



# SUPERVISORY BOARD REPORT

Dear shareholders, ladies and gentlemen,

I am presenting to you, on behalf of the Supervisory Board of ČEZ, a. s., the report on its activities since the last Annual General Meeting, which took place on June 12 last year.

In accordance with the Company's Articles of Association, the Supervisory Board has 12 members who are elected and removed by the General Meeting, with 4 members of the Supervisory Board elected by the General Meeting from among employees.

Due to personnel changes, the Supervisory Board currently has one substitute member appointed by the Supervisory Board. The following personnel changes occurred during the period from the last Annual General Meeting held on June 12, 2015 to April 28, 2016 (when this report was debated by the Supervisory Board):

- At the first Supervisory Board meeting held after the last General Meeting, Mr. Petr Blažek was elected as Vice-Chairman of the Supervisory Board;
- In February 2016, Mr. Vladimír Vlk resigned from the Supervisory Board (with effect from February 25, 2016);
- In the same month of February, the Supervisory Board appointed (with effect from February 25, 2016) Mr. Petr Polák as a substitute member for the period until the next General Meeting.

As at April 28, 2016, when this report was debated by the Supervisory Board, Supervisory Board members are as follows:

- Václav Pačes—Chairman of the Supervisory Board;
- Petr Blažek and Vladimír Hronek—Vice-Chairmen of the Supervisory Board;
- Zdeněk Černý, Radek Mucha, Jiří Novotný, Petr Polák, Jan Sixta, Drahošlav Šimek, Robert Šťastný, Jiří Tyc, and Lukáš Wagenknecht—members of the Supervisory Board.

The Supervisory Board had a total of 10 ordinary meetings and one extraordinary meeting in the past period (i.e. from the last Annual General Meeting to April 28, 2016 when the Supervisory Board debated this report).

Supervisory Board meetings were regularly attended by the Chairman of the Board of Directors. Depending on the contents and importance of the agenda, competent members of the Board of Directors and Company employees or representatives of consulting firms were invited to meetings.

As part of its inspection activities, the Supervisory Board also collaborated with the Internal Audit function and the Audit Committee of ČEZ, a. s.

The Supervisory Board has two advisory boards:

1. The Personnel Committee of the Supervisory Board (which held 11 meetings in the past period) having the following members:

- Vladimír Hronek—Committee Chairman;
- Zdeněk Černý—Committee Vice-Chairman;
- Radek Mucha, Jan Sixta, and Robert Šťastný—Committee members.

2. The Strategy Committee of the Supervisory Board (which held seven meetings in the past period) currently having the following members:

- Jiří Tyc—Committee Vice-Chairman;
- Václav Pačes, Petr Blažek, Petr Polák, and Jiří Novotný—Committee members;

Pursuant to the Company's Articles of Association, the Company's Board of Directors should have seven members. There were no changes in the staffing of the Company's Board of Directors in the period in question. In view of the forthcoming expiration of the terms of office of incumbent Board of Directors members Mr. Pavel Cyrani (at October 21, 2015), Ms. Michaela Chaloupková (at October 21, 2015), and Mr. Martin Novák (at May 22, 2016), the Supervisory Board re-elected all aforementioned Board of Directors members for the subsequent term of office.

The Supervisory Board:

- Continuously monitored the activities of ČEZ, a. s. and key decisions made by its Board of Directors and management;
- Dealt with not only suggestions made by its members but also submissions from Company employees, shareholders, or customers, submissions from Company labor unions and citizens associations, a submission from the mayors of some municipalities in the area of the Temelín Power Plant, as well as journalists' questions and anonymous submissions;
- In the past period, the Supervisory Board, either collectively or its individual members, visited the Počerady, Ledvice, Dětmárovice, and Hodonín Power Plants, the Lipno hydro power plants, the nuclear power plants at Dukovany and Temelín, and the nuclear power plant at Kozloduy, Bulgaria;
- Held a number of fruitful workshops concerning e.g.: supervisory board members' positions and powers; supervisory boards in companies co-owned by the government; planning and setting financial goals; designing systemic maintenance measures; specifying key performance indicators (KPIs) for Board of Directors members in 2016 and evaluating their KPIs in 2015; a change in the Company's stock option plan; selling residential property in Prague; procurement process matters; creation/powers/expected activities of the Design Authority for nuclear power plants; trends in renewables;
- Had 2 discussions with the SÚJB Chairwoman concerning the design of systemic measures for maintenance and repair at nuclear power plants and issues associated with welded joints at the Dukovany Power Plant.

Within the scope of its powers and beyond the scope of its obligations as specified by the Company's Articles of Association, the Supervisory Board requested and debated the following information:

- About any obligations arising for the Company from shareholders' suggestions debated at the last Annual General Meeting—here, on behalf of the Supervisory Board, I would like to draw shareholders' attention to the fact that the Annual Report has been expanded to include a list of sponsorship projects (a list of donations and beneficiaries) in 2015 based on such suggestions and beyond the scope required by law;
- About developments in litigation concerning motions seeking nullification of resolutions of the Company General Meeting held on June 27, 2014;
- About the preparation of conditions for selling residential property in Prague;
- About election variants and about calling the election for employee candidates to one-third of the Supervisory Board of ČEZ, a. s.;
- About CEZ Group's approach to the end-customer market;
- About recent developments in the Comprehensive Renovation of the Prunéřov II Power Plant project and the New Ledvice Power Plant Unit project;
- About the Bara power plant, a Bulgarian project for biomass gasification with combined heat and power generation;
- About a technical solution and options for its application concerning the adequate installation of electric meters in areas with high non-technical losses in Bulgaria;

- About the course of cooperation between CEZ Shpendarje and Debt International Advisory in the context of Albania's internal situation and in relation to CEZ Group's foreign operations;
- About the issuance of debt securities, including an overview of issued and outstanding bonds;
- About the results of an internal audit inquiry into the acquisition of Energotrans, a.s.;
- About the selection of the external auditor and the price of audit services for CEZ Group in 2016;
- About plans for CEZ Group's advertising and marketing activities, including a debate on their assessment, and the operations and grant programs of the CEZ Foundation;
- About security concerns relating to physical protection for the Temelín and Dukovany nuclear power plants;
- About costs of nuclear fuel increasing over budget primarily due to exchange rate differences in USD payments and the purchasing of additional conversion and enrichment services;
- About the state of preparation for a nuclear fuel tendering process;
- About the ČEZ Ombudsman activities in the past 5 years;
- About the causes of a boiler house roof fire at the Mělník Power Plant site on October 2, 2015;
- About coal combustion by-products analysis, especially the usability of fly ashes from selective non-catalytic reduction (SNCR) DeNOx;
- About a potential clash of interest from the perspective of the lines of business of ČEZ, a. s.;
- About CEZ Group's financial outlook for 2016–2020 in the context of current electricity prices.

As already mentioned, the Supervisory Board regularly monitored and discussed in detail at its meetings matters concerning welded joints at the Dukovany nuclear power plant, especially: creating a Steering Committee to coordinate work to remedy the undesirable situation and creating a work group to assess the causes of the undesirable situation; investigating the causes; verifying the established system of controls and method of evaluation of X-ray weld images; reviewing all X-ray images of safety-relevant equipment made in 2007–2015 and performing necessary repairs (and additional checks and repairs of welds from 2000–2006 at Dukovany Unit 1); making logistic and technical preparations, including documentation for the repair of unsatisfactory welds; expanding the portfolio of specialist for X-ray inspections and the verification of inspection results/reports by an independent authority; obtaining sufficient expert personnel to repair the welds; reviewing the numbers of checked, evaluated, and repaired welded joints; expected unit start-up dates; the duration and impact of forced power plant unit outages on the Company's financial performance; and the deadline for nuclear power plant compliance with requirements for Unit 1 license renewal by the State Office for Nuclear Safety, which provided consultations and oversight all the time. ČEZ, a. s. reported to the District Prosecuting Attorney's Office in Třebíč a suspected crime of fraud committed by an unknown person in the matter of heterogeneous weld diagnostics at the Dukovany Power Plant. The Supervisory Board acknowledged the Board of Directors' information on key findings, corrective measures, legal assessment, and anticipated future steps resulting from findings made by the Welds Team and Internal Audit of ČEZ, a. s. to date.

At its meetings, the Supervisory Board regularly dealt with:

- Developments in the regulatory environment and legislation in the EU (developments concerning the 2030 Climate and Energy Policy Framework, including European energy companies' operations; activities aimed at establishing the Energy Union; the international agreement concluded at the 21st session of the Conference of the Parties to the United Nations Framework Convention on Climate Change, which is to enter into force in 2020) and the Czech Republic (establishing a "Register of Contracts"; drawing up the "National Action Plan for Nuclear Energy Development in the Czech Republic"; an amendment to the "Energy Act, Mining Act, and Payments from the Extraction of Mined Minerals in the Czech Republic"; the "Raw Material Policy and Coal Mining Limits"; "Payments from the Extraction of Mined Minerals in the Czech Republic"; the "Award Procedure Act"; the "Atomic Energy Act"; the "Water Act"; "Simplification of Licensing Procedures"; "Extension of the Supreme Audit Office's Powers"; as well as issues associated with the handling of boric acid, support for supported energy sources, etc.);

- As well as developments in the regulatory environment for foreign acquisitions and the impacts of the external environment on CEZ Group—especially in Bulgaria, Romania, Turkey, and Poland:
  - The Supervisory Board was informed by the Board of Directors about the Republic of Albania’s fulfillment of the Settlement Agreement;
  - The Supervisory Board regularly monitored developments concerning CEZ Group’s operations in the Bulgarian energy market: repeated proceedings for revoking ČEZ’s electricity trading license by the Bulgarian regulatory authority, with the proceedings still pending; disallowing legitimate operating costs, amount of technical losses, return standards, the distribution company’s recognized investments, or the sales company’s losses resulting from a failure to open up the market (liberalization was promised back in 2007); increased price decisions that aggravate our Bulgarian subsidiaries’ distribution as well as sales positions;
  - The Supervisory Board acknowledged that the procedure in the European Commission, started with a complaint against Bulgaria filed in March 2013, is still underway, as well as that no progress towards remedy has been seen since a Warning Letter was sent to the Bulgarian government in October 2014; therefore, a Notice of Dispute was served, aiming at initiating an international investment arbitration against the Republic of Bulgaria;
 

Therefore (as a result of information on zero improvement and expending all available means), the Supervisory Board at its April meeting acknowledged information about the Board of Directors’ decision to commence an international investment arbitration against the Republic of Bulgaria by submitting a Request for Arbitration to the International Centre for Settlement of Investment Disputes (ICSID) under the Agreement Between the Czech Republic and the Republic of Bulgaria for the Promotion and Reciprocal Protection of Investments and/or under the Energy Charter Treaty;
  - The Supervisory Board was kept informed about developments in the legislative process concerning changes in the system of support for renewable sources and the postponement of green certificate allocation in Romania;
  - The Supervisory Board was also informed about operational matters and the financial performance of foreign assets within CEZ Group.

The Supervisory Board regularly debated impacts of developments in the external environment on the Company’s acquisition and investment priorities and granted its prior consent, for example, to decisions on:

- Increasing the registered capital of CEZ Distributie S.A. by increasing the nominal value of its shares and subsequently decreasing the registered capital of CEZ Distributie S.A. by decreasing the nominal value of its shares (in connection with paying the company’s shareholders);
- Increasing the registered capital of a controlled company: Tomis Team S.A. in Romania and Ovidiu Development S.R.L. having its registered office in Romania;
- Winding up the Dutch subsidiary CEZ Silesia B.V. through a merger by acquisition by CEZ Poland Distribution B.V. (in order to decrease the cost of the administration of Dutch subsidiaries and unify the shareholding ownership structure);
- Winding up CEZTel, a.s., and putting it into liquidation with effect from January 1, 2016;
- Legal actions to implement the project for increasing the registered capital of ČEZ ESCO, a. s. (as part of the consolidation of entities in which ČEZ, a. s. has a stake);
- A project according to a merged document with a business plan / project outline for the Dukovany NPP, “6985—Provisions for Storing Spent Nuclear Fuel at the Dukovany NPP After 2021,” revision 1 (in relation to resolving issues associated with the storage of newly introduced enhanced nuclear fuel);
- Establishing wholly owned subsidiary Elektrárna Temelín II, a.s. with a registered capital of CZK 50m and wholly owned subsidiary Elektrárna Dukovany II, a.s. with a registered capital of CZK 50m, acknowledging the plan to spin off the projects for the construction of the Temelín new nuclear power plant (NNPP) and Dukovany NNPP into the subsidiaries;

And subsequently on the implementation of the plan to increase the registered capital of Elektrárna Temelín II, a. s. and Elektrárna Dukovany II, a. s. in the form of non-cash contribution consisting of a part of the enterprise of ČEZ, a. s.—the “Temelín NNPP” organizational unit and the “Dukovany NNPP” organizational unit—including the transfer of immovable and movable property included in the part of the enterprise in question;

- Proceeding with the implementation of the capital project “New 660 MWe Unit at the Ledvice Power Plant” according to Amendment 5 to the Plan for Project Construction, including a postponement of the project completion date until March 31, 2016 and an increase in the project’s budgetary costs of no more than CZK 1.183bn (recommending the Board of Directors to request extended warranties in place of contractual penalties for default during negotiations with selected contractors);
- Issuing bonds under the domestic bond program in 2016 through 2018 on condition that the total value of issued and outstanding bonds shall not exceed CZK 15bn (or the equivalent amount in a foreign currency) at any moment;
- Providing a security by ČEZ, a. s. for a loan for controlled Turkish companies AKCEZ, SEDAS, and SEPAS in connection with refinancing an existing guaranteed loan and a new investment loan, acknowledging the terms and conditions of the transaction, defining the conditions and circumstances under which financial documents are to be concluded.

In the context of the foregoing, the Supervisory Board furthermore debated and acknowledged:

- Information about the course and development of an opportunity to acquire Vattenfall’s selected assets in Germany, continually at its every meeting since the spring of 2015, including information on valuation and a summary of due diligence findings, with the conclusion that a firm offer will not be submitted;
- Information about the performed restructuring of the ownership structure of Polish companies under the Consolidation Abroad program; information about the course and progress of project development during the preparation of a wind portfolio in Poland; and information about the evaluation of projects concerning a potential acquisition in Poland;
- Information about the preparation, course, and execution of distribution and sales unbundling at the Turkish company AKCEZ (in order to comply with applicable legislation);
- Information about the preparation and execution of the sale of the Akocak, Turkey 80 MW run-of-river hydro power plant (as part of the optimization of Turkish Akenerji’s generation assets portfolio);
- Information about the joint venture with Hungarian company MOL, namely that all assets were sold back to MOL and the Company thus left the Hungarian market;
- Information about key business transactions in progress, business plan fulfillment, and crucial transformation activities at the subsidiary ŠKODA PRAHA, a.s.;
- And finally, information about the investment strategy of ČEZ Nová energetika, a. s., operating under the brand name of INVEN CAPITAL, through which ČEZ wants to participate in the quickly growing “new energy” market (e.g. acquiring a stake in Sonnenbatterie).

In addition to the condition of domestic and foreign shareholdings of ČEZ, a. s. (including selected financial results in the periods in question), the Supervisory Board also debated trends and developments in CEZ Group’s market share, the condition and development of CEZ Group’s debt capacity, CEZ Group’s risk management system and hedging, and the issuance of debt securities.

Several times in the past period the Supervisory Board granted its prior consent to the Board of Directors taking decisions on changes in the staffing and number of members of supervisory boards at companies in whose registered capital ČEZ, a. s. has a stake exceeding CZK 500m.

The Supervisory Board also expressed its favorable opinion of the CEZ Group Business Plan for 2016–2020 and the Budget of ČEZ, a. s. and the budgets of CEZ Group subsidiaries for 2016.

The Supervisory Board also debated the modification of Company management to keep fulfilling its strategy (establishing the “Development” and “Operations” teams), expressing its favorable opinion of the plan for organizational change aimed at adjusting the Company’s organizational structure (as at January 1, 2016). Accordingly, the Supervisory Board debated changes to the Organizational Rules of ČEZ, a. s., expressing its favorable opinion on them. It also acknowledged information about the approval of a revision of the Work Rules

of ČEZ, a. s. and the Signature Rules of ČEZ, a. s. as well as information on the results of collective bargaining at the Company. With regard to the Company's goals and priorities for the next period, the Supervisory Board discussed in detail the specification of individual tasks in 2016 and criteria thereof for members of the Board of Directors at the Supervisory Board's discussion workshop and in collaboration with the Supervisory Board Personnel Committee. The Supervisory Board subsequently approved the assessment of the fulfillment of specific tasks of members of the Board of Directors in 2015, which is crucial for the determination of their annual royalties. The Supervisory Board debated any stock option plans to be opened or terminated for selected managers on an ongoing basis. Additionally, the Supervisory Board concerned itself with draft templates for contracts of service on the Supervisory Board and on the Audit Committee at its meeting, debating and acknowledging the templates.

In addition to regular information on the current condition of any events at the nuclear power plants, as well as regular information on the course of comprehensive power plant renovation projects and new plant construction projects, the Supervisory Board also debated regular reports on CEZ Group's major investment projects, in particular projects concerning: the comprehensive renovation of the Prunéřov Power Plant, projects for new units at the Temelín Nuclear Power Plant (Temelín 3 & 4) and Dukovany Nuclear Power Plant (Dukovany 5), EcoWind projects in Poland, risk management for the Dukovany Long-Term Operation (LTO) program, and capital expenditure at ČEZ Distribuce, Severočeské doly, and in Information and Communication Technologies (ICT). In those reports, the Supervisory Board was informed about the status and course of capital projects, technologies used, contractors, work schedules, and budget utilization.

The Supervisory Board regularly debated monthly, quarterly, and annual financial results at its meetings. **On behalf of the Supervisory Board, I can state that the financial performance of ČEZ, a. s. in 2015**—in relation to the developments in the energy market and fatal effect of electricity prices, unfavorable events, in particular the issues with welded joints at the Dukovany Power Plant, in relation to some unfavorable effects in Bulgaria and Romania, and considering the effects of the competitive environment in the Czech energy market—**is considered satisfactory.**

In compliance with Article 18(5)(c) of the Company's Articles of Association, the Supervisory Board **reviewed** the Related Parties Report for 2015 and **has no reservations** about its contents.

As for the other items on the agenda of today's General Meeting, I would like to inform you of the following opinions of the Supervisory Board:

#### **Concerning item 4:**

In compliance with Article 18(5)(c) of the Company's Articles of Association, the Supervisory Board **reviewed**:

- The financial statements of ČEZ, a. s. prepared as at December 31, 2015, including the auditor's opinion (dated April 18, 2016),
- The consolidated financial statements of CEZ Group prepared as at December 31, 2015, including the auditor's opinion (dated April 18, 2016)

And during this review, it **did not find any shortcomings or errors** in the contents or the method of compilation or the process of audit of the financial statements and, on the basis of these facts and taking account of the auditor's opinions, it **recommends** that the General Meeting of ČEZ, a. s. approve both sets of financial statements.

#### **Concerning item 5:**

Pursuant to Article 18(5)(c) of the Company's Articles of Association, the Supervisory Board **reviewed** the presented proposal for the distribution of the 2015 profit of ČEZ, a. s., including the decision on the payment of dividends and royalties, **and recommends** that the General Meeting **approve** it.

Finally, I am conveying the Supervisory Board's satisfaction with the fact that ČEZ, a. s. has one of the highest Standard & Poor's investment ratings among European electric companies and that ČEZ's rating by this leading ratings agency was not downgraded, as was the case with many of our competitors.

Ladies and gentlemen, dear shareholders, thank you for your attention.

**Václav Pačes,**  
Chairman of the Supervisory Board of ČEZ, a. s.