude refining, include crude condensate, sulfur, and propane-butane. Some of the produced nitrogen-rich gas is further treated into high-methane gas at the Odolanów and Grodzisk Wielkopolski nitrogen rejection units. Apart from high-methane gas, the cryogenic processing of nitrogen-rich gas yields such products as liquefied natural gas (LNG), gaseous and liquid helium, and liquid nitrogen.

The tables below present sales of high-methane and nitrogen-rich gas directly from Polish fields (as high-methane gas equivalent).

Domestic sales of natural gas produced by the segment outside the PGNiG Group mcm		**2016**		**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	53	53	52	52	33	36	39
Nitrogen-rich gas (Ls/Lw as E equivalent)	644	644	633	633	682	658	651
Total (measured as E equivalent)	697	697	685	685	715	695	690

In crude oil trading, in 2016 PGNiG continued its policy of trading with major Polish and foreign players in the fuel sector.

Rail deliveries of crude oil (64% of sales) were made to the refinery of the LOTOS Group in Gdańsk and to Orlen Południe's Trzebinia Production Plant (the ORLEN Group). In 2016, crude oil was also delivered by road − to Orlen Południe's Jedlicze Production Plant (6% of sales), and via the PERN pipeline − to TOTSA TOTAL Oil Trading S.A. (30% of sales). PGNiG sells crude oil at market prices. In 2016, Brent crude traded at USD 43.47/bbl on average, with the prices fluctuating from USD 30/bbl in January to USD 55/bbl in December.

Crude oil* in Poland, PGNiG Group 000' tonnes		**2016**		**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
PGNiG Zielona Góra Branch	719	719	719	719	742	766	442
PGNiG Sanok Branch	44	44	46	46	47	49	50
Crude oil production*	763	763	765	765	789	815	492
Sales of crude oil* produced in Poland	754	754	772	772	780	809	485

** including condensate*

(in PLN million, unless stated otherwise)

Seismic surveys

In 2016, GEOFIZYKA Toruń, GEOFIZYKA Kraków w likwidacji (in liquidation) and other companies acquired 168.5 km of 2D seismic data and 576.7 km^2 of 3D seismic data. The largest 2D and 3D projects in 2016 included Korczowa 2D (76.5 km), Hoczew-Lutowiska 2D (60.9 km), Przemyśl 3D (164.6 km^2) and Wańkowa-Bandrów 3D (120.5 km^2).

Underground gas storage facilities

PGNiG's gas system includes two storage facilities for L group gas (Daszewo UGSF and Bonikowo UGSF), whose main role is to regulate the operation of the nitrogen-rich gas system and store gas from nitrogen-rich gas production facilities.

Key parameters of underground gas storage facilities

Underground gas storage facilities	Working capacity	Maximum withdrawal capacity	Maximum injection capacity
	mcm	mcm/day	mcm/day
Bonikowo	200	2.4	1.7
Daszewo	30	0.4	0.2

In 2016, PGNiG applied to the Minister of Environment for a licence for exploration, appraisal and extraction of coal bed methane within the Międzyrzecze area. The tender procedure was completed with PGNiG's bid recognised as the best (the licence decision is pending).

Exploration for shale gas − summary

Even though the exploration for unconventional shale gas deposits in Poland has not been successful, we have gained skills in using new technologies to drill and access formations previously considered unproducible, mainly because of very poor reservoir properties.

The geological conditions in Poland create a need to explore for hydrocarbons in formations where no large-scale extraction has taken place so far, mainly due to technological constraints. Knowledge gained during the search for shale gas deposits can be drawn on to facilitate the exploration and extraction of tight gas and coal bed methane. The projects currently under way in the Carpathian Mountains (e.g. Siedleczka − tight gas) and in Upper Silesia (Gilowice − coal bed methane) are good examples in this respect. It ought to be noted that the opening of new horizons in the Siedleczka and Kramażówka projects has brought measurable effects, namely an increase in gas reserves.

The widespread use of directional and horizontal drilling, combined with advanced methods by means of which access can be gained to formation areas with low or very low permeability, offer opportunities for acquiring new areas for petroleum prospecting in Poland. The daily rate system adopted for drilling works has attracted to Poland the most advanced technologies. By opening to a wide market of services, PGNiG specialists were able to learn about the technologies and acquire skills to use them in practice.

Equity investment in Polska Grupa Górnicza Sp. z o.o.

Under an Investment Agreement signed on April 28th 2016 between Węglokoks S.A., PFR Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycji Zamkniętych Aktywów Niepublicznych, Towarzystwo Finansowe SILESIA Sp. z o.o., PGE Górnictwo i Energetyka Konwencjonalna S.A., ENERGA Kogeneracja Sp. z o.o., PGNiG TERMIKA, and Polska Grupa Górnicza Sp. z o.o. (PGG), PGNiG TERMIKA, as a new shareholder in PGG, agreed − together with the other investors − to make a total financial investment in PGG of PLN 1,800m; PGNiG TERMIKA's commitment was PLN 500m.

As part of the project, the PGG share capital was increased, and the new shares were acquired and paid for, in three tranches:

- The first tranche, of PLN 1,300m (PGNiG TERMIKA: PLN 361m), was paid on April 29th 2016,
- The second tranche, of PLN 300m (PGNiG TERMIKA: PLN 83m), was paid on November 3rd 2016,
- The third tranche, of PLN 200m (PGNiG TERMIKA: PLN 56m), was paid on February 1st 2017.

As at this Report date, the shareholding structure of PGG, following the payment of the third tranche, was as follows:

1. PGE Górnictwo i Energetyka Konwencjonalna S.A. – 17.1%,
2. ENERGA Kogeneracja Sp. z o.o. – 17.1%,
3. PGNiG TERMIKA – 17.1%,
4. PFR Fundusz Inwestycji Polskich Przedsiębiorstw Fundusz Inwestycji Zamkniętych Aktywów Niepublicznych – 10.3%,
5. Towarzystwo Finansowe SILESIA Sp. z o.o. – 13.7%,
6. Węglokoks S.A. – 24.6%,
7. State Treasury – 1 share – 0.000004%.

PGNiG TERMIKA treats its shareholding in PGG as a long-term financial investment. The decision to invest in the company was based on the assumption that the profitability of coal sales would improve markedly in the long term, mainly on the back of reduced production costs. Currently, PGG is implementing its Business Plan and the Technical and Economic Plan, both approved by the Investors, which specify measures intended to improve efficiency and restructure the business.

To strengthen control of the company and thus enhance the chance of success, on June 17th 2016 PGNiG TERMIKA and the other Investors signed a Memorandum of Understanding to set up the Investor Committee. Its role is to agree common positions on matters concerning PGG and work out effective ways of exercising the owners' supervision.

Meanwhile, PGG has embarked on an organisational restructuring effort, while taking measures to improve its operating efficiency.

5.1.4. Foreign operations

Natural gas production abroad mcm		**2016**		**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	517	-	573	-	419	340	-
including in Norway	517	-	573	-	419	340	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	59	59	52	52	58	25	-
PGNiG Pakistan Branch	59	59	52	52	58	25	-
Total (measured as E equivalent)	577	59	624	52	477	365	-

Sales outside the PGNiG Group mcm		**2016**		**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	24	-	1	-	-	-	-
including in Norway	24	-	1	-	-	-	-
Nitrogen-rich gas (Ls/Lw as E equivalent)	58	58	51	51	56	25	-
PGNiG Pakistan Branch	58	58	51	51	56	25	-
TOTAL (measured as E equivalent)	83	58	52	51	56	25	-

Crude oil* '000 tonnes		**2016**		**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Production in Norway	555	-	664	-	418	283	-
Sales in Norway	593	-	619	-	389	297	-

** including NGL*

Norway

PGNiG UI holds interests in exploratory and production licences on the Norwegian Continental Shelf, in the Norwegian Sea, in the North Sea, and in the Barents Sea. Jointly with partners, the company has been producing hydrocarbons from the Skarv, Morvin, Vilje and Vale fields and working on the development of the Snadd and Gina Krog fields. In the other licence areas, the company is engaged in exploration projects. The company's main asset is the Skarv field, which has been developed using a floating production, storage and offloading (FPSO) vessel. The FPSO is owned by the licence holders, including PGNiG UI, and is expected to continue is operations for the next 20 years. The other fields (Morvin, Vilje and Vale) comprise a group of wells connected to the existing production infrastructure.

In 2016, the company produced a total of 555 thousand tonnes of crude oil with condensate and NGL (measured as tonnes of crude oil equivalent) and 517 mcm of natural gas from the Skarv, Morvin, Vilje, and Vale fields. Production from the deposits was higher than initially planned. Greater output was achieved mainly thanks to the high efficiency of the production facilities. In addition, the larger output from the Skarv field was achieved through the use of a technique of injecting natural gas into the deposit to improve oil recovery.

In 2016, PGNiG UI and its partners continued the development of the Gina Krog and Snadd fields. In the Gina Krog field, exploration wells were being drilled. The Samsung shipyard in South Korea completed the construction of components of surface infrastructure for receiving oil and gas, which were subsequently transported to Norway and installed over the Gina Krog field. The field is now being prepared for production launch, which is scheduled for 2017. In 2016, a development concept for the Snadd field was selected. The preferred scenario provides for drilling three new production wells and launch of production in 2020.

Jointly with its partners, PGNiG UI also continued work on its other exploration licence areas. For example, the company was evaluating the prospectivity of the PL702, PL703, PL707, PL756 and PL799 licence areas. Based on the results of geological and economic analyses, a decision was made to relinquish the PL702, PL707, PL756 and PL799 licences, with no wells drilled.

In 2016, further APA 2015 rounds (Awards in Pre-defined Areas) and the 23rd Licence Round were concluded; PGNiG UI was awarded interests in five new exploration licences.

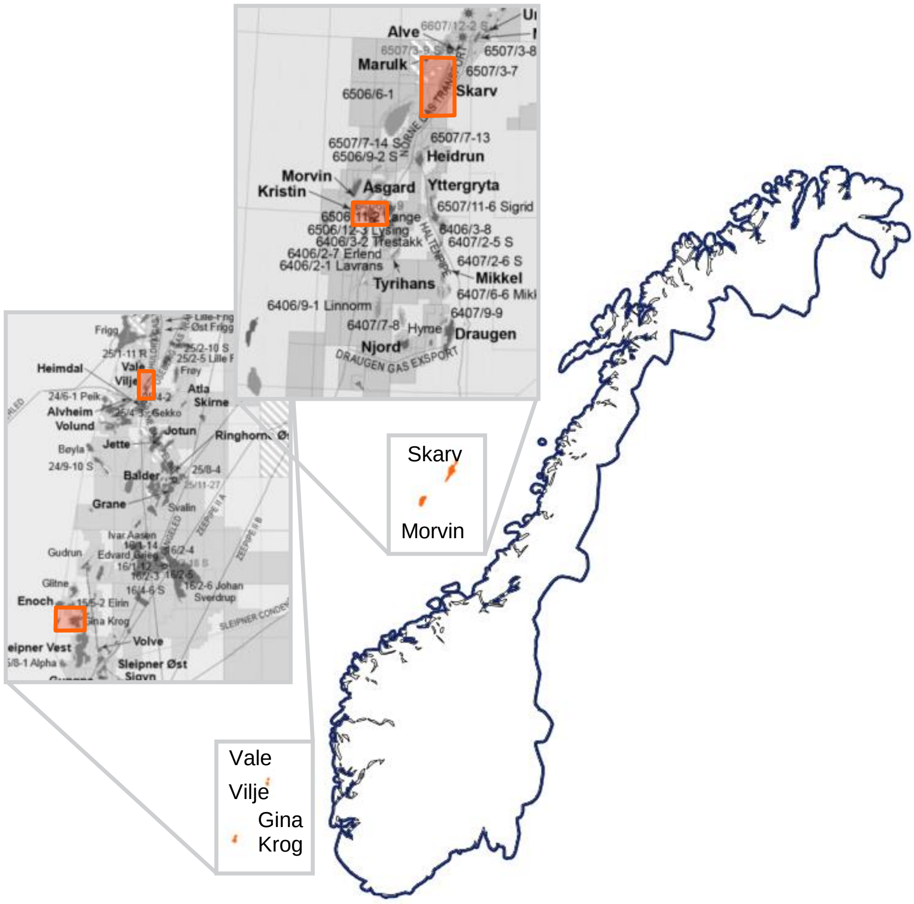
Within two to three years, the licence partners will perform geological and geophysical investigations allowing them to make precise estimates of the hydrocarbon potential of the licences. After that period, drill-or-drop decisions will be made.

As at December 31st 2016, PGNiG UI held interests in 17 exploration and production licences on the Norwegian Continental Shelf, in two of them as the operator. On January 17th 2017, PGNiG UI was awarded two more licences by the Norwegian government in the APA 2016 round, and granted operatorship of one of them. The licence partners were given two years to acquire seismic data and carry out geological and geophysical surveys, with drill-or-drop decisions due afterwards.

The awarded licences have significant gas potential, which fits in with plans envisaging gas imports from Norway to Poland. Both licences are located close to existing production and pipeline infrastructure, which will make project work much simpler and faster.

As at the date of this Report, PGNiG UI held interests in 18 exploration and production licences in Norway, in three of them as the operator. The table below presents licences held at the end of 2016.

Map of PGNiG UI producing fields



(in PLN million, unless stated otherwise)

Licence	Operator	PGNiG UI interest	Type	Planned activities
PL029C (Gina Krog)	Statoil	~30% (8% in Gina Krog project)	Exploration/development	Development (production to start in 2017)/exploration
PL036D (Vilje)	Det norske	~24%	Production	Production
PL036 (Vale) PL249 (Vale)	Centrica	~24%	Exploration/production	Production
PL134B (Morvin) PL134C (Morvin)	Statoil	6 %	Production	Production
PL212 (Skarv) PL212B (Skarv) PL262 (Skarv)	BP	15 % (~12% in the project)	Exploration/development/production	Production/planned development/exploration
PL212E (Snadd Outer)	BP	15%	Exploration	Possible tie-back to Snadd
PL703 (Asterix S/Loki)	OMV	40%	Exploration	DoD* July 2017
PL813 (Elli)	Statoil	8%	Exploration	DoD February 2018
Op. PL838 (Tunfisk/Shrek)	PGNiG	40%	Exploration	DoD February 2018
PL839 (Nise/Storkobbe)	BP	~12%	Exploration	DoD February 2018, seismic interpretation
PL850 (Ulv)	Edison	20%	Exploration	DoD February 2019
PL856 (Princesse)	Capricorn	25%	Exploration	DoD July 2018

**Drill-or-drop decision – a decision to either commit to drilling exploration wells or relinquish the licence*

Skarv field was brought on stream in December 2012. PGNiG UI's key partners on the project are the world's leading E&P companies BP (the field's operator with a 24% interest), Statoil (an approximately 36% interest), and E.ON (an approximately 28% interest). The project work involved construction of a Skarv FPSO, designed to produce oil and gas and to store crude oil. Skarv was developed with 16 wells from five subsea templates, ranking among the largest projects completed in Norway in 2007−2012. The templates can support a further seven wells, adding flexibility to Skarv operations going forward. The Skarv FPSO has a long useful life and can be an attractive production and transport hub for future discoveries in the region.

Snadd field – a gas and condensate field in the Skarv licence area comprising three discoveries: Snadd South (2000), Snadd North (2010) and Snadd Outer (2012). A production test commenced in 2011 has revealed above-average reservoir properties and potential production profile. Six more wells are to be tied back to the Skarv FPSO and existing transport infrastructure. The main phase of the project is due to commence in the second quarter of 2017, with wells to be brought on stream sequentially between 2018 and 2024.

Skarv and Snadd reserves: 51.1 mm boe, including 35.0 mm boe of natural gas and 16.1 mm boe of crude oil and NGL

Morvin field was discovered in the Norwegian Sea in 2001. The field development plan was prepared in 2008, with production launched in August 2010 through two subsea templates (North and South). Tied back to the Åsgard B platform, the field has a stable and predictable production profile.

Reserves: 1.8 mm boe, including 0.6 mm boe of natural gas and 1.2 mm boe of crude oil and NGL

Vilje field is located in the central part of the North Sea, close to the Alvheim and Heimdal facilities. The field is developed with three subsea wells linked by pipeline to the Alvheim FPSO. Production from the field commenced in August 2008. The last well (Vilje South) was brought on stream on April 7th 2014.

Oil reserves: 4.6 mm boe

Gina Krog is an oil and gas field. The development plan for the field was approved in June 2013, with production launch scheduled for April 2017. The concept for the field is a new steel platform and an oil storage vessel, with oil to be transported by tankers for transshipment. Raw natural gas will be sent to the Sleipner platform for processing and then exported via Gassled. Condensate and NGL will be transported to the Kårstø processing plant in Norway. The project is at an advanced stage of development, with exploration drilling continuing on the field.

Reserves: 18.2 mm boe, including 6.0 mm boe of natural gas and 12.6 mm boe of crude oil and NGL

Vale field is a gas and condensate field discovered in the North Sea in 1991. The development plan was prepared in 2000, and production from the field started in 2002. Output from the Vale field is expected to rise in the coming years as a result of recent investments made in the Heimdal platform.

Reserves: 2.3 mm boe, including 1.4 mm boe of natural gas and 0.9 mm boe of crude oil

Sales

Crude oil is sold directly from the fields to Shell International Trading and Shipping Company Ltd (from the Skarv, Vilje and Vale fields) and to TOTSA Total Oil Trading S.A. (from the Morvin field). All fields except for Vilje also produce associated gas, which is transferred via a gas pipeline mainly to Germany, where it is collected by PST.

In 2016, PUI sold a total of 593 thousand tonnes of crude oil and other fractions (measured as tonnes of crude oil equivalent) and 517 mcm of natural gas, including 24 mcm outside the PGNiG Group.

PGNiG UI's key sales markets are Norway, Germany and the UK.

Pakistan

PGNiG is engaged in exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG and the government of Pakistan on May 18th 2005. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd. (PPL), with production and expenses shared proportionately to the parties' interests in the licence: PGNiG (operator) – 70%, PPL – 30%. Exploration activities within the licence area have resulted in the discovery of two gas deposits − Rehman and Rizq.

Natural gas reserves: 11.3 bcm (Rehman) and 3.8 bcm (Rizq)

In line with the concept providing for simultaneous development of the Rehman and Rizq fields, the drilling of Rehman-2 was completed in November 2016, with Rehman-3 spudded on November 17th. 2016 saw further progress in the construction of pipeline infrastructure, which was used to enable production from Rizq-1 as of November 7th. Rizq-1 is producing natural gas as part of an extended well testing programme, and the gas is sold to the Pakistani gas system. The same pipeline will be used to make the Rehman-2 well available for production. Gas from the Rehman and Rizq fields is produced via facilities located in the Rehman field. In mid-2016, preparatory work began for drilling four new wells (two production wells, one appraisal well, and one exploration well). As part of further exploration and documentation work, work on a new 3D seismic survey was completed. The Company also continued production from the Rehman-1 and Hallel X-1 wells.

In 2017 in Pakistan, PGNiG will continue drilling the Rehman-3 well and will commence drilling the Rehman-4 and Rizq-2 wells. In the following years, under the Kirthar licence, the Company will perform work to gradually expand the capacity of the production installations; further drilling work will also be performed on the Rehman and Rizq fields. In addition, PGNiG plans to continue exploration work within three potential fields: N2, W1 and W2. PGNiG is seeking to secure an exploration licence in the Baran Block, adjacent to the Kirthar licence area.

Libya

Due to a rapid deterioration of the security situation in Libya in mid-2014, on August 12th 2014 POGC Libya gave notice of a force majeure to the National Oil Corporation (NOC) and started to scale back its operations in the country. In November 2015, POGC-Libya entered into an Interim Agreement with NOC, under which the parties agreed that the EPSA will not expire even if the force majeure continues for more than two years after its notification. In 2016, steps were taken to stabilise the situation in Libya by engaging the international community in coordinating the peace process aimed at electing a new unity government. Last year, Libya's total oil output rose from around 200 thousand bbl/d in September to 700 thousand bbl/d in December.

Throughout 2016, POGC Libya made efforts to reduce the impact of the force majeure on the project. The efforts were pre-approved by NOC and involved analysing seismic data and verifying the prospectivity of the LC113 licence. Steps were also taken to ensure safety of the Libyan assets, including offices, downhole equipment in storage, and core samples from two wells (A1 and B1) drilled in late 2013 and early 2014.

Germany

Work was continued within a subdivision of the Lubben licence area in east Germany (Brandenburg) under a joint operations agreement of August 4th 2015. PGNiG's (36% interest) project partners are Central European Petroleum Gmbh (39% interest and operatorship) and Austria's Rohöl-Aufsuchungs AG (25% interest). In the first half of 2016, drilling of the Markische Heide-1 exploration well was completed, and the acquired data was analysed to identify a potential prospect. Given major differences in the interpretation of seismic data and the increased exploration risk, PGNiG decided to withdraw from the project.

Iran

On November 5th 2016, a Memorandum of Understanding and a Confidentiality Agreement were signed with National Iranian Oil Company (NIOC) concerning joint operations on the Soumar oilfield owned by NIOC's subsidiary Iranian Central Oil Fields Company. By the end of March 2017, PGNiG is to prepare a development concept for the field based on data supplied by its Iranian partner. After the concept is approved by NIOC and a relevant consent is secured, the parties will be able to proceed to negotiate a potential contract.

Seismic surveys

In 2016, seismic data acquisition was carried out by PGNiG in Hungary, Italy, Algeria, Mozambique, Tunisia, Egypt, and Morocco. Processing and interpretation activities were conducted in Gabon, Germany, France, Belgium, Italy, Algeria, Switzerland, Pakistan, India, Spain, and Columbia. In 2016, the Group also worked on projects related to well logging and measurement of gas drilling parameters in Germany.

5.1.5. Key investment projects and CAPEX

In 2016, PGNiG's capital expenditure in the Exploration and Production segment amounted to PLN 830m, 16% less than in 2015. As regards exploration, capital expenditure was mainly related to drilling of appraisal wells (PLN 55m) and exploratory wells (PLN 239m), of which PLN 57m was attributable to the Wysin and Lubocino wells and PLN 26m − to the Tyczyn well. PLN 94m was spent on seismic and geophysical work, with PLN 66m of that amount allocated to 3D seismic surveys.

Expenditure on production in 2016 included PLN 210m related to drilling of production wells and PLN 178m spent on field development. Key production projects included drilling of wells on and development of the Przemyśl field (PLN 56m), development of the Radoszyn field (PLN 37m), drilling of wells on and development of the Kamień Mały field (PLN 25m), and recovery of helium from natural gas on the Kościan-Brońsko field (PLN 24m).

Other operations in Poland

Projects completed in 2016 in Poland:

- Development of 12 wells (expenditure in 2016: PLN 20.3m),
- Development of 2 fields (expenditure in 2016: PLN 18.2m),
- Construction of the helium recovery unit (expenditure in 2016: PLN 24.8m).

Projects in progress in Poland:

- Development of 60 wells (expenditure in 2016: PLN 12.3m),
- Development of 10 fields (expenditure in 2016: PLN 56.9m),
- Stimulation projects and works to raise the quality of hydrocarbons produced (expenditure in 2016: PLN 11.7m).

Projects in progress abroad:

In 2016, capital expenditure in Norway totalled PLN 343m. In 2016, PGNiG UI and its partners continued the development of the Gina Krog and Snadd fields. Exploration and production wells on the Gina Krog field are drilled with the use Maersk, a new drilling rig placed in service in October 2015. Furthermore, in 2016 a major part of the work to construct a production platform was completed. Production from Gina Krog is scheduled to commence in 2017. Exploration projects are still in progress. On the Snadd field, work on selecting the optimum project scenario is under way. At the same time, a long-term production test is being carried out, which will help collect more detailed geological data to facilitate optimum development of the field. An official development plan for the field is to be submitted in 2017.

In 2016, capital expenditure made in Pakistan totalled PLN 98m, and was 81% higher than in 2015.

5.1.6. Development prospects

In each of 2017 and 2018, PGNiG plans to produce 3.8 bcm of natural gas (measured as high-methane equivalent) and 745,000 and 840,000 tonnes of crude oil, respectively. Once new wells on the Barnówko-Mostno-Buszewo and Lubiatów-Międzychód-Grotów fields come on stream, the oil production volume will grow in 2018. Plans for the upstream area in Poland include development and tie-in of 22 new wells, and expansion of two facilities, in Dębno and Grodzisk, in 2017.

(in PLN million, unless stated otherwise)

On the Norwegian Continental Shelf, PGNiG UI, as a project partner, will continue to produce hydrocarbons from the Skarv, Morvin, Vilje and Vale fields and will proceed with the development of the Snadd and Gina Krog fields. PGNiG UI will also work towards ensuring stable, predictable and long-term gas supplies to Poland. These efforts will include analysis of infrastructure scenarios for transmission of Norwegian gas to Poland, but also potential acquisitions of gas fields in Norway. Based on the interests currently held in the Norwegian fields, the production volume is projected to reach 0.5 bcm of gas and 571 thousand tonnes of oil (including NGL) in 2017, and 0.5 bcm of gas and 579 thousand tonnes of oil (including NGL) in 2018.

PGNiG UI also intends to acquire new licence areas by participating in annual APA licensing rounds and in regular licensing rounds held every two to three years. The company may seek to acquire new licence areas through farm-in (purchase of interests from other companies) or farm-down (exchange of interests with other companies) arrangements. In the future, the company may participate, as a partner, in drilling projects in deep-sea waters (below 1,000 m) and in the Arctic Zone through its interests in the PL703 licence within the Vøring Basin in the Norwegian shelf, where the sea depth exceeds 1,000 m, and in two licences (PL850 and PL 856) in the Barents Sea.

As regards seismic surveys, in 2017 acquisition is planned of 2D seismic data (two projects) and 3D seismics (one project) in Poland, and of 2D seismic data (two projects in Mozambique and Myanmar) and 3D seismic data (eight projects in Germany, Austria, Egypt, Tunisia, Algeria, Myanmar, and Italy) abroad.

5.2. Trade and Storage

The principal activity of the segment is trade in natural gas. In Poland, where the PGNiG Group is the largest natural gas supplier, the segment sells natural gas produced from domestic fields or imported. Through PGNiG Sales and Trading GmbH (wholesale) and PST Europe Sales GmbH (retail sale), the PGNiG Group is also developing its natural gas business (both wholesale and sales to end users) in Germany and Austria. The segment also trades in electricity, certificates of origin for electricity, and CO_2 emission allowances. The segment operates seven underground gas storage facilities (Brzeźnica, Husów, Mogilno, Strachocina, Swarzów, Wierzchowice and Kosakowo).

5.2.1. Segment's figures

mcm		2016		2015	2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Total revenue	28,180	15,578	31,742	16,798	28,825	25,659	23,713
Revenue from outside the PGNiG Group, including from sale of:	27,740	14,011	31,274	15,223	28,367	25,341	23,353
- high-methane and nitrogen-rich gas,	25,644	12,461	29,413	14,042	26,555	24,392	23,148
Intersegment revenue	440	1,592	468	1,575	458	318	360
EBITDA	1,410	1,395	623	352	764	170	487
EBITDA adjusted for impairment losses on assets	1,437	1,422	627	355	822	183	496

Natural gas sales outside the PGNiG Group mcm		2016		2015	2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	22,822	13,527	21,600	12,224	17,289	14,934	13,684
Nitrogen-rich gas (Ls/Lw as E equivalent)	671	207	612	192	514	519	505
TOTAL (measured as E equivalent)	23,493	13,734	22,211	12,415	17,802	15,453	14,189
including:							
PGNiG	13,734		12,415		12,834	14,070	13,865
PGNiG OD	7,246		7,483		3,209	-	-
PST	2,511		2,311		1,760	1,383	324

5.2.2. Segment's strategy

Maintaining stable value of sales (both retail and wholesale)

Sales

The Group's portfolio of gas customers grew as PGNiG expanded its presence in the neighbouring countries. On August 4th 2016, the Group signed an agreement with Ukraine's ERU Trading for natural gas supplies to industrial customers. PGNiG also entered into new contracts for the sale of gas in Poland, which were an effect of the Company's consistent pursuit of its policy of high quality customised sales. On July 1st 2016, PGNiG started to sell gas via the InfoEngine brokerage platform.

PGNiG keeps changing to meet the needs and expectations of end users, offering them discount schemes, which were well received by the largest customers and delivered the expected results. In retail trade, the new gas supply contracts concluded in 2016 provide for sales of approximately 566 mcm of gas (calculated based on the entire contract terms, which in some cases are longer than one year).

On September 1st 2016, PGNiG launched dual fuel (electricity and gas) plans for households. From September to December 2016, PGNiG OD successfully met its dual fuel sales targets, with more than 13,100 new customer contracts by the year end. New customer service points were opened in popular locations, e.g. in the largest shopping centres, and, concurrently, self-service channels (e-BOK) were developed. The growing effectiveness of the sales force and the constantly expanding product mix helped PGNiG to acquire new and win back old business customers (a total of 1,312 in 2016).

Diversification of supply sources

PGNiG seeks to ensure technical possibilities for sourcing gas from markets other than east of Poland. The Company's key objectives include security of gas supplies and finding new sources and directions of gas imports, including via the LNG Terminal and the Norwegian Corridor.

As part of its diversification efforts, PGNiG, supported by the Polish government, is holding talks with Norway and Denmark about connecting the Polish gas system with the Norwegian Continental Shelf. PGNiG actively supports all efforts leading to the construction of a connection which would give Poland direct access to gas from North Sea fields. Such connection would enable delivery of natural gas from the upstream assets already held by PGNiG in Norway, and would ultimately help achieve natural synergies between individual segments of the PGNiG Group. Notably, PGNiG has by now secured a long-term, diversified portfolio of gas production assets in Norway, which it will be able to exploit until 2030.

In 2016, PGNiG took a major step to further diversify its gas supplier portfolio, and thus improve the security of gas supply to customers in Poland. It entered the LNG wholesale market as gas was first delivered to the Terminal in Świnoujście under a long-term contract with Qatargas. Pursuing its diversification strategy in 2016, PGNiG received seven LNG deliveries under the contract. Additionally, as part of short-term balancing, PGNiG purchased LNG on the spot market in Norway (a contract with Statoil). PGNiG reserved approximately 60% of the Świnoujście Terminal capacity.

In another step to consolidate its position on the gas supply market, on June 28th 2016 PGNiG set up an LNG trading office in London. Opened for business in early 2017, the office will reach operational readiness by the end of Q1 2017. It was established and is supported by PGNiG Supply & Trading GmbH (PST), a company trading in gas and electricity in Western Europe. Ultimately, the London office is to become the PGNiG Group's international LNG competence centre and the main trading office for short- and medium-term contracts for liquefied gas. It will also actively search for alternative sources of supply to the LNG Terminal in Świnoujście, to best utilise the Terminal's capacity reserved for PGNiG.

Yamal Contract

PGNiG is taking steps to bring its long-term contract with Gazprom in line with current conditions on the European market. On February 1st 2016, the Company filed a claim against OAO Gazprom and OOO Gazprom Export in arbitration proceedings pending before the Arbitration Court in Stockholm.

Storage

A strategic objective set for GSP is to ensure equal and non-discriminatory access to storage facilities to all interested entities. Therefore, GSP offers all the available storage capacities as required under Regulation 715/2009 of the European Parliament and of the Council on conditions for access to the natural gas transmission networks, in accordance with the Rules of Storage Services and the relevant tariff.

As the PGNiG Group is responsible for national energy security, GSP increases the TPA storage capacities once successive stages of the UGSF expansion project (carried out by PGNiG) are completed. In 2016, additional storage capacities of 126.45 mcm and 6.6 mcm, respectively, were made available at the Mogilno and Kosakowo cavern facilities.

(in PLN million, unless stated otherwise)

5.2.3. Trade in Poland

The principal activity of the segment is trade in natural gas in Poland. Natural gas sold in Poland by the PGNiG Group, which is the largest natural gas supplier on this market, is produced from domestic fields or imported. On August 1st 2014, the structure of the PGNiG Group changed: retail operations were separated from the wholesale gas business, the latter remaining with PGNiG. Retail customer service was transferred to PGNiG OD, a new company.

Natural gas sales in Poland outside the PGNiG Group (including gas exports from Poland) mcm		**2016**		**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	20,438	13,527	19,561	12,224	15,543	13,555	13,392
Nitrogen-rich gas (Ls/Lw as E equivalent)	671	207	612	192	514	519	505
TOTAL (measured as E equivalent)	21,109	13,734	20,172	12,415	16,057	14,075	13,897
including:							
PGNiG	13,734		12,415		12,834	13,555	13,392
PGNiG OD	7,246		7,483		3,209	-	-
PST	127		272		14	5	32

PGNiG Group's gas customer base mcm		**2016**		**2015**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG
Households	3,913	-	3,630	-
Other industrial customers	2,468	618	3,097	740
Retail, services, wholesale	1,475	233	1,520	239
Nitrogen processing plants	1,798	1,798	1,757	1,754
Power and heat plants	607	419	598	371
Refineries and petrochemical plants	1,338	1,327	1,238	1,223
Exchange	9,141	8,968	8,332	8,088
Exports from Poland	370	370	-	-
Total sales outside the PGNiG Group	21,109	13,734	20,172	12,415

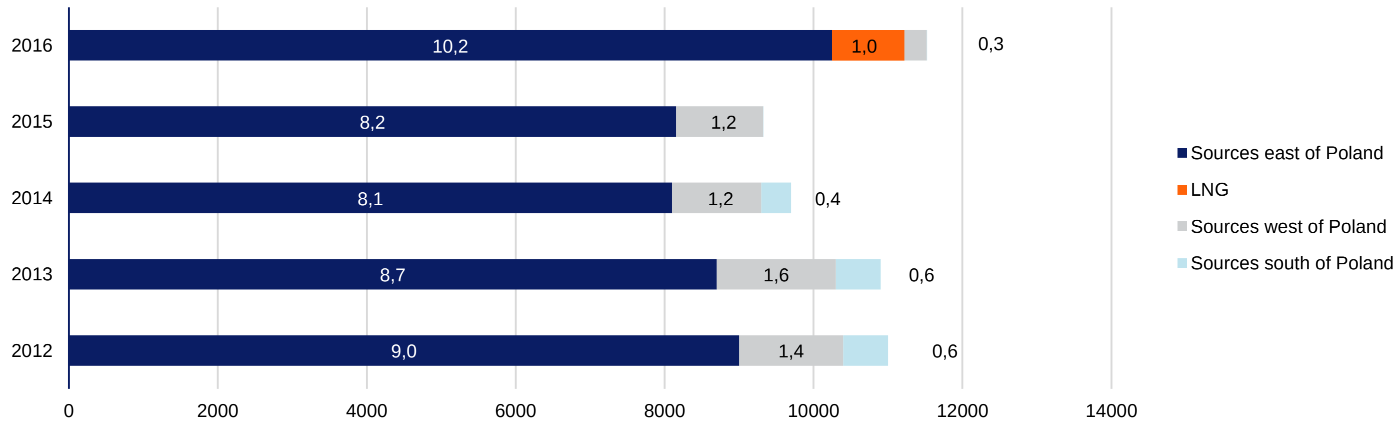
Wholesale market

Gas imports

In 2016, PGNiG bought natural gas mainly under the long-term agreements and contracts as well as short-term gas supply agreements with European suppliers specified below:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until 2022 (the Yamal Contract);
- Contract with Qatar Liquefied Gas Company Limited (3) for sale of liquefied natural gas, dated June 29th 2009, effective until 2034 (the Qatar Contract);
- Agreement with VNG-Verbundnetz Gas AG for sale of Lasów natural gas, dated August 17th 2006, effective until October 1st 2016.

Imports of natural gas to Poland in 2015 and 2016 (bcm)



Renegotiation of price terms under the Contract with OOO Gazprom Export

In 2016, PGNiG continued its efforts to revise the price terms under the Yamal Contract as part of a procedure formally launched on November 1st 2014. Having failed to achieve an understanding with the supplier within the time frame provided for in the contract, on May 13th 2015 PGNiG instigated arbitration proceedings, in accordance with the contract. The subject matter of the dispute is a revision of the price terms under the contract for gas supply to Poland. In the course of the arbitration proceedings, on February 1st 2016 PGNiG filed with the Arbitration Court a claim against PAO Gazprom and OOO Gazprom Export. The arbitration proceedings are expected to conclude in the third quarter of 2017. The fact of referring the dispute to the Arbitration Court does not preclude commercial negotiations and earlier amicable settlement with the supplier.

LNG supplies

The first LNG supplies necessary in the cool-down and start-up of the LNG Terminal in Świnoujście were delivered in December 2015 and February 2016. In January 2016, PGNiG, OGP GAZ-SYSTEM S.A. and Polskie LNG S.A. began testing the delivery of gas from the President Lech Kaczyński LNG Terminal in Świnoujście into the Polish transmission system. Pursuant to an agreement with Polskie LNG S.A. of December 28th 2015, PGNiG purchased gas from the start-up process and fed it into the transmission system.

In connection with a delay in the launch of the LNG Terminal, on October 21st 2015 PGNiG and Qatargas signed a Supplemental Agreement to amend the terms of LNG supplies in the first half of 2016. Under the agreement, Qatargas placed the volumes specified in the long-term contract on other markets, while PGNiG was to cover any difference between the LNG price specified in the long-term contract and the selling price obtained by Qatargas.

On June 1st 2016, the LNG Terminal in Świnoujście became operational, enabling commercial deliveries of LNG to Poland, the first of which, under the Qatar Contract, arrived at the terminal on June 17th 2016. In 2016, PGNiG received a total of seven LNG shipments under the contract.

Additionally, PGNiG purchased on the spot market 136,000 cm of LNG, equivalent to 84 mcm of grid gas, from Norway's Statoil ASA. The LNG shipment arrived in Świnoujście on June 25th 2016.

In 2016, PGNiG imported a total of approximately 1.8 mcm of LNG (i.e. approximately 1.04 bcm of gas after regasification), of which 0.85 bcm was fed into the Polish transmission system.

Expiry of agreement with VNG AG

From January 1st 2016 until October 1st 2016, when the agreement expired, natural gas purchased from VNG-Verbundnetz Gas AG was sold in the German market under an agreement with PGNiG Sales & Trading GmbH.

(in PLN million, unless stated otherwise)

Sales of gas

In Poland in 2016, the largest amounts of natural gas were sold to the PGNiG Group's industrial customers, accounting for about 31% of the total sales volume.

The largest Polish customers in this group include: Grupa Azoty S.A., PKN Orlen S.A., PGE Polska Grupa Energetyczna S.A., KGHM Polska Miedź S.A., and Grupa Lotos S.A.

Key natural gas sale agreements executed in 2016:

Grupa Azoty

On April 13th 2016, PGNiG concluded a framework agreement for sale of gas fuel and bilateral contracts with Grupa Azoty S.A. and its subsidiaries: Grupa Azoty Zakłady Azotowe Puławy S.A., Grupa Azoty Zakłady Chemiczne Police S.A., Grupa Azoty Zakłady Azotowe Kędzierzyn S.A., Grupa Azoty Kopalnie and Zakłady Chemiczne Siarki Siarkopol S.A. The framework agreement was concluded for an indefinite term, and it defines general terms of cooperation between the parties. The individual contracts, concluded for varying periods (with the longest contract expiring on September 30th 2019), define commercial terms of gas supplies to each of the Grupa Azoty Group companies. The estimated aggregate value of the framework agreement and the individual contracts is approximately PLN 3.3bn, and the maximum volume of supplies over the entire term of the agreement is 4.5 bcm.

EDF Gaz Toruń

On June 22nd 2016, PGNiG signed contracts with EDF Gaz Toruń Sp. z o.o. and EDF Toruń S.A. for the supply of gas to EDF's new CHP plant in Toruń. The parties signed two contracts, one of which provides for the supply of gas for the plant's start-up, and the other for the supply of gas after the plant comes on stream commercially, for the period until October 1st 2019. The aggregate volume of contracted gas is approximately 355 mcm.

PGE Górnictwo i Energetyka Konwencjonalna

On August 30th 2016, PGNiG and PGE Górnictwo i Energetyka Konwencjonalna S.A. executed gas sale contracts with an estimated value of PLN 2bn. The contracts are effective until October 1st 2019, with an option to extend them until January 1st 2023. The gas will be transported to the PGE Polska Grupa Energetyczna Group's Lublin-Wrotków and Rzeszów CHP plants, and the total volume of supplies may reach about 2.2 bcm.

PKN Orlen

On September 30th 2016, PGNiG and PKN Orlen S.A. signed a new contract for gas supplies to the ORLEN Group. The five-year contract is valid from October 1st 2016 until September 30th 2021 (five gas years), and its value is estimated at more than PLN 7bn.

ERU Trading and NAK Naftogaz of Ukraine

As part of a strategy to increase its activity on foreign markets, PGNiG executed separate Framework Agreements with NAK Naftogaz of Ukraine on July 12th 2016, and ERU Trading on July 21st 2016, under which natural gas was supplied through the Polish-Ukrainian border. The total volume of gas supplied from July to the end of 2016 was approximately 370 mcm. In the first half of 2017, PGNiG intends to further expand its natural gas sales in Ukraine.

In 2016, sales on the Polish Power Exchange (PPX) accounted for the largest portion of the PGNiG Group's total gas sales. The Group sold 114 TWh of the fuel on PPX in 2016, a year-on-year increase of 7%. Significantly higher volumes (up 87%) were sold on the Day-Ahead Market. The table below presents the volumes of gas sold by PGNiG on PPX in 2016 and 2015 on the Commodity Futures Instruments Market, the Day-Ahead Market and on the Intraday Market for natural gas (data by delivery dates):

Volume (TWh)	2016	2015
Total – Commodity Futures Instruments Market (natural gas)	78.7	79.5
Total – Day-Ahead and Intraday Market (natural gas)	19.1	9.3
TOTAL – Polish Power Exchange	97.8	88.8

The volume of gas sold by PGNiG on PPX with delivery in 2016 increased year on year by approximately 9 TWh.

To meet the obligation to sell 55% of the gas fed into the national transmission system through the exchange market, PGNiG has adopted a pricing policy covering all natural gas-linked instruments on PPX, both on the futures and day-ahead markets, allowing it to offer natural gas to other market participants at prices corresponding with those on deregulated wholesale, exchange and OTC markets in Western and Northern Europe. As a result, the commodity exchange has become an attractive gas trading platform.

Competition

In the business customer segment, PGNiG's main competitors operating directly in Poland include PGE Polska Grupa Energetyczna S.A., DUON (Fortum Holdings), Hermes Energy Group S.A., RWE Polska S.A., TAURON Polska Energia S.A., and PKN ORLEN S.A. Competitors step up gas sales by strengthening their sales force, improving on the flexibility of their offering and price hedging mechanisms, as well as bundling gas and electricity.

The activity of competitors, as well as the growing customer awareness, result in mounting market pressure on PGNiG to focus on product development, reduce gas prices and negotiate contract terms on a case-by-case basis. In 2016, in response to customer expectations to link the prices of supplied gas with prices on gas exchanges, PGNiG continued its '2015/2016 Price Deregulation' discount scheme. Also, a large number of customers decided to sign new agreements with PGNiG to replace existing ones. Under the new agreements, customers can purchase PGNiG's products more flexibly and execute procurement contracts for entire corporate groups. PGNiG offers contracts where price-setting mechanisms link gas prices to market indices. Such contracts may be structured as open agreements under which clients, depending on their current needs, may enter into further contracts for gas supplies in the future.

Currently, prices under agreements with most PGNiG's customers are determined taking into account the market conditions and competitive environment.

Sales of electricity

In 2016, PGNiG engaged in wholesale trading in electricity and related products in Poland and Germany. In Poland, the Company traded on the OTC market and on PPX. In Germany, PGNiG was engaged in futures trading on the European Energy Exchange (EEX). PGNiG also provided services to PGNiG OD and PGNiG TERMIKA under a commercial balancing agreement as the entity responsible for balancing, working directly with the power transmission system operator.

Apart from electricity, the trade portfolio includes related products, such as property rights and carbon emission allowances. PGNiG's Wholesale Trading Division is responsible for optimising the prices of electricity procured for customers and for own needs, as well as for sales of electricity from PGNiG's own generating units. Total trading volume in 2016 was more than 5.8 TWh.

Retail market

The focus of PGNiG OD's business is on the sale of natural gas (high-methane and nitrogen-rich gas), electricity, compressed natural gas (CNG), and liquefied natural gas (LNG).

Gas procurement

High-methane gas is procured from three main sources:

- PPX,
- PGNiG, under an OTC agreement providing for delivery to a virtual trading point in the transmission network operated by OGP GAZ-SYSTEM S.A. (agreement for the balancing of supplies),
- PGNiG, under an OTC agreement providing for delivery to a physical trading point in Słubice.

The largest share in the total volume of purchased high-methane gas was attributable to transactions on PPX. Moreover, in 2016 the company reached an operational capacity allowing it to enter into transactions on the OTC market via the brokerage platform operated by InfoEngine S.A., to be launched in early 2017. OTC transactions will be executed depending on their financial attractiveness versus the PPX regulated market.

Nitrogen-rich gas and LNG are purchased under a bilateral agreement with PGNiG.

Given the rapid changes on the retail gas market, PGNiG OD structures its gas supply portfolio by signing contracts on an ongoing basis, taking into account customer types and probability that demand for gas may change within the assumed time span.

Thanks to such fuel procurement policy, the company has a competitive and flexible product offering.

Sales of gas

PGNiG OD's business customers (contracted capacity above 110 kWh/h) include entities which require process gas and businesses buying gas for heating. The largest group of customers by number are businesses operating in the retail and services segment, whereas industrial customers lead in terms of gas volumes received.

As at the end of December 2016, PGNiG OD provided its services to 25.8 thousand customers (gas meter points), from tariff groups with contracted capacity above 110 kWh/h. Gas consumption in that customer group reached 30.9 TWh, including 28.5 TWh of high-methane gas and 2.3 TWh of nitrogen-rich gas, representing 94% and 6%, respectively, of the total volume.

Customers consuming lower volumes of gas (tariff groups 1−4) purchase gas used mainly for cooking, water and space heating, and − to a lesser extent − in manufacturing. As at the end of December 2016, the company supplied gas to 6.79 million group 1−4 customers, who over the entire year consumed 46.35 TWh of gas, including 43.61 TWh of high-methane gas and 2.74 TWh of nitrogen-rich gas.

Competition

In 2016, PGNiG OD saw intensified competitor activity in gas sales. According to URE's data, licences to trade in gas fuels were held by 191 entities. These include both strong companies with a European reach (using the financial potential and know-how of their head offices), as well as local players. Local sellers include both companies specialised in the sale of energy products and businesses (for instance telecoms operators) whose core product range is supplemented by gas.

Aggressive pricing policy, especially in the business customer segment, was the main competition tool in 2016. Attractive product bundles (mainly gas and electricity deals) were also commonly used.

Marketing policy with respect to business customers (contracted capacity >110 kWh/h)

2016 was marked by aggressive customer acquisition efforts by competitors and, on the other hand, growing market awareness among customers. In response to competitive pressures, PGNiG OD was forced to pursue an active pricing policy aimed at offering competitive prices and analysing contracts on a case-by-case basis.

To meet customer expectations, the company markedly expanded its product mix. It continued to run its promotional schemes ('Flexible Price' and 'Constant Savings for Business'), while larger customers were offered new products − priced based on individual consumptions profiles. In the third quarter of 2016, the company launched a range of products for the most demanding customers, with gas prices linked to prices on energy exchanges. Customers may choose exchange indices by reference to which their gas supply contracts will be settled, which allows them to tailor the price to their needs.

2016 saw the launch of Biznes24, a modern online platform designed to facilitate customers' access to information on payments and their past gas and electricity consumption volumes. The platform also serves as an effective channel for communicating with customers, which attractively presents the company's promotional offers.

To maintain its market position and keep customers satisfied, the company launched a programme to reorganise its internal processes and took steps to more effectively roll out new products and services.

An undisputed strength of PGNiG OD is its image of a reliable, secure and responsible business. Customers appreciate the key objective of the company's marketing policy, which is to consistently build lasting relationships based on mutual benefits.

The effects of its marketing policy in 2016 included the execution of a record contract with Ceramika Paradyż, under which 1.3 TWh of gas is to be supplied from October 2016 to September 30th 2018. Another major contract was concluded with Philips Lighting, which is to receive 260 GWh in the period from October 2016 to September 2017.

Marketing policy with respect to retail customers (contracted capacity <110 kWh/h), customer service and sale channels

In response to increasingly aggressive customer acquisition efforts of its competitors, in March and April 2016 PGNiG OD launched a discount scheme 'Savings for you and your business W4' dedicated to the W-4 tariff group customers. The scheme was available to both existing and new gas fuel buyers. Under a twelve-month forward contract, customers were offered an attractive price and a fixed price guarantee until contract expiry. Benefits for the company included stable revenue and more effective gas contracting on the PPX.

In 2016, PGNiG OD stepped up its work on the development of e-channels (e-customer service, e-invoice), but also − catering for the needs of customers who prefer more traditional forms of communication − opened five Premium customer service offices at shopping centres in Kraków, Katowice, and Poznań and at two locations in Warsaw. Seven days a week, during extended office hours, they serve customers with information on the conditions of gas network connection, tariffs, promotions and billing details, while selling the company's products.

(in PLN million, unless stated otherwise)

Sales of electricity

On September 1st 2016, PGNiG OD launched a comprehensive dual-fuel plan for households and small businesses − the 'PiG Package' (electricity and gas package). In addition to competitive prices (guaranteed for 12 months), another advantage for customers is the plan's transparent structure and no penalties for early contract termination. The deal is particularly attractive to customers with active gas supply contracts, as they pay no subscription fees and their bills are reduced.

In 2016, PGNiG OD continued to supply electricity to business customers. The main product is based on a fixed price mechanism, while larger customers are also offered individual pricing terms. In Q4 2016, the company launched innovative electricity schemes for its most demanding customers providing for tranche- or index-based purchases. The schemes allow customers to build their procurement portfolios on an as needed basis.

According to URE, in 2016 more than 86 thousand customers (consumers and entities not classified as consumers) switched their electricity supplier, including more than 71 thousand customers billed under tariff groups G.

5.2.4. Trade abroad

Through PGNiG Sales and Trading GmbH (wholesale) and PST Europe Sales GmbH (retail sale), the PGNiG Group is also developing its natural gas business (both wholesale and sales to end users) in Germany and Austria. In 2016, PGNiG launched its operations in Ukraine, thus entering a new significant market. PGNiG's increased activity on foreign markets included gas supplies to ERU Trading and NAK Naftogaz of Ukraine. › For more information, see Section 6.2.3).

Natural gas sales outside the PGNiG Group (excluding gas exports from Poland) mcm	**2016**		**2015**		**2014**	**2013**	**2012**
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
High-methane gas (E)	2,384	-	2,039	-	1,745	1,378	292
Nitrogen-rich gas (Ls/Lw as E equivalent)	-	-	-	-	-	-	-
TOTAL (measured as E equivalent), including:	2,384	-	2,039	-	1,745	1,378	292
PST	2,384		2,039		1,745	1,378	292

Customer base

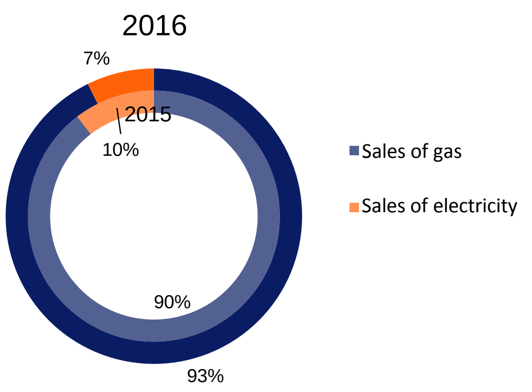
mcm	**2016**		**2015**	
	PGNiG Group	PGNiG	PGNiG Group	PGNiG
Households	51	-	73	-
Other industrial customers	57	-	78	-
Retail, services, wholesale	1,460	-	1,268	-
Exchange	816	-	620	-
Total sales outside the PGNiG Group	2,384	-	2,039	-

Exchange and OTC wholesale trading

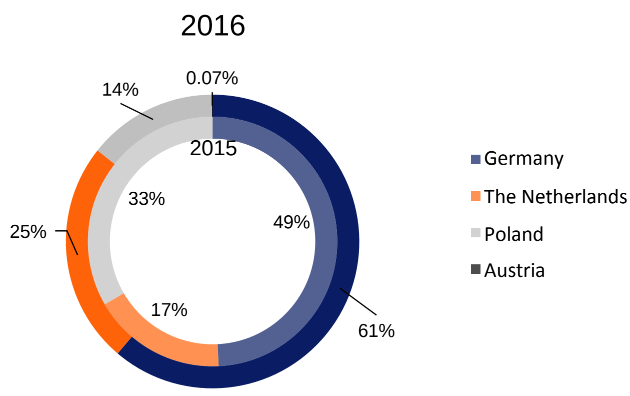
PST is an active player on organised markets (exchanges) and in OTC trading; it trades with over 50 counterparties under EFET or similar standardised contracts. The company operates in Germany and its neighbouring countries, Austria and the Netherlands. PST registered for trading on the UK gas market (NBP) and launched its operations there after successful implementation of the market based on the ETRM (Energy Trading and Risk Management) system in August 2016. PST has also registered its activity in the Czech Republic and Poland. PST is ready to engage in trading on the Czech market if such demand arises from customers or to support liquidity. The company's presence on the Czech market has been and may still be used to transmit gas to Poland through the territory of that country. PST is fully prepared to launch trading operations in Poland if such need arises from the PGNiG Group. PST is also a registered supplier on the Danish and Slovak markets. The presence on both these markets will be exploited if new business opportunities emerge (e.g. to supply gas from Slovakia to Ukraine). PST is a market maker on the PEGAS exchange for the GASPOOL gas hub market area.

PST's commodity trading portfolio was expanded with its entry on the global LNG market, including an analysis of the company's potential operations in the small-scale LNG sector (LNG as fuel for lorries). To support its trading activity on the global LNG market, a decision was made for PST to open a branch in London, UK. The branch was registered in 2016, and became operational in February 2017.

PST's sales structure by product



Structure of PST's sales outside the PGNiG Group, by country



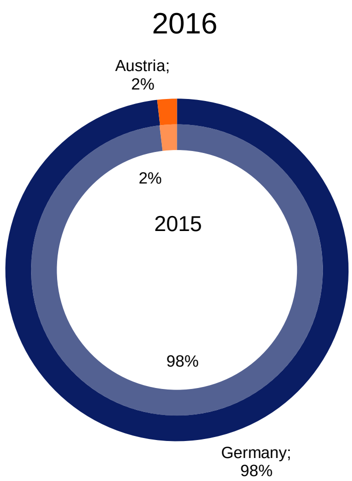
Retail sales

In 2015, PST spun off its retail operations and gas and electricity are sold to end users in Germany and Austria through its newly established subsidiary, PST Europe Sales GmbH (PSTES). The target customer group includes small and medium-sized enterprises, as well as households with standard consumption profiles.

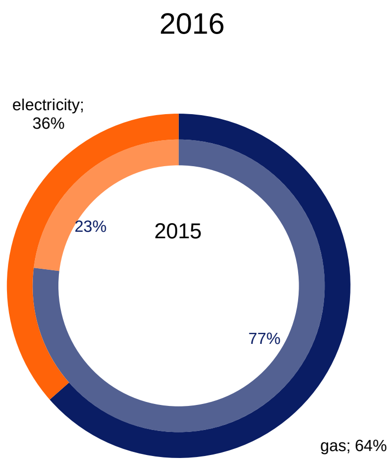
In 2015, the portfolio was restructured and adjusted, which resulted in a significant reduction of the end user portfolio (mainly management of receivables − monitoring of customers defaulting on their monthly payments) and in a substantially improved margin per customer.

The overall size of the portfolio (existing and newly acquired customers) stabilised at the year's beginning and started to grow in Q2 2016, thanks mainly to new customers newly by the company's marketing partner Premio through its telemarketing platform.

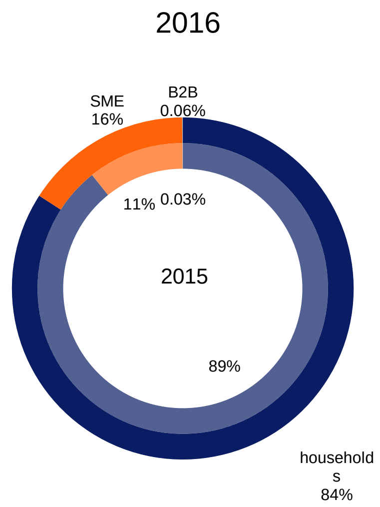
Structure of PST's customer base by country



Structure of PST's customer base by product



Structure of PST's customer base by segment



In 2016, PST Europe Sales GmbH signed 60.5 thousand new end user agreements. The majority of customers who signed an agreement in 2016 will receive supplies in 2017 and partially in 2018.

Key services provided to PGNiG Group entities

PST's key contracts effective in 2016 included a contract for the management of commercial storage capacity for own needs at gas storage facilities in the Netherlands (with a working capacity of 250 GWh) and Austria (with a working capacity of 17 GWh). The objective of the contract is to optimise the growing end-user demand for gas in winter and the trading portfolio.

Under its current contracts, PST supplies natural gas to PGNiG on the Polish-German and Polish-Czech borders, thus securing diversification of supply sources.

PST has also a contract in place with PGNiG UI for the purchase of gas produced from the Norwegian Skarv field since 2013, and from the Vale and Morvin fields since 2015. In addition, the company provides access to the market to 100 industrial producers of energy from biogas (E2M) and helps optimise PGNiG's portfolio by trading on Western European markets. PST actively manages gas supply interruptions in real time, on a 24x7 basis, with a view to minimising PUI's costs.

Key information on trading activities (without physical delivery)

PST continues to trade in electricity (and emission certificates) on the EEX, and in gas on the PEGAS and ICE Index markets. It can also trade on the PPX under a contract with a broker.

5.2.5. Storage

The Trade and Storage segment uses for its own needs the working capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities, as well as the Mogilno and Kosakowo underground cavern facilities. A part of the working capacity of the Mogilno facility, which was made available to OGP GAZ-SYSTEM S.A., is not a storage facility within the meaning of the Polish Energy Law.

The capacities of gas storage facilities are managed by Gas Storage Poland Sp. z o.o.

GSP conducts activities in two principal areas:

- Regulated activities comprising the provision of gaseous fuel storage services at storage facilities owned by PGNiG, as well as operation of the Mogilno and Kosakowo underground gas storage caverns;
- Non-regulated activities comprising the provision of services related to design, construction and extension of underground gas storage facilities.

Storage services are provided by GSP at underground high-methane gas storage facilities owned by PGNiG. Under an outsourcing agreement with PGNiG, GSP operates the following storage facilities: the Mogilno CUGSF, Kosakowo CUGSF, Wierzchowice UGSF, Husów UGSF, Strachocina UGSF, Swarzów UGSF and Brzeźnica UGSF.

Short-term peak fluctuations in demand for natural gas are balanced by supplies from the Mogilno and Kosakowo facilities, where gas is stored in worked-out salt caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica facilities are used to balance out changes in demand for natural gas in the summer and winter seasons, to meet the obligations under take-or-pay import contracts, to ensure the continuity and security of natural gas supplies, and to meet the obligations under gas supply contracts with customers.

GSP, in its capacity of the storage system operator, provides gas fuel storage services to storage facility users under standardised procedures, on a non-discriminatory, equal-treatment basis, so as to ensure the most efficient use of the storage capacities. Storage services are provided under standard storage service agreements (SSSA).

To ensure equal treatment of storage service users, SSSAs are concluded based on GSP's Rules of Storage Services and the gas fuel storage tariff. GSP's services are provided using the following Storage Facilities (SF) and Groups of Storage Facilities (GSF):

- Kawerna GSF (comprising the Mogilno CUGSF and Kosakowo CUGSF, located in worked-out salt caverns),
- Sanok GSF (comprising the Husów UGSF, Strachocina UGSF, Swarzów UGSF and Brzeźnica UGSF, located in partly depleted gas reservoirs),
- Wierzchowice UGSF.

In the 2016 reporting year, GSP offered the following gas fuel storage services:

- Packaged services (in the form of standard or flexible packages) and stand-alone services (with working, injection and withdrawal capacities offered separately),
- Services provided on a firm or interruptible basis. In the case of services provided on a firm basis, GSP guarantees the withdrawal of stored gas fuel within no more than 40 days. In the case of services provided on an interruptible basis, the injection and/or withdrawal capacities may be limited or interrupted if services offered on a firm basis are being performed,
- Long-term services (from one to four consecutive storage years, and in the case of the Kawerna GSF, one, two, three or four consecutive storage years, or periods of 12, 24, 36 or 48 consecutive gas months, not overlapping with storage years), short-term services (7, 14 or 21 consecutive gas days, or from one to 11 consecutive storage months) and single-day services (injection or withdrawal capacity for one to 24 hours, on an interruptible basis),

(in PLN million, unless stated otherwise)

- Extension/reduction of the scope of services provided.

As at December 31st 2016, GSP had provided a total of 5,757 storage capacity packages, including 2,192 packages of services provided on a firm basis and 3,565 packages on an interruptible basis.

As at December 31st 2016, 97% of the storage capacities were reserved for PGNiG, 2% for external customers, with the remaining 1% of total capacities idle.

Third-party access (TPA) storage capacities

As at December 31st 2016, the PGNiG Group had a total working storage capacity of 2,928.7 mcm, of which 2,888.5 mcm was made available on a TPA basis or to the Gas Transmission System Operator OGP GAZ-SYSTEM S.A. under a long-term contract. 35 mcm was made available under a short-term contract, for the period from 6.00 am on September 11th 2016 to 6.00 am on June 1st 2017 5.2 mcm of Kawerna's working capacity is allocated for the Mogilno and Kosakowo cavern facilities' own needs.

Total working capacities and TPA working capacities

	Working storage capacities (mcm)		TPA working storage capacities (mcm)		TPA working storage capacities (GWh)*	
	2016	**2015**	**2016**	**2015**	**2016**	**2015**
Kawerna SFG	714	581	709	576	7,774	6,314
Wierzchowice UGSF	1,200	1,200	1,200	1,200	13,166	13,166
Sanok SFG	1,015	1,015	1,015	1,015	11,137	11,137
Total	2,929	2,796	2,924	2,791	32,077	30,617

** Converted to gas with a calorific value of 39.5 MJ/cm.*

5.2.6. Key projects and capital expenditure

In 2016, a new storage chamber (K-5) was placed in service at the Kosakowo CUGSF. After the President of URE issues a decision to amend the licence, the working capacity of that storage site will increase to 145.5 mcm. The target working capacity of the Kosakowo CUGSF, following completion of the still ongoing construction project, will be 250 mcm. Steps were also taken to secure administrative decisions necessary to further expand the Kosakowo CUGSF's working capacity to 655.7 mcm. In 2016, acting on behalf of and for PGNiG, GSP obtained a decision issued on July 21st 2016 by the Regional Director for Environmental Protection in Gdańsk, specifying the environmental conditions to be met by the project 'Extension of the working capacity of the Kosakowo Cavern Underground Gas Storage Facility to 655.7 mcm, including construction of storage chambers, a leaching installation, surface infrastructure and internal pipelines'. Also in 2016, the extension of the Brzeźnica UGSF's working capacity was completed; after the President of URE issues a decision to amend the licence, its working capacity will increase to 100.0 mcm.

In February 2016 r., GSP made available, for third-party access, new storage capacities at the Kawerna GSF achieved through the extension of the Mogilno CUGSF and Kosakowo CUGSF, and through geological processes in the salt dome on the Mogilno CUGSF site. Third-party access has been provided under contracts for long-term storage service or short-term storage service on an interruptible basis, in packages, flexible packages or as stand-alone services.

5.2.7. Development prospects

Development prospects in Poland

Procurement of natural gas

In the long term, PGNiG will focus on meeting its obligations under the long-term contracts with Gazprom Export and Qatargas with respect to the minimum offtake volumes. If an unforeseen surge in demand occurs, the Company will purchase natural gas under short-term contracts from the neighbouring countries or on the LNG market, wherever more favourable prices are available.

Business development in the CNG and LNG segments

- Small LNG Regasification Facilities for businesses – construction of LNG stations to serve business customers (based on a one customer – one station model), if the expected consumption volume and profile guarantees economic viability of the project.
- LNG bunkering – activity in the market of LNG supply for use by ships, including submission of an application for EU co-financing under the Connecting Europe Facility;
- CNG stations for municipal transport – selective approach to customers, maintaining the existing stations, and new projects subject to economic viability.

New offers have been prepared for customers, with prices based on a flexible market-linked formula, and work commenced to investigate the possibilities of linking the offered LNG/CNG price to prices of petroleum fuels.

Storage

With respect to the Kosakowo CUSGF expansion, work will continue on construction of five Cluster B chambers and leaching of the K-6, K-8 and K-9 caverns. The contractual deadline for completion of all works related to the construction of the five Cluster B chambers falls in 2021.

Further steps will be taken to secure administrative decisions necessary to expand the Kosakowo CUGSF's working capacity to 655.7 mcm.

Development prospects abroad

PST is planning to further expand its business, focused on selling electricity and gas to end customers and in wholesale. In the retail area, the company will be seeking to considerably expand its customer base. Furthermore, PST entered into cooperation with Premio Energie GmbH as its trading partner. Under the arrangement, Premio Energie will offer exclusively PST products as their sole reseller.

As part of its trading activity, besides being an active player in OTC and exchange markets, PST intends to develop a business model based on cooperation with municipal entities as well as gas and electricity trading companies, by offering them standard and structured trading products and auxiliary services related to trading (for instance balancing services).

In 2016, PST gained a foothold in the UK market, where it started trading natural gas in the NBP market area (the National Balancing Point is the British equivalent of Polish VTP). A London branch of PST was set up as a dedicated international LNG trading operator. The London branch will act in the capacity of PGNiG's agent with a mission to secure LNG supplies to the Świnoujście LNG Terminal and to execute transactions in the global LNG market.

Further automation of processes is planned as part of the trading operations in order to ensure compliance with the requirements imposed by institutions whose role is to implement the REMIT (Regulation on Wholesale Energy Market Integrity and Transparency) and EMIR (European Market Infrastructure Regulation).

In retail sales, PST's IT systems and internal processes are of vital importance from the point of view of retail sale objectives (reaching end customers in the mass market), where the new customer connection efficiency ratio and the 'cost to serve' (CTS) are viewed as key performance indicators (KPI).

As part of its strategy to increase activity on foreign markets, PGNiG intends to continue its natural gas sales operations in Ukraine. PGNiG is also keeping a close eye on the negotiations between Gaz-System and Ukrtransgaz concerning extension of the interconnector capacity between Poland and Ukraine. Their successful conclusion would increase the volume of gas PGNiG could transmit to Ukraine, thus allowing it to expand gas sales on the Ukrainian market.

(in PLN million, unless stated otherwise)

5.3. Distribution

The segment's principal business activity consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of coke-oven gas, over the distribution network to retail and corporate customers. The segment is also engaged in extending and upgrading the gas network and connecting new customers. Gas distribution services are rendered by Polska Spółka Gazownictwa Sp. z o.o. (PSG). As the Distribution System Operator, the company conducts its business in all provinces of Poland. As the owner of approximately 96% of Poland's distribution network and nearly 99% of the gas service lines, PSG enjoys a dominant market share,

5.3.1. Segment's figures

	2016	2015	2014	2013	2012
	PGNiG Group	PGNiG Group	PGNiG Group	PGNiG Group	PGNiG Group
Total revenue, including	4,915	4,585	4,283	4,250	3,583
- external sales of distribution services	729	363	67	23	10
- intragroup sales of distribution services	3,657	3,748	3,868	4,045	3,385
EBITDA	2,559	2,339	2,002	1,596	1,697
EBITDA adjusted for impairment losses on assets	2,563	2,341	1,994	1,597	1,698

Volume of distributed gas (high-methane, nitrogen-rich, propane-butane, and coke gas)

in natural units – mcm	2016	2015	2014	2013	2012
Total volume of distributed gas	10,858	9,823	9,586	10,128	9,924
- including high-methane gas	9,301	8,646	8,495	8,922	8,816
- including nitrogen-rich gas	836	643	568	610	578
including outside the PGNiG Group	*3,081*	*1,793*	*804*	*641*	*556*

Geographical coverage in terms of the number or area of communes/municipalities with mains gas connection: 59.78%.

Number of communes/municipalities in Poland 2,479, including 1,482 connected to mains gas network

5.3.2. Segment's strategy

Maximising cash flows from the infrastructure area

While pursuing its mission of the National Gas Distribution System Operator, PSG has been building its portfolio of development initiatives in such a way as to support its dedicated values highlighted in PSG's strategy for 2016–2022, namely:

1st Value building;
2nd Continuous improvement of operational efficiency;
3rd Search for and implementation of innovative solutions and technologies;
4th Taking up new market challenges.

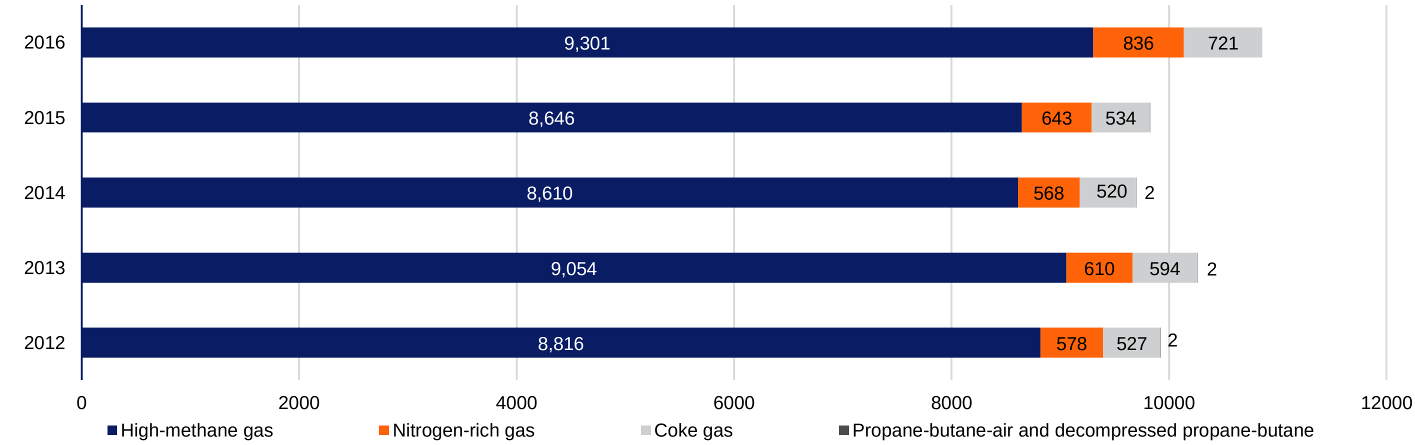
PSG's new strategy primarily assumes an increase in the volume of distributed gas and the number of new customers, as well as a meaningful increase in the number of communes and municipalities connected to the mains gas network across the country.

PSG's primary goal for the following periods is to extend the service to unserved regions on Poland's gas distribution map. By 2022, PSG intends to roll out its gas network into 74 municipalities and communes and connect approximately 350,000 new customers. In 2016−2022, the planned cumulative EBITDA increase will be PLN 15.98bn, while the cumulative volume of distributed gas is expected to reach 79.06 bcm.

5.3.3. Operations in 2016

In 2016, all settlements between PSG and its customers were based on Tariff No. 3 for Gas Fuel Distribution Services and LNG Regasification Services, as amended by the President of URE on December 16th 2015, and then on June 9th 2016. As a result of the amendments, the tariff validity term was extended until December 31st 2016. Rates of distribution and regasification service charges remained unchanged.

Volume of gas transmitted via the distribution system (mcm)

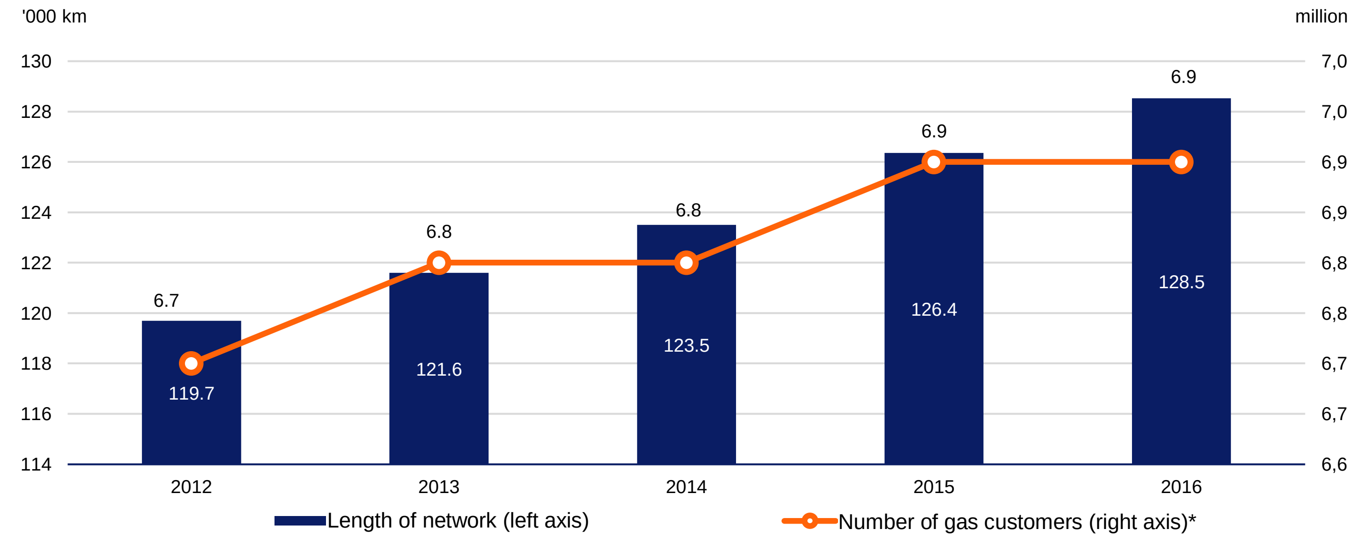


Starting from January 1st 2017, a new three-tier organisational structure was introduced, comprising the head office, 17 gas distribution branches, 167 local gas utilities and 67 service points. PSG's organisational structure corresponds to the administrative division of Poland, which will simplify interaction with local governments and facilitate access to PSG's services.

PSG's mission is to provide gas fuel distribution services to all gas fuel consumers and traders (while ensuring that all of them receive equal treatment) on the terms and conditions and to the extent defined in the Energy Law. Distribution services are provided on the basis of relevant distribution agreements. In 2016, PSG executed in total 21 distribution agreements and two Interoperator Distribution Agreements. In the same period, about 62 thousand gas fuel buyers changed their supplier. PSG's main competitors include EWE Energia Sp. z o.o., DUON Dystrybucja S.A., and G.EN. Gaz Energia Sp. z o.o.

In 2016, as part of customer connection services, PSG issued about 127 thousand grid connection conditions (up by about 20% on 2015) and executed more than 64 thousand agreements for connection to the mains gas network (up by about 30% on 2015).

Length of network, excluding service lines, and number of customers



* Customer − anyone receiving or drawing gas fuel under an agreement with a gas supplier

(in PLN million, unless stated otherwise)

5.3.4. Key investment projects and CAPEX

In 2016, PSG's total CAPEX ran to PLN 1.1bn. The focus areas of CAPEX, which accounted for the largest share of the funds spent, were:

- Projects to enhance gas fuel sales through network extension and construction of new connections (PLN 551m),
- Projects to upgrade the gas network due to its technical condition, depreciation of network infrastructure and potential threat to the security of gas supply (PLN 305m),
- Purchase of new measurement devices (gas meters) to be installed on the premises of new customers, or to replace existing meters after their certificates expire (PLN 108m).

Other initiatives included implementation of a new PSG organisational structure, optimisation of processes, developing a concept for a Management Information System, as well as a number of IT projects and projects related to application of LNG technologies in gas fuel distribution (including a project to build a plant that would manufacture installations and equipment used in construction of LNG regasification stations).

Furthermore, PSG has been engaged in a regulatory/cost benchmarking project pursued jointly with selected European distribution network operators, projects in the area of gas transport, as well as infrastructure projects, aimed at implementing guidelines designed to improve the operational safety and quality of gas networks.

PSG is strongly committed to connecting new customers and upgrading the gas network to ensure the security and reliability of gas supply, which in the future will translate into a sustainable revenue stream from gas distribution services. Approximately half of the company's total CAPEX budget is allocated to extending the gas network and connecting new customers. Funds allocated to network upgrade projects are the second most important item of the budget. Infrastructure upgrades are designed to ensure secure and reliable gas supply to customers. Taking into account the above expenditure as well as costs incurred on the purchase of gas meters, approximately 87% of the CAPEX budget was allocated to network projects.

Thanks to these investments, the number of new customers (meter points) went up by more than 6,000 in 2016. The length of the company's own gas network in 2016 was 128,500 km, over 2,000 km more than in 2015.

5.3.5. Development prospects

As regards development of natural gas distribution and new services, PSG is planning to pursue its Strategy for Development of the PSG Distribution Network in 2017−2026 and prepare a Draft Development Plan for 2018−2022. Specific projects will include extending the functionality of the gas distribution system using the Power to Gas (P2G) technology. The P2G process involves conversion of surplus electricity into hydrogen (H2) and, following methanation, into synthetic natural gas (SNG). Indirect (low-emission) energy carriers may be stored in the gas grid, which has large storage capacities and high flexibility, and then be used in accordance with the business needs of customers, e.g. to generate power in fuel cells or high-efficiency gas turbines. The gas grid will become a sub-system of the future integrated and convergent Smart Power Grid.

Description of planned investment projects:

Project category	Expenditure in 2017 (PLNm)
Gas mains and service line extensions	774
Network upgrades	463
Other	432
Total	1,669

Based on the Strategy for Development of the PSG Distribution Network in 2017−2026, which is currently under preparation, PSG will continue to pursue gas network construction and expansion projects, including with large-scale application of LNG technologies. In the coming years, the company intends to implement an investment model that would promote growth in the volume of transported gas and accelerate its key investment projects. In order to carry out its plans, PSG will rely, insofar as possible, on external funding available under EU programmes planned as part of the new multi-annual financial framework 2014−2020. Particular emphasis will be placed on intensifying acquisition of new customers, improving the reliability of gas networks, and security of gas supplies.

PSG is monitoring the market for groundbreaking technology innovations in the energy sector, as well as administrative incentives introduced to support the development of low-emission energy generation relying on environmentally friendly sources. Examples of such administrative incentives include the Clean Transport Promotion Package, which comprises three documents: the Plan for Development of an Electric Vehicle Network, the National Framework Policy for Development of Alternative Fuel Infrastructure and the Act Establishing a Low-Emission Transport Fund. Pending implementation of the Clean Transport Promotion Package, PSG is engaged in cooperation between the PGNiG Group and fuel sector operators focused on developing the alternative fuel infrastructure, and will create conditions in which vehicle users can be provided with an appropriate offering with respect to

(in PLN million, unless stated otherwise)

CNG/LNG filling. Chances are that these initiatives will translate into higher volumes of transported gas, and consequently into higher revenue from sale of the distribution service and other, new services.

Furthermore, PSG is continuing efforts to secure external financing for its development projects (from EU funds and other sources), to support the company's investments in construction and re-engineering of natural gas distribution networks and R&D projects.

5.4. Generation

The segment's principal business consists in the production of heat and electricity, as well as execution of major natural gas-fired projects in the power sector.

PGNiG TERMIKA SA is the Group's competence centre for heat and electricity generation as well as execution of heat and power projects.

The company's main revenue sources are sales of heat, electricity, system services, and certificates of energy origin. The installed capacity of the company's generating assets is 4.6 GW of achieved thermal power and 1 GW of achieved electrical power, which satisfies approximately 70% of the heat demand on the Warsaw metropolitan market. PGNiG TERMIKA is also a producer and supplier of heat and the owner of heat sources and heat networks in Pruszków, Komorów and Piastów.

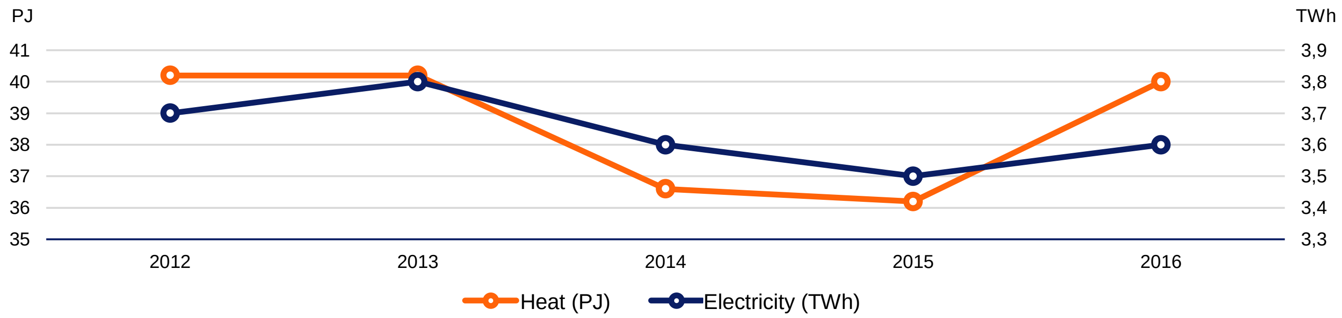
It is the largest producer of electricity and heat from high-efficiency cogeneration and the ninth largest electricity producer in Poland, with an 11% share in all heat generated by licensed domestic producers.

In 2016, Przedsiębiorstwo Energetyki Cieplnej S.A. of Jastrzębie Zdrój (PEC) and Spółka Energetyczna Jastrzębie S.A. (SEJ) were included in the Generation segment.

5.4.1. Segment's figures

	2016	**2015**	**2014**	**2013**	**2012**
	PGNiG Group	PGNiG Group	PGNiG Group	PGNiG Group	PGNiG Group
Total revenue	2,195	1,887	1,943	2,063	1,957
Revenue from external sales, including:	1,472	1,215	1,149	1,658	1,893
- heat	1,262	1,126	1,079	1,069	978
- electricity	36	8	7	514	739
Intersegment revenue	723	672	794	405	64
EBITDA	759	679	463	503	471
EBITDA adjusted for impairment losses on assets	775	710	463	503	473

Heat and electricity sales volumes from own generation sources



(in PLN million, unless stated otherwise)

Achievable capacity as per licence/plant/branch

Generating unit	Heat [MW]	Electricity [MW]	Cooling [MW]	Compressed air capacity [thousand cm/h]
PGNiG TERMIKA	4,648	1,015	-	-
Siekierki CHP Plant	2,068	620	-	-
Żerań CHP Plant	1,580	386	-	-
Pruszków CHP Plant	186	9	-	-
Kawęczyn Heating Plant	465	-	-	-
Wola Heating Plant*	349	-	-	-
PEC	255	2	-	-
Żory Heating Plant	87	-	-	-
Wodzisław Śląski Heating Plant	57	2	-	-
Racibórz Heating Plant	91	-	-	-
Knurów Heating Plant	16	-	-	-
Jastrzębie Heating Plant	0,5	-	-	-
Rybnik Heating Plant**	4	-	-	-
SEJ	505	130	15	423
Zofiówka Branch	235	64	-	135
Moszczenica Branch	156	38	-	
Pniówek Branch	72	14	15	191
Suszec Branch (Suszec site)	39	11	-	97
Suszec Branch (Częstochowa site)	2	3	-	-

** Excluding K1; K1 is covered by the Wola Heating Plant licence*
*** The boiler station at ul. Karłowicza in Rybnik was closed in September 2016 The nameplate thermal capacity of the Rybnik Heating Plant as at December 2016 is the sum of capacities of the boiler stations at ul. Obywatelska 5 and at ul. Mościckiego 5D.*

5.4.2. Segment's strategy

Maximising cash flows from the generation area

The PGNiG Group's strategy for the generation business is to expand its share in the heat generation and distribution market. On April 28th 2016, PGNiG TERMIKA acquired a 100% interest in PEC of Jastrzębie Zdrój, and on August 11th 2016 it acquired a shareholding in SEJ from Jastrzębska Spółka Węglowa S.A. With these acquisitions, the PGNiG Group expanded its business into new geographical markets in Poland. PEC and SEJ operate in the promising heat markets of Upper Silesia. The PGNiG Group is building a strong group of companies around PGNiG TERMIKA, offering significant growth potential that will create value for the entire Group.

PGNiG TERMIKA's strategy is a natural extension of the PGNiG Group strategy for 2014–2022 and a response to market risks and challenges the company is expected to face in the years to 2022.

PGNiG TERMIKA's aspirations until 2022

- Increase EBITDA to PLN 1bn by 2020
- Implement the Capital Investment Plan to ensure that generation assets comply with current and future environmental requirements
- Secure a leading position among Poland's heating companies in terms of network infrastructure
- Facilitate regulatory and market change in the sector
- Achieve market benchmarks for organisational efficiency in Poland.

The PGNiG Group's 2014−2022 Strategy had to be reviewed and revised by modifying the existing and adding new initiatives, in order to reflect material changes in the company's regulatory environment, adjustments made to its key investment projects, and new asset acquisitions. Also, a review of PGNiG TERMIKA's strategy until 2022 commenced.

5.4.3. Operations in 2016

PGNiG TERMIKA

The company's main competitors in local heat markets are district heating network operators and independent heat sources or small boiler stations serving a limited number of customers. A large portion of demand for heat in Poland is still covered by small-sized off-grid sources. Even in large urban areas with extensive heating infrastructure, many consumers are supplied by stand-alone sources or small local boiler stations.

The largest customer for heat produced by PGNiG TERMIKA, with a 93.9% share in the volume of heat produced, is Veolia Energia Warszawa S.A. Electricity is mostly sold to PGNiG (98.4%). The length of PGNiG TERMIKA's Pruszków and Warsaw heat networks is 74 km and 6.1 km, respectively.

In 2016, PGNiG TERMIKA completed a series of projects that are key to delivering its strategic goals. One of them is to ensure that district heating remains the most affordable building heating option in the Warsaw area. In terms of thermal capacity, PGNiG TERMIKA meets the requirements set out in the annual arrangement with Veolia Energia Warszawa S.A., a heat network operator, which guarantees security of heat supply to Warsaw residents. As of September 2016 a new annual arrangement between the two companies came into effect, raising heat network demand by 59 MW (9 MW more than planned). The company is an active participant in the development of a regulatory framework for implementing capacity market mechanisms in Poland and in regulatory consultations concerning renewable energy sources.

PGNiG TERMIKA controls the maintenance of budget discipline in its organisational units. The real property sale process is progressing as planned. Furthermore, as cost optimisation measures, the portfolio of suppliers of repair services was diversified to increase competition among them, maintenance standards and asset life cycle management methods were implemented, and internal energy consumption was reduced.

In pursuit of geographical expansion of its heat network and generation business, PGNiG TERMIKA acquired PEC and SEJ.

In addition, on September 16th 2016 PGNiG TERMIKA and its partners PGE Polska Grupa Energetyczna S.A., ENEA S.A. and ENERGA S.A. made a joint preliminary offer to purchase assets from EDF Polska; as at the date of this Report negotiations were pending.

PEC

Przedsiębiorstwo Energetyki Cieplnej S.A. PEC operates heat systems (mainly heat networks and several local heat sources) in nine municipalities: Jastrzębie-Zdrój, Czerwionka-Leszczyny, Knurów, Kuźnia Raciborska, Pawłowice, Rybnik, Wodzisław-Śląski, and Żory. PEC comprises six heating plants operating local heating systems. Its networks are approximately 288 km long. Total capacity contracted with all PEC plants is approximately 445 MWt. PEC operates 14 heating plants and one CHP plant with total capacities of approximately 255 MWt and 2 MWe. Heat from its own sources accounts for 41% of total heat sales.

PEC is the PGNiG TERMIKA Group's first large heat network operator, with a customer base of 2,150, including mainly housing cooperatives in Jastrzębie Zdrój, Rybnik, Żory, Racibórz, Wodzisław Śląski, and Knurów, with total heat consumption of 1.4 PJ. The company serves both large business customers, small businesses and households.

SEJ

The principal business of Spółka Energetyczna Jastrzębie (SEJ) is production of electricity, heat, cooling, and compressed air for JSW's coal mines. Its CHP plants are located close to the mines. SEJ operates five plants with a total capacity of 130.1 MWe, 504.66 MWt, 422.5 thousand cm/h of compressed air, and 14.8 MWc. SEJ is a leader in the production of heat and cooling for mine ventilation in a trigeneration process from coal mine methane. For this reason, SEJ is the PGNiG TERMIKA Group company responsible for expanding the Group's industrial power generation business, and in the future will oversee its operations.

SEJ sells energy to 186 customers, the largest of them being JSW S.A. (electricity, heat, cooling, and compressed air), PEC (heat), TAURON Polska Energia S.A. (electricity), Koksownia Częstochowa NOWA Sp. z o. o. (electricity and heat), and Spółka Restrukturyzacji Kopalń S.A. (heat).

SEJ has no competition in the heat generation market in which it operates. SEJ's competitors in the electricity market include system operators and producers; the key competitor is PGE Polska Grupa Energetyczna S.A. As a supplier serving local customers, SEJ has no competition for cooling and compressed air. SEJ-owned heat networks are 28.8 km long.

Sales of other products generated by SEJ S.A.'s plants in 2016 are presented below:

- Sales of cooling to external customers: 55.8 GWh.
- Sales of compressed air to external customers: 769.5 mcm.

5.4.4. Key projects and capital expenditure

PGNiG TERMIKA

In order to meet the more stringent emission requirements, PGNiG TERMIKA S.A. is gradually modernising its generating assets. In 2016, capital expenditure of the Generation segment amounted to PLN 273.7m, of which approximately PLN 41.5m was spent on environmental protection projects.

In 2016, major investment projects included:

- Construction of a 450 MW CCGT unit at the Żerań CHP Plant (Żerań CCGTU) − the first phase of a four-phase project to alter the cooling water system was completed. Designs were made for a project to adapt and connect the existing equipment of the Żerań CHP Plant to PSE SA's new switchgear; a building permit was obtained for the project. In line with the procedure timetable, on February 16th 2017 tenders were opened in a second tendering procedure for the delivery and installation of a CCGT unit at the Żerań CHP plant. Tenders were submitted by two consortia: the GE Power Sp. z o.o./General Electric International, Inc. and Mitsubishi Hitachi Power Systems Europe GmbH/Mitsubishi Hitachi Power Systems Ltd/Mitsubishi Hitachi Power System Europe Ltd/Polimex Mostostal S.A. The final award decision will be made after the tenders have been reviewed and evaluated.
- Conversion of the K1 boiler in the Siekierki CHP Plant to biomass combustion − licences to generate electricity and heat from biomass in a hybrid system were secured.
- Construction of a peak-load boiler house at the Żerań CHP Plant − tender documents were prepared for a limited scope of work for the gas-fired boiler house at the Żerań CHP Plant. A second tendering procedure was announced in October. The process is currently underway.
- Construction of a 5 MWe/8 MWt gas-fired CHP plant in Przemyśl (Przemyśl CHP Plant) − design work was in progress. A building permit and grid connection conditions were obtained for the project. Work began to design a pipeline for carrying fuel from PGNiG's local natural gas extraction facilities. The plant is scheduled to come on stream in the third quarter of 2018.
- Construction of a CCGT unit in Stalowa Wola (ECSW) − construction of the project was not completed to schedule. Accordingly, PGNiG and TAURON Polska Energia S.A. made a decision to restructure the project by:
  - changing the project financing model to corporate financing, with ECSW as a party to the loan agreement and the sponsors as parties to or applicants for bank guarantees issued in favour of the entities financing the project,
  - changing the terms of sale of electricity by ECSW to a free-market pricing formula where the price of electricity would be indexed to PPX prices, and changing the policy for determining electricity sales volumes,
  - changing the terms of gas fuel procurement by ECSW from PGNiG to a free-market pricing formula where the price of purchased gas would be indexed to PPX prices, and changing the policy for determining gas demand.

  An agreement on key preconditions for the project restructuring was signed in October 2016, aligning ECSW's existing commercial agreements to the expected start date of commercial operation and current market conditions. As the financing banks suspended loan disbursements, a need arose to renegotiate the terms of debt financing for the project. In mid-September 2016, the parties to the project signed a standstill deed, under which the financing institutions agreed not to accelerate their loans or enforce their security interests.

  A survey of the project's status ended in 2016. The project will be resumed by a specialised firm, responsible for supporting its coordination on an EPCM basis. Preparations are ongoing for the launch of an EPCM contract award procedure. In 2016, the project sponsors PGNiG and TAURON Polska Energia S.A. provided an approximately PLN 25m loan to fund ECSW's day-to-day operations.

PEC

Total capital expenditure on property, plant and equipment incurred in 2016 was PLN 10.2m. The key CAPEX projects involved the construction (PLN 4.3m), upgrade and reconstruction (PLN 3.0m) of heating network main and branch lines.

SEJ

Total capital expenditure on property, plant and equipment incurred from the SEJ acquisition date to the end of 2016 was PLN 59m, with most of the funds spent on the construction of a CFB cogeneration unit with a gross installed capacity of approximately 75 MWe at the Zofiówka CHP Plant.

(in PLN million, unless stated otherwise)

5.4.5. Development prospects

The largest projects planned for 2017 at PGNiG TERMIKA include the 450 MWe CCGT and peak demand boiler house projects at the Żerań CHP Plant. The projects will contribute to delivery of the strategic objectives to preserve leadership in the heat generation market in the Warsaw area, to improve return on assets and to diversify the fuel mix (coal, natural gas, biomass, alternative refuse-derived fuels). In the domestic market, the company will consider heat system acquisitions and projects to apply gas-fired technologies in heat generation, industrial power generation and distributed generation based on coal mine gas, including for the health and wellness/utilities sectors.

PEC's future projects will be focused on ensuring security of heat supply to all PEC customers and on expanding the local heat market.

SEJ's largest projects scheduled for 2017 include moving forward on the CFB cogeneration project with a gross installed capacity of around 75 MWe at the Zofiówka CHP Plant; relocation of two gas engines from the Suszec CHP Plant to Zofiówka; modernisation of the compressor facility at Zofiówka; improving compressed air generation efficiency; and replacement of absorption chillers at the Pniówek CHP Plant to improve cooling generation efficiency.

As part of its strategic efforts, SEJ will foster relationships with and supply energy to industrial customers (one of the key goals in this area is to ensure energy security to the JSW Group), increase the use of by-products from the JSW Group's coal mining operations (including coal mine gas), advance and ramp up CHP generation operations, and capitalise on the geographical advantage by siting facilities close to industrial customers.

5.5. Other Segments

5.5.1. Segment's figures

Segment financial highlights	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Revenue	240	4	325	4	325	424	542
EBITDA	(61)	(4)	12	(2)	(49)	(44)	(2)

5.5.2. Operations in 2016

PGNiG Branch – Central Measurement and Testing Laboratory (CLPB)

In 2016, the CLPB provided such services as testing of measurement devices and systems used in the natural gas industry, calibration of measurement devices in terms of pressure, volume, temperature, geometric measurements, electrical values, chemical properties (including gas composition), supervision of measurement systems at entry points in Belarus and Ukraine, and at the LNG Terminal in Świnoujście, performance of technical analyses, etc.

Key customers of the CLPB Branch are EuRoPol Gaz S.A. (approximately 33%), OGP GAZ-SYSTEM S.A. (approximately 15%), the PGNiG Group (approximately 20%), and others (approximately 32%).

PGNiG Technologie

The core business of PGNiG Technologie is the comprehensive execution of projects involving construction of crude oil and natural gas production facilities as well as gas transmission systems, construction and upgrades of process units at gas storage facilities, manufacture and repair of drilling and production equipment for crude oil and natural gas, manufacture of pressure vessels, storage tanks and steel structures, and repairs of diesel engines.

PGNiG Technologie operates primarily on the Polish market, and in 2016 it exported only finished goods to Norway and Pakistan.

PGNiG Serwis

The principal business of PGNiG Serwis is the provision of comprehensive finance and accounting services, HR and payroll services, ICT services, project management support, property management, vehicle fleet management, porter and reception services, and direct physical security services for the PGNiG Group companies.

PGNiG Serwis renders its services only to PGNiG and the PGNiG Group companies. It does not provide any services to external customers.

Biuro Studiów i Projektów Gazownictwa Gazoprojekt

Gazoprojekt provides consultancy and planning services at all stages of administrative procedures: development of technical and economic project assumptions, drafting documentation and implementation of investment plans. It performs feasibility studies and environmental studies, prepares formal documents to comply with building regulations, design and as-built documentation, as well as 3D visualisations. In 2016, Gazoprojekt was awarded contracts for a total amount of PLN 15.9m.

Geovita

Geovita engages in leisure-related activities, spa treatment services, health protection, medical rehabilitation, as well as conference and training services. Geovita facilities are located in Dąbki, Mrzeżyno, Dźwirzyno, Jadwisin near Serock, Płotki near Piła, Jugowice, Lądek-Zdrój, Zakopane, Wisła, Złockie near Muszyna, and Krynica-Zdrój. Geovita leases and manages three hotels: Orient in Kraków, Bukowy Dworek in Gronowo near Łagów, and Perła Bieszczadów near Ustrzyki Dolne. Pursuant to a decision of the PGNiG Management Board of May 17th 2016, the hotels will be contributed to Geovita.

5.5.3. Development prospects

CLBP (Central Measurement and Testing Laboratory)

CLBP's primary objective is to maintain its position as the leading research laboratory and attestation centre for measurement systems and devices used in the natural gas industry. Its tasks include increasing the number of process analyser systems for the evaluation of gas quality, supervision of LNG custody transfer on a large scale (marine terminal) and on a small scale (tank transport), and maintenance of the leading position as a training unit which cooperates with international inspection units and in the area of gas industry and technical training.

PGNiG Technologie

Tasks assigned to PGNiG Technologie for 2017 include active searching for and performance of contracts offering good margins (both on the domestic and international markets) and identification of new business areas within the construction and production segments (with a particular focus on power generation). In terms of cost optimisation, PGNiG Technologie will continue the process of asset restructuring commenced in 2014, optimised deployment of human resources, equipment and assets, and reduction of overheads.

PGNiG Serwis

In 2017, PGNiG Serwis aims to broaden its service offering and to expand its customer base to include other Group companies.

Gazoprojekt

The main contracts in Gazoprojekt's order book for 2017 include preparation of designs and plans and the author's supervision of the construction of gas pipelines from Rembelszczyzna to Mory and from Mory II to Wola Karczewska with ancillary infrastructure, as well as construction of an interconnection gas pipeline between the Polish and Slovak systems – the Strachocina – PL/SK Border pipeline.

Geovita

The largest projects to be pursued in 2017 include completion of the restructuring process, contribution of three leased hotels: Orient, Bukowy Dworek and Perła Bieszczadów to the company, as well as winning and implementing new contracts for the PGNiG Group and external customers.

(in PLN million, unless stated otherwise)

6. Additional information on the PGNiG Group

6.1. PGNiG Group structure

As at December 31st 2016, the PGNiG Group comprised PGNiG SA (the Parent), 33 production, trade and service companies, and a mutual insurance company, including:

- 20 direct subsidiaries of PGNiG
- 14 indirect subsidiaries of PGNiG

The list of the PGNiG Group companies as at December 31st 2016 is presented in the table below.

PGNiG Group companies as at December 31st 2016

No.	Name	Share capital	Value of shares held by PGNiG	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Subsidiaries – first tier				
1	BSiPG Gazoprojekt S.A.	4,000,000	900,000	22.50%	75%[1)]
2	EXALO Drilling S.A.	981,500,000	981,500,000	100%	100%
3	GEOFIZYKA Kraków S.A. w likwidacji (in liquidation)	64,400,000	64,400,000	100%	100%
4	GEOFIZYKA Toruń S.A.	66,000,000	66,000,000	100%	100%
5	Geovita S.A.	86,139,000	86,139,000	100%	100%
6	Gas Storage Poland Sp. z o.o.	15,290,000	15,290,000	100%	100%
7	PGNiG Obrót Detaliczny Sp. z o.o.	600,050,000	600,050,000	100%	100%
8	PGNiG Serwis Sp. z o.o.	9,995,000	9,995,000	100%	100%
9	PGNiG Technologie S.A.	182,127,240	182,127,240	100%	100%
10	PGNiG TERMIKA S.A.	1,440,324,950	1,440,324,950	100%	100%
11	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550	10,454,206,550	100%	100%
12	PGNiG Finance AB	SEK 500,000	SEK 500,000	100%	100%
13	PGNiG Supply & Trading GmbH	EUR 10,000,000	EUR 10,000,000	100%	100%
14	PGNiG Upstream International AS	NOK 1,100,000,000	NOK 1,100,000,000	100%	100%
15	Polish Oil And Gas Company – Libya B.V.	EUR 20,000	EUR 20,000	100%	100%
16	GAS-TRADING S.A.	2,975,000	1,291,350	43.41%	79.58%[2)]
17	PGNiG SPV 5 Sp. z o.o.	250,000	250,000	100%	100%
18	PGNiG SPV 6 Sp. z o.o.	51,381,000	51,381,000	100%	100%
19	PGNiG SPV 7 Sp. z o.o.	250,000	250,000	100%	100%
20	Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych	20,000,000	20,000,000	100%	100%
	Subsidiaries – second tier				
21	Przedsiębiorstwo Energetyki Cieplnej S.A.	85,000,000	85,000,000	-	100%[9)]
22	Spółka Energetyczna Jastrzębie S.A.	288,233,300	288,233,300	-	100%[9)]
23	GAZ Sp. z o.o.	300,000	300,000	-	100%[3)]
24	Powiśle Park Sp. z o.o.	81,131,000	81,131,000	-	100%[3)]
25	Oil Tech International F.Z.E.	USD 20,000	USD 20,000	-	100%[4)]
26	Poltava Services LLC	EUR 20,000	EUR 20,000	-	100%[4)]
27	PST Europe Sales GmbH	EUR 1,000,000	EUR 1,000,000	-	100%[5)]
28	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000	2,565,350	-	85.51%[6)]
29	Gas Assets Management Sp. z o.o.	1,360,000	1,360,000	-	100%[7)]
30	Gas-Trading Podkarpacie Sp. z o.o.	6,670,627	5,257,524	-	78.82%[8)]
31	NYSAGAZ Sp. z o.o.	9,881,000	9,881,000	-	100%[9)]
32	Zakład Gospodarki Mieszkaniowej Sp. z o.o.	1,806,500	1,806,500	-	100%[4)]
	Subsidiaries – third tier				
33	XOOL GmbH	EUR 500,000	EUR 500,000	-	100%[10)]
34	SEJ-Serwis Sp. z o.o.	200,000	200,000	-	100%[11)]

1) PGNiG's direct interest is 22.5%, with a 52.5% interest held indirectly through PGNiG Technologie. PGNiG has the right to appoint the majority of the company's supervisory board members.
2) PGNiG's direct interest is 43.41%, with a 36.17% interest held indirectly through PGNiG SPV 6 Sp. z o.o.
3) PGNiG's interest held indirectly through Polska Spółka Gazownictwa Sp. z o.o.
4) PGNiG's interest held indirectly through EXALO Drilling S.A.
5) PGNiG's interest held indirectly through PGNiG Supply & Trading GmbH.
6) PGNiG's interest held indirectly through Gas Storage Poland Sp. z o.o.
7) PGNiG's indirect interest in the company is 100%, with 99.98% held through PGNiG SPV 6 Sp. z o.o. and 0.02% held through PGNiG SPV 5 Sp. z o.o.
8) PGNiG's interest held indirectly through GAS TRADING S.A.
9) PGNiG's interest held indirectly through PGNiG TERMIKA S.A.
10) PGNiG's interest held indirectly through PGNiG Supply & Trading GmbH and PST Europe Sales GmbH.
11) PGNiG's interest held indirectly through PGNiG TERMIKA S.A. and its subsidiaries Przedsiębiorstwo Energetyki Cieplnej S.A. (45%) and Spółka Energetyczna Jastrzębie S.A. (55%).

Changes in the Group structure in 2016:

- On January 4th 2016, reduction of the share capital of PGNiG Obrót Detaliczny Sp. z o.o. by PLN 490.95m, to PLN 600,05m, effected through reduction of the par value of 10,910,000 shares (from PLN 100 per share to PLN 55 per share), was registered with the National Court Register;
- On January 14th 2016, share capital increase at Gas Assets Management Sp. z o.o. was registered with the National Court Register; the share capital was increased by PLN 1.34m, to PLN 1.36m; the relevant General Meeting resolution was passed on October 28th 2015; 6,700 shares in the increased share capital were acquired by PGNiG SPV 6 Sp. z o.o. by way of conversion of debt (loan from PGNiG SPV 6 Sp. z o.o.) into the company's equity;
- On February 9th 2016, amendment to the Articles of Association of GAZ Sp. z o.o. was registered with the National Court Register; on October 26th 2015, the General Meeting of GAZ Sp. z o.o. passed a resolution to amend the company's Articles of Association by increasing the par value of its shares to make their total par value equal to the share capital; as a result of the amendment, the share capital of PLN 300,000 is now divided into 160 shares with a par value of PLN 1,875 per share;
- On March 31st 2016, the General Meeting of Poltava Services LLC passed a resolution to remove Mr Hubert Leszek Praski-Ćwiok from the list of shareholders of Poltava Services LLC. As a result, EXALO Drilling S.A. acquired the 1% interest held by Mr Praski-Ćwiok in the share capital of Poltava Services LLC, thus increasing EXALO Drilling S.A.'s share in the share capital to UAH 229.2 thousand (i.e. by UAH 2,292 or EUR 200). Exalo Drilling currently holds 100% of shares in the share capital of Poltava Services LLC. The transaction was registered with the state register in Ukraine on April 19th 2016;
- On April 19th 2016, the Extraordinary General Meeting of PGNiG TERMIKA S.A. passed a resolution to increase the company's share capital from PLN 670.32m to PLN 1,240.32m, i.e. by PLN 570m. The increase was effected by way of issue of 57,000,000 Series F registered ordinary (non-preference) shares with a par value of PLN 10 per share. All new shares were acquired by PGNiG for cash (PLN 570m). The increase was registered with the National Court Register on May 17th 2016;
- On April 28th 2016, under an agreement with Spółka Energetyczna Jastrzębie S.A., PGNIG TERMIKA acquired, for PLN 190.4m, 85,000,000 shares in the share capital of Przedsiębiorstwo Energetyki Cieplnej S.A. The acquired shares, with a par value of PLN 1 per share, represent 100% of the share capital of Przedsiębiorstwo Energetyki Cieplnej S.A.;
- On July 29th 2016, the Extraordinary General Meeting of PGNiG Upstream International AS of Sandnes, Norway, passed a resolution to increase the company's share capital by NOK 8m by way of issue of 8,000 new shares with a par value of NOK 1,000 per share and a subscription price of NOK 37,500 per share, i.e. a total subscription price of NOK 300m. The share capital increase was registered on September 13th 2016;
- on August 1st 2016, the Extraordinary General Meeting of Geofizyka Kraków passed a resolution to dissolve the company, thus opening the process of its liquidation;
- On August 11th 2016, PGNiG TERMIKA purchased from Jastrzębska Spółka Węglowa S.A. 2,882,333 shares in Spółka Energetyczna Jastrzębie S.A. The shares, with a par value of PLN 100 per share, represent 100% of the share capital of Spółka Energetyczna Jastrzębie S.A., which holds 110 shares, or 55%, of the share capital of SEJ-Serwis Sp. z o.o. Thus, PGNiG TERMIKA's total indirect holding in SEJ-Serwis Sp. z o.o. is 100%;
- On September 14th 2016, PGNiG established a mutual insurance company under the name of Polski Gaz Towarzystwo Ubezpieczeń Wzajemnych. The company was registered with the National Court Register on October 22nd 2016. Its share capital amounts to PLN 20m and is divided into 1,000,000.00 shares with a par value of PLN 20 per share. PGNiG, as the only founder of the insurance company, acquired all shares in its share capital;
- On September 20th 2016, by virtue of an EGM resolution, Operator Systemu Magazynowania Sp. z o.o. was renamed as Gas Storage Poland Sp. z o.o. The change was registered with the National Court Register on October 4th 2016;
- On September 21st 2016, the Extraordinary General Meeting of PGNiG TERMIKA passed a resolution to increase the company's share capital from PLN 1,240,324,950 to PLN 1,440,324,950, i.e. by PLN 200m. The share capital was increased through an issue of PLN 20,000,000 Series G ordinary (non-preference) registered shares with a par value of PLN 10 per share. All new shares were subscribed for by PGNiG against a cash contribution of PLN 200m. The share capital increase was registered with the National Court Register on November 24th 2016.

By the date of this Report, the following changes occurred in other ownership interests within the PGNiG Group:

- On January 27th 2017, an increase of the share capital of Polska Grupa Górnicza Sp. z o.o. (PGG), effected under a resolution of the company's General Meeting of November 3rd 2016, was registered with the National Court Register. Following the registration of the increase, the company's share capital amounts to PLN 2,672,274,200. PGNiG TERMIKA holds 4,444,444 shares in PGG, with a par value of PLN 100 per share and a total par value of PLN 444,444,400, which corresponds to 16.63% of PGG's share capital and total voting rights.
- On February 1st 2017, the Extraordinary General Meeting of PGG passed another resolution to increase the company's share capital, by PLN 244,444,000, i.e. to PLN 2,916,718,200, through the issue of 2,444,440 new shares with a par value of PLN 100 per share. 555,556 new shares with a par value of PLN 100 per share and a total par value of PLN 55,555,600 in the increased share capital of PGG were acquired by PGNiG TERMIKA, in return for a cash contribution of PLN 55,555,600. The share capital increase has not yet been registered with the National Court Register.

(in PLN million, unless stated otherwise)

Following the registration of the increase in the National Court Register, PGNiG TERMIKA will hold in aggregate 5,000,000 shares in PGG, with a par value of PLN 100 per share and a total par value of PLN 500m, which corresponds to 17.14% of PGG's share capital and total voting rights.

- On January 18th 2017, the Extraordinary General Meeting of PGNiG Technologie passed a resolution to increase the company's share capital from PLN 182,127,240 to PLN 272,727,240, i.e. by PLN 90,600,000. The share capital was increased through the issue of 90,600,000 Series C ordinary (non-preference) registered shares with a par value of PLN 1 per share. All the new shares were subscribed for by PGNiG against a cash contribution of PLN 90,600,000. The share capital increase has not yet been registered with the National Court Register (registration is pending).
- On January 18th 2017, PGNiG Technologie acquired 37,500,000 new shares in Polimex-Mostostal S.A., with a par value of PLN 2 per share, for a total of PLN 75m. The share capital increase was registered with the National Court Register on February 21st 2017. The registered share capital of Polimex-Mostostal S.A. amounts to PLN 473,237,604. Also, in the performance of the agreement with SPV Operator Sp. z o.o., PGNiG Technologie acquired 1,500,000 shares in Polimex-Mostostal S.A. for a total of PLN 5,640 thousand, i.e. PLN 3.76 per share. As a result, PGNiG Technologie's equity interest in Polimex-Mostostal S.A. is 16.48%.

6.2. Other ownership interests and organisational links

The list of the PGNiG Group related entities as at December 31st 2016 is presented in the table below.

PGNiG Group companies as at December 31st 2016

No.	Name	Share capital	Value of shares held by PGNiG	PGNiG's ownership interest (%, direct holdings)	PGNiG Group's ownership interest (%, direct and indirect holdings)
	Jointly-controlled and associated entities - first tier				
1	Sahara Petroleum Technology Llc w likwidacji1) (in liquidation)	OMR 150,000	OMR 73,500	49.00%	49.00%
2	SGT EUROPOL GAZ S.A.	80,000,000	38,400,000	48.00%	51.18%[1)]
3	PFK GASKON S.A.	13,061,325	6,000,000	45.94%	45.94%
4	ZWUG INTERGAZ Sp. z o.o.	4,700,000	1,800,000	38.30%	38.30%
5	Dewon ZSA	UAH 11,146,800	UAH 4,055,205.84	36.38%	36.38%
	Jointly-controlled and associated entities - second tier				
6	Zakład Separacji Popiołów Siekierki Sp. z o.o.	10,000,000	7,000,000	-	70%[2)]
7	Elektrociepłownia Stalowa Wola S.A.	28,200,000	14,100,000	-	50%
8	Polska Grupa Górnicza Sp. z o.o.	2,305,607,200	361,111,100	-	15.66%

1) PGNiG's direct interest is 48.00%, with a 3.18% interest held indirectly through GAS-TRADING S.A.
2) PGNiG's interest held indirectly through PGNiG TERMIKA

Changes in other ownership interests within the PGNiG Group in 2016:

- On April 29th 2016, the Extraordinary General Meeting of Polska Grupa Górnicza Sp. z o.o. (PGG) passed a resolution to increase the company's share capital from PLN 500,050,000 to PLN 2,305,607,200 through the issue of 18,055,572 new shares with a par value of PLN 100 per share. As part of the increase, on the same day PGNiG TERMIKA acquired shares with a total par value of PLN 361,111,100.00, which represents 15.66% of PGG's share capital and total voting rights. The share capital increase was registered with the National Court Register on July 25th 2016.
- On November 3rd 2016, the Extraordinary General Meeting of PGG passed a resolution to increase the company's share capital by PLN 366,667,000, i.e. to PLN 2,672,274,200, through the issue of 3,666,670 new shares with a par value of PLN 100 per share. PGNiG TERMIKA acquired 833,333 new shares with a par value of PLN 100 per share and a total par value of PLN 83,333,300 in the increased share capital of PGG, in return for a cash contribution of PLN 83,333,300. After the share capital increase, PGNiG TERMIKA holds 4,444,444 shares in PGG, with a par value of PLN 100 per share and a total par value of PLN 444,444,400, which corresponds to 16.63% of PGG's share capital and total voting rights.

Equity investments outside the group of related entities:

In 2016, the PGNiG Group made no material equity investments outside the group of related entities. As at the end of 2016, the total par value of PGNiG's equity interests held outside the group of related entities was PLN 22.8m.

As at the end of 2016, the total par value of the PGNiG Group's equity interests held outside the group of related entities was PLN 66.4m.

6.3. Basic rules of management at the PGNiG Group and their changes in 2016

In 2016, steps were taken to streamline the management of the PGNiG Group. The ongoing activities are aimed to change the rules of corporate supervision within the Group by putting in place a comprehensive and uniform procedure covering all aspects of corporate supervision, taking into account the provisions of an agreement concluded between PGNiG SA as the Parent and selected PGNiG Group companies (the 'Parent − Subsidiaries Agreement').

The purpose of these activities is also to set up uniform rules of communication between PGNiG and its subsidiaries, obtaining and disclosing authorised information on a regular basis or otherwise, and clear allocation of responsibilities for a given area of cooperation.

Delivery of the PGNiG Group's Strategy is ensured by an extensive remuneration system for members of the Management Boards of the PGNiG Group companies. › For more information, see Section 10.3.

6.4. Court proceedings

6.4.1. Pending court proceedings

Proceedings with respect to the obligation of public sale of natural gas

The Act Amending the Energy Law and Certain Other Acts, dated July 26th 2013 (Dz.U. of 2013, item 984), imposed on energy companies meeting certain criteria the obligation of public sale of no less than 55% of high-methane gas volume introduced into the transmission network in a given year:

- At entry points to the Polish transmission system, at interconnections with transmission systems of other countries, or
- Via a network of production site pipelines, or
- Through liquefied natural gas terminals.

Pursuant to the transitional provisions of the Act, the volume of gas covered by the public sale obligation from the effective date of the amendment to December 31st 2013 was 30%; from January 1st 2014 to December 31st 2014: 40%; and as from January 1st 2015: 55%.

On January 13th 2015, the President of URE instigated proceedings to impose a financial penalty on PGNiG for its failure to meet the obligation to sell gas through the exchange market in 2013. PGNiG filed an appeal with the Competition and Consumer Protection Court at the Regional Court of Warsaw against one of the interlocutory decisions made by the President of URE in the course of the proceedings. On April 15th 2016, the Competition and Consumer Protection Court at the Regional Court of Warsaw dismissed the appeal. On May 25th 2016, the President of URE instigated ex officio proceedings to impose a financial penalty on PGNiG for its failure to meet the exchange sale requirement in 2013. On June 17th 2016, acting under Art. 56.6a of the Energy Law, the Company filed a request that the President of URE refrain from imposing the penalty. As at the date of this Report, the proceedings instigated by the President of URE were pending.

On October 28th 2015, the President of URE instigated proceedings to impose a financial penalty on PGNiG for its failure to meet the obligation to sell gas through the exchange market in 2014. On April 20th 2016, having considered the evidence, PGNiG filed a request under Art. 56.6a of the Energy Law that the President of URE refrain from imposing the penalty. By a decision of May 9th 2016, the President of URE imposed on PGNiG a fine of PLN 15m for its failure to meet the exchange sale requirement in 2014. PGNiG appealed against the decision. By the date of this Report, the Competition and Consumer Protection Court at the Regional Court of Warsaw had not notified PGNiG of a hearing date.

6.4.2. Proceedings before the President of the Office of Competition and Consumer Protection (UOKiK)

Anti-trust proceedings instigated on December 28th 2010

On December 28th 2010, the President of the Office of Competition and Consumer Protection ('UOKiK') instigated ex officio anti-trust proceedings concerning alleged abuse by PGNiG of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting trade in natural gas against the interests of trading partners or consumers and in impeding the development of market conditions necessary for the emergence or development of competition by refusing to sell gas fuel under a comprehensive supply contract to a business entity that intended to resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. In its decision of July 5th 2012, the President of UOKiK found these actions to be anti-competitive practices, concluded that PGNiG had discontinued them as of November 30th 2010, and imposed on the Company a fine of PLN 60m. On July 24th 2012, PGNiG filed an appeal against the decision of the President of UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. In its judgment of May 12th 2014, the Regional Court of Warsaw dismissed the appeal. On June 4th 2014, PGNiG appealed against the decision to the Warsaw Court of Appeals. In its judgment of May 29th 2015, the Court of Appeals amended the President of UOKiK's decision where it referred to the amount of the fine, by reducing the fine to PLN 5.5m. The judgment is final. On June 12th 2015, PGNiG paid the penalty imposed by the judgment of the Warsaw Court of Appeals. Both

PGNiG and the President of UOKiK filed cassation complaints against the Court of Appeals' judgment to the Supreme Court. PGNiG's cassation complaint seeks to challenge the finding of competition law infringement, whereas the President of UOKiK's cassation complaint seeks to question the Court of Appeals' decision to reduce the penalty imposed on PGNiG.

On January 10th 2017 (case No. III SK 61/15), the Supreme Court reversed the Court of Appeals' judgment concerning PGNiG's cassation complaint and remanded the case to the Court of Appeals for re-examination and decision on the costs of the cassation procedure. At the same time, the Supreme Court dismissed the President of UOKiK's cassation complaint and ordered the President of UOKiK to reimburse the costs of the cassation proceedings to PGNiG.

Anti-trust proceedings instigated on April 3rd 2013

On April 3rd 2013, the President of UOKiK instigated anti-trust proceedings concerning alleged abuse by PGNiG of its dominant position on the domestic wholesale and retail natural gas market, which consisted in impeding the development of market conditions necessary for the emergence or development of competition by:

- Limiting the ability of business customers to reduce the contracted volumes of gas fuel and capacity,
- Limiting the ability of business customers to resell gas fuel,
- Requiring that business customers define the maximum volume of gas fuel purchased for resale in the contract,
- Refusing to grant wholesale customers the right to a partial change of supplier.

In the course of the proceedings, PGNiG submitted a request to the President of UOKiK for a commitment decision, in which it voluntarily agreed to revise certain provisions in its contracts with non-household customers. By virtue of decision No. DOK-8/2013 of December 31st 2013, the President of UOKiK resolved not to impose a fine on the Company and obliged the Company to fulfil its commitment. PGNiG performed its obligations set out in the President of UOKiK's commitment decision within the deadlines specified therein.

On August 1st 2014, PGNiG OD took over the existing retail gas trading business from PGNiG and assumed all rights and obligations arising from the decisions issued by the President of UOKiK under the Act on Competition and Consumer Protection in respect of agreements to which PGNiG OD became a party. PGNiG OD is in the course of performing the obligation (in the part corresponding to its scope of business) imposed under the decision of the President of UOKiK dated December 31st 2013.

On October 17th 2014, the President of UOKiK commenced administrative proceedings to impose a fine under Art. 107 of the Act on Competition and Consumer Protection of February 16th 2007 (Dz.U. No. 50, item 331, as amended) on PGNiG and PGNiG OD for alleged delay in complying with the President of UOKiK's decision of December 31st 2013 where it relates to optional reduction by business customers of gas fuel quantities and capacity contracted for future years. In their response, PGNiG and PGNiG OD presented grounds for their actions and stated that by taking such actions they duly complied with the decision. However, on September 24th 2015, the President of UOKiK issued decision No. DOK-3/2015 to impose a financial penalty of PLN 10.4m on PGNiG for its delay in compliance with the decision. The President of UOKiK also decided to discontinue the proceedings against PGNiG OD. The President of UOKiK found that PGNiG OD had performed its obligations under the President of UOKiK's decision of December 31st 2013.

On November 2nd 2015, PGNiG filed an appeal against the decision of the President of UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. The first hearing was scheduled for March 14th 2017.

6.4.3. Proceedings concerning the OPAL pipeline

Proceedings concerning the OPAL pipeline are pending before:

- The General Court of the European Union, with which a complaint and a request for injunctive relief were filed by PST on December 3rd 2016,
- The Higher Regional Court of Düsseldorf (Oberlandesgericht Düsseldorf), with which a complaint and a request for injunctive relief (application of injunctive measures) were filed on December 15th 2016, and subsequently extended on January 20th 2017, by PGNiG and PST.

The complaint and the request for injunctive relief filed with the General Court of the European Union are against the European Commission's decision of October 28th 2016 whereby the Commission allowed a revision to the exemption of the OPAL pipeline from the common gas market regulations (especially with respect to the Third Party Access (TPA) rule), in accordance with text of the administrative decision issued by the German regulator – Federal Network Agency (Bundesnetzagentur), subject to modifications referred to in the Commission's decision. The complaint and the request for the application of injunctive measures were lodged by PST. By virtue of a decision of December 23rd 2016, the President of the General Court of the European Union stayed the implementation of the European Commission's challenged decision, temporarily granting PST's request for injunctive relief. The parties exchanged pleadings, but no further decisions were issued on the case.

The complaint and the request to apply injunctive measures filed with the Higher Regional Court of Düsseldorf are primarily against the administrative settlement between the German regulator, OPAL Gastransport GmbH & Co. KG, OAO Gazprom and OOO Gazprom Export, specifying the revised conditions for exemption of the OPAL pipeline from the common gas market regulations.

On December 30th 2016, the Higher Regional Court of Düsseldorf issued an injunction whereby it obliged the German regulator to suspend the effects of the disputed administrative settlement by prohibiting OPAL Gastransport GmbH & Co. KG from conducting any further daily, weekly, monthly and annual capacity auctions for the OPAL pipeline. Following the Court's ruling, on the same day the German regulator issued an immediately enforceable decision whereby it prohibited OPAL Gastransport GmbH & Co. KG from conducting such auctions.

On January 20th 2017, PGNiG and PST extended the earlier complaint by lodging a complaint against a decision of the German regulator – Federal Network Agency (Bundesnetzagentur), dated December 20th 2016, where under the regulator refused to instigate formal administrative proceedings concerning revised conditions for the pipeline's exemption from the common gas market regulations and allow the applicants, i.e. PGNiG and PST, to join the proceedings. The companies also extended the list of arguments contained in their earlier pleading.

As no further rulings were issued on the case, the Court's decision of December 30th 2016 remains in force.

6.4.4. Other proceedings

Proceedings with a value equal to 10% or more of the Company's equity

In 2016, neither PGNiG nor its subsidiaries were engaged in any proceedings before a court, arbitration court or administrative authority concerning liabilities or claims whose value (whether in any single case or in two or more cases jointly) would represent at least 10% of PGNiG's equity.

Proceedings concerning resolutions of the Annual General Meeting

The Company was notified that a shareholder had filed an application with the court for cancellation of Resolution No. 7/VI/2016 of the Annual General Meeting of PGNiG dated June 28th 2016, whereby the General Meeting refused to grant discharge to Mr Jarosław Bauc, Member of the Management Board of PGNiG, in respect of performance of his duties in the financial year 2015.

7. Financial standing of the PGNiG Group in 2016

7.1. Fuel prices and exchange rates

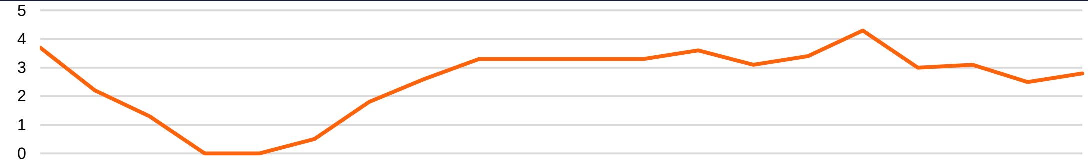
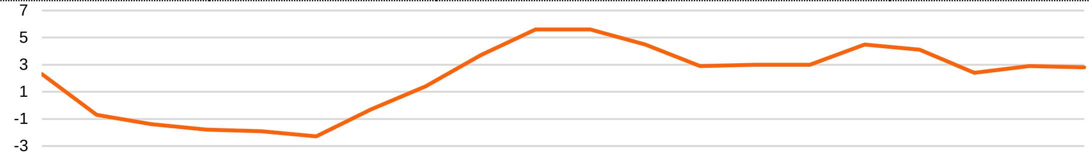
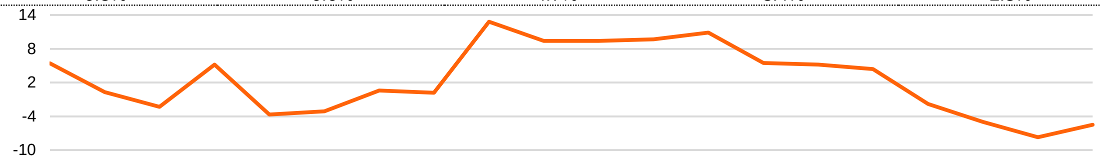
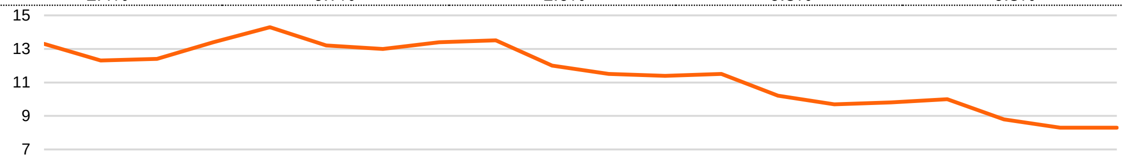
7.1.1. Macroeconomic environment

In 2016, the global economy expanded by 3%, up 0.1 percentage point year on year. According to Eurostat's preliminary estimations, the GDP growth rate across the EU was moderate at 1.9% year on year. The growth rate remained stable relative to 2015, despite the high probability that the EU's ranks will shrink following the outcome of the Brexit referendum in the UK. Positive economic sentiment was attributable to several factors, including the European Central Bank's quantitative easement policy, increased capital expenditure, and the continued rise of raw material prices. As a result, Europe recorded inflation of 1.1% year on year, with projections showing that the uptrend will be maintained. Positive sentiment also continues on the European labour market, where the number of unemployed has fallen again and the unemployment rate (8.2%) is at its lowest in 8 years.

Preliminary estimates of Gross Domestic Product (GDP) published by Poland's Central Statistics Office (GUS) indicate that in 2016 the Polish economy grew by 2.8%, down 1.1 percentage points relative to 2015. The slight slowdown in Poland's economic growth was caused by a temporary decline in investment activity (5.5% year on year in Q4), both in the public and private sectors. Dampened investment sentiment is chiefly attributable to delays in completion of infrastructure projects co-financed with EU funds. On the other hand, domestic demand grew by 2.8% year on year in Q4 2016 on improved private consumption, robust labour market, and launch of government social programmes. According to GUS, at the end of 2016 the unemployment rate was 8.3% (down 1.4 percentage points year on year), its lowest for over 25 years. The consumer price index (CPI) data published in December 2016 pointed to a return of month-on-month inflation after two and a half years, with rising commodity prices among the contributing factors. Also the manufacturing sector confirmed its sound condition, as the Purchasing Managers Index (PMI), measuring industrial activity in Poland, stood at 54.3 points at the end of 2016, an 18-month high.

(in PLN million, unless stated otherwise)

Selected macroeconomic indicators in 2012–2016.

Indicator [%]	2012	2013	2014	2015	2016
Gross Domestic Product (quarterly data, change y/y)*					
Change y/y*	1.4%	1.6%	3.3%	3.9%	2.8%
Domestic demand (quarterly data, change y/y)*					
Change y/y*	-0.5%	-0.6%	4.7%	3.4%	2.8%
Capex projects (gross spending on capital goods) (quarterly data, change y/y)*					
Change y/y*	-2.8%	-1.2%	9.5%	7.1%	-5.5%
Inflation (data as at end of quarter, change y/y/)* (December of previous year)					
Change y/y*	2.4%	0.7%	-1.0%	-0.5%	0.8%
Unemployment rate (at end of quarter)* (year-end data)					
year-end data	13.4%	13.4%	11.5%	9.7%	8.3%

Source: Central Statistics Office

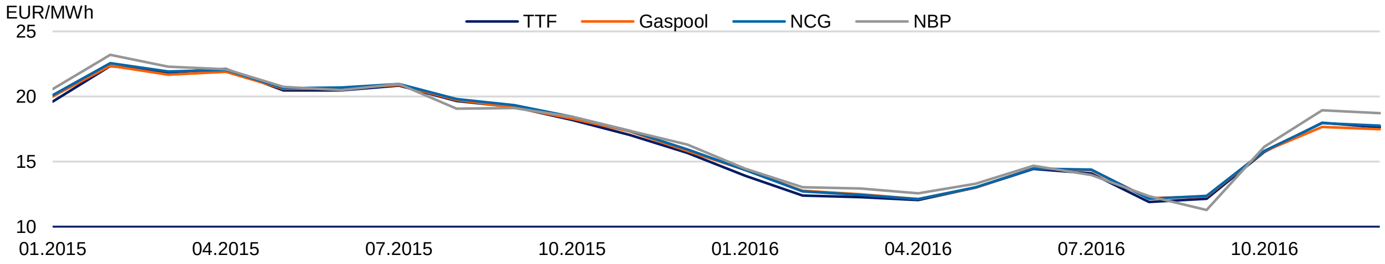
7.1.2. Trends on natural gas market

In 2016, prices of gas futures quoted on the TTF declined by 29% relative to 2015. The price plummeted on the back of low prices of crude oil and petroleum products, which are used to determine pricing terms in some natural gas import contracts. The European market was flooded with natural gas delivered under flexible import contracts, which generated excess supply and led to declining prices. Prices on the spot market fell 30% year on year. Average prices on the TTF day-ahead market were EUR 13.97/MWh, compared with EUR 19.77/MWh the year before. In 2016, natural gas prices were at their lowest in February–April and August–September, and at their highest – in the fourth quarter.

Average prices across the main European markets were similar, although there were differences between Continental Europe's markets and the British hub. For instance, lower prices in the United Kingdom in September were attributable to increased supplies from Continental Europe and Norway, as well as high regasification rates. This coincided with the temporary shutdown of the UK's largest storage facility, Rough, which prevented gas surplus injections. The Rough facility was partially re-opened at the end of 2016, however, its injection capacity remained unstable which, coupled with the elevated demand (weather factors), contributed to a higher spread over Continental Europe.

Average monthly spot prices of natural gas at selected European hubs in 2015–2016. GPL and NCG – Germany; NBP – United Kingdom; TTF – the Netherlands.

(in PLN million, unless stated otherwise)

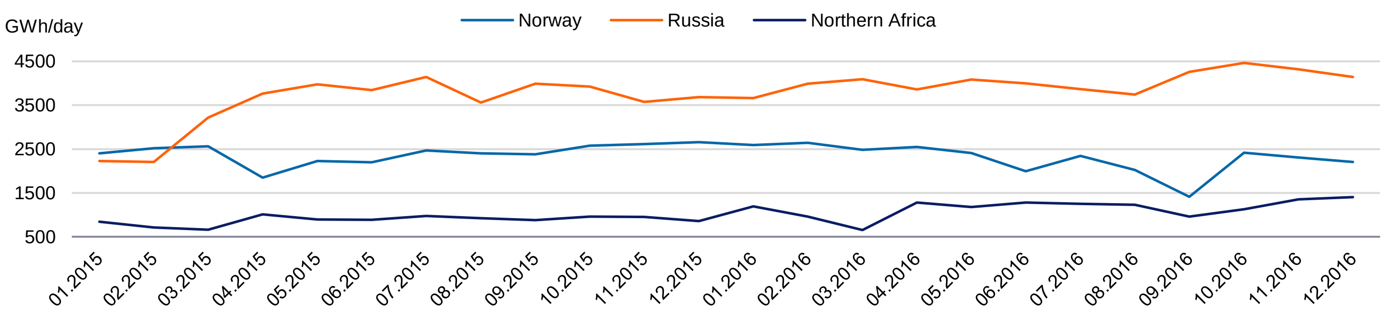


Source: ICE - Intercontinental Exchange, EEX – European Energy Exchange

Increased demand for natural gas in Europe was recorded for a third year running. Total demand amounted to 493 bcm, 17 bcm more than in 2015. The demand generated by power plants and combined heat and power plants grew by 13 bcm, to 149 bcm. Households and small business also showed increased need for natural gas with an aggregate consumption of 192 bcm, up 2% year on year. No changes were observed in consumption generated by the industrial sector. Countries with the most pronounced increase in natural gas consumption were the United Kingdom and Germany, with their demand growing by 6 bcm and 5 bcm, respectively.

Over 1447 TWh (135 bcm), representing 54% of last year's European imports via gas pipelines, originated from Russia. The share of Russian imports increased 15% year on year. Norway emerged as the second largest supplier of gas to Europe, providing 835 TWh (76 bcm), or 31% of total imports. Supply of gas fuel from Norwegian deposits dipped 5% relative to 2015. Exports from North Africa amounted to 423 TWh (39 bcm). The primary factor driving higher imports from Russia was falling crude oil prices. The flexible structure of purchase contracts linked to crude oil prices allowed European importers to increase imports from the East during the slump on the crude oil market and scale back purchases from other directions.

Sources of fuel imports to Europe.



Source: Thomson Reuters.

The European LNG market also saw certain changes in 2016. The average daily regasification rate was approximately 1.1 TWh/day, on average down 8% compared with 2015. The United Kingdom curbed its demand by 25% year on year, yet the country continues as the undisputed leader with a 27% share in Europe's total LNG imports. Imports to other European countries remained relatively stable year on year.

As at the end of 2016, volumes of gas stored in European gas storage facilities fell to 65% of the capacity. In the corresponding period of 2015, storage facilities were 70% full. In Poland, storage facilities were filled to 77% of the capacity, one of the highest levels among countries covered by the analysis.

Gas inventory levels in European countries as at December 30th 2016.

Country	**Gas in storage [GWh]**	**Utilisation [%]**
Austria	60,439	64%
Belgium	7,108	79%
Czech Republic	24,273	70%
Germany	166,482	70%
Spain	19,360	62%
France	86,102	64%
Italy	148,965	79%
The Netherlands	85,055	61%
Poland	24,935	77%
Slovakia	21,591	60%
Europe	676,950	65%

Source: GIE - Gas Infrastructure Europe

Progress in implementing infrastructural projects on the European gas market

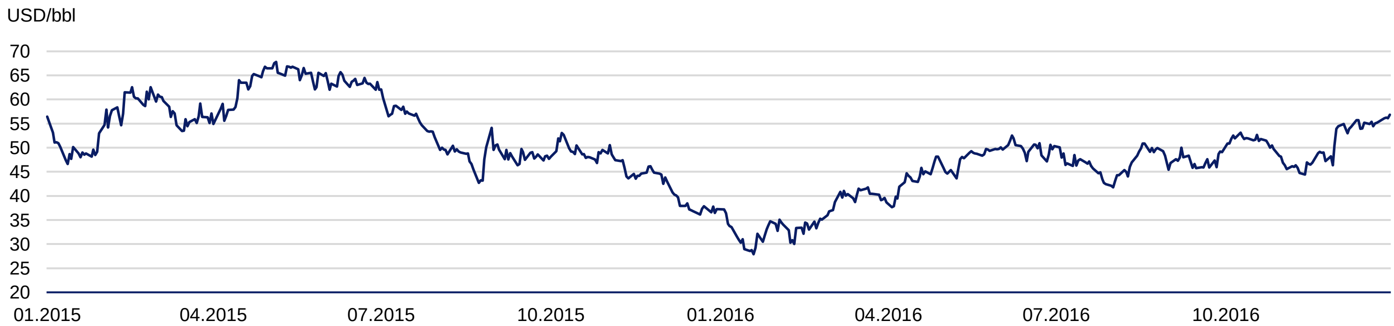
In early September 2015, representatives of Gazprom, Germany's E.On and BASF Wintershall, Anglo-Dutch Royal Dutch Shell, France's Engie (former GdF Suez) and OMB signed a legally binding shareholders' agreement on the construction of the Nord Stream 2 gas pipeline. Pursuant to the agreement, a company will be formed to first build and then operate the gas pipeline, with Gazprom as the majority shareholder with a 51% interest, and the remaining shareholders having minority stakes adding up to 49%. Next, an application for the registration of the consortium responsible for building the pipeline was submitted with German and Polish antitrust authorities. In mid-August 2016, the Polish Office of Competition and Consumer Protection concluded that concentration of gas supplies through the pipeline would jeopardise competition on the gas markets of Poland and other CEE countries. As a result, the consortium could not be established and Russia was left with a dilemma on how to finance the project. Despite these hurdles, in December 2016, the CEO of Russia's Gazprom, Mr Alexey Miller, announced that Nord Stream 2 would progress as planned and its second leg would be commissioned by the end of 2019.

The Turkish Stream project was put on hold in late 2015 after a Russian Su-24 attack aircraft was shot down by the Turkish air force. Following a spell of tensions between Moscow and Ankara, relations between the two countries improved. On October 10th 2016, Russia and Turkey returned to work on the project and signed an international agreement on the construction of two legs of the pipeline, which are slated for commissioning in December 2019, upon the expiry of a transit agreement between Russia and Ukraine. The pipeline's planned capacity is approximately 28-30 bcm, two times less than originally assumed. Turkey ratified the gas pipeline deal already in December 2016. On December 15th 2016 the bill for the ratification of Turkish Stream was approved by the Russian government. On January 20th 2017 the act was ratified by the State Duma, and in early February − by the Federation Council. The act on the gas pipeline construction was then signed by Vladimir Putin, the last formal approval needed to start the project. As things stand currently, the Turkish Stream has a greater chance of completion than Nord Stream 2 as the former is not subject to the jurisdiction of the European Commission and cannot be blocked like its predecessor, the South Stream.

7.1.3. Trends on the crude oil market.

In early 2016, the downward trend on the crude oil market continued. In January, prices of Brent crude slipped to approximately USD 28/bbl, a 13-year low. After the minimum was reached, prices gradually rebounded with a strong upward trend prevailing until June 2016 when Brent crude topped out at approximately USD 52/bbl, to follow a lateral trend in subsequent months. In November, members of OPEC and certain non-OPEC producers agreed on production cuts designed to limit the persisting oversupply, deplete high inventories, and neutralise the consequences of the flow of Iran oil. At year-end, one barrel of crude oil cost approximately USD 57.

Brent crude oil prices



Source: ICE – Intercontinental Exchange.

The average global demand for crude oil in 2016 was 1.4m bbl/day higher than in 2015, at 95.4m barrels per day. Among the world's largest consumers outside the OECD, the most pronounced increase was observed in India and China – by 7% and 3.5%, respectively. A decline in consumption was only recorded in Oceania and some countries of Latin America. The reasons for higher demand include a very low base price of crude oil.

In 2016, the supply of crude oil expanded by 0.4 bbl/d year on year, to 96.1m barrels per day. Non-OPEC producers reduced output in 2016, while production among OPEC members grew to 32.5m barrels, that is 0.8m barrels more than in 2015.

Oversupply on the oil market was 0.7m bbl per day in 2016, down 1m bbl/d year on year. According to forecasts, in 2017 the oversupply is expected to be reduced by a further 0.4m barrels per day. Scenarios assuming continued stifled output from OPEC even suggest that a market equilibrium was possible. Global oversupply was reflected in high inventory levels of crude oil, exerting additional downward price pressures. As at the end of 2016, inventories in OECD countries were 3bn barrels.

(in PLN million, unless stated otherwise)

Crude oil demand and supply worldwide

bn bbl	Demand		Supply	
	2015	2016	2015	2016
OECD	46.42	46.62	26.82	26.41
including the US	19.53	19.66	15.12	14.8
non-OECD	47.66	48.81	68.96	69.72
including China	11.28	11.66	4.72	4.46
including former USSR countries	-	-	14.1	14.3
including OPEC	-	-	38.3	39.29
Worldwide	94.08	94.53	95.78	96.14

Source: Thomson Reuters

The main driving factor of the oil market in 2016 were the arrangements between OPEC members to cut global supply. Following numerous announcements and lengthy negotiations, members of the cartel decided to reduce output by 1.8m barrels per day in the first half of 2017. According to early 2017 data, OPEC countries followed through with the agreement and some members, such as Saudi Arabia and Qatar, committed to even greater reductions. The group's determination is best attested by the appointment of a special committee tasked with monitoring the performance of mutual commitments.

Moreover, on December 10th 2016, an agreement was reached between non-OPEC oil producers. Russia, together with Mexico and nine smaller producers, agreed to bring down daily output by 558 thousand barrels, marking the first such agreement between non-OPEC countries in 15 years. The signatories' aggregate share of the global crude oil output is 60%. However, the programme does not involve such key oil-rich countries as the US, China, Canada and Brazil, which, given the price rebound, may readily ramp up their output.

In January 2016, the EU decided to abolish economic sanctions banning imports of oil from Iran by its Member States, triggering a downward pressure on prices. Iran boasts the second largest oil deposits in the world and fourth largest deposits of natural gas.

7.1.4. Outlook for crude oil and natural gas market

A decline in global crude oil supply is expected to markedly affect prices in 2017. Joint and consistent performance of the agreement by all signatories should favour price increases. However, a number of large producers (including the US, China, Canada, Brazil, Libya and Nigeria) made no commitments to reduce output in 2017. In their case, and the US's in particular, an increase in oil prices may be followed by a major growth in output, which may, at least to a certain extent, compensate for the reduced supply. It should further be noted that inventories of crude oil are very high. To make any meaningful dent, a supply shortage would have to continue for a very long time.

Considering the above, oil prices in 2017 may be visibly higher than in 2016, but are expected to stay within the range of USD 50-60/bbl. Survey conducted by information agencies among global investors present similar expectations.

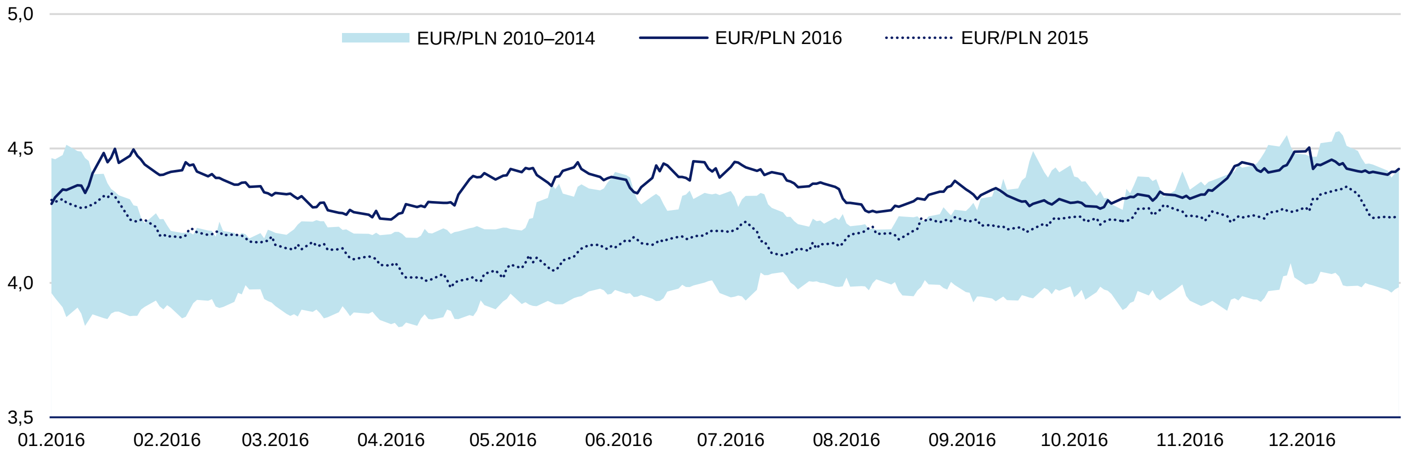
Gas prices in Europe were low in 2016 and they are is very unlikely to continue at such low levels in 2017. In the second half of 2016, crude prices rallied contributing to an increase in prices of indexed import contracts for natural gas in Europe. Forecasts suggest that this trend may persist in the coming year.

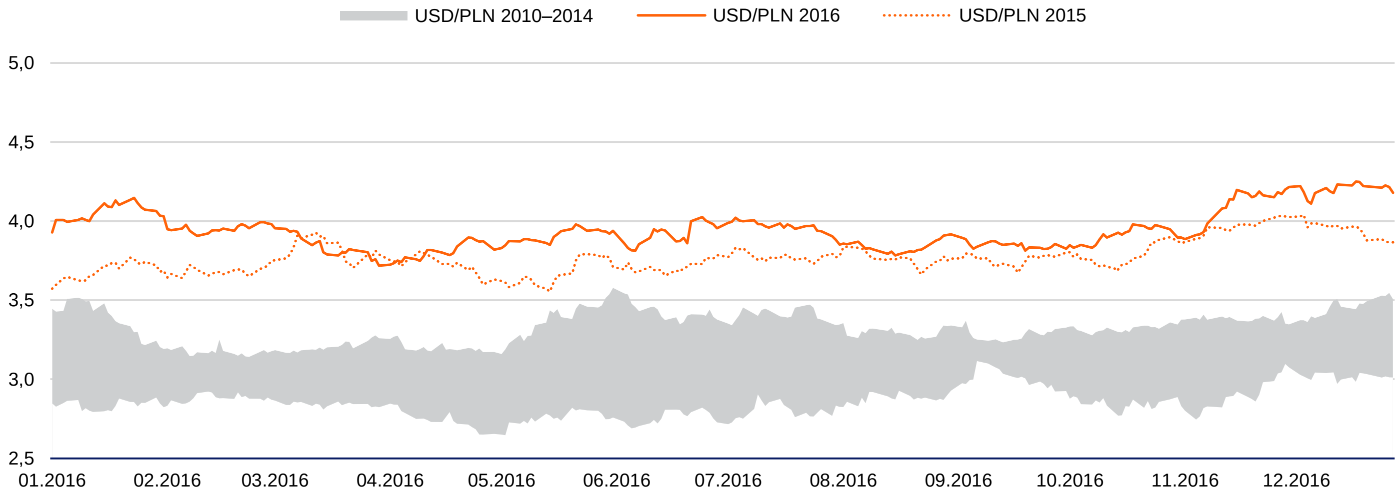
Similar factors drive up prices of import contracts on the LNG market. On the other hand, the expected increase in liquefaction capacities in Australia and the US may curb any LNG price rises and indirectly erode the price of natural gas. Forecasts show that in the coming years an oversupply will affect the LNG market, which may trigger a strong downward trend in prices.

All of the above factors suggest that in 2017 gas prices may be higher than in 2016. The expected growth may be checked by price competition between traditional suppliers (Russia, Norway) and LNG suppliers entering the European market. As a result, gas prices in Western Europe may oscillate between the level seen in 2016 (approximately EUR 14/MWh) and the prices of futures contracts seen in early 2017 (approximately EUR 18/MWh).

7.1.5. EUR/PLN and USD/PLN exchange rates

In 2016, the currency market was highly volatile. The Polish złoty significantly weakened relative to the euro and the US dollar amid concerns about the economic situation in China. However, the depreciation of the Polish złoty was short-lived and the exchange rate was soon back on a downward trajectory. In April, the EUR/PLN and USD/PLN pairs were at their all-year low of 4.2455 and 3.7193, respectively. Rising expectations regarding potential interest rate hikes in the US caused the exchange rate to deviate from its established price band. Market sentiment was negative, spurred by the UK's exit from the EU. Contrary to investors' concerns, the third quarter brought about a stabilization in forex trading and the Polish currency once again rallied. Donald Trump's win in the US presidential elections had a profound impact on market sentiment. In consequence, the USD/PLN exchange rate spiked to the its highest level since 2002 (4.2493) and the EUR/PLN pair recorded an all-year high (4.5035). The downward trend was only consolidated by interest rate hikes in the US and the Fed's plans to pursue a tighter monetary policy.





(in PLN million, unless stated otherwise)

7.2. Financial performance

Summary information on the financial performance of the PGNiG Group and the Parent in 2016 is presented below.

7.2.1. Financial highlights of PGNiG

Financial highlights of PGNiG (PLNm)

	2016	2015	Change y/y
Revenue	17,183	18,646	(1,463)
Total operating expenses, including	(15,902)	(17,852)	1950
Depreciation and amortisation	(767)	(799)	32
Operating profit	1,281	793	488
Profit before tax	2,851	1,617	1,234
Net profit	2,576	1,472	1,104
Cash flows from operating activities	2,502	2,487	15
Cash flows from investing activities	(200)	2,222	(2,422)
Cash flows from financing activities	(2,001)	(1,530)	(471)
Net increase/(decrease) in cash and cash equivalents	301	3,179	(2,878)
	2016	**2015**	**Change y/y**
Total assets	35,769	34,489	1,280
Non-current assets	25,759	25,816	(57)
Current assets, including	10,010	8,673	1,337
Inventories	1,942	1,638	304
Total equity and liabilities	35,769	34,489	1,280
Total equity	25,228	23,738	1,490
Total non-current liabilities	2,144	6,667	(4,523)
Total current liabilities	8,397	4,084	4,313
Total liabilities	10,541	10,751	(210)

Profitability

	2016	2015
EBIT operating profit	1,281	793
EBITDA operating profit + depreciation/amortisation	2,048	1,592
ROE net profit to equity at end of period	10.2%	6.2%
Net margin net profit to revenue	15.0%	7.9%
ROA net profit to assets at end of period	7.2%	4.3%

Liquidity

	Dec 31 2016	Dec 31 2015
Current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.3	2.4
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.0	2.0

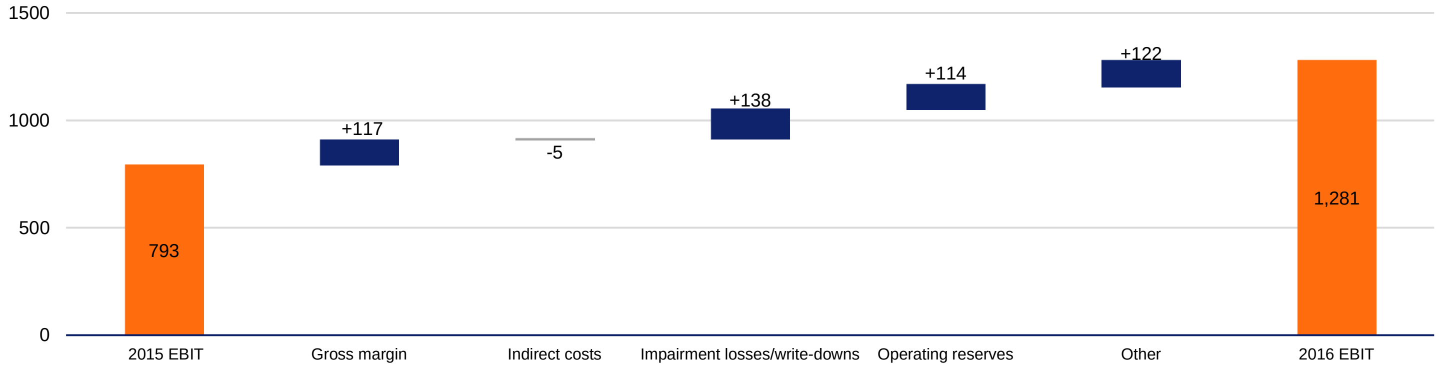
Debt

	Dec 31 2016	Dec 31 2015
Debt ratio total liabilities to total equity and liabilities	29.5%	31.2%
Debt/equity ratio total liabilities to equity	41.8%	45.3%

Financial performance of PGNiG

In 2016, PGNiG's operating profit (EBIT) came in at PLN 1,281m, up PLN 488m year on year. The chart below shows changes in EBIT from 2015 to 2016.

Change in EBIT: 2015 vs 2016



The PLN 117m year-on-year increase in gross margin (difference between revenue and direct costs) was mainly attributable to:

- Higher gross margin on sales of high-methane gas, resulting primarily form a lower purchase price of imported gas.

The margin growth was partially offset by the following factors:

- Lower margin on sales of nitrogen-rich natural gases, mainly as a result of lower average selling prices caused by three reductions in tariff prices;
- Decrease in gross margin on sales of crude oil driven by lower average selling prices; difference in the average quoted Brent crude prices between 2015 and 2016 was -18%;
- Lower margin on services, in particular storage system operator services, mainly due to the reduced rate of return on the regulatory value of assets.

Margins on sales of other products, including electricity, helium, LPG and sulfur, declined slightly on 2015.

Operating profit (EBIT) was further improved by the following factors:

- Lower impairment losses/write-downs, in particular on gas inventories,
- Lower operating reserves,
- Higher net gain on forwards/futures.

In 2016, net finance income/(costs) increased PLN 747m year on year, driven by a PLN 795m increase in dividends from subsidiaries.

The Company's financial position was reflected in its key financial ratios. ROE, ROA and net margin increased from 6.2% to 10.2%, from 4.3% to 7.2% and from 7.9% to 15%, respectively.

(in PLN million, unless stated otherwise)

7.2.2. Financial highlights of the PGNiG Group

Financial highlights of the PGNiG Group (PLNm)

	2016	2015	Change y/y
Revenue	33,196	36,464	(3,268)
Total operating expenses, including	(29,836)	(33,174)	3,338
Depreciation and amortisation	(2,614)	(2,790)	176
Operating profit (EBIT)	3,360	3,290	70
Profit before tax	3,210	3,014	197
Net profit	2,349	2,136	213
Cash flows from operating activities	5,922	7,271	(1,349)
Cash flows from investing activities	(3,842)	(3,147)	(695)
Cash flows from financing activities	(2,269)	(829)	(1,440)
Net increase/(decrease) in cash and cash equivalents	(189)	3,282	(3,471)
	2016	2015	
Total assets	49,672	48,292	1,380
Non-current assets	36,236	35,643	593
Current assets, including	13,436	12,649	787
Inventories	2,510	2,229	281
Total equity and liabilities	49,672	48,292	1,380
Total equity	32,016	30,741	1,274
Total non-current liabilities	7,303	11,262	(3,959)
Total current liabilities	10,353	6,289	4,064
Total liabilities	17,656	17,551	105

Profitability

	2016	2015
EBIT operating profit	3,360	3,290
EBITDA operating profit + depreciation/amortisation	5,974	6,080
ROE net profit to equity at end of period	7.3%	6.9%
Net margin net profit to revenue	7.1%	5.9%
ROA net profit to assets at end of period	4.7%	4.4%

Liquidity

	2016	2015
Current ratio current assets to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.5	2.5
Quick ratio current assets less inventories to current liabilities (net of employee benefit obligations, provisions and deferred revenue)	1.2	2.0

Debt

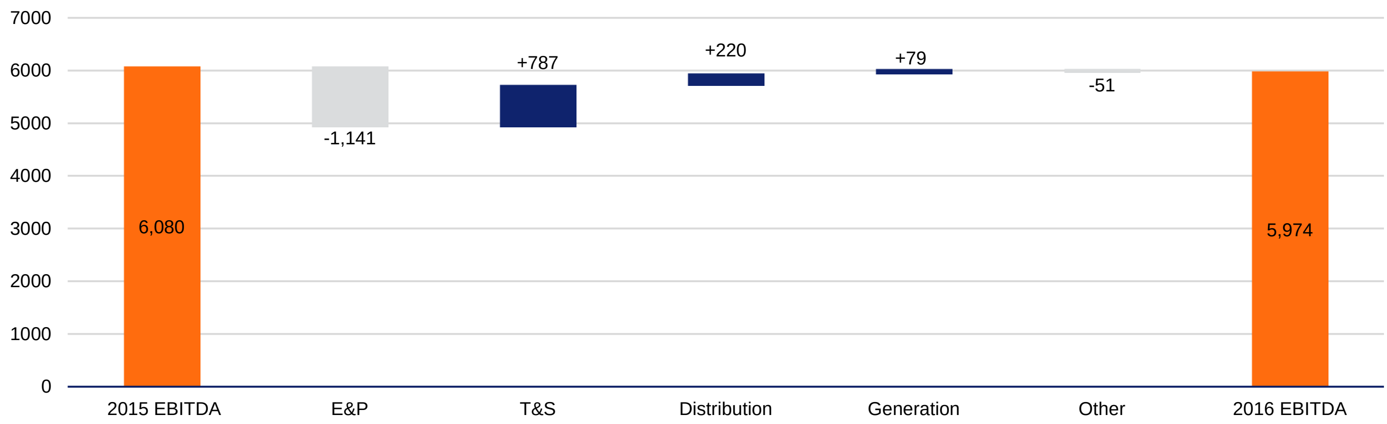
	2016	2015
Debt ratio total liabilities to total equity and liabilities	35.5%	36.3%
Debt/equity ratio total liabilities to equity	55.1%	57.1%

Financial performance of the PGNiG Group

In 2016, the PGNiG Group's revenue was PLN 33,196m, down PLN 3,268m (9%) from PLN 36,464m posted in 2015. With operating expenses down 10% to PLN 29,836m, the Group earned consolidated operating profit (EBIT) of PLN 3,360m (up 2% yoy). Operating profit before depreciation and amortisation (EBITDA) came in at PLN 5,974m, which represents a slight decrease by 105m (2%) on the previous year. The result was achieved against the backdrop of low prices of crude oil on global markets, low prices of natural gas in Central Europe, and the ongoing deregulation of the Polish gas market.

The combination of sales promotion and lower temperatures drove the gas volumes sold by the PGNiG Group up from 23 bcm in 2015 to 24.3 bcm in 2016 (+6%).

Change in EBITDA: 2015 vs 2016



Exploration and Production (E&P)

At the end of 2016, the Exploration and Production segment reported an operating profit of PLN 219m, a decrease of PLN 875m relative to 2015. At PLN 1,285m, EBITDA was also lower than the year before, by PLN 1,140m (47%). The segment's revenue fell by PLN 564m (12%) year on year, to PLN 4,290m. The revenue decline reflected the 3% drop in oil sales volumes and lower crude oil prices (in Polish złoty terms, the average quarterly price of Brent in 2016 was approximately 12% lower than in 2015). Crude oil sales volumes were down in 2016 mainly as a result of longer scheduled maintenance shutdowns in Norway (in the third quarter) and unscheduled stoppages for repairs (in the fourth quarter). The PLN 311m increase in the Exploration and Production segment's operating expenses (up 8%) was caused by higher impairment losses on non-current assets, which in 2016 amounted to PLN 771m, compared with PLN 555m a year earlier. The segment's expenses were also affected by lower depreciation and amortisation charges, down from PLN 1,331m in 2015 to PLN 1,066m in 2016. The decline resulted mainly from the revaluation of reserves on the Norwegian Continental Shelf, which reduced depreciation rates applied to producing assets.

Trade and Storage (T&S)

In 2016, the Trade and Storage segment's operating profit was PLN 1,158m, up PLN 776m, having more than doubled on the previous year. At PLN 1,410m, EBITDA was higher than in 2015, by PLN 787m. The segment's revenue reached PLN 28,179m, down by PLN 3,564m (or 11%) year on year. However, operating expenses were reduced by PLN 4,339m (14%), to a total of PLN 27,022m, contributing to the segment's improved performance.

The segment's result was attributable to low prices of oil bringing down the cost of gas procurement under PGNiG's key long-term contract and, consequently, translating into higher margins. Thanks to the efforts aimed at making prices more flexible, operating profit doubled despite several tariff reductions.

As the end of 2016, ca. 2.2 bcm of gas was held in underground storage – approximately 24% more than at the end of 2015.

Distribution

The Distribution segment's operating profit in 2016 increased 13% year on year, to PLN 1,635m, while EBITDA came in at PLN 2,559m, up by PLN 221m year on year. The improvement resulted primarily from higher revenue from distribution services (up 7% yoy), with distribution volumes reaching 10.9 bcm (up 11% yoy). Expenses incurred in 2016 increased by PLN 145m (or 5%) on 2015, primarily as a result of a significant increase in provisions and inventories (PLN 180m in 2016 vs PLN 42m in 2015). As regards the change in provisions, in 2015 PLN 41m of the provision for extra-contractual use of land was reversed, compared with a reversal of PLN 1m in 2016.

Generation

The segment's operating profit for 2016 was PLN 400m, up PLN 33m year on year. EBITDA was reported at PLN 759m, up PLN 80m, or 12%, year on year. The segment generated revenue of PLN 2,195m – PLN 308m more than in 2015, with the acquisition of PEC and SEJ assets contributing additional PLN 181m to the 2016 revenue.

The segment's performance was driven up by higher revenue achieved on increased sales volumes of heat (+10.4%), higher tariffs, and a slight increase in electricity sales volumes (+3.3%), with electricity price down. The result was further improved by lower coal prices (including transport charges) and a shift in the fuel mix consumed towards biomass. Also coal and fuel oil consumption was reduced in 2016.

Fluctuations in financial performance

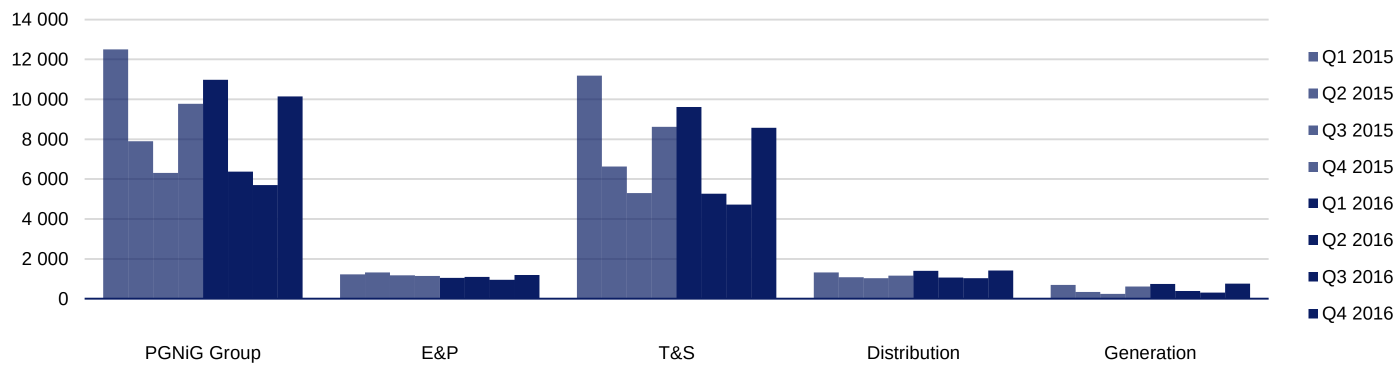
The sale, distribution and storage of gas fuels, as well as cogeneration of heat and electricity, which, in addition to hydrocarbon exploration and production, constitute the core business of the Group, are subject to significant seasonal fluctuations.

Revenue from sale of natural gas and heat in the winter season (Q1 and Q4) is substantially higher than in summer (Q2 and Q3). This is due to the seasonal changes in weather conditions in Poland, and the extent of the fluctuations is determined by temperatures – low in winter and higher in summer. Revenue from gas and heat sales is subject to much greater seasonal changes in the case of households, where gas and heat are used for heating, than in the case of industrial customers.

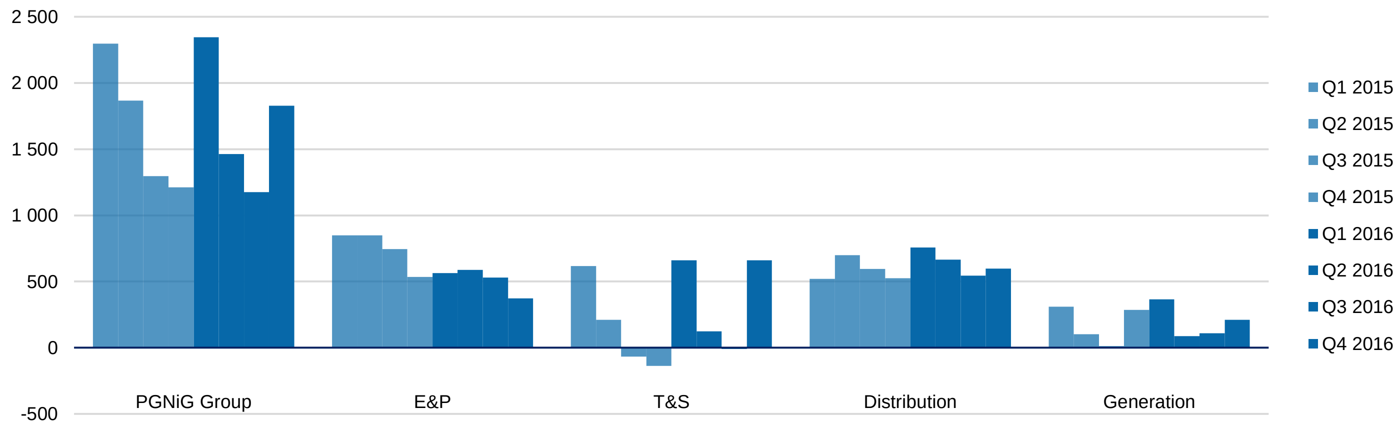
In order to ensure uninterrupted gas supplies in periods of peak demand and to maintain the security of gas supplies, it is necessary to replenish the gas stocks of underground gas storage facilities in summer, and to reserve higher transmission and distribution system capacities for winter.

The performance of individual segments is also subject to significant fluctuations reflecting changes in product prices. Moreover, the performance of the Exploration and Production segment reflects changes in hydrocarbon production profiles.

Fluctuations in revenue of the PGNiG Group in 2015–2016



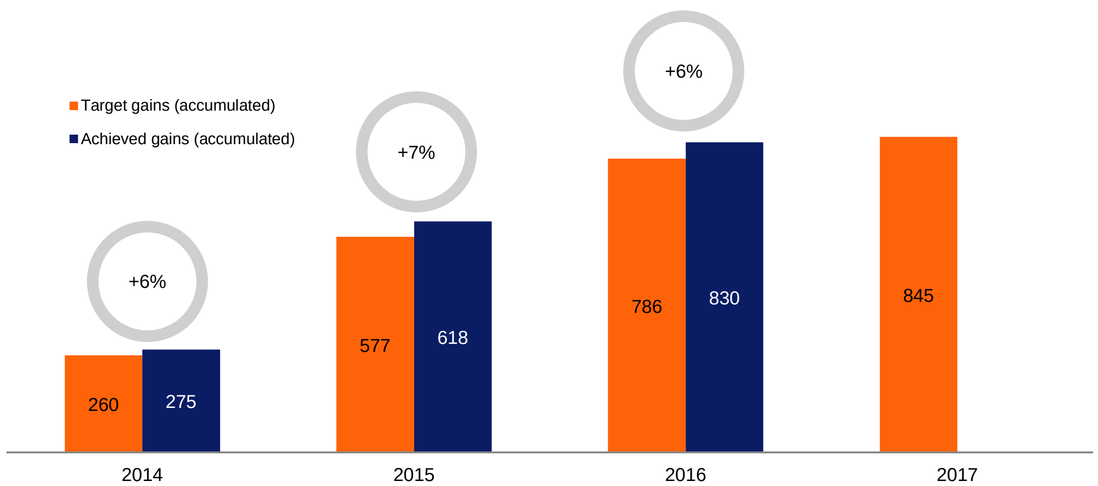
Fluctuations in EBITDA of the PGNiG Group (adjusted for impairment losses on property, plant and equipment) in 2015–2016



Efficiency Improvement Programme

Cost reduction under the Efficiency Improvement Programme helps improve the PGNiG Group's financial performance and generates funds necessary for strategic investment projects, in particular in the Exploration and Production segment. Also, under the Efficiency Improvement Programme two initiatives were carried out to ensure more efficient CAPEX spending. They involved optimisation of processes and tools related to the assessment, prioritisation and selection of CAPEX projects to be pursued by the PGNiG Group. Their main objective was to tighten the existing system of CAPEX planning and spending so that free cash would be allocated to the most profitable projects (offering the highest return on investment).

In 2014–2016, the Programme participants generated PLN 830m of sustainable savings, approximately 5% above the initial target (of ca. PLN 786m). Measurable savings are generated by improved organisation of customer service, employment optimisation and reduction of the scope of services rendered internally.



Following identification of new areas, cost savings will go up from the initially planned PLN 800m to nearly PLN 850m in 2014−2017. Currently, work is under way to extend the portfolio of projects covered by the Programme in 2017 by identifying new projects that may generate qualitative and quantitative savings.

Statement of financial position

As at December 31st 2016, total assets recognised in the consolidated statement of financial position were PLN 49,672m, up PLN 1,380m (0.3%) on the end of 2015.

Assets

Property, plant and equipment represent the largest component of the PGNiG Group's assets. As at the end of 2016, this item amounted to PLN 33,149m, having decreased by PLN 182m (or 0.6%) relative to December 31st 2015. The balance of impairment losses on those assets rose by PLN 816m year on year.

Equity-accounted investees rose by PLN 389m (or 46%) year on year, following the acquisition of shares in Polska Grupa Górnicza Sp. z o.o.

As at the end of 2016, the PGNiG Group's current assets were PLN 13,436m, up PLN 787m (or 6%) relative to the end of 2015. Receivables and inventories were the main contributing items, having risen by PLN 909m (27%) and PLN 281m (13%), respectively, year on year. This is an effect of seasonality of gas fuel sales, with volumes peaking in autumn and winter, when receivables also rise reflecting higher sales volumes.

Equity and liabilities

Equity is the main source of financing of the PGNiG Group's assets. At the end of 2016, the Group's equity was PLN 32,016m, up by PLN 1,275m (or 4%) relative to 2015. The change in equity was primarily attributable to net profit earned in the reporting period, of PLN 2,349m, adjusted for the PLN 1,062m dividend to be paid for the previous year (as per AGM resolution).

As at the end of 2016, non-current liabilities were PLN 7,303m, down PLN 3,959m (or 35%) on the end of December 2015. This considerable decline was due to the reclassification of liabilities under debt securities (PLN 4,607m) maturing in 2017 as current.

As at December 31st 2016, the PGNiG Group carried current liabilities of PLN 10,353m, up PLN 4,064m (65%) relative to the end of 2015. The increase was due to the reclassification of some of the debt under debt securities from non-current to current, as referred to above.

In connection with the increase in equity, the Group saw an improvement in its debt to equity and debt ratios. The debt to equity ratio and the debt ratio fell from 45.3% to 41.8% and from 36.3% to 35.5%, respectively.

The reclassification of liabilities under debt securities as current led to a decrease in liquidity ratios: the current ratio decreased to 1.4, from 2.4 at the end of December 2015, while the quick ratio was 1.2 in the reporting period, compared with 2.0 at the end of the previous year.

Material related-party transactions on non-arm's length terms

In 2016, PGNiG and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

7.2.3. Financial highlights of key subsidiaries

PGNiG UI (NOKm)	2016	2015
Revenue	2,227	3,000
EBITDA	1,348	2,119
EBIT	455	859
Net profit/(loss)	(55)	(217)
Total assets	8,433	8,650
Equity	573	327

PGNiG OD (PLNm)	2016	2015
Revenue	11,560	13,445
EBITDA	(36)	254
EBIT	(42)	248
Net profit/(loss)	(30)	199
Total assets	2,459	2,586
Equity	714	1,290

PST (EURm)	2016	2015
Revenue	571	881
EBITDA	5	1
EBIT	5	0
Net profit/(loss)	2	(1)
Total assets	160	180
Equity	9	7

PSG (PLNm)	2016	2015
Revenue	4,757	4,584
EBITDA	2,460	2,292
EBIT	1,525	1,393
Net profit/(loss)	1,246	1,133
Total assets	14,746	14,625
Equity	11,858	11,676

PGNiG TERMIKA (PLNm)	2016	2015
Revenue	2,033	1,888
EBITDA	731	680
EBIT	385	367
Net profit/(loss)	241	231
Total assets	5,281	4,333
Equity	2,892	1,874

7.3. Projected future financial standing

In the coming periods, the financial standing of the PGNiG Group will be materially affected by changes in the prices of hydrocarbons on global commodity markets and fluctuations in foreign exchange rates. These factors will be of particular importance for the PGNiG Group's performance in the Exploration and Production and Trade and Storage segments.

Any changes in crude oil prices affect revenues of the Group entities engaged in crude production and sale, and determine the demand for seismic and exploration services offered by the Group companies. Rising crude oil prices have a positive effect on performance generated by the Exploration and Production segment. Long-term forecasts of crude oil prices strongly influence projected cash flows from production assets, and as a consequence entail the necessity of revaluation of property, plant and equipment.

On the other hand, in view of the fact that the prices of gas purchased by PGNiG under the Yamal and Qatar Contracts are linked to prices of crude oil, rising crude prices have just the opposite effect on performance generated by the Trade and Storage segment. Any increase of crude oil prices translates into higher cost of gas purchased by PGNiG.

The PGNiG Group's financial results will also be materially affected by situation on the domestic currency market. Any strengthening of the złoty against foreign currencies (primarily the US dollar) will have a positive effect on performance of the Trade and Storage segment by driving down PGNiG's gas procurement costs, although it must be noted that the effect of exchange rate fluctuations is mitigated by the PGNiG Group's hedging policy.

The PGNiG Group's financial results will also be affected by the President of URE's position regarding the level of gas fuel sale and distribution tariffs and heat sale tariffs. In addition, the progressing deregulation of the gas market in Poland will continue to put pressure on the performance of the PGNiG Group's Trade and Storage companies engaged in the provision of gas sale services. Competition for customers has prompted the launch of a number of discount schemes dedicated to customers buying gas from the Group and the change in pricing terms to reflect market prices. These factors may have an adverse effect on the profitability of the Trade and Storage segment by eroding its margins.

However, the PGNiG Group companies have put in place a number of initiatives to improve efficiency. These initiatives focus, among other things, on optimisation of the cost base and are expected to have a positive effect on the PGNiG Group's financial results.

In the case of the Generation segment, the Group's performance will also be considerably affected by the support programmes for electricity from high-efficiency cogeneration and renewable sources. Legislative changes in this area and fluctuations in market prices of certificates of origin (both red and green) will have a bearing on the segment's financial position. Another key factor affecting performance of the Generation segment relates to prices of the fuels used to produce heat and electricity.

(in PLN million, unless stated otherwise)

In the coming quarters, the Group intends to maintain a high level of capital expenditure. Spending will focus primarily on projects involving maintenance of hydrocarbon production rates, as well as projects in the exploration for and appraisal of crude oil and natural gas deposits, and development of the power generation segment.

Capital expenditure on property, plant and equipment planned by the PGNiG Group in 2017

	PLNm	2017
I.	Exploration* and Production, including:	2,225
1	*Norway*	269
2	*Pakistan*	127
3	*Libya*	7
II.	Trade and Storage	356
III.	Distribution	1,669
IV.	Generation	872
V.	Other segments	19
VI.	Total capital expenditure (I-V)	5,140
	including PGNiG	*2,126*

** capital expenditure includes expenditure on geophysical surveys and drilling campaigns, as well as capitalised borrowing costs*

The above amounts do not include potential expenditure on acquisition of hydrocarbon deposits or acquisitions in the power sector.

When evaluating the feasibility of its investment plans for 2017 and beyond, the PGNiG Group took into account its financial standing, including the available sources of external financing and cash generated by the Group's day-to-day operations. It can thus be concluded that the funds available to the PGNiG Group were found sufficient to finance its investment plans.

7.4. Borrowings

Credit facility agreements executed in 2016

In 2016, the PGNiG Group did not execute any material credit facility agreements. The total amount of liabilities under credit facility agreements executed in 2016 was PLN 28.5m.

Key credit facility agreements executed by the PGNiG Group

Bank	Facility amount (m)	Currency	Interest rate	Type	Maturity date
Syndicate of eight banks	400	USD	LIBOR USD/EURIBOR*+1.55%**	working capital/ investment facility	13.08.2022
Deutsche Bank	35	EUR	EONIA+0.0085%	working capital facility	-

** Multi-currency credit facility, may be drawn in USD and EUR; provides for 1M, 3M or 6M interest periods*
*** In 2016 and 2017, the interest rate will be LIBOR USD/EURIBOR+1.80%*

Credit facility agreements terminated in 2016

In 2016, the PGNiG Group did not terminate any material credit facility agreements.

Loan agreements executed in 2016

In 2016, the PGNiG Group did not advance any material loans. For detailed information on loans advanced by PGNiG to its subsidiaries and other related entities, see Note 7.4 to the separate financial statements.

7.5. Securities issuance programmes

In 2016, the PGNiG Group was able to issue bonds and notes under the following programmes:

- Note issuance programme of June 10th 2010,
- Note issuance programme of May 22nd 2012,
- Note issuance programme of October 2nd 2014,
- Note issuance programme of July 4th 2012, with notes issued by PGNiG TERMIKA,
- Note issuance programme of July 4th 2012, with notes issued by SEJ,
- Eurobond programme of August 25th 2011, with bonds issued by PGNiG Finance AB,
- Note issuance programme of December 1st 2010, dedicated to PGNiG Group companies.

For detailed information on the effective terms and utilisation of the programmes, as well as debt outstanding under the notes in issue, see Note 5.2 to the consolidated financial statements.

The issue proceeds were applied to finance the PGNiG Group's day-to-day financial needs related to implementation of its strategy. They were also used to finance the exploration for conventional and unconventional oil and gas deposits, field development, construction and extension of underground gas storage capacities and the distribution network, including new connections, as well as power generation projects.

Furthermore, pursuant to an agreement of December 1st 2010 (as amended by annexes of 2011 and 2014), in 2016 PGNiG continued to issue short-term discount notes to PGNiG Group companies. Under an annex of August 7th 2015, the programme amount was increased from PLN 3bn to PLN 5bn. For PGNiG, the maximum amount of notes in issue remained at PLN 1bn, with the balance allocated to other PGNiG Group companies. The note issuance programme is designed to facilitate the flow of cash between companies, thus optimising the liquidity management within the PGNiG Group.

As at December 31st 2016, PGNiG's outstanding debt under the notes in issue was PLN 200m, while GEOFIZYKA Kraków's was PLN 40m and PGNiG OD's − PLN 100m.

7.6. Contingent liabilities and receivables

As at December 31st 2016, the PGNiG Group's most important off-balance-sheet item was contingent liabilities of PLN 8.7bn, as disclosed in the consolidated financial statements (December 31st 2015: PLN 9.2bn). The key items of contingent liabilities included:

- Guarantee securing performance of the obligations of PGNiG Finance AB (a subsidiary of PGNiG) towards bondholders, in connection with the Eurobond programme (PLN 6.6bn);
- Bond securing performance of the licence commitments and legal obligations of PGNiG Upstream International AS (a subsidiary of PGNiG) towards the state of Norway (PLN 2.8bn).

8. Risks

Key: Risk materiality level: low ●○○ ; medium ●●○ ; high ●●●

Probability that the risk will materialise: low ●○○ ; medium ●●○ ; high ●●●

Yoy change in the risk level: increase↗ ; decrease↘ ; no change→

8.1. Operational risk

8.1.1. Risks in the Exploration and Production segment

Resource discoveries and estimates ●●● ●●○ ↗Poland ●○○ ●●● → Norway

The main risk inherent in exploration activities is the risk of failure to discover hydrocarbons, i.e. exploration risk. This means that not all identified leads and prospects actually have deposits of hydrocarbons which can qualify as an accumulation.

Reserves estimates and production projections may be erroneous due to imperfections inherent in the applied equipment and technology, which affect the quality of the acquired geological information. Irrespective of the methods applied, data on the volume and quality of commercial reserves of crude oil and natural gas is always an estimate. Actual production, income and expenses relating to a given deposit may significantly differ from the estimates. The weight of this risk is further increased by the fact that in the full business cycle the period from start of exploration to the launch of production from a developed field takes six to eight years, while the production lasts from 10 to 40 years. Formation characteristics determined at the stage of preparing the relevant documentation are reviewed after production launch. Each downgrade of the size of reserves or production quantities may lead to lower revenue and adversely affect the PGNiG Group's financial performance.

The risk is managed by analysing the chances of success of exploratory projects and by estimating the reserves under various scenarios (P90, P50 and P10) which represent the expected probability distribution of the size of reserves.

Exploration for unconventional deposits of gas ●○○ ●●● ↘

The risk associated with exploration for unconventional deposits of gas in Poland relates to the lack of confirmed presence of shale gas and tight gas. Exploration for shale gas has now been closed, and the experience gained from such projects will allow PGNiG to minimise risks associated with exploration for tight gas. Even if the existence of in-place tight gas resources is confirmed, production may prove uneconomic due to insufficient recovery rates and high investment expenditure necessary to drill wells and construct production facilities. Another material factor is the difficulty of accessing unconventional gas plays given the environmental regulations and the requirement to obtain the landowners' consent for access to the area.

Competition ●●● ●○○ ↘ Poland ●○○ ●●○ → Norway

Both in Poland and abroad there is a risk of competition from other companies seeking licences for exploration and appraisal of hydrocarbon deposits, although it should be noted that this risk has significantly diminished in the Polish market over the past year. Certain competitors of the PGNiG Group, especially global players, enjoy strong market positions and greater financial resources than those available to the Group. Thus, it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences, offering better terms than the Group could offer given its financial and human resources. This competitive advantage of oil majors is particularly important on the international market.

Delayed work ●●● ●●● ↗ Poland ●●○ ●●○ → Norway

Under the applicable Polish laws and regulations, the process of obtaining a licence for exploration and appraisal of crude oil and natural gas reserves lasts from one to one and a half years. In foreign markets such procedures may even take up to two years from the time the winning bid is awarded until the actual contract is ratified. Prior to the commencement of field work, it is also required to make a number of arrangements, for instance to obtain legal permits and approvals for entering the area, and to meet the environmental protection requirements and, in some cases, requirements related to the protection of archaeological sites. It is also required to hold tenders to select a contractor. All this delays the execution of an agreement with the contractor by another few months. Frequently the waiting time for customs clearance of imported equipment is very long.

Further, PGNiG's obligation to comply with the Public Procurement Law frequently protracts tender procedures. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracting project exacerbates the risk related to estimation of capital expenditure.

The risk is managed through ongoing monitoring of the project status and by taking action by the licence Operator whenever any issue arises.

Cost of exploration ●●● ●●○ ↗

Capital intensity of an exploration project depends on prices of energy and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed onto prices of casing pipes and production tubing used in drilling. An increase in prices of energy and materials translates into higher costs of exploratory work. Profitability of foreign exploration projects also depends to a significant extent on prices of oil derivative products and on exchange rates. To reduce drilling costs, in 2011 PGNiG introduced the daily rate system into its procedure for selecting drilling contractors and paying for their work.

Safety, environmental protection and health regulations ●●● ●●○ ↘Poland ●●● ●●○ → Norway

Ensuring compliance with environmental laws in Poland and abroad may lead to a significant increase in the Group's operating expenses. Currently, PGNiG incurs significant capital expenditure and costs to ensure compliance of its operations with the ever more complex and stringent regulations concerning safety and health at work, and environmental protection. The Act of May 18th 2005 Amending the Natural Environment Protection Law and Certain Other Acts (Dz.U. No. 113, item 954 of June 27th 2005) introduced more stringent regulations governing projects which might affect Natura 2000 sites. It also imposed more stringent obligations with regard to operations in habitats of protected species of plants and animals Also in countries where PGNiG is engaged in exploration activities, a trend towards tightening environmental regulations is observed.

Upstream operations at sea entail a significant risk of environmental pollution in the event of an oil spill. The risk is monitored on an ongoing basis and various barriers and technical solutions are put in place to minimize it.

Unforeseen events ●●○ ●○○ ↘

Hydrocarbon deposits developed by PGNiG are usually located at great depths, which involves extremely high pressures and, in many cases, the presence of hydrogen sulfide. Consequently, the risk of hydrocarbon blowout or leakage is very high, which in turn may pose a threat to people (employees and local population), natural environment and production equipment.

Other changes in laws and regulations ●●● ●●● ↗

In some countries, exploration and production activities may be hindered by frequent and unexpected changes in legislation, which may create particularly serious risks in countries with authoritarian regimes.

Political and economic situation − PGNiG Group ●●○ ●○○ ↘

Some countries where the PGNiG Group is conducting exploration are threatened by armed conflicts and terrorist attacks, which may lead to limitation, suspension or even discontinuation of such activities.

The PGNiG Group's operations are also exposed to the risk of social or political unrest in some regions. Changes of governments may result in withholding issuance of petroleum licences. Those countries are also at risk of internal conflicts and civil unrest due to poverty and demographic issues.

In certain countries, operations of exploration companies may be hindered by the absence of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Problems may also arise in providing supplies and ensuring appropriate health care. These risks may lead to limitation or suspension of the Company's exploration activities.

8.1.2. Risks in the Trade and Storage segment

Administrative regulation of natural gas prices and deregulation of Polish gas market ●●● ●●● →

Gas trading on the exchange market has been excluded from the tariff regime. Prices of gas paid by end users are also expected to be gradually liberalised as the process of deregulation advances. The first customer groups in respect of which the tariff requirement will be disapplied are wholesale customers and the largest business customers. As regards gas trading on the Polish Power Exchange or direct sales to customers at prices similar to those quoted on the exchange, there is a risk that revenues from such sales will be lower than gas procurement costs due to the growing disconnect between the market prices of gas and of petroleum products, to which gas prices under the long-term import contracts continue to be linked. The obligation to submit gas fuel tariffs for approval by the President of URE adds to that risk, since tariffs are crucial to the Company's ability to generate revenue sufficient to cover its reasonable costs and deliver a return on capital employed. As a consequence, revenue is subject to forecasting risk. Inaccurate estimates of costs (particularly the cost of gas purchase) may result in a risk of miscalculation of selling prices and charges, which may adversely affect financial results.

Competition ●●● ●●● →

Competitors seek to increase gas fuel sales by offering competitive prices of the fuel or dual fuel (gas and electricity) deals. In response to changes taking place on the natural gas market in Poland, the PGNiG Group introduced a number of discount schemes.

Take-or-pay gas supply contracts●●● ●○○ →

PGNiG SA is a party to two long-term take-or-pay contracts for gas supply to Poland − the Yamal Contract and the Qatar Contract. Assuming that PGNiG SA's customer portfolio remains unchanged, the volume of gas imports specified in the take-or-pay contracts will limit its purchases of spot gas, which are currently most attractive in price terms. If PGNiG SA loses its market share, there is a risk that the Company would be forced to look for new ways to utilise the surplus volumes of gas in its portfolio.

Disruptions to gas supplies from countries east of Poland ●●○ ●○○ →

Given the continuing political instability in Ukraine and experience from late 2014 and early 2015, a risk of limitations in gas supplied by OOO Gazprom Export cannot be discounted.

8.1.3. Risks in the Distribution segment

Risk associated with lack of long-term regulatory policy ●●● ●●● →

Poland has no long-term tariff policy for natural gas distribution operators that would outline detailed rules and methodologies for determining the level of regulatory revenue acceptable to the regulator. The prevailing practice consists in determining short-term tariffs based on annual negotiations with the President of URE. This solution gives the President of URE much room for discretion in the process of evaluating costs incurred by the Distribution System Operator, its investment expenditure and regulatory value of its assets, which is a source of uncertainty as to the amount of revenue and profit that may be generated.

Risk of PSG's major customers reconnecting to the transmission network operated by OGP GAZ-SYSTEM ●●● ●●○ →

In view of the growing competition in the sector, there is a risk that PSG's large customers may opt for reconnecting directly to the gas transmission network operated by OGP GAZ-SYSTEM S.A. Customers justify their intention to reconnect by the need to cut costs. The departure of some customers would mean a loss of transferred gas volumes and thus also of revenue from sale of distribution services and, as a consequence, the need to cover any resulting excess of costs over revenue, for instance by increasing tariff rates.

Claims raised by property owners ●●○ ●●○ →

PSG is facing excessive financial claims raised by the owners of land where the gas network was developed in the past. Transmission easement serves as a basis for determining the extent of the use of third-party property by a transmission company, for which fair consideration is due to the owner. The owners' claims give rise to additional, frequently considerable costs, and thus may adversely affect the financial performance of the segment.

Sources of gas supply for the distribution system ●●● ●●○ →

PSG's distribution network is connected to the transmission system operated by OGP GAZ-SYSTEM S.A., which is its main source of gas supplies. The transmission system's limited capacity in terms of volume and pressure of supplied gas hinders, or sometimes renders impossible, further development of the gas grid within the PSG's key areas of operation.

Substitution ●●● ●●○ →

The strong competitive position of substitute energy sources (coal, wood) in some areas where PSG operates hampers growth in demand for natural gas as a fuel. Continuing low prices of coal, hydrocarbons (fuel oils, heating oils) and other energy carriers used for municipal heating are hardly an incentive (in particular for households) to switch to environmentally friendly gas fuel.

Dwindling average gas consumption among small customers ●●● ●●● →

The decline is largely attributable to the improving energy efficiency (thermal modernisation) of buildings, reduced usage of individual gas-fired boilers for heating water, and migration. Thermal modernisation of buildings includes thermal insulation of outer walls, replacement of windows, use of condensing boilers, automated control of heating systems, and installation of solar panels. All this translates into a decrease in the average volume of gas fuel supplied to small customers, and consequently erodes revenue from distribution services. This is a material risk for PSG, despite more than 80 thousand new customers acquired every year (mainly households), as total volumes of gas distributed in the segment have been falling.

Unstable gas demand in the power generation sector ●●● ●●○ →

The growing competitiveness of natural gas may encourage its use for power generation purposes, which would increase the distribution volumes and revenue from PSG's core operations. In the event of a sudden increase in demand for natural gas, the distribution network may be unable to handle supplies due to its limitations, which can be removed by expanding the distribution system's entry points and/or constructing new gas lines.

Legislation ●●● ●●● →

The complex provisions of the Construction Law and regulations governing construction projects impose the obligation to prepare extensive project and legal documentation, which is an integral part of any development process. The need to prepare such documentation extend the time needed for project preparation and thus may significantly delay its completion, exposing PSG to the risk of cost overruns caused by potential delays in contract performance, as well as the risk of a decline in revenues.

8.1.4. Risks in the Generation segment

Support for cogeneration ●●● ●●● ↗

The system of cogeneration support in the form of certificates of origin will only remain in effect until the end of 2018. The need to develop a new system supporting high-efficiency cogeneration, designed with a view to increasing electricity output, has been included in the Polish Energy Policy until 2050. For PGNiG TERMIKA, there is a serious threat that 2019 could mark the beginning of revenue decline. In Poland, work is currently under way to develop a power capacity market that would ensure additional revenues for cogeneration units after 2022. According to estimates, such revenues will not fully offset losses resulting from the lack of support for cogeneration. In addition, there is a risk of postponed introduction or even rejection of the capacity market solutions in the process of seeking their approval by the European Commission.

More stringent gas and dust emission standards ●●○ ●●○ →

2016 was the first year of application of the tighter emission requirements under the Industrial Emissions Directive (IED). Another step in making emission standards for the power segment more rigorous is expected in 2021, as a consequence of the BAT Conclusions for the power industry coming into force under the already effective IED. In their investment plans, companies should take into account the need to meet the emission and technological requirements set out in the draft BAT Conclusions – for new build and modernisation projects.

Maintaining share in the municipal heat market ●●○ ●●○ ↘

Following expansion of the Warsaw municipal waste incineration plant, the quantity of heat supplied to the city's municipal network will increase. As a result, PGNiG TERMIKA's share in total heat supplies to the Warsaw municipal network will fall from the current 99%, to 96% in 2020.

8.2. Regulatory risks

Elimination of administrative price control ●●○ ●○○ ↘

In connection with the ruling by the Court of Justice of the EU of September 10th 2015 on the system of regulated gas fuel prices, changes to the regulations on administrative price control were required. PGNiG expressed its opinion that liberalisation of gas prices was the key element of gas market liberalisation. At the same time, the Company emphasised that the process must be conducted in such a manner as to guarantee billing continuity in contracts with customers, as the inability to guarantee continuity of billing is a risk to the Company's business. In view of the expected removal of tariffs, PGNiG took a number of measures to adapt itself to the new regulatory framework, including:

- preparation of new framework agreements and individual contracts, as well as an updated product portfolio and price list to meet the customers' current needs,
- conclusion of contracts with the majority of key industrial customers, with price-setting mechanisms ready for the post-tariff regime.

Upholding of the decision to exempt the OPAL pipeline from the Third Energy Package regime ●●● ●●●

Pursuant to Art. 36 of Directive 2009/73/EU (part of the Third Energy Package), it is possible to exempt new infrastructure from the TPA principle. In 2009, exemption from the TPA rule and tariff system was granted to the OPAL pipeline which is used to transmit natural gas from Russia through the Nord Stream I pipeline under the Baltic Sea to Germany and further south to the Czech border.

After securing the exemption from the European Commission in 2009, the stakeholders and entities interested in full exemption from the TPA rule applied to the European Commission for a revision of the exemption decision, so as to make it possible for Gazprom to transport larger volumes of gas via the OPAL pipeline (and, consequently, also via the Nord Stream pipeline), without the need to satisfy additional conditions.

On October 28th 2016, the European Commission decided to revise the exemption from the TPA principle granted to the OPAL pipeline (the decision was published on January 3rd 2017). The PGNiG Group challenged the decision in the Court of Justice of the European Union, and the related decisions of the German regulator Bundesnetzagentur in the court in Düsseldorf.

The decision taken by the European Commission has negative implications both for the PGNiG Group and the entire gas market in Poland. The decision in its current wording not only upholds the exemption granted to the OPAL pipeline from the TPA regime at the level of 50% of available capacity, but also opens the door for Gazprom to actually reserve full capacity of the OPAL pipeline. Moreover, the new regulation will increase the volume of Russian gas transmitted via the Nord Stream pipeline at the expense of other routes (the Yamal and Bratstvo pipelines), which will undermine PGNiG's position in negotiations with third-party gas suppliers.

Obligation to diversify gas imports ●●○ ●○○ ↘

The Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies prescribes the maximum share of gas imported from a single country in total gas imports in a given year. In 2015–2018, the share may not exceed 59%. PGNiG is a party to a long-term take-or-pay contract with OOO Gazprom Export of September 25th 1996. The Regulation, however, does not take into account the specific position of PGNiG in the context of its obligations under the contract. As long as the Regulation is not amended, the President of URE will be able to impose fines on the Company for failing to comply with the diversification requirement. In comparison with the previous year, the risk was reduced with the measures proposed in the new draft diversification regulation to increase the maximum share of gas imported from a single source to 70% in 2017−2022.

Best upstream practices ●○○ ●●○ ↘

In 2017, work will continue on the non-binding document outlining best practices for the upstream operations. In this case, there is a risk that the document may become a binding regulation, setting additional requirements for the upstream segment and hindering fulfilment of the objectives in an alternative, more cost effective way. This could impose additional charges on the PGNiG Group.

Winter package (electricity) – Clean energy for all Europeans

On November 30th 2016, as part of the so-called Winter Package, the European Commission announced proposals of new electricity-related regulations. Their objective is to ensure that the European Union is capable of meeting the commitments assumed under the Paris Agreement (COP21) and, after achieving the target, that the EU economy evolves towards a low-emission economy.

PGNiG will actively participate in these works in order to mitigate certain risks, such as the unfavourable approach to the classification of certain technologies as capacity mechanisms or the uncertain status of some electricity carriers (such as biomass) as renewable energy sources (RES).

At this stage, it is impossible to present a complete analysis of the probability that these risks will materialise and of their impact on the PGNiG Group's business. The proposed regulations are currently being analysed.

8.3. Non-compliance risk ●●● ●○○ →

PGNiG has an organisationally and functionally separated Compliance unit. The functional separation was effected through the 'PGNiG Compliance Programme', adopted by the Management Board of PGNiG on June 30th 2015. In line with the non-compliance risk management model, each area at risk of non-compliance was assigned a dedicated non-compliance risk area manager (leader), who is in charge of ensuring that compliance standards are met.

The non-compliance risk (risk of breach of compliance standards) may arise in various areas, and pertain to: (i) the financial area, in the form of fines, damages, compensations and other liabilities that may arise for PGNiG, (ii) the Company's reputation, the loss of which can also have financial ramifications, (iii) the operational area, and (iv) the Company's value for stakeholders, including shareholders.

8.4. Financial risks

PGNiG and the PGNiG Group are exposed to financial risks, including in particular:

- Credit risk > For more information, see Note 7.3.1 to the consolidated financial statements of the PGNiG Group,
- Market risk > For more information, see Note 7.3.2 to the consolidated financial statements of the PGNiG Group,
- Liquidity risk > For more information, see Note 7.3.3 to the consolidated financial statements of the PGNiG Group.

Assessment of financial resources management

The PGNiG Group actively manages its financial resources by optimising both its debt structure and financing costs. PGNiG Group companies adapt the form of financing to its purpose (operating or investing activity) and to its term. The forms of financing available to PGNiG Group companies include note issuance programmes, credit facilities, finance leases and intra-Group loans advanced by PGNiG.

An important tool improving the efficiency of financial resources management is the liquidity management system in which the balances of specified bank accounts of PGNiG and its subsidiaries can be aggregated (cash pooling). Thanks to the cash pooling system within the Group, cash of entities with excess liquidity is used to finance the operations of entities recording cash deficits. The result is improved efficiency of cash management within the PGNiG Group, but also a material reduction in interest expenses incurred by companies financing their cash deficits through the system. To finance their operations, these companies do not use other, external sources of funding, which are usually more expensive than cash pooling.

While assessing the efficiency of financial resources management, a noteworthy fact is the optimum diversification of the portfolio of financial institutions. It should also be noted that, thanks to the diversity of available financing sources and liquidity management tools at the PGNiG Group, the Group companies are able to timely fulfil their financial obligations.

(in PLN million, unless stated otherwise)

9. Shareholding structure and PGNiG at WSE

9.1. Shareholding structure

As at December 31st 2016, the share capital of PGNiG was approximately PLN 5.78bn, and comprised 5,778,314,857 shares, with a par value of PLN 1 per share. Series A shares were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The State Treasury remains PGNiG's majority shareholder.

On June 26th 2008, a disposal by the Minister of State Treasury of one PGNiG share in accordance with general rules triggered the eligible employees' rights to acquire for free a total of up to 750,000,000 PGNiG shares. The start date for executing agreements on acquisition of free Company shares was April 6th 2009 and the rights to acquire free PGNiG shares by eligible employees expired on October 1st 2010. As at December 31st 2016, nearly 60,000 eligible employees subscribed for 728,294,000 shares. The free Company shares acquired by eligible employees were locked up until July 1st 2010, while trading in free shares acquired by members of the Company's Management Board was restricted until July 1st 2011.

At the end of March 2016, the State Treasury sold 25,063,197 shares in PGNiG to Towarzystwo Finansowe Silesia Sp. z o.o.

In 2016, the Company performed two share buy-backs. By Resolution No. 6/XI/2016 of November 24th 2016, the PGNiG Extraordinary General Meeting cancelled 121,685,143 ordinary bearer shares in the Company, with a par value of PLN 1 per share.
› For more information, see Section 9.2.

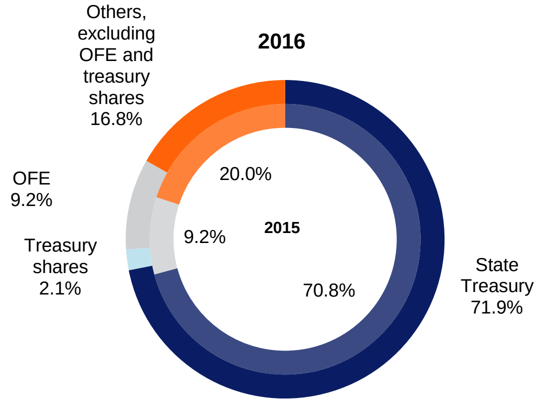
Shareholding structure at the end of 2016

Shareholder	Number of shares/voting rights attached to the shares as at Dec 31 2015	Percentage of share capital/total voting rights at the GM as at Dec 31 2015	Change in 2016	Number of shares/voting rights attached to the shares as at Dec 31 2016	Percentage of share capital/total voting rights at the GM as at Dec 31 2016
State Treasury	4,178,771,608	70.83%	(25,065,451)	4,153,706,157	71.88%
Treasury shares*	-	-	-	-	-
Others, including:	1,721,228,392	29.17%	(96,619,692)	1,624,608,700	28.12%
- OFE (open-end pension funds)	543,721,767	9.22%	(11,331,352)	532,390,415	9.21%
Total	5,900,000,000	100.00%	(121,685,143)	5,778,314,857	100.00%

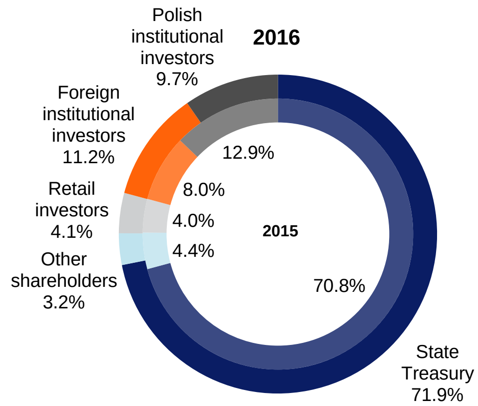
* › For more information, see Section 9.2.

Institutional investors, primarily open-end pension funds (OFE), pension fund management companies, as well as Polish and foreign investment funds, held over one-fifth of all shares issued by PGNiG. Nearly 10% of the Company shares were in the portfolios of Polish investors, while more than 11% of the shares were held by foreign institutions – mainly from Europe and the United States. As regards European investors, most PGNiG shares were held by UK entities (over 2%).

Shareholding structure at the end of 2015 vs 2016

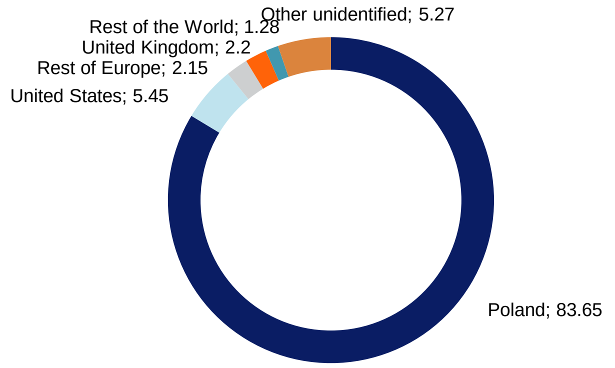


Shareholding structure by investor type



Substantial holdings of PGNiG shares were included in the portfolios of open-end pension funds, which at December 30th 2016 held more than 9% of PGNiG's equity, valued at just under PLN 3bn. Compared with 2015, their shareholdings were practically unchanged (down by less than 1%). Based on the closing price on the last trading day in 2016, the value of PGNiG shares held by open-end pension funds rose more than PLN 200m relative to 2015.

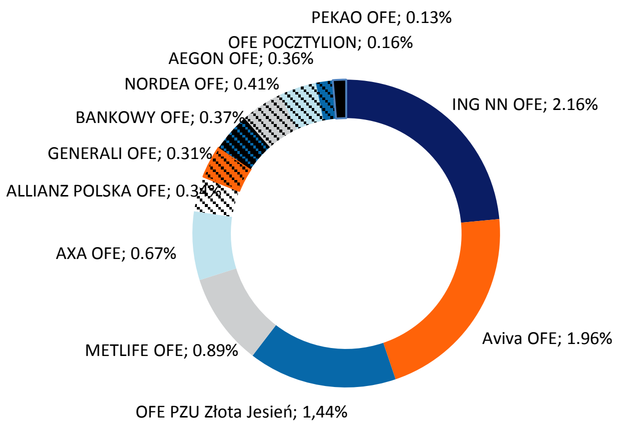
Shareholding structure by geography



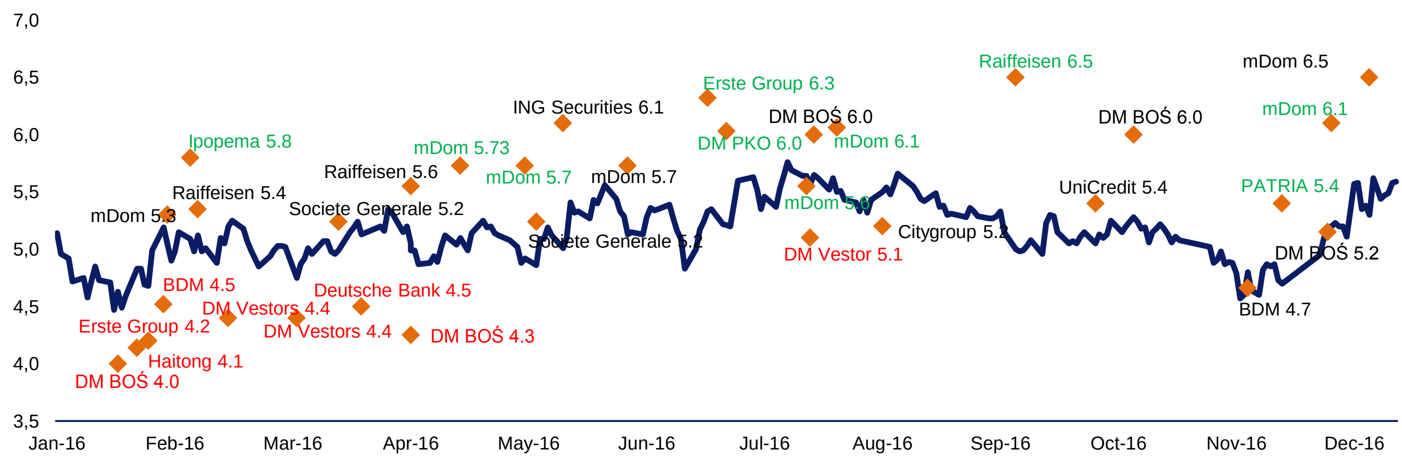
Top 3 for Rest of Europe: Sweden 0.48%, Netherlands 0.36%, Germany 0.35%.

Top 3 for Rest of the world: Singapore 0.57%, Japan 0.36%, Canada 0.22%.

Percentage of PGNiG share capital held by open-end pension funds at the end of 2016



The funds holding the largest equity interests in PGNiG were those managing the largest portfolios of future pensions, that is Nationale-Nederlanden, AVIVA and PZU Złota Jesień. The share of open-end pension funds in the PGNiG shareholder base rose significantly from the IPO in 2005, when it accounted for 3.5% of the share capital (valued at PLN 711m). Pension funds are typically long-term investors whose equity portfolios are characterised by low turnover, especially with respect to large dividend-paying companies, such as PGNiG. They have a stabilising effect on the Company's shareholding structure, while limiting its free float, which can translate into lower trading volumes. In the case of PGNiG shares, the daily trading volume averaged PLN 25.5m in 2016, which is a good result considering the low free float.



(in PLN million, unless stated otherwise)

Number of recommendations:

2016	**13**	buy	2015	**9**	buy
	9	sell		**29**	sell
	11	hold		**11**	hold

Relative to 2015, the Company's coverage by equity analysts fell off noticeably (by over 33% year on year). But, importantly, there was an increase in 'buy' recommendations (from 9 in 2015 to 13 in 2016), with a spectacular drop in 'sell' recommendations (from 29 to just 9).

PGNiG shares and shares in PGNiG's related entities held by management and supervisory personnel

Full name	Position	Number of shares/voting rights attached to the shares as at Dec 31 2016	Par value of shares (PLN)
Ryszard Wąsowicz	Member of the Supervisory Board	19,500	19,500

As at the date of this report, PGNiG was not aware of any agreements which could lead to future material changes in the equity interests held in the Company by its existing shareholders.

9.2. Treasury shares

The Extraordinary General Meeting of August 25th 2016 authorised the Management Board to buy back Company shares for cancellation. The authorisation to buy back up to 129,870,129 ordinary bearer shares, for an aggregate amount of up to PLN 700m, was valid until December 31st 2016.

On September 7th 2016, PGNiG bought back 92,764,327 book-entry ordinary bearer shares with a par value of PLN 1.00 per share, representing 1.57% of its share capital. The shares were acquired at the price of PLN 5.39 per share, and for the aggregate price of PLN 499,999,722.53.

On November 14th 2016, PGNiG bought back 28,920,816 book-entry ordinary bearer shares with a par value of PLN 1.00 per share, representing 0.49% of its share capital. The shares were acquired at the price of PLN 5.00 per share, and for the aggregate price of PLN 144,604,080.

As at December 31st 2016, PGNiG held a total of 121,685,143 treasury shares, representing 2.06% of its share capital. Pursuant to Art. 364.2 of the Commercial Companies Code, the Company did not exercise voting rights on its treasury shares. The aggregate price paid by PGNiG to buy back the treasury shares amounted to PLN 644,603,802.53. The Extraordinary General Meeting of November 24th 2016 passed a resolution to cancel PGNiG's treasury shares.

Cancellation of the treasury shares and changes to the share capital were registered with the National Court Register on March 2nd 2017.

9.3. Performance of the PGNiG stock

Since September 23rd 2005, the PGNiG stock has been listed in the continuous trading system of the main market at the Warsaw Stock Exchange. Its issue price in the public offering was PLN 2.98. In 2016, the PGNiG shares were included in the following WSE indices: WIG, WIG20, WIG30, WIG-Poland, RESPECT, WIG-PALIWA (sectoral index) and WIGdiv (until December 16th 2016).

Performance of PGNiG shares vs WSE indices

Index / PGNiG stock price*	Value/price as at Dec 30 2015	Value/price as at Dec 30 2015	2016 low	2016 high	PGNiG's weight in the index as at Dec 30 2016
WIG	46,467 points	51,754 points	42,152 points	51,754 points	3.3%
WIG20	1,859 points	1,948 points	1,675 points	2,000 points	5.2%
WIG30	2,076 points	2,243 points	1,879 points	2,244 points	4.8%
WIG-Poland	47,412 points	52,584 points	43,016 points	52,584 points	3.4%
WIG-Paliwa	4,468 points	5,669 points	3,950 points	5,702 points	22.8%
RESPECT Index	2,269 points	2,516 points	2,066 points	2,519 points	9.0%
PGNiG	PLN 5.14	PLN 5.63	PLN 4.4	PLN 5.76	-

Source: Warsaw Stock Exchange, www.gpw.pl.
** PGNiG stock price and index values based on closing prices, excluding the ex-dividend day effect.*

The PGNiG share price movements ranged between -13% (lowest price: PLN 4.47 on January 14th 2016) and +12% (highest price: PLN 5.76 on July 13th 2016) from the 2015 closing price (PLN 5.14 on December 31st 2016). To compare, fluctuations of the WIG20 index ranged between -10% (lowest value: 1674.57 points January 20th 2016) and +7.5% (highest value: 1,999.3 points on March 30th 2016). Compared with 2015, both the PGNiG stock and WIG20 index fluctuated within a much narrower range. The main reasons behind their changes included:

- Fluctuations in crude oil prices globally (historical lows in the first quarter, upsurge in the fourth quarter),
- Receding prices on PPX (average spot price of gas on PPX in 2016 fell 24% on 2015),
- Ongoing deregulation of the gas market in Poland.

In the first quarter of 2016, the PGNiG stock slid to the year's low of PLN 4.45 (on January 14th 2016). The year's beginning saw a massive slump in crude oil prices. The price per barrel on the Intercontinental Exchange (ICE) and London Metal Exchange (LME) fell below USD 30 – a level unseen in some 12 years. With the gas price equally depressed, this signalled a possible deterioration in the Exploration and Production segment's performance. For all that, at the end of Q1 2016 the PGNiG share price on the Warsaw Stock Exchange rallied – closing at PLN 5.32 on March 31st 2016. Although in Q4 2015, PGNiG's net loss was slightly higher than the market consensus, analysts appreciated the Company's strong balance sheet and dividend capacity.

In Q2 2016, the PGNiG stock price was highly volatile − on June 16th 2016 it fell to the quarterly low of PLN 4.83, to surge to the quarterly high of PLN 5.60 only two weeks later (June 30th 2016). The Company's performance in Q1 2016, especially in the Trade and Storage segment, was well received by analysts and investors. A major increase in the PGNiG share price in late June was driven, among other things, by URE's decision on a lower-than-expected reduction in the PGNiG OD retail tariff until the end of 2016. Therefore, the robust performance of the Trade and Storage segment was expected to continue in H2. Furthermore, on June 28th 2016, the Annual General Meeting of PGNiG passed a resolution on distribution of net profit for 2015. The dividend amount was PLN 1.062bn (PLN 0.18 per share).

In early Q3 2016, the upward trend continued, with the share price peaking for the year at PLN 5.76 on July 13th 2016. After that date the trend reversed and in September 2016 the price sank below PLN 5 again. The first major plunge took place following the release of the Company's selected operating data estimates for H1 2016. Some analysts and investors were slightly disappointed with lower oil sales by the PGNiG Group and a high share of gas from Gazprom in PGNiG's basket. The share price fell also after the Management Board's decision to buy back shares.

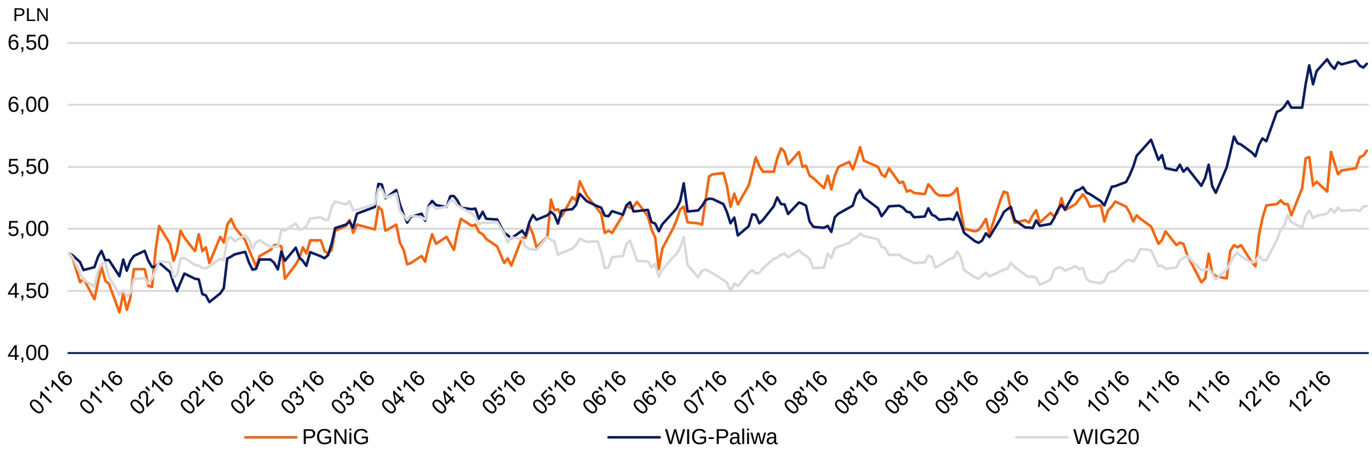
The downward trend continued throughout most of Q4 2016, bringing the PGNiG stock back to the year's lows (PLN 4.57 at the close of trading on November 14th 2016). Following the OPEC deal to cut oil production, the trend reversed again in late 2016 and the PGNiG stock price rebounded to PLN 5.6 on December 13th, driven mainly by a rise in oil and gas prices. During the key week of negotiations by OPEC members, the crude oil price per barrel on ICE rose by over 13% (Brent crude monthly futures contract price at the close of trading on November 28th vs December 2nd 2016).

On December 30th 2016 (the last session day in the year), the PGNiG stock price closed at PLN 5.63.

The price was nearly 89% above the issue price of 2005 and 28% above the closing price on the first day of listing. Factoring in the dividends of PLN 1.46 per share paid in 2005–2016, investors who acquired PGNiG shares at the issue price and held them until the end of 2016 saw a profit of 138%.

(in PLN million, unless stated otherwise)

PGNiG share price vs WIG20 and WIG-Paliwa



Source: Warsaw Stock Exchange, www.gpw.pl.

Rates of return on WSE indices vs PGNiG stock in 2016 and from PGNiG's IPO

Index	Rate of return in 2016	Rate of return from PGNiG's IPO** to Dec 30 2016
WIG	11.4%	-20.7%
WIG20	4.8%	55.8%
WIG30	8.1%	-11.7%***
WIG-Poland	10.9%	60.6%
WIG-Paliwa	26.9%	59.2%****
RESPECT Index	10.9%	151.6%*****
PGNiG	9.5%	47.8%******

Source: Warsaw Stock Exchange, www.gpw.pl.

** Rates of return do not include dividends paid in 2005−2016.*
*** Closing price on September 23rd 2005.*
**** Calculated in relation to the reference value of the index (reference date: September 23rd 2013).*
***** Calculated in relation to the reference value of the index (reference date: December 30th 2005).*
****** Calculated in relation to the reference value of the index (reference date: December 30th 2008).*
******* Relative to the issue price of PLN 2.98, PGNiG shares yielded a rate of return of 89%.*

9.4. Trading multiples

Key metrics*	Unit	2016	2015	2014	2015/2016 change (%)
Net profit attributable to owners of the parent	PLNm	2,351	2,134	2,823	10.2%
Earnings per share*	PLN	0.40	0.36	0.48	11.1%
Stock price at the close of trading on last session day in the year	PLN	5.63	5.14	4.45	9.5%
Average stock price in the year	PLN	5.16	5.94	4.85	-13%
Number of shares outstanding	million shares	5,778	5,900	5,900	-
Capitalisation at year end	PLNm	32,532	30,326	26,255	7.3%
Average daily trading volume	million shares	4.9	4.7	3.9	4.3%
Average daily trading value	PLNm	25.5	27.9	18.8	-8.6%
Dividend amount***	PLNm	1,062	1,180	885	-10%
Trading multiples**					
P/E at average share price	-	12.69	16.41	10.14	-22.7%
P/E at year end	-	13.85	14.21	9.30	-2.5%
P/BV at year end	-	1.02	0.99	0.87	3%
EV/EBITDA	-	5.53	5.02	4.39	10.2%
Dividend per share***	PLN	0.18	0.2	0.13	-10%

Source: Warsaw Stock Exchange, www.gpw.pl.

Attributable to holders of ordinary shares in the parent (in PLN).
*** Prices at close.*
**** Dividend from previous year's profit.*

P/E at average share price = average share price in financial year / net earnings per share attributable to owners of the parent
P/E at year end = share price at close of trading on last session day in financial year / net earnings per share attributable to owners of the parent
P/BV at year end = share price at close of trading on last session day in financial year / book value per share
EV/EBITDA = market capitalisation at close of trading on last session day in financial year + net debt at end of financial year / earnings before interests and taxes in financial year + total depreciation and amortisation in financial year
Dividend per share = dividend for previous financial year / number of shares outstanding

9.5. Dividend

The PGNiG Group's Strategy for 2014–2022 in place as at the date of this Report provides for distribution of up to 50% of consolidated net profit as dividend, with the proviso that in recommending dividend payments the PGNiG Management Board must always take into account the PGNiG Group's current financial standing and investment plans. PGNiG will recognise net profits of its subsidiaries in the consolidated accounts net of any dividends paid by the subsidiaries, so achieving the planned level of dividend payments may be postponed by one year.

Dividend paid

	2015	2014	2013	2012	2011
Dividend for financial year (PLNbn)	1.06	1.18	0.89	0.77	-
Dividend per share (PLN)	0.18	0.20	0.15	0.13	-
Average annual share price (PLN)	5.94	4.85	5.83	4.06	3.97
Dividend yield	3.03%	4.12%	2.57%	3.20%	-

10. Corporate governance

10.1. Management Board

Piotr Woźniak − President of the Management Board

Piotr Woźniak graduated from the University of Warsaw in 1980 with a degree in geology. Until 1989, he was an assistant at the Geological Institute in Warsaw. In 1990−1991, he served as an adviser to the Minister of Agriculture and to the Minister of Industry. He was the Trade Commissioner of the Republic of Poland in Canada in 1992−1996. In 1998−2000, Mr Woźniak was an adviser on infrastructure to the Polish Prime Minister. He served as a member of the PGNiG Supervisory Board in 1999−2000, and Vice President of the Management Board from June 2000. In the 2002−2006 term, he was a member of the Warsaw City Council, and in 2005−2007 he was the Minister of Economy. From December 2011 to December 2013, Mr Woźniak served as the Deputy Minister of Environment and Chief State Geologist. He is a lecturer at the Łazarski University and at the Warsaw School of Economics, and a member of the Council of the Maria Grzegorzewska University in Warsaw. From December 2009, he served as the Chairman, and as of March 2014 the Deputy Chairman of the Administrative Board of the Agency for the Cooperation of Energy Regulators (ACER). On December 4th 2015, the Minister of State Treasury appointed Piotr Woźniak as member of the Supervisory Board of PGNiG SA. On December 11th 2015, the PGNiG Supervisory Board delegated Piotr Woźniak, member of the PGNiG Supervisory Board, to temporarily perform the duties of President of the PGNiG Management Board from December 11th 2015 to March 11th 2016. On February 11th 2016, Mr Woźniak was appointed President of the Management Board of PGNiG SA for the term of office ending December 30th 2016.

On December 19th 2016, he was appointed President of the Management Board of PGNiG SA for the three-year term of office beginning December 31st 2016.

The President directs the Management Board's meetings and coordinates the work of all its members in all areas of the PGNiG Group's activity; the President also supervises and coordinates the Company's operations with respect to internal control and audit functions, in accordance with commonly accepted standards of internal audit, HR strategies, payment schemes and working time, employment policy and payroll, liaising with trade unions, the Employee Council and other employee organisations in respect of the Company and the PGNiG Group, allocation of shares to eligible employees, protection of confidential information, protection of personal data, defence, protection of the Company's facilities, management of the PGNiG Group, including exercise of corporate supervision at the PGNiG Group, establishment of new companies within the PGNiG Group to pursue new projects undertaken as part of the PGNiG Group's strategy, preparing and implementing privatisation plans for companies where PGNiG is a shareholder, developing and overseeing implementation of the PGNiG Group's Strategy, optimising the PGNiG Group's structure, policy, objectives and projects related to hydrocarbon exploration, appraisal and production in Poland and abroad, overseeing all licensing processes related to hydrocarbon exploration, appraisal and production, as well as the storage of waste matter in rock mass and non-reservoir storage of substances in accordance with the geological and mining law, development of technical assumptions and regulations, norms and standards applicable in the area of oil drilling, operation and safety of production systems and underground storage facilities, standardisation and oversight of uniform quality systems within the Company, acquisition of foreign upstream assets, planning, development and operation of the Company's IT systems, implementation of the PGNiG Group's strategic objectives at the Group companies in the areas of IT development and management, operations of the Geology and Hydrocarbon Production Branch, the PGNiG Branches in Odolanów, Sanok and Zielona Góra, Well Mining Rescue Station in Kraków, and the Company's foreign branches and foreign representative offices in Brussels and Moscow.

Radosław Bartosik − Vice President of the Management Board, Chief Operating Officer

He graduated from the Faculty of Drilling, Oil and Gas of the AGH University of Science and Technology in Kraków. He also completed a number of post-graduate courses, e.g. in business management, marketing and electricity, heat and gas market. Radosław Bartosik holds an MBA degree and passed the examination for candidates for members of the supervisory boards of state-owned companies. He is a qualified technical supervisor of mining operations. Save for a four-year interval, Radosław Bartosik has worked for the PGNiG Group since 1997. He started his career with PGNiG in the Zielona Góra Branch, where he gained professional experience first working in oil and gas production facilities, and then as Marketing Specialist and head of the Contracts and Tenders Department. In 2006, he was appointed Economic and Commercial Director. Three years later he moved to Warsaw, where he became Deputy Director of PGNiG's Branch Operator Systemu Magazynowania (currently Gas Storage Poland sp. z o.o., a subsidiary of PGNiG SA). He was also a Chief Specialist for EU Funds at the PGNiG Head Office. Until the end of 2016, Radosław Bartosik was Deputy Economic Director at the Warsaw Branch of Polska Spółka Gazownictwa.

On December 19th 2016, he was appointed Vice President of the Management Board, Chief Operating Officer, for the three-year term of office beginning December 31st 2016.

The Vice President of the Management Board, Chief Operating Officer, supervises and coordinates the Company's operations in respect of comprehensive legal support protecting PGNiG's legal interests, uniform application of general law, including EU law, issuance of official orders and circulars for the Company, organisational and technical support of the Company's governing bodies, information policy and corporate communication, Corporate Social Responsibility (CSR) programme, procurement strategy at the Company and the PGNiG Group, ensuring proper OHS and fire safety conditions, administrative management of the Company's property (excluding network assets, extraction assets and underground gas storage facilities), management of non-production assets, including the Company's real property.

Łukasz Kroplewski – Vice President, Development

Łukasz Kroplewski holds MA degrees in law and in administration. He gained professional experience by serving in public administration, and taught intellectual property law at the Koszalin University of Technology. He has close ties with the HR industry, where he worked from 2005 holding managerial positions. He has provided legal and business consultancy support to corporations. Since 2009, he has been a member of the Self-Government Board of Appeals and is one of the founders of the Mediation Centre at the Association of Merchants and Entrepreneurs in Koszalin, where he works as a mediator. Łukasz Kroplewski is a member of the UNECE Group of Experts on Coal Mine Methane. In July 2016, he was appointed Vice President of the Chamber of the Natural Gas Industry, an association of gas industry operators. Thanks to Łukasz Kroplewski's efforts, PGNiG joined the International Centre of Excellence on Coal Mine Methane (ICE-CMM). On February 11th 2016, Mr Kroplewski was appointed Vice President of the Management Board of PGNiG SA, Development, for the term of office ending December 30th 2016.

On December 19th 2016, he was appointed Vice President of the Management Board, Development, for the three-year term of office beginning December 31st 2016.

The Vice President of the Management Board for Development supervises and coordinates the Company's operations in the area of innovation and development projects involving PGNiG, analysing and monitoring opportunities to obtain EU funding for the Company's operations, cooperation with operators of transmission and distribution systems, oversight of standardisation efforts at the Company, development of technical assumptions, rules, norms and standards for the gas area, overseeing operations of the Central Measurement and Testing Laboratory and of the PGNiG foreign representative offices in Kiev and Vysokoye.

Michał Pietrzyk – Vice President, Finance

Graduate of Finance and Banking at the Kraków University of Economics, he completed a post-graduate course in law for managers at the Kozminski University. In 2009, he received the title of Chartered Financial Analyst. He started his professional career in 1995 in the banking sector. With the PGNiG Group since 2003, he first worked as Head of the Treasury Department of PGNiG SA and from 2006 to 2016 as Deputy Head of the Economic Department. In February 2016, Mr Pietrzyk became the Head of PGNiG's Economic Department.

On December 19th 2016, he was appointed Vice President of the Management Board, Finance, for the three-year term of office beginning December 31st 2016.

The Vice President of the Management Board for Finance supervises and coordinates the Company's operations in respect of its strategic economic and financial objectives, preparation and implementation of the Company's Business Plan, economic and financial evaluations and analyses of development and investment projects, planning and overseeing financial aspects of the investment policy, monitoring the use of financial resources allocated to production, investment and repair work, the Company's internal settlement procedures, financing operations, cash flows of the PGNiG Group, budgeting, controlling the Company's costs and revenue, its credit policy, tax policy and tax liabilities, financial risk management, economic and financial analyses of new capital projects, implementation and development of accounting procedures, defining the rules of and overseeing the preparation of financial statements, as well as investor relations.

Maciej Woźniak – Vice President, Trade

Maciej Woźniak is a graduate of the Cracow University of Economics (holding a master's degree in economics) and the National School of Public Administration. He also completed a post-graduate course in property valuation at the Warsaw University of Technology. He is a member of the Polish Civil Service Corps. In 2011, he participated in the International Visitor Leadership Program run by the US Department of State. In 2003−2008, he worked at the Ministry of Finance and at the Ministry of Economy, where he led the Oil and Gas Department and was responsible for implementation of the act on mandatory oil, gas and fuels stocks and for securing Poland's accession to OECD's International Energy Agency based in Paris. After it joined the IEA, he represented

Poland at IEA Governing Board meetings a number of times. He also coordinated preparations ahead of implementation of the second package of the EU gas market liberalisation legislation and participated in the EU's work on the third package. In 2008−2010, he was Prime Minister's chief adviser on energy security and secretary of the Prime Minister's interdepartmental energy security policy team. He represented Poland in the V4 High-Level Group on Energy and the EC's Group for the Baltic Energy Market Interconnection Plan. He supervised the pre-construction phase of the Świnoujście LNG Terminal project. He was on the team negotiating the intergovernmental gas supply contract between Poland and Russia. He resigned from the position of Prime Minister's adviser only after the contract was signed in November 2010. In 2011−2013, he advised the Environment Minister and Chief Geologist on the geological and mining law reform. He sat on the Supervisory Boards of Operator Logistyczny Paliw Płynnych and Wielkopolska Spółka Gazownictwa and served as Chairman of the Supervisory Board of the Provincial Fund for Environmental Protection and Water Management of Warsaw. On February 11th 2016, Mr Woźniak was appointed Vice President of the Management Board of PGNiG SA, Trade, for the term of office ending December 30th 2016.

On December 19th 2016, he was appointed Vice President of the Management Board, Trade, for the three-year term of office beginning December 31st 2016.

The Vice President of the Management Board for Trade supervises and coordinates the Company's operations in respect of developing a regulatory policy in consultation with government authorities, EU authorities and industry organisations, planning and implementing the Company's trade policy, particularly in respect of natural gas and electricity sales, including the execution and settlement of contracts for the supply of natural gas, electricity and other products, guiding the development of the gas market, natural gas import policy, also in respect of supply diversification, establishing and maintaining long-term relationships with foreign companies, international organisations and foreign government authorities with respect to trade relations, monitoring and analysis of foreign markets, collaboration with OGP Gaz-System SA, Polskie LNG SA, the Maritime Office in Szczecin and the Management Board of Porty Morskie Szczecin i Świnoujście in respect of importing LNG to Poland, planning, executing and settling contracts for the provision of gas transmission and distribution services for PGNiG, preparing periodic gas fuel balance reports in accordance with contracts and gas sale plans, periodic settlements of gas deliveries, information services, including the receipt of information on events and crises in all areas of the Company's business, the Company's tariff policy, liaising with URE in respect of preparing draft tariffs and prices of PGNiG's products and services, obtaining licences, development and implementation of the Company's policies with respect to sponsorship and brand image in Poland and abroad, operations of the Wholesale Trading Division, and operations of the Company's foreign representative office in Brussels.

Magdalena Zegarska – Vice President of the Management Board

Magdalena Zegarska graduated from the University of Environmental Sciences in Radom. She completed an MBA oil and gas course and holds a certificate of completion of studies in Management of Large Enterprises from the School of Management and Marketing of the Business Initiatives Association in Warsaw. She completed numerous training programmes and courses in psychology of team management, as well as a course for supervisory board members, completed with a passed exam before the State Treasury Commission. From 2011 to 2014, she served as Secretary of the Employee Council of the second term of office, and from 2010 to 2014 as Secretary of the Coordination Committee of the NSZZ Solidarność trade union at PGNiG. In 2014−2017, she served as a Member of the PGNiG Supervisory Board, as the Board's Secretary and as Deputy Chair of the Audit Committee.

She joined PGNiG in 1998 as an employee of Mazowiecka Spółka Gazownictwa and then worked at the Mazovian Trading Division. From 2013, she held various positions at the Retail Trading Department, Infrastructure Department and Asset and Administration Department of the PGNiG Head Office. At the Asset and Administration Department she was Deputy Director. Since January 2016, she has been the Representative of the PGNiG Management Board for Quality, Health, Safety and Environment (QHSE) Management. From April 2016 to March 2017, she served as Deputy Director of the QHSE Department, delegated to direct the work of the Department. She has received honorary awards for outstanding service to the Oil Mining and Gas Sector and the Mazovian Trading Division. She is a Grade III Mining Director.

On March 6th 2017, Magdalena Zegarska was appointed as Vice President of the Management Board.

Until March 6th 2017, the position had been held by Waldemar Wójcik.

10.2. Supervisory Board

Bartłomiej Nowak – Chairman of the Supervisory Board

Bartłomiej Nowak specialises in energy law, business law, competition law, and EU law. In 2007-2009, he worked for Directorate-General for Transport and Energy of the European Commission and as an adviser to the President of the Energy Regulatory Office. In 2010-2014, he was an adviser at the Kancelaria Domański Zakrzewski Palinka sp.k. law firm and member of the Supervisory Board of PTE WARTA S.A. Since 2009, he has worked for the Leon Kozminski University of Warsaw, initially as Assistant Professor and then Professor at the Law College, as well as Vice-Rector for Economic and Social Studies. Bartłomiej Nowak is a member of the Scientific Boards of the Aviation Institute, Electron Technology Institute, and the National Centre for Nuclear Research.

Wojciech Bieńkowski – Deputy Chairman

Mr Wojciech Bieńkowski is a professor of economics and international economic relations at the Łazarski University of Warsaw, where he heads the US Economy and Transatlantic Relations Institute. For eight years (until July 2015), Mr Bieńkowski was also Dean of the University's Faculty of Economics and Management. Previously, he worked at the Warsaw School of Economics, where he obtained a PhD degree and habilitation. He spent many years as visiting fellow, including at Harvard (twice) and other leading universities in the US, Japan and Europe. Mr Bieńkowski's academic achievements cover the fields of economic politics, competitiveness and comparative analysis of the effectiveness of social and economic systems. He authored or co-authored many academic papers published by recognised academic publishing houses at home and abroad. He has gained professional experience as head of international cooperation at the National Fund for Environmental Protection and Water Management and as supervisory board member at BOŚ, Famur, PAIiIZ, Elektrownie Szczytowo-Pompowe (currently PGE), and the Polish-American Corporation for Technology Transfer (PAKTO).

Sławomir Borowiec – Secretary

Mr Borowiec graduated from the AGH University of Science and Technology in Kraków (Faculty of Drilling, Oil and Gas) in 1992 and in the same year joined Zielonogórski Zakład Górnictwa Nafty i Gazu. In 2001, he graduated from The Jacob of Paradyż University of Applied Sciences in Gorzów Wielkopolski − Institute of Management and Finance, where he completed studies in Management and Marketing. In 2014, he earned a degree from the Koszalin University of Technology, where his principal field of study was Accounting − Accounting of Business Entities. At present, he is Head of the Administrative Centre for Oil and Gas Production Facilities in Drezdenko. Mr Borowiec is also a licensed Mine Operations Manager. In 2002, he passed an examination for candidates to supervisory boards of state-owned companies and in 2010 he received a title of Grade II Mining Director.

Mateusz Boznański – Member

Mr Mateusz Boznański graduated from the Faculty of Law, Administration and Economics of the University of Wrocław. In 2002−2006, he completed legal training as an attorney-at-law at the Regional Bar Association in Wrocław. Since April 2007, he has worked as an attorney-at-law in his own law firm; in 2011−2015, he has also been a partner in a law partnership. In the course of his professional career, Mr Boznański has gained considerable experience in the provision of services to commercial-law companies (both Polish and foreign-owned) and to local government bodies. As part of his duties, he has provided legal advice to capital groups across Poland, in particular with respect to civil, labour, EU, and commercial law. He provides ongoing legal advisory services with respect to construction law and related legal areas for companies operating in the property development sector. He also specialises in cases related to the protection of personal rights, acting as an attorney in major court trials. He has participated in bankruptcy proceedings of entities operating in the property development sector. Mr Boznański has also provided legal services as an attorney in proceedings before courts of general jurisdiction, as a lawyer in criminal proceedings, including with respect to criminal economic law, and criminal fiscal proceedings. He was (in 2010−2013) and, since 2013 to date, has been a member of the Human Rights Committee at the Polish Bar Council. Since 2013, he has been a member of the Audit Committee at the Regional Bar Association in Wrocław.

Mr Mateusz Boznański has represented that he meets the independence criteria defined in Art. 36 of the Company's Articles of Association.

Andrzej Gonet – Member

Mr Andrzej Gonet graduated with honours from the Faculty of Drilling, Oil and Gas of the AGH University of Science and Technology in Kraków in 1975. He was then employed at the Faculty of Drilling, Oil and Gas, where in 1980 he defended with honours his doctoral thesis and in 1989 received the higher academic qualification of Doctor of Science. In 1998, he was awarded professorship and is now employed as a full professor at the AGH University of Science and Technology. He has completed several post-graduate programmes run by the AGH University of Science and Technology, Jagiellonian University and Polish Academy of Sciences, as well as a course for candidates to supervisory boards of state-stock companies. He was a member of the Supervisory Boards of ZUN Sp. z o. o. of Krosno (2000–2002) and PNiG Sp z o. o. of Kraków (2011–2013). Mr Gonet has authored or co-authored over 300 publications, 260 unpublished research papers, 29 approved and submitted patents and 8 licences. He is a certified environmental impact assessment expert of the Kraków Province Governor, expert of the Polish Association of Oil and Gas Industry Engineers and Technicians, and has extensive professional experience gained in Poland and abroad. He has been a consultant and reviewer of many scientific papers and research projects. He is a member of the Drilling and Borehole Mining Section of the Mining Committee of the Polish Academy of Sciences. Throughout his professional career he has held various positions, including head of the Drilling Department, Deputy Director of the Institute of Drilling, Oil and Gas, two terms of office as Vice-Dean and Dean of the Faculty of Drilling, Oil and Gas of the AGH University of Science and Technology, in which function he serves for the third term. In addition, Mr Andrzej Gonet was a co-founder of the PWSZ Krosno State College, where he has served as Vice-Rector and Rector.

Piotr Sprzączak − Member

Piotr Sprzączak is a graduate of the Maria Curie-Skłodowska University of Lublin and the National School of Public Administration of Warsaw. He began his professional career in 2011 at the Oil and Gas Department of the Ministry of Economy, and then the Ministry of Energy. He is currently Head of the Infrastructure Department at the Ministry of Energy. His main professional focus is on matters related to security of natural gas supplies to Poland. As part of his professional duties, he negotiates EU laws and drafts legislation concerning security of gas supplies. He also coordinates activities related to Poland's membership in the EU and international organisations, energy agreements of which it is a signatory, as well as activities related to international cooperation. In 2011−2014, he was involved in preparing and updating the assessment of risk related to security of gas supplies, a prevention plan and an emergency response plan.

Ryszard Wąsowicz – Member

Ryszard Wąsowicz graduated from the School of Law and Public Administration in Rzeszów with a Bachelor's Degree in Administration − Human Resources Management (continuation – Master's Degree programme). He started his professional career in 1978 at Sanocki Zakład Górnictwa Nafty i Gazu, working at the Husów gas extraction facility. In 1990−1992, he was a member of the Employee Council at Sanocki Zakład Górnictwa Nafty i Gazu, and in 1992−1996, for two (the fifth and sixth) terms of office, he was a member of the Employee Council at PGNiG SA. Until 1998, he was a member of the Consulting Board at PGNiG. In 1998, he completed a course for supervisory board members and passed a state exam before the State Treasury Commission. Since 1990, he has been delegated to work in trade union bodies. Mr Wąsowicz was nominated to the Supervisory Board of PGNiG by the President of the Trade Union of Workers of the Mining and Oil Industries (NSZZ Górników – Naftowców). On May 15th 2014, he was appointed to the PGNiG Supervisory Board as a member elected by the employees.

Anna Wellisz − Member

Anna Wellisz is a graduate of the University of Warsaw. She has completed a postgraduate doctoral course at the Institute of Philosophy and Sociology of the Polish Academy of Sciences and a postgraduate course in Management at the Warsaw School of Economics. Holding a PhD in the humanities, she has received scholarships from Fondation Intellectuelle Européenne and the Czesław Miłosz Foundation. She is also a mediator licensed by the Minister of Family, Labour and Social Policy. In the early 1990s, having defended her doctoral thesis, Ms Wellisz carried out academic research, principally into mass social movements, and then began to work as a consultant. As an expert at the NSZZ Solidarność Mazowsze Region's Consulting and Negotiation Office, she provided advice to company committees. As a partner of Grupa Gospodarcza Sp. z o.o., she was responsible for organisation, marketing and management projects, as well as regional restructuring and company restructuring programmes. From 1996, Ms Wellisz occupied various management positions, working as Marketing Director at the Centrum Prywatyzacji Foundation, HR Deputy Director for employment policy and professional development at Polskie Sieci Elektroenergetyczne SA, and CIECH SA's Deputy Director of the Management Board Office (later the Owner Supervision and HR Policy Office). In 2001, she moved to New York to serve as First Secretary of the Economic and Trade Department of the Consulate General of the Republic of Poland. Since 2006, she has occupied various supervisory management positions in public administration – initially at the Ministry of Economy and then, since 2008, at the Ministry of Science and Higher Education. During her employment at the Ministry of Economy, she served on the Supervisory Board of Spółka Restrukturyzacji Kopalń S.A. and Węglozbycie S.A. Ms Wellisz is currently Deputy Director at the Department of Science of the Ministry of Science and Higher Education.

Until March 5th 2017, Ms Magdalena Zegarska served as Member and Secretary of the Supervisory Board.

On March 6th 2017, Mr Sławomir Borowiec assumed the position of Secretary of the Supervisory Board.

10.3. Remuneration policy and remuneration of management personnel

PGNiG's remuneration policy

The key internal document governing the remuneration policy at PGNiG is the Collective Bargaining Agreement concluded with trade unions active at the Company on July 15th 2009. The remuneration system is additionally governed by internal rules implemented at individual organisational units and agreements with trade unions.

In line with the adopted remuneration policy, base pay rates are based on job grading. The rate depends on the qualifications required for a given job, type of work performed and professional experience.

The policy also provides for additional components of remuneration, the most important of them being:

- Awards and bonuses under an incentive scheme,
- St. Barbara's Day awards, paid, as a rule, in the amount of a monthly base pay,
- Jubilee benefits and one-off retirement benefits, in amounts depending on the length of service with PGNiG, and
- Annual bonuses, in amounts depending on the Company's performance, negotiated every year with employees.

In 2016, the average gross monthly pay at PGNiG, including bonuses and awards, was PLN 31.3 thousand in directorial positions and PLN 11.1 thousand in managerial positions. The other employees received a gross monthly pay averaging PLN 6.4 thousand.

An average gross monthly pay is the quotient of total remuneration paid under employment contracts to the average number of FTEs.

The key components of remuneration under employment contracts included: base pay, periodic bonuses, task and project bonuses, St. Barbara's Day awards, annual bonuses, length-of-service awards, retirement severance payments, and payments for unused holidays.

Incentive scheme

At PGNiG, a bonus scheme is in place whose key components include:

- MBO (Management By Objectives) bonus, which applies to management positions responsible for achieving PGNiG's key objectives; the amount of an MBO bonus depends on the quality and progress in the achievement of allocated objectives;
- Discretionary periodic bonus, which applies to the remaining employees and is granted on a quarterly basis, based on discretionary assessment of an employee's performance by their superior;
- Discretionary task bonus, paid from a special account placed at the disposal of the PGNiG Management Board and earmarked for discretionary bonuses granted to employees excelling in their work for the Company;
- Discretionary project bonus, for employees who have been involved in the execution of project work; the bonus amount depends on the quality and progress in the execution of specific projects.

Another component of the incentive scheme is a system of retention of PGNiG's key personnel, implemented in 2015. The system is designed to prevent departures of employees whose expertise, experience and access to PGNiG's sensitive information might be exploited by competitors.

Employee benefits

Social benefits

It is with utmost care that PGNiG strives to comply with its duties towards employees and their families, especially those related to social welfare, including organisation and co-financing of holidays in Poland and abroad for employees and their children, financial assistance and material support for families facing financial difficulties and health problems, repayable housing assistance, as well as organisation and co-financing of recreation, sports, cultural and educational activities.

Medical care

PGNiG also provides its employees with preventive medical care, going beyond the scope of occupational medicine. From its own funds, PGNiG also finances preventive treatment of employees in sanatoriums and health resorts if an employee has had an accident at work or their health has been found to deteriorate.

Employee Pension Plan

PGNiG has in place an Employee Pension Plan within the meaning of the Act on Employee Pension Plans of April 20th 2004 (Dz.U. No. 116, item 1207). Every employee who has continuously worked for the Company for at least three months is eligible for the plan.

Employee vouchers

For Easter and Christmas, PGNiG employees receive vouchers with a value determined by the Employer.

Group insurance

PGNiG has negotiated and signed a group life insurance agreement with PZU Życie S.A., covering employees of the PGNiG Group companies and their family members. Participation in the insurance is voluntary and open to all employees, their family members and persons who, having departed from PGNiG, intend to continue the insurance coverage on an individual basis. Thanks to the group nature of the insurance, the Company obtained more favourable terms.

Remuneration policy for members of the governing bodies of subsidiaries

PGNiG has adopted rules of remuneration for members of the governing bodies of subsidiaries.

In line with those rules, PGNiG's direct subsidiaries have been classified into four groups: strategic companies, support companies, other companies and foreign companies. General rules of remuneration have been defined separately for each of those groups.

Key rules and components of remuneration for management board members at subsidiaries are as follows:

- Basis of employment (a managerial contract with a non-compete clause or an employment contract defining the management board member's monthly remuneration) – base pay,
- MBO bonus – annually up to 50% of the total remuneration received in a given financial year (in the case of a managerial contract with a non-compete clause) or an annual bonus (in the case of an employment contract), paid in accordance with the Rules of the Bonus Scheme for Management Board Members at PGNiG Group Companies. At Group companies based abroad, the maximum amount of the MBO bonus is defined in an employment contract.
- Discretionary bonus – annually up to three-fold the fixed monthly remuneration defined in a managerial contract with a non-compete clause. It is not applicable at Group companies based abroad.
- Compensation for non-compete undertaking included in a managerial contract with a non-compete clause − 50% of the fixed remuneration defined under the managerial contract with a non-compete clause and received before the termination of the contract, payable on a monthly basis for 12 months after the termination; to be eligible for such compensation, a management board member has to provide managerial services under a managerial contract for at least three months.

As the Act on Rules of Remunerating Persons Who Manage Certain Companies, dated June 9th 2016, has come into force, the rules of remuneration for management board members at PGNiG Group companies will be amended in 2017.

The average monthly gross remuneration of members of the management and supervisory personnel at subsidiaries was PLN 23.4 thousand in 2016.

Remuneration policy for PGNiG management and supervisory personnel

On November 24th 2016, the General Meeting of PGNiG passed Resolution No. 9/XI/2016 on the rules of remuneration for members of the Management Board of PGNiG.

Pursuant to the resolution, total remuneration of a member of the Management Board consists of a fixed component in the form of a monthly base pay ('Fixed Remuneration') and a variable component representing additional remuneration payable for PGNiG's financial year ('Variable Remuneration').

The General Meeting authorised the Supervisory Board to define the amounts of Fixed Remuneration of Management Board members, subject to the following conditions:

a) Fixed Remuneration of the President of the Management Board will range from 7x to 15x of the average remuneration in the business sector, net of bonuses paid from profit, in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland;

b) Fixed Remuneration of other Management Board members will range from 7x to 15x of the average remuneration in the business sector, net of bonuses paid from profit, in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland.

The General Meeting resolved that Variable Remuneration would depend on the progress in the achievement of Management Objectives and would not exceed 100% of Fixed Remuneration. Detailed Management Objectives are defined by the Supervisory Board.

A Management Board member may not receive remuneration for holding positions on the governing bodies of PGNiG subsidiaries included in its group within the meaning of Art. 4.14 of the Competition and Consumer Protection Act of February 16th 2007.

If PGNiG terminates a Contract for reasons other than a material breach of the Contract, the Management Board member may receive a severance payment of:

a) up to 1x (one time) the Fixed Remuneration, provided that the member has held the position for at least 6 (months) and up to 12 (twelve) months prior to the termination;

b) up to 3x (three times) the Fixed Remuneration, provided that the member has held the position for at least 12 (twelve) months prior to the termination.

In 2016, before the General Meeting of PGNiG passed Resolution No. 9/XI/2016, the remuneration policy for Management Board Members provided for remuneration consisting of a fixed component, in an amount defined under the Supervisory Board's separate resolution, and a variable component in the form of an annual bonus. The annual bonus was of a discretionary nature, granted only if a Management Board Member achieved the objectives specified in their MBO sheets, in an amount depending on the degree to which the objectives were achieved.

On September 9th 2016, the General Meeting of PGNiG passed Resolution No. 9/VIII/2016 on the rules of remuneration for members of the Supervisory Board of PGNiG.

Pursuant to the resolution, the monthly remuneration of Supervisory Board members equals the average monthly remuneration in the business sector (net of bonuses paid from profit) in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland, multiplied by the following factors:

- For the Chairman of the Supervisory Board – 1.7;
- For the Deputy Chairman and Secretary of the Supervisory Board − 1.6;
- For other members of the Supervisory Board − 1.5.

Before the General Meeting of PGNiG passed Resolution No. 9/VIII/2016 concerning the rules of remuneration for members of the Supervisory Board, the remuneration of a Supervisory Board Member was determined in accordance with Art. 8.8 of the Act of March 3rd 2000 on Remunerating Persons Who Manage Certain Legal Entities (consolidated text in Dz.U. of 2015, item 2099). Pursuant to the provisions referred to above, the monthly remuneration of Supervisory Board Members could not exceed the average monthly remuneration in the business sector (net of bonuses paid from profit) in the fourth quarter of the previous year, as announced by the President of the Central Statistics Office of Poland.

In 2016, the average gross monthly remuneration of PGNiG Management Board members was PLN 71.3 thousand.

Remuneration paid to members of management and supervisory bodies of PGNiG

	January 1st–December 31st 2016		
Full name	**Total remuneration, additional benefits and bonuses paid and due in 2016 for holding key positions at PGNiG**	**Total remuneration for holding key positions at subordinates in 2016**	**Total remuneration in 2016**
	(PLN '000)		
Total remuneration of Management Board members, including:	7,163	3,999	11,162
Piotr Woźniak − President [1)]	939	859	1,798
Waldemar Wójcik – Vice President	1,067	498	1,565
Łukasz Kroplewski – Vice President [2)]	750	449	1,199
Maciej Woźniak – Vice President [3)]	781	606	1,387
Radosław Bartosik − Vice President [4]	-	-	-
Michał Pietrzyk – Vice President [4)]	-	0.4	0.4
Violetta Jasińska-Jaśkowiak – Proxy	508	98	607
Persons who were Management Board members in 2016 but not as at Dec 31 2016:			
Janusz Kowalski [5)]	800	697	1,497
Bogusław Marzec [5)]	798	791	1,589
Persons who were Management Board members in 2015 but not as at Dec 31 2015:			
Mariusz Zawisza [6)]	564	-	564
Jarosław Bauc [7)]	481	-	481
Zbigniew Skrzypkiewicz [7)]	475	-	475
Total remuneration of Supervisory Board members, including:	514	-	514
Bartłomiej Nowak [8)]	37	-	-
Wojciech Bieńkowski	61	-	-
Magdalena Zegarska	61	-	-
Sławomir Borowiec	61	-	-
Ryszard Wąsowicz	60	-	-
Mateusz Boznański	59	-	-
Andrzej Gonet	60	-	-
Anna Wellisz [9)]	47	-	-
Piotr Sprzączak [8)]	34	-	-
Grzegorz Nakonieczny [10)]	25	-	-
Krzysztof Rogala [11)]	9	-	-
Total	7,677	3,999	11,676

1) Piotr Woźniak has served as President of the Management Board since February 11th 2016, and served as Member of the Supervisory Board delegated to temporarily perform the duties of President of the Management Board from December 11th 2015 to February 10th 2016,
2) Łukasz Kroplewski has served as Member of the Management Board since February 10th 2016,
3) Maciej Woźniak has served as Member of the Management Board since February 11th 2016, and served as Proxy from December 11th 2015 to February 10th 2016,
4) Management Board Members since December 31st 2016,
5) Persons who served as Members of the Management Board from February 11th to December 30th 2016, and as Proxies from December 11th 2015 to February 10th 2016,

6) Mariusz Zawisza served as President of the Management Board until December 11th 2015,
7) Management Board Members until December 11th 2015,
8) Supervisory Board Members until June 28th 2016,
9) Anna Wellisz has served as Member of the Supervisory Board since April 1st 2016,
10) Grzegorz Nakonieczny served as Member of the Supervisory Board until June 28th 2016,
11) Krzysztof Rogala served as Member of the Supervisory Board until February 25th 2016.

January 1st–December 31st 2015

Full name	Total remuneration, additional benefits and bonuses in 2015	Total remuneration for holding key positions at subordinates in 2015	Total remuneration in 2015
	(PLN '000)		
Total remuneration of Management Board members, including:	7,678	2,906,02	10,583,90
Piotr Woźniak − President [1]	13	43	57
Waldemar Wójcik – Vice President	1,457	492	1,949
Bogusław Marzec – Vice President [2]	11	40	52
Maciej Woźniak – Vice President [2]	11	38	49
Janusz Kowalski – Vice President [2]	11	37	48
Violetta Jasińska-Jaśkowiak – Proxy	494	105	599
Persons who were Management Board members in 2015 but not as at Dec 31 2015:			
Mariusz Zawisza [3]	1,961	891	2,852
Jarosław Bauc [4]	1,645	771	2,415
Zbigniew Skrzypkiewicz[4]	1,645	488	2,134
Persons who were Management Board members in 2014 but not as at Dec 31 2014:			
Jerzy Kurella	429	-	429
Total remuneration of Supervisory Board members, including:	361	-	361
Grzegorz Nakonieczny [10]	9	-	9
Wojciech Bieńkowski [6]	0,5	-	0,5
Magdalena Zegarska	45	-	45
Sławomir Borowiec	45	-	45
Ryszard Wąsowicz	45	-	45
Mateusz Boznański [6]	0,5	-	0,5
Andrzej Gonet [6]	0,5	-	0,5
Krzysztof Rogala [6]	-	-	-
Wojciech Chmielewski [8]	25	-	25
Agnieszka Woś [9]	36	-	36
Andrzej Janiak [5]	45	-	45
Janusz Pilitowski [5]	45	-	45
Piotr Woźniak [11]	1	-	1
Irena Ożóg [7]	32	-	32
Maciej Mazurkiewicz [7]	32	-	32
Total	8,039	2,906	10,945

1) Piotr Woźniak has served as President of the Management Board since February 11th 2016, and served as Member of the Supervisory Board delegated to temporarily perform the duties of President of the Management Board from December 11th 2015 to February 10th 2016,
2) Persons who have served as Members of the Management Board since February 11th 2016, and served as Proxies from December 11th 2015 to February 10th 2016,
3) Mariusz Zawisza served as President of the Management Board until December 11th 2015,
4) Management Board Members until December 11th 2015,
5) Supervisory Board Members until December 29th 2015,
6) Supervisory Board Members since December 29th 2015,
7) Supervisory Board Members from April 16th 2015 to December 29th 2015,
8) Wojciech Chmielewski served as Member of the Supervisory Board until July 22nd 2015,
9) Agnieszka Woś served as Member of the Supervisory Board until October 19th 2015,
10) Grzegorz Nakonieczny served as Member of the Supervisory Board from October 19th 2015,
11) Piotr Woźniak served as Member of the Supervisory Board from December 4th 2015 to December 10th 2015.

11. Initiatives for sustainable development

The CSR activities focused on continued efforts to implement PGNiG's previous Sustainable Development and Social Engagement Strategy, and included work on updating that strategy. Projects were pursued for both the Company's internal and external stakeholders. These included meetings devoted to CSR matters and promotion of responsible business practices in the sector, various workshops for children and employees, as well as community-building initiatives.

Key CSR projects implemented in 2016 included:

- Meeting of representatives of the energy industry's largest players under the name of 'Energy Sector Round Table'. The event was devoted to corporate social responsibility and sustainable development challenges faced by the sector, and was organised to share experience and good practice. The 'Energy Sector Round Table', moderated by the Responsible Business Forum, was attended by Jacqueline Kacprzak, advisor to the Minister of Development, and Beata Wereszczyńska-Dembska, Director of the Strategy and Social Communication Department at URE;
- 'Pogoń for Pogoń' programme, promoting PGNiG in an innovative way as a socially responsible business, which builds and strengthens community relations, fosters patriotic attitudes among youth and popularises sports through education among the youngest children. The project is a joint initiative of PGNiG and the Minister of Energy, Krzysztof Tchórzewski. Under the programme, the Pogoń Siedlce and Pogoń Lwów football clubs and the communities of both cities work together towards educating children and youth in history and sports. Considering PGNiG's business presence in Ukraine, it was only natural for the Company to engage in work towards building social relations there, including stronger ties with the Polish community living in Ukraine. To this end, PGNiG, a sponsor of sports for many years, was trying to find symbols that would embody Poland's remarkable history of physical culture, the cradle of which is Lwów (now Lviv, Ukraine). It was in Lwów that Poland's first official football match was played and where Towarzystwo Gimnastyczne Sokół, a sports association, began to practise skiing, luging, basketball, palant (a Polish game similar to baseball), tennis, fencing, archery, swimming and other disciplines. 'Pogoń for Pogoń' is a project combining education, sports and history, and promoting PGNiG as a socially responsible business that supports local communities;
- Activities under the Ethics Programme Management System, which promotes ethical behaviour at the PGNiG Group and provides a framework for resolving disputes in labour matters. Through communication efforts, the number of ethics officers in PGNiG Group companies has grown and cooperation between them has strengthened. In addition, the management staff were trained in the issues of mobbing and ethics in the workplace.
- Another important project involved updating the CSR Strategy for the PGNiG Group. Work on the revised strategy will be concluded in the first half of 2017.

11.1. Ethics

The ethics programme in place aims to ensure ethical conduct and strengthen PGNiG's corporate culture by identifying behaviours the Company wants to encourage, as well as those that are not tolerated in the organisation. Standards of conduct are laid down in the PGNiG Code of Ethics and in the Code of Best Practice for PGNiG Group Managers.

The PGNiG Code of Ethics consists of the Statement of Values and the Ethical Standards Code. The Statement of Values sets out the moral principles and ethical ideals to foster development of an ethical environment and mutual trust at PGNiG. The Ethical Standards Code spells out specific rules of conduct for PGNiG employees, which are in line with declared corporate values and best industry practices from around the world.

As stipulated in the ethics programme, the presented values and ethical principles must be fully upheld by every PGNiG employee in the course of their professional duties. The Code allows the Group companies to further improve their best practices and ethical standards based on their own judgement, in accordance with the specific nature of their market sectors, conditions in which they operate in various countries, and prior experience.

Promotion of ethical behaviour at PGNiG is a duty of the Ethics Officer, who also monitors compliance with the Code of Ethics by receiving and assessing ethics violation reports, and works with the Ethics Committee and ethics officers of the PGNiG Group companies. Altogether, there are eight ethics officers at the PGNiG Group.

No breaches of ethical conduct rules were reported to the Ethics Officer of PGNiG in 2016.

Two meetings were held in 2016 with the ethics officers of the PGNiG Group companies to discuss, among other things, the issues of mobbing. The material presented at the meetings was later used in training the management staff of the PGNiG Group companies.

(in PLN million, unless stated otherwise)

11.2. Environmental protection

11.2.1. Gas emissions, generation of waste and by-products

CO_2 emissions from installations covered by the 2016 EU ETS for PGNiG*

Installation	National Allocation Plan (KPRU) No.	Emission allowances [Mg]*	Emissions in 2016 [Mg]	balance [Mg]
Mogilno CUGSF	PL- 898-08	5,917	15,477	(9,560)
PGNiG Odolanów Branch	PL-562-05	5,957	10,075	(4,118)
PGNiG Odolanów Branch	PL-950-08	15,092	18,489	(3,397)
Lubiatów Oil and Gas Production Facility	PL-1070-13	42,351	56,207	(13,856)
Wierzchowice UGSF	PL-1072-13	0	6,552	(6,552)
Kosakowo CUGSF	PL-1076-13	0	3,630	(3,630)
PGNiG, Zielona Góra Branch, Dębno Oil and Gas Production Facility	PL-563-05	26,340	29,629	(3,289)
Total		95,657	140,059	**(44,402)**

** Preliminary data*

In 2016, PGNiG TERMIKA emitted:

- 10,764 tonnes of SO_2
- 5,429 tonnes of NO_x
- 628 tones of dust.

The emission volumes were lower than in previous years thanks to a wide-ranging investment programme involving construction and upgrade of flue gas desulfurisation units, construction of NOx reduction units, and modernisation of dust removal units. In 2016, the Siekierki CHP Plant operated a biomass-fired unit (converted from a coal-fired boiler), which contributed to a reduction of pollutant emissions and helped lower CO_2 emissions in 2016, to 5,478,745 tonnes. In 2016, PGNiG TERMIKA discharged 155.9 mcm of spent cooling water and 1.6 mcm of wastewater into surface water.

The volume of ash and slag generated in 2016 was 536 thousand tonnes, including 53 thousand tonnes of ash classified as a by-product. Also, 59 thousand tonnes of gypsum was generated as a by-product from the flue gas desulfurisation units. All this waste and by-products were transferred for recycling (production of cement and building materials, mining, road engineering and land reclamation).

11.2.2. Environmental protection initiatives

Well and extraction pit abandonment

Abandonment of wells and boreholes is performed in accordance with the Geological and Mining Law and applicable secondary legislation. Abandoned wells are permanently marked in the field, in accordance with the Regulation of the Minister of Economy of April 25th 2014 on specific requirements for the operation of mining facilities producing minerals through wells, the Regulation of the Minister of Economy of June 12th 2002 on mining rescue, and with the 'Mine Operations Manager Guidelines on securing, temporary plugging and abandonment of boreholes and wells'.

Environmental protection in drilling operations

Environmental protection initiatives connected with drilling for both conventional and unconventional hydrocarbons are carried out in accordance with the applicable Polish and EU laws, as well as internal good practice documents.

Land reclamation and surveying of non-productive assets

On September 1st 2016, a regulation of the Minister of Environment was adopted concerning the procedure of assessing soil contamination, which necessitated a new approach towards planned remediation of the soil-water environment on non-producing assets where municipal gas production from hard coal in the past caused changes in the environment and local pollution. As part of a remediation plan, priority must be given to tests assessing the state of the environment as well as development of cheaper and more effective methods of removing pollutants. Tests conducted to date may no longer be used to support applications for approval of remediation plans. Tender documentation was drafted for the first two properties: Barlinek and Szprotawa, where *in-situ* bioremediation is planned. The tender procedures are pending. It is expected that the planned biological remediation methods will deliver environmental benefits, considerably reduce costs of bringing the properties into compliance with applicable standards, and will make it possible sell the properties in future without any risk.

Additionally, monitoring was conducted of the soil-water environment of the reclaimed landfill site in Zabrze-Biskupice and a property in Zabrze.

(in PLN million, unless stated otherwise)

Underground gas storage facilities

Environmental protection initiatives carried out in the vicinity of the Kosakowo CUGSF involved continued land and sea monitoring to assess the project's environmental impacts during its construction and operation, as part of two programmes: the environmental monitoring programme of May 2009 and the basic and emergency control programme for the Kosakowo CUGSF of April 2014.

The programmes cover monitoring of underground and surface water, soil, tightness of the storage facility, vertical earth surface movements, the impact of discharged brine on waters of the Puck Bay, as well as the technical condition and proper operation of the installation for discharging brine from leached caverns to the Puck Bay. The surveys and observations conducted so far indicate that the construction and operation of the Kosakowo CUGSF do not have any negative impacts on the environment.

Monitoring activities are also conducted by personnel of the Mogilno CUGSF; detailed analyses of water and soil samples were carried out by an accredited laboratory, tests were performed by the AGH University of Science and Technology in Kraków to monitor the tightness of the Z-8 and Z-11 caverns, and chromatographic analysis of gas from five control wells was carried out by PGNiG, CLBP Branch. The surveys and observations conducted so far indicate that the construction and operation of the Mogilno CUGSF do not have any negative impacts on the environment.

11.3. Employees

Employment at the PGNiG Group by segment

	2016		2015		2014	2013	2012
	PGNiG Group	PGNiG	PGNiG Group	PGNiG	PGNiG Group	PGNiG Group	PGNiG Group
Exploration and Production	7,720	3,714	8,903	3,849	10,221	10,754	10,990
Trade and Storage	3,520	914	3,462	988	3,929	4,070	4,397
Distribution	10,846	-	10,678	-	12,173	13,050	13,255
Generation	1,870	-	1,071	-	1,068	1,066	1,069
Other Activities	1,315	41	1,305	37	1,605	1,990	2,327
TOTAL	25,271	4,669	25,419	4,874	28,996	30,930	32,038

As at December 31st 2016, PGNiG employed 4,669 staff, 205 (or 4%) fewer than as at December 31st 2015. The decrease was primarily attributable to:

- Launch and operation of the Voluntary Redundancy Programme, under which 164 employees terminated their employment; and
- Transfer of 64 field employees of accounting units to PGNiG OD, under Art. 23^1 of the Labour Code.

Other changes in employment numbers were caused by natural turnover.

As at December 31st 2016, the PGNiG Group employed 25,271 staff, 148 fewer than as at December 31st 2015.

In the Exploration and Production segment, a significant drop in employment was recorded. Relative to December 31st 2015, the number of employees fell by 1,183 (or 13%), owing mainly to the following processes:

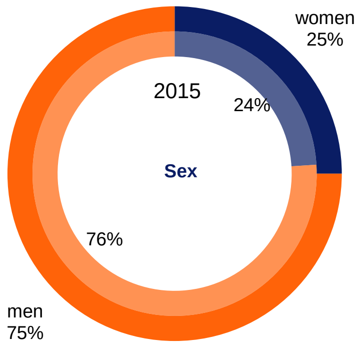
- Employment restructuring at EXALO caused by the company's difficult ecnomic situation, where 800 employees (25%) were made collectively redundant,
- Ongoing liquidation of Geofizyka Kraków, where 219 people (or 26%) were made redundant,
- Voluntary Redundancy Programme launched and implemented by PGNiG to optimise its workforce. Under the programme, 164 employees departed, the majority of them from the hydrocarbon production branches.

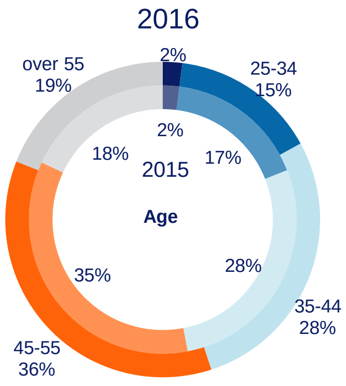
In the Generation Segment, the headcount increased by 799 (or 75%), which was attributable to PEC's and SEJ's inclusion in the PGNiG Group.

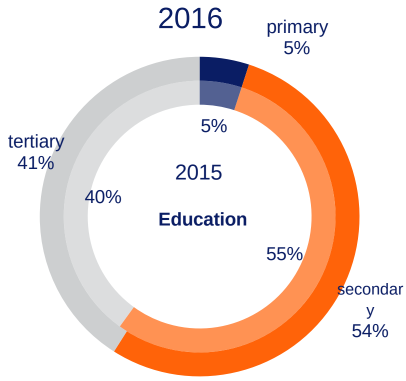
Workforce in the Distribution segment grew by 168 (or 2%) in connection with the structural reorganisation of PSG's business, resulting in a higher number of local gas utilities and service points.

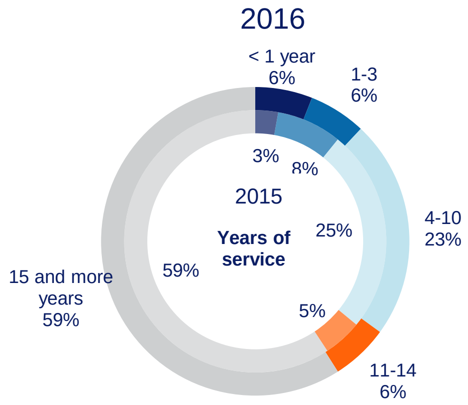
(in PLN million, unless stated otherwise)

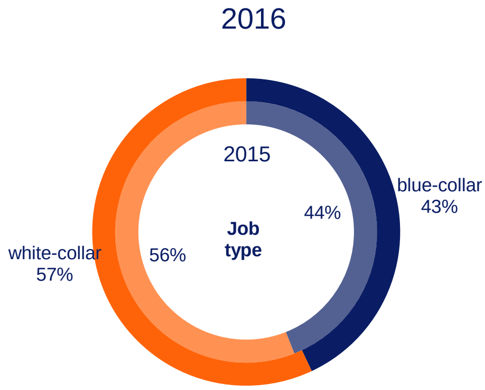
Workforce structure at the PGNiG Group (in persons, as at the end of 2016)











Workforce turnover – new hires/departures (by age and sex)

Age (years)	Number of new hires		Number of departures	
	Women	Men	Women	Men
Up to 24	40	239	12	193
25-34	228	579	145	707
35-44	160	551	194	611
45-55	58	304	133	558
Over 55	13	103	169	638
TOTAL	499	1,776	653	2,707

Parental leaves

In 2016, the rate of return to work at the PGNiG Group was 92.8%.

The rate of return to work for employees who took parental leave is the quotient of:

- Number of staff who maintained their jobs/continued work after return from parental leave in 2016; and
- Number of staff who returned to work after parental leave in 2016.

Parental leave is any leave to which an employee may be entitled after child birth/adoption, including maternal, additional maternal, paternal and childcare leave.

11.3.1. Human resources management

Training and development programmes

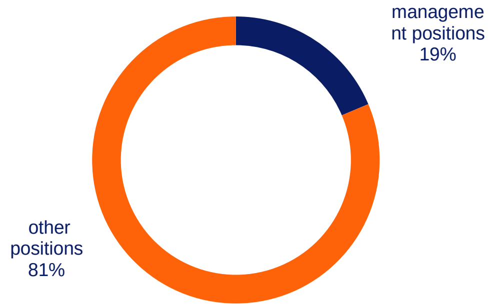
The training management system in place is a vital tool in developing human resources. Our employees are given opportunities to improve their professional qualifications through a range of training programmes, postgraduate studies, trade conferences, seminars and symposia, and also through occupational training.

In June 2016, the Talent Identification System was launched as a first step in the establishment of the Future Leaders Academy. The aim is to identify high-potential employees (talent), who might later be included in the Future Leaders Academy development programme preparing them to perform other (also managerial) functions in the organisation.

Number of training hours per PGNiG employee in 2016: 32.

Number of training hours, by sex

Number of training hours, by type of job



Performance assessment

Twice a year, employees are evaluated based on the Performance Assessment System in place. In the process, particular emphasis is placed on targets assigned to individual employees, which are linked to strategic objectives of the PGNiG Group. It allows employees to discuss the needs and challenges associated with their positions, and is a source of feedback on both their achievements and potential issues in professional development.

In 2016, all PGNiG employees were subject to performance assessment.

In 2016, 85.5% of PGNiG Group employees were subject to performance assessment.

11.3.2. Student internships and work placement programmes

PGNiG offers a number of work placement initiatives and competitions. Its internships are attractive opportunities to gain professional experience, develop new skills and learn more about working in the industry. In 2016, PGNiG had in place the following internships and work education programmes:

GeoTalent

It is a proprietary education and internship programme for students of the AGH University of Science and Technology in Kraków, the Faculty of Geographical and Geological Sciences of the Adam Mickewicz University in Poznań, and the Faculty of Geology of the Warsaw University. It seeks to identify and attract the best students and graduates who want to pursue their professional careers in the oil and gas industry. GeoTalent comprises workshops, competitions for students, the Mentoring Programme, the Ambassadorial Programme, GeoTournament, the Summer Internship Programme, and other similar initiatives. A total of 57 interns completed paid placements with PGNiG from June 2016.

Energy for the Future

'Energy for the Future' is an internship programme run jointly with two other groups under the Ministry of Energy's patronage. It aims to find the most talented students and graduates of faculties relevant to the Polish energy sector. Each participating student will have a chance to gain hands-on experience and skills in the areas of interest. Currently, the number of interns enrolled is 21.

Energy Academy

For several years now, PGNiG has participated in the Energy Academy education project, run by the Lesław Paga Foundation, as a sponsor of paid internships for students planning their professional careers in the energy sector. In 2016, PGNiG signed graduate work placement agreements with three interns of the Foundation.

EU co-financed internship programmes

In 2016, PGNiG first offered paid internships for participants of university internship programmes co-financed from EU aid funds under the Knowledge−Education−Development Operational Programme. In Q3 and Q4 2016, there were six interns enrolled.

Deposits of Career

The 'Deposits of Career' programme offers students and graduates of all faculties (except oil and gas engineering, covered by GeoTalent) an opportunity to gain professional experience. Its participants can complete an internship and take part in educational events to support career building.

Internships are also offered by PGNiG outside the programmes discussed above. In 2016, 382 persons, including 360 students and 22 academics, took advantage of internship and work placement opportunities at PGNiG.

11.3.3. Recruitment

PGNiG's recruitment policy is focused on employing top-class specialists whose expertise and competence, combined with the experience and professionalism of the Company's other staff, will ensure continuity and high standard of business processes. Priority in filling vacancies at the PGNiG Group is given to internal recruitment, to best use the potential of the current employees.

11.3.4. Cooperation with trade unions

There are a number of trade unions active at PGNiG. Considerable importance is attached by the Company to maintaining constructive links with the trade unions, making sure that social dialogue is based on the independence of all parties, legal compliance, as well as trust, willingness to compromise, and adherence to rules.

In 2016, the Company worked with the trade unions on a regular basis, in accordance with the agreements concluded and the labour law. There were 24 meetings between the Company and trade unions over the period, at which participants discussed staff-related matters and individual segments of the PGNiG Group's business, including a revision of the strategy for 2014−2022. As regards changes in remuneration terms, in 2016 the Company, acting pursuant to Art. 44.2 of the Collective Bargaining Agreement, was holding pay negotiations, which however did not end in any agreement with the trade unions. Therefore, the Company made a unilateral decision on remuneration rules in 2016. The new arrangements led to a 4.8% pay increase in 2016, and employee benefits were also paid in the form of pre-paid vouchers. There were no collective redundancies or disputes at PGNiG in 2016. The Company's Bargaining Labour Agreement, dated July 8th 2009, was not terminated or suspended.

11.3.5. Occupational health and safety

Main OHS tasks performed in 2016:

- Determination of the circumstances and causes of work accidents, preparation of a lesson learnt report from that investigation, and monitoring of its implementation,
- Update of the occupational risk assessment for the Geology and Hydrocarbon Production Branch together with the physician providing preventive medical care to employees,
- Development of PGNiG staff's OHS competences through introductory training in OHS, fire safety and first aid procedures,
- Implementation of a procedure for reimbursement of the cost of corrective eyeglasses for PGNiG employees using screen monitors at work,
- Implementation of the decision on rules of providing and settling the cost of meals and drinks for PGNiG employees,
- Participation in and supervision of evacuation drills on the Head Office premises.

(in PLN million, unless stated otherwise)

Accident reporting facilitates analysis of the causes of injuries and diseases arising from accidents at work, helping to work out and adopt preventative measures. As a result, it helps raise the staff's awareness and foster a work safety culture. Below are presented 2015 and 2016 accident statistics for PGNiG and the following companies of the PGNiG Group: GEOFIZYKA Kraków w likwidacji (in liquidation), GEOFIZYKA Toruń, EXALO Drilling, PGNiG TERMIKA, PGNiG Serwis, Geovita, Gas Storage Poland, PGNiG Technologie, PGNiG OD, PSG and Polski Gaz TUW.

Year	Total accidents	Casualties	Group accidents	Serious accidents	Fatalities	Occupational diseases	Days lost/days of absence
2015	225	229	6	1	1	2	11,763
2016	210	214	3	1	0	4	11,278

11.4. Sponsorship and charity

For many years, PGNiG has been involved in a wide range of sponsorship activities, with a major focus placed on sport, culture and education. In November 2004, the Company established the PGNiG Ignacy Łukasiewicz Foundation, of which it is the sole founder and donor.

11.4.1. PGNiG Ignacy Łukasiewicz Foundation

The mission of the Foundation is to conduct public benefit activities, in particular by promoting and supporting culture as an element of the national heritage, including theatrical plays, musical performances and film screenings in Poland and abroad, scientific and technical research, with a focus on particular achievements in the area of fundamental and technical sciences, R&D activities, and protection of historical buildings and monuments, including in particular those relating to the gas industry.

The Foundation is entered in the register of associations, other social and trade organisations, foundations and public healthcare facilities maintained by the District Court for the capital city of Warsaw in Warsaw, 12th Commercial Division of the National Court Register.

In 2016, the Foundation focused on two proprietary programmes − 'To Be Like Ignacy' and 'We Warm up Polish Hearts', and supported a number of initiatives falling within the scope of its mission. It donated funds to the Ignacy Łukasiewicz Museum of Oil and Gas Industry Foundation in Bóbrka, to support the museum's activities.

'To Be Like Ignacy'

The PGNiG Ignacy Łukasiewicz Foundation has long supported initiatives promoting science, education and history. They have resulted in a project to popularise science while commemorating Ignacy Łukasiewicz, a petroleum industry pioneer in Poland and the world. Run together with PGNiG, 'To Be Like Ignacy' is a programme aimed to promote science among primary school children and, at the same time, teach them about the life of Ignacy Łukasiewicz. Its main element is a website featuring an interactive comic strip, educational videos showing scientific experiments, and an adventure game.

As part of the programme, the Foundation holds a competition called 'Ignacy's School of Science', with more than 150 schools from all over Poland having enrolled to win the Ignaś statuettes. The competition seeks to award schools with the most interesting science clubs set up specifically for the purpose of the project. To assist teachers in running such clubs, the Foundation prepared lesson scenarios for 0−3 and 4−6 forms. The programme is run under the honorary patronage of the Speaker of the Sejm and the Ministry of National Education. The official media partner of 'To Be Like Ignacy' is TVP ABC.

'We Warm Up Polish Hearts'

'We Warm Up Polish Hearts' is a motto of the Foundation's and PGNiG's joint project to raise historical awareness of Poles, preserve national identity and commemorate Polish heroes. As part of the programme, the Foundation supports educational and film making projects, initiatives to aid war veterans, and a variety of cultural activities. A particular focus is placed on reviving the memory and history of the so-called cursed or indomitable soldiers, heroes that fell into oblivion for decades. Under the programme, more than 36 projects for almost 2 million recipients have been implemented or supported by the Foundation. They included 10 film productions, six musical projects (two records were released), seven educational projects, and 10 historical awareness projects.

11.4.2. Sponsorship

Sport

PGNiG is strongly committed to sponsoring sport. It provides comprehensive support to one leading professional sport, namely handball. It is worth noting that the growing professionalism of handball games, commitment of players and the dynamic nature of handball have stirred up Poles' interest in the sport. This creates an excellent opportunity to uphold and further strengthen our corporate image as a modern and dynamic company. Together with the Ministry of Sport and Tourism, PGNiG launched a dedicated website, www.klubiks.pl, and published a coursebook on sports marketing for small and medium-size sports clubs. In recognition of the initiatives undertaken in 2016, PGNiG was named the 'Sponsor of the Year' in the 82nd prestigious poll organised by the *Przegląd Sportowy* daily and the Polish Television.

Culture

PGNiG's patronage for the Television Theatre is a fine example of how to tap the potential of economic patriotism by combining culture and business. The three-year long partnership between PGNiG and the Polish Television was the Company's largest and most prominent investment in Polish culture in 2016. In this way, PGNiG confirmed its commitment to shaping and promoting events, projects and phenomena that represent Poland's high culture and popularise national history. One of the key cultural events sponsored by the Company was the Gala Concert in memory of the legendary Polish composer and musician Przemysław Gintrowski.

Beside sponsoring high culture, PGNiG supported a number of patriotic initiatives. Under the 'We Warm Up Polish Hearts' programme run together with the PGNiG Ignacy Łukasiewicz Foundation, the Company co-financed the production of Konrad Łęcki's feature film 'Wyklęty' (The Cursed), to premiere in 2017. PGNiG is also the Main Sponsor of the 8th Film Festival 'Non-humble, Indomitable, Cursed'.

Education

The Company and the PGNiG Foundation carried out the 'To Be Like Ignacy' educational programme for children aged 7−12, who were guided through the world of science by an animated figure of Ignacy Łukasiewicz. As part of the programme, PGNiG participated in Science Festivals, where its interactive stand attracted thousands of young visitors and their parents. 'To Be Like Ignacy' was approved by the Ministry of National Education and TVP ABC television station, which extended their honorary patronage to the project.

11.4.3. Sponsorship activities planned in 2017

Sport

In 2017 PGNiG will continue its strategy adopted in 2016 to focus on handball as the only sponsored sports discipline. This is in line with a regulation of the Ministry of Sport and Tourism recommending that a business should sponsor a single sport of its choice. As a strategic sponsor of Polish handball, PGNiG will partner with Superliga Sp. z o.o. (until 2019) and with the Polish Handball Association (until 2020). Besides typical sponsorship, the Company intends to work on popularising handball among children, teenagers and adults.

Culture

2017 will be another year of PGNiG's three-year contract with the Polish Television to sponsor the Television Theatre, a strategic cultural project for the Company.

Together with the PGNiG Ignacy Łukasiewicz Foundation, the Company will also continue the 'Debt of Gratitude' project under the wider 'We Warm Up Polish Hearts' initiative, to commemorate participants of the 1944 Warsaw Uprising. In 2017, the Company will join in planning the celebration of the 100th anniversary of Poland's regained independence, which will be held in 2018. Additionally, PGNiG intends to support the 9th edition of the 'Non-humble, Indomitable, Cursed' film festival.

Education

The Company and the PGNiG Foundation will further develop their 'To Be Like Ignacy' programme, offering other educational initiatives for children, teenagers and university students in 2017.

PGNiG SA Management Board:

President of the Management Board	Piotr Woźniak	....
Vice President of the Management Board	Radosław Bartosik	....
Vice President of the Management Board	Łukasz Kroplewski	....
Vice President of the Management Board	Michał Pietrzyk	....
Vice President of the Management Board	Maciej Woźniak	....
Vice President of the Management Board	Magdalena Zegarska	....

Warsaw, March 6th 2017

Statement of compliance with corporate governance rules

Pursuant to Par. 91.5.4 of the Regulation of the Minister of Finance on current and periodic information to be published by issuers of securities and the conditions for recognition as equivalent of information whose disclosure is required under the laws of a non-member state (the 'Regulation'), dated February 19th 2009, the Management Board of PGNiG (the 'Issuer' or the 'Company') hereby presents its statement of compliance with corporate governance rules.

The Issuer's objective is to ensure maximum transparency of its activities, appropriate quality of its investor communications and protection of shareholder rights.

1. Corporate governance code applicable to the Issuer and where the text of such code is publicly available

In 2016, PGNiG complied with the set of corporate governance rules laid down in the 'Best Practice for WSE Listed Companies 2016' (the 'Code of Best Practice'), adopted by the WSE Supervisory Board in its Resolution No. 26/1413/2015 of October 13th 2015. The amended text of the code is available on the Warsaw Stock Exchange's corporate governance website at https://www.gpw.pl/dobre_praktyki_spolek_regulacje and in the 'Corporate Governance' section of the Issuer's website at www.pgnig.pl.

The Code of Best Practice was developed by experts representing various groups of capital market participants, who are members of the WSE Corporate Governance Consultative Committee. All changes in the Code of Best Practice were introduced in a way ensuring continuity of coverage of the matters addressed in the previous versions of the Code. To ensure clarity of the document and to emphasise the most important matters, a new thematic division of the Code was introduced. Further, a new scheme of the document, compliant with the European Commission's recommendation, was adopted.

2. Corporate governance standards referred to in Section 1 which were not applied by the Issuer, with a statement of reasons for the non-compliance

In 2016, the Issuer did not comply with four of the rules and two recommendations of the Code of Best Practice:

1. Disclosure Policy and Investor Communications – I.Z.1.15;
2. Management and Supervisory Board – II.Z.3;
3. Management and Supervisory Board – II.Z.2.7;
4. Management and Supervisory Board – II.Z.2.8;
5. General Meeting, Shareholder Relations – IV.R.2;
6. Remuneration − VI.R.4.

Reasons for the non-compliance with these rules and recommendations are presented below.

2.1. Disclosure Policy, Investor Communications – I.Z.1.15

'A company should operate a corporate website and publish on it, in a legible form and in a separate section, in addition to information required under the legislation, information about the company's diversity policy applicable to the company's governing bodies and key managers; the description should cover the following elements of the diversity policy: gender, education, age, professional experience, and specify the goals of the diversity policy and its implementation in the reporting period; where the company has not drafted and implemented a diversity policy, it should publish the explanation of its decision on its website.'

Decisions to select members of the Company's governing bodies are made by the owner, taking into consideration the Ministry of Energy's 'Standards of the owner's supervision at state-owned companies in which rights attached to shares are exercised by the Minister of Energy' and 'Rules and procedure for selecting candidates for members of the supervisory bodies of state-owned companies in which rights attached to the State Treasury's shares are exercised by the Minister of the Energy' - Regulation of the Minister of Energy of August 4th 2016.

The Company believes there is no need to define a diversity policy for its key managers.

2.2. Management and Supervisory Board – II.Z.3

'At least two members of the supervisory board should meet the criteria of being independent referred to in principle II.Z.4.'

In the reporting period, there was only one independent member on the Issuer's Supervisory Board – Mr Mateusz Boznański, appointed on December 29th 2015.

Pursuant to Art. 36.1 of the Issuer's Articles of Association, one of the members of the Supervisory Board appointed by the General Meeting should meet all of the following requirements:

1. He or she must be appointed in accordance with the special procedure set forth in the Articles of Association;
2. He or she may not be a related party or a subsidiary of the Issuer;
3. He or she may not be a related party of the Issuer's parent or of another subsidiary of such parent; and
4. He or she may not have any connections with the Issuer or with any of the entities referred to in items 2 and 3 which could materially affect his or her ability to make impartial decisions as a member of the Supervisory Board.

Given the fact that, in accordance with Art. 12 of the Act on Commercialisation and Privatisation of August 30th 1996 (consolidated text in Dz.U. of 2002, No. 171, item 1397, as amended), some of the Company's Supervisory Board members are elected by employees, the Issuer cannot ensure that there are more independent members on its Supervisory Board. Increasing the number of independent members on the Company's Supervisory Board relative to the number currently set out in the Company's Articles of Association would lead to a situation where the State Treasury (the Issuer's majority shareholder) would be unable to appoint the majority of the Supervisory Board members. This in turn would violate the rule stipulating that a shareholder's influence on a company's business should be proportionate to the share capital held by such shareholder.

2.3. Management and Supervisory Board – II.Z.7

'Annex I to the Commission Recommendation referred to in principle II.Z.4 applies to the tasks and the operation of the committees of the Supervisory Board. Where the functions of the audit committee are performed by the supervisory board, the foregoing should apply accordingly.'

An Audit Committee operates within the Issuer's Supervisory Board as a standing committee, advising the Supervisory Board on matters within the Committee's remit.

Pursuant to the Best Practice for WSE Listed Companies, with respect to the tasks and the operation of its Supervisory Board committees, the Issuer should apply the rules laid down in Annex I to Commission Recommendation of February 15th 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board. In the case of the Audit Committee, the primary purpose of the rules is to ensure that the Audit Committee performs its role correctly.

The Issuer has complied with all the requirements which guarantee the Audit Committee's involvement in the supervision of the Issuer's business. However, the Issuer did not comply with all the detailed requirements for the operation of the Committee. The requirements which the Issuer did not comply with include:

1. the rule laid down in Section 4.3.2 of Annex I, pursuant to which the management should inform the audit committee of the methods used to account for significant and unusual transactions where the accounting treatment may be open to different approaches;
2. the rule laid down in Section 4.3.8 of Annex I, pursuant to which the audit committee should review the process whereby the company complies with the existing regulations regarding the possibility for employees to report alleged significant irregularities in the company, by way of complaints or through anonymous submissions, normally to an independent director, and should ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.

Given the way the Audit Committee currently operates, the Issuer does not consider it necessary to introduce very detailed rules to regulate its operation.

The Issuer will take appropriate steps in the future, if justified by the actual manner of operation of the Audit Committee.

2.4. Management and Supervisory Board – II.Z.8

'The chair of the audit committee should meet the independence criteria referred to in principle II.Z.4.'

In accordance with the Rules of Procedure for the Audit Committee of the PGNiG Supervisory Board, the Audit Committee is composed of at least three Supervisory Board members, of whom at least one is independent from the Company and entities materially related to the Company. The independent member is appointed by the General Meeting under Art. 36.1 of the Articles of Association and is qualified in accounting and finance. Pursuant to Section 3.2 of the Rules of Procedure for the Audit Committee, the Audit Committee elects the Chairperson and Deputy Chairperson from among all of its members. Election of the Chairperson is a discretionary decision of the Audit Committee. The Chairperson may, but does not have to, be a person meeting the independence criteria referred to in principle II.Z.4. Furthermore, the Rules of Procedure do not give the Chairperson of the Audit Committee any additional rights, other than the right to manage the work of the Committee and convene its meetings. In the absence of the Chairperson, these functions are performed by the Deputy.

Currently, no amendments in this respect are planned to be made to the Rules of Procedure for the Audit Committee. In the Company's opinion, the regulations currently in force are sufficient to ensure proper operation of that Committee.

2.5. General Meeting, Shareholder Relations – IV.R.2

'If justified by the structure of shareholders or expectations of shareholders notified to the company, and if the company is in a position to provide the technical infrastructure necessary for a general meeting to proceed efficiently using electronic communication means, the company should enable its shareholders to participate in a general meeting using such means, in particular through:

1st real-life broadcast of general meetings,
2nd real-time bilateral communication where shareholders may take the floor during a general meeting from a location other than the general meeting,
3rd exercise of the right to vote during a general meeting either in person or through a proxy.'

The Company has decided not to comply with Section 2) of the recommendation, as its Articles of Association currently do not provide for shareholders' participation in a General Meeting using electronic communication means. In accordance with the Commercial Companies Code, bringing that recommendation into effect would require a relevant amendment to the Company's Articles of Association.

The Company does not rule out making such amendments in the future. Only after they are made will it be able to comply with the recommendation.

2.6. Remuneration − VI.R.4

'The remuneration levels of members of the management board and the supervisory board and key managers should be sufficient to attract, retain and motivate persons with skills necessary for proper management and supervision of the company. Remuneration should be adequate to the scope of tasks delegated to individuals, taking into account additional functions, for instance on supervisory board committees.'

The Company follows recommendation IV.R.4 on the remuneration levels of the Management Board members and key managers. The recommendation cannot be implemented with respect to members of the Supervisory Board, as their remuneration is regulated by the generally applicable laws, namely the Act on Remunerating Persons Who Manage Certain Legal Entities, dated March 3rd 2000.

3. Basic features of internal control and risk management systems used by the Issuer in the process of preparation of financial statements and consolidated financial statements

The Issuer's internal control system consists of:

1. Group-wide uniform accounting policies on measurement, recognition and disclosure in accordance with the International Financial Reporting Standards, as well as unified templates for separate and consolidated financial statements;
2. Internal control mechanisms, including separation of duties, multi-stage data verification, accuracy reviews of data received, independent checks, etc;
3. Internal operating procedures implemented under Orders of the President of the Management Board;
4. Definition of accounting, financial reporting and tax settlement responsibilities at the Company, in the task book and in relevant rules approved by the Management Board and the Supervisory Board;
5. Definition of rules on supervision of the flow of financial and accounting documents, including review of the documents in terms of form, substance and accounting correctness;
6. Recording of economic events in an integrated finance and accounting system configured in compliance with the accounting policies in place at the Company, containing controls and checks ensuring data consistency and integrity, such as integrity checks, hardware checks, operating checks, and authority checks;
7. An IT system supporting the consolidation process, enabling the Group to streamline the consolidation process at the level of financial and management reporting, and speed up the preparation of consolidated reports;
8. Uniform rules and procedures for consolidating financial data, ensured through the use of unified reports, automatic validations of the consistency and completeness of reported data, as well as two-stage authentication and approval in the data consolidation system;
9. Formalised procedure for the preparation of financial statements (scheduled tasks with individual deadlines and persons responsible);
10. Multi-stage review and authorisation process for financial statements, involving the Supervisory Board;
11. Assessment of current reporting risk by the PGNiG Group's Internal Audit and Control Department and the Security Department;
12. Independent review of financial statements for reliability and accuracy by an independent external auditor;
13. Progressive development of the Group's internal procedures and regulations designed to ensure uniformity of the reporting processes and their continuous improvement.

At the centre of the accounting and financial reporting controls is a fully integrated financial and accounting system. The system checks recorded transactions for correctness, but also identifies which users have entered and approved individual transactions. Access to financial information is restricted by an authorisation system. Access authorisation is granted based on an employee's function and responsibilities, and is subject to stringent controls.

(in PLN million, unless stated otherwise)

An additional level of control was introduced to oversee the Group's financial statements by assigning the preparation of the Issuer's financial statements and the Group's consolidated financial statements to two separate Departments at the Company's Head Office; the financial statements are entered in the integrated IT system with the accounts of other consolidated entities. Data undergoing consolidation is automatically checked for correctness by automatic validation systems and is subject to logical verification procedures carried out by dedicated Group employees.

The PGNiG Group's Accounting Policy ensures compliance of the Issuer's accountancy and financial statements with the relevant regulations, in particular with the International Financial Reporting Standards. The Accounting Policy is regularly updated to ensure its continuing compliance with amended regulations. The most recent update to the Accounting Policy was made in 2016.

To further mitigate the risks associated with financial reporting, financial statements are verified by an independent auditor every three months. The Issuer's auditor selection procedures ensure the auditor's independence in performing its duties (auditors are selected by the Supervisory Board) and high standards of auditing services.

Full-year financial statements are audited, whereas Q1, H1 and Q3 statements are reviewed. The results of both processes are presented by the auditor to the Management Board and to the Supervisory Board's Audit Committee.

In its operations, the Issuer manages its overall financial security using dedicated liquidity, financial risk, budget drafting and control management systems.

The financial reporting process is also reviewed on an ongoing basis through internal audit of individual processes and projects, which consists in reviewing accounting records for specific processes and one-off events in terms of their reliability and completeness, as well as in checking the correctness of the flow of accounting documents. Based on the findings and assessments formulated during operating audits in different areas of accounting, no need to develop a dedicated mechanism for reviewing the preparation process for financial statements has been identified. In particular, there are no reasons to believe that the absence of such a dedicated mechanism poses any threat to the Issuer's business. There is also no reason to believe that this situation is likely to significantly change in the near future. Annual reviews of the internal control and risk management system at the Company level show consistent implementation of recommendations intended to improve the financial reporting components of the system.

Factors mitigating the risks related to financial reporting include constant upgrading of particular modules of the integrated management system and improvement of the practical and specialist skills of employees operating the system.

4. Shareholders directly or indirectly holding significant holdings of shares, with an indication of the number of shares and percentage of the share capital held by such shareholders, and the number of votes and percentage of the total vote that such shares represent at the General Meeting

The Issuer's shares are listed on the Warsaw Stock Exchange, and its share capital is divided into 5,778,314,857 ordinary bearer shares with a par value of PLN 1.00 per share.

In 2016, the State Treasury, represented by the Minister of Energy (Plac Trzech Krzyży 3/5, 00-507 Warsaw), was the only shareholder with a significant holding of Issuer shares (more than 5% of the Issuer's share capital).

Issuer's shareholding structure as at December 31st 2016

	Number of shares	Ownership interest	Number of votes at the Issuer's General Meeting	Percentage of the total vote at the Issuer's General Meeting
State Treasury	4,153,706,157	71.88,%	4,153,706,157	71.88,%
Treasury shares	-	-	-	-
Other shareholders	1,624,608,700	28.12,%	1,624,608,700	28.12,%
Total	5,778,314,857	100.00,%	5,778,314,857	100.00%

The specification given above takes into consideration the EGM's Resolution No. 7/XI/2016 of November 24th 2016 to cancel 121,685,143 treasury shares. The cancellation of treasury shares was registered with the National Court Register on March 2nd 2017.

As at December 31st 2016, 728,293,842 PGNiG shares, representing 12.60% of the share capital and total voting rights at the General Meeting, were distributed among 59,256 of the 61,516 eligible employees.

5. Holders of any securities conferring special control rights, with a description of those rights

Pursuant to the Articles of Association, as long as the State Treasury holds Issuer shares, the State Treasury, represented by the minister competent for matters pertaining to energy, has the right to appoint and remove one member of the Supervisory Board.

Further, pursuant to the Articles of Association, the State Treasury (as a shareholder) approves in writing: (i) any changes to the material provisions of existing trade agreements for natural gas imports to Poland, as well as execution of such agreements, and (ii) the implementation of any strategic investment projects or the Company's involvement in investment projects which, permanently or temporarily, impair the economic efficiency of the Company's business activities, but which are necessary to ensure Poland's energy security.

Irrespective of the amount of the State Treasury's ownership interest in the Issuer's share capital, the State Treasury has the right to demand that the General Meeting be convened and that particular matters be placed on its agenda.

As a shareholder in PGNiG SA, the State Treasury also enjoys other rights under relevant laws and regulations.

6. Restrictions on voting rights, such as limitation of the voting rights of holders of a given percentage or number of votes, time limits on the exercising of voting rights, or provisions under which, with the company's cooperation, equity rights attaching to securities are separated from the holding of the securities

Since December 31st 2012, under PGNiG's Articles of Association, the voting rights of the Company's shareholders have been restricted so that no shareholder (except as specified below) can exercise at a General Meeting more than 10% of the total voting rights existing as at the date of the General Meeting, with the proviso that this restriction is deemed non-existent for the purposes of determining the obligations of buyers of significant holdings of shares.

The voting right restrictions do not apply to shareholders who, as at the date of the General Meeting's resolution imposing the restriction, are holders of shares conferring more than 10% of the total vote at the Company, and shareholders acting together with shareholders holding more than 10% of the total vote, pursuant to agreements concerning joint exercise of voting rights.

For the purposes of restricting the voting rights, the votes of shareholders bound by a parent-subsidiary relationship are aggregated, and if the aggregated number of votes exceeds 10% of the total vote at the Company, it is subject to reduction.

7. Restrictions on the transfer of ownership rights to the Issuer's securities

There are no restrictions on the transfer of ownership rights to the Issuer's securities.

8. Rules governing the appointment and removal of management personnel and such personnel's powers, particularly the power to make decisions on the issuance or buy-back of shares

Pursuant to the Articles of Association, individual members of the Management Board or the entire Management Board are appointed and removed by the Supervisory Board. A member of the Management Board is appointed following a recruitment and selection procedure carried out pursuant to the Regulation of the Polish Council of Ministers of March 18th 2003 concerning recruitment procedures for members of management boards of certain commercial-law companies (Dz.U. No. 55, item 476, as amended). The procedure does not apply to Management Board members elected by employees.

As long as the State Treasury holds Issuer shares and the Issuer's annual average headcount exceeds 500, the Supervisory Board appoints to the Management Board one person elected by the employees, to serve for the Management Board's term of office. A person is considered a candidate to the Management Board elected by the employees if, during the election, 50% of valid votes plus one were cast in favour of that person, with the reservation that the election results are binding on the Supervisory Board if at least 50% of the Company's employees participated in the election.

Management Board members are appointed for a joint term of three years.

A member of the Management Board may resign from his or her position by delivering a notice to that effect to the Company, represented by another Management Board member or commercial proxy, with copies to the Chairman of the Supervisory Board and the minister competent for matters pertaining to energy. The resignation must be submitted in writing, or will otherwise be ineffective towards the Company.

The Management Board member elected by the employees may also be removed upon a written request submitted by at least 15% of the Company's employees. The Supervisory Board orders the voting and its results are binding on the Supervisory Board if at least 50% of the Issuer's employees participate in the ballot, and if the percentage of votes cast in favour of the removal is not lower than the majority required for the election of a member of the Management Board by the employees.

The powers of the Management Board are described in Section 11.1.2 hereof.

Pursuant to the Articles of Association, decisions on the issuance or buy-back of shares are adopted by the Issuer's General Meeting.

9. Rules governing amendments to the Issuer's Articles of Association

Pursuant to the Commercial Companies Code and the Issuer's Articles of Association, amendments to the Articles of Association are introduced by virtue of resolutions adopted by the General Meeting with the required majority of votes, and must be recorded in the business register. Any amendment to the Articles of Association must be submitted by the Management Board to the registry court within three months from the date on which the General Meeting adopted the resolution introducing the amendment.

The consolidated text of the Articles of Association is drawn up by the Management Board and then approved by the Supervisory Board.

10. The operation of the General Meeting, its basic powers and description of shareholders' rights, with the procedure for their exercise, in particular the rules stipulated in the Rules of Procedure for the General Meeting, to the extent not prescribed directly by law

10.1. Description of the operation of the General Meeting

The General Meeting operates in accordance with the provisions of the Commercial Companies Code, the Articles of Association and the Rules of Procedure for the General Meeting. The Rules of Procedure for the General Meeting stipulate, in particular, the rules of conducting meetings and adopting resolutions. The Rules of Procedure for the General Meeting are available on the Issuer's website at www.pgnig.pl.

The General Meeting may be convened as either Annual or Extraordinary, and is held at the Issuer's registered office. The General Meeting may only adopt resolutions on matters included in the detailed agenda, unless the entire share capital is represented at the General Meeting and no one present at the meeting objects to the adoption of a resolution which has not been included on the agenda. The agenda is proposed by the Management Board or by the party convening the General Meeting.

Pursuant to the provisions of the Commercial Companies Code, a shareholder or shareholders representing at least 5% of the share capital may request that certain matters be placed on the agenda of the forthcoming General Meeting. Moreover, the State Treasury, as a Company shareholder, is entitled to submit such a request, irrespective of the percentage of its ownership interest in the share capital. A General Meeting is convened by the Management Board, which in this respect acts:

1. On its own initiative;
2. At the request of a shareholder or shareholders representing at least 5% of the share capital, made in a written or electronic form;
3. At the request of the State Treasury as a Company shareholder, irrespective of the percentage of its ownership interest in the Company's share capital, made in a written or electronic form;
4. At the request of a Supervisory Board member appointed pursuant to Art. 36.1 of the Articles of Association (independent member), made in a written or electronic form,
5. at the written request of the Supervisory Board.

If the Management Board does not convene a General Meeting within two weeks from the date of receiving the relevant request, the registry court may authorise the shareholders to convene an Extraordinary General Meeting.

Shareholders representing at least 50% of the share capital or at least 50% of the total vote may convene an Extraordinary General Meeting.

The Supervisory Board may convene an Annual General Meeting if the Management Board fails to do so within the time limit specified in the Commercial Companies Code or the Articles of Association, or an Extraordinary General Meeting, if the Supervisory Board deems it advisable.

General Meetings are convened by publishing a notice on the Company's website and in any other form prescribed for the purposes of current disclosures under the Act on Public Offering, Conditions Governing the Introduction of Financial Instruments to Organised Trading, and Public Companies.

The notice should be published at least 26 days before the date of the General Meeting.

The Annual General Meeting is convened by the Management Board once a year, no later than within six months following the end of the financial year.

Votes at the General Meeting are cast in an open ballot. A secret ballot is ordered when voting on the election or removal from office of members of the Issuer's governing bodies or on appointment of its liquidator, on bringing members of the Issuer's governing bodies or its liquidator to account, and on personnel matters. Furthermore, a secret ballot is ordered if at least one shareholder present or represented at the General Meeting so demands.

The General Meeting adopts resolutions regardless of the number of shares represented at the meeting, unless the provisions of the Commercial Companies Code or the Articles of Association provide otherwise.

Any shareholder is entitled to object to a resolution of the General Meeting, and in accordance with the Rules of Procedure for the General Meeting, should be given an opportunity to concisely present the reasons for such objection. During the Company's General Meeting, each shareholder may submit draft resolutions concerning items on the agenda.

A General Meeting is opened by the Chairman of the Supervisory Board or the Deputy Chairman of the Supervisory Board, or in the event of their absence, by the President of the Management Board or a person appointed by the Management Board. The person opening the General Meeting should procure that the Chair of the Meeting is immediately elected and should refrain from any decisions on the substance of matters or on procedural issues. The Chair of the General Meeting is elected by secret ballot. The Chair's role is to ensure that the meeting proceeds smoothly and that the rights and interests of all the shareholders are respected. The Chair should not resign from their function without a sound reason, and may not unreasonably delay the signing of the minutes of the General Meeting.

Apart from the shareholders, the following persons are entitled to participate in the General Meeting:

1. Members of the Management Board and Supervisory Board, as well as candidates to the Supervisory Board (if the General Meeting is to deal with the appointment of a member or members of the Supervisory Board). The General Meeting may limit the right of Supervisory Board candidates to speak, to issues related directly to the candidacy;
2. Guests invited by the body convening the General Meeting, as well as experts, including auditors of financial statements and members of the Company's legal support staff, invited to present their opinions on and provide clarification of matters included on the agenda, with the proviso that their right to speak may be limited by the General Meeting to those items on the agenda about which they have been invited;
3. Notaries public drawing up the minutes of the General Meeting.

Short breaks in the meeting (technical breaks), which do not constitute adjournments, may be ordered by the Chair, provided that they are not aimed at hindering the exercise of the shareholders' rights.

10.2. Description of key powers of the General Meeting

The General Meeting is the Issuer's constituent body and has the power to adopt resolutions on the following matters:

1. Review and approval of the financial statements for the preceding financial year and the Directors' Report on the Issuer's operations;
2. Approval of performance of duties by members of the Issuer's governing bodies;
3. Distribution of profit or coverage of loss;
4. Determination of the dividend record date or a decision on payment of dividend in instalments;
5. Appointment and removal of Supervisory Board members;
6. Review and approval of the Group's consolidated financial statements and the Directors' Report on the Group's operations for the preceding financial year;
7. Suspension of members of the Management Board from their duties, or their removal from office;
8. Disposal or lease of the Issuer's business or its organised part, or creation of limited property rights therein;
9. Acquisition of non-current assets, including property, perpetual usufruct rights to property or interest in property, with a value higher than the PLN equivalent of EUR 2,000,000;
10. Disposal of non-current assets, including property, perpetual usufruct rights to property or interest in property, with a value higher than the PLN equivalent of EUR 1,000,000;
11. Contribution to another company of non-current assets, including property, perpetual usufruct rights to property or interest in property, with a value exceeding the PLN equivalent of EUR 1,000,000;
12. Conclusion by the Issuer of a loan, borrowing, surety or similar agreements with or for the benefit of a member of the Management or Supervisory Board, a commercial proxy or a liquidator;
13. Increase or reduction of the Issuer's share capital;
14. Issue of convertible bonds or bonds with pre-emptive rights, issue of subscription warrants;
15. Acquisition of the Issuer's own shares for the purpose of offering them to the Issuer's employees or to persons who were employed by the Issuer or its related entities for at least three years;
16. Mandatory buy-back of shares;
17. Creation, use and liquidation of capital reserves;
18. Use of statutory reserve funds;
19. Decisions on claims for redress of any damage caused in connection with the Issuer's formation or the exercise of management or supervisory duties;
20. Merger, transformation or demerger of the Issuer;
21. Relocation of the Issuer's registered office abroad;
22. Establishment of preference on shares;
23. Establishment of an European company (societas Europaea), transformation into or joining such company;
24. Amendments to the Issuer's Articles of Association and changes in its business profile;
25. Dissolution and liquidation of the Issuer;
26. Definition of the rules of remuneration for Supervisory Board members.
27. Subscription, acquisition or disposal of shares in companies of the PGNiG Group which operate, pursuant to generally applicable laws, as a distribution system operator or storage system operator, including definition of the terms and procedures for the disposal;
28. Formation of a company, or acquisition of or subscription for shares in a company other than the company referred to in item 27 above, except if:

    a) Made in exchange for the Company's claims as part of settlement or arrangement proceedings;

b) Made with a view to implementing the strategy approved in accordance with Article 33.1.6a and related to a company whose business consists in:

- Production or generation of fuels or energy, or
- Trading in fuels or energy, or
- Transmission, distribution or transport of fuels or energy, or
- Construction of buildings and structures used for the production, generation, transmission, distribution or transport of fuels or energy, or
- Production or supply of steam, hot water or air for air-conditioning systems, or

c) Related to a company in which the Company holds at least a 50% interest; or

d) Related to acquisition of or subscription for shares in other companies which have not yet commenced operations; or

e) Made with a view to implementing the strategy approved in accordance with Article 33.1.6a and related to the acquisition of or subscription for shares in a company that owns, as part of a holding company structure, shares in the companies referred to in b); or

f) Made in the primary or secondary trading of securities on the public market;

29. Disposal of shares in a company other than the company referred to in item 27 above, including definition of the terms and procedure for the disposal, except for:

a) Disposal of shares traded on the public market;

b) Disposal of shares held by the Company if the holding does not exceed 10% of the share capital of a given company;

c) Disposal of shares acquired in exchange for the Company's claims as part of settlement or arrangement proceedings.

10.3. Shareholders' rights at General Meetings and their exercise

Shareholders have the right to participate in General Meetings and to exercise the voting rights attached to their shares.

Each shareholder of the Issuer has the right to participate in General Meetings, with one share conferring the right to one vote.

Only persons who have been the Issuer's shareholders for at least 16 days prior to the date of the General Meeting (the record date for participation in the General Meeting) are entitled to participate in the General Meeting. The record date for participation in the General Meeting is the same for the holders of rights under bearer shares and under registered shares.

Holders of rights under registered shares or provisional certificates as well as pledgees and usufructuaries holding voting rights are entitled to participate in the General Meeting, provided that they are entered in the share register on the record date for participation in the General Meeting.

Bearer shares in certificated form entitle their holders to participate in the General Meeting if the share certificates are submitted with the Company no later than on the record date for participation in the General Meeting and are not collected prior to the end of that day. In place of their shares, a shareholder may submit a document confirming that their shares have been deposited with a notary public, bank or investment firm having its registered office or a branch in the European Union, or in a state which is a party to the treaty on the European Economic Area, as indicated in the notice of the General Meeting. The document should specify the serial numbers of the share certificates and should state that the share certificates will not be released prior to the end of the record date for participation in the General Meeting.

The list of entities entitled to participate in the General Meeting as holders of rights under bearer shares is determined based on the shares submitted with the Company and on a list prepared by Krajowy Depozyt Papierów Wartościowych S.A. (Central Securities Depository of Poland), in accordance with the provisions of the Act on Trading in Financial Instruments.

Shareholders may participate in the General Meetings and exercise their voting rights in person, through a representative or through a proxy. Powers of proxy should be granted in a written or electronic form. A written or electronic document confirming the right to represent a shareholder at the General Meeting is deemed legally valid and needs no other confirmation, unless the Management Board or the Chair of the General Meeting has doubts, prima facie, about its authenticity or validity.

Shareholder(s) representing at least 5% of the Issuer's share capital, as well as the State Treasury (irrespective of the percentage of its ownership interest in the Issuer), may demand that the General Meeting be convened, provided that they submit the request in a written or electronic form. If the Management Board fails to convene a General Meeting at the request of the shareholder(s) within two weeks from the date the request was submitted, the registry court may, after demanding a relevant statement from the Management Board, authorise the shareholder(s) to convene the meeting. Additionally, shareholders representing at least 5% of the Issuer's share capital may request that certain matters be placed on the agenda of the forthcoming General Meeting. The same right is held by the State Treasury, irrespective of the percentage of its ownership interest in the Issuer. Any such request must be made in the Polish language and sent to the Issuer in a written or electronic form. The request should contain the grounds for, or draft resolutions of, the proposed agenda items, and should be submitted to the Management Board no later than 21 days before the scheduled date of the General Meeting. A shareholder or shareholders representing at least 5% of the Issuer's share capital may, before a General Meeting, submit to the Company, in a written or electronic form, draft resolutions on items which have been, or are to be, placed on the agenda of the General Meeting. Any item included on the agenda of the General Meeting may, at the request of the shareholder(s), be removed or abandoned only if a relevant resolution is passed by a majority of three quarters of votes and if all the shareholders that made the request and attend the meeting consent to such removal or abandonment.

The Company's Articles of Association do not provide for the possibility of participating in the General Meeting by means of electronic communication (including speaking at the General Meeting by means of electronic communication), or of exercising voting rights by postal ballot or by means of electronic communication.

At the request of shareholders representing at least 20% of the share capital, the Supervisory Board is elected by way of block voting. Shareholders at the General Meeting representing that portion of the shares resulting from division of the total number of represented shares by the number of Supervisory Board members, may form a block to elect one member of the Supervisory Board, but do not then participate in the elections of other members. Shareholders that belong to a block may exercise their voting rights exclusively within the block, which means that the shares held by them cannot be divided. The number of Supervisory Board members that may be elected within a block is determined by dividing the number of shares represented by the block by the minimum number of shares necessary to form a block. If a position on the Supervisory Board that should be filled by an appropriate block remains vacant, it is filled by the vote of all shareholders not participating in the block voting.

At the General Meeting, the Management Board is required to provide shareholders – at their request – with information on the Issuer, if such information is needed to assess an item on the Meeting's agenda. The Management Board may refuse to provide information if this could adversely affect the Issuer, its affiliate, or its subsidiary company or cooperative, especially through disclosure of any technical, trade or organisational secrets.

A Management Board member may refuse to provide information if this could lead to their criminal, civil or administrative liability.

In justified cases, the Management Board may provide information in writing within two weeks of being requested to do so at the General Meeting.

An answer is deemed to have been given if the relevant information is available on the Issuer's website in the section dedicated to shareholders' questions and answers to the questions.

Information on the Issuer may also be provided outside the General Meeting. Such information, along with indication of when and to whom it was provided, should be disclosed by the Management Board in writing in the materials to be presented at the next General Meeting. These materials need not include information which has been made publicly available, including by way of current reports issued pursuant to Par. 38.1.12 of the Regulation, or provided at the General Meeting.

A shareholder may require that a list of shareholders be sent to him/her free of charge by email, may inspect the book of minutes or demand to be given copies of the resolutions of the General Meetings certified as true copies by the Management Board.

Moreover, a shareholder may request to be provided with certified copies of proposals to the items included on the agenda one week before a General Meeting. Copies of the Directors' Report on the Company's operations and of the financial statements, along with copies of the Supervisory Board's report and the auditor's opinion, are provided to the shareholders at their request, not later than fifteen days before the Annual General Meeting.

At General Meetings, attending shareholders may propose procedural motions, including motions to change the sequence of items on the agenda, or to order a break. Each shareholder may also request that a matter be voted on by way of secret ballot.

The Issuer has its own website, where the following information is made available from the date of the convening of a General Meeting:

1. Notice of the General Meeting;
2. Information on the total number of Company shares and the number of votes attached to such shares as at the notice date, and on types of shares and the number of votes attached to the shares of each type (if such variety exists);
3. Documents to be presented to the General Meeting;
4. Draft resolutions or – if no resolutions are planned to be adopted – comments by the PGNiG Management or Supervisory Board on matters which have been placed on the agenda or are to be placed on the agenda prior to the General Meeting.

11. Composition and activities of the Issuer's management, supervisory and administrative bodies or their committees; changes in their composition during the last financial year

11.1. Activities of management bodies – Management Board

11.1.1. Composition of the Management Board

As at January 1st 2016, the Issuer's Management Board was composed of:

1. Mr Piotr Woźniak – acting President of the Management Board,
2. Mr Waldemar Wójcik – Vice President of the Management Board.

As at January 1st 2016, the Company's Commercial Proxies were:

1. Ms Violetta Jasińska-Jaśkowiak,
2. Mr Janusz Kowalski,
3. Mr Bogusław Marzec,
4. Mr Maciej Woźniak.

Ms Violetta Jasińska-Jaśkowiak was the Company's Commercial Proxy throughout 2016.

Mr Janusz Kowalski, Mr Bogusław Marzec and Mr Maciej Woźniak terminated their appointments as Commercial Proxies as of February 10th 2016.

At its meeting on February 10th 2016, the PGNiG Supervisory Board appointed the following persons to the PGNiG Management Board, as of February 11th 2016, for a joint term of office ending December 30th 2016:

1. Mr Piotr Woźniak – President of the Management Board,
2. Mr Janusz Kowalski – Vice President of the Management Board, Corporate Affairs,
3. Mr Łukasz Kroplewski – Vice President of the Management Board, Development,
4. Mr Bogusław Marzec – Vice President of the Management Board, Finance,
5. Mr Maciej Woźniak – Vice President of the Management Board, Trade.

Mr Waldemar Wójcik, elected by Company employees on April 3rd 2014, continued to serve as Vice President of the Management Board, so the Management Board consisted of six persons.

On November 14th 2016, Mr Janusz Kowalski, Vice President of the Management Board, Chief Operating Officer, decided not to stand for re-appointment to the Management Board of PGNiG.

On December 13th 2016, Mr Bogusław Marzec, Vice President of the Management Board, Finance, decided not to stand for re-appointment to the Management Board of PGNiG.

At its meeting on December 19th 2016, the PGNiG Supervisory Board appointed to serve for the joint three-year term of office beginning December 31st 2016 a new PGNiG Management Board composed of:

1. Mr Piotr Woźniak – President of the Management Board,
2. Mr Radosław Bartosik − Vice President of the Management Board, Chief Operating Officer,
3. Mr Łukasz Kroplewski – Vice President of the Management Board, Development,
4. Mr Michał Pietrzyk – Vice President of the Management Board, Finance,
5. Mr Maciej Woźniak – Vice President of the Management Board, Trade.

As at December 31st 2016, the Issuer's Management Board was composed of:

1. Mr Piotr Woźniak − President of the Management Board,
2. Mr Radosław Bartosik − Vice President of the Management Board, Chief Operating Officer,
3. Mr Łukasz Kroplewski – Vice President of the Management Board, Development,
4. Mr Michał Pietrzyk – Vice President of the Management Board, Finance,
5. Mr Maciej Woźniak – Vice President of the Management Board, Trade,
6. Mr Waldemar Wójcik – Vice President of the Management Board.

At its meeting held on March 6th 2017, the PGNiG Supervisory Board removed Mr Waldemar Wójcik from the Management Board and appointed Ms Magdalena Zegarska to the Management Board as a member elected by PGNiG employees.

11.1.2. Rules governing the operation of the Management Board

The operation of the Management Board is defined in its Rules of Procedure, adopted by the Management Board and approved by the Supervisory Board.

The Rules of Procedure for the Management Board are available on the Issuer's website at www.pgnig.pl, in the 'Corporate Governance' section.

The Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board, being the body authorised to appoint individual Management Board members, or the entire Management Board. Management Board members are appointed for a joint term of three years. As long as the State Treasury holds Issuer shares and the Issuer's annual average headcount exceeds 500, the Supervisory Board appoints as a Management Board member one person elected by the employees, to serve for the Management Board's term of office.

The Management Board manages the affairs of the Issuer and represents the Issuer in and out of court. The powers and responsibilities of the Management Board involve management of all of the Issuer's affairs, other than those which the law or the Issuer's Articles of Association reserve for the General Meeting or the Supervisory Board. The Management Board is headed by the President of the Management Board.

The responsibilities of the Management Board particularly include:

1. Preparation of annual business plans, including investment plans, the strategy for the Company and the PGNiG Group, as well as long-term strategic plans, and their submission to the Supervisory Board for approval;
2. Submission to the minister competent for matters pertaining to energy, upon its request, of detailed reports on projects undertaken with a view to ensuring the country's energy security;
3. Submission to the minister competent for matters pertaining to energy, within two months from the closing of the General Meeting approving the financial statements and the Directors' Reports of the Company's subsidiaries and related companies, of annual reports on the matters listed below, with an assessment of their content in the context of Poland's energy security:

   a) Implementation of strategic investment projects or involvement in investment projects resulting in lasting or temporary deterioration of the economic efficiency of that subsidiary's or related company's operations, but necessary to ensure Poland's energy security,

   b) Entry by the operator or owner of a distribution system or an interconnection gas pipeline into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

   c) Entry by the operator or owner of a storage facility into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

   d) Entry by the owner of a generation unit or a cogeneration unit into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

   e) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Polish Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,

   - with the proviso that items a) to e) above do not apply to information on credit agreements or maintenance services, including overhauls, geophysical, drilling and well services and projects, nor to services or deliveries under such agreements or projects.

   - item e) does not apply to information on the activities of a foreign subsidiary's contracts and agreements concluded as part of the day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses.

4. Submission of relevant information to the minister competent for matters pertaining to energy, within 21 days from the closing of the General Meeting of a subsidiary or related company which addressed the following matters:

   a) Implementation of strategic investment projects or involvement in investment projects resulting in lasting or temporary deterioration of the economic efficiency of that subsidiary's or related company's operations, but necessary to ensure Poland's energy security,

   b) Entry by the operator or owner of a distribution system or an interconnection gas pipeline into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

   c) Entry by the operator or owner of a storage facility into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

d) Entry by the owner of a generation unit or a cogeneration unit into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

e) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Polish Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,

f) Approval of annual budgets, with detailed information on resolutions adopted by the General Meeting of the subsidiary or related company on the matters specified in items a) to f), with an assessment of their implications for the country's energy security,

- the above does not apply to information on credit agreements and maintenance services, including overhauls, geophysical, drilling and well services and projects, as well as services or deliveries under such agreements or projects.

- item e) does not apply to information on the activities of a foreign subsidiary's contracts and agreements concluded as part of the day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses.

5. Preparation of economic and financial reviews of the Company and its subsidiaries acting as distribution or storage system operators, in the form defined by the minister competent for matters pertaining to energy, and their submission to the minister by the end of the month in which a periodic report was published at the Warsaw Stock Exchange.

The Management Board submits to the Supervisory Board the following documents for assessment: financial statements for the preceding financial year, with the auditor's opinion; the Directors' Report on the Issuer's operations in the preceding financial year, and a proposal for distribution of profit or coverage of loss for that financial year. These documents should be submitted without the Management Board being called upon to do so, and with sufficient time for the Supervisory Board to assess them before they are presented to the General Meeting.

Declarations of intent may be made on behalf of the Issuer by two Management Board members acting jointly, or one Management Board member acting jointly with a commercial proxy. Any matters which fall beyond the scope of the day-to-day management of the Issuer's affairs require adoption of a resolution.

In particular, the Management Board adopts resolutions on the following matters:

1. Adoption of the Management Board's rules of procedure;
2. Adoption of organisational rules for the Issuer's business;
3. Establishment and closure of branches;
4. Appointment of commercial proxies;
5. Division of powers between the Management Board members, provided that a relevant resolution of the Management Board must be approved by the Supervisory Board;
6. Appointment and removal from office of members of the governing bodies of the company's subsidiaries or related companies, to the permitted extent of the company's powers;
7. Contracting and extending loans and contracting credit facilities, except where the Articles of Association require the Supervisory Board's approval of or opinion on the transaction;
8. Adoption of annual business plans, including investment plans, subject to the approval of the Supervisory Board;
9. Adoption of the strategy for the Company and the PGNiG Group and long-term strategic plans, subject to the approval of the Supervisory Board;
10. Assumption of contingent liabilities, including extension by the Issuer of guarantees and sureties, as well as issuance of promissory notes, except where the Articles of Association require the Supervisory Board's approval or opinion;
11. Acquisition or disposal of non-current assets, including property, perpetual usufruct rights or interests in property, with a value equal to or higher than the PLN equivalent of EUR 50,000, except where the Articles of Association require the Supervisory Board's approval or a resolution of the General Meeting;
12. Matters to be considered by the Supervisory Board or the General Meeting upon the Management Board's request;
13. Adoption of detailed reports on the performance of tasks undertaken with a view to ensuring the country's energy security, which are submitted, upon each request, to the minister competent for matters pertaining to energy;
14. Formation of another company, subscription for, acquisition or disposal of shares in another company, including definition of the terms and procedures for their disposal, with a value not exceeding the PLN equivalent of EUR 2,000,000, provided that such transaction does not require approval by the General Meeting;
15. Donations, release of debtors from their debt obligations and entry into other agreements beyond the scope of business defined in the Issuer's Articles of Association;
16. Execution of sale or purchase transactions and contracts or other disposal agreements, as well as the making of declarations of intent and assumption of liabilities in respect of: gas fuels (including LNG and LNG regasification), crude oil, natural gasoline, other oil and gas derivatives, electricity, heat, emission allowances for greenhouse gases or other

substances; property rights under certificates of origin for electricity, hard coal, lignite, biomass, ancillary control services, other derivative rights based on gas fuels or electricity; other financial instruments and commodities, provision of transmission capacities for electricity, performance of balancing and dispatching services or provision of transmission capacities for gas fuels with a value exceeding 20% of the Issuer's share capital (however, in the case of contracts with a value exceeding the PLN equivalent of EUR 100,000,000, an opinion of the Supervisory Board is required, except where the Articles of Association specifically require the Supervisory Board's approval);

17. Entry into legal transactions other than those listed in items 1 to 16, if their value exceeds the PLN equivalent of EUR 400,000.

In those matters which do not require adoption of a Management Board resolution, each Management Board member attends to the responsibilities assigned to them on an individual basis. During Management Board meetings, each Management Board member has the duty to brief the other Management Board members on their material decisions and the results of their supervisory work, in particular with respect to the Issuer's business units, in accordance with the division of powers between the Management Board members.

Management Board meetings are held as needed. Each Management Board member may submit a request to the President of the Management Board (or acting President) to call a Management Board meeting in connection with matters requiring an urgent decision by the Management Board or for the purpose of presenting information on matters of significance to the Issuer. The Chairman of the Supervisory Board is also entitled to request that a Management Board meeting be called, by providing the President of the Management Board with a written agenda for the meeting. In addition, the Chairman of the Supervisory Board has the right to demand of the President of the Management Board that certain items be placed on the agenda of a Management Board meeting.

In accordance with the Articles of Association of PGNiG, in justified cases votes may be cast by written ballot or by means of remote communication, with the minutes of such voting to be approved at the next meeting of the Management Board.

The Supervisory Board defines the rules and amounts of remuneration for Management Board members, unless applicable mandatory provisions of law state otherwise.

Management Board meetings and resolutions

In 2016, the Management Board held 63 meetings and passed 733 resolutions, of which 8 were passed by circulation (outside of a meeting) under Art. 21.6 of PGNiG's Articles of Association and Section 4.10 of the Rules of Procedure for the PGNiG Management Board. A recess was ordered during 25 meetings of the Management Board.

In 2016, the General Meeting did not assign any tasks be performed at the Company.

Recommendations issued in 2016 by the Minister of Energy included:

1. Selection by the Supervisory Board of a bid for audit of the Company's financial statements after carrying out a procedure ensuring unbiased and independent selection, based on the Ministry of Energy's criteria.

   As the auditor of financial statements in 2016−2018 was selected by the Company's Supervisory Board in 2015, at present there is no need to carry out a procedure to select such entity.

2. Taking effective measures by the Company's Supervisory Board to ensure that, by the end of June 2017, members of the supervisory bodies of the Group companies have the same qualifications as are required of candidates for supervisory boards of state-owned companies.

   The Supervisory Board, with the support of the Management Board, has taken the necessary steps to ensure that the qualifications of members of the supervisory bodies of the Group companies meet the requirements of the Minister of Energy's recommendations.

3. Ensuring by the Supervisory Board that rules governing remuneration for members of the Management Board and Supervisory Board are adopted at the Company in accordance with the Act on Rules of Remunerating Persons Who Manage Certain Companies, of June 9th 2016, and in accordance with the rules governing remuneration for members of the Management Boards and Supervisory Boards of companies in which rights attached to shares are exercised by the Minister of Energy, approved by the Minister of Energy on October 14th 2016.

   On September 9th 2016, the General Meeting of PGNiG passed Resolution No. 9/VIII/2016 on rules governing remuneration for the PGNiG Supervisory Board members, and on November 24th 2016 it passed Resolution No. 9/XI/2016 on rules governing remuneration for the PGNiG Management Board members, thereby ensuring compliance of the rules governing remuneration for members of management and supervisory bodies with applicable laws and the Minister of Energy's guidelines.

4. Meeting by the Company of the Minister of Energy's expectations with respect to the manner of exercise of the owner's supervision at state-owned companies in which rights attached to shares are exercised by the Minister of Energy, in line with the standards of the owner's supervision at state-owned companies in which rights attached to shares are exercised by the Minister of Energy, approved by the Minister of Energy on October 14th 2016.

The Company, taking into account its status as a public company and role in Poland's energy security system, has taken the necessary steps to meet the Minister of Energy's expectations with respect to the manner of exercise of the owner's supervision at state-owned companies in which rights attached to shares are exercised by the Minister of Energy.

11.2. Activities of supervisory bodies – Supervisory Board

11.2.1. Composition of the Supervisory Board

As at January 1st 2016, the PGNiG Supervisory Board was composed of:

1. Mr Grzegorz Nakonieczny – Chairman,
2. Mr Wojciech Bieńkowski – Deputy Chairman,
3. Ms Magdalena Zegarska – Secretary,
4. Mr Sławomir Borowiec – Member,
5. Mr Ryszard Wąsowicz – Member,
6. Mr Mateusz Boznański – Member,
7. Mr Andrzej Gonet – Member,
8. Mr Krzysztof Rogala – Member.

The Management Board and the Supervisory Board accepted Mr Piotr Woźniak's resignation from the position of member of the Supervisory Board as of February 10th 2016.

On February 25th 2016, Mr Krzysztof Rogala resigned from the position of member of the Supervisory Board as of February 25th 2016, without giving reasons for his resignation.

The State Treasury, PGNiG SA's shareholder, acting pursuant to Art. 35.1 of the Company's Articles of Association, appointed Ms Anna Wellisz to the PGNiG Supervisory Board with effect as of April 1st 2016.

At its meeting held on June 28th 2016, the Annual General Meeting of PGNiG made the following changes in the composition of the PGNiG Supervisory Board:

- Mr Grzegorz Nakonieczny was removed from the Supervisory Board,

- Messrs Bartłomiej Nowak and Piotr Sprzączak were appointed to the Supervisory Board.

On December 6th 2016, Ms Magdalena Zegarska, Secretary of the Supervisory Board, decided not to stand for re-appointment to the Company's Supervisory Board.

As at December 31st 2016, the Supervisory Board consisted of eight members:

1. Mr Bartłomiej Nowak – Chairman,
2. Mr Wojciech Bieńkowski – Deputy Chairman,
3. Ms Magdalena Zegarska – Secretary,
4. Mr Sławomir Borowiec – Member,
5. Mr Ryszard Wąsowicz – Member,
6. Mr Mateusz Boznański – Member,
7. Mr Andrzej Gonet – Member,
8. Ms Anna Wellisz − Member,
9. Mr Piotr Sprzączak − Member.

The Supervisory Board's term of office expires on May 15th 2017.

In addition, the following persons were elected by PGNiG employees as their candidates to be appointed as Supervisory Board members:

1. Mr Sławomir Borowiec,
2. Mr Mieczysław Kawecki,
3. Mr Stanisław Sieradzki.

As at the issue date of this Report, the General Meeting of PGNiG passed no resolution to appoint these candidates to the Company's Supervisory Board.

On March 3rd 2017, Ms Magdalena Zegarska, Secretary of the Supervisory Board, resigned from her post of Supervisory Board Member, with effect as of March 5th 2017, having been elected as the PGNiG employees' candidate for appointment to the PGNiG Management Board.

On March 6th, the Supervisory Board appointed a new Secretary from among its members – Mr Sławomir Borowiec.

11.2.2. Rules governing the operation of the Supervisory Board

The Supervisory Board operates in accordance with the rules set out in the Commercial Companies Code, the Articles of Association and the Rules of Procedure for the Supervisory Board. The Rules of Procedure for the Supervisory Board have been adopted by a Supervisory Board resolution and are available on the Issuer's website at www.pgnig.pl in the 'Corporate Governance' section.

The Issuer's Supervisory Board is composed of five to nine members appointed by the General Meeting. One Supervisory Board member should meet the independence criteria specified in the Articles of Association. As long as the State Treasury holds Company shares, the State Treasury, represented by the minister competent for matters pertaining to energy, has the right to appoint and remove one member of the Supervisory Board. If the Supervisory Board is composed of up to six members, two members are appointed from among the candidates elected by the Issuer's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among the candidates elected by the Issuer's employees.

Supervisory Board members are appointed for a joint term of office lasting three years.

The Supervisory Board exercises ongoing supervision of the Issuer's activities in all areas of its operations, and presents its opinions on all matters submitted by the Management Board for consideration to the General Meeting. The powers and responsibilities of the Supervisory Board particularly include:

1. Assessment of the Directors' Report on the Issuer's operations and of the financial statements for the preceding financial year, in terms of their consistency with the accounting books, supporting documentation, and the actual state of affairs;
2. Assessment of the Management Board's proposals concerning distribution of profit or coverage of loss;
3. Submission to the General Meeting of written reports on results of the activities referred to in items 1 and 2;
4. Assessment of the consolidated financial statements with respect to their consistency with the accounting books, supporting documentation, and the actual state of affairs, as well as assessment of the Directors' Report on the Issuer's operations, and reporting to the General Meeting on the results of these assessments;
5. Appointment of an auditor to audit the financial statements;
6. Approval of annual business plans, including investment plans;
7. Approval of the strategy for the Company and the PGNiG Group and long-term strategic plans;
8. Adoption of detailed rules governing the Supervisory Board's operation;
9. Approval of the consolidated text of the Articles of Association, drawn up by the Issuer's Management Board;
10. Approval of the Rules of Procedure for the Management Board;
11. Approval of the organisational rules for the Issuer's business;
12. Approval of the Management Board's resolution on division of powers between the Management Board members;
13. Issue of opinions on all matters submitted by the Management Board for consideration to the General Meeting;
14. Issue of opinions on detailed reports concerning the performance of tasks undertaken with a view to ensuring the country's energy security, submitted by the Management Board to the minister competent for matters pertaining energy;
15. Issue of opinions on requests to be submitted to the shareholder State Treasury, represented by the minister competent for matters pertaining to energy, to approve: 1) any changes to the material provisions of existing trade agreements for import of natural gas to Poland, as well as the execution of new trade agreements, 2) any strategic investment projects or the Company's involvement in investment projects which, permanently or temporarily, impair the economic efficiency of the Company's business activities, but which are necessary to ensure Poland's energy security;
16. Granting of approval to the Management Board for:

    a) Acquisition of non-current assets with a value falling between the PLN equivalent of EUR 500,000 and EUR 2,000,000, except where the transaction has been provided for in any annual business plans, including investment plans, long-term strategic plans and investment plans for development of the transmission system, previously approved by the Supervisory Board;

    b) Disposal of non-current assets with a value falling between the PLN equivalent of EUR 500,000 and EUR 1,000,000, except where the transaction has been provided for in any of the plans referred to in a) above, and approved by the Supervisory Board;

    c) Assumption of other liabilities in an amount exceeding 20% of the Company's share capital, except where the liability has been provided for in the plans referred to in item 6, approved by the Supervisory Board, or agreements for the provision of gas fuel transmission or distribution services or amendments to gas fuel trading agreements to the extent they refer to the term of such agreements,

    d) Execution of an agreement of the type discussed in Art. 19b of the Act on Commercialisation and Privatisation, dated August 30th 1996;

    e) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

f) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

g) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000,

h) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Polish Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,

- With the proviso that items e) to h) above do not apply to credit agreements or maintenance services, including overhauls, geophysical, drilling and well services and projects, as well as services or deliveries under such agreements or projects,
- Item h) does not additionally apply to the activities of a foreign subsidiary pertaining to contracts and agreements concluded as part of day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses.

17. Appointment and removal of Management Board members;
18. Definition of rules and amounts of remuneration for Management Board members, unless applicable mandatory provisions of law state otherwise;
19. Suspension of Management Board members from their duties – for valid reasons, and by an absolute majority of votes;
20. Delegation of Supervisory Board members to temporarily replace Management Board members unable to perform their duties;
21. Conduct of the recruitment and selection procedure referred to in Art. 19a of the Act on Commercialisation and Privatisation;
22. Granting of permission for establishment and closure of the Issuer's foreign branches;
23. Granting of permission to Management Board members to accept positions in the governing bodies of other companies, where such permission is required by law;
24. Granting of approval for the Company to form another company with a share capital exceeding the PLN equivalent of EUR 2,000,000, or to subscribe for, acquire or dispose of shares in another company with a value exceeding the PLN equivalent of EUR 2,000,000, including definition of the terms and procedure for such disposal. If a transaction requires approval by the General Meeting, the Supervisory Board only issues an opinion concerning the proposal;
25. Monitoring of the Issuer's debt level;
26. Issue of opinions on Management Board recommendations for appointment or removal of the Issuer's representatives on the management and supervisory boards of System Gazociągów Tranzytowych EuRoPol GAZ S.A. and submission of such recommendations for approval to the shareholder State Treasury, represented by the minister competent for matters pertaining to energy;
27. Issue of opinions on the exercise of voting rights by the Issuer's representative at the General Meeting of System Gazociągów Tranzytowych EuRoPol GAZ S.A.;
28. Approval of how the Issuer's representative should vote at the General Meetings of the distribution system operators, with respect to approval of the operators' annual budgets;
29. Approval of how the Issuer's representative should vote at the General Meetings of the distribution system operators, with respect to approval of the operators' long-term strategic plans;
30. Approval of how the Issuer's representative should vote at the General Meetings of the distribution system operators, with respect to:

a) Amendments to the company's articles of association;

b) Increase or reduction in the company's share capital;

c) Merger, transformation or demerger of the company;

d) Sale of company shares;

e) Sale or lease of, or creation of limited property rights in, the company's business or its organised part;

f) Dissolution and liquidation of the company;

g) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000, excluding credit agreements and maintenance services, overhauls, well services and projects, as well as services or deliveries under such agreements or projects.

31. Approval of how the Issuer's representative should vote at the General Meetings of the storage system operators, with respect to:

    a) Amendments to the company's articles of association;

    b) Increase or reduction in the company's share capital;

    c) Merger, transformation or demerger of the company;

    d) Sale of company shares;

    e) Sale or lease of, or creation of limited property rights in, the company's business or its organised part;

    f) Dissolution and liquidation of the company;

    g) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000, excluding credit agreements and maintenance services, overhauls, well services and projects, as well as services or deliveries under such agreements or projects;

32. Approval of how the PGNiG representative should vote at the General Meeting of a company in which the Company holds at least a 50% interest, or which owns a transmission network, distribution network, interconnection gas pipeline, direct gas pipeline, storage facility, or a generation or cogeneration unit (in the case of companies owning generation or cogeneration units – provided that it is engaged in energy trading activities within the meaning of the Polish Energy Law), subject to items 30 and 31, with respect to the following matters:

    a) Amendments to the company's articles of association;

    b) Increase or reduction in the company's share capital;

    c) Merger, transformation or demerger of the company;

    d) Sale of company shares;

    e) Sale or lease of, or creation of limited property rights in, the company's business or its organised part;

    f) Dissolution and liquidation of the company;

    g) Creation of pledges or other forms of encumbrance over company shares;

    h) Obligating shareholders to make additional contributions to equity;

    i) Issue of bonds/notes;

    j) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a transmission network, distribution network, interconnection gas pipeline or direct gas pipeline, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;

    k) Entry into an obligational relationship with a foreign entity in relation for the planning, analysis, construction, expansion or disposal of a storage facility, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;

    l) Entry into an obligational relationship with a foreign entity for the planning, analysis, construction, expansion or disposal of a generation unit or cogeneration unit, within the meaning of the Polish Energy Law, if the obligational relationship is related to infrastructure with a present value or – in the case of new infrastructure or infrastructure being planned – with an estimated value exceeding the PLN equivalent of EUR 500,000;

    m) Entry into an obligational relationship with a foreign entity for hydrocarbon exploration, appraisal or production, within the meaning of the Polish Geological and Mining Law, if the value of the obligational relationship exceeds the PLN equivalent of EUR 5,000,000,

    - With the proviso that items j) to m) above do apply to credit agreements or maintenance services, including overhauls, geophysical, drilling and well services and projects, as well as services or deliveries under such agreements or projects,
    - Item m) does not additionally apply to a foreign subsidiary's activities pertaining to contracts and agreements concluded as part of the day-to-day management of the organisational structure, including employment contracts, use of assets where the related liabilities are equal to or less than EUR 5,000,000, and day-to-day administrative expenses.

33. Issue of opinions on Management Board proposals for assumption of liabilities in an amount exceeding the PLN equivalent of EUR 100,000,000.

Supervisory Board meetings are convened by the Chairman or Deputy Chairman of the Supervisory Board any time the Issuer's interest so requires, but no less frequently than once every two months. Supervisory Board meetings are also convened at the request of a Supervisory Board member, or at the request of the Management Board. The Supervisory Board express its opinions exclusively in the form of resolutions. The Supervisory Board may adopt resolutions if at least 50% of its members are present at a meeting, and all the members have been invited to participate. The Supervisory Board may only adopt resolutions on matters included on the agenda, which however can be amended if all members are present at a meeting and no member objects to the agenda being amended. The Supervisory Board adopts resolutions in an open vote by an absolute majority of votes. A secret ballot is ordered at the request of a Supervisory Board member or when the matter put to vote concerns personnel matters. Members of the Management Board may be invited to participate in Supervisory Board meetings. In order to be valid, a resolution of the Supervisory Board on appointment of an auditor requires a favourable vote from a member of the Supervisory Board who meets the independence criteria defined in the Issuer's Articles of Association. Except as specified in the Rules of Procedure for the Supervisory Board, the Supervisory Board may adopt resolutions by written ballot or by means of remote communication. Adoption of a resolution using any of these methods must be justified, and a draft resolution must be made available to all Supervisory Board members beforehand.

The Chairman of the Supervisory Board is entitled to request that a Management Board meeting be called, by providing the President of the Management Board with a written agenda for the meeting. The Chairman of the Supervisory Board may request the President of the Management Board that certain matters be included on the agenda of a Management Board meeting. The Management Board must submit the following documents to the Supervisory Board for assessment: financial statements for the preceding financial year, with the auditor's opinion; the Directors' Report on the Issuer's operations in the preceding financial year, and a proposal for distribution of profit or coverage of loss for that financial year. These documents should be submitted without the Management Board being called upon to do so, and with sufficient time for the Supervisory Board to assess them before they are presented to the General Meeting.

The Supervisory Board or its members delegated to perform certain supervisory functions independently are authorised to supervise all areas of the Issuer's business, and in particular to examine all of the Issuer's documents, demand that the Management Board and the Issuer's employees produce reports and explanations, or review the Issuer's assets.

The Supervisory Board may appoint standing or ad hoc committees (established as needed), to act as the Supervisory Board's collegiate advisory and opinion-forming bodies. The Supervisory Board also has the right to seek opinions from legal counsels and to engage experts in relevant fields to provide opinions on matters within the Supervisory Board's range of competence.

The amount of remuneration to be received by Supervisory Board members is set by the General Meeting, pursuant to the Act on Remuneration of Persons Managing Certain Legal Entities, dated March 3rd 2000 (Dz.U. No. 26, item 306, as amended).

For important reasons, the Supervisory Board may delegate individual members to perform certain supervisory functions independently for a specified term. A Supervisory Board member so delegated must submit written reports to the Supervisory Board on all actions taken.

11.3. Committees

In 2016, there was one committee operating at the Company – the Audit Committee. The Audit Committee is composed of at least three members of the Issuer's Supervisory Board.

In the period from January 1st to December 31st 2016, the Audit Committee held four meetings and passed six resolutions. The Committee did not adopt any resolutions by written ballot or by means of remote communication. At two of its meetings, the Audit Committee met with the auditor and performed a review and assessment of the Company's financial reporting system.

Composition of the Audit Committee

Following changes to the composition of the Supervisory Board made on December 29th 2015, Ms Magdalena Zegarska was the only member of the Audit Committee as at January 1st 2016.

On January 7th 2016, the following persons were additionally appointed to the Audit Committee:

1. Mr Mateusz Boznański – as Chairman of the Audit Committee (independent member of the Supervisory Board),
2. Mr Krzysztof Rogala – as Deputy Chairman of the Audit Committee,
3. Mr Grzegorz Nakonieczny – as Member of the Audit Committee,
4. Mr Wojciech Bieńkowski – as Member of the Audit Committee.

On February 25th 2016, Mr Krzysztof Rogala tendered his resignation as member of the PGNIG Supervisory Board.

On June 28th 2016, the Annual General Meeting removed Mr Grzegorz Nakonieczny from the PGNiG Supervisory Board.

On September 12th 2016, the Supervisory Board appointed Mr Bartłomiej Nowak to the Audit Committee.

On December 19th 2016, the Supervisory Board appointed Mr Piotr Sprzączak to the Audit Committee.

As at December 31st 2016, the Audit Committee was composed of the following members:

1. Mateusz Boznański – Chairman of the Audit Committee;
2. Magdalena Zegarska − Deputy Chairman of the Audit Committee;
3. Wojciech Bieńkowski – Member of the Audit Committee;
4. Bartłomiej Nowak – Member of the Audit Committee;
5. Piotr Sprzączak – Member of the Audit Committee.

On March 3rd 2017, Ms Magdalena Zegarska resigned from the position of Supervisory Board Member as of March 5th 2017. On March 6th 2017, the Supervisory Board appointed Mr Piotr Sprzączak as Deputy Chairman of the Audit Committee.

11.3.1. Rules governing the operation of the Audit Committee

The Audit Committee operates within the Supervisory Board as a standing committee, advising the Supervisory Board on matters for which the Board is responsible.

In accordance with the Rules of Procedure for the Supervisory Board's Audit Committee, the Audit Committee is composed of at least three members of the Supervisory Board, including at least one member independent of the Issuer and entities materially related to the Issuer, who is appointed by the General Meeting under Art. 36.1 of the Articles of Association and is qualified in accounting and finance. The members of the Audit Committee are appointed by the Supervisory Board.

Meetings of the Audit Committee are held as needed, but at least once every quarter, and are convened by the Chair of the Committee. The Chair of the Audit Committee may invite other members of the Supervisory Board to an Audit Committee meeting, as well as members of the Issuer's Management Board, the Issuer's employees, or other persons whose participation in a given meeting is considered important to the performance of the Committee's duties. The Audit Committee may adopt resolutions if at least a half of its members are present at a meeting and all the members have been properly invited. The Committee may adopt its resolutions by written ballot or by means of remote communication. Resolutions of the Audit Committee are adopted by a simple majority of votes cast. In the event of a tied vote, the Chair of the Audit Committee has the casting vote.

Every six months, the Audit Committee submits reports on its activities to the Supervisory Board. Each report is made available to the Issuer's shareholders at the next General Meeting.

The responsibilities of the Audit Committee include, in particular:

1. Monitoring of the financial reporting process;
2. Checking of financial information presented by the Issuer for reliability;
3. Monitoring of internal control, internal audit and risk management systems for their effectiveness;
4. Monitoring of the audit/review process for financial statements by external auditors;
5. Issuing recommendations to the Supervisory Board on the selection, appointment, re-appointment and removal of an auditor of financial statements, as well as the terms and conditions of the auditor's engagement;
6. Monitoring of the independence and objectivity of the auditor of financial statements;
7. Control of the nature and extent of services not related to audit or review of financial statements, but contracted from the auditor of financial statements;
8. Review of the external audit process for effectiveness and monitoring of the response of members of the Management Board and the Issuer's employees to the external auditor's recommendations;
9. Examining the reasons for termination of the agreement with an auditor of financial statements.