POLSKIE GÓRNICTWO NAFTOWE I GAZOWNICTWO S.A.

Polskie Górnictwo Naftowe
i Gazownictwo SA

DIRECTOR'S REPORT
ON PGNiG GROUP'S OPERATIONS
IN 2006

Warsaw, April 3rd 2007

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Chapter I: Key Information on the PGNiG Group

1. Establishment of PGNiG S.A.

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with registered offices in Warsaw, ul. Krucza 6/14, was established as a result of transformation of the state-owned enterprise under the name Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. The Deed of Transformation, together with the Company's Articles of Association, were executed in the form of a notarial deed dated October 21st 1996 (Rep. A No. 18871/96).

The Minister of the State Treasury executed the Deed of Transformation pursuant to the Regulation of the President of the Polish Council of Ministers on transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo of Warsaw into a state-owned stock company.

On October 30th 1996, the Company was entered in the commercial register under the name Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw under entry No. RHB 48382. As of the registration date, the Company acquired legal personality. On November 14th 2001, the Company was entered into the Register of Entrepreneurs of the National Court Register under entry No. 0000059492.

With a view to implementing the Restructuring and Privatisation Programme of PGNiG adopted by the Polish Council of Ministers on October 5th 2004, by virtue of a decision issued by the Polish Securities and Exchange Commission, PGNiG S.A. shares were admitted to public trading on May 24th 2005.

On October 6th 2005, the District Court of the Capital City of Warsaw registered a share capital increase at PGNiG S.A. Following the increase, the Company's share capital amounts to PLN 5.9bn and is divided into 5,900,000,000 shares, including:

- 4,250,000,000 Series A bearer shares with a total par value of PLN 4,250m,
- 750,000,000 Series A1 bearer shares with a total par value of PLN 750m,
- 900,000,000 Series B bearer shares with a total par value of PLN 900m.

PGNiG S.A. shares have been listed on the Warsaw Stock Exchange since October 20th 2005.

The PGNiG Group remains the only vertically integrated company in the Polish gas sector, holding the leading position in most segments of the domestic gas sector. Polskie Górnictwo Naftowe i Gazownictwo S.A. is the parent company of the PGNiG Group.

The scope of the PGNiG Group's business comprises exploration of reserves, import of natural gas, extraction and storage of gaseous fuels as well as trade in and distribution of natural gas. The natural gas and crude oil production are among the key factors securing the Company's competitive advantage on the liberalised gas market. The core business of the PGNiG Group includes retail trade in and distribution of natural gas. These activities are handled by the Gas Companies, which are strategic members of the Group. The Gas Companies are also engaged in operation, maintenance and development of the distribution system. In the first half of 2007, gas trading will be separated from gas distribution and Distribution System Operators will be separated within the Gas Companies

The trade in and distribution of natural gas, which together with natural gas and crude oil production constitute the core business of the PGNiG Group, are governed by the Polish Energy Law, and therefore the Group's operations require a licence and the Group's revenue depends on the tariff rates for gaseous fuels as approved by the Polish Energy Regulatory Authority. Exploration and production activities are governed by the Polish Geological and Mining Law and are conducted on a licence basis.

2. Organisational Structure of the PGNiG Group

The PGNiG Group consists of production, trading and service companies incorporated under the commercial law. PGNiG S.A. is the parent undertaking in the Group.

As at December 31st 2006, PGNiG S.A. held shares in 56 commercial-law companies, including:

- 25 companies in which PGNiG S.A. held over 50% of shares,
- 17 companies in which PGNiG S.A. held between 20% and 50% of shares,
- 14 companies with the Company's shareholding below 20%.

The total nominal value of PGNiG S.A.'s equity interests in the commercial-law companies was PLN 6,574.4m as at December 31st 2006.

The companies in which PGNiG S.A. held 5% or more of shares as at December 31st 2006 are listed in the table below.

PGNiG S.A.'s equity interests in other companies

	Company name	Share capital (PLN)	Shareholding of PGNiG S.A. (PLN)	% of share capital held
	Strategic companies			
1	Karpacka Spółka Gazownictwa Sp. z o.o.	1,570,832,000.00	1,570,832,000.00	100.00%
2	Górnośląska Spółka Gazownictwa Sp. z o.o.	1,292,551,000.00	1,292,551,000.00	100.00%
3	Mazowiecka Spółka Gazownictwa Sp. z o.o.	999,634,000.00	999,634,000.00	100.00%
4	Wielkopolska Spółka Gazownictwa Sp. z o.o.	893,019,000.00	893,019,000.00	100.00%
5	Pomorska Spółka Gazownictwa Sp. z o.o.	563,031,000.00	563,031,000.00	100.00%
6	Dolnośląska Spółka Gazownictwa Sp. z o.o.	552,762,000.00	552,762,000.00	100.00%
	Core companies			
7	PNiG Jasło Sp. z o.o.	100,000,000.00	100,000,000.00	100.00%
8	PNiG Kraków Sp. z o.o.	98,850,000.00	98,850,000.00	100.00%
9	PN Diament Sp. z o.o.	62,000,000.00	62,000,000.00	100.00%
10	PNiG NAFTA Sp. z o.o.	60,000,000.00	60,000,000.00	100.00%
11	GEOFIZYKA Kraków Sp. z o.o.	34,400,000.00	34,400,000.00	100.00%
12	GEOFIZYKA Toruń Sp. z o.o.	33,000,000.00	33,000,000.00	100.00%
13	Zakład Robót Górniczych Krosno Sp. z o.o.	26,802,000.00	26,802,000.00	100.00%
14	B.SiP.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%
15	SGT EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%
16	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%
	Special-purpose vehicles			
17	Górnictwo Naftowe Sp. z o.o.	50,000.00	50,000.00	100.00%
18	PGNiG Finance B.V. (EUR)*	20,000.00	20,000.00	100.00%
19	NYSAGAZ Sp. z o.o.	3,700,000.00	1,887,000.00	51.00%
20	InterTransGas GmbH (EUR)*	200,000.00	100,000.00	50.00%
21	INVESTGAS S.A.	502,250.00	502,250.00	100.00%
22	Polskie Elektrownie Gazowe Sp. z o.o.	2,500,000.00	1,212,000.00	48.48%
23	Dewon Z.S.A. (UAH)*	11,146,800.00	4,055,205.84	36.38%

Other companies - material

24	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%
25	BUG Gazobudowa Sp. z o.o.	39,220,000.00	39,220,000.00	100.00%
26	ZUN Naftomet Sp. z o.o.	23,500,000.00	23,500,000.00	100.00%
27	ZRUG Sp. z o.o. (of Pogórska Wola)	4,300,000.00	4,300,000.00	100.00%
28	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%

Other companies – non-material

29	BN Naftomontaż Sp. z o.o. in bankruptcy	44,751,000.00	39,751,000.00	88.83%
30	PPUiH „TURGAZ" Sp. z o.o.	176,000.00	90,000.00	51.14%
31	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%
32	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%
33	IZOSTAL S.A.	22,488,000.00	1,360,000.00	6.05%
34	TeNET 7 Sp. z o.o.	50,000.00	5,000.00	10.00%
35	Agencja Rynku Energii S.A.	1,376,000.00	100,000.00	7.27%
36	ZRUG Warszawa S.A. in liquidation	6,000,000.00	2,940,000.00	49.00%
37	Sahara Petroleum Technology Llc (RO)*	150,000.00	73,500.00	49.00%
38	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%
39	ZRUG Sp. z o.o. (of Poznań)	3,781,800.00	1,515,000.00	40.06%
40	HS Szczakowa S.A. in bankruptcy	16,334,989.44	5,439,494.72	33.30%
41	ZRUG TORUŃ S.A.	4,150,000.00	1,300,000.00	31.33%
42	Przeds. Wielobranżowe MED - FROZ S.A. in liquidation	151,700.00	35,000.00	23.07%
43	ZRUG Zabrze Sp. z o.o.	2,750,000.00	600,000.00	21.82%
44	TE-MA WOC Małaszewicze Terespol Sp. z o.o. in liquidation	262,300.00	55,000.00	20.97%
45	Zakład Remontowy Urządzeń Gazowniczych Wrocław Sp. z o.o. in bankruptcy	1,700,000.00	270,000.00	15.88%
46	Polski Serwis Płynów Wiertniczych Sp. z o.o.	250,000.00	35,000.00	14.00%
47	WALCOWNIA RUR JEDNOŚĆ Sp. z o.o.	220,590,000.00	18,310,000.00	8.30%
48	PI GAZOTECH Sp. z o.o. **	1,203,800.00	65,000.00	69.44%
49	Polskie Konsorcjum Energetyczne Sp. z o.o.	100,000.00	9,500.00	9.50%

* Amounts in foreign currencies

** The shares held by one of the partners were cancelled by virtue of a decision by the Extraordinary General Shareholders Meeting of April 23rd 2004. The share capital and par value of shares remained unchanged.

Based on their business and importance to the Group's operations, the Group companies have been divided into the following categories:

- strategic companies,
- core companies,
- special-purpose vehicles,
- other companies (material and non-material).

Strategic companies

Gas Companies are the strategic companies within the Group. Their activities encompass retail trade in and distribution of natural gas, sales-related activities as well as the activities connected with the operation, maintenance and development of the distribution system. The companies were created on the basis of 23 gas utilities by way of contribution of the utilities' assets. Their operations span the entire territory of Poland. They supply gas to over six million customers, including industrial customers and households. Retail customers form their largest customer group (more than 95%).

The strategic companies include:

- Dolnośląska Spółka Gazownictwa Sp. z o.o.
- Górnośląska Spółka Gazownictwa Sp. z o.o.
- Karpacka Spółka Gazownictwa Sp. z o.o.
- Mazowiecka Spółka Gazownictwa Sp. z o.o.
- Pomorska Spółka Gazownictwa Sp. z o.o.
- Wielkopolska Spółka Gazownictwa Sp. z o.o.

Core companies

Core companies are the companies of major importance to the PGNiG Group. Their scopes of business and functions they perform are vital for implementation of PGNiG S.A.'s principal business objectives, facilitate expansion of the supply base and development of the gas sales market. Most of the core companies have been established on the basis of PGNiG S.A.'s branches, and the range of their activities covers exploration of reserves, geophysical surveying, specialisst services, gas transmission services and engineering services.

The core companies include:

- Three exploration companies (PNiG Kraków Sp. z o.o., PNiG Jasło Sp. z o.o., and PNiG NAFTA Sp. z o.o. of Piła), which are of key importance for attaining the strategic goals of the PGNiG Group and play crucial role in the implementation of principal business task, namely, increase in production and maintenance of the resource sustainability index.
- Two service companies (PN Diament Sp. z o.o. and Zakład Robót Górniczych Krosno Sp. z o.o.), which provide professional services related to exploration and production activities as well as borehole mining.
- Two geophysical companies (GEOFIZYKA Kraków Sp. z o.o. and GEOFIZYKA Toruń Sp. z o.o.), which play the key role in the exploration segment and significantly contribute to the implementation of principal business objectives of increasing production and maintaining the resource sustainability index.

- SGT EUROPOL GAZ S.A which operates the transmission capacities of the first line of the Polish section of the transit pipeline network, and provides services of gas transmission between the Belarus-Poland border and gas terminals in Włocławek and Lwówek, as well as between the terminals and the Germany-Poland border.
- GAS-TRADING S.A., a shareholder in SGT EUROPOL GAZ S.A and a company trading in propane-butane gas.
- B.S.iP.G. Gazoprojekt S.A., an engineering company, included in the group of core companies as an undertaking which supports operations of the entire Group by providing consulting and engineering services as well as expertise on gas market issues.

Special-purpose vehicles

Special-purpose vehicles are undertakings established for the purpose of pursuing long-term strategic objectives of the PGNiG Group. Upon evaluation of performance (i.e. extent to which the objectives have been achieved, and revenue levels) and future prospects of a special-purpose vehicle, it is either re-classified as a core company or dissolved/ disposed of if it has failed to meet its objectives.

This group of companies includes:

- PGNiG Finance B.V. – a company incorporated for the purpose of issuing euro-denominated bonds of PGNiG S.A.
- Górnictwo Naftowe Sp. z o.o. – a company incorporated on December 22nd 2000 in order to implement the Polish Council of Ministers' resolution on changes to the organisational restructuring programme for Polskie Górnictwo Naftowe i Gazownictwo. The company's share capital is PLN 50,000. The company does not conduct any business activities.
- InterTransGas GmbH – a company incorporated with a view to executing the construction of an interconnector, linking the Polish and European transmission networks, and providing the platform for conducting gas transmission operations outside Poland (currently the company does not conduct the activities defined as its core business).
- Dewon Z.S.A. – the aim behind PGNiG S.A.'s acquiring an interest in the company was to gain access to foreign reserves of natural resources, their production and import to Poland.
- INVESTGAS S.A. – the company was established to provide operator services to KPMG Mogilno.
- NYSAGAZ Sp. z o.o. – the company was established to upgrade (to gas-fired utilities) and operate CHP plants in Zgorzelec, Bolesławiec and Wrocław, and to provide energy production and supply services. Currently, the company executes projects involving gas as a fuel for heat production.
- Polskie Elektrownie Gazowe Sp. z o.o. – the company was founded to implement projects involving the use of natural gas as fuel for heat and electricity generation, including operation and maintenance of cogeneration units.

Other companies – material

Other companies of the PGNiG which are considered material include undertakings which support the Group's operations and offer added value through provision of unique services. This category comprises:

- BUD-GAZ PPUH Sp. z o.o. – engaged in real property management and provision of training services

- BUG Gazobudowa Sp. z o.o. – design, construction and repair of pipelines, equipment and units used in oil mining and gas engineering
- ZRUG Sp. z o.o. of Pogórska Wola – general construction services related to linear engineering structures: pipelines, power supply lines, electrified tracks and telecommunication transmission lines
- ZUN Naftomet Sp. z o.o. – manufacture, repair and maintenance of machinery for mining, quarrying and construction
- Geovita Sp. z o.o. – operator of leisure and tourist centres.

Other companies – non-material

The other PGNiG Group companies, considered non-material, are those undertakings which are not directly involved in PGNiG S.A.'s core business or which do not provide significant support for the Group. This category includes companies which are engaged in the construction, maintenance and repair of pipelines; companies whose shares were acquired as a result of bank arrangement proceedings; companies in which PGNiG S.A. does not hold significant interests or whose business profile no longer justifies their presence in PGNiG S.A.'s portfolio.

Companies consolidated in 2006

List of companies consolidated with the full method and included in the PGNiG's accounts for 2006:

1. Karpacka Spółka Gazownictwa Sp. z o.o.
2. Wielkopolska Spółka Gazownictwa Sp. z o.o.
3. Mazowiecka Spółka Gazownictwa Sp. z o.o.
4. Pomorska Spółka Gazownictwa Sp. z o.o.
5. Górnośląska Spółka Gazownictwa Sp. z o.o.
6. Dolnośląska Spółka Gazownictwa Sp. z o.o.
7. GEOFIZYKA Kraków Sp. z o.o.
8. GEOFIZYKA Toruń Sp. z o.o.
9. Poszukiwania Nafty i Gazu Jasło Sp. z o.o.
10. Poszukiwania Nafty i Gazu Kraków Sp. z o.o.
11. Poszukiwania Nafty i Gazu NAFTA Sp. z o.o.
12. Poszukiwania Naftowe Diament Sp. z o.o.
13. Zakład Robót Górniczych Krosno Sp. z o.o.
14. Budownictwo Urządzeń Gazowniczych Gazobudowa Sp. z o.o.
15. Zakład Urządzeń Naftowych Naftomet Sp. z o.o.
16. Geovita Sp. z o.o.
17. PGNiG Finance B.V.
18. Budownictwo Naftowe Naftomontaż Sp. z o.o. w upadłości (in bankruptcy)
19. NAFT-STAL Sp. z o.o. (an indirect subsidiary controlled through BN Naftomontaż Sp. z o.o.)
20. B.SiP.G. Gazoprojekt S.A.
21. INVESTGAS S.A.

List of companies consolidated using the equity method and included in the PGNiG's accounts for 2006:

1. SGT EUROPOL GAZ S.A.
2. GAS-TRADING S.A.

3. Changes in the Structure of the PGNiG Group in 2006

The changes in structure of the PGNiG Group which occurred in 2006 or subsequent to the balance-sheet date are described below.

1. In May 2006, PGNiG S.A. obtained a confirmation from the National Court Register on deletion from the Register of Entrepreneurs of entities in which the Company held insignificant interests, i.e. HSW-Zakład Mechaniczny Sp. z o.o. w upadłości (in bankruptcy) and PZUO WARMA S.A. w upadłości (in bankruptcy).

2. On June 30th 2006, the Extraordinary General Shareholders Meeting of INVESTGAS S.A. resolved to acquire 255 shares from Energopol-Warszawa S.A. with a view to cancelling them. The 255 shares held by Energopol-Warszawa S.A. were valued at PLN 5,000,000 and paid for paid with funds available for distribution under Art. 348.1 of the Commercial Companies Code.

   Pursuant to the resolution adopted by the company's Extraordinary General Shareholders Meeting, 255 shares were cancelled, whereby the company's share capital was reduced from PLN 500,000 to PLN 245,000. Concurrently, the Extraordinary General Shareholders Meeting increased the company's share capital to PLN 502,250, by way of increasing the par value of each of 245 shares held by PGNiG S.A. to PLN 2,050; the increase was confirmed with a court decision of July 24th 2006. The share capital increase was financed with capital reserves of INVESTGAS S.A., created from profit. Currently, the company is wholly-owned by PGNiG S.A.

3. Share capital of two Gas Companies was increased by way of contributions in kind. The share capital of Górnośląska Spółka Gazownictwa Sp. z o.o. was increased by PLN 4,148,000, to PLN 1,292,551,000, and the share capital of Wielkopolska Spółka Gazownictwa Sp. z o.o. was increased by PLN 28,948,000, to PLN 893,019,000.

4. On December 27th 2006, as part of work related to separation of gas distribution from gas trading, under"The Restructuring Plan for the PGNiG Group concerning Integration of the Trading Business at PGNiG S.A. and Transformation of the Gas Companies into Distribution System Operators", adopted by the Extraordinary General Shareholders Meeting on November 3rd 2006, the following companies were established, each with share capital of PLN 50,000:

   - Dolnośląska Spółka Obrotu Gazem Sp. z o.o.
   - Górnośląska Spółka Obrotu Gazem Sp. z o.o.
   - Karpacka Spółka Obrotu Gazem Sp. z o.o.
   - Mazowiecka Spółka Obrotu Gazem Sp. z o.o.
   - Pomorska Spółka Obrotu Gazem Sp. z o.o.
   - Wielkopolska Spółka Obrotu Gazem Sp. z o.o.

In the first quarter 2007, the Gas Trading Companies were entered in the National Court Register. The management boards of the Gas Trading Companies filed demerger plans with their respective courts for review.

4. Workforce

Since 2000, the PGNiG Group has been implementing the "Programme of employment restructuring and employee protection measures for PGNiG S.A. branches and subsidiaries". As part of the Programme, extensive restructuring measures are to be taken, including:

- Old-age and early retirement schemes,
- Granting pre-retirement benefits to eligible employees,
- Employing some staff in companies partly owned by PGNiG S.A. and in companies taken over by employees,
- Employing some staff at entities cooperating with PGNiG S.A.,
- Shortening the working hours on certain posts and making other posts redundant.

Since 2003, the PGNiG Group has been implementing the "Programme of employment restructuring... Phase II", whose completion is scheduled for 2007.

In the period from January 1st 2004 to December 31st 2006, 4,296 employees were covered by the Programme, including:

- at PGNiG S.A. branches - 1,245 employees
- at the Gas Companies - 1,982 employees
- at other subsidiary companies - 962 employees
- at regional transmission branches (until June 30th 2005) - 107 employees.

As a result of the Programme implementation, in the discussed period the Group achieved cost savings related to payroll and employee benefits of PLN 296m, while the positive effect of restructuring, after costs of restructuring and the financial costs incurred in connection with recruitment of new staff, reached PLN 128m. In the period from January 1st 2003 to December 31st 2006, headcount at the companies covered by the Programme decreased in absolute terms by 5,829 employees (taking into account the transfer of 2,181 employees in connection with the spin-off of OGP GAZ-SYSTEM S.A.). In 2006, the restructuring processes covered 1,036 employees.

Chapter II: Governing Bodies of PGNiG S.A.

1. Management Board

As stipulated in the Company's Articles of Association, the number of persons on PGNiG S.A.'s Management Board is determined by the Supervisory Board and ranges from two to seven. The members are appointed for the common term of office, which lasts three years. Individual members or the entire Management Board are appointed by the Supervisory Board. The member of the Management Board is appointed following the verification procedure, pursuant to the Regulation of the Council of Ministers on the verification procedure for positions of Management Board members in certain companies, dated March 18th 2003 (Dz. U. No. 55, item 476). The regulation does not apply to the Management Board member appointed by employees. Each Management Board member may be appointed or removed from office by the Supervisory Board or the General Shareholders Meeting. As long as the State Treasury remains the Company's shareholder and the average annual headcount exceeds 500, a person elected by the Company employees is appointed to the Management Board.

1.1. Changes in the Management Board

As at December 31st 2006, PGNiG S.A.'s Management Board consisted of five persons:

- Krzysztof Głogowski – President
- Jan Anysz – Vice-President
- Zenon Kuchciak – Vice-President
- Stanisław Niedbalec – Vice-President
- Tadeusz Zwierzyński – Vice-President.

The following changes occurred in the composition of the PGNiG S.A.'s Management Board in 2006:

- On February 17th 2006, the Supervisory Board appointed Mr Stanisław Niedbalec for the position of Vice-President and Director of Investments and Technology, and Mr Bogusław Marzec – for the position of Vice-President and Financial and Economic Director.
- On March 3rd 2006, the Supervisory Board removed from office Mr Franciszek Krok, who had held the position of Vice-President of the Management Board.
- On April 6th 2006 the Supervisory Board appointed Mr Bartłomiej Pawlak as Vice-President and Strategic Projects Director.
- On April 7th 2006 the Supervisory Board appointed Mr Zenon Kuchciak as Vice-President and Sales and Marketing Director.
- On April 25th 2006 the Supervisory Board appointed Mr Bogusław Marzec as President of the Management Board.
- Mr Bogusław Marzec resigned from as President of the Management Board as of June 21st 2006.

- On June 23rd 2006, Mr Mieczysław Puławski, who performed the function of Supervisory Board member, was delegated to temporarily serve as President of the Management Board in the period from June 24th 2006 to September 12th 2006.
- Mr Bartłomiej Pawlak resigned as Management Board member, effective as of July 21st 2006.
- On September 12th 2006, Mr Mieczysław Puławski, Supervisory Board member, was delegated to temporarily serve as President of the Management Board for another period from September 13th 2006 to September 23rd 2006.
- On September 11th 2006, the Supervisory Board appointed Mr Tadeusz Zwierzyński as Management Board member and Vice-President and Strategic Projects Director.
- On September 11th 2006, the Supervisory Board appointed Mr Krzysztof Głogowski as President of the PGNiG S.A.'s Management Board, effective as of October 1st 2006.

The Management Board are governed by Polish laws, in particular the provisions of the Commercial Companies Code, as well as by the Company's Articles of Association and the Rules of PGNiG S.A.'s Management Board. The latter are adopted by the Management Board and approved by the Supervisory Board.

In 2006, the Rules were amended; the amendments primarily consisted in bringing the provisions on the scope of issues to be resolved by means of Management Board's resolutions in line with the wording of PGNiG S.A.'s Articles of Association. Pursuant to the amended sub-paragraph 2 in section III of the Rules, the following issues are to be resolved by way of the Management Board's resolutions:

1. adopting the Rules for the Management Board,
2. adopting the organisational rules for the Company,
3. creating and dissolving the Company branches,
4. appointing a proxy,
5. dividing powers between the Board members, with the proviso that a relevant resolution of the Board requires approval of the Supervisory Board, pursuant to Par. 33.1.11 of the Company' Articles of Association,
6. contracting and advancing loans, subject to Par. 33.2.3 and Par.33.3.16 of the Company's Articles of Association,
7. adopting annual business plans (i.e. specifying the tasks to be performed and the related budgets), investment plans, long-term strategic plans, and investment plans concerning the development of the transmission network, subject to Par. 33.1.6 of the Articles of Association,
8. assuming contingent liabilities, also through issuance of guarantees, sureties or promissory notes, subject to Par. 33.2.3 and Par.33.3.16 of the Company's Articles of Association,
9. disposing of and acquiring non-current assets such as real estate, perpetual usufruct rights or interests in real estate with a value of no less than the złoty equivalent of EUR 50,000, subject to Par. 33.2.1–2 and Par. 56.3.2–3 of the Articles of Association,
10. issues to be examined by the Supervisory Board or the General Shareholders Meeting upon request made by the Management Board,
11. approving the information specified in Par. 23.2 of the Company's Articles of Association,
12. making donations, releasing debtors from their debt obligations and entering into other agreements outside the scope of the Company's business activities as specified in the Company's Articles of Association,

13. concluding sales contracts for natural gas, oil, gasoline and other oil and gas derivatives with a value exceeding 20% of the Company's share capital, with the proviso that in the case of sale contracts with a value exceeding the PLN equivalent of EUR 100,000,000, a Supervisory Board's opinion is to be sought, subject to the provisions of Par. 33.2.3 of the Company's Articles of Association,
14. entering into legal transactions other than those specified in Par. 1.1.1–13, if their value exceeds the PLN equivalent of EUR 420,000.

The Management Board does not have the right to issue or repurchase Company shares. In accordance with Par. 56.3.5 and Par. 56.3.8 of the Articles of Association, such right is vested with the General Shareholders Meeting.

1.2. Agreements Concluded with Members of the Management Board

In 2006, employment contracts concluded between PGNiG S.A., represented by Chairman of the Supervisory Board acting pursuant to the Company's Articles of Association and the Rules of PGNiG S.A.'s Supervisory Board, contained the following clause: "In the event of removal from office, termination of the employment contract for reasons other than breach of basic responsibilities related to employment, or reasons leading to termination of the employment contract under Art. 52 of the Polish Labour Code, member of the Management Board may be granted severance pay whose amount does not exceed three times monthly salary."

At present, the employment contracts concluded with the managing personnel after June 2006 include the following clause: "In the event of removal from office or termination of the employment contract for reasons other than breach of basic responsibilities related to employment, member of the Management Board may be granted severance pay whose amount does not exceed three times monthly salary."

Non-competition agreements are concluded for 12 months, from the date of termination of the employment relation. In return for compliance with the non-competition agreement during its term, Management Board member is entitled to monthly compensation of 150% of the average gross remuneration for the last three months, received while under employed.

1.3. Proxies

As at December 31st 2006, two persons were appointed as the Company's proxies:

- Ewa Bernacik
- Bogusław Marzec.

In 2006, the following changes were made in relation to the PGNiG S.A.'s proxies:

- In connection with the appointment of Messrs Zenon Kuchciak and Bartłomiej Pawlak to the Management Board of PGNiG S.A., the powers of proxy granted to them were revoked on April 11th 2006.
- On June 23rd 2006, the Management Board of PGNiG S.A. appointed Mr Bogusław Marzec as proxy.

- On July 24th 2006, the Management Board of PGNiG S.A. appointed Mr Tadeusz Zwierzyński as proxy. In connection with the appointment of Mr Tadeusz Zwierzyński to the Management Board of PGNiG S.A., the powers of proxy granted to him were revoked on September 12th 2006.
- On October 2nd 2006, the Management Board of PGNiG S.A. revoked the powers of proxy granted to Teresa Mikosz.
- On October 2nd 2006, the Management Board of PGNiG S.A. appointed Ewa Bernacik as proxy.

2. Supervisory Board

Pursuant to the provisions of PGNiG S.A.'s Articles of Association, its Supervisory Board is composed of five to nine members, appointed by the General Shareholders Meeting for a common term of three years. As long as the State Treasury holds an interest in the Company, the State Treasury, represented by the minister competent for matters pertaining to the State Treasury, acting in consultation with the minister competent for economic affairs, has the right to appoint and remove one member of the Supervisory Board. In accordance with the PGNiG S.A.'s Articles of Association the General Shareholders Meeting appoints one independent member to the Supervisory Board. Par. 36.3 of PGNiG S.A.'s Articles of Association stipulates that an independent Supervisory Board member will be elected by way of a separate vote. Written proposals of candidates for the post of an independent Supervisory Board member may be submitted to the Chairman of the General Shareholders Meeting by the shareholders present at the General Shareholders Meeting whose agenda includes the election of such Supervisory Board member. If there are no candidates for the position of an independent Supervisory Board member proposed by the shareholders, candidates to the Supervisory Board are put forward by the Supervisory Board. If the Supervisory Board is composed of up to six members, two of them are appointed from among persons nominated by the Company's employees. In the event of the Supervisory Board composed of seven to nine members, three of them are appointed from among persons nominated by the Company's employees.

As at December 31st 2006, the Supervisory Board was composed of the following nine members:

- Andrzej Rościszewski – Chairman
- Piotr Szwarc – Deputy Chairman
- Kazimierz Chrobak – Secretary
- Wojciech Arkuszewski – Member
- Mieczysław Kawecki – Member
- Marcin Moryń – Member
- Mieczysław Puławski – Member
- Mirosław Szkałuba – Member
- Jarosław Wojtowicz – Member.

The following changes occurred in the composition of the PGNiG S.A.'s Supervisory Board in 2006:

- On January 1st 2006, Mr Wojciech Arkuszewski was appointed as Supervisory Board member.
- Magdalena Bąkowska resigned from the position of the Supervisory Board Member as of June 19th 2006.
- On June19th 2006, Mr Marcin Moryń was appointed as Supervisory Board member.
- On June 23rd 2006, Mr Mieczysław Puławski was delegated to temporarily serve as President of the Management Board of PGNiG S.A. in the period from June 24th 2006 to September 12th 2006.
- On September 12th 2006, Mr Mieczysław Puławski, Supervisory Board member was delegated to temporarily serve as President of the Management Board for another period from September 13th 2006 to September 23rd 2006.
- On October 26th 2006, Mr Jarosław Wojtowicz was appointed to the Supervisory Board.
- As of September 30th 2006, Mr Krzysztof Głogowski resigned from the function of Chairman of the Supervisory Board due to his appointment as President of the Management Board of PGNiG S.A. as of October 1st 2006.
- On December 7th 2006, the Supervisory Board of PGNiG S.A. appointed Mr Andrzej Rościszewski as Chairman of the Supervisory Board and Mr Piotr Szwarc as Deputy Chairman of the Supervisory Board.

Remuneration of Members of Management and Supervisory Boards

For information on the remuneration paid to members of the Parent Undertaking's Management and Supervisory Boards see: Notes to the PGNiG Group's 2006 Financial Statements.

Chapter III: Changes in Management Rules

As stated in the Company's Articles of Association, PGNiG S.A. operates in particular pursuant to the provisions of:

- The Polish Commercialisation and Privatisation Act of August 30th 1996 (Dz.U. of 2002, No. 171, item 1397, as amended)
- The Commercial Companies Code of September 15th 2000 (Dz.U. No. 94, item 1037, as amended) and
- PGNiG S.A.'s Articles of Association.

On October 26 th 2006 r., the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted a resolution on amendments to the Company's Articles of Association. The amendments referred in particular to the powers of the Management Board, the Supervisory Board and the General Shareholders Meeting.

The Management Board's resolution is also required for the following:

- Distribution of powers among the members of the Management Board, with the proviso that the relevant resolution requires the Supervisory Board's approval.
- Approval of information concerning the tasks performed in order to ensure the country's energy security, before the Management Board submits such information to the minister competent for the State Treasury and the minister competent for economy on any request by any of those ministers.

Changes to the powers of the Supervisory Board primarily include:

1. Approval of the Management Board's resolution concerning the distribution of powers among the members of the Management Board.
2. Granting consent to the Management Board for contracting liabilities with a value in excess of 20% of the Company's share capital, with the exception of liabilities under annual investment plans, as well as strategic multi-year plans and investment plans related to the development of the transmission system, provided that each such plan has been approved by the Supervisory Board (prior to the amendment, the Supervisory Board granted consent to the Management Board for contracting contingent liabilities, including the Company's issuing guaranties and sureties, as well as drawing up promissory notes with a value in excess of the PLN equivalent of EUR 1,000,000, and for concluding a loan/borrowing agreement with a value in excess of the PLN equivalent of EUR 20,000,000 EUR).
3. Giving opinion on the information concerning the tasks performed in order to ensure the country's energy security, before the Management Board submits such information to the minister competent for the State Treasury and the minister competent for economy on any request by any of those ministers.
4. Giving opinion on the motions based on which a shareholder, the State Treasury, represented by the minister competent for the State Treasury gives its written consent for:
    - amendments to material provisions of the binding trade agreements concerning import of natural gas to Poland and conclusion of new such agreements;
    - execution of strategic projects or the Company's participation in investment projects which permanently or temporarily deteriorate the economic efficiency of the Company's operations, but are indispensable for Poland's energy security.

5. Approval of the voting instructions for PGNiG S.A.'s representative to be followed during the General Shareholders Meetings of the Gas Companies while voting on the approval of multi-year strategic operating plans for those Companies.
6. Approval of the voting instructions for PGNiG S.A.'s representative to be followed during the General Shareholders Meetings of the Gas Companies while voting on:
   - amendments to a company's Articles of Association,
   - increase or decrease in share capital,
   - merger, transformation or demerger of a company,
   - disposal of company shares,
   - disposal and lease of a company's enterprise or an organised part thereof, as well as establishment thereon of a limited right in property,
   - dissolution and liquidation of a company.
7. Approval of the voting instructions for PGNiG S.A.'s representative to be followed during the General Shareholders Meetings of the companies in which the Company holds at least 50% of the share capital, subject to Par. 33.3.14 of the Articles of Association, while voting on:
   - amendments to a company's Articles of Association,
   - increase or decrease in share capital,
   - merger, transformation or demerger of a company,
   - disposal of company shares,
   - disposal and lease of a company's enterprise or an organised part thereof, as well as establishment thereon of a limited right in property,
   - dissolution and liquidation of a company,
   - establishment of a pledge or another encumbrance on company shares,
   - obliging the shareholders to additional contributions to equity,
   - issue of bonds.
8. Giving opinion on the Management Board's motions concerning contracting liabilities with a value in excess of the PLN equivalent of EUR 100,000,000 EUR, subject to Par. 33.2 of the Articles of Association.

Under the new amendments, the General Shareholders Meeting lost its powers with respect to the Gas Companies and other companies in which the Company holds at least 50% of share capital, as these powers are now bestowed on the Supervisory Board. It was added to the Articles of Association, where they refer to the General Shareholders Meeting's rules of procedure, that the removal of an item on the General Shareholders Meeting's agenda or the abandonment of considering such an item shall require the General Shareholders Meeting resolution adopted by a majority of three-fourths of votes cast. If a given item was included in the General Shareholders Meeting's agenda upon a motion of a shareholder(s), then such removal or abandonment shall additionally require consent of all shareholders who are present at the Meeting and have submitted the motion. A motion for the removal of an item included in the General Shareholders Meeting's agenda or the abandonment of considering it should be justified in detail.

Other material management rules changed by the amendment to the Articles of Association performed on October 26th 2006 include:

1. A shareholder, the State Treasury, represented by the minister competent for the State Treasury gives its written consent for:

- amendments to material provisions of the binding trade agreements concerning import of natural gas to Poland and conclusion of new such trade agreements;
- execution of strategic projects or the Company's participation in investment projects which permanently or temporarily deteriorate the economic efficiency of the Company's operations, but are indispensable for Poland's energy security.

2. The amended Articles of Association stipulate that in the event of a tied vote (the number of affirmative votes equal to the sum of the numbers of votes against and abstainees) on the Management Board's resolution, the President of the Management Board shall have the casting vote, while in the event of a tied vote on the Supervisory Board's resolution, the Chairman of the Supervisory Board shall have the casting vote.
3. The member of the Management Board identified as such in the Management Board's resolution concerning the distribution of powers is responsible for legal transactions which under special provisions are to be performed by the manager of an organisational unit, as well as for transactions related to labour law (the President of the Management Board performed these transactions formerly).

In 2006, no changes in the basic rules of the management of the PGNiG group occurred.

Management Board's Representation on Application of Corporate Governance Rules

In performance of the obligation provided for in Par. 29 of the Warsaw Stock Exchange Rules and the resolution of the WSE Management Board on adoption of corporate governance rules for joint-stock companies issuing shares, convertible bonds, or bonds with pre-emptive rights admitted to stock-exchange trading, on March 29 2007 the Management Board of PGNiG S.A. made a representation concerning application of the corporate governance rules.

On March 20th 2007, the Supervisory Board of PGNiG S.A. approved the Company's position on the corporate governance rules, prepared by the Management Board, and on March 29th 2007, the General Shareholders Meeting of PGNiG S.A. adopted the position. In a representation published on March 29th 2007, PGNiG S.A. undertook to comply with 49 out of the 53 corporate governance rules. Non-compliance with the other four rules (No. 2, 20, 28 and 43) is primarily caused by the special nature of the Company.

Rule 2 (best practices of general shareholders meetings) provides for the need to justify a request for convening a general shareholders meeting and including specified items in the meeting's agenda. While the Company acknowledges the materiality of this rule, the Company may not guarantee that each entity entitled would always apply it. In its current wording, Par. 57 of the Company's Articles of Association, provides for the Supervisory Board's obligation to give its opinion on issues submitted to the General Shareholders Meeting for examination (with the exception of issues concerning the Supervisory Board), as such issues are identified in Par. 56 of the Articles of Association. Accordingly, the Company has decided to abstain from the application of Rule 2.

Rule 20 (best practices of supervisory boards) stipulates that independent members should represent at least a half of the composition of a supervisory board. Pursuant to Art. 12 of the Polish Commercialisation and Privatisation Act of August 30th 1996, representatives of employees are included in the composition of the Supervisory Board of PGNiG S.A. Given that the Supervisory Board of PGNiG S.A. is composed of five to nine members appointed by the General Shareholders Meeting, the Company is not able to arrange for a larger number of independent members of the Supervisory Board. It is so, because any increase in the number of independent members of the Supervisory Board in relation to the current number provided for in the Articles of Association would lead to a situation in which the State Treasury (the majority shareholder) would be deprived of the right to appoint the majority of the Supervisory Board's composition. PGNiG S.A. fully acknowledges that best corporate practices should include the participation of independent members in the Supervisory Board. However, the Company is not able to apply Rule 20.

Rule 28 (best practices of supervisory boards) obliges a supervisory board to proceed in line with its publicly available rules of procedure. Such rules of procedure should provide for the appointment of at least two committees: the audit and remuneration committees. The audit committee should include at least two independent members and at least one member with qualifications and experience in accountancy and finance. The Company acknowledges that it is necessary to guarantee the impact of an independent member on supervision function within the Company, as well as the appropriate qualifications of the Supervisory Board members. However, given the fact that – in accordance with the Company's Articles of Association – the Supervisory Board includes one independent member only, the Company has chosen to abstain from adopting Rule 28. Currently, audit and remuneration committees are not appointed in the Company. The Company envisages the appointment thereof in the future.

Rule 43 (best practices in the area of external relations) defines the procedure for selection and appointment of an auditor. The procedure requires the audit committee to give its opinion. Given the fact that the Company does not apply Rule 28, the Company has also chosen to abstain from the application of Rule 43. An auditor is selected by the Supervisory Board of PGNiG S.A. Pursuant to Par. 33.5, in conjunction with Par. 33.1.5 of the Articles of Association, the selection of an auditor is conditional upon the consent of an independent member of the Supervisory Board.

PGNiG S.A. applies corporate governance rules through internal corporate law documents, that is the Rules of Procedure for the Management Board, for the Supervisory Board and for the General Shareholders Meeting, as well as other internal procedures guaranteeing the transparency and rationality of decisions adopted by the Company's governing bodies. PGNiG S.A. applies the rules, while taking into consideration justified interests of the Company and its shareholders in the scope adequate to market expectations.

Chapter IV: Regulatory Environment

The key laws regulating the activities of the PGNiG Group are:

- Polish Energy Law of April 10th 1997 (Dz.U. of 2003, No. 153, item 1504, as amended) and the secondary legislation – with respect to the activities in the area of trade in gaseous fuels, gas transmission and storage of gaseous fuels.
- Polish Geological and Mining Law of February 4th 1994 (Dz.U. of March 1st 1994, No. 27, item 96, as amended) – with respect to production activities and related sales of gas.

On March 23rd 2007, the Act on Reserves of Crude Oil, Petroleum Products and Natural Gas, as well as Rules of procedure to be followed when the state's fuel security is threatened or the petroleum market is disturbed (Dz.U. of 2007, No. 52, item 343) was published. Under the new Act, changes are introduced in the area of PGNiG S.A.'s business activity, including the following:

- the Act imposes the obligation to maintain mandatory reserves of natural gas;
- the Act defines the timetable for the creation of mandatory reserves of natural gas; it stipulates that in 2012, the volume of mandatory reserves will cover 30 days' average daily imports of gas;
- the Act provides for return on capital employed in storage activity of at least 6%;
- the Act stipulates that cost related to maintaining, releasing and supplementing reserves is justified operating cost within the meaning of Art. 3.21 of the Polish Energy Law.

1. Polish Energy Law

The PGNiG Group's activity in the area of trade in gaseous fuels is regulated under the Energy Law and requires a licence granted and tariff approved by the President of URE. The tariff includes prices of gaseous fuels.

Pursuant to the provisions of the Polish Energy Law implementing Directive 2003/55/EC, work is going on within the PGNiG Group on a legal separation of trade and distribution as from July 1st 2007.

On September 20th 2006, the Polish Energy Law was amended in connection with the implementation of Council Directive 2004/67/EC, dated February 26th 2004, concerning measures to safeguard security of natural gas supply. The amendments introduced included:

- requirement to gather mandatory reserves (in the amount of 3% of annual imports) in the territory of the Republic of Poland by energy companies involved in international trade ;
- requirement to implement instructions issued by the Transmission System Operator in situations threatening secure operation of the gas system, applicable to each user of the gas system, operator of a gaseous fuel storage and liquefying system, entity operating storage capacity and gas liquefying installations;
- statutory obligation to develop procedures to be followed in the event of disturbed gaseous fuel supply or unexpected increase in the use of such fuels by customers; the obligation rests with each energy company involved in the trade in gaseous fuels, entity

mandating transmission services, as well as storage system operator and liquefying system operator.

The amended Polish Energy Law requires that the secondary legislation be harmonised with the amendments introduced. The currently binding secondary legislation was issued under the previous wording of the Energy Law, prior to the amendment of May 3rd 2005; consequently, it does not provide for the preparation of a tariff for a comprehensive service, provided for in the amended Polish Energy Law.

1.1. Licences

Pursuant to the provisions of the Polish Energy Law, PGNiG S.A.'s business in the area of trade in gaseous fuels requires a licence. As a company involved in the sale of gaseous fuels, PGNiG S.A. is obliged to prepare tariffs that are subject to approval by the President of URE. The rules for tariff preparation are stipulated in the Polish Energy Law and the Regulation of the Minister of Economy and Labour on detailed rules for preparing and calculating tariffs and on settlements in gaseous fuels trade, dated December 15th 2004. Pursuant to the regulations, a tariff should guarantee the coverage of a gas company's justified operating costs, as well as protect a customer against unjustifiably high prices.

In 2006, PGNiG S.A.'s business included the execution of tasks and performance of actions in compliance with the following licences granted by the President of URE:

1. Licence PPG/4/652/U/1/2/99/PK of April 30th 1999 for the transmission and distribution of gaseous fuels,
2. Licence OPG/4/652/U/1/2/99/PK of April 30th 1999 for trade in gaseous fuels,
3. Licence OGZ/1/652/W/1/2/2001/AS of April 17th 2001 for international trade in natural gas,
4. Licence MPG/2/652/W/2/2005/2006/BT of February 1st 2006 for the storage of gaseous fuels.

The Gas Companies of the PGNiG Group have conducted their business activities under their respective licences for trade in, transmission and distribution of gaseous fuels, in their respective geographical areas of operation.

1.2. Tariff Policy

The crucial factor determining PGNiG Group's regulated business is the dependence of the Group's revenue on tariffs which are subject to approval by the President of URE. Tariff prices are crucial for the feasibility of generating revenue that can cover the incurred justified costs plus return on capital employed. Currently, this revenue depends on the gas selling prices, which are regulated. The gas selling prices are directly connected with the applied tariff preparation methodology.

The rules for determination of tariffs are stipulated in secondary legislation to the Polish Energy Law. The applied tariff preparation methodology is based on the determination of prices and charge rates against the forecast costs and gas sales targets. In accordance with the guidelines issued by the regulatory authority, calculation of prices of gaseous fuels included the cost of acquisition of natural gas from all possible sources, that is of both imported and domestically produced gas. In practice this means that both international trade and domestic production are subject to regulated pricing. Given that the current prices of imported gas are higher than those of domestically produced gas, the inclusion of production cost for gas from domestic sources in the cost basket, taken into account in pricing, resulted in a situation where the tariff prices (applicable in settlements with customers) were determined below the level that would have been set based on the cost of acquisition of imported gas.

The objective of changes in tariffs introduced in 2005 was to reflect the change in prices of imported gas in selling prices of gaseous fuels. Those changes enabled the Company to generate higher revenue and, to some extent, to improve the margin on sales of domestically produced nitrogen-rich gas. Despite the introduced changes in selling prices of gas, the approved tariffs did not fully offset the increased gas acquisition cost and the increased costs reflecting the changes in business environment.

In the settlements with customers with which PGNiG S.A. had concluded agreements for sale of gaseous fuels with the delivery to the customer's premises were regulated by the settlement rules and charge rates specified in subsequent tariffs approved by the President of URE.

In connection with the agreement between PGNiG S.A. and OGP GAZ-SYSTEM Sp. z o.o., high-methane gas and nitrogen-rich gas have been transmitted to points of gas acceptance by PGNiG S.A.'s customers supplied from the transmission network. Since July 8th 2005 PGNiG S.A. have had a dual role in these transactions: it supplied gaseous fuels to customers and, at the same time, have ordered transmission service on behalf of the customer.

1.3. Changes in PGNiG S.A. Tariffs

In Q1 2006, the binding settlement rules and charge rates were specified in Tariff No. 1/2003 for Gaseous Fuel, approved under a decision issued by the President of URE on September 16th 2003, in which price adjustments were made. The last decision of the President of URE, whereby the aforementioned tariff was extended until March 31st 2006 and new prices of gaseous fuels were approved, was issued on December 14th 2005.

On March 17th 2006, the President of URE issued a decision on introduction of new tariffs, which reflected the changes on the gas market resulting from the separation of gaseous fuel transmission (performed by OGP GAZ-SYSTEM S.A.) from natural gas trading (performed by PGNiG S.A.), as well as the changes in prices and acquisition cost of gaseous fuels. The PGNiG S.A. tariff (Tariff No. 4 for Gaseous Fuels) and OGP GAZ-SYSTEM S.A. tariffs were set for the period of nine and twelve months, respectively. The tariffs have been in effect since of April 1st 2007.

In accordance with the amended Polish Energy Law, the responsibility for gas supplies was distributed among individual companies participating in the supply of gas to customers. Accordingly, new settlement rules and charge rates were defined for:

- transmission of gas over high-pressure networks – settled under the OGP GAZ-SYSTEM S.A Tariff;

- transmission of gas over transit networks – settled based on the cost of acquisition of transmission service from System Gazociągów Tranzytowych EUROPOL GAZ S.A., under the PGNiG S.A. Tariff;
- storage of high-methane gas – settled under the PGNiG S.A. Tariff;
- supplies of gaseous fuel – settled under the PGNiG S.A. Tariff;
- subscription charges – settled under the PGNiG S.A. Tariff.

Changes introduced to PGNiG S.A. Tariff No. 4 for Gaseous Fuels include:

- Changes in prices of gaseous fuels

Gas type	Price applicable for settlement in Q2–Q4 2006
	PLN/m^3
High-methane gas E	0.7086
Nitrogen-rich gas Ls	0.4490
Nitrogen-rich gas Lw	0.5240

- Introduction of a charge rate for high-methane gas transmission, based on the acquisition cost of transmission service provided by System Gazociągów Tranzytowych EUROPOL GAZ S.A.; the objective of the charge is to compensate for the cost of gas transmission over transit networks from the country border to a point of entry into the domestic system.

Tariff group	Rate based on the acquisition cost of transmission service provided by SGT EUROPOL GAZ S.A.
	PLN/m^3
For customers supplied with high-methane gas E	
E 1–E 4	0.0068

- Introduction of a charge rate for the storage of high-methane gas:

Tariff group	Storage charge rate
	PLN/m^3
For customers supplied with high-methane gas E	
E 1	0.0215
E 2	0.0174
E 3	0.0157
E 4	0.0098

- Change of subscription charges

Gas type	Price applicable for settlement in Q2–Q4 2006
	PLN/m^3
High-methane gas E	541.00
Nitrogen-rich gas Ls	541.00
Nitrogen-rich gas Lw	541.00

In 2006, PGNiG S.A. submitted three requests for change of Tariff No. 4 for Gaseous Fuels to be approved by the President of URE, in view of changes in the Company's business environment.

On May 10th 2006, PGNiG S.A. submitted a request for change of Tariff No. 4 for Gaseous Fuels to be approved by the President of URE, in view of changes in the Company's business environment. The change followed from increased gas acquisition cost, exceeding the level assumed for determination of tariffs based on the tariff established, and growth in the volume of imported gas.

By virtue of decision DTA-4212-3(24)/2006/652/IV/RT of June 20th 2006, the President of URE refused to approve the change of tariff, as requested by PGNiG S.A. The refusal was justified, among other things, on the grounds of the PGNiG S.A.'s shareholder structure. The justification for refusal stated that the companies, in which the State Treasury holds interest, should not seek to increase their value.

Having found the decision of the President of URE incompliant with the law, on July 4th 2006 PGNiG S.A. lodged an appeal against the decision on refusal to approve the change in tariff for wholesale customers, as requested by the Company. The decision did not recognise changes in the Company's business environment, thus forcing PGNiG S.A. to carry out its core business, namely, trading in gas, at a loss. According to PGNiG S.A., the decision was erroneously based on Par. 30 of the Regulation of the Minister of Economy and Labour on detailed rules for preparing and calculating tariffs and on settlements in gaseous fuels trade, dated December 15th 2004, whereas the notions of social interests as well as the party's "justified" interests were misinterpreted since it was found necessary for the Company to fulfil "public mission".

Under the law, PGNiG S.A. lodged an appeal to the Anti-Trust and Consumer Protection Court through the President of URE.

The Company's inability to introduce the change of Tariff as of July 1st 2006, as requested on May 14th 2006, brought about a further deterioration in the margin on PGNiG S.A.'s gas sales.

On July 14th 2006, for the second time the Company applied for change of Tariff for wholesale customers. PGNiG S.A. requested that gas prices be adjusted by 10.2%, due to, among other things, greater cost of acquisition of imported gas and foreign currencies. As part of the adjustment of the request, formerly planned price rise was reduced to 4.9%, as a consequence of substantial appreciation of złoty against dollar during the last month.

By virtue of decision DTA-4212-3(42)/2006/652/IV/RT of September 20th 2006, the President of URE again refused to approve the change of tariff, as requested by PGNiG S.A. The refusal was justified, among other things, on the grounds of:

- falling prices of oil products and falling prices of imported gas
- feasibility of generating positive financial result from trading in all sorts of gas despite unprofitable trading in high-methane gas.

PGNiG S.A. was of opinion that the decision of the President of URE did not allow for factual arguments, therefore on October 4th 2006 the Company lodged an appeal against the decision to the Anti-Trust and Consumer Protection Court through the President of URE.

The third request for change of Tariff No. 4 for Gaseous Fuels was submitted on November 14th 2006 in relation to:

- approaching expiry date of Tariff No. 4 for Gaseous Fuels
- increase in acquisition cost of gas under import contracts and further deterioration in margin on sales of gas.

By virtue of decision DTA-4212-3(62)/2006/652/IV/PB of December 15th 2006, the President of URE approved the change of tariff for gaseous fuels, as requested by PGNiG S.A., and extended Tariff No. 4 for Gaseous Fuels until December 31st 2007. As a result of the change of tariff the prices of gaseous fuels went up by 9.9% as of January 1st 2007.

- Prices of gaseous fuels as of January 1st 2007

Gas type	Price applicable for settlement in Q1 2007
	PLN/m^3
High-methane gas E	0.7788
Nitrogen-rich gas Ls	0.4936
Nitrogen-rich gas Lw	0.5761

On February 20th 2007, PGNiG S.A. applied to the President of URE for extension of Tariff No. 4 for Gaseous Fuels until September 30th 2007. PGNiG S.A. indicated that it is reasonable to set new tariff upon completing the process of integration of trading business and publication of secondary legislation to the current Polish Energy Law. By virtue of decision DTA-4212-3(64)/2006/2007/652/IV/PB of March 14th 2007, the President of URE extended Tariff No. 4 for Gaseous Fuels until September 30th 2007.

1.4. Changes in the Tariffs of the Gas Companies

In Q1 2006, in their settlements with customers the Gas Companies of the PGNiG Group used Tariff No. 1/2003 for Gaseous Fuels, approved under decisions issued by the President of URE on September 16th 2003. The effective period of the Tariff was repeatedly extended because of the still ongoing process of harmonising secondary legislation with the amended Polish Energy Law, which makes it impossible to determine in a definite way the settlement rules to be applied in transactions between a Gas Company and the gas seller (PGNiG S.A.), and between a Gas Company and the transmission service provider (OGP Gaz-System S.A.). Price changes in the tariffs prepared by the Gas Companies were driven by changes in acquisition cost of gaseous fuels, caused by the modifications introduced in the PGNiG S.A. Tariff. The most recent decisions concerning the extension of the effective period of the Tariff used by the Gas Companies until March 31st 2006 and changing price rates for gaseous fuels were issued on December 16th 2005.

On March 17th 2006, the President of URE issued decisions concerning the introduction of new tariffs for individual Gas Companies. These new tariffs reflected the increased cost of supply of gaseous fuels to end customers supplied by the Gas Companies, as well as the cost of operations of the Gas Companies, whose tariffs (in the network-related component) had not been changed for two and a half years. Charges for distribution services increased by 7% on average, and for the first time ever, return on capital employed has been included in the computation of charges. The effective period for those tariffs was determined as nine months.

On December 16th 2006, the President of URE approved changes in tariffs where they relate to prices of gaseous fuels and extended the effective periods of individual tariffs until March 31st 2007. Charges connected with the provision of a distribution service (rates of the fixed and variable charges), as well as subscription fees remained unchanged.

On March 16th 2007, the President of URE issued decisions under which the effective periods of tariffs used by the Gas Companies were extended until September 30th 2007. Prices and charge rates remained unchanged.

1.5. Tariff Risks

Calculation Risk

Pursuant to the applicable rules for price regulation, while approving tariffs for a given period, the President of URE considers other external factors which are beyond PGNiG S.A.'s control. In an attempt to protect weaker customers, while verifying costs of operating activities, the President of URE may consider certain cost unjustified or may reject the assumptions adopted by PGNiG S.A. with respect to main drivers of cost changes and profit targets allowing for business risk. The URE may also refuse to accept tariff prices and charge rates applied for by PGNiG S.A. Lower tariff prices and charges might adversely affect PGNiG S.A.'s profitability.

Forecasting Risk

The current methodology for the calculation of prices and charge rates is based on forecast values; accordingly, revenue is encumbered with forecasting risk. Inaccurate estimates of demand affecting the accuracy of forecast purchase and supply volumes, as well as the value of costs on which the determinations of prices and charge rates are based may adversely affect financial results. An increase in demand above the forecast level would necessitate additional purchases from all possible sources (in numerous cases, at prices higher than those forecast).

Market Risk

Prices of imported gas are determined in USD or EUR, as well as based on indexation formulae reflecting the prices of petroleum products. Changes in foreign exchange rates and prices of petroleum products materially affect acquisition cost of imported gas. The market of crude oil and petroleum products has recently been to a large extent unpredictable, given the continual price changes. These material changes in fuel prices on the international market affect the prices of imported gas. Each, even accurate forecast of changes of natural gas prices is encumbered with a high error risk. There can be no guarantee that, despite legal possibility of adjusting prices approved for a tariff period, an increase in the price of imported gas may not be fully passed on customers or the changes in selling prices may lag behind the changes in import prices.

Risk of Regulatory Environment

The legal regulations concerning tariff-based trade in gas are a material risk factor. The work on the amended secondary legislation to the amended Polish Energy Law has not been completed yet, which in particular relates to the Regulation on detailed rules for preparing and calculating tariffs and on settlements in gaseous fuels trade.

There are no definite rules for changing the methodology applied in the preparation of tariffs with respect to:

- the possibility of including the return on capital employed and the margin reflecting business risk in the tariff price,
- inclusion of costs connected with the maintenance and continuous availability of stocks in the tariff charges,
- settlement rules for transactions between companies, including in particular the settlement of comprehensive services.

Changes in the legal environment gradually implemented in connection with Poland's accession to the European Union may not allow for the specific nature of PGNiG S.A.'s business. Further legal changes affecting the operation of gas companies may be introduced in following years. Legal changes create risk factors relating to business adaptation to such changes, which might adversely affect the PGNiG Group's business, financial results and growth prospects.

2. Polish Geological and Mining Law

The Polish Geological and Mining Law of February 4th 1994 (Dz.U. 05.228.1947) defines the rules and conditions for:

- carrying out geological work
- extracting minerals from reserves
- storing waste matter in rock mass, including in worked out caverns
- protection of mineral reserves, underground waters and other environmental resources in connection with geological works and extraction of minerals.

The provisions of the Geological and Mining Law also govern business activities in the field of tankless storage of substances in rock mass, including in worked out caverns in mines.

Business activities involving exploration and prospecting for mineral reserves, extraction of minerals from reserves, tankless storage of substances and storage of waste matter in rock mass, including in worked out caverns, may only be conducted on the basis of licences.

Geological and mining activities are subject to the supervision of competent geological administration and mining supervision authorities. The Geological and Mining Law provides for criminal sanctions in case of failure to comply with its regulations and specifies the upper and lower limits of mining fees.

<u>Licences</u>

As at December 31st 2006, PGNiG S.A. held:

- 66 licences for exploration and prospecting of crude oil and natural gas reserves
- 208 licences for production of crude oil and natural gas from reserves
- 8 licences for underground gas storage
- 4 licences for waste matter storage.

In the course of 2006, the four licences for exploration and prospecting of crude oil and natural gas reserves which ceased to be valid were not extended, as on the areas covered by those licences no work could be carried out for reasons including environmental protection requirements. 10 exploration licences were extended. One production licence which ceased to be valid was not extended, because further production would be unprofitable. In 2006, no changes occurred with respect to licences for underground gas storage and waste matter storage.

On January 3rd 2007, the Ministry of Environment assigned eight licences held by Eurogas Polska Sp. z o.o. to PGNiG S.A. These licences are located in the Carpathians and cover a total area of 3,520 km^2. Moreover, before March 31st 2007, two licences for exploration and prospecting of crude oil and natural gas reserves and one licence for production of crude oil and natural gas from reserves expired. Before March 31st 2007, PGNiG S.A. also obtained two licences for production of crude oil and natural gas from reserves.

Risk of Changes in Licence Areas

The "Map of Licence Areas Designed for Tenders for the Acquisition of Mining Usufruct for Crude Oil and Natural Gas Exploration and Prospecting" prepared by the Ministry of Environment covers approximately 90% of PGNiG S.A.'s licence areas. Thus a risk arises that certain licence areas might be lost and right of mining usufruct for crude oil and natural gas exploration and prospecting partially lost to third parties which participate in the tenders and have at their disposal financial resources larger than PGNiG S.A.'s.

Chapter V: Shareholder Structure

As at December 31st 2006, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share.

PGNiG S.A.'s shareholder structure as at December 31st 2006 is presented in the table below.

Shareholder structure

Shareholder	% share in the total vote at the General Shareholders Meeting as at December 31st 2006	Number of shares as at December 31st 2006
State Treasury	84.75%	5,000,000,000
Other	15.25%	900,000,000
Total:	100.00%	5,900,000,000

As at December 31st 2006, only the State Treasury held shares representing 5% or more of the Company's share capital, which conferred the right to 5% or more of the total vote at the Company's General Shareholders Meeting.

As at December 31st 2006, the only member of the Company's managing personnel who held shares in PGNiG S.A. was Stanisław Niedbalec (holding 857 shares with a total par value of PLN 857). As at December 31st 2006, no member of the Company's supervisory personnel held shares in PGNiG S.A.

PGNiG S.A. is not aware of any agreements as a result of which any changes in the proportion of shares held by the present shareholders could occur in the future.

The shares of all series (A, A1 and B) are ordinary bearer shares and each confers the right to one vote at the General Shareholders Meeting. The Articles of Association of PGNiG S.A. do not provide for any limitations on the exercise of voting rights attached to PGNIG shares.

<u>Price of the PGNiG S.A. Stock</u>

Over 2006, the price of the PGNiG S.A. stock increased by 3.7%. With the dividend paid out at PLN 0.15 per share, the rate of return stood at 8.1%. The highest price of the Company's stock recorded in 2006 was PLN 4.13. In 2006, the WIG and WIG20 indices gained 39.9% and 21.9%, respectively, while WIG-Paliwa, the index reflecting the economic situation in the fuel sector recorded a 12.6% decrease. The increase in the price of the PGNiG S.A. stock over the same period further confirms PGNiG S.A.'s stable financial standing.

WSE indices and PGNiG S.A. stock performance in 2006

	As at Jan 2 2006	Max	Min	As at Dec 29 2006	Rate of return	PGNiG S.A.'s weigh in index as at Dec 29 2006
WIG	36,047	52,371	36,021	50,412	39.9%	2.0%
WIG20	2,695	3,430	2,537	3,285	21.9%	5.3%
WIG-Paliwa	3,601	4,027	2,887	3,149	-12.6%	16.0%
PGNiG S.A.	3.47	4.08	3.11	3.60	3.7%	–

Source: WSE.

Chapter VI: Trading Activities

PGNiG S.A. conducts commercial activities consisting in the trade in natural gas and sales of products manufactured by the Company, including natural gas from domestic sources, crude oil, condensate, LPG, helium, nitrogen and sulphur. Imported natural gas is purchased chiefly from eastern markets. The sale of natural gas through the transmission network is regulated by the Polish Energy Law, while gas prices are determined based on the tariffs approved by the President of the Polish Energy Regulatory Authority. Sales of natural gas directly from reserves as well as sales of other products of the Company are conducted on free-market terms, whereby prices are individually negotiated with customers on a case-by-case basis.

1. Structure of Sales and Purchases

The key products sold by PGNiG S.A. are natural gas and crude oil. The sales of natural gas and crude oil represent approx. 97% of the sales revenue from PGNiG S.A. products. The sales structure of PGNiG S.A. in 2006 is presented in the table below.

The sales structure of key products:

Product		Unit	Quantity	Value, net of VAT (PLNm)
1.	Natural gas	million m^3*	13,657.5	11,027.3
2.	Crude oil	thousand tonnes	515.0	739.1
3.	Condensate	thousand tonnes	3.9	6.3
4.	Helium, LPG, nitrogen, sulphur	-	–	72.5
Total:		–	–	11,845.2

* Million m^3 measured as high-methane gas equivalent.

The Company’s main customers include Gas Companies, members of the PGNiG Group. Other customers who purchase the Company’s products through the transmission network primarily include nitrogen plants, the steel industry and the power sector. The table below presents the structure of natural gas sales by major customers.

Structure of natural gas sales by customers:

Sales of natural gas to		Unit*	Quantity	%
1.	Gas companies, including:	million m^3	8,118.1	60.0%
	– Dolnośląska Spółka Gazownictwa	million m^3	853.6	6.2%
	– Górnośląska Spółka Gazownictwa	million m^3	1,353.9	9.9%
	– Karpacka Spółka Gazownictwa	million m^3	1,940.7	14.2%
	– Mazowiecka Spółka Gazownictwa	million m^3	1,717.5	12.7%
	– Pomorska Spółka Gazownictwa	million m^3	849.0	6.2%
	– Wielkopolska Spółka Gazownictwa	million m^3	1,403.4	10.3%
2.	End-customers, from the transmission network	million m^3	4,974.0	36.4%
3.	Customers, directly from reserves	million m^3	565.4	4.1%
Total:		million m^3	13,657.5	100,0%

* Million m^3 measured as high-methane gas equivalent.

PGNiG S.A. is an importer of natural gas. In 2006, the main sources of natural gas included Russia, Central Asia, Germany, Norway, Ukraine and the Czech Republic. The imports of natural gas, amounting to 10bn m^3, represented approx. 73% of PGNiG S.A.'s total sales in 2006. The table below presents the natural gas supply structure by the sources of natural gas supply.

Structure of natural gas supply by supply sources:

Natural gas purchases		Unit	Quantity	%
1.	Russia – OOO Gazexport	million m^3	6,839.7	68.2%
2.	Germany	million m^3	477.5	4.8%
3.	Norway	million m^3	360.1	3.6%
4.	Central Asia – ROSUKRENERGO AG	million m^3	2,346.9	23.4%
5.	Ukraine	million m^3	3.9	0.0%
6.	Czech Republic	million m^3	0.3	0.0%
Total:		million m^3	10,028.4	100.0%

In January 2006, the supplies of natural gas from the eastern markets were disrupted. Thanks to the implemented procedures – despite record-high consumption of natural gas caused by the prolonged cold spell and reduced supplies from the eastern markets, gas disruptions affected only industrial customers, while individual customers received gas in the full quantity. Gas supplies were resumed after a few days, to stabilise at levels specified in the relevant commercial contracts.

2. Major Commercial Agreements

Agreements on sales of gaseous fuel from the transmission system, concluded with the customers, are governed by the Polish Energy Law and are compliant with the effective tariffs for gaseous fuels, while agreements on sales of natural gas directly from reserves are governed by the provisions of the Polish Geological and Mining Law; they are settled at prices established based on the economic assessment.

In 2006, PGNiG S.A. executed seven agreements on sale of gaseous fuel from the transmission system, including:

- two agreements for a total annual target volumes of gaseous fuel of 1.2m m^3, signed with end customers for indefinite term;
- one agreement, concluded with an end customer for a definite term from March 1st 2006 to September 30th 2006;
- three agreements for a total annual target volumes of gaseous fuel of 53.3m m^3, executed for indefinite term with customers who resell gaseous fuel based on their own tariffs approved by the President of URE;
- one agreement, concluded for a definite term from September 7th 2006 to September 30th 2007 with Operator Gazociągów Przesyłowych GAZ-SYSTEM S.A. which purchases gaseous fuel for the transmission system.

In June 2006, gas supplies to Arctic Paper Kostrzyń S.A. commenced as part of the agreements on sale of natural gas directly from reserves concluded in 2003. The agreement provides for a total annual target volumes of gaseous fuel of 125m m^3.

Currently, PGNiG S.A. is adjusting provisions of the existing agreements on sale of gas to the requirements imposed, among other things, by the Transmission Network Traffic and Operation Guidelines. The new provisions will be included in framework agreements which are to supersede the existing agreements for sale of gaseous fuels with delivery to customer's premises.

A substantial growth in crude oil prices on the global markets translated into the increase in margins on sale of this product. Once the profitability of oil sales from the mines located in south-eastern Poland has risen, the number of low performance boreholes to be liquidated was materially reduced. Given the discontinuation of crude oil refining at Rafineria Trzebinia S.A. (in June 2005) and Rafineria Czechowice S.A. (in March 2006), PGNiG's largest customers on the domestic market, the Company changed logistics of oil sales. In view of reorganisation of the railway logistics, the Company commenced active cooperation with PKN Orlen S.A. with regard to regular supplies of crude oil. In March 2007, as part of the cooperation, an agreement for supplies of crude oil was concluded with Rafineria Trzebinia. The Company continues to supply crude oil to Rafineria Nafty Jedlicze, a member of the Orlen Group. In 2006, PGNiG S.A. did not change the agreements for crude oil supplies concluded with foreign companies.

In 2006, PGNiG S.A. imported natural gas mainly under the agreements and contracts specified below; i.e. the long-term contract for imports from Russia and Germany, as well as medium-term contracts for supplies directly from Central Asia, Norway and Germany:

- Long-term contract for delivery of Russian natural gas executed with OOO Gazexport (as of November 1st 2006 the company changed its name to OOO Gazprom eksport), dated September 25th 1996, which will remain in force until 2022;
- Agreement on imports of natural gas executed with VNG-Verbundnetz GAS AG/ E.ON Ruhrgas AG, dated August 17th 2006, which will remain in force until October 1st 2008;
- Agreement on sales of natural gas executed with VNG-Verbundnetz GAS AG/ E.ON Ruhrgas AG, dated September 15th 2004, which will remain in force until September 30th 2008;
- Agreement for imports of Norwegian natural gas executed with Statoil ASA, Norsk Hydro Produksjon AS and Total E&P Norge AS, dated May 5th 1999, which will remain in force until September 30th 2006;
- Agreement for imports of natural gas from Central Asia executed with ROSUKRENERGO AG, dated August 10th 2005, which will remain in force until December 31st 2006.

On June 6th 2006, PGNiG S.A. and Statoil ASA entered into a Framework Agreement, based on which agreements for supplies of natural gas are to be executed. The Framework Agreement sets forth general rules defining cooperation of the companies with regard to gas supplies, whereas the details concerning particular deliveries, their volume and pricing will be specified more precisely upon execution of each new Gas Agreement. Under the Framework Agreement PGNiG S.A. is granted access to Norwegian gas terminals in Europe, including TTF and BEB/VEP gas trading hubs, thus being able to purchase natural gas in times of stronger demand for the product and resell the surplus, if any. The Framework Agreement was concluded for an indefinite term.

On June 7th 2006, Annex 5 to the Natural Gas Sales Agreement between PGNiG S.A. and DONG Naturgas A/S of July 2nd 2001 was executed, under which all the deadlines of the terms defined in Art. 12.7 of the Agreement were extended until December 31st 2006, subject to termination at one month's notice. December 31st 2006 was the expiration date for the terms ad conditions under the Natural Gas Sales Agreement. Upon the expiration of the Agreement, PGNiG S.A. and DONG Naturgas A/S were released from all rights and obligations thereunder.

On June 7th 2006, Annex 5 to the BalticPipe Consortium Agreement between PGNiG S.A. and DONG Naturgas A/S of July 2nd 2001 was executed, under which all the deadlines of the terms defined in Art. 17 of the Agreement were extended until December 31st 2006, subject to termination at one month's notice. On December 31st 2006, the terms ad conditions of the BalticPipe Consortium Agreement expired. Upon the expiration of Agreement, PGNiG S.A. and DONG Naturgas A/S were released from all rights and obligations thereunder.

On August 17th 2006, the agreement for imports of natural gas was concluded between PGNiG S.A. and the German natural gas supplier, VNG-Verbundnetz Gas AG. The natural gas has been supplied to the Lasów gas terminal as of October 1st 2006. During the first two years, the annual volume of supplies will amount to 500m m^3, and from October 1st 2008 to October 1st 2016 the annual volume of supplies will amount to 400m m^3. Therefore, as of October 1st 2008 this agreement will supersede the existing agreement on sales of natural gas with E.ON Ruhrgas AG and VNG.

October 1st 2006 was the expiration date for the agreements concluded with the Norwegian companies on May 5th 1999, under which 500m m^3 of natural gas was imported annually.

On November 17th 2006, Natural Gas Sales Agreement between PGNiG S.A. and ROSUKRENERGO AG was executed. The supplies of natural gas in the amount of 2.5bn m^3 (according to GOST), which commenced on January 1st 2007, are to be carried out until January 1st 2010 and may be extended for another three years.

On November 17th 2006, Annex 26 was executed to the agreement for the supplies of Russian gas with OOO Gazprom eksport, dated September 25th 1996, whereby the form of determination of gas prices was changed.

On January 17th 2007, PGNiG S.A. and DONG Energy A/S signed a protocol, in which they expressed intention to continue their cooperation related to natural gas industry. In their future cooperation the parties will draw on their experience, taking into account the European gas markets environment, and may carry out infrastructure projects in the Baltic Sea basin to ensure safety of supplies.

On March 27th 2007, PGNiG S.A. and TOTAL E&P NORGE AS of Norway concluded the General Terms of Natural Gas Sales, which act as a framework agreement and provide basis for execution of agreements for supplies of natural gas. The General Terms of Natural Gas Sales set forth general rules defining cooperation of the companies with regard to gas supplies, whereas the details concerning particular deliveries, their volume and price will be specified more precisely in the Transaction's heads of terms. Under the provisions of the General Terms of Natural Gas Sales PGNiG S.A. is granted access to Norwegian gas terminals in Europe, thus being able to purchase natural gas in the periods of greater demand for the product and resell the surplus, if any. The General Terms were concluded for an indefinite term.

3. Separation of Natural Gas Trading from Distribution

In 2006, PGNiG S.A. and the Gas Companies continued work on bringing the organisational structures in line with the EU Directive (2003/55/EC), under which natural gas distribution should be kept separate from the trading business and Distribution System Operators (DSO) are to be separated by July 1st 2007. The requirement is binding for the Gas Companies operating within the PGNiG Group.

On April 11th 2006, by virtue of Resolution No. 256/2006, the Management Board of PGNiG S.A. adopted a model of separation of gas trading from distribution to be implemented at PGNiG S.A., which provides for:

- integration of PGNiG S.A.'s wholesale and retail business activity

- assigning distribution to the Distribution System Operators (DSO), established on the basis of Gas Companies.

In accordance with the PGNiG S.A.'s programme for restructuring and privatisation, the companies under commercial law, whose business activity is limited to gas distribution, will be equipped with all assets indispensable for performing a function of a Distribution System Operator. The transformation of Gas Companies into Distribution System Operators will be based on the Companies' network assets, which currently represent approximately 95% of the Gas Companies' assets.

On May 12th 2006, the Management Board of PGNiG S.A. adopted the "Project of Separation of Gas Trading and Distribution at the PGNiG Group", which was approved by the Supervisory Board on June 22nd 2006. The Project was submitted for consultation to a number of entities, including the Ministry of State Treasury, Ministry of Economy, URE and trade union organisations active at the PGNiG Group.

The crucial phases of execution of the "Project of Separation of Gas Trading and Distribution at the PGNiG Group" include:

- establishment of six Trading Branches in the Gas Companies,
- demerger of Gas Companies and transfer of six Trading Branches from the Gas Companies to six Gas Trading Companies (Temporary Companies) established by PGNiG S.A., with the registered offices in Warsaw, by July 1st 2007,
- merger of six Gas Trading Companies (Temporary Companies) with PGNiG S.A., scheduled for Q3 2007.

On November 3rd 2006, the Extraordinary General Shareholders Meeting of PGNiG S.A. approved "The Restructuring Plan for the PGNiG Group concerning Integration of the Trading Business at PGNiG S.A. and Transformation of the Gas Companies into Distribution System Operators" together with the implementation schedule, and concurrently launched the process of organisational changes in the PGNiG Group.

On December 27th 2006, the Deeds of Incorporation of the six Gas Trading Companies were executed. The share capital of each of the following Gas Trading Companies amounts to PLN 50,000:

- Dolnośląska Spółka Obrotu Gazem Sp. z o.o. of Warsaw
- Górnośląska Spółka Obrotu Gazem Sp. z o.o. of Warsaw
- Karpacka Spółka Obrotu Gazem Sp. z o.o. of Warsaw
- Mazowiecka Spółka Obrotu Gazem Sp. z o.o. of Warsaw
- Pomorska Spółka Obrotu Gazem Sp. z o.o. of Warsaw
- Wielkopolska Spółka Obrotu Gazem Sp. z o.o. of Warsaw

The Companies are wholly owned by PGNiG S.A.

As at December 31st 2006, the Trading Branches were spun off the Gas Companies.

As a result of demerger of each of the six Gas Companies under Art. 529.1.4 of the Commercial Companies Code (demerger by way of a spin-off), an organised, commercial part of the business will be separated and "attached" to each of the six Gas Trading Companies.

The Distribution System Operator will be equipped with the remaining assets and human resources of the Gas Companies.

Given that PGNiG S.A. holds 100% of the share capital in Gas Trading Companies, their merger with the PGNiG S.A.'s structures will be carried out by way of a simplified procedure, pursuant to Art. 514–516 of the Commercial Companies Code, whereby PGNiG S.A.'s share capital increase will not be required, for PGNiG S.A. acts as the acquiring company.

4. Activities Planned in the Trading Segment

Natural Gas Sale

The projected rise in the natural gas sales volume is attributable to development investments of PGNiG's strategic customers. Account managers for key customers have commenced to provide their services, and their primary role will be to establish customer relations by undertaking a variety of measures, such as maintaining a regular and direct contact with the customer, perfecting customer service processes within the Company, and creating a positive image of PGNiG S.A.

Natural Gas Purchase

PGNiG S.A. does not plan to introduce any changes in the structure of supply sources in the 2007, or to make any changes to the effective natural gas purchase agreements. Steps are being undertaken, however, to ensure a greater diversification of natural gas supply areas and sources in the coming years.

Marketing Strategy

In 2006 PGNiG S.A performed a series of marketing research studies regarding customer preferences and satisfaction as well as brand and product image. The results prove that a vast majority of customers is satisfied with the quality of services provided by PGNiG S.A. The PGNiG brand awareness remains virtually unchanged compared with the previous years, while the PGNiG logo recognisability is low and requires intensified promotion and advertising activities to be undertaken by the Company.

The marketing strategy adopted by the Company in 2006 identifies actions which aim at maintaining the current customer base and developing a long-term pro-customer policy, consistent within the entire corporation. The marketing strategy necessitates the development of offers tailored to the needs of particular customer segments, improvement of the customer service standards, as well as establishment of a strong company brand and creation of a product brand family.

5. Trade-Related Risk

High Natural Gas Prices

The major risk factor posing a threat to gas market growth is a high price of natural gas, which is a natural consequence of high prices of crude oil and crude oil derivatives. This combined with an insignificant rise in the prices of electricity and heat as well as with lack of economic incentive, potentially generated by rigid emission requirements, brings a serious impediment to the growth of gas power business, which was to contribute largely to the development of the Polish gas market.

Competition Risk

At present PGNiG S.A. is the largest natural gas supplier in Poland. Majority of the companies holding licences for trade, transmission and distribution of gaseous fuels sell gas to customers who are located at the site of licence-holders or in their immediate vicinity. Only 14 companies non-members of the PGNiG Group trade in and distribute natural gas to retail customers and small institutional customers. These companies include businesses with both Polish and foreign capital (in the latter case, mostly of German origin). They are active mainly in northern and western Poland. The Group's competitors expand mostly in the areas which have not yet been covered by the gas pipeline network. Some of the aforementioned companies own a transmission infrastructure. A number of gaseous fuel distributors outside the PGNiG Group enjoy a firm position on the local markets and offer a range of value-added services. Recently, new entities are becoming increasingly active on the Polish market. These entities are local gas distributors which offer innovative solutions of the natural gas supply involving the use of LNG.

As at February 20th 2007, the President of URE (Energy Regulation Authority) granted licences (to companies other than PGNiG S.A. and the Gas Companies) for conducting the following business activities:

- trade in gaseous fuels (76 licences)
- transmission and distribution of gaseous fuels (48 licences)
- distribution of gaseous fuels (12 licences)
- foreign trade in gaseous fuels (12 licences).

Furthermore, the President of URE issued letters of promise regarding licences to conduct business activities in the following areas:

- trade in gaseous fuels (24 letters of promise)
- transmission and distribution of gaseous fuels (19 letters of promise)
- distribution of gaseous fuels (3 letters of promise).

An intensified commercial activity of competitors which aims at attracting current customers of the PGNiG Group may pose in the future a tangible threat of customer churn in favour of the competitors.

On March 27th 2006, Emfesz NG Polska Sp. z o.o. and Zakłady Azotowe of Puławy executed a contingent gas supply agreement, whereby Emfesz NG Polska Sp. z o.o. was to supply 150 m m^3 of natural gas to Zakłady Azotowe of Puławy, which will represent approximately 17% of natural gas hitherto supplied by PGNiG S.A. In January 2007, the Management Board of Zakłady Azotowe Puławy S.A. terminated the gas supply agreement concluded with Emfesz NG Polska Sp. z o.o., with the effect as of January 15th 2007.

Risk Related to Disruptions in Imported Gas Supplies

In 2006, the deliveries of natural gas from the eastern markets were disrupted due to the Russia-Ukraine conflict. The supplies were resumed after a few days to stabilise at levels specified in the relevant commercial contracts. Taking into consideration the policy pursued by the key supplier and political and economic conditions prevailing in the transit countries (the Ukraine and Belarus), similar incidents are likely to reoccur in the future.

Risk Related to the Separation of Natural Gas Supply and Transmission Agreements

Until now, the PGNiG Group has been the only customer served by the transmission operator, and, thereby, the only entity in the gas market to bear the consequences of the separation of the transmission operator. New agreements on transmission of gaseous fuel, signed by PGNiG S.A. and OGP GAZ-SYSTEM S.A. on August 31st 2006, and a newly introduced tariff necessitate determination of new terms for continuation of the agreements on sale of gaseous fuel. the continuation of the agreements on the same terms poses a risk to the proper functioning of PGNiG S.A. The risk arises as PGNiG S.A. incurs measurable costs as a result of conducting activities under sales agreements executed prior to the spin-off of OGP GAZ-SYSTEM S.A.

Transmission Network Traffic and Operation Guidelines

Following the approval of the Transmission Network Traffic and Operation Guidelines (IRiESP) issued by the President of URE, PGNiG S.A. launched the process of amending agreements with customers in order to adjust them to current sale conditions. The IRiESP rules for ordering capacity, balancing and placing nominations together with relevant charges for failure to balance or place nominations, are extremely strict and, in effect, may lead to a drastic rise in transmission service costs.

Risk Related to Separation of Gas Trade and Distribution

Significant organisational changes both at PGNiG S.A. and the Gas Companies may in short-term perspective affect the quality of customer service. Also, there exists a risk of incurring additional expenses connected, for instance, with the need to standardise the IT and organisational systems.

Rozdział VII: Distribution

Natural gas retail trading and distribution represent one area of the core business activities of the PGNiG Group. These activities are conducted by the Gas Companies, which are of strategic importance for the PGNiG Group. The Gas Companies also operate, maintain and expand the distribution system.

1. Business Activities of the Gas Companies in 2006

The trading activities conducted by the Gas Companies in 2006 primarily included the sale of high-methane gas (E), which represented 91% of the volume of natural gas sold and 92% of the value of sales in the distribution segment. Nitrogen-rich gas (Lw and Ls), which was sold by Wielkopolska Spółka Gazownictwa and Dolnośląska Spółka Gazownictwa, accounted for 9% of the volume of natural gas sold, and 8% of the value of sales in the distribution segment. In 2006 the volume of compressed natural gas (CNG) sales reached the level of 3.6m m^3, up by 2.3m m^3 (277%) on the 2005 figure. The 2006 structure of natural gas sales by quantity and value is presented in the table below.

The structure of natural gas sales of the Gas Companies

	Gas Companies (in total)	
	Volume of natural gas sold (m m^3)	Value of natural gas sold (PLNm)
E high-methane gas **	7 315.0	8,345.7
GZ Lw nitrogen-rich gas *	272.4	272.8
GZ Ls nitrogen-rich gas *	465.1	458.4
Total	8,052.5	9,076.9

* measured as high-methane gas equivalent
** including 3.6m m^3 CNG

The table below presents the volume of sold natural gas, customer structure, employment and capital expenditure made as at December 31st 2006.

Key information on the Gas Companies in 2006

Gas Companies	DSG	GSG	KSG	MSG	PSG	WSG
Volume of natural gas sold in 2006 (m m^3)	851.1	1,324.3	1,942.7	1,699.8	831.4	1,403.2
Number of customers, including:	737,150	1,287,210	1,362,859	1,435.894	726,967	875,762
1–4 tariff groups	734,990	1,283,642	1,358,879	1,430,593	724,304	872,539
5–7 tariff groups	2,160	3,512	3,940	5,301	2,651	3,220
8–10 tariff groups	0	44	17		8	
E 1-4 tariff groups		12	23			2
L1 tariff groups						1
T tariff groups					4	
Network length (km)	6,561.0	19,676.4	42,278.5	15,940.8	7,626.0	12,960.0
Headcount (employees)	1,705	3,100	4,003	3,527	2,184	2,186
Capital expenditure (PLNm)	86.1	126.14	170.7	133.8	128.0	110.5

As part of the development policy for the natural gas sales market, the Gas Companies expanded and upgraded their gas pipeline networks and connected new customers to their grids. Replacement of cast iron piping and technical control of the network performed on a regular basis contributed to a drop in the share of gas loss in sales. The Gas Companies carried out marketing research studies in order to determine the market potential of the communes not covered by the gaspipe network, or covered by the network to a negligible extent, as well as to preserve firm relations with local governments, current and prospective customers, and to promote knowledge on new uses of natural gas. The Gas Companies actively stimulated the increase in demand for natural gas by taking various measures including promotion of state-of-the-art equipment for co-generation of electricity and thermal energy, local gas-fired boiler houses and the use of compressed natural gas by combustion engines. In addition, the Companies performed work connected with the contruction of the general use CNG filling stations network.

In 2006 PGNiG S.A. and the Gas Companies conducted work aiming at rendering their organisational structures compliant with the requirements set forth in Directive 2003/55/EC of the European Union, which imposes the obligation to legally separate gas distribution from the trading business and to spin off the Distribution System Operators (OSD) by July 1st 2007.

Within the framework of the PGNiG Group Restructuring Project concerning Trade Integration at PGNiG S.A. and Transformation of the Gas Companies into Distribution System Operators, each of the Gas Companies span off the organised part of its business, i.e. the branch responsible for trading in gaseous fuels, and furnished it with the indispensable property and non-property assets as well as employees. The Trading Branches were spun off on December 31st 2006.

2. Planned Directions for Development of the Gas Companies

The changes to be implemented by the Companies will be primarily determined by the fulfilment of provisions stipulated in the Directive 2003/55/EC. Since the beginning of 2007, the Company has carried out work aimed at separating gas trading from distribution and detaching Distribution System Operators (DSO), to be completed by July 7th 2007. The work will comprise analysis, development and implementation of the project for modification of processes, procedures and documentation related to the Company's business activity. The separation process itself will require adoption of the internal procedures for effective cooperation between distribution and trading.

Poland's economic growth and its membership in the European Union positively affect the condition of energy businesses as they contribute to increasing demand for natural gas. The economic growth and consequent increase in people's income entail rapid growth of construction market, which in turn offers prospects of increased natural gas sales.

The trade-centred actions taken by the Gas Companies are intended to increase revenues, especially the revenues derived from activities which do not require licences, to strengthen their market positions and reduce the effects of seasonality of natural gas sales. The Companies will focus on the following tasks:

- enhancing the Companies' position on the local markets
- soliciting new customers
- increasing sales on the markets of individual and institutional customers
- developing modern organisation of sales and customer service oriented towards the customers' needs
- creating product image and establishing the identity of the strong Group
- increasing sales of natural gas through promoting its new uses
- increasing sales of compressed natural gas (CNG) for vehicles through construction of new CNG service stations
- modifying the Companies' vehicles to be powered by compressed natural gas
- providing associated services
- developing IT resources

As regards distribution, the Gas Companies (Distribution System Operators) will carry out the following development-oriented activities so as to ensure the competitive edge of its businesses in relation to other entities operating on the liberalised gas market:

- increasing transmission capacities of the distribution network (development investment projects)
- managing network transmission
- streamlining gas pipeline networks

- optimising network operations and enhancing safety of its utilisation
- using new natural gas distribution systems by employing CNG and LNG technologies
- delivering natural gas to the areas that have not been provided with natural gas
- developing IT resources

3. Risks Related to Distribution

Risk Related to Direct Competition

The liberalisation of the gas market, resulting from the legal requirement to separate gas trading from distribution, is likely to boost activity of the competitive companies. For a few years, the activity of natural gas suppliers has proved regular and steady. They gradually developed their gas networks and solicited new customers, both among individuals and businesses. Additionally, since an increased marketing activity, aimed at soliciting customers of the Gas Companies, could be observed on the part of competitive companies, the actual threat of losing these customers for the benefit of competitors may occur in the future.

Legislation Risk

The negative phenomena observed in the Polish legal system include inconsistency or duality of the applicable laws (the Construction Law and the Supervision Law regulating the construction of gas pipeline networks being a case in point) as well as permanent delays in drafting secondary legislation for the purposes of statutes under which it is issued. This leads to differing interpretations of the laws. Another adverse factor is the lack of understanding for the needs of the gas industry as opposed to strong support in the case of other fuels, especially coal. Other factors which may adversely affect the Companies' operations include the fact that interest rates on past due receivables have been lower than interest rates on bank loans. This has been prompting customers to deliberately delay payments for gas, which adversely affects the Companies' ability to collect debts .

Risk Related to Regional Policy

The dependency of heating plants on local governments (communes) significantly affects the Companies' ability to expand their customer base as the communes have a decisive say in energy supply plans for their respective regions and at the same time they issue construction permits. This frequently results in preferential treatment of their own heating plants where communes can opt for energy sources other than gas. Such a situation affects in particular the residential construction sector. Developers may conclude contracts with heating plants even if their terms are unfavourable to end users.

Substitution Risk

The rapidly rising gas prices pose a serious threat to the Gas Companies. The surge in fuel prices may translate into lower consumption levels owing to cost-saving measures on part of customers and their transition to alternative fuels. In view of rising gas prices, some customers seek alternative gas suppliers or consider changing the energy medium. Moreover, the observable increase in market activity of competitive companies, which offer substitutes of natural gas, including especially liquid gas, may result in a loss of prospective benefits, which would result from customers being provided with services of the competitive companies on the areas, where gas has not been yet delivered.

Risk Related to Discontinuation of Gas Pipelines Network Development

As demonstrated by the events of 2006, a substantial risk, attributable to the OGP GAZ-SYSTEM S.A.'s policy, occurs with regard to discontinuation of gas pipelines network development. The Gas Companies face problems connected with the extensive period of time required for the construction or modernisation of the connections to the transmission network. The dates of execution of any technological change in the OGP's network prove a great hindrance to development of the market of key customers. According to the policy adopted by OGP GAZ-SYSTEM S.A., the new connections are not allowed if the existing stations have free transmission capacities, which in practice translates into necessity of constructing several kilometres long sections of distribution network, connected to the existing gas pipeline networks, instead of connecting directly to the nearby transmission pipeline. Such measures lead to lowering profitability of connecting new customers.

Chapter VIII: Liquefied Natural Gas (LNG)

In the recent year, liquefied natural gas (LNG) has grown in significance as a source of natural gas supplies. Importing LNG to Poland is one of the strategies to diversify sources of natural gas supplies and a way to meet the growing demand for gas. Accordingly, it is necessary to build an LNG terminal and the supporting technical infrastructure, including storage and network facilities, to enable LNG imports by sea.

In 2006, PGNiG S.A. and a consortium of advisors performed a study of feasibility and technical and economic assumptions for imports of LNG to Poland. One of the key objectives of the prepared study was to verify the cost-effectiveness of the construction of an LNG terminal on the Polish seaside (in Gdańsk or w Świnoujście), which would handle first LNG supplies in 2011. The study confirms the feasibility of LNG imports to Poland and of the construction of a regasification terminal on the Polish coast by 2011 and provides recommendations on many matters including:

- possibile location,
- technological solutions,
- the means of financing the project and its organisation.

The terminal's initial handling capacity will be 2.5b m^3 gas a year.

The LNG project was divided into three basic stages, which are consistent with the accepted deadline and investment cycle as well as the specific nature of the tasks to carried out:

- 2007–2008 – implementation (preparation) stage
- 2008–2010/11 – investment stage
- 2011 – operation stage (first LNG supplies shipped to the terminal).

Based on the results of the feasibility study, on December 15th 2006, the Management Board of PGNiG S.A. took a decision to build an LNG terminal in Świnoujście, and on February 6th 2007, a decision was made to commence preparatory and design work for the project.

On February 20th 2007, the Management Board of PGNiG S.A. adopted a decision whereby an SPV was established to construct the LNG terminal; the SPV's name is Polskie LNG Sp. z o.o. On March 29th 2007, following the approval of PGNiG S.A.'s Supervisory Board, the Extraordinary General Shareholders Meeting of PGNiG S.A. consented to the creation of the SPV.

The LNG regasification terminal needs a connection with the existing transmission network. Therefore, cooperation with OGP GAZ-SYSTEM S.A. is necessary as this company is a transmission system operator as defined in the Polish Energy Law. In January 2007, a request was filed with OGP GAZ-SYSTEM S.A. to specify to the conditions for the connection of the planned terminal to the transmission network.

Furthermore, a pre-condition for the construction of the LNG terminal in Świnoujście is to construct the necessary port infrastructure, which will be the responsibility of the Szczecin Maritime Office and Zarząd Morskich Portów Szczecin i Świnoujście S.A.

Risk of Related to the Absence of LNG Supplies

The key risk related to the LNG Project concerns LNG supplies on the terms acceptable to PGNiG S.A. The lack of security in the form of a long-term contract for LNG supplies can result in:

- a failure to attain one of the key objectives of the LNG Project – the diversification of LNG supplies
- a delay in the completion of the LNG Project if the investment decision is conditioned upon supplies of LNG
- having to incur the costs related to the terminal operating at a less-than-optimal level.

Risk of Not Meeting the Announced Deadline

Due to a tense timetable and the fact that the LNG terminal will be built concurrently with other investment projects (a breakwater, an external port and a connection of the terminal to the transmission network), there is a risk that the set deadline for the completion of the LNG Project may not be met. Timely implementation of the LNG Project largely depends on formal and legal procedures and connection to the newly built technical infrastructure in line with the pre-arranged schedule.

Charter IX: Exploration

PGNiG S.A. conducts exploration and prospecting work domestically and abroad through the exploration companies of the PGNiG Group. The work mainly includes the exploration and development of geological structures containing reserves of hydrocarbons in the form of natural gas and crude oil. The exploration and prospecting of reserves comprise a study of historical data, as well as geological analyses and geophysical and drilling research.

1. Exploratory Activities in 2006

In 2006, PGNiG S.A. conducted exploration work in Poland in the following three geological regions: in the Carpathians, Carpathian Foreland and Polish Lowlands. A total of 67,235m drillings were performed during the exploratory work. Drilling work covered 31 exploration and prospecting boreholes. As at December 31st 2006, work was concluded on 27 boreholes (including 18 exploratory boreholes and nine prospecting boreholes) and continued in four boreholes (including 3 exploratory boreholes and 1 prospecting boreholes)

Based on bore sampling, 22 boreholes were classified as positive (which translates into 71-percent efficiency of work performed). Based on deposit-related results in the form of industrial outflow of gas or crude oil, nine gas boreholes in the Carpathian Foreland, eight gas boreholes in the Polish Lowlands and one in the Carpathians as well as four crude oil boreholes in the Polish Lowlands were classified as productive and placed in operation.

In 2006, the expenditure on exploration and prospecting work totalled PLN 486.9m; the expenditure brought fruit in the form of an increase in the reserves of:

- crude oil by 413 thousand tonnes
- natural gas by 4.5bn m^3 high-methane equivalent.

As at the end of 2006, the reserves of natural gas amounted to 102.5bn m^3 (high-methane equivalent), while the reserves of crude oil were estimated at 21.4m tonnes. The majority of the reserves were favourably assessed by the Mineral Reserves Commission and accepted by the Minster of Environment.

In 2006, PGNiG S.A. conducted geophysical research in the Carpathians, Carpathian Foreland and Polish Lowlands. The Company performed a total 1,094.2 km of 2D seismological survey and 731.8 km^2 of 3D seismological survey.

2. Operations of the Exploration Companies

The following Companies included in the PGNiG Group conduct deposit exploration:

- GEOFIZYKA Kraków Sp. z o.o.
- GEOFIZYKA Toruń Sp. z o.o.
- Poszukiwania Nafty i Gazu Jasło Sp. z o.o.
- Poszukiwania Nafty i Gazu Kraków Sp. z o.o.

- Poszukiwania Nafty i Gazu NAFTA Sp. z o.o.
- Poszukiwania Naftowe „Diament” Sp. z o.o.
- Zakład Robót Górniczych Krosno Sp. z o.o.

Business profile of the Companies

The core business of the exploration Companies comprises the broadly meant exploration of crude oil and natural gas deposits within the territory of Poland and abroad. Modern equipment and experienced staff enable the Companies to perform high-quality work in the field of deposit exploration, including:

- work in the area of field seismics with use of 2D and 3D sources of vibration- or dynamite-induced excitation,
- comprehensive processing and interpretation of seismic data,
- geophysical measurements, operations in non-cased, cased and production boreholes, as well as interpretation thereof,
- shallow geophysical tests in the area of broadly meant environmental protection, geology and hydrogeology,
- design and execution of deep groundbeds for cathode protection,
- design, execution and documentation of research, prospecting, exploratory and production boreholes,
- geothermal drillings and frozen drilling wells,
- drilling of boreholes for underground storage of hydrocarbons,
- specialist drilling servicing, including cementing, flushing, borehole reinforcement, as well as servicing of control and instrumentation at well surface installations,
- intensifying operations with use of specialist equipment for hydraulic slotting, mini-slotting, acid treatment and casing hydroperforation,
- unloading of liquids from boreholes with use of nitrogen or coiled tubing unit,
- borehole recompletion,
- borehole reinforcement together with anti-eruption protection, through a specialised packer service,
- liquidation of infrastructure and drilling pits,
- liquidation of other effects of borehole mining,
- mine rescue work.

2006 Operations of Exploration Companies

In 2006, PGNiG S.A. held the dominant position in domestic order portfolios of the exploration Companies, in terms of geophysical and borehole work and specialised reconstruction, drilling and cementation services. In the domestic market of crude oil licence operators, the German RWE Dea AG and the American FX Energy Poland Sp. z o.o. were the companies which ordered geophysical work in 2006. Services provided by the companies to non-oil businesses included work ordered by opencast mines, the Institute of Geology, local authority entities and the construction industry. In the drilling and exploration segment, drilling companies implemented a multi-borehole drilling project for RWE Dea AG in 2006. From April 2006, work continued on drilling 43 boreholes on the freezing plate for PeBeKa

S.A. Specialised reconstruction, drilling and cementation services to investors outside of PGNiG S.A. were provided to Albrecht S.C. and Petrobaltic S.A.

At the same time, the exploration Companies were active on foreign markets. The main markets on which the geophysical companies of the PGNiG Group focused their foreign operations in 2006 were Austria, Iran, India, the Czech Republic, Turkey, Libya and Pakistan. Drilling services were provided to customers from Kazakhstan, Pakistan, India, Morocco, Hungary, Ukraine, Lithuania, Libya, Germany, Denmark and Mozambique. The servicing Companies of the PGNiG Group provided their services in Belarus, Lithuania, Ukraine, Russia, Kazakhstan, the Netherlands, Germany and Mozambique

The table below sets forth, by customer group, the structure of geophysical and drilling services provided in 2006 by the exploration Companies.

Structure of geophysical and drilling services

Customer group	Drilling services	Geophysical services	
		2D	3D
	(m)	(km)	(km^2)
PGNiG Group	73,021.0	1,094.2	731.8
Other domestic customers	24,344.0	719.5	48.0
Foreign customers	209,322.5	2,958.0	5,206.5
Total	306,687.5	4,771.7	5,986.3

In 2006, the exploration Companies made drillings with the total length of 306,687.7 m, including 73,021 m of exploration, prospecting and operating boreholes ordered by PGNiG S.A. In 2006, geophysical companies performed 4,771.7 of 2D seismological survey and 5,986.3 km^2 of 3D seismological survey

Factors and Events Material to the Business of the PGNiG Group

The growing demand for energy sources, guaranteeing winning new contracts and entering new markets for the companies' services was the most important factor affecting the 2006 financial results of the Group exploration, servicing and geophysical companies. High prices of crude oil per one barrel reported in 2006 encouraged oil companies to increase expenditure on oil exploration and to expand the conducted exploration projects. Another year of presence in promising markets for geological and exploration services helped strengthen the exports position of the PGNiG Group companies.

The environmental policy adopted by the Group companies and the measures taken with a view to limiting the negative environmental impact had a major effect on the exploratory Companies' financial results. Performing work complying with the effective environmental protection standards and the effects of pricing and technical competitiveness of bids were reflected in an increased number of successful tenders. To perform the current and future tasks, in 2006 exploration companies incurred capital expenditure of PLN 144.5m on the purchases of equipment and appliances necessary for maintaining an appropriate technical condition. New investments not only improved the quality of work and services provided by the Group Companies, but also contributed to further specialisation in the scope of tasks performed and reduction of costs affecting the companies' financial results.

3. Joint Ventures

<u>Exploratory Work in Poland</u>

In 2006, the borehole Huwniki-1 was drilled to a depth of 5,000 m under an agreement with the National Fund for Environmental Protection and Water Management. The agreement provided for the recompletion of the borehole Huwniki-1 with view to identify the geological structure as well as oil and gas-bearing characteristics in the north-east part in the Przemyśl sigmoid zone in the Polish Carpathians. The study "Borehole Geological Documentation" is being prepared.

In 2006, PGNiG S.A. continued joint projects with FX Energy Poland Sp. z o.o. in the following areas:

- "Płotki" (under the Agreement for Joint Operations dated May 12th 2000, as amended)
- "Płotki" – „PTZ" – in cooperation with CalEnergy Resources Poland Sp. z o.o. (the so-called Extended Zaniemyśl Area, under the Operating Agreement of Mining Users dated October 26th 2005)
- "Poznań" (under the Agreement for Joint Operations dated June 1st 2005)
- Blok 255 (under the Agreement for Joint Operations dated dated October 29th 1999).

As a result of the work conducted under the agreements for joint operations, modest reserves of non-commercial natural gas were discovered through Rusocin-1 and Środa Wielkopolska-5 boreholes. Numerous 2D and 3D photographs were taken, and the Winna Góra-1 exploratory borehole completed, where a production test will be carried out.

In H2 2006, the Zaniemyśl natural gas reservoir was developed and the trial production was launched; in September 2006, the Wilga (Block 255) reservoir started to be exploited.

<u>Exploratory Work Abroad</u>

In 2006, an interpretation of reprocessed archival seismic profiles was prepared for the Kirthar block in Pakistan. A contractor to perform seismic work with a view to implementing the prepared study "Project for 2D Seismic Work in the Kirthar block area" was selected in an open tender.

Exploratory work in the Kirthar block area is conducted in cooperation with Pakistan Petroleum Ltd. (project cost participation: 70% PGNiG S.A., 30 % PPL).

4. Planned Directions of Exploratory Work

<u>Exploratory Work in Poland</u>

In 2007, exploratory work is planned in the following regions:

- Lubaczów-Tarnogród
- Przemyśl-Jarosław
- Rzeszów-Łańcut-Kolbuszowa
- Pilzno-Tarnów
- Ostrów Wielkopolski-Pogorzela
- Międzychód-Gorzów Wielkopolski
- Świebodzin- Wolsztyn-Nowy Tomyśl
- Środa Wielkopolska-Jarocin (cooperation with FX Energy Poland Sp. z o.o.)
- Pniew-Stęszew
- Gubin-Krosno Odrzańskie
- Sulęcin-Międzyrzecz
- Wronki-Sieraków

To a limited extent, exploratory work will be conducted in the Lublin region, the Gdańsk Pomerania and in the north of Poland, in the area of Bartoszyce-Górowo Iławeckie.

It is also planned that work will be conducted in the Bieszczady area covered by the existing Eurogas Polska Sp. z o.o.'s licence, which was assigned to PGNiG S.A. in January 2007.

The planned work will include the following tasks:

- based on seismic operations, discovery and documentation of new fields with potential hydrocarbon reserves,
- research into gas and oil bearing characteristics of new prospective fields,
- continuation of exploratory work on prospective or newly discovered fields,
- preparation of identified deposits of crude oil and natural gas for production.

Exploratory Work Abroad

On February 28th 2007, PGNiG S.A. concluded a conditional agreement with Mobil Development Norway A/S and ExxonMobil Production Norway Inc. (ExxonMobil) concerning the purchase of 15% interest in three licences covering Skarv and Snadd fields in the Norwegian Continental Shelf. Under the agreement, PGNiG S.A. will acquire 15% interest in the licences for the price of USD 360m.

According to the data approved by the Norwegian Petroleum Directoriate (2006 Fact Book), the aggregate capacity of the fields in which PGNiG S.A. will acquire interest from ExxonMobil is estimated at approximately:

- 35.8bn m^3 natural gas,
- 18.3m m^3 crude oil and condensate (approx. 15m tonnes)
- 5.8 mln tonnes NGL (Natural Gas Liquids).

British Petroleum is the direct operator of the fields, while the other partners include Shell, Statoil and Norsk Hydro.

Natural gas and crude oil will be produced starting from mid-2011. It is estimated that capital expenditure on the development of oilfields will amount to around USD 5bn, including PGNiG S.A.'s capital expenditure of around USD 600m.

The acquisition of the three exploration and production licences in Norway is part of PGNiG S.A.'s strategy aiming to increase the volume of oil and natural gas reserves owned by the Company outside of Poland and to ensure diversified sources of gas supplies. PGNiG S.A.'s investment in the licences is a long-term investment.

In January 2007, PGNiG S.A. and GSPC (Gujart State Petroleum Company), an Indian company, executed a memorandum of understanding concerning potential cooperation in the exploration and production of hydrocarbons in India, Egypt, Yemen and other countries in the Middle and Far East.

In 2006, PGNiG S.A. applied for exploration licences in Libya, Algeria, Egypt and Denmark. It plans continue efforts in this field in 2007.

<u>Growth Prospects for Exploration Companies</u>

In 2007, the activities of the exploration Companies will include both the strengthening of their positions on the domestic market and continued expansion on foreign markets, focusing on the exploration and development of crude oil and natural gas reserves. Prices of crude oil and natural gas, which stabilised at high levels, opened a growth opportunity for the exploratory work market.

In 2007, the major foreign markets for services offered by the geophysical companies of the PGNiG Group will be India, Iran, Turkey, Pakistan, Libya and the EU countries. Work supported by professional expertise and innovativeness of service performed, as well as multiyear marketing-focused efforts enable the companies to acquire orders for services and geophysical work. Vast experience and constantly enhanced service portfolio have contributed to an optimised use of resources.

Given their rich reserves of crude oil and the expansion of crude oil and natural gas reserve exploration and development activities, the countries of Africa (Libya, Mozambique and Egypt) and the Middle East, Asia (India, Pakistan and Kazakhstan) and Ukraine are the most promising exports markets for the exploration (drilling) Companies. Furthermore, a wide range of geothermal projects are being prepared in Germany; in Hungary, drilling work is planned with a view to supporting underground gas storage facilities in used-up reserves. The conducted marketing actions, comprehensive range of work and continuous modernisation of specialist equipment and subassemblies, all contribute to the strengthening of the Companies' positions on prospective foreign markets. Constant effort to ensure work quality and safety, as well as limiting adverse effect of work on natural environment, combined with multiyear experience support the Companies in winning new business partners on foreign markets.

The domestic market remains the strategic market of the servicing companies in 2007, while the target market of these Companies is Central and Eastern Europe, and especially Belarus, Lithuania and Ukraine as well as Russia, Kazakhstan and Mozambique, which report demand for intensification work and borehole mining services. Deepening specialisation in the scope of servicing provided, purchases of state-of-the-art investment assets supporting service range broadening, as well as repairs and specialist equipment undertaken with view to maintaining the appropriate technical condition of the operated equipment, all render placing a part of production capacities on the prospective service markets feasible.

5. Risks and Threats Relating to Exploration

Risk relating to the Discovery of New Deposits and Decreasing Production from the Existing Developed Deposits

When the results of PGNiG S.A.'s successful exploration activity, in the form of documented new reserves do not offset the production from the existing operated deposits, PGNiG S.A.'s documented reserves will decrease in line with the ongoing production.

Risk of Competition on the Exploration Market

The risk of competition from other companies active on the Polish market appears to be high in the scope of acquisition of licences for exploration and prospecting of deposits or the implementation of a strategy providing for acquiring access to own hydrocarbon reserves, in the light of growing global interest in new exploration and economic expansion areas. Certain competitors, especially those active globally, enjoy strong market positions and have financial resources larger than those of PGNiG S.A. Thus it is probable that such companies would submit their bids in tender offers and be able to acquire promising licences. Competitors are also able to define, value, offer and purchase numbers of fields (including the operation thereof and underlying licences) larger than it would be possible in the case of PGNiG S.A., given the Company's financial and human resources. This competitive edge of other market players is especially material on the international market.

Risk of Loss of Highly Qualified Personnel

The activity of foreign companies on the Polish market intensified the companies' takeover of highly qualified employees with vast professional experience. This risk is especially high with respect to professionals specialised in the exploration of natural gas and crude oil deposits.

Risk Relating to the Assessment of Economically Viable Producible Reserves

Data on economically viable producible reserves of crude oil and natural gas is actually estimated and the 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 the full business cycle from the commencement of exploration to the launch of production from a developed field lasts six to eight years.

Risk of Growing Cost of Ensuring Compliance with Legal Regulations Concerning Safety, Environmental Protection and Health

Ensuring compliance with environmental law in Poland and abroad might significantly increase PGNiG S.A.'s costs of operations. PGNiG S.A. has incurred and expects to incur significant capital expenditure and costs on harmonising its operations with ever more complex and stringent legal regulations concerning safety and health at work, as well as environmental protection. 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) rendered the regulations governing the execution of projects which might affect the Nature 2000 area more stringent and enhanced the environmental protection-related requirements in the scope of entering the areas of the occurrence of protected plant species and habitats of protected animals.

Risk of Delayed Exploratory Work

Under the currently binding legal regulations, obtaining a licences for exploration and prospecting of crude oil and natural gas deposits lasts from one to one and a half year. Moreover, prior to the commencement of field work, the Company is obliged to arrange for numerous formalities, including obtaining formal and legal permits and approvals for entering the area, meeting environmental protection-related requirements and abiding by the regulations governing tenders for a work contractor. Under the currently binding legal regulations, another several months pass before an agreement with the work contractor is signed. These factors create the risk of delayed exploratory work.

Risk of Growing Cost of Exploration

Exploratory work is capital consuming, given the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed on prices of casing pipes and lifting casing used in drilling. An increase in prices of energy and materials translates into an increase in the cost of exploratory work.

Operating Risk

Low profitability of certain ordered tasks poses a serious threat to the Exploration Companies' achievement of their respective objectives. This risk is especially high with respect to turnkey contracts and execution thereof, where the responsibility for due performance and consequences of undue performance are transferred onto the general contractor, even in the event of unpredictable geological conditions. Delayed (particularly on the domestic market) adjustment of prices provided for in earlier cost estimates or absence of such adjustments may result in settlements at unadjusted prices and affect the recorded work profitability.

Market Risks

Whenever the economic situation improves, the oil and gas industry increases expenditure on the exploration of and production from new deposits, while simultaneously increasing capital expenditure on plant and equipment necessary to achieve specific technological potential. Enhancement of the scope of drilling services offered by the Exploration Companies abroad and maximising the security of the work conducted require the plant, equipment and drilling subassemblies to be modernised continually.
Another feature characterising the operations of the Exploration Companies is high fixed cost of maintaining the Companies' potential ready for the provision of services and export thereof. A major threat exists that changes in raw material prices, as well as in exchange and interest rates might adversely affect the economic and financial standing of the Exploration Companies.

Risk of Unsatisfactory Knowledge of Local Law

Exploration Companies conduct their business on numerous foreign markets. Companies' expansion on new markets renders harmonising their operations to new conditions necessary.

Unsatisfactory knowledge of local law might expose a Company exporting its services to the risk of unexpected costs and legal effects.

Chapter X: Production

PGNiG S.A. conducts production all over the country. The production from deposits comprises reserves estimation, development of discovered deposits and economic management of the reserves. In the course of production, boreholes are repaired and intensifying operations are carried out on the operated reserves in order to maintain their original production capacities. The boreholes where production does not cover maintenance cost are liquidated and the post-production ground is cleaned up.

1. 2006 Production

Two of PGNiG S.A.'s branches, the Zielona Góra Branch and Sanok Branch, carry out production of natural gas and crude oil in Poland. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 27 mines (including 17 gas mines, and 10 oil and gas mines), while the Sanok Branch produces crude oil and high-methane natural gas at 47 mines (including 25 gas mines, and 22 oil and gas mines).

In 2006, PGNiG S.A. produced a total of 4,277.1m m^3 of natural gas (high-methane equivalent). Total production of crude oil stood at 517.6 thousand tones in 2006.

The table below sets forth PGNiG S.A.'s production in 2006.

Production structure

Product		Unit	Quantity
1.	Natural gas, including:	million m^3 *	4,277.1
	- Zielona Góra Branch - Sanok Branch	million m^3 * million m^3	2,377.6 1 899.5
2.	Crude oil, including:	thousand tonnes	517.6
	- Zielona Góra Branch - Sanok Branch	thousand tonnes thousand tonnes	469.5 48.1
3.	Condensate	thousand tonnes	12.1
4.	Sulphur	thousand tonnes	20.7
5.	LPG	thousand tonnes	17.1
6.	Helium	million m^3	2.4
7.	LNG	million m^3 **	19.9

* High-methane equivalent.
** High-methane volume equivalent in normal conditions.

In January 2006, because of the extremely difficult weather conditions, demand for natural gas increased dramatically. Daily gas supplies and consumption increased to a record high of 61.5m m^3. Daily domestic production stood at 17.7m m^3 then, while daily supplies from the underground gas storage facilities at 28.2m m^3.

PGNiG S.A. owns seven and operates six underground gas storage facilities. The Sanok Branch uses four underground gas storage facilities located in worked out natural gas caverns (the Underground Gas Storage Facility Brzeźnica, Underground Gas Storage Facility Husów, Underground Gas Storage Facility Strachocina and Underground Gas Storage Facility Swarzów), The Zielona Góra Branch operates the Underground Gas Storage Facility Wierzchowice, and INVESTGAS S.A., acting on behalf and to the benefit of PGNiG S.A., operates the Underground Gas Storage Cavern Facility Mogilno (in salt caverns). Agreement with INVESTGAS S.A for the operation of the Underground Gas Storage Cavern Facility Mogilno was concluded in September 2006.

The operations of the Underground Gas Storage Facilities are summarised in the table below.

Underground Gas Storage Facility		Active capacity (million m^3)	Amount of gas drawn from facility (million m^3)	Amount of gas delivered to system (million m^3)	Amount of gas pumped into facility (million m^3)	Amount of gas accepted from system (million m^3)
1.	Wierzchowice	575.0	356.0	355.5	578.1	582.7
2.	Brzeźnica	65.0	35.2	35.2	73.1	73.1
3.	Strachocina	150.0	96.2	96.1	162.4	162.4
4.	Swarzów	90.0	47.0	46.9	86.2	86.3
5.	Husów	400.0	309.2	308.9	373.8	373.8
6.	Jaśniny	10.0	0.0	0.0	0.0	0.0
7.	Mogilno	371.6	315.2	315.2	359.2	359.3
Total		1,661.6	1,158.8	1,157.8	1,632.8	1,637.6

Currently, the ratio of active capacity of the underground gas storage facilities in Poland to annual natural gas consumption by PGNiG S.A.'s customers stands around 13.4%, which covers average gas consumption for 49 days.

In the second half of 2006, the active capacity of the Underground Gas Storage Facility Wierzchowice increased to 575m m^3. The decision to increase the active capacity was driven by the increasing demand for natural gas and technological feasibility of compressing additional gas volumes into the facility.

The decrease in the active capacity of the Underground Gas Storage Cavern Facility Mogilno to 371.6m m^3 was caused by the occurrence of the convergence phenomenon and the temporary active capacity reduction for the purposes of running tightness tests for chambers Z-8 and Z-11.

The Underground Gas Storage Facility Jaśniny has not been operated since May 2001.

In 2006, PGNiG S.A. repaired 51 boreholes and liquidated 99 boreholes. The tables below set forth the borehole repairs and liquidations performed by the Branches in 2006.

Repairs

Branch	Cost of repairs (PLNm)	Non-complete boreholes	Complete boreholes	Total boreholes
Zielona Góra	31.4	4	16	20
Sanok	18.4	6	25	31
Total	49.8	10	41	51

Liquidated boreholes

Branch	Liquidation cost (PLNm)	Number of boreholes
Zielona Góra	2.4	5
Sanok	30.4	94
Total	32.8	99

In 2006, the main tasks in the area of intensifying hydrocarbon production were to maintain production capacities of production boreholes and improve absorption capacity in boreholes used for pumping deposit water. The structure of related expenditure was as follows:

- Natural gas reserves PLN 1.2m (including PLN 0.8m at the Zielona Góra Branch and PLN 0.4m at the Sanok Branch),
- Crude oil reserves PLN 0.8m (including PLN 0.7m at the Zielona Góra Branch and PLN 0.1m at the Sanok Branch).

In 2006, a total of 20 boreholes were placed in operation at the Sanok Branch on the following deposits: Stobierna, Terliczka, Trzebownisko, Księżpol, Biszcza, Żołynia and Gruszów.

On October 26th 2005, PGNiG S.A. on the one hand, and FX Energy Poland Sp. z o.o. and CalEnergy Resources Poland Sp. z o.o. on the other signed the Operating Agreement of Mining Users was signed for the area Płotki-PTZ (Powiększony Teren Zaniemyśla – Extended Zaniemyśl Area). Under this Agreement, in 2006, the Zielona Góra Branch placed in operation borehole Zaniemyśl-3.

In January 2007, the natural gas deposit Jasionka (Phase I) was placed in operation. The natural gas mine is located in Jasionka near Rzeszów within the operating area of the Sanok

Branch. The mine was placed in operation in PGNiG S.A.'s implementation of a programme providing for increasing natural gas production from domestic deposits.

2. PGNiG S.A.'s Growth Prospects

Growth Prospects for Natural Gas Production

PGNiG S.A. is in the process of implementing the programme of increasing the production of natural gas. The current forecast assumes that the production capacities will reach 4.3bn m^3 in 2007.

The decision of OGP GAZ-SYSTEM S.A. on pressure increase at interconnector terminal points of the transmission network translated into a change in production capacity of the Sanok Branch. Therefore, it was necessary to install compressors on certain reserves in order to ensure appropriate volumes of natural gas extraction and its injection into the transmission system. Necessary adjustments to the investment plan were made and the adopted procedure for the purchase and installation of seven compressors is being followed. It is expected that the installation of eight compressors will be carried out in 2007–2010.

New Connections

In 2007, the Company plans to develop the new Jesionka reserve at the Sanok Branch (the first phase was executed in January 2007) and begin production in five boreholes on the already exploited reserves, whose aggregate production capacity will reach approximately 580 m^3/min, which in terms of annual exploitation translates into incremental extraction volumes of around 260m m^3.

In 2008, the Company envisages to commence production at the Jesionka reserve, Cierpisz reserve, Łękawica reserve and in eight producing reserves (second phase), whose aggregate production capacity amounts to approximately 600 m^3/min, thus increasing annual production capacity by 280m m^3.

In line with the Company's plans for 2007–2008, at the Zielona Góra Branch the production is to begin in the following five natural gas reserves: Kaleje, Kaleje-E, Łęki, Paproć-W, Nowy Tomyśl. The aggregate production capacity of these reserves will reach approximately 635 m^3/min, which in terms of annual exploitation translates into incremental extraction volumes of around 320m m^3.

Grodzisk Denitriding Plant

The Grodzisk Denitring Plant, with the annual throughput capacity of feedstock gas amounting to 500m m^3, is to commence its operations in 2009. The objective behind its construction is to allow for the development of the reserves located in the Nowy Tomyśl-Grodzisk region (Paproć, Paproć W, Wielichowo, Ruchocice and Jabłonna) and of the gas extracted from the Lubiatów-Międzychód-Grotów (LMG) reserves, as well as the construction of a second controller, besides the Odolanów Branch, connecting the system for extraction of nitrogen-rich gas to the high-methane gas transmission network. It will be possible to route gas from this facility both to the E gas system and the Lw system, and thus to achieve considerable flexibility of these systems.

Underground Gas Storage Facilities

The PGNiG S.A.'s project of expanding the underground gas storage capacity provides for development of the existing gas storage facilities by expanding the active capacity of the Underground Gas Storage Strachocin and the Underground Gas Storage Wierzchowice and development of the Cavern Underground Gas Storage Mogilno. In the coming years, the Company will continue to run the project related to construction of the cavern underground gas storage facility in Kosakowo. The storage facility will offset the irregular gas acceptance in the Trójmiasto (Gdańsk-Gdynia-Sopot) region. In view of the technological limitations encountered with respect to the salt cavern leaching, the project is to be completed around 2019.

According to the project, the first two Polish storage facilities for nitrogen-rich gas are to be built – UGS Daszewo (in the Seaside Belt region for the Ls gas subgroup) and UGS Bonikowo (for "the gas ring from the Lw subgroup"). The storage facilities will make it possible to optimise natural gas supplies, delivered as part of the nitrogen-rich gas subsystem, and respond to increasing demand for natural gas in the areas located in the vicinity of the gas storage facilities.

In 2007, the expenditure on the investment projects related to expanding the storage capacities amounted to approximately PLN 121.5m.

Feasibility Prospects for Crude Oil Extraction

The current projection of crude oil extraction assumes the extraction capacity of 520 thousand tonnes in 2007, including crude oil extracted during the production testing conducted at the LMG reserves.

With a view to maintaining the current production levels and counteracting regular decrease in volumes (owing to slide in pressure inside the storage facility) extracted from the already exploited reserves, the work is conducted to enhance the extraction process at the Barnówko-Mostno-Buszewo reserve, which includes drilling five boreholes in 2006–2007. The work should enable PGNiG S.A. to maintain the current production volumes of the already exploited reserves in the coming years and to guarantee incremental extraction volumes following the incorporation of new reserves.

Since the date of development of the LMG reserves was postponed from 2007 to 2009, the production levels of 1.1m tonnes, previously assumed for 2008, will be achieved in 2010. The current projection of crude oil extraction for 2008 amounts to 520 thousand tonnes.

3. Risks and Threats

Risk Related to the Emergence of Competitors on the Hydrocarbon Market

For the time being, competition in the domestic hydrocarbon market is limited. However, after having been granted relevant licences, PGNiG S.A.'s competitors will enter the Polish market. A strong competitive edge may be gained especially by large companies which have an established position on the international markets and much greater financial resources compared to PGNiG S.A.

Risk Related to Unpredictable Events

Hydrocarbon reserves developed by PGNiG S.A. are usually located at great depth, which is accompanied by extremely high pressures, and many of them include hydrogen sulphide in its chemical composition. Consequently, there exists a high degree of risk of an explosion, eruption or hydrocarbon leakage, which in turn may pose a threat to people (workers and local inhabitants), natural environment and also production equipment.

Risk Related to Production Projections and Accuracy of Resource Documentation

A number of the factors and assumptions adopted when determining the extent of resources and production projections may turn out erroneous due to flaws in the methods and measurement equipment used in the geophysical surveys, drilling and production testing. Deposit parameters established in the course of preparing the relevant documentation are reviewed upon deposit development. Each negative adjustment to the extent of the resources or to the extraction schedule may lead to a lower revenue and adversely impact PGNiG S.A.'s financial performance.

4. Environmental Protection

Carbon Credit Trade System

PGNiG S.A. has been participating in the carbon credit trade system (CCTS) since 2005. In the first settlement period 2005–2007, the Company was allotted permit of 13,400 $MgCO_2$/*pa* and 35,900 $MgCO_2$/*pa* for the combustion unit at the Odolanów Branch and at the Zielona Góra Branch – the Dębno Crude Oil and Natural Gas Mine, respectively.

In 2006, the following tasks were performed by PGNiG S.A. in connection with the implementation of the carbon credit management system in the first settlement period 2005–2007:

- developing guidelines for monitoring and reporting greenhouse gases emission
- applying for and obtaining a change of the decision allowing the Company to participate in the EU Carbon Credit Trade System, as a consequence of the Company's adoption of a new method for measurement of carbon dioxide emission and improvement in accuracy in this respect
- reviewing the annual report on carbon dioxide emission for 2006
- bringing the volumes of carbon dioxide emission in line with the amounts stipulated by the permit held and cancelling unused carbon credits (8,299 carbon credit units were retained from 2005)

At the end of 2006, the National CCTS Administrator presented outcomes of work on extending the definition of a combustion unit to include new sources, operating as part of the PGNiG S.A.'s unit, such as engines (motor compressors), gas turbines (turbo compressors) and gas flares, during the next settlement period. As part of the work PGNiG S.A. undertook to determine which units and sources will be additionally included in the CCTS. Concurrently, PGNiG S.A. required that its branches assessed the volume of carbon dioxide emission for the next settlement period 2008–2012 for the National Plan for the Distribution of Carbon Credits. The data thus obtained for the National Plan for the Distribution of Carbon Credits was submitted by the Company to the National CCTS Administrator.

Measurement of Methane Emissions

In 2006, PGNiG S.A. carried out a preliminary measurement of greenhouse gases emissions, as listed in the Act on greenhouse gases and other substances credit trade system, dated December 22nd 2004 (Dz. U. of 2004, No. 281, item 2784). Apart from carbon dioxide (CO_2), the branches emit methane. As a result of overhaul, it was possible to identify the sources of the methane emission. However, given the lack of definite methane emission ratios, in terms of technological processes of both the organised and unorganised emissions, for the time being the emission volumes cannot be measured precisely. The necessity arose to determine methane emission ratios for particular processes, carried out as part of the PGNiG S.A.'s operations. The work in this respect will be conducted by the Oil and Gas Institute of Kraków.

Integrated Permits

In December 2006, PGNiG S.A. was granted an "integrated permit for exploitation of the nitrogen-rich natural gas refining unit" for the Odolanów Branch. The permit comprises the overall adverse effect of a given unit on natural environment and requires that the Company use best technologies available and monitor condition of the environment, in accordance with the adopted guidelines.

Environmental Tests and Clean-Up Work

In 2006, environmental land and water tests designed to determine environmental condition were carried out on the majority of real properties, administered by the Company's Head Office, where traditional gas plants were operating previously. From among 31 real properties, which underwent tests, the permissible quality levels for soil and deep groundwater were not exceeded only in two of them. Other real properties differed in terms of the area size and depth of occurrence of pollution related to the natural gas production, carried out on those areas in the past. The findings made it possible to identify most polluted areas, for which clean-up work is a priority. In addition, the real properties were identified, which require more detailed tests, change in the proposed clean-up work or just monitoring of the environmental condition.

At the end of 2006, PGNiG S.A. carried out public consultations with a view to developing the Operational Programme for Infrastructure and Environment. Given the possibility of obtaining EU funds to carry out clean-up work on the rezoned industrial land, where traditional gas plants were operating and production of hydrocarbons was carried out, the Company undertook to draw up projects and applications for subsidies.

In 2006, as part of the environmental protection tasks, PGNiG S.A.:

- commenced clean-up work on the real property in Sławno, where traditional gas plant operated – clean-up will be based on the ex-situ bioremediation method, completion is scheduled for 2009
- completed work related to management of wastes from desulphurisation of coke-oven gas at the gas pumping station in Radlin
- secured perimeter ditches and drainage system of the waste matter storage facility in Zabrze Biskupice, where environmental condition is monitored periodically

- continued clean-up work on the soil polluted with the oil substances at the Jaroszewo Crude Oil Distribution Centre and Grodzisk-Ujazd-Bukowiec Natural Gas Mine (Grodzisk Group Centre) and the land of the liquidated Granowo centre, supervised by the Zielona Góra Branch of PGNiG S.A.
- continued work on liquidating drilling pits and mining pits on the area of operation of the PGNiG S.A.'s Sanok Branch.

Environmental Management Systems

The Environmental Management Systems meeting the requirements of Standard PN-EN ISO 14001 have been implemented and certified in all Branches of PGNiG S.A. In March 2006, the external control audit was carried out with regard to the Integrated Environmental Management Systems and compliance with the amended Environmental Standard PE-EN ISO 14001:2004 at the Zielona Góra Branch of PGNiG S.A. The same audit was conducted in the second half of 2006 at the Sanok Branch of PGNiG S.A.

Chapter XI: Investment Projects

PGNiG S.A. is carrying out a number of investment projects in all of its business areas. The major ones include oil mining investment projects prepared to ensure proper functioning of the natural gas and crude oil production chain, extention of underground gas storage facilities, and investments made to guarantee natural gas delivery at times of increased demand. Within the financial constraints of PGNiG S.A. and in line with procedures defined in the agreement with OGP GAZ-SYSTEM S.A., investment projects are being implemented for the purposes of the transmission system.

1. PGNiG S.A.'s Capital Expenditure in 2006

In 2006, capital expenditure incurred by PGNiG S.A. amounted to PLN 408.8m. The table below presents the expenditure structure.

Investment project	Value (PLNm)
Investment projects in the area of oil mining, including:	227.6
Development of the Stobierna, Terliczka, Jasionka, and Trzebowisko reserves	32.6
Development of the Żołynia, Biszcza, and Księżpol reserves	24.3
The Lubiatów-Międzychód-Grotów Project (LMG)	3.5
The Grodzisk Project	32.1
The Kaleje Project	12.8
Other investments in the area of oil mining	99.0
Underground gas storage facilities	48.6
Investments in the area of trading activities	9.1
Investments in the area of transmission	107.7
Other investments	15.8
Total capital expenditure:	408.8

Described below are the major investment projects implemented in 2006.

Development of the Stobierna, Terliczka, Jasionka, and Trzebowisko Reserves

The project provides for the development of the Stobierna, Terliczka, Jasionka, and Trzebowisko natural gas reserves with a view to delivering high-methane gas to the national gas system. The project will be completed in 2008 and comprises investment tasks with the aggregate value of PLN 69.8m.

In 2006, the Sobierna-Terliczka and Trzebowisko-3 reserves were developed and placed in operation. The total gas volume extracted from the reserves approximated 53.3m nm^3. Capital expenditure incurred in 2006 in connection with the project totalled PLN 32.6m.

Development of the Żołynia, Biszcza, and Księżpol Reserves

The project provides for the development of the Żołynia, Biszcza, and Księżpol natural gas reserves with a view to delivering high-methane gas to the national gas system. The aggregate value of the investment project comprises capital expenditure of PLN 76.3m. Its termination date is scheduled for 2008.

The Biszcza-Księżpol reserve was developed and placed in operation in 2006. Capital expenditure incurred in 2006 in connection with the project amounted to PLN 24.3m. The gas production volume was 17.3m nm^3.

The LMG Project

The objective of this project is to develop the Lubiatów-Międzychód-Grotów (LMG) reserves of crude oil and natural gas, as well as arrange for transport, storage and sale of crude oil, natural gas, sulphur and LPG from the LMG Crude Oil and Natural Gas Mine. The project value totals around PLN 681.5m. Captial expenditure incurred in 2006 in connection with the project amounted to PLN 3.5m.

By virtue of its decision, Regional Court of Warsaw invalidated a tender pertaining to the project, which delayed its execution and led to postponement of the project termination date by approximately one year until the end of 2009. In October 2006, tender procedure was inititiated to select the general contractor. The procedure is expected to be concluded by the end of August 2007.

The Grodzisk Project

The objective of this project is to support the sale of gas from nitrogen-rich reserves after the gas has been treated (cryogenic denitriding of nitrogen-rich gas) to obtain its uniform composition meeting the parameters of high-methane gas. The Grodzisk Denitriding Plant is constructed with a view to increasing nitrogen-high gas production volume at the existing mines and from reserves earmarked for development, and to supporting a balanced exploitation of the nitrogen-high natural gas reserves in the winter and summer seasons.

The project provides for the treatment of natural gas produced from the Wielichowo, Ruchocice and Paproć-W reserves, as well as for modernisation of the Paproć Natural Gas Mine (KGZ Paproć), construction of the Przyłęk-KGZ Paproć gas pipeline network and construction of the Grodzisk Denitriding Plant. The project value is estimated at approximately PLN 330m. Capital expenditure incurred in 2006 in connection with the project amounted to PLN 32.1m. Total capacity of the Grodzisk Denitriding Plant will reach approximately 35,000 m^3/h. The high-methane gas from the Denitriding Plant will be delivered to the national gas system.

A notice of appeal submitted by a bidder in the tender procedure, which aimed at selecting the contractor responsible for constructing the Grodzisk Denitriding Plant, and awaiting for the court's decision delayed contract execution and commencement of construction work. As a consequence, the project termination date was postponed by approximately a year until the end of 2009.

<u>The Kaleje Project</u>

The project provides for the treatment of nitrogen-high natural gas extracted from the Kaleje reserve and, upon obtaining trading parameters, its sale to the national gas system. The project framework involves the development of the Kaleje reserve (Kaleje and Kaleje-E reserves) and construction of the Kaleje-Mchy gas pipeline network. Implementation of the investment project will result in obtaining the aggregate industrial production capacity of the Lw subgroup natural gas in the amount of approximately 7,200 nm^3/h. The project value totals PLN 30.7m. Capital expenditure incurred in 2006 in connection with the project amounted to PLN 12.8m. Completion of the investment task is scheduled for 2007.

<u>Other Investment Projects in the Area of Oil Mining</u>

Other investment projects provide for the development of documented or exploited natural gas reserves, maintenance and recreation of gas production capacity (to set off the naturally occurring decrease in reserve capacity) and the functioning of the production business segment. 2006 saw the implementation of the other investment projects in the area of oil mining, whose value totalled PLN 99m. Key investment tasks performed in 2006 included:

- work at the Barnówko-Mostno-Buszewo reserve – work is being conducted in order to maintain crude oil production at the already exploited reserves on current levels and to ensure incremental extraction volumes following the incorporation of new reserves. Capital expenditure incurred in connection with the task totalled PLN 108m, PLN 31m of which was spent in 2006

- development of the Wilga reserve – development of the gas and condensate deposit Wilga on Block 255-5 is carried out in cooperation with FX Energy Poland Sp. z o.o. Capital expenditure incurred by PGNiG in 2006 in connection with the task reached PLN 3.7m

- modernisation and extention of the Natural Gas Mine (KGZ) – modernisation and extention of KGZ is carried out to maintain or increment natural gas production capacity at the existing gas mines. Tasks performed in 2006 included the following: technological installation equipment upgrade, modernisation of buildings within the technical and administrative backup production structures, assembly and upgrade of compressors, and incorporation of new structures. Capital expenditure incurred in connection with modernisation and extention of KGZ totalled PLN 27.6m

- modernisation of the Odolanów denitriding plant – the task consists in upgrading production installations at the Odolanów denitriding plant. Capital expenditure incurred in 2006 in connection with the task totalled PLN 11m

- purchases of ready-to-use investment assets as well as backup and infrastructure – capital expenditure incurred in 2006 in connection with the purchases totalled PLN 25m.

Underground Gas Storage Facilities

The 2006 capital expenditure on underground gas storage facilities totalled PLN 48.6m, PLN 40m of which was allocated to gas purchases aiming at an increased buffering capacity (gas bubble) at the Wierzchowice Underground Storage Facility (PMG Wierzchowice). The remainder of the expenditure was incurred in launching investment cycles connected with extending the underground gas storage facilities.

Investment Projects in the Area of Gas Trade

The 2006 investment projects in the area of gas trade, with the value of PLN 9.1m, involved expanding the coverage of gas pipeline network in new regions and construction of pipelines to reach end-users.

Investment Projects in the Area of Gas Transmission

In line with the investment plan of OGP GAZ-SYSTEM S.A. as well as the financial capabilities of PGNiG S.A. and the procedures specified in the agreement for the technical preparation and execution of investment projects for the purposes of the transmission system, PGNiG S.A. carried out investment projects involving transmission assets, which are subsequently incorporated in the register of tangible assets covered by the lease agreement.

In 2006, in the area of transmission operations, expenditure of PLN 107.7m was incurred in the following investment directions:
- transmission systems comprising transmission pipelines, pump and compressor stations and system nodes
- measurements and settlements covering gas stations, gas stream measurements and natural gas quality
- connections to the network
- expenditures on the SCADA system, technical backup facilities and other facilities.

Other investments

Capital expenditure of PLN 15.8m was incurred principally on telecommunications and data transmission investment projects and purchase of transport vehicles.

2. Risk Factors and Threats

Risk of Delayed Investment Work

Formal and legal issues beyond PGNiG S.A.'s control, such as:

- local governments' failure to adopt Local Land Development Plans (MPZPs)
- obstacles in incorporating investment projects into the MPZPs
- need to obtain and comply with administrative or other formal and legal decisions

- amendments to the current planning and development concept
- obstacles in obtaining permission from land owners to enter the site,

constitute factors which significantly delay implementation of investment projects and commencement of on-site construction work. Concurrently, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently prolongs the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire investment project.

Risk Related to Estimation of Capital Expenditure

A protracted investment process exacerbates the risk related to estimation of capital expenditure. A variety of factors, such as price fluctuations of production materials (notably steel), necessity to comply with the requirements regarding safety of individuals and property as well as environmental protection (Natura 2000 network), situation of contractors, unforeseeable circumstances and market competition, may cause the estimated capital expenditure amounts to materially deviate from the original assumptions contained in the investment plan. Furthermore, major price hikes necessitate amendments to the agreements executed with contractors, which is yet another source of delay.

Chapter XII: Other Events

Distribution of Profit for 2005

On June 27th 2006, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution on the 2005 net profit distribution in the amount of PLN 1,132.2m. Distributions from profit were allocated according to the following formula:

- PLN 885m was allocated to dividend payments (PLN 0.15 per share), including:
  - PLN 750m as non-cash dividend of PLN 681.5m to the State Treasury in the form of 6 subsystems, along with their constituent and accessory parts necessary to use these subsystems, and cash dividend of PLN 68,5m
  - PLN 135m as cash dividend to the other shareholders
- PLN 7.3m was allocated to increase the Company's social benefits fund
- PLN 27.6m was allocated to employee awards
- PLN 8m was allocated to the employment restructuring funds
- PLN 204.3m was allocated to the Company's statutory reserve funds.

Concurrently, the Annual General Shareholders Meeting of PGNiG S.A. set July 27th 2006 as the dividend record date and October 2nd 2006 as the dividend payment date.

The Company's Debt Reduction

On July 12th 2006, the Management Board of PGNiG S.A. resolved to temporarily use the Company's funds, including proceeds from the increase in share capital performed in September 2005, towards reduction of the Company's debt by EUR 600m. The debt will be repaid after the Company has guaranteed the availability of funds of at least the same value in the form of a revolving credit facility.

Cooperation with PKN Orlen

On July 14th 2006, PGNiG S.A. and PKN Orlen signed a letter of intent pertaining to mutual cooperation. As part of joint undertakings, the companies intend to commence work involving exploration and production of crude oil and natural gas both in and outside Poland. They also declared their willingness to hold talks concerning actions aimed at increasing sales of compressed natural gas (CNG) to be used as vehicle fuel. Furthermore, the companies will examine cooperation prospects connected with imports of liquefied natural gas (LNG) into Poland.

Private Placements of Bonds for the PGNiG Group Companies

On July 28th 2006, the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted a resolution on private placements of bonds for the PGNiG Group companies as part of a bond issue programme. The private placement will provide for a more efficient use of funds within the PGNiG Group. The companies having excess liquidity will enjoy the opportunity to invest the surplus funds in bonds issued by PGNiG S.A., while companies facing cash shortages will be able to contract loans from PGNiG S.A. The maximum par value of the outstanding bonds will not exceed PLN 500m. The bond programme will extend for three years, and the unit par value will not fall below PLN 10 thousand. The bonds will be issued in line with market terms and conditions: the programme allows for the issue of fixed rate and floating rate notes as well as for the issue of discount bonds. As at the date of this Directors' Report on the PGNiG Group's operations, a decision to launch the bond issue had not been taken.

Gas Transmission Agreements with OGP GAZ-SYSTEM S.A.

On August 31st 2006, PGNiG S.A. and OGP GAZ-SYSTEM S.A. entered into two transmission agreements which contemplate provision of high-methane and nitrogen-rich gas transmission services and stipulate the conditions for the supply of gaseous fuel to and its collection from the transmission system. The terms of the agreements extend from September 1st 2006 until September 30th 2007, and their estimated gross value approximates PLN 2.2bn.

Agreement with Energetyka Sp. z o.o.

Talks are being currently held between Energetyka Sp. z o.o. and PGNiG S.A., with participation of KGHM Polska Miedź S.A., concerning the review of gas supply contracts concluded on December 1st 2003 in the area of contractual terms and supply volume.

Acquisition of Perpetual Usufruct Right to Developed Land at ul. Kasprzaka 25, Warsaw

On December 7th 2006, the decision of the President of Warsaw, concerning acquisition, as of December 5th 1990, by force of law, for the period of 99 years, by Przedsiębiorstwo Państwowe Polskie Górnictwo Naftowe i Gazownictwo of Warsaw, whose legal successor is PGNiG, of perpetual usufruct rights to developed land owned by the City of Warsaw, situated at ul. Kasprzaka 25 in Warsaw, entered into the Land and Mortgage Register under No. KW WA4M/00227834/7, together with property rights to the buildings, structures and other items located on the land, became final. The total market value of the property has been estimated by a property appraiser at PLN 262.5m. The acquisition of the land and buildings was gratuitous, however, for the perpetual usufruct of the land the Company will pay an annual fee equal to 1.5% of the land's value. The decision is final and binding.

Motion on Rescision of Resolution No. 2 of the Extraordinary General Shareholders Meeting

On January 17th 2007, PGNiG S.A. received from the Regional Court of Warsaw, XX Commercial Division, a copy of a lawsuit filed by PGNiG S.A.'s shareholders, Mr Bolesław Potyrała, Mr Józef Ryl and Mr Juliusz Wroński, to rescind Resolution No. 2 of the Extraordinary General Shareholders Meeting of PGNiG S.A. on amendments to the Company's Articles of Association, dated October 26th 2006.

Action Against PI GAZOTECH Sp. z o.o.

1. On March 7th 2006, the Regional Court of Warsaw dismissed PGNiG S.A.'s action instituted against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the General Shareholders Meeting's resolutions, dated April 23rd 2004, including the resolution whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 52m. In view of the dismissal, PGNiG S.A. filed an appeal against the court ruling, which

was rejected by the Court of Appeal in Warsaw on January 10th 2007 on account of the Company's failure to duly paid the required fees. On March 1st 2007, PGNiG S.A. filed a complaint with the Supreme Court regarding the Court of Appeal's ruling. The Company's claim is secured by suspension of the resolution authorising the additional contributions.

2. The proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the General Shareholders Meeting's resolution, dated January 19th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 25,999,998, held before the Regional Court of Warsaw were adjourned until rulings on the issues referred to in item 1 and 3 become legally binding. The Company's claim is secured by suspension of the resolution authorising the additional contributions.

3. On December 7th 2006, the Regional Court of Warsaw dismissed PGNiG's action instituted against PI GAZOTECH Sp. z o.o. to confirm the non-existence of the resolution on redemption of shares. The Company filed an appeal against the ruling.

4. The proceedings based upon PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the General Shareholders Meeting's resolution, dated October 6th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 6,522,000, instigated before the Regional Court of Warsaw are pending. The Company's claim is secured by suspension of the resolution authorising the additional contributions.

<u>Dispute with the Town Commune of Wysokie Mazowieckie</u>

In connection with the claim filed against PGNiG S.A. upon the motion of the Wysokie Mazowieckie Commune on January 7th 2004, the President of the Anti-Trust and Consumer Protection Authority imposed a fine of PLN 41,362,000 on the Company by virtue of his decision dated September 29th 2004. The fine was awarded on the charge of the Company's abusing its dominant position on the local natural gas sale market in Wysokie Mazowieckie by way of postponing the release of technical terms and conditions for connection of the existing boiler house to the existing gauging station despite a requirement to do so. PGNiG S.A. filed an appeal against the decision, demanding a statement asserting that the actions undertaken by the Company did not constitute an abuse of its dominant position and requesting that the imposed fine be quashed. Upon the Regional Court's rejection of the request, PGNiG S.A. filed an appeal.

On February 6th 2007, the Court of Appeal passed a judgement, whereunder the fine was reduced to PLN 2,068,100, and ordered that the cost of proceedings be covered jointly by both parties. The decision is final and binding.

<u>Dispute with Bartimpex S.A.</u>

On August 9th 2005, in connection with a motion filed by PHZ Bartimpex S.A., the President of the Anti-Trust and Consumer Protection Authority ruled that the Company pursues anti-competitive practices through abusing its dominant position on the domestic natural gas transmission market, this being manifested in the refusal to provide the services of transmitting natural gas extracted outside Poland. The President of the Anti-Trust and Consumer Protection Authority also stated the abovementioned practices ceased as of June 2nd 2003. By virtue of his decision of August 9th 2005, the President of the Anti-Trust and Consumer Protection Authority imposed a fine on PGNiG S.A. in the amount of PLN 2,000,000 along with an order to repay the costs of proceedings for the benefit of PHZ Bartimpex S.A.

By way of submitting a letter of August 31st 2005, PGNiG appealed against the decision. As a consequence, on January 31st 2007 the Regional Court of Warsaw issued a verdict reducing the fine imposed on PGNiG S.A. to the amount of PLN 500,000. The decision is not final.

Dispute with EMFESZ NG Sp. z o.o.

On March 9 2006, proceedings before the President of URE were instigated upon a motion filed by EMFESZ NG Polska Sp. z o.o. regarding refusal to execute an agreement on provision of gaseous fuel storage services.

On December 18th 2006, the proceedings, instigated upon a motion submitted by EMFESZ NG Polska Sp. z o.o., commenced before The President of the Anti-Trust and Consumer Protection Authority in order to make a preliminary assessment whether the objectionable conduct, i.e. refusal to execute an agreement on provision of gaseous fuel transmission services and refusal to execute an agreement on provision of storage services, and, thus, a violation of the provisions under the Anti-Trust and Consumer Protection Act, actually took place.

Adoption of the Natural Gas Industry Policy by the Council of Ministers

On March 20th 2006, the Council of Ministers adopted the Natural Gas Industry Policy, drafted by the Ministry of Economy. As stipulated by the Policy, PGNiG S.A. is a strategic company in light of Poland’s energy security policy, with respect to which the following course of action has been designed:

1. PGNiG S.A. will complete the process of separating gas distribution from the trading business. As a consequence of spinning off the Gas Companies from the PGNiG Group, the former will be transformed into Distribution System Operators and furnished with assets vital for conducting distribution business activities.

2. No later than on July 1st 2007, assets relevant for the distribution system will be excluded from the lease agreement between PGNiG S.A. and OGP GAZ-SYSTEM S.A. and contributed to the Gas Companies.

3. A possibility may not ruled out that the minister in charge of economic issues will establish a dedicated team responsible for supervising the process of excluding the assets referred to in item 2 above from the lease agreement and for assessing the adopted solutions from the perspective of safe functioning of the transmission network.

4. Dividend attributable to the State Treasury, arising from profit generated by PGNiG S.A. in 2006 and 2007, will be paid in the form of a non-cash distribution.

5. As soon as reasonably practicable, PGNiG S.A. will sell to OGP GAZ-SYSTEM S.A. the Company's transmission assets specified in the lease agreement and excluded from the non-cash dividend for 2006 and 2007.

6. Until the issue of re-export prohibition clause in PGNiG S.A.'s contracts is resolved, it is not envisaged that an exploration and production company will be spun off from the PGNiG structure.

7. PGNiG S.A. will persist in taking actions necessary to identify alternative sources of gas supplies, according to the directions presented in resolutions of the Council of Ministers, dated January 3rd 2006 and May 31st 2006 on supply diversification of energy carriers. Termination of the diversification projects is scheduled for 2010–2011.

8. PGNiG S.A. will perform relevant economic analyses and develop a plan for extending the underground gas storage facilities (PMG), taking into consideration co-financing with the funds contributed as part of the Operational Programme – Infrastructure and Environment (European Regional Development Fund), which, upon its adoption by the Company's governing bodies, will constitute the basis for making the necessary investments connected with the extension of existing storage facilities and construction of new ones, up to the capacities which guarantee security and continuity of gas supplies delivered to domestic customers.

9. The PGNiG Group will continue to be the owner and operator of the underground gas storage facilities, which had been in the Group's possession or were constructed on its own account.

10. It is recommended that PGNiG S.A. concludes the analyses peformed to assess the possibilities of enhancing domestic natural gas production capacity within a ten-year perspective and develops investment plans targeting at an incremented domestic production capacity of hydrocarbons. In order to ensure a coordinated execution of the natural gas sector investment project, it is advised that the aforementioned analyses be conducted within a timeframe corresponding to the deadline for submitting applications for co-financing from the Operational Programme – Infrastructure and Environment with respect to other energy security projects.

11. PGNiG S.A.'s actions will also be supported which aim at the Company's obtaining access to natural gas and crude oil reserves outside Poland, and identifying alternative natural gas sources and routes.

Until the objectives stipulated by the Policy are accomplished, further privatisation of PGNiG S.A., which includes rendering employee shares available, is not envisaged.

Chapter XIII: Financial Standing

1. 2006 Financial Results

The 2006 financial statements of PGNiG S.A. and the 2006 consolidated financial statements of the PGNiG Group are audited by Deloitte Audyt Sp. z o.o. The services are rendered under an agreement concluded on December 1st 2006 which provides for a total consideration of PLN 510,000. The scope of the auditor's task is as follows:

- auditing the 2006 financial statements of PGNiG S.A.
- auditing the 2006 consolidated financial statements of the PGNiG Group.

The financial statements of PGNiG S.A. for 2005 and the consolidated financial statements of the PGNiG Group for 2005 were audited by Deloitte Audyt Sp. z o.o. The aggregate amount of the auditor's fee in consideration for the services rendered was PLN 780,000. The scope of the auditor's tasks was covered by two agreements:

- an agreement for the implementation of the agreed procedures related to the evaluation of the internal control function, concluded on October 26th 2005. The tasks assigned under the agreement were completed on January 31st 2006. The auditor's fee in consideration for the said tasks amounted to PLN 147,000.
- an agreement for the audit of the financial statements, concluded on February 3rd 2006. The auditing services comprised the audit of PGNiG S.A.'s 2005 financial statements and the PGNiG Group's 2005 consolidated financial statements, as well as the review of the (non-consolidated and consolidated) financial statements for H1 2006, and were completed on September 26th 2006. The auditor's fee in consideration for the services provided under the agreement amounted to PLN 633,000.

In addition, PGNiG S.A. undertook to reimburse all reasonable and documented costs incurred by the auditor in connection with the performance of the above agreements (business travel expenses, overnight accommodation, telephone bills, courier services) up to the amount of 9% of the auditor's fee.

1.1. Economic and Financial Highlights

The net financial result posted by the PGNIG Group in 2006 confirms that the Group continued along the path of value growth, despite a number of unfavourable economic events. The 2006 net profit of the PGNiG Group, presented in accordance with the International Financial Reporting Standards, stood at PLN 1,323.5m and was PLN 442.8m (50%) higher from the net result recorded in the previous year. It should be emphasised that the growth of the net result was accompanied by considerable drop in profitability of PGNiG's core business, i.e. high-methane gas sales.

Summary information on the PGNiG Group's financial standing in 2006, compared with the 2005 data, is presented in the following financial statements prepared in accordance with the International Financial Reporting Standards:

- the balance sheet,
- the profit and loss account,
- the cash flow statement,

- the selected financial ratios.

Consolidated Balance Sheet (PLNm)

ASSETS	Dec 31 2006	Dec 31 2005
Non-current assets	**23,221.6**	**23,530.5**
Property, plant and equipment	17,756.1	17,524.4
Investment property	6.7	10.6
Intangible assets	1,086.7	952.7
Investments in associated undertakings valued with equity method	589.3	512.1
Financial assets available for sale	18.1	21.4
Other financial assets	3,275.4	4,107.6
Deferred tax asset	440.6	384.5
Other non-current assets	48.7	17.2
Current (short-term) assets	**7,518.0**	**6,833.2**
Inventories	1,351.2	815.3
Trade and other receivables	2,529.6	2,618.3
Current income tax receivable	17.2	30.9
Prepayments and accrued income	33.2	17.5
Financial assets held for sale	23.3	30.4
Derivative financial instrument assets	5.7	120.3
Cash and cash equivalents	3,557.8	3,200.5
Total assets	**30,739.6**	**30,363.7**

EQUITY AND LIABILITIES	Dec 31 2006	Dec 31 2005
Equity	**21,208.1**	**20,767.6**
Share capital	5,900.0	5,900.0
Currency-translation differences on foreign-currency undertakings	(15.6)	(14.0)
Share premium account	1,740.1	1,740.1
Other reserve funds	2,890.0	2,624.8
Retained earnings/(deficit)	10,685.9	10,509.5
Equity (attributable to parent undertaking's shareholders)	**21,200.4**	**20,760.4**
Equity attributable to minority interests	7.7	7.2
Non-current liabilities	**6,661.9**	**6,624.9**
Loans, borrowings and debt securities	2,343.8	2,369.1
Provisions	1,179.9	981.5
Accruals and deferred income	1,082.1	1,151.1
Deferred tax liability	2,056.1	2,123.2
Current liabilities	**2,869.6**	**2,971.2**
Trade and other payables	2,173.7	2,108.8
Loans, borrowings and debt securities	113.6	89.2
Liabilities under derivative financial instruments	55.1	173.2
Current tax liability	184.5	75.2
Provisions	250.5	426.3
Accruals and deferred income	92.2	98.5
Total liabilities	**9,531.5**	**9,596.1**
Total equity and liabilities	**30,739.6**	**30,363.7**

Consolidated Profit and Loss Account (PLNm)

	Dec 31 2006	Dec 31 2005
Sales revenue	**15,197.6**	**12,560.0**
Total operating expenses	**(13,733.0)**	**(11,162.3)**
Change in inventories	9.5	5.8
Cost of products and services for own needs	565.0	499.1
Raw materials and energy used	(8,611.5)	(6,439.0)
Employee benefits	(1,822.1)	(1,645.8)
Depreciation and amortisation	(1,296.1)	(1,401.9)
Contracted services	(2,652.5)	(1,779.1)
Other net operating expenses	74.7	(401.4)
Operating profit	**1,464.6**	**1,397.7**
Financial income	520.1	645.0
Financial expenses	(495.6)	(838.0)
Share in profit/(loss) of undertakings valued with equity method	77.5	49.6
Pre-tax profit	**1,566.6**	**1,254.3**
Corporate income tax	(243.1)	(206.8)
Net profit on business activities before statutory profit distribution	**1,323.5**	**1,047.5**
Profit distribution		(166.8)
Net profit on business activities	**1,323.5**	**880.7**
Discontinued operations		
Profit/(loss) for the financial year on discontinued operations		
Net profit for the financial year	**1,323.5**	**880.7**
attributable to:		
parent undertaking's shareholders	1,323.0	879.8
minority interests	0.5	0.9

Consolidated Cash Flow Statement (PLNm)

	Dec 31 2006	Dec 31 2005
Net cash provided by/used in operating activities	1,535.0	2,399.1
Net cash provided by/used in investing activities	(867.2)	(732.3)
Net cash provided by/used in financing activities	(295.0)	626.9
Change in net cash	**372.8**	**2,293.7**
Cash and cash equivalents at beginning of period	3,205.1	911.4
Cash and cash equivalents at end of period	3,578.0	3,205.1

Financial Ratios

PROFITABILITY RATIOS	**Dec 31 2006**	**Dec 31 2005**
EBIT (PLNm) operating profit	**1,464.6**	**1,397.7**
EBITDA (PLNm) operating profit + depreciation/amortisation	**2,760.7**	**2,799.6**
ROE (Return on Equity) net profit ** to equity * at end of period	**6.2%**	**4.2%**
NET MARGIN net profit ** to sales revenue	**8.7%**	**7.0%**
ROA (Return on Assets) net profit ** to assets at end of period	**4.3%**	**2.9%**

LIQUIDITY RATIOS	**Dec 31 2006**	**Dec 31 2005**
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	**2.6**	**2.3**
QUICK RATIO current assets (net of prepayments and accrued income)decreased by inventories to current liabilities	**2.1**	**2.0**

DEBT RATIOS	**Dec 31 2006**	**Dec 31 2005**
DEBT RATIO total liabilities to total equity and liabilities	**31.0%**	**31.6%**
DEBT/EQUITY RATIO total liabilities to equity *	**45.0%**	**46.2%**

* equity attributable to the parent undertaking's shareholders

** net profit for the financial year attributable to the parent undertaking's shareholders

1.2. Financial Review

In 2006, the PGNiG Group's sales revenue amounted to PLN 15,197.6m, which represents a 21% growth on the previous year. Higher value of sales was mainly driven by higher selling prices of natural gas and to a minor extent by a larger volume of gas sold. The volume of gas sales is affected by seasonality of sales, predominantly in the sector of public utilities where gas is used for heating. Due to seasonality and high temperatures which occurred in the winter season in the second half of the year, the volume of gas sold by the PGNiG Group was lower than was originally planned for that period.

Considerable increase in sales revenue translated into a mere 5% growth in the operating profit (EBIT) (up by PLN 66.9m). What is symptomatic, however, was a major change in the operating result structure when compared with 2005, primarily reflecting a change in the structure of operating income and expense resulting from the spin-off of transmission business in 2005 and the execution of a lease agreement for transmission assets. Until July 2005, the Group generated a margin on transmission service sales but after the spin-off of transmission business this revenue was replaced by income provided by repayment of capital and interest on leased transmission infrastructure.

Low increase in operating profit was related to:

- higher prices of imported gas,
- tariff rates approved by the President of the URE,
- a drop in the result on crude oil sales.

Another important factor affecting the result generated by the PGNiG Group are fluctuations in imported gas prices on account of high share of imported gas in the total sales of gaseous fuels (imported gas satisfies approx. 73% of the Group's demand for gaseous fuels and import costs account for over 60% of total operating expenses). The prices of natural gas in international markets were rising nearly continuously all over 2006. In November 2006, Annex No. 26 was executed to the delivery contract for Russian gas of September 25th 1996 concluded between PGNiG S.A. and OOO "Gazprom-Eksport". The Annex provides for a change in the formula of determining the purchase price of gas based on oil product prices quoted on international markets. Following the change in the pricing formula, the price for 1,000 m^3 of gas rose on average by 10% in comparison with the price established in accordance with the previous formulas. The rise of natural gas prices on international markets and change in the pricing formula resulted in a 32% increase in unit purchase price of imported gas. Consequently, the costs of consumption of energy and materials grew by PLN 2.172.5m (34%).

In 2006, although the tariffs for gaseous fuel was changed twice (in January and in April), the growth dynamics of tariff prices for high-methane gas (31%) was lower than the growth dynamics for unit purchase cost of imported gas (32%). The tariff effective from April 2006 was extended to include additional charges for such services as gas storage and transmission via the transit pipeline network. This enabled the PGNiG Group to cover in full the costs related to maintenance of underground gas storage facilities and purchase of transmission services from SGT EUROPOL GAZ S.A. On the other hand, the tariffs for gaseous fuels did not account for higher cost of buying imported gas, which resulted in significantly lower profitability of trading in high-methane gas. Furthermore, in 2006 the President of the URE two times refused to approve the change of tariff motioned the PGNiG Group.

In 2006, net result on sales of crude oil fell by PLN 14.1m (3%) from the previous year. The decline in net result on sales of crude oil was caused by a decrease of 93 thousand tonnes (15%) in the volume of crude oil sold. Lower volume of crude oil sales was primarily a result of weaker domestic demand for oil. In H1 2006, two major customers of the PGNiG Group, i.e. Rafineria Trzebinia S.A. and Rafineria Czechowice S.A., discontinued their operations. Waning demand from the existing customers was partially counterbalanced by an increase in export sales and the addition of a new domestic customer, a member of the ORLEN Group, which however did not help maintain the sales volume at the previous year's level.

High profitability of the production business and an increase in net result on sales of the distribution segment, mainly caused by sales of gas transmission services over medium- and low-pressure gas systems, were the critical factors in preventing a steeper decline in the operating profit. In 2006, the PGNiG Group reported high profitability of the production business. Sales of natural gas and crude oil from the Group's own sources, whose acquisition costs grow at a slow rate, combined with a concurrent sharp rise in selling prices conditioned on the level of prices of oil-based products on global markets, generated additional earnings to cover losses resulting from trading in imported gas. Increased tariff rates in the wholesale segment were reflected in rises of prices of gas sold by the distribution segment.

The 2006 gross profit rose by PLN 312.3m (25%) from the previous year and was positively affected by the profit on financing activities, which rose by PLN 245.5m. Increase in the profit on financing activities was caused by financing expenses lower by PLN 342.4m (41%), mainly resulting from debt restructuring in 2005.

The net profit for the 2006 financial year was PLN 1,323.5m, representing an increase of PLN 442.8m (50%) from the 2005 figure. A 15% reduction in the tax burden after losing the status of a state-owned stock company was a key factor with a bearing on the net profit (in 2005, the tax payable was PLN 166.8m). As a result of the remarkable growth of net profit, the key management efficiency ratios, including net margin, return on equity and return on assets, improved.

Compared to the 2005-year-end balance, the balance-sheet total slightly increased in value, by PLN 375.9m (1%).

The largest item in non-current assets is represented by property, plant and equipment. As at the end of 2006, it amounted to PLN 17,756.1m, which was a PLN 231.7m increase relative to 2005.

Compared to 2005, the balance of intangible assets increased by PLN 134.0m (14%) to PLN 1,086.7m. The costs of exploration and prospecting work related to pre-production crude oil and natural gas represented the largest item of intangible assets. The costs of exploration and prospecting work are recognised, in accordance with the geological success method, as intangible assets, following from the industrial qualification of a well. The value of exploration and prospecting work stood at PLN 1,005.9m, representing a PLN 129.8m increase from the previous year.

The value of investments in associated undertakings valued with the equity method as at the end of 2006 was PLN 589.3m and was higher by PLN 77.2m relative to 2005. A higher level of valuation of equity interests was primarily a result of a rise in equity of associated undertakings, increased by the current year financial result.

In 2006, the value of other financial assets fell by PLN 832.2m (20%). This decline in value was largely due to successive lease payments by OGP GAZ-SYSTEM S.A. and a non-cash dividend paid to the State Treasury from profit. The value of the non-cash dividend from the 2005 profit amounted to PLN 681.5m. The level of other financial assets was also affected by changes in the value of industrial property used under leasing agreements as a result of withdrawal of part of the property from the lease agreement and placement of new transmission assets financed by the direct investments of PGNiG S.A. in lease.

In 2006, the value of current assets totalled PLN 7,518.0m, up by PLN 684.8m from 2005.

Inventories increased by PLN 535.9m (66%). Inventories disclosed in the balance sheet primarily represent gas stored in underground gas storage facilities. The increase in the value of stored gas reflects a higher volume of stored gas and an increase in the unit acquisition cost of imported gas.

The 2006 value of trade and other receivables decreased by PLN 88.7m from the previous year. A decrease in current receivables was primarily a result of the improvement in efficiency of trade receivable collection.

As at the end of 2006, the balance of derivative financial instrument assets was PLN 5.7m, falling by PLN 114.6m (95%) from the previous year. At the opposite side of the balance sheet, liabilities under derivative financial instruments stood at PLN 55.1m, which was a decrease of PLN 118.1m (68%) from the level reported at the end of 2005. Derivative financial instrument assets represent a positive component of the fair value of financial derivative instruments. Significant differences in the valuation of derivative financial instruments are primarily a result of the impact of EUR and USD exchange rates decreasing from the previous year, and a rise in EUR and USD interest rates combined with a concurrent decrease in PLN interest rates.

Cash and cash equivalents represent the largest item of current assets, with monetary assets (short-term deposits) accounting for a greater part of this item. The high level of monetary assets was a result of a public issue of shares completed in 2005. They are invested on an-going basis in instruments involving minimum credit risk, mainly in conditional buy/sell transactions on securities issued by the State Treasury (State Treasury bills and bonds).

Liquidity ratios presenting the relation between total current assets or its more liquid part and current liabilities are at a level reflecting a stable financial standing of the PGNiG Group. A substantial increase in inventories and monetary assets resulted in the improvement of current and quick ratios, respectively, from 2.3 to 2.6, and from 2.0 to 2.1 during 2006. A high level of current assets enables the Group to settle all its current operating liabilities. A high level of operating assets, whose main components are monetary assets, indicates that the Group has substantial financial overliquidity. The PGNiG group's overliquidity is of a temporary nature. According to the PGNiG group's development strategy, financial surplus, especially from the public issue of shares, is to be used to carry out a number of investment projects in the upcoming periods.

In 2006, the main financing source of the Group's assets was equity, whose share in the balance-sheet total was 69%. Compared to the balance at the end of 2005, equity rose by PLN 440.5m (2%).

The value of other reserve funds increased by PLN 265.2m (10%) from the 2005 figure. The rise was mainly driven by the value of reserve funds from the distribution of profit above the statutory minimum, of PLN 262.2m.

In 2006, the value of retained earnings rose by PLN 176.4m relative to 2005, reaching the level of PLN 10.685.9m. Change in retained earnings was fuelled by the current year's net profit of PLN 1,323.5m and the distribution of the previous year's profit. The amount of PLN 885m from the 2005 net profit was used to pay non-cash and cash dividend to the holders of the parent undertaking.

Compared to 2005, the indicators describing the relation between capitals and other items of shareholders' equity and liabilities did not change significantly. A slight decrease in total debt-to-equity ratio (from 46.2% to 45.0%) reported in 2006 was caused by an increase in total shareholders equity and a marginal decline in total liabilities.

The value of loans, borrowings and debt securities (including current and non-current portion) decreased by PLN 0.9m from the previous year (less than 1%). Non-current liabilities mainly include a EUR 600m long-term syndicated loan contracted under a loan agreement concluded between PGNiG S.A. and a banking syndicate on July 27th 2005.

At the end of 2006, total provisions for liabilities (both non-current and current) rose by PLN 22.6m to PLN 1,430.4m. The provision for liquidation of oil wells, jubilee awards and retirement severance pays and gas allowances represent the largest items of provisions for contingent liabilities.

Current liabilities remained at a similar level as in the previous year, but their structure slightly changed. In 2006, trade payables rose by PLN 64.9m; their upsurge was largely fuelled by higher prices of imported gas. Concurrently, liabilities under financial instruments decreased by PLN 118.1m.

Deferred income did not change significantly in the analysed period. It mainly comprises unamortised value of gas network connections financed by customers and connection charge settled over time.

To conclude, it should be noted that despite unfavourable economic environment prevailing throughout 2006, the PGNiG Group's activities continue to be marked by growth in management efficiency. However, in view of the fact that it is impossible for the PGNiG Group to follow an independent pricing policy, in the upcoming periods the development of the growth path will be conditional on the position of the URE concerning gas selling prices.

The Use of Issue Proceeds until December 31st 2006

As a result of the Public Offering, in 2005 PGNiG S.A. earned issue proceeds totalling PLN 2,682.0m. Net of the amount of PLN 41.9m representing the issue's costs, net proceeds amounted to PLN 2,640.1m.

The aggregate expenditure of the funds obtained from the public issue of shares at the end of 2006 totalled PLN 1,324.1m, which accounted for 50.2% of total proceeds.

The use of proceeds from the public issue of shares in individual business segments:

- upstream – PLN 855.9m
- transmission and storage – PLN 157.2m
- distribution – PLN 179m
- debt repayment (5% of the issue proceeds) – PLN 132m.

Until the end of 2006, PGNiG S.A. did not incur any expenses related to the generation of electricity and thermal energy.

Transactions with Related Undertakings

In 2006, the transactions with related undertakings were executed in the area of the PGNiG Group's core business. The table below sets forth the transactions whose total value exceeds EUR 500,000.

Transactions with related undertakings, with a unit value exceeding EUR 500,000

Undertaking	Sales[1] [PLNm]	Other sales[2] [PLNm]	Purchases[3] [PLNm]	Other purchases[4] [PLNm]
Total (related undertakings)	**6,968.0**	**14.8**	**1,167.5**	**0.8**
Undertakings consolidated with full method	**6,926.1**	**14.6**	**875.9**	**0.8**
GEOFIZYKA Kraków Sp. z o.o.	1.7	0.0	72.3	0.0
GEOFIZYKA Toruń Sp. z o.o.	0.7	1.1	88.6	0.0
PNiG Jasło Sp. z o.o.	28.5	0.0	143.3	0.0
PNiG Kraków Sp. z o.o.	14.5	0.0	75.2	0.0
PNiG NAFTA Sp. z o.o. of Piła	30.5	0.0	130.6	0.0
Zakład Robót Górniczych Krosno Sp. z o.o.	4.1	0.6	49.5	0.0
Dolnośląska Spółka Gazownictwa Sp. z o.o.	738.2	0.1	2.0	0.0
Górnośląska Spółka Gazownictwa Sp. z o.o.	1,136.6	0.5	1.8	0.0
Karpacka Spółka Gazownictwa Sp. z o.o.	1,621.2	11.5	4.3	0.0
Mazowiecka Spółka Gazownictwa Sp. z o.o.	1,461.4	0.1	0.9	0.0
Pomorska Spółka Gazownictwa Sp. z o.o.	707.7	0.0	15.8	0.0
Wielkopolska Spółka Gazownictwa Sp. z o.o.	1,165.5	0.3	1.1	0.0
BUG Gazobudowa Sp. z o.o.	0.6	0.0	81.8	0.0

BN Naftomontaż Sp. z o.o. w upadłości [in bankruptcy]	4.5	0.0	72.3	0.0
Naft-Stal Sp. z o.o. Krosno	0.1	0.2	3.4	0.0
ZUN Naftomet Sp. z o.o.	1.0	0.0	14.5	0.0
PN Diament Sp. z o.o.	4.4	0.0	87.1	0.0
B.SiP.G. Gazoprojekt S.A.	0.8	0.0	10.4	0.0
Geovita Sp. z o.o.	1.1	0.0	2.5	0.6
INVESTGAS S.A.	3.1	0.1	18.4	0.0
Undertakings consolidated with equity method	**35.2**	**0.0**	**86.2**	**0.0**
EUROPOL GAZ S.A.	35.2	0.0	86.2	0.0
Other related entities, excluded from consolidation	**5.1**	**0.2**	**166.2**	**0.0**
ZRUG Sp. z o.o. of Pogórska Wola	0.9	0.0	44.3	0.0
BUD-GAZ PPUH Sp. z o.o.	1.8	0.0	13.3	0.0
ZRUG Sp. z o.o. of Poznań	0.2	0.1	29.6	0.0
ZRUG Toruń S.A.	0.1	0.0	11.6	0.0
ZRUG Zabrze Sp. z o.o.	1.4	0.0	10.8	0.0
PFK GASKON S.A.	0.1	0.0	16.7	0.0
BG GAZOMONTAŻ S.A. of Wołomin	0.7	0.0	17.4	0.0
ZWUG INTERGAZ Sp. z o.o.	0.0	0.0	22.5	0.0
Subsidiary and associated undertakings of the Parent Company's subsidiary and associated undertakings	**1.5**	**0.0**	**39.3**	**0.0**
Gaz Sp. z o.o. of Błonie	0.2	0.0	9.2	0.0
Gaz Media Sp. z o.o. of Wołomin	0.1	0.0	11.6	0.0
PBU Petromin Sp. z o.o. of Wołomin	0.3	0.0	2.6	0.0
Gazobudowa Poznań Sp. z o.o. of Poznań	0.6	0.0	6.2	0.0
Gazobudowa Kraków Sp. z o.o. of Kraków	0.3	0.0	9.6	0.0

1) Revenue on sales of products, goods for resale and materials
2) Other operating income and other income
3) Costs by type, tangible assets under construction and inventories
4) Other operating expenses and other expenses

Sale transactions relate to the sale of natural gas to the six Gas Companies and SGT EUROPOL GAZ S.A. Sale transactions also include the sale of services of an operator of a transit pipeline to SGT EUROPOL GAZ S.A. Purchase transactions include the purchase of services relating to the exploration and operation of reserves, trade in gas and transmission of gas.

2. Financial Management

The PGNiG S.A.'s funds guarantee financing of current and planned expenses related to the Company's current and investing activities. Although no risk of liquidity loss occurs, in order to enhance security, PGNiG S.A. concluded current account loan agreements as a reserve and a loan agreement of July 27th 2005, providing for a revolving loan of EUR 300m, which remains fully available. The credit facilities are not used.

The management of financial resources at the PGNiG Group is governed by internal procedures, applicable for both the Company and its subsidiaries. In accordance with the relevant regulations, the financial investments may involve treasury bills, treasury bonds and bank deposits. In addition, the share of financial instruments issued by the State Treasury in PGNiG S.A. may not be lower than 50% of the investment portfolio. Free funds are deposited as deposits on the bank accounts, taking into consideration the need to diversify banks, and as debt securities issued by the State Treasury and the National Bank of Poland.

2.1. Current Investments

In 2006, the PGNiG S.A. made the following current investments:

- Bank deposits,
- Conditional buy/sell transactions on securities issued by the State Treasury (treasury bills, treasury bonds and bonds issued by the National Bank of Poland).

Investments in debt securities issued by the State Treasury and the National Bank of Poland represented approximately 89% of the transaction volume. The financial investments executed in 2006 were primarily current investments, maturing in up to three months, which was consistent with the Company's policy of making financial investments and the objectives disclosed in the issue prospectus.

2.2. Contracted Loans and Borrowings

As at December 31st 2006, PGNiG S.A. used one loan under an agreement concluded on July 27th 2005 between PGNiG S.A. and a group of banks, with Bank Handlowy w Warszawie S.A. as their agent. The credit facility agreement was executed for the total amount of EUR 900m, being divided into a five-year term loan of EUR 600m and a three-year revolving loan of EUR 300m. The facility was secured with guarantees issued by the Gas Companies. The guarantee agreement regarding the amount of EUR 1,250m, which was executed on September 22nd 2005, will remain in force until January 27th 2012. To secure against recourse claims of the Gas Companies, should any such claims arise, on September 22nd 2005, PGNiG S.A. submitted a declaration on submission to enforcement under Art. 777.1.5 and Art. 777.2 of the CCP up to the amount of EUR 1,250m. The loans under the facility of July 27th 2005 were used in the following manner:

- EUR 600m term loan was disbursed on October 10th 2005. The maturity date is July 27th 2010.
- EUR 300m revolving loan remains fully available and matures on July 27th 2008.

As at December 31st 2006, PGNiG S.A. was bound by current account loan agreements of PLN 40m each with the following banks:

- Bank Millennium S.A.
- Bank Handlowy w Warszawie S.A.
- Bank Pekao S.A.
- Bank PKO BP S.A.
- Bank BPH S.A.
- Bank Societe Generale S.A. Polish Branch

PGNiG S.A. did not use the funds available under these loans.

2.3. Granted Loans and Borrowings

In 2006, PGNiG S.A. advanced a loan to the companies of the PGNiG Group for the aggregate amount of PLN 216.5m. As at December 31st 2006, the companies' balance of debt under loans advanced by PGNiG S.A. amounted to PLN 247.9m and USD 70.9m. In 2006, PGNiG S.A. disclosed bank guarantees in the amount of PLN 447m, as issued at the Company's request.

The Gas Companies issued bank guarantees for the benefit of PGNiG S.A. in the aggregate amount of PLN 4,809.9m (EUR 1,250m). The guarantee agreement, which was concluded on September 22nd 2005, will be in force up to January 27th 2012.

The table below present the loans advanced to the PGNiG Group, guarantees and sureties advanced by PGNiG S.A., and bank guarantees issued at PGNiG S.A.'s request as at December 31st 2006.

Loans advanced to the Companies of the PGNiG Group as at December 31st 2006

Company	Loan agreement date	Unit	Loan amount	Principal	Interest	Total debt	Past due debt	Loan repayment date
EUROPOL GAZ S.A.	Sep 25 1995	USDm	78.6	58.5	7.6	66.1	7.6*	Dec 31 2012
PNiG Kraków Sp. z o.o. 1)	Sep 14 1998	PLNm	9.1	8.1	6.7	14.8	0.0	Jun 30 2011
PNiG Kraków Sp. z o.o.	Apr 25 2001	PLNm	54.0	54.0	0.2	54.2	0.9	Nov 15 2011
Dewon Z.S.A. 2)	Apr 25 2001	USDm	3.1	3.1	1.7	4.8	0.5	Jun 30 2009
DSG Sp. z o.o.	Jan 20 2003	PLNm	40.0	0.0	0.04	0.04	0.0	Dec 31 2006
DSG Sp. z o.o. 3)	Oct 30 2006	PLNm	40.0	20.0	0.0	20.0	0.0	Mar 31 2012
GEOFIZYKA Toruń Sp. z o.o. 4)	Aug 21 2006	PLNm	12.3	11.2	0.05	11.25	0.0	Aug 31 2009
GEOFIZYKA Kraków Sp. z o.o.	Oct 26 2006	PLNm	23.1	22.4	0.0	22.4	0.0	Oct 31 2011
WSG Sp. z .o.o.	Oct 26 2006	PLNm	15.1	15.1	0.00	15.1	0.0	Dec 31 2009
WSG Sp. z .o.o.	Oct 26 2006	PLNm	75.0	75.0	0.00	75.0	0.0	Apr 20 2007
PSG Sp. z o.o. 5)	Nov 16 2006	PLNm	14.8	11.8	0.03	11.83	0.0	Jan 31 2012
PSG Sp. z o.o. 6)	Nov 16 2006	PLNm	24.2	17.2	0.07	17.27	0.0	Jan 31 2017
PNiG Jasło Sp. z o.o. 7)	Dec 21 2006	PLNm	12.0	6.0	0.00	6.0	0.0	Mar 31 2012

The agreement of October 26th 2006 concerning the restructuring of indebtness under the Loan Agreement. The repayment schedule for the amount of PLN 9.1m was prepared up to June 30th 2006. The parties agreed that PGNiG S.A. will convert claims under due interest on the loan of PLN 6.4m advanced for the share capital increase of PNiG Kraków, by way of increase in the number of 6,381 shares, subject to the consent of General Shareholders Meeting of PGNiG S.A. (Resolution No. 3 adopted by the Extraordinary General Shareholders Meeting on March 8th 2007 grants consent to the PGNiG S.A.'s acquisition of 6,381 new shares in the increased share capital of PNiG Kraków, whose total value amounts to PLN 6.4m, and finance the shares with the claim for repayment of interest on the loan).

In 2001, Dewon incurred a loan and has not performed liabilities under the agreement. Because of the delay in repayment, the negotiations with the debtor were conducted with a view to settling due and current liabilities. In September 2005, Annex 2 to the Agreement was executed, whereby a new repayment schedule was drawn up. The amount of loan has not changed and is USD 3,096,626. In the grace period, from the beginning of 2002 to the end of Q3 2006, the interest of USD 1,578,066 were incurred. The first instalment for the principal and interest in the amount of USD 519,232.68 was scheduled for the end of Q4 2006. Given that the instalment for Q4 2006 was not paid, as at the end of 2006, the debt amount under the instalment due and interest for the grace period was USD 1,672,328.59.

The first loan of PLN 20m was disbursed on October 31st 2006, and the second loan of PLN 20m on January 4th 2007.

The advanced loan amounts to USD 4m. The amount was translated into Polish złoty at the USD exchange rate in accordance with Par. 2.3.2, i.e. as at the date of submitting a request by the debtor. The first loan of PLN 2m was disbursed between July and August 2006, and the second loan of PLN 2m was disbursed between September and October 2006.

The loan advanced under the agreement amounts to USD 14.8m. The first loan was disbursed until November 20th 2006, the second and third loan of PLN 7.8m and PLN 3m, respectively, were disbursed until December 15th 2006 and January 15th 2007.

The loan advanced under the agreement amounts to USD 24m. The first loan of PLN 17.2m was disbursed on November 20th 2006, and the second loan of PLN 7m was disbursed on January 19th 2007.

The loan advanced under the agreement amounts to USD 12m. The first loan of PLN 6m was disbursed on December 30th 2006, and the second loan of PLN 6m was disbursed until March 31st 2007.

* As at December 31st 2006, disputed interest amounted to PLN 24.2m (USD 8.3m). The interest was overpaid in the amount of PLN 2.2m (USD 0.7m). The balanced interest amounts to PLN 22m (USD 7.6m).

Bank guarantees issued at PGNiG S.A.'s request (figures in million)

Guarantee beneficiary	Guarantee-issuing bank	Guarantee date	Guarantee term	Guarantee limit (USD)	Guarantee limit (PLN)
The President Islamic Republic of Pakistan	Polish branch of Societe Generale S.A.	Nov 20 2000	Dec 31 2008	2.3	6.7
The Supreme Court of Pakistan	Polish branch of Societe Generale S.A.	Jul 8 2004	Jan 30 2008	1.1	3.3
OOO Gazprom-eksport	Polish branch of Societe Generale S.A.	Dec 14 2005	Feb 8 2007	100.0	291.1
OOO Gazprom-eksport	Bank Pekao S.A.	Dec 14 2005	Feb 8 2007	50.0	145.5
OOO Gazprom-eksport	Polish branch of Societe Generale S.A.	Dec 12 2006	Feb 8 2008	90	261.9
OOO Gazprom-eksport	Bank Pekao S.A.	Dec 12 2006	Feb 8 2008	90	261.9

Guarantees and sureties advanced by PGNiG S.A. (PLNm)

Borrower	Bank or any other institution for the benefit of which surety was granted	Date of surety	Expiry of liability	Surety term	Loan amount	Type of surety
SGT EUROPOL GAZ S.A.	Bank Gdański S.A. (currently Millennium S.A.)	Oct 8 1996	Sep 30 2009	Sep 30 2012*	56.0	Loan surety

* Pursuant to Art. 118 of the Polish Civil Code, claims are subject to a three-year statute of limitations counting from a liability's maturity.

2.4. Structure of Material Equity Investments

The PGNiG Group holds substantial surplus of funds, which in accordance with the internal procedures are invested in the instruments ensuring safety and liquidity, namely, the securities issued by the State Treasury and the National Bank of Poland, and are deposited on the bank accounts as deposits. In 2006, the Company made mostly current financial investments with the maturity of up to three months.

In 2006, the average volume of funds invested by PGNiG S.A. amounted to PLN 3,010.5, 89% of which was represented by the debt securities issued by the State Treasury and the National Bank of Poland, and 11% by deposits and placements. In October 2006, following settlement of swap transactions, the PGNiG S.A.'s bank account was credited with EUR 449m. As at the end of 2006, the balance of euro on the Company's accounts was approximately EUR 459m.

In 2006, the average volume of investments made by strategic companies stood at PLN 614.7m, the majority of which was represented by the funds of Karpacka Spółka Gazownictwa. The companies invested 91% of funds in deposits on the bank accounts, the remaining portion was invested in the debt securities issued by the State Treasury.

2.5. Financial Risk Management

In 2006, the PGNiG Group was exposed to the financial risk related to:

- loan
- exchange rate
- operations (e.g. cash flow disruptions)
- loss of financial liquidity

The following was undertaken by the PGNiG Group to mitigate the credit risk:

- investment of free cash in instruments with a minimum credit risk (treasury bills, treasury bonds and bonds issued by the National Bank of Poland);
- cooperation with the leading commercial banks holding an investment rating;
- restructuring of debt (simplification of documentation, elimination of a substantial number of covenants, significant cost reduction), as a result of which the Company uses one credit facility for the total amount of EUR 600m;
- conclusion of framework agreements with business partners, which expressly define the rights and obligations of the parties;
- diversification of business partners;
- cooperation with rating agencies

PGNiG S.A. used the following financial instruments to mitigate the exchange rate:

- FX forwards – transactions involving an exchange of foreign currency in the future at the price (exchange rate) which is determined at the time of concluding the transaction;

* purchased foreign exchange call options – transactions giving the right, in exchange for a specific premium, to purchase assets in the future at the price determined at the time of concluding the transaction;
* options – generally representing combinations of at least two FX options, for example a combination of a call and a put option helps to limit the risk of price fluctuations to a specific range (a risk reversal transaction).

The measures undertaken by the PGNiG Group to mitigate the risk of cash-flow disruptions included:

* diversification of e-banking systems
* on-going control of credit/debit operations on bank accounts,
* gathering information on cash flows at the Company/the Group,
* consolidation of bank accounts,
* conclusion of current account facility agreements

To mitigate the risk of losing financial liquidity, the PGNiG Group undertook measures which included:

* conclusion of current-account facility agreements and a revolving facility agreement;
* projections of cash flows at the Company/the Group;
* estimation of the condition and the value of assets available for sale;
* maintenance of highly liquid financial assets.

The main objective of the PGNiG S.A.'s financial risk management policy is to limit the volatility of the cash flows related to the Company's operations to the acceptable levels in the short and mid term and building the Company value in the long term.

The Company limited the volatility of the cash flows resulting from payments under concluded gas purchase agreements and the payments resulting from repayment of the Company's credit liabilities in 2006 by concluding transactions hedging the foreign exchange risk (FX forwards, FX options, option strategies).

In connection with the separation of gas trading from distribution the potential risk of liquidity loss occurs, which is related to the incorrect settlement of obligations by the customers. The whole risk is to be taken by PGNiG S.A. The Company's funds guarantee financing all current and planned expenses related to the Company's current and investing activities.

In 2006 PGNiG S.A. did not apply hedge accounting, therefore the changes in the fair value of hedged financial instruments and hedging instruments were disclosed in the profit and loss account for the given accounting period. However, most of the concluded transactions are effective in terms of hedge accounting (according to IAS 39).

3. Projected Financial Standing

Changes in the prices of petroleum products and, what follows, the prices of imported gas will be crucial for the performance of the PGNiG Group. The global market for such products is characterised by a significant uncertainty and volatility. In 2006, the dynamics of the domestic price increases did not match the dynamics of the increases in import prices.

The key factor affecting the 2007 results will be the position of the President of the Polish Energy Regulatory Authority on the approval of tariff effective until the end of 2007. The tariff rate for gaseous fuel, applicable as of January 1st 2007, is 9.9% higher than the tariff rates set for the previous three quarters. The rise in gas prices, as approved by the President of the URE, is a consequence of the increase in prices of the imported high-methane natural gas and the necessity to allow for the costs incurred in relation to the requirement to keep 3% of imported gas in the storage facility.

The prices of petroleum products also affect profitability of the PGNiG Group's production activity. The production of crude oil is the most important area of such activity for the Group, which in 2006 contributed PLN 739.1m to the Group's revenue. In 2007 the Group plans to maintain high profitability of its production operations and intensify its investment activity in order to increase domestic production of natural gas and crude oil.

The fact that gas trading, carried out by the gas Companies, will be taken over by PGNiG S.A. will significantly affect the structure of the PGNiG Group's financial results. The integration of gas trading in PGNiG S.A. will unify and improve the quality of customer service, which owing to the economies of scale, will lower the costs of functioning of the whole PGNiG Group in the long run.

The financial standing of the PGNiG Group is significantly affected by the situation on the foreign exchange markets. The foreign exchange market is characterised by significant volatility. In 2005, the difference between the lowest and highest US dollar exchange rate was over 18.6%. In the subsequent year the difference exceeded 15.3%. In the case of euro the difference in 2005 amounted to over 11.9% and in 2006 it exceeded 9.3%. It should be noted that in the case of increases in the purchase prices of imported gas (and also in foreign exchange rates) of up to 5% from the levels assumed in the tariff approval request, PGNiG S.A. has no formal legal grounds to apply to the Polish Energy Regulatory Authority to change the tariff and make the customers incur the increased cost. The risk related to a significant increase in foreign exchange rates and, what follows, the cost of acquisition of imported gas is limited by active hedging policy conducted by the Group.

The Company's good financial standing supports the performance of planned investment projects. The balance of available funds provides PGNiG S.A. with flexibility with regard to performance of the investment projects. Owing to the low financial leverage and positive assessment of the PGNiG S.A.'s risk, as confirmed by the rating agencies (in February 2007, the S&P agency increased the Company's rating to BBB+ with the stable prospects), along with the creditworthiness, the opportunity arise for the Company to finance the planned investment projects with the bank loans advanced on favourable conditions or the issue of debt securities.

Members of the Management Board

President	Krzysztof Głogowski	
Vice-President	Jan Anysz	
Vice-President	Zenon Kuchciak	
Vice-President	Stanisław Niedbalec	
Vice-President	Tadeusz Zwierzyński	