PGNiG

Polskie Górnictwo Naftowe
i Gazownictwo SA

DIRECTORS' REPORT ON THE OPERATIONS OF THE PGNiG GROUP IN 2011

Warsaw, March 1st 2012

Contents

Chapter I: Events in 2011

March	PGNiG SA, PGNiG Energia S.A., Tauron Polska Energia S.A. Elektrownia Stalowa Wola S.A. and Elektrociepłownia Stalowa Wola S.A. executed an agreement on operation of the special purpose vehicle Elektrociepłownia Stalowa Wola S.A. The Supervisory Board appointed the President and members of the PGNiG Management Board for the new joint term of office. The following members of the Management Board were reappointed for the three-year term: Michał Szubski (CEO and President), Radosław Dudziński, Sławomir Hinc, Marek Karabuła and Mirosław Szkałuba. PGNiG Norway AS and its partners abandoned work on licence PL419 on the Norwegian Continental Shelf. PGNiG SA and Gazprom Export signed an annex to the contract providing for sales of natural gas to the Republic of Poland.
April	PGNiG Norway AS acquired a 25% interest in licence PL599 and a 30% interest in licence PL600 on the Norwegian Continental Shelf. The Annual General Meeting of PGNiG SA approved the financial statements and the Director's Report on the operations of PGNiG SA, as well as the consolidated financial statements and the Director's Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG SA in respect of their performance of duties in the financial year 2010.
June	The President of the Energy Regulatory Office approved the tariff for gas fuels (Part A - supply of gas fuels - No. 4/2011). Average prices and charge rates for the supply of high-methane gas E, Lw nitrogen-rich gas and Ls nitrogen-rich gas were increased by 8.9%, 7.6% and 6.3%, respectively.
August	The FPSO vessel was anchored on the Skarv field in the Norwegian Continental Shelf. PGNiG Norway AS and its partners abandoned work on licence PL326 on the Norwegian Continental Shelf. PGNiG SPV1 Sp. z o.o. and Vattenfall AB executed a memorandum of understanding concerning the sale of shares in Vattenfall Heat Poland S.A.
September	PGNiG SA completed extension of the Strachocina Underground Gas Storage Facility.

October	PGNiG Norway AS executed an agreement on sale of crude oil with Shell International Trading and Shipping Company Ltd. PGNiG Norway AS purchased a 15% interest in licence PL558 on the Norwegian Continental Shelf from Nexen Exploration Norge AS.
November	PGNiG SA requested from OAO Gazprom and OOO Gazprom Export initiation of arbitration proceedings. The President of the Energy Regulatory Office approved the tariff for gas fuels (Part A - storage of gas fuels - No. 1/2011). PGNiG SA completed the Grodzisk Project. PGNiG SA and Mazowiecka Spółka Gazownictwa Sp. z o.o. completed network switch-over from propane-butane-air to high-methane gas in the town of Pisz.
December	Mr. Michał Szubski resigned from the post of CEO and President of the PGNiG Management Board.

Chapter II: Information on the PGNiG Group

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

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG SA), registered office in Warsaw, ul. Marcina Kasprzaka 25, was established as a result of transformation of state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. On October 30th 1996, the Company was entered in the commercial register as Polskie Górnictwo Naftowe i Gazownictwo S.A. of Warsaw, under entry No. RHB 48382. On November 14th 2001, the Company was entered into the Register of Entrepreneurs of the National Court Register under entry No. 0000059492.

On May 24th 2005, the Polish Securities and Exchange Commission admitted PGNiG shares to public trading. The Company floated its shares on the Warsaw Stock Exchange on September 23rd 2005. PGNiG shares have been listed on the WSE since October 20th 2005. Currently, the share capital of PGNiG SA amounts to PLN 5.9bn and is divided into 5,900,000,000 shares.

The scope of the PGNiG Group’s business comprises oil and gas exploration and production, storage of gas fuels, as well as trade in and distribution of natural gas. The upstream operations in Poland and abroad are one of the material factors securing the Group's competitive position on the liberalised gas market. The Group's activities also include design and execution of construction projects, as well as construction of plant and equipment for the mining, fuels and power sectors. The Group also participates in gas-fired power projects and in electricity trading.

1. Development directions

The key strategic objective pursued by the PGNiG Group is to secure shareholder value growth. The growth in the PGNiG Group’s value is to be achieved through the development of the domestic gas market and expansion into selected foreign markets.

One of the strategic objectives defined in the Group’s policy is to develop its trading operations and ensure security and continuity of natural gas supplies to Poland by entering into gas purchase contracts. An appropriate diversification structure will allow the Company to supply gas to Poland from different countries and from different suppliers, which will significantly enhance the bargaining power of PGNiG SA and will guarantee balanced gas supplies to the PGNiG Group’s customers.

High commodity prices on the global markets and growing competition for access to natural gas reserves prompt the PGNiG Group to step up its efforts aimed at enhancing the growth potential of its exploration and production business in Poland and abroad by expanding its own natural gas and crude oil reserves and acquiring new licences in foreign markets. The Group seeks to gain a stable position on the three key foreign markets, including the North Sea, North Africa and the Middle East.

Another important growth area for the Group is the extension and construction of underground gas storage facilities. The PGNiG Group wishes to secure sufficient storage capacity in order to enhance its ability to flexibly respond to customer needs, to secure the continuity and stability of gas supplies, and to minimise the risk of disrupted gas supplies from foreign sources.
The distribution business plays an important in the building of the PGNiG Group’s value. One of the Group’s strategic objectives is to improve margins in the distribution business by maximising revenue from regulated operations, rationalising costs and developing the distribution network.

The PGNiG Group will also participate in gas-fired power projects. The power projects will drive the demand for natural gas and expand the Group's product offering to include electricity and heat from the Group's own sources. The PGNiG Group will also intensify its trading activity on the electricity market.

Implementation of these objectives will ensure gradual transformation of the PGNiG Group from a vertically integrated gas and oil organisation into a strong power conglomerate, grouping businesses from the power, fuels and heat industries. The expansion into the electricity and heat markets will strengthen the Group's position on the power market in Poland and in Central Europe.

2. Structure of the PGNiG Group

As at December 31st 2011, the PGNiG Group comprised PGNiG SA (the parent) and 36 production and service companies, including:

- 27 subsidiaries of PGNiG SA
- 9 indirect subsidiaries of PGNiG SA.

The following table presents a list of the PGNiG Group companies as at December 31st 2011:

Companies of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG SA (PLN)	% of ownership interest held by PGNiG SA	% of total vote held by PGNiG SA
	PGNiG SA's subsidiaries				
1	Poszukiwania Nafty i Gazu Jasło Sp. z o.o.	100,000,000.00	100,000,000.00	100.00%	100.00%
2	Poszukiwania Nafty i Gazu Kraków Sp. z o.o.	105,231,000.00	105,231,000.00	100.00%	100.00%
3	Poszukiwania Nafty i Gazu NAFTA Sp. z o.o.	60,000,000.00	60,000,000.00	100.00%	100.00%
4	GEOFIZYKA Kraków Sp. z o.o.	64,400,000.00	64,400,000.00	100.00%	100.00%
5	GEOFIZYKA Toruń Sp. z o.o.	66,000,000.00	66,000,000.00	100.00%	100.00%
6	Poszukiwania Naftowe Diament Sp. z o.o.	62,000,000.00	62,000,000.00	100.00%	100.00%
7	Zakład Robót Górniczych Krosno Sp. z o.o.	26,903,000.00	26,903,000.00	100.00%	100.00%
8	PGNiG Norway AS (NOK)[1)]	1,092,000,000.00	1,092,000,000.00	100.00%	100.00%
9	Polish Oil and Gas Company - Libya B.V. (EUR)[1)]	20,000.00	20,000.00	100.00%	100.00%
10	PGNiG Sales & Trading GmbH (EUR)[1)]	10,000,000.00	10,000,000.00	100.00%	100.00%
11	Operator Systemu Magazynowania Sp. z o.o.	5,000,000.00	5,000,000.00	100.00%	100.00%
12	INVESTGAS S.A.	502,250.00	502,250.00	100.00%	100.00%
13	Dolnośląska Spółka Gazownictwa Sp. z o.o.	658,384,000.00	658,384,000.00	100.00%	100.00%
14	Górnośląska Spółka Gazownictwa Sp. z o.o.	1,300,338,000.00	1,300,338,000.00	100.00%	100.00%
15	Karpacka Spółka Gazownictwa Sp. z o.o.	1,484,953,000.00	1,484,953,000.00	100.00%	100.00%
16	Mazowiecka Spółka Gazownictwa Sp. z o.o.	1,255,800,000.00	1,255,800,000.00	100.00%	100.00%
17	Pomorska Spółka Gazownictwa Sp. z o.o.	653,646,000.00	653,646,000.00	100.00%	100.00%
18	Wielkopolska Spółka Gazownictwa Sp. z o.o.	1,033,186,000.00	1,033,186,000.00	100.00%	100.00%

Companies of the PGNiG Group – contd.

	Name	Share capital (PLN)	Value of shares held by PGNiG SA (PLN)	% of ownership interest held by PGNiG SA	% of total vote held by PGNiG SA
	PGNiG SA's subsidiaries				
19	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%	100.00%
20	PGNiG Energia S.A.	30,000,000.00	30,000,000.00	100.00%	100.00%
21	PGNiG Technologie Sp. z o.o.	166,914,000.00	166,914,000.00	100.00%	100.00%
22	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%	100.00%
23	Polskie Elektrownie Gazowe Sp. z o.o.	1,212,000.00	1,212,000.00	100.00%	100.00%
24	PGNiG SPV1 Sp. z o.o.	20,000.00	20,000.00	100.00%	100.00%
25	PGNiG Finance AB (SEK)[1)]	500,000.00	500,000.00	100.00%	100.00%
26	B.S. i P.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
27	NYSAGAZ Sp. z o.o.	9,881,000.00	6,549,000.00	66.28%	66.28%
	Indirect subsidiaries of PGNiG SA	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	% of ownership interest held by PGNiG SA's subsidiaries	% of the total vote held by PGNiG SA
28	Oil Tech International F.Z.E. (USD)[1)]	20,000.00	20,000.00	100.00%	100.00%
29	Powiśle Park Sp. z o.o.	81,131,000.00	81,131,000.00	100.00%	100.00%
30	Zakład Gospodarki Mieszkaniowej Sp. z o.o. (Piła)	1,806,500.00	1,806,500.00	100.00%	100.00%
31	Biogazownia Ostrowiec Sp. z o.o.	105,000.00	105,000.00	100.00%	100.00%
32	Poltava Services LLC (EUR)[1)]	20,000.00	19,800.00	99.00%	99.00%
33	Ośrodek Badawczo-Rozwojowy Górnictwa Surowców Chemicznych CHEMKOP Sp. z o.o.	3,000,000.00	2,550,000.00	85.00%	85.00%
34	PT Geofizyka Torun Indonesia LLC (IDR)[1)2)]	8,773,000,000.00	4,825,150,000.00	55.00%	55.00%
35	GAZ Sp. z o.o. (Błonie)	300,000.00	153,000.00	51.00%	51.00%
36	GAZ MEDIA Sp. z o.o. (Wołomin)	300,000.00	153,000.00	51.00%	51.00%

[1)] In foreign currencies
[2)] Share capital partially paid up

Changes in the Group's structure in 2011:

- On February 10th 2011, POGC Trading GmbH was registered in Germany; the company's name was changed to PGNiG Sales & Trading GmbH. The company's new name was registered on August 25th 2011.
- On April 29th 2011, PGNiG SA acquired Goldcup 5839 AB. Following the acquisition, the company's name was changed to PGNiG Finance AB. The company's purpose is to service the issues of PGNiG Eurobonds. Its share capital amounts to SEK 500,000 (Swedish krona). The company's new name was entered in the Register of Companies in Stockholm on June 20th 2011.
- On June 7th 2011, PT Geofizyka Torun Indonesia LLC of Jakarta, Indonesia, was registered. GEOFIZYKA Toruń Sp. z o.o. acquired a 55% interest in the company's share capital, with a total par value of IDR 4,825,150,000 (Indonesian rupiah), i.e. USD 550,000 equivalent. As at the end of 2011, GEOFIZYKA Toruń Sp. z o.o. paid up USD 40,687.13 of the company's share capital.
- On June 17th 2011, PGNiG acquired PGNiG SPV1 Sp. z o.o. whose purpose is to execute power projects. The company's share capital amounts to PLN 20,000 and is divided into 400 shares with a par value of PLN 50 per share.
- On June 23rd 2011, Poszukiwania Nafty i Gazu Kraków Sp. z o.o. established Poltava Services LLC, a subsidiary in Ukraine. PNiG Kraków Sp. z o.o. holds a 99% equity interest in Poltava Services LLC.

- On June 29th 2011, PGNiG Technologie Sp. z o.o. acquired 5,000 shares in BN Naftomontaż Sp. z o.o. from minority shareholders. Following the transaction, its shareholding in BN Naftomontaż Sp. z o.o. increased to 100%.
- On October 15th 2011, Geofizyka Torun Kish Ltd was deleted from the commercial register in Iran.

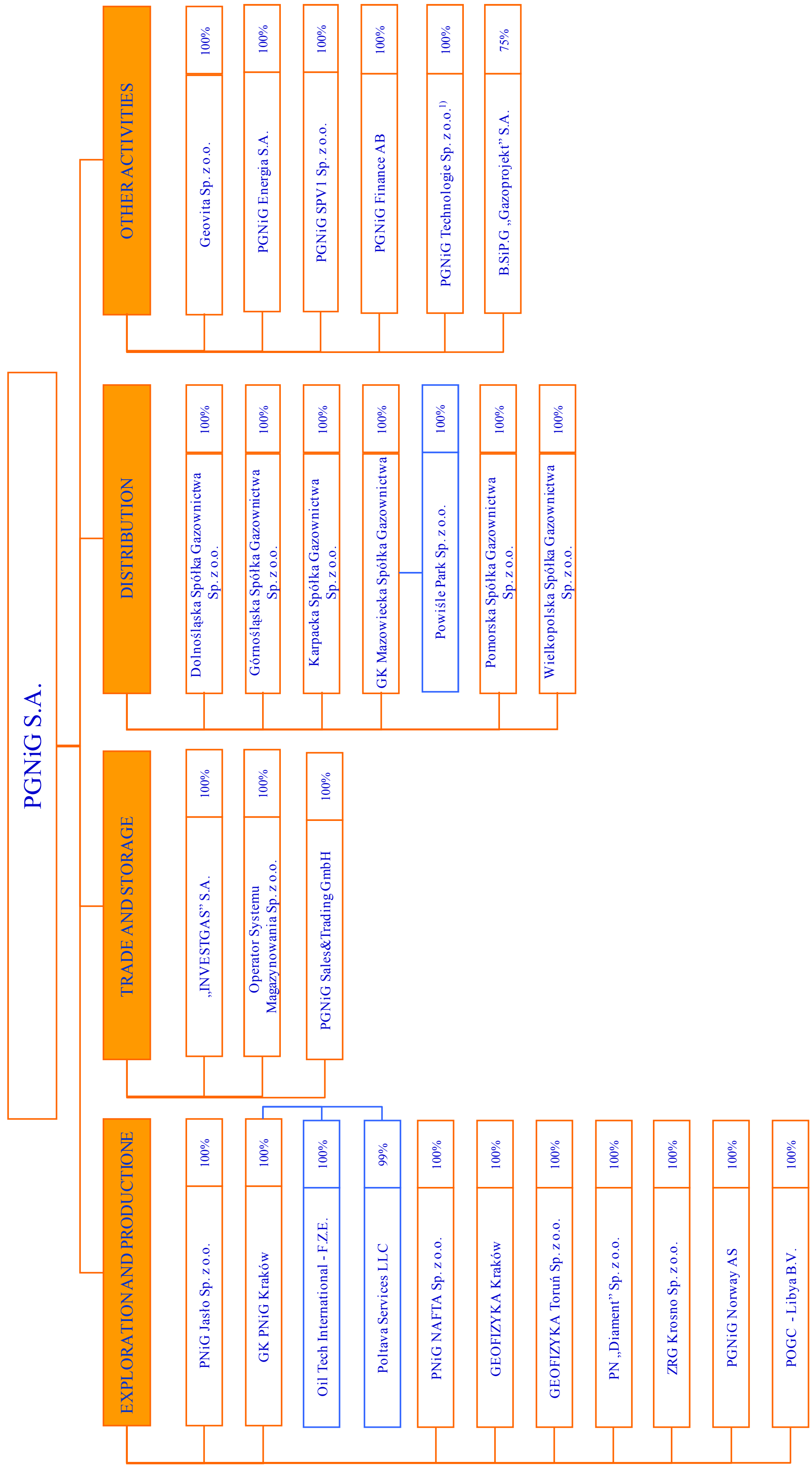
On December 22nd 2011, merger of PGNiG Technologie Sp. z o.o. (as the surviving company) with ZRUG Sp. z o.o., Zakład Urządzeń Naftowych Naftomet Sp. z o.o., Budownictwo Naftowe Naftomontaż Sp. z o.o. and BUG Gazobudowa Sp. z o.o. was registered in the National Court Register; the merger was effected by way of transfer of the target companies' total assets to the surviving company.

Changes in the Group companies' share capital in 2011:

- Share capital increase at PGNiG Energia S.A. by PLN 14,000,000 to PLN 20,000,000; all new issue shares were acquired by PGNiG SA. The increase was registered with the National Court Register on April 29th 2011.
- Share capital increase at NYSAGAZ Sp. z o.o. by PLN 3,081,000 to PLN 9,881,000; all new issue shares were acquired by PGNiG SA and covered by a non-cash contribution in the form of 27 gas-fired boiler houses. Upon the increase, PGNiG SA's share in the share capital of NYSAGAZ Sp. z o.o. increased to 66.3%. The capital increase was registered with the National Court Register on July 20th 2011.
- Share capital increase at PGNiG Norway AS by NOK 140,673,000, to NOK 1,092,000,000; all new issue shares were acquired by PGNiG SA. The capital increase was registered with the Norwegian commercial register on October 14th 2011.
- Share capital increase at Operator Systemu Magazynowania Sp. z o.o. by PLN 4,000,000, to PLN 5,000,000; all new issue shares were acquired by PGNiG SA. The increase was registered with the National Court Register on September 22nd 2011.
- Share capital increase at PGNiG Energia S.A. by PLN 10,000,000, to PLN 30,000,000; all new issue shares were acquired by PGNiG SA. The increase was registered with the National Court Register on October 21st 2011.
- Share capital increase at Pomorska Spółka Gazownictwa Sp. z o.o. by PLN 38,950,000, to PLN 653,646,000; all new issue shares were acquired by PGNiG SA and covered with a non-cash contribution in the form of the PGNiG gas transmission business segment. The increase was entered in the National Court Register on November 4th 2011.
- Share capital increase at PGNiG Technologie Sp. z o.o. by PLN 46,516,000, to PLN 166,914,000; all new issue shares were acquired by PGNiG SA. The increase was registered with the National Court Register on December 30th 2011.

The chart below presents the consolidated companies of the PGNiG Group as at December 31st 2011 (by segments).

CONSOLIDATED COMPANIES OF THE PGNIG GROUP



1) On December 22nd 2011, ZRUG Sp. z o.o., ZUN Naftomet Sp. z o.o., BN Naftomontaż Sp. z o.o., and BUG Gazobudowa Sp. z o.o. were merged with PGNiG Technologie Sp. z o.o.

Changes after the end of the financial year:

On January 2nd 2012, the transformation of PNiG Jasło Sp. z o.o. into a joint-stock company was registered with the National Court Register.

On January 11th 2012, PGNiG SPV 1 Sp. z o.o. executed a final share purchase agreement with Vattenfall AB, whereby PGNiG SPV 1 Sp. z o.o. acquired 24,591,544 shares in Vattenfall Heat Poland S.A., which account for 99.8% of the company's share capital and confer the right to 99.8% of the total vote at the General Meeting of Vattenfall Heat Poland S.A.

On January 13th 2012, the Extraordinary General Meeting of PGNiG SPV 1 Sp. z o.o. adopted a resolution concerning an increase in the company's share capital by PLN 770,000,000, to PLN 770,020,000 by way of an issue of 15,400,000 new shares with a par value of PLN 50 per share. All new issue shares were acquired by PGNiG SA. The increase was registered with the National Court Register on January 25th 2012.

On January 23rd 2012, Vattenfall Heat Poland S.A. changed its name to PGNiG TERMIKA S.A.

On February 16th 2012, the Extraordinary General Meeting of PGNiG Energia S.A. adopted a resolution concerning an increase in the company's share capital by PLN 11,000,000, to PLN 41,000,000, by way of an issue of 110,000 new shares with a par value of PLN 100 per share. All new issue shares were acquired by PGNiG SA.

Changes in management policies

In 2011, there were no material changes in the management policies of PGNiG SA.

On December 22nd 2011, the process of consolidation of construction and assembly companies in the Other Activities segment was completed. PGNiG Technologie Sp. z o.o. (as the surviving company) merged
with ZRUG Sp. z o.o., Zakład Urządzeń Naftowych Naftomet Sp. z o.o., Budownictwo Naftowe Naftomontaż Sp. z o.o. and BUG Gazobudowa Sp. z o.o. Total assets of the target companies were transferred to PGNiG Technologie Sp. z o.o.

3. Ownership interests in other related entities

The table below presents other related entities of the PGNiG Group as at December 31st 2011.

Related entities of the PGNiG Group

	Name	Share capital (PLN)	Value of shares held by PGNiG SA (PLN)	% of ownership interest held by PGNiG SA	% of total vote held by PGNiG SA
	Related entities of PGNiG SA				
1	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
2	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
3	InterTransGas GmbH (EUR) [1)]	200,000.00	100,000.00	50.00%	50.00%
4	Dewon Z.S.A. (UAH)1)	11,146,800.00	4,055,205.84	36.38%	36.38%
5	Sahara Petroleum Technology LLC w likwidacji (in liquidation) (OMR)[1)]	150,000.00	73,500.00	49.00%	49.00%
6	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
7	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
8	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
9	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
10	ZRUG TORUŃ S.A.	5,150,000.00	1,300,000.00	25.24%	25.24%
	Related entities of PGNiG SA's subsidiaries	Share capital (PLN)	Value of shares held by PGNiG SA's subsidiaries (PLN)	% of share capital held by PGNiG SA's subsidiaries	% of total vote held by PGNiG SA's subsidiaries
1	NAFT-STAL Sp. z o.o. w upadłości likwidacyjnej (in bankruptcy by liquidation)	667,500.00	450,000.00	67.40%	67.40%
2	Elektrociepłownia Stalowa Wola S.A.	28,000,000.00	14,000,000.00	50.00%	50.00%
3	Al Mashariq - Geofizyka Torun Limited Company (SAR)[1)]	500,000.00	250,000.00	50.00%	50.00%
4	Gazobudowa Kraków Sp. z o.o.	79,500.00	37,500.00	47.20%	47.20%
5	NAFTEK Sp. z o.o. in liquidation	5,000.00	2,200.00	44.00%	44.00%
6	Przedsiębiorstwo Badawczo-Usługowe Petromin Sp. z o.o.	200,000.00	80,000.00	40.00%	40.00%
7	Geotermia Sp. z o.o.	4,000.00	1,000.00	25.00%	25.00%

[1)] In foreign currencies

Changes in the Group's ownership interests in other related entities in 2011:

- On February 9th 2011, TE-MA WOC Małaszewicze Terespol Sp. z o.o. w likwidacji (in liquidation) was deleted from the National Court Register.
- On February 11th 2011, the bankruptcy proceedings concerning Huta Szkła Szczakowa S.A. w upadłości (in bankruptcy) were completed. On June 7th 2011, the company was deleted from the National Court Register.
- On December 14th 2011, the Court of Appeals dismissed PI GAZOTECH Sp. z o.o.'s appeal requesting that certain resolutions adopted by the Extraordinary General Meeting of PI GAZOTECH Sp. z o.o. on April 23rd 2004 be abrogated or declared invalid, including the resolution obliging PGNiG SA to make an additional contribution to equity in the amount of PLN 52m and resolution concerning a partial retirement of company shares. The Court's decision resulted in the reduction of PGNiG SA's equity interest in PI GAZOTECH Sp. z o.o. to 5.4%.

In 2011, the share capital of Elektrociepłownia Stalowa Wola S.A. was increased by PLN 26,000,000, to PLN 28,000,000, by way of an issue of 26,000,000 new shares with a par value of PLN 1 per share. PGNiG Energia S.A. acquired 13,000,000 shares in the increased capital, with a total par value of PLN 13,000,000, which represents 50% of the share capital. The increase was registered with the National Court Register on April 14th 2011.

Investments outside the group of related entities

As at the end of 2011, the aggregate par value of the PGNiG Group's equity investments outside the group of related entities amounted to PLN 34.6m. In 2011, PGNiG SA disposed of 4,000,001 shares in Zakłady Azotowe w Tarnowie-Mościcach S.A. with a par value of PLN 5 per share, for a price of PLN 37 per share. In 2011, the PGNiG Group made no material equity investments outside the group of related entities.

4. Employment

The table below presents employment at the PGNiG Group as at December 31st 2011, by segments. As the PGNiG Head Office provides services to all segments in the Group, it is disclosed separately.

Employment by segments (no. of staff)

	2011	2010
PGNiG Head Office	838	840
Exploration and Production	12,054	11,592
Trade and Storage	3,841	3,809
Distribution	13,865	13,881
Other Activities	2,185	2,296
Total	32,783	32,418

On October 25th 2011, PGNiG SA and representative trade union organisations entered into an agreement on mass redundancies at the PGNiG Head Office. The mass redundancies took place in December 2011. Actual reduction of the staffing levels at the PGNiG Head Office will take effect in the course of 2012 due to varying lengths of the notice periods given to the dismissed employees.

Since January 2009, the Group has operated the Programme for Employment Streamlining and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (Stage 3). The term of the Programme has been extended for another calendar year.

Its operation is based on the "stand-by" principle. It may be implemented in extraordinary circumstances and requires all the companies to follow a procedure which is uniform across the Group.

In 2011, the Programme was implemented in four companies of the PGNiG Group: ZUN Naftomet Sp. z o.o., BUG Gazobudowa Sp. z o.o., MSG Sp. z o.o. and ZRUG Pogórska Wola Sp. z o.o., and covered 178 employees. In 2011, funds from the capital reserve designated as Central Restructuring Fund were allocated to one-off benefits to 159 dismissed employees of ZUN Naftomet Sp. z o.o. and BUG Gazobudowa Sp. z o.o.

5. Sale and acquisition of natural gas

The PGNiG Group recorded revenue of PLN 23.0bn, 88% of which was derived from sales of natural gas.

Revenue (PLNm)

	2011	2010
Natural gas, including:	20,268.3	19,105.1
- high-methane gas	19,051.6	17,917.8
- nitrogen-rich gas	1,216.6	1,187.3
Crude oil	1,095.2	838.7
Condensate	5.1	3.2
Helium	57.5	44.1
Propane-butane	60.0	49.9
Gas storage services	31.5	31.7
Geophysical and geological services	448.1	278.8
Exploration services	577.6	442.6
Other sales	460.2	487.1
Total	23,003.5	21,281.2

In 2011, the PGNiG Group sold 14.3 billion cubic metres of natural gas, with 95% of that figure represented by sales from the transmission and distribution systems and the balance – by direct gas sales from the fields.

Natural gas sales volume (million cubic metres)

	2011	2010
Trade and Storage	13,595.7	13,562.2
Exploration and Production	681.7	673.8
Total	14,277.4	14,236.0

In 2011, the volume of natural gas acquired by the PGNiG Group was 15.4 billion cubic metres, with 71.1% of that amount sourced from imports, mostly from Russia. Natural gas production from fields in Poland represented 28.2% of the total volume acquired. The table below presents the structure of natural gas supplies to the Group, measured as high-methane gas equivalent.

Supply sources of natural gas (million cubic metres)

	2011	2010
Imports	10,915.3	10,066.4
Domestic production	4,329.4	4,220.4
Domestic suppliers	112.3	96.1
Total	15,357.0	14,382.9

Chapter III: Company's Governing Bodies

1. Management Board

Pursuant to PGNiG SA'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). 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 2011, the composition of the PGNiG Management Board was as follows:

- Michał Szubski – CEO and President of the Management Board
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Finance
- Marek Karabuła – Vice-President, Petroleum Mining
- Mirosław Szkałuba – Vice-President, Trade.

At its meetings on January 12th 2011 and March 8th 2011, the Supervisory Board appointed the President and members of the PGNiG Management Board for another joint term of office starting on March 13th 2011. The following members of the Management Board were reappointed for the three-year term: Michał Szubski (CEO and President), Radosław Dudziński, Sławomir Hinc, Marek Karabuła and Mirosław Szkałuba.

Mirosław Szkałuba is the Management Board member elected by employees in the elections held in January and February 2011.

As at December 31st 2011, the composition of the PGNiG Management Board was as follows:

- Michał Szubski – CEO and President of the Management Board
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Finance
- Marek Karabuła – Vice-President, Petroleum Mining
- Mirosław Szkałuba – Vice-President.

On December 19th 2011, Michał Szubski, CEO and President of the PGNiG Management Board, resigned from his position.

Contracts with Management Board Members

The employment contracts concluded with all the Management Board members contain a clause in Par. 8, which reads: “In the event of removal from office or termination of this employment contract for reasons other than breach of basic duties under the employment contract, the employee is entitled to a severance pay equal to three times the employee's monthly salary.”

As at December 31st 2011, the non-competition agreements concluded with the President, Mr. Michał Szubski, and Vice-Presidents, Messrs. Radosław Dudziński, Sławomir Hinc, Mirosław Szkałuba and Waldemar Wójcik were in force. The non-competition agreements continue in force for 12 months following termination of the employment relationship. In return for observing the competition ban during the term of the non-competition agreement, a Management Board member is entitled to a monthly compensation of 100% of such member's average gross remuneration for the last three months received in connection with the legal relationships between the member and the Company.

2. Supervisory Board

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

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

In accordance with the 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 the candidates elected by the Company's employees. If the Supervisory Board is composed of seven to nine members, three members are appointed from among the candidates elected by the Company’s employees.

As at January 1st 2011, the composition of the PGNiG Supervisory Board was as follows:

- Stanisław Rychlicki – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board
- Mieczysław Kawecki – Secretary of the Supervisory Board
- Grzegorz Banaszek – Member of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

Upon the expiry of the Supervisory Board's term of office, on April 20th 2011, the General Meeting of PGNiG SA appointed members of the PGNiG Supervisory Board for a new joint term of office starting on May 1st 2011. Stanisław Rychlicki, Marcin Moryń, Mieczysław Kawecki, Grzegorz Banaszek, Agnieszka Chmielarz, Mieczysław Puławski (the independent member) and Jolanta Siergiej were re-appointed for the three-year term.

Agnieszka Chmielarz, Mieczysław Kawecki and Jolanta Siergiej are Supervisory Board members elected by employees in the elections held in January and February 2011.

As at December 31st 2011, the composition of the PGNiG Supervisory Board was as follows:

- Stanisław Rychlicki – Chairman of the Supervisory Board
- Marcin Moryń – Deputy Chairman of the Supervisory Board
- Mieczysław Kawecki – Secretary of the Supervisory Board
- Grzegorz Banaszek – Member of the Supervisory Board
- Agnieszka Chmielarz – Member of the Supervisory Board
- Mieczysław Puławski – Member of the Supervisory Board
- Jolanta Siergiej – Member of the Supervisory Board.

On January 5th 2012, Mr. Stanisław Rychlicki, Chairman of the Supervisory Board, tendered his resignation from the position with effect from January 11th 2012.

On January 12th 2012, the Extraordinary General Meeting of PGNiG SA removed Mr. Grzegorz Banaszek from the Supervisory Board and appointed Mr. Wojciech Chmielewski. Also on January 12th 2012, the Minister of State Treasury, acting in consultation with the Minister of Economy, appointed Mr. Janusz Pilitowski to serve on the PGNiG Supervisory Board.

On January 13th 2012, the PGNiG Supervisory Board appointed Mr. Wojciech Chmielewski as its Chairman.

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the annual consolidated financial statements for the year ended December 31st 2011 (Note 37.5).

Chapter IV: Shareholder Structure

As at December 31st 2011, the share capital of PGNiG SA 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 State Treasury was the only shareholder directly holding a large block 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 as at December 31st 2011 is presented in the table below:

Shareholder structure

Shareholder	Number of shares as at Dec 31 2011	% of share capital held as at Dec 31 2011	Number of votes conferred by shares held	% of total vote at GM as at Dec 31 2011
State Treasury	4,272,063,451	72.41%	4,272,063,451	72.41%
Other shareholders	1,627,936,549	27.59%	1,627,936,549	27.59%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

PGNiG shares and shares in the related undertakings of PGNiG SA held by management and supervisory personnel

The table below presents PGNiG shares held by the management and supervisory personnel as at December 31st 2011:

PGNiG shares held by the management and supervisory personnel

Name	Position	Number of shares	Par value of shares (PLN)
Michał Szubski	CEO, President of the Management Board	6,825	6,825
Mirosław Szkałuba	Vice-President of the Management Board	9,425	9,425
Stanisław Rychlicki	Chairman of the Supervisory Board	9,897	9,897,
Mieczysław Kawecki	Secretary of the Supervisory Board	19,500	19,500,
Jolanta Siergiej	Member of the Supervisory Board	9,425	9,425,
Mieczysław Jakiel	Proxy	30,101	30,101
Kazimierz Chrobak	Proxy	19,500	19,500,

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 SA was not aware of any agreements which could lead to future changes in the equity interests held in the Company by its existing shareholders.

Control of employee stock option plans

On October 1st 2010, the eligible employees' rights to acquire PGNiG shares free of charge expired. As a result, agreements for free-of-charge disposal of the Company shares may be entered into only by the heirs of eligible employees who filed – on or before October 1st 2010 – a petition with court seeking a ruling that they had acquired the eligible employees' rights by way of inheritance. As at December 31st 2011, 59,248 eligible employees or their heirs (96.3% of the total number of eligible persons) acquired 727,936,548 shares, representing 97.1% of the pool of shares available to be acquired free of charge by eligible persons.

55,250 PGNiG shares acquired free of charge by members of the Company's Management Board were admitted to stock-exchange trading on July 1st 2011.

Performance of the PGNiG Stock

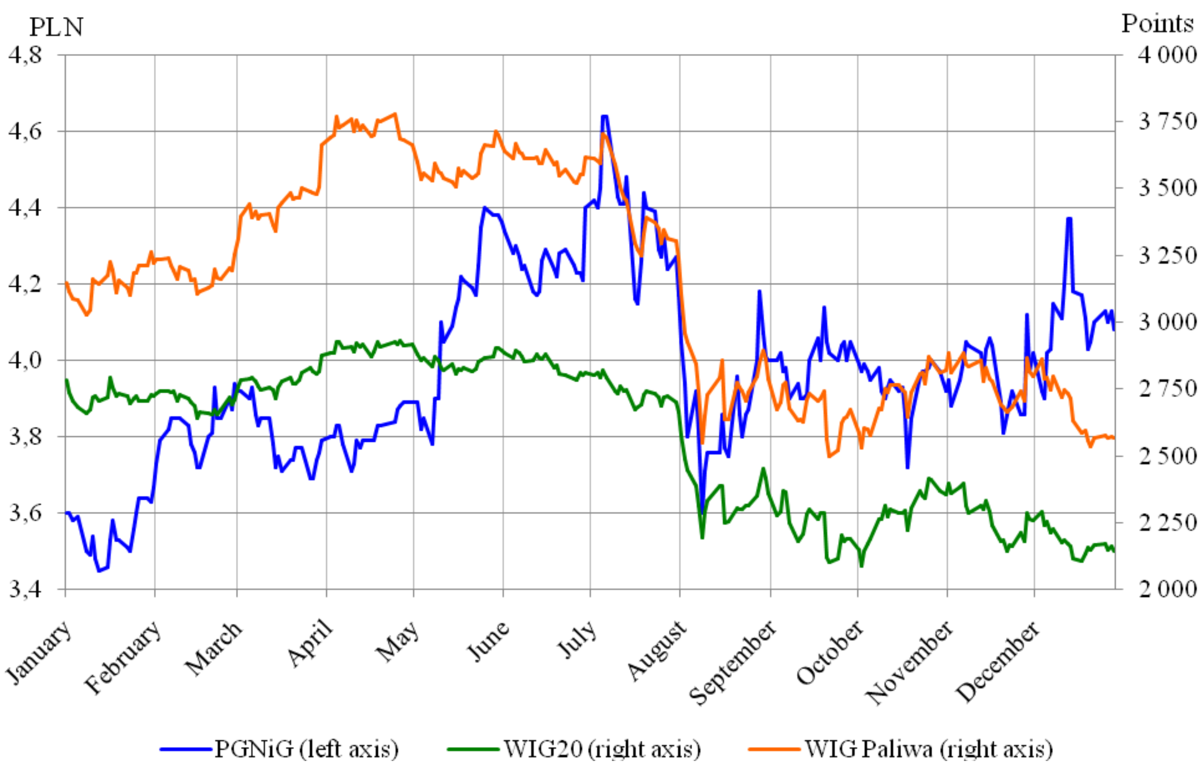
PGNiG shares have been listed at the Warsaw Stock Exchange since October 20th 2005. As at December 31st 2011, the Company was included in the following indices:

- WIG – all-cap index of the WSE
- WIG20 – blue-chip index of the 20 largest and most liquid companies
- WIG-Paliwa – index of the fuel sector companies
- WIG-div – total return index of 30 companies with the highest dividend yields and regular dividend payments
- WIG-Poland – index of Polish companies listed on the WSE
- Respect Index – index of socially responsible companies.

In 2011, the rate of return on the PGNiG stock was 14.3% (PLN 0.12 per share), or 17.6% including dividend income. For the period from the first listing until December 31st 2011, the rate of return on the PGNiG stock was 7.1%. Investors who acquired the PGNiG shares on the WSE at their issue price earned a 36.9% return.

The following figure presents the relative performance of the PGNiG stock against the WIG 20 and WIG Paliwa indices. The table shows the values of the WSE indices and the PGNiG share price in 2011.

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



WSE indices and the PGNiG share price

	Value/price as at Dec 31 2010	2011 high	2011 low	Value/price as at Dec 31 2011	PGNiG’s weight in the index as at Dec 31 2011
WIG	47,490,	50,372	36,549	37,595	1.0%
WIG20	2,744	2,933	2,090	2,144	1.4%
WIG-Fuels	3,079	3,776	2,499	2,568	19.0%
Respect Index	2,259	2,577	1,944	2,005	3.4%
PGNiG SA	3.57,zł	4.64,zł	3.45,zł	4.08,zł	-

Source: WSE.

Chapter V: Regulatory Environment

The PGNiG Group's activities are regulated by the following laws:

- Polish Energy Law of April 10th 1997 (consolidated text in Dz. U. of 2006, No. 89, item 624, as amended) with secondary legislation, to the extent the act governs gas fuel trading, distribution and storage.
- Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, and 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 (Dz. U. of 2007, No. 52, item 343, as amended) with the secondary legislation, to the extent the act governs international trade in natural gas.
- Polish Geological and Mining Law of February 4th 1994 (Dz. U. of 1994, No. 27, item 96, as amended), to the extent the act governs production and sale of gas.

1. Polish Energy Law

The activities of the PGNiG Group in the area of gas fuel trading, distribution and storage are regulated and require a licence granted and a tariff approved by the President of the Energy Regulatory Office. The tariff determines the prices of gas fuels.

In 2011, the Polish Energy Law was amended several times, in particular with respect to the electricity generation sector. The most significant amendments relating to the gas sector provided for regulations governing the change of a gas fuel supplier by customers and determination of rules for obtaining certificates of origin for biogas supplied to the gas distribution network. Additionally, amendment to 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 necessitated the introduction of relevant changes to the Polish Energy Law with respect to obtaining the licence for international trade in natural gas

1.1. Licences

As at December 31st 2011, PGNiG SA held the following licences granted by the President of the Polish Energy Regulatory Office under the Energy Law:

- one licence for trade in gas fuels
- one licence for international trade in natural gas
- one licence for storage of gas fuels
- one licence for trade in liquid fuels
- one licence for electricity production
- one licence for electricity trading.

In 2010, the President of the Energy Regulatory Office refused to approve changes in the working capacities of the Husów Underground Gas Storage Facility, due to the technical conditions determining the facility's operations. The President of the Energy Regulatory Office also refused to exclude from the licence scope the storage facility working capacities which are used by the production segment or by the Transmission System Operator, as requested by PGNiG SA, citing the Polish Energy Law under which such capacities are not storage facilities.

On November 2nd 2010, PGNiG SA appealed against that decision to the Regional Court of Warsaw – the Court of Competition and Consumer Protection. Pursuant to its decision of June 21st 2011, the Court of Competition and Consumer Protection initiated proceedings on the case. As in November

2011 a procedure was initiated to make storage capacities previously used for production purposes available on a TPA (Third Party Access) basis, on January 13th 2012 PGNiG SA withdrew the appeal.

At the same time, PGNiG SA filed a request for a change in the licence. In order to make the scope of the licence compatible with the Polish Energy Law, the Company requested that the scope of licensed activities be defined as "storage of gas fuels in storage facilities with the use of underground gas storage facilities specified in the licence." PGNiG SA also requested approval of the change in the working storage capacities of the Strachocina Underground Gas Storage Facility, the Wierzchowice Underground Gas Storage Facility and the Mogilno Cavern Underground Gas Storage Facility due to their expansion; and of the Husów Underground Gas Storage Facility due to technological considerations determining the facility's operations. As at the date of this report, the proceedings were pending.

By virtue of a decision of the President of the Energy Regulatory Office of July 11th 2011, PGNiG SA obtained a licence for electricity trading for the period from July 12th 2011 to December 31st 2030.

1.2. Tariff policy

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

The tariff preparation methodology is based on the determination of prices and charges against forecast costs and gas sales targets. In accordance with the applicable regulatory policies, the cost of acquisition of natural gas from all sources, that is of both imported and domestically produced gas, is taken into account in the calculation of prices of gas fuels. In practice this means 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, inclusion of the cost of domestically produced gas in the cost basket, used for the purpose of pricing calculations, resulted in a situation where the tariff prices (applicable in settlements with customers) were determined below the cost of acquisition of imported gas.

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

1.3. Changes in PGNiG SA's Tariffs

Until July 14th 2011, settlements with customers were based on the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 3/2010); the tariff's gas fuel price was changed by an adjustment effective as of January 1st 2011.

On February 11th 2011, PGNiG SA applied to the President of the Energy Regulatory Office requesting a change to the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 3/2010). The Company requested a change of the gas fuel price and an extension of the effective term of the changed tariff until May 31st 2011. As the term for which the tariff was approved expired, the President of the Energy Regulatory Office URE discontinued the proceedings by virtue of its decision of May 16th 2011.
On March 30th 2011, PGNiG SA applied to the President of the Energy Regulatory Office requesting approval of Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 4/2011).

In its decision of June 30th 2011, the President of the Energy Regulatory Office approved the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 4/2011) which has been used in settlements with customers since July 15th 2011. Average prices and charge rates for the supply of high-methane gas E, Lw nitrogen-rich gas and Ls nitrogen-rich gas were increased by 8.9%, 7.6% and 6.3%, respectively.

The new tariff introduced a broader range of settlement options available to customers in tariff groups 1-3, who will be able to choose a settlement system suitable to their needs. Customers in tariff groups 6-11 are classified according to the gas consumption variance ratio. Based on this criterion, a customer may be classified to one of three (instead of two, as was the case previously) tariff groups (A, B, C), depending on the assigned ratio value. Additionally, customers may now enter into agreements providing for gas collection on an intermittent basis.

On October 25th 2011, PGNiG SA applied to the President of the Energy Regulatory Office requesting approval of:

- change to the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 4/2011) with respect to gas fuel prices, which was to be applied in settlements with customers from January 1st 2012 to March 31st 2012.
- change to the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 5/2012), which was to be applied in settlements with customers from January 1st 2012 to March 31st 2012.

With respect to the request for change to the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 4/2011) the President of the Energy Regulatory Office, by virtue of a decision of January 11th 2012, refused to approve of the change. With respect to the request for approval of the Gas Fuel Tariff (Part A – Gas Fuel Supply Tariff No. 5/2012), the proceedings had are pending.
The following tables present the average tariffs (PLN per cubic meter) used in settlements with customers purchasing gas fuels, by fuel type and place of receipt.

Area covered by Dolnośląska Spółka Gazownictwa Sp. z o.o.

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
W-1	2.4623	2.5779	4.7%
W-2	1.9047	2.0167	5.9%
W-3	1.7238	1.8340	6.4%
W-4	1.5928	1.7036	7.0%
W-5 - W-7C	1.4474	1.5629	8.0%
W-8A - W-10C	1.2090	1.3185	9.0%

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
S-1	1.7738	1.8537	4.5%
S-2	1.3553	1.4415	6.4%
S-3	1.2334	1.3152	6.6%
S-4	1.0765	1.1911	10.7%
S-5 - S-7B	1.0520	1.1225	6.7%
S-8 - S-10	0.9309	1.0113	8.6%

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
Z-1	1.3764	1.4575	5.9%
Z-2	1.2553	1.3255	5.6%
Z-3	1.1062	1.1749	6.2%
Z-4	0.9908	1.0954	10.6%
Z-5 - Z-7B	1.0289	1.0825	5.2%

Area covered by Górnośląska Spółka Gazownictwa Sp. z o.o.

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
W-1	2.4154	2.5468	5.4%
W-2	1.9701	2.0803	5.6%
W-3	1.6906	1.8014	6.6%
W-4	1.6085	1.7314	7.6%
W-5 - W-7C	1.4552	1.5854	8.9%
W-8A - W-11C	1.2053	1.3243	9.9%

Area covered by Karpacka Spółka Gazownictwa Sp. z o.o.

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
W-1	2.3037	2.4284	5.4%
W-2	1.8709	1.9928	6.5%
W-3	1.6224	1.7450	7.6%
W-4	1.5688	1.6960	8.1%
W-5 - W-7C	1.4654	1.5918	8.6%
W-8A - W-10C	1.1805	1.2933	9.6%

Area covered by Mazowiecka Spółka Gazownictwa Sp. z o.o.

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
W-1	2.6563	2.8082	5.7%
W-2	1.7818	1.9019	6.7%
W-3	1.5811	1.7044	7.8%
W-4	1.5372	1.6918	10.1%
W-5 - W-7C	1.4119	1.5658	10.9%
W-8A - W-10C	1.1142	1.2341	10.8%

Area covered by Pomorska Spółka Gazownictwa Sp. z o.o.

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
W-1	2.5089	2.6499	5.6%
W-2	1.9095	2.0396	6.8%
W-3	1.6856	1.8144	7.6%
W-4	1.6121	1.7530	8.7%
W-5 - W-7C	1.4680	1.6114	9.8%
W-8A - W-10C	1.1857	1.3075	10.3%

Area covered by Wielkopolska Spółka Gazownictwa Sp. z o.o.

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
W-1	2.5548	2.6742	4.7%
W-2	1.8365	1.9479	6.1%
W-3	1.6972	1.8085	6.6%
W-4	1.6031	1.7181	7.2%
W-5 - W-7C	1.4125	1.5291	8.3%
W-8A - W-10C	1.1610	1.2698	9.4%

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
S-1	1.7685	1.8642	5.4%
S-2	1.3279	1.4032	5.7%
S-3	1.1944	1.2723	6.5%
S-4	1.1009	1.1974	8.8%
S-5 - S-7B	1.0513	1.1246	7.0%
S-8 - S-10	-	-	

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
Z-1	1.6174	1.6976	5.0%
Z-2	1.2034	1.2649	5.1%
Z-3	1.0664	1.1314	6.1%
Z-4	0.9826	1.0645	8.3%
Z-5 - Z-7B	0.9588	1.0184	6.2%

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

Tariff group	Tariff No. 3/2010	Tariff No. 4/2011	Change (%)
	1	2	2/1
E-1A - E-2C	1.0630	1.1818	11.2%
Lw-1 - Lw-2	0.8271	0.9130	10.4%
Ls-1 - Ls-2	0.6730	0.7564	12.4%

In its decision of May 12th 2011, the President of the Energy Regulatory Office, in response to a request from PGNiG SA, extended the term of Gas Fuel Tariff (Part B – Gas Fuel Storage Services Tariff No. 1/2010) until September 30th 2011. On July 22nd 2011, PGNiG SA applied to the President of the Energy Regulatory Office requesting approval of a new Gas Fuel Storage Services Tariff. On November 16th 2011, the President of the Energy Regulatory Office approved the Gas Fuel Tariff (Part B – Gas Fuel Storage Services Tariff No. 1/2011), effective in settlements with customers as of December 1st 2011.

The new tariff introduced charge rates applicable to storage services provided as follows:

- in the form of long-term, short-term or daily services
- on a continuous or intermittent basis
- in the form of packages, flexible packages or individual services.

On January 13th 2012, PGNiG SA applied to the President of the Energy Regulatory Office requesting approval of a new Gas Fuel Storage Services Tariff (Part B – Gas Fuel Storage Services Tariff No. 1/2012), which is to be effective in settlements with customers from April 1st 2012 to Match 31st

2013. The tariff submitted for approval takes into account a change in storage charge rates relating to the expected commissioning of new storage capacities (180m cubic meters in the Strachocina Underground Gas Storage Facility and 34m cubic metres in the Mogilno Cavern Underground Gas Storage Facility).

1.4. Changes in Gas Distribution Companies' Tariffs

Until July 14th 2011, settlements with customers using the services of the Gas Distribution Companies were based on Tariffs for Gas Fuel Distribution Services, approved by the President of the Energy Regulatory Office on May 17th 2010.

By virtue of a decisions of June 30th 2011, the President of the Energy Regulatory Office approved the Tariffs for Gas Fuel Distribution Services provided by the Gas Distribution Companies; the tariffs have been used in settlements with customers as of July 15th 2011.

In a decision of January 9th 2012, the President of the Energy Regulatory Office approved the change to the Tariff for Gas Fuel Distribution Services provided by Pomorska Spółka Gazownictwa Sp. z o.o. The change introduces two groups: W-9A and W-9B, instead of the previous W-9 group.

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 the 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 setting 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 SA, the Act:

- sets the timetable for building up the mandatory stock of natural gas: the volume of mandatory stock should cover 20 days' average daily imports of gas as of October 1st 2010, and 30 days' average daily imports of gas as of October 1st 2012;
- provides that the return on the capital employed in the storage business should be at least 6%;
- stipulates that the cost related to maintaining, releasing and restocking the reserves represents justified operating expenses within the meaning of Art. 3.21 of the Polish Energy Law.

On December 4th 2011, the amended 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 came ito force. The amendment provides for:

- the possibility to store mandatory stocks in another EFTA member state, upon fulfilment of certain conditions set in the Act,
- the possibility to exempt a power utility company whose business involves international trade in natural gas or an entity which imports natural gas from the obligation to keep mandatory stock, if the number of their customers does not exceed 100 thousand and the natural gas volume imported in a calendar year does not exceed 100m cubic metres.

3. Polish Geological and Mining Law

The Polish Geological and Mining Law of February 4th 1994 regulates:

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

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

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 administration bodies and mining supervision authorities. The Geological and Mining Law provides for criminal sanctions for failure to comply with its regulations, and specifies the upper and lower limits of royalty fees.

In 2011, the Ministry of Environment awarded PGNiG SA seven licences for exploration for and appraisal of crude oil and natural gas deposits, the terms of 21 licences were extended and one licence expired. Additionally, in 2011, six licences for production of crude oil and natural gas from deposits were obtained, while three licences expired. In the reviewed period, there were no changes to the licences for underground gas storage or licences for waste matter storage.

As at December 31st 2011, PGNiG SA held the following licences, granted pursuant to the Geological and Mining Law:

- 95 licences for exploration for and appraisal of crude oil and natural gas deposits
- 1 licence for appraisal of a salt deposit
- 225 licences for production of crude oil and natural gas from deposits
- 9 licences for underground gas storage (underground gas storage facilities)
- 3 licences for storage of waste

The New Polish Geological and Mining Law of June 9th 2011 (Dz.U. of 2001, No. 63, item 638) became effective as of January 1st 2012. The Act satisfies the requirements of the Directive 94/22/EC of the European Parliament and of the Council of May 30th 1994. The Act introduces the tender procedure for the licence for exploration for and appraisal of hydrocarbons and for production of hydrocarbons, superceding the previous tender procedure with respect to the establishment of mining usage rights.

4. Regulatory risks

Polish Energy Law

Further changes in the laws governing operation of the gas sector companies are to be expected in 2012. First of all, the Gas Law is to be adopted; the new law will supersede the Energy Law and 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 , with respect to the regulation of the gas industry. The Gas Law will also implement the regulations included in the Third Energy Package adopted by the European Parliament, including the Directive of the European Parliament and of the Council concerning common rules for the internal market in natural gas, repealing Directive 2003/55/EC.

Work is also in progress on amending the Regulation of the Minister of Economy on detailed rules for determining and calculating tariffs for gas fuels and on settlements in gas fuels trading (the Tariff Regulation).

Legal changes, including delays in amending legal acts, create risks stemming from uncertainty as to the scope of regulatory changes and shorter time for adaptation to such changes, which might adversely affect the financial performance and growth prospects of the PGNiG Group.

Act on Mandatory Stocks

The amendment of 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 a Disruptions on the Petroleum Market has limited the number of entities required to keep mandatory stocks to energy companies importing natural gas for resale. Additionally, the amended act allows for exemption from the obligation to keep mandatory stocks (upon fulfilment of certain conditions defined in the act) and ability to keep mandatory stocks within the territory of another EFTA member state.

The above change may help PGNiG's competitors reduce their operating costs, and thus have a negative effect on the Company's competitive position.

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 until 2016 should be no less than 9% of the annual national consumption of energy. In line with the provisions of the new act, PGNiG SA, as a trading company, is required to purchase energy efficiency certificates or, alternatively, to pay the non-compliance penalty. This will drive up the cost of regulated activities and, consequently, inflate the price paid for gas by customers.

Tariff calculation

PGNiG SA's ability to cover the costs of its core operations depends on prices and charge rates approved by the President of the Energy Regulatory Office. When approving tariffs for a given period, the President of the Energy Regulatory Office takes into consideration external factors which are beyond PGNiG SA's control. In an attempt to protect customers, the President of the Energy Regulatory Office may consider certain business costs as unjustified. Moreover, the President of the Energy Regulatory Office does not always agree the assumptions made by PGNiG SA with respect to the main cost drivers and profit targets allowing for business risk. Consequently, the Energy Regulatory Office frequently refuses to approve tariff prices and charge rates applied for by PGNiG SA. Lower tariff prices and charges might adversely affect PGNiG SA's profitability.

In 2011, the President of the Energy Regulatory Office once again unilaterally extended the effective period of an applicable tariff. The Company believes that such actions by the President of the Energy Regulatory Office create a risk of a tariff being calculated below costs, as it does not account for the cost of supply of gas fuel to customers in the period by which the tariff effective period is extended by the President of the Energy Regulatory Office. As a result, it should be expected that in the next round of tariff approval proceedings this factor may be taken into consideration in the tariff calculation.

Moreover, the President of the Energy Regulatory Office protracts the tariff approval proceedings, and tariffs are approved at later dates than those originally requested by PGNiG SA.

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 determinations of prices and charge rates are based, may adversely affect the Group's financial performance. An increase in demand from customers above the forecast level would necessitate additional purchases under all existing contracts which allow such additional (often more expensive) purchases.

Purchase price 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. Changes in foreign exchange rates and prices of petroleum products materially affect the cost of imported gas. Material changes in prices of fuels on the international markets affect the prices of imported gas. Any accurate forecast of changes of natural gas prices is encumbered with a high risk of error. There can be no assurance that despite the legal possibility of adjusting prices approved for a tariff term an increase in the price of imported gas may not be fully passed on to customers or the changes in gas selling prices may lag behind the changes in its import prices.

Chapter VI: Exploration and Production

The segment's business focuses on extracting hydrocarbons from underground formations and preparing products for sale. The segment comprises the entire process of oil and gas exploration and production, starting from geological analyses, through geophysical surveys and drilling work, to field development and hydrocarbon production. The segment's gas storage needs are satisfied by the Brzeźnica, Daszewo, Strachocina, Swarzów and Bonikowo underground gas storage facilities.

1. Exploration

In 2011, the PGNiG Group was involved in oil and natural gas exploration and appraisal projects which it implemented either on its own or in cooperation with partners. 52,838 m of exploration/appraisal drillings were performed in the Group's licence areas, including 49,248 m in Poland, and 3,590 m abroad (in Denmark and Pakistan). Also, 1,489 km of 2D seismic surveys (973 km in Poland and 516 km in Egypt) and 843 sq km of 3D seismic surveys (in Poland) were performed as part of exploration work. The PGNiG Group also cooperated with third parties in their licence areas in Poland and on the Norwegian Continental Shelf.

For third-party customers (primarily foreign), the Group performed 141,153 m of drillings, 6,389 km of 2D seismic surveys, and 1,631 sq km of 3D seismic surveys in search of hydrocarbons. For these customers, the Group also performed well servicing activities such as major remedial treatments, workovers, well abandonment services and services consisting in application of enhanced recovery techniques. Furthermore, the Group rendered services related to exploration for coal, metal ores and geothermal water.

1.1. Exploration in Poland

In 2011, 49,248 m of drillings were performed in the licence areas of the PGNiG Group (including drillings performed as part of joint ventures). In Poland, PGNiG SA conducted, both on its own and in cooperation with partners, exploration and appraisal work, specifically in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands. Drilling work was under way on 28 boreholes, including 24 exploration boreholes, and 4 appraisal boreholes (in the case of one borehole drilling ended in 2010, and tests were carried out in 2011). Out of 23 wells the test results of which are known (19 exploration wells and 4 appraisal wells, including one where drilling ended in 2010, and tests were carried out in 2011), 11 wells were classified as positive (including 9 gas wells and 2 oil and gas wells), whereas the remaining 11 wells were dry.

Test carried out in 2011 (in new exploration areas where thus far there had been little appraisal) have confirmed the presence of gas in Piaski-3 well (tight gas) in Western Pomerania, and Lubocino-1 (shale gas) in Eastern Pomerania. No commercial gas flow rates were recorded from the Tymowa-1 exploration and appraisal well in the Carpathian Mountains. In 2011, drillings of deep boreholes were carried out in the Carpathian Mountains and Carpathian Foothills: the Kramarzówka-1 borehole was completed, and drilling of the Dukla-1 borehole started.

In 2011, geophysical work was conducted in PGNiG SA's licence areas in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands, as part of which 973 km of 2D seismic data and 843 sq km of 3D seismic data was acquired. Also, 516 km of 2D seismic surveys were carried out abroad, in the area covered by PGNiG SA's licence in Egypt.

As at December 31st 2011, the Group's recoverable reserves were:

- 91.9 billion cubic metres of natural gas measured as high-methane equivalent,
- 21.1 million tonnes of crude oil.

Joint ventures in Poland

In 2011, PGNiG SA collaborated with other entities in areas covered by licences awarded to PGNiG SA, FX Energy Poland Sp. z o.o., and Aurelian Oil & Gas PLC.

Under licences awarded to PGNiG SA, work continued in the following areas:

- "Płotki" – in cooperation with FX Energy Poland Sp. z o.o.
- "Płotki" – "PTZ" – in cooperation with FX Energy Poland Sp. z o.o. and Calenergy Resources Poland Sp. z o.o.
- "Poznań" – in cooperation with FX Energy Poland Sp. z o.o.
- "Bieszczady" – in cooperation with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o.
- "Sieraków" – in cooperation with Orlen Upstream Sp. z o.o.

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

- "Warszawa-Południe" (blocks 234, 235, 254, 255, 274N) – in cooperation with FX Energy Poland Sp. z o.o.
- "Ostrowiec" (blocks 163 and 164) – in cooperation with FX Energy Poland Sp. z o.o.
- "Kutno" (blocks 211, 212, 231 and 232) – in cooperation with FX Energy Poland Sp. z o.o.

Under licences awarded to Aurelian Oil & Gas PLC, work was performed in the following areas:

- "Karpaty Zachodnie" – in cooperation with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (a subsidiary of Aurelian Oil & Gas PLC)
- "Karpaty Wschodnie" – in cooperation with Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (a subsidiary of Aurelian Oil & Gas PLC)

Also, production continued from the Roszków field in the "Płotki" area, and from the Zaniemyśl field in the "Płotki" – "PTZ" area.

With respect to the "Poznań" licence area, in 2011 gas production continued from the Środa Wielkopolska field and was launched from the Kromolice and Kromolice S fields. Development of the new Winna Góra gas field also commenced, with the well scheduled to come on stream in 2012. Economic quantities of natural gas were discovered in 2011 from the Lisewo-1k exploration well (Lisewo field). Furthermore, a 4,200 m exploratory borehole was completed in Pławce-2 tight gas deposits. Well testing and fracturing is scheduled for 2012. In 2011, field work related to stage II of the 3D seismic survey was executed in the Żerków-Pleszew area. Data processing commenced, and the process is expected to be completed in 2012. Drilling of the Komorze-3k borehole and commencement of the 3D field seismic surveys in the Mirosław area are also schduled for 2012.

In 2011, drilling of the Niebieszczany-1 well (depth: 4,219 m) was completed in the "Bieszczady" area, and well tests started. Furthermore, 2D field work was conducted in the Paszowa-Brzegi Dolne area, followed by geological interpretation of the data acquired. Seismic 2D field work commenced in the Jaśliska-Baligród area, and field gravimetric surveys were launched in the Hoczew-Lutowiska area.

In the "Sieraków" area, the Sieraków-5 borehole was drilled. As no hydrocarbon flow was identified in the borehole, analysis was carried out to determine the best location for the Sieraków 2 borehole, scheduled for drilling in 2012.

In the "Warszawa-Południe" area, Machnatka-2 borehole was drilled within block 254 (depth: 4,500 m). The borehole was abandoned, as no hydrocarbon flow was identified. Analytical work continued for the "Ostrowiec" area. In the "Kutno" area, the drilling of a deep exploration borehole Kutno-2 commenced, with a planned depth of 6,450 m.

In 2011, in the "Karpaty Wschodnie" licence area, 2D seismic data acquisition and data processing was completed for the Mszana area, and a new 2D seismic survey was performed for the Jordanów area.

1.2. Exploration abroad

In 2011, the PGNiG Group conducted work in licence areas in Pakistan, Denmark, Egypt, Libya and Norway (PGNiG SA's subsidiaries were involved in the Libyan and Norwegian projects).

Pakistan

PGNiG SA conducts exploration work in Pakistan under an agreement on hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG SA 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 proportionately to the parties' interests in the licence: PGNiG SA (operator) – 70%, PPL – 30%. In 2011, work was under way on workover of the Hallel-1 borehole. Also, processing and interpretation of 2D and 3D seismic data were completed. Results of the interpretation confirmed the presence of a structure giving rise to accumulation of hydrocarbons (Rehman field).

Denmark

Since the execution of the agreement on assignment of interests in 2007, PGNiG SA has been engaged in exploration activity in the 1/05 licence area in Denmark. Currently, the licence interests are: PGNiG SA (operator) – 80%, Nordsøfonden – 20%. Drilling of the Felsted-1 exploration well started in 2011. Following well logging performed at the beginning of 2012, no commercial hydrocarbon flow was identified. The well was abandoned. Given the negative results from the exploration well, PGNiG SA decided not to extend the 1/05 licence in Denmark.

Egypt

In Egypt, PGNiG SA has been conducting exploration work in the Bahariya licence area (Block 3) under an Exploration and Production Sharing Agreement (EPSA) with the government of Egypt of May 17th 2009. The Company holds a 100% interest in the licence. In connection with unstable political situation in Egypt, at the beginning of 2011 the Polish employees of the PGNiG SA Egypt Branch were temporarily withdrawn from the country, which however did not affect the progress of the exploration work. In 2011, field gravimetric surveys and their interpretation were completed. The planned acquisition of 1,600 km of 2D profiles was commenced, of which 516 km were acquired in 2011. Protracting administrative procedures concerning tender approval delayed acquisition of the rest of the 2D seismic data until the following year. Processing of seismic data and drilling work are scheduled for 2012.

2. Production

Natural gas and crude oil production in Poland is conducted by two branches of PGNiG SA: the Zielona Góra Branch and the Sanok Branch. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 22 sites, including 14 gas production facilities and 8 oil and gas production facilities. The Sanok Branch produces high-methane and nitrogen-rich natural gas and crude oil at 46 sites, including 26 gas production facilities and 20 oil and gas and oil production facilities.

In 2011, PGNiG SA produced a total of 4.3 billion cubic meters of natural gas (measured as high-methane gas equivalent). Crude oil production was 455.3 thousand tonnes. The table below presents PGNiG SA's production volumes in 2011:

Production volumes

		Entity	2011	2010
1	Natural gas, including:	million cubic metres*	4,329.4	4,220.4
a	high-methane, including:	million cubic meters	1,616.4	1,605.3
	- Zielona Góra Branch	million cubic meters	0.0	0.0
	- Sanok Branch	million cubic meters	1,616.4	1,605.3
b	nitrogen-rich, including:	million cubic metres*	2,713.0	2,615.1
	- Zielona Góra Branch	million cubic metres*	2,637.2	2,530.9
	- Sanok Branch	million cubic metres*	75.8	84.2
2	Crude oil	thousand tonnes	455.3	487.8
	- Zielona Góra Branch	thousand tonnes	407.3	440.7
	- Sanok Branch	thousand tonnes	48.0	47.1

* Measured as high-methane gas equivalent.

Further filelds were brought onstream: the Jeżowe, Nowosielec and Łękawica fields within the Sanok Branch's operating area, as well as the Elżbieciny, Jabłonna, Jabłonna S, Jabłonna W (feeding the Grodzisk Denitriding Plant) and Sławoborze fields within the Zielona Góra's operating area,. Moreover, within the Sanok Branch's operating area, another 15 wells commenced production on already producing fields (Zalesie, Jaśniny, Dzików and Rudka). The total addition to production capacity is estimated at approximately 46 thousand cubic metres of gas per hour (measured as high-methane gas equivalent). Moreover, the Kromolice and Kromolice S fields, with a joint production capacity of approximately 8 thousand cubic meters per hour (measured as high-methane gas equivalent), were brought onstream as part of the cooperation with FX Energy Poland Sp. z o.o.

In 2011, PGNiG SA was engaged in various activities aimed at maintaining the gas and oil output from the currently producing fields. In order to increase hydrocarbon production, 9,846 metres of production drilling was performed. Major remedial treatments were performed on a total of 36 wells whose technical condition prevented their further operation. Of that number, 31 wells flowed hydrocarbons at commercial rates. Of the other five, two wells are used as injectors, while one, which did not flow gas at commercial rates, was abandoned. The other two of the treated wells will be used by the underground gas storage facilities. In 2011 recovery techniques were applied on a total of 71 wells (including intensification initiatives), designed to maintain or improve production capacities of producing wells or to recover operating condition of sub-surface extraction equipment. Recovery techniques were also applied on wells operated by the underground gas storage facilities and on injectors.

Products such as crude condensate, sulphur and propane-butane are obtained through the refining of crude oil. A portion of produced nitrogen-rich gas is further treated into high-methane gas at the

Odolanów and Grodzisk Wielkopolski Denitriding Plants. 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. The Elżbieciny, Jabłonna, Jabłonna S and Jabłonna W fields having been brought upstream in May 2011, the Grodzisk Denitriding Plant increased its output to the maximum production capacity.

The table below presents volumes of sales of natural gas (including LNG) directly from fields, and of crude oil and other products to external customers. The key customers for natural gas customers were industrial customers, accounting for 85% of the total sales volume.

Sales structure of key products

		Entity	2011	2010
1	Natural gas, including:	million cubic meters	681.7	673.8
	- high-methane gas	million cubic meters	63.9	53.7
	- nitrogen-rich gas*	million cubic meters	617.8	620.1
2	Crude oil	thousand tonnes	464.6	499.0
3	Condensate	thousand tonnes	2.2	1.9
4	Helium	million cubic meters	3.4	3.1
5	Propane-butane	thousand tonnes	20.7	21.0
6	Nitrogen	thousand kg	489.8	783.1
7	Sulphur	thousand tonnes	23.8	25.2

* Measured as high-methane gas equivalent.

In 2011, PGNiG SA continued to sell crude oil to Rafineria Trzebinia S.A. and TOTSA TOTAL OIL TRADING S.A. under the agreements executed in 2009, and to Rafineria Nafty Jedlicze S.A. under a ten-year contract executed in 2007.

PGNiG SA's foreign customers accounted for 40% of the total volume of crude sales, and for 71% of helium sales. Crude oil was sold to a German refinery (through the Druzhba pipeline), whereas most of the helium volume was sold in liquid form to foreign wholesale customers, who resell the product in European countries.

Underground gas storage facilities

In 2011, the Exploration and Production segment used the working capacities of the Brzeźnica, Strachocina and Swarzów high-methane gas storage facilities, as well as of the Daszewo and Bonikowo nitrogen-rich gas storage facilities. The capacities used to store produced gas are not storage facilities within the meaning of the Polish Energy Law.

In 2011, PGNiG SA completed construction and assembly work connected with the extension of the Strachocina Underground Gas Storage Facility and commenced tests and analyses designed to determine the operating parameters and other characteristics of the facility.

Under the annex of December 29th 2011 to the agreement for additional financing of the Strachocina project (as part of the EU Infrastructure and Environment Operational Programme), the expenditure qualification period was extended until June 30th 2012. The table below presents working capacities of the underground storage facilities used by the Exploration and Production segment as at December 31st 2010 and December 31st 2011.

Working capacities of the underground storage facilities used by the Exploration and Production segment (million cubic metres)

High-methane gas	2011	2010
Brzeźnica (E)	65.0	65.0
Strachocina (E)	150.0	150.0
Swarzów (E)	90.0	90.0
Nitrogen-rich gas		
Daszewo (Ls)	30.0	30.0
Bonikowo (Lw)	200.00	200.00

In November 2011, PGNiG SA provided access to third parties, as from the beginning of the 2012/13 storage year, working capacities of the Brzeźnica, Strachocina and Swarzów Underground Gas Storage Facilities. The access was provided on an intermittent basis, as part of long-term storage services.

3. Exploration and production companies

PNiG Jasło Sp. z o.o.

The business of Poszukiwania Nafty i Gazu Jasło Spółka z o.o. comprises drilling of core, exploration and production wells, well workovers, well abandonment services, provision of specialised well servicing services such as cementing, mud services or well completions, as well as operation of drilling rig instrumentation and control systems.

In 2011, PNiG Jasło Sp. z o.o. provided services mainly on the Polish market. The company's revenue was PLN 301.6m, of which revenue from services provided to the PGNiG Group accounted for 72%. For the PGNiG Group, the company provided drilling services on exploratory and appraisal wells and on production wells, as well as specialist service work. The company's services for third-party customers included drilling of crude oil wells, drilling of a geothermal well, cementing services and Datawell services. On the foreign markets, the company completed well drilling performed as part of the extension of an underground gas storage facility in the Czech Republic (in a consortium with PNiG Kraków Sp. z o.o.) and workover services in Russia. The company also provided specialist service in several other European countries.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	301.6	241.6
Net profit (loss)	PLNm	2.0	8.1
Equity	PLNm	141.2	142.7
Total assets	PLNm	279.9	245.8
Headcount as at December 31	persons	917	925

At the beginning of 2012, PNiG Jasło Sp. z o.o. was transformed into a joint-stock company. In 2012, the company will continue to perform services for the PGNiG Group, which will remain the company's main customer, and also for external customers, including Termo-Glob Sp. z o.o. and Vabush Energy Sp. z o.o. Abroad, the political situation in Libya having stabilised, the company intends to continue its operations in the country. In 2012, the company will also provide services for customers outside the PGNiG Group on foreign markets. This will include continued Datawell service operation in Ukraine, workover and drilling services in Lithuania, and cementing services in Russia.

GK PNiG Kraków

The PNiG Kraków Group comprises Poszukiwania Nafty i Gazu Kraków Sp. z o. o., as well as its subsidiaries – Oil Tech International - F.Z.E. and Poltava Services LLC. Poltava Services LLC was established in Ukraine in 2011. The core business of PNiG Kraków Sp. z o.o. comprises geological, exploration and production drillings, well workovers, as well as well drilling, testing and operation. The company also provides hospitality, catering, rental and training services. Oil Tech International – F.Z.E. provides drilling teams, materials, machinery and equipment Poltava Services LLC's services include drilling and lease of drilling teams.
In 2011 GK PNiG Kraków, recorded revenue of PLN 421.1m, of which 69% represents revenue from services sold to customers outside the PGNiG Group. Exports represented 96% of revenue from sales to third parties. On foreign markets, the PNiG Kraków Group continued drilling work in Kazakhstan, Uganda, Pakistan, Ukraine, and the Czech Republic. In 2011, the company completed a contract in Mozambique, where four wells were drilled. The Group also provided drill teams and equipment rent services for cuatomers in the United Arab Emirates. In Poland, the company mainly drilled exploratory, appraisal and production wells for PGNiG SA.

Group's highlights

	Entity	2011	2010
Revenue	PLNm	421.1	362.0
Net profit (loss)	PLNm	17.0	16.8
Equity	PLNm	174.6	174.3
Total assets	PLNm	497.7	392.5
Headcount as at December 31	persons	1,226	1,182

The PNiG Kraków Group's strategic market is East Africa. In 2012, the company will continue work on its contract in Uganda. The PNiG Kraków Group will also continue to provide drilling services in Kazakhstan, Pakistan, Ukraine and the Czech Republic. The group intends to expand its drilling operations on the Polish market. To this end, the company purchased a state-of-the-art drilling rig Drillmec 2000 HP with the walking system, supporting drilling multiple deep wells from a single spot.

PNiG NAFTA Sp. z o.o.

The core business of PNiG Nafta Sp. z o.o. comprises exploration for oil and gas, including in particular designing and drilling appraisal, exploration and production boreholes and preparing borehole documentation. The company also drills wells for underground storage of hydrocarbons, decommissions wells in used-up reserves, reconstructs developed wells, and provides support services through its workshop (specialising in repair of drilling equipment) and storage facilities.

In 2011, the company provided its services mainly on the Polish market, for both the PGNiG Group and external customers. In 2011, revenue amounted to PLN 301.7m, of which 53% was derived from services provided to the PGNiG Group. On the domestic market, drilling services mainly included exploratory and workover drilling for PGNiG SA, drilling for FX Energy Poland Sp. z o.o., as well as well drilling for companies exploring for unconventional gas fields: Energia Zachód Sp. z o.o., mSaponis Investments Sp. z o.o., Talisman Energy Polska Sp. z o.o. and Chevron Polska Energy Resources Sp. z o.o. Outside Poland, PNiG Nafta Sp. z o.o. participated in drilling campaigns in Egypt and Denmark.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	301.7	296.4
Net profit (loss)	PLNm	15.6	14.0
Equity	PLNm	201.1	192.5
Total assets	PLNm	358.9	321.1
Headcount as at December 31	persons	860	799

In 2012, on the domestic market, PNiG NAFTA Sp. z o.o. intends to continue to provide drilling services to PGNiG SA and to operators outside the PGNiG Group, holding licences for hydrocarbon exploration in Poland: FX Energy Sp. z o.o., Talisman Energy Polska Sp. z o.o. and Chevron Polska Energy Resources Sp. z o.o. Abroad, the company plans to continue drilling in Egypt.

GEOFIZYKA Kraków Sp. z o.o.

GEOFIZYKA Kraków Sp. z o.o. offers geophysical services (2D/3D vibroseis and dynamite data acquisition), well logging data processing and interpretation, measurements, special well interventions, interpretations, perforating and downhole seismic surveys.

In 2011, GEOFIZYKA Kraków Sp. z o.o. generated revenue of PLN 247.3m, of which 53% was derived from services sold to customers outside the PGNiG Group. Eighty-seven percent of the company's revenue represents sales to domestic customers. The key external customers for the company's field seismics services include RWE Dea AG S.A., Oculis Energy and Orlen Upstream Sp. z o.o. in Poland, and OMV Exploration & Production GmbH in Austria. The company also performed well logging in Slovakia. The company provided the full range of services to the PGNiG Group.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	247.3	224.3
Net profit (loss)	PLNm	8.9	1.9
Equity	PLNm	102.5	97.7
Total assets	PLNm	236.5	221.1
Headcount as at December 31	persons	1,604	1,517

In 2012, on the domestic market, the company will provide 2D and 3D seismic services to the PGNiG Group and Aurelian Oil & Gas PLC. On foreign markets, the company will continue to perform the contract with OMV Exploration & Production GmbH in Austria. The political situation in Libya and Pakistan having stabilised, the company also intends to provide its services in those countries.

GEOFIZYKA Toruń Sp. z o.o.

GEOFIZYKA Toruń Sp. z o.o. offers geophysical services in the area of seismic services, from design and data acquisition, through digital data processing, to comprehensive geophysical and geological interpretations. The company also provides services in the area of well logging and well interventions, including interpretation of well data. Further, the company's offering includes a variety of near-surface geophysical services in the field of geology, hydrogeology and environmental protection, as well as design and delivery of deep anode groundbeds for cathodic protection.

In 2011, GEOFIZYKA Toruń Sp. z o.o. generated revenue of PLN 371.1m. Sale of services to customers outside the PGNiG Group accounted for 70% of total revenue, of which 70% was generated on the Polish market. In 2011, the company continued its work for Chevron Polska Energy Resources Sp. z o.o., ExxonMobile Usługi Sp. z o.o. and FX Energy Poland Sp. z o.o., mainly in the area of data acquisition, as well as processing and interpretation of 2D and 3D seismic data. The services provided to the PGNiG Groupincluded acquisition, processing and interpretation of seismic data, and well logging. On foreign markets, the company provided services almost exclusively to third-party customers. The services primarily included acquisition of 2D and 3D seismic data and were provided in Germany, India, and Egypt.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	371.1	302.0
Net profit (loss)	PLNm	21.3	22.0
Equity	PLNm	187.9	177.3
Total assets	PLNm	253.5	235.0
Headcount as at December 31	persons	1,881	1,630

In 2012, GEOFIZYKA Toruń Sp. z o.o.'s operations on the domestic market will include acquisition, processing and interpretation of 2D and 3D seismic data, as well as well logging mainly for the PGNiG Group, and – outside the PGNiG Group – for FX Energy Poland Sp. z o.o., BNK Petroleum and DPV Service Sp. z o.o. On foreign markets, the company will continue to acquire seismic data in Egypt, Germany and India, as well as in Hungary, which is a new market for GEOFIZYKA. The company also plans to acquire new customers for its geological and well-logging services.

PN Diament Sp. z o.o.

The core business of PN Diament Sp. z o.o. are specialist well services, including drillings, major remedial treatments, well abandonment services, well testing, downhole measurements, application of enhanced recovery techniques and other services with the use of coiled tubing and nitrogen equipment, as well as well completion, drillstem testing and mud services. The company's business also includes general and road construction.

In 2011, revenue of PN Diament Sp. z o.o. amounted to PLN 206.4m, 53% of which represented sales to the PGNiG Group. The services provided to the PGNiG Group comprised drilling of research boreholes, well workovers, major remedial treatments and well abandonment, as well as a range of specialist services, including mud services, downhole measurements, completion, coiled tubing interventions and interventions with the use of nitrogen equipment. The services provided to external customers included mianly drilling of research boreholes (in particular, 12 boreholes for KGHM Polska Miedź S.A. drilled within a copper licence area) and a range of maintenance services. The company also provided services in the area of general construction, including construction of earth and road structures, as well as construction and reclamation of waste dumps. These services were mainly provided to customers outside the PGNiG Group.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	206.4	154.4
Net profit (loss)	PLNm	9.9	7.3
Equity	PLNm	103.3	99.8
Total assets	PLNm	151.8	135.3
Headcount as at December 31	persons	707	674

In 2012, PN Diament Sp. z o.o. plans to provide a range of services to the PGNiG Group, including well drillings, workovers, abandonments and maintenance, as well as further construction work on the Barnówko oil terminal and storage depot. The services planned to be provided to external customers include drilling of 11 boreholes for KGHM Polska Miedź S.A. and site preparation for Stare Miasto and Kamionka oil well surface installations for DrillTec GUT Gmbh Grossbohr und Umwelttechnik.

ZRG Krosno Sp. z o.o.

Zakład Robót Górniczych Krosno Sp. z o.o. is a provider of well servicing services. Its business includes mainly well interventions, such as workovers of active oil and gas wells, shallow drillings, coring, well abandonment services, decommissioning of infrastructure and waste pits, and other reclamation work. The company also performs a wide range of well servicing activities consisting in the application of enhanced recovery techniques, measurements and laboratory services.

In 2011, ZRG Krosno Sp. z o.o. generated revenue of PLN 71.5m, 74% of which represented sales to the PGNiG Group. The company's key customers included PGNiG domestic branches, to which ZRG Krosno Sp. z o.o. provided well intervention services, such as workovers, well reconditioning, application of enhanced recovery techniques and measurements of reservoir parameters. Services to external customers were provided mainly in Poland. They included drilling of a 1,400 metres deep coal well for NWR KARBONIA Sp. z o.o. The company also provided services consisting in application of enhanced recovery techniques and measurements of reservoir parameters for RWE DEA AG. S.A. and Park Wodny Bania Sp. z o.o. in Poland, as well as for RWE Gas Storage s.r.o. in the Czech Republic and NAFTA a.s. in Slovakia.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	71.5	91.4
Net profit (loss)	PLNm	1.4	0.1
Equity	PLNm	42.6	41.1
Total assets	PLNm	58.7	58.7
Headcount as at December 31	persons	395	431

In 2012, in Poland ZRG Krosno Sp. z o.o. will continue to provide workover services and services involving the application use enhanced recovery techniques or measurement of reservoir parameters. In 2012, the company will also continue to drill coal wells for NWR KARBONIA Sp. z o.o. in Poland and provide services consisting in the application of coiled tubing enhanced recovery techniques on further wells in the Czech Republic. The company's operations in the Czech Republic will also include execution of a contract for abandonment of 27 wells.

PGNiG Norway AS

PGNiG Norway AS has been established for the purposes of the Norwegian Continental Shelf project, the aim of which is to provide access to new recoverable reserves of oil and gas outside Poland. The principal business objective of PGNiG Norway AS is exploration for and production of crude oil and natural gas on the Norwegian Continental Shelf. The company has been pre-qualified by the Norwegian authorities as an operator.

On the Norwegian Continental Shelf, PGNiG Norway AS and its partners are implementing the Skarv/Snadd/Idun development project. PGNiG Norway AS holds a 12% interest in the licence; other interest holders are British Petroleum (operator, 24%), Statoil (36%) and E.ON Ruhrgas (28%).

The Skarv project is one of the largest investment projects under way in Norway. Under the project, 17 wells will be drilled, including seven oil production wells, six natural gas production wells and four injectors. At a later stage of the reserve life, the injectors will be transformed into gas producers in order to fully exploit the reserve potential. Production from the Skarv field will be carried out using a floating production, storage and offloading (FPSO) vessel with a flare tower.

The platform is the largest FPSO vessel in the world, able to operate in rough weather conditions. It was built in South Korea and transported to Norway in 2011. After the finishing work and installation tests had been performed in the shipyard, the vessel was anchored in open sea, directly above the Skarv field, upon which all subsea structures (foundation slabs, gas pipelines etc.) were installed on the Skarv and Idun fields. Rough weather conditions delayed the installation of production pipes. Accordingly, the launch of production was postponed until Q2 2012.

On October 19th 2011, PGNiG Norway AS and Shell International Trading and Shipping Company Ltd. ("Shell") concluded a crude oil sale agreement, whereby PGNiG Norway AS will sell to Shell PGNiG Norway AS's share in crude oil produced from the Skarv field. The Agreement was executed for an indefinite term and becomes effective in the month when production from the field is launched. The minimum term of the agreement is 12 months.

In 2011, following the conclusion of the 21st licence round, PGNiG Norway AS acquired:
- a 20% interest in licence PL599, the direct operatorship of which was awarded to BG Norge AS (40% interest),
- a 30% interest in licence PL600, the direct operatorship of which was awarded to Dana Petroleum (70% interest).

Moreover, in 2011, PGNiG Norway AS purchased another 15% interest in licence PL558 from Nexen Exploration Norge AS. Following the transaction, PGNiG Norway AS's interest in this licence increased to 30%.

In 2011, an appraisal well was drilled in the Snadd North field, discovered in 2010. Given to the fact that the exploratory well on licence PL419 proved dry and due to the low permeability of gas reservoir on licence PL326 (Gro field), work on the licences was discontinued.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	0.0	0.0
Net profit (loss)	PLNm	-131.6	-76.8
Equity	PLNm	291.0	314.2
Total assets	PLNm	4,661.4	3,424.1
Headcount as at December 31	persons	23	22

In February 2012, following the conclusion of the licence round, PGNiG Norway AS acquired:

- a 50% interest in and the direct operatorship of licence PL648S,
- a 20% interest in licence PL646, the direct operatorship of which was awarded to Wintershall Norge AS (40% interest),
- a 30% interest in licence PL350B, the direct operatorship of which was awarded to E.ON Ruhrgas Norge AS (40% interest).

PGNiG Norway expects to launch production from the Skarv field in 2012. The produced oil will be sold directly from the platform and transported by a business partner operating a fleet of shuttle tankers. The produced gas will be transmitted over the Gassled Area B System gas pipeline to the onshore terminal in Kårsto, to be redirected to Germany over the Gassled Area D System gas pipeline. In 2012, the company will also continue appraisal work on the Snadd North field. Further, the company also plans to acquire new licence areas through participation in annual licence rounds or acquisition of interests from other entities.

POGC–Libya B.V.

The core business of Polish Oil and Gas Company – Libya B.V. consists in exploration for and production of hydrocarbons in Libya. The company conducts exploration work in the 113 licence area located within the Murzuq petroleum basin, under an Exploration and Production Sharing Agreement of February 25th 2008 concluded with the Libyan government.

In 2011, the National Oil Corporation gave its consent to the company's drilling two exploratory wells within the licence area, including one conditional consent. The company has also submitted two further drilling projects for approval by the National Oil Corporation. By February 2011, the company acquired 3,000 km of 2D profiles and 1,087 sq km of 3D profiles, and carried out a number of geological analyses. Preparations for drilling are under way.

When the civil war in Libya broke out in February 2011, all non-Libyan employees of POGC-Libya B.V. were evacuated from the country. In March 2011, the company gave notice to National Oil Corporation of a force majeure event, which suspended performance of the Exploration and Production Sharing Agreement (EPSA) until the situation which provides the basis for such notice ceases to apply. In October 2011, the civil war in Libya ended and the company resumed the operation of the office for local employees.

In 2011 in Poland, in cooperation with PGNiG SA, the company completed the geological interpretation of 2D seismic data and developed the design of data acquisition for the remaining second phase of 3D survey.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	0.0	0.0
Net profit (loss)	PLNm	-20.7	-55.3
Equity	PLNm	47.6	54.8
Total assets	PLNm	52.9	64.8
Headcount as at December 31	persons	36	37

In 2012, POGC-Libya B.V. plans to bring the other employees back to Libya , and when the situation is stable enough to ensure the employees' personal security, the company will resume its work under the EPSA agreement. Having resumed the performance of the agreement, the company will commence drilling of exploratory wells in the second half of 2012 and the acquisition of second-phase 3D data. If the wells prove positive, POGC-Libya B.V. intends to commence drilling appraisal wells. Given the expected opening of the Libyan market to foreign investors, the company will apply for new exploratory and production licences.

4. Planned activities

Exploration in Poland

In 2012, PGNiG SA plans to carry out geophysical work and drillings as part of exploration work in Poland on a few dozen of prospects in the Carpathian Mountains, Carpathian Foothills and the Polish Lowlands. These operations will be carried out by PGNiG SA independently as well as in cooperation with foreign partners. As part of these activities, PGNiG SA intends to implement projects focused on exploring new potential in the area of unconventional reserves (shale oil/gas and tight gas), where little appraisal has so far been made. Further drilling work is scheduled in the Lubocino formation explored by the drilling of the Lubocino-1 reserch borehole. The Company intends to start drilling the Opalino-2, Lubocino-2h, Miłowo-1 and Mirowo-2 wells (Pomerania), as well as the Lubycza Królewska well (Lublin region). In the Carpathian Mountains and Carpathian Foothills, the drilling of the deep Dukla-1 well is to be completed, while the Kramarzówka1 well will undergo testing.

Exploration Abroad

In 2012, PGNiG SA will continue exploration work in Egypt. In Denmark, given the negative results from the Felsted-1 exploration well, PGNiG SA decided not to extend the 1/05 licence. In Pakistan, test production from the Hallel-1 and Rehman-1 wells will be launched. PGNiG Norway will continue appraisal work in the Snadd North field in Norway. POGC-Libya B.V. intends to resume performance of the EPSA agreement in Lybia. Having resumed the performance of the agreement, the company will commence drilling of exploratory wells in the second half of 2012 and the acquisition of second-phase 3D data. If the wells prove positive, POGC-Libya B.V. intends to commence drilling appraisal wells.

Natural gas production

The PGNiG Group is implementing an investment programme aimed at increasing, in a long-term perspective, its natural gas production capacity. As part of the programme, the PGNiG Group 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.

The plans for 2012 assume an annual natural gas production volume of approximately 4.7 billion cubic meters of high-methane gas equivalent with a calorific value of 39.5MJ per cubic meter, of which approximately 4.4 billion cubic meters will be produced in Poland, 0.2 billion cubic meters – in the Norwegian Continental Shelf and 0.1 billion cubic metres – in Pakistan. In the first half of 2012, the PGNiG Group will commence production from the Skarv field. The production launch date, previously scheduled for the second half of 2011, was postponed due to delays in the installation of production piping caused by difficult weather conditions in the Norwegian Sea. In Poland, 2012 will see new wells put on stream in the existing fields (Bogdaj-Uciechów, Jarocin, Rudka and Pruchnik), and launch of production from new fields (Góra Ropczycka, Rylowa-Rajsko and Lubliniec), with total production capacities of approximately 18.5 thousand cubic metres per hour.

Crude oil production

In 2012, the PGNiG Group plans to produce 660 thousand tonnes of crude oil, including 480 thousand tonnes in Poland and 180 thousand tonnes in the Norwegian Continental Shelf. Three new wells are to be hooked up in the Barnówko-Mostno-Buszewo (BMB) field in Poland.

5. Risks related to exploration and production

Resource Discoveries and Estimates

The main risk inherent in exploration activity is the risk of failure to discover reserves, i.e. the exploration risk. This means that not all the identified potential deposit sites have deposits of hydrocarbons which can qualify as an accumulation. Whether or not a sufficient accumulation exists depends on a number of geological factors. Furthermore, the actual quantity and quality of the accumulated hydrocarbons may differ from estimates. When the results of successful exploration activity, in the form of new reserves, do not offset the production from the existing reserves, PGNiG SA's recoverable reserves will decrease pro rata to the current production volumes.

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 SA's financial performance.

Exploration for Unconventional Gas

The risk associated with exploration for unconventional 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 and high investment expenditure necessary on drillings and construction of production infrastructure. Another material factor is connected with difficult access to unconventional gas prospects given the environmental regulations and the necessity to obtain the landowners' consent for access to the area.

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 SA, especially those active globally, enjoy strong market positions and have financial resources larger than those of PGNiG SA. 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 SA could offer given its financial and human resources. This competitive advantage is particularly important on the international market.

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 tender for licence until the relevant contract is ratified. Moreover, prior to the commencement of field work, the Company is 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. In addition, 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 SA's control include:
- local governments' failure to approve local zoning plans or amendments to those already approved;
- obstacles in incorporating investment projects 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. Concurrently, PGNiG SA's obligation to comply with the Public Procurement Law frequently prolongs the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire investment project. 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 to a significant extent depends on the prices of oil derivative products and on exchange rates. In 2011, PGNiG SA introduced the Daily Rate system into the drilling contractors selection procedure, which is expected to reduce the costs of drilling services.

Safety, Environmental Protection and Health Regulations

Ensuring compliance with environmental laws in Poland and abroad may significantly increase PGNiG SA's operating expenses. Currently, PGNiG SA 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 the 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. The tendency to tighten up the environmental protection regulations is seen also in other countries where PGNiG SA conducts exploration activity.

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 SA operates, highly qualified staff is difficult to recruit.

Unpredictable Events

Hydrocarbon deposits developed by PGNiG SA are usually located at great depth, which involves extremely high pressures and, in many cases, presence of hydrogen sulphide. Consequently, there 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.

Changes in laws and regulations

The laws and regulations in some countries change frequently and unexpectedly, causing problems to entities involved in exploration activity. This problem may be particularly acute in countries where changes in law depend on decisions made by authoritarian governments.

Political and Economic Situation

In some countries where PGNiG SA conducts exploration activity there is a risk of armed conflicts or terrorist attacks, which may lead to a limitation, suspension or discontinuation of the exploration and production activities.

In some regions where PGNiG SA is present there is a risk of social and political unrest. Changes of governments may bring to a halt licensing proceedings before state administration authorities. Additionally, these countries are at risk of internal conflicts and social unrest caused by poor social and demographic conditions. The risks specified above may lead to a limitation, suspension or discontinuation of PGNiG SA's activities.

In certain countries, operations of exploration companies may be hindered by the lack of adequate infrastructure, which may be an obstacle in transporting equipment, personnel and materials to the sites. Problems may also arise in providing supplies and ensuring appropriate health care. These risks may lead to a limitation or suspension of the Company's exploration activities.

Chapter VII: 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 uses three underground gas storage facilities, located in Mogilno, Wierzchowice and Husów.

1. Gas purchases

In 2011, PGNiG SA imported gas and, to a limited extent, purchased the fule from domestic suppliers. PGNiG SA imported natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with Gazprom Export and medium-term gas supply agreements with VNG-Verbundnetz Gas AG:

- Contract with Gazprom Export for sales of natural gas to the Republic of Poland, dated September 25th 1996, which will remain in force until 2022;
- Agreement with VNG-Verbundnetz Gas AG for sales of the Lasów natural gas, dated August 17th 2006, which will remain in force until October 1st 2016;
- Agreement with VNG-Verbundnetz Gas AG for sales of the Lasów 2008 natural gas, dated September 29th 2008, in force until October 1st 2011.

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

Structure of natural gas purchases by supply sources (million cubic metres)

	2011	%	2010	%
Imports, including:	10,915.3	99.0%	10,066.4	99.1%
- Gazprom Export	9,335.5	85.5%	9,028.4	89.7%
- VNG AG	716.0	6.6%	890.8	8.8%
- Other foreign suppliers	863.8	7.9%	147.2	1.5%
Domestic suppliers	112.3	1.0%	96.1	0.9%
Total	11,027.6	100.0%	10,162.5	100.0%

On January 1st 2011, NAK Naftogaz Ukrainy suspended gas deliveries via the Zosin cross-border point (near Hrubieszów) on the Polish-Ukrainian border, where gas is supplied to Poland under a gas supply agreement of October 26th 2004. As at the date of this report, NAK Naftogaz Ukrainy has not resumed gas deliveries to the Hrubieszów area. PGNiG SA is looking for other suppliers who could guarantee gas deliveries to the Zosin terminal. Despite the suspension of gas supplies from Ukraine, the Hrubieszów area has been receiving sufficient gas supplies to meet the local demand.

New agreements

On March 21st 2011, PGNiG SA and Gazprom Export executed an annex to the contract of September 25th 1996 providing for sales of natural gas to the Republic of Poland. The parties agreed on an option to increase the daily offtake at the Vysokoye cross-border point to 15 million cubic metres, with the annual contracted volumes remaining unchanged.

On May 13th 2011, PGNiG SA and Vitol SA concluded an Individual Agreement for natural gas supplies to a cross-border terminal on the Polish-Czech border in the Cieszyn area. Under the agreement, approximately 550 million cubic metres of gas per year will be delivered in the period from October 1st 2011 to October 1st 2014. The gas will be supplied via a newly built interconnector, which has connected the gas systems of Poland and the Czech Republic.

On May 13th 2011, PGNiG SA and VNG-Verbundnetz Gas AG signed an Individual Agreement for summer gas supplies to the Lasów cross-border terminal. Under this agreement, gas was supplied in the period from May 17th to July 3rd 2011.

On June 30th 2011, PGNiG SA and VNG-Verbundnetz Gas AG executed an Individual Agreement for summer gas supplies to the Lasów cross-border terminal. Under the agreement, gas was supplied in the period from July 3rd to September 30th 2011.

In 2011, PGNiG SA reserved transmission capacities in the German transmission system in order to transport gas volumes purchased at the VTP Gaspool platform (virtual trading point) to the Lasów cross-border terminal (in the period October 1st 2011–September 30th 2016) and to the Gubin cross-border terminal (in the period October 1st 2011–October 1st 2014). In September 2011, PGNiG SA executed three short-term EFET (European Federation of Energy Traders) standard contracts at the VTP Gaspool platform for delivery of small amounts of natural gas.

Also, in order to transport the volumes of gas purchased on the German market (at the VTP Gaspool platform), the Company and OGP GAZ-SYSTEM S.A. executed a short-term agreement for the provision of virtual reverse flow services on the Yamal gas pipeline in the period from November 1st 2011 to January 1st 2012. The gas was delivered on the basis of a series of separate transactions executed by PGNiG Sales & Trading GmbH.

2. Gas sales

In 2011, PGNiG SA signed comprehensive agreements for supply of gas fuel, both from the transmission system and from the distribution system, to 90.1 thousand new customers.

On March 11th 2011, a comprehensive agreement for the supply of gas fuel was executed signed with Elektrociepłownia Stalowa Wola S.A. The fuel will be used to fire a CCGT unit. The planned annual offtake is approximately 540 million cubic metres. The agreement was concluded for 14 years, starting from the launch of supplies. Performance of the agreement will commence upon fulfilment of certain conditions precedent. The value of the agreement throughout its term is estimated at approximately PLN 9.7bn.

In the period June 27th–29th 2011, PGNiG SA executed six agreements with Gas Distribution Companies, including:

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

Under the agreements, the Gas Distribution Companies will provide gas fuel distribution services to PGNiG SA. The agreements remain in effect from June 29th 2011 to June 28th 2015. The estimated aggregate value of the agreements over their entire term is approximately PLN 14bn.

On November 29th 2011, PGNiG SA and Grupa LOTOS S.A. executed an annex to the comprehensive gas fuel supply agreement of June 16th 2010. Under the annex, the starting date of gas fuel supplies to Grupa LOTOS S.A. was changed from December 16th 2011 to April 30th 2012. The annex also changes the planned, target annual volume of natural gas deliveries from 447 million cubic metres to 585 million cubic metres. The estimated value of the agreement over a period of five years amounts to approximately PLN 3.2bn.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. In 2011, sales of natural gas remained flat year on year. PGNiG SA sold gas chiefly on the Polish market. The structure of the Trade and Storage segment's sales in 2011 is presented in the table below.

Sales structure of key products

		Entity	2011	2010
1	Natural gas, including:	million cubic meters	13,595.7	13,562.2
	- high-methane gas	million cubic meters	13,102.9	13,044.9
	- nitrogen-rich gas*	mln m^3	492.8	517.3
2	Propane-butane	thousand tonnes	1.8	1.9

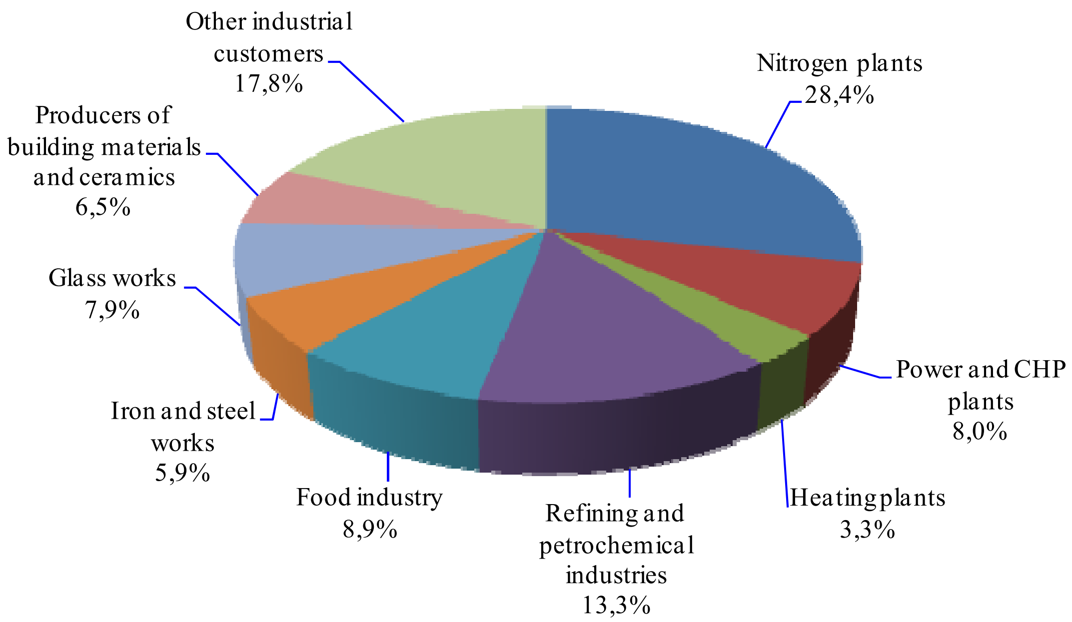
* Measured as high-methane gas equivalent.

The Group's key customers included companies from the chemical, petrochemical and metallurgical sectors, as well as households. Households made up the largest group of customers purchasing natural gas, accounting for 97% of the entire customer base (approximately 6.5m). Their share in the total sales volume was 27%, down by approximately 9% year on year. On the other hand, sales of natural gas to industrial customers, representing 60% of the total sales volume, grew by 518.2 million cubic metres (approximately 7%). 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 (million cubic meters)

	2011	%	2010	%
Industrial customers	8,149.7	60.0%	7,631.5	56.3%
Trade and services	1,467.6	10.8%	1,573.3	11.6%
Households	3,730.2	27.4%	4,095.8	30.2%
Wholesale customers	221.5	1.6%	217.7	1.6%
Exports	26.7	0.2%	43.9	0.3%
Total	13,595.7	100.0%	13,562.2	100.0%

Structure of sales of natural gas to industrial customers in 2011



In 2011, PGNiG SA and Mazowiecka Spółka Gazownictwa Sp. z o.o. completed network switch-over from propane-butane-air to high-methane gas in the town of Pisz in the Olsztyn province.

PGNiG SA and ZRUG Sp. z o.o. of Poznań completed construction of a gas network in the Rakoniewice municipality. The project involved construction of a 75km medium-pressure gas pipeline. Completion of this project will contribute to an increase in the number of new connections and in the volume of gas sold.

In the first half of 2011, PGNiG SA launched a gas distribution project consisting in LNG distribution of gas fuel to Ełk and Olecko. This project is a part of a initiative to switch Pisz, Ełk, Suwałki and Olecko to high-methane gas (the PESO project). Construction of gas distribution installations under the project is to be completed in 2013.

3. Storage

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

Short-term peak fluctuations in customer demand for natural gas are balanced out with the supplies from the Mogilno Underground Gas Storage Cavern Facility, where gas is stored in worked-out. The capacities of the Wierzchowice and Husów Underground Gas Storage 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 contracts for imports, to safeguard the continuity and security of natural gas supplies and to meet the obligations under sales agreements providing for the delivery of natural gas to customers' premises.
In addition, the capacities of the Wierzchowice, Husów and Mogilno facilities are used by the Group 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.

Since 2009, PGNiG SA has the status of Storage System Operator. In March 2011, PGNiG SA applied to the President of the Energy Regulatory Office requesting the appointment of Operator Systemu Magazynowania Sp. z o.o. as the Storage System Operator for gas fuels and the granting of a licence for storage of gas fuels in storage facilities. These steps were taken with a view to meeting the obligations under Regulation (EC) No. 715/2009 of the European Parliament and of the Council of July 13th 2009 on conditions for access to the natural gas transmission networks and repealing Regulation (EC) No. 1775/2005. As at the date of this report, the proceedings were pending.

Detailed terms of providing gas fuel storage services (working capacity, injection capacity, withdrawal capacity) and sale of storage services are laid down in the "Rules of Provision of Storage Services". The current version of "Rules of Provision of Storage Services" are available at the Storage System Operator's website.

In 2011, PGNiG SA continued work related to the construction of four caverns in the Mogilno Underground Gas Storage Cavern Facility and the surface part of the Wierzchowice Underground Gas Storage Facility. The Company also commenced construction of the surface part of a new high-methane gas storage facility, i.e. the Kosakowo Underground Gas Storage Cavern Facility.

Under an annex of December 29th 2011 to the agreement for co-financing of the Wierzchowice Underground Gas Storage Facility project (as part of the EU Infrastructure and Environment Operational Programme), the period for qualifying the project-related expenditure as eligible was extended until March 31st 2014. The agreement for partial financing of the Mogilno Underground Cavern Gas Storage Facility was terminated, because the European Commission did not approve the expenditure submitted by PGNiG SA for partial financing as qualifying. The table below presents working capacities of the underground storage facilities as at December 31st 2010 and December 31st 2011.

Working capacities of the storage facilities in the Trade and Storage segment (million cubic meters)

	2011	2010
Husów	350.0	350.0
Mogilno	377.9	377.9
Wierzchowice	575.0	575.0

In November 2011, PGNiG SA made available a total of 751.5 million cubic metres of working storage capacity (of both the Storage and Trade segment and the Exploration and Production segment) for third party access, provided on an intermittent basis, of which 730 million cubic metres was made available under long-term agreements effective as as of the beginning of the 2012/2013 storage year, and 21.5 million cubic metres under short-term agreements in the 2011/2012 storage year.

Until the end of 2011, PGNiG SA made available a total of 1,378.5 million cubic metres of working storage capacity for third party access, provided on a continuous or intermittent basis, of which 1,357 million cubic metres was made available under long-term agreements and 21.5 million cubic metres under short-term agreements.

4. Trade and storage companies

INVESTGAS S.A.

INVESTGAS S.A. specialises in execution of hydrocarbon storage and transport projects. It also executes specialist and general construction projects. The company provides services covering the entire investment process: from preparation, through design, construction and commissioning, to operation of gas storage units in salt caverns and other types of facilities.

In 2011, INVESTGAS S.A.'s revenue totalled PLN 141.6m. Revenue from services provided to PGNiG SA represented 99% of total revenue. The key projects executed for PGNiG SA in 2011 included:

- continued operation and construction of new caverns in the Mogilno Underground Gas Storage Cavern Facility;
- continued construction of the Kosakowo Underground Gas Storage Facility;
- continued extension of the Strachocina Underground Gas Storage Facility;
- continued construction of the Kościan Gas Production Facility - KGHM Polkowice/Żukowice gas pipeline.

Additionally, in 2011, the company conducted preparatory work related to construction of a gas pipeline from Hermanowice to Strachocina for OGP GAZ- SYSTEM S.A.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	141.6	242.7
Net profit	PLNm	8.7	16.9
Equity	PLNm	40.5	33.5
Total assets	PLNm	79.1	111.8
Headcount as at December 31	persons	114	108

In 2012, the company will continue work related to the operation, construction and extension of underground gas storage facilities as well as the construction of the Kościan Gas Production Facility - KGHM Polkowice/Żukowice and Hermanowice-Strachocina gas pipelines. The company also intends to secure new orders for construction and extension of underground gas storage facilities, and for construction of gas and fuel pipelines with auxiliary infrastructure.

Operator Systemu Magazynowania Sp. z o.o.

Operator Systemu Magazynowania Sp. z o.o. was established on 16th November 2010 to ensure compliance with the requirements of Directive 2009/73/EC with respect to legal separation of gas fuel storage functions from other types of business conducted by vertically integrated gas utilities.

In March 2011, PGNiG SA applied to the President of the Energy Regulatory Office requesting the appointment of Operator Systemu Magazynowania Sp. z o.o. as the Storage System Operator for gas fuels and the granting of a licence for storage of gas fuels in storage facilities. As at the date of this report, proceedings were pending.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	0.0	0.0
Net profit	PLNm	-1.0	0.0
Equity	PLNm	4.0	1.0
Total assets	PLNm	4.3	1.0
Headcount as at December 31	persons	3	0

PGNiG Sales & Trading GmbH

PGNiG Sales & Trading GmbH was established to conduct trading activities on international gas and energy markets. Currently, the company is in the process of organisation and has been preparing to commence operations.

As part of the process, PGNiG Sales & Trading GmbH has became a member of the European Energy Exchange in Germany and has been registered at German virtual trading platforms, such as NetConnect Germany and Gaspool. PGNiG Sales & Trading GmbH contracted Nordea Bank to settle the company's transactions executed on the European Energy Exchange and on the over-the-counter market. Additionally, the company executed agreements with brokerage firms, through which it will trade energy on the OTC market.

In 2011, PGNiG SA obtained the right to use the transmission capacity of the Polish section of the Yamal gas pipeline as part of OGP GAZ-SYSTEM S.A.'s virtual reverse service. Therefore, PGNiG Sales & Trading GmbH executed short-term gas supply contracts with European gas trading companies and in the period from November 1st 2011 to January 1st 2012 supplies 388m $^{\text{cubic metres}}$ of gas to PGNiG through the virtual reverse service.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	449.9	0
Net profit (loss)	PLNm	-3.3	0
Equity	PLNm	40.6	39.6
Total assets	PLNm	221.3	39.6
Headcount as at December 31	persons	14	0

In 2012, the company plans to start trading on the European gas and energy market, to commence cooperation with PGNiG Norway AS in the area of trading in natural gas produced from the Skarv field and to launch gas sales to institutional customers.

5. Planned activities

Gas Supplies

In order to reduce gas acquisition costs in the coming years, PGNiG SA executed an agreement with OGP GAZ-SYSTEM S.A. for the provision of virtual reverse services on the Yamal gas pipeline from January 1st 2012 to December 31st 2015, on an intermittent basis. It will enable the Company to purchase gas at the VTP Gaspool platform (virtual trading point) and provide a sufficient level of gas supplies to Poland.

Storage

In 2012, PGNiG SA will continue work on extending the Mogilno Underground Gas Storage Cavern Facility and the Wierzchowice Underground Gas Storage Facility. Completion of the surface part of the Wierzchowice Underground Gas Storage Facility has been rescheduled for 2012. Moreover, the Company will continue construction of a new high-methane gas storage facility, i.e. the Kosakowo Underground Gas Storage Cavern Facility. In the future, the Company intends to make available to third parties the extended storage capacities in Strachocina, Mogilno and Wierzchowice facilities.

6. Risks related to Trade and Storage

Requirement to diversify supplies of imported gas

On December 16th 2010, the President of the Energy Regulatory Office imposed a PLN 2m fine on PGNiG SA for breaching the terms and conditions of its licence for international trade in natural gas, by failing to comply with the requirement to diversify supplies of imported gas in 2007 and 2008. The maximum share of gas imported from one country in total gas imports 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. On January 4th 2011, PGNiG SA filed an appeal against the decision imposing a fine through the agency of the President of the Energy Regulatory Office to the Regional Court of Warsaw. The Company challenged in full the decision of the President of the Energy Regulatory Office, citing, among other things, breach of the Constitution, erroneous interpretation and improper application of the Energy Law. Moreover, in order to avoid similar situations in the future, PGNiG SA 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 no changes are made to the Regulation, the President of the Energy Regulatory Office may keep on imposing fines on the Company for failing to comply with the diversification requirement until gas starts to be delivered to the Company from other sources (e.g. through the LNG terminal).

Deregulation of gas prices for customers

PGNiG SA is the largest supplier of natural gas in Poland. Its share in the gas market is estimated at approximately 98%, and the remaining 2% is represented by suppliers from outside the PGNiG Group which usually purchase gas from PGNiG SA However, in 2012–2013, important changes are expcted to take place on the natural gas market and in the legal environment. Deregulation of gas prices for institutional customers is planned for January 1st 2013, followed by deregulation of gas prices for households (in 2–3 years time). Additionally, the Gas Law and the new Energy Law are planned to be adopted in 2012. As a result of introducing the planned changes, the Company's share in the natural gas sales volume may significantly fall to the benefit of the existing or new gas trading entities. On the other hand, following the deregulation process, gas prices will be chiefly market-driven.

Storage

Pursuant to the Act on Mandatory Stocks, as of October 1st 2012, the volume of mandatory stocks must be increased from 20 to 30 days of average annual imports. As a result, there is a risk that the Company will not be able to meet its obligations under the gas sales agreements, given that significant storage capacities which will have to be used for storage of the increased mandatory stocks.

Chapter VIII: Distribution

The segment's core business consists in the transmission of high-methane and nitrogen-rich gas, as well as of small amounts of propane-butane and coke-oven gas over the distribution network. Natural gas distribution is the business of six Gas Distribution Companies, which supply gas to households, as well as to industrial and wholesale customers. In addition, they are responsible for operating, repairing and expanding the distribution network. On the basis of a decision issued by the President of the Energy Regulatory Office, since mid-2007 the Gas Distribution Companies have had the status of Distribution System Operators.

1. Dolnośląska Spółka Gazownictwa Sp. z o.o.

Dolnośląska Spółka Gazownictwa Sp. z o.o. (Lower Silesian Gas Distribution Company, "DSG") supplies gas to customers in the Wrocław province and the Zielona Góra / Gorzów Wielkopolski province, as well as in the Wolsztyn and Nowy Tomyśl counties of the Poznań Province. The percentage of households and businesses connected to the gas grid varies between communes, depending on geographical conditions. Areas without access to the gas supply system are usually those located at a considerable distance from the pipelines, where the relevant studies have shown that their connection to the gas grid would not be economically viable. In such areas, for instance in the area around the village of Świętoszów, the company supplies gas in liquefied form (LNG).

The total volume of natural gas transmitted by DSG over the distribution network in 2011 was 936.5 million cubic meters (measured as high-methane gas equivalent), of which high-methane gas and nitrogen-rich gas accounted for approximately 679.8 and 256.7 million cubic meters, respectively . The company provides its services to approximately 749.7 thousand customers. In 2011, DSG Sp. z o.o. connected 7.9 thousand new customers to the gas network.

In 2011, the company continued the replacement of cast-iron piping whose further operation would have posed a safety hazard and resulted in large gas losses. The implementation of the cast-iron piping replacement programme, as well as regular technical inspections of the network, have reduced the share of gas losses in total sales. The company completed the replacement of low-pressure gas pipelines at ul. Mickiewicza in Szczawno Zdrój, at ul. Wschodnia, Niecała, Wrocławska, Wierzbowa and Komunalna in Świdnica and at ul. Nowowiejska, Modlińska and Górnicza in Wrocław.

Other work carried out by DSG related to extension and modernisation of the gas network. Major projects carried out in 2011 included:

- continuation of design work and commencement of construction work for phase 1 of gas network connection to Długołęka, Domaszczyn, Kamień and Szczodre in the Długołęka commune; the project involves construction of a medium-pressure gas pipeline and a pressure reduction station; in 2011, work continued on construction of the pipline from the station in Mirków to the Długołęka ring road, and from Długołęka to Byków;
- connection of Pęgów, Zajączków, Golędzinów, Paniowice in the Oborniki Śląskie commune and Szewce in the Wisznia Mała commune to the gas supply system; the project involves construction of medium-pressure gas pipelines and connections; in December 2011, the pipeline in Szewce (from the Rogoż pressure reduction station to Zajączków) was completed;
- construction of a pressure reduction system in the Miękinia commune; the project will be continued in 2012;
- commencement of phase 1 of the gas network extension to Mieroszów, with the use of the LNG technology.

In 2011, the company completed two projects co-financed with EU funds under the Infrastructure and Environment Operational Programme:

- construction of a distribution network and medium-pressure connections in Mokronos Górny and Mokronos Dolny in the Kąty Wrocławskie commune, involving construction of medium-pressure gas pipelines and connections;
- construction of a medium-pressure gas network in Krępice, Wróblowice, Błonie and Źródła in the Miękinia Commune, involving construction of medium-pressure gas pipelines and connections.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	356.5	374.9
Net profit	PLNm	44.7	216.1
Equity	PLNm	1,157.4	1,172.7
Total assets	PLNm	1,373.3	1,376.5
Length of network, excl. connections	km	7,809.0	7,741.2
Headcount as at December 31	persons	1,424	1,420

In 2012, the company will continue to connect to the gas supply system the villages of Długołęka, Domaszczyn, Kamień and Szczodre in the Długołęka commune, Golędzinów, Paniowice, Pęgów, Zajączków in the Oborniki Śląskie commune, Szewce in the Wisznia Mała commune and Krzeszów in the Kamienna Góra commune. The company will also continue the design work (started in 2011) to connect to the gas grid the villages of Strzelin, Kurów, Witowice and Wiązów in the Strzelin commune, Radomierzyce and Biestrzyków in the Siechnice commune and Suchy Dwór, Mędłów, Żórawina and Wojkowice in the Żórawina commune.

In the area covered by the DSG network, a number of other gas sellers and distributors are intensifying their activities. In future, they may take over the company's existing or prospective customers (both industrial customers and households). There are four key competitors in the region: G.EN. Gaz Energia S.A., EWE Energia sp. z o.o., KRI S.A. and CP ENERGIA S.A.

2. Górnośląska Spółka Gazownictwa Sp. z o.o.

Górnośląska Spółka Gazownictwa Sp. z o.o. (Upper Silesian Gas Distribution Company, "GSG") supplies gas to customers in the Katowice and Opole provinces, in 41 communes of the Kraków province, in 5 communes of the Łódź province and in 3 communes of the Kielce province. It serves approximately 1.3 million customers. The total volume of gas transmitted by GSG over the distribution network in 2011 was 1,651.6 million cubic meters.

In 2011, GSG connected 5.5 thousand new customers to the network. The company also worked on upgrading the network, and continued the roll-out of the grid in areas west of Częstochowa. Major projects carried out in 2011 included:

- completion of the rehabilitation project on a 20 km section of the high-pressure gas pipeline from Zdzieszowice to Płużniczka in Olszowa (economic zone in the Ujazd commune)
- completion of stages I, II, and III of the upgrade project on a medium-pressure gas pipeline in Bolęcin, Trzebinia commune

- completion of the upgrade project on a medium-pressure gas pipeline from Szobiszowice to Ząbkowice (section from Ostrożnica to the zinc mill in Miasteczko Śląskie)
- completion of the upgrade project on a low-pressure gas pipeline at ul. 1-go Maja in Katowice (section from ul. Graniczna to the pressure reduction and metering station)
- continuation of design work as part of the project to connect the municipalities and communes of Blachownia, Herby, Wręczyca Wielka, Kłobuck, Opatów, and Krzepice to the gas network; the project involves construction of (i) an approximately 18 km high-pressure gas pipeline from Blachownia to Kłobuck, with a pressure reduction station, (ii) high- and medium-pressure gas pipelines and two pressure reduction stations for the towns of Herby and Blachownia, and (iii) a 52 km medium-pressure gas pipeline serving Wręczyca Wielka and Kłobuck
- commencement of reconstruction of the high-pressure gas pipeline from Zdzieszowice to Tworzeń (section from Wielowieś to Tworóg)
- commencement of reconstruction of a medium-pressure gas pipeline from ul. Obrońców Poczty Gdańskiej in Zawiercie to ul. Niepodległości in Poręba
- acquisition from PGNiG SA of a high-pressure gas pipeline from Hanuszów to Paczków.

GSG also worked on the roll-out of gas distribution systems in the communes of Komprachcice and Dąbrowa, which received EU co-financing under the Infrastructure and Environment Operational Programme. The project involves construction of 62 km of medium-pressure gas pipelines, which are planned to be placed in service in 2012-2013.

GSG also completed the upgrade of a decommissioned coke-oven gas high-pressure pipeline from Czarnocin to Ujazd, which will allow the company to supply gas to a new economic zone in Ujazd in the Opole province. In 2012, work will continue on upgrading sections of the pipeline situated in the Katowice province.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	608.9	633.3
Net profit	PLNm	102.0	117.7
Equity	PLNm	1,619.5	1,630.2
Total assets	PLNm	1,892.9	1,898.1
Length of network, excl. connections	km	20,960.9	20,875.2
Headcount as at December 31	persons	2,631	2,619

In 2012, the company will continue the roll-out of the gas distribution system in the communes of Komprachcice, Dąbrowa, Herby, Blachownia, Wręczyca Wielka, Kłobuck, Opatów and Krzepice. The company will also begin work on preparing documentation necessary to connect the Elektrociepłownia Katowice CHP plant to the gas distribution network; once connected, the plant will be the company's largest customer. In the coming years, GSG will continue the roll-out of the gas distribution network in areas to the west of Częstochowa and in the Opole region.

EWE Energia Sp. z o.o. and its subsidiaries operate in northern parts of the GSG coverage area, providing gas distribution and trading services.

3. Karpacka Spółka Gazownictwa Sp. z o.o.

The operations of Karpacka Spółka Gazownictwa Sp. z o.o. (Carpathian Gas Distribution Company, "KSG") cover the area of four provinces in south-eastern Poland, namely the provinces of Kraków, Rzeszów, Kielce and Lublin. The company's operating area is crossed by one of the main gas pipelines of the Polish transmission system, fed with both imported and domestically-produced natural gas. The company serves ca. 1.4m customers. The total volume of gas transmitted by KSG over the distribution network in 2011 was 1,986.3 million cubic meters.

In 2011, KSG connected 12.5 thousand new customers to the gas network. The company also worked on upgrading its gas distribution networks to enhance the security of network operation, and implemented network extension projects. The key projects in the area included:

- continuation of reconstruction of a 20.2 km high-pressure gas pipeline from Warzyce to Gorlice (stages IV and V), situated in the Tarnowiec and Jasło communes
- continuation of design work related to the upgrade of a 61 km high-pressure gas pipeline from Sandomierz to Ostrowiec Świętokrzyski; the project is scheduled for completion in 2015
- continuation of reconstruction of a 12.2 km high-pressure gas pipeline from Tuszyma to Mielec; in 2011, 8.3 km of the gas network was upgraded; construction and assembly work is scheduled for completion in 2012
- continuation of reconstruction of a 6.6 km medium-pressure gas pipeline from ul. Piłsudskiego to the Biegonice district in Nowy Sącz; in 2011, 4.1km of the gas network was upgraded
- continuation of design work related to the upgrade of a 37 km high-pressure gas pipeline from Parszów to Kielce; the project is scheduled for completion in 2015
- continuation of design work related to the construction of a 5 km high-pressure gas pipeline from Mójcza to Masłów
- continuation of design work for the planned roll-out of the gas distribution system in in the Włoszczowa and Małogoszcz communes; the project comprises construction of a 43.3 km high-pressure gas pipeline with pressure reduction stations, and a 51 km medium-pressure gas pipeline with eight gas governor stations; the project is scheduled for completion in 2015; the company has taken steps to secure EU funding for the project
- continuation of design work for the planned roll-out of the gas distribution network to industrial and municipal customers and households in the Chęciny and Sitówka communes; the project comprises construction of a 4.5 km high-pressure gas pipeline with a pressure reduction station, and a 67.2 km medium-pressure gas pipeline network with connections and gas governor stations; the project is scheduled for completion in 2015; the company has taken steps to secure EU funding for the project
- continuation of design work on the project to install gas supply lines in Szczawnica commune; the project comprises construction of a 13.5 km high-pressure gas pipeline with a pressure reduction station, and a 51 km medium-pressure gas pipeline network with connections; the project is scheduled for completion in 2015; the company has taken steps to secure EU funding for the project
- completion of a 13.5 km medium-pressure gas pipeline with a pressure reduction station in Horyniec; the project was designed to increase the volume of transmitted gas
- completion of a metering station on the border of the transmission system in Sworzyce;
- completion of the reconstruction of a pressure reduction station in the Wąchock commune.

KSG also worked on the distribution network roll-out in Włodawa, for which EU co-financing was secured under the Infrastructure and Environment Operational Programme. In 2011, KSG continued design work related to construction of a 54.8 km high-pressure gas pipeline from Kamień to Włodawa, with a 18.6 km medium-pressure gas pipeline network and three pressure reduction stations. The company plans to complete the project in 2015.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	776.1	767.0
Net profit	PLNm	153.6	136.8
Equity	PLNm	2,369.6	2,353.5
Total assets	PLNm	2,846.5	2,802.6
Length of network, excl. connections	km	45,004.6	44,762.0
Headcount as at December 31	persons	3,320	3,319

In 2012, KSG will focus its efforts on connecting new customers to the gas network, on projects involving reconstruction and extension of gas networks for which the company has completed the legal and formal documentation; and on completion of design works for projects where the documentation preparation process is under way. The key projects in this area include: the roll-out of the gas network in the Włodawa and Beskid Sądecki region; reconstruction of high-pressure gas pipelines from Tuszyma to Mielec, from Warzyce to Gorlice, from Parszów to Kielce, and from Sandomierz to Ostrowiec Świętokrzyski; construction of a high-pressure gas pipeline from Mójcza to Masłów;
roll-out of the gas distribution system in the Szczawnica. Włoszczowa, Małogoszcz, Chęciny, and Sitkówka-Nowiny communes.

Given its network infrastructure, KSG enjoys a considerable competitive advantage over potential competitors in the area of traditional distribution of natural gas. KSG's competitors provide gas to customers with the use of the LNG technology in areas not yet connected to the gas distribution system. The market entry barriers are significantly lower, as entry into the LNG segment requires much less capital expenditure. Moreover, LNG suppliers do not need to incur high expenditure to relocate operations to another geographical area. Global trends suggest that the share of LNG in the natural gas market will be growing, with the resulting intensification of competition.

4. Mazowiecka Spółka Gazownictwa Group

Mazowiecka Spółka Gazownictwa Sp. z o.o. (Mazovian Gas Distribution Company, "MSG") supplies gas to customers in the provinces of Warsaw, Łódź and Białystok, as well as in certain parts of the provinces of Lublin, Olsztyn and Kielce. The total volume of gas transmitted by MSG over the distribution network in 2010 was 2,053.2 million cubic meters. Gas is supplied to ca. 1.5m customers via gas distribution networks and gas stations operated by the company.

In 2011, the company conducted projects related to the operation, extension and upgrade of its gas network. MSG connected ca. 24.7 thousand new customers to the gas network. Major projects carried out in 2011 included:

- continuation of construction of the Błonie commune section of the medium-pressure gas pipeline from Kopytów to Pass; the project is designed to secure gas supplies to customers in the Błonie commune and to increase the volume of gas fuel collected by the largest industrial customer in the area, i.e. the Błonie-Pass Strefa Przemysłowa co-generation plant; construction work was carried out in 2011; the project is scheduled for completion in 2012
- continuation of construction of a pressure reduction station in Klęk/Kiełmina in the Stryków commune
- construction of a pressure reduction station in Kutno
- start of design work for the planned roll-out of the gas distribution network in the Brwinów and Pruszków communes

- construction of a medium-pressure gas-pipeline in Warsaw at ul. Zdziarska, along the eastern bank of Kanał Markowski, and at ul. Wyszkowska and ul. Chudoby along the northern bank of Kanał Markowski; an administrative decision laying down the technical conditions for the project was issued in 2011;
- completion of conversion of a low-pressure gas pipeline network in Siedlce (oś. Warszawska) into a medium-pressure gas pipeline network;
- completion of a medium-pressure gas pipeline with 116 connections in Mostówka;
- completion of a medium-pressure gas pipeline from Radom to Rajec Poduchowny;
- upgrade of a 15 km high-pressure gas pipeline from Piotrków Trybunalski to the Warta river (Phase I: Piotrków); construction works are scheduled to start in 2012
- completion of a 27 km high-pressure gas pipeline from Piotrków Trybunalski to the Warta river (Phase III: section from Piotrków to Kamieńsk);
- completion of a medium-pressure gas pipeline in Warszawa Bemowo district at Osiedle Groty;
- completion of a medium-pressure gas pipeline in Warszawa Wawer district, at ul. Trakt Lubelski (section from ul. Kaczeńca to ul. Dzielnicowa).

In addition, the company and PGNiG SA completed network switch-over from propane-butane-air to high-methane gas in the town of Pisz in the Olsztyn province. In 2011, MSG worked on design documentation for the planned network switch-over from propane-butane-air to high-methane gas in the town of Suwałki. The project involves construction of an LNG regasification station, a 21 km medium-pressure gas with connections, and a pressure reduction station. The is scheduled for 2012-2014.

In 2011, the company executed agreements on EU co-financing of the following four projects:

- Roll-out of the gas distribution system in the Prażmów, Tarczyn, Góra Kalwaria and Żabia Wola communes – Phase I; the entire project involves construction of a 100 km of medium-pressure gas pipeline and ca. 1,400 connections in 2011-2014; Phase I of the project (started in 2011) involves construction of a 5.5 km gas pipeline and 100 connections; design documentation for the remaining pipelines was contracted.
- Construction of a medium-pressure gas pipeline running through the villages of Kiełmina, Józefów and Zelgoszcz, to provide gas supplies to investment areas in the Stryków commune"; in 2012, design documentation was completed; construction work is scheduled for 2012-2013.
- Reconstruction of the gas pipeline underneath ul. Biegańskiego in Łódź.
- Reconstruction of gas pipelines in Rawa Mazowiecka to improve gas supply security for customers in Rawa Mazowiecka and in the Łódź Special Economic Zone.

In its financial statements, MSG consolidates Powiśle Park Sp. z o.o., a company established to construct a building that will accommodate MSG's offices as well as residential units and office and commercial space for sale.

Group's highlights

	Entity	2011	2010
Revenue	PLNm	716.6	711.9
Net profit	PLNm	101.3	479.5
Equity	PLNm	2,259.9	2,262.6
Total assets	PLNm	2,937.4	2,892.0
Length of network, excl. connections	km	19,208.0	18,900.0
Headcount as at December 31	persons	2,912	2,925

MSG's plans for 2012 include: continued construction of a medium-pressure gas pipeline from Kopytów to Pass in the Błonie commune; continued construction of a gas station in Klęk/Kiełmina in the Stryków commune; roll-out of the gas distribution networks in the Prażmów, Tarczyn, Góra Kalwaria and Żabia Wola communes, and in Kiełminia, Józefów, Zelgoszcz villages; and construction of an LNG regasification station in Suwałki.

5. Pomorska Spółka Gazownictwa Sp. z o.o.

The geographical reach of Pomorska Spółka Gazownictwa (Pomeranian Gas Distribution Company, "PSG") covers the provinces of Gdańsk and Bydgoszcz, a part of the province of Olsztyn, and two communes (Sławno and Postomino) in the province of Szczecin. The area covered by the company's operations poses certain geographical challenges to installation of gas supply lines (a large number of lakes and woods). The percentage of households and businesses connected to PSG's gas network is approximately 40%. The total volume of gas transmitted by PSG over the distribution network in 2011 was 923.1 million cubic meters. The company provides its services to ca. 744 thousand customers.

In 2011, PSG worked on extension and modernisation of the gas network. PSG connected ca. 7.6 thousand new customers to the gas distribution network. Major projects in this area included:

- continuation of construction (stage 2) of a high-pressure pipeline as part of project "Duplex Supply for the City of Toruń"; the project is designed to ensure gas supplies to the city of Toruń, to industrial customers, to the municipality of Łysomice and commune of Wielka Nieszawka, and to the Pomeranian Special Economic Zone; in 2011 the design and cost estimate documentation for the high-pressure gas pipeline from Ostaszewo to Różankowo was completed and construction work began
- continuation of construction of a medium-pressure gas pipeline, including connection to the MPEC Rypin CHP; the project involves construction of a connection for the CHP plant and roll-out of the gas distribution network in the Osiek and Rypin communes; in 2011, design work for the medium-pressure gas pipeline from Brodnica to Osiek, and Rypin, with connection and pressure reduction station for MPEC Rypin was under way
- continuation of construction of medium-pressure gas pipelines and connections as part of the distribution network roll-out to the villages of Jonkowo, Warkały and Giedajty
- completion of construction of a medium-pressure gas pipeline and connections in the village of Orle
- completion of the distribution network roll-out in Ciele (Białe Błota commune), in the Zławieś Wielka commune and in the Wrocław Economic Development Zone - Industrial and Technological Park; the projects comprised construction of medium-pressure gas pipelines with connections; the company executed relevant agreements for project co-financing from the EU funds under the Province of Bydgoszcz Regional Operational Programme for 2007-2013
- connection of Łochowo, Łochowice and Lisi Ogon in the Białe Błota commune to the gas distribution network; the project comprises construction of medium-pressure and high-pressure gas pipelines with connections, and construction of a pressure reduction station; design work began in 2011
- connection of Dobrcz and Koronowo communes to the gas supply network; the project comprises construction of medium-pressure and high-pressure gas pipelines and the connections, as well as construction of a pressure reduction station; design work was under way in 2011.

PSG has also worked on three network roll-out projects in new areas, which received EU co-financing under the Infrastructure and Environment Operational Programme:

- construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn and distribution network roll-out; in 2011, Phase I of the construction of a 26.2 km high-pressure gas pipeline from Szczytno to Rybno, and Phase I of the construction of the medium-pressure gas pipeline were completed; constructiuon of the gas distribution network in the villages of Sątopy and Sątopy-Samulewo in the Bisztynek commune (Phase II) was contracted; construction of an 8 km medium-pressure gas pipeline in Barciany was contracted; and a contractor was selected for the design and cost estimate documentation for the Młynowo–Mulawki section of the high-pressure gas pipeline and the pressure reduction station in Mikołajki

- construction of south-eastern supply for the city of Gdańsk and roll-out of the gas dstribution networks in Wiślinka and Wyspa Sobieszewska; in 2011, the construction of a high-pressure gas pipeline from Kolnik to Gdańsk commenced, Phase I of the distribution system roll-out in Wiślinka was completed, and a contractor was selected to prepare the design and cost estimate documentation for the Żuławy medium-pressure gas pipeline
- commencement of construction of a high-pressure DN 300 gas network connecting Brodnica, Nowe Miasto Lubawskie, and Iława, and distribution network roll-out; the project involves construction of high-pressure gas pipelines from Brodnica to Nowe MIasto Lubawskie with a pressure reduction station, and from Nowe Miasto Lubawskie to Iława, and medium-pressure gas pipelines in Nowe Miasto Lubawskie and Kurzętniki; in 2011, work commenced on the design and cost estimate documentation for the medium-pressure gas pipelines.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	424.7	439.5
Net profit	PLNm	75.8	91.4
Equity	PLNm	1,153.4	1,038.7
Total assets	PLNm	1,551.7	1,428.3
Length of network, excl. connections	km	9,898.8	9,588.1
Headcount as at December 31	persons	1,768	1,772

In 2012, PSG will continue the projects "Duplex Supply for the City of Toruń", "Construction of a high-pressure gas network connecting Szczytno, Młynowo and Muławki near Kętrzyn and distribution network roll-out", "Construction of south-eastern supply for the city of Gdańsk and distribution network roll-out in Wiślinka and Wyspa Sobieszewska", and "Construction of a high-pressure DN 300 gas network connecting Brodnica, Nowe Miasto Lubawskie, and Iława, and the distribution network orll-out". The company also intends to execute new agreements on EU co-financing of four projects.

A number of other gas distribution and trading companies operate in the PSG coverage area, including G.EN. GAZ ENERGIA S.A., US.EN.EKO, KRI S.A., ENERGO-EKO-INWEST Sp. z o.o., P.L. Energia S.A., and Amber Gaz.

6. Wielkopolska Spółka Gazownictwa Sp. z o.o.

Wielkopolska Spółka Gazownictwa Sp. z o.o. (Greater Poland Gas Distribution Company, "WSG") manages a gas distribution network covering the provinces of Poznań and Szczecin, several communes in the provinces of Zielona Góra / Gorzów Wielkopolski, Łódź and Wrocław, as well as one commune in the province of Gdańsk. The percentage of households and businesses connected to WSG's gas network is approximately 45% (ca. 78% in towns, ca. 55% in large urban areas, ca. 29% in mixed urban and rural areas, and ca. 18% in typical rural areas).

The total volume of gas transmitted by WSG over the distribution network in 2011 was 1,530.0 million cubic meters (measured as high-methane gas equivalent), including ca. 1,338.6 million cubic meters of high-methane gas, 102.3 million cubic meters of nitrogen-rich (Lw) gas and ca. 89.1 million cubic meters of nitrogen-rich (Ls) gas. At the end of 2011, the total number of customers served by the company was 918.5 thousand.

In 2011, the company conducted projects related to the operation, extension and upgrade of its gas network. Also, WSG connected ca. 9.1 thousand new customers to the gas network. Major projects carried out in 2011 included:

- continuation of supply system switch-over in the Kościan-Śmigiel distribution area, including network extension to the ETEX economic zone; in 2011, technical acceptance procedures were completed; connection to an operational gas pipeline, start-up, and final acceptance of the project are scheduled for 2012
- completion of a gas supply pipline to the town of Skoki; as part of the project, 11.6 km of the gas network was built
- completion of a medium-pressure gas pipeline from Witkowo to Wólka, and from Wólka to Strzałkowo and Słupca as part of the distribution network roll-out in the Witkowo and Strzałkowo communes;
- continuation of construction of a medium-pressure gas pipeline in Krzycko Wielkie (Włoszakowice commune); 7.7 km of the gas pipeline was built in 2011
- continuation of extension of the medium-pressure gas network in Kąkolewo (Osieczna commune); in 2011, the technical acceptance of the pipelines was completed; project completion is scheduled for 2012
- completion of upgrade of the medium-pressure gas network in Poznań, covering ul. Dożynkowa, ul. Owsiana, ul. Gromadzka and ul. Winogrady
- commencement of construction of a pressure reduction station in Żukowice
- commencement of construction of a high-pressure pressure reduction station in Polkowice
- commencement of construction of a pressure reduction station in Goleniów
- upgrade of a medium-pressure gas pipeline at ul. Naramowicka in Poznań (section from ul. Serbska to ul. Lechicka); the project was launched and completed in 2011
- finance lease of a gas network in the coastal strip, sections from Gorzysław to Koszalin, and from Gorzysław to Kołobrzeg.

WSG also pursued three distribution network roll-out projects which received EU co-financing under the Infrastructure and Environment Operational Programme:

- Construction of low-pressure and medium-pressure gas pipelines and connections, with a governor station in Syców, county of Oleśnica"; the project will help create conditions conducive to development of business activity and residential construction in Syców; the project is divided into eight tasks; in 2011, two tasks were completed, i.e. 4.7 km of gas pipeline network and connections were upgraded along the following streets: ul. Wierzbowa, ul. Kolejowa, ul. Powstańców, ul. Wrocławska, ul. 1-go Maja, ul. Piastowska, ul. Daszyńskiego, ul. Przemysłowa, ul. Robotnicza, and ul. Kusocińskiego, and works began along the following streets: ul. Garncarska, ul. Matejki, ul. Daszyńskiego, ul. Komorowska, ul. Osiedle Matejki, ul. Pawłówek, ul. Szkolna, and ul. Szosa Kępińska

- Provision of equal access to gas network in the Gorzów Wielkopolski region"; the project includes construction of an 11.6 km of high-pressure gas pipeline from Mościszki (Witnica commune) to Osiedle Warniki (Kostrzyn n. Odrą commune), and construction of a 13.2 km medium-pressure gas pipeline with connections in the village of Białcz; in 2011, most of the required building permits were obtained and a contractor was selected for the high-pressure pipeline construction and assembly works

- Provision of natural gas supply to entities operating in the northern part of the Pełczyce commune; in 2011, an 11.6 km of a medium-pressure gas pipeline was built.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	588.7	612.0
Net profit	PLNm	116.8	130.4
Equity	PLNm	1,830.2	1,787.3
Total assets	PLNm	2,270.6	2,225.8
Length of network, excl. connections	km	15,916.0	15,488.0
Headcount as at December 31	persons	1,810	1,826

In 2012, WSG will continue the roll-out of gas distribution systems in Syców, the northern part of the Pełczyce commune, the Gorzów Wielkopolski region, and Lubasza nad Witkowa communes. Preparation of technical documentation for the distribution network roll-out project in the Włoszkowice and Lipno communes took longer than anticipated due to the protracting procedure of obtaining environmental and siting permits. In effect, the project was postponed until 2012.

A number of other gas transmission, distribution and trading companies as well as heat production and distribution operators trade in the WSG coverage area, including: G.EN. GAZ ENERGIA S.A, EWE Energia Sp. z o.o., E.ON edis energia Sp. z o.o., KRI S.A., CP ENERGIA S.A., and Avrio Media Sp. z o.o.

7. Risks related to distribution

Direct competition

Liberalisation of the gas market contributes to intensification in competition faced by the Gas Distribution Companies. Companies distributing natural gas progressively expand their gas networks and attract new customers. Additionally, companies have emerged which offer LNG distribution services. The market entry barriers are definitely lower here, as LNG distribution involves significantly lower capital expenditure and does not require a connection to the gas system or adequate reserve capacity to be maintained in the transmission and distribution networks. Another issue which affects the Gas Distribution Companies' competitive position is the tariff policy of the Energy Regulatory Office, which prevents the Gas Distribution Companies from operating a flexible pricing policy for their key customers. With the lack of flexible pricing, the competitors' offerings may prove to be an attractive alternative for the Gas Distribution Companies' customers.

Legislation

The long time required to prepare an investment project is an important factor affecting the Gas Distribution Companies' operations. Complex provisions of the Construction Law and regulations governing implementation of investment projects impose the obligation to prepare extensive project and legal documentation. The process is time-consuming, but indispensable for any investment project.

Substitution

Easy and quick access to alternative energy sources (i.e. fuel oil, LPG, hard coal, electricity or heat generated by central CHP plants, or local or community heat plants) may weaken the position of the Gas Distribution Companies on the local energy markets.

Sources of gas supply for MSG Sp. z o.o.'s distribution system

MSG Sp. z o.o.'s distribution network is connected to the transmission system operated by OGP GAZ-SYSTEM S.A., which is its main source of gas supplies. The geographical distribution of gas supply sources and the topology of domestic transmission networks are unfavourable across a large portion of the company's coverage area. A risk exists that no reserve transmission capacity will be available at the points of entry into the company's distribution system, which may inhibit the development of the gas fuel market in most of the company's area of operation.

Chapter IX: Other Activities

This segment includes the following areas of activity: design and construction of structures, machinery and equipment for the mining and power industries, as well as catering and hospitality services. These operations are conducted mainly by the Group companies other than PGNiG SA. The segment’s business also includes power generation projects (natural-gas fired generation) and electricity trading.

Acquisition of shares in Vattenfall Heat Poland S.A.

On August 23rd 2011, PGNiG SPV 1 Sp. z o.o., a wholly-owned subsidiary of PGNiG SA, and Vattenfall AB executed a preliminary share purchase agreement. The agreement provides for the purchase of 24,591,544 shares in Vattenfall Heat Poland S.A., representing over 99.8% of the company's share capital, which carry voting rights representing more than 99.8% of the total voting rights at the General Meeting of Vattenfall Heat Poland S.A. The shares are registered shares with a par value PLN 10.00 per share and a total par value of PLN 245,915,440.00. The transaction value as at the date of the agreement was approximately PLN 2.96bn, which reflected enterprise value of approximately PLN 3.5bn.

To finance the acquisition of Vattenfall Heat Poland S.A. and all related transaction costs, PGNiG SA advanced to PGNiG SPV 1 Sp. z o.o. a loan of up to PLN 3.78bn, to be repaid by December 31st 2012.

On December 7th 2011, PGNiG SA obtained clearance from UOKiK for a business combination involving the purchase of shares in Vattenfall Heat Poland S.A. by PGNiG SPV1 Sp. z o.o., and thus the condition precedent to the final share purchase agreement was satisfied.

On January 11th 2012, PGNiG SPV 1 Sp. z o.o. signed the final agreement with Vattenfall AB to purchase 24,591,544 shares in Vattenfall Heat Poland S.A. The purchase price as at the date of the agreement was PLN 3.02bn. The company's name was changed to PGNiG TERMIKA S.A.

Acquisition of shares in Vattenfall Heat Poland S.A. represents an implementation of one of the PGNiG Group's strategic goals in the power sector. The core business of Vattenfall Heat Poland S.A. is co-generation of heat and electricity. The installed capacity of the company's generating units is 4.8 GW of thermal power and 1 GW of electrical power, which satisfies approximately 75% of the heat demand on the Warsaw market. The company's main customer is SPEC S.A.

PGNiG TERMIKA S.A. is to be the main competence centre responsible for large gas-fired power projects (construction of a 400 MWe gas-fired power unit at the Żerań CHP).

1. PGNiG Energia S.A.

The business of PGNiG Energia S.A. involves execution of power construction projects, investments in gas-fired cogeneration and pilot biogas projects. The Company also trades in electricity on the wholesale market, and in carbon and other greenhouse gas allowances.

The largest project implemented in cooperation with Elektrownia Stalowa Wola S.A. is the construction of a CCGT unit with 400MW electricity and 229 MW heat capacity in Stalowa Wola. In 2011, the company continued the organisational and investment activities related to the project, as part of which an agreement on operation of an SPV (Elektrociepłownia Stalowa Wola S.A., in which PGNiG Energia S.A. holds a 50% interest) was executed, the share capital of the SPV was increased, and a procedure for selecting the general contractor was commenced.

Furthermore, in 2011 PGNiG SA executed a comprehensive gas supply agreement with Elektrociepłownia Stalowa Wola S.A., and Elektrociepłownia Stalowa Wola S.A. executed an electricity sales agreement with PGNiG Energia S.A. and TAURON Polska Energia S.A. The agreements will come into force on the condition precedent that relevant agreements are signed providing for the financing of construction, start-up and launch of the CCGT unit in Stalowa Wola.

In 2011, PGNiG Energia S.A. started to provide a comprehensive range of services related to electricity purchasing to members of the PGNiG Group and one external customer. In the carbon allowances trading segment, the company signed three contracts based on the EFET (European Federation of Energy Traders) standards.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	24.2	4.7
Net profit (loss)	PLNm	-1.8	-0.6
Equity	PLNm	27.4	5.4
Total assets	PLNm	32.4	7.5
Headcount as at December 31	persons	48	20

On January 31st 2012, PGNiG Energia S.A. began trading in electricity and CO_2 emission allowances on the Polish Power Exchange.

In 2012, the company will continue its organisational and investment activities as part of the Stalowa Wola project, including in particular selection of the general contractor and share capital increase at the company (SPV). The company will also continue wholesale trade in electricity and related products on exchanges and OTC platforms.

2. PGNiG Technologie Sp. z o.o.

PGNiG Technologie Sp. z o.o. was established in 2010 to consolidate construction and installation companies within PGNiG Group's "other activities" segment. On December 22nd 2011, the consolidation process involving the merger of BUG Gazobudowa Sp. z o.o., ZUN Naftomet Sp. z o.o., BN Naftomontaż Sp. z o.o. and ZRUG Sp. z o.o. into PGNiG Technologie Sp. z o.o. was completed. All assets of the merged companies were transferred to PGNiG Technologie Sp. z o.o. The consolidation of the construction and assembly companies into one strong entity will help enhance its competitive position on the domestic and international markets.

PGNiG Technologie Sp. z o.o. offers construction and assembly services, including construction of gas transmission and gas distribution pipelines and infrastructure, such as nodes, gas compressor stations, and gas stations, development of gas reserves and construction of oil and gas production facilities, construction and extension of underground gas storage facilities, manufacture of field equipment and drilling rig components, as well as manufacture and repair of equipment for the coal mining industry. The services offered by the company also include repair of drilling and production equipment.

Below are presented business activities carried out by the companies merged into PGNiG Technologie Sp. z o.o. in the period from January 1st to December 22nd 2011.

BUG Gazobudowa Sp. z o.o.

The business of Budownictwo Urządzeń Gazowniczych Gazobudowa Sp. z o.o. comprised construction and repair of high- and medium-pressure gas pipelines, water pipelines, oil pipelines, as well as gas compressor stations and pressure reduction and metering stations. In 2011, 52% of the company's revenue was derived from sale of services to customers from outside the PGNiG Group. The key external customers included foreign partners BONATTI S.p.A. of Germany and IMP PROMONT d.d. of Slovenia, as well as domestic customers Stalbud Tarnów Sp. z o.o. of Tarnów, Alkat Sp. z o.o. of Dąbrowa Górnicza, the Dąbrowa Górnicza municipality, and others. The largest customer within the Group was PGNiG SA.

The key projects implemented in 2011 were contracts for the construction of high-pressure gas pipelines. The services performed included:

- construction of the KGZ Kościan-KGHM Żukowice-Polkowice high-pressure gas pipeline (with Kościan and Szczyglice nodes and reduction and metering stations) for PGNiG SA.
- welding and installation work on OPAL and NEL gas pipelines in Germany for BONATTI S.p.A.
- work related to the construction of the Cersak-Kidricevo high-pressure gas pipeline in Slovenia for IMP PROMONT d.d.
- pipe laying for the high-pressure gas pipeline from Mieszalnia Kłodawa to the LMG oil and gas production facility;

The company was also engaged in construction and assembly work, including modernisation of a process node and gas compressor reduction and metering station, as well as construction of a sewage system with sewage pumping station in the Dąbrowa Górnicza municipality.

ZUN Naftomet Sp. z o.o.

Zakład Urządzeń Naftowych Naftomet Sp. z o.o. specialised in manufacturing and repair of equipment for the oil and gas industry. In 2011, the key services provided by ZUN Naftomet Sp. z o.o. included manufacture of surface well infrastructure components, pressure equipment for oil and gas production facilities, as well as equipment and spare parts for drilling rigs and drillships. Revenue from domestic and foreign customers from outside the Group accounted for ca. 54% of total revenue, of which almost 49% represented revenue from sale of drilling rigs and drillships equipment and spare parts for a Norwegian business partner.

The largest customer within the Group was PGNiG SA which purchased surface well infrastructure components manufactured by the company. Revenue derived from the sale of the components represented over 24% of total revenue.

BN Naftomontaż Sp. z o.o.

Budownictwo Naftowe Naftomontaż Sp. z o.o. offered the full range of services related to construction of complete oil and gas production facilities along with the related infrastructure. In 2011, revenue from services performed for the Group companies accounted for 97% of ZUN Naftomet's total revenue. The company conducted work related to development of natural gas and crude oil reserves, including in particular construction and repair of oil and gas production facility process machinery, as well as construction of underground gas storage facility process installations. Key projects implemented in 2011 were performed under contracts with PGNiG SA. The scope of work included:

- development of the Rylowa-Rajsko gas field
- hook up of the Elżbieciny and Jabłonna wells.
- extension of the surface part of the Strachocina Underground Gas Storage Facility;
- development of the Barnówko-12, Mostno-8K and 9H wells drilled in the BMB field.

Since 2005, BN Naftomontaż Sp. z o.o. has operated under an arrangement with creditors, following a decision by the District Court of Krosno, Commercial Division V, on declaration of the company's bankruptcy with an option to enter into an arrangement. By December 22nd 2011, the company had made two payments as scheduled under the arrangement, for a total value of PLN 1.1m. The outstanding balance of PLN 7.2m was paid by PGNiG Technologie Sp. z o.o.

ZRUG Sp. z o.o.

The services provided by Zakład Remontowy Urządzeń Gazowniczych Sp. z o.o. of Pogórska Wola included construction of transmission pipelines, gas stations, gas compressor stations, and gas nodes, as well as development of gas reserves and production wells. The company also offered comprehensive services involving piping operations on live pipelines (TD Williamson technology). In 2011, revenue from services performed for the Group accounted for 90% of the company's total revenue. The company's largest external customer was OGP GAZ-SYSTEM S.A. Key services provided in 2011 involved work under contracts performed for PGNiG SA, including:

- construction of a high-pressure gas pipeline from Mieszalnia Kłodawa to the LMG oil and gas production facility;
- extension of the surface part of the Strachocina Underground Gas Storage Facility;
- extension of the Paproć-Cicha Góra gas production facility
- development of the Rylowa-Rajsko gas field.

The table below highlights the key data on PGNiG Technologie Sp. z o.o. for 2010 and 2011. In 2010, PGNiG SA consolidated PGNiG Technologie Sp. z o.o.'s subsidiaries. Consquently, the data for 2010 was restated to ensure comparability with the 2011 figures.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	409.2	469.9
Net profit (loss)	PLNm	0.6	21.6
Equity	PLNm	165.4	116.3
Total assets	PLNm	293.8	306.5
Headcount as at December 31	persons	1,507	1,688

In 2012 and beyond, PGNiG Technologie Sp. z o.o. intends to grow its business in the existing market segment, while seeking to ensure that its technical resources and production potential deliver maximum leverage. As part of its development plan, the company intends to become a provider of complete design, construction and installation services for the oil and gas industry in Poland and abroad. PGNiG SA will continue to be the key customer for PGNiG Technologie Sp. z o.o.'s. Major projects planned for implementation in 2012 for PGNiG SA include the following:

- construction of the Szczyglice Node-KGHM high-pressure gas pipeline, extension of the Kościan node, and construction of the Mieszalnia Kłodawa-LMG oil and gas production facility high-pressure gas pipeline,
- development of the drilling wells in the Rylowa-Rajsko, BMB, Lubliniec, Pruchnik and Góra Ropczycka gas fields,
- construction of gas compressor stations for Mirocin and Maćkowice gas production facilities,
- reconstruction of the Husów gas production facility.

3. B.S. i P.G. Gazoprojekt S.A.

Biuro Studiów i Projektów Gazownictwa Gazoprojekt S.A. specializes in comprehensive design of installations for gas production, storage, transmission and distribution, as well as of gas system stations and switching stations. With a 75% equity interest, PGNiG SA is the majority shareholder in the company. 25% of the B.S. i P.G. Gazoprojekt S.A. shares are held by natural persons - the company's employees. Gazoprojekt S.A.

In 2011, B.S. and P.G. Gazoprojekt S.A. generated revenue of PLN 45.4m, of which 59% was derived from services rendered to customers outside the PGNiG Group. The key third-party customers were OGP GAZ-SYSTEM S.A. and PBG S.A. In 2011, B.S. and P.G. Gazoprojekt S.A. drafted project design documents for the construction of Gustorzyn-Odolanów and Świnoujście-Szczecin high-pressure gas pipelines, and provided supervision services for the Wierzchowice underground storage facility construction project.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	45.4	95.8
Net profit (loss)	PLNm	4.5	4.3
Equity	PLNm	38.1	33.6
Total assets	PLNm	48.7	55.0
Headcount as at December 31	persons	243	246

In 2012, the company plans to deliver work under awarded contracts. The largest ones include a contract for the preparation of project design documents under the Odolanów node extension project for OGP GAZ-SYSTEM S.A., a contract for the preparation of preliminary and project design documents under the KRNiGZ LMG-Paproć high-pressure gas pipeline construction project for PGNiG SA, and a contract for the preparation of project design documents under the project involving construction of gas pipelines and gas service lines in the Prażmów, Tarczyn, Góra Kalwaria, Piaseczno and Żabia Wola communes for a company from the PGNiG Group.

4. Geovita Sp. z o.o.

Geovita Sp. z o.o. offers accommodation and catering services in Poland, through 11 own facilities and three leased hotels. The company's facilities form a network of recreational, training and spa centres. They are located either at the sea coast, in mountain areas or in the central part of Poland. The company offers its services to Polish and foreign customers.

In 2011, Geovita Sp. z o.o. expanded its hotel management business by adding new accommodation facilities. Since October 2011, the company has operated two PGNiG-owned hotels: Bukowy Dworek in Gronów and Perła Bieszczadów in Czarna. A relevant facility management agreement is effective until September 2013.

In 2011, Geovita Sp. z o.o. reported total revenue of PLN 36m, including ca. PLN 8m from the sale of hotel management services. Most of the company's customers were customers from outside the PGNiG Group. Revenues from services performed for third-party customers accounted for 73% of the company's total revenue.

In 2011, the 2007–2011 business recovery programme ended. The programme's key objective was to achieve profitability as from 2010. The company failed to deliver the PLN 1.9m net profit target in 2011 mainly due to lower revenue in the training/conference and family leisure segments.

Company's highlights

	Entity	2011	2010
Revenue	PLNm	36	32.8
Net profit (loss)	PLNm	-1.2	0.2
Equity	PLNm	77.9	79.1
Total assets	PLNm	98.5	100.8
Headcount as at December 31	persons	349	303

In 2012, the company will continue the restructuring efforts. A plan is in place to transform Geovita Sp. z o.o. (a limited liability company) into a joint stock company in 2012. In the future, the company plans to expand its customer base and roll out uniform service standards across its entire network.

5. Risks related to Other Activities

Power generation projects

Our involvement in power generation projects will to a large extent depend on the prices of CO_2 emission allowances, which, if they fall, will result in low profitability of electricity generation in gas-fired cogeneration systems. Higher crude oil prices on the global markets, resulting in increased prices of natural gas, will contribute to lower competitiveness of gas fuel relative to power coal. Moreover, an uncertainty factor affecting the profitability of power projects is the fact that the government administration has clearly stated whether it would continue to maintain the gas-fired cogeneration support system in the form of "yellow certificates" beyond 2012.

Legislation

Administrative regulations and procedures related to the preparation of investment projects and obtaining building permits, including in particular with respect to compliance with the environmental requirements, may significantly delay investment projects and expose the company to additional costs due to potential delayed performance of contracts, and to the risk of lower revenues.

Competition

The operations of companies offering construction and assembly services and manufacturers of drilling equipment are significantly exposed to growing competition from foreign companies, both those operating in their local markets abroad and those entering the Polish market, and from Polish market players. Given the current level of investment in the segment's area of operations, growing competition results in, among other consequences, continually low prices for the services offered by the segment companies. As far as designing of gas transmission installations is concerned, acquisition of medium-sized design offices by large contractors and setting up of new design offices within gas industry operators are unfavourable phenomena which adversely affect the segment companies' capacity to form consortia with project execution companies and secure new orders. Another major threat in this area is growing competition from new business groups.

Chapter X: Investments

In 2011, the PGNiG Group's capital expenditure on property, plant and equipment and intangible assets amounted to PLN 4,259.4m. The table below presents the expenditure in the individual segments.

Capital expenditure (PLNm)

	2011
Exploration and Production	2,519.2,
Trade and Storage	548.2,
Distribution	1,172.8,
Other Activities	19.2,
Total	4,259.4,

Below are described the key investment projects implemented by the PGNiG Group

Exploration

In the area of exploration, capital expenditure of PLN 510.3m was incurred mainly on 11 wells drilled with positive results, wells the drilling of which is still under way, and 12 dry wells, where the related expenditure was charged to expenses in the current reporting period.

Skarv project

The project involves development of fields on the Norwegian Continental Shelf using a floating production, storage and offloading (FPSO) unit, which was transported to Norway and anchored above the Skarv field in 2011. Installation of all the submarine structures (foundation slabs, pipelines, etc.) on the Skarv and Idun fields was also completed in 2011. Expenditure incurred on the development of the Skarv field in 2011 amounted to PLN 550.5m.

Lubiatów-Międzychód-Grotów project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów ("LMG") oil and gas field and to facilitate the transport, storage and sale of crude oil, natural gas, liquid sulphur 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 Denitriding Plant to provide for transmission of surplus gas from the LMG oil and gas production facility to the Grodzisk Denitriding Plant.

In 2011, construction of the LMG Central Facility was underway. The total project value is estimated at approximately PLN 1.6bn. The expenditure incurred in 2011 amounted to PLN 435.5m.
Grodzisk project

The objective of this project is to ensure that gas produced from nitrogen-rich gas fields is of commercial garde; to this end, the gas must be processed to achieve the parameters of high-methane gas (cryogenic nitrogen removal). The Grodzisk project involved development of the Paproć W, Wielichowo and Ruchocice fields, development of the Nowy Tomyśl-2k well, modernisation of the Paproć Gas Production Facility, construction of the gas pipeline from Przyłęk to the Paproć Gas Production Facility, and construction of the Grodzisk Denitriding Plant.

In 2011, extension of Paproć-Cicha Góra Gas Production Facility and development of Elżbieciny and Jabłonna wells makred completion of the entire project. Total expenditure on the Grodzisk project was PLN 458m.

High-pressure gas pipeline from Kłodawa mixing plant to LMG oil and gas production facility

The project involves construction of a high-pressure gas pipeline from Kłodawa Mixing Plant to LMG oil and gas production facility, which will connect two production areas and enable transmission of natural gas from the Dębno region, through Kłodawa mixing plant and LMG oil and gas production facility to the Grodzisk mixing and denitriding plant. The gas pipeline will also be used as a storage facility to cover temporary shortages of commercial-grade gas. Construction of the pipeline continued in 2011. The total cost of the project is estimated at approximately PLN 110.7m. In 2011, the incurred expenditure was PLN 80.4m.

Gas pipeline to KGHM

The project involves construction of a high-pressure gas pipeline and optic-fibre cable with infrastructure, from the Kościan gas production facility to KGHM Polkowice/Żukowice; the pipeline will be used to sell natural directly to KGHM Polkowice/Żukowice. Construction of the pipeline continued in 2011. The total cost of the project is estimated at approximately PLN 220m. In 2011, the expenditure was PLN 31.5m.

Other investment projects in the Production segment

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

- modernisation and extension of the existing gas production facilities
- development of the Rylowa-Rajsko, Góra Ropczycka and Rudka gas fields
- completion of the Zalesie gas field development
- completion of the Sarzyna well development
- commencement of Radlin and Wola Różaniecka well drilling.

Underground gas storage facilities (Exploration and Production)

The Exploration and Production segment's expenditure on the gas storage facilities amounted to PLN 90.1m. In July 2011, construction and assembly works related to the extension of Strachocina Underground Gas Storage Facility were completed. Total expenditure on the Strachocina Underground Gas Storage Facility amounted to PLN 424m.

Underground gas storage facilities (Trade and Storage)

Capital expenditure on underground gas storage facilities in the Trade and Storage segment amounted to PLN 430.7m and related to:

- continuation of construction of the surface part of the Wierzchowice Underground Gas Storage Facility
- commencement of construction of the surface part of the Kosakowo Underground Gas Storage Facility and continued leaching work in the caverns

- continuation of construction of four caverns in the Mogilno Underground Gas Storage Cavern Facility.

Distribution

Capital expenditure incurred by the PGNiG Group in the Distribution segment amounted to PLN 1,172.8m. The key investemtn activities of Gas Distribution Companies included connecting new customers to the distribution networks as well as upgrading and extending the gas network. For a discussion of key investment projects of the Distribution segment, see Chapter VIII Distribution.

Other Activities

In 2011, the Other Activities segment incurred capital expenditure on property, plant and equipment and intangible assets of PLN 19.2m. Major investments included purchase of production plant and equipment, purchase of vehicles and implementation of an integrated IT system.

Chapter XI: Environmental protection

Well abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG SA is required to properly abandon worked-out mining caverns, eliminate the danger, repair any damage caused by mining activities, 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 to water courses. Furthermore, if gas wells remained unplugged, there would be a risk that escaping gas could accumulate inside, posing a fire hazard. In 2011, a total of 11 wells (including one well where there were no commercial gas flows following a workover) and 11 mining pits were abandoned.

Carbon credit trading system

In 2011, the Zielona Góra Branch and the Odolanów Branch, as well as the Mogilno Underground Gas Storage Cavern Facility, were covered by the carbon dioxide emission trading scheme (ETS). Emission from those installations amounted to 91,098 Mg CO_2. In 2011, an initial review was carried out to qualify Wierzchowice Underground Gas Storage Facility for the carbon dioxide emission trading scheme.

Methane emissions

In 2011, detailed recording of methane emissions from the gas distribution system commenced. Its purpose is to estimate the size of methane emissions from particular components of the system, review the emission indicators applied to date, and develop uniform indicators and calculation methods for methane emissions. Standardised and reliable methane emission indicators will help reduce the cost of environmental fees and charges.

Land reclamation and non-productive asset surveying

Pursuant to the Environmental Protection Law, PGNiG SA conducts diagnosis tests and surveys and land reclamation work in the areas polluted in the course of past activities with a view to restoring them to the condition required under the environmental quality standards. In 2011, supplementary tests and surveys concerning properties located in Kargowa, Zabrze, Łabiszyn and Międzylesie (with a total area of 15,500 sq m), as well as land reclamation work on the properties in Pyrzyce and Koźmin Wielkopolski (with a total area of 9,000 sq m), were completed. In addition, land reclamation work on the properties in Karkowa and Radków commenced in 2011.

Integrated Management System and Environmental Management System

In 2011, Wielkopolska Spółka Gazownictwa Sp. z o.o. implemented an Integrated Management System. Results of the certification were positive. In addition, Mazowiecka Spółka Gazownictwa Sp. z o.o. implemented the Environmental Management System.

Exploration for and appraisal of unconventional hydrocarbons

In 2011, PGNiG SA commenced research to identify types and scale of threats that may be brought by exploration and appraisal work involving high water consumption and use of chemicals in the hydraulic fracturing of shale, as well as large amount of waste generated by the process

Chapter XII: Other information

Distribution of the 2010 profit

On April 20th 2011, the Annual General Meeting of PGNiG SA adopted a resolution to distribute the 2010 net profit of PLN 1,702.1m in the following manner:

- PLN 921.6m was allocated for contribution to the Company's statutory reserve funds
- PLN 708.0m was allocated for dividend payment (PLN 0.12 per share), of which up to PLN 30.1m will be transferred to the State Treasury as non-cash dividend in the form of transmission system components, and as cash dividend (the difference between the value of dividend due given the number of shares held by the State Treasury and the final value of the non-cash dividend)
- PLN 9.1m was allocated for contribution to the Company's social benefits fund
- PLN 58.4m was allocated for awards (bonuses) for the Company's employees
- PLN 5.0m was allocated for contribution to the Central Restructuring Fund capital reserve.

In addition, retained earnings of PLN 76.5m was allocated for contribution to the Company's statutory reserve funds.

The Annual General Meeting of PGNiG SA set July 20th 2011 as the dividend record date and October 6th 2011 as the dividend payment date.

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

On April 20th 2011, the Annual General Meeting of PGNiG SA approved the financial statements and the Director's Report on the operations of PGNiG SA, as well as the consolidated financial statements and the Director's Report on the operations of the PGNiG Group, and granted discharge to members of the Management and Supervisory Boards of PGNiG SA in respect of their performance of duties in the financial year 2010.

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

Proceedings concerning PGNiG SA's action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of resolutions by the General Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution obliging PGNiG SA to pay additional contributions 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 SA's claims and declared the resolution concerning share redemption and the resolution concerning the additional contributions as invalid. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, along with a petition to be exempt from court fees. On June 4th 2011, PGNiG SA filed a response to the above appeal with the Warsaw Court of Appeals. On December 14th 2011, the Court of Appeals dismissed PI GAZOTECH Sp. z o.o.'s appeal against the Regional Court's decision.

Proceedings based on PGNiG SA's action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of the resolution of the General Meeting of PI GAZOTECH Sp. z o.o., dated January 19th 2005, whereunder PGNiG SA was obliged to pay additional contributions 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 rescinded the resolution on additional contributions. On November 12th 2010, PI GAZOTECH Sp. z o.o. filed an appeal with the Regional Court, along with a petition to be exempt from court fees. The Regional Court of Warsaw accepted the appeal for consideration. On June 28th 2011, PGNiG SA filed a response to the above appeal with the Warsaw Court of Appeals.

Proceedings based upon PGNiG SA's action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of the resolution of the General Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, whereunder PGNiG SA was obliged to pay additional contributions in the amount of PLN 6,552,000, were brought before the Regional Court of Warsaw. On May 30th 2008, the Regional Court dismissed the Company's claim and reversed the decision concerning implementation of measures to safeguard the claim (the temporary injunction order). The proceedings to rescind or declare invalidity of the resolution on additional contributions and to maintain the safeguarding measures have been held before the Court of Appeals and the Regional Court of Warsaw since 2008. By virtue of its decision of May 25th 2010, the Court of Appeals changed the Regional Court's decision concerning maintenance of the safeguarding measures dated May 30th 2008 and dismissed the request for reversing the final decision on implementation of the safeguarding measures. During its session held on April 11th 2011, the Regional Court issued a decision suspending the proceedings to rescind or declare invalidity of the resolution on additional contributions.

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 abuse of dominant position by PGNiG SA on the domestic natural gas wholesale market, which consisted in inhibiting sale of gas against the interest of other business players or consumers and impeding the development of market conditions necessary for the emergence or growth of competition by refusing to sell gas fuel under a comprehensive agreement to an entrepreneur that intended to further resell the gas, i.e. NowyGaz Sp. z o.o. of Warsaw. The President of UOKiK extended the deadline for closing the anti-trust proceedings to February 29th 2012.

On July 4th 2011, the President of UOKiK instigated anti-trust proceedings concerning abuse of dominant position by PGNiG SA on the domestic natural gas retail market. In the President's opinion, the abuse consisted in impeding the emergence or growth of competition on the domestic natural gas wholesale and retail markets by limiting the possibility to terminate comprehensive agreements for supplies of gas fuel. On August 1st 2011, PGNiG SA sent a letter to the President of UOKiK in which it challenged, in its entirety, the charge of abuse of dominant position by the Company on the domestic natural gas market and applied for the proceedings to be discontinued.

On February 9th 2012, the President of UOKiK instigated anti-trust proceedings concerning practices employed by PGNiG SA which infringe collective consumer interests. The President of UOKiK has accused PGNiG SA of including in the comprehensive agreement for supplies of gas fuel a provision classified as illegal contractual clause.

In each of the cases referred to above, the President of UOKiK may impose on PGNiG SA a fine of up to 10% of the revenue generated by the Company in the financial year preceding the date of the decision imposing the fine.

Proceedings before the Court of Arbitration

On March 31st 2011, PGNiG SA requested OOO Gazprom Export to renegotiate the price of gas deliveries under the Contract dated September 25th 1996, providing for supplies of natural gas to the Republic of Poland, so as to reduce the price. Since the parties failed to reach an agreement in the period of six months, on November 7th 2011, PGNiG SA filed a request to OAO Gazprom and OOO Gazprom Export to start arbitration proceedings before the Court of Arbitration in Stockholm. In accordance with the Court's procedure, on February 20th 2012, the Company filed a suit against OAO Gazprom and OOO Gazprom Export.

Chapter XIII: Financial performance

1. Financial performance in 2011

The financial statements of PGNiG SA and the consolidated financial statements of the PGNiG Group for 2011 were audited by Deloitte Audyt Sp. z o.o. The agreement with the audit firm was executed on June 28th 2010 for a period of three years (2010–2012). The agreement provides for:

- audit of the financial statements for 2010, 2011 and 2012 (PGNiG SA and subsidiaries);
- review of the financial statements for Q1 2011, Q1 2012 and Q1 2013 (PGNiG SA);
- review of the financial statements for H1 2010, H1 2011 and H1 2012 (PGNiG SA);
- review of the financial statements for the first three quarters of 2010, 2011 and 2012 (PGNiG SA);
- carrying out certain procedures required by the banks providing financing to PGNiG SA for 2010, 2011 and 2012;
- translation of the audited annual and semi-annual financial statements into English.

The table below presents the fees paid or payable by PGNiG SA to the auditor for 2010–2011.

Auditor's fees (PLN)

	2011	2010
Audit of the annual financial statements	230,000	230,000
Other certification services, including review of financial statements	448,942	320,000
Tax advisory services	-	-
Other services	30,669	11,923
Total	709,611	561,923

1.1. Key financial and business data

In 2011, the PGNiG Group posted a net profit of PLN 1,626.2m, down by PLN 831.0m year on year. The weakening of the Group's financial position was caused chiefly by the lower profitability of high-methane gas sales.

Summary information reflecting the PGNiG Group's financial standing in 2011 relative to 2010 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.

Consolidated statement of financial position (PLNm)

ASSETS	Dec 31 2011	Dec 31 2010
Non-current assets		
Property, plant and equipment	28,427.0	25,662.2
Investment property	7.1	9.9
Intangible assets	275.5	246.7
Investments in associates accounted for using the equity method	598.4	555.8
Financial assets available for sale	56.4	170.5
Other financial assets	9.4	39.9
Deferred tax assets	963.8	676.8
Other non-current assets	97.8	71.1
Current assets	7,529.0	6,209.5
Inventories	2,082.4	1,049.6
Trade and other receivables	3,378.1	3,387.3
Current income tax receivable	164.5	229.7
Prepayments and accrued income	83.9	78.8
Financial assets available for sale	22.3	8.8
Derivative financial instrument assets	284.6	77.9
Cash and cash equivalents	1,504.8	1,373.3
Non-current assets held for sale	8.4	4.1
Total assets	37,964.4	33,642.4

Consolidated statement of financial position (PLNm) – contd.

EQUITY AND LIABILITIES	Dec 31 2011	Dec 31 2010
Equity		
Share capital	5,900.0	5,900.0
Currency translation differences on foreign operations	(23.0)	(57.3)
Share premium account	1,740.1	1,740.1
Other capital reserves	14,149.3	12,268.2
Retained earnings/(deficit)	2,723.5	3,655.1
Equity (attributable to owners of the parent)	24,489.9	23,506.1
Equity attributable to non-controlling interests	6.8	13.4
Non-current liabilities	5,621.5	4,973.3
Loans, borrowings and debt securities	1,382.3	969.9
Provisions	1,625.8	1,501.1
Deferred income	1,160.1	1,089.2
Deferred tax liability	1,433.4	1,392.0
Other non-current liabilities	19.9	21.1
Current liabilities	7,846.2	5,149.6
Trade and other payables	3,354.9	3,206.2
Loans, borrowings and debt securities	3,616.6	1,229.2
Derivative financial instrument liabilities	416.8	104.4
Current tax liability	57.7	226.0
Provisions	305.2	289.7
Deferred income	95.0	94.1
Total liabilities	13,467.7	10,122.9
Total equity and liabilities	37,964.4	33,642.4

Consolidated income statement (PLNm)

	2011	2010
Revenue	23,003.5	21,281.2
Total operating expenses	(21,318.0)	(18,394.5)
Raw and other materials used	(14,059.1)	(11,675.2)
Employee benefits	(2,808.7)	(2,647.3)
Depreciation and amortisation	(1,574.1)	(1,524.7)
Third-party services	(3,240.9)	(3,148.8)
Cost of products and services for own needs	1,001.3	1,043.0
Other operating expenses, net	(636.5)	(441.5)
Operating profit/loss	1,685.5	2,886.7
Finance income	135.7	80.5
Finance expenses	(152.0)	(30.4)
Share in net profit/loss of entities accounted for using the equity method	42.6	(0.7)
Pre-tax profit/loss	1,711.8	2,936.1
Corporate income tax	(85.6)	(478.9)
Net profit/loss	1,626.2	2,457.2
Attributable to:		
Owners of the parent	1,626.8	2,453.7
Non-controlling interests	-0.6	3.5
	1,626.2	2,457.2

Consolidated statement of cash flows (PLNm)

	2011	2010
Net cash provided by/used in operating activities	2,467.9	3,843.3
Net cash provided by/used in investing activities	(4,019.2)	(3,558.8)
Net cash provided by/used in financing activities	1,682.2	(107.9)
Net change in cash	130.9	176.6
Cash and cash equivalents at beginning of period	1,372.9	1,196.3
Cash and cash equivalents at end of period	1,503.8	1,372.9

Financial Ratios

Profitability

	2011	2010
EBIT (PLNm) operating profit	1,685.5	2,886.7
EBITDA (PLNm) operating profit + depreciation/amortisation	3,259.6	4,411.4
ROE net profit* to equity at end of period	6.6%	10.4%
NET MARGIN net profit* to revenue	7.1%	11.5%
ROA net profit* to assets at end of period	4.3%	7.3%

*Net profit for the financial year attributable to owners of the parent.

Liquidity

LIQUIDITY	2011	2010
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	0.9	1.2
QUICK RATIO current assets (net of prepayments and accrued income) less inventories to current liabilities	0.7	1.0

Debt

DEBT	2011	2010
DEBT RATIO total liabilities to total equity and liabilities	35.5%	30.1%
DEBT/EQUITY RATIO total liabilities to equity*	55.0%	43.1%

*Equity attributable to owners of the parent.

1.2. Financial overview

Relative to the corresponding period of 2010, the Group's operating profit decreased significantly, by PLN 1,201.2m. This decline was was caused by the considerably lower profitability of high-methane gas sales.

Exploration and Production

The upstream business continued to secure the the stability of the Group's financial position. The Exploration and Production segment posted operating profit of PLN 1,126.2m, up by PLN 538.6m on 2010. This increase followed chiefly from higher profitability of crude oil sales, as its selling prices rose by 40%, following the general trend on global markets. Operating profit of the segment advanced also on higher revenue from sales of geophysical, geological and exploration services, in connection with intensified exploration for unconventional natural gas in Poland. Furthermore, the Company recorded a 4% rise in production of nitrogen-rich gas and a 7% increase in output of the denitriding plants.

The Exploration and Production segment's result was also significantly affected by lower net other operating expenses, mainly on the back of higher foreign exchange gains.

Trade and Storage

Operating profit of the the Trade and Storage segment fell by PLN 999.3m relative to 2010. The weakening of the segment's financial position came as a result of the significantly lower profitability of high-methane gas sales, caused mainly by a 24% rise in the unit purchase price of imported gas, driven by higher crude oil prices on the global markets. The increase would have been higher, had it not been for rebates and discounts received in December 2011 under the existing import contracts.

The US dollar, the main currency used in gas imports, depreciated relative to 2010. However, the depreciation was not enough to offset the increase in prices of imported gas pushed up by higher crude oil prices.

The margins on high-methane gas sales deteriorated despite a 5.7% year on year increase in the average gas selling prices and charge rates. The benefits offered by the new tariff effective as of July 2011 were completely eliminated by the strong depreciation of the Polish złoty, pushing profitability of high-methane gas below the break-even point.

The decline of the segment's operating profit was substantially limited due to lower net other operating expenses, attributable primarily to higher reversals of impairment losses on trade receivables, higher income from penalties and compensations, as well as a refund by SGT EUROPOL GAZ S.A. of overpayment for purchased transmission services.

Distribution

Operating result of the Distribution segment amounted to PLN 783.7m, down by PLN 707.5m year on year, primarily on the back of significantly lower reversals of impairment losses on assets of the Gas Distribution Companies. Furthermore, higher amortisation/depreciation charges and employee benefits were reported. The higher amortisation/depreciation charges were caused by a higher gross value of the Distribution segment's fixed assets (following completion of new investments) and a reversal of impairment losses on the assets of Dolnośląska Spółka Gazownictwa Sp. z o.o. and Mazowiecka Spółka Gazownictwa Sp. z o.o. in 2010. The segment's profitability was down despite the higher rates and charges for network services effective as of July 15th 2011, mainly due to a lower volume of transmitted gas.

Financial data of the PGNiG Group's segments for 2011 (PLNm)

2011	Exploration and Production	Trade and Storage	Distribution	Other Activities	Eliminations	Total
Sales to external customers	2,878.6	19,820.8	141.3	162.8	-	23,003.5
Intercompany sales	1,202.0	224.1	3,329.4	341.4	(5,096.9)	-
Segment's total revenue	4,080.6	20,044.9	3,470.7	504.2	(5,096.9)	23,003.5
Segment's expenses	(2,954.4)	(20,228.7)	(2,687.0)	(508.6)	5,060.7	(21,318.0)
Operating profit/loss	1,126.2	(183.8)	783.7	(4.4)	(36.2)	1,685.5
Net finance expenses						(16.3)
Share in net profit/loss of entities accounted for using the equity method	-	42.6	-	-	-	42.6
Pre-tax profit/loss						1,711.8
Corporate income tax	-	-	-	-	-	(85.6)
Net profit/loss						1,626.2

Financial data of the PGNiG Group's segments for 2010 (PLNm)

2010	Exploration and Production	Trade and Storage	Distribution	Other Activities	Eliminations	Total
Sales to external customers	2,244.8	18,701.4	126.5	208.5	-	21,281.2
Intercompany sales	1,206.7	378.2	3,411.4	359.5	(5,355.8)	-
Segment's total revenue	3,451.5	19,079.6	3,537.9	568.0	(5,355.8)	21,281.2
Segment's expenses	(2,863.9)	(18,264.1)	(2,046.7)	(541.4)	5,321.6	(18,394.5)
Operating profit/loss	587.6	815.5	1,491.2	26.6	(34.2)	2,886.7
Net finance expenses						50.1
Share in net profit/loss of entities accounted for using the equity method	-	(0.7)	-	-	-	(0.7)
Pre-tax profit/loss						2,936.1
Corporate income tax						(478.9)
Net profit/loss						2,457.2

Deterioration of the PGNiG Group's financial position is reflected in the decline of the key efficiency ratios. Return on equity decreased from 10.4% to 6.6%; return on assets amounted to 4.3% against 7.3% in 2011, and net margin dropped from 11.5% to 7.1%.

As at December 31st 2011, total assets were PLN 37,964.4m, up by PLN 4,332.0m relative to the end of 2010.

Property, plant and equipment, of PLN 28,427.0m as at the end of 2011 (up by PLN 2,764.8m, or 11%, on December 31st 2010), was the largest item of the Group's assets. The increase in the value of property, plant and equipment was primarily attributable to the investment projects implemented by the PGNiG Group, as well as to revaluation of assets.

As at December 31st 2011, financial assets available for sale stood at PLN 56.4m, down by PLN 114.1m relative to the end of 2010. The decrease was primarily due to the disposal of shares in Zakłady Azotowe w Tarnowie-Mościcach S.A.

Other financial assets stood at PLN 9.4m and were down by 30.5m relative to December 31st 2010 due to the termination of the transmission assets lease agreement between PGNiG SA and OGP GAZ-SYSTEM S.A.

As at December 31st 2011, current assets of the PGNiG Group were PLN 7,529.0m, up by PLN 1,319.5m (or 21%) year on year. This increase was atributtable to higher inventories, which grew by PLN 1,032.8m (98%). The inventories disclosed in the balance sheet comprise mainly the gas stored in underground storage facilities. The rise in the value of inventories was primarily caused by the increase of the unit purchase price of imported gas and by the higher volume of gas stocks.

Cash and cash equivalents stood at PLN 1,504.8m, up by PLN 131.5m (10%) on 2010, and followed primarily from an increase in debt under issue of debt securities and non-current loans.

The value and structure of current assets held by the PGNiG Group guarantee its ability to settle all liabilities in a timely manner. The current ratio was 0.9, compared with 1.2 as at the end of December 2010, whereas the quick ratio fell from 1.0 to 0.7.

Equity is the primary source of financing of the PGNiG Group's assets. Relative to the end of 2010, the Group's equity rose by PLN 977.2m (or 4%). The level of equity was affected mainly by net profit for the year (PLN 1,626.2m) and payment of non-cash and cash dividend (PLN 708.0m) as part of distribution of previous year's profit.

As at December 31st 2011, non-current liabilities were PLN 5,621.5m, up by PLN 648.2m (13%) on the end of December 2010. This came as a result of a PLN 412.4m increase in loans, borrowings and debt securities, following subsequent drawdowns of the credit facility by PGNiG Norway AS. Furthermore, the Group reported an increase in deferred income due to an investment subsidy granted for construction and extension of the underground gas storage facilities, as well as higher provision for well decommissioning costs.

Current liabilities rose by PLN 2,696.6m (52%) relative to the end of December 2010 chiefly as a result of the increase in loans, borrowings and debt securities. Relative to 2010, the Group significantly increased the external financing to meet its liquidity needs driven mainly by the implementation of investment programmes. Following the execution of the notes issue programmes, as at the end of December 2011 current loans, borrowings and debt securities stood at PLN 3,616.6m, up by PLN 2,387.4m relative to December 2010.

Due to the rise in external financing used by the PGNiG Group, the ratios of equity to liabilities changed. Debt to equity increased from from 43.1% to 55.0% as at the end of 2011. Debt ratio (total liabilities to total equity and liabilities) went up from 30.1% to 35.5%.

Material off-balance-sheet items

As at December 31st 2011, the PGNiG Group's most important off-balance-sheet item was represented by contingent liabilities of PLN 11,428.7m. The main items of contingent liabilities included:

- performance bond securing performance of PGNiG Norway AS's licence and legal obligations towards the state of Norway, issued by PGNiG SA (PLN 2,771.79m);
- performance bond securing performance of POGC-Libya B.V.'s obligations towards National Oil Corporation of Libya, issued by PGNiG SA (PLN 369.1m);

- performance bond securing performance of PGNiG Finance AB's obligations towards bondholders, in connection with the Eurobond programme, issued by PGNiG SA (PLN 6,625.2m).

Feasibility of investment projects

Thanks to the positive assessment of PGNiG SA's creditworthiness by rating agencies, as well as the improving situation on the financial markets, the Group has been able to carry out its investment projects as planned. However, as the approval of the new tariff reflecting the increase in price of imported gas is still pending, there is a risk that execution new investment projects may be suspended or limited.

Transactions concluded on non-arm's' length terms

In 2011, PGNiG SA 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 the forecasts for 2011

In 2011, the PGNiG Group did not publish any financial forecasts.

Key equity investments and capital placements at the PGNiG Group

The PGNiG Group's key equity investments in 2011 included:
- payment of a new tranche (NOK 660.0m) of the long-term loan advanced to PGNiG Norway AS by PGNiG S.A; the loan was advanced to finance capital expenditure related to the Norwegian Continental Shelf project
- payment of the first tranche (PLN 88.7m) of the short-term loan to PGNiG SPV1 Sp. z o.o. by PGNiG SA; the facility was advanced to finance the acquisition of shares in Vattenfall Heat Poland S.A.
- issue of short-term notes offered to the PGNiG Group companies; as at December 31st 2011, PGNiG SA's debt under the notes was PLN 297.5m.
- share capital increases at subsidiaries: PGNiG Norway AS (PLN 74.7m), PGNiG Technologie Sp. z o.o. (PLN 46.5m), PSG Sp. z o.o. (PLN 39.0m), and PGNiG Energia S.A. (PLN 24m).

2. Financial management

In 2011, the PGNiG Group significantly raised the amount of external financing.

In 2011, two annexes were signed to the notes issue programme agreement signed with six banks on June 10th 2010. Under the annexes, three new banks, i.e. BRE Bank S.A., Bank Zachodni WBK S.A. and Nordea Bank Polska S.A., joined the agreement. The value of the notes issue programme was increased to PLN 7bn, and the agreement term was extended until July 31st 2015. Under the programme, PGNiG may issue discount and coupon notes with maturities ranging from one month to one year. In 2011, the Company issued notes with a total nominal value of PLN 16.4bn. As at December 31st 2011, the debt under the programme stood at PLN 3.3bn. PGNiG SA used the proceeds from the issue to finance investment projects involving field development, construction and extension of underground storage facilities, acquisition of shares in Vattenfall Heat Poland S.A. (in January 2012), as well as PGNiG SA's operations.

On August 25th 2011, PGNiG SA signed the documentation for a five-year Eurobond issue programme of up to EUR 1.2bn with PGNiG Finance AB and three banks (Societe Generale SA, BNP Paribas SA and UniCredit Bank AG). Under the programme, PGNiG Finance AB of Stockholm, PGNiG SA's wholly-owned subsidiary, will issue on the European market fixed or floating rate medium-term bonds with maturities of up to 10 years . On August 25th 2011, PGNiG SA granted a guarantee of up to EUR 1.5bn in respect of repayment by PGNiG Finance AB of the liabilities under the Eurobond programme. The guarantee remains valid until December 31st 2026. The first EUR 500m tranche of Eurobonds with a five-year maturity and a yield of 4.098% p.a. was issued on February 10th 2012. The bonds were assigned the Baa1 (Moody’s) and BBB+ (Standard & Poor’s) credit ratings. Proceeds from the issue will be used to finance PGNiG S.A's investment programme and its day-to-day operations.

Furthermore, pursuant to the agreement of December 1st 2010, the Company continues to issue short-term discount notes to the companies of the PGNiG Group. The agreement is valid until November 30th 2013. By virtue of an annex of June 10th 2011, the value of the programme was increased from PLN 397.3m to PLN 1bn. In 2011, the Company issued notes with a nominal value of PLN 4.6bn. The note issue programme provides for a flow of cash from the companies having excess to liquidity and optimises liquidity management within the Group. As at December 31st 2011, PGNiG SA's debt under the notes in issue amounted to PLN 297.5m.

The funds available to the PGNiG Group ensure timely financing of all current and planned expenditure related to the core business and investing activities. External financing is raised mainly through debt securities issue programmes. Moreover, the PGNiG Group has a liquidity reserve in the form of overdraft facility agreements. In 2011, the Group used overdraft facilities to a limited extent. In the long term, the negative margin on sales of imported natural gas may lead to a downgrade of the credit rating and considerably increase borrowing costs.

2.1. Short-term investments

The financial investments made by the Group in 2011 were short-term, with maturities of up to one month. The Company invested in instruments carrying the lowest possible credit risk, mainly bank deposits, which represented 95% of the investments. Conditional purchases/sales of treasury securities accounted for the remaining 5% of transactions. Such placements were consistent with PGNiG SA's financial investment policy adopted by the Company's governing bodies and with the Issue Prospectus.

2.2. Loan agreements

In 2011, the PGNiG Group entered into loan agreements for a total amount of PLN 724.7m, EUR 15m, USD 11.5m and CZK 5m in order to finance day-to-day operations and investments. Also, the Group executed overdraft facility agreements for a total amount of PLN 463.4m, USD 11.5m and CZK 5m. The remaining credit facilities, for a total amount of PLN 261.3m and EUR 15m, were used to finance investment projects, including the construction of MSG Sp. z o.o.'s headquarters and purchase of drilling equipment.

The table below presents details of the key loan agreements executed by the PGNiG Group in 2011.

Key loan agreements concluded by the PGNiG Group

Bank	Loan amount (PLNm)	Currency	Interest rate	Type	Maturity date
PKO BP S.A.	241.0	PLN	3M WIBOR + 1.3%–1.7%	investment loan	Dec 31 2019
BGK	15.0	EUR	1M EURIBOR + 0.95%	investment loan	May 31 2016
Bank Handlowy w Warszawie SA	40.0	PLN	1M WIBOR + 0.30%	working capital loan	Dec 31 2012
Bank Pekao S.A.	40.0	PLN	1M WIBOR + 0.45%	working capital loan	Jul 31 2012
PKO BP S.A.	40.0	PLN	1M WIBOR + 0.60%	working capital loan	13.07.2012
BRE Bank S.A.[1]	40.0	PLN	O/N WIBOR + 0.15%	working capital loan	07.09.2012
Societe Generale S.A. Polish Branch	40,0	PLN	1M WIBOR + 0.40%	working capital loan	Aug 31 2012
ING Bank Śląski S.A.[2]	40.0	PLN	1M WIBOR + 0.40%	working capital loan	Dec 6 2012
Bank Millennium S.A.	40.0	PLN	1M WIBOR + 0.40%	working capital loan	Dec 18 2012
Bank Pekao S.A.	40.0	PLN	1M WIBOR + 0.45%	working capital loan	May 26 2012

[1] during the term of the agreement, the interest rate was changed from ON WIBOR + 0.19% to ON WIBOR + 0.15%.

[2] during the term of the agreement, the interest rate was changed from ON WIBOR + 0.50% to ON WIBOR + 0.40%.

In 2011, the PGNiG Group did not terminate any loan agreements. The Group did not advance any loans and it neither contracted nor terminated loans from entities other than banks.

2.3. Guarantees and sureties

In 2011, the PGNiG Group provided guarantees and sureties for a total amount of PLN 7,405.3m. The most significant of them were as follows:

- EUR 1,500m (PLN 6,625.2) guarantee for the liabilities of PGNiG Finance AB under the Eurobond programme, which remains valid until December 31st 2026
- NOK 600m (PLN 340.6m) guarantee for PGNiG Norway AS's liabilities towards GASSCO; the guarantee remains valid until April 1st 2024 and covers PGNiG Norway AS's liabilities under tariff charges for transmission of gas in the Norwegian gas transport system Gassled.

In 2011, the PGNiG Group received guarantees and sureties for a total amount of PLN 118.7m, of which 16% (PLN 19m) was attributable to guarantees and sureties of less than PLN 500 thousand. The remaining guarantees and sureties were performance bonds, including bonds securing gas contracts. The most significant of them were:

- two advance payment bonds for a total amount of EUR 8.5m (PLN 37.5m) issued by Drillmec SPA, an Italian company, relating to an advance payment for drilling equipment
- PLN 7.8m performance bond issued by a consortium comprising Control Process Sp. z o.o., STALBUD Tarnów Sp. z o.o. and Biuro Projektów „NAFTA GAZ" Sp. z o.o., related to the construction of the surface part of the Kosakowo Underground Gas Storage Facility.

2.4. Financial risk management

The main objective of the PGNiG Group's financial risk management policy is to limit the volatility of cash flows related to the Group'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 its business activities in 2011, the PGNiG Group 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

The PGNiG Group 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 Group's financial performance.

The key risks to which the Group is exposed include the risk of commodity price and exchange rate fluctuations, which affect the Group's gas purchases.

In 2011, the PGNiG Group used the following financial instruments to manage the gas price risk:
- purchases of Asian commodity call options settled as European options;
- commodity option structures (consisting in a combination of two commodity options);
- commodity swaps based on the average price of gas over the term of the transaction.

In 2011, to mitigate the currency risk the Group used the following financial instruments:
- Forward contracts
- FX swaps
- purchases of currency call options;
- option structures (in most cases consisting in a combination of two currency options).

PGNiG SA also used CCIRS transactions (to mitigate the FX and interest rate risks) to hedge the loan advanced to PGNiG Norway AS.

The Company has 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 on profit or loss of valuation of hedging instruments 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.

Credit risk

The PGNiG Group's credit risk is related to the likelihood of failure by the counterparties or other entities to meet their obligations to the Group. In 2011, the Group managed credit risk by investing its free cash in instruments carrying the lowest possible credit risk (treasury bonds and bills), entering into framework agreements with its counterparties (precisely defining the rights and obligations of the parties), and diversifying its counterparties. The PGNiG Group also worked with leading commercial banks. The key criteria for the selection of counterparties to whom the Group 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 the PGNiG Group 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 Group, consolidating bank accounts and entering into overdraft facility agreements. The Company mitigated any cash flow volatility on payments under the gas contracts by entering into FX risk hedges (currency options, option strategies) and gas price hedges (Asian options, option strategies and commodity swaps).

Liquidity Risk

In order to mitigate its liquidity risk, in 2011 PGNiG SA signed annexes to the overdraft facility agreements executed in 2010 and the PLN 7bn notes issue programme agreement. PGNiG SA also prepared cash flow projections for the Company and the Group, assessed the condition and value of assets available for sale, maintained highly liquid financial assets and cooperated with rating agencies.

3. Projected future financial performance

Key factors with a bearing on the PGNiG Group's financial performance will include crude oil prices on international markets, conditions prevailing on the currency markets, and the position of the Energy Regulatory Office on gas fuel tariffs.

The financial position of the PGNiG Group is to a significant extent affected by the prices of crude oil and petroleum products. Following the adverse developments in the global political and economic environment in 2011, crude oil prices on the international markets increased. If the current trend continues, crude prices may continue to rise in the coming quarters.

The PGNiG Group is significantly exposed to changes in foreign exchange rates and, consequently, to fluctuations in PLN-denominated prices of imported gas. In Q3 and Q4 2011 the Polish currency weakened significantly. Further weakening of the złoty may have a material adverse effect on the Company's financial performance.

Another factor with a bearing on the Company's financial results is the level of prices and charges set in the gas fuel tariffs. The tariff currently applied by PGNiG SA had been originally scheduled for the period until December 31st 2011. Given the unfavourable developments on the currency and fuel markets, in October 2011, PGNiG SA filed two applications with the Energy Regulatory Office: the first requesting the approval of an adjustment to the then effective tariff and the other requesting a new tariff for Q1 2012. As at the date of this report, proceedings were pending. In the current market climate, if the new tariff is not approved, the PGNiG Group will suffer losses on operations, suspend new projects and may lose financial liquidity.

In 2011, PGNiG SA started to renegotiate the price of gas supplied under the long-term contract with OOO Gazprom Export and then referred the case to the Arbitration Court in Stockholm. If the dispute is settled in favour of PGNiG SA, it will help reduce the cost of gas imports.

In 2011, PGNiG SA and OGP GAZ-SYSTEM S.A. executed an agreement for additional gas supplies to Poland with the use of virtual reverse flow on the Yamal Pipeline. The agreement permits the Company to purchase gas at lower prices than those specified in the contract with OOO Gazprom Export. The first volumes of gas were supplied in November and December 2011 through PGNiG Sales & Trading GmbH. In 2012, the Company plans to continue supplies with the use of reverse flow which will help improve the balance of gas supplies to Poland.

In Q2 2012 the PGNiG Group plans to commence production from the Skarv field on the Norwegian Continental Shelf. Sale of the Skarv oil and gas on the European markets may strengthen the Group's financial position.

External financing of the Company's operations in 2012 will be based on the PLN 3.0bn notes issue programme under the agreement concluded with six banks on June 10th 2010 (under the annexes, the value of the programme was increased to PLN 7bn). The agreement will remain in force until July 31st 2015. Also, on August 25th 2011, PGNiG SA and three banks signed the documentation for a EUR 1.2bn medium-term Eurobond issue programme. The first EUR 500m tranche of Eurobonds was issued by PGNiG Finance AB on February 10th 2012.

In the coming quarters, the PGNiG Group intends to maintain the high level of capital expenditure, mainly on projects designed to extend the underground gas storage facilities, maintain hydrocarbon production capacities, and diversify gas supply sources, as well as on projects related to the exploration for and appraisal of crude oil and natural gas deposits and development of the Group's power generation segment.
In January 2012, PGNiG SA completed the transaction of purchase of 99.8% of shares in Vattenfall Heat Poland SA (now PGNiG TERMIKA S.A.). PGNiG TERMIKA S.A. is to be the main competence centre for large gas-fired power projects.

Members of the Management Board

Vice-President of the Management Board	Radosław Dudziński	
Vice-President of the Management Board	Sławomir Hinc	
Vice-President of the Management Board	Marek Karabuła	
Vice-President of the Management Board	Mirosław Szkałuba	