Strategy

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The PGNiG Group strives to become an increasingly more modern organisation operating as a logically streamlined and optimised capital group, managed by objectives and project-oriented. The Group seeks opportunities for better use of the synergies and economies of scale, and aspires to become an organisation ensuring both increase in shareholder value and minimisation of the operating risk. Our product offering will be, to an increasingly greater extent, based on modern gas-related energy solutions and complementary services. Retail and business customers' satisfaction is of the greatest importance to us, therefore we place a special emphasis on the reliability and continuity of our operations.

Long-term and sustainable value growth is our key strategic objective, which requires us to ensure continuous business development on the Polish and international markets. Our sound financial standing means a more secure energy environment for Poland. Therefore, our strategic priorities include:

- To increase the scale of operations by extending the value chain, to include all; activities from exploration and production to sales and customer service;
- To secure uninterrupted supplies of natural gas to our customers;
- To create a diversified and stable portfolio of natural gas sources;
- To develop our trading activity;
- To develop our R&D activity.

Trading strategy on international markets

The PGNiG Group launched projects designed to diversify supply sources in order to become independent from natural gas supplies originating from a particular direction or a particular supplier. Our strategy is focused primarily on balancing natural gas supplies from the eastern direction with an increased volume of natural gas imports from the north and concurrent increase in domestic gas production. To create a balanced portfolio of supplies, we plan to:

- Develop new infrastructure enabling natural gas supplies to Poland (LNG terminal in Świnoujście, new connections providing access to the Norwegian reserves: participation in the Skanled consortium and construction of the Baltic Pipe);
- Ensure proper structure of the import contracts (new contracts to be diversified and reflect market conditions; variable shares of long- and short-term contracts in the portfolio; securing stable supplies of natural gas to Poland at reasonable prices).

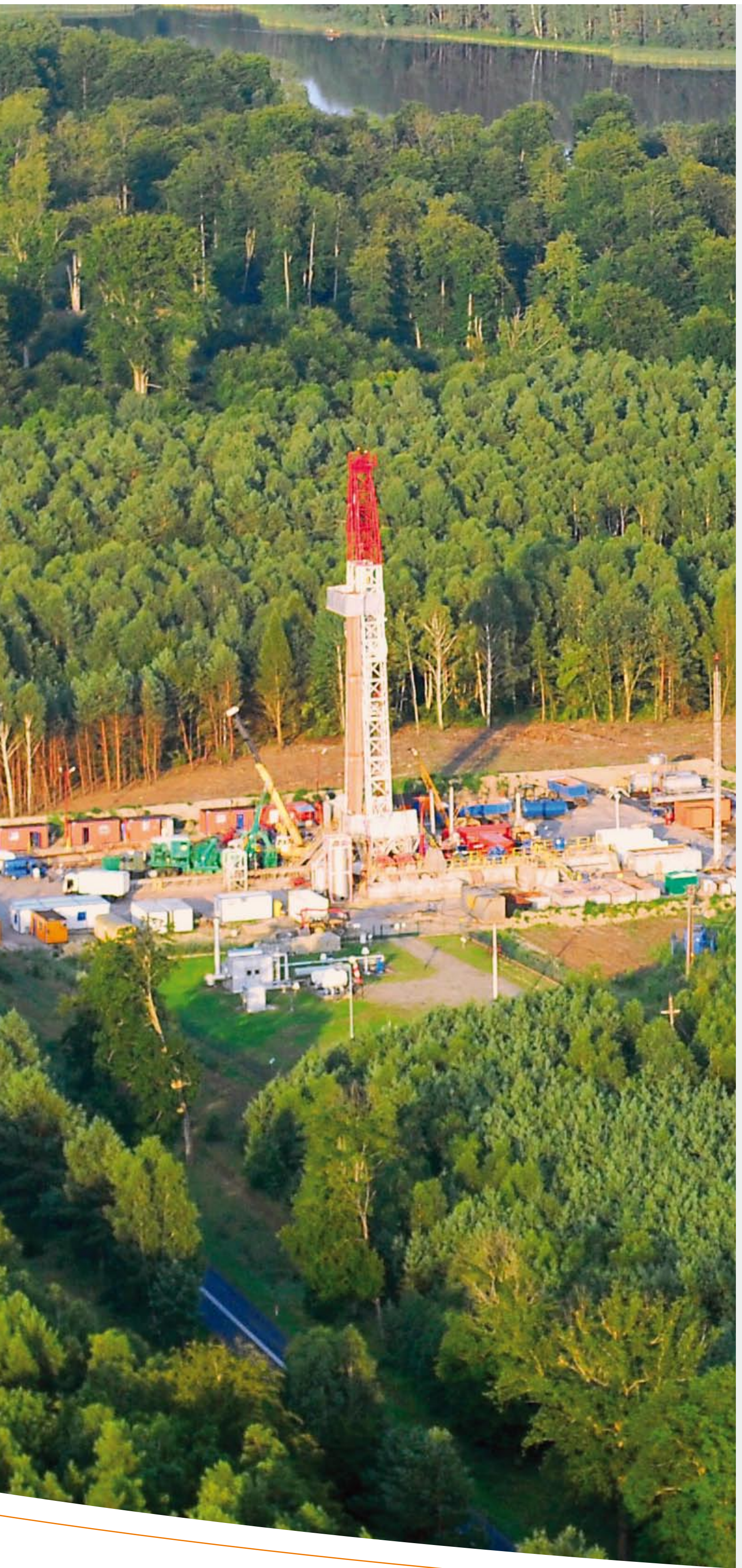
An equally important element of our international trading strategy is to start using derivative instruments in trading in hydrocarbons on commodity markets. Such international trading activities will not only offer attractive margins but will also be conducive to diversification of natural gas supply sources and risk management, thus making product offering price- competitive.

Strategy implementation

In 2007, we embarked upon a number of initiatives designed to diversify sources, directions and routes of natural gas supplies. The PGNiG Group assigned over PLN 1bn for this purpose.

In April 2007, PGNiG established Polskie LNG (PLNG), a special purpose vehicle responsible for construction and operation of an LNG terminal in Świnoujście. On January 10th 2008, PLNG executed an agreement with SNC Lavalin Services Ltd. for design of the LNG terminal.

As part of our plan to purchase reserves on the Norwegian Continental Shelf, we acquired a 12% interest in the licence covering Skarv, Snadd and Idun fields. In May 2007, we formed PGNiG Norway, our subsidiary responsible execution of this project. The Skanled gas pipeline project moved into the design stage last year, and the project's financial model was prepared. On June 20th 2007, we joined the Skanled gas pipeline construction and acquired 15% of shares in the consortium for no consideration. As part of the Baltic Pipe project, we executed a cooperation agreement with Energinet.dk, a Danish operator of transmission, energy and gas systems, and with OGP GAZ-SYSTEM SA, a Polish operator of gas transmission pipelines.



Exploration and production strategy

In order to increase the domestic natural gas and oil production capacity and to develop business internationally (i.e. to gain access to foreign reserves of natural resources), PGNiG runs a large-scale investment program which contributes to the growth of the Company value.

Domestic natural gas production is crucial not only in creating competitive pricing edge, but also in reinforcing the security of the Polish natural gas supplies. The increase in our oil production volumes mitigates the regulatory risk, and hence stabilises our financial performance. Maintenance and development of these operational areas, as well as our efficiency improvement, requires the following measures:

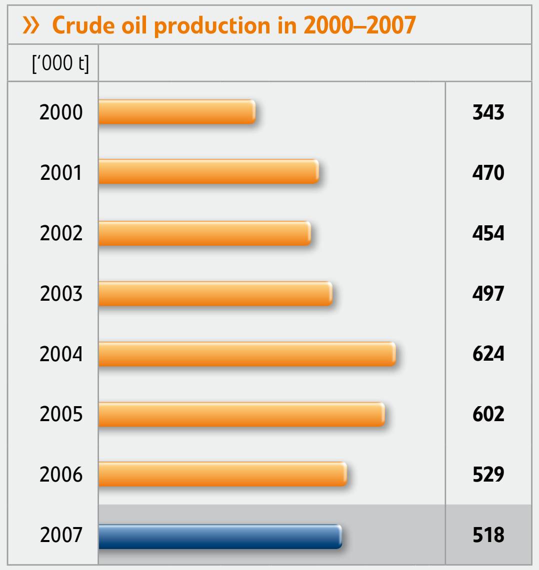
- Maintaining the domestic licence areas within the range of 45–50 thousand km^2 (submitting licence applications for new areas and extending the expired licences);
- Maintaining the environmental sustainability index within the range of 1.0–1.1 (performing domestic seismic surveys which enable better geological structure prospecting).

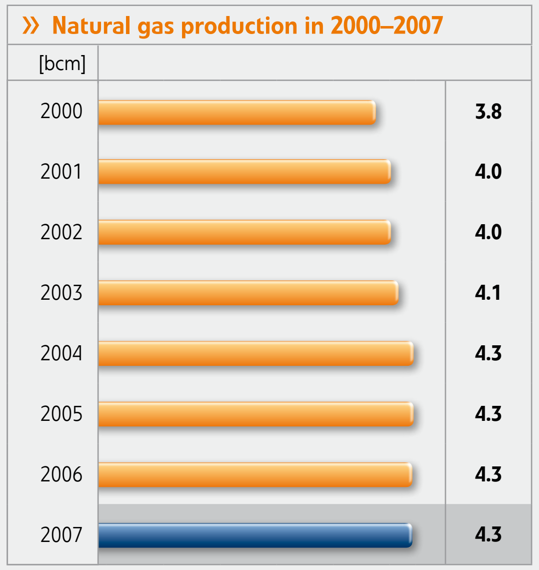
The strategy for development of our own resources involves not only increase in the domestic production volumes but also gaining access to foreign reserves and entering international markets. Accordingly, the PGNiG Group will apply for exploration and production licences in tender rounds, and form alliances with other companies, which will significantly reduce the risks of the Group's projects and facilitate our access to markets. Currently talks on acquisition of new oil assets are planned with several national oil companies. We also plan to obtain interests in licences or in other exploration and production projects directly from the companies willing to dispose of them.

Strategy implementation

In order to gain access to foreign reserves, PGNiG acquired a 12% interest in the exploration and production licence covering Skarv, Snadd and Idun fields in the North Sea. Moreover, we will continue similar activities in countries such as Libya, Algeria, Egypt, Pakistan or Denmark. It is thanks to these projects that the PGNiG Group is viewed as an active and strong partner.

The service companies within the PGNiG Group operate successfully on international markets, and the good reputation, which they have acquired, facilitates their development in both the prospected and in new areas. Apart from the acquisition of licences on the Norwegian Continental Shelf, in 2007 we also operated in Libya (where we won a tender for an exploration licence covering the Murzuq oil basin) and in Egypt (where won a tender for a Bahariya licence). As part of our strategy for increasing domestic natural gas production volumes, last year we developed Jasionka I (stage I) natural gas reservoir and connected OZG Jasionka I Stobiernia-Terliczka by transmission pipeline. Moreover, a total of 52 thousand metres of drillings was performed on 31 boreholes across Poland. In 2007, the expenditure on domestic and foreign exploration work totalled PLN 477m.





Storage strategy

The PGNiG Group is the leading company on the natural gas market in Poland and owns all domestic storage facilities connected to the gas distribution system. The current storage capacities allow the Group to store only natural gas reserves that can be used in case of short disruptions of supplies or to balance seasonal demand peaks. In order to fully meet the needs connected with abnormal peak growth, the storage capacity needs to be extended.

Extension of underground storage facilities will increase safety and ensure continuity of supplies to customers, which plays an important role in building our reliability as a supplier, and is one of the key drivers of our competitive advantage on the natural gas market. Extended facilities will also enable us to observe the regulatory requirements related to the mandatory reserves of natural gas held in storage.

The aggregate working storage capacity of the facilities in Poland amounts to approx. 1.66 billion cu. m. The storage facilities for high-methane gas are estimated to be extended to hold additional 0.9 billion cu. m (up to approx. 2.6 billion cu. m) by 2012. This project will allow us to comply with the Act on Reserves of Crude Oil, Petroleum Products and Natural Gas, as well as Rules of procedure to be followed when the state's fuel security is threatened or the petroleum market is disturbed. The aggregate storage capacity (including the nitrogen-rich gas facilities) will be 2.8 billion cu. m.

The extension projects are aligned with the strategy of ensuring Poland's energy security, as well as with other programmes carried out at the national and the Community levels. They also fit in the operational programme Infrastructure and Environment for 2007–2013, and National Strategic Reference Framework for 2007–2013 (National Coherence Strategy), Poland's energy policy by 2025, and the Lisbon Strategy. Therefore, the PGNiG Group has taken steps designed to source EU funds to finance these projects.

The estimated cost of extending the storage capacities by 2012 will amount to approx. PLN 2bn.

Strategy implementation

In 2007, implementation of the strategy of increasing storage capacities included modernisation of the surface infrastructure at the Swarzów facility as well as work aimed at increasing the working capacity of the facilities in Wierzchowice, Mogilno and Strachocina. In Kosakowo we commenced preparation for construction of underground storage facilities, and the work included cavern leaching, systems assembly and connection of the facility to the grid. In 2007, the total capital expenditure related to underground storage facilities was PLN 61.2m.

Distribution strategy

The Distribution System Operators' priority related to capital expenditure will include optimised development of the distribution network through connection of new clients. By rolling out the gas distribution systems to municipalities adjacent to the transmission and distribution networks, we will increase the network's density thus enhancing our ability to supply gas to new locations. Market research into investment attractiveness of several geographical regions will be conducted prior to these activities.

We are able to source EU funds for extension of the distribution infrastructure as part of the Operational Programme Infrastructure and Environment. In order to use the funds effectively, the Distribution System Operators will actively participate in preparation of projects conducted by local governments, which involve system rollout or extension of the existing distribution network in areas with significant potential for gas consumption.

Another strategic objective in the area of distribution is to secure continuity and growth of service-generated revenue streams. This activity is regulated and includes long-term investments; therefore appropriate mechanisms must be created to guarantee stable revenue growth.

Distribution plays an important role in building the value of the PGNiG Group. Therefore, the Distribution System Operators cannot concentrate on growing sales alone as they also need to optimise costs while maintaining the quality standard of gas supplies. To this effect, the network assets must be managed effectively, and the following systems must be implemented: an integrated ISO-compliant system for managing quality, environment, and health and safety at workplace, an integrated billing system (both at DSOs and the Trading Division), and a system for weather risk management.

Strategy implementation

The year 2007 was a break-through year for the Distribution segment. The legal separation of gas trading from distribution resulted in the spin-off of Distribution System Operators. As a consequence, the segment became an independent business division. Each of the six distribution companies was assigned responsibilities and operational tasks. This is fundamental for implementation of the strategy.

Sales strategy

Future selling activities are an important part of our strategy. To be able to maintain its dominating position on the market, the Company must increase the number of its customers, divide the customer group into segments, and build lasting relations with its clients.

Alliances with companies operating in the electrical power engineering sector will help increase the number of customers, both individual and institutional. This objective will also be fulfilled by supplying gas to new regions of Poland, where we have not operated before, and by using new ways and methods of gas transmission, such as virtual gas pipelines. They offer possibilities of supplying gas to customers who are not connected to the distribution network with liquefied natural gas (LNG) by rail or road transport.

The customer segmentation based on modern principles will help us identify the most valuable groups of customers offering best business prospects. This will also facilitate development of an appropriate product and service offering tailored to the needs of particular customer groups. Customers are assigned to segments based on advanced assessment criteria, such as volume of gas supplies, balanced demand, seasonality, profitability, attractiveness of the sector, development prospects and sensitivity to competitors' offerings.

Our selling activities will also profit from continuous improvement of relations with clients. The most important tasks of our sales staff include identification of clients' individual needs and flexible structuring of tailored-made offerings. Within this framework, we are currently working of customer service standardisation, the most important objective being to build lasting relationship with the clients in the most attractive sectors.

The product offering is to be upgraded to meet the growing needs of our customers. This will additionally reduce our operating risks. The PGNiG Group derives a large portion of its revenue from sales of gas and related services regulated by the Energy Laboratory Office. Expansion into new non-regulated segments will generate additional value for PGNiG help reduce the risks involved. An enhanced requires calls for a new sales policy, reflecting the contemporary approach to customers, products and services.

Strategy implementation

As part of the strategy implementation, our organisation was restructured in 2007. The Gas Companies were transformed into Distribution System Operators, which resulted in concentration of retail sales in a single entity. This positively affected the customer service quality and standardisation.

Operating risks

The most important identified types of risks the PGNiG Group faces are regulatory risk, market and currency risk, risk of delayed exploratory work, risk of delayed projects, and risk related to estimation of capital expenditure.

Regulatory risk

The key tariff risk relates to the inadequacy of secondary legislation to the current primary acts concerning the Polish gas market. Such a situation occurred at the turn of 2007, when the lack of a tariff regulation adjusted to the amended Polish Energy Law delayed the proceedings related to the approval of Gaseous Fuel Tariff No.1/2008.

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 in terms of specific conditions under which the gas system operates. Once the amended Law enters into force, the tariff regulation will need to be amended again.

Market and currency risk

Prices of imported gas are determined in the U.S. dollar or the euro, 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. Material changes in fuel prices on the international markets affect the prices of imported gas. Therefore, accurate forecast of gas prices is encumbered with a substantial risk of error.

Risk of delayed exploratory work

Under the currently binding legal regulations, obtaining licences for exploration and prospecting of crude oil and natural gas deposits takes from one to one and a half years. Moreover, prior to the commencement of field work, it is necessary to obtain formal and legal permits and approvals for entering the area, to meet environmental protection-related requirements and to abide by the regulations governing tenders for a work contractor. Another several months pass before an agreement with the work contractor is signed. These factors create the risk of delayed exploratory work.

Risk of growing cost of exploration

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

Risk of delayed investment projects

Investment work is substantially delayed by formal and legal issues beyond control of PGNiG which relate to the lack of land development plans approved by local administrative authorities. It is also delayed by problems of incorporating such investments into such plans and by difficulties with receiving administrative and other decisions. Moreover, the obligation to comply with the Public Procurement Act frequently protracts the tender procedure. Appeals and complaints filed by bidders lead to long-lasting court proceedings and, consequently, to delays in executing investment projects.

Risk related to estimation of capital expenditure

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

Risk of loss of highly 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.

Regulatory environment

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

- Polish Energy Law of April 10th 1997 (Dz. U. of 2003, No. 153, item 1504, as amended) – with respect to the activities in the area of trade in gaseous fuels, gas distribution and storage of gaseous fuels;
- Act on Reserves of Crude Oil, Petroleum Products and Natural Gas, as well as Rules of procedure to be followed when the state's fuel security is threatened or the petroleum market is disturbed, dated February 16th 2007 (Dz. U. of 2007, No. 52, item 343);
- with respect to the activities in the area of international trade in natural gas;
- Polish Geological and Mining Law of February 4th 1994 (Dz. U. of 1994, No. 27, item 96, as amended) – with respect to production activities and related sales of gas.

Business activities involving exploration and prospecting for mineral reserves, extraction of minerals from reserves, tankless storage of substances and storage of waste matter in rock mass, including in worked-out caverns, require licences from the Ministry of Natural Environment.

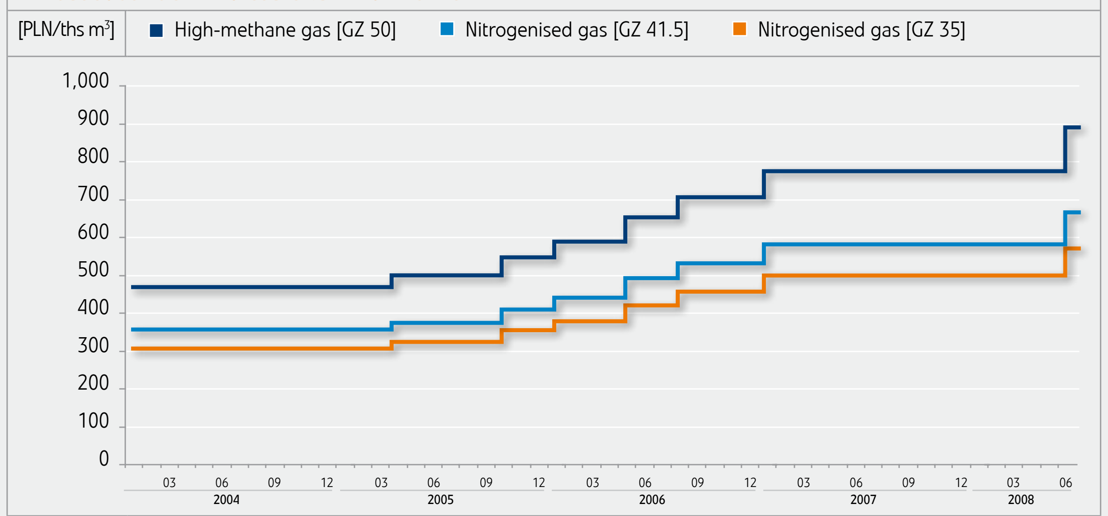
As at December 31st 2007, PGNiG held:

- 67 licences for exploration and prospecting for crude oil and natural gas reserves;
- 213 licences for production of crude oil and natural gas from reserves;
- 8 licences for underground gas storage (UGS);
- 4 licences for waste matter storage.

Tariff policy

The natural gas market in Poland is regulated by the Energy Regulatory Office. The regulation principally consists in determination of tariffs, and the tariff prices are crucial for our ability to generate revenue that can cover the incurred justified costs plus return on capital employed. For this reason, a key objective of the PGNiG Group's pricing policy is to make our revenue independent of these regulations. Currently, this revenue depends on regulated selling prices of gaseous fuels. The gas prices are officially regulated and directly connected with the applied tariff preparation methodology. The rules for determination of tariffs are stipulated in secondary legislation to the Polish Energy Law, and especially in the Tariff Regulation.

» Gaseous fuel wholesale tariff of PGNiG



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

In 2007, settlements with customers were made according to Tariff No. 4 for Gaseous Fuels approved by the President of Energy Regulatory Office on March 17th 2006. By virtue of a decision of December 15th 2006, the Tariff was extended until March 31st 2007, and new prices of gaseous fuels were approved. Following the tariff changes effected as at January 1st 2007, the prices of gaseous fuels increased by 9.9%. By virtue of another decision issued in March 2007, the Tariff was extended until September 30th 2007. As it was reasonable to set new tariffs upon completion of the process of integration of trading business and enactment of secondary legislation to the current Polish Energy Law, PGNiG applied for another extension of the Tariff until the end of 2007. By virtue of a decision of August 17th 2007, the Company's application was approved.

On November 14th 2007, PGNiG applied to the President of Energy Regulatory Office for approval of the Gaseous Fuel Tariff No. 1/2008 for the period from January 1st 2008 to March 31st 2008. The tariff approval process commenced as late as February 20th 2008, only after the new Regulation of the Minister of Economy on detailed rules of tariff structuring and calculation and on settlements in gaseous fuels trade, dated February 6th 2008, took effect. On the same date, that is February 20th 2008, we amended the application in order to bring it to compliance with the new Tariff regulation. The amendment included a request for change of the term of the Tariff. On April 10th 2008, the President of Energy Regulatory Office approved the Gaseous Fuel Tariff No. 1/2008. Accordingly, the wholesale price of gaseous fuel increased by 15.34% as of April 25th 2008. With the transmission charge for gas transmission over the SGT EuRoPol GAZ networks included (currently, theses charges are included in the wholesale price of gaseous fuel), the tariff price of high-methane gas increased on average by 14.3%.

Gaseous Fuel Tariff No. 1/2008 of Polskie Górnictwo Naftowe i Gazownictwo SA, which, since October 1st 2007, has been supplying gaseous fuels under comprehensive agreements for supply of gaseous fuel to customers, from both transmission and distribution systems, includes:

- price of gaseous fuel (including cost of gas transmission over SGT EuRoPol GAZ networks);
- subscription charge for customer service;
- network charge for fuel transport;
- charge for storage of high-methane gas.