PGNiG

Polskie Górnictwo Naftowe i Gazownictwo SA

DIRECTORS' REPORT ON THE OPERATIONS OF PGNiG S.A. IN 2010

Warsaw, March 3rd 2011

Contents

Chapter I: General Information on the Company

1. Establishment of the Company

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), 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. The Deed of Transformation, together with the Company's Articles of Association, were executed in the form of a notarial deed dated October 21st 1996 (Rep. A No. 18871/96).

The Minister of the State Treasury executed the Deed of Transformation in performance of the provisions of the Regulation of the President of the Polish Council of Ministers of September 30th 1996 on transformation of the state-owned enterprise Polskie Górnictwo Naftowe i Gazownictwo of Warsaw into a state-owned stock company.

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

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

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

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

The Company's debut on the Warsaw Stock Exchange took place on September 23rd 2005. PGNiG S.A. shares have been listed on the Warsaw Stock Exchange since October 20th 2005.

2. Business Profile

PGNiG S.A. is the largest company in Poland operating in the area of hydrocarbon exploration and production, and natural gas trading. PGNiG S.A. is the leader across all areas of the Polish gas sector, including natural gas import, exploration, oil and gas production, gaseous fuel storage and sale of natural gas.

Pursuant to its Articles of Association, the Company engages in production, service and trade activities. The scope of the Company's core business is as follows:

- exploration for, and development of reserves and extraction of, crude oil, natural gas and sulphur-containing minerals,
- production and processing of refined petroleum products,
- production and distribution of gaseous fuels,
- wholesale and retail sale of fuels,

- test drilling and boring,
- geological and exploration activities, geodetic and cartographic activities,
- generation, transmission and distribution of electricity,
- lease, management, purchase and sale of real estate,
- lease of power and gas transmission assets,
- distribution of gaseous fuels through mains.

Pursuant to its Articles of Association, the Company performs activities aimed at ensuring energy security of Poland. These relate in particular to the following:

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

3. PGNiG S.A.'s Organisational Structure

PGNiG S.A. has a number of branches. As at December 31st 2010, the PGNiG S.A. corporate structure comprised the Head Office and fifteen branches. Their core activities are presented in the table below:

Core activities of PGNiG S.A.'s organisational units

Unit	Core activity
Head Office, Warsaw	Corporate supervision over the Company branches Supervision over the PGNiG Group as part of ownership supervision
Sanok Branch	Production of natural gas and crude oil Operating underground gas storage facilities Direct sale of off-system natural gas and other products and services Exploration-related work
Zielona Góra Branch	Production of natural gas and crude oil Operating underground gas storage facilities Direct sale of off-system natural gas and other products and services Exploration work
Odolanów Branch	Processing of nitrogen-rich natural gas into high-methane gas

Core activities of PGNiG S.A.'s organisational units - continued

Branch	Core activity
Operating Branch in Pakistan	Exploration for and production of hydrocarbons in licence areas in Pakistan
Egypt Branch	Exploration for and production of hydrocarbons in licence areas in Egypt
Denmark Branch	Exploration for and production of hydrocarbons in licence areas in Denmark
Algieria Branch	Exploration for and production of hydrocarbons in licence areas in Algieria
Lower Silesian Gas Trading Division in Wrocław	Comprehensive customer sales service related to sale of natural gas and other products and services
Upper Silesian Gas Trading Division in Zabrze	
Carpathian Gas Trading Division in Tarnów	
Mazovian Gas Trading Division in Warsaw	
Pomeranian Gas Trading Division in Gdańsk	
Greater Poland Gas Trading Division in Poznań	
Storage System Operator in Warsaw	Gaseous fuel storage
Central Measurement and Testing Laboratory, Warsaw	Provision of services to ensure accuracy and reliability of measurements related to natural gas

As at December 31st 2010, PGNiG S.A. had foreign representative offices in Moscow (Russia), Brussels (Belgium), Kiev (Ukraine) and Vysokoye (Belarus).

On January 1st 2011 a new branch was established within the structures of PGNiG S.A., namely the Emergency Rescue Station Branch in Kraków (Oddział Ratownicza Stacja Górnictwa Otworowego w Krakowie). It was established based on an organised part of business in the form of the Emergency Rescue Station, purchased by PGNiG S.A. from Poszukiwania Nafty i Gazu Kraków Sp. z o.o. The Branch will engage in activities related to rescue operations in well mining and in work aimed at preventing any direct hazard to the safety of employees, safe operation of well mining units, or safety in general.

Changes in Management Policies

In 2010, there were no material changes in the management policies of PGNiG S.A.

In 2010, the process of consolidation of construction and assembly companies in the Other Activities segment commenced. PGNiG Technologie Sp. z o.o. was established, to which shares in four subsidiaries of PGNiG S.A. (BUG Gazobudowa Sp. z o.o., ZRUG Sp. z o.o. of Pogórska Wola, BN Naftomontaż Sp. z o.o. and ZUN Naftomet Sp. z o.o.) were contributed. The merger of PGNiG Technologie Sp. z o.o. and the four companies subject to consolidation will be the last stage of the consolidation process. By consolidating its construction and assembly companies, the PGNiG Group will form a single strong entity capable of more effectively competing on the domestic and foreign markets. The consolidation will also facilitate effective management of this operating area.

4. Equity Links

Polskie Górnictwo Naftowe i Gazownictwo S.A. holds shares in production and service companies. As at December 31st 2010, PGNiG S.A. had 38 related undertakings, including:

- 25 subsidiary undertakings, and
- 13 other related undertakings.

The table below presents related undertakings of PGNiG S.A. as at December 31st 2010.

PGNiG S.A.'s related undertakings

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of total vote held by PGNiG S.A
	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)]	951,327,000.00	951,327,000.00	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	POGC Trading GmbH (EUR)[1)]	10,000,000.00	10,000,000.00	100.00%	100.00%
11	Operator Systemu Magazynowania Sp. z o.o.	1,000,000.00	1,000,000.00	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.	614,696,000.00	614,696,000.00	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%
19	Geovita Sp. z o.o.	86 139 000,00	86 139 000,00	100.00%	100.00%
20	PGNiG Energia S.A.	6,000,000.00	6,000,000.00	100.00%	100.00%
21	PGNiG Technologie Sp. z o.o.	120,398,000.00	120,398,000.00	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	B.S. i P.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
25	NYSAGAZ Sp. z o.o.	6,800,000.00	3,468,000.00	51.00%	51.00%

PGNiG S.A.'s related undertakings – contd.

	Name	Share capital (PLN)	Value of shares held by PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of total vote held by PGNiG S.A
	Other related undertakings				
26	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
27	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
28	InterTransGas GmbH (EUR) [1)]	200,000.00	100,000.00	50.00%	50.00%
29	Dewon Z.S.A. (UAH)[1)]	11,146,800.00	4,055,205.84	36.38%	36.38%
30	Przedsiębiorstwo Inwestycyjne GAZOTECH Sp. z o.o.	1,203,800.00	65,000.00	69.44%	46.30%
31	Sahara Petroleum Technology llc w likwidacji (in liquidation) (OMR)[1)]	150,000.00	73,500.00	49.00%	49.00%
32	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
33	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
34	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
35	ZWUG INTERGAZ Sp. z o.o.	47,000,000.00	1,800,000.00	38.30%	38.30%
36	ZRUG TORUŃ S.A.	5,150,000.00	1,300,000.00	25.24%	25.24%
37	TE-MA WOC Małaszewicze Terespol Sp. z o.o. w likwidacji (in liquidation)	262,300.00	55,000.00	20.97%	21.32%
38	H.S. Szczakowa S.A. w upadłości (in bankruptcy)	16,334,989.44	5,439,494.72	33.30%	33.30%

[1)] Figures in foreign currencies

5. Changes in Equity Interests

The following changes took place in 2010:

- On January 11th 2010, PGNiG Energia S.A. was registered with the National Court Register.
- On July 14th 2010, PPUiH TURGAZ Sp. z o.o. w likwidacji (in liquidation) was deleted from the National Court Register.
- On July 30th 2010, Górnictwo Naftowe Sp. z o.o. was transformed into PGNiG Technologie Sp. z o.o. The new company was established with a view to consolidating the Group's construction and assembly companies in a single entity, benefiting from greater competitive advantage and enhanced ability to win new orders on the domestic and international markets.
- On August 12th 2010, the Extraordinary General Shareholders Meeting of TE-MA WOC Małaszewicze Terespol Sp. z o.o. w likwidacji (in liquidation) approved the liquidation report prepared as at the balance-sheet date of July 10th 2010. The company's liquidation process was completed.
- On November 16th 2010, Operator Systemu Magazynowania Sp. z o.o. was established. The new company has a share capital of PLN 1,000,000, divided into 20,000 shares with a par value of PLN 50 per share. All the shares were acquired for cash by PGNiG S.A., which is the company's sole shareholder. The company was registered with the National Court Register on December 29th 2010. Operator Systemu Magazynowania Sp. z o.o. was established to ensure compliance with the requirements of Directive 2009/73/EC with respect to legal separation of the gaseous fuel storage from other types of business conducted by a vertically integrated gas undertaking.
- On December 21st 2010, POGC Trading GmbH was established, with a share capital of EUR 10,000,000. The company's business profile comprises purchase and sale of, and trading in, gas, fuels, other forms of energy, and their derivatives in physical form, as well as trading in financial derivatives and other financial products on the European and other gas, fuels and energy markets.

The following changes in the companies' share capitals took place in 2010:

- The share capital increase at Górnośląska Spółka Gazownictwa Sp. z o.o. by PLN 850,000, to PLN 1,300,338,000 was registered on January 4th 2010.
- The share capital of ZRUG TORUŃ S.A. was increased by PLN 1,000,000. PGNiG S.A. did not participate in the share capital increase, so its shareholding in ZRUG TORUŃ S.A. fell to 25.24%. The share capital increase was registered on June 23rd 2010.
- The share capital of PGNiG Energia S.A. was increased by PLN 1,000,000, to PLN 6,000,000. The increase was registered on December 14th 2010.
- The share capital of Polskie Elektrownie Gazowe Sp. z o.o. was reduced from PLN 2,500,000 to PLN 1,212,000, by way of retirement of the shares held by PGNiG Energia S.A. As a result, PGNiG S.A. remained the sole shareholder in the company. The share capital reduction was registered on December 28th 2010.
- The share capital of PGNiG Technologie Sp. z o.o. was increased by PLN 2,000,000, to PLN 2,050.000 (registered on August 26th 2010). Another share capital increase, by PLN 118,348,000, to PLN 120,398,000, was registered on December 30th 2010. The new shares were acquired partly for a cash contribution of PLN 500,000 and partly for a non-cash contribution in the form of shares previously held by PGNiG S.A. in the following companies: BUG Gazobudowa Sp. z o.o., Zakład Urządzeń Naftowych Naftomet Sp. z o.o., ZRUG Sp. z o.o. of Pogórska Wola, and Budownictwo Naftowe Naftomontaż Sp. z o.o.

<u>Changes following the end of the financial year</u>

- 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 10th 2011, POGC Trading GmbH was entered in the Court Register maintained by the District Court of Munich.
- On February 11th 2011, the District Court for Katowice Wschód in Katowice issued a decision declaring completion of the bankruptcy proceedings relating to Huta Szkła Szczakowa S.A. of Jaworzno.

<u>Investments outside the group of related undertakings</u>

As at the end of 2010, the nominal value of PGNiG S.A.'s equity commitment outside the group of related undertakings was PLN 43.7m. During the financial year, PGNiG S.A. did not make any equity investments outside the group of related undertakings.

6. Employment

The table below presents employment at the PGNiG Group as at December 31st 2010, by segments. As the PGNiG S.A. Head Office provides services to all the segments, it is disclosed separately.

Employment by segments (no. of staff)

	2010	2009
PGNiG S.A. Head Office	840	833
Exploration and Production	4,375	4,300
Trade and Storage	3,701	3,730
Other Activities	39	37
Total	8,955	8,900

Since January 2009, the Group has had in place the Programme for Employment Streamlining and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (Stage 3). Unlike previous employment restructuring programmes, this scheme 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. Any decision to implement the programme may only be made where it is justified by the scope of planned restructuring involving workforce downsizing or job shedding.

In April 2010, the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted a resolution to apply PLN 1,070,002 from the capital reserve designated as Central Restructuring Fund to provide one-off benefits to 23 employees of PNiG Kraków Sp. z o.o. who were made redundant.

On February 24th 2011, the Extraordinary General Shareholders Meeting of PGNiG S.A. decided to apply PLN 1,774,099 from the capital reserve to provide one-off benefits to 35 employees of ZUN Naftomet Sp. z o.o. who were made redundant.

7. Sale and Acquisition of Natural Gas

PGNiG S.A. recorded sales revenue of PLN 20.4bn, with 95% of that figure derived from sales of natural gas.

Sales revenue (PLNm)

	2010	2009
Natural gas, including:	19,300.7	17,655.0
- high-methane gas	18,109.6	16,371.0
- nitrogen-rich gas	1,191.1	1,284.0
Crude oil	838.6	661.6
Crude condensate	3.2	2.7
Helium	44.1	37.1
Propane-butane	50.5	37.2
Gas storage services	31.7	23.5
Geophysical and geological services	27.2	26.9
Other sales	119.5	134.3
Total	20,415.5	18,578.3

In 2010, PGNiG S.A. sold 14.4 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 sales of natural gas from the fields.

Natural gas sales volume (million cubic meters)

	2010	2009
Trade and Storage	13,743.0	12,644.0
Exploration and Production	673.8	640.0
Total	14,416.8	13,284.0

In 2010, the volume of natural gas acquired by PGNiG S.A. reached 14.4 billion cubic meters, with 70% of that amount sourced from imports, mostly from Russia. Natural gas production from fields in Poland represented 29.3% of the total volume acquired. The table below sets forth the structure of natural gas supplies measured as high-methane gas equivalent.

Acquisition of natural gas (million cubic meters)

	2010	2009
Imports	10,066.4	9,135.9
Domestic production	4.220.4	4.105.2
Domestic suppliers	96.1	58.1
Total	14,382.9	13,299.2

Chapter II: Company's Governing Bodies

1. Management Board

Pursuant to the Articles of Association of PGNiG S.A., the Company's Management Board is composed of two to seven members. The number of Management Board members is determined by the Supervisory Board. The Management Board members are appointed for a joint term of office lasting three years. Individual members or the entire Management Board are appointed by the Supervisory Board. A member of the Management Board is appointed following a qualification procedure carried out under 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 in the case of the Management Board members elected by employees. Each member of the Management Board may be removed from office or suspended from their duties by the Supervisory Board or the General Shareholders Meeting. 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.

As at January 1st 2010, the composition of the Management Board of PGNiG S.A. was as follows:

- Michał Szubski – President
- Mirosław Dobrut – Vice-President, Gas and Trade
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Finance
- Mirosław Szkałuba – Vice-President, Social Dialogue and Assets
- Waldemar Wójcik – Vice-President, Petroleum Mining.

On April 26th 2010, Mirosław Dobrut resigned from his position as Vice-President of the Management Board for Gas and Trade, with effect from April 30th 2010. The reason for Mirosław Dobrut's resignation was his appointment as President of the Management Board of SGT EUROPOL GAZ S.A.

On May 12th 2010, Marek Karabuła, member of the Supervisory Board, was delegated to temporarily stand in as Vice-President of the Management Board for Gas and Trade in the period from June 1st to August 31st 2010. On July 19th 2010, the Supervisory Board of PGNiG S.A. appointed Marek Karabuła as member of the Management Board of PGNiG S.A., following his resignation from membership of the Supervisory Board.

On August 15th 2010, Waldemar Wójcik resigned from his position as Vice-President of the Management Board for Petroleum Mining.

Following a division of powers and responsibilities between the Management Board members approved by the Supervisory Board on September 15th 2010, as at December 31st 2010, the composition and powers of the Management Board of PGNiG S.A. were as follows:

- Michał Szubski – President
- Radosław Dudziński – Vice-President, Strategy
- Sławomir Hinc – Vice-President, Finance
- Marek Karabuła – Vice-President, Petroleum Mining.
- Mirosław Szkałuba – Vice-President, Trade

On January 12th 2011, the Supervisory Board of PGNiG S.A. appointed the President and the members of PGNiG S.A.'s Management Board for a joint term of office starting from March 13th 2011. The following persons were appointed for the three-year term:

- Michał Szubski – President
- Radosław Dudziński – Member of the Management Board
- Sławomir Hinc – Member of the Management Board
- Marek Karabuła – Member of the Management Board.

In the period January-February 2011, elections were carried out to choose the Management Board nominee representing the employees. Mirosław Szkałuba was elected as the employees' representative.

Agreements 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 2010, the non-competition agreements concluded with President of the Management Board Michał Szubski and Vice-Presidents 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 legal 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 S.A., the Supervisory Board is composed of five to nine members, appointed by the General Shareholders Meeting for a common term of three years. As long as the State Treasury holds an interest in the Company, the State Treasury, represented by the minister competent for matters pertaining to the State Treasury, acting in consultation with the minister competent for economic affairs, has the right to appoint and remove one member of the Supervisory Board. In accordance with the Articles of Association, the General Shareholders Meeting appoints one independent member of the Supervisory Board. Pursuant to Par. 36.3 of PGNiG S.A.'s Articles of Association, the independent Supervisory Board member is elected in a separate vote. Written proposals of candidates for the position of an independent Supervisory Board member may be submitted to the Chairman of the General Shareholders Meeting by the shareholders present at the General Shareholders Meeting whose agenda includes the election of such 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 2010, the Supervisory Board of PGNiG S.A. was composed of:

- Stanisław Rychlicki – Chairman
- Marcin Moryń – Deputy Chairman
- Mieczysław Kawecki – Secretary
- Grzegorz Banaszek – Member
- Agnieszka Chmielarz – Member
- Marek Karabuła – Member
- Mieczysław Puławski – Member
- Jolanta Siergiej – Member

On July 19th 2010, Marek Karabuła resigned from his position as member of the Supervisory Board of PGNiG S.A. As at December 31st 2010, the Supervisory Board was composed of seven members:

- Stanisław Rychlicki – Chairman
- Marcin Moryń – Deputy Chairman
- Mieczysław Kawecki – Secretary
- Grzegorz Banaszek – Member
- Agnieszka Chmielarz – Member
- Mieczysław Puławski – Member
- Jolanta Siergiej – Member

Following the elections held at the end of January and beginning of February 2011 to elect candidates for Supervisory Board members representing PGNiG S.A.'s employees, Agnieszka Chmielarz, Mieczysław Kawecki and Jolanta Siergiej were appointed as the employee representatives.

Remuneration of management and supervisory personnel

For information on the remuneration paid to management and supervisory personnel, see the annual separate financial statements for the year ended December 31st 2010 (Note 36.4).

Chapter III: Shareholder Structure

As at December 31st 2010, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with a par value of PLN 1 per share. The 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 of them conferred the right to one vote at the General Shareholders Meeting. The shareholder structure as at December 31st 2010 is shown in the table below:

Shareholder structure

Shareholder	Number of shares as at Dec 31 2010	% of share capital held as at Dec 31 2010	Number of votes conferred by shares held	% of total vote at GM as at Dec 31 2010
State Treasury	4,273,650,532	72.43%	4,273,650,532	72.43%
Others	1,626,349,468	27.57%	1,626,349,468	27.57%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

PGNiG shares and shares in the related undertakings of PGNiG S.A. held by management and supervisory personnel

The table below shows PGNiG shares held by the management and supervisory personnel as at December 31st 2010:

PGNiG shares held by the management and supervisory personnel

Name	Title	Number of shares	Par value of shares (PLN)
Michał Szubski	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

Agreements which may give rise to future changes in the number of shares held by the existing shareholders and bondholders

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

Control of employee stock option plans

On June 25th 2008, the Ministry of State Treasury disposed of one share in PGNiG S.A. The settlement of the transaction with the National Depository of Securities, and thus transfer of the title to the shares, took place on June 30th 2008. Pursuant to the Commercialisation and Privatisation Act, dated August 30th 1996, eligible employees or their heirs gained the right to acquire the Company shares free of charge as of October 1st 2008. The right expired on October 1st 2010. After that date, the right to acquire shares free of charge may be exercised only by the heirs of eligible employees who before the rights expiry date filed a petition with the court seeking a confirmation of the acquisition of an inheritance from an eligible employee.

The process of execution of agreements on free-of-charge disposal of PGNiG shares to eligible employees or their heirs commenced on April 6th 2009. Eligible persons had the right to acquire free of charge up to 15% of the shares acquired by the State Treasury on the Company registration date, that is up to 750,000,000 Series A1 bearer shares with a par value of PLN 1 per share. The Company shares acquired free of charge by eligible employees or their heirs can be traded since July 1st 2010, while the shares acquired free of charge by members of the Company's Management Board cannot be traded before July 1st 2011. As a result of the free-of-charge acquisition of the Company shares, the State Treasury's share of the total vote decreased from 84.75% to 72.43%. Until December 31st 2010, 59,134 eligible persons acquired 726,349,467 shares, representing approximately 96.85% of the pool of shares available to be acquired free of charge and 12.3% of the Company's share capital.

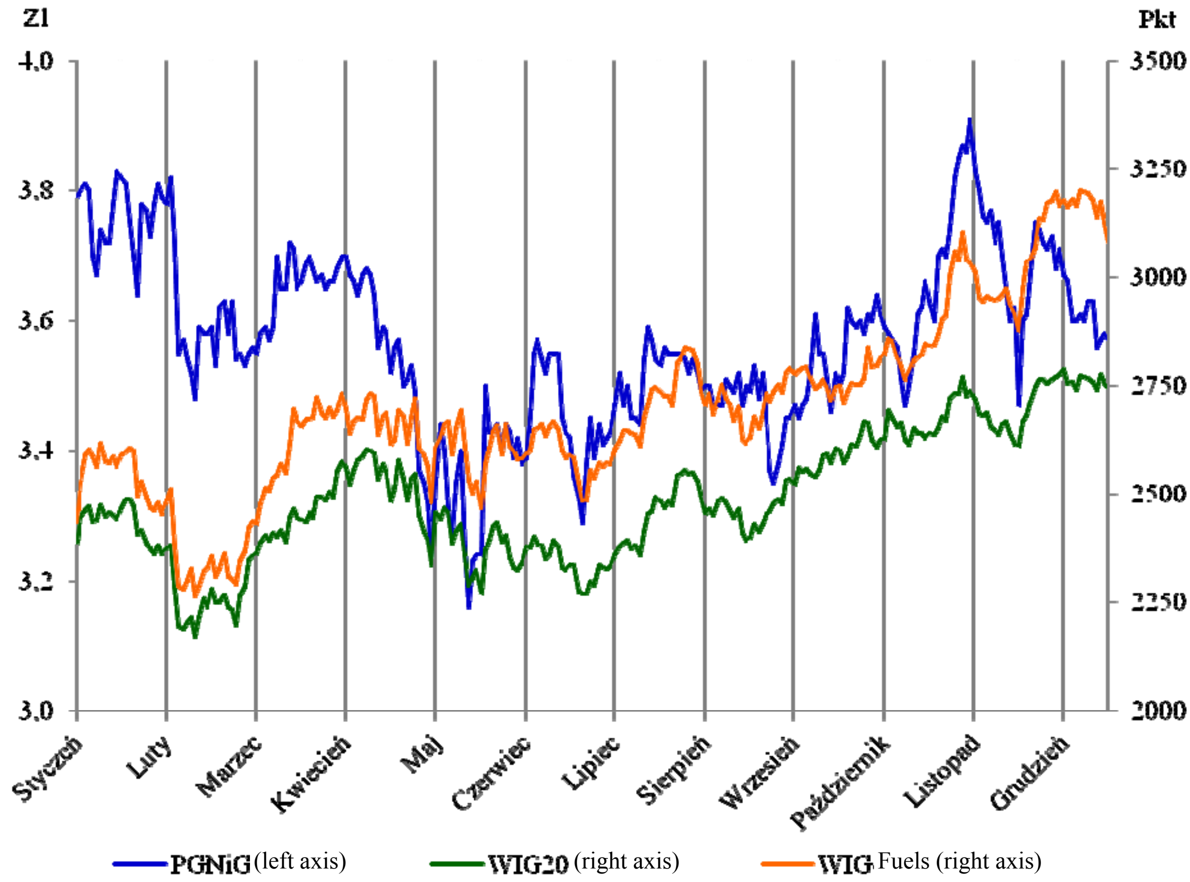
Performance of the PGNiG stock

PGNiG S.A. shares have been listed at the Warsaw Stock Exchange since September 23rd 2005. As at December 31st 2010, the Company was included in the following indices:
- WIG – index of WSE companies
- WIG20 – index of the 20 biggest and most liquid companies
- WIG-Paliwa – index of the fuel sector companies
- WIG-div – total return index (published since January 3rd 2011)
- Respect Index – index of socially responsible companies.

In 2010, the rate of return on the PGNiG stock was -5.8% (or -3.7% if the dividend paid is taken into account). For the period from the first listing until December 31st 2010, the rate of return on the PGNiG stock was -6.3%. Investors who acquired the PGNiG shares on the WSE at their issue price earned a 19.8% return on their money.

The following figure compares the PGNiG stock price performance against WIG 20 and WIG Paliwa. The table shows the values of the WSE indices and the PGNiG share price in 2010.

PGNiG share price compared with the WIG 20 and WIG Paliwa indices



WSE indices and the PGNiG share price

	Value/price as at Dec 31 2009	2010 high	2010 low	Value/price as at Dec 31 2010	PGNiG's weight in the index as at Dec 31 2010
WIG	39,986	47,911	37,323	47,490	2.4%
WIG20	2,389	2,787	2,165	2,744	3.6%
WIG-Paliwa	2,435	3,200	2,265	3,079	20.7%
Respect Index	1,709	2,278	1,543	2,259	5.6%
PGNiG S.A.	PLN 3.79	PLN 3.95	PLN 3.14	PLN 3.57	-

Source: WSE.

Chapter IV: Regulatory Environment

The key laws regulating the activities of PGNiG S.A. are:

- Polish Energy Law of April 10th 1997 (consolidated text in Dz. U. of May 30th 2006, No. 89, item 624, as amended) along with the secondary legislation – with respect to activities in the area of gaseous fuel trading, distribution and storage.
- Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of a Threat to National Fuel Security or a Disruption on the Petroleum Market, dated February 16th 2007 (Dz. U. of March 23rd 2007, No. 52, item 343, as amended) along with the secondary legislation – with respect to activities in the area of international trade in natural gas.
- Polish Geological and Mining Law of February 4th 1994 (Dz. U. of March 1st 1994, No. 27, item 96, as amended) – with respect to production activities and sales of gas as part of production operations.

1. Polish Energy Law

The activities of PGNiG S.A. in the area of gaseous fuel trading 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 gaseous fuels.

In 2010, work was conducted on new amendments to the Polish Energy Law and on the Regulation of the Minister of Economy on detailed rules for functioning of the gas system, which came into force on August 6th 2010. On February 8th 2010, amendments to the Energy Law were published, introducing, inter alia, regulation with respect to the terms and conditions of agreements between energy utilities and customers buying gaseous fuel or electricity.

1.1. Licences

As at December 31st 2010, PGNiG S.A. held the following licences granted by the President of the Polish Energy Regulatory Office under the Energy Law:

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

On October 7th 2010, the President of the Energy Regulatory Office issued a decision changing the scope of the licence for storage of gaseous fuels by introducing changes in the working capacities of the Mogilno Underground Gas Storage Cavern Facility due to the technical conditions determining the facility's manner of operation, while refusing to introduce similar changes as regards the working capacities of the Husów Underground Gas Storage Facility. Moreover, the President of the Energy Regulatory Office 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 S.A. due to the fact that pursuant to the Polish Energy Law such capacities are not storage facilities as defined in this act. On November 2nd 2010, PGNiG S.A. filed an appeal against that decision through the agency of the President of the Energy Regulatory Office to the Regional Court of Warsaw – the Court of Competition and Consumer Protection. By the date of this report, the appeal proceedings had not been concluded.

On December 27th 2010, the President of the Energy Regulatory Office issued a decision excluding one of the electricity generation sources located in Rzeszów from the scope of the Group's electricity production licence, given the fact that the source had been taken over by PGNiG Energia S.A.

1.2. Tariff Policy

Dependence of PGNiG S.A.'s revenue on the tariffs approved by the President of the Energy Regulatory Office is a key factor affecting the Company's regulated business. Tariffs are crucial to the Company's ability to generate a revenue covering the incurred justified costs of operations 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 gaseous 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, taken into account in gaseous fuel 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.

The settlements with customers with which PGNiG S.A. had sale agreements were regulated by the settlement rules and based on prices and charge rates specified in subsequent tariffs approved by the President of the Energy Regulatory Office.

1.3. Changes in Tariffs

Until May 31st 2010, settlements with customers were made according to Gaseous Fuel Tariff No. 2/2009, approved by virtue of the decision issued by the President of the Energy Regulatory Office on May 7th 2009.

In 2010, the President of the Energy Regulatory Office approved changes in the PGNiG S.A.'s Tariff on three occasions:

- by virtue of a decision of May 17th 2010, the President of the Energy Regulatory Office approved the new Gaseous Fuel Tariff of PGNiG S.A. which was effective for settlements with customers since June 1st 2010, including Part A – "Gaseous Fuel Supply Tariff No. 3/2010," which remained in effect until November 30th 2010, and Part B – "Gaseous Fuel Storage Services Tariff No. 1/2010," which remains in effect until May 31st 2011; the average amount of charges related to the supply of high-methane gas (E) to customers increased by 3.3%, while the average amount of charges related to the supply of nitrogen-rich gas to customers rose by 5.9% and 3.6% respectively for Lw gas and Ls gas;

- by virtue of a decision of September 16th 2010, the President of the Energy Regulatory Office approved an adjustment (increase in gaseous fuel prices, excluding the following gases: propane-butane-air and propane-butane-decompressed) to the Gaseous Fuel Tariff (Part A "Gaseous Fuel Supply Tariff No. 3/2010") which has been effective for settlements with customers since October 1st 2010; the average amount of charges related to the supply of high-methane gas(E) to customers increased by 4.4%, while the average amount of charges related to the supply of nitrogen-rich gas to customers rose by 4.5%and 4.0% for Lw gas and Ls gas, respectively;

- by virtue of a decision of December 16th 2010, the President of the Energy Regulatory Office approved an adjustment (decrease in gaseous fuel prices, excluding the following gases: propane-butane-air and propane-butane-decompressed) to the Gaseous Fuel Tariff (Part A "Gaseous Fuel Supply Tariff No. 3/2010") which is effective for settlements with customers from January 1st 2011 to March 31st 2011; the average amount of charges related to the supply of high-methane gas (E) to customers fell by 2.3%, while the average amount of charges related to the supply of nitrogen-rich gas to customers declined by 2.3% and 2.05% respectively for Lw gas and Ls gas;

The following tables show the average tariffs (PLN per cubic meter) used in settlements with customers purchasing gaseous fuels, by fuel type and place of receipt.

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
W-1	2.3528	2.4073	2.4683	2.4355	2.3%	2.5%	-1.3%
W-2	1.7798	1.8265	1.8875	1.8547	2.6%	3.3%	-1.7%
W-3	1.6249	1.6838	1.7448	1.7120	3.6%	3.6%	-1.9%
W-4	1.5206	1.5742	1.6352	1.6024	3.5%	3.9%	-2.0%
W-5 - W-7B	1.3752	1.4273	1.4886	1.4556	3.8%	4.3%	-2.2%
W-8 - W-10	1.1207	1.1587	1.2199	1.1870	3.4%	5.3%	-2.7%

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
S-1	1.6798	1.7686	1.8167	1.7909	5.3%	2.7%	-1.4%
S-2	1.2450	1.3437	1.3918	1.3660	7.9%	3.6%	-1.9%
S-3	1.1371	1.2181	1.2662	1.2404	7.1%	3.9%	-2.0%
S-4	1.0002	1.0583	1.1065	1.0807	5.8%	4.6%	-2.3%
S-5 - S-7B	0.9612	1.0301	1.0773	1.0520	7.2%	4.6%	-2.3%
S-8 - S-10	0.8241	0.8735	0.9207	0.8954	6.0%	5.4%	-2.7%

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
Z-1	1.3124	1.3897	1.4307	1.4087	5.9%	3.0%	-1.5%
Z-2	1.1419	1.2377	1.2787	1.2567	8.4%	3.3%	-1.7%
Z-3	1.0100	1.0865	1.1275	1.1055	7.6%	3.8%	-2.0%
Z-4	0.9130	0.9715	1.0125	0.9905	6.4%	4.2%	-2.2%
Z-5 - Z-7B	0.9296	1.0055	1.0469	1.0247	8.2%	4.1%	-2.1%

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
W-1	3.142	2.3981	2.4591	2.4263	3.6%	2.5%	-1.3%
W-2	1.8665	1.9388	1.9998	1.9670	3.9%	3.1%	-1.6%
W-3	1.5846	1.6488	1.7098	1.6770	4.1%	3.7%	-1.9%
W-4	1.5129	1.5693	1.6303	1.5975	3.7%	3.9%	-2.0%
W-5 - W-7B	1.4080	1.4627	1.5240	1.4911	3.9%	4.2%	-2.2%
W-8 - W-10	1.1441	1.1881	1.2494	1.2164	3.8%	5.2%	-2.6%

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
W-1	2.2241	2.3057	2.3667	2.3339	3.7%	2.6%	-1.4%
W-2	1.7483	1.8178	1.8788	1.8460	4.0%	3.4%	-1.7%
W-3	1.5245	1.5886	1.6496	1.6168	4.2%	3.8%	-2.0%
W-4	1.4697	1.5336	1.5946	1.5618	4.3%	4.0%	-2.1%
W-5 - W-7B	1.3845	1.4422	1.5035	1.4706	4.2%	4.2%	-2.2%
W-8 - W-10	1.1233	1.1664	1.2277	1.1948	3.8%	5.3%	-2.7%

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
W-1	2.5681	2.6210	2.6820	2.6492	2.1%	2.3%	-1.2%
W-2	1.7210	1.7665	1.8275	1.7947	2.6%	3.5%	-1.8%
W-3	1.5085	1.5520	1.6130	1.5802	2.9%	3.9%	-2.0%
W-4	1.4592	1.4994	1.5604	1.5276	2.8%	4.1%	-2.1%
W-5 - W-7B	1.3728	1.4115	1.4728	1.4399	2.8%	4.3%	-2.2%
W-8 - W-10	1.0609	1.0942	1.1554	1.1225	3.1%	5.6%	-2.9%

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
W-1	2.4457	2.5192	2.5802	2.5474	3.0%	2.4%	-1.3%
W-2	1.8459	1.8964	1.9574	1.9246	2.7%	3.2%	-1.7%
W-3	1.6050	1.6611	1.7221	1.6893	3.5%	3.7%	-1.9%
W-4	1.5336	1.5875	1.6485	1.6157	3.5%	3.8%	-2.0%
W-5 - W-7B	1.4252	1.4712	1.5324	1.4995	3.2%	4.2%	-2.1%
W-8 - W-10	1.1194	1.1476	1.2089	1.1759	2.5%	5.3%	-2.7%

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
W-1	2.4259	2.5206	2.5816	2.5488	3.9%	2.4%	-1.3%
W-2	1.7731	1.8355	1.8965	1.8637	3.5%	3.3%	-1.7%
W-3	1.6151	1.6749	1.7359	1.7031	3.7%	3.6%	-1.9%
W-4	1.5159	1.5712	1.6322	1.5994	3.6%	3.9%	-2.0%
W-5 - W-7B	1.3545	1.4005	1.4618	1.4288	3.4%	4.4%	-2.3%
W-8 - W-10	1.0964	1.1324	1.1936	1.1607	3.3%	5.4%	-2.8%

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
S-1	1.6803	1.7620	1.8101	1.7843	4.9%	2.7%	-1.4%
S-2	1.2637	1.3222	1.3703	1.3445	4.6%	3.6%	-1.9%
S-3	1.1407	1.1800	1.2281	1.2023	3.4%	4.1%	-2.1%
S-4	1.0388	1.0799	1.1281	1.1023	4.0%	4.5%	-2.3%
S-5 - S-7B	1.0192	1.0371	1.0843	1.0590	1.8%	4.5%	-2.3%

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
Z-1	1.5663	1.6440	1.6850	1.6630	5.0%	2.5%	-1.3%
Z-2	1.1522	1.2071	1.2481	1.2261	4.8%	3.4%	-1.8%
Z-3	1.0067	1.0465	1.0875	1.0655	4.0%	3.9%	-2.0%
Z-4	0.9359	0.9740	1.0150	0.9930	4.1%	4.2%	-2.2%
Z-5 - Z-7B	0.9197	0.9385	0.9800	0.9578	2.1%	4.4%	-2.3%

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

	Tariff No. 2/2009*	Tariff No. 3/2010	Change in Tariff No. 3/2010 effective from October 1st 2010	Change in Tariff No. 3/2010 effective from January 1st 2011	Change (%)		
	1	2	3	4	2/1	3/2	4/3
E-1A - E4-B	1.0114	1.0410	1.1023	1.0694	2.9%	5.9%	-3.0%
Lw-1 - Lw-4	0.7549	0.8033	0.8505	0.8252	6.4%	5.9%	-3.0%
Ls-1 - Ls-4	0.6175	0.6652	0.7066	0.6844	7.7%	6.2%	-3.1%

* The average 2009 prices have been determined based on the structure of sales adopted for the calculation of Tariff No. 3/2010, in accordance with the tariff calculation methodology.

On July 2nd 2010, PGNiG S.A. filed a request with the President of the Energy Regulatory Office that the President's decision of May 17th 2010 approving PGNiG S.A.'s Gaseous Fuel Tariff (Part A – "Gaseous Fuel Supply Tarriff No. 3/2010") be declared invalid with respect to its effective period, citing the fact that the President of the Energy Regulatory Office had unilaterally decided to extend that period by two months. Following the approval by the President of the Energy Regulatory Office of the change in the PGNiG S.A.'s Gaseous Fuel Tariff (Part A – "Gaseous Fuel Supply Tarriff No. 3/2010"), PGNiG S.A. withdrew the request on September 30th 2010.

On February 11th 2011, PGNiG S.A. filed a request with the President of the Energy Regulatory Office to change gaseous fuel prices for high-methane gas (E) and nitrogen-rich gas (subgroups Ls and Lw) and to extend the effective term of the changed tariff until May 31st 2011. As at this report date, the proceedings were still under way.

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 a Threat to National Fuel Security or a Disruption on the Petroleum Market regulates the issues related to ensuring the national fuel security, setting forth the rules for building up, maintaining, and financing the stocks of natural gas by those energy companies whose business involves international trade in natural gas or which import gas for their own needs. In the area of the business activity conducted by PGNiG S.A., 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 supplementing the stocks represents justified operating expenses within the meaning of Art. 3.21 of the Polish Energy Law.

In 2010, work started on amending 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 a Threat to National Fuel Security or a Disruption on the Petroleum Market. The proposed new act provides, inter alia, for the possibility to store mandatory stocks in the territory of another EU member state, provided that the rules applicable to stocks maintained in storage facilities in the territory of Poland are observed.

3. Polish Geological and Mining Law

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

- 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 in case of failure to comply with its regulations, and specifies the upper and lower limits of royalty fees.

As at December 31st 2010, the Company held the following licences, granted on the basis of the Geological and Mining Law:

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

4. Regulatory Risks

<u>Changes in laws and regulations</u>

Further changes in the laws governing the operation of the gas sector companies are to be expected in 2011. First of all, the Gas Law is planned to be adopted, which will supersede the Energy Law 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.

The Regulation of the Minister of Economy of July 2nd 2010 on detailed terms of operation of the gas system (the Gas System Regulation) became effective in 2010. The Regulation provides the framework for the operation of the domestic gas system, including the rules of cooperation between energy-sector companies. It defines the manner in which trade in gaseous fuels is to be conducted, as well as the quality parameters of gaseous fuels and quality standards of customer service.

Work also commenced on amending the Regulation of the Minister of Economy on detailed rules for determining and calculating tariffs for gaseous fuels and on settlements in gaseous 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 Company.

Draft law on energy efficiency

Since 2009, work has been under way on a draft law on energy efficiency, which is to implement Directive 2006/32/EC of the European Parliament and of the Council of April 5th 2006 on energy end-use efficiency and energy services. Upon its enactment, the law will require PGNiG S.A., as a gas trading company, to purchase white certificates or, alternatively, to pay the non-compliance penalty. This in turn will drive up the cost of regulated activities and, consequently, inflate the price paid by customers.

Tariff calculation

PGNiG S.A.'s ability to cover the costs of its core operations depends on the prices 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 S.A.'s control. In an attempt to protect customers, while verifying the operating costs in the business, the President of the Energy Regulatory Office may consider certain costs as unjustified. Moreover, the President of the Energy Regulatory Office does not always accept the assumptions adopted by PGNiG S.A. with respect to the main drivers of cost changes and profit targets allowing for business risk. Consequently, the Energy Regulatory Office frequently refuses to accept the tariff prices and charge rates applied for by PGNiG S.A. Lower tariff prices and charges might adversely affect PGNiG S.A.'s profitability.

In 2010, the President of the Energy Regulatory Office unilaterally extended the effective period of an applicable tariff. In the Company's opinion, the provisions of the Polish Energy Law do not authorise the President of the Energy Regulatory Office to set an effective period of a tariff that was not requested by an energy company. Should such a situation occur in the future, there is a risk that a tariff will be calculated below costs as it will not account for the cost of supply of gaseous fuel to customers in the period by which the tariff effective period is extended by the President of the Energy Regulatory Office.

Demand for natural gas

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

Purchase price of imported gas

Prices of imported gas are determined 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 acquisition cost of imported gas. Material changes in fuel prices on the international markets affect the prices of imported gas. Each, even accurate forecast of changes of natural gas prices, is encumbered with a high error risk. There can be no 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 customers or the changes in selling prices may lag behind the changes in import prices.

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 S.A. 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. If no changes are made to the aforementioned 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 stars to be delivered to the Company from other sources (e.g. through the LNG terminal).

Chapter V: 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 end with field development and hydrocarbon production. The segment's gas storage needs are met by the Brzeźnica, Daszewo, Strachocina, Swarzów and Bonikowo underground gas storage facilities.

1. Exploration

In 2010, PGNiG S.A. conducted, both on its own and in cooperation with partners, exploration and appraisal work in Poland, specifically in the Carpathian Mountains, Carpathian Foothills, Polish Lowlands and the Lublin Province. In PGNiG S.A.'s licence areas, work was carried out on 25 boreholes, including 17 exploration boreholes (in the case of one borehole drilling ended in 2009, and tests were carried out in 2010) and 8 appraisal boreholes. PGNiG S.A. performed 49.543 metres of drilling work in Poland. No drilling work was conducted abroad.

Out of 14 wells the test results of which are known (including 9 exploration and 5 appraisal wells) , 9 were classified as positive (including 6 gas wells, 1 oil well and 2 oil and gas wells), and 5 wells were dry. The gas wells and oil and gas wells are located in the Carpathian Foothills and Polish Lowlands, while the oil well is in the Polish Lowlands.

In 2010, PGNiG S.A. completed drilling of the Markowola-1 well in the Lublin Province. As an analysis of geophysical data confirmed the probability of presence of unconventional gas (tight gas), a hydraulic fracturing operation was carried out in the well. Since no commercial gas flow rates were recorded from the formation, the well was classified as dry and intended for abandonment. Drillings of new exploration and core holes, including in search for shale gas and tight gas, started in 2010 in new exploration areas where thus far there had been little appraisal (including Tymowa-1 in the Carpathian Mountains, Piaski-3 in Western Pomerania and Lubocino-1 in Eastern Pomerania).

In 2010, geophysical work was conducted in PGNiG S.A.'s licence areas in the Carpathian Mountains, Carpathian Foothills and Polish Lowlands, as part of which 1,759 km of 2D seismic data and 595 km^2 of 3D seismic data was acquired. In foreign markets (Denmark and Pakistan), the Company performed 104 km of 2D seismic surveys and 279 km^2 of 3D seismic surveys.

In 2010, expenditure on exploration and appraisal work amounted to PLN 1,059.4m.

As at December 31st 2010, the Group's recoverable reserves were:
- 95.1 billion cubic meters of natural gas, measured as high-methane gas equivalent,
- 21.2 million tonnes of crude oil.

<u>Joint ventures in Poland</u>

In 2010, PGNiG S.A. cooperated with FX Energy Poland Sp. z o.o. in the following areas covered by licences awarded to PGNiG S.A.:

- “Płotki” – under the Agreement for Joint Operations dated May 12th 2000; licence interests: PGNiG S.A. (operator) – 51%, FX Energy – 49%,
- “Płotki” – “PTZ” (the Extended Zaniemyśl Area) – under the Operating Agreement of Mining Users dated October 26th 2005; licence interests: PGNiG S.A. (operator) – 51%, FX Energy – 24.5%, Calenergy – 24.5%,

- "Poznań" – under the Agreement for Joint Operations dated June 1st 2005; licence interests: PGNiG S.A. (operator) – 51%, FX Energy – 49%,

and in the areas covered by licences awarded to FX Energy Poland Sp. z o.o.:

- "Blok 255" – under the Agreement for Joint Operations dated October 29th 1999; licence interests: FX Energy (operator) – 81.82%, PGNiG S.A. – 18.18%,
- "Ostrowiec" – under the Agreement for Joint Operations dated February 27th 2009, covering licence blocks nos. 163 and 164; licence interests: FX Energy (operator) – 51%, PGNiG SA – 49%.

In the "Płotki" area, production from the Kłęka field was ended in 2010. Cumulative production of natural gas from the Kłęka field was approx. 76 million cubic meters. In the "Płotki"-"PTZ" area, production continued on the Zaniemyśl and Roszków gas fields.

With respect to the "Poznań" area, reprocessing and interpretation of the Żerków-Pleszew 3D seismic survey was completed. In 2010, gas production started on the Środa Wielkopolska gas field (the Środa Wielkopolska-4 well). Also, drilling of the Lisewo-1k exploration borehole was commenced in 2010, which led to discovery of a new natural gas field at the beginning of 2011. The design documentation for the drilling of the Pławce-2 exploration well was prepared, with the drilling work scheduled for 2011. Plans for 2011 include start of production from the Kromolice and Kromolice S fields, completion of stage II of the Żerków-Pleszew 3D seismic survey, tests on the Lisewo-1k borehole, and drilling of the Pławce-2 exploration well (depth: 4,000 m).

Despite discontinued production from the Wilga field (in the "Blok 255" licence area) and no hydrocarbon flow identified in the Ostrowiec-1 borehole, analyses of the available material continued during 2010 with a view to identifying any further exploration potential in these areas.

Under Agreement for Joint Operations dated June 1st 2007, PGNiG S.A. cooperated with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o. in the "Bieszczady" area. The licence interests are as follows: PGNiG S.A. (operator) – 51%, Eurogas Polska Sp. z o.o. – 24%, and Energia Bieszczady Sp. z o.o. – 25%. In 2010, the processing and interpretation of the Kostarowce-Zahutyń 2D seismic surveys shot in the Carpathian Mountains were completed and drilling of the Niebieszczany-1 exploration well commenced. Plans for 2011 assume acquisition of 340 km of 2D seismic data, completion of drilling of the Niebieszczany-1 well and start of drilling of the Puławy Górne-1 exploration well (depth: 5,000 m).

In 2010, PGNiG S.A. was engaged in joint operations with Orlen Upstream Sp. z o.o. in the "Sieraków" area, under Agreement for Joint Operations dated June 22nd 2009. The project interests are as follows: PGNiG S.A. (operator) – 51%, Orlen Upstream Sp. z o.o. – 49%. In 2010, in the "Sieraków" area, the Sieraków-4 well was worked over and tested. In early 2011, drilling of the Sieraków-5 well commenced. Plans for 2011 include also drilling of the Sieraków-3 well.

In 2010, in the Carpathian Mountains PGNiG S.A. cooperated with Energia Karpaty Zachodnie Sp. z o.o. Sp. k. and Energia Karpaty Wschodnie Sp. z o.o. Sp. k. Joint operations were conducted under the following agreements:

- Agreement for Joint Operations of December 17th 2009 covering the "Karpaty Zachodnie" area; the interests are: Energia Karpaty Zachodnie Sp. z o.o. Sp. k. (operator) – 60%, PGNiG S.A. – 40%,
- Agreement for Joint Operations of December 17th 2009 covering the "Karpaty Wschodnie" area; the interests are: Energia Karpaty Wschodnie Sp. z o.o. Sp. k. (operator) – 80%, PGNiG S.A. – 20%.

As part of the cooperation, over 3,000 km of 2D seismic profiles were reprocessed and well log data from 113 old wells was analysed. Plans for 2011 assume reprocessing of approx. 1,000 km of 2D seismic data and acquisition of approx. 250 km of new 2D field seismic data in both licence areas.

On September 30th 2010, FX Energy Poland Sp. z o.o. and PGNiG S.A. executed an agreement providing for cooperation in the licence areas awarded to FX Energy Poland Sp. z o.o. (blocks 211, 212, 231 and 232). Interests held by the parties are as follows: PGNiG S.A. - 50%, FX Energy - 50%. FX Energy Poland Sp. z o.o. is the operator. Drilling of the Kutno deep well is scheduled for 2011.

With respect to the following areas, in 2010 the Minister of Environment approved an allocation of working interests (division of mining usufruct rights) among the parties to the agreements for joint operations that is consistent with such parties' interests in the joint venture projects as established under the agreements:

- "Budzów", "Bielsko-Biała", "Bestwina" and "Cieszyn" – under Agreement for Joint Operations with Energia Karpaty Zachodnie Sp. z o.o. Sp. k.,
- "Mszana Dolna" and "Jordanów" – under Agreement for Joint Operations with Energia Karpaty Wschodnie Sp. z o.o. Sp. k.,
- "Płotki" – under Agreement for Joint Operations with FX Energy Poland Sp. z o.o.
- "Płotki" – "PTZ" (the Extended Zaniemyśl Area) – under Operating Agreement of Mining Users with FX Energy Poland Sp. z o.o. and Calenergy Resources Poland Sp. z o.o.,
- "Poznań" – under Agreement for Joint Operations with FX Energy Poland Sp. z o.o.

The division of mining usufruct rights (allocation of working interests) consistently with the parties' interests in the joint operations determines the method of accounting for produced hydrocarbons. In addition, the possibility to divide mining usufruct right through allocation of working interests facilitates negotiations with potential E&P partners.

Exploration abroad

PGNiG S.A. conducts exploration work in Pakistan on the basis of an agreement on hydrocarbon exploration and production in the Kirthar licence area executed between PGNiG S.A. and the government of Pakistan on May 18th 2005,. Work in the Kirthar block is conducted jointly with Pakistan Petroleum Ltd., with production and expenses shared proportionately to the parties' interests in the licence: PGNiG S.A. (operator) - 70%, PPL - 30%. In 2010, enhanced recovery techniques were applied in the Rehman-1 exploration borehole resulting in gas flow. PGNiG S.A. engaged Chinese company BGP (owned by China National Petroleum Corporation) which in performed 242km^2 of 3D and 96km of 2D seismic surveys. Workover of the Hallel-1 borehole is planned for 2011.

Since the execution of the agreement on assignment of interests in 2007, PGNiG S.A. has been engaged in exploration activity in the 1/05 licence area in Denmark. Currently, the licence interests are: PGNiG S.A. (operator) – 80%, Nordsofonden – 20%. In 2010, 2D and 3D field seismic surveys and processing of field data were completed. Advanced processing of seismic data was carried out. Drilling work is scheduled to start in 2011.

In Egypt, PGNiG S.A. has been conducting exploration work in the Bahariya licence area (Block 3) under an Exploration and Production Sharing Agreement with the government of Egypt of May 17th 2009. The Company holds a 100% interest in the licence. As part of the exploration work, 2,000km of back-file 2D seismic materials were reprocessed and reinterpreted in 2010. BGP of China, engaged by PGNiG S.A., commenced gravimetric surveys. The work is scheduled for completion in 2011. In connection with the political situation in Egypt, in January 2011 PGNiG S.A. employees were temporarily withdrawn from the country, which, however, had no negative effect on the progress of the exploration activities.

2. Production

Natural gas and crude oil production in Poland is conducted by two branches of PGNiG S.A.: 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 2010, the new Wielichowo gas production facility came onstream. The facility produces hydrocarbons from the Wielichowo and Ruchocice fields.

In 2010, PGNiG S.A. produced a total of 4.2 billion cubic meters of natural gas (measured as high-methane gas equivalent). Due to prolonged installation checks following the commissioning of the Grodzisk Denitriding Plant, gas production was slightly lower than the forecast 4.3 billion cubic meters. Crude oil production amounted to 487.8 thousand tonnes. Lower-than-forecast oil production levels were due to the geological and formation-specific conditions as well to limited collection of gas by the Gorzów CHP Plant (which collects gas generated in the process of crude degassing at the Dębno production facility). The table below shows the PGNiG S.A.'s production volumes in 2010:

Production volumes

		Unit	2010	2009
1	Natural gas, including:	million cubic meters*	4,220.4	4,105.2
a	high-methane, including:	million cubic meters	1,605.3	1,633.9
	- Zielona Góra Branch	million cubic meters	0.0	0.0
	- Sanok Branch	million cubic meters	1,605.3	1,633.9
b	nitrogen-rich, including:	million cubic meters*	2,615.1	2,471.3
	- Zielona Góra Branch	million cubic meters*	2,530.9	2,391.9
	- Sanok Branch	million cubic meters*	84.2	79.4
2	Crude oil	thousand tonnes	487.8	491.6
	- Zielona Góra Branch	thousand tonnes	440.7	446.3
	- Sanok Branch	thousand tonnes	47.1	45.3

* Measured as high-methane gas equivalent.

In the operating area of the Sanok Branch, the following fields came onstream: Kupno, Morawsko, Sarzyna and Jasionka phase II. The fields that came onstream in the operating area of the Zielona Góra branch were: Wielichowo, Ruchocice, Środa Wielkopolska and Łęki. In total, 27 new wells were hooked up, both on new fields and on fields where production has already been under way for some time (Pruchnik-Pantałowice, Zalesie, Przemyśl, Palikówka). Total production capacity addition is estimated at 71.5 thousand cubic metres of gas per hour (measured as high-methane gas equivalent).

In 2010, PGNiG S.A. was engaged in various activities aimed at maintaining the gas and oil output from the currently producing fields. In order to increase hydrocarbon production, 2,499 m of production drilling work was performed, as part of which drilling of three wells (Rudka-16, Wola Różaniecka-17 and Buszewo-6k) was completed. Also, drilling of another production well commenced.

In order to maintain hydrocarbon production or counteract the natural decline in production yields, 35 wells whose technical condition made further production impossible were subject to major remedial treatment, out of which four wells were subsequently converted into injectors and five wells were abandoned due to their bad condition or lack of commercial gas flow rates following the remedial treatment.

Additionally, in 2010, a total of 49 enhanced recovery technique applications and well interventions were carried out in order to sustain or increase the rates of recovery or to improve absorption rates in injectors. Major enhanced recovery technique applications consisted in fracturing and acidizing, while well interventions included mainly removing wellbore obstructions and paraffin deposits, or cleaning out and activating wells with the use of coiled tubing and nitrogen equipment.

In order to raise the pressure of gas supplied to the transmission network, four field compressors were installed: two on the Jodłówka field and two on the Sarzyna field.

Commercial products such as crude condensate, sulphur and propane-butane are obtained through processing of crude oil. A part of the nitrogen-rich gas produced by a production facility operated by the Zielona Góra Branch is processed into high-methane gas by the Odolanów Branch. Also, the cryogenic nitrogen removal process generates helium and LNG. Moreover, nitrogen-rich gas is processed into high-methane gas and LNG at the Grodzisk Wielkopolski Denitriding Plant. Maintenance work and installation checks were carried out at the Grodzisk Wielkopolski Denitriding Plant in 2010. The installation was re-started in late August 2010.

The table below sets forth off-tariff sales of natural gas (including LNG), as well as sales of crude oil and other products to external customers by volume. The key natural gas customers were industrial customers, accounting for 84% of the total sales volume.

Sales structure of key products

		Unit	2010	2009
1	Natural gas, including:	million cubic meters	673.8	640.0
	- high-methane gas	million cubic meters	53.7	46.8
	- nitrogen-rich gas*	million cubic meters	620.1	593.2
2	Crude oil	thousand tonnes	499.0	503.7
3	Crude condensate	thousand tonnes	1.9	1.9
4	Helium	million cubic meters	3.1	2.5
5	Propane-butane	thousand tonnes	21.0	20.2
6	Nitrogen	thousand kg	832.2	1,338.3
7	Sulphur	thousand tonnes	25.2	24.6

* Measured as high-methane gas equivalent.

In 2010, PGNiG S.A. continued to sell crude oil to Rafineria Trzebinia S.A. and TOTSA TOTAL OIL TRADING S.A. under the agreements executed in 2009.

PGNiG S.A.'s foreign customers accounted for 42% of the total sales volume in the case of crude oil, and for 81% in the case of helium. Crude oil was sold to a German refinery (through the Druzhba pipeline), whereas most of the helium volume was sold in liquid form to a foreign wholesale customer, who resells the product in European countries.

Underground gas storage facilities

The Exploration and Production segment uses 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 storage capacities used to store produced gas are not storage facilities within the meaning of the Polish Energy Law. The chief purpose of underground gas storage facilities is to provide a possibility to handle the produced gas during periods of low demand for the product.

Besides, underground storage facilities enable optimum production from domestic fields during the year and rational management of natural gas reserves.

In 2010, PGNiG S.A. completed the construction of and placed in service the Bonikowo Underground Storage Facility for Lw nitrogen-rich gas, with a working capacity of 200 million cubic meters. Furthermore, the Company was involved in drillings of nine wells and construction of the surface facilities of the Strachocina Underground Storage Facility. The table below sets forth working capacities of the underground storage facilities used to store produced gas as at December 31st 2010.

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

High-methane gas	2010	2009
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	-

In 2010, PGNiG S.A. and The Oil and Gas Institute of Kraków signed an agreement for co-financing of the Strachocina Underground Gas Storage Facility project (up to PLN 53.2m) as part of the EU Infrastructure and Environment Operational Programme. The amount of the co-financing depends on the fulfilment of a number of conditions specified in the agreement.

3. Investment Projects in the Exploration and Production Segment

The expenditure incurred by PGNiG S.A. in 2010 on investments in property, plant and equipment and intangible assets in the Exploration and Production segment amounted to PLN 1,233.9m. The key projects are described below.

Exploration

In the area of exploration, capital expenditure was chiefly incurred on nine wells drilled with positive results, wells the drilling of which is still under way, and five wells which proved to be dry, where the related expenditure was charged to expenses in the current reporting period.

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 2010, work was conducted on construction of the Central Facility under an investment sub-project "LMG Project – Central Facility, well areas and other infrastructure". The total value of the project is estimated at approximately PLN 1.6bn.

Grodzisk project

The objective of this project is to support the sale of gas produced from nitrogen-rich gas fields after it has been processed to achieve the parameters of high-methane gas (cryogenic nitrogen removal). The Grodzisk project comprised, among other things, development of the Paproć W field, 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 2010, development of the Wielichowo and Ruchocice fields was completed and work continued on extension of the Paproć-Cicha Góra Gas Production Facility and development of the Elżbieciny and Jabłonna wells. The Grodzisk project is scheduled for completion at the end of 2011. The total value of the project is estimated at PLN 463m.

Gas pipeline to KGHM

The project involves construction of a high-pressure gas pipeline and optic-fibre cable along with infrastructure, from the Kościan Gas Production Facility to KGHM Polkowice/Żukowice, owing to which natural gas could be sold directly to KGHM Polkowice/Żukowice. Construction of the pipeline continued in 2010. The total cost of the project is estimated at approximately PLN 220m.

Other investment projects in the production segment

Other projects involved development of gas reserves, including those already in production, projects executed in order to maintain or replace hydrocarbon production capacity, and projects related to the functioning of the hydrocarbon production segment. The key investment projects included:

- modernisation and extension of the existing gas production facilities;
- development of the Rylowa-Rajsko, Góra Ropczycka and Zalesie gas fields;
- commencement of development of the Rudka field;
- development of the Sarzyna and Pilzno wells;
- completion of upgrade of production installations at the Odolanów Denitriding Plant;
- commencement of construction of a high-pressure gas pipeline from Mieszalnia Kłodawa to the LMG Oil and Gas Production Facility;
- purchases of ready-to-use investment goods as well as backup facilities and infrastructure.

Underground gas storage facilities

Construction of the Bonikowo underground storage facility for Lw nitrogen-rich gas was completed in 2010. Total capital expenditure incurred on the Bonikowo storage facility were approximately PLN 165m. Furthermore, the final ninth well was drilled and work continued on construction of the surface part of the Strachocina Underground Gas Storage Facility.

4. Planned Activities

Exploration in Poland

In 2011, PGNiG S.A. 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 S.A. independently as well as in cooperation with foreign partners. As part of the above activities, PGNiG S.A. plans to implement projects focused on exploring new potential (including in the area of unconventional shale gas and tight gas): completion of drilling of Lubocino-1, Tymowa-1 and Piaski-3 wells and drilling of further wells.

Exploration abroad

In 2010, PGNiG S.A. took a number of steps with a view to acquiring new sites for exploration and new licence areas in Algeria, Iraq, Tunisia and East Africa. All these initiatives will be continued throughout 2011. Furthermore, the Company plans to carry on exploration work in Pakistan, Egypt and Denmark.

Underground gas storage facilities

The extension of the Strachocina Underground Gas Storage Facility is planned to be completed in 2011. The extension of the facility is designed to increase its working capacity to 330 million cubic meters.

Natural gas production

PGNiG S.A. 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, among other things, to develop new deposits and wells, modernise and expand the existing gas production facilities, as well as build new underground gas storage facilities and expand the existing ones.

The plans for 2011 assume an annual natural gas production volume of 4.3 billion cubic meters of high-methane gas equivalent with a calorific value of 39.5MJ per cubic meter.

In 2011, the Company intends to hook up wells with the aggregate production capacity of approx. 3 thousand cubic metres of high-methane gas per hour (in the area of operations of the Sanok Branch) and start production from the Elżbieciny, Jabłonna and Paproć fields with the total production capacity approximating 46.5 thousand cubic metres of nitrogen-rich gas per hour (in the area of operations of the Zielona Góra Branch). In cooperation with FX Energy Poland Sp. z o.o., the Company intends to start production from Kromolice and Kromolice S fields, whose aggregate production capacity is estimated at 11.4 thousand cubic metres of nitrogen-rich gas per hour.

Crude oil production

Production of crude oil in 2011 is estimated at about 480 thousand tonnes. With two new wells in the Barnówko-Mostno-Buszewo (BMB) field having started production in 2010 and another three to be hooked up in 2011, the PGNiG Group will be able to keep its production at current levels. A significant production increase, to approximately 0.9 million tonnes per annum, is expected in 2013, after development of the Lubiatów-Międzychód-Grotów (LMG) field is completed and production starts.

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 counterbalance the depletion of the currently producing reserves, PGNiG S.A.'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 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 the full business cycle from the commencement of exploration to the launch of production from a developed field takes six to eight years, while the hydrocarbon production cycle lasts from 10 to 40 years. Formation characteristics defined at the stage of preparing the relevant documentation are reviewed after production starts. Each downgrade of the size of the reserves or production volume may lead to a lower revenue and adversely impact PGNiG S.A.'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 plays 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 with respect to acquisition of licences for exploration for and appraisal of hydrocarbon deposits, impeding implementation of a strategy providing for gaining access to own hydrocarbon resources. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have financial resources larger than those of PGNiG S.A. Thus it is probable that such companies would submit their bids in tender procedures and be able to acquire promising licences. Competitors are also able to identify, value, offer and purchase a larger number of fields (including operator status and licences) than it is possible in the case of PGNiG S.A., given its financial and human resources. This competitive advantage enjoyed by other market players is particularly important on the international market.

Delayed work

Under the currently binding 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 year. As regards business activity on foreign markets, it may take even two years from the time that the tender for licence is awarded until the relevant contract is ratified. Moreover, prior to the commencement of field work, the Company is obliged to make numerous 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. Under the currently binding regulations, another several months pass before an agreement with the contractor is signed. In addition, companies must frequently wait for a very long time before their imported equipment receives customs clearance. These factors create the risk of delayed exploration work.

Formal and legal issues beyond PGNiG S.A.'s control include:
- local governments' failure to adopt local land development plans;
- obstacles in incorporating investment projects into the local land development plans;
- need to obtain and comply with administrative or other formal and legal decisions, including environmental decisions;
- amendments to the current planning and development concept;
- 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 S.A.'s obligation to comply with the Public Procurement Law frequently prolongs the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire investment project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of exploration

Exploration work is capital consuming, given the prices of energy carriers and materials. Cost of exploration work is especially sensitive to steel prices, which are passed on to prices of casing pipes and lifting casing that is used in drilling. Any increase in prices of energy and materials translates into an increase in the cost of exploration work. Moreover, profitability of foreign exploration projects will to a significant extent depend on the movements in prices of oil derivative products and in exchange rates.

Legal regulations concerning safety, environmental protection and health

Ensuring compliance with environmental law in Poland and abroad might significantly increase the PGNiG S.A.'s costs of operations. Currently, PGNiG S.A. incurs significant capital expenditure and costs on harmonising 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 in the scope of 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 present also in other countries where PGNiG S.A. conducts exploration activity.

Qualified personnel

The presence of foreign companies on the Polish market has intensified the phenomenon whereby highly qualified employees with extensive professional experience are taken over. This risk is especially high with respect to professionals specialised in oil and gas exploration. In countries where PGNiG S.A. operates, highly qualified staff is difficult to recruit.

Unpredictable events

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

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 may be a particular threat in countries where the law changes depend on decisions made by authoritarian governments.

Political and economic situation

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

In some areas where PGNiG S.A. is present there is a risk of social and political destabilisation. Changes of governments may bring to a halt the processes of state administration issuing permits to conduct business in the petroleum sector. Additionally, these countries are at risk of internal conflicts and social unrest caused by poor social and demographic conditions in which their inhabitants live. The risks specified above may lead to a limitation, suspension or discontinuation of PGNiG S.A.'s activities.

In certain countries, the exploration business is hindered by lack of adequate infrastructure, which may be an obstacle in transporting equipment, staff and materials to the sites. Providing supplies and ensuring appropriate health care may also be a problem. These risks may lead to a limitation or suspension of the Company's exploration activities.

Chapter VI: Trade and Storage

The segment sells both imported and domestically-produced natural gas. Imported natural gas is purchased chiefly from the eastern markets. Sale of natural gas through the distribution and transmission network is regulated by the Polish Energy Law, and gas prices are determined based on the tariffs approved by the President of the Energy Regulatory Office. For the segment's purposes, three underground gas storage facilities are used, located in Mogilno, Wierzchowice and Husów.

1. Purchases

In 2010, PGNiG S.A. derived natural gas from imports and, to a limited extent, from domestic suppliers. PGNiG S.A. imported natural gas mainly under the agreements and contracts specified below, i.e. the long-term contract with Gazprom Export as well as the medium-term agreements for gas supplies from VNG-Verbundnetz GAS AG:

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

The table below presents the natural gas supply structure measured as high-methane gas equivalent.

Structure of natural gas supplies by supply sources (million cubic meters)

	2010	%	2009	%
Imports, including:	10,066.4	99.1%	9,135.9	99.4%
- Gazprom Export	9,028.4	89.7%	8,137.2	89.1%
- VNG AG	890.8	8.8%	938.0	10.3%
- Other foreign suppliers	147.2	1.5%	60.7	0.6%
Domestic suppliers	96.1	0.9%	58.1	0.6%
Total	10,162.5	100.0%	9,194.0	100.0%

In the period from September 1st to September 28th 2010, and subsequently from January 1st 2011, NAK Naftogaz Ukrainy suspended gas deliveries via the Zosin near Hrubieszów cross-border point on the Polish-Ukrainian border, where gas is supplied to Poland under a gas supply agreement of October 26th 2004. NAK Naftogaz Ukrainy stopped its deliveries due to a change in internal regulations applicable in Ukraine, which require that Ukrainian production of natural gas may be allocated to meet the domestic demand only. PGNiG S.A. will demand that the gas supplies agreement, valid until December 31st 2020, be performed. 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 18th 2010, PGNiG S.A. executed a regasification services contract with Polskie LNG S.A. of Świnoujście. Under the contract, Polskie LNG will provide LNG regasification services to PGNiG S.A. at the LNG terminal in Świnoujście for a period of 20 years starting from July 1st 2014. In order to ensure proper performance of the contract, Polskie LNG S.A. agreed to construct a terminal which is to reach full operational capacity by July 1st 2014. Execution of the regasification services contract will enable PGNiG to fulfil the conditions under the LNG purchase agreement concluded between PGNiG S.A. and Qatargas Operating Company Ltd. in June 2009.

On October 22nd 2010, PGNiG S.A. and SGT EURPOL GAZ S.A. executed an annex to the agreement of July 1st 2004 on gas transmission from the Kondratki cross-border point on the Polish-Belarusian border to gas terminals in Włocławek and Lwówek Wielkopolski through the Yamal-Western Europe gas pipeline. The agreement term was extended to expire on December 31st 2022 instead of the original December 31st 2012.

On October 29th 2010, PGNiG S.A. and Gazprom Export signed an annex to the contract of September 25th 1996 providing for sale of Russian natural gas to the Republic of Poland. The execution of the annex was connected with the adoption in 2009 of a package of arrangements and the approval on October 29th 2010 of relevant amendments to the Agreement between the Governments of the Republic of Poland and the Russian Federation concerning construction of a gas pipeline system for transmission of the Russian gas across the territory of Poland, dated August 25th 1993, as amended. The annex provides for increased volume of natural gas supplies to Poland in 2010–2022 and lifts the ban on re-export of natural gas to third countries without Gazprom Export's consent. The annex also introduces a preference price in the period 2010–2014 for the quantities of gas collected during a year above the contracted minimum annual quantity. Other terms and conditions of the contract, including the pricing formula for gaseous fuel, remained unchanged.

2. Sale

In 2010, PGNiG S.A. signed comprehensive agreements for the supply of gaseous fuel, both from the transmission system and from the distribution system, to 83.3 thousand new customers.

On June 16th 2010, PGNiG S.A. and Grupa LOTOS S.A. executed a comprehensive agreement on supply of gaseous fuel. The agreement provides for the supply of gaseous fuel starting from December 16th 2011. The annual supplies of natural gas will be 403 million cubic meters in 2012, while the target annual volume is 447 million cubic meters. The estimated value of the agreement in the period of five years amounts to approximately PLN 2.2bn.

On July 30th 2010, PGNiG S.A. and KGHM Polska Miedź S.A. executed a comprehensive agreement on sale of gaseous fuel. The agreement provides for the sale of Lw natural gas to be used as a power source to the Głogów and Polkowice collection points in the target amount of 266 million cubic meters per annum. The gaseous fuel will be delivered through the distribution network of Wielkopolska Spółka Gazownictwa Sp. z o.o. The agreement is effective from its date until June 30th 2033, and contains a clause whereunder the start of gas deliveries may be scheduled to a date falling between July 1st and December 31st 2012, to be agreed by the parties. The estimated value of the agreement is approximately PLN 4.0bn.

On August 3rd 2010, PGNiG S.A. executed arrangements to terminate the natural gas sale agreements of December 1st 2003 with Energetyka Sp. z o.o. (a subsidiary of KGHM Polska Miedź S.A.), providing for the supply of gas to be used for power generation purposes. The agreements were terminated due to the parties' inability to meet the contractual terms of natural gas deliveries as well as in connection with the approval of a new agreement on the supply of natural gas to KGHM Polska Miedź S.A.

The key products sold by the Trade and Storage segment are high-methane gas and nitrogen-rich gas. In 2010, sales of natural gas rose by approx. 9% (or 1,099 million cubic meters) year on year. This sales volume increase was mostly due to low temperatures during the winter, which boosted demand for gaseous fuel from households by approx. 10% (or 371.5 million cubic meters). Moreover, demand for natural gas also rose from the trade and services sector, as well as from industrial customers, mostly in those industries which benefited from the economic recovery, i.e. the refining, petrochemical and metallurgical industries. PGNiG S.A. sold gas chiefly on the domestic market. The sales structure of the Trade and Storage segment in 2010 is presented in the table below.

Sales structure of key products

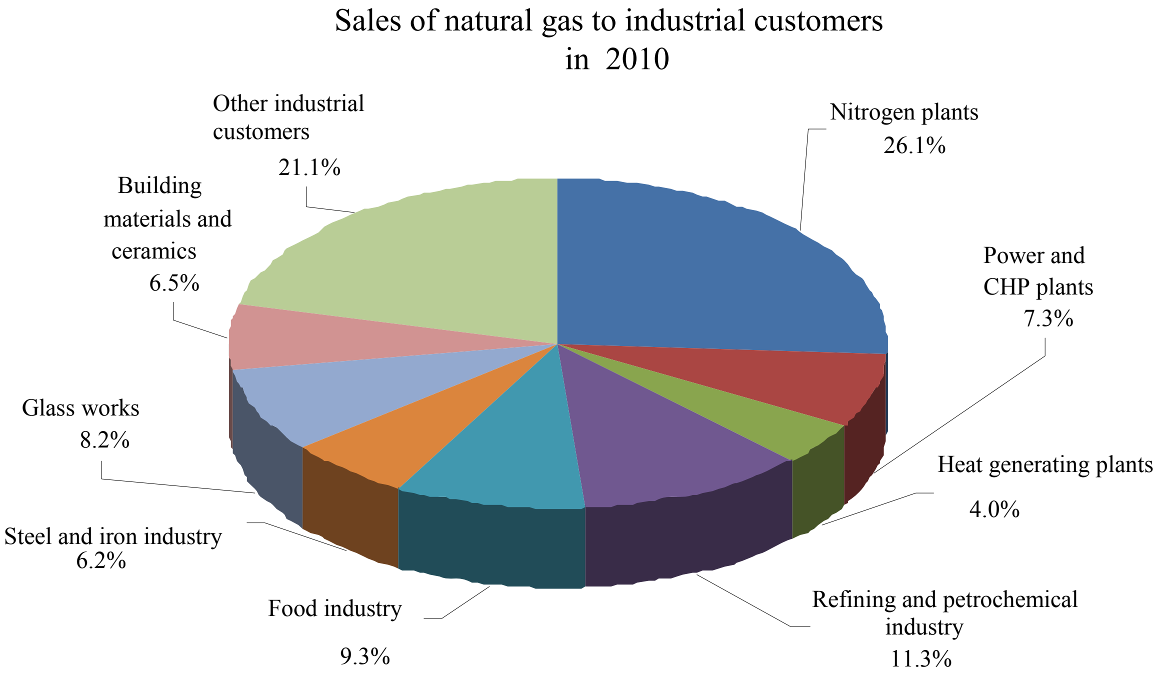
		Unit	2010	2009
1	Natural gas, including:	million cubic meters	13,743.0	12,644.0
	- high-methane gas	million cubic meters	13,221.9	12,001.5
	- nitrogen-rich gas*	million cubic meters	521.1	642.5
2	Propane-butane	thousand tonnes	2.1	2.1

* Measured as high-methane gas equivalent.

The Group’s main customers purchasing natural gas included companies from the chemical, metallurgical and power 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 6.4m). Their share in the total sales volume was 30%. The most prominent share in the natural gas sales volume was claimed by industrial customers (57%). The table below presents the structure of natural gas sales (measured as high-methane gas equivalent) broken down by major customers.

Sales of mains natural gas (million cubic meters)

	2010	%	2009	%
Industrial customers	7,811.3	56.8%	7,313.3	57.8%
Trade and services	1,574.3	11.5%	1,425.1	11.3%
Households	4,095.8	29.8%	3,724.3	29.5%
Wholesale customers	217.7	1.6%	142.4	1.1%
Exports	43.9	0.3%	38.9	0.3%
Total	13,743.0	100.0%	12,644.0	100.0%



In 2010, PGNiG S.A. and Mazowiecka Spółka Gazownictwa Sp. z o.o. continued an investment project to switch the customers in Pisz (Olsztyn Province) who receive propane-butane-air to high-methane gas (E) produced from LNG. Due to the contractor's default on contract terms, the project completion date has been postponed to July 2011.

On September 8th 2010, PGNiG S.A. and ZRUG Sp. z o.o. of Poznań entered into an agreement on the construction of a gas network in the Rakoniewice municipality. The project covers the construction of 75km of a medium-pressure gas pipeline. Implementation of this project will contribute to an increase in the number of new connection agreements as well as to higher volumes of gas sold.

3. Storage

The Trade and Storage segment uses for its own needs parts of the working capacities of the Wierzchowice Underground Gas Storage Facility, the Husów Underground Gas Storage Facility and the Mogilno Underground Gas Storage Cavern Facility. The Wierzchowice and Husów underground gas storage facilities are also used by the production segment of PGNiG S.A., whereas a part of the working capacity of the Mogilno facility has been made available to OGP GAZ-SYSTEM S.A. To the extent of the working capacity used for production needs and used by OGP GAZ-SYSTEM S.A., underground storage facilities are not storage facilities within the meaning of the Polish Energy Law.

Short-term 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 salt caverns to be withheld at periods of peak demand. 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 Underground Gas Storage Facility, the Husów Underground Gas Storage Facility and the Mogilno Underground Gas Storage Cavern Facility 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 a Threat to National Fuel Security or a Disruption on the Petroleum Market, dated February 16th 2007.

On January 1st 2009, PGNiG S.A. was appointed as the Storage System Operator. Detailed terms of providing gaseous fuel storage services (working capacity, injection capacity, withdrawal capacity) and sale of storage services are compiled in the "Rules of Provision of Storage Services", which took effect on July 1st 2009. After public consultations, on May 17th 2010, the revised "Rules of Provision of Storage Services" came into force.

In compliance with the Rules, in 2009 PGNiG S.A. made available a total of 627 million cubic meters of working storage capacity as part of bundled services provided on a continuous or interrupted basis. On July 1st 2010, under a short-term agreement, PGNiG S.A. made available an additional 8 million cubic meters of working storage capacity on a continuous basis for the needs of third-party access (TPA) as part of a bundled services arrangement.

In 2010, PGNiG S.A. continued works 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. Moreover, the Company continued to conduct work related to the construction of a new high-methane gas storage facility, namely the Kosakowo Underground Gas Storage Cavern Facility. The Company has completed the construction of a leaching installation along with pipeline for brine discharge, as well as drillings for the needs of the storage facility. The Company has commenced leaching work in two caverns. The table below presents the working capacities of the underground gas storage facilities.

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

	2010	2009
Husów	350.0	350.0
Mogilno	377.9	370.0
Wierzchowice	575.0	575.0

In 2010, under the EU's Infrastructure and Environment Operational Programme PGNiG S.A. the Oil and Gas Institute of Kraków executed an agreement on co-financing of the following projects: "The Wierzchowice Underground Gas Storage Facility" (for up to PLN 503.6m), "The Kosakowo Underground Gas Storage Cavern Facility" (for up to PLN 93.5m) and "The Mogilno Underground Gas Storage Cavern Facility" (for up to PLN 23.1m). The amount of the co-financing depends on the fulfilment of a number of conditions specified in individual agreements.

4. Investment Projects in the Trade and Storage Segment

The amount of capital expenditure incurred in the Trade and Storage segment on property, plant and equipment and intangible assets was PLN 553.0m. The most important investment projects were related to construction and extension of underground gas storage facilities and included:

- construction of the surface part of the Wierzchowice Underground Gas Storage Facility;
- completion of construction of the leaching installation along with pipeline for brine discharge, as well as of the drillings for the needs of the storage facility, and commencement of the leaching work in two caverns of the Kosakowo Underground Gas Storage Facility;
- construction of four caverns in the Mogilno Underground Gas Storage Cavern Facility.

In addition, the investment projects carried out in the Trade and Storage segment included information and communication technology projects, purchase and clarification of the legal status of real property and construction work related to gas pipelines.

5. Planned Activities

Underground gas storage facilities

In 2011, PGNiG S.A. will continue the extension of the Wierzchowice Underground Gas Storage Facility and of the Mogilno Underground Gas Storage Cavern Facility, to target working capacities of 1.2 billion cubic meters and 800 million cubic meters, respectively. The first stage of the Wierzchowice Underground Gas Storage Facility extension project is planned to be completed at the end of 2011. In addition, the Company will continue the construction of a new high-methane gas storage facility, namely the Kosakowo Underground Gas Storage Cavern Facility, which is ultimately to consist of ten underground caverns with a total working capacity of 250 million cubic meters. The contractor for the construction of the surface part of the facility will be selected in the first half of 2011.

6. Risks Related to Trade and Storage

Competition

At present, PGNiG S.A. is the largest supplier of natural gas in Poland. PGNiG S.A.'s share in the gas market is estimated at approximately 98%. The remaining 2% is represented by suppliers from outside the PGNiG Group which to a large extent purchase gas from PGNiG S.A. Suppliers from outside the PGNiG Group which trade in natural gas operate mostly in those areas where there are no gas networks. These include local gas distributors that own transmission infrastructure and offer – in addition to traditional network gas supply – innovative gas supply solutions involving the use of LNG. An intensified commercial activity of competitors with the aim of attracting current and potential customers of PGNiG S.A. may in the future pose a tangible threat of customer churn.

Higher receivables

In connection with the economic crisis, which resulted a downturn on the markets of PGNiG S.A.'s customers and, by the same token, a deterioration in the financial standing of customers purchasing gas, there may still be some difficulties with timely settlement of payments for the supplied gaseous fuel.

Storage

A delay in the implementation of investment projects may prevent PGNiG from building up sufficient mandatory stocks of natural gas in compliance with the Act on Mandatory Stocks, pursuant to which as of October 1st 2012 the volume of mandatory stocks must be increased from 20 to 30 days of average annual imports.

Chapter VII. Other Activities

PGNiG S.A.'s organisational unit classified in the "Other Activities" segment is the Central Measurement and Testing Laboratory Branch. The Branch provides services aimed at ensuring accurate and reliable measurements of natural gas, comprising in particular calibration of measurement devices, attestation of gas meters and gas volume converters, gas quality testing, testing of new gas equipment as well as measurement and analytical supervision over process analyser systems and equipment installed in transmission and distribution networks, and in gas storage facilities. The Branch also provides advisory services, issues opinions and provides expert reports.

In 2010, the Branch's main areas of activity included:

- metrological control of measurement systems on the Yamal-Europe transit gas pipeline (Polish section),
- metrological control of measurement systems on metering stations of industrial customers (45 facilities),
- checking natural gas measurement systems for the purpose of evaluation of CO_2 emissions by large industrial emitters,
- measurement supervision of the process analyser systems for the evaluation of quality of natural gases in the transmission and distribution networks, mines and storage facilities,
- validations and measurement supervision of the field laboratories controlling the quality of natural gases.
- testing performance of turbine and rotary gas meters under non-standard conditions.

Furthermore, in 2010 the Branch prepared studies on diagnosing the performance of turbine and rotary gas meters, and an assessment of the possibility to use biogas in gas networks, including an overview of biogas purification methods consistent with the standards applicable to natural gas.

The Branch provided its services mainly to the companies of the PGNiG Group, EUROPOL GAZ S.A. and OGP GAZ-SYSTEM S.A.

<u>Planned activities</u>

The Branch intends to maintain and strengthen its leading market position in the area of metrologic control of measurement systems and devices, attestation of gas meters, rota meters, other types of flow meters and gas volume converters, quality assessment of natural gases of all types (E and L) and forms (NG, LNG, CNG) and biogas, as well as evaluation of measurement and process analyser systems used to estimate CO_2 emissions.

<u>Risks</u>

Liberalisation of the gas market poses a risk that competitive Polish and foreign laboratories will enter the domestic market of natural gas measurement and analysis services. In 2010, the Polish Centre for Accreditation granted licences to several Polish laboratories providing services similar to the ones offered by the Central Measurement and Testing Laboratory.

Chapter VIII: Environmental Protection

Well abandonment

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. 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 wells and mining 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 2010, well abandonment operations were carried out on 22 wells and 5 waste pits.

Carbon credit trading system

In the National Allowance Plan for 2008–2012, the total credits granted to PGNiG S.A.'s installations were 99,982 Mg CO_2 per annum. In the 2008–2012 trading period, installations participating in the scheme were those of the Odolanów Branch, the Zielona Góra Branch and the Mogilno Underground Gas Storage Cavern Facility.

Under the existing carbon dioxide emission trading scheme (ETS), in 2010 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2010 and reconciled its emission volume with the permit held. Following cancellation of the carbon credits used in 2009, 18,278 Mg CO_2 credit units were retained.

Methane emissions

In 2010, the Company continued work on defining standardised methane emission indicators and unifying the methods for calculating the volume of 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 S.A. conducts diagnosis tests and surveys and land reclamation work in the areas which became polluted due to past activities (including traditional activities related to gas) with a view to restoring them to the condition required under the environmental quality standards. In 2010, the Company completed supplementary tests and surveys concerning properties located in Toruń, Koźmin Wielkopolski, Gorzów Wielkopolski, Szczecin, Katowice–Mysłowice, Reszel, Gryfice, Czersk, Zabrze (ul. Pyskowicka), Radków, Szprotawa and Wałbrzych, and initiated procedures for supplementary tests and surveys concerning properties located in Kargowa, Zabrze, Łabiszyn and Międzylesie. In 2010, the Company also completed reclamation work on properties located in Wrocław, Świdnica, Jugowice, Lądek Zdrój and Ziębice with the total area of approx. 60.000 square meters and commenced reclamation work on properties located in Bartoszyce, Radków, Pyrzyce and Koźmin Wielkopolski with the total area of approx. 24,000 square meters.

REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals)

In order to ensure compliance with the new regulations concerning mandatory registration of chemicals, their evaluation and authorisation for use in production and trading that came into effect in 2008, in November 2008 the Company pre-registered sulphur in the REACH-IT system. The full registration of sulphur on the ECHA (European Chemicals Agency) platform was made in November 2010 (No. TK948791-11).

Chapter IX: Other Information

Distribution of the 2009 profit

On April 29th 2010, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution to distribute the 2009 net profit, of PLN 665.9m, in the following manner:

- PLN 117.4m was allocated to the Company's statutory reserve funds;
- PLN 472.0m was allocated to dividend payments (PLN 0.08 per share), of which PLN 340.0m was transferred to the State Treasury in the form of non-cash dividend (sub-elements of the transmission system and rights to capital expenditure on tangible assets under construction connected with these sub-elements), subject to a reservation that additional cash would be transferred to the State Treasury if the value of the non-cash assets is below PLN 340.0m;
- PLN 8.9m was allocated to increase the Company's social benefits fund;
- PLN 54.6m was allocated to awards (bonuses) for the Company's employees;
- PLN 13.0m was allocated to increase the Central Restructuring Fund capital reserve.

In addition, retained profit of PLN 53.6m was allocated to increase the Company's statutory reserve funds.

The Annual General Shareholders Meeting of PGNiG S.A. set July 27th 2010 as the dividend record date and October 4th 2010 as the dividend payment date.

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

On April 29th 2010, the Annual General Shareholders Meeting of PGNiG S.A. approved the financial statements and the Director's Report on the operations of PGNiG S.A., 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 S.A. in respect of their performance of duties in the financial year 2009.

Transmission services agreements

On December 29th 2010, PGNiG S.A. and OGP GAZ-SYSTEM S.A. executed two transmission services agreements. The agreements cover the provision of high-methane gas and nitrogen-rich gas transmission services and stipulate the terms and conditions of supply of the gaseous fuel to and its collection from the transmission system. The agreements are effective from January 1st 2011 until December 31st 2014. The estimated aggregate value of the two agreements over their entire term is approximately PLN 6.0bn.

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

Proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of resolutions by the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution obliging PGNiG S.A. 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 S.A.'s claims and declared invalidity of the resolution concerning redemption of shares and the resolution concerning 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.

Proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated

January 19th 2005, whereunder PGNiG S.A. 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. By virtue of its decision of November 24th 2010, the Regional Court dismissed the petition. On December 30th 2010, PI GAZOTECH Sp. z o.o. lodged an appeal against the decision of the Regional Court.

Proceedings based upon PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or declare invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, whereunder PGNiG S.A. 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. On December 21st 2009, the Court of Appeals reversed the Regional Court's ruling of May 30th 2008 (by virtue of which the Company's claim to rescind or declare invalidity of the resolution on additional contributions to equity had been dismissed) and remanded the case for re-examination by the Regional Court. A hearing at the Regional Court is scheduled for April 11th 2011. 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.

Dispute with Bartimpex S.A.

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

On August 31st 2005, PGNiG S.A. appealed against the decision. The case was heard successively by the following courts: the Regional Court of Warsaw, the Warsaw Court of Appeals, and the Supreme Court. In connection with the cassation complaint filed by PGNiG S.A., on July 15th 2009 the Supreme Court revoked the Court of Appeals' decision and remanded the case for re-examination by the Court of Appeals.

By virtue of its ruling of January 5th 2010, the Court of Appeals reversed the decision issued by the President of the Office of Competition and Consumer Protection on August 9th 2005, dismissed PHZ Bartimpex S.A.'s appeal, and ordered the President of the Office of Competition and Consumer Protection to reimburse PGNiG S.A. for the costs of the appeal and cassation proceedings.

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 on the domestic natural gas wholesale market by PGNiG S.A., consisting in:

- inhibiting sale of gas against the interest of other business players or consumers,
- impeding the development of market conditions necessary for the emergence or growth of competition,

refusing to sell gaseous fuel under a framework agreement to an entrepreneur that intended to further resell the gas, i.e. Nowy Gaz Sp. z o.o. of Warsaw.

The President of UOKiK may impose on PGNiG SA a fine of not more than 10% of the revenue generated in the financial year preceding the date of the decision imposing the fine.

Chapter X: Financial Performance

1. Financial Performance in 2010

The financial statements of PGNiG S.A. and the consolidated financial statements of the PGNiG Group are 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 financial statements for 2010, 2011 and 2012 (PGNiG S.A. and subsidiaries);
- review of financial statements for Q1 2011, Q1 2012 and Q1 2013 (PGNiG S.A.);
- review of financial statements for H1 2010, H1 2011 and H1 2012 (PGNiG S.A.);
- review of financial statements for the first three quarters of 2010, 2011 and 2012 (PGNiG S.A.);
- carrying out certain procedures required by the banks financing PGNiG S.A. for 2010, 2011 and 2012;
- translation of the audited financial statements into English for yearly and half-yearly periods.

The table below presents the fees paid or payable to the qualified auditor of financial statements, for 2009-2010.

Auditor's fees (PLN)

	2010	2009
Audit of the annual financial statements	230,000	310,000
Other certification services, including review of financial statements	320,000	510,000
Tax advisory services	-	-
Other services	11,923	124,703

1.1. Key Financial and Business Data

In 2010, PGNiG S.A. posted a net profit of PLN 1,702.1m, up by PLN 1,036.2m year on year.

Summary information reflecting PGNiG S.A.'s financial standing in 2010 relative to 2009 is presented below in the financial statements prepared in accordance with the International Financial Reporting Standards, which comprise:

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

Separate statement of financial position (PLNm)

ASSETS	Dec 31 2010	Dec 31 2009
Non-current assets	20,038.8	18,772.1
Property, plant and equipment	10,940.9	9,726.9
Investment property	3.4	3.8
Intangible assets	81.9	68.9
Financial assets available for sale	6,408.7	6,219.4
Other financial assets	2,260.8	2,417.6
Deferred tax asset	291.5	299.6
Other non-current assets	51.6	35.9
Current assets	5,512.1	5,411.4
Inventories	879.3	1,110.2
Trade and other receivables	3,968.9	3,687.1
Current income tax receivable	-	161.5
Prepayments and accrued income	18.8	9.4
Financial assets available for sale	-	-
Derivative financial instruments	77.6	18.0
Cash and cash equivalents	565.9	425.2
Non-current assets held for sale	1.6	-
Total assets	25,550.9	24,183.5

Separate statement of financial position (PLNm) – contd.

EQUITY AND LIABILITIES	Dec 31 2010	Dec 31 2009
Equity	18,663.7	17,339.7
Share capital	5,900.0	5,900.0
Currency translation differences on foreign operations	(0.8)	(2.9)
Share premium account	1,740.1	1,740.1
Other capital reserves	9,245.7	8,983.1
Retained earnings/(deficit)	1,778.7	719.4
Non-current liabilities	1,758.4	1,638.7
Loans, borrowings and debt securities	0.3	2.6
Provisions	1,175.5	1,084.4
Deferred income	76.2	3.9
Deferred tax liability	491.5	531.3
Other non-current liabilities	14.9	16.5
Current liabilities	5,128.8	5,205.1
Trade and other payables	2,921.6	2,359.7
Loans, borrowings and debt securities	1,218.7	1,904.1
Derivative financial instruments	104.4	260.4
Current tax liability	135.7	-
Provisions	156.3	134.6
Deferred income	592.1	546.3
Total liabilities	6,887.2	6,843.8
Total equity and liabilities	25,550.9	24,183.5

Separate income statement (PLNm)

	2010	2009
Sales revenue	20,415.5	18,578.3
Total operating expenses	(18,792.7)	(18,205.0)
Raw and other materials used	(11,148.5)	(11,006.2)
Employee benefits	(857.7)	(774.8)
Depreciation and amortisation	(589.1)	(610.1)
Contracted services	(5,799.9)	(5,381.2)
Cost of products and services for own needs	20.7	13.7
Net other operating expenses	(418.2)	(446.4)
Operating profit/(loss)	1,622.8	373.3
Finance income	538.7	699.9
Finance expenses	(134.9)	(349.9)
Pre-tax profit/(loss)	2,026.6	723.3
Income tax	(324.5)	(57.4)
Net profit/(loss)	1,702.1	665.9

Separate statement of cash flows (PLNm)

	2010	2009
Net cash provided by/used in operating activities	2,386.0	1,109.7
Net cash provided by/(used in) investing activities	(1,336.1)	(2,412.9)
Net cash provided by/used in financing activities	(909.3)	920.2
Change in net cash	140.6	(383.0)
Cash and cash equivalents at beginning of period	425.2	808.2
Cash and cash equivalents at end of period	565.8	425.2

Financial ratios

Profitability

	2010	2009
EBIT (PLNm) operating profit	1,622.8	373.3
EBITDA (PLNm) operating profit + depreciation/amortisation	2,211.9	983.4
ROE net profit to equity at end of period	9.1%	3.8%
NET MARGIN net profit to sales revenue	8.3%	3.6%
ROA net profit to assets at end of period	6.7%	2.8%

Liquidity

	2010	2009
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	1.1	1.0
QUICK RATIO current assets (net of prepayments and accrued income) less inventories to current liabilities	0.9	0.8

Debt

DEBT	2010	2009
DEBT RATIO total liabilities to total equity and liabilities	27.0%	28.3%
DEBT/EQUITY RATIO total liabilities to equity	36.9%	39.5%

1.2. Financial Overview

Relative to 2009, the Company's operating profit rose by PLN 1,249.5m. The strengthening of the PGNiG S.A.'s financial position followed primarily from improved margins on high-methane gas sales and better results on crude oil sales. The margins on high-methane gas sales were driven by the following factors:

- a 7% fall in imported gas purchase prices, and
- a ca. 0.5% drop in the average annual gas sale prices.

The substantial increase in the profitability of high-methane gas sales was driven primarily by a 7% decrease in the price of imported gas, primarily due to a weaker US dollar. In addition decrease in the unit cost of imported gas in 2010 was also a result of discounts negotiated in the annex to the Yamal contract, assuming a preferential price for the gas received above minimum quantities.

The margins on high-methane gas sales improved despite a fall in average annual gas selling prices by about 0.5%. This decline was due to three subsequent changes in the gaseous fuel tariff rates and charges. In June 2009, the President of the Energy Regulatory Office approved a tariff with the average gas price reduced by 8.8%, whereas effective from June 2010, the average price of high-methane was raised by 4.8%. On September 16th 2010, as a result of significant volatility of the FX market, the President of the Energy Regulatory Office approved a new tariff, applicable in settlements with customers from October 1st 2010. In accordance with the new tariff, the average prices of high-methane gas went up by 6.3%.

PGNiG S.A's financial standing remained stable also owing to its good performance in the production business. Compared with 2009, PGNiG S.A. recorded a considerable margin improvement on sales of crude oil. Given higher prices of crude oil on the global markets, PGNiG S.A. sold the product at prices which were by 28% higher than in 2009. Moreover, following the launch of the new denitriding plant in Grodzisk Wielkopolski, production of nitrogen-rich gas rose by 7%. The higher production volumes were accompanied by a concurrent 7% drop in the sales volumes of nitrogen-rich gas, as more gas was sent for denitriding and projects were implemented to switch customers to high-methane gas.

Exploration and Production

The Exploration and Production segment posted operating profit of PLN 824.6m, up by PLN 562.4m relative to 2009. The increase in operating profit was driven mainly by improved margins on crude oil sales, higher reversals of impairment losses on production assets and lower value of expenditure incurred on dry wells charged to expenses.

Trade and Storage

In the Trade and Storage segment, the Company reported a PLN 687.3m increase in operating profit relative to 2009. The improvement in the segment's financial performance was mainly due to improved profitability of sales of high-methane gas as a result of lower costs of gas imports. Moreover, a lower result on valuation of derivative instruments had a significant effect on the operating profit of the Trade and Storage segment.

Financial data of PGNiG S.A.'s segments for 2010 (PLNm)

2010	Exploration and Production	Trade and Storage	Other Activities	Eliminations	Total
Sales to external customers	1,479.8	18,932.8	2.9	-	20,415.5
Intersegment sales	1,113.2	-	-	(1,113.2)	-
Segment's revenue	2,593.0	18,932.8	2.9	(1,113.2)	20,415.5
Segment's expenses	(1,768.4)	(18,132.0)	(5.5)	1,113.2	(18,792.7)
Operating profit/(loss)	824.6	800.8	(2.6)	-	1,622.8
Net finance expenses					403.8
Share in profit/(loss) of equity-accounted undertakings					-
Pre-tax profit/(loss)					2,026.6
Income tax					(324.5)
Net profit/(loss)					1,702.1
Capital expenditure on property, plant and equipment and intangible assets	(1,233.9)	(553.0)	-	-	(1,786.9)

Financial data of PGNiG S.A.'s segments for 2009 (PLNm)

2009	Exploration and Production	Trade and Storage	Other Activities	Eliminations	Total
Sales to external customers	1,230.8	17,344.8	2.7	-	18,578.3
Intersegment sales	1,092.2	-	-	(1,092.2)	-
Segment's revenue	2,323.0	17,344.8	2.7	(1,092.2)	18,578.3
Segment's expenses	(2,060.8)	(17,231.3)	(5.1)	1,092.2	(18,205.0)
Operating profit/(loss)	262.2	113.5	(2.4)	-	373.3
Net finance expenses					350.0
Share in profit/(loss) of equity-accounted undertakings					-
Pre-tax profit/(loss)					723.3
Income tax					(57.4)
Net profit/(loss)					665.9
Capital expenditure on property, plant and equipment and intangible assets	(1,143.0)	(789.1)	(0.4)	-	(1,932.5)

Relative to 2009, the Company reported a PLN 53.8m improvement in its result on financing activity. This growth was chiefly attributable to higher dividend income, mainly due to better financial performance by the Gas Distribution Companies, and higher interest income. The improved result on financing activities came along with lower reversals of impairment losses on financial investments, following last year's reversal of impairment losses on disputed interest and a loan advanced to SGT EUROPOL GAZ S.A.

The PLN 1,036.2m increase in net profit was reflected in improved basic efficiency ratios. Return on equity (ROE) went up from 3.8% to 9.1%, return on assets (ROA) rose from 2.8% to 6.7%, and net margin improved from 3.6% to 8.3%.

The balance sheet as at December 31st 2010 shows a balance-sheet total of PLN 25,550.9m, up by PLN 1,367.4m (or 6%) year on year.

The largest item of the Company's assets was property, plant and equipment, which at the end of 2010 stood at PLN 10,940.9m, up by PLN 1,214.0m (or 13%) on December 31st 2009. This increase was primarily due to investment projects implemented by PGNiG S.A., as well as revaluation of assets, mainly those related to the exploration and production business.

Another significant item of the balance sheet is represented by financial assets available for sale, which amounted to PLN 6,408.7m as at December 31st 2010, up by PLN 189.3m (or 3%) from the end of 2009. The increase in the value of this item was attributable mainly to an additional contribution to the equity of POGC-Libya B.V., a revaluation of shares in Zakłady Azotowe w Tarnowie-Mościcach and a recapitalisation of POGC Trading GmbH.

Other financial assets fell considerably, by PLN 156.8m (or 7%) compared with the end of December 2009. This change is attributable to the decrease in non-current receivables following the payment of non-cash dividend to the State Treasury and regular lease payments received from OGP GAZ-SYSTEM S.A. The decrease in other financial assets was accompanied by an increase in loans advanced, including mainly loans advanced to PGNiG Norway AS.

As at December 31st 2010, current assets totalled PLN 5,512.1m, up by 100.7m (or 2%) compared with the figure reported as at December 31st 2009.

The change in current assets was chiefly attributable to a PLN 281.8m (or 8%) increase in trade and other receivables on the back of record high sales of natural gas in 2010.

During the period under review, inventories fell by PLN 230.9m (or 21%). The inventories disclosed in the balance sheet comprise mainly the gas stored in underground storage facilities. The decrease in inventories was primarily caused by the drop of unit purchase price of imported gas and the withdrawal of gas from storage facilities in order to satisfy increased demand for gaseous fuel.

Cash and cash equivalents stood at PLN 565.9m and were by PLN 140.7m (or 33%) higher than the figure reported at the end of 2009, primarily due to higher cash provided by current operating activities.

The value and structure of the current assets held by PGNiG S.A. continued to guarantee the Company's full capacity to settle all its liabilities in a timely manner. Liquidity ratios reflected the Company's improved operational efficiency in this area. Current ratio increased from 1.0 to 1.1 as well as Quick ratio went up from 0.8 to 0.9.

Equity is the primary source of financing of the Company's assets. Relative to the end of 2009, equity increased by PLN 1,324.0m (or 8%). The level of equity was mainly affected by the net profit generated in the period (of PLN 1,702.1m) and the payment of non-cash and cash dividend (of PLN 472.0m) as part of distribution of the previous year's profit.

Relative to the end of December 2009, the Company recorded a PLN 91.1 (or 8%) increase in non-current provisions. The increase in this balance-sheet item was primarily due to the revaluation of provisions for decommissioning of production assets.

As at December 31st 2010, current liabilities stood at PLN 5,128.8m, and were by PLN 76.3m (or 2%) lower than on December 31st 2009. Current liabilities were chiefly impacted by a PLN 685.4m (or 36%) drop in loans, borrowings and debt securities and a PLN 561.9m (or 24%) increase in trade and other payables.

The Company made significant changes to its external financing structure. In 2010, the debt under the multi-currency syndicated credit facility was fully refinanced, with some of the funds used to repay the facility coming from the note issue programme launched in July 2010. In December 2010, PGNiG S.A. also launched a separate short-term note issue programme under which it has been selling short term discount notes to the Gas Distribution Companies. As at December 31st 2010, the Company's total debt, mainly under debt securities, stood at PLN 1,218.7m.

The ratios reflecting the relation between equity and other items of equity and liabilities improved. As at the end of 2010, debt to equity ratio fell from 39.5% to 36.9%, whereas the debt ratio (total liabilities to total equity and liabilities) decreased from 28.3% to 27.0%.

Use of share issue proceeds

As a result of the Public Offering carried out in 2005, PGNiG S.A. obtained issue proceeds totalling PLN 2,682.0m. Net of the issue costs of PLN 41.9m, the proceeds amounted to PLN 2,640.1m. As at the end of 2010, PLN 2,304.6m of the issued proceeds (87% of the total proceeds) were spent in aggregate. Of this amount, PLN 21m was spent in 2010. The key investment projects financed with the issue proceeds in 2010 included modernisation and extension of the distribution network, carried out by the Gas Distribution Companies, as well as PGNiG S.A.'s contribution to the share capital of its subsidiary PGNiG Energia S.A.

As at December 31st 2010, the use of the issue proceeds in the individual business segments was as follows:

- exploration and production – PLN 1,078.5m
- trade, storage and transmission – PLN 627.0m
- distribution – PLN 466.1m
- generation of electricity and heat – PLN 1.0m
- debt repayment (5% of the issue proceeds) – PLN 132m.

The total limit set in the Issue Prospectus for spending in the exploration and production business was reached by the end of 2007. In 2009, the Company reached the spending limit set for trade, storage and transmission. The funds which remain available for use amount to PLN 335.5m.

Feasibility of investment projects

Given its low financial leverage, positive assessment of the PGNiG S.A.'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. External financing will be raised mainly through debt securities issue programmes.

Transactions concluded on non-arms' length terms

In 2010, PGNiG S.A. and its subsidiaries did not enter into any material related party transactions on non-market terms.

Explanation of discrepancies between the actual results and the forecasts for 2010

In 2010, the Company did not publish any financial forecasts.

2. Financial Management

The funds at the disposal of PGNiG S.A. ensure timely financing of all current and planned expenditure related to the core business and investing activities. However, in order to enhance its financial safety, the Company has a reserve in the form of available overdraft facilities (PLN 280m in total), as well as a syndicated loan agreement effective until July 27th 2010 which provided for a revolving multi-currency credit facility of EUR 600m. On June 10th 2010, PGNiG S.A. executed an agreement (effective until July 31st 2013) with six banks (Bank Pekao SA, ING Bank Śląski S.A., PKO BP S.A., Bank Handlowy w Warszawie SA, Societe Generale SA and BNP Paribas S.A. Polish Branch) on a PLN 3.0bn Note Issue Programme. Under the Programme, PGNiG S.A. may issue discount and coupon notes with maturities ranging from one month to one year. The first note issue took place on July 26th 2010. The Company used the proceeds to repay the EUR 600m multi-currency revolving credit facility contracted on July 27th 2005. As at December 31st 2010, the Company's debt under the Programme amounted to PLN 1.1bn.

Furthermore, on September 17th 2010, PGNiG S.A. executed a mandate agreement with three banks (Societe Generale SA, BNP Paribas S.A. and Unicredit Bank AG) concerning arrangement of a EUR 1.2bn Eurobond issue programme and the first Eurobond issue, which is expected to take place in the first half of 2011. Proceeds from the issue will be used to finance PGNiG S.A's investment programme and its day-to-day operations.

In order to optimise liquidity management within the Group, on December 1st 2010 the Parent Undertaking executed a PLN 397.3m short-term note issue programme agreement with Bank Handlowy w Warszawie S.A. The agreement is effective until November 30th 2013. The note issue programme optimises liquidity management within the Group by providing for a flow of cash from the companies having excess liquidity to those seeking external financing. The first issue was carried out on December 22nd 2010. As at December 31st 2010, PGNiG S.A.'s debt under the notes in issue amounted to PLN 120m.

2.1. Current investments

In 2010, the Company invested its free cash in instruments carrying the lowest possible credit risk, i.e. treasury securities and bank deposits. Investments in debt securities issued by the State Treasury represented approximately 14% of the total transaction volume. The financial investments made in 2010 were current investments, with maturities of up to one month. This was consistent with PGNiG S.A.'s financial investment policy adopted by the Company's governing bodies and with the provisions of the Issue Prospectus.

2.2. Loan Agreements

In 2010, PGNiG S.A. entered into overdraft facility agreements for a total amount of PLN 280m. As at December 31st 2010, the Company reported no liabilities under these overdraft facility agreements. The table below presents loan agreements concluded by the Company in 2010.

Loan agreements concluded by PGNiG S.A.

Bank	Loan amount (PLNm)	Interest rate	Type	Maturity date
Bank Handlowy w Warszawie SA	40.0	1M WIBOR + 0.45%	working capital loan	Dec 30 2011
Bank Pekao S.A.	40.0	1M WIBOR + 0.80%	working capital loan	Jul 31 2011
PKO BP S.A.	40.0	1M WIBOR + 1.15%	working capital loan	Jul 13 2011
BRE BANK S.A.	40.0	O/N WIBOR + 0.85%	working capital loan	Sep 9 2011
Societe Generale S.A. Polish Branch	40.0	1M WIBOR + 0.40%	working capital loan	Aug 31 2011
ING Bank Śląski SA	40.0	1M WIBOR + 0.70%	working capital loan	Dec 6 2011
Bank Millennium S.A.	40.0	1M WIBOR + 0.50%	working capital loan	Dec 18 2011

In 2010, PGNiG S.A. did not terminate any loan agreements.

In 2010, PGNiG S.A. advanced loans only to its related undertakings. These loans totalled NOK 5,186.0m and PLN 56.5m. The loans denominated in NOK were granted chiefly to finance the purchase of interests in licences on the Norwegian Continental Shelf and investment expenditure on the Skarv and Gro projects, as well as to refinance the loan of October 16th 2007, advanced by PGNiG S.A. The PLN-denominated loans were granted to finance investment projects involving extension of gas pipelines and connection of new customers to the gas grid, upgrade the gas network, purchase of equity interests and day-to-day operations. The table below contains detailed information on the loans advanced by PGNiG S.A.

Loans advanced by PGNiG S.A.

Company	Loan amount (PLNm)	Currency	Interest rate	Type	Maturity date
PGNiG Norway AS	786.0	NOK	3M NIBOR + 2.20%	investment loan	Dec 31 2010
PGNiG Norway AS	4,400.0	NOK	3M NIBOR + 2.25%	investment loan	Dec 20 2021

INVESTGAS S.A.	9.0	PLN	1M WIBOR + 2.50%	investment loan	Aug 31 2015
Mazowiecka Spółka Gazownictwa Sp. z o.o.	40.3	PLN	3M WIBOR + 2.50%	investment loan	Aug 31 2020
PGNiG Jasło Sp. z o.o.	7.2	PLN	1M WIBOR + 1.70%	working capital loan	Dec 31 2011

In 2010, PGNiG S.A. did not contract or terminate any loans from entities other than banks.

2.3. Guarantees and Sureties

In 2010, PGNiG S.A. provided guarantees and sureties for a total amount of PLN 11m. A PLN 10m performance bond was provided to the Energy Regulatory Authority to ensure proper performance of a guarantee agreement (executed in connection a licence for power trading) by PGNiG Energia S.A.

In 2010, PGNiG S.A. received guarantees and sureties for a total amount of PLN 51.3m, of which 81% was attributable to 24 guarantees and sureties of more than PLN 500 thousand. The received guarantees and sureties were related to PGNiG Group's day-to-day operations, with most of them securing gas sales contracts.

2.4. Financial Risk Management

The main objective of PGNiG S.A.'s financial risk management policy is to limit the volatility of cash flows related to the Company's operations to levels which are acceptable in the short and mid term perspective and to build the company value in the long term. In 2010, PGNiG S.A. was exposed to a number of financial risks, and in particular to market risk (including commodity price, interest rate and currency risk) as well as liquidity and credit risk.

Market risk

PGNiG S.A. manages market risk by identifying, measuring, monitoring and limiting key risks, i.e. the adverse effect of changes in commodity prices and exchange and interest rates on the Company's financial performance.

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

In 2010, PGNiG S.A. used the following financial instruments to manage the gas price risk:
- purchase of Asian commodity call options with European settlement;
- commodity option structures (a combination of two commodity options);
- commodity swaps settled by reference to the average price of the commodity over the term of the transaction.

In order to mitigate its currency risk, the Company used the following financial instruments in 2010:
- forward contracts;
- purchase of currency call options;
- option structures (in most cases consisting in a combination of two currency options).

In addition, PGNiG S.A. used CCIRS (limiting the currency and interest rate risk) to hedge its exposure related to the loan advanced to PGNiG Norway AS.

Since April 1st 2009, the Company has used cash flow hedge accounting with respect to transactions hedging payments for gas, and since May 2010 - with respect to transactions hedging gas prices. The application of cash flow hedge accounting allows the Company to recognize the effective portion of the hedge in the revaluation 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 to achieve the offsetting effect in the income statement in one reporting period. In consequence, the economic and accounting effects of hedging are reflected in the same period.

Credit risk

The credit risk to which PGNiG S.A. is exposed is related to the potential failure by the Group's counterparties or other entities to meet their obligations towards the Company. In 2010, the Company managed its credit risk by entering into framework agreements with its counterparties (precisely defining the rights and obligations of the parties) and diversifying its counterparties. Furthermore, the key criteria for the selection of counterparties to whom the Company entrusted a portion of its assets included their financial standing as confirmed by rating agencies, as well as their market shares.

Cash flow disruption risk

The measures taken by PGNiG S.A. to mitigate the risk of disruptions in its day-to-day operational cash flow included diversification of electronic banking systems used, ongoing monitoring of credit/debit transactions in bank accounts, collecting information on cash flows within the Company, consolidating bank accounts and entering into overdraft facility agreements.

Liquidity risk

In order to mitigate its risk of loss of financial liquidity, in 2010 the Company executed an agreement providing for a PLN 3bn note issue programme, as well as a number of overdraft facility agreements. Moreover, PGNiG S.A. prepared cash flow projections at the Company and Group level, estimated the condition and the value of assets available for sale, maintained highly liquid financial assets and cooperated with rating agencies.

3. Projected Future Financial Performance

Factors of key importance to the financial performance of PGNiG S.A. will include crude oil prices on the international markets, situation on the foreign-exchange markets, and the position adopted by the President of the Energy Regulatory Office regarding gaseous fuel tariffs.

Crude oil and petroleum product prices have a significant effect on the Company's financial standing. Stability of the fuel market seen in 2010 was materially disturbed by the waves of public demonstrations spreading across North Africa. Following the outbreak of the conflict in Libya, prices of crude on the global markets soared to their highest level in the last two years. This dramatic rise in oil prices will become reflected in higher prices of imported gas in future periods.

The situation on currency markets is another factor with a material bearing on the financial results posted by PGNiG S.A. In 2010, the currency market was characterised by significant volatility and unpredictability. Appreciation of the dollar has been increasing the cost of high-methane gas imports. Given that the Company is not able to immediately transfer rapid USD/PLN exchange rate fluctuations onto its gas selling prices, it has sustained a loss on trading operations. Volatility of exchange rates will be significantly determining the financial performance of the PGNiG Group in the future.

On December 16th 2010, the President of the Energy Regulatory Office approved a new gaseous fuel tariff, applicable in settlements with customers from January 1st to March 31st 2011. In the new tariff, gas prices were reduced on average by 3.2%. The decision to change the tariff was related to the discount on natural gas supplies received from Gazprom Export. On February 11th 2011, the Company filed an application with the President of the Energy Regulatory Office requesting a rise in gaseous fuel prices. The requested increase of natural gas selling prices is justified by higher prices of crude oil on the global markets, to which the price of imported gas is correlated, as well as by the appreciation of the US dollar. The Company’s future margins on natural gas trading will substantially depend on the decision of the President of the Energy Regulatory Office.

External financing of the Company's operations in 2011 will be based on the PLN 3.0bn note issue programme to be implemented under the agreement concluded with six banks on June 10th 2010. The agreement is effective until July 31st 2013. Under the programme, PGNiG S.A. may issue discount and coupon notes with maturities ranging from one month to one year. Moreover, on September 17th 2010 PGNiG S.A. concluded a mandate agreement with three banks providing for the arrangement of a EUR 1.2bn Eurobond issue programme. The first Eurobond issue is expected to take place in the first half of 2011.

PGNiG S.A. intends to maintain a high level of capital expenditure on investments, including mainly investment projects designed to extend underground gas storage facilities, increase hydrocarbon production capacity and diversify gas supply sources, as well as on projects related to exploration for and appraisal of crude oil and natural gas reserves or building of the power segment.

Members of the Management Board

President of the Management Board	Michał Szubski	______________________
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	______________________