DIRECTORS' REPORT ON THE OPERATIONS OF PGNIG S.A. IN 2013

Warsaw, February 19th 2014

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Section I: Company's highlights

1. Incorporation

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with its registered office in Warsaw, ul. Marcina Kasprzaka 25, was incorporated through transformation of the state-owned enterprise 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 notary deed (No. A 18871/96 in the Register of Notary Deeds) on October 21st 1996.

On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw, under No. RHB 48382. As of the date of entry in the commercial register, the Company became a legal entity. On November 14th 2001, it was entered in the register of entrepreneurs of the National Court Register under No. 0000059492.

Currently, the share capital of PGNiG S.A. amounts to PLN 5.9bn and is divided into 5,900,000,000 shares with a par value of PLN 1 per share.

The Company floated its shares on the Warsaw Stock Exchange on September 23rd 2005. PGNiG shares have been listed on the Warsaw Stock Exchange since October 20th 2005.

2. Scope of business

PGNiG S.A. is the largest Polish company in the hydrocarbon exploration and production industry, and on the natural gas market. It is the leader in all areas of the Polish gas sector, including natural gas import, exploration, oil and gas production, gas fuel storage and sale of natural gas.

Pursuant to its Articles of Association, the Company's role is to perform activities aimed at ensuring energy security of Poland. These relate in particular to:

- ensuring continuity of gas supplies to consumers and maintaining the necessary stocks of gas,
- ensuring safe operation of gas networks,
- balancing the gas system, managing the operations and capacity of the power equipment connected to the common gas network,
- production of natural gas.

3. Organisational structure of PGNiG S.A.

On January 15th 2013, the names of six PGNiG gas trading divisions were changed to: Lower Silesian Trading Division in Wrocław (Dolnośląski Oddział Handlowy we Wrocławiu), Upper Silesian Trading Division in Zabrze (Górnośląski Oddział Handlowy w Zabrzu), Carpathian Trading Division in Tarnów (Karpacki Oddział Handlowy w Tarnowie), Mazovian Trading Division in Warsaw (Mazowiecki Oddział Handlowy w Warszawie), Pomeranian Gas Trading Division in Gdańsk (Pomorski Oddział Handlowy w Gdańsku), and Greater Poland Trading Division in Poznań (Wielkopolski Oddział Handlowy w Poznaniu).

On April 9th 2013, the Mogilno Underground Gas Storage Cavern Facility Branch in Palędzie Dolne was established, followed, on October 22nd 2013, by the establishment of the Wierzchowice Underground Gas Storage Facility Branch in Czarnogoździce. The formation of these new branches was a part of the process of reorganising the storage operations at the PGNiG Group, aimed at streamlining the operations by transferring the storage assets, as well as the technical and management competencies related to storage, to Operator Systemu Magazynowania Sp. z o.o.

On May 27th 2013, the Wholesale Trading Division in Warsaw was established to manage the organisation, supervision and execution of the wholesale of natural gas, electricity and related products within the PGNiG Group.

PGNiG S.A. operates a multiple-unit structure. As at December 31st 2013, the structure comprised the Head Office and 18 branches. The table below presents the business range of PGNiG S.A.'s organisational units.

Business range of PGNiG S.A.'s organisational units

Organisational unit	Business range
Head Office in Warsaw	Corporate supervision of the Company branches Owner's supervision of the operations of the PGNiG Group
Geology and Hydrocarbon Production Branch in Warsaw	Management and coordination of exploration for and production of natural gas and crude oil
Sanok Branch	Production of natural gas and crude oil Direct sale of off-system natural gas and other products and services
Zielona Góra Branch	Production of natural gas and crude oil Direct sale of off-system natural gas and other products and services
Odolanów Branch	Processing of nitrogen-rich natural gas into high-methane gas
Operator Branch in Pakistan	Exploration for and production of hydrocarbons in licence areas in Pakistan
Egypt Branch	Exploration for and production of hydrocarbons in licence areas in Egypt
Denmark Branch	Exploration for and production of hydrocarbons in licence areas in Denmark
Mogilno Underground Gas Storage Cavern Facility Branch in Palędzie Dolne	Development and operation of the Mogilno Underground Gas Storage Cavern Facility
Wierzchowice Underground Gas Storage Facility Branch in Czarnogoździce	Development and operation of the Wierzchowice Underground Gas Storage Facility
Well Mining Rescue Station in Kraków	Provision of rescue services to the petroleum extraction industry

Business range of PGNiG S.A.'s organisational units (cont.)

Organisational unit	Business range
Wholesale Trading Division in Warsaw	Trade in natural gas, electricity and related products
Lower Silesian Gas Trading Division in Wrocław	Comprehensive customer service related to sale of natural gas and other products and services
Upper Silesian Gas Trading Division in Zabrze	
Carpathian Gas Trading Division in Tarnów	
Mazovian Gas Trading Division in Warsaw	
Pomeranian Gas Trading Division in Gdańsk	
Greater Poland Gas Trading Division in Poznań	
Central Measurement and Testing Laboratory in Warsaw	Provision of services ensuring the accuracy and reliability of measurements related to natural gas

As at December 31st 2013, PGNiG S.A. operated foreign representative offices in Moscow (Russia), Brussels (Belgium), Kiev (Ukraine) and Vysokoye (Belarus).

4. Changes in management policies

In 2013, the PGNiG Group reorganised the trade, storage, and distribution segments. The purpose of this effort was to improve the efficiency of the Group's operations and ensure that it stays competitive in a deregulated gas market.

PGNiG S.A. merged with PGNiG Energia S.A., whose operations consisted mainly in electricity trading. Furthermore, PGNiG S.A. established the Wholesale Trading Division, which is to take over all wholesale trading processes and manage the Group's product mix, i.e. natural gas, crude oil, and electricity. This is to ensure that the Group maintains its competitive edge in the changing market environment.

As part of the storage segment's reorganisation at PGNiG S.A., the Mogilno Underground Gas Storage Cavern Facility and Wierzchowice Underground Gas Storage Facility were established, while INVESTGAS S.A. was merged with Operator Systemu Magazynowania Sp. z o.o. The management and supervisory processes in the storage segment were centralised in OSM Sp. z o.o., which is to improve long-term efficiency.

In 2013, PGNiG SPV 4 Sp. z o.o. (later to be renamed Polska Spółka Gazownictwa Sp. z o.o.) was merged with six regional gas distribution companies, whose core business was gas distribution, as well as management and development of the distribution infrastructure. This will allow to introduce uniform standards and procedures across the Group, help optimise the distribution costs and enhance customer service.

5. Ownership interests in other related entities

PGNiG S.A. holds shares in production and service companies. As at December 31st 2013, PGNiG S.A. had 32 directly related entities, including:

- 22 subsidiaries
- 10 other related entities.

The table below presents related entities of PGNiG S.A. as at December 31st 2013.

PGNiG S.A.'s related entities

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total vote held by PGNiG S.A.
	Subsidiaries				
1	Exalo Drilling S.A.	981,500,000.00	981,500,000.00	100.00%	100.00%
2	GEOFIZYKA Kraków S.A.	64,400,000.00	64,400,000.00	100.00%	100.00%
3	GEOFIZYKA Toruń S.A.	66,000,000.00	66,000,000.00	100.00%	100.00%
4	PGNiG Upstream International AS (NOK)[1)]	1,092,000,000.00	1,092,000,000.00	100.00%	100.00%
5	Polish Oil and Gas Company - Libya B.V. (EUR)[1)]	20,000.00	20,000.00	100.00%	100.00%
6	PGNiG Sales & Trading GmbH (EUR)[1)]	10,000,000.00	10,000,000.00	100.00%	100.00%
7	Operator Systemu Magazynowania Sp. z o.o.	15,290,000.00	15,290,000.00	100.00%	100.00%
8	Polska Spółka Gazownictwa Sp. z o.o.	10,454,206,550.00	10,454,206,550.00	100.00%	100.00%
9	Geovita S.A.	86,139,000.00	86,139,000.00	100.00%	100.00%
10	Biogazownia Ostrowiec Sp. z o.o. w likwidacji (in liquidation)	165,000.00	165,000.00	100.00%	100.00%
11	PGNiG Technologie S.A.	182,127,240.00	182,127,240.00	100.00%	100.00%
12	BUD-GAZ PPUH Sp. z o.o. w likwidacji (in liquidation)	51,760.00	51,760.00	100.00%	100.00%
13	Polskie Elektrownie Gazowe Sp. z o.o. w likwidacji (in liquidation)	1,212,000.00	1,212,000.00	100.00%	100.00%
14	PGNiG TERMIKA S.A.	670,324,950.00	670,324,950.00	100.00%	100.00%
15	PGNiG Finance AB (SEK) [1)]	500,000.00	500,000.00	100.00%	100.00%
16	PGNiG Serwis Sp. z o.o.	9,995,000.00	9,995,000.00	100.00%	100.00%
17	PGNiG Obrót Detaliczny Sp. z o.o.	1,000,000.00	1,000,000.00	100.00%	100.00%
18	PGNiG SPV 5 Sp. z o.o.	250,000.00	250,000.00	100.00%	100.00%
19	PGNiG SPV 6 Sp. z o.o.	250,000.00	250,000.00	100.00%	100.00%
20	PGNiG SPV 7 Sp. z o.o.	250,000.00	250,000.00	100.00%	100.00%
21	B.S. i P.G. Gazoprojekt S.A.[2)]	4,000,000.00	900,000.00	22.50%	22.50%
22	NYSAGAZ Sp. z o.o.	9,881,000.00	6,549,000.00	66.28%	66.28%
	Other related entities	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	Ownership interest held by PGNiG S.A.	% of total vote held by PGNiG S.A.
23	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
24	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
25	InterTransGas GmbH (EUR) [1)]	200,000.00	100,000.00	50.00%	50.00%
26	Dewon Z.S.A. (UAH)[1)]	11,146,800.00	4,055,205.84	36.38%	36.38%
27	Sahara Petroleum Technology llc w likwidacji (in liquidation) (OMR)[1)]	150,000.00	73,500.00	49.00%	49.00%
28	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
29	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
30	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
31	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
32	ZRUG TORUŃ S.A. w upadłości likwidacyjnej (in bankruptcy by liquidation)	5,150,000.00	1,300,000.00	25.24%	25.24%

1) In foreign currencies
2) PGNiG S.A. has the right to appoint the majority of the company's Supervisory Board members.
Also, PGNiG S.A. holds a 52.50% indirect interest in the company through PGNiG Technologie S.A.

Other changes in ownership interests within the Group in 2013:

- On January 2nd 2013, the Extraordinary General Meeting of BUD-GAZ PPUH Sp. z o.o. resolved to wind up the company and place it in liquidation.
- On February 1st 2013, the merger of PGNiG Poszukiwania S.A. (now Exalo Drilling S.A.) with PNiG Kraków S.A., PNiG NAFTA S.A., PNiG Jasło S.A., PN Diament Sp. z o.o. and ZRG Krosno Sp. z o.o. was effected and registered with the National Court Register.
- On February 6th 2013, the change of PGNiG Poszukiwania S.A.'s name to Exalo Drilling S.A. was registered with the National Court Register.
- On May 23rd 2013, an amendment to the Articles of Association of PGNiG Norway AS, which involved a change of the company's name to PGNiG Upstream International AS, was registered with the National Court Register.
- On May 14th 2013, the General Meeting of Biogazownia Ostrowiec Sp. z o.o. resolved to wind up the company and place it in liquidation.
- On July 1st 2013, the merger of PGNiG SPV 4 Sp. z o.o. (acquiring company) with six gas distribution companies (target companies), i.e. Mazowiecka Spółka Gazownictwa Sp. z o.o., Wielkopolska Spółka Gazownictwa Sp. z o.o., Karpacka Spółka Gazownictwa Sp. z o.o., Pomorska Spółka Gazownictwa Sp. z o.o., Dolnośląska Spółka Gazownictwa Sp. z o.o. and Górnośląska Spółka Gazownictwa Sp. z o.o., was effected pursuant to Art. 492.1.1 of the Commercial Companies Code; as a result, the share capital of PGNiG SPV 4 Sp. z o.o. was increased by PLN 10,453,211,550, to PLN 10,454,206,550; the merger and the share capital increase were registered with the National Court Register on July 1st 2013; the company name was changed to Polska Spółka Gazownictwa Sp. z o.o.; the change of the company name was registered with the National Court Register on September 12th 2013.
- On July 1st 2013, the merger of Operator Systemu Magazynowania Sp. z o.o. (acquiring company) with INVESTGAS S.A. (target company) was effected pursuant to Art. 492.1.1 of the Commercial Companies Code; as a result, the share capital of Operator Systemu Magazynowania Sp. z o.o. was increased by PLN 10,290,000, to PLN 15,290,000; the merger and the share capital increase were registered with the National Court Register on July 1st 2013.
- On July 23rd 2013, the merger of PGNiG S.A. (acquiring company) with PGNiG Energia S.A. (target company) without a share capital increase was effected pursuant to Art. 492.1.1 of the Commercial Companies Code; the merger was registered with the National Court Register on July 23rd 2013.
- On August 22nd 2013, the Extraordinary General Meeting of Polskie Elektrownie Gazowe Sp. z o.o. resolved to wind up the company and place it in liquidation.
- On October 31st 2013, a new company under the name of PGNiG Obrót Detaliczny Sp. z o.o. was established; the company's share capital is PLN 1,000,000 and is divided into 10,000 shares with a par value of PLN 100 per share; PGNiG S.A. holds a 100% equity interest in PGNiG Obrót Detaliczny Sp. z o.o.; the company was registered with the National Court Register on December 3rd 2013.
- On November 21st 2013, a new company under the name of PGNiG SPV 5 Sp. z o.o. was established; PGNiG S.A. holds a 100% equity interest in PGNiG SPV 5 Sp. z o.o. (PLN 250,000; 2,500 shares with a par value of PLN 100 per share); the company was registered with the National Court Register on December 13th 2013.
- On November 21st 2013, a new company under the name of PGNiG SPV 6 Sp. z o.o. was established; PGNiG S.A. holds a 100% equity interest in PGNiG SPV 6 Sp. z o.o. (PLN 250,000; 2,500 shares with a par value of PLN 100 per share); the company was registered with the National Court Register on December 11th 2013.
- On November 21st 2013, a new company under the name of PGNiG SPV 7 Sp. z o.o. was established; PGNiG S.A. holds a 100% equity interest in PGNiG SPV 7 Sp. z o.o. (PLN 250,000;

2,500 shares with a par value of PLN 100 per share); the company was registered with the National Court Register on December 9th 2013.

6. Changes in equity interests

In 2013, the following changes in PGNiG S.A.’s equity interests took place:

- Registration of a share capital increase at Biogazownia Ostrowiec Sp. z o.o. by PLN 60,000, to PLN 165,000, by way of an issue of 1,200 new shares with a par value of PLN 50 per share; the new shares were acquired by PGNiG Energia S.A., the company’s sole shareholder, and paid for with cash. The share capital increase was registered with the National Court Register on March 5th 2013;
- Increase in the share capital of PGNiG SPV 4 Sp. z o.o. by PLN 990,000, to PLN 995,000, by way of an issue of 19,800 new shares with a par value of PLN 50 per share, which were subscribed for by PGNiG S.A. and fully paid for with cash; the increase was registered with the National Court Register on March 6th 2013;
- Increase in the share capital of PGNiG TERMIKA S.A. by PLN 33,984,000, to PLN 896,300,000, by way of an issue of 3,398,400 Series D shares; all the new issue shares were subscribed for by PGNiG S.A.; PGNiG S.A.’s interest in the company’s share capital increased to 72.52%; the increase was registered with the National Court Register on March 22nd 2013;
- Reduction of the share capital of PGNiG TERMIKA S.A. by PLN 246,300,000, to PLN 650,000,000, by way of retirement of all of the company’s 24,630,000 treasury shares without consideration (i.e. 24,629,609 shares in respect of which the company did not exercise the voting rights, and 391 shares acquired from non-controlling shareholders under Art. 418 of the Commercial Companies Code); PGNiG S.A. holds a 100% interest in PGNiG TERMIKA S.A.’s share capital and voting rights; the reduction was registered with the National Court Register on May 27th 2013; the court also registered PGNiG S.A. as the sole shareholder in the company;
- Increase in the share capital of PGNiG Technologie S.A. by PLN 15,213,240, to PLN 182,127,240; all the new shares were subscribed for by PGNiG S.A. and fully paid for with a non-cash contribution in the form of 21,000 shares in B.S.i P.G. Gazoprojekt S.A.; PGNiG S.A.’s direct interest in the share capital of B.S.i P.G. Gazoprojekt S.A. was reduced to 22.50%, while its indirect interest through PGNiG Technologie S.A. is 52.50%; the changes were registered with the National Court Register on June 21st 2013;
- Increase in the share capital of PGNiG TERMIKA S.A. to PLN 670,324,950, by way of an issue of 2,032,495 Series E shares with a par value of PLN 10 per share; all the shares were fully covered with a non-cash contribution in the form of 14,100,000 registered non-preference shares, with a par value of PLN 1 per share, in Elektrociepłownia Stalowa Wola S.A. of Stalowa Wola; the increase in PGNiG TERMIKA S.A.’s share capital was registered with the National Court Register on November 20th 2013.

Equity investments outside the group of related entities

As at the end of 2013, the total par value of PGNiG S.A.’s equity interests held outside the group of related entities was PLN 21.3m. In 2013, PGNiG S.A. made no material equity investments outside the group of related entities.

7. Employment

The table below presents employment at PGNiG as at December 31st 2013, by segments. Employment at the PGNiG Head Office is presented in the Trade and Storage segment.

Workforce by segments (no. of staff)

	2013	2012*
Exploration and Production	4,207	4,408
Trade and Storage	3,901	4,333
Other Activities	39	37
Total	8,147	8,778

* Following the 2013 merger of PGNiG S.A. and PGNiG Energia S.A., the headcount was adjusted as at December 31st 2012.

Compared with December 31st 2012, the number of employees at PGNiG S.A. fell by 631, which was mainly attributable to the launch of the voluntary termination programme for Company employees in H2 2012. Most of the employees who participated in the programme terminated their employment contracts with effect as of December 31st 2012, which resulted in a substantial reduction of the staffing level in 2013.

Since January 2009, the Group has operated the Programme for Workforce Streamlining and Redundancy Payments to Employees of the PGNiG Group for 2009–2011 (Stage 3). The Programme remains operational until its expiry on December 31st 2015, but its duration may be shortened if it is terminated by one of the parties. The Programme is operated on a stand-by basis. It may be implemented in extraordinary circumstances and requires all companies to follow a procedure which is uniform across the Group.

In 2013, the Programme was implemented in three companies of the PGNiG Group: PGNiG Technologie S.A., GEOFIZYKA Kraków S.A. and PNiG Jasło S.A. (now Exalo Drilling S.A.), and covered 206 former employees of those companies. The one-off redundancy payments to the terminated employees were financed with PGNiG S.A.'s Central Restructuring Fund reserve.

8. Sales and production

In 2013, PGNiG S.A. recorded revenue of PLN 27.2bn, 86% of which was derived from sales of natural gas.

Revenue (PLNm)

	2013	2012
Natural gas, including:	23,416	23,548
- high-methane gas	21,978	22,154
- nitrogen-rich gas	1,438	1,394
Crude oil	2,058	1,263
Helium	184	161
Propane-butane	76	67
Electricity	639	133
Other sales	813	514
Total	27,186	25,686

In 2013, PGNiG S.A. sold 14.9bcm of natural gas, with 95% of that amount representing sales from the transmission and distribution systems and the balance – direct sales from gas fields.

Natural gas sales volume (mcm)

	2013	2012
Trade and Storage	14,128.9	14,005.4
Exploration and Production	754.6	723.4
Total	14,883.5	14,728.8

PGNiG S.A. produced a total of 4.2bcm of natural gas (measured as high-methane gas equivalent), of which 99% was produced from the fields in Poland, and the balance – from the fields in Pakistan.

Natural gas production volume (mcm)

	2013	2012
Poland	4,211.2	4,317.3
Abroad	31.1	0.0
Total	4,242.3	4,317.3

Section II: Company's Governing Bodies

1. Management Board

Pursuant to PGNiG S.A.'s Articles of Association, its Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board. Individual members or the entire Management Board are appointed for a joint three-year term of office.

A member of the Management Board is appointed following a qualification procedure carried out pursuant to the Regulation of the Polish Council of Ministers of March 18th 2003 concerning qualification procedures for members of management boards of certain commercial-law companies (Dz. U. No. 55, item 476, as amended). The Regulation does not apply to Management Board members elected by employees.

As long as the State Treasury remains a shareholder of the Company and the Company's average annual headcount exceeds 500, the Supervisory Board appoints one person elected by the Company's employees to serve on the Management Board during its term. The Supervisory Board adopts the rules governing election and removal from office of the Management Board member representing the employees, and the rules of by-elections.

Each member of the Management Board may be removed from office or suspended from their duties by the Supervisory Board or the General Meeting.

As at January 1st 2013, the composition of the PGNiG Management Board was as follows:

- Grażyna Piotrowska-Oliwa – President
- Radosław Dudziński – Vice-President, Trade
- Sławomir Hinc – Vice-President, Finance
- Mirosław Szkałuba – Vice-President, Procurement and IT

On January 22nd 2013, Mr Sławomir Hinc tendered his resignation from the position of Vice-President of the PGNiG S.A.'s Management Board for Finance, with effect as of March 31st 2013. The reason of the resignation was his appointment as President (CEO) of PGNiG Norway AS (now PGNiG Upstream International AS).

On February 27th 2013, the PGNiG Supervisory Board appointed, with effect as of April 1st 2013, Mr Krzysztof Bocian to the position of Vice-President of the Management Board for Exploration and Production, and Mr Jacek Murawski to the position of Vice-President of the Management Board for Finance, for the joint term of office expiring on March 13th 2014.

On March 30th 2013, the PGNiG Management Board was notified that Mr Krzysztof Bocian had submitted a declaration to avoid the legal consequences of his acceptance of the position of Vice-President of the PGNiG Management Board for Exploration & Production. As a result, Mr Krzysztof Bocian could not take the position. On April 2nd 2013, the PGNiG Supervisory Board repealed the resolution to appoint Vice-President of the PGNiG Management Board for Exploration & Production.

On April 29th 2013, the PGNiG Supervisory Board removed Ms Grażyna Piotrowska-Oliwa, CEO and President of the Management Board, and Mr Radosław Dudziński, Vice-President of the Management Board for Trade, from the PGNiG Management Board and their respective positions. The reason of the removal was that the PGNiG Supervisory Board had lost trust in those members of the Management Board. At the same time, the PGNiG Supervisory Board delegated Mr Mirosław

Szkałuba, Vice-President of the Management Board, to coordinate the Management Board's work until a new President is appointed.

On May 6th 2013, the PGNiG Supervisory Board initiated a qualification process for the positions of President of the Management Board and Vice-President of the Management Board for Trade.

On June 11th 2013, the PGNiG Supervisory Board appointed Mr Jerzy Kurella as Vice-President of the PGNiG Management Board for Trade, with effect as of June 14th 2013, for a joint term of office expiring on March 13th 2014. The PGNiG Supervisory Board also resolved to close the qualification procedure for the position of President of the PGNiG Management Board without selecting a candidate.

On September 16th 2013, Mr Zbigniew Skrzypkiewicz was delegated by the PGNiG Supervisory Board to temporarily serve as Member of the PGNiG Management Board for Corporate Affairs in the period from September 16th 2013 to December 16th 2013.

On December 20th 2013, Mr Mirosław Szkałuba tendered his resignation as Member of the Management Board of PGNiG S.A., effective from the same date.

On December 30th 2013, the PGNiG Supervisory Board removed the Company's Management Board, including Jerzy Kurella – Vice-President, and Jacek Murawski – Vice-President.

On December 30th 2013, the PGNiG Supervisory Board appointed the following persons to serve on the Management Board for a joint term of office beginning December 30th 2013 and ending December 30th 2016:

- Jarosław Bauc, as Vice-President of the Management Board, Finance (effective from December 30th 2013)
- Jerzy Kurella, as Vice-President of the Management Board, Trade (effective from December 30th 2013)
- Andrzej Parafianowicz, as Vice-President, Corporate Affairs (effective from December 31st 2013)
- Zbigniew Skrzypkiewicz, as Vice-President, Exploration and Production (effective from December 31st 2013)
- Mariusz Zawisza, as President (effective from January 1st 2014).

As at December 31st 2013, the composition of the PGNiG Management Board was as follows:

- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs
- Zbigniew Skrzypkiewicz – Vice-President, Exploration and Production.

Changes in the Management Board subsequent to the end of the reporting period

As at January 1st 2014, the composition of the PGNiG Management Board was as follows:

- Mariusz Zawisza – President
- Jarosław Bauc – Vice-President, Finance
- Jerzy Kurella – Vice-President, Trade
- Andrzej Parafianowicz – Vice-President, Corporate Affairs
- Zbigniew Skrzypkiewicz – Vice-President, Exploration and Production.

In January-February 2014, elections were held to choose the employees' nominee to the Management Board. As at the date of this report, no employee representative was elected.

Contracts with Management Board members

Contracts were concluded with all members of the PGNiG Management Board whereby they are to receive compensation in the event of their resignation or removal from office without a valid reason, or when their resignation or removal from office is caused by acquisition of the Company and its merger into another company.

The Company was a party to an employment contract and non-competition agreement with Sławomir Hinc, Vice-President of the Management Board, Finance. On March 27th 2013, a settlement was reached to terminate the non-competition agreement following Mr Hinc's resignation, by mutual agreement, from the PGNiG Management Board, effective as of March 31st 2013.

The Company executed managerial contracts and non-competition agreements with Grażyna Piotrowska-Oliwa, President of the Management Board, as well as Radosław Dudziński, Jacek Murawski and Mirosław Szkałuba, Vice-Presidents of the Management Board.

The Company executed managerial contracts and non-competition agreements with Mariusz Zawisza, President of the Management Board, and Jarosław Bauc, Jerzy Kurella, Andrzej Parafianowicz and Zbigniew Skrzypkiewicz, Vice-Presidents of the Management Board.

2. Supervisory Board

Pursuant to the Articles of Association of PGNiG S.A., the Supervisory Board is composed of five to nine members, appointed by the General Meeting for a three-year joint term of office.

As long as the Polish State Treasury holds an equity interest in the Company, the State Treasury, represented by the minister competent for treasury matters, acting in consultation with the minister competent for economic matters, has the right to appoint and remove one member of the Supervisory Board.

In accordance with the Articles of Association, the General Meeting appoints one independent member of the Supervisory Board. The independent Supervisory Board member is elected in separate voting.

Written nominations of candidates for the position of an independent Supervisory Board member may be submitted to the Chairman of the General Meeting by the shareholders present at the General Meeting whose agenda includes the election of such a Supervisory Board member. Any such written proposal should be submitted along with a written representation by a given candidate to the effect that the candidate agrees to stand for the election and meets the criteria for an independent member of the Supervisory Board. If no candidates for the position are proposed by the shareholders, such candidates are nominated by the Supervisory Board.

If the Supervisory Board is composed of up to six members, two members are appointed from among candidates elected by the Company's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among candidates elected by the Company's employees.

As at January 1st 2013, the composition of the PGNiG Supervisory Board was as follows:

- Wojciech Chmielewski – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board

- Mieczysław Kawecki – Secretary of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Józef Głowacki – Member of the Supervisory Board
- Janusz Pilitowski – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Ewa Sibrecht-Ośka – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

On June 26th 2013, the Extraordinary General Meeting of PGNiG S.A. removed Mr. Mieczysław Puławski from the Supervisory Board and appointed Mr. Zbigniew Skrzypkiewicz as a new member of the Board.

On September 16th 2013, Mr Zbigniew Skrzypkiewicz was delegated by the PGNiG Supervisory Board to temporarily serve as Member of the PGNiG Management Board, Corporate Affairs, in the period from September 16th 2013 to December 16th 2013.

On December 30th 2013, Mr Zbigniew Skrzypkiewicz resigned as Member of the PGNiG Supervisory Board.

As at December 31st 2013, the composition of the PGNiG Supervisory Board was as follows:

- Wojciech Chmielewski – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board
- Mieczysław Kawecki – Secretary of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Józef Głowacki – Member of the Supervisory Board
- Janusz Pilitowski – Member of the Supervisory Board
- Ewa Sibrecht-Ośka – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

In January-February 2014, elections were held to choose the employees' nominees to the Supervisory Board. As at the date of this report, no employee representatives were elected.

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the annual separate financial statements for the year ended December 31st 2013 (Note 37.4).

Section III: Shareholder structure

As at December 31st 2013, 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. The Polish State Treasury was the only shareholder with a large direct holding of PGNiG shares. The shares of all series, that is Series A, A1 and B, were ordinary bearer shares and each share conferred the right to one vote at the General Meeting. The shareholder structure of PGNiG S.A. as at December 31st 2013 is presented in the table below.

Shareholder structure

Shareholder	Number of shares as at Dec 31 2013	% ownership interest as at Dec 31 2013	Number of votes conferred by shares held	% of total vote at GM as at Dec 31 2013
State Treasury	4,271,740,477	72.40%	4,271,740,477	72.40%
Other shareholders	1,628,259,523	27.60%	1,628,259,523	27.60%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

PGNiG shares and shares in PGNiG S.A.'s related entities held by management and supervisory personnel

The table below presents PGNiG shares held by the management and supervisory personnel as at December 31st 2013.

PGNiG shares held by the management and supervisory personnel

Name	Position	Number of shares	Par value of shares (PLN)
Mieczysław Kawecki	Secretary of the Supervisory Board	19,500	19,500
Jolanta Siergiej	Member of the Supervisory Board	9,425	9,425

Agreements which may give rise to future changes in the interests held by the existing shareholders or bondholders

As at the date of this report, PGNiG S.A. was not aware of any agreements which could lead to future changes in the equity interests held in the Company by its existing shareholders.

Performance of the PGNiG stock

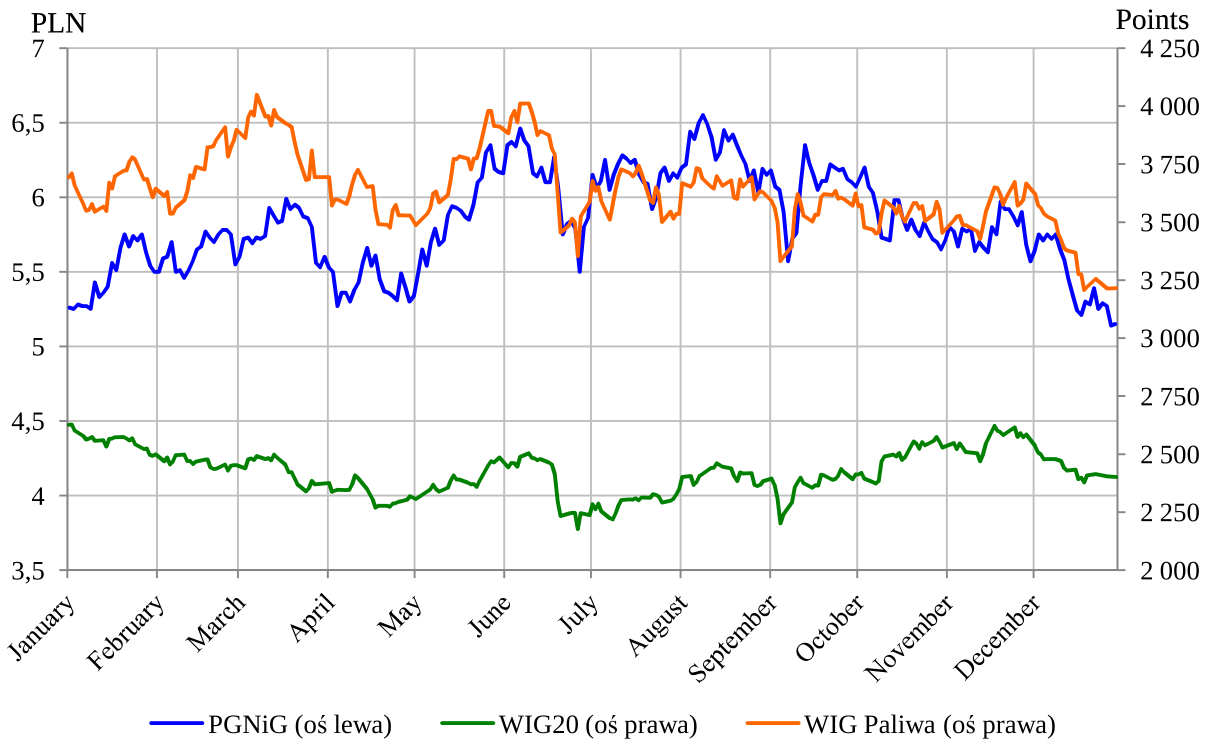
PGNiG shares have been listed at the Warsaw Stock Exchange since September 23rd 2005. As at December 31st 2013, the Company was included in the following indices listed at the WSE:

- WIG – all-cap index
- WIG20 – blue-chip index of the 20 largest and most liquid companies
- WIG30 – new index of the 30 largest companies listed at the WSE, launched on September 23rd 2013
- WIG-Paliwa – index of the fuel sector companies
- WIG-Poland – index of Polish companies
- Respect Index – index of socially responsible companies.

The rate of return on the PGNiG stock in 2013 was -2.1%. In the period from PGNiG's first listing to December 31st 2013, the rate of return was 35.2%. Investors who acquired PGNiG shares on the WSE at their issue price earned a 72.8% return (excluding dividends).

The following figure presents the relative performance of the PGNiG stock against the WIG 20 and WIG Paliwa indices. The table presents the values of the WSE indices and the PGNiG share price in 2013.

PGNiG share price vs. the WIG 20 and WIG Paliwa indices



Performance of WSE indices and PGNiG stock (in points)

Index	Value/price as at Dec 28 2012	2013 high	2013 low	Value/price as at Dec 30 2013	PGNiG's weight in the index as at Dec 30 2013
WIG	47,461	55,246	43,160	51,284	2.98%
WIG20	2,583	2,628	2,177	2,401	4.69%
WIG-Paliwa	3,571	4,049	3,207	3,215	34.17%
Respect Index	2,591	2,854	2,251	2,559	9.25%
PGNiG S.A.	PLN 5.21	PLN 6.55	PLN 5.14	PLN 5.15	-

Source: gpwinfostrefa.pl

Section IV: Regulatory environment

PGNiG S.A.'s activities are regulated by the following laws:

- Polish Energy Law of April 10th 1997 (consolidated text in Dz. U. of 2012, item 1059) with secondary legislation, to the extent it governs gas fuel trading, distribution and storage, as well as foreign trade in natural gas.
- Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007 (consolidated text in Dz. U. of 2012, item 1190) with secondary legislation, to the extent it governs gas fuel storage and foreign trade in natural gas.
- Polish Geological and Mining Law of June 9th 2011 (Dz. U. of 2011, No. 163, item 981, as amended), to the extent it governs production and sale of gas.

1. Polish Energy Law

The activities of PGNiG S.A. are quite heavily regulated, and require a licence granted by the President of the Energy Regulatory Office (URE). For instance, such licence is needed to trade in gas fuels or electricity.

On September 11th 2013, the Act Amending the Energy Law and certain other acts, dated July 26th 2013 (the so-called 'Small Three Pack') came into force. The most important change it has introduced is the requirement to sell a specific portion of high-methane gas volumes fed into the transmission network in a given year on commodity exchanges. In the period September 11th−December 31st 2013, the obligation covered 30% of the sales volume. In 2014, it will cover 40% of the sales volume, and will further increase to 55% as of January 1st 2015. Also, the 'Small Three Pack' clarifies the procedure for a change of gas fuel supplier, defines the procedure for handling complaints, and introduces a procedure for certification of the Transmission System Operator's independence.

On July 25th 2013, the Regulation of the Minister of Economy on detailed rules for determining and calculating tariffs for gas fuels and on settlement of transactions in gas fuels trading (the Tariff Regulation) came into force. The new Tariff Regulation introduces, among other things, settlements by energy units instead of volume units, full separation of transmission and distribution services from trading, *entry-exit* transmission tariffs, rules for calculation of charges for short-term and intermittent services and for virtual reverse flow services provided by transmission and distribution system operators, as well as rules for calculation of charges for storage services rendered on a packaged or stand-alone basis by the Storage System Operator. The Tariff Regulation also provides for the possibility of offering transmission services under an auction system in the case of interconnections between transmission systems within the EU, and for passing along the costs of gas fuel transport to the tariffs of other energy utilities. Another purpose of the Tariff Regulation is to bring its provisions fully in line with the provisions of the Gas System Regulation.

1.1. Licences

As at December 31st 2013, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office (URE) under the Energy Law:

- one licence to trade in gas fuels
- one licence to trade in natural gas with foreign partners
- one licence to trade in liquid fuels
- one licence to produce electricity
- one licence to trade in electricity.

On June 14th 2013, the President of the Energy Regulatory Office approved an amendment to the licence for co-generation of electricity. The amendment extends the scope of activities covered by the licence to include another co-generation unit, situated at the oil production facility in Nosówka, in the Rzeszów Province.

In connection with the merger of PGNiG S.A. and PGNiG Energia S.A., the rights under decisions to grant PGNiG Energia S.A. licences for gas fuels and electricity trading were transferred, by way of universal succession, to PGNiG S.A. PGNiG S.A. applied for expiry of those licences. In administrative decisions dated September 30th and October 16th 2013, the President of the Energy Regulatory Office granted PGNiG's request.

1.2. Tariff policy

Dependence of PGNiG S.A.'s revenue on tariffs approved by the President of the Energy Regulatory Office is one of the key factors affecting its regulated business. Tariffs are crucial to the Company's ability to generate revenue that would cover its reasonably incurred costs, while delivering a return on capital employed and reasonable margin. Gas prices and charges are directly connected with the applied tariff preparation methodology,

whereby such prices and charges are determined against forecast costs and gas sales targets. In accordance with the applicable regulatory policies, the calculation of gas fuel prices takes into account the cost of gas acquisition from all sources, that is of both imported and domestically produced gas. What this means in practice is that both imported and domestically produced gas is subject to price regulation. Given that the current prices of imported gas are higher than those of domestically produced gas, the inclusion of the cost of domestically produced gas in the cost basket used for the purpose of price calculations resulted in a situation where the tariff prices (applicable in settlements with customers) were set below the cost of acquisition of imported gas.

Settlements with customers with which PGNiG S.A. had concluded sale agreements were based on the rules, prices and charges specified in successive tariffs approved by the President of the Energy Regulatory Office.

1.3. Changes in PGNiG S.A.'s tariffs

In 2013, the amendment to Gas Fuel Supply Tariff No. 5/2012, approved by decision of the President of the Energy Regulatory Office dated December 17th 2012, was in effect. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were reduced by 6.7%, 8.0% and 10.9%, respectively.

On January 25th 2013, the President of the Energy Regulatory Office approved an amendment to Gas Fuel Supply Tariff No. 5/2012. The approved amendment related to the rules of classifying customers to the tariff groups for the supply of nitrogen-rich gas over the distribution network of the Poznań Branch of Polska Spółka Gazownictwa Sp. z o.o. It was required in order to bring PGNiG S.A.'s tariff in line with the tariff of WSG Sp. z o.o., and concerned the S-8 and Z-8 tariff groups.

On August 30th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office for an amendment of Gas Fuel Supply Tariff No. 5/2012. The amended tariff submitted for approval included: the contract year definition (compliant with the provisions of the Distribution Grid Code), provisions necessary to introduce an exemption from the obligation to submit wholesale gas trading tariffs for approval, as well as provisions that would allow for the expiry, as of November 1st 2013, of statutory excise duty exemptions for customers receiving gas for heating purposes and as an automotive fuel.

The President of the Energy Regulatory Office issued decisions partially approving the amendment to Gas Fuel Supply Tariff No. 5/2012, which included:

- introduction of the contract year definition and extension of the tariff term until December 31st 2013 (decision dated September 16th 2013);
- adjustment of the tariff provisions to allow for the expiry, as of November 1st 2013, of statutory excise duty exemptions for customers receiving gas for heating purposes and as an automotive fuel (decision dated October 17th 2013);
- adjustment of the wording to the applicable regulations (decision dated October 25th 2013).

The proceedings with respect to the provisions necessary to introduce an exemption from the obligation to submit wholesale gas trading tariffs for approval have not yet been completed.

On July 18th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office for approval of a new PGNiG Gas Fuel Tariff. (Part A – Gas Fuel Supply Tariff No. 6/2013), which was to be effective from October 1st 2013 to September 30th 2014. Due to the prolonged approval proceedings, the number of the Tariff was changed to 6/2014. Finally, on December 17th 2013, the President of the Energy Regulatory Office approved the new PGNiG Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 6/2014) for the period January 1st−July 31st 2014. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 1.5%, 4.7% and 7.3%, respectively.

The following tables present the average rates (PLN/cubic metre) applicable in 2013 in settlements with customers purchasing gas fuels, by fuel type and place of delivery. The tables do not take into account the excise duty introduced on November 1st 2013.

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Wrocław Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.7648	2.4969	-9.7%
W-2.1	2.2036	1.9816	-10.1%
W-3.1	2.0209	1.8029	-10.8%
W-4	1.8905	1.6693	-11.7%
W-5 - W-7C	1.7507	1.7071	-2.5%
W-8A - W-10C	1.5063	1.4651	-2.7%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
S-1	2.0010	1.7900	-10.5%
S-2	1.5888	1.4044	-11.6%
S-3	1.4625	1.3013	-11.0%
S-4	1.3384	1.1801	-11.8%
S-5 - S-7B	1.2677	1.2338	-2.7%
S-8 - S-9	1.1566	1.1225	-2.9%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
Z-1	1.5830	1.4156	-10.6%
Z-2	1.4510	1.2888	-11.2%
Z-3	1.3004	1.1623	-10.6%
Z-4	1.2209	1.0841	-11.2%
Z-5 - Z-7B	1.2088	1.1793	-2.4%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Zabrze Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.7337	2.4726	-9.6%
W-2.1	2.2672	2.0440	-9.8%
W-3.1	1.9883	1.7660	-11.2%
W-4	1.9183	1.6909	-11.9%
W-5 - W-7C	1.7732	1.7314	-2.4%
W-8A - W-11C	1.5121	1.4681	-2.9%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Tarnów Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.6153	2.3594	-9.8%
W-2.1	2.1797	1.9590	-10.1%
W-3.1	1.9319	1.7288	-10.5%
W-4	1.8829	1.6843	-10.5%
W-5 - W-7BC	1.7796	1.7355	-2.5%
W-8A - W-10C	1.4811	1.4310	-3.4%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Warsaw Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.9951	2.7039	-9.7%
W-2.1	2.0888	1.8693	-10.5%
W-3.1	1.8913	1.6877	-10.8%
W-4	1.8787	1.6755	-10.8%
W-5 - W-7C	1.7536	1.7086	-2.6%
W-8A - W-10C	1.4219	1.3669	-3.9%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Gdańsk Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.8368	2.5658	-9.6%
W-2.1	2.2265	2.0058	-9.9%
W-3.1	2.0013	1.8006	-10.0%
W-4	1.9399	1.7451	-10.0%
W-5 - W-7C	1.7992	1.7606	-2.1%
W-8A - W-10C	1.4953	1.4601	-2.4%

Area covered by Polska Spółka Gazownictwa Sp. z o.o. Poznań Branch

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
W-1.1	2.8611	2.5856	-9.6%
W-2.1	2.1348	1.9143	-10.3%
W-3.1	1.9954	1.7881	-10.4%
W-4	1.9050	1.7032	-10.6%
W-5 - W-7C	1.7169	1.6715	-2.6%
W-8A - W-10C	1.4576	1.4140	-3.0%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
S-1	2.0115	1.8046	-10.3%
S-2	1.5505	1.3774	-11.2%
S-3	1.4196	1.2602	-11.2%
S-4	1.3447	1.1889	-11.6%
S-5 - S-7B	1.2699	1.2365	-2.6%

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
Z-1	1.8231	1.6422	-9.9%
Z-2	1.3904	1.2408	-10.8%
Z-3	1.2569	1.1208	-10.8%
Z-4	1.1900	1.0570	-11.2%
Z-5 - Z-7B	1.1446	1.1157	-2.5%

Customers connected to the transmission grid of OGP GAZ-SYSTEM S.A.

	Tariff No. 5/2012	Amendment to Tariff No. 5/2012	Change (%)
	1	2	2/1
E-1A - E-2C	1.3713	1.3302	-3.0%
Lw-1 - Lw-2	1.0582	1.0196	-3.6%
Ls-1 - Ls-2	0.8827	0.8537	-3.3%

Exemption from the obligation to submit wholesale gas tariffs for approval

On February 19th 2013, the President of the Energy Regulatory Office announced that energy utilities holding gas fuel trading licences were exempt from the obligation to submit wholesale gas trading tariffs for approval. However, energy utilities must individually apply to the President of the Energy Regulatory Office for the exemption.

On August 30th 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit wholesale gas trading tariffs for approval. As at the date of this report, the proceedings were still pending.

Furthermore, on October 23rd 2013, PGNiG S.A. applied to the President of the Energy Regulatory Office to be exempted from the obligation to submit for approval tariffs for high-methane natural gas (E) traded at a virtual gas trading point (*OTC* market). As at the date of this report, the proceedings were still pending.

2. Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

The Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market regulates matters related to ensuring the national fuel security, and sets the rules for building up, maintaining, and financing stocks of natural gas by those energy companies whose business involves international trade in natural gas or which import gas for their own needs. With respect to the business activity of PGNiG S.A., the Act:

- specifies the volume of mandatory stocks, which since October 1st 2012 is equivalent to 30 days' average daily imports of gas (for the period from April 1st of the previous year to March 31st of the current year, calculated based on the figures contained in the Company's statistical reports);
- provides that the return on capital employed in the storage business should be at least 6%;
- stipulates that the cost related to maintaining, releasing and restocking the mandatory stocks represents a justified operating cost within the meaning of Art. 3.21 of the Polish Energy Law;
- introduces the possibility of storing mandatory stocks in another EFTA member state, upon fulfilment of certain conditions set forth in the Act;
- introduces the possibility of exempting an energy company whose business involves international trade in natural gas or an entity which imports natural gas from the obligation to build and maintain mandatory stocks, if the number of their customers does not exceed 100 thousand and the natural gas volume imported in a calendar year does not exceed 100mcm.

On September 11th 2013, the amended Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, provided for in the so-called 'Small Three Pack', came into force. The amendment introduced the possibility of storing mandatory stocks in another European Union member state, upon fulfilment of certain conditions set forth in the Act.

3. Polish Geological and Mining Law

The Polish Geological and Mining Law of June 9th 2011 regulates:

- geological work;
- extraction of minerals from deposits;
- storage of waste matter in rock mass, including in worked-out caverns;
- protection of mineral deposits, underground waters and other components of the environment in connection with geological works and extraction of minerals.

Furthermore, under the Act, a tender procedure was introduced to award licences for exploration or appraisal of hydrocarbons and for production of hydrocarbons, superseding the previous tender procedure for establishment of mineral extraction rights.

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

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

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

In 2013, the Ministry of Environment extended the terms of PGNiG S.A.'s 20 licences for exploration and appraisal of crude oil and natural gas deposits, while 11 licences were allowed to expire. In addition, the Company was granted three licences for extraction of crude oil and natural gas, while four of its licences were amended, and one licence was allowed to expire. In 2013, one licence for underground gas storage was granted and one licence was allowed to expire. The licence for appraisal of the Goleniów salt deposit for the purpose of underground gas storage was allowed to expire.

As at December 31st 2013, PGNiG S.A. held the following licences, granted pursuant to the Geological and Mining Law:

- 84 licences for exploration and appraisal of crude oil and natural gas deposits
- 227 licences for production of crude oil and natural gas from deposits
- 9 licences for storage of gas in underground facilities (underground gas storage facilities)
- 3 licences for storage of waste.

4. Regulatory risks

Polish Energy Law

In 2013, work was still underway on a set of three bills to regulate the energy sector: the Gas Law, the Energy Law and the Law on Renewable Energy Sources (the so-called 'Large Three Pack'). On September 11th 2013, the Act Amending the Energy Law and certain other acts (the so-called 'Small Three Pack') came into force. The amendment introduced a number of changes in the regulatory regime governing the natural gas market, relating, in particular, to the need to harmonise Polish legislation with the provisions of the 3rd energy package, as well as the necessity to deregulate the gas market, especially by imposing the requirement to sell gas on the exchange market.

The requirement to sell gas on the exchange market, which has been imposed on the Company, is aimed to deregulate the Polish gas market and boost competition. The mechanism improves the market's transparency and allows market participants to purchase products on equal terms. On the other hand, it may cause PGNiG to gradually lose its market share. However, the actual rate at which PGNiG S.A.'s market share might shrink will depend on the number and size of new players entering the gas market and the price differentials between the OTC and exchange markets.

Furthermore, the amendments to the Polish Energy Law provide that an end user may terminate the agreement with a utility company for the supply of gas fuels without incurring any expenses or having to pay any compensation other than those stipulated in the agreement. Taking into account the costs of purchasing gas (which include the cost of transmitting it to Poland and associated transaction costs) and the security of supply, customers will seek to optimise their purchase portfolios, acquiring gas on or outside of the exchange market.

Meeting the requirement to sell gas on the exchange market

While PGNiG S.A. is prepared to fulfil this statutory obligation in terms of supply, the low demand for gas on the exchange market may prevent it from selling the amounts it is required to sell via this channel. The Group has taken steps to boost demand on the Polish Power Exchange.

Energy Efficiency Act

The Energy Efficiency Act came into force on August 11th 2011. The Act implements Directive 2006/32/EC of the European Parliament and of the Council of April 5th 2006 on energy end-use efficiency and energy services. The Energy Efficiency Act establishes a national target for economical energy use, according to which savings of end-use energy by 2016 should be no less than 9% of the annual national consumption of energy. Since January 1st 2013, PGNiG, as a trading company, has been obliged to purchase energy efficiency certificates or else to pay the buy-out price. This obligation will drive up the cost of regulated activities and, consequently, inflate the price of gas for customers.

Act on Stocks of Crude Oil, Petroleum Products and Natural Gas

Meeting the statutory requirements related to mandatory stocks exposes PGNiG S.A. to balancing and technology risks, and threatens the performance of its contractual obligations.

The balancing risk is related to the Company's inability to meet peak demand for natural gas in autumn and winter months. During longer spells of low temperatures, it may happen that – despite maximum gas supplies under long-term contracts and from underground gas storage facilities (remaining at the disposal of PGNiG S.A.) – the demand for gas will exceed the volumes which the Company is able provide. This risk may arise even assuming the maximum use of import capacities. To note, given the legally required technical parameters necessary to deliver mandatory gas stocks to the system, a significant portion of the stocks had to be placed at the Mogilno underground gas storage cavern, which is a peak-demand storage facility. As a result, the mandatory stocks significantly limit the commercial use of the facility's storage capacity and deliverability.
As gas from mandatory stocks may be withdrawn only upon the Minister of Economy's consent and only after gas supply limits have been introduced for users, the Company may fail to ensure continuity of gas supplies to consumers. Notwithstanding the above, withdrawal of gas from stocks may lead to a situation where users face gas supply limits despite high volumes of gas held in storage.

The technology risk follows from the fact that the need to maintain mandatory stocks has a negative impact on the operating parameters of underground storage facilities. In a longer run, if gas is not drawn from water-drive storage facilities (such as the Husów Underground Gas Storage Facility), gas will migrate to the reservoir section with poorer porosity and permeability, which will lead to a decrease in gas withdrawal capacity. This will make gas withdrawal more difficult at the end of the withdrawal process, and will reduce withdrawal capacity in the next cycle. In order to restore the operating parameters of the facility, it may be necessary to inject more gas to increase buffer volumes, which will in turn entail additional costs.

Another consequence of maintaining mandatory stocks is that the storage capacities remain partially filled after the winter season is over, which reduces the injection capacities in the summer. In the 2013/2014 season, nearly a half of the total underground gas storage capacities are filled with mandatory stocks and base gas enabling mandatory stocks to be withdrawn by the statutory deadline. Injection of gas into storage during the summer season, when demand for gas is low, enables the Company to meet the summer minimum volume to be imported under the Yamal contract, as it increases total demand for natural gas. Consequently, PGNiG may not be able to meet its contractual obligations concerning supply of imported gas if the gas volumes in storage are high at the beginning of the summer season.

Geological and Mining Law

In 2013, legislative work was underway on a fundamental change in the regulatory regime for the exploration and production segment, comprising two bills: the draft act amending the Geological and Mining Law and certain other acts, and the draft act on the special hydrocarbon tax, and on amendment to the act on the tax on production of certain minerals and certain other acts. The draft acts provide for increasing the fiscal burden on production of minerals and for a change to the existing licensing system. In future, the amendments will adversely affect the profitability of PGNiG S.A.’s operations.

Tariff calculation

PGNiG’s ability to cover the costs of its core operating activities depends on the prices and charge rates approved by the President of the Energy Regulatory Office. However, the President of the Energy Regulatory Office does not always agree with the assumptions made by PGNiG S.A. with respect to the main cost drivers and profit targets allowing for business risks. Consequently, the prices and charge rates applied for by PGNiG S.A. and set in the tariff might adversely affect the Company’s profitability.

In previous years, the President of the Energy Regulatory Office unilaterally extended the effective tariff periods. The Company is of the opinion that such actions by the President of the Energy Regulatory Office create the risk of a tariff being set below costs, as it does not account for the cost of gas fuel supplies in the period by which the tariff’s effective period is so extended. As a result, it should be expected that in the next rounds of tariff approval, this factor may be taken into consideration in the tariff calculation. Moreover, the President of the Energy Regulatory Office may protract the tariff approval proceedings, with tariffs approved at later dates than those originally requested by PGNiG S.A.

Demand for natural gas

The current methodology for calculation of prices and charge rates is based on demand forecasts; accordingly, revenue is exposed to forecasting risk. Inaccurate estimates of demand, affecting the accuracy of forecast purchase and supply volumes, as well as costs on which the determination of prices and charge rates is based, may adversely affect the Company’s financial performance.

Purchase prices of imported gas

Prices of imported gas are denominated in USD or EUR and are based on indexation formulae reflecting the prices of petroleum products and/or natural gas prices quoted on western markets. Changes in foreign exchange rates and prices of petroleum products have a material effect on the cost of imported gas. Material changes in prices of fuels on the international market affect the prices of imported gas. Any precise forecast of changes in natural gas prices carries a high risk of error. There is a risk that, despite the legal possibility of adjusting the prices already approved for a tariff term, an increase in the prices of imported gas will not be fully passed on to customers, or that changes in gas sale prices will lag behind changes in its import prices.

Take-or-pay gas delivery contracts

PGNiG S.A. is a party to four long-term take-or-pay contracts for gas fuel deliveries to Poland, of which the most important are contracts with Gazprom Eksport and Qatargas Operating Company Ltd. Assuming that PGNiG S.A.’s customer portfolio remains unchanged, the volume of gas imports specified in the take-or-pay contracts will limit its purchases of spot gas, currently the most attractively priced. If PGNiG S.A. loses its market share, there is a risk that the Company will have to look for new opportunities to sell or utilise surplus gas to avoid payment of penalties for the uncollected quantities under the take-or-pay contracts, or to sell the surplus with a negative margin. There is also a risk that if Polskie LNG S.A. fails to place the LNG Terminal in operation by

December 31st 2014, PGNiG S.A. will have to pay penalties for uncollected quantities of liquefied natural gas, as required under the take-or-pay contract with Qatargas Operating Company Ltd. Another risk is that with the existing contract terms and market conditions, the tariffs approved by the President of the Energy Regulatory Office will not cover PGNiG S.A.'s weighted average cost of gas acquisition.

Section V: Exploration and Production

The segment's business focuses on extracting hydrocarbons from deposits and preparing products for sale. The segment comprises the entire process of oil and gas exploration and production, from geological analyses, to geophysical surveys and drilling work, to field development and hydrocarbon production. It relies on storage capacities available at the Daszewo and Bonikowo Underground Gas Storage Facilities.

1. Exploration

Exploration in Poland

In 2013, PGNiG S.A. was engaged in exploration for both conventional and unconventional gas (shale gas and tight gas). In Poland, PGNiG S.A. carried out exploration and appraisal work, both on its own and jointly with partners, in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands. Drilling work in Poland was performed on 27 exploratory wells, including 7 research boreholes and 6 appraisal wells.

In 2013, 16 wells were tested, including 7 wells drilled in previous years. The tests confirmed the presence of gas in 9 wells: 4 exploratory wells and 5 appraisal wells. 7 wells did not flow hydrocarbons at commercial rates.

2 wells were tested in search for unconventional deposits. Drilling work was performed on 8 wells, with 6 reaching the target depths.

As at December 31st 2013 (i.e. as at the reporting date – although, in accordance with the Geological and Mining Law, the final calculation of reserves is made in March), the Company's recoverable reserves were:

- 85.5bcm of natural gas measured as high-methane equivalent,
- 19.2m tonnes of crude oil with condensate.

Exploration abroad

In 2013, PGNiG S.A. conducted exploration work within Egypt's Bahariya licence area (Block 3) under an *Exploration and Production Sharing Agreement* (*EPSA*) executed with the government of Egypt on May 17th 2009. The Company holds a 100% interest in the licence. In 2013, two exploration wells were drilled, but the wells were abandoned as they did not flow hydrocarbons at commercial rates. The Bahariya licence's potential was re-evaluated based on newly acquired geological data, which proved that further work was not economically viable. Therefore, a decision was made to terminate the licence and liquidate the Egypt branch.

2. Joint ventures

Joint ventures in Poland

In 2013, PGNiG S.A. conducted joint operations with other entities in licence areas awarded to PGNiG S.A., FX Energy Poland Sp. z o.o., and San Leon Energy PLC (the company acquired licence interests from the former partner, Aurelian Oil & Gas PLC).

In addition, in 2013 PGNiG S.A., Tauron Polska Energia S.A., KGHM Polska Miedź S.A., PGE Polska Grupa Energetyczna S.A. and Enea S.A. held negotiations to work out the detailed terms of their cooperation under the framework agreement of July 4th 2012 (concerning exploration for and production of shale gas and oil within the Wejherowo licence area). The framework agreement expired on December 31st 2013 due to non-fulfilment of certain conditions defined therein.

On August 14th 2013, PGNiG S.A. and LOTOS Petrobaltic S.A. signed an agreement for joint operations within the Kamień Pomorski licence area. The performance of the agreement will be possible upon fulfilment of certain conditions precedent, i.e. if positive tax interpretations are obtained from the Ministry of Finance and sub-lease of the mining usufruct (mineral extraction rights) is approved by the Ministry of Environment. By the end of 2013 not all of the conditions precedent had been fulfilled.

Under the licences awarded to PGNiG S.A., work continued in the following areas:

- "Płotki" – under the agreement for joint operations dated May 12th 2000; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Płotki" – "PTZ" (the Extended Zaniemyśl Area) – under the Operating Agreement dated October 26th 2005; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 24.5%, Calenergy Resources Poland Sp. z o.o. – 24.5%;
- "Poznań" – under the agreement for joint operations dated June 1st 2004; licence interests: PGNiG S.A. (operator) – 51%, FX Energy Poland Sp. z o.o. – 49%;
- "Bieszczady" – under the agreement for joint operations dated June 1st 2007; licence interests: PGNiG S.A. (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%;
- "Sieraków" – under the agreement for joint operations dated June 22nd 2009; licence interests: PGNiG S.A. (operator) – 51%, Orlen Upstream Sp. z o.o. – 49%;

Under licences awarded to FX Energy Poland Sp. z o.o., work was conducted in the following areas:

- "Warszawa-Południe" (blocks 254 and 255) – under the agreement for joint operations dated May 26th 2011; licence interests: FX Energy Poland Sp. z o.o. (operator) – 51%, PGNiG S.A. – 49%;
- "Ostrowiec" – under the agreement for joint operations dated February 27th 2009; licence interests: FX Energy Poland Sp. z o.o. (operator) – 51%, PGNiG S.A. – 49%;
- "Kutno" – under the agreement for joint operations dated September 30th 2010; licence interests: FX Energy Poland Sp. z o.o. (operator) – 50%, PGNiG S.A. – 50%.

Under licences awarded to San Leon Energy PLC, work was conducted in the following areas:

- "Karpaty Zachodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy PLC); licence interests: Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (operator) – 60%, PGNiG S.A. – 40%;
- "Karpaty Wschodnie" − under the agreement for joint operations dated December 17th 2009, concluded with Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (a subsidiary of San Leon Energy

PLC); licence interests: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG S.A. – 20%.

Joint ventures abroad

PGNiG S.A. conducts exploration work in Pakistan under an agreement for hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. and the government of Pakistan on May 18th 2005. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd., with production and expenses shared in proportion to the parties’ interests in the licence: PGNiG S.A. (operator) – 70%, PPL – 30%. In 2012, the operator decided to move to the second exploration stage on the Kirthar licence, as part of which a new exploration well is to be drilled by July 2014. In 2013, the construction of pipelines and temporary surface installations was completed and test production from the Rehman-1 and Hallel X-1 wells began. The gas produced is sold to the Pakistani transmission system. Also in 2013, preparatory work began for drilling of the Rizq-1 exploration well, which is scheduled for 2014.

3. Production

In 2013, in the territory of Poland, PGNiG S.A. produced natural gas and crude oil both on its own and jointly with partners. In 2013, gas production was also launched from the Rehman field (tight gas) in Pakistan.

Natural gas and crude oil in Poland is extracted by two branches of PGNiG S.A.: the Zielona Góra Branch and the Sanok Branch. In 2013, the number of production facilities was reduced following their merger. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 22 sites, including 13 gas production facilities, 6 oil and gas production facilities and 3 oil production facilities. The Sanok Branch produces high-methane and nitrogen-rich natural gas and crude oil at 38 sites, including 20 gas production facilities, 12 oil and gas production facilities and 6 oil production facilities.

In the same period, PGNiG S.A. produced a total of 4,242.3 mcm of natural gas (high-methane gas equivalent), of which 4,211.2 mcm was produced from fields in Poland, and 31.1 mcm from fields abroad. Lower-than-forecast production levels were due to the geological conditions in producing formations, as well as to limited gas offtake by certain industrial customers.

Following the launch of production from the Lubiatów, Międzychód and Grotów (LMG) fields, the crude output increased significantly, to 815.4 thousand tonnes. Since 2013, crude oil and condensate production have been presented jointly, which is why production forecasts had to be adjusted accordingly (see Current Report No. 166/2013). Natural gas and crude oil production volumes are presented in the table below.

Production volumes

	Product	Unit	2013	2012
1.	Natural gas, including:	mcm	4,242.3	4,317.3
a.	high-methane gas, including:	mcm	1,550.5	1,607.6
	- Zielona Góra Branch	mcm	0.0	0.0
	- Sanok Branch	mcm	1,550.5	1,607.6
b.	nitrogen-rich gas, including:	mcm*	2,691.8	2,709.7
	- Zielona Góra Branch	mcm*	2,574.1	2,625.6
	- Sanok Branch	mcm*	86.6	84.1
	- Pakistan Branch	mcm*	31.1	0.0
2.	Crude oil, including:	thousand tonnes	815,4	491.6
	- Zielona Góra Branch	thousand tonnes	766.4	442.0
	- Sanok Branch	thousand tonnes	49.0	49.6

* Measured as high-methane gas equivalent.

In 2013, in the Sanok Branch area ten new gas wells were brought on stream (including two wells on test production). The total addition to gas production capacity from the new wells is approximately 3.9 thousand cubic metres of gas per hour (high-methane gas equivalent). In the Zielona Góra Branch area, six new oil wells were brought on stream, with an aggregate production capacity of 620 tonnes per day; as well as two gas wells, with an aggregate capacity of 6.4 thousand cubic metres per hour (high-methane gas equivalent). In addition, the Winna Góra and the Lisewo gas fields, with an aggregate production capacity of 5.5 thousand cubic metres per hour (high-methane gas equivalent), were also brought on stream in partnership with FX Energy Poland Sp. z o.o.

Underground gas storage facilities

In 2013, the Exploration and Production segment used the working capacities of the Daszewo and Bonikowo nitrogen-rich gas storage facilities. Storage capacities used to meet the needs of the Production segment are not storage facilities within the meaning of the Polish Energy Law.

The table below presents the working capacities of the underground storage facilities used by the Exploration and Production segment as at December 31st 2012 and December 31st 2013.

Working capacities of the underground storage facilities used by the Exploration and Production segment (mcm)

Nitrogen-rich gas	2013	2012
Daszewo (Ls)	30.0	30.0
Bonikowo (Lw)	200.0	200.0

4. Sales of key products

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

In 2013, PGNiG S.A.'s sales of natural gas totalled 754.6 mcm, of which 723.8 mcm was sold in Poland, and 30.8 mcm was sold in Pakistan. The table below presents volumes of natural gas (including LNG) sold directly from the fields, and volumes of crude oil and other fractions, as well as other products sold to third-party customers.

Sales of key products

		Unit	2013	2012
1	Natural gas, including:	mcm	754.6	723.4
	- high-methane gas	mcm	72.2	72.0
	- nitrogen-rich gas*	mcm	682.4	651.4
2	Crude oil	thousand tonnes	809.5	484.6
3	Helium	mcm	2.9	3.3
4	Propane-butane	thousand tonnes	29.9	22.6
5	Nitrogen	thousand kilograms	452.7	505.2
6	Sulfur	thousand tonnes	38.1	25.3

*Measured as high-methane gas equivalent.

In Poland, the largest amounts of natural gas were sold to industrial customers, accounting for 80% of the total sales volume. In 2013, PGNiG S.A. sold crude oil to Rafineria Trzebinia S.A., Rafineria Nafty Jedlicze S.A., TOTSA TOTAL OIL TRADING S.A. and BP Europe SE.
PGNiG S.A.'s foreign customers accounted for 49.8% of the total crude sales in volume terms, for 85.8% of helium sales and for 22.5% of sulfur sales. Crude oil was exported through the Druzhba pipeline to a German refinery. Most of the helium was sold to EU customers, and the sulfur was sold to customers in Germany and the Czech Republic.

On October 3rd 2013, PGNiG S.A. and PGE Górnictwo i Energetyka Konwencjonalna S.A. signed an agreement for supply of nitrogen-rich gas from the local wells to the new CCGT unit at the Gorzów CHP plant. The term of the agreement is 20 years from the beginning of gas deliveries. The deliveries will commence once the new unit is placed in operation. The value of the agreement over its entire term is estimated at approximately PLN 3bn.

Also in 2013 PGNiG S.A. executed the following crude oil sales agreements:

- Short-term agreement with TOTSA TOTAL OIL TRADING S.A. for test deliveries of crude oil from the Lubiatów field;
- Annex to the agreement with TOTSA TOTAL OIL TRADING S.A., executed indefinite term; the value of the agreement in the period from November 2013 to December 2015 is approximately PLN 1.4bn; the crude is delivered to the buyer from the Lubiatów and Dębno facilities via the Druzhba pipeline;

- Agreement with BP Europe SE for the period from November 13th 2013 to December 31st 2014; the value of the agreement is approximately PLN 420m; the crude is delivered to the buyer from the Lubiatów facility via the Druzhba pipeline;
- Agreement with Grupa LOTOS S.A., for 2015-2019, with an option of its extension for indefinite period; the estimated value of the agreement is approximately PLN 3.2bn; the crude oil, to be delivered to the Gdańsk refinery from January 1st 2015, will be collected by the buyer from PGNiG's railway terminals at the PGNiG Zielona Góra Branch.

5. Planned activities

Exploration

In 2014, PGNiG S.A. will continue its exploratory, geophysical and drilling work in Poland on a number of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. The work will be conducted by PGNiG S.A. on its own and jointly with partners. The exploration for conventional reserves in less-well appraised area of the Carpathian Mountains will include continuation of drilling the deep Fredropol-1 well.

As part of these activities, PGNiG S.A. also intends to pursue projects focused on exploring new potential opportunities offered by unconventional resources (*shale gas/oil* and *tight gas*), where little appraisal has so far been made. In Pomerania, the Company plans to test the Opalino-3 well and drill several new wells in the Wejherowo, Kartuzy Szemud and Stara Kiszewa licence areas. In the Lublin Province, the Company will continue to drill the Kościaszyn-1 well.

In 2014, PGNiG S.A. will also continue its exploration work in Pakistan. In order to verify the potential of the structure located to the north of the Kirthar discovery, the Company plans to drill the Rizq-1 well.

Natural gas production

PGNiG S.A. is implementing an investment programme aimed at maintaining, in a long-term perspective, its natural gas production capacity. As part of the programme, PGNiG S.A. plans to develop new deposits and wells, modernise and expand the existing gas production facilities, build new underground gas storage facilities and expand the existing ones.

Within the Sanok Branch area, plans for 2014 include launch of production from new wells on the Przemyśl, Księżpol and Lubliniec-Cieszanów producing fields, as well as launch of production from the new Wola Rokietnicka and Pogwizdów fields. Within the Zielona Góra Branch area, it is planned that in 2014 the production will be launched from new wells on the Radlin, Daszewo, Zaniemyśl, Wilków and Lisewo producing fields. Launch of production from the new Komorze field is also planned. The project will be executed in partnership with FX Energy Poland Sp. z o.o.

6. Risks related to exploration and production

Resource discoveries and estimates

The main risk inherent in exploration activities is the risk of failure to discover resources, i.e. exploration risk. This means that not all the identified potential deposit sites actually have deposits of hydrocarbons which can qualify as an accumulation.

The reserves estimates and production projections may be erroneous due to imperfections inherent in the equipment and technology, which affect the quality of the acquired information concerning the geological factors and the characteristics of the deposit site. Irrespective of the methods applied, data on the volume and quality of commercial reserves of crude oil and natural gas is always an estimate. Actual production, income and expenses relating to a given deposit may significantly differ from the estimates. The weight of this risk is further increased by the fact that in the full business cycle the period from the commencement of exploration to the launch of production from a developed field takes six to eight years, while the production lasts from 10 to 40 years. Formation characteristics determined at the stage of preparing the relevant documentation are reviewed after production starts. Each downgrade of the size of the reserves or production quantities may lead to a lower revenue and adversely affect PGNiG S.A.'s financial performance.

Exploration for unconventional deposits of gas

The risk associated with exploration for unconventional deposits of gas in Poland relates to the lack of confirmed presence of *shale gas* and *tight gas*. Furthermore, even if existence of in-place petroleum is confirmed, its production may prove uneconomic due to insufficient gas recovery rates and high investment expenditure necessary to drill wells and construct production facilities. Another material factor is connected with difficult access to unconventional gas plays given the environmental regulations and the necessity to obtain the landowners' consent for access to the area.

Delayed work

Under the applicable Polish legal regulations, obtaining a licence for exploration for and appraisal of crude oil and natural gas deposits lasts from one to one and a half years. On foreign markets, such procedures may take even two years from the time that the winning bid is awarded in a licensing tender for until the relevant contract is ratified. Prior to the commencement of field work, the Company is also required to make a number of arrangements, including obtaining formal and legal permits and approvals for entering the area, meeting environmental protection-related requirements and, in some cases, requirements related to protection of archaeological sites, and abiding by the regulations governing tenders held to select a contractor, which delays execution of an agreement with a contractor by another few months. Frequently the waiting time for customs clearance of imported equipment is very long. These factors create the risk of delays in the start of exploration work.

Formal and legal hurdles beyond PGNiG S.A.'s control include:

- local governments' failure to approve local zoning plans or amendments to those already approved;
- obstacles in having investment projects incorporated into the local zoning plans;
- need to obtain and comply with administrative or other formal and legal decisions, including environmental decisions or building permits;
- amendments to the current investment project;
- obstacles in obtaining permission from land owners to enter the site.

These factors significantly delay implementation of investment projects and commencement of on-site construction work. Further, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently protracts the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

Exploratory work is capital intensive, given the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed onto 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. Moreover, profitability of foreign exploration projects depends to a significant extent on the prices of oil derivative products and on exchange rates. To reduce drilling costs, PGNiG S.A. introduced the *daily rate* system into its drilling contractors selection procedure in 2011.

Qualified personnel

The presence of foreign companies on the Polish market has intensified competition for highly qualified employees with extensive professional experience. This risk of losing experienced personnel is especially high with respect to oil and gas exploration professionals. In countries where PGNiG S.A. operates, highly qualified staff is difficult to recruit.

Competition

Both on the Polish market and abroad there is a risk of competition from other companies in the area of acquisition of licences for exploration for and appraisal of hydrocarbon deposits. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have greater financial resources than those available to PGNiG S.A. Thus, it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences, offering better terms than PGNiG S.A. could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

Safety, environmental protection and health regulations

Ensuring compliance with environmental laws in Poland and abroad may significantly increase PGNiG S.A.'s operating expenses. Currently, PGNiG S.A. incurs significant capital expenditure and costs on ensuring compliance of its operations with ever more complex and stringent regulations concerning safety and health at work, as well as environmental protection. The act of May 18th 2005 amending the Natural Environment Protection Law and certain other acts (Dz.U. No. 113, item 954 of June 27th 2005) rendered the regulations governing the execution of projects which might affect Natura 2000 sites more stringent and enhanced the environmental protection-related requirements with regard to entering the areas of the occurrence of protected plant species and habitats of protected animals.

Changes in laws and regulations

Frequent changes in laws and regulations (especially in countries with authoritarian regimes) may cause difficulties for entities involved in exploration activity.

Unforeseen events

Hydrocarbon deposits developed by PGNiG S.A. are usually located at great depths, which involves extremely high pressures and, in many cases, the presence of hydrogen sulfide. Consequently, the risk of hydrocarbon blowout or leakage is very high, which in turn may pose a threat to people (workers and local population), natural environment and production equipment.

Section VI: Trade and Storage

The segment sells both imported and domestically-produced natural gas. Imported natural gas is purchased chiefly from markets east of Poland. Sale of natural gas through the distribution and transmission network is regulated by the Polish Energy Law, and gas prices are determined based on tariffs approved by the President of the Energy Regulatory Office. The segment also trades in electricity, certificates of origin for electricity, and CO_2 emission allowances. The segment operates six underground gas storage facilities (Brzeźnica, Husów, Mogilno, Strachocina, Swarzów and Wierzchowice).

1. Gas purchases

In 2013, PGNiG S.A. purchased gas from abroad and, to a limited extent, from domestic suppliers. PGNiG SA bought natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with OOO Gazprom Export and short- and medium-term gas supply agreements with European suppliers:

- Contract with OOO Gazprom Export for sale of natural gas to the Republic of Poland, dated September 25th 1996, effective until December 31st 2022;
- Individual transactions for natural gas supplies, including with the use of reverse flow on the Yamal Pipeline, with PGNiG Sales & Trading GmbH;
- Individual Agreement with Vitol S.A. for sale of natural gas, dated May 13th 2011, effective until October 1st 2014;
- Agreement with VNG-Verbundnetz Gas AG for sale of Lasów natural gas, dated August 17th 2006, effective until October 1st 2016.

The table below presents the structure of natural gas purchases, measured as high-methane gas equivalent.

Structure of natural gas purchases, by supply sources (mcm)

	2013	%	2012	%
Foreign suppliers:	10,850.0	96.5%	10,999.9	98.9%
- Gazprom Export	8,733.3	80.5%	9,017.3	82.0%
- Other foreign suppliers	2,116.7	19.5%	1,982.6	18.0%
Domestic suppliers	389.7	3.5%	127.2	1.1%
Total	11,239.7	100.0%	11,127.1	100.0%

On November 6th 2013, PGNiG S.A. and NAK Naftogaz Ukrainy signed an arrangement to terminate the agreement for supplies of natural gas of October 26th 2004. This was due to the fact that on January 1st 2011 NAK Naftogaz Ukrainy suspended gas deliveries via the Zosin cross-border point on the Polish-Ukrainian border. The decision to terminate the agreement will not preclude any future cooperation with the Ukrainian partner on new terms. PGNiG customers in the Hrubieszów area receive natural gas from the Polish transmission system through the Lubaczów-Krasnystaw gas pipeline.

New contracts

In 2013, PGNiG S.A. and PGNiG Sales & Trading GmbH executed short-term contracts for the supply of ca. 1,210.3 mcm of natural gas, including 760.3 mcm using the reverse flow service on the Yamal Pipeline.

2. Sales

In 2013, PGNiG S.A. executed contracts for the supply of gas fuel, both from the transmission system and from the distribution system, to 86.9 thousand new customers.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. PGNiG S.A. sold gas on the Polish market. The sales structure of the Trade and Storage segment in 2013 is presented in the table below.

Sales structure of key products

		Unit	2013	2012
1	Natural gas, including:	mcm	14,128.9	14,005.4
	- high-methane gas	mcm	13,602.9	13,497.3
	- nitrogen-rich gas*	mcm	526.0	508.1
2	Propane-butane	thousand tonnes	1.4	1.5

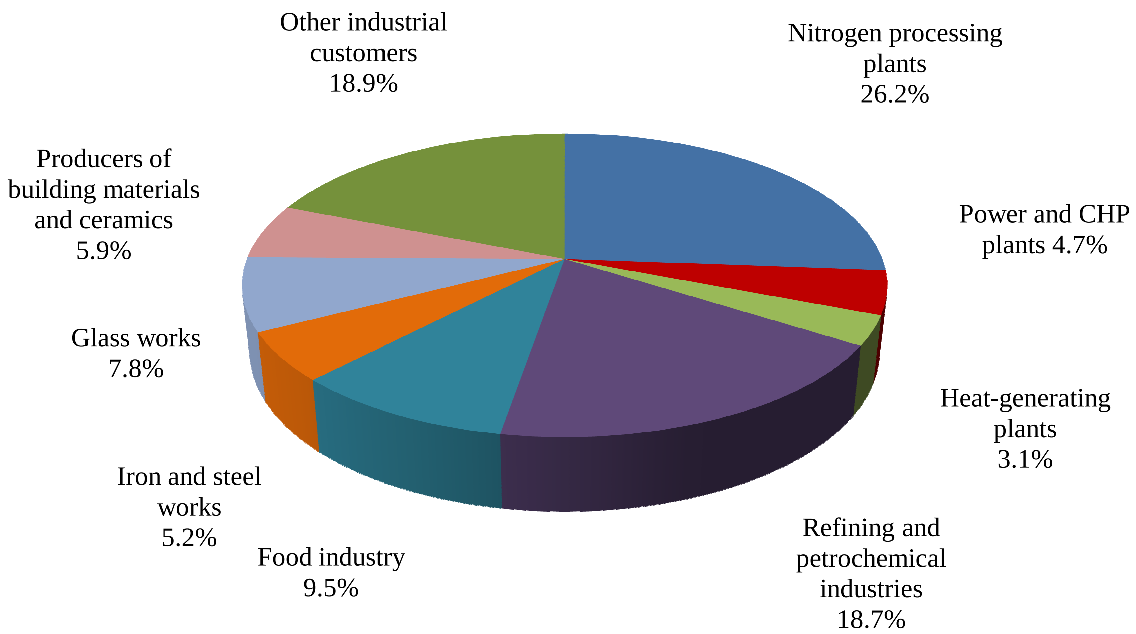
*Measured as high-methane gas equivalent.

Gas was purchased primarily by industrial customers (mainly in the chemical, oil refining, petrochemical and metallurgical sectors) and by households. The latter were identified as the largest customer group (approximately 6.5m), accounting for 97% of the entire PGNiG customer base. Compared with 2012, the volume of gas sales to this customer group rose by about 2%. Industrial customers had the largest share in the sales volume, though sales to this group fell by approximately 3% on 2012. PGNiG S.A. began selling gas on the Polish Power Exchange, where it sold 66 mcm of gas in 2013. The table below presents the structure of sales of natural gas (measured as high-methane gas equivalent) by customer groups.

Sales of natural gas through the national grid (mcm)

	2013	%	2012	%
Industrial customers	8,127.0	57.5%	8,407.2	60.0%
Trade and services	1,701.5	12.0%	1,524.2	10.9%
Households	3,919.3	27.8%	3,851.6	27.5%
Wholesale customers	230.9	1.6%	222.4	1.6%
Exports	83.9	0.6%	0.0	0.0%
Exchange	66.3	0.5%	0.0	0.0%
Total	14,128.9	100.0%	14,005.4	100.0%

Structure of natural gas sales in 2013 {sp} to industrial customers



In September 2013, PGNiG S.A. became a member of the London-based ICE Futures exchange, thanks to which it can now enter into transactions on the European largest platform for trading in emission allowance futures contracts.

On November 1st 2013, PGNiG S.A. became the first direct member of the gas market at the Polish Power Exchange. Earlier, the Company had executed trades at the exchange through commodity brokers. The Company also agreed to act as a market maker in the natural gas futures market, and to regularly place both sell and buy orders on this market. The market maker's key role is to enhance the market's liquidity and transparency.

<u>New contracts</u>

On October 25th 2013, PGNiG S.A. executed a framework agreement with Ukraine-based DTEK Trading for supply of natural gas to evaluate the possibility of natural gas transmission across Poland to the Polish transmission system's exit point in Hermanowice. Three individual gas supply transactions were executed under the agreement, for the following periods: from October 28th to October 31st 2013, from November 6th to November 12th 2013 and from November 9th to December 1st 2013. The aggregate volume of gas supplied was 83.9 mcm.

On January 30th 2014, PGNiG S.A. and KGHM Polska Miedź S.A. signed an annex to the comprehensive gas fuel supply contract of July 30th 2010 for period until June 30th 2033. Under the annex, the annual volume of gas supplies was reduced from 266mcm to 41.5mcm. The change follows from a decision by KGHM to reduce the output of co-generated electricity and heat due to changes in the co-generation support mechanisms in 2013 and low prices of electricity. The estimated value of the annexed contract is approximately PLN 830m. The parties may restore the original supply volume in future. The parties also signed annexes to the three other contracts for gas fuel supplies to KGHM, i.e. the contracts of September 25th 2001, January 4th 1999, and October 1st 1998. The annexes changed only the duration of the contracts, from indefinite term to the period until June 30th 2033. The estimated aggregate value of the three contracts over their entire term is approximately PLN 2.8bn.

PESO project

In 2013, PGNiG S.A. continued a project consisting in LNG-based distribution of gas fuel to customers in Ełk and Olecko. This project is a part of an initiative to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (PESO project). The project involves construction of an LNG regasification station and two-step pressure reduction, metering and odorising stations in Ełk and Olecko, and switching customers in those towns to high-methane gas. In 2013, the Company commenced construction of an LNG regasification station and pressure reduction and metering stations in Ełk and Olecko.

Consolidation of trading operations

On May 27th 2013, the Wholesale Trading Branch was established. The Branch’s operations involve wholesale trade in natural gas, electricity, heat, certificates of electricity origin and CO_2emission allowances. Then, on July 23rd 2013 PGNiG S.A. merged with PGNiG Energia S.A. As a result, wholesale trading in electricity and related products was consolidated within the Wholesale Trading Branch.

3. Electricity

In 2013, PGNiG S.A. engaged in wholesale trading in electricity and related products in Poland and Germany. In Poland, the Company traded on the OTC market (under EFET (European Federation of Energy Traders) standard agreements and through brokers) and on the Polish Power Exchange. In Germany, the Company engaged in spot contract trading on the EPEX (European Power Exchange) Spot market, and in the inter-system Poland-Germany exchange (between the areas covered by PSE and 50 Hertz Transmission).

Purchase of electricity

In 2013, PGNiG S.A. purchased 3,830.3 GWh of electricity, with ca. 61% of that amount representing purchases from PGNiG TERMIKA S.A.

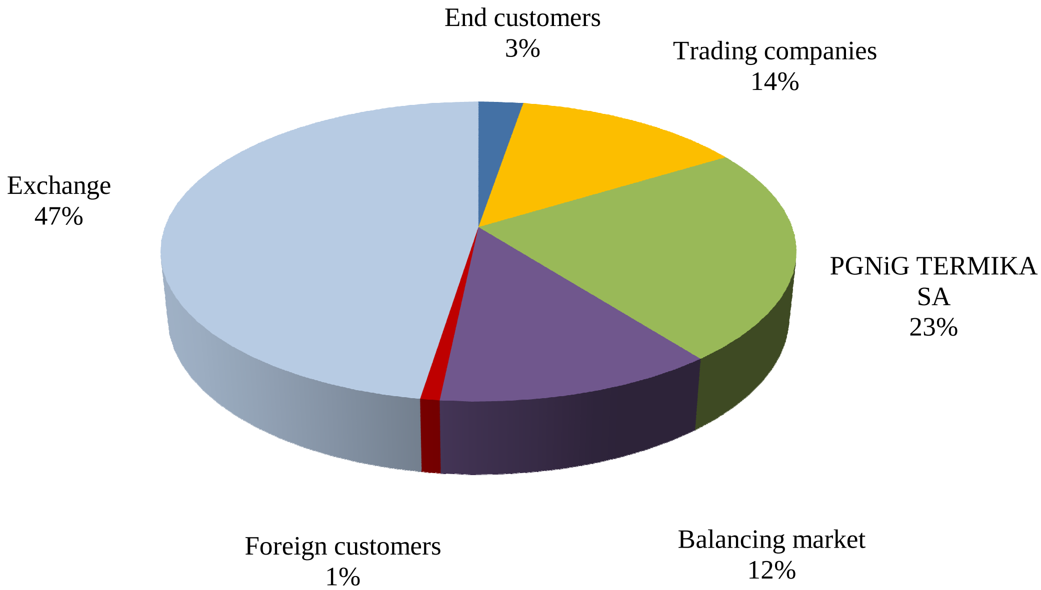
Sales of electricity

PGNiG S.A. expanded its offering by launching sales of electricity to business customers (tariff groups A, B and C). The Company also began preparations to launch sales of electricity to households (tariff group G).

PGNiG S.A. sells electricity with fixed price guarantee (for periods as long as until 2016) and offers full balancing of customers’ electricity requirements. In October 2013, PGNiG S.A. launched a promotional campaign “Energia w dwupaku”, (“Energy double play”), as part of which it offers to subsidise its customers’ electricity bills. This offer is addressed primarily to small and medium-sized companies which already buy gas from the Company or want to sign gas-supply contracts with PGNiG S.A.

In 2013, PGNiG S.A. sold 3,719.5 GWh of electricity. The chart below presents the structure of electricity sales in 2013 by customer groups.

Sales of electricity by customer groups in 2013



4. Storage

The Trade and Storage segment uses for its own needs the working capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica underground gas storage facilities, as well as the Mogilno Underground Gas Storage Cavern Facility. A part of the working capacity of the Mogilno facility, which was made available to OGP GAZ-SYSTEM S.A., is not a storage facility within the meaning of the Polish Energy Law.

Short-term peak fluctuations in demand for natural gas are balanced by the supplies from the Mogilno facility, where gas is stored in worked-out caverns. The capacities of the Wierzchowice, Husów, Strachocina, Swarzów and Brzeźnica facilities are used to minimise the effect of changes in demand for natural gas in the summer and winter seasons, to meet the obligations under the *take-or-pay* import contracts, to ensure the continuity and security of natural gas supplies, and to meet the obligations under contracts for gas deliveries to customers’ premises.

The capacities of the Wierzchowice, Husów, Mogilno and Strachocina facilities are also used by PGNiG S.A. to meet its obligation to maintain mandatory stocks, imposed by the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of Threat to National Fuel Security or Disruptions on the Petroleum Market, dated February 16th 2007. The table below presents working capacities of the storage facilities as at December 31st 2012 and December 31st 2013.

Working capacities of the storage facilities used by the Trade and Storage segment (mcm)

	Dec 31 2013	Dec 31 2012
Brzeźnica underground gas storage facility	65.0	65.0
Husów underground gas storage facility	350.0	350.0
Mogilno underground gas storage cavern facility	407.9*	411.9*
Strachocina underground gas storage facility	330.0	330.0
Swarzów underground gas storage facility	90.0	90.0
Wierzchowice underground gas storage facility	575.0	575.0
Total	1,817.9	1,821.9

*The working capacity of the facility was reduced as a result of the process of convergence (tightening) of the salt rock mass.

5. Planned activities

Purchases of natural gas

In 2014, PGNiG S.A. will continue to purchase imported gas under the long-term contract with OOO Gazprom Export and short- and medium-term gas supply contracts with European suppliers. With a view to optimising the costs of gas purchases, the Company will purchase natural gas on the German market, under short-term contracts. The gas will be delivered using the virtual reverse flow service on the Yamal gas pipeline.

Electricity

In 2014, PGNiG S.A. plans to launch electricity sales to retail customers, and to add energy products to its offering for business customers.

Storage

In 2014, PGNiG S.A. will continue work on extending the Mogilno cavern facility and the Husów facility. The Company will also continue the construction (begun in 2007) of the Kosakowo underground gas storage cavern for high-methane gas.

6. Risks related to Trade and Storage

Obligation to diversify imported gas supplies

The maximum share in total gas imports of gas importable from one country in a given year is determined in the Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies. In 2012, the President of the Energy Regulatory Office instigated administrative proceedings to impose a fine on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2010 and 2011 – on May 11th and December 5th, respectively. Similar administrative proceedings were instituted by the President of the Energy Regulatory Office concerning PGNiG S.A.'s failure to comply with the obligation to diversify supplies of imported gas in 2007, 2008 and 2009. The 2009, 2010 and 2011 proceedings were suspended ex officio until the conclusion of the 2007 and 2008 proceedings, held before the Court of Competition and Consumer Protection.

On October 10th 2013, the Regional Court of Warsaw – the Court of Competition and Consumer Protection amended the decision issued by the President of the Energy Regulatory Office on December 16th 2010 (concerning a failure to comply with the obligation to diversify supplies of imported gas in 2007 and 2008), by reducing the imposed fine from PLN 2,000,000 to PLN 1,500,000, taking into consideration the narrow margin of failure. The court also awarded an amount of PLN 115 from the Energy Regulatory Office as reimbursement of the cost of proceedings. In the remaining part, the appeal was dismissed. On January 21th 2014, PGNiG S.A. appealed against the decision to the Warsaw Court of Appeals.

On November 6th 2013, the President of the Energy Regulatory Office instigated administrative proceedings to impose a fine on PGNiG S.A. for its failure to comply with the obligation to diversify supplies of imported gas in 2009, 2010 and 2011. On November 19th 2013, PGNiG S.A. filed a complaint against those proceedings.

In order to avoid a similar situation in the future, in 2011 PGNiG S.A. submitted an inquiry to the Constitutional Court concerning the compliance of the Council of Ministers' Regulation of October 24th 2000 on the minimum level of diversification of foreign sources of gas supplies with the Polish Constitution.

If the Regulation is not amended, the President of the Energy Regulatory Office may continue imposing fines on the Company for failing to comply with the diversification requirement until gas starts to be supplied from other sources (e.g. through the LNG terminal).

Deregulation of gas prices

PGNiG S.A. is the largest supplier of natural gas in Poland. However, the pending gas market deregulation in Poland is bound to trigger major changes, in the market itself and in the related legal framework. In 2012, a natural gas market was launched on the Polish Power Exchange. Under a decision of the President of the Energy Regulatory Office, natural gas trading handled by PGNiG S.A. on the exchange is exempt from the tariff obligation. In 2012, PGNiG S.A. also started work on liberalisation of gas prices for customers. This will be implemented gradually, with gas prices for large industrial customers to be liberalised first. As a result of the expected changes, the Company's share in the natural gas market may fall, to the benefit of both existing and new gas trading entities.

Section VII: Other Activities

PGNiG S.A.'s organisational unit classified in the Other Activities segment is the Central Measurement and Testing Laboratory Branch. The Branch provides services ensuring accurate and reliable measurements of natural gas quality and volume. It also performs calibration and testing of measurement devices and systems used in the natural gas industry, including testing of new measurement and analysis apparatus. The Laboratory also offers occupational training and advisory services, issues opinions, prepares expert reports, as well as validates and supervises field quality-testing laboratories.

In 2013, the Laboratory's main areas of activity included:

- Metrological inspections of measurement systems on the Yamal-Europe transit gas pipeline (Polish section),
- Estimations of CO_2 emission indicators on the Yamal-Europe transit gas pipeline (Polish section),
- Metrological inspections of measurement systems at industrial customers' metering stations (27 facilities),
- Above-ground environmental testing at the underground gas storage facilities,
- Calibration of measurement equipment used in natural gas settlements,
- Checking of natural gas measurement systems for the purposes of assessment of CO_2 emissions by large industrial emitters,
- Technological and metrological supervision of gas meter attestation posts,
- Testing of ultrasound gas meters, including clamp-on meters,
- Analyses of sulfur content in natural gas,
- Measurement oversight of process analyser systems for the evaluation of gas quality in transmission and distribution networks, at production sites and in storage facilities, including for the purposes of implementing energy-unit-based settlement and balancing systems,
- Validations and measurement supervision of the field laboratories controlling the quality of natural gases,
- Development of analytic procedures, technical consultancy, mainly for LNG quality control and measurements (as part of preparatory work for acceptance of the LNG terminal in Świnoujście).

The Laboratory also participated in a consortium building a laboratory for high-pressure calibration of gas meters − an investment carried out by OGP GAZ-SYSTEM S.A. As a consortium member, the Laboratory is responsible for the set-up and preparation of documentation for the laboratory's quality management system.

The Laboratory mainly rendered its services to PGNiG Group entities, including Polska Spółka Gazownictwa Sp. z o.o., EUROPOL GAZ S.A. and OGP GAZ-SYSTEM S.A.

<u>Planned activities</u>

The Laboratory intends to continue the organisation and provision of industry training programmes that it launched in 2013. These involve training programmes in power engineering, construction and operation of gas networks, as well as verification of gas network construction, safety-at-work, fire-fighting and environmental protection qualifications.
The Laboratory intends to maintain its position as the leading research laboratory and attestation centre, carrying out metrological inspections of measurement systems and devices used in the natural gas industry. The Laboratory also intends to remain the key laboratory in the area of quality assessment of natural gases of all types and forms, including LNG, CNG and biogas; evaluation of measurement and process analyser systems used to estimate CO_2 emissions and other types of emissions; settlement of gas fuels in units of energy; and in the area of measurement supervision of field laboratories.

Moreover, the Laboratory intends to develop services related to measurement and settlement of LNG shipments by sea.

Section VIII: Investments

In 2013, capital expenditure incurred by PGNiG S.A. on property, plant and equipment and intangible assets was PLN 1,485m, having gone down by ca. 10% year on year. The table below presents expenditure in the individual segments.

Capital expenditure (PLNm)

	2013	2012
Exploration and Production	1,020	1,078
Trade and Storage	465	574
Other Activities	0	0
Total	1,485	1,652

Below are described the key capex projects implemented by PGNiG S.A. in 2013.

Exploration

The capital expenditure of PLN 626m incurred by PGNiG S.A. on exploration work was incurred chiefly on geophysical surveys, nine wells drilled with positive results and wells on which work is still underway.

Lubiatów-Międzychód-Grotów project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów ("LMG") oil and gas field and to enable the transport, storage and sale of crude oil, natural gas, liquid sulfur and propane-butane from the LMG Oil and Gas Production Facility. The LMG project involves:

- Construction of the LMG Central Facility to serve as a hub for collection, distribution and treatment of reservoir fluids
- Construction of the Dispatch Terminal in Wierzbno (sub-project completed in previous years)
- Construction of a gas pipeline to the Grodzisk nitrogen rejection unit to provide for transmission of surplus gas from the LMG Oil and Gas Production Facility to the Grodzisk nitrogen rejection unit.

In 2013, the LMG Central Facility was placed in service and construction of the high-pressure gas pipeline from the Wierzbno terminal to the Paproć gas production facility was completed. With its completion, the entire project was also completed, at a total capex of ca. PLN 1,627m.

Other investment projects in the Exploration and Production segment

Other investment projects involved the development of gas reserves (including already producing fields), projects executed to sustain or restore hydrocarbon production rates, and projects for the operation of the hydrocarbon production area. The key investment projects included:

- Upgrade and extension of the existing gas production facilities
- Commencement of upgrade of the processing line at the Zielin oil and gas production facility and development of the Różańsko field
- Completion of development of wells in the Wola Różaniecka field
- Development of the Lisewo gas field
- Drilling work and development of a well in the Radlin field

- Drilling work and development of a well in the Daszewo field
- Completion of drilling work and commencement of the Księżpol 19 well development.

Trade and Storage

In 2013, capital expenditure of the Trade and Storage segment amounted to PLN 465m, of which PLN 402m was spent on underground gas storage facilities. Major projects in the area of underground gas storage facilities included:

- Completion of the construction of the surface section of the Wierzchowice Underground Gas Storage Facility and launch of the gas injection and withdrawal cycle, as well as completion of technical acceptance of the storage facility
- Continued leaching work at the Mogilno Underground Gas Storage Cavern Facility (caverns Z-15, Z-16, and Z-17) and hydraulic leakage testing of the Z-13 cavern
- Extension of the Husów Underground Gas Storage Facility up to 500mcm of storage capacity.

Furthermore, the construction of the surface part and a leaching installation along with pipeline for brine discharge, as well as the leaching process of two of the first five caverns, were completed in 2013. Also, the trial operation of the facility was launched to establish its technical parameters and operating profile. In December 2013, the final acceptance of the storage facility (consisting of two caverns with an approximate capacity of 61mcm) took place. The expenditure incurred in 2013 was close to PLN 140m. The project was co-financed by the EU.

Section IX: Environmental protection

Well and extraction pit abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to properly abandon worked-out extraction pits, eliminate the danger and repair any damage caused by mineral extraction, and restore the land to its original condition. Plugging of wells and pits prevents leakage of crude oil and natural gas to the surface and into water courses. Furthermore, if gas wells remain unplugged, there is a risk that escaping gas could accumulate, posing a fire hazard. In 2013, a total of 25 wells and 18 extraction pits were abandoned.

Carbon credit trading system

In 2013, the Zielona Góra Branch and the Odolanów Branch, the Mogilno Underground Gas Storage Cavern Facility, as well as the LMG crude oil and natural gas production facility, were covered by the carbon dioxide emissions trading scheme (ETS). The LMG oil and gas production facility joined the ETS scheme in October 2013. The facility has not yet been allocated free carbon dioxide emission allowances, and PGNiG S.A. will only be able to apply for them after the annual reports on carbon dioxide emissions for 2013 are reviewed. In 2013, emissions from the installations were 56,658 Mg CO_2.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG S.A. conducts diagnostic tests, surveys and land reclamation work in areas polluted in the course of past activities, with a view to restoring them to the condition required under the environmental quality standards. In 2013, the Company carried out reclamation work on properties with a total area of 665 m^2 in Kargowa, Radków and Łabiszyn, and commenced reclamation work on a property in Warsaw. The land reclamation work involves decommissioning of tar pits and removal of local soil contaminations (most often found near reservoirs) through their extraction and neutralisation by operators contracted by the Company. In 2013, work was performed to analyse the soil environment of a property in Działdów. The Company also monitored the soil-water environment of the reclaimed landfill site in Zabrze-Biskupice, and a property in Zabrze.

REACH and CLP

In 2013, PGNiG S.A. was supervising the compliance by its subcontractors using chemical substances for well treatments with the regulations of the European Parliament and of the Council of the European Union on safe use of chemicals (*REACH*) and on the classification, labelling and packaging of substances and mixtures (*CLP*). The Company also drew up contractual provisions, to be included in its hydraulic fracturing agreements, concerning the use of chemical substances and mixtures, which would facilitate the control of related hazards and ensure compliance with all requirements imposed by Polish and EU laws.

Environmental Management System

In 2013, PGNiG S.A. completed the first stage of the implementation of an Environmental Management System at its trading divisions. As part of the work, an environmental review was performed.

Section X: Other information

Distribution of the 2012 profit

On May 22nd 2013, the Annual General Meeting of PGNiG S.A. adopted a resolution on the distribution of the 2012 net profit of PLN 1,918.5m. The profit was distributed as follows:

- PLN 1,151.5m was allocated to the Company's statutory reserve funds
- PLN 767.0m was allocated for dividend payments (dividend per share of PLN 0.13).

In addition, retained earnings of PLN 625.9m were allocated to the Company's statutory reserve funds.

The Annual General Meeting of PGNiG S.A. set July 20th 2013 as the dividend record date and October 3rd 2013 as the dividend payment date.

Discharge granted to Management Board and Supervisory Board members in respect of their duties

On May 22nd 2013, the Annual General Meeting of PGNiG S.A. approved the financial statements and the Directors' Report on the operations of PGNiG S.A., as well as the consolidated financial statements and the Directors' Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG S.A. in respect of performance of their duties in the financial year 2012.

Legal actions against PI GAZOTECH Sp. z o.o.

Proceedings concerning PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to repeal or declare the invalidity of resolutions adopted by the Extraordinary General Meeting of PI GAZOTECH Sp. z o.o. on April 23rd 2004, including the resolution obliging PGNiG S.A. to pay an additional equity contribution in the amount of PLN 52m, were held in turn before the Regional Court of Warsaw, the Warsaw Court of Appeals and the Supreme Court. On June 25th 2010, the Regional Court granted PGNiG S.A.'s claims and declared the resolution concerning retirement of shares and the resolution concerning the additional equity contributions invalid. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, together with a request for a court fee waiver. On December 14th 2011, the Court of Appeals dismissed PI GAZOTECH Sp. z o.o.'s appeal. The judgment is final. On April 24th 2012, PI GAZOTECH Sp. z o.o. filed a cassation complaint. By virtue of its decision of March 13th 2013, the Supreme Court refused to examine the cassation complaint. Thus the proceedings in this case were concluded.

Proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to repeal or declare the invalidity of the resolution adopted by the Extraordinary General Meeting of PI GAZOTECH Sp. z o.o. on January 19th 2005, whereunder PGNiG S.A. was obliged to pay an additional equity contribution in the amount of PLN 25,999,998, were held before the Regional Court of Warsaw and the Warsaw Court of Appeals. By virtue of its ruling of October 18th 2010, the Regional Court of Warsaw invalidated the resolution. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, together with a request for a court fee waiver. By virtue of its decision of June 22nd 2012, the Warsaw Court of Appeals dismissed PI GAZOTECH Sp. z o.o.'s appeal. The judgment is final. On October 30th 2012, PI GAZOTECH Sp. z o.o. filed a cassation complaint. On August 14th 2013, the Supreme Court issued a decision refusing to examine the cassation complaint. Thus the proceedings in this case were concluded.

Proceedings before the President of the Polish Office of Competition and Consumer Protection (UOKiK)

On December 28th 2010, the President of the Polish Office of Competition and Consumer Protection ("UOKiK") instigated, ex officio, anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interests of other business players or consumers and in impeding the development of market conditions necessary for the emergence or development of competition by refusing to sell gas fuel under a comprehensive supply contract to an entrepreneur that intended to further resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. In its decision of July 5th 2012, the President of the UOKiK found these practices to be anti-competitive, concluded that PGNiG S.A. had discontinued those practices as of November 30th 2010, and imposed on the Company a fine of PLN 60,016,474.40. On July 24th 2012, PGNiG S.A. filed an appeal against the decision of the President of the UOKiK with the Competition and Consumer Protection Court at the Regional Court of Warsaw. As at the date of this report, the Competition and Consumer Protection Court had not notified PGNiG S.A. of a hearing date.

On February 9th 2012, the President of the UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG S.A. of practices infringing collective consumer interests. The President of the UOKiK accused PGNiG S.A. of using, in comprehensive gas fuel supply contracts, a provision classified as an abusive clause. In the course of the proceedings, PGNiG S.A. voluntarily agreed to revise certain contractual provisions. By virtue of a decision of August 10th 2012, the President of the UOKiK resolved not to impose a fine on PGNiG S.A. and obligated the Company to fulfil its commitment. On September 11th 2013, PGNiG S.A. notified the President of the UOKiK that it had fully complied with the obligation imposed on it by virtue of the above decision.

On February 22nd 2013, the President of the UOKiK instigated anti-trust proceedings concerning alleged employment by PGNiG S.A. of practices infringing collective consumer interests. The President of the UOKiK accused PGNiG S.A. of using provisions classified as abusive clauses in contract forms based on which comprehensive gas fuel supply contracts are concluded. PGNiG S.A. voluntarily agreed to revise the above contract forms with respect to the questioned clauses. By virtue of a decision of June 28th 2013, the President of the UOKiK resolved not to impose a fine on PGNiG S.A. and obliged the Company to fulfil its commitment. PGNiG S.A. is in the process of fulfilling this obligation.

On April 3rd 2013, the President of the UOKiK instigated anti-trust proceedings concerning alleged abuse by PGNiG S.A. of its dominant position on the domestic wholesale and retail natural gas market, which consisted in impeding the development of market conditions necessary for the emergence or development of competition by:

- limiting the ability of business customers to reduce ordered volumes of gas fuel and contractual capacity,
- limiting the ability of business customers to resell gas fuel,
- requiring that business customers define the maximum volume of gas fuel purchased for resale in the contract,
- refusing to grant wholesale customers the right to a partial change of supplier.

In the course of the proceedings, PGNiG S.A. voluntarily agreed to revise certain provisions in contracts with its non-household customers. By virtue of a decision of December 31st 2013, the President of UOKiK resolved not to impose a fine on the Company and obliged the Company to fulfil its commitment. PGNiG S.A. is in the process of fulfilling this obligation.

Proceedings with a value in excess of 10% of the Company's equity

In 2013, neither PGNiG S.A. nor its subsidiaries were engaged in any proceedings before a court, arbitration tribunal or administrative authority concerning liabilities or claims whose value (whether in any single case or in two or more cases jointly) would represent at least 10% of the Company's equity.

Section XI: Financial performance

1. Financial performance in 2013

The separate financial statements of PGNiG S.A. and the consolidated financial statements of the PGNiG Group for 2013 are audited by PKF Consult Sp. z o.o. The agreement with the auditor was signed on February 5th 2013, for three years (2013-2015). Detailed information on the auditor’s fees has been provided in the separate financial statements of PGNiG S.A. for the year ended December 31st 2013 (Note 37,5).

1.1. Key financial and business data

The separate financial statements of PGNiG S.A. for the year ended December 31st 2013 have been prepared in accordance with the International Financial Reporting Standards (IFRS) as endorsed by the European Union (“EU”) as at December 31st 2013.

The accounting policies applied in preparing the separate financial statements are presented in the separate financial statements of PGNiG S.A. for the year ended December 31st 2013 (Note 2).

In 2013, PGNiG S.A. posted a net profit of PLN 1,688m, down by PLN 222m year on year.

Summary information on PGNiG S.A.’s financial standing in 2013 relative to 2012 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

- statement of financial position,
- income statement,
- statement of cash flows,
- selected financial ratios.

Separate statement of financial position (PLNm)

ASSETS	Dec 31 2013	Dec 31 2012	Jan 1 2012
Total non-current assets	26,946	27,770	22,929
Property, plant and equipment	13,775	14,094	13,035
Investment property	1	2	3
Intangible assets	282	204	159
Financial assets available for sale	7,796	7,246	6,454
Other financial assets	4,668	5,780	2,902
Deferred tax assets	380	397	350
Other non-current assets	44	47	26
Total current assets	8,478	8,875	6,324
Inventories	2,707	2,427	1,897
Trade and other receivables	3,695	5,185	3,172
Current tax assets	-	24	5
Other assets	18	18	28
Derivative financial instrument assets	307	105	285
Cash and cash equivalents	1,683	1,043	936
Non-current assets held for sale	68	73	1
Total assets	35,424	36,645	29,253

Separate statement of financial position (PLNm) – contd.

LIABILITIES AND EQUITY	Dec 31 2013	Dec 31 2012	Jan 1 2012
Total equity	22,969	21,962	20,250
Share capital	5,900	5,900	5,900
Share premium	1,740	1,740	1,740
Accumulated other comprehensive income	14	(66)	135
Retained earnings	15,315	14,388	12,475
Total non-current liabilities	7,023	7,287	2,158
Borrowings and other debt instruments	4,432	4,390	-
Employee benefit obligations	154	89	97
Provisions	1,156	1,576	1,154
Deferred income	621	559	257
Deferred tax liabilities	609	632	634
Other non-current liabilities	51	41	16
Total current liabilities	5,432	7,396	6,845
Trade and other payables	2,888	2,774	2,660
Borrowings and other debt instruments	1,691	3,879	3,591
Derivative financial instrument liabilities	123	393	417
Current tax liabilities	175	-	-
Employee benefit obligations	117	191	86
Provisions	434	154	89
Deferred income	4	5	2
Total liabilities	12,455	14,683	9,003
Total liabilities and equity	35,424	36,645	29,253

Separate income statement (PLNm)

	2013	2012
Revenue	27,186	25,686
Total operating expenses	(25,053)	(23,882)
Raw materials and consumables used	(16,625)	(15,626)
Employee benefits	(970)	(997)
Depreciation and amortisation expense	(731)	(603)
Services	(6,101)	(5,815)
Work performed by the entity and capitalised	11	13
Other income and expenses	(637)	(854)
Operating profit	2,133	1,804
Finance income	1,020	728
Finance costs	(1,040)	(280)
Profit before tax	2,113	2,252
Income tax	(425)	(342)
Net profit	1,688	1,910

Separate statement of cash flows (PLNm)

	2013	2012
Net cash flows from operating activities	4,317	464
Net cash flows from investing activities	(413)	(4,566)
Net cash flows from financing activities	(3,262)	4,210
Net change in cash	642	108
Exchange differences on cash and cash equivalents	(2)	(1)
Cash and cash equivalents at beginning of the period	1,043	936
Cash and cash equivalents at end of the period	1,683	1,043
including restricted cash	476	238

Financial ratios

Profitability

	2013	2012
EBIT (PLNm) operating profit	2,133	1,804
EBITDA (PLNm) operating profit + depreciation/amortisation	2,864	2,407
ROE net profit to equity at end of the period	7.3%	8.7%
NET MARGIN net profit to revenue	6.2%	7.4%
ROA net profit to assets at end of the period	4.8%	5.2%

Liquidity

	Dec 31 2013	Dec 31 2012
CURRENT RATIO current assets (net of other assets) to current liabilities	1.6	1.2
QUICK RATIO current assets (net of other assets) less inventories to current liabilities	1.1	0.9

Debt

DEBT	Dec 31 2013	Dec 31 2012
DEBT RATIO total liabilities to total equity and liabilities	35.2%	40.1%
DEBT/EQUITY RATIO total liabilities to equity	54.2%	66.9%

1.2. Financial standing

Year on year, the PGNiG S.A.'s operating profit (EBIT) rose by PLN 329m. This improvement was attributable mainly to higher revenue in the Exploration and Production segment and a better result on other operating activities.

The upstream business continued to secure the stability of the Company's financial position. Production of crude oil rose in 2013 following the launch of the Lubiatów- Międzychód-Grotów project in late 2012/early 2013. The crude sales volume rose by 67% relative to the previous year, while the selling prices were kept unchanged.
New impairment losses were recognised in 2013 on non-current assets, as were provisions for obligations under the licences in Egypt and Libya.

In 2013, the profit margin on sales of high-methane gas deteriorated to
-2%, due to the fact that the tariff price was not sufficient to cover the cost of gas sold. The year-on-year increase in the cost of gas sold was attributable to the reduced gas purchase cost in 2012, resulting from the recognition in the Q4 figures of the financial effect of the annex to the Yamal contract, which changed the pricing terms of gas supplies.

A significant factor behind PGNiG S.A.'s financial performance were conditions prevailing on the currency markets. The US dollar, the main currency used in settlements of gas imports, depreciated relative to 2012. Currency appreciation or depreciation is the key macroeconomic factor behind the Company's financial performance. PGNiG S.A. has adopted a hedging policy to minimise this risk.

Compared with 2012, the balance of other income and expenses was up PLN 217m. This growth was attributable to unrealised positive currency exchange differences relating to amounts payable for the supplied gas and the imposition of a fine on PBG in connection with its failure to timely proceed with the Wierzchowice underground storage facility extension project.

Relative to 2012, the result on financing activity fell by PLN 468m, chiefly as a consequence of recognition of impairment losses on shares in POGC-Libya B.V.

The Company's financial position was reflected in its key financial ratios. Return on equity (ROE) fell from 8.7% to 7.3%. Return on assets (ROA) was 4.8%, against 5.2% in 2012, and net margin fell from 7.4% to 6.2%.

As at December 31st 2013, total assets recognised in the statement of financial position were PLN 35,424m, down PLN 1,221m on the end of December 2012.

<u>Deferred tax assets</u>

Property, plant and equipment, of PLN 13,775m as at the end of December 2013, down PLN 319m (2%) relative to December 31st 2012, was the largest item of the Company's assets. The decrease in property, plant and equipment was caused mainly by the lease to Polska Spółka Gazownictwa Sp. z o.o. of the gas pipeline running from the Company's gas fields to KGHM.

Financial assets available for sale are another major item of assets. As at December 31st 2013, they totalled PLN 7,796m, up PLN 550m on the end of 2012. The increase was attributable to the Company's higher ownership interest in PGNiG TERMIKA S.A. PGNiG TERMIKA S.A.'s equity increased following its acquisition of PGNiG SPV1 Sp. z o.o. and as a result of an equity increase paid for with cash. In December 2013, an impairment loss was also recognised on the shares and equity contributions in POGC Libya-B.V., a related entity.

Other financial assets stood at PLN 4,668m, down PLN 1,112m on December 31st 2013. The decline was attributable to repayment of loans by related entities.

As at December 31st 2013, current assets stood at PLN 8,478m, down PLN 397m (or 4%) relative to December 31st 2012.

Relative to December 31st 2012, there was an increase in inventories by PLN 280m. The inventories disclosed in the statement of financial position comprise mainly gas stored in underground storage facilities. The volume of gas stored was up by over 300 mcm relative to the end of 2012.

Trade and other receivables fell by PLN 1,490m (29%) relative to the end of 2012. The change was attributable chiefly to a decrease in receivables from gas sales and to a settlement of OOO Gazprom Export's liabilities towards PGNiG S.A. under the annex of November 2012 to the Contract with OOO Gazprom Export for sales of natural gas to the Republic of Poland of September 25th 1996.

Cash and cash equivalents stood at PLN 1,683m, up PLN 640m on the end of 2012, thanks primarily to the Company's improved operating margin and the settlement with OOO Gazprom Export. Net cash flows from operating activities reached PLN 4,317m in 2013.

The value and structure of current assets held by the Company guaranteed its ability to settle all liabilities in a timely manner. The current ratio was 1.6 compared with 1.2 as at the end of December 2012, while the quick ratio rose from 0.9 to 1.1.

Liabilities and equity

Equity is the primary source of financing of the Company's assets. Relative to December 31st 2012, the Company's equity rose by PLN 1,007m (or 5%). The increase was primarily driven by the 2013 net profit, reduced by dividend for 2012 paid out in an amount of PLN 767m.

As at December 31st 2013, non-current liabilities were PLN 7,023m, down PLN 264m on the end of December 2012. The change was chiefly attributable to a release of provisions for costs of well decommissioning.

Current liabilities were down significantly, by PLN 1,964m (27%) on the end of 2012, which was primarily the effect of notes redemption.

Due to a decrease in external financing used by the Company, the ratios of equity to liabilities changed. Debt to equity was 54.2%, down 12.7pp, while debt ratio (total liabilities to total equity and liabilities) fell from 40.1% to 35.2%.

Feasibility of investment plans

In 2014, PGNiG S.A. intends to maintain a high level of expenditure on investments, in particular on oil and gas exploration projects (including unconventional deposits) in Poland and abroad. PGNiG S.A. intends to finance investments both from its own funds and using external financing.

Transactions concluded on non-arm's length terms

In 2013, PGNiG S.A. and its subsidiaries did not enter into any material related-party transactions on non-arm's length terms.

Explanation of differences between the actual results and forecasts for 2013

In 2013, the Company did not publish any financial forecasts.

2. Financial management

In 2013, PGNiG S.A. placed new issues of short-term notes under its issuance programme agreement of May 22nd 2012. Under the programme, the Company may issue (for private placement) fixed or floating rate notes with maturities of up to 10 years, for up to PLN 4.5bn. In 2013, the Company issued a PLN 2.1bn tranche of short-term notes under the programme. As at December 31st 2013, the debt outstanding under the programme was PLN 3.5bn.

In 2013, PGNiG S.A. also placed new issues of short-term notes under the issuance programme agreement of June 10th 2010 (as amended under two annexes of 2011). Under the programme, PGNiG S.A. may issue discount notes and coupon-bearing notes with maturities ranging from one month to one year, for up to PLN 7bn. The total nominal value of notes issued in 2013 was PLN 6.3bn. As at December 31st 2013, no outstanding debt was recognised by PGNiG S.A. under the programme.

PGNiG S.A. used the issue proceeds to finance its capital expenditure projects involving exploration for conventional and unconventional oil and gas deposits, field development, construction and extension of underground gas storage facilities and the distribution network, including new connections. The issue proceeds were also used to finance power projects and PGNiG S.A.'s operating activities.

Furthermore, pursuant to the agreement of December 1st 2010 (as amended under an annex of 2011), in 2013 the Company continued to issue short-term discount notes to PGNiG Group companies. In 2013, the Company issued notes for a total nominal value of PLN 7.4bn. The note programme is designed to enable the flow of cash from the companies with excess liquidity, thus optimising the liquidity management within the Group. As at December 31st 2013, PGNiG S.A.'s outstanding debt under the notes in issue was PLN 564m.

Assessment of financial resources management

The funds available to PGNiG S.A. ensure timely financing of all current and planned expenditure related to the core business and investing activities. The liquidity risk is mitigated by bond/note issue programmes under agreements with banks executed in previous years. The Company also has a liquidity reserve in the form of overdraft facilities (PLN 250m in total), which serve to smooth out daily liquidity fluctuations.

2.1. Short-term investments

The financial investments made by PGNiG S.A. in 2013 were short-term, with maturities of up to three months. The Company invested in instruments carrying the lowest possible credit risk, i.e. bank deposits, which represented 100% of the placements. Such placements were consistent with PGNiG S.A.'s financial investment policy adopted by the Company's governing bodies, and with the Issue Prospectus.

2.2. Borrowings

Credit facility agreements executed in 2013

In 2013, PGNiG S.A. entered into overdraft facility agreements for a total amount of PLN 250m. The table below presents detailed information on the credit facility agreements executed by the Company in 2013.

PGNiG S.A.'s credit facility agreements

Bank	Facility amount (PLNm)	Interest rate	Type	Maturity date
Bank Handlowy w Warszawie S.A.	40	1M WIBOR + 0.30%	working capital facility	Dec 31 2014
Bank Millenium S.A.	40	1M WIBOR + 0.40%	working capital facility	Dec 18 2014
Nordea Bank Polska S.A.	40	1M WIBOR + 0.40%	working capital facility	Apr 30 2014
mBank S.A.	40	1M WIBOR + 0.30%	working capital facility	Sep 4 2014
Societe Generale S.A. Polish Branch	40	1M WIBOR + 0.30%	working capital facility	Aug 29 2014
ING Bank Śląski S.A.	40	1M WIBOR + 0.40%	working capital facility	Dec 5 2014
Bank Pekao S.A.	10	1M WIBOR + 0.45%	working capital facility	Jul 31 2014

Credit facility agreements terminated in 2013

In 2013, PGNiG S.A. did not terminate any credit facility agreements.

Loans advanced in 2013

In 2013, PGNiG S.A. executed loan agreements only with related entities, of aggregate amounts of NOK 500m and PLN 65m. PGNiG S.A.'s loans were used to finance expenditure on the project carried out on the Norwegian Continental Shelf (NOK-denominated loan), construction of gas networks, and construction of a CCGT unit in Stalowa Wola. The table below presents detailed information on the loans advanced by PGNiG S.A.

Loans advanced by PGNiG S.A.

Company	Loan amount (m)	Currency	Interest rate	Type	Maturity date
PGNiG Upstream International AS	500	NOK	3M NIBOR + 2.25%	investment loan	Dec 27 2013
Pomorska Spółka Gazownictwa Sp. z o.o. (currently: Polska Spółka Gazownictwa Sp. z o.o.)	30	PLN	3M WIBOR + 3.0%	investment loan	Dec 31 2024
Elektrociepłownia Stalowa Wola S.A.	25*	PLN	3M WIBOR + 2.5%	investment loan	Dec 31 2032
Elektrociepłownia Stalowa Wola S.A.	10*	PLN	1M WIBOR + 2.5%	investment loan	Dec 31 2032

* Loans to Elektrociepłownia Stalowa Wola S.A. were advanced under annexes to loan agreements concluded in 2012, increasing the loan amounts by PLN 35m in total.

Loan agreements received and terminated in 2013

In 2013, PGNiG S.A. did not contract or terminate any loans.

2.3. Guarantees and sureties

Guarantees and sureties provided by PGNiG S.A. in 2013 were PLN 151.3m as at December 31st 2013. This amount included a guarantee of PLN 82.9m securing gas supplies by PGNiG Sales&Trading GmBH, and a PLN 68.4m surety for a guarantee limit for PGNiG Technologie S.A.

Guarantees and sureties received by PGNiG S.A. in 2013 amounted to PLN 68.2m as at December 31st 2013, of which 31% (PLN 21.2m) were guarantees and sureties for less than PLN 1m each. The remaining guarantees and sureties comprised performance bonds, including under gas sales contracts, and bid bonds. The most significant of them were:
- a PLN 12.2m performance bond issued by Operator Systemu Magazynowania Sp. z o.o. in relation to the construction of five caverns (cluster B) of the Kosakowo Underground Gas Storage Facility;
- a PLN 8.8m performance bond issued by Exalo Drilling S.A. related to the drilling works at the Kosakowo Underground Gas Storage Facility.

2.4. Financial risk management

The main objective of PGNiG S.A.'s financial risk management policy is to limit the volatility of cash flows related to the Company's operations to levels which are acceptable in the short- and mid-term perspective and to build the company value in the long term. In the regular course of business in 2013, PGNiG S.A. was exposed to a number of financial risks, and in particular to market risk (including commodity price, interest rate and currency risks) as well as liquidity and credit risks.

Market risk

PGNiG S.A. manages market risk through identification, measurement, monitoring and mitigation of key sources of risk, i.e. the adverse effect of changes in commodity prices, exchange rates and interest rates on the Company's financial performance.

The key risks to which the Company is exposed include the risk of commodity price and exchange rate fluctuations, which affect the Company's gas purchases. The Company also executed transactions related to electricity prices, property rights and carbon emission allowances.

In 2013, PGNiG S.A. used the following financial instruments to manage the gas price risk:
- Purchase of Asian commodity call options settled as European options
- Commodity option structures (consisting in a combination of two commodity options)
- Commodity swaps.

In 2013, to mitigate the currency risk the Company used the following financial instruments:
- Forward contracts
- FX swaps
- Purchase of European currency call options
- Purchase of Asian currency call options
- Option structures (in most cases consisting in a combination of two currency options).

PGNiG S.A. also used *CCIRS* transactions (to mitigate the FX and interest rate risks) to hedge the Eurobonds in issue and the loan advanced to PGNiG Upstream International AS, as well as *IRS* transactions to hedge against changes in the fair value of the loan advanced to PGNiG TERMIKA S.A.

PGNiG S.A. used cash flow hedge accounting with respect to transactions hedging payments for gas and with respect to transactions hedging gas prices. The application of cash flow hedge accounting allows the Company to charge the effective portion of the hedge to revaluation capital reserve, which results in the matching of the effect of valuation of hedging instruments on profit or loss and the result on the hedged item. This approach allows to eliminate profit or loss volatility attributable to valuation of derivative instruments and makes it possible to offset its effect in the income statement in the same reporting period. In consequence, the economic and accounting effects of the hedge are reflected in the same period. Since July 2013, the Company has also applied fair-value hedge accounting with respect to selected loans bearing interest at fixed rates.

Credit risk

PGNiG S.A.'s credit risk is related to the likelihood of failure by the counterparties or other entities to meet their obligations to the Company. In 2013, the Company managed credit risk by investing its free cash in instruments carrying the lowest possible credit risk (bank deposits and treasury bonds), entering into framework agreements with its trading partners (precisely defining the rights and obligations of the parties), and diversifying the group of its trading partners. PGNiG S.A. also worked with leading commercial banks. The key criteria for the selection of counterparties to whom the Company entrusted a portion of its assets included their financial standing as confirmed by rating agencies, and their respective market shares.

Risk of cash-flow disruptions

The measures taken by PGNiG S.A. to mitigate the risk of disruptions in its day-to-day operating cash flows included diversification of electronic banking systems used, ongoing monitoring of credit/debit transactions in bank accounts, collecting information on cash flows within the Company and the Group, consolidating bank accounts and entering into overdraft facility agreements. The Company mitigated cash flow volatility related to payments under gas purchase contracts by entering into FX risk hedges (currency options, *FX swaps*, *forwards*) and gas price hedges (Asian options and option strategies).

Liquidity risk

In order to mitigate liquidity risk, PGNiG S.A. has a liquidity reserve in the form of overdraft facilities (for a total amount of PLN 250m). PGNiG S.A. also prepared cash flow projections for the Company and the Group, estimated the condition and value of assets available for sale, maintained highly liquid financial assets and maintained communication with rating agencies.

3. Projected future financial standing

Key factors with a bearing on PGNiG S.A.'s financial performance will include prices of crude oil, natural gas and petroleum products, current natural gas prices, conditions prevailing on the currency markets, and the stance taken by the President of the Energy Regulatory Office with regard to gas fuel tariffs.

The prices of crude oil, petroleum products and gas are an essential factor determining PGNiG S.A.'s financial position. In 2014, no significant changes in crude oil prices are expected. Natural hedging in the form of higher sales of crude oil and a change of pricing formulas has reduced the sensitivity of PGNiG S.A.'s performance to volatility in crude oil prices.

Gas prices on global markets will be driven primarily by the pace of economic recovery in individual countries. Despite a higher global supply of natural gas, caused by increased production of gas from unconventional deposits, the economic upturn may boost the market prices of gas, raising costs related to gas imports for PGNiG S.A.

A significant factor behind the Company's financial performance are conditions prevailing on the currency markets. In 2013, the average annual USD exchange rate depreciated relative to 2012. According to forecasts of the Gdańsk Institute for Market Economics, the downward trend will continue into 2014, which will lead to lower costs of high-methane gas imports translated into the złoty, and will have a positive effect on the Company's financial performance.

Other drivers of the Company's performance are the rates and charges provided for in the gas fuel tariffs. Pursuant to a decision of the President of the Energy Regulatory Office, PGNiG S.A. is subject to the new PGNiG Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 6/2014) effective from January 1st 2014, which accounts for the new model of the gas market in Poland. On average, the prices and charge rates for the supply of high-methane gas type E, and nitrogen-rich gas types Lw and Ls were increased by 1.5%, 4.7% and 7.3%, respectively.

In 2013, the loss on sales of high-methane gas on the regulated market was lower, following the signing of an annex to the Yamal contract in November 2012. The approval by the President of the Energy Regulatory Office of the new gas fuel tariffs effective from January 1st 2014, as well as the pricing formula for gas purchases based on the prices of petroleum products and the current market prices of gas, will allow the Company to achieve a minimal positive gross margin on this core product.

Since January 1st 2013, PGNiG S.A., as a trading company, has been obliged to purchase energy efficiency certificates (white certificates) in the amount set in the Energy Efficiency Act or else to pay a buy-out price. This obligation was driving up the cost of regulated activities. The new gas fuel tariff accounts for this cost item, which should help improve the Company's performance in 2014.

In December 2012, the Company started to trade in natural gas on the Polish Power Exchange (TGE). By virtue of a decision by the President of the Energy Regulatory Office, such trade is exempt from the tariff obligation. In February 2013, the President of the Energy Regulatory Office announced that energy utilities were exempt from the obligation to submit their wholesale gas trading tariffs for approval. In addition, the draft act amending the Energy Law and certain other acts provided for an obligation to sell 30% of gas fed into the transmission network in Poland on the energy exchange (in 2013; 40% in 2014 and 55% from 2015 onwards).

The new regulations have had a significant impact on the functioning of the market and, primarily, on PGNiG S.A.'s business model. The Company made a number of organisational changes (establishment of PGNiG Obrót Detaliczny Sp. z o.o. on December 3rd 2013, and establishment of the Wholesale Trading Division) as well as structural changes designed to adjust the organisation to new market requirements and regulations.

At the transition of 2012 into 2013, PGNiG S.A. launched production from the Lubiatów, Międzychód and Grotów oil and gas fields, which allowed the Company to increase crude oil production in 2013. Production from that field will also support the Company's future performance. Since the beginning of 2013, PGNiG S.A. has intensified exploration for both conventional and unconventional hydrocarbon deposits, but the economic effects of this effort will only be visible in several years.

In 2013, PGNiG S.A. pursued a short-term value creation strategy for the PGNiG Group until 2014. Its objective was to prepare the Group for operating in a deregulated gas market. The PGNiG Group is intent on maintaining its lead in the upstream segment, while remaining the leading supplier of natural gas, whose product mix also includes heat and electricity. In 2013, the merger of PGNiG Energia S.A. with PGNiG S.A. made it possible to optimise the shared resources and thus provide customers with a broader and better tailored product offering of gas and electricity.

Given the high level of current and planned capital expenditure, PGNiG S.A. uses external financing raised by issuing debt securities on the domestic and foreign markets. In 2013, PGNiG S.A. issued short-term notes for a nominal amount of PLN 2.1bn and PLN 6.3bn under its issuance programme agreements of, respectively, May 2012 and June 2010. In 2014, PGNiG S.A. intends to issue notes under both issuance programmes, depending on its liquidity needs and market conditions.

In the coming quarters, the Company intends to maintain a high level of capital expenditure. Spending will focus primarily on projects involving maintenance of hydrocarbon production rates, and diversification of gas supply sources, as well as on projects in the exploration for and appraisal of crude oil and natural gas deposits, and development of the Company's power generation segment.

Members of the Management Board

President of the Management Board	Mariusz Zawisza	....
Vice-President of the Management Board	Jarosław Bauc	....
Vice-President of the Management Board	Jerzy Kurella	....
Vice-President of the Management Board	Andrzej Parafianowicz	....
Vice-President of the Management Board	Zbigniew Skrzypkiewicz	....