

29. Contingent liabilities and assets

29.1 Material court, arbitration and administrative proceedings and other risks to the Parent or its subsidiaries

Material court proceedings to which the Parent is a party

There were no significant changes with respect to pending material court, arbitration, and administrative proceedings or with respect to other risks to the Company or its subsidiaries in the period between the end of the previous financial year, i.e. December 31st 2017, and the date of issue of these financial statements. For information on pending material proceedings, see Note 30.1 to the consolidated financial statements for 2017.

Tax settlements

In 2015, the Company's VAT settlements for 2010–2011 were subject to two inspections by tax inspection authorities. On June 23rd 2015, the Company received post-inspection reports and challenged some of the findings contained in the reports. On September 30th 2015, the Company received two decisions issued by the Director of the Tax Audit Office in Bydgoszcz, in which the Tax Audit Office assessed the VAT amount payable by the Company for the period from January to December 2010 and from January to December 2011, identifying VAT arrears of PLN 48.4m for 2010 and PLN 112.5m for 2011. In these decisions, the Director of the Tax Audit Office stated that certain transactions with two of the Company's trade partners had involved fraudulent tax practices, arguing that the Company had failed to exercise due care in executing transactions with those trade partners and that it should at least have been aware that the transactions were connected to and resulted from a tax fraud committed at an earlier stage, and therefore the Company had no right to make VAT deductions. Having reviewed the decisions, the Company dismissed the allegations of the Director of the Tax Audit Office as entirely groundless and on October 14th 2015 filed an appeal with the Director of the Tax Chamber in Gdańsk. The Director of the Tax Chamber in Gdańsk upheld the decisions of the Director of the Tax Audit Office in Bydgoszcz, whereas the complaint lodged by the Company with the Provincial Administrative Court in the first half of 2016 was dismissed. In Q3 2016, the Company lodged cassation complaints with the Supreme Administrative Court of Warsaw. On December 11th 2018, the Supreme Administrative Court dismissed the Company's complaint against the ruling of the Provincial Administrative Court of Gdańsk of July 20th 2016, specifying the Company's VAT liability for the individual months of 2011. The date of a hearing concerning VAT for the individual months of 2010 was set for March 27th 2019. In connection with other VAT inspections, provisions for tax risk were recognised, as presented in Notes 9.4 and 9.6.

Agreement to which LOTOS Exploration and Production Norge AS is a party

LOTOS Exploration and Production Norge AS ("LOTOS E&P Norge AS") was a party to proceedings held before an arbitration court in Norway in connection with claims filed by Single Buoy Moorings Inc. ("SBM"), the supplier of the MOPU (Mobile Offshore Production Unit) for operation of the YME field, against Talisman Energy Norge AS, the operator of the YME field ("Talisman", "Operator") and the other YME licence holders. The share of SBM's claims attributable to LOTOS E&P Norge AS was 20%.

In 2013, Talisman Energy Norge AS ("Talisman", the then operator of the YME field) and Single Buoy Moorings Inc. ("SBM", owner of the MOPU) announced that an agreement was reached to terminate all existing contracts and agreements executed by the parties in connection with the YME project and remove the defective MOPU from the YME field.

SBM paid USD 470m to the consortium members, and Talisman Energy, on behalf of the licence holders, agreed to make the necessary preparations and remove the platform from the field. Under the agreement, SBM was responsible for towing the MOPU to the port and its scrapping, whereas following completion of certain works, the ownership of elements of the YME field in situ subsea infrastructure delivered by SBM should be transferred to the consortium members, who would be required to perform site restoration (and disassembly) activities related to the subsea infrastructure. Each of the parties will cover the costs of its scope of decommissioning work as set out in the agreement.

In accordance with the agreement made with SBM, the balance of the Group's share in the amount due to the consortium members under the agreement (USD 81.8m) was transferred to the YME project escrow account, to be gradually released to finance the removal of the MOPU and related infrastructure from the field, in accordance with the agreement.

On August 22nd 2016, the YME project partners completed evacuation of the defective MOPU from the field. In Q1 2017, the caisson (element of the subsea infrastructure) was inspected. As a result of the inspection it was found that the caisson can stand without additional support until 2019 (provided that it is inspected on a semi-annual basis and its condition remains unimpaired).

As at December 31st 2018, available cash deposited in the escrow account, denominated in the presentation currency, was recognised in the amount of PLN 2.8m under **Other assets** in the statement of financial position. The remaining provision for future costs of removal of the MOPU and disassembly of the related fixed assets amounted to PLN 2.4m and was recognised under the short-term portion of **Other liabilities and provisions**.

On August 11th 2017, SBM Offshore confirmed the conclusion of an agreement with a majority of MOPU insurers to settle insurance claims relating to the faulty execution of the MOPU. On September 10th 2018, SBM announced that the insurance claim concerning the YME project was fully and finally settled. The gross amount received by SBM as insurance compensation was USD 390m. The share of LOTOS E&P Norge AS (net of the cost of legal services and other expenses) is expected at USD 30.7m. The Group recognised its share in the compensation under **Other income**, in the amount of PLN 118.3m.

Dispute between LOTOS Kolej Sp. z o.o. and Newag S.A.

In December 2017, Newag S.A. indicated its readiness to deliver five Griffin locomotives produced under lease contracts concluded on December 23rd 2015 with LOTOS Kolej Sp. z o.o. However, as permits to operate these locomotives were subject to certain restrictions, LOTOS Kolej Sp. z o.o. refused to accept them and called on Newag S.A. to provide permits enabling their operation without any restrictions. In connection with the company's refusal to accept the locomotives, on January 26th 2018 Newag S.A. terminated its contract with LOTOS Kolej Sp. z o.o. with immediate effect, arguing that the locomotives were in conformity with the contract and permitted to be used in the area of operation – but excluding the core network. In the Management Board's opinion, the termination was not effective and the risk of imposition of contractual penalties on LOTOS Kolej Sp. z o.o. was low, therefore no provisions were recognised consolidated financial statements. On February 28th 2019, a settlement was reached before a mediator, waiving all risks and counterclaims of the parties in connection with the termination of the lease contracts. The settlement supersedes the previous agreements and re-defines the rights and obligations of the parties.

In the twelve months ended December 31st 2018, there were no material settlements under court or other proceedings, save for those presented above.

29.2 Other contingent liabilities

In the period between the end of the previous financial year, i.e. December 31st 2017, and the date of issue of these financial statements, there were no changes in the Company's or its subsidiaries' other material contingent liabilities.

30. Related parties

30.1 Transactions with related entities in which the Group holds equity interests

Equity-accounted joint ventures	2018	2017
Sales	635.5	431.4
Purchases	26.7	-
	Note	December 31st 2018
Receivables	15	23.1
Liabilities	25	5.2
		December 31st 2017
		34.5
		-

In 2018 and 2017, material transactions were made by the Group with LOTOS-Air BP Polska Sp. z o.o. and involved mainly sale of aviation fuel. The aggregate value of the transactions made in 2018 was PLN 635.4m (2017 PLN 431.3m). As at December 31st 2018, the balance of outstanding receivables under these transactions was PLN 23.1m (December 31st 2017: PLN 34.5m).

In 2018, the Group also executed transactions with UAB Minijos Nafta, for a total amount of PLN 26.7m. The transactions involved purchase of crude oil. As at December 31st 2018, the balance of outstanding payables under those transactions was PLN 5.2m. In the comparative period, the Group did not enter into any material transactions with UAB Minijos Nafta.

For general information on joint ventures in which the Group holds interests, see Note 14.

30.2 Entity having control of the Group

As at December 31st 2018 and December 31st 2017, the State Treasury held a 53.19% interest in Grupa LOTOS S.A. In 2017 and 2018, no transactions were concluded between Grupa LOTOS S.A. and the State Treasury.

30.2.1 Transactions with related entities of which the State Treasury has control or joint control or on which the State Treasury has significant influence

In 2018 and 2017, the Group executed transactions with parties related to it through the State Treasury, the aggregate value of which was material. They were concluded on an arm's length basis in the course of the Group's day-to-day operations and involved mainly purchase and sale of fuels, purchase of crude oil and natural gas, and transport services.

	2018	2017
Sales	661.2	394.0
Purchases	1,922.7	1,587.5
	December 31st 2018	December 31st 2017
Receivables	47.4	82.9
Liabilities	202.8	263.4

In addition, the Group has liabilities under bank borrowings, non-bank borrowings, notes and finance leases towards banks and financial institutions of which the State Treasury has control or joint control or over which it exercises significant influence. These entities include PKO BP S.A., PEKAO S.A., Bank Gospodarstwa Krajowego and Agencja Rozwoju Przemysłu S.A.

	December 31st 2018	December 31st 2017
Bank borrowings	1,304.7	1,039.3
Non-bank borrowings	55.8	68.3
Notes	227.0	201.7
Finance lease liabilities	20.3	27.4
Total	1,607.8	1,336.7