

DIRECTORS' REPORT  
ON PGNiG S.A.'S OPERATIONS  
IN H1 2008



Warsaw, September 1st 2008

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## Chapter I: General Information on the Company

### 1. Establishment of the Company

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with registered office in Warsaw, ul. Marcina Kasprzaka 25, was established as a result of transformation of the state-owned enterprise under the name Polskie Górnictwo Naftowe i Gazownictwo into a state-owned stock company. The Deed of Transformation, together with the Company's Articles of Association, were executed in the form of a notarial deed dated October 21st 1996 (Rep. A No. 18871/96).

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.

Currently, the Company's share capital amounts to PLN 5.9b and is divided into 5,900,000,000 shares.

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

### 2. Organisational Structure

PGNiG S.A. is the largest company in Poland dealing with exploration, production and trade in natural gas. PGNiG S.A. is the leader across all areas of the domestic gas sector, i.e. natural gas imports, exploration work, production of crude oil and natural gas, storage of gaseous fuels and sale of natural gas.

PGNiG S.A. has a number of branches. As at June 30th 2008, the organisational structure contained the Head Office and eight branches. The table below presents the core activities by individual units:

Branch	Core activity
Head Office, Warsaw	Corporate supervision Supervision over the PGNiG Group as part of ownership supervision
Odolanów Branch	Conversion of nitrogen-rich natural gas into high-methane gas
Sanok Branch	Production of natural gas and crude oil Maintenance of underground gas storage facilities Direct sale of off-system natural gas and other products and services Exploration
Zielona Góra Branch	Production of natural gas and crude oil Maintenance of underground gas storage facilities Direct sale of off-system natural gas and other products and services Exploration
Operating Branch in Pakistan	Exploration of and production from hydrocarbon deposits
Central Measurement and Research Lab, Warsaw	Provision of services to ensure accurate and reliable measurements related to natural gas
Trading Division, Warsaw	Sale of natural gas, crude oil and other products and services
Branch in Egypt	Exploration of and production from hydrocarbon deposits

Branch in Denmark	Exploration of and production from hydrocarbon deposits
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As at June 30th 2008, PGNiG S.A. had foreign representative offices in Moscow (Russia), Brussels (Belgium), Kiev (Ukraine), Vysokoye (Belarus) and Sanaa (Yemen).

The following branches and representative offices were established in H1 2008:

- Representative office in Yemen – on January 22nd 2008
- Branch in Denmark – on January 29th 2008.

The Branch in Libya was established on December 5th 2007 to obtain the right to conduct exploratory work on the licence block no. 113 in Libya. The branch was closed down on June 25th 2008, after POGC – Libya B.V. signed the licence agreement.

On August 1st 2008, the following six Gas Trading Divisions were established:

- Lower Silesian Gas Trading Division in Wrocław
- 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.

Pursuant to the decision of the Management Board of PGNiG S.A. of July 29th 2008, the Trading Division in Warsaw will be closed down by November 1st 2008.

### 3. Equity Links

PGNiG S.A. holds shares and equity interests in production and service companies. As at June 30th 2008, PGNiG S.A. had 42 related companies, of which:

- 27 were subsidiary companies
- 15 were other related companies.

Total par value of PGNiG S.A.'s equity interests in the related companies was PLN 7,210m as at June 30th 2008. The related companies of PGNiG S.A. are listed in the table below.

PGNiG S.A.'s related companies

	Company name	Share capital (PLN)	Shareholding of PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of the 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)*	497,327,000.00	497,327,000.00	100.00%	100.00%
9	Polish Oil and Gas Company – Libya B.V. (EUR)*	20,000.00	20,000.00	100.00%	100.00%
10	Polskie LNG Sp. z o.o.	50,000,000.00	50,000,000.00	100.00%	100.00%
11	INVESTGAS S.A.	502,250.00	502,250.00	100.00%	100.00%
12	Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o.	651,145,000.00	651,145,000.00	100.00%	100.00%
13	Górnolśląski Operator Systemu Dystrybucyjnego Sp. z o.o.	1,288,680,000.00	1,288,680,000.00	100.00%	100.00%
14	Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o.	1,476,112,000.00	1,476,112,000.00	100.00%	100.00%
15	Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o.	1,217,350,000.00	1,217,350,000.00	100.00%	100.00%
16	Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o.	596,141,000.00	596,141,000.00	100.00%	100.00%
17	Wielkopolski Operator Systemu Dystrybucyjnego Sp. z o.o.	978,287,000.00	978,287,000.00	100.00%	100.00%
18	B.S. i P.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
19	BUG Gazobudowa Sp. z o.o.	39,220,000.00	39,220,000.00	100.00%	100.00%
20	Zakład Urządzeń Naftowych Naftomet Sp. z o.o.	23,500,000.00	23,500,000.00	100.00%	100.00%
21	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%	100.00%
22	Budownictwo Naftowe Naftomontaż Sp. z o.o.	44,751,000.00	39,751,000.00	88.83%	88.83%
23	Górnictwo Naftowe Sp. z o.o.	50,000.00	50,000.00	100.00%	100.00%
24	NYSAGAZ Sp. z o.o.	3,700,000.00	1,887,000.00	51.00%	51.00%
25	ZRUG Sp. z o.o. (Pogórska Wola)	4,300,000.00	4,300,000.00	100.00%	100.00%
26	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%	100.00%
27	PPUiH TURGAZ Sp. z o.o.	176,000.00	90,000.00	51.14%	51.14%

PGNiG's related companies – continued

	Company name	Share capital (PLN)	Shareholding of PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of the total vote held by PGNiG S.A.
	Other related companies				
28	System Gazociągów Tranzytowych EUROPOL GAZ S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
29	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
30	InterTransGas GmbH (EUR)*	200,000.00	100,000.00	50.00%	50.00%
31	Polskie Elektrownie Gazowe Sp. z o.o. in liquidation	2,500,000.00	1,212,000.00	48.48%	48.48%
32	Dewon Z.S.A. (UAH)*	11,146,800.00	4,055,205.84	36.38%	36.38%
33	Przedsiębiorstwo Inwestycyjne GAZOTECH Sp. z o.o.	1,203,800.00	65,000.00	69.44%	46.30%
34	Sahara Petroleum Technology llc (RO)*	150,000.00	73,500.00	49.00%	49.00%
35	PFK GASKON S.A.	13,061,325.00	6,000,000.00	45.94%	45.94%
36	GAZOMONTAŻ S.A.	1,498,850.00	677,200.00	45.18%	45.18%
37	ZRUG Sp. z o.o. (Poznań)	3,781,800.00	1,515,000.00	40.06%	41.71%
38	ZWUG INTERGAZ Sp. z o.o.	4,700,000.00	1,800,000.00	38.30%	38.30%
39	ZRUG TORUŃ S.A.	4,150,000.00	1,300,000.00	31.33%	31.33%
40	TE-MA WOC Małaszewicze Terespol Sp. z o.o. in liquidation	262,300.00	55,000.00	20.97%	21.32%
41	H.S. Szczakowa S.A. in bankruptcy	16,334,989.44	5,439,494.72	33.30%	33.30%
42	TeNET 7 Sp. z o.o. in liquidation	50,000.00	5,000.00	10.00%	10.00%

\* Figures shown in foreign currencies.

## 4. Changes in Equity Interests

The following changes occurred in H1 2008:

- Share capital increase at Polskie LNG Sp. z o.o. by PLN 11,000,000, to PLN 50,000,000; the increase was registered with the National Court Register on January 7th 2008;
- Share capital increase at Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 286,531,000, to PLN 1,217,350,000; the increase was registered with the National Court Register on January 24th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 165,363,000, to PLN 1,476,112,000; the increase was registered with the National Court Register on February 12th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 93,391,000, to PLN 596,141,000; the increase was registered with the National Court Register on

February 29th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;

- Share capital increase at GEOFIZYKA Kraków Sp. z o.o. by PLN 30,000 thousand, to PLN 64,400 thousand; the increase was registered with the National Court Register on April 2nd 2008;
- Share capital increase at Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 104,697 thousand, to PLN 651,145 thousand; the increase was registered with the National Court Register on April 9th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Wielkopolski Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 131,128 thousand, to PLN 978,287 thousand; the increase was registered with the National Court Register on May 27th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at ZRUG Zabrze Sp. z o.o. by PLN 2,500 thousand to PLN 5,250 thousand; the increase in the company's share capital was registered with the National Court Register on May 29th 2008. PGNiG S.A. did not participate in the share capital increase and, consequently, the Company's share in the share capital of ZRUG Zabrze Sp. z o.o. decreased to 11.43%;
- Share capital increase at Górnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 91,366 thousand, to PLN 1,288,680 thousand; the increase was registered with the National Court Register on June 25th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Registration of amendments to the articles of association of PGNiG Finance B.V. (the Netherlands, February 4th 2008); under the amended articles of association, the company's name was changed to Polish Oil and Gas Company - Libya B.V. and its business profile was redefined;
- Deletion of ZRUG Warszawa S.A. (in liquidation) from the Register of Entrepreneurs on March 31st 2008 (PGNiG S.A.'s share in the share capital was 49%).

The following changes have occurred since June 30th 2008:

- Share capital increase at Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 18,555,000, to PLN 614,696,000; the increase was registered with the National Court Register on August 4th 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 8,841,000, to PLN 1,484,953,000; the increase was registered with the National Court Register on August 22nd 2008; the newly issued shares were acquired by PGNiG in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network.

#### Investments Outside PGNiG S.A.'s Related Companies

As at June 30th 2008, the total nominal value of PGNiG S.A.'s capital exposure outside PGNiG S.A.'s related companies was PLN 23.8m.

On June 18th 2008, the Management Board of Zakłady Azotowe w Tarnowie-Mościcach S.A. allotted to PGNiG S.A. 4,000,001 Series B shares with a par value of PLN 5.00 and the issue price of PLN 19.50 per share, representing 10.23% of the share capital of Zakłady Azotowe w Tarnowie-Mościcach S.A. The increase in the share capital of Zakłady Azotowe w Tarnowie-Mościcach S.A. was registered with the National Court Register on July 22nd 2008. The total value of the investment was PLN 78m.



## 5. Employment

The table below presents the employment as at June 30th 2008, by segments. PGNiG S.A.'s Head Office provides services to all segments. Accordingly, it is disclosed separately.

Employment by segments (no. of staff)

	No. of staff
Head Office	649
Exploration and Production	4,127
Trade and Storage	3,754
Other activities	35
<b>Total</b>	<b>8,565</b>

Since 2000, PGNiG S.A. has been implementing the "Programme of employment restructuring and employee protection measures for PGNiG S.A. branches and subsidiaries". The Programme has been extended until the end of 2008. In H1 2008, 193 persons were covered by the Restructuring Programme.

## 6. Sales and Supplies

PGNiG S.A. recorded sales revenue of PLN 9.3bn, with 94% of that figure derived from sales of natural gas.

Sales revenue (PLNm)

	Value
Natural gas, including:	8,707.9
- high-methane gas	7,951.1
- nitrogen-rich gas	756.8
Crude oil	447.4
Condensate	2.0
Helium	13.4
Propane-butane	21.3
Geophysical and geological services	26.2
Other sales	72.4
<b>Total</b>	<b>9,290.6</b>

In H1 2008, PGNiG S.A. sold 7.4bn m<sup>3</sup> of natural gas, with 96% of that figure accounted for by revenues from the transmission and distribution systems and the balance – by direct sales of natural gas from deposits.

Natural gas sales volume (million m<sup>3</sup>)

	Volume
Sales under tariff	7,106.3
Direct sales from deposits	330.9
Total	7,437.2

In H1 2008, the volume of natural gas acquired by PGNiG S.A. reached 7.5bn m<sup>3</sup>, with 72% of that amount sourced from imports, mostly from Russia and the Middle East. Natural gas production from domestic deposits represented 28% of the total volume acquired. The table below sets forth the structure of natural gas supplies measured as high-methane gas equivalent.

Natural gas supplies (million m<sup>3</sup>)

	Volume
Imports	5,407.5
Domestic production	2,114.5
Domestic suppliers	7.8
Total	7,529.8

## Chapter II: Governing Bodies of the Company

### 1. Management Board

As at January 1st 2008, the Management Board of PGNiG S.A. had the following composition:

- Krzysztof Głogowski – President
- Jan Anysz – Vice-President and Financial, HR and Restructuring Director
- Zenon Kuchciak – Vice-President and Trading Director
- Stanisław Niedbalec – Vice-President and Director of Investments and Technology
- Tadeusz Zwierzyński – Vice-President and Director of Strategic Projects.

On March 12th 2008, PGNiG S.A.'s Supervisory Board removed the following members from the Management Board of the Company:

- Krzysztof Głogowski
- Zenon Kuchciak
- Stanisław Niedbalec
- Tadeusz Zwierzyński.

On March 12th 2008, PGNiG S.A.'s Supervisory Board appointed the following members to the Management Board of the Company:

- Michał Szubski – as President
- Mirosław Dobrut – as Vice-President and Director of Investments and Technology
- Sławomir Hinc – as Vice-President and Financial and Economic Director
- Radosław Dudziński – as Vice-President and Director of Strategic Projects.

On March 20th 2008, the Supervisory Board of PGNiG S.A. removed Jan Anysz from the Management Board and appointed Mirosław Szkałuba as Vice-President of the Management Board.

As at June 30th 2008, the Management Board of PGNiG S.A. had the following composition:

- Michał Szubski – President
- Mirosław Dobrut – Vice-President and Director of Investments and Technology
- Sławomir Hinc – Vice-President and Financial and Economic Director
- Radosław Dudziński – Vice-President and Director of Strategic Projects
- Mirosław Szkałuba – Vice-President and HR and Restructuring Director.

### 2. Proxies

As at January 1st 2008, there were two Company proxies:

- Ewa Bernacik
- Bogusław Marzec.

On January 3rd 2008, the Management Board of PGNiG S.A. appointed Jan Czerepok, Waldemar Wójcik and Marek Dobryniewski as proxies. On March 17th 2008, the Management Board of PGNiG S.A. revoked the power of proxy granted to Jan Czerepok and on April 25th 2008 revoked the power

of proxy granted to Bogusław Marzec. On April 29th 2008, the Management Board of PGNiG S.A. appointed Stanisław Radecki as proxy.

As at June 30th 2008, there were four Company proxies:

- Ewa Bernacik
- Waldemar Wójcik
- Marek Dobryniewski
- Stanisław Radecki.

### 3. Supervisory Board

As at January 1st 2008, the Supervisory Board of PGNiG S.A. had the following composition:

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

On February 7th 2008, Mirosław Szałuba resigned from the Supervisory Board of PGNiG S.A.

On February 15th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. removed Piotr Szwarec, Jarosław Wojtowicz, Andrzej Rościszewski and Wojciech Arkuszewski from the Supervisory Board.

On February 15th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. appointed Stanisław Rychlicki and Grzegorz Banaszek to the Supervisory Board.

On April 28th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. removed Kazimierz Chrobak from the Supervisory Board, with effect as of April 29th 2008.

On April 28th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. appointed Agnieszka Chmielarz, Hubert Konarski, Jolanta Siergiej and Joanna Stuglik to the Supervisory Board, with effect as of April 30th 2008.

As at June 30th 2008, the Supervisory Board of PGNiG S.A. had the following composition:

- Stanisław Rychlicki – Chairman
- Marcin Moryń – Deputy Chairman
- Mieczysław Kawecki – Secretary
- Grzegorz Banaszek – Member
- Agnieszka Chmielarz – Member
- Hubert Konarski – Member
- Mieczysław Puławski – Member
- Jolanta Siergiej – Member
- Joanna Stuglik – Member.

## Chapter III: Tariff Policy

### 1. Licences

As a result of the legal separation of distribution and trade functions in mid 2007, the Company acquired by succession from the Gas Trading Companies six licences for trade in gaseous fuels, two licences for international trade in natural gas and one licence for trade in liquid fuels. With a view to maintaining the transparency of its operations, the Company requested the President of URE to harmonise the licences with PGNiG's new business conditions.

On February 18th and 19th 2008, the President of URE issued decisions in which he declared expiry of the licences for trade in gaseous fuels, granted to the six Gas Trading Companies and two licences for international trade in natural gas granted to Karpacka Spółka Obrotu Gazem Sp. z o.o. and Pomorska Spółka Obrotu Gazem Sp. z o.o., as a result of deletion of the Gas Trading Companies from relevant registers.

As at June 30th 2008, the Company held the following licences granted by the President of URE under the Energy Law:

- one licence for transmission and distribution of gaseous fuels,
- one licence for trade in gaseous fuels,
- one licence for international trade in natural gas,
- one licence for storage of gaseous fuels,
- two licences for trade in liquid fuels.

In H1 2008, the Ministry of Environment granted to PGNiG S.A. six licences for exploration and prospecting of crude oil and natural gas reserves and three licences for production of crude oil and natural gas from reserves. Nine licences for exploration and prospecting of crude oil and natural gas reserves were extended. One licence for production of crude oil and natural gas from reserves and one licence for underground gas storage expired. No changes in the number and terms of the licences for waste matter storage occurred in the period under review.

As at June 30th 2008, the Company held the following licences granted under the Geological and Mining Law:

- 73 licences for exploration and prospecting of crude oil and natural gas reserves,
- 215 licences for production of crude oil and natural gas from reserves,
- 7 licences for underground gas storage,
- 4 licences for waste matter storage.

### 2. Changes in PGNiG S.A.'s Tariffs

On March 28th 2008, the President of URE issued a decision whereby PGNiG S.A. was released from the obligation to submit for approval tariffs for compressed natural gas, used as fuel in motor vehicles.

Until April 24th 2008, settlements with customers were made according to Tariff No. 4 for Gaseous Fuels approved by the President of URE on March 17th 2006.

On November 15th 2007, PGNiG S.A. applied to the President of URE for approval of the Gaseous Fuel Tariff No. 1/2008 of Polskie Górnictwo Naftowe i Gazownictwo S.A. for the period from January

1st 2008 to March 31st 2008. On February 20th 2008, the Regulation of the Minister of Economy and Labour on detailed rules for preparing and calculating tariffs for gaseous fuels and on settlements in gaseous fuels trade (Dz.U. of February 20th 2008, No. 28, item 165) became effective, which necessitated changes in the application. On February 20th 2008, the Company amended the application in order to bring it to compliance with the new Tariff regulation.

Under his decision of April 10th 2008, the President of URE approved the Gaseous Fuel Tariff No. 1/2008, in effect from April 25th 2008. The tariff provides for:

- the prices, subscription fees and network rates applicable to settlements with customers receiving gaseous fuels from the transmission grid,
- the prices, subscription fees and network rates applicable to settlements with customers receiving gaseous fuels from distribution networks.

The table below sets forth the prices and rates applied in settlements with customers receiving gaseous fuels from the transmission grid.

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m <sup>3</sup> ]	[PLN/month]
E1A-E4B	0.8983	600.00
Ls1-Ls4	0.5693	600.00
Lw1-Lw4	0.6645	600.00

The tables below set forth the prices and rates applied in settlements with customers receiving gaseous fuels from the distribution network, by tariff groups.

- High-methane natural gas (E groups)

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m <sup>3</sup> ]	[PLN/month]
W-1	0.9500	4.30
W-2	0.9350	6.40
W-3	0.9215	7.10
W-4	0.9160	18.00
W-5	0.9100	110.00
W-6	0.9011	130.00
W-6A	0.9011	130.00
W-6B	0.9011	130.00
W-7	0.8993	270.00
W-7A	0.8993	270.00
W-7B	0.8993	270.00
W-8	0.8988	600.00
W-9	0.8988	600.00
W-10	0.8988	600.00

- Nitrogen-rich natural gas (Ls subgroups)

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m <sup>3</sup> ]	[PLN/month]
Z-1	0.6025	4.30
Z-2	0.5930	6.40
Z-3	0.5840	7.10
Z-4	0.5810	18.00
Z-5	0.5770	110.00
Z-6	0.5710	130.00
Z-7	0.5699	270.00
Z-7A	0.5699	270.00
Z-7B	0.5699	270.00
Z-8	0.5695	600.00
Z-9	0.5695	600.00

- Nitrogen-rich natural gas (Lw subgroups)

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m <sup>3</sup> ]	[PLN/month]
S-1	0.7030	4.30
S-2	0.6920	6.40
S-3	0.6820	7.10
S-4	0.6780	18.00
S-5	0.6740	110.00
S-6	0.6670	130.00
S-7	0.6657	270.00
S-7A	0.6657	270.00
S-7B	0.6657	270.00
S-8	0.6653	600.00
S-9	0.6653	600.00

The introduction of network rates is a material modification in the tariff. These rates are calculated based on fixed and variable costs incurred in connection with the Company's contracting services for gas transmission, distribution, storage and liquefying, and liquefied natural gas regasification, as well as costs of storage in the Company's own facilities and cost of system balancing and system limitation management.

Moreover, the tariff defines the manner for determination of the charge for exceeding the contractual capacity and of the discount for failure to maintain quality parameters for gaseous fuels and quality standards in customer service.

PGNiG S.A.'s tariff is applied in gaseous fuel supplies under such comprehensive agreements or gaseous fuel sale agreements concluded prior to the tariff effective date, whose performance requires PGNiG S.A. to mandate a third party to transport gaseous fuel over the transmission grid or a distribution network, or to use storage facilities. Under a comprehensive agreement, PGNiG S.A. undertakes not only to sell gaseous fuel to customers but also to ensure its delivery to the delivery point specified by the customer.

On August 12th 2008, PGNiG S.A. applied to the President of URE for approval of an amendment to Gaseous Fuel Tariff No. 1/2008 necessitated by PGNiG's changed business conditions, namely the increase in gas acquisition cost above the level assumed for the calculation of prices in the approved tariff; and for adjustment of the wording of the tariff. The adjustment is intended to ensure harmonisation of the provisions of Gaseous Fuel Tariff No. 1/2008 with provisions of the tariffs of the Transmission System Operator and Distribution System Operators. Until at the date of this Report, the President of URE has not issued any decision in this respect.



### 3. Tariff-Related Risks

#### Regulatory Risk

The key tariff risk relates to the inadequacy of secondary legislation with regard to the current legal acts concerning the Polish gas market. Such a situation occurred at the turn of 2007, when the lack of a Tariff regulation amended in accord with the amended Polish Energy Law delayed the proceedings related to the approval of the Gaseous Fuel Tariff. The Minister of Economy signed the tariff regulation as late as in February 2008. However, another regulation, crucial for the operation of the gas market and outlining detailed terms of the gas system operation (system regulation), is being drafted.

In 2008, further amendments may be made to the legal acts regulating operation of the gas sector. These amendments will be made, first and foremost, to the Polish Energy Law. Once the amended Law becomes effective, the tariff regulation will need to be amended.

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

#### Calculation Risk

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

#### Forecasting Risk

The current methodology for 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 those forecast).

#### Market Risk

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. The market of crude oil and petroleum products has recently been to a large extent unpredictable, given the continual price changes. These material changes in fuel prices on the international 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 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.

#### Risk of Competition

In recent years, the increase in prices of fuels on global markets has led to increased interest in exploration activities. There is a risk of competition from other companies active on the Polish market seeking licenses for exploration and prospecting of deposits or the implementation of a strategy providing for acquiring access to own hydrocarbon reserves. At present, competition in the domestic market is limited. However, after having been granted relevant licenses, PGNiG S.A.'s competitors will enter the Polish market. A strong competitive edge may be gained especially by large companies which enjoy established positions on the international markets and have access to much greater financial resources compared with PGNiG S.A., helping them to accept the high risk of exploration activities in Poland.

## Chapter IV: Exploration and Production

### 1. Exploration

In H1 2008, PGNiG S.A. conducted exploration and prospecting work in the Carpathian Foreland and Polish Lowlands. Drilling work covered 20 boreholes, including 14 exploratory boreholes and six prospecting boreholes (drilling work on six boreholes started in 2007). By the end of June 2008, drilling was completed on 15 boreholes (of which 10 were exploratory boreholes and 5 were prospecting boreholes). A total of 30,281 m of drillings were made.

From among the 15 boreholes with known deposit-related results, six (five gas boreholes and one crude oil borehole) were classified as positive, while nine other boreholes were classified as negative. The gas boreholes are located in the Carpathian Foreland while the oil borehole is in the Polish Lowlands.

A total of PLN 234.5m was spent on the exploratory and prospecting work in H1 2008.

Producible reserves of natural gas increased by 945 m<sup>3</sup> high-methane equivalent. The size of the reserves was favourably assessed by the Mineral Reserves Commission and accepted by the Minister of Environment.

In H1 2008, PGNiG S.A. conducted geophysical research in the following locations:

- the Carpathian Foreland and Polish Lowlands, where a total of 410 km 2D seismic field works were performed,
- the Polish Lowlands, where 3D seismic field works were performed on an area of 273.8 km<sup>2</sup>.

#### Joint Ventures in Poland

In H1 2008, PGNiG S.A. continued cooperation with FX Energy Poland Sp. z o.o. in the following areas:

- "Płotki" – under the Agreement for Joint Operations dated May 12th 2000, as amended;
- "Płotki" – "PTZ" (the Extended Zaniemyśl Area) – under the Operating Agreement of Mining Users dated October 26th 2005;
- "Poznań" – under the Agreement for Joint Operations dated June 1st 2005;
- Block 255 – under the Agreement for Joint Operations dated October 29th 1999.

Under the Agreement on Settlement of Payments for Natural Gas Produced from the Klęka-11 Borehole, PGNiG extracted gas from the Klęka deposit. Additionally, the reprocessing and reinterpretation of seismic data were continued in the "Płotki" area. Furthermore, productivity was measured and the open hole tests were carried out on the Roszków-1 borehole (drilled in 2007). In H1 2008, the Roszków gas deposit, with producible reserves of 0.9bn m<sup>3</sup>, was documented.

In H1 2008, PGNiG continued production of gas from the Zaniemyśl natural gas deposit in the "Płotki" – "PTZ" area and from the Wilga (Block 255) deposit.

Exploratory boreholes Grundy-2, Kromolice-1 and Środa Wielkopolska-6 have been being drilled on the "Poznań" area since the beginning of 2008. In H1 2008, 3D seismics were made in the Kórnik-Środa Wielkopolska area. Additionally, previous seismics were reprocessed and interpreted to identify new sites where drilling work can be performed in 2008 and the following years.

In H1 2008, PGNiG S.A., in cooperation with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o., conducted studies and geological and geophysical surveys to identify sites within the "Bieszczady" area where hydrocarbon reserves may be explored and prospected. The licences and mining usage right with respect to exploration and prospecting of crude oil and natural gas deposits in that area are held by the operator, i.e. PGNiG S.A.

#### Exploratory Work Abroad

PGNiG S.A. conducts exploratory work in Pakistan under an agreement between PGNiG S.A. and the Pakistani government dated May 18th 2005, concerning exploration and production of hydrocarbons in the area covered by the Kirthar licence. Exploratory work in the Kirthar block area is conducted in cooperation with Pakistan Petroleum Ltd. (interests/project cost participation: PGNiG S.A. – 70%; PPL – 30 %). Based on the results of geological and geophysical studies, it was decided to drill the first exploration borehole. The drilling work is due to start at the end of 2008.

On December 6th 2007, PGNiG S.A. executed an agreement concerning assignment of an interest in the 1/05 exploration and production licence in Denmark and took over the operator functions. Interests held in the license: PGNiG S.A. – 40%, Odin Energi A/S – 40%, Nordsofonden – 20%. On April 5th 2008, by virtue of the decision of the Danish Energy Agency, the licence was extended until October 5th 2009, contingent on performing a 3D seismic shot covering an area of not less than 50 km<sup>2</sup>. In 2008, 48 km of 2D seismics has been reprocessed; additionally, there are also plans to reprocess approx. 1,000 km of 2D seismics with a view to locating the 3D shot.

In 2007, PGNiG S.A. won a tender for the Bahariya exploration and production license (Block 3) in Egypt. The licence covers an area of 4,414.4 km<sup>2</sup>. In July 2007, the Production Sharing Agreement was initialled. Following the ratification of the PSA, PGNiG S.A. plans to perform reprocessing activities and carry out 1,450 km 2D of seismic surveys.

In 2007, PGNiG S.A. won a tender for provision of operating services and obtained the right to carry out exploration on the exploration and production under the exploration and production licence no. 113 located in the Murzuq petroleum basin (western Libya). On February 4th 2008, PGNiG Finance B.V. was transformed into Polish Oil and Gas Company Libya B.V. for the purposes of the project execution in Libya. The company obtained a performance bond from PGNiG S.A. securing the performance of its licence obligations. On February 25th 2008, POGC-Libya B.V. signed the Exploration and Production Sharing Agreement (EPSA) with state-owned Libyan company National Oil Corporation.

In February 2008, PGNiG S.A. signed a letter of intent with Iranian Offshore Oil Company (IOOC) for development of the Lavan gas and condensate deposit.

## 2. Production

Two of PGNiG S.A.'s branches, the Zielona Góra Branch and the Sanok Branch, carry out production of natural gas and crude oil in Poland. As a result of a merger, the Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 21 mines (including 12 gas mines, and 9 oil and gas mines), while the Sanok Branch produces high-methane natural gas and crude oil at 47 mines (including 25 gas mines, and 22 oil mines and oil and gas mines).

In H1 2008, PGNiG S.A. produced a total of 2,114.5m<sup>3</sup> of natural gas (high-methane equivalent) – 1,221.7m<sup>3</sup> was produced by the Zielona Góra Branch, and 892.8m<sup>3</sup> by the Sanok Branch. Total production of crude oil was 249.5 thousand tones in H1 2008. The table below sets forth PGNiG S.A.'s production in H1 2008:

Production structure

Product		Unit	Quantity
1.	Natural gas	million m <sup>3</sup> *	2,114.5
2.	Crude oil	thousand tonnes	249.5
3.	Condensate	thousand tonnes	5.1
4.	Sulphur	thousand tonnes	10.8
5.	Propane-butane	thousand tonnes	8.6
6.	Helium	million m <sup>3</sup>	1.2
7.	LNG	million m <sup>3</sup> *	10.3

\* High-methane equivalent

In H1 2008, a total of four boreholes were put in operation in the Sanok Branch area (Tarnów-81 k, Rzeszów-9, Miocin-62g,d, Wierzchosławice-5); in the case of the Zielona Góra Branch, two new boreholes were commissioned (BU-101 H and Sławoborze-1). The new boreholes increased the natural gas production capacity by ca. 260 m<sup>3</sup>/min.

In H1 2008, PGNiG S.A. conducted a number of projects aiming to increase natural gas and crude oil production and maintain the current level of production. In order to achieve hydrocarbon production from the existing fields, 5,647 m of operational drill holes were performed in the following fields: Radlin, Sędziszów, Dzieduszyce and Cierpisz. With a view to limiting the natural decline in production, 24 non-producing boreholes were overhauled (14 overhauls were completed).

In connection with a pressure decrease at interconnector terminal points on the reserves in Palikówka and Kuryłówka, it was necessary to install compressors. Increasing gas pressure to an adequate level will be instrumental in maintaining the level of production and transfer of natural gas to the transmission system. There are plans to install two more compressors on the Jodłówka reserve.

In H1 2008, the exploration and production segment was engaged in off-tariff sale of natural gas, as well as sale of crude oil and other products. The table below sets forth sales of the key products to third parties by volume:

Sales of the key products

Unit	Quantity	
Natural gas	million m <sup>3</sup>	330.9
Crude oil	thousand tonnes	257.7
Condensate	thousand tonnes	0.6
Helium	million m <sup>3</sup>	1.1
LPG	thousand tonnes	8.7
Nitrogen	thousand kilos	624.9
Sulphur	thousand tonnes	10.9

The segment uses underground gas reserves. The chief objective of underground gas storage is to balance the differences between the demand for natural gas in the winter and summer seasons. Besides, the underground storage facilities enable optimum production from domestic deposits during the year and provide tools for rational management of natural gas reserves.

### 3. Investment Projects

In H1 2008, PGNiG S.A. carried out several investment projects in the exploration and production segment, the most important of which are described below.

#### Lubiatów-Międzychód-Grotów Project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów reserves of crude oil and natural gas and to facilitate transport, storage and sale of crude oil, natural gas, liquid sulphur and propane-butane mixture from the LMG Crude Oil and Natural Gas Mine. 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 to support collection and shipment of crude oil in rail tank cars and handle the pumping of crude oil collected from the LMG Crude Oil and Natural Gas Mine to the PERN Druzhba Pipeline,
- construction of a gas pipeline to the Denitrating Plant in Grodzisk to support the transmission of surplus gas from the LMG Mine to Grodzisk Denitrating Plant.

In June 2008, the tender to select the contractor for the LMG project was successfully concluded with the selection of a bid with the price of PLN 1.4bn submitted by a consortium comprising PBG S.A. (Poland), KTI S.P.A. (Italy) and Thermo Design Engineering Ltd. (Canada). The total value of the project is estimated at approx. PLN 1.6bn.

#### Grodzisk Project

The objective of this project is to support the sale of gas from nitrogen-rich reserves after the gas has been treated (cryogenic denitrating of nitrogen-rich gas) to the parameters of high-methane gas. The Grodzisk Denitrating Plant is constructed with a view to increasing nitrogen-high gas production volume at the existing mines and from reserves earmarked for development.

The project provides for the development of the Wielichowo, Ruchocice and Paproć W reserves, connection of the Elżbieciny and Jabłonna boreholes, development of the Nowy Tomyśl 2k borehole, modernisation of the Paproć Natural Gas Mine (KGZ Paproć), construction of the Przylęk-KGZ Paproć gas pipeline network and construction of the Grodzisk Denitrating Plant. The total capacity of the Denitrating Plant will stand at around 35,000 m<sup>3</sup>/h. Following the revaluation of the expenditure on one of the investment tasks, the total value of the project is estimated at PLN 440m.

#### Gas Pipeline to KGHM

The project involves the construction of a high-pressure gas pipeline and optic-fibre cable along with infrastructure, from the Kościan Natural Gas Mine (KGZ Kościan) to KGHM Polkowice/Żukowice, in order to enable the Company to sell natural gas directly to KGHM Polkowice/Żukowice. The total cost of the project is estimated at approx. PLN 220m.

#### Barnówko-Mostno-Buszewo Project

The objective of the project is to develop new reserves and to drill production boreholes on the BMB (Barnówko-Mostno-Buszewo) reserve. The investment is carried out in order to maintain crude oil production at the already exploited reserves on current levels and to ensure incremental extraction volumes following the incorporation of new reserves. The Company plans to complete the drilling of production boreholes in 2008. The total expenditure on this investment project amounts to PLN 120m.

In H1 2008 work was also in progress on the construction of new and extension of existing underground gas storage facilities, development of reserves and boreholes as well as upgrade and extension of natural gas mines.

## 4. Planned Exploratory Work

### Exploratory Work in Poland

In 2008, exploratory work is planned mainly in the following regions of southern and western Poland:

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

### Exploratory Work Abroad

In H1 2008, PGNiG S.A. took a number of steps to acquire new sites for exploration and new licence areas in such countries as Algeria, Iraq, Morocco and Tunisia. All these efforts will be continued in 2008. Furthermore, PGNiG S.A. plans to press ahead with the exploratory work in the licence areas in Pakistan and Denmark.

### Natural Gas Production

PGNiG S.A. is following an investment programme aimed at increasing, in a longer perspective, the natural gas production capacity. As part of the programme, the Company plans to develop new reserves and boreholes, modernise and expand the existing natural gas mines, and build new underground gas storage facilities and expand the existing ones. Moreover, PGNiG will take steps to maintain the volume of hydrocarbons production from fields already in use at the current levels.

In 2008, the Company envisages to commence production in ten boreholes (Kowale-2; Luchów-1, 3; Cierpisz-2, 3, 4; Wola Różaniecka- 2, 12, 14, 16), whose aggregate production capacity amounts to approximately 196 m<sup>3</sup>/min. By 2010, PGNiG S.A. plans to develop 20 reserves through the Sanok Branch and 10 through the Zielona Góra Branch.

2010 is to see completion of the construction of the Grodzisk Nitrogen-Removal Plant, with the annual throughput capacity of feedstock gas amounting to 500m m<sup>3</sup>. The project provides for development of the reserves located in the Nowy Tomyśl-Grodzisk region and of the gas extracted from the Lubiatów-Międzychód-Grotów (LMG) reserves, as well as the construction of a second controller, besides the Odolanów Branch, connecting the system for extraction of nitrogen-rich gas to the high-methane gas transmission network.

The current forecast assumes that the natural gas production volume will reach approx. 4.2bn m<sup>3</sup> in 2008 and approx. 4.6bn m<sup>3</sup> in 2009. The decrease in natural gas production, relative to previous forecast, is primarily due to drilling in increasingly difficult geological and mining conditions. Moreover, in H1 2008 we reported failure of two gas compressor stations in the gas transmission system operated by OGP GAZ-SYSTEM S.A., a process stoppage in gas collection by one of the customers of the Sanok Branch, and delayed supply of field compressors.

#### Crude Oil Production

Development of the Lubiatów-Międzychód-Grotów (LMG) reserve and intensified production from the Barnówko-Mostno-Buszewo (BMB) reserve are two projects aimed at increasing PGNiG's crude oil production output. The Company will seek to intensify production from the BMB reserve, which will include development of five production boreholes. In 2008, crude oil production is forecast to reach 509 thousand tonnes. A significant increase in crude oil production is expected in 2013, when the LMG reserve is developed and placed in operation, and is to amount to approx. 0.9m tonnes annually.

## 5. Risks Related to Exploration and Production

#### Resource Discoveries and Estimates

The main risk inherent in exploration activity is the risk of reserve discovery, i.e. the exploratory risk. This means that not all the identified potential reserve sites have sufficient deposits of hydrocarbons. Whether or not such deposits exist depends on a number of geological factors. Furthermore, the actual quantity and quality of the accumulated hydrocarbons may differ from expected. When the results of successful exploration activity, in the form of documented new reserves, do not offset the production from the existing deposits, PGNiG S.A.'s documented producible reserves will decrease pro rata to the current production volumes.

A number of the factors and assumptions adopted when determining the extent of resources and production projections may turn out erroneous due to flaws in the methods and measurement equipment used in the geophysical surveys, drilling and production testing. Data on economically viable producible reserves of crude oil and natural gas is actually estimated and the actual production, income and expenses relating to a given deposit may significantly differ from the estimates. The weight of this risk is further increased by the fact that the full business cycle from the commencement of exploration to the launch of production from a developed field lasts six to eight years, while the hydrocarbon production cycle lasts from 10 to 40 years. Deposit parameters established in the course of preparing the relevant documentation are reviewed upon deposit development. Each downgrade of the extent of the resources, the extraction schedule or financial figures may lead to a lower revenue and adversely impact PGNiG S.A.'s financial performance.

#### 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 and prospecting of deposits or implementation of a strategy providing for acquiring access to own hydrocarbon reserves. In the light of the growing global interest in new exploration and economic expansion areas this risk appears to be high. 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 offers and be able to acquire promising licences. Competitors are also able to define, value, offer and purchase numbers of fields (including the operation thereof and underlying licences) larger than it would be possible in the case of PGNiG S.A., given its financial and human resources. This competitive edge of other market players is particularly important on the international market.



### Delayed Work

Under the currently binding Polish legal regulations, obtaining a licence for exploration and prospecting 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 winning bid is awarded in a tender for licence until the relevant contract is ratified. Moreover, prior to the commencement of field work, the Company is obliged to arrange for numerous formalities, 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 for a work contractor. Under the currently binding legal regulations, another several months pass before an agreement with the work 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 exploratory work.

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

- local governments' failure to adopt local land development plans (MPZPs)
- obstacles in incorporating investment projects into the MPZPs
- need to obtain and comply with administrative or other formal and legal decisions, 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 Exploratory Work

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

### Legal Regulations Concerning Safety, Environmental Protection and Health

Ensuring compliance with environmental law in Poland and abroad might significantly increase PGNiG S.A.'s costs of operations. Currently, PGNiG S.A. incurs significant capital expenditure and costs on harmonising its operations with ever more complex and stringent legal regulations concerning safety and health at work, as well as environmental protection. Act of May 18th 2005 amending the Natural Environment Protection Law and certain other acts (Dz.U. No. 113, item 954 of June 27th 2005) rendered the regulations governing the execution of projects which might affect the Nature 2000 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 clear also in other countries where PGNiG S.A. conducts exploratory activity.

### Qualified Personnel

The presence of foreign companies on the Polish market intensified the companies' takeover of highly qualified employees with vast professional experience. This risk is especially high with respect to professionals specialised in the exploration of natural gas and crude oil deposits. In countries where PGNiG S.A. operates highly qualified staff is difficult to recruit.

### Unpredictable Events

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

### Changes in Legal Regulations

The legal regulations in some countries change frequently and unexpectedly, causing problems to entities conducting exploratory activity. This may be a particular threat in countries where law changes depend on the decisions of authoritarian governments.

### Political and Economic Situation

Some countries where PGNiG S.A. carries out exploratory activity face the risk of armed conflicts or terrorist attacks, which may result in limitation, suspension or discontinuation of the exploration and production business there.

In some areas of PGNiG S.A.'s operations 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 activity related to oil. Additionally, these countries are at risk of internal conflicts and social unrest caused by poor social and demographic conditions in which the inhabitants of these countries live. The risks specified above may lead to limitation, suspension or discontinuation of the Company's operations.

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

## Chapter V: Trade and Storage

### 1. Structure of Sales and Purchases

The key products sold by this segment are methane-rich natural gas and nitrogen-rich gas. The sales structure of PGNiG S.A. in H1 2008 is presented in the table below.

Sales structure of key products

	Product	Unit	Quantity
1	Natural gas, including:	million m <sup>3</sup>	7,106.3
	- methane-rich gas	million m <sup>3</sup>	6,646.2
	- nitrogen-rich gas*	million m <sup>3</sup>	460.2
2	Propane-butane	thousand tonnes.	1.0

\* Million m<sup>3</sup> measured as methane-rich gas equivalent

PGNiG S.A.'s main customers who purchased natural gas included chemicals sector, the steel industry and the power sector, as well as households. The table below presents the structure of natural gas sales measured as methane-rich gas equivalent broken down by major customers.

Sales of natural gas supplied via the transmission system (million m<sup>3</sup>)

	Sales	Quantity	%
1.	Industrial customers	4,243.0	59.7%
2.	Trade and services	806.3	11.4%
3.	Households	1,970.7	27.7%
4.	Wholesale customers	66.9	0.9%
5.	Exports	19.4	0.3%
	Total	7,106.3	100.0%

Households make up the largest group of customers purchasing natural gas, accounting for 97% of the entire customer base of PGNiG S.A. (approx. 6.3m). Their share in the sales volume is 28%. The most prominent share in the natural gas sales was claimed by industrial customers (60%).

In H1 2008, PGNiG S.A. derived natural gas from imports and, to a limited extent, from domestic suppliers. Natural gas was primarily sourced from the East, i.e. from Russia and Central Asia. The table below presents the natural gas supply structure measured as methane-rich gas equivalent.

Structure of natural gas supplies by supply sources (million m<sup>3</sup>)

Gas supplies		Quantity	%
1.	Imports, including:	5,407.5	99.9%
	- OOO Gazprom eksport	3,896.9	72.1%
	- ROSUKRENERGO AG	1,093.3	20.2%
	- Other foreign suppliers	417.3	7.7%
2.	Domestic suppliers	7.8	0.1%
Total:		5,415.3	100.0%

## 2. Major Commercial Agreements

### Purchase Agreements

In H1 2008, PGNiG S.A. imported natural gas mainly under the agreements and contracts specified below, i.e. the long-term contracts for imports from OOO "Gazprom Eksport" and VNG-Verbundnetz Gas AG, as well as medium-term contracts for supplies from ROSUKRENERGO AG and VNG-Verbundnetz GAS AG/ E.ON Ruhrgas AG:

- Contract for sales of Russian natural gas to the Republic of Poland, executed with OOO "Gazprom Eksport", dated September 25th 1996, which will remain in force until 2022;
- Agreement on sales 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 sales of natural gas executed with VNG-Verbundnetz GAS AG/E.ON Ruhrgas AG, dated September 15th 2004, which will remain in force until September 30th 2008;
- Agreement on sales of natural gas executed with ROSUKRENERGO AG, dated November 17th 2006, which will remain in force until January 1st 2010 and may be extended until January 1st 2012.

### Sale Agreements

In H1 2008, PGNiG S.A. signed comprehensive agreements for supply of gaseous fuel, from both transmission and distribution systems, to 33.6 thousand new customers, of which the majority are households (32.9 thousand).

The Company also executed agreements for the supply of crude oil to refineries of the Orlen Group, including Rafineria Trzebinia S.A. and Rafineria Nafty Jedlicze S.A. As far as supplies via pipelines are concerned, the agreement concluded with BP International for the sale of crude oil abroad was replaced with an agreement with TOTSA TOTAL OIL TRADING S.A. The terms of export sales of crude oil remain unchanged.

## 3. Underground Storage Facilities

The segment uses a part of the capacities of underground storage facilities for its own purposes. Short-term fluctuations in the demand for natural gas are balanced out with the supplies from the Underground Gas Storage Cavern Facility Mogilno located in worked-out salt caverns, which is operating at full capacity. The capacities of the Underground Storage Facility Wierchowice and the Underground Storage Facility Husów are used to minimise the effect of an uneven demand for natural gas in 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 Underground Storage Facility Wierchowice, Underground Storage Facility Husów and the Underground Gas Storage Cavern Facility Mogilno help PGNiG comply with the 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.

## 4. Activities Planned in the Trading Segment

### LNG Terminal

In H2 2008, PGNiG S.A. will continue work on the sourcing of LNG by concluding a long-term contract for LNG supplies.

### The Baltic Pipe Project

The objective of the project is to create a direct pipeline for the supply of natural gas from Denmark to Poland and also, in the future, from Poland to Denmark.

In H1 2008, pursuant to a cooperation agreement executed by PGNiG S.A., OGP GAZ-SYSTEM S.A. and Energinet.dk on November 15th 2007, the parties jointly conducted technical analyses and worked on the detailed arrangements relating to the execution of the Baltic Pipe project. To date, the technical analyses focused on the agreement on the different scenarios concerning technical capabilities of natural gas transmission in the subsequent years of project execution, taking into account the necessary extension of the Danish and Polish transmission systems.

Currently, the Baltic Pipe project has entered the stage of preparations for its execution. According to the project schedule, the gas pipeline is to be placed in operation in 2013, with a target throughput within the range of 3bn m<sup>3</sup> *pa*. Under the various scenarios, the length of the pipeline varies from 260 to 290 km. The gas pipeline is to run through the Danish and Polish territorial waters, however, its largest section is to be located in the waters of the Polish, Danish, Swedish or German exclusive economic zones. According to the current concept, OGP GAZ-SYSTEM S.A. is to take responsibility for the execution of the Baltic Pipe project going forward. The handing over of the project is in progress.

### The Skanled Project

In 2007, PGNiG S.A. joined the consortium established for the purpose of construction of the Skanled gas pipeline which is designed to connect a gas terminal on the Norwegian Continental Shelf with Sweden and Denmark. PGNiG S.A. acquired a 15% stake in the project and became one of its 15 shareholders. The investment is executed by Gassco, a Norwegian operator of off-shore gas pipelines. In January 2008, the Skanled Consortium approved the technical changes in the design, consisting primarily in the increase of the pipeline diameter in order to raise its throughput. On April 17th 2008, the members of the Consortium resolved to commence the pre-design stage of the project and concurrently approved the changes to the technical concept of the network proposed by Gassco, which increased the estimated cost of the project. The investment decision is planned to be made in October 2009. According to the project schedule, the Skanled gas pipeline is to be placed in operation in 2013.

Concurrently, PGNiG S.A. is working on the transfer of its stake in the Skanled Project to its Norwegian subsidiary, PGNiG Norway AS.

### Natural Gas Purchase

PGNiG S.A. does not plan to introduce any changes in the structure of supply sources in 2008, or to make any changes to the effective natural gas purchase agreements. Steps are being undertaken to ensure gas supplies in connection with the expiry, on September 30th 2008, of the gas sale agreement executed with VNG-Verbundnetz Gas AG/ E.ON Ruhrgas AG dated September 15th 2004.

### Natural Gas Sales

The projected rise in the natural gas sales volume is attributable to development investments of PGNiG S.A.'s strategic customers in the petrochemical, construction and steel sectors. In 2007, PGNiG S.A. established cooperation on possible gaseous fuel supplies with several major prospective customers, including companies operating in the power sector and planning to replace hard coal fired generating units with gas fired ones. In addition, the forecast increase in natural gas sales volume to customers from the petrochemical, construction and power sectors is further attributable to the favourable market conditions in these sectors, encouraging such customers to invest in gradual expansion of their capacities, which is reflected in their higher demand for natural gas.

## 5. Trade- and Storage-Related Risks

### High Natural Gas Prices

The major risk factor posing a threat to gas market growth is a high price of natural gas. Pursuant to the medium- and long-term import contracts to which PGNiG S.A. is a party, prices of natural gas are computed in accordance with pricing formulas based primarily on crude oil derivatives whose prices are closely linked to the quoted prices of crude oil. In H1 2008, the price of crude oil in global exchanges rose significantly. In spite of the present decrease in crude oil prices, the prices of natural gas may remain high throughout H2 2008 on account of the effect of the H1 2008 surge in crude oil prices on the average reference period applied to purchase formulas, and the weaker zloty exchange rate against the dollar.

### Competition

At present, PGNiG S.A. is the largest supplier of natural gas in Poland. The Company's share in the gas market is approx. 98%, the remaining 2% is represented by suppliers from outside the PGNiG Group which usually purchase gas from PGNiG S.A. Suppliers from outside the PGNiG Group which trade in natural gas operate mostly in the areas which have not yet been covered by the gas pipeline networks. Some of the aforementioned companies own a transmission infrastructure. Recently, new entities are becoming increasingly active on the Polish market. These entities are local gas distributors which offer innovative solutions of the natural gas supply involving the use of LNG. An intensified commercial activity of competitors which aims at attracting current and potential customers of the PGNiG Group may pose in the future a tangible threat of customer churn.

### Substitution

The rapidly rising gas prices pose a serious threat. The surge in fuel prices may translate into lower consumption owing to cost-saving by customers and their transition to alternative fuels. In view of the rising gas prices, some customers seek alternative gas suppliers or consider changing the energy source. This trend may cause a loss of prospective benefits, which would result from customers being provided with services by of competitors.

### Gas Supplies

In the previous years, the deliveries of natural gas from the eastern markets were disrupted. Taking into consideration the difficult relations with the main supplier of natural gas, as well as between the main supplier and the transit countries, similar incidents are likely to occur in the future.

### LNG Terminal

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

Meeting the deadline for the terminal construction is important. If the projected date of the first deliveries and the completion of the project are not concurrent, the party ordering natural gas may have to incur additional costs.

### Baltic Pipe Project

The key to success of the concept of transmitting natural gas from the Norwegian Continental Shelf to Poland is the coordination of the Baltic Pipe Project and Skanled Project, as well as of the steps taken to obtain the necessary flow capacity in the Danish transmission system. Main threats which might cause delays in the implementation of the Baltic Pipe Project timetable include a protracted process of obtaining administrative and environmental permits, and a limited access to materials, specialist equipment or qualified personnel.

### Skanled Project

The construction of the Skanled Pipeline is conditional upon numerous factors, including principally the execution, by all Consortium members, of gas purchase agreements providing for sufficient quantities of natural gas. Another factor upon which the pipeline construction in line with the current concept is conditional is Ineos's construction of an ethane separation unit in Rafnes, the unit being one of the key elements of the Skanled Project. The execution of the Skanled Project in line with the timetable requires timely obtainment of necessary administrative permits. Moreover, PGNiG S.A.'s participation in the Project depends upon the final decision concerning implementation of the Baltic Pipe Project and PGNiG S.A. obtaining the required flow capacity in the Danish transmission system.

## Chapter VI: Other Activities

PGNiG S.A.'s organisational unit classified as the "Other Activities" segment is the Central Measurement and Research Laboratory Branch which provides services aimed at ensuring accurate and reliable measurements of natural gas, comprising in particular calibration of measurement devices, attestation of gas meters, evaluation of the quality of natural gas and testing of new gas equipment. The Branch also provides advisory services, issues opinions and provides expert reports.

In H1 2008, the Branch's main areas of activity included:

- metrologic control of measurement systems on the Yamal-Europe transit gas pipeline (Polish section),
- verification of natural gas measurement systems for the purpose of evaluation of CO<sub>2</sub> emissions,
- measurement supervision of the process analyser systems for the evaluation of the quality of natural gases in the transmission grids,
- validations and supervision of measurements of the field laboratories controlling the quality of natural gases,
- cooperation with the Laboratory of Gas Standards of the Central Office of Measures (*Laboratorium Wzorców Gazowych Głównego Urzędu Miar*) on the project providing for the creation of the national quality standard for type E and type L natural gases.

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

The Branch intends to maintain and strengthen its leading position in the area of gas meters attestation by providing services concerning larger equipment. The Branch plans, as the first in Poland, to obtain the status of a notified body in the area of testing equipment used for recalculating gas parameters.



## Chapter VII: Environmental Protection

### Carbon Credit Trade System

Under the existing carbon credit trading system (CCTS), in H1 2008 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2007 and brought the volumes of carbon dioxide emission in line with the amounts stipulated by the permit held. Following the cancellation of the carbon credits used in 2007, 8,405 Mg CO<sub>2</sub> credit units were retained.

Preliminary analysis of the volumes of carbon dioxide emission in H1 2008 did not exceed half of the volumes allowed for each of the facilities. In that settlements period, the system included the facilities of the Odolanów Branch, Zielona Góra Branch and the Gas Storage Facility in Mogilno.

Furthermore, in H1 2008, in the National Plan for the Distribution of Carbon Credits for 2008–2012 (KPRU II) the facilities of PGNiG S.A. were allowed the total of 99,982 Mg CO<sub>2</sub> per annum.

### Environmental Management System

On January 2nd 2008, PGNiG S.A. started to implement the environmental management system meeting the requirements of PN-EN ISO 14001:2005 at its Warsaw head office. In H1 2008, within the framework of the undertaken actions, the Company carried out an initial inspection, developed a schedule concerning the implementation of the environmental management system, conducted trainings of employees and developed system procedures.

### REACH (Registration, Evaluation, Authorisation of Chemicals)

In order to ensure compliance with the new regulations concerning mandatory registration of chemical substances, evaluation of substances and authorisations for use of substances in production and trading, which came into effect in H1 2008, PGNiG S.A. undertook actions to fulfil its obligations such as updating of chemical data sheets. The first stage – the initial registration commenced on June 1st and shall continue until the end of November 2008.

### Natura 2000

As part of extensive social consultations concerning the already indicated and planned to be marked out areas of Natura 2000, PGNiG S.A. identifies the areas of current and planned projects pertaining to the construction of UGS, the Baltic Pipe project, the LNG terminal, construction of gas network, crude oil and natural gas mines, crude oil shipment and exploration projects. The key projects of PGNiG S.A., located within or in the vicinity of the already indicated and planned to be marked out areas of Natura 2000, will be included in the National Spatial Strategy 2008-2033.

### Methane Emissions

In each of its Branches, PGNiG S.A. conducted inspections which enabled to identify the sources of methane emission. PGNiG S.A. commissioned preparation of an analysis, which will set out uniform methods and rates of methane emission for specific processes. This study will be concluded in H2 2008, and its results will be presented to the Ministry of the Environment and the National Emission Centre.

## Chapter VIII: Other Events

### Distribution of 2007 Profit

On June 26th 2008, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution on the 2007 net profit distribution in the amount of PLN 2,154.9m. Distributions from profit were allocated in the following manner:

- PLN 991.6m was allocated to the Company's statutory reserve funds
- PLN 1,121m was allocated to dividend payments (PLN 0.19 per share), including:
  - PLN 950m as non-cash dividend to the State Treasury – 29 transmission subsystems, along with their constituent and accessory parts, and PLN 5,885.30 in cash.
  - PLN 171m as cash dividend to the other shareholders
- PLN 8.4m was allocated to increase the Company's social benefits fund
- PLN 33.9m was allocated to awards for the Company employees.

The Annual General Shareholders Meeting of PGNiG S.A. set July 25th 2008 as the dividend record date and October 1st 2008 as the dividend payment date.

### Approval for the Performance of Duties

On June 26th 2008, the Annual General Shareholders Meeting of PGNiG S.A. adopted resolutions on the approval of the non-consolidated financial statements and the Director's Report, on approval of the consolidated financial statements and the Director's Report on the activities of the PGNiG Group, and on granting approval to members of the Management and Supervisory Boards of PGNiG S.A. for the performance of their duties in the financial year 2007.

### Employee Shares

On June 25th, the Ministry of State Treasury disposed of one share in PGNiG S.A. The transaction was concluded on market terms. Pursuant to the Commercialisation and Privatisation Act of August 30th 1996, eligible employees will gain the right to acquire the Company shares free of charge as of October 1st 2008; the right will expire on October 1st 2009. The eligible employees have the right to acquire free of charge, on the Company registration date, up to 15% of the shares acquired by the State Treasury, i.e. up to 750,000,000 shares with a par value of PLN 1 per share. The Company shares acquired free of charge by the eligible employees cannot be traded before July 1st 2010, and the shares acquired free of charge by members of the Company's Management Board cannot be traded before July 1st 2011.

### Actions Against PI GAZOTECH Sp. z o.o.

1. On March 7th 2006, the Regional Court of Warsaw dismissed PGNiG S.A.'s action instituted against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolutions of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 52m. In view of the dismissal, PGNiG S.A. filed an appeal against the court ruling, which was rejected by the Court of Appeals in Warsaw on January 10th 2007 on account of the Company's failure to duly paid the required fees. On March 1st 2007, PGNiG S.A. filed a complaint with the Supreme Court regarding the Court of Appeals's ruling. On July 20th 2007, the Supreme Court examined the complaint in closed session and overruled the Court of Appeals's decision to reject PGNiG's appeal. On February 4th 2008, the Court of Appeals dismissed PGNiG's appeal. The decision is final and binding. From the date of passing the verdict by the Court of Appeals the Company's claim is no longer secured by suspension of the resolution

authorising the additional contributions. On July 8th 2008, a cassation complaint against the decision of the Court of Appeals of February 4th 2008 was filed.

2. On December 7th 2006, the Regional Court of Warsaw dismissed PGNiG's action instituted against PI GAZOTECH Sp. z o.o. to confirm the non-existence of the resolution on redemption of shares, adopted by the General Shareholders Meeting of PI GAZOTECH Sp. z o.o. on April 23rd 2004. PGNiG S.A. filed an appeal against the ruling. The Court of Appeals in Warsaw dismissed the appeal at the hearing of February 5th 2008. The decision is final and binding. On May 27th 2008, a cassation complaint against the decision of the Court of Appeals of February 5th 2008 was filed.
3. The proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated January 19th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 25,999,998, held before the Regional Court of Warsaw were taken up for further hearing. The case is pending. The Company's claim is secured by suspension of the resolution authorising the additional contributions.
4. The proceedings based upon PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 6,552,000, instigated before the Regional Court of Warsaw were concluded in the first instance. On May 30th 2008, the Regional Court dismissed the Company's claim and reversed the decision on securing this claim. Neither of the decisions is final and binding. PGNiG S.A. filed for presenting grounds for both decisions in order to lodge an appeal against the verdict and a complaint against the reversing of the decision on securing the Company's claim. The claim is still secured by suspension of the resolution authorising the additional contributions. On July 22nd 2008, PGNiG S.A. lodged a complaint against the reversing of the decision on securing its claim, and on July 29th 2008, it filed appeal against the Regional Court's judgement.

#### Dispute with Bartimpex S.A.

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

By way of submitting a letter of August 31st 2005, PGNiG appealed against the decision. As a consequence, on January 31st 2007 the Regional Court of Warsaw issued a verdict reducing the fine imposed on PGNiG S.A. to the amount of PLN 500,000.

As a result of appeals filed by both parties to the proceedings, the Court of Appeals changed the Regional Court's decision. Accordingly, a fine of PLN 2,000,000 was imposed and PGNiG's appeal was dismissed. On September 1st 2008, PGNiG S.A. filed a cassation complaint against the decision of the Court of Appeals of March 27th 2008 was filed.

Dispute with EUROPOL GAZ S.A.

The proceedings based upon PGNiG S.A.'s actions against EUROPOL GAZ S.A. to receive payment of interest due under agreement no. DF/33/95, dated September 25th 1995, on a loan and guarantee to finance the construction of a system of transmission pipelines, have been pending since February 27th 2004. On March 31st 2006, the Regional Court of Warsaw passed a decision whereby PGNiG S.A. was to receive PLN 32,699,276.36 with statutory interest accrued from February 27th 2004 to the payment date, and PLN 107,200 as costs of proceedings. EUROPOL GAZ S.A. appealed against the decision. On December 7th 2006, the Court of Appeals in Warsaw overruled the decision and submitted the case for re-examination by the Regional Court of Warsaw, which was also to decide on costs of the appellate instance. By way of submitting a letter of April 23rd 2007, PGNiG S.A. modified its claim to the effect that it demanded PLN 36,618,037.33 and withdrew its claim concerning payment of PLN 2,382,581.66, due to the statute of limitation. On July 2nd 2007, the Regional Court of Warsaw rejected the claim for payment of PLN 36,618,037.33, discontinued the proceedings concerning payment of PLN 2,382,581.66, and decided that PGNiG S.A. is to cover costs of proceedings of PLN 119,815 to EUROPOL GAZ S.A. On July 30th 2007, PGNiG S.A. appealed against this decision. On November 15 2007, the Court of Appeals in Warsaw dismissed the appeal. The decision is final and binding. On March 20th 2008, a cassation complaint was filed against the Court of Appeals's decision.

Dispute with EMFESZ NG Sp. z o.o.

On March 9th 2006, proceedings before the President of URE were instigated upon a motion filed by EMFESZ NG Polska Sp. z o.o. regarding refusal to execute an agreement on provision of gaseous fuel storage services. On June 11th 2007, a team of URE experts completed their work aimed at preparing an expert opinion on the technological feasibility of provision of gas storage services by PGNiG S.A. to third parties. On August 24th 2007, the President of URE announced that the relevant decision would be made by October 24th 2007.

Afterwards, by virtue of subsequent documents, the President of URE was continuously postponing this date up to February 24th 2008. On February 25th, he passed a resolution suspending the proceedings until the decision of the European Commission on the introductory issue regarding examination of the President of URE's stand on PGNiG's request for temporary exemption from the obligation to store gaseous fuels.

## Chapter IX: Financial Performance

The financial statements of PGNiG S.A. have been prepared in accordance with the International Financial Reporting Standards ("IFRS") and the Minister of Finance's regulation on current and periodic information to be published by issuers of securities, dated October 19th 2005 (Dz. U. No. 209, item 1744).

The accounting policies applied in preparing the non-consolidated financial statements are presented in the consolidated financial statements of the PGNiG Group for the period ended June 30th 2008.

### 1. Financial Standing

The H1 2008 net profit of PGNiG S.A. stood at PLN 919.1m, down by PLN 286.3m (or 24%) compared with the figure posted in H1 2007.

Summary information on the Company's financial standing in H1 2008 is presented in the following financial statements prepared in accordance with the International Financial Reporting Standards:

- the balance sheet,
- the income statement,
- the cash flow statement,
- the selected financial ratios.

Non-Consolidated Balance Sheet (PLNm)

ASSETS	June 30th 2008	December 31st 2007
Non-current assets	17,615.7	17,021.5
Property, plant and equipment	8,669.1	8,568.9
Investment property	5.3	4.5
Intangible assets	66.9	33.1
Financial assets available for sale	5,727.6	4,787.4
Other financial assets	2,837.7	3,340.7
Deferred tax asset	278.5	261.2
Other non-current assets	30.6	25.7
Current assets	5,398.9	6,542.8
Inventories	1,209.5	1,061.2
Trade and other receivables	2,404.7	4,355.6
Current income tax receivable	-	-
Prepayments and accrued income	65.2	24.1
Financial assets held for sale	29.3	29.3
Derivative financial instrument assets	85.9	17.4
Cash and cash equivalents	1,604.2	1,055.0
Assets available for sale	0.1	0.2
Total assets	23,014.6	23,564.3

Non-Consolidated Balance Sheet (PLNm)

EQUITY AND LIABILITIES	June 30th 2008	December 31st 2007
Equity	17,579.3	17,796.0
Share capital	5,900.0	5,900.0
Currency-translation differences on foreign-currency undertakings	(3.8)	(1.5)
Share premium account	1,740.1	1,740.1
Other reserve funds	8,981.6	3,344.2
Retained earnings/(deficit)	961.4	6,813.2
Non-current liabilities	1,836.3	1,858.5
Loans, borrowings and debt securities	1.8	0.1
Provisions	968.0	901.1
Deferred income	8.2	7.6
Deferred tax liability	835.3	929.1
Other non-current liabilities	23.0	20.6
Current liabilities	3,599.0	3,909.8
Trade and other payables	2,706.2	3,174.0
Loans, borrowings and debt securities	5.4	4.3
Liabilities under derivative financial instruments	41.2	35.5
Current tax liability	247.6	187.2
Provisions	155.2	111.8
Deferred income	443.4	397.0
Total liabilities	5,435.3	5,768.3
Total equity and liabilities	23,014.6	23,564.3

Non-Consolidated Income Statement (PLNm)

	H1 2008	H1 2007
Sales revenue	9,290.6	6,650.5
Total operating expenses	(8,267.9)	(5,459.5)
Raw materials and energy used	(4,658.9)	(4,051.8)
Employee benefits	(334.3)	(204.2)
Depreciation and amortisation	(305.5)	(267.2)
Contracted services	(2,869.5)	(1,010.3)
Cost of products and services for own needs	2.8	4.2
Other net operating expenses	(102.5)	69.8
Operating profit	1,022.7	1,191.0
Financial income	281.6	317.7
Financial expenses	(130.9)	(84.3)
Pre-tax profit	1,173.4	1,424.4
Corporate income tax	(254.3)	(219.0)
Profit distribution	-	-
Net profit	919.1	1,205.4
Discontinued operations	-	-
Profit/(loss) for the financial year on discontinued operations	-	-
Net profit for the financial year	919.1	1,205.4

Non-Consolidated Cash Flow Statement (PLNm)

	H1 2008	H1 2007
Net cash provided by/used in operating activities	1,374.7	1,144.4
Net cash provided by/used in investing activities	(862.5)	(154.7)
Net cash provided by/used in financing activities	37.0	(2,346.7)
Change in net cash	549.2	(1,357.0)
Cash and cash equivalents at beginning of period	1,055.3	2,993.5
Cash and cash equivalents at end of period	1,604.5	1,636.5



## Financial Ratios

### Profitability Ratios

	H1 2008	H1 2007
EBIT (PLNm) operating profit	1,022.7	1,191.0
EBITDA (PLNm) operating profit + depreciation/amortisation	1,328.2	1,458.2
ROE (Return on Equity) net profit to equity at end of period	5.2%	-
NET MARGIN net profit to sales revenue	9.9%	18.1%
ROA (Return on Assets) net profit to assets at end of period	4.0%	-

### Liquidity Ratios

	H1 2008	2007
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	1.5	1.7
QUICK RATIO current assets (net of prepayments and accrued income) decreased by inventories to current liabilities	1.1	1.4

### Debt Ratios

	H1 2008	2007
DEBT RATIO total liabilities to total equity and liabilities	23.6%	24.5%
DEBT/EQUITY RATIO total liabilities to equity	30.9%	32.4%

In H1 2008, PGNiG S.A.'s operating profit deteriorated by PLN 168.3m (14%) year on year, while its net profit declined by PLN 286.3m (24%) year on year. The decrease in operating profit (EBIT) is an effect of lower profitability of trading in methane-rich gas, resulting from:

- a change in the structure of purchases of methane-rich gas, and
- an increase in unit purchase costs of imported gas.

In the period under review, the Company purchased more imported gas to meet the domestic demand for gaseous fuels caused by lower air temperatures in the heating season. In addition, the use of gas from underground storage facilities was less intensive year-on-year on account of optimal management of import contracts. Gas production decreased as a result of the Company's facing natural production barriers; while an increase in sales volume of nitrogen-rich gas reduced the deliveries of feedstock to denitrifying plants.

An upward trend prevailed in unit purchase prices of imported gas throughout the first six months of 2008, driven primarily by the situation on the global oil and oil derivatives market. The continuing depreciation of the dollar/zloty exchange rate partly mitigated the rise in prices of imported gas.

Despite the approval by the President of URE of a new tariff for gaseous fuels at the end of April 2008, the price level still did not guarantee a satisfactory recovery of unit purchase costs of imported

gas for the Company. The gains on gas trading generated by PGNiG S.A. are attributable only to sales of methane-rich gas from own production.

In H1 2008, PGNiG S.A. recorded a significant increase in the profitability of sales of crude oil and nitrogen-rich natural gas from own production. Higher margins on sales of oil were driven primarily by rising prices of crude oil on global markets. The increase in the average selling prices of oil was partially offset by strengthening of the Polish zloty against the US dollar. The improved result on sales of nitrogen-rich gas resulted from the application of new gaseous fuel tariffs as of April 2008 and a 14% increase in sales volume of nitrogen-rich gas. The margin on sales of crude oil and nitrogen-rich gas improved despite higher production costs which may be attributed to more substantial exploration spending and higher expenses – charged to costs – incurred on drilling wells classified as dry.

The deterioration in operating profit (EBIT) was mainly caused by an increase in other net operating expenses, which grew by PLN 172.3m. The increase in other net operating expenses was driven by:

- a decline in income under a lease of transmission assets, which was due to a reduction in the operating lease assets (following from the payment of non-cash dividend to the State Treasury and provision of a contribution-in-kind to the Distribution System Operators);
- a decline in the value of released provisions for liquidation of boreholes, mining pits and drilling pits;
- a decline in the value of reversed impairment losses on property, plant and equipment and a lower value of reversed impairment losses on trade receivables.

The H1 2008 pre-tax profit decreased by PLN 251.0m (18%) year on year due to lower net financial income which declined by PLN 82.7m (35%). The deterioration in net financial income was driven mainly by lower dividend income received from subsidiary undertakings and an increase in foreign-exchange losses.

The balance sheet as at June 30th 2008 shows a balance-sheet total of PLN 23,014.6m, down by PLN 549.7m (2%) relative to the figure as at December 31st 2007.

The largest item in assets is represented by property, plant and equipment whose value disclosed as at June 30th 2008 was PLN 8,669.1m, up by PLN 100.2m (1%) from the end of 2007. The increase is attributable primarily to investment activities undertaken by PGNiG S.A.

Financial assets available for sale represent the item of non-current assets which recorded the largest increase, growing by PLN 940.2m (20%) relative to the figure as at December 31st 2007. Such a substantial increase in the value of that asset item was driven by the exclusion of distribution assets from lease and purchase of a block of shares in Zakłady Azotowe Tarnów – Mościce S.A.

In H1 2008, other financial assets declined by PLN 503.0m (15%), relative to the end of 2007. The decrease was caused mainly by lower non-current receivables under operating lease, and lease payments being made on a consistent basis by OGP GAZ-SYSTEM S.A.

As at June 30th 2008, current assets totalled PLN 5,398.9m, down by 1,143.9m (18%) compared with the end of 2007.

Trade receivables represent the largest item of current assets. As at June 30th 2008, trade receivables fell by PLN 1,950.9m (45%) relative to December 31st 2007, which was due mainly to:

- seasonal fluctuations in gas sales volumes,
- lower receivables under acquired shares in the increased capital of the Distribution System Operators.

During the period under review, the value of inventories advanced by PLN 148.3m (14%). The inventories disclosed in the balance sheet comprise mainly the gas stored in underground storage

facilities. The increase in the volumes of natural gas stored was caused by a seasonal rise in reserves to be used during the coming heating season. Also, the level of inventories was affected by an increase in the purchase prices of imported gas.

As at June 30th 2008, cash and cash equivalents totalled PLN 1,604.2m, up by PLN 549.2m (52%) compared with the end of 2007. The increase was caused by seasonal fluctuations in trade receivables and trade payables. In addition, in October 2007 PGNiG S.A. paid out the first tranche of the loan advanced to PGNiG Norway AS, which drove down the balance of cash as at the end of 2007.

Despite a substantial rise in cash, the liquidity ratios of the Company edged down. The current ratio dropped from 1.7 to 1.5, while the quick ratio fell from 1.4 to 1.1. This resulted from a considerable decrease in trade receivables. Despite the decline in liquidity ratios, the value and structure of current assets held by PGNiG S.A. still enables it to settle all its current operating liabilities.

In H1 2008, the main financing source of the Company's assets was equity, whose value dropped by PLN 216.7m (1%) relative to December 31st 2007. The change was largely caused by net profit generated during the year to date (PLN 919.1m) and distribution of the previous year's profit in the form of non-cash and cash dividend (PLN 1,121.0m).

As at the end of June 2008, current liabilities totalled PLN 3,599.0m and were down by PLN 310.8m (8%) relative to the figure as at December 31st 2007. The decline in current liabilities was driven mainly by:

- lower liabilities under the contribution-in-kind made in exchange for the shares in the increased share capital of the Distribution System Operators,
- lower other trade payables, including mainly liabilities under gas supplies and purchases of distribution and transmission services.

The drop in total current liabilities coincided with an increase in liabilities under unpaid dividend from the distribution of the balance-sheet profit of PLN 1,121.0m for the previous financial year.

The ratios reflecting the relation between capital and other items of shareholders' equity and liabilities did not change significantly compared with the end of 2007. As at the end of June 2008, the total debt-to-equity ratio declined from 32.4% to 30.9%, while the debt ratio (total liabilities to total equity and liabilities) dropped from 24.5% to 23.6%.

Although net profit posted in H1 2008 declined year-on-year, the financial standing of PGNiG S.A. in H1 2008 was strong. However, the development of the growth path in the years ahead will be primarily conditional on the position of the Polish Energy Regulatory Authority on gas selling prices in the domestic market.

## 2. Forecast Financial Performance

The financial performance of PGNiG S.A. will be under a strong influence of the prices of crude oil and its derivatives quoted on international markets. An upward trend in crude oil prices continued on global markets in the first six months of this year. At the end of June, the oil price broke the USD 140 per-barrel mark. The situation seen on the fuel market in H1 2008 will significantly drive the prices of imported gas in the next few months.

Under Polish law, the Company does not pursue a fully independent pricing policy. As long as PGNiG S.A. is obliged to apply the tariffs approved by the President of URE, there will always be a risk that any increases in purchase prices of gas will not be fully reflected in gas prices determined in accordance with the tariffs. Consequently, the approval by the President of URE of such new tariffs as would allow PGNiG S.A. to fully recover the increased cost of purchase of imported gas will be of crucial importance for the Group's financial performance.

Profitability of crude oil production is closely linked to prices of oil derivative products. Any increase in commodity prices on global exchanges automatically improves the profitability of crude oil production, partly offsetting the losses incurred by the Company in connection with having to pay more for imported gas.

In addition, the situation on the currency markets has profound implications for the Company's financial performance. In H1 2008, depreciation of the dollar against the złoty significantly mitigated the effect of increases in prices of imported gas. In the periods ahead, the dollar exchange rate will still affect PGNiG S.A.'s financial standing and performance.

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

#### Members of the Management Board

President	Michał Szubski	_____
Vice-President	Mirosław Dobrut	_____
Vice-President	Radosław Dudziński	_____
Vice-President	Sławomir Hinc	_____
Vice-President	Mirosław Szałuba	_____