



LOTOS Group
Integrated Annual Report 2018

06. **GOVERNANCE**

Governance structure

Structure of the LOTOS Group

The LOTOS Group is composed of 18 direct subsidiaries, some of which are parents of their own groups. Grupa LOTOS S.A. is both the parent of the Group and an integrator of the key management and support functions. The LOTOS Group companies focus on exploration for, production of and refining hydrocarbons as well as trading in petroleum products and provision of services.

Management Board

The Management Board of Grupa LOTOS S.A. runs the affairs of the LOTOS Group and represents it in all business dealings and transactions, with the exception of any matters expressly reserved for the General Meeting or the Supervisory Board and those falling outside the ordinary course of business. Such matters are defined in the Rules of Procedure for the Management Board. Matters which do not require a resolution of the Management Board are decided individually by the President and Management Board members in line with the division of powers and responsibilities.

Pursuant to Management Board resolutions of March 1st 2018 and September 25th 2018, the Management Board's organisational structure changed after the closing of the following organisational units: Chief Strategy and Development Officer and Chief Refining Officer, and establishing the following organisational units and divisions: Vice President of the Management Board, Chief Financial Officer, Vice President of the Management Board, Corporate Affairs, and Vice President of the Management Board, Chief Refining and Marketing Officer, who, together with the President of the Grupa LOTOS S.A. Management Board, manage the Company's business.

DIVISION OF POWERS AND RESPONSIBILITIES WITHIN THE MANAGEMENT BOARD OF GRUPA LOTOS S.A.

President of the Management Board	Vice President of the Management Board, Chief Investment and Innovation Officer	Vice President of the Management Board, Chief Refining and Marketing Officer	Vice President of the Management Board, Chief Financial Officer	Vice President of the Management Board, Corporate Affairs
Strategy and Development	Efficiency	Refining	Finance	Compliance
Critical Infrastructure and Defence	EFRA Project	Technology/Maintenance/Turnarounds	Investor Relations	Corporate Supervision
Management Board Office	Innovation	Refining Efficiency	Management Control	Human Resources
Data Security	Technology Development	Occupational Health and Safety	IT	Communication
Supply Chain Management	Project Management	Environmental Protection	Purchases	Marketing
Legal office		Commodity Trading	Planning and Reporting	Process Management
Enterprise Risk Management		Logistics		Organisation and Management System
Internal Security		Trade in Refinery Products		
Audit/Control				



More information on the powers and responsibilities of individual members of the Management Board and its Rules of Procedure

COMPOSITION OF THE GRUPA LOTOS MANAGEMENT BOARD AS AT DECEMBER 31ST 2018:

- **Mateusz Aleksander Bonca** – President of the Management Board
- **Jarostaw Kawula** – Vice President of the Management Board, Chief Refining and Marketing Officer
- **Patryk Demski** – Vice President of the Management Board, Chief Investment and Innovation Officer
- **Robert Sobków** – Vice President of the Management Board, Chief Financial Officer
- **Jarostaw Wittstock** – Vice President of the Management Board, Corporate Affairs



Current composition of the Grupa LOTOS Management Board


Supervisory Board

The Supervisory Board of Grupa LOTOS S.A. exercises ongoing supervision of the Company's operations. Its powers include issuing opinions (including submitting motions and proposals) on all matters related to the organisation's business, delegating its members to perform specific functions and appointing standing or ad hoc committees to supervise particular areas of the Group's operations. Grupa LOTOS has three standing committees: the Audit Committee, the Strategy and Development Committee, and the Organisation and Management Committee, which act as advisory, support and consultative bodies.

In accordance with the applicable laws, the Supervisory Board selects an auditor and recommends it to the key companies of the Group to audit their financial statements.

COMPOSITION OF THE GRUPA LOTOS SUPERVISORY BOARD AS AT DECEMBER 31ST 2018:

- **Beata Kozłowska-Chyła** – Chairwoman
- **Piotr Ciach** – Deputy Chairman
- **Katarzyna Lewandowska** – Secretary
- **Agnieszka Szklarczyk-Mierzwa** – Member
- **Dariusz Figura** – Member
- **Mariusz Golecki** – Member
- **Adam Lewandowski** – Member
- **Grzegorz Rybicki** – Member

 [More information on the Supervisory Board of Grupa LOTOS](#)

General Meeting

The powers and responsibilities of the General Meeting cover a range of matters as laid down in the Articles of Association of Grupa LOTOS. All matters are first presented for consideration by the Supervisory Board. The Rules of Procedure for Grupa LOTOS S.A. General Meetings specify the procedures for convening and cancelling General Meetings, the proceedings of the Meetings, holding elections to the Supervisory Board, as well as the rules of attendance and voting at General Meetings.

 [More information on the General Meetings of Grupa LOTOS](#)

Corporate governance

The LOTOS Group's Corporate Governance is a set of ethical standards and best practices we follow in our operations. These standards help us ensure a balance between the interests of all parties involved in the operation of our companies. They build the Group's value and strengthen its credibility in the eyes of our shareholders, thus enhancing the Group's competitiveness on the market.

THE OBJECTIVES OF CORPORATE GOVERNANCE AT THE LOTOS GROUP ARE AS FOLLOWS:

- ensuring transparency of the LOTOS Group's operations as a listed company,
- increasing trust in relations with stakeholders,
- increasing openness and accessibility for investors,
- consistent shareholder value creation.

We report all breaches of corporate governance principles, both incidental and long-term ones. Such information is published similarly to current reports, in two languages, on the Company's Investor Relations website.



[Corporate Governance reports](#)

Ethics and anti-corruption

Ethical Conduct Programme

The Ethical Conduct Programme, which is the cornerstone of our activities, enables effective and ethical management of LOTOS Group's organisational culture. It builds value for our employees and external stakeholders.

THE ETHICAL CONDUCT PROGRAMME COMPRISES:



Code of Ethics



Ethics Officer



Channels for reporting breaches of the Code



Employee education



Easy communication

The Code of Ethics defines the system of ethical values and standards of conduct our employees are expected to uphold in the workplace and in relations with key stakeholder groups. Breaches of the Code of Ethics are reported to and handled by the Ethics Officer, who oversees compliance with the LOTOS Group Code of Ethics.

The Ethics Officer is available to each employee and trading partner of the LOTOS Group.

THE FOLLOWING METHODS CAN BE USED TO COMMUNICATE WITH THE ETHICS OFFICER:

- a meeting in person at a time convenient to the employee, arranged in advance by phone,
- telephone conversation with or voicemail to the Ethics Officer (phone: +48 58 308 80 70),
- by email: liniaetyki@grupaLOTOS.pl,
- online report form available at www.LOTOS.pl,
- by traditional mail.

We operate in compliance with the Code of Best Practice for WSE Listed Companies. Compliance with the Code helps us build the Company's ethical culture, which is vital for our relations with the market environment and for building our market position.



For more information on the LOTOS Group's Code of Ethics, go to

 [Code of Ethics for downloading](#)

Misconduct prevention

The Group has in place a Misconduct Prevention Policy, designed to enhance the safety of our business processes through management of potential misconduct risks. The misconduct prevention system helps us reduce misconduct incidents, mitigate their detrimental effects and mobilise resources to accelerate the organisation's return to normal operations. Our stakeholders can report any suspected irregularities and/or misconduct at the LOTOS Group to the Grupa LOTOS Internal Audit Office.

In our organisation, we do not tolerate any instances of misconduct, including corruption. In 2014, we signed the United Nations Global Compact's Call to Action on Anti-Corruption, a global initiative where businesses join forces to fight corruption in all its forms. Both members of the management boards and all employees of the 13 Group companies are familiar with the anti-corruption policies and procedures. Each new hire is provided with information on the Misconduct Prevention Policy and employee responsibility during training.

To reduce the risk of misconduct, corruption and other irregularities, we have taken a number of steps to monitor compliance with our anti-corruption standards on an ongoing basis. We also place emphasis on educating our employees. In 2018, annual anti-corruption training sessions were carried out at LOTOS Group companies. Raising the management's and all employees' awareness and involvement reduces the organisation's vulnerability to potential risks.

PROGRAMMES AND POLICIES ADOPTED BY THE LOTOS GROUP TO PREVENT AND IDENTIFY INSTANCES OF MISCONDUCT:

- Misconduct Risk Management Programme, designed to educate on identifying misconduct risks, provide information about liability for corrupt behaviour and offences, and implement risk mitigation mechanisms. It also plays a role in carrying out investigation proceedings in response to suspected misconduct reports.
- The LOTOS Group Misconduct Prevention Policy, containing the Management Board's position on misconduct and specifying steps to be taken in case of suspected misconduct as well as misconduct reporting channels.
- Risk Management Card, defining the manner in which risk is managed and monitored, as well as a Risk Mitigation Plan.
- CSR clause and anti-corruption clause, used in requests for proposals and agreements/contracts concluded by the LOTOS Group.
- Misconduct Risk Management Team, set up within the Internal Audit Office.
- The LOTOS Group Trading Partner Vetting Department.

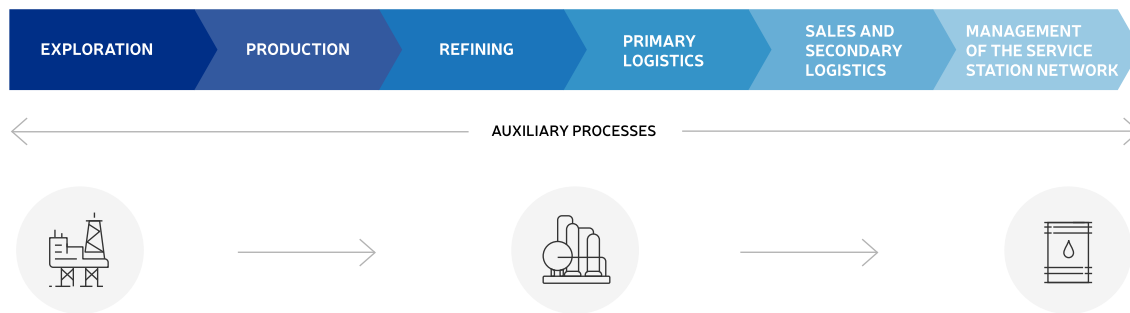
Misconduct prevention measures include the obligation for all Group companies to vet their trading partners in accordance with the procedure and to ensure compliance with the Misconduct Prevention Policy.

 [Misconduct Prevention Policy](#)

Ethical supply chain


The LOTOS Group's operations affect many social and environmental aspects, so we ensure that our supply chain, from exploration of deposits through production to sale of finished products and services, is sustainable.

SUPPLY CHAIN AT THE LOTOS GROUP



WE SUPPORT VALUE BUILDING THROUGHOUT THE LOTOS GROUP'S SUPPLY CHAIN BY:

- striving for efficient use of assets throughout the value chain,
- actively managing opportunities and risks,
- creating technological innovations to enhance competitiveness,
- improving processes to ensure the safety of people and the environment.

 See our business model and strategy for 2017-2022

We build value for the environment in the E&P, refining and marketing segments.

WE BUILD VALUE FOR THE ENVIRONMENT IN THE E&P SEGMENT BY:

- contributing to ensuring Poland's energy security,
- reducing negative environmental impact.

WE BUILD VALUE FOR THE ENVIRONMENT IN THE REFINING SEGMENT BY:

- ensuring safety in the surroundings of production plants,
- mitigating any negative environmental impact.

WE BUILD VALUE FOR THE ENVIRONMENT IN THE MARKETING SEGMENT BY:

- managing a network of 495 service stations,
- selling 11,689 thousand tonnes of products in 2018,
- achieving a 31.4% share in the domestic fuel market in 2018,
- developing products and services,
- introducing product and service innovations that meet customer needs.

We build an ethical supply chain

In building an ethical supply chain, we select our trading partners with care. We work only with companies and organisations which, like the LOTOS Group, comply with the principles of responsible business. We audit the implementation of standards and requirements that we impose on our suppliers, as well as their process improvement activities.

Human rights – impact on the value chain

At any stage of the supply chain, there are people who create, transport or sell the product. The LOTOS Group respects human rights. Therefore, it cooperates only with legally operating companies, and pursues business activities in an environment where human rights are governed by a legal system in force. The LOTOS Group's trading partners are obliged to comply with the generally accepted system of values, respect their employees, and respect their dignity. Observing these principles makes it possible to create an ethical supply chain.

The LOTOS Group seeks to ensure that all requests for proposals in the process of selecting a trading partner, and contracts concluded with both new and existing suppliers, contain CSR clauses regarding: OHS, rules and standards of conduct, ethics, absence of conflicts of interest, anti-corruption, environmental protection, respect for human rights, and social impacts. Inclusion of such clauses in contracts signed by the LOTOS Group companies is mandatory.

The LOTOS Group's CSR strategy in the supply chain has been developed based on the Corporate Human Rights Benchmark project methodology.

Risk management

The LOTOS Group is socially responsible and follows the principles of sustainable development. As part of its corporate risk management, it identifies risks in its business and undertakes measures to eliminate those related to the personnel, social matters, respect for human rights and the environment, and works to counteract corruption.

The LOTOS Group has implemented an Enterprise Risk Management (ERM) system to boost the effective implementation of its business strategies and processes. The above measures have been implemented as part of the Enterprise Risk Management Policy.

Risk management model

Mechanisms of the risk management model are embedded in the existing business processes. The model comprises three defence lines which are adjusted to the nature of particular activities and the possible impact of risks on the Group's performance.

RISK MANAGEMENT MODEL AT THE LOTOS GROUP

1st LINE OF DEFENCE

Business

- ▶ Operational risk management
- ▶ Development of operational procedures
- ▶ Risk identification and assessment at the decision-making stage and periodic risk reviews in processes and projects

2nd LINE OF DEFENCE

Risk, Finance, Compliance

- ▶ Alignment of risk management policies with the Group's strategy
- ▶ Linking risk management to the LOTOS Group's strategy
- ▶ Forecasting and shaping of the Group's risk profile

3rd LINE OF DEFENCE

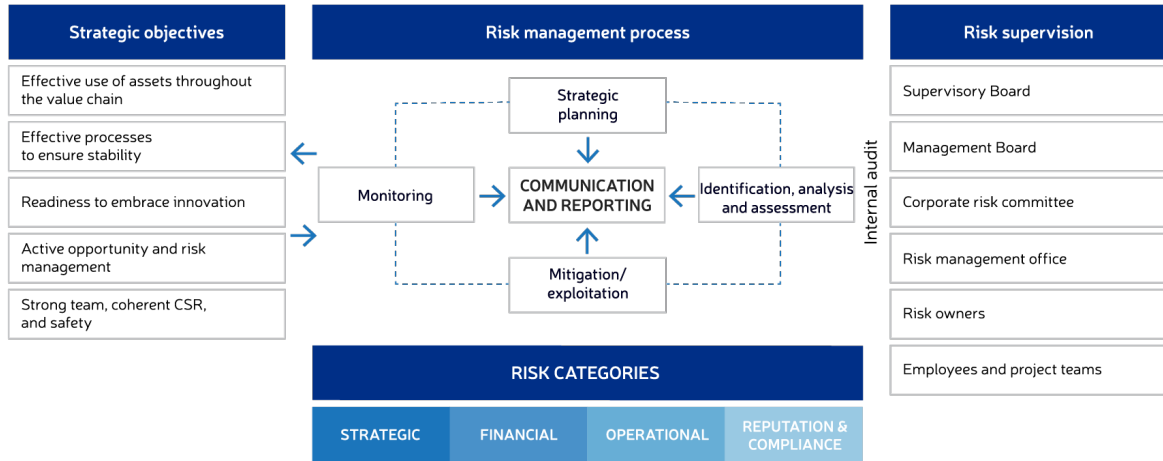
Internal audit

- ▶ Independent assessment of the effectiveness and adequacy of the risk management process at the LOTOS Group

Structure of the Enterprise Risk Management (ERM) system

The ERM system focuses on key risks and forecasts their impact on the company's operations and performance, thus facilitating the development of pre-emptive measures that may help mitigate or exploit risks or their consequences. This key functionality of the system is currently being strengthened at the LOTOS Group.

ENTERPRISE RISK MANAGEMENT SYSTEM AT THE LOTOS GROUP

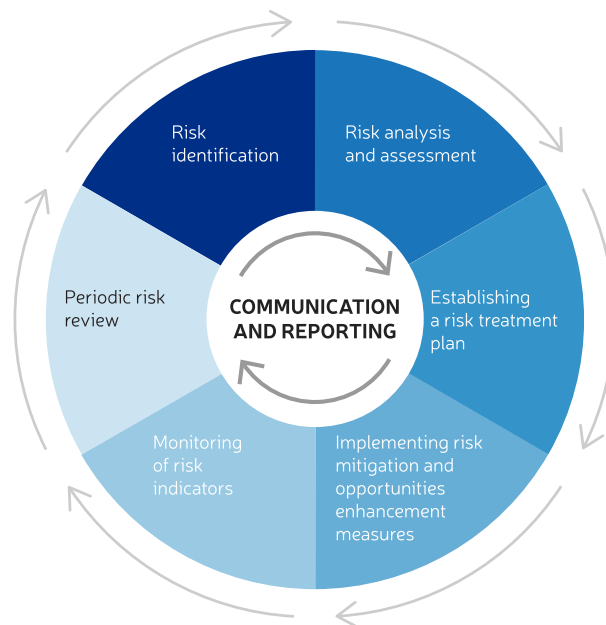


Risk management process

Management of opportunities and threats at the corporate level is carried out as part of a process involving:

- risk identification – risks are identified in the context of (annual) strategic and operational objectives pursued,
- risk analysis and assessment – the assessment is carried out in two time horizons: annual and long-term. The assessment criteria include both financial and reputational consequences, aggregated as the impact on non-financial parameters, such as the image, environment, and people,
- establishing a risk treatment plan – for each material risk, an operational management procedure as well as controls and protection measures are defined. For TOP RISKS, detailed risk management charts are prepared, which cover relevant risk mitigation and exploitation measures, as well as response plans to be followed in case of materialisation of such risk,
- implementation of risk mitigation and opportunities enhancement measures – performing tasks defined in risk treatment plans and monitoring their progress on an ongoing basis,
- monitoring of risk indicators – for top risks, key risk indicators (KRIs) are defined, which allow risk exposure levels and risk materialisation probability to be monitored in accordance with relevant rules,
- risk reviews – periodically (every six months), all identified risks are reviewed and re-assessed,
- communication and reporting – standards for communicating and reporting the results of risk management are in place at every stage of the process, The Management and Supervisory Boards receive regular, quarterly reports on existing risks to the organisation and on the effectiveness of risk mitigation or exploitation measures,
- the effectiveness and adequacy of the ERM are assessed and its future development directions are defined on an annual basis.

ENTERPRISE RISK MANAGEMENT PROCESS AT THE LOTOS GROUP



Risk management in view of climate change and new market requirements

The LOTOS Group is a listed company. Therefore, it maintains a compliance system ("Compliance System") which covers all its organisational units and subsidiaries. The Compliance System prevents and mitigates legal risks by ensuring compliance of the business with legal requirements.

The LOTOS Group analyses the potential impact of climate change megatrends by identifying opportunities and threats to its operations and growth prospects.

The key risks for Grupa LOTOS S.A. arising from climate change are the regulatory risks related to meeting the required levels for the National Indicative Target (NIT) and the National Reduction Target (NRT) in 2020 (8.5% for NIT and 6% for NRT).

Ensuring that fuels for internal combustion engines contain the proper amount of biocomponents (achievement of the NIT) is extremely difficult and entails very high costs for the entire industry considering technological capabilities (fuel quality requirements) and market capabilities (limited market of suppliers).

A failure to meet the required NIT level may result in the necessity to pay high fines. This is why the LOTOS Group and other key industry representatives have entered into legislative dialogue with the Ministry of Energy concerning the feasibility of meeting the legal requirements.

Similarly, meeting the National Reduction Target (reduction of life cycle greenhouse gas emissions) under the current regulatory regime is hindered by the necessity to incur high costs and, as in the case of the NIT, by a limited market of emission reduction mechanisms. The LOTOS Group analyses and uses all means of effectively reducing emissions and conducts a dialogue with the regulatory body on how to achieve the required NRT level.

Apart from the identified and addressed threats, the LOTOS Group also sees opportunities in climate change and macroeconomic trends, and is pursuing a growing number of projects consistent with the megatrends.

One such project is active entry into the electromobility market. Under the ongoing Blue Trail project, the first 12 electric vehicle charging points have been launched at LOTOS service stations on the route between the Tricity and Warsaw. More charging points are planned at expressways and motorways in the coming years. By the end of Q1 2020, a total of 38 new EV charging points are to be launched.

The year 2020 will see further environmental restrictions coming into force. The International Maritime Organisation (IMO) is introducing a new global limit on sulphur content in marine fuels, changing the current 3.5% to 0.5% m/m. Therefore, LOTOS has embarked on a project to increase the share of low-emission fuels through the use of LNG as marine fuel. Another response of the Group to the new regulations is the EFRA Project, which will help address the problem of heavy residue from crude oil processing. Heavy residue is currently being used for the production of asphalt, an important component in road construction, as well as high-sulphur heavy fuel oil, used primarily as marine fuel. It is a product with a negative margin, i.e., its price is lower than that of crude oil. Being environmentally unfriendly, it is difficult to sell now, and starting from 2020, its sale will become virtually impossible. EFRA will make it possible to sell approximately 1.1m tonnes of excellent quality fuels, mainly diesel oil, produced from the heavy residue.

In addition to its pure business-oriented projects, the LOTOS Group actively engages in promoting the use of hydrogen in transport. On the Group's initiative, the Hydrogen Technologies and Clean Energy Technologies Cluster has been established, with a mission to initiate efforts aimed at increasing the role of hydrogen technologies.

As part of its strategy, the Group seeks to become the leader of new generation fuels. In order to implement these plans, the Innovation Division initiates and coordinates the implementation of innovative projects. In September 2018, representatives of the LOTOS Group signed documents initiating joint R&D activities with the Warsaw University of Technology. The cooperation will involve the development of prototypes of selected low-carbon transport and energy storage equipment. In March 2019, a similar document was signed with the Gdańsk University of Technology.

Process safety

Security is an indisputable priority for the LOTOS Group. This applies to our employees, employees of our contractors, our customers, the environment, and the communities living close to our operation sites alike.

We follow best practices to maintain the highest level of security and integrity of technical infrastructure in all our companies.

THE MOST IMPORTANT OF THEM ARE AS FOLLOWS:

- At the LOTOS Group – zero-testing of materials and equipment, predictive and preventive maintenance, an inspection and surveillance testing programme, non-destructive testing (NDT) – testing of apparatus and pipeline wall thickness, RBI (Risk-Based Inspection) programme, regular plant overhauls, execution of annual preventive equipment inspection plans, corrosion monitoring, functional testing of security systems and process interlocks, equipment criticality management with respect to response times, as well as management of spare part stocks and scopes of preventive testing.
- Security monitoring is in place at LOTOS Asphalt, and any deviations in this area are addressed by means of corrective and preventive measures.
- LOTOS Infrastruktura is equipped with video monitoring of facilities, tank bottom leak detection, and monitoring of tank filling levels – overflow protection and containment tray monitoring.
- LOTOS Oil Sp. z o.o., on the other hand, keeps a record of measuring equipment which includes the required check, calibration or verification intervals. The plants are checked by employees on an ongoing basis. Any operational defects in production plants, such as leaks or damage to structural components of buildings, are reported and addressed on an ongoing basis. The raw materials used and the products obtained are, in most cases, classified as out-of-class in terms of flash point. As a result, the risk of ignition or explosion is low. In case of leaking tanks or plants, negative environmental impact has been minimised by placing the tanks in appropriately sized containment trays. Some of the tanks are additionally equipped with double bottoms with leak monitoring systems. The Company has in place Accident and Emergency Response Procedure OIL.47.01.00.00 to ensure efficient and effective crisis management in order to limit any impacts on human health and the environment and minimise financial losses.

Thanks to our multifaceted preventive measures, accidents at our facilities are extremely rare. We strive to identify any hazardous situations as early as possible.

In 2018, we recorded **32** process safety incidents.

- **24** of them were identified at an early stage (and classified as Tier 2), which enabled us to address them quickly and prevent them from escalating to Tier 1.
- Eight events were classified as Tier 1.