Polskie Górnictwo Naftowe i Gazownictwo SA

MANAGEMENT'S REPORT ON THE OPERATIONS OF THE PGNiG GROUP IN 2007

Warsaw, 04 April 2008

Contents

Section I: Overview of the Group

The PGNiG Group is the only vertically integrated company in the Polish gas sector and has the leading position in most areas of the gas sector in the country. Polskie Górnictwo Naftowe i Gazownictwo S.A.is the parent company of the PGNiG Group.

Polskie Górnictwo Naftowe i Gazownictwo Spółka Akcyjna (PGNiG S.A.), with its registered office in Warsaw, at ul. Marcina Kasprzaka 25, emerged from the transformation of the state-owned enterprise under the name Polskie Górnictwo Naftowe i Gazownictwo into a joint-stock company with the State Treasury as the single shareholder. On 30 October 1996, the Company was entered in the commercial register under the business name Polskie Górnictwo Naftowe i Gazownictwo S.A. having its registered office Warsaw under the number RHB 48382. On 14 November 2001, the Company was entered into the Register of Entrepreneurs of the National Court Register under the number 0000059492.

On 24 May 2005, by virtue of the decision issued by the Polish Securities and Exchanges Commission the shares of PGNiG S.A. were admitted to public trading. The Company's debut on the Warsaw Stock Exchange took place on 23 September 2005. PGNiG S.A. shares have been listed on the WSE since 20 October 2005. The share capital of the Company currently stands at PLN 5.9 billion and is divided into 5,900,000,000 shares.

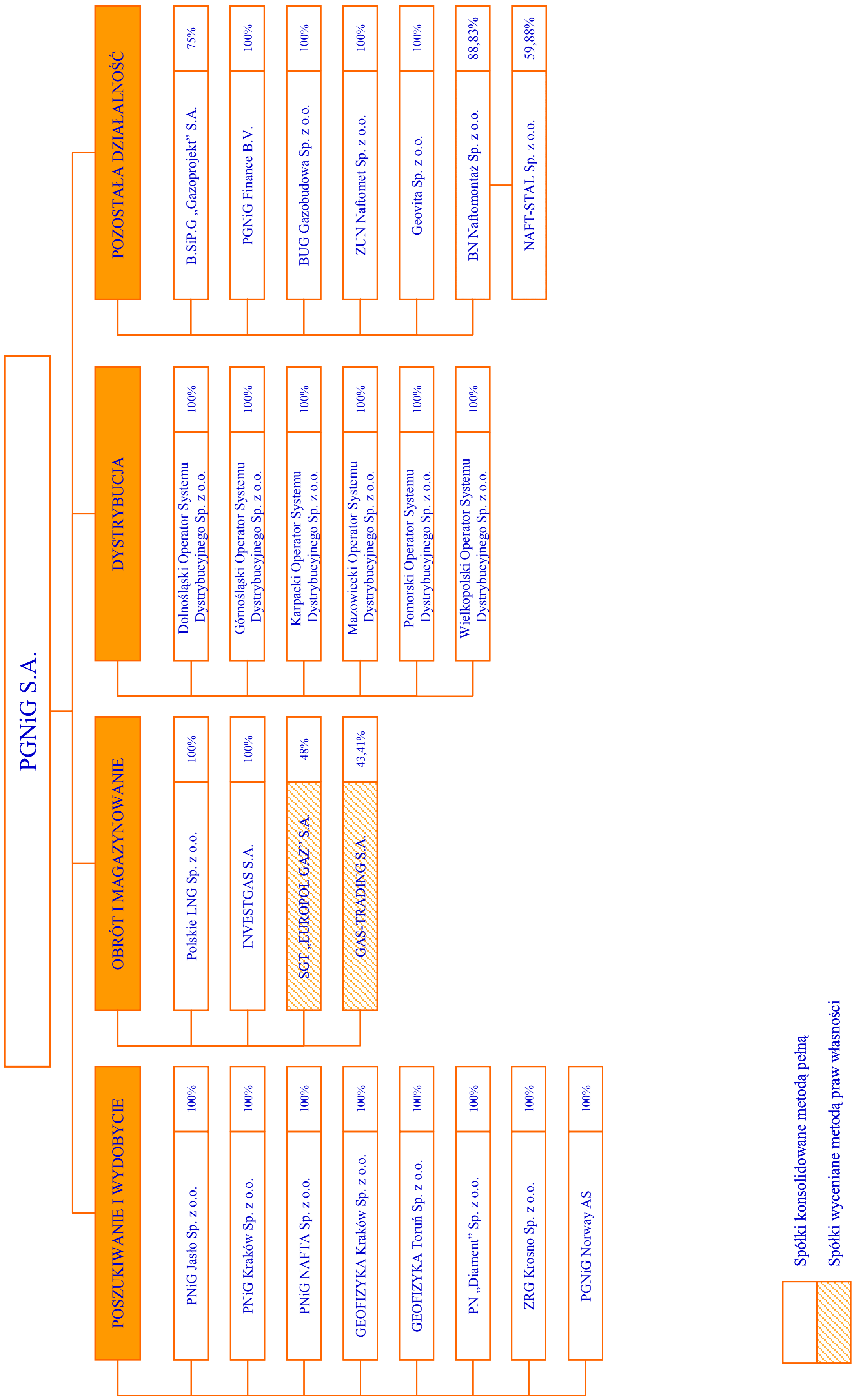
The scope of business activity of the PGNiG Group encompasses field exploration, production, gas storage, as well as trade in and distribution of natural gas. The production of natural gas and crude oil is one of the key sources of the Company's competitive advantage in the liberalized gas market. Natural gas trade and distribution constitute an integral area of the business activity of the PGNiG Group. Following to the completion of the process of unbundling of the trading activity from the distribution in 2007, the entire trading function was taken over by PGNiG S.A. Meanwhile, the distribution activity is carried out by six Distribution System Operators that are affiliates of the PGNiG Group.

1. Structure of the PGNiG Group

The PGNiG Group consists of production, trading and service companies incorporated under the commercial law. Polish Oil and Gas Company (Polskie Górnictwo Naftowe i Gazownictwo S.A.) is the parent company of the Group.

The list of entities of the PGNiG Group subject to consolidation as at 31 December 2007 is presented in the following chart.

KONSOLIDOWANE SPÓŁKI GRUPY KAPITAŁOWEJ PGNiG



2. Changes in the structure of the PGNiG Group

In 2007, PGNiG S.A. and the Gas Distribution Companies finalised the efforts to align the organisational structures with the Energy Law implementing the requirements of EU Directive (2003/55/EC), which provides for obligatory legal unbundling of the distribution of natural gas from the supply activities and the unbundling of Distribution System Operators (DSO) by July 1st 2007.

In H1 2007, the incorporation of six Gas Trading Companies was registered in the National Court Register, followed by the registration of an increase of their respective share capitals as a result of the incorporation of the trading branches separated from the Gas Distribution Companies. In addition, a decrease of the share capital and changes to the articles of association of the six Gas Distribution Companies were entered to the register. The Gas Distribution Companies were renamed into Distribution System Operators and their scope of business was reduced accordingly. On June 30th 2007, the President of ERO issued a decision whereby the DSO companies were designated as the Distribution System Operators for one year.

The incorporation of the Gas Trading Companies into PGNiG S.A. took effect on October 1st 2007. As a result, all activities related to gas trading and customer service through the country are carried out by PGNiG S.A. The core business of the Distribution System Operators consists in the transportation of natural gas through the distribution network.

In 2007, no changes were introduced to the key management policies of PGNiG S.A. or the Group.

3. Capital commitment

As at December 31st 2007, PGNiG S.A. held shares in 57 commercial-law companies, including:

- 27 companies in which PGNiG S.A. held over 50% shares or voting rights;
- 16 companies in which PGNiG S.A. held between 20% and 50% shares or voting rights;
- 14 companies with the Company's shareholding below 20% of shares or voting rights.

The total face value of equity interests held by PGNiG S.A. in the commercial-law companies as at December 31st 2007 was PLN 6,338.5 million.

The companies in which PGNiG S.A. held at least 5% interest as at 31 December 2007 are listed in the table below.

Equity interests held by PGNiG S.A. in commercial-law companies as at December 31st 2007

	Company name	Share capital (PLN)	Equity interest of PGNiG PLN	% of share capital held	% of voting rights held
	Strategic companies				
1	Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o.	1,310,749,000.00	1,310,749,000.00	100.00%	100.00%
2	Górnośląski Operator Systemu Dystrybucyjnego Sp. z o.o.	1,197,314,000.00	1,197,314,000.00	100.00%	100.00%
3	Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o.	930,819,000.00	930,819,000.00	100.00%	100.00%
4	Wielkopolski Operator Systemu Dystrybucyjnego Sp. z o.o.	847,159,000.00	847,159,000.00	100.00%	100.00%
5	Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o.	502,750,000.00	502,750,000.00	100.00%	100.00%
6	Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o.	546,448,000.00	546,448,000.00	100.00%	100.00%
	Core-business companies				
7	PNiG Jasło Sp. z o.o.	100,000,000.00	100,000,000.00	100.00%	100.00%
8	PNiG Kraków Sp. z o.o.	105,231,000.00	105,231,000.00	100.00%	100.00%
9	PN „Diament" Sp. z o.o.	62,000,000.00	62,000,000.00	100.00%	100.00%
10	PNiG NAFTA Sp. z o.o.	60,000,000.00	60,000,000.00	100.00%	100.00%
11	GEOFIZYKA Kraków Sp. z o.o.	34,400,000.00	34,400,000.00	100.00%	100.00%
12	GEOFIZYKA Toruń Sp. z o.o.	66,000,000.00	66,000,000.00	100.00%	100.00%
13	Zakład Robót Górniczych Krosno Sp. z o.o.	26,903,000.00	26,903,000.00	100.00%	100.00%
14	B.SiP.G „Gazoprojekt" S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
15	SGT „EUROPOL GAZ" S.A.	80,000,000.00	38,400,000.00	48.00%	48.00%
16	GAS-TRADING S.A.	2,975,000.00	1,291,350.00	43.41%	43.41%
	Special-purpose vehicles				
17	Górnictwo Naftowe Sp. z o.o.	50,000.00	50,000.00	100.00%	100.00%
18	PGNiG Finance B.V. (EUR)*	20,000.00	20,000.00	100.00%	100.00%
19	NYSAGAZ Sp. z o.o.	3,700,000.00	1,887,000.00	51.00%	51.00%
20	InterTransGas GmbH (EUR)*	200,000.00	100,000.00	50.00%	50.00%
21	INVESTGAS S.A.	502,250.00	502,250.00	100.00%	100.00%
22	„Polskie Elektrownie Gazowe" Sp. z o.o. in liquidation	2,500,000.00	1,212,000.00	48.48%	48.48%
23	„Dewon" Z.S.A. (UAH)*	11,146,800.00	4,055,205.84	36.38%	36.38%
24	Polskie LNG Sp. z o.o.	39,000,000.00	39,000,000.00	100.00%	100.00%
25	PGNiG Norway AS (NOK)*	497,327,000.00	497,327,000.00	100.00%	100.00%

	Company name	Share capital (PLN)	Equity interest of PGNiG PLN	% of share capital held	% of voting rights held
	Other companies - material				
26	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%	100.00%
27	BUG Gazobudowa Sp. z o.o.	39,220,000.00	39,220,000.00	100.00%	100.00%
28	ZUN Naftomet Sp. z o.o.	23,500,000.00	23,500,000.00	100.00%	100.00%
29	ZRUG Sp. z o.o. (in Pogórska Wola)	4,300,000.00	4,300,000.00	100.00%	100.00%
30	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%	100.00%
	Other companies – immaterial				
31	BN Naftomontaż Sp. z o.o.	44,751,000.00	39,751,000.00	88.83%	88.83%
32	PI GAZOTECH Sp. z o.o. **	1,203,800.00	65,000.00	69.44%	46.30%
33	PPUiH „TURGAZ" Sp. z o.o.	176,000.00	90,000.00	51.14%	51.14%
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. (in 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	ZRUG Zabrze Sp. z o.o.	2,750,000.00	600,000.00	21.82%	21.82%
41	Polski Serwis Płynów Wiertniczych Sp. z o.o.	250,000.00	35,000.00	14.00%	14.00%
42	TeNET 7 Sp. z o.o. in liquidation	50,000.00	5,000.00	10.00%	10.00%
43	Polskie Konsorcjum Energetyczne Sp. z o.o.	100,000.00	9,500.00	9.50%	9.50%
44	"WALCOWNIA RUR JEDNOŚĆ" Sp. z o.o.	220,590,000.00	18,310,000.00	8.30%	8.30%
45	Agencja Rynku Energii S.A.	1,376,000.00	100,000.00	7.27%	12.70%
46	ZRUG Warszawa S.A. in liquidation	6,000,000.00	2,940,000.00	49.00%	49.00%
47	„TE-MA" WOC Małaszewicze Terespol Sp. z o.o. in liquidation	262,300.00	55,000.00	20.97%	20.97%
48	HS „Szczakowa" S.A. in bankruptcy	16,334,989.44	5,439,494.72	33.30%	33.30%
49	Zakład Remontowy Urządzeń Gazowniczych Wrocław Sp. z o.o. in bankruptcy	1,700,000.00	270,000.00	15.88%	15.88%

* figures in foreign currencies

** on April 23rd 2004, the Extraordinary General Shareholders Meeting decided to redeem the shares held by one of the shareholders. The share capital and face value of the shares remained unchanged.

In H1 2007, the following six Gas Trading Companies were registered with the National Court Register:

- Dolnośląska Spółka Obrotu Gazem Sp. z o.o. (on February 21st 2007)
- Górnośląska Spółka Obrotu Gazem Sp. z o.o. (on February 27th 2007)
- Karpacka Spółka Obrotu Gazem Sp. z o.o. (on January 31st 2007)
- Mazowiecka Spółka Obrotu Gazem Sp. z o.o. (on February 12th 2007)
- Pomorska Spółka Obrotu Gazem Sp. z o.o. (on February 8th 2007)
- Wielkopolska Spółka Obrotu Gazem Sp. z o.o. (on January 30th 2007).

Additionally, the respective share capitals of the Gas Trading Companies were increased as a result of the incorporation of the trading branches previously spun off from the Gas Distribution Companies (these changes were registered by the Court on June 29th 2007).

Also in H1 2007, the decreased in the share capitals of the Gas Distribution Companies were registered, as was the change of their names into Distribution System Operators, i.e.

- Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. (changes registered on June 27th 2007)
- Górnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. (changes registered on June 19th 2007)
- Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o. (changes registered on June 27th 2007)
- Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o. (changes registered on June 26th 2007)
- Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o. (changes registered on June 27th 2007)
- Wielkopolski Operator Systemu Dystrybucyjnego Sp. z o.o. (changes registered on June 22nd 2007).

The incorporation of the six Gas Trading Companies into PGNiG S.A. in accordance with the procedure set out in Article 492.1 of the Commercial Companies Code, i.e. by transferring of all their assets to PGNiG S.A., was registered on October 1st 2007. The registration of this incorporation automatically resulted in the deletion of the Gas Trading Companies from the National Court Register.

On May 21st 2007, Polskie LNG Sp. z o.o. was registered with the National Court Register, with a share capital of PLN 28,000,000. All of the 28,000 shares, with the face value of PLN 1,000 each, were taken up by PGNiG S.A.

On June 9th 2007, PGNiG Norway AS of Stavanger, Norway, was registered. The company's share capital is NOK 10,000,000. All of the 10,000 shares, with face value of NOK 1,000 each, were taken up by PGNiG S.A.

On April 16th 2007, Przedsiębiorstwo Wielobranżowe MED-FROZ S.A. (in liquidation) was deleted from the National Court Register. PGNiG S.A.'s interest in the company's share capital was 23.07%.

In 2007, PGNiG S.A. increased its equity positions held by in the following subsidiaries:

- increase of the share capital of GEOFIZYKA Toruń Sp. z o.o., by PLN 33,000,000 up to PLN 66,000,000; the increase was registered with the National Court Register on April 18th 2007;
- increase of the share capital of PGNiG Kraków Sp. z o.o., by PLN 6,381,000 up to PLN 105,231,000; the increase was registered with the National Court Register on June 15th 2007;
- increase of the share capital of Zakład Robót Górniczych Krosno Sp. z o.o. by PLN 101,000 up to PLN 26,903,000; the increase was registered with the National Court Register on July 27th 2007;
- increase of the share capital of Polskie LNG Sp. z o.o. by PLN 11,000,000 up to PLN 39,000,000; the increase was registered with the National Court Register on October 8th 2007;
- increase of the share capital of PGNiG Norway AS by NOK 487,327,000 up to NOK 497,327,000; the increase was registered with the National Court Register on November 8th 2007.

Other changes in the equity positions held by PGNiG S.A. were related to the following transactions:

- On July 4th 2007, a decrease in the face value of the shares in Huta Stalowa Wola S.A. (HSW S.A.), from PLN 6.86 to PLN 4.75 per share, was registered with the National Court Register. Accordingly, the total face value of the PGNiG S.A.' shareholding in HSW S.A. fell to PLN 2,066,069.50. The face value decrease was combined with an increase of the share capital of HSW S.A. PGNiG S.A. did not participate in the share capital increase. Accordingly, the Company's share in the HSW S.A. share capital fell to 0.85%;
- On August 22nd 2007, an increase of the share capital of IZOSTAL S.A. PLN by 7,000,000 was registered with the National Court Register. PGNiG S.A. did not participate in the share capital increase. Accordingly, the Company's share in the IZOSTAL S.A. share capital fell to 4.61%;
- On September 14th 2007, a PLN 2,580,000 increase in the share capital of Agencja Rozwoju Pomorza S.A. was registered with the National Court Register. PGNiG S.A. did not participate in the share capital increase. Accordingly, the Company's share in Agencja Rozwoju Pomorza S.A. share capital fell to 0.64%.

In 2007, two companies in which PGNiG S.A. holds equity interests (Polskie Elektrownie Gazowe Sp. z o.o. and TeNET 7 Sp. z o.o.) were put into liquidation.

The following changes have occurred since the end of the financial year 2007:

- further increase of the share capital of Polskie LNG Sp. z o.o. by PLN 11,000,000, up to PLN 50,000,000; the increase was registered with the National Court Register on January 7th 2008;
- increase of the share capital of Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o., by PLN 286,531,000 up to PLN 1,217,350,000; the increase was registered with the National Court Register on January 24th 2008;
- increase of the share capital of Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 165,363,000, up to PLN 1,476,112,000; the increase was registered with the National Court Register on February 12th 2008;
- increase of the share capital of Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o. by PLN 93,391,000, up to PLN 596,141,000; the increase was registered with the National Court Register on February 29th 2008;
- on February 4th 2008, amendments to the articles of association of PGNiG Finance B.V. were registered in the Netherlands; 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 completely redefined;
- on February 5th 2008, the Extraordinary General Shareholders Meeting of Polski Serwis Płynów Wiertniczych Sp. z o.o. adopted a resolution to redeem 50 shares held by PPiEZRiG PETROBALTIC S.A. without decreasing the share capital; by virtue of a court decision of March 10th 2008, PPiEZRiG PETROBALTIC S.A. was deleted from the National Court Register as a shareholder of Polski Serwis Płynów Wiertniczych Sp. z o.o. Consequently, PGNiG S.A.'s share in the voting rights at the General Meeting increased to 15.56%;
- on January 23rd 2008, a court decision was issued declaring WALCOWNIA RUR JEDNOŚĆ Sp. z o.o. bankrupt. The decision has not become final yet.

4. Employment

The table below presents the employment levels by segment as at December 31st 2007 and 2006, respectively. The Head Office of PGNiG S.A. provides services to all segments and therefore was not assigned to any of them.

Employment by segment (persons)

	2007	2006
Head Office of PGNiG S.A.	604	811
Exploration and production	10,151	9,919
Trade and storage*	4,104	467
Distribution	13,538	16,705
Other	1,928	1,895
Total	30,325	29,797
*including companies valued by equity method	294	293

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 program provides for extensive restructuring measures including, *inter alia*, the following:

- employee retirement at the statutory retirement age and early retirement
- taking advantage of pre-retirement benefits
- outplacement of employees to subsidiaries of PGNiG S.A. and employee-owned companies
- outplacement of employees to in other companies cooperating with PGNiG S.A.
- reduction of working time in selected positions and liquidation of job positions.

The programme term has been extended until the end of 2008. In 2007, the restructuring programme covered 1,489 individuals within the Group.

5. Sales and Supply

The sales revenue of the PGNiG Group was PLN 16.7 billion, of which 86% was generated from the distribution and sales of natural gas.

Sales revenue in PLN million

	2007	2006
Natural gas	14,401.1	13,311.1
Crude oil	777.9	739.1
Condensate	1.6	6.3
Helium	30.5	32.7
LPG	43.7	46.5
Exploration services	749.3	614.4
Other sales	648.0	447.6
Total	16,652.1	15,197.7

In 2007, the PGNiG Group sold 13.6 bcm of natural gas. Sales from the transmission and distribution system accounts for 95% of this volume, the reminder being constituted by direct gas sales from the fields.

Natural gas sales in million cu.m

	2007	2006
Tariff sales	12,974.8	12,950.3
Direct sales from fields	628.7	564.6
Total	13,603.5	13,514.9

In 2007, the volume of gas sourced by the PGNiG Group amounted to 13.6 billion cu.m with 68% share of imported gas, primarily from Russian and Central Asian sources. The production of natural gas from domestic fields accounted for 31.5% of the gas sourcing volume. The table below presents the natural gas supply structure measured as high-methane gas equivalent.

Gas supply in million cu.m

	2007	2006
Imports	9,286.0	10,028.4
Production	4,276.1	4,277.1
Domestic suppliers	15.8	10.1
Total	13,577.9	14,315.6

Section II: Corporate bodies of PGNiG S.A.

1. Management Board

Pursuant to the Articles of Association, the Management Board of PGNiG S.A. is composed of two to seven members. The number of members of the Management Board is determined by the Supervisory Board. The members are appointed for a joint three-year term of office. Individual members or the Management Board as a whole are appointed by the Supervisory Board. A member of the Management Board is appointed following the verification procedure, pursuant to the Regulation of the Council of Ministers on verification procedure for positions of Management Board members in certain commercial companies, dated March 18th 2003 (Dz. U. No. 55, item 476). This provision is not applicable to the member of the Management Board elected by the employees. Each member of the Management Board may be removed from the office or suspended by the Supervisory Board or the General Shareholders Meeting. As long as the State Treasury remains the Company's shareholder and the yearly average headcount in the company exceeds 500 employees, the Supervisory Board appoints one person elected by the employees to serve as a member of the Management Board for the duration of its term of office.

In 2007, there were no changes in the composition of the Management Board of PGNiG S.A. and as at December 31st 2007 it included the following members:

- Krzysztof Głogowski – President of the Management Board
- 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, the Supervisory Board of PGNiG S.A. removed the following members from the Management Board of the Company:

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

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

- Michał Szubski – as President of the Management Board
- 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.

Contracts with key managers

The contracts with President of the Management Board, Vice-President and Trading Director, Vice-President and Director of Technology and Investments, and Vice-President and Director of Strategic Projects, which were in force in 2007, included a clause whereby the Management Board members are guaranteed to receive a severance pay equal to three months' salary in case of their removal from office or termination of the employment contract for reasons other than a breach of basic responsibilities related to the employment. The contracts with other managers, i.e. Vice-President and HR and Restructuring Director and the proxies did not include such clauses.

In 2007, non-competition agreements signed with all members of the Management Board continued in force. The non-competition agreements cover a period of 12 months starting from the date of termination of the legal relationship. In return for respecting the prohibition to compete, throughout the period covered by the agreement, a Management Board member is entitled to monthly compensation equivalent to 150% of the average gross remuneration for the last three months he or she received under the relevant legal relationship. Concurrently, non-competition agreements concluded with all proxies continued in force in 2007. The non-competition agreements cover a period of 12 months starting from the date of termination of the legal relationship. In return for respecting the prohibition to compete, throughout the period covered by the agreement, a proxy is entitled to monthly compensation of 100% of the average gross remuneration for the last three months he or she received under the relevant legal relationship.

2. Proxies

On July 30th 2007, the Management Board of PGNiG S.A. revoked the power of proxy granted to Bogusław Marzec. On August 28th 2007, the Management Board of PGNiG S.A. appointed Bogusław Marzec as proxy. As at December 31st 2007, two persons were appointed as the Company's 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.

3. Supervisory Board

Pursuant to the provisions of PGNiG S.A.'s Articles of Association, its Supervisory Board is composed of five to nine members, appointed by the General Shareholders Meeting for a joint term of three years. As long as the State Treasury remains a shareholder of the Company, the State Treasury, represented by the minister competent for matters pertaining to the State Treasury, acting in consultation with the minister competent for economic affairs, has the right to appoint and remove one member of the Supervisory Board. In accordance with PGNiG S.A.'s Articles of Association, the General Shareholders Meeting appoints one independent member to the Supervisory Board. Pursuant to Par. 36.3 of PGNiG S.A.'s Articles of Association, the independent member of the Supervisory Board shall be elected by way of a separate vote. Proposals of candidates for the position of an independent Supervisory Board member may be submitted to the Chairman of the General Shareholders Meeting by the shareholders present at the General Shareholders Meeting convened with a view to elect such member. Proposals in writing shall be submitted along with a declaration delivered by the candidate in writing confirming his or her consent to be a candidate and fulfilment of all requirements applicable to such independent member. If no candidates for the position of an independent Supervisory Board member are proposed by the shareholders, such candidates to the Supervisory Board shall be proposed by the Supervisory Board. When the Supervisory Board is composed of up to six members, two of them are appointed from among persons nominated by the Company's employees. In the event of the Supervisory Board being composed of seven to nine members, three of them are appointed from among persons nominated by the Company's employees.

In 2007, there were no changes in the composition of the Supervisory Board of PGNiG S.A. As at December 31st 2007, the Supervisory Board was composed of the following nine members:

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

After the date of this Report, the following changes occurred in the Supervisory Board of PGNiG S.A.:

- on February 7th 2008, Mr Mirosław Szkałuba resigned from the Supervisory Board of PGNiG S.A.
- on February 15th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. removed Piotr Szwarc, 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.

4. Remuneration of Members of the Management and Supervisory Boards

The table below presents the remuneration and awards paid to the Members of the Management Board and Supervisory Board:

Remuneration and awards paid to the Members of the Management Board (PLN thousand)

Name	Total amount of remuneration, benefits and awards paid in 2007	Total amount of remuneration and awards paid in 2007 for performing functions in the governing bodies of subordinated undertakings	Total remuneration paid in 2007
Krzysztof Głogowski	222.7	840.8	1,063.5
Jan Anysz	270.3	178.2	448.5
Zenon Kuchciak	242.3	779.5	1,021.8
Stanisław Niedbalec	251.7	378.0	629.7
Tadeusz Zwierzyński	226.0	130.3	356.3
Ewa Bernacik	251.8	39.6	291.4
Bogusław Marzec	315.0	470.4	785.4

Remuneration and awards paid to the Members of the Supervisory Board (PLN thousand)

Name	Total amount of remuneration, benefits and awards paid in 2007	Total amount of remuneration and awards paid in 2007 for performing functions in the governing bodies of subordinated undertakings	Total remuneration paid in 2007
Andrzej Rościszewski	33.9	-	33.9
Piotr Szwarc	33.9	56.6	90.5
Kazimierz Chrobak	33.9	6.0	39.9
Wojciech Arkuszewski	33.9	-	33.9
Mieczysław Kawecki	33.9	31.9	65.8
Marcin Moryń	33.9	-	33.9
Mieczysław Puławski	33.9	-	33.9
Mirosław Szkałuba	33.9	33.8	67.7
Jarosław Wojtowicz	33.9	-	33.9

Section III: Corporate Governance

Corporate Governance rules in 2007

In a statement published on March 29th 2007, PGNiG S.A. undertook to comply with 49 out of the 53 corporate governance rules set out in "Best Practices in Public Companies 2005". The Company's non-compliance with four rules (No. 2, 20, 28 and 43) is due primarily to certain legal considerations involved in the nature of the Company's operations.

Rule No. 2 (best practices of general shareholders meetings) concerns the need to justify a request for convening a general shareholders meeting and for including specific items in the meeting's agenda. While the Company acknowledges the relevance of this rule, it is not in the position to guarantee that each entitled entity would always observe it. Pursuant to Par. 57 of the Company's Articles of Association, a request to convene a General Shareholders Meeting wherein specific matters are submitted for that body's consideration, should be accompanied by a justification of the Management Board together with a written opinion of the Supervisory Board, expect for matters pertaining to members of the Management and Supervisory Boards as specified in Par. 56 of the Articles of Association. Accordingly, the Company decided to refrain from adopting Rule No. 2.

Rule No. 20 (best practices of supervisory boards) provides that at least half of the supervisory board members should meet the criteria of being independent. Pursuant to Art. 12 of the Polish Commercialisation and Privatisation Act of August 30th 1996, representatives of employees are serve on the Supervisory Board of PGNiG S.A. Given that the Supervisory Board of PGNiG S.A. is composed of five to nine members appointed by the General Shareholders Meeting, the Company is not able to ensure a larger independent membership in its Supervisory Board. It is so because any increase in the number of independent members of the Supervisory Board in relation to the number currently provided for in the Articles of Association would lead to a situation where the State Treasury (as the majority shareholder) would not be able to appoint a majority of the Supervisory Board's members. PGNiG S.A. fully agrees that participation of independent members in supervisory boards should be considered a best practice in corporate governance. Nevertheless, the Company was not able to adopt Rule No. 20.

Under Rule No. 28 (best practices of supervisory boards), supervisory boards are obliged to act in accordance with their publicly available rules of procedure. Such rules of procedure should provide for the appointment of at least two committees: i.e. audit and remuneration committee. The audit committee should include at least two independent members and at least one member qualified and experienced in accounting and finance. The Company acknowledges the need to ensure that the Company's supervisory function is influenced by an independent member and that the Supervisory Board members have the appropriate professional qualifications. However, given the fact that – in accordance with the Company's Articles of Association – the Supervisory Board includes only one independent member, the Company chose to refrain from adopting Rule No. 28. No separate audit or remuneration committees were established in the Company.

Rule No. 43 (best practices in the area of external relations) defines the procedure for selection of an auditor. The procedure requires the audit committee to give its opinion. Given the fact that the Company does not apply Rule No. 28, the Company also chose to refrain from the application of Rule No. 43. The auditor selection is made by the Supervisory Board of PGNiG S.A. Pursuant to Par. 33.5 and Par. 33.1.5 of the Articles of Association, selection of an auditor is conditional upon an approval by an independent member of the Supervisory Board.

A report on PGNiG S.A.'s compliance with corporate governance rules in 2007 is enclosed to the annual report.

Corporate Governance principles in 2008

PGNiG S.A observes the corporate governance rules embodied in the "Code of Best Practice for WSE Listed Companies" implemented by the Warsaw Stock Exchange as of January 1st 2008, with the exclusion of Rules No. 6, 7 and 8 from Part III of the Code.

The above rules concern independent members of the Supervisory Board and the audit committee established as part of the Supervisory Board.

Under Rule No. 6 from Part III of the "Code of Best Practice for WSE Listed Companies", at least two members of the Supervisory Board should meet the criteria of being independent from the company and entities with material associations with the company. PGNiG S.A. acknowledges the need to ensure that the Company's supervisory function is influenced by independent members. However, according to the Articles of Association of PGNiG currently in effect, the Company's Supervisory Board includes only one independent member. Pursuant to Art. 12 of the Polish Commercialisation and Privatisation Act of August 30th 1996, representatives of employees serve as members of the Supervisory Board of PGNiG S.A. The Supervisory Board of PGNiG S.A. is composed of five to nine members appointed by the General Shareholders Meeting. Any increase in the number of independent members of the Supervisory Board in relation to the number currently provided for in the Articles of Association would lead to a situation where the State Treasury (as the majority shareholder) would not be able to appoint a majority of the Supervisory Board's members.

Under Rule No. 7 from Part III of the "Code of Best Practice for WSE Listed Companies", the Supervisory Board should establish at least an audit committee. The committee should include at least one member independent of the company and entities with material associations with the company, with accounting and finance qualifications. The Company agrees with the need to ensure that its supervisory function is influenced by an independent member and that the Supervisory Board members have the appropriate professional qualifications. However, given the fact that – in accordance with the Company's Articles of Association – the Supervisory Board includes only one independent member, the Company chose to abstain from adopting this rule in its current wording. In addition, it should be noted that currently there is no practice at the Company to establish a separate audit committee. However, the Company informs that it will consider compliance with Rule No. 7 when the need to do so arises and when certain circumstances (especially those related to PGNiG S.A.'s ownership structure) change.

Under Rule No. 8 from Part III the "Code of Best Practice for WSE Listed Companies", Annex I to the Commission Recommendation of February 15th 2005 on the role of non-executive or supervisory directors should apply to the tasks and the operation of the committees of the Supervisory Board. As currently there are no committees operating as part of the Company's Supervisory Board, PGNiG S.A. does not observe Rule No. 8.

Nevertheless, bearing in mind the importance of corporate governance standards, the Company will consider recommending to its shareholders an introduction of appropriate solutions (in the form of amendments to the Articles of Association) that would result in an increase in the number of independent members of the Supervisory Board and the establishment of an audit committee.

PGNiG S.A. implements the principles of good corporate governance through its internal corporate documents, that is the Rules of Procedure for the Management Board, for the Supervisory Board and for the General Shareholders Meeting, as well as other internal procedures that ensure transparent and sound decisions by the Company's corporate bodies. The rules applied by PGNiG S.A. reflect legitimate interests of the Company and its shareholders to the extent expected by the market.

Section IV: Shareholder Structure

As at 31 December 2007, the share capital of PGNiG S.A. amounted to PLN 5,900,000,000 and was divided into 5,900,000,000 shares with face value of PLN 1 each. The shares of all series (A, A1 and B) are ordinary bearer shares and each confers the right to one vote at the General Shareholders Meeting. The Articles of Association of PGNiG S.A. do not provide for any limitations on the exercise of voting rights attached to PGNIG shares.

Shareholder structure

Shareholder	Shares held as at 31.12.2007	% of share capital as at 31.12.2007	Number of voting shares	% of votes at General Meeting as at 31.12.2007
State Treasury	5,000,000,000	84.75%	5,000,000,000	84.75%
Other	900,000,000	15.25%	900,000,000	15.25%
Total	5,900,000,000	100.00%	5,900,000,000	100.00%

As at December 31st 2007, only the State Treasury held shares representing 5% or more of the Company's share capital, which conferred the right to 5% or more of the total vote at the Company's General Shareholders Meeting.

<u>Changes in significant shareholders</u>

In 2007, and by the date of this Report, there were no changes in the significant shareholders of PGNiG S.A.

<u>PGNiG shares and shares in the affiliates of PGNiG S.A. held by the management and supervisors</u>

As at December 31st 2007, Stanisław Niedbalec was the only member of the Company's management holding shares in PGNiG S.A. (857 shares for total face value of PLN 857). As at December 31st 2007, no member of the Company's supervisory bodies held shares in PGNiG S.A.

<u>Purchase of own shares</u>

In 2007, and by the date of this Report, PGNiG S.A. did not purchase any own shares.

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

As at the date of this Report, PGNiG S.A. is not aware of any agreements which may give rise to future changes in the number of shares held by the existing shareholders and bondholders.

<u>Information on holders of securities which confer special control powers with respect to the Company</u>

As at the date of this Report, PGNiG S.A. has no knowledge of any holders of securities which confer special control powers with respect to the Company.

<u>Restrictions on transfer of ownership of the Company's securities</u>

PGNiG S.A. is not aware of any restrictions on transfer of ownership of the Company securities or any limitations on the exercise of voting rights attached to the Company shares.

Information on control systems for Employee Stock Option Plans

By the date of this report, PGNiG S.A. had not issued any employee shares.

Stock price of PGNiG S.A.

900,000,000 Series B shares, representing 15.25% of the Company's share capital, are listed on the Warsaw Stock Exchange. Over 2007, the price of the PGNiG S.A. stock increased by 37.1%. With the dividend paid out at PLN 0.17 per share, the rate of return stood at 41.7%. The highest price at which the Company's stock traded in 2007 was PLN 6.10. To compare, in 2007 the WIG and WIG20 indices gained 8.7% and 3.2%, respectively, while WIG-Paliwa, the main index reflecting the economic situation in the fuel sector, recorded a 9.2% increase. The high price of the Company stock confirms PGNiG S.A.'s stable financial standing. The performance of the WSE indices and PGNiG S.A. stock is presented in the table below.

WSE indices and PGNiG S.A. stock performance in 2007

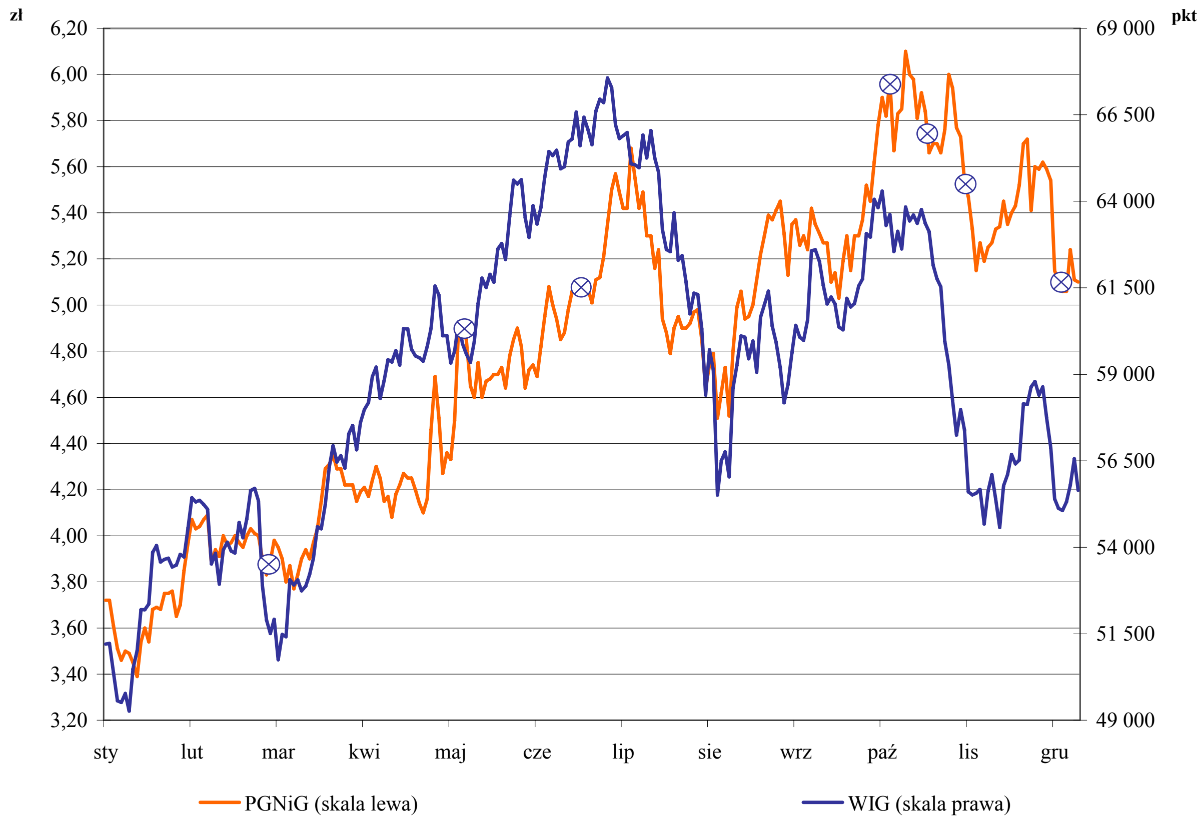
	Value as at Jan 2 2007	Max	Min	Value as at Dec 28 2007	Rate of return	PGNiG S.A.'s weight in index as at Dec 28 2007
WIG	51,203	67,569	49,264	55,649	8.7%	2.24%
WIG20	3,348	3,918	3,149	3,456	3.2%	3.88%
WIG-Paliwa	3,250	4,122	2,880	3,548	9.2%	19.41%
PGNiG S.A.	3.72	6.10	3.39	5.10	37.1%	-

Source: WSE

In 2007, the fluctuations in the value of indices on the global markets were driven mainly by the news on the situation in the U.S. economy. The economic slowdown in the United States and the threat of a recession triggered a slump of the indices also on the Warsaw Stock Exchange in the second half of 2007. The reports on macroeconomic developments from the United States proved to have much stronger influence on the price of the PGNiG S.A. stock than the news on the internal situation of the Company.

The chart below illustrate the price performance of the PGNiG S.A. stock against the WIG index and description of the selected events at the Company in 2007.

PGNiG stock price versus the WIG index



1.03.2007
Publication of the Q4 2006 consolidated quarterly report. The published results were in line with analysts' expectations. On the same day, PGNiG S.A. also announced that it had concluded a conditional agreement for purchase of interests in the licences on the Norwegian Continental Shelf. The stock price over two consecutive trading days increased from PLN 3.83 to PLN 3.98.

15.05.2007
The publication of the Q1 2007 consolidated quarterly report. Investors expected very good results, which was reflected in the changes of the stock price. In the period between May 10th and May 15th the stock price increased from PLN 4.33 to PLN 4.92.

28.06.2007
Decision of the General Shareholders Meeting on profit distribution for 2006 (PLN 0.17 per share dividend). The dividend yield was 63.4%. The decision on distribution of dividend did not affect the stock price on the day of the announcement; however, over the next two weeks the stock price went up from PLN 5.07 to PLN 5.68.

17.10.2007
Conclusion of a loan agreement between PGNiG S.A. and PGNiG Norway AS to finalise the purchase of interests in the licences in the Norwegian Continental Shelf. Both companies subsequently concluded a guarantee agreement. The news met with a very positive reaction of the market, which was reflected in the stock price. In the period from October 19th to October 23rd, the stock price grew from PLN 5.67 to PLN 6.10 and reached its all-time high.

31.10.2007
Purchase by PGNiG Norway AS of interests in the PL212, PL212B and PL262 exploration and production licences on the Norwegian Continental Shelf.
The information met with a positive reaction from investors: over the subsequent week the stock price grew by 6.0% to PLN 6.00.

14.11.2007
Publication of the Q3 2007 consolidated quarterly report. The Company's performance was fell short of the analysts' expectations, which resulted in a decline of the stock price from PLN 5.78 to PLN 5.54 (-4.2%). On the same day, the WIG20 index lost 2.5%, and the WIG index decreased by 2.3%.

18.12.2007
The Supervisory Board of PGNiG S.A. closed the recruitment process for the positions of President of the Management Board and Members of the Management Board of PGNiG S.A. without selecting any candidate. The decision of the Supervisory Board coincided with a lack of decision of the President of ERO on the new tariff for the gaseous fuels. Over three trading days (December 13th, 14th and 17th 2007), the Company stock price lost 8.0%. The WIG20 and WIG indices also decreased by 5.3% and 4.0%, respectively.

Section V: Regulatory Environment

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

- Polish Energy Law of April 10th 1997 (Dz.U. of September 1st 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 March 23rd 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 March 1st 1994, No. 27, item 96, as amended) – with respect to production activities and related sales of gas.

1. Polish Energy Law

The activities of the PGNiG Group in the area of trade in gaseous fuels are regulated and require a licence granted and tariff approved by the President of ERO. The tariff specifies prices of gaseous fuels.

Pursuant to the provisions of the Polish Energy Law implementing Directive 2003/55/EC, on July 1st 2007, PGNiG S.A. implemented legal unbundling of the supply and distribution activities.

In 2007, the amended Energy Law, dated June 15th 2007 (Dz. U. of June 29th 2007, No. 115, item 790) came into force. The provisions of the Act regulate the process of unbundling of supply and distribution activities with respect to vertically integrated undertakings. The Act ensures smooth operation of the undertakings whose business consists in distribution and trade, as well as new undertakings emerging from such unbundling.

The secondary legislation concerning tariffs, connections and restrictions, which was in force in 2007 was issued under the previous wording of the Energy Law, prior to the amendment of May 3rd 2005; consequently, it did not include appropriate provisions to design a tariff for a comprehensive service, as envisaged under the current Polish Energy Law.

On February 20th 2008, the Regulation of the Minister of Economy and Labour concerning detailed principles of tariff design and calculation and settlements in gas trade (Dz. U. of February 20th 2008, No. 28, item 165) became effective. 165).

In 2007, the Regulation of the Minister of Economy and Labour on detailed rules for functioning of the gas system was prepared and submitted for public consultations. Until the date of preparation of this Report, the Regulation has not been implemented.

1.1. Licences

As a result of the integration of PGNiG S.A.'s trading activities, in 2007 the Company acquired by succession six licences for trade in gaseous fuels, two licences for international trade in natural gas and one licence for trade in liquid fuels from the Gas Trading Companies.

As at December 31st 2007, the Company held the following licences granted by the President of Energy Regulatory Office (ERO):

- one licence for transmission and distribution of gaseous fuels,

- seven licences for trade in gaseous fuels,
- three licences for international trade in natural gas,
- one licence for storage of gaseous fuels,
- two licences for trade in liquid fuels.

On November 7th 2007, the Company filed a request to the President of ERO for revision of the licences in line with to the new conditions of conducting business by PGNiG S.A. and for extension of their validity until December 31st 2025 with respect to:

- trade in gaseous fuels,
- international trade in natural gas,
- trade in liquid fuels.

Until the date of preparation of this Report, the President of ERO has issued no decisions with respect to the abovementioned proceedings.

The objective of the proceedings pending with respect to the licences for international trade in natural gas and trade in liquid fuels, among other things, is to make the Company actually hold only one licence for each type of activity.

On February 18th and February 19th 2008, the President of ERO issued decisions where he declared that six licences for trade in gaseous fuels granted to the Gas Trading Companies had expired due to the removal of those entities from the relevant register.

On November 14th 2007, the Company filed a request to the President of ERO for the existing transmission and distribution licence to be maintained in force at least until its expiry date. The respective administrative proceedings are pending.

1.2. Tariff Policy

The dependency of the revenues generated by the Group on the tariffs approved by the President of ERO is a key factor determining the regulated business of the PGNiG Group. Tariff prices are crucial for the Company's ability to generate sufficient revenue to recover the incurred justified costs plus a return on the capital employed. Currently, this revenue depends on regulated selling prices for gaseous fuels. The gas prices are directly connected with the applied tariff design methodology.

The principles of tariffs setting are set out in the relevant secondary legislation to the Polish Energy Law, and specifically in the Tariff Regulation. In spite of a number of amendments to the Polish Energy Law, the lack of secondary legislation and Tariff Regulation protracted the proceedings aimed at obtaining the approval of the PGNiG's tariff by the President of ERO. The proceedings were initiated on November 14th 2007 and by the date of this Report no tariff for gaseous fuels has been approved.

The applied tariff design methodology is based on the determination of prices and charges based on the projected costs and planned gas sales volumes. In accordance with the guidelines issued by the regulatory authority (the President of ERO), the calculation of gas prices included the cost of gas sourcing from all possible supply directions, i.e. both from imports and domestic production. 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 the production cost for gas from domestic sources in the cost basket that provides the basis for tariff calculation resulted in a situation where the tariff price charged from consumers was lower than the cost of acquisition of imported gas.

Consumers who had a gas sales contracts with PGNiG S.A. for supply of gas to a specific delivery point were charged based on the prices and charges set forth in the subsequent tariffs approved by the President of ERO.

On November 8th 2006, Karpacka Spółka Gazownictwa Sp. z o.o. filed a request to the President of ERO for an exemption from the obligation to submit tariffs for approval with respect to compressed natural gas used as a fuel for motor vehicles. On June 15th 2007, the President of ERO issued a decision exempting the Company from the obligation to submit tariffs for compressed natural gas for approval, stating that the compressed natural gas market, on which the requesting party operates, meets with the requirements for a competitive market within the meaning of Art. 49 of the Polish Energy Law.

In August and September 2007, the Gas Trading Companies filed requests for exempting them from the obligation to submit for approval their tariffs for compressed natural gas used in motor vehicles. As a result of integration of PGNiG S.A.'s trading activities, by succession the Company has taken over and continues as a party to the abovementioned proceedings.

On March 28th 2008, the President of ERO issued a decision on exemption from the obligation to submit for approval tariffs for compressed natural gas used in motor vehicles.

1.3. Changes to the tariffs of PGNiG S.A.

In 2007, consumers were billed according to Tariff No. 4 for Gaseous Fuels approved by the President of ERO on March 17th 2006. Subsequently, the following adjustments were made to the Tariff at PGNiG S.A.'s request:

- by virtue of a decision of December 15th 2006, the Tariff term 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 a decision of March 14th 2007, the Tariff term was extended until September 30th 2007.
- by virtue of a decision of August 17th 2007, the Tariff term was extended until December 31st 2007, as it was deemed appropriate that the new tariff be set only after completion of the integration process in the trading business and promulgation of secondary legislation to the current Polish Energy Law.

Prices and charges applicable in settlements with customers in 2007:

- prices of gaseous fuels

Gas type	Chargeable price in 2007
	PLN/m3
High-methane gas E	0.7788
Nitrogen-rich gas Ls	0.4936
Nitrogen-rich gas Lw	0.5761

- charges for transmission of high-methane gas, based on the costs of transmission services provided by SGT EUROPOL GAZ S.A.; the charge is to compensate for cost of gas transmission through transit networks from the border to the point of entry into the domestic system.

Tariff group	Rate based on the purchase cost of transmission service provided by SGT EUROPOL GAZ S.A.
	PLN/m3
For consumers of high-methane gas E	
E 1- E 4	0.0068

- charges for storage of high-methane gas:

Tariff group	Storage charges
	PLN/m3
For consumers of high-methane gas E	
E 1	0.0215
E 2	0.0174
E 3	0.0157
E 4	0.0098

- subscription charges

Gas type	Applicable price in 2007
	PLN/month
High-methane gas E	541.00
Nitrogen-rich gas Ls	541.00
Nitrogen-rich gas Lw	541.00

On November 14th 2007, PGNiG S.A. applied to the President of ERO 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 Company amended the application in order to bring it into compliance with the new Tariff Regulation. The amendment included, among others, a request for a change of the term of the Tariff. By the date of this Report, no decision in respect of the above proceedings has been issued by the President of ERO.

1.4. Changes to the tariffs of Distribution System Operators

The tariffs applied by the Gas Distribution Companies of the Group for billing the consumers in 2007 were approved by the decision of the President of ERO of March 17th 2006.Upon applications of individual Companies, on 16 December 2006, the President of ERO issued decisions approving

changes to the tariffs with respect to the gas prices and extended the term of the tariffs by 31 March 2007. The charges related to the distribution service (both fixed and variable charge) and the subscription fees remained unchanged.
On 16 March 2007 the President of the Energy Regulation Office issued decisions on the extension of the tariffs of the Gas Distribution Companies by 30 September 2007. The prices and charges remained unchanged.

In connection with the legal unbundling of gas distribution from trading activities and the need for continued tariff application by the entities that emerged from such unbundling, on 27-28 June 2007 the individual DSO companies applied to the President of the Energy Regulatory Office for an extension of the tariff term until 31 December 2007. Accordingly, each of the Gas Trading Companies submitted the appropriate application on 20-23 July 2007. On 26 July 2007 (for the DSOs) and 30 July 2007 (for the Gas Trading Companies) the President of ERO issued decisions to discontinue the administrative proceedings initiated upon the request of individual companies with regard to the extension of the tariff term. At the same time, the President of ERO concluded in the decisions that pursuant to Article 5.2 of the amended Energy Law of 15 June 2007 each of the companies is authorized and obliged to apply the existing tariffs by virtue of the law to the extent they are applicable to their respective activities and the term of tariff application is not limited by any specific date other than the date of the entry into force of new tariffs to be approved in accordance with the procedure set out in the Energy Law.

As at the date of this report the six tariffs of the Gas Distribution Companies continued in force with respect to consumer billing, accordingly to the respective scope (distribution) and area of activity.

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

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 regulate the questions related to ensuring the national fuel security, including the area of international trade in natural gas. The Act introduces certain changes with respect to the business activity of PGNiG S.A.:

- imposes the obligation to maintain mandatory reserves of natural gas,
- sets out the timetable for accumulation of mandatory reserves of natural gas; in 2012, the volume of mandatory reserves shall reach the level corresponding to the average 30 days' gas imports volume;
- provides for the rate of return on capital employed in storage activity of at least 6%;
- stipulates that costs related to maintaining, releasing and supplementing the reserves do constitute a justified operating cost within the meaning of Art. 3.21 of the Polish Energy Law.

3. Polish Geological and Mining Law

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

- performance of geological works,
- extracting minerals from fields,
- disposal of waste in the subsurface, including underground mining excavations,
- protection of mineral deposits, underground waters and other environmental resources in connection with geological works and extraction of minerals.

The provisions of the Geological and Mining Law are also applicable to any business activity involving non-reservoir storage of substances in the subsurface, including underground mining excavations.

Any business activity involving prospecting for or exploration of mineral deposits, extraction of minerals from fields, non reservoir storage of substances and disposal of waste in the subsurface, including underground mining excavations is subject to licensing.

Geological and mining activities are supervised the competent geological administration and mining supervision authorities. The Geological and Mining Law provides for penal measures in case of a breach of its provisions and sets out the upper and lower limits of the royalty rates.

Licences

As at December 31st 2007, PGNiG S.A. held:
- 67 licences for exploration and prospecting of crude oil and natural gas deposits;
- 213 licences for production of crude oil and natural gas from fields;
- 8 licences for underground gas storage (UGS);
- 4 licences for disposal of waste.

In 2007, the Ministry of Environment assigned eight licences held by Eurogas Polska Sp. z o.o. to PGNiG S.A. covering the total area of 3520 km^2 and granted one new licence for exploration and prospecting of crude oil and natural gas deposits. Since the beginning of 2007, eight expired licences had not been renewed because further exploration and prospecting would be unprofitable. In 2007, eight new production licences were obtained, while three licences were cancelled. In the period under review, no changes occurred with respect to licences for underground gas storage and disposal of waste.

In 2008, the Company intends to renew all expiring exploration licences and apply for nine new licences. The Company has also applied to the Minister of Environment for three new production licences.

Section VI: Exploration and Production

The core business of this segment consists in hydrocarbon sourcing from the fields and preparation of the products for sale. The segment covers the entire process of exploration and production of natural gas crude oil from fields, starting from geological analyses, to geophysical surveys and drilling operations and field development and operation. The exploration and production activity involves PGNiG S.A. itself and the Group companies providing the related upstream services.

1. Exploration

In 2007, the PGNiG Group was involved in prospecting for and exploration of hydrocarbon deposits, which included, *inter alia*, 367,156 meters of drilling, 6,864 km of 2D seismics and 4,447 km^2 of 3D seismics. The above efforts where serving both the needs of the PGNiG Group with respect to exploration and field development and those of third parties domestically and aboard.

For field exploration by PGNiG S.A. the total of 52,081 m was drilled in the Carpathians, the Carpathian Foredeep and the Polish Lowlands. In 2007 the drilling work and field tests were completed on 24 wells. Based on the well tests, 16 wells were recognised as successful with 13 and 3wells flowing natural gas and crude oil, respectively, at commercial rates. In addition, 1,573 km of 2D seismic surveys and 600 km2 of 3D seismics were performed domestically plus 161.7 km of 2D seismics abroad.

In 2007 the recoverable reserves on natural gas, expressed as high-methane gas equivalent, increased by 2,807 million cu. m and 360 thousand tonnes for natural gas and crude oil, respectively. As at the end of 2007, the documented reserves of natural gas amounted to 96.9bn m^3 (high-methane equivalent), while the reserves of crude oil were estimated at 21.2m tonnes. The volume of the reserves was positively validated by the Mineral Reserves Commission and approved by the Minster of Environment.

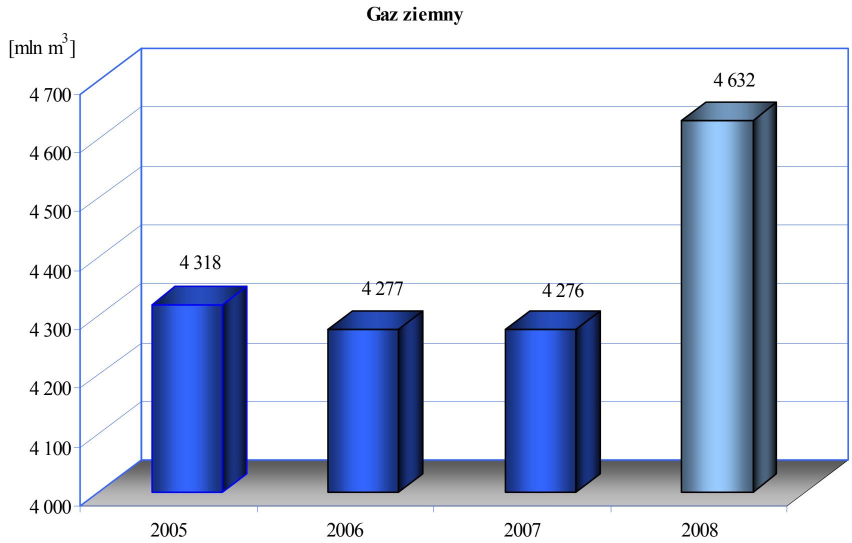
In 2007, PGNiG S.A. continued to work together with FX Energy Poland Sp. z o.o. under the four previously signed joint operating agreements concerning the areas of "Płotki", "Płotki"-"PTZ" (in cooperation with CalEnergy Resources Poland Sp. z o.o.), "Poznań" and Block 255. Furthermore, PGNiG S.A. started joint exploration efforts with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o. on the existing license held by Eurogas Polska Sp. z o.o. , which covers the "Bieszczady" area. In 2007, 2D seismic field works were completed on the Kirthar block in Pakistan and the processing of the acquired field data was undertaken. The above project was carried out in cooperation with Pakistan Petroleum Ltd.

2. Production

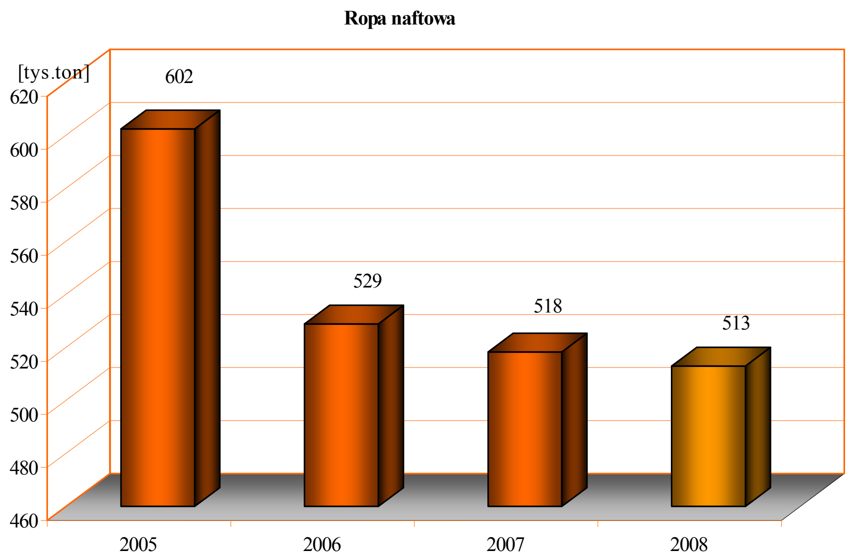
In 2007, the PGNiG Group carried out extensive exploitation operations including production of hydrocarbons, as well as assessment of the reserves, development of discovered fields, well workover and stimulation efforts to preserve the original reservoir production rates. Furthermore, the company proceeded with abandonment of those wells where the production rates dropped below the costs of operation and maintenance. The abandoned areas were undergoing land reclamation.

The operations of natural gas and crude oil Fields in Poland is carried out by two branches of PGNiG S.A. i.e. the Branch in Zielona Góra and the Branch in Sanok. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 26 production facilities (including 16 that produce gas only and 10 producing both oil and gas), while the Sanok Branch produces crude oil and high-methane natural gas at 47 production facilities (including 25 with gas only, and 22 producing either oil and gas or oil only). The processing of nitrogen-rich gas into high-methane gas takes place in the nitrogen removal plant in Odolanów.

In 2007, the PGNiG Group. produced the total volume of 4,276.1m m^3 of natural gas (high-methane equivalent) – 1,885.1m m^3 was produced in the Sanok Branch, and 2,391.0m m^3 in the Zielona Góra Branch. The natural gas production volumes in the years 2005-2007 and the production forecast for 2008 are presented in the following chart.



The crude oil production in 2007 reached the level of 518.2 thousand tonnes, of which 472.0 thousand tonnes were produced in the Zielona Góra Branch and 472.0 thousand tonnes in the Sanok Branch. The crude oil production volumes in the years 2005-2007 and the production forecast for 2008 are illustrated in the following chart. A major leap in the crude oil production is expected following to the development of the LMG field (Lubiatów-Międzychód-Grotów).



Additionally, in the course of field operations and the process of nitrogen removal from natural gas other products were obtained, i.e. condensate, sulphur, LPG, helium and liquefied natural gas. The structure of the remaining production of the PGNiG Group is shown in the following table.

Other production

	Product	Unit	2007	2006
1.	Condensate	thousand tonnes	9.6	12.1
2.	Sulphur	thousand tonnes	23.3	20.7
3.	LPG	thousand tonnes	18.2	17.1
4.	Helium	million m^3*	2.3	2.4
5.	LNG	million m^3*	21.7	19.9

In 2007, a total of 10 wells were placed in operation within the operating area of the Sanok Branch on the following deposits: Żołynia, Kańczuga, Jasionka (first phase – seven wells) and Przemyśl. The aggregate incremental production capacity of these wells is approx. 530 m^3/min. Also in 2007, two wells were put in operation within the operating area of the Zielona Góra Branch: Radlin, with the natural gas production capacity of 30 m^3/min, and Buszewo, with a production capacity of 70 tonnes of crude oil per day.

In 2007, the exploration and production segment was engaged in non-tariff sales of natural gas, as well as the sales of crude oil and other products. The following table presents the product sales by volume.

Sales

	Product	Unit	2007	2006
1.	Natural gas	million m^3*	628.7	564.6
2.	Crude oil	thousand tonnes	540.6	515.0
3.	Condensate	thousand tonnes	1.1	3.9
4.	Helium	million m^3*	2.4	2.4
5.	LPG	thousand tonnes	18.4	16.9

PGNiG S.A. operates six underground gas storage facilities with the total working capacity of 1,660.2m m^3. The Sanok Branch operates four underground gas storage facilities located in depleted natural gas deposits (Brzeźnica UGS, Husów UGS, Strachocina UGS and Swarzów UGS). The Zielona Góra Branch operates the Wierzchowice UGS while INVESTGAS S.A., acting on behalf of PGNiG S.A., is the operator the Mogilno UGS (in salt caverns).

3. Planned Activities

Exploration in Poland

In 2008, exploration efforts are planned in the following regions:

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

Exploration abroad

In 2007, PGNiG S.A. took a number of steps to acquire new sites for exploration and new licence areas in such countries as Libya, Algeria, Egypt, Iran, India, Kazakhstan and Denmark. All these efforts will be continued in 2008.

On June 18th 2007, PGNiG S.A. and Willumsen Exploration Consultants Aps (WeXco), a Danish company, signed a memorandum of understanding concerning the assignment of a 40% interest in the onshore licence 1/05 in Denmark to PGNiG S.A. The assignment agreement was signed on December 6th 2007. Currently the interests in the licence stand as follows: PGNiG S.A. – 40%, Odin Energi A/S – 40%, Nordsofonden (a Danish government-controlled company) – 20%. Reprocessing of the existing seismic data started at the beginning of 2008.
In mid 2007, PGNiG S.A. won a tender for operatorship on new license blocks in Libya and was invited to sign an Exploration and Production Sharing Agreement (EPSA), regulating the exploration and production operations on Block 113. On February 6th 2008, PGNiG Finance B.V. was transformed into POGC Libya B.V. for the purposes of the project execution in Libya. The exploration work on Block 113 is due to commence in 2008.

In May 2007, PGNiG S.A. won a tender for the Bahariya license (Block 3) in Egypt. The license contract was initialled in July 2007. As soon as the contract is signed, PGNiG S.A. intends to commence the exploration on this licence block.

On February 6th 2008, PGNiG S.A. signed a letter of intent with Iranian Offshore Oil Company (IOOC) for the development of the Lavan field containing natural gas and condensate.

LMG Project

The objective of this project is to develop the Lubiatów-Międzychód-Grotów (LMG) fields with crude oil and natural gas, as well as to arrange for transportation, storage and sale of crude oil, natural gas, sulphur and LPG from the LMG Crude Oil and Natural Gas Production Facility.

Grodzisk Nitrogen-Removal Plant

The objective of this project is to enable the sale of gas from nitrogen-rich fields following to its processing (cryogenic process to remove nitrogen from nitrogen-rich gas) into standard composition matching the parameters of high-methane gas. The Grodzisk Nitrogen Removal Plant is constructed with a view to increasing the volume of nitrogen-rich gas produced from both the existing fields and those planned for development, and will help to even out the production rate of nitrogen-rich natural gas fields in the winter and summer seasons. The project value is estimated at PLN 380 million.

The project comprises the development of natural gas produced from the Wielichowo, Ruchocice, Elżbieciny, Jabłonna and Paproć-W fields, as well as for modernisation of the Paproć Natural Gas Production Facility (KGZ Paproć), construction of the Przyłęk-KGZ Paproć gas pipeline and construction of the Grodzisk Nitrogen Removal Plant. The total throughput capacity of the Nitrogen Removal Plant will reach around 35,000 m^3/h. The high-methane gas from the Nitrogen Removal Plant will be delivered to the national gas system.

New connections

In 2008, the Company plans to commission three new fields including Jasionka (Phase 2), Cierpisz, and Łękawica and ten wells at producing fields (Rzeszów-9, Tarnów-81k, Kowale-2, Wierzchosławice-5, Mirocin-62, Żołynia-75, 76, 82, 83, 84), with aggregate production capacity estimated at 470 m^3/min.

4. E&P Subsidiaries

PNiG Jasło Sp. z o.o.

Poszukiwania Nafty i Gazu Jasło Sp. z o.o. (PNiG Jasło) is involved in the drilling and documentation of prospecting, exploration, appraisal and production wells, drilling geothermal wells and freeze holes, well workover and abandonment, as well as specialised drilling services including cementation and mud services, well reinforcement and measurement and control instrumentation in well surface installations.

In 2007, the company's revenues from sales reached PLN 236.6 million with sales revenues from drilling and maintenance services provided to the PGNiG Group reaching 65%. Drilling works and specialist services were provided to PGNiG S.A. under 12 well development contracts. Furthermore, the company performed well drilling services for RWE Dea Sp. z o.o. and freeze hole drilling for PeBeKa S.A. as well as cementation and packer services for other third-party customers. The company's international activity included drilling services in Libya and drilling and workover services in Ukraine as well as certain specialist services for customers in Lithuania, Latvia and Bulgaria.

The domestic market shall remain the company's key market in 2008 and in the years to come with Libya, Germany, Russia and Ukraine as its supplementary markets both in the field of petroleum and geothermal services. In November 2007 the company signed contracts to drill appraisal wells for KGHM Polska Miedź S.A. and two geothermal wells in Germany. Over the next few years, the company is planning to involve 35-50% of its potential in the foreign activity.

PNiG Kraków Sp. z o.o.

The company's core business consists in drilling geological, exploration and production wells, well workover and specialist services related to well drilling, testing and operation. Other services provided by the company include underground rescue, hospitality, catering, renting and training services.

In 2007 PNiG Kraków Sp. z o.o. reached PLN 301.0 million in sales revenues with its services rendered to foreign customers from outside the PGNiG Group amounting to 68% of the overall sales. The revenues from sales to the PGNiG Group reached 28%.

The main markets where the company sold its drilling services to foreign operators in 2007 included Kazakhstan, Pakistan Mozambique and Ukraine whereas the PGNiG Group remained its key partner on the domestic market for whom the company performed several drilling works and provided maintenance services as part of domestic contracts with PGNiG S.A. Furthermore, PNiG Kraków Sp. z o.o. signed new drilling contracts with operators in Pakistan Kazakhstan and won the tender to perform drilling operations in Uganda.

The company's main goal is to ensure further growth of its activity in the countries involved in the exploration and development of crude oil and natural gas. The most promising export markets include Kazakhstan, Pakistan, Libya and India due to their ample oil and gas reserves with relatively low production levels. The company's plans for the year 2008 assume continued performance of its contracts in Kazakhstan, Pakistan, Mozambique and Ukraine. In addition, the company plans to mobilise one from Mozambique to Uganda as part of the new drilling contract.

PNiG NAFTA Sp. z o.o.

PNiG NAFTA's core business is the exploration of natural gas and oil deposits, specialist drilling services, drilling wells for the purpose of underground hydrocarbon storage, abandonment of wells in depleted fields and workover of producing wells.

The company's overall sales in 2007 reached PLN 256.9 million with revenues from services provided to the PGNiG Group at the level of 61%. In 2007 the company started drilling operations for the underground gas storage facility in Mogilno for with INVESTGAS S.A. as the project's key investor. As part of its foreign activity PNiG NAFTA Sp. z o.o. continued drilling operations under contracts signed in the previous years and also under new contracts won in India Egypt and Hungary. Export sales to customers outside the PGNiG Group accounted for approximately 30% of the company's overall sales revenues.

As part of the company's foreign contracts in 2008, drilling operations will continue in India, Egypt and Hungary. The company has launched an extensive promotional/marketing campaign to diversify its drilling services to include the Danish and German markets where massive drilling activity is planned for the purpose of those countries' geothermal projects. The company is also planning to purchase a new drilling rig to be used in its foreign drilling activity.

GEOFIZYKA Kraków Sp. z o.o.

GEOFIZYKA Kraków is mainly involved in providing geophysical services including 2D and 3D field seismics with vibration and dynamite excitation sources, processing and interpretation of seismic data from geophysical surveys, logging, specialist treatments and services on wells, and also interpretation, perforation and seismometric services.

In 2007, GEOFIZYKA Kraków's overall sales revenues reached PLN 226.5 million with 65% of its sales being exported outside the PGNiG Group. The company performed field seismics services in Austria, Hungary, Denmark and Turkey. GEOFIZYKA Kraków also executed a 2D and 3D seismic data interpretation and acquisition contract in the Czech Republic. The seismic data processing contract the company carried out in 2007 included a contract for the Hungarian company MOL (as part of exploration under its Yemen licence) and a contract for the French scientific institution BRGM. In 2007 the company also signed a number of long-term framework agreements for geophysical prospecting services in Latvia and Hungary, whereas in Pakistan it expanded its range of services to include vibration methods. The PGNiG Group remains GEOFIZYKA Kraków's key customer on the domestic market with 29% of the company's sales.

In order to launch the company's activity in Libya, a joint stock company under the name of "GEOFIZYKA Kraków Libya JSC" was created on 29 January 2008 whose share holders include GEOFIZYKA Kraków with 60% of the share capital and BARARI Co. For Oil Services – 40 % of the share capital.

In 2008 the company is going to concentrate its activity in Libya, Pakistan Czech Republic, Slovakia, Hungary, Denmark and Austria as well as on the domestic market. By the end of 2007 and early in 2008, the company was awarded a number of major contracts including a USD 15 million contract in Pakistan and a USD 6.7 million one in Libya and same drilling geophysics contracts in Slovakia and Hungary to be performed in 2008.

Due to the unstable political situation in Pakistan in 2007, GEOFIZYKA Kraków was forced to temporarily suspend the works being carried out in this country. Owing to long term experience on that market, the company is able to minimise the risks involved. In the first quarter of 2008 the company commenced the USD 15 million contract for the Pakistani company OGDCL.

<u>GEOFIZYKA Toruń Sp. z o.o.</u>

GEOFIZYKA Toruń Sp. z o.o. is involved in providing geophysical services including seismic services ranging from data design and acquisition to digital data processing and comprehensive geological/geophysical interpretation. Moreover, it provides well logging and treatment services including interpretation, drilling services shallow geophysical surveying for the environmental, geological and hydrological purposes, as well as for the design and execution of deep groundbeds in cathodic protection.

In 2007, the company's sales revenues reached PLN 314.6 million. Sales outside the PGNiG Group amounted to 62% and the exports of services reached 55% of overall company sales. The company's key markets included India, Syria and Iran and the scope of services provided included the full range of seismic surveys. The PGNiG Group was the key domestic customer of GEOFIZYKA Toruń. In addition, on the domestic market the company provided its services to the American company FX Energy as well as open-pit mines, the Geological Institute, local government administration units and the construction industry.

In 2007 GEOFIZYKA Toruń succeeded in 92 tenders, the most important of which included commissions for 2D seismic data acquisition for Shell (Syria) and Reliance Industries (India) as well as 3D seismic data acquisition for Oil India (India) and GeoEnergy (Germany).

In 2008, the company intends to continue strengthening its position on the domestic market and selected foreign markets (India, Iran, Syria) through expanding the range of services provided and optimising the use of its resources. The company's plans also include making entries into new foreign markets (Yemen, Egypt and Saudi Arabia)

<u>Poszukiwania Naftowe „Diament" Sp. z o.o.</u>

Poszukiwania Naftowe "Diament" Sp. z o.o. provides professional services including drilling, well drilling, well overhauls and production tests, well logging, stimulation and other treatments using coiled tubing and nitrogen equipment, as well as well completions and tests with the use of formation testers with anti-eruption protection. Furthermore, the company is involved in activities related to general construction, road construction, construction of landfills, ground insulation and other pro-environmental earthworks, vehicle repairs, mechanical and electrical servicing as well as transportation and equipment lease services.

PN Diament's overall sales revenues reached PLN 161.3 million in 2007 where the sales within the PGNiG Group constituted 67%. The company performed a range of specialist works for the Group including stimulation and workover of production wells, well cementation works and mud services. The remaining 33% of sales were related to general construction and road services and a wide range of pro-environmental investment projects and constructions for external, mainly domestic customers.

The PGNiG Group will remain the key customer for PN Diament for specialist services in 2008. Other customers include external companies with whom in 2007 the company signed new contracts including drilling appraisal wells, service works, making a waste disposal facility with on-site infrastructure as well as earthworks, road works and large-scale levelling works.

Zakład Robót Górniczych Krosno Sp. z o.o.

Zakład Robót Górniczych Krosno Sp. z o.o. is a specialist company providing well services. The company's core business consists in services related to production wells, including reconstruction and servicing of oil and gas production wells, subsurface drilling (up to maximum depth of 1000 m), deepening of production wells in use, abandonment of wells, infrastructure and mining excavations, as well as other adverse effects of the well drilling activity. Furthermore, the company offers a wide range of specialist drilling, logging and laboratory services.

ZRG Krosno's overall 2007 sales revenues reached PLN 88.6 million. The PGNiG Group is the company's key customer (78%) and its remaining partners are the domestic well mining companies prospecting mineral deposits and geothermal waters. The company also provided its services on foreign markets including Kazakhstan, Mozambique (for PNiG Kraków), Ukraine and Latvia.

In 2008 ZRG Krosno is planning to purchase a drilling rig for core drillings within the depth range up to 1500m . With this investment, ZRG Krosno will become one of the few companies in Europe able to perform professional and effective core drilling. The PGNiG Group will remain the company's key market in 2008 and in the near future. As a long-term goal, ZRG Krosno is planning to expand into the Middle and Eastern European markets in order to win new service contracts.

PGNiG Norway AS

The presence of the PGNiG Group on the Norwegian Continental Shelf is driven by the strategy of PGNiG S.A. aimed at developing the Company's reserves of crude oil and natural gas outside of Poland. The acquisition of interests in three exploration and production licences in Norway is a long-term investment and a way to diversification of the sources of natural gas supply and thereby it enhances the security of gas supply to Poland.

On February 28th 2007, PGNiG S.A. concluded a conditional agreement with Mobil Development Norway A/S and ExxonMobil Production Norway Inc. concerning purchase of a 15% interest in the three PL 212, PL 212B and PL 262 licences covering the Skarv and Snadd fields in the Norwegian Continental Shelf, for the price of USD 360 million.

At the time British Petroleum acted as the operator of the fields and other partners to the license were Shell, Statoil and Norsk Hydro. In August 2007, E.ON Ruhrgas Norge entered into a transaction with Shell for a purchase of its interests in the exploration and production licenses for the Skary-Idun fields. At the moment British Petroleum continues to be the operator and the other partners to the development are StatoilHydro and E.ON Ruhrgas Norge.

As a result of the unitisation of the Skarv and Snadd fields with the Idun field on the Norwegian Continental Shelf, PGNiG S.A.'s share in the unitized (expanded to include the Idun field) exploration and production block is approx. 12%.

According to the data approved by the Norwegian Petroleum Directorate, the total volume of the reserves in all the fields covered by the licences acquired form ExxonMobil Production Norway Inc., is estimated at approximately:

- 37.9 billion m^3 of natural gas
- 16.8 million m^3 of crude oil and condensate (approx. 15 million tonnes)
- 5.3 million tonnes of NGL (Natural Gas Liquids).

The first production of natural gas and crude oil is expected in H2 2011. It is estimated that capital expenditure on the development of the fields will amount to around USD 5bn, including PGNiG S.A.'s capital expenditure of around USD 600m.

For the purposes of the Norwegian Continental Shelf project, PGNiG S.A. established a dedicated subsidiary operating under the name of PGNiG Norway AS and based in Stavanger, Norway. PGNiG Norway AS was registered in the Register of Business Enterprises on June 9th 2007. Its share capital is NOK 10,000,000 and PGNiG S.A. took up 100% shares in the company. Its scope of business encompasses prospecting for and exploration of oil and gas fields and participation in infrastructure development projects related to offshore transportation.

As a precondition to start its operations on the Norwegian Continental Shelf the company had to be pre-qualified by the Norwegian Ministry of Petroleum and Energy (MPE). PGNiG S.A. obtained the relevant consent in September 2007.

On 16 October 2007, a loan agreement was executed between PGNiG S.A. and PGNiG Norway AS. The loan for the amount of NOK 3,800,000,000 was extended for the term until 20 December 2022. The funds served to finance the purchase of interests in the license areas on the NCS and other expenditures related to the field development.

On October 19th 2007, PGNiG S.A. and PGNiG Norway AS signed an agreement on assignment of all the rights and obligations arising under the agreement on the purchase of interests in the licence areas on the Norwegian Continental Shelf. The agreement became effective upon closing of the transaction concerning the purchase of interests in the licence areas on the Norwegian Continental Shelf.

At the same time, a guarantee agreement was signed whereby PGNiG S.A. provided a guarantee to PGNiG Norway AS in the amount of EUR 627.6 thousand until 1 January 2050. The parent guarantee secures the performance of certain obligations of PGNiG Norway arising under the licences or by operation of the law with respect to, *inter alia,* the Norwegian government and certain Norwegian entities. The obligation to provide such guarantee stems from the Norwegian Petroleum Activities Act of 1996. The guarantee is a standard document customarily used in respect to production operations in Norway.

In 2007, the Company fulfilled a number of conditions precedent to the performance of the agreement under the Polish and Norwegian law. The relevant decisions and approvals were issued by the Minister of State Treasury, General Shareholders Meeting of PGNiG S.A., Norwegian Ministry of Petroleum and Energy, and Norwegian Ministry of Finance.

Having fulfilled the conditions, on October 30th 2007, PGNiG Norway AS acquired interests in the PL 212, PL 212B, PL 262 licences from Mobil Development Norway A/S and ExxonMobil Production Norway Inc, for the price of USD 360m. The transaction was financed with the loan advanced by PGNiG S.A. and the funds raised from an increase of the share capital of PGNiG Norway AS.

The capital increase up to NOK 497,327,000 was registered on 8 November 2007. PGNiG S.A. holds 100% of the shares in PGNiG Norway AS representing 100% of the voting rights at the General Meeting.

At the moment the primary focus of PGNiG Norway AS is on the Skarv field development project. In December 2007, following approval of the Field Development Plan by the Norwegian Parliament, the execution phase of the Scarv Project was officially launched.

The field development involves the use of a floating production, storage and offloading platform (FPSO). The development plan envisages drilling 16 wells (including 12 production wells and 4 injection wells). At a later stage of the field life the injection wells will be transformed into gas production wells to ensure full depletion of the field. The first production has been planned for the year 2011.

Section VII: Trade and Storage

The segment is concerned with the sales of natural gas, both imported and produced from domestic fields, and use of the underground gas storage capacity for commercial needs. Following to the process of integrating the trading activities, PGNiG S.A. took over the responsibility for natural gas sales. The segment uses three underground gas storage facilities – in Mogilno, Wierzchowice and Husów. The operation and development of the storage facilities are a responsibility of PGNiG S.A. and INVESTGAS S.A. – one of subsidiary companies of the Group.

The segment sells both high-methane and nitrogen-rich gas supplied to the transmission and distribution system. The gas trade is regulated by the Energy Law and the prices are set based on tariffs approved by the President of the Energy Regulatory Office.

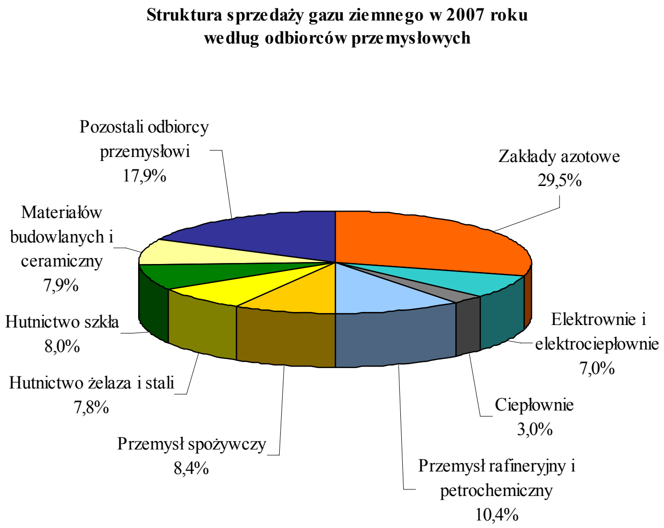
1. Sales Structure

The main groups of gas consumers were constituted by the chemical, metal and power generation industry and households. The table below presents the structure of natural gas sales measured as high-methane gas equivalent broken down by major consumer groups.

Natural gas sales from the system in million cu.m

	Total sales	2007		2006	
		12,974.8	100.0%	12,950.3	100.0%
1.	Industrial consumers	7,848.6	60.5%	7,658.3	59.1%
2.	Commercial and service sector	1,326.3	10.2%	1,391.2	10.8%
3.	Households	3,640.9	28.1%	3,783.8	29.2%
4.	Wholesale consumers	119.2	0.9%	76.4	0.6%
5.	Exports	39.8	0.3%	40.6	0.3%

Households were the largest group of natural gas consumers (approx. 6.5 million) accounting for 99.6% of all customers served by the Group. The share of this group in the sales volume was 28.1%. Meanwhile, the industry consumed the bulk of the natural gas sold (60.5%). The breakdown of the sales volume to industrial consumers is presented in the following chart.



2. Supply Structure

In 2007, the PGNIG Group purchased natural gas from imports and, marginally, from domestic suppliers. The imported natural gas originated primarily from the eastern direction, i.e. from Russia and Central Asia. The table below presents the structure of natural gas supply measured as high-methane gas equivalent.

Structure of natural gas supply (million cu. m)

Source of gas supply		2007	%	2006	%
1.	Imports, of which:	9,286.0	99.8%	10,028.4	99.9%
	- OOO Gazprom Eksport	6,219.2	67.0%	6,839.7	68.1%
	- ROSUKRENERGO AG	2,279.3	24.5%	2,346.9	23.4%
	- Other foreign suppliers	787.5	8.5%	841.8	8.4%
2.	Domestic suppliers	15.8	0.2%	10.1	0.1%
Total:		9,301.8	100.0%	10,038.5	100.0%

3. Major Commercial Agreements

Purchase Agreements

In 2007, 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 gas deliveries from ROSUKRENERGO AG and VNG-Verbundnetz GAS AG/ E.ON Ruhrgas AG:

- Contract for supply 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 natural gas sales to the Lasów border point 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.

On January 17th 2007, PGNiG S.A. and DONG Energy A/S signed a Memorandum, in which they expressed the intention to continue their cooperation in the natural gas business. In their future cooperation, the Parties will draw on their experience, taking into account the European gas markets environment, and may undertake joint infrastructure development projects in the Baltic Sea basin to ensure security of supply.

On March 27 2007, PGNiG and the Norwegian company TOTAL E&P NORGE AS signed the General Terms and Conditions of Gas Sales. The General Terms and Conditions are conceived as a framework agreement and provide a basis for execution of individual transactions for natural gas supply. The General Terms and Conditions of Natural Gas Sales set forth general rules defining cooperation of the companies with regard to gas supply, whereas the details concerning particular deliveries, their volumes and prices will be specified more precisely in the future Transaction Agreements. The General Terms and Conditions provide for access by PGNiG S.A. to the delivery points for Norwegian gas in Europe. Thereby PGNiG S.A. will be able to purchase additional gas volumes in the periods of increased demand and resell the potential surplus volumes. The term of the General Terms and Conditions is indefinite.

<u>Sales Contracts</u>

In 2007, PGNiG S.A. signed nine comprehensive agreements for supply of gaseous fuel to customers, from both transmission and distribution systems. In addition, PGNiG S.A. signed two agreements with OGP GAZ-SYSTEM S.A. for sale of natural gas for own consumption needs.

The Company also executed two agreements on sale of gaseous fuel directly from fields, including:
- one contract for 10 years' term concerning sale of nitrogen-rich natural gas, with the start of supplies scheduled for Q2 2008;
- one contract to continue in force until the end of 2008.

In Q2 2007, as part of cooperation with the Orlen Group, PGNiG S.A. resumed cooperation with Rafineria Trzebinia which thus became the main customer for crude oil delivered by rail. The Company continues to supply crude oil to Rafineria Nafty Jedlicze, a member of the Orlen Group, under a ten-year contract.

<u>Transmission Service Agreements</u>

On 1 October 2007, PGNiG S.A. singed two transmission agreements with OGP GAZ-SYSTEM S.A. The agreements concern provision of transmission services for, respectively, high-methane gas and nitrogen-rich gas and set out the terms and conditions for supply of the gas to and its offtake from the transmission system. The term of both contracts covers the period from 1 October 2007 until 31 December 2010. The estimated contract value is PLN 5.6 billion.

Distribution Service Agreements

In late August and early September 2007, the six agreements for distribution services were executed between:

- Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. and Dolnośląska Spółka Obrotu Gazem Sp. z o.o., with an estimated value of PLN 811.7m over the entire agreement term;
- Górnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. and Górnośląska Spółka Obrotu Gazem Sp. z o.o., with an estimated value of PLN 2,200.0m over the entire agreement term;
- Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o. and Karpacka Spółka Obrotu Gazem Sp. z o.o., with an estimated value of PLN 3,200.0m over the entire agreement term;
- Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o. and Mazowiecka Spółka Obrotu Gazem Sp. z o.o., with an estimated value of PLN 3,800.0m over the entire agreement term;
- Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o. and Pomorska Spółka Obrotu Gazem Sp. z o.o., with an estimated value of PLN 2,040.6m over the entire agreement term;
- Wielkopolski Operator Systemu Dystrybucyjnego Sp. z o.o. and Wielkopolska Spółka Obrotu Gazem Sp. z o.o., with an estimated value of PLN 1,364.9m over the entire agreement term.

Under the agreements the respective Distribution System Operator shall provide services in respect of gas distribution to the respective Gas Trading Company, on a continuous basis, using the distribution system owned or operated by the Distribution System Operator. The agreements entered into force as of 29 June 2007 for a term of 4 years. As a result of the incorporation of the Gas Trading Companies into PGNiG S.A., the Company became, by virtue of succession, a party to the above agreements.

4. Activities Planned in the Trading Segment

Alternative Gas Supply Routes

On April 19th 2007, PGNiG S.A. and Energinet.dk executed a Letter of Intent concerning the construction of the Baltic Pipe – a gas pipeline connecting the Polish and Danish gas systems. On November 7th 2007, PGNiG S.A. and OGP GAZ-SYSTEM S.A. executed a bilateral Cooperation Agreement Concerning the Baltic Pipe Project. On November 15th 2007, Energinet.dk, PGNiG S.A. and OGP GAZ-SYSTEM S.A. executed a trilateral cooperation agreement, which is another step in the execution of the Baltic Pipe Project. At present, the parties to the agreement are jointly conducting technical analyses and working on the detailed arrangements relating to the project execution.

On June 20th 2007, PGNiG S.A. joined the consortium established for the purpose of construction of the Skanled gas pipeline (from Karsto in Norway to Sweden and Denmark) and acquired 15% interest in the consortium for no consideration. The investment decision is to be made in October 2009.

Natural Gas Purchase

PGNiG S.A. does not expect any major changes in the structure of supply sources in 2008, nor any amendments to the existing gas purchase contracts. Steps are being taken to secure additional gas supply in connection with the expiry, on September 30th 2008, of the gas sale contract with VNG-Verbundnetz Gas AG/ E.ON Ruhrgas AG dated September 15th 2004.

Natural Gas Sales

The expected growth of the natural gas sales volume is attributable to the investments of PGNiG's strategic customers in the petrochemical, construction and steel industries in the expansion of their business. In 2007, PGNiG S.A. established cooperation concerning potential gas supply with several major prospective customers, including some power generators planning to replace their coal-fired generation units with gas-fired ones. The start of natural gas deliveries to modernised power plants and CHP plants has been planned for 2011-2012. Furthermore, in 2007 the Company started negotiations with electricity suppliers concerning joint sales of electricity and natural gas. It is expected that in 2008 the cooperation model will be defined and first joint implementation initiatives will be undertaken.

5. Trade and Storage Subsidiaries

Polskie LNG Sp. z o.o.

Polskie LNG was established on 29 March 2007 and entered into the National Court Register on 21 May 2007. The company's share capital is PLN 28 million with PGNiG S.A. holding 100% of the shares. The core business of PLNG Sp. z o.o. concerns the regasification process including unloading, handling and regasification of liquefied natural gas in the LNG terminal.

Importing LNG into Poland is one of the diversification alternatives for gas supplies and a method to satisfy a growing demand for gas. Based on the Feasibility Study of 15 December 2006 the PGNiG management made the decision on the location of the LNG terminal in Świnoujście, and on 6 February another decision was made to embark on preparatory and design activities. As assumed, the initial volume of gas deliveries from the LNG terminal to the network will be of the order of 2.5 BCM/year. Depending on gas demand, the capacity may be increased to 5 BCM/year and, ultimately, 7.5 BCM/year

On 8 October 2007 the company's share capital was increased to PLN 39 million and, repeatedly, on 7 January by another PLN 11 million, thus amounting to PLN 50 million. The shares in the increased capital were paid-up by PGNiG in the form of a cash contribution.

On 17 October 2007 PGNiG transferred to PLNG the property lease agreement intended for the purpose of the LNG terminal in Świnoujście (concluded by PGNiG and the Szczecin and Świnoujście Seaports Authority). The local land development plan was also updated.

On 10 January 2008 an agreement was concluded between PLNG and SNC Lavalin Services Ltd. to prepare the terminal's engineering and economic documentation including the required permits.

INVESTGAS S.A.

INVESTGAS specialises in the execution of projects related to storage and transportation of hydrocarbons. It is also involved in specialist and general construction projects. The scope of the company's services includes the entirety of the investment process from the preparation and design stages, through the building site management, technical commissioning and operation of the gas storage facilities in the salt caverns or other facilities covered by the scope of the contract.

In 2007 INVESTGAS achieved total sales revenues of PLN 33.9 million. of which sales of services to PGNiG S.A. constituted 86%. The scope of work carried out for PGNiG S.A. included:

- operation, overhaul and development of the Mogilno Cavern Underground Gas Storage Facility
- preparations for the construction of the Kosakowo Underground Gas Storage Facility and the KGZ Kościan-KGHM Polkowice/Żukowice gas pipeline

Moreover, the company carried out preparatory works for the construction of the Ostrów Wielkopolski – Wrocław Fuel Pipeline for PKN ORLEN.

The company's goal is to retain its leading position in the area of gas and fuel storage facilities in salt caverns both within the PGNiG Group and on the fuel market in Poland. The scope of services provided by INVESTGAS in 2008 will include: the continuation of projects commenced in the previous periods and preparatory works related to the construction of the Baltic Pipe offshore pipeline. INVESTGAS's scope of activity will be expanded to include comprehensive solutions for strategic investment projects undertaken by PGNiG S.A. Furthermore, the company is planning to boost its sales value by acquiring new large fuel contracts for such investors as PKN ORLEN, LOTOS, PERN.

SGT EUROPOL GAZ S.A.

The company's core business consists in the provision of services related to transmission of natural gas. The company provides transportation services and offers transportation capacity in the Polish section of the transit pipeline system (from the Belarus-Poland border to the entry points to the terminal exit-entry points). The transmission volume realised by the company in 2007 reached 30.8 BCM of gas.

PGNiG holds 48% of the shares SGT EUROPOL GAZ's share capital which amounts to PLN 80,000,000 and is divided into 800,000 shares with face value of PLN 100 each. The company's shareholder structure is presented below.

Shareholder structure

Shareholder	Shares held	Share capital held (PLN)	Share capital held (%)
PGNiG S.A.	384,000	38,400,000	48%
OAO "Gazprom"	384,000	38,400,000	48%
GAS-TRADING S.A.	32,000	3,200,000	4%

GAS-TRADING S.A.

GAS-TRADING is involved in various forms of business activity including investments, production, services and trading. The company's core business is primarily concerned with LPG (propane-butane, propane and butane) and its distribution in Poland. In 2007 the company imported approximately 35 thousand tons of LPG from the territory of the Russian Federation and some small amounts of the same from a German supplier. The main customers for LPG include GasTrading Podkarpacie Sp. z o.o. and Progas Eurogaz Sp. z o.o.

PGNiG is the majority shareholder holding 43.41% of the share capital. which amounts to PLN 2,975,000 and is divided into 59,500 shares with face value of PLN 50 each. The company's shareholder structure is presented below.

Shareholder structure

Shareholder	Shares held	Share capital held (PLN)	Share capital held (%)
PGNiG S.A.	25,827	1 291,350	43.41%
PHZ Bartimpex S.A.	21,523	1 076,150	36.17%
OAO „Gazprom"	9,450	472,500	15.88%
WĘGLOKOKS S.A.	1,350	67,500	2.27%
WIEH GmbH	1,350	67,500	2.27%

Section VIII: Distribution

The core activity of the segment consists in the transportation of natural gas through the distribution network. There are six DSO companies involved in the distribution of natural gas, which delivery gas to households, industries and wholesalers. In addition, the companies are responsible for the operation, maintenance and expansion of the distribution networks.

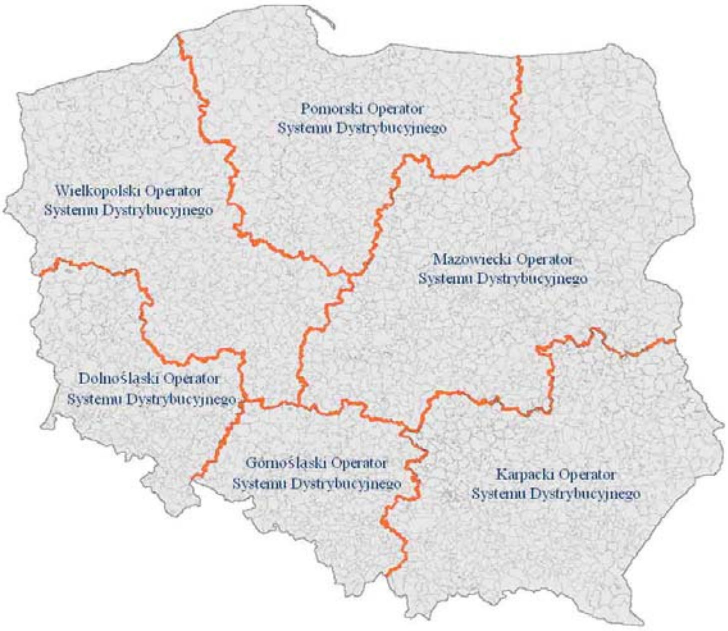
In 2006 and in the first half of 2007, the former Gas Distribution Companies of the Group were engaged in both the sales and distribution of natural gas. As a result of the legal unbundling of gas distribution from the commercial activities at mid of 2007, all commercial activities of the Group were integrated within PGNiG S.A. The Gas Distribution Companies were transformed into Distribution System Operators (DSOs). The unbundling not only changed the business profile of the company but also affected their financial performance.

In billing their customers, the Distribution System Operators apply the tariff that was in force before the unbundling and is not aligned with the business profile of the DSOs. The tariff being currently in force does not recover in full the cost of operation of the companies' assets and constraints the level of generated revenues, as well as their growth and investment potential.

In 2007, the DSO companies performed revaluation of their assets for the amount of approx. PLN 1.4 billion, which was necessary because of the change in their operating environment and scope of business. The asset revaluation reduced the financial results reported by the companies, although it did not affect the cash flows. The impairment tests applied to fixed assets revealed that the carrying value of the assets is considerably higher than its current recoverable value, which was mostly due to the fact that the cash flow projections were based solely on the distribution business. In addition, the reduction in the recoverable value of the fixed assets was determined by:

- amount of revenue from the distribution tariff approved by the President of ERO, which did not ensure the required return on distribution assets
- higher increase in the costs of the distribution activity as compared to the plans from previous years
- higher level of capital expenditures on asset replacement as compared to the plans from previous years.

The following map presents the geographies covered by each of the DSO companies



Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o.

Dolnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. supplies gas to consumers in Dolnośląskie and Lubuskie Voivodeships and Wolsztyn county in Wielkopolskie Voivodeship.

In 2007, DOSD Sp. z o.o. transported 910.2 million m^3 of gas through the distribution system, of which high-methane gas was approx. 72%. The company connected new consumers to the network, including two businesses whose ultimate gas consumption level will reach 29M m^3/year, and carried on with upgrading of the medium and low pressure networks.

In 2007, around 33.6 km of most unreliable cast-iron gas pipeline sections were replaced as their continued operation posed a safety threat and generated significant gas losses. The implementation of the cast-iron pipeline replacement program and regular inspections of the technical condition of the network leads to a reduced share of the gas losses in the overall sales volume.

In the coming years the company will focus on preserving its current market position and further increase of the transported gas volume through:

- Expansion of the pipeline infrastructure for new consumers
- replacement of cast-iron pipelines and modernisation of medium and low pressure networks
- replacement of gas meters manufactured before 1992
- Transportation of liquefied form and gas market development with the aid of LNG facilities.

	Unit	2007	2006
Sales revenue	PLN million	711.3	967.8
Net profit/loss	PLN million	-165.9	128.0
Equity	PLN million	795.0	996.5
Total assets	PLN million	1,055.8	1,321.6
Employment as at 31 December	persons	1,319	1,705
Network length (excluding service lines)	km	6,920.3	6,812.9

The area covered by the operations of DOSD Sp. z o.o. is being actively penetrated by other companies engaged in gas sales and distribution. In the future they could take over the potential and existing consumers of the company (both industrial and individual). There are two major competitors operating the area - Media Odra Warta Sp. z o.o. (MOW) and G.EN. GAZ ENERGIA S.A.

Górnośląski Operator Systemu Dystrybucyjnego Sp. z o.o.

Górnośląski Operator Systemu Dystrybucyjnego Sp. z o.o. supplies gas to consumers the Małopolskie Voivodeship, five communes of Łódzkie Voivodeship and three communes of Świętokrzyskie Voivodeship. The company serves 1.3 million consumers.

The economic upturn in the region and the planned construction of new transport routes in the Upper Silesia and Opolskie Voivodeship leads to both the emergence of new corporate consumers and increased interest in natural gas among individual consumers. However, because of the increased popularity of energy-saving technologies and warmer weather during the heating season it is not possible to draw a simple linear relationship between the growth trends and the raising volume of distributed gas.

Along with the completed construction of the transmission pipeline from Lubliniec to Częstochowa, in 2007 the company initiated the development of areas west of Częstochowa. It also embarked on a project to develop gas network in the towns of Herby and Blachownia, and in 2008 plans to start gas network construction in Wręczyca Wielka and Kłobuck.

Company overview

	Unit	2007	2006
Sales revenue	PLN million	1,126.9	1,543.2
Net profit/loss	PLN million	19.2	11.2
Equity	PLN million	1,394.8	1,470.2
Total assets	PLN million	1,636.3	1,739.2
Employment as at 31 December	persons	2,515	3,100
Network length (excluding service lines)	km	19,827.4	19,676.4

In the area covered by GOSD Sp. z o.o. competitive distribution companies have entered the market, positioning themselves as integrated companies capable of supplying the gas in addition to the construction of a gas service line. As a major advantage, competitive distribution companies offer the possibility of providing temporary deliveries of liquefied gas for the time of the construction of the gas network.

Karpacki Operator Systemu Dystrybucyjnego Sp. z o.o.

The operating area of the company covers four voivodeships in southern and eastern Poland: Małopolskie, Podkarpackie, Świętokrzyskie and Lubelskie. The area covered by the company's operations is crossed by one of the major gas pipelines of the national transmission system, which is supplied with natural gas from imports and domestic sources. Moreover, KOSD Sp. z o.o. has an extensive infrastructure consisting of transmission and distribution pipelines, compressor stations and underground gas storage, as well pressure reduction and measurement stations.

The company plans to expand the distribution network both by the means of traditional pipelines and through the development of the LNG market where the role of KOSD Sp. z o.o. would involve liquefaction and distribution of the fuel. The liquefied natural gas will be used at an early stage of the gas market development in those areas where an investment in the construction of a conventional gas pipeline is not economically justified. Such early development of the gas market with the means of LNG will enable, once the local market for natural gas develops, the construction of conventional gas supply pipelines, thereby optimising the investment processes and asset efficiency.

The market for compressed natural gas (CNG) is seen as another area that may have a positive impact on the company's growth. With respect to CNG stations owned by PGNiG S.A., the activities of KOSD Sp. z o.o. will consist in the construction of connection lines to the CNG stations, operation activities involving periodic checks, maintenance and repairs the station equipment.

In addition, KOSD Sp. z o.o. plans to continue providing additional services to its customers, apart from its core business activity, which will include: equipment installation and maintenance, installation tightness tests, energy audits.

Company overview

	Unit	2007	2006
Sales revenue	PLN million	1,561.5	2,188.0
Net profit/loss	PLN million	-16.6	98.1
Equity	PLN million	1,947.8	2,321.4
Total assets	PLN million	2,405.9	2,833.0
Employment as at 31 December	persons	3,265	4,003
Network length (excluding service lines)	km	42,545.9	42,227.7

In the area where KOSD Sp. z o.o. operates, increased activity of players seeking to build their own distribution networks in undeveloped areas is currently observed, e.g. by Media Odra Warta Sp. z o.o. (MOW), POLENERGIA S.A. or ENESTA Sp. z o.o. Other competitive undertakings that could present a potential threat to the market position of the company, include the distribution of liquefied natural gas. This form of gas supply started to be offered by CP Energia S.A.

Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o.

Mazowiecki Operator Systemu Dystrybucyjnego Sp. z o.o. supplies gas to consumer in the following voivodeships: Mazowieckie, Łódzkie, Podlaskie and parts of Lubelskie, Warmińsko-Mazurskie and Świętokrzyskie. The company serves 1.5 million consumers.

In 2007, the company focused its efforts mostly on the expansion and modernisation of the gas networks. In addition, the company signed 4 connection agreements, as a result of which the incremental gas consumption will reach approx. 3M m^3.

In 2008 MOSD Sp. z o.o. plans to build service lines and gas pipelines to connect consumers representing such industries as ceramics, steel, food, as well as cosmetics and chemicals. The target gas consumption resulting from these investments is estimated at approx. 70M m^3.

Company overview

	Unit	2007	2006
Sales revenue	PLN million	1,413.8	1,964.8
Net profit/loss	PLN million	-508.3	20.9
Equity	PLN million	1,379.9	2,014.9
Total assets	PLN million	1,801.0	2,637.6
Employment as at 31 December	persons	2,920	3,527
Network length (excluding service lines)	km	16,202.3	15,957.2

Pomorski Operator Systemu Dystrybucyjnego Sp. z o.o.

The territory of POSD Sp. z o.o. covers Pomorskie and Kujawsko-Pomorskie voivodeships, a part of Warmińsko-Mazurskie Voivodeship and two communes of Zachodnio-Pomorskie Voivodeship (Sławno i Postomino).

The customer service at POSD Sp. z o.o. is mostly concerned with the connection process, in which the gas delivery conditions are defined and connection agreements are signed with customers. The company also offers the transportation service with respect of LNG and CNG, particularly in those locations where the gas network already is or shortly will be available. Implementation of early gas development projects with the use of LNG and CNG facilities will be an additional source of revenue from gas transportation and its distribution.

One of the key drivers of the regional policy concerns the development of proactive relationships with local and regional authorities. The company undertakes an assessment of individual communes, particularly those without access to gas networks, in order to understand the profitability of potential investments in their development.

In 2007, the construction of a pipeline section from Bytów to Słupsk was started. The expansion of the system in this direction is mostly intended to improve the security of gas supply for the town of Słupsk and its vicinities, and will enable, in the future, the development of gas supply to the villages and communes located along the route of the pipeline. The investment will ensure diversification of supply and connect two gas systems supplying the Pomerania: the system serving the territory of POSD Sp. z o.o. with the gas system of WOSD Sp. z o.o.

In 2008 POSD Sp. z o.o. plans to start the construction of a pipeline from Szczytno to Rybno. The construction of this gas network is a precondition to ensuring the continuity of gas supply in this area, as well as to connecting large consumers and providing more communes with access to gas supply. The implementation of this project will enable further development of the gas market, especially in the locations at the end of the gas networks (Giżycko, Mikołajki, Węgorzewo i Ryn).

Another investment project concerns the preparation of engineering design documentation for the construction of a gas pipeline between Brodnica and Nowe Miasto Lubawskie. The project is intended to connect two independently operated systems, both situated with the territory of POSD Sp. z o.o. , into a single efficient system that ensures the security and diversification of supply and access to gas for currently undeveloped communes.

Company overview

	Unit	2007	2006
Sales revenue	PLN million	736.7	971.1
Net profit/loss	PLN million	-160.7	6.3
Equity	PLN million	672.5	920.7
Total assets	PLN million	1,017.7	1,222.6
Employment as at 31 December	persons	1,741	2,184
Network length (excluding service lines)	km	7,935.5	7,626.0

One of the major market risks for the company concerns the initiatives undertaken by the competitors with respect to natural gas distribution, as well as the expansion of the gas network and use of new gas transportation technologies. In the operating area of POSD Sp. z o.o., new distribution and trading players have entered the gas market, e.g. G.EN. GAZ ENERGIA S.A., US.EN.EKO, KRI Sp. z o.o., ENERGO-EKO-INWEST Sp. z o.o., P.L. Energia S.A.

Wielkopolski Operator Systemu Dystrybucyjnego Sp. z o.o.

WOSD Sp. z o.o. operates a network of gas distribution pipelines in Wielkopolskie and Zachodniopomorskie Voivodeships and in several communes of Łódzkie, Dolnośląskie and Lubuskie Voivodeships, and one commune of Pomorskie Voivodeship. The penetration of these areas by the network of WOSD Sp. z o.o.is 44.4%, with a fairly high level for urban areas , average for rural/urban areas and low for typically rural areas.

In 2007, the company completed a number of pipeline construction investments including gas stations for companies representing various industries, including automotive, chemical, construction, timber, pulp and paper, hotel and agriculture and food. The planned yearly gas consumption resulting from these investments is estimated at approx. 30M m^3.

In 2008, the company plans to carry on with the above investments and the construction of service lines and pipelines to new consumers from construction, power, food and agriculture industries.

A serious risk that affects the development of WOSD Sp. z o.o. concerns the divergence of the goals of the TSO and the DSO, which results from the unbundling of transmission and distribution. Furthermore, the unlimited and ready access to other energy carriers, i.e. fuel oil, LPG, hard coal, as well as electricity and heat generated in central heat and power plants and district heating plants could undermine the position of WOSD Sp. z o.o. in the local energy market.

Company overview

	Unit	2007	2006
Sales revenue	PLN million	1,116.6	1,500.8
Net profit/loss	PLN million	-299.1	-31.7
Equity	PLN million	1,184.0	1,538.6
Total assets	PLN million	1,520.7	2,046.4
Employment as at 31 December	persons	1,778	2,186
Network length (excluding service lines)	km	13,431.5	12,963.0

In the operating territory of WOSD Sp. z o.o., increased activity of other gas distribution and trading players, e.g. G.EN. GAZ ENERGIA S.A., Media Odra Warta Sp. z o.o., E.ON edis energia Sp. z o.o., CP Energia S.A., P.L. Energia S.A, is observed in the market.

Section IX: Other activities

The segment covers a wide range of activities including engineering and delivery of construction projects, machinery and equipment for the upstream, petroleum and energy sectors, as well in as hospitality and catering services. The above activities are mostly carried out by the subsidiary companies of the PGNiG Group.

B.SiP.G Gazoprojekt S.A.

Biuro Studiów i Projektów Gazownictwa „Gazoprojekt" S.A. (B.SiP.G Gazoprojekt) specialises in end-to-end engineering of installations used in gas production, storage, transportation and distribution, as well as system gas stations and distribution stations . PGNiG is the majority shareholder holding 75% of the share capital with the remaining 25% of the shares being held by B.SiP.G Gazoprojekt's employees.

In 2007, B.SiP.G Gazoprojekt's sales revenues reached PLN 26.2 million. The company provided its services in the whole territory of Poland. Services provide to the PGNiG Group amounted to 53% of overall company's sales. The company's other significant customers included OGP GAZ-SYSTEM S.A. and the Czech company Moravia Energio A.S. The projects and studies completed by B.SiP.G Gazoprojekt in 2007 included:

- development of Wierzchowice UGS
- construction of Bonikowo UGS
- construction of Jarosław compressor station
- modernisation of the high-methane gas transmission system
- construction of DN 500 gas pipeline in the Podbeskidzie region.

The company intends to retain its leading position in the area of gas systems engineering and expand into other segments of the domestic and foreign markets (EU countries) by providing design services for the petroleum industry covering the production and transportation of crude oil and other petroleum products, general construction projects (airports and roads) as well as services related to the comprehensive organisation of the investment process including financing methods.

PGNiG Finance B.V.

PGNiG Finance B.V. was established to service the issue of PGNiG bonds denominated in EUR. On 6 February 2008, PGNiG Finance B.V. was transformed into Polish Oil and Gas Company – Libya B.V. A new management board was appointed and the articles of association and scope of activity were changed. The company's new scope of activity is the exploration and production activity in Libya.

BUG Gazobudowa Sp. z o.o.

Budownictwo Urządzeń Gazowniczych Gazobudowa (BUG Gazobudowa) is involved in the construction and overhauls of high-to-medium-pressure gas pipelines, water supply systems and oil pipelines as well as gas compressor stations and gas pressure reduction and metering stations. The company provides its services both in the country and abroad.

In 2007 BUG Gazobudowa's overall sales revenues reached PLN 141.4 million. Revenues for the services provided to the PGNiG Group accounted for 74% of the overall sales. Other large customers included OGP GAZ SYSTEM S.A. and the Slovenian company GEOPLIN PLINOVODI d. o.o.

In 2007 the company completed 83,8 km of pipelines including 77,8 km of transmission gas pipelines. Other projects carried out by the company included construction/assembly projects related to gas distribution hubs and modernisation of the Borzęcin natural gas production facility including its adaptation for waste disposal.

In the near future, BUG Gazobudowa is planning to expand into other segments of the domestic and foreign markets by getting involved in the construction of water supply and sewage disposal systems with the associated infrastructure. The company intends to join Phase I of the already-launched project to enhance the water/sewage management system in the Zabrze municipality.

ZUN Naftomet Sp. z o.o.

Zakład Urządzeń Naftowych Naftomet (ZUN Naftomet) specialises in the manufacture and overhaul of equipment for the petroleum and gas industry. The company operates both domestically and abroad.

In 2007 the company was involved in the manufacture of high pressure equipment for the surface well development facilities, equipment and spares for oil platforms and drilling vessels, intrinsically safe transformer casings for the coal mining industry as well as components and spares for construction equipment. Furthermore, the company provided overhauls of diesel engines as well as repairs and deliveries manufacture of components for drilling equipment.

ZUN Naftomet's overall sales revenues in 2007 reached PLN 39.1 million and its key customers included domestic and foreign companies from outside the PGNiG Group. Sales to this group of customers amounted to 61% of total sales.

In the near future the company intends to strengthen its position on the domestic and foreign market while retaining its current manufacture program and increasing sales trends.

Geovita Sp. z o.o.

Geovita is involved in the hospitality and catering activity in 12 resorts located in Poland which constitute a network of recreational, conference/training and spa centres. They are located by the sea, in the mountains as well as in central Poland and offer their services to domestic and foreign customers.

Geovita's overall sales revenues in 2007 reached PLN 26.4 million and its main customers were from outside the PGNiG Group. Sales to this group of customers amounted to 89% of overall company sales.

Since 2007 Geovita has been implementing a Recovery Plan for 2007-2010 whose main goal is to achieve profitability starting from 2009. As part of the above plan the company launched an investment program to develop and upgrade its training and lodging facilities in the recreation and training centres in Jadwisin, Wisła, Złockie, Lądek Zdrój and Dąbki.

BN Naftomontaż Sp. z o.o.

Budownictwo Naftowe Naftomontaż Sp. z o.o. (BN Naftomontaż) is involved in comprehensive construction projects to build crude oil and natural gas production facilities together with the supporting infrastructure. PGNiG holds 88.83% of the company's shares. The other shareholders are PBG S.A. Wysogotowo with 7.82% and Control Process Sp. z o.o. of Tarnów with 3.35% of the shares.

BN Naftomontaż's overall sales revenues in 2007 reached PLN 88.2 million. Services provided to the PGNiG Group amounted to 92% of overall company's sales.

In 2007 the company carried out projects related to the development of crude oil and natural gas deposits, including the construction and overhaul of technical equipment used in crude oil and natural gas production as well as the construction of underground gas storage facilities. Moreover, the company completed a prototype facility for waste disposal in the reservoir.

Since 2005, BN Naftomontaż has been implementing a composition program following a decision by the District Court in Krosno, Commercial Department No. 5, on bankruptcy with the possibility of entering into a composition agreement. The decision by the District Court in Krosno, Commercial Department No. 5 of 26 July 2005 closed the bankruptcy proceedings against BN Naftomontaż. By the end of 2007 the company managed an early payment of its obligations under the composition agreement. Aggregate instalments paid under the above agreement in 2007 amounted PLN 2.2 million.

In the near future the company is planning to carry out projects for the petroleum industry on the domestic investment market, mainly for PGNiG and foreign companies holding domestic licences. The company is also planning to start exporting its services

BN Naftomontaż holds 67.4% of shares in NAFT-STAL Sp. z o.o. while the remaining 32.6 % belongs to natural persons. NAFT-STAL's core business is the fabrication of steel structural components and equipment for the upstream, mining and construction industries.

Section X: Risks and Threats

1. Regulatory Risks

Legislation

The primary tariff risk relates to the misalignment of the secondary legislation with to the current statutory acts applicable to the Polish gas market. Such a situation occurred at the turn of 2007, when the lack of a tariff regulation that would be aligned with the amended Polish Energy Law delayed the process of approving the new gas tariff. The Minister of Economy signed the tariff regulation as late as in February 2008. Another regulation of key importance for the operation of the gas market and outlining detailed terms of the gas system operation (system regulation) is still being drafted.

The changes in the legal environment, which are progressively implemented following to Poland's accession to the European Union not always take into account the specific nature of PGNiG S.A.'s business. Further legal changes having a major impact on the gas sector should be expected in the years to come. The regulatory changes, including delayed enactment of the necessary amendments to the legislation, create risks involved in the adaptation to such changes, which might adversely affect the business activity, financial performance and growth prospects of the PGNiG Group.

Tariff calculation

Pursuant to the applicable rules for price regulation, while approving tariffs for a given period, the President of ERO considers other external factors which are beyond PGNiG S.A.'s control. With a view to protecting more vulnerable consumers, in the review of the operating costs, the President of ERO may consider certain cost unjustified or may reject the assumptions adopted by PGNiG S.A. with respect to key cost drivers and the profit targets allowing for the underlying business risk. Furthermore, the tariff prices and charges at the level requested by PGNiG S.A. are found unacceptable by the ERO. The underpriced tariffs translated into lower profitability of PGNiG S.A.

The prices of imported gas are determined in USD or EUR, and are based on indexation formulae linked to the prices of petroleum products. Changes in foreign exchange rates and prices of petroleum products materially affect the acquisition cost of imported gas. The market for crude oil and petroleum products has recently been to a large extent unpredictable due to the continual price changes. Such major variations of the fuel prices on the international markets affect the prices of imported gas. Any projection of the gas price development is subject to considerable error. There is a risk that, despite the option to adjust the approved prices applicable during a tariff term, which is available under the law, the increase in the price of imported gas may not be fully passed on the consumers or the adjustments to the selling price may lag behind the market prices.

2. Risks in Exploration and Production

Competition in the exploration market

The risk of competition from other companies active on the Polish market appears to be high with respect to acquisition of licences for exploration and prospecting of deposits or implementation of a strategy to gain access to own hydrocarbon reserves, in the light of the growing global interest in new exploration and economic expansion areas. Some competitors, especially those who operate globally, enjoy a strong market position and better access to financing than PGNiG S.A. Consequently, it is probable that such companies would take part in tender procedures and be able to acquire prospective exploration licences. The competitors also have the capabilities to identify, value, offer and acquire more fields (including the operatorship thereof and underlying licences) than it would be possible in the case of PGNiG S.A., given the Company's financial and human resources. This competitive advantage is particularly important on the international market.

Barriers to entry to foreign markets

Considerable barriers to entry to prospective foreign markets may pose a threat to the achievement of the business goals of the upstream companies. In order to pursue the acquisition of new sales markets and the presence on the existing foreign markets the companies also need to take into account the risk of political instability in the key or potential markets.

Qualified personnel

The presence of foreign companies on the Polish market has led to the solicitation of highly qualified experienced professionals. This risk is especially high with respect to professionals with the oil and gas exploration expertise.

Cost of compliance with HSE regulations

Ensuring compliance with the environmental law in Poland and abroad could significantly increase the operating costs of PGNiG S.A. To date, PGNiG S.A. has incurred and expects to incur significant capital expenditures and expenses to align its operations with ever more complex and stringent legal regulations concerning safety and health at work, as well as environmental protection. The act of May 18th 2005 amending the Natural Environment Protection Law and certain other acts (Dz.U. No. 113, item 954 of June 27th 2005) rendered the regulations governing the execution of projects which might affect the Nature 2000 area 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.

Exploration expenditures

The high capital intensity of exploration efforts is driven by the prices of energy carriers and materials. Cost of exploratory work is especially sensitive to steel prices, which are passed on the prices of casing and production tubing used in drilling. The raising prices of energy and materials drive up the cost of exploration operations.

Assessment of commercially recoverable reserves

Figures for commercially recoverable reserves of crude oil and natural gas are provided as estimates and the actual production, revenues and costs relating to a specific field may significantly differ from the estimates. The weight of this risk is further increased by the fact that the full business cycle from the commencement of exploration to the launch of production from a developed field takes six to eight years.

Production projection and documentation of reserves

A number of the factors and assumptions adopted when determining the reserves volume and production projections could be subject to error due to flaws in the methods and measurement equipment used in the geophysical surveys, drilling and production testing. The reservoir characteristics established in the course of preparing the relevant documentation are reviewed during the production phase. Each negative adjustment to the reserves volume or to the production plans may lead to a lower financial revenue and thereby have an adverse impact on the financial performance of the PGNiG Group.

Contingencies

Hydrocarbon deposits exploited by PGNiG S.A. are usually located at a considerable depth, which is accompanied by extremely high pressures, and many of them include hydrogen sulphide in the 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.

Delays

Under the currently binding legal regulations, the process of obtaining a licence for prospecting and exploration of crude oil and natural gas deposits typically takes 12-18 months. Moreover, prior to the commencement of field work, the Company is obliged to secure the rights of way, comply with the environmental requirements and follow the relevant regulations with respect to procurement of the contract. Under the applicable regulations it takes additional few months before the agreement with a project contractor is signed. All these factors create the risk of delays in the exploration work.

Formal and legal issues beyond PGNiG S.A.'s control, such as:
- local governments' failure to adopt local development plans
- obstacles in incorporating the projects into the local development plans
- need to obtain administrative decisions or other formal and legal authorisations, including environmental decisions
- changes to the current planning and development concept
- obstacles in obtaining rights-of-way from the land owners ,

may significantly delay the 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. Appeals and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in the execution of the entire investment project.

3. Risks in Trade and Storage

Competition

At present, PGNiG S.A. is the largest supplier of natural gas in Poland. The share of the PGNiG Group in the gas market is approx. 98%, the remaining 2% is represented by suppliers from outside of the Group who usually purchase the gas from PGNiG S.A. Local gas distributors are businesses with both Polish and foreign capital (in the latter case, mostly of German origin). They are active mainly in northern and western Poland. PGNiG S.A.'s competitors expand mostly in the areas which have not yet been covered by the gas pipeline networks. Some of the aforementioned companies operate their own transmission infrastructure. Some independent gas distributors have already established a strong position on their local markets and offer a range of value-added services. Recently, new entities are becoming increasingly active on the Polish market. These entities are local gas distributors offering innovative solutions of the natural gas supply involving the use of LNG. The 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 rapid growth of the gas prices presents a serious threat. Further increase in the fuel prices could prompt the consumers to look for savings by reducing their consumption or switching to alternative fuels. Some consumers, due to the increasing gas prices, proactively search for alternative gas suppliers or consider switching to a different energy carrier. Furthermore, and increased market activity of competitive companies is observed in offering substitutes for natural gas, especially in the form of liquid gas. This trend could lead to the loss of potential benefits if the customers in currently undeveloped areas are served by competitors.

Gas supply

In the previous years, there have been cases when the gas deliveries from the eastern direction were disrupted. Taking into consideration the complex relations between the main gas supplier and the transit countries (Ukraine and Belarus), similar incidents could occur again in the future.

Comprehensive agreements

Since 2007, PGNiG S.A. has been a party to new agreements on provision of transmission services, concluded with OGP GAZ-SYSTEM S.A., and a party to agreements on provision of distribution services, concluded with the Distribution System Operators (DSO). The Company has commenced the process of harmonising the comprehensive agreements with the applicable legal regulation, which involves the following risks:

- potential defaults of the DSO in the performance of their obligations under the agreements might prevent PGNiG S.A. from performing its obligations under agreements with customers;
- additional financial liabilities towards DSOs due to lack of nomination and the need to perform readings and inspections of the measurement systems.

Gas sales to the power generation sector

In accordance with the provisions of Art. 9a.8 of the Energy Law (Dz.U. of 1997, No. 54, item 348, as amended), since July 1st 2007 the Polish Energy Exchange (Towarowa Giełda Energii S.A.) has operated the Register of Certificates of Origin for energy from high-efficiency cogeneration sources. Under the provisions governing issuance of Certificates of Origin for energy produced by cogeneration, the annualised efficiency of converting the chemical energy of fuel into electricity or mechanical energy and usable heat in steam and gas systems must be at least 80%. The requirement to obtain such a high efficiency factor may lead to a situation where electricity and heat are generated in full cogeneration only. This in turn may cause the CHP plants to work only in the heating season (i.e. in winter), so as to obtain the Certificates of Origin for energy produced by cogeneration – and the resulting subsidies. The possible emergence of the market for Certificates of Origin for energy produced by cogeneration over the next few years may result in lower volumes of gas fuel purchased by the power sector and limited development prospects for the sub-sector concerned with gas power.

LNG Terminal

A considerable risk is involved in the sourcing of LNG supply 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 supply;
- extra costs of maintaining a terminal that operates at non-optimum rate.

Due to a tight schedule and the fact that the LNG terminal will be built concurrently with other projects (a breakwater, an external port and a connection of the terminal to the transmission network), there is a risk that the set deadline for completion of the LNG Project may not be met.

Furthermore, the location of the LNG terminal close to the Polish border could not only involve the need to obtain environmental permits not only from the relevant Polish authorities, but also to conduct lengthy procedures with regard to cross-border impact of the project on the environment. Timely implementation of the LNG Project largely depends on formal and legal procedures and connection to the newly built technical infrastructure in line with the pre-arranged schedule.

Another risk concerns to the time-consuming process of obtaining a waiver of the Third Party Access (TPA) principle. The procedure includes arrangements with the Energy Regulatory Office and the European Commission. A failure to obtain the waiver will result in changes in the financing structure and basic assumptions of the LNG Project.

4. Distribution Risks

Tariffs

The fact that the DSO companies continue to apply the tariff that came into force before the unbundling of the trading activity is an important constraint in the development of the Distribution System Operators. The current tariff does not allow for full recovery of the costs of operating the companies' assets, and therefore limits the level of generated revenues, as well as their the growth and investment potential.

Direct competition

The gas market liberalisation resulting from the legal unbundling requirement with respect to trading and distribution, will stimulate the activity of competitors. Companies supplying natural gas have been increasingly active and for a number of years now have been gradually expanding their gas networks and attracting new customers, from among both individuals and businesses. Additionally, increased marketing activity has been recently observed, which is aimed at attracting the customers served by the Distribution System Operators by competitors presenting a potential tangible threat of customer churn in the future.

Legislation

Inconsistencies in the applicable legislation or its duplication (e.g. the construction and supervision law with respect to construction of gas networks) are further aggravated by gaps in the secondary regulations which constantly lag behind the statutory acts. As a result, different interpretations of the legal regulations exist. Furthermore, the needs of the gas industry do not seem to get enough recognition comparing to strong initiatives in support of other fuels (particularly coal).

Gas network development

The experience of the year 2006 indicates a considerable risk that the development of the gas network might be halted by the policy adopted by OGP GAZ-SYSTEM S.A. The main issue DSO companies struggle with concern the very long lead times needed for construction or modernisation of a connection to the transmission network. The completion times for any technical modification in the TSO network present a serious obstacle to the development of the key accounts market. The policy of OGP GAZ-SYSTEM S.A. provides for restrictions in the issuance of the terms of connection in case when spare capacity is available at an existing station. Effectively, this means that many kilometres of the new distribution pipelines have to be build from the existing networks instead of connecting directly to a nearby transmission pipeline. This policy makes the connection of new consumers less profitable.

Charges payable to third parties

The obligatory third party charges imposed on the Distribution System Operators could significantly undermine their business profitability. The DSO companies are obliged to pay the charges under the applicable legal regulations (including charges for occupation of the roadway and gas pipelines running under public roads), as well as a draft regulations (charges for gas networks to be ultimately covered by the supervision by the Office of Technical Inspection). Distribution System Operators will generate lower revenues from sales as a result of the unbundling of the trading and distribution activities, which will affect their profitability and growth opportunities.

Section XI: Environmental Protection

CO_2 emissions trading scheme

Under the existing CO_2 emissions trading scheme, in H1 2007 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2006 and brought the volumes of carbon dioxide emission in line with the obtained allowance. Following the redemption of the carbon credits used in 2006, 6,454.7 Mg CO_2 credit units were retained.

Furthermore, under the CO_2 emissions trading scheme, PGNiG S.A. collected data necessary to develop the National Allocation Plan for CO_2 emission allowances for 2008–2012. In that settlement period, the scheme will cover the facilities of the Odolanów Branch, Zielona Góra Branch and the Gas Storage Facility in Mogilno.

Environmental Management Systems

In 2007, PGNiG S.A. commenced preparatory work on implementation and certification of the environmental management system meeting the requirements of the PN-EN ISO 14001 standard at its Warsaw head office. Obtaining a PN-EN ISO 14001 compliance certificate will enable the Company to increase its environmental credibility versus the government administration and customers. Implementation of the environmental management system commenced in January 2008.

REACH (Registration, Evaluation, Authorisation of Chemicals) – Chemical Substances and Preparations

In order to ensure compliance with the new regulations concerning mandatory registration of chemical substances, assessment of technical documentation, evaluation of substances and authorisations for use of substances in production and trading, which came into effect in H1 2007, PGNiG S.A. initiated work aimed at identifying the relevant substances produced in its operations or purchased and used by the PGNiG Group. Completion of the work is scheduled for the beginning of 2008.

Natura 2000

As part of the national consultations regarding the Natura 2000 network, in 2007 the Ministry of Environment began identifying new special areas of habitat protection and new areas of special bird protection. PGNiG S.A. reported the existence of the Natura 2000 areas within the operating areas of the PGNiG Group and/or the planned investment, exploration and production projects potentially colliding with the Natura 2000 areas.

Section XII: Other Events

Adoption of the Policy for the Natural Gas Industry by the Council of Ministers

On March 20th 2007, the Council of Ministers approved the Policy for the Natural Gas Industry, drafted by the Ministry of Economy. The document stipulates that PGNiG S.A. is a strategic company in light of Poland's energy security policy.

Distribution of Profit for 2006

On June 28th 2007, the Annual General Shareholders Meeting of PGNiG S.A. adopted a resolution on the 2006 net profit distribution in the amount of PLN 1,582.3m. Distributions from profit were allocated according to the following formula:

- PLN 545.3m was allocated to the Company's statutory reserve funds
- PLN 1,003m was allocated to dividend payments (PLN 0.17 per share), including:
  - PLN 850m as non-cash dividend to the State Treasury – eleven subsystems, along with their constituent and accessory parts necessary to use these subsystems, and cash dividend of PLN 1,615.19
  - PLN 153m as cash dividend to the other shareholders
- PLN 9m was allocated to increase the Company's social benefits fund
- PLN 25m was allocated to employee awards.

Concurrently, the Annual General Shareholders Meeting of PGNiG S.A. set July 27th 2007 as the dividend record date and October 1st 2007 as the dividend payment date.

Annex to the Agreement with OGP GAZ-SYSTEM S.A.

In line with the Policy for the Natural Gas Industry, an Annex to the Operating Lease Agreement concluded between PGNiG S.A. and OGP GAZ-SYSTEM S.A. on July 6th 2005 was executed on July 2nd 2007. Execution of the Annex results in exclusion of distribution assets, whose value amounts to PLN 851.9m, from the lease as of January 1st 2008.

Litigation with PI GAZOTECH Sp. z o.o.

1. On March 7th 2006, the District Court in 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. PGNiG S.A. appealed against this decision, which was rejected by the Court of Appeals in Warsaw on 10 January 2007 on account of the Company's failure to pay the applicable fees in the due amount. 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 the appeal by PGNiG S.A. On February 4th 2008, the Court of Appeals dismissed PGNiG's appeal. The decision is final and binding. On February 6th 2008, PGNiG requested for the grounds of the decision to be presented. From the date of passing the decision by the Court of Appeals the Company's claim is no longer secured by suspension of the resolution authorising the additional contributions.

2. On December 7th 2006, the District Court in 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. The grounds for the decision were delivered to the Company by the Court of Appeals in Warsaw. PGNiG S.A. considers filing a cassation complaint against the decision.

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 District Court in Warsaw were adjourned until rulings on the issues referred to in item 1 and 2 become legally binding.

4. 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 6,552,000, held before the District Court in Warsaw were adjourned until rulings on the issues referred to in item 1 and 2 become legally binding. The hearing is to be held before the District Court in Warsaw on May 30th 2008.

Litigation with the Commune of Wysokie Mazowieckie

In connection with the claim filed against PGNiG S.A. upon the motion of the Wysokie Mazowieckie Commune on January 7th 2004, the President of the Anti-Trust and Consumer Protection Authority imposed a fine of PLN 41,362,000 on the Company by virtue of his decision dated September 29th 2004. The fine was awarded on the charge of the Company's abusing its dominant position on the local natural gas sale market in Wysokie Mazowieckie by way of postponing the release of technical terms and conditions for connection of the existing boiler house to the gauging station despite a requirement to do so. PGNiG S.A. filed an appeal against the decision, demanding a statement asserting that the actions undertaken by the Company did not constitute an abuse of its dominant position and requesting that the imposed fine be quashed. Upon the District Court's rejection of the request, PGNiG S.A. filed an appeal.

On February 6th 2007, the Court of Appeals passed a judgement, whereunder the fine was reduced to PLN 2,068,100, and ordered that the cost of proceedings be covered jointly by both parties. The decision is final and binding.

On June 1st 2007, PGNiG S.A., through the Court of Appeals in Warsaw, filed a cassation complaint with the Supreme Court demanding a reformatory decision, i.e. a decision to overrule the verdicts issued by the Court of Appeals and the District Court in Warsaw, as well as the decision of the President of the Anti-Trust and Consumer Protection Authority dated September 29th 2004, or alternatively to overrule the verdict of the Court of Appeals and submit the case for re-examination.

The complaint was rejected by virtue of a resolution passed at introductory hearing by a single judge of the Supreme Court on October 11th 2007.

Litigation 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 transmission services with respect to natural gas produced 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 reimburse PHZ Bartimpex S.A. for the costs of the proceedings.

By way of submitting a letter of August 31st 2005, PGNiG appealed against the decision. As a consequence, on January 31st 2007 the District Court in 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 District Court's decision. Accordingly, a fine of PLN 2,000,000 was imposed and PGNiG's appeal was dismissed. The decision whether to file a cassation complaint against the Court of Appeals's verdict will be made upon obtaining the verdict and the reasons for it.

Litigation with SGT EUROPOL GAZ S.A.

The proceedings based upon PGNiG S.A.'s actions against SGT 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 District Court in 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. SGT 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 District Court in 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 District Court in 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 SGT 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.

Litigation with EMFESZ NG Sp. z o.o.

On March 9th 2006, proceedings before the President of ERO were instigated upon a motion filed by EMFESZ NG Polska Sp. z o.o. regarding refusal to enter into an agreement for provision of gas storage services. On June 11th 2007, a team of ERO 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 ERO announced that the relevant decision would be made by October 24th 2007.

Afterwards, by virtue of subsequent documents, the President of ERO repeatedly postponed the decision until 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 the examination of the position of the President of ERO on PGNiG's request for temporary exemption from the obligation of gaseous fuels storage.

On December 18th 2006, the proceedings, instigated upon a motion submitted by EMFESZ NG Polska Sp. z o.o., commenced before the President of the Anti-Trust and Consumer Protection Authority in order to make a preliminary assessment whether the objectionable conduct, i.e. OGP GAZ-SYSTEM S.A.'s refusal to execute an agreement on provision of gaseous fuel transmission services and PGNiG S.A.'s refusal to execute an agreement on provision of storage services, and, thus, a violation of the provisions under the Anti-Trust and Consumer Protection Act, actually took place. On February 20th 2007, the President of the Anti-Trust and Consumer Protection Authority closed explanatory proceedings and recognised that neither the actions of PGNiG S.A. nor those of OGP GAZ-SYSTEM S.A. violated the provisions of the Anti-Trust and Consumer Protection Act of December 15th 2000.

Litigation with EWE Sp. z o.o. of Poznań

On June 28th 2007, proceedings before the President of ERO were instigated upon a motion filed by EWE Sp. z o.o. to resolve the dispute concerning PGNiG S.A.'s refusal to conclude a gas sales agreement. The clarifications and documents demanded by the President of ERO were provided. By virtue of a decision issued by the President of ERO on October 15th 2007, the proceedings were discontinued.

Section XIII: Financial Situation

1. Financial Performance in 2007

The 2007 financial statements of PGNiG S.A. and the 2007 consolidated financial statements of the PGNiG Group have been audited by Deloitte Audyt Sp. z o.o. The agreement with the auditor was concluded on August 16th 2007 for a term of three years (2007–2009). The scope of the auditor's responsibilities includes:

- auditing financial statements for 2007, 2008 and 2009,
- reviewing financial statements for Q1 2008, Q1 2009 and Q1 2010,
- reviewing financial statements for H1 2007, H1 2008 and H1 2009, and
- reviewing financial statements for three quarters of 2007, three quarters of 2008 and three quarters of 2009.

The auditor's fee under the agreement (review and audit of the financial statements prepared in 2007 (i.e. a review of the Q1 2007 financial statements and the financial statements for three quarters of 2007, and an audit of the 2007 financial statements) amounts to PLN 830,000.

The 2006 financial statements of PGNiG S.A. and the 2007 consolidated financial statements of the PGNiG Group have been audited by Deloitte Audyt Sp. z o.o. The agreement was concluded on December 1st 2006, and the agreed fee was PLN 510,000. In addition, PGNiG S.A. undertook to reimburse all reasonable and documented costs incurred by the auditor in connection with the performance of the agreement (business travel expenses, accommodation, telephone bills, courier services) up to the amount of 9% of the auditor's fee. The audit was completed on April 20th 2007; the scope of the auditor's tasks was as follows:

- auditing the 2006 financial statements of PGNiG S.A.
- auditing the 2006 financial statements of the PGNiG Group.

1.1. Economic and Financial Highlights

The 2007 net profit of the PGNiG Group stood at PLN 916.1m, and was by PLN 411.8m (31%) lower from the net result recorded in the previous year.

Summary information on the PGNiG Group's financial standing in 2007, compared with the 2006 figures, is presented in the following financial statements prepared in accordance with the International Financial Reporting Standards:

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

Consolidated Balance Sheet (PLNm)

ASSETS	31 December 2007	31 December 2006
Non-current assets	22,131.1	23,234.5
Plant and equipment	18,715.5	18,762.0
Investment property	10.6	6.8
Intangible assets	84.6	80.8
Investments in associates measured with the equity method	557.5	589.3
Financial assets held for sale	20.0	18.1
Other financial assets	2,292.2	3,275.4
Deferred tax asset	419.8	453.4
Other non-current assets	30.9	48.7
Current (short-term) assets	6,270.8	7,442.2
Inventories	1,216.0	1,351.2
Trade and other receivables	3,331.0	2,473.4
Current income tax receivable	17.5	17.2
Prepayments and accrued income	82.4	32.3
Financial assets held for sale	22.4	23.3
Derivative financial instrument assets	17.4	5.7
Cash and cash equivalents	1,583.6	3,539.1
Assets available for sale	0.5	-
Total assets	28,401.9	30,676.7

Consolidated Balance Sheet (PLNm)

EQUITY AND LIABILITIES	31 December 2007	31 December 2006
Equity	21,021.8	21,153.4
Share capital	5,900.0	5,900.0
Exchange differences from translation of foreign operations	(44.5)	(15.6)
Share premium account	1,740.1	1,740.1
Other reserve funds	3,478.1	2,890.1
Retained earnings	9,939.4	10,631.1
Equity (attributed to equity holders of the parent)	21,013.1	21,145.7
Minority interests	8.7	7.7
Non-current liabilities	3,879.5	6,725.2
Loans, borrowings and debt securities	31.4	2,343.8
Provisions	1,153.8	1,179.9
Deferred income	1,142.4	1,144.3
Deferred tax liability	1,530.3	2,056.1
Other non-current liabilities	21.6	1.1
Current liabilities	3,500.6	2,798.1
Trade and other payables	2,408.0	2,173.5
Loans, borrowings and debt securities	106.7	113.6
Liabilities under derivative financial instruments	36.2	55.1
Current tax liability	281.4	184.5
Provisions	181.2	173.8
Deferred income	487.1	97.6
Total liabilities	7,380.1	9,523.3
Total equity and liabilities	28,401.9	30,676.7

Consolidated Income Statement (PLNm)

	2007	2006
Sales revenue	16,652.1	15,197.6
Total operating expenses	(15,800.5)	(13,727.6)
Raw materials and consumables used	(8,331.6)	(8,611.5)
Employee benefits	(2,014.1)	(1,822.1)
Depreciation	(1,430.2)	(1,2961)
External services	(2,692.5)	(2,652.5)
Cost of products and services for own needs	686.9	564.9
Other net operating expenses	(2,019.0)	89.7
Profit from operating activities	851.6	1,470.0
Financial income	282.3	289.8
Financial expenses	(115.2)	(265.2)
Share of profits of associates measured with equity method	(16.0)	77.4
Profit before tax	1,002.7	1,572.0
Corporate income tax	(86.6)	(244.1)
Net profit	916.1	1,327.9
Attributable to:		
Equity holders of the parent	915.1	1,327.4
Minority interests	1.0	0.5
	916.1	1,327.9

Consolidated Cash Flow Statement (PLNm)

	2007	2006
Net cash provided by/used in operating activities	3,028.7	1,535.2
Net cash provided by/used in investing activities	(2,455.6)	(867.2)
Net cash provided by/used in financing activities	(2,547.4)	(295.0)
Net change in cash bank balances	(1,974.3)	373.0
Cash and cash equivalents at the beginning of the financial year	3,559.2	3,186.2
Cash and cash equivalents at the end of the financial year	1,584.9	3,559.2

Financial Ratios

Profitability Ratios

	2007	2006
EBIT in PLN million operating profit	851.6	1,470.0
EBITDA in PLN million operating profit+depreciation	2,281.8	2,766.1
net profit* to equity at end of period	4.4%	6.3%
NET MARGIN net profit* to sales revenue	5.5%	8.7%
ROA net profit* to assets at end of period	3.2%	4.3%

* net profit for the financial year attributable to the equity holders of the parent

Liquidity Ratios

	2007	2006
CURRENT RATIO current assets (net of prepayments and accrued income) to current liabilities	1.8	2.6
QUICK RATIO current assets (net of prepayments and accrued income) less inventories to current liabilities	1.4	2.2

Debt Ratios

	2007	2006
DEBT RATIO total liabilities to total equity and liabilities	26.0%	31.0%
DEBT/EQUITY RATIO total liabilities to equity*	35.1%	45.0%

* equity attributed to equity holders of the parent

1.2. Financial Overview

Year on year, the PGNiG Group recorded an decrease in operating profit by PLN 618.4m (42%).

The drop of the operating profit (EBIT) was mostly due to the revaluation of the assets of the Distribution System Operators for the amount of PLN 1,361.9, which took place in 2007. The asset revaluation was necessary due to the change in the conditions and scope of the business of the DSOs following the unbundling of gas distribution and sales. The impairment tests run in the new circumstances with respect to the fixed assets owned by the DSOs revealed that the carrying value of the assets is considerably higher than their current recoverable value.

In the other segments of the operating activities the PGNiG Group achieved a considerable improvement of the operating profit (EBIT). The EBIT growth was primarily driven by the improved result on high-methane gas sales. Dynamic growth of high-methane gas sales profitability is attributed to the following:

- higher average selling prices of natural gas than in 2006,

- lower purchase cost per unit of imported gas,
- lower volume of imported high-methane gas,

The increase of gas selling prices by 9.9% as a result of the approval by the President's of the Polish Energy Regulatory Office of a tariff change effective from January 1st 2007 positively affected revenue on sales of gaseous fuels. The average prices of gaseous fuels were higher by approx. 13% year on year, mainly due to the increase in gas prices. However, the price level set by the Polish Energy Regulatory Office was too low to fully reflect the unit purchase price of imported gas. PGNiG S.A. generated profit on gas sales exclusively thanks to selling gas from own production.

Fluctuations in imported gas prices are an important factor affecting the result generated by PGNiG S.A. due to high share of imported gas in the total sales of gaseous fuels. The unit prices of imported natural gas followed a declining trend throughout 2007, principally on account of the situation on the global crude oil market and a strengthening of the exchange rate of the zloty against the dollar. As a result, the negative unit margin on imported high-methane gas decreased by approx. 79% year on year.

The net result on high-methane gas sales in 2007 was also affected by the 7% decline in the volume of the imported gas purchases. The reduction of was possible owing to increased withdrawal of gas from underground storage facilities in Q4 2007, which contain also cheaper gas from domestic production.

In 2007, the most important change in the organisation of the PGNiG Group was marked by the unbundling of the commercial activities and gas distribution. The commercial activities were integrated within PGNiG S.A. while the Gas Distribution Companies formerly engaged in both the supply and distribution of gas, were transformed into Distribution System Operators (DSOs).

Business segments of the PGNiG Group in 2007 (PLNm)

2007	Exploration and production	Trade and storage	Distribution	Other activities	Eliminations	Total
Sales to external customers	2,054.2	9,468.8	5,013.7	115.4	-	16,652.1
Sales between segments	1,851.4	4,416.2	1,643.6	218.3	(8,129.5)	-
Segment revenues	3,905.6	13,885.0	6,657.3	333.7	(8,129.5)	16,652.1
Segment expenses	(2,904.6)	(12,689.3)	(7,968.4)	(325.3)	8,087.1	(15,800.5)
Profit from operating activities	1,001.0	1,195.7	(1,311.1)	8.4	(42.4)	851.6
Net financial expenses	-	-	-	-	-	167.1
Share of profits of associates measured with equity method	-	(16.0)	-	-	-	(16.0)
Profit before tax						1,002.7
Corporate income tax	-	-	-	-	-	(86.6)
Net profit						916.1

Business segments of the PGNiG Group in 2007 (PLNm)

2006	Exploration and production	Trade and storage	Distribution	Other activities	Eliminations	Total
Sales to external customers	1,822.5	4,167.3	9,110.1	97.7	-	15,197.6
Sales between segments	1,145.8	6,798.7	8.8	199.4	(8,152.7)	-

Segment revenues	2,968.3	10,966.0	9,118.9	297.1	(8,152.7)	15,197.6
Segment expenses	(1,980.6)	(10,707.4)	(8,887.7)	(296.0)	8,144.1	(13,727.6)
Profit from operating activities	987.7	258.6	231.2	1.1	(8.6)	1,470.0
Net financial expenses	-	-	-	-	-	24.6
Share of profits of associates measured with equity method	-	77.4	-	-	-	77.4
Profit before tax						1,572.0
Corporate income tax	-	-	-	-	-	(244.1)
Net profit						1,327.9

Exploration and Production

The operating profit in the exploration and production segment in 2007 totalled PLN 1,001m and remained at a comparable level to the year 2006. In this segment, there were no major changes taking place within the PGNiG Group. The volume of gas production from the fields and at the nitrogen removal plant matched the previous year's levels while the volume of crude oil production dropped by 2% comparing to 2006.

Trade and Storage

In the trade and storage segment, the operating profit in the year 2007 was PLN 1,195.7 m and was nearly five times higher than in the year 2006. The increase in the segment operating result was achieved through improved profitability on gas sales following the raise of the selling price, reduction in the purchase cost per unit of imported gas and reduced volume of gas imports. The operating profit was also influenced by structural and organisational changes within individual business segments. The change in the scope of business activity was a stronger driver of the increased sales value and changes in its structure, which was reflected in lower sales to other segments coupled with higher sales to external customers. The increase of the overall cost is attributable to the fact that the trade segment became the direct buyer of the distribution services provided by Distribution System Operators, for which it subsequently charges its external customers.

Distribution

In the distribution segment, the PGNiG Group reported an operating loss for 2007 amounting to PLN 1,311.1 million. The operating result plummeted by PLN 1,542.3m comparing to the preceding year due to the revaluation of the assets owned by the Distribution System Operators, which took place in 2007. In addition, the change in the scope of business of the Distribution System Operators contributed to lower revenues of the distribution segment.

Comparing to the preceding year, in 2007 the PGNiG Group reported an improvement of the result on financing activities by PLN 49.1m as a result of increased profit on revaluation, execution of transactions in the futures market and higher net interest income.

Overall, the financial results of the Group for 2007 were below the 2006 levels. The 2007 profit before taxation dropped by PLN 569.3m (36%) and the net profit by PLN 411.8m (31%), which is reflected in deteriorated key profitability ratios. The return on equity (ROE) decreased from 6.3% to 4.4%, while the net margin on sales from 8.7% to 5.5%. The return on assets (ROA) went down from 4.3% to 3.2%. The revaluation of the distribution assets had most significant impact on the deterioration of the Group results although it did not affect the cash flows.

On the assets and liabilities side, the balance sheet of the PGNiG Group as at December 31st 2007 shows a balance sheet total of PLN 28,401.9m, down by PLN 2,274.8m (7%) year on year.

The largest item in assets is represented by property, plant and equipment. As at the end of 2007, it stood at PLN 18,715.5m, down by PLN 46.5m (0.2%) year on year. The change in property, plant and equipment is attributed primarily to the revaluation of the assets owned by Distribution System Operators for the amount of PLN 1,361.9m and extensive investments.

The investment expenditures on property plan and equipment and intangible assets in 2007 totalled PLN 2,980m, including:

- PLN 1,686.2m in the exploration and production segment
- PLN 460.9m in the trade and storage segment
- PLN 822.2m in the distribution segment
- PLN 10.7m on investments in other activities.

The high level of investment expenditures in the exploration and production was largely attributable to the purchase of interests in licenses on the Norwegian Continental Shelf by PGNiG Norway AS. Significant decrease in other financial assets by PLN 983.2m (30%) with respect to 2006 was caused by the payment of non-cash dividend to the State Treasury and the gradual repayment of the lease instalments by OGP GAZ-SYSTEM S.A.

As at December 31st 2007, current assets totalled PLN 6,270.8m, down by PLN 1,171.4m (16%) year on year. The key factors contributing to the change in current assets were the increase in trade and other receivables and a decrease in cash.

Trade and other receivables increased by PLN 857.6m (35%) relative to 2006 on account of an increase in sales revenue and a growth of average selling prices of gaseous fuels.

As at the end of the year, cash and cash equivalents were lower by PLN 1,955.5m (55%) year on year, primarily on account of:
- debt restructuring; at the beginning of May 2007 the Company repaid its EUR 600m term loan, and secured availability of a renewable facility of the same amount,
- Advancement of a long-term loan in the amount of NOK 3,800m to PGNiG Norway AS to finance purchase of the interest in licenses on the Norwegian Continental Shelf; the first tranche of the loan, totalling NOK 1,800m (equivalent to PLN 809.5m, according to mid exchange rate quoted by NBP for December 31st 2007), was disbursed in 2007.

Decrease in cash affected the liquidity ratios of the PGNiG Group. The current ratio dropped from 2.6 to 1.8, while the quick ratio fell from 2.2 to 1.4. Despite the decline in liquidity ratios, the value and structure of current assets held by the Group continue to ensure its full capability to discharge the operating liabilities on an ongoing basis.

Inventories decreased by PLN 135.2m (10%) in the period under review as the natural gas and crude oil volumes kept in underground gas storage were offered for sale in 2007

The value of equity, which is the main source of asset financing for the PGNiG Group fell by PLN 131.6m year on year. The change in equity was primarily driven by the net profit for the financial year (PLN 916.1m) and the payment of non-cash and cash dividend in the amount of PLN 1,003.0m as a result of profit distribution for the preceding year.

The value of non-current liabilities disclosed under equity and liabilities decreased by PLN 2,845.7m (42%). Lower level of non-current liabilities results primarily from the repayment of EUR 600m term loan and the reduction in deferred income tax provision by PLN 525.8m.

Overall value of current liabilities increased by PLN 702.5m (25%) relative to 2006. The level of current liabilities was mostly affected by change in deferred income, which went up by PLN 389.5m as a result of the adopted billing arrangements based on gas sales projections.

Changes in the structure of equity and liabilities of the Group were reflected in the ratios that characterise the relation between equity and other items of this part of the balance sheet. The total debt-to-equity ratio fell from 45% to 35.1% in 2007, while the debt ratio (total liabilities to total equity and liabilities) fell from 31% to 26 %.

The economic and financial standing of the PGNiG Group continues to be strong. Considering that the Group does not shape independently its pricing policy, the ability to sustain the current growth rate strongly depends on the position of the Energy Regulatory Office with respect to the price setting for the gas sold in the domestic market.

The Use of Proceeds until December 31st 2007

As a result of the Public Offering, in 2005 PGNiG S.A. raised proceeds totalling PLN 2,682.0m Net of the amount of PLN 41.9m representing the costs of the share offering, net proceeds amounted to PLN 2,640.1m.

The aggregate expenditure of the funds raised from the public issue of shares at the end of 2007 totalled PLN 1,849.7m, which accounted for 70% of total proceeds. The breakdown of the use of profits by year: PLN 31.8m was spent by the end of 2005, PLN 1,292.3m was spent in 2006, while PLN 525.6m was spent in 2007.

The use of proceeds from the public issue of shares by business segment:

- upstream – PLN 1,078.5m
- trade, transmission and storage – PLN 361.2m
- distribution – PLN 278.0m
- debt repayment (5% of the proceeds) – PLN 132m.

Major investment projects funded with the use of the proceeds in 2007 were:

- upstream projects, including the LMG project, the nitrogen removal plant in Grodzisk, the Skarv project and exploration works,
- expansion of underground gas storage capacity in Swarzów, Mogilno, Wierzchowice and Strachocina UGS facilities, and investment in transmission assets included in the list of fixed assets under a lease agreement
- modernisation and extension of distribution network carried out by the Distribution System Operators.

As at the end of 2007, the total limit set in the Prospectus for expenditures on upstream activities was exhausted.

<u>Explanation of differences between the actual and projected results for the year</u>

In 2007, the Group did not publish any financial projections.

1.3. Transactions with Related Parties

The table below sets forth the transactions with related parties for the value in excess of EUR 500,000.

Transactions of the PGNiG GK with related parties

Party	Sales[1)]	Other sales[2)]	Purchases[3)]	Other purchases[4)]
Total (related parties)	28.4	40.6	310.6	0.8
Entities consolidated with equity method	21.5	28.8	96.1	0.0
EUROPOL GAZ S.A.	21.5	13.1	96.1	0.0
GAS-TRADING S.A.	0.0	15.7	0.0	0.0
Other related parties, excluded from consolidation	6.6	2.4	178.1	0.8
ZRUG Sp. z o.o. (in Podgórska Wola)	0.3	0.2	44.5	0.6
BUD-GAZ PPUH Sp. z o.o.	1.7	0.0	18.0	0.2
„ZRUG" Sp. z o.o. (in Poznań)	2.3	0.9	41.5	0.0
„ZRUG TORUŃ" S.A.	0.0	0.0	7.0	0.0
ZRUG Zabrze Sp. z o.o.	0.2	0.0	5.3	0.0
PFK GASKON S.A.	0.0	0.3	5.1	0.0
„GAZOMONTAŻ" S.A.	2.1	0.2	28.3	0.0
ZWUG „INTERGAZ" Sp. z o.o.	0.1	0.8	28.4	0.0
Subsidiaries and affiliates of subsidiaries and affiliates	0.4	9.3	36.3	0.0
Gaz Sp. z o.o. Błonie	0.0	0.1	12.4	0.0
Gaz Media Sp. z o.o. Wołomin	0.1	0.1	18.5	0.0
PBU Petromin Sp. z o.o. Wołomin	0.2	0.0	1.3	0.0
Gazobudowa Poznań Sp. z o.o. Poznań	0.0	0.0	4.1	0.0
Oil Tech International F.Z.E. Ajman	0.0	9.0	0.0	0.0

[1)] revenue on sales of products, goods for resale and materials
[2)] financial income and other income
[3)] allocated costs, tangible assets under construction and inventories
[4)] financial expenses and other expenses

The sales transactions are primarily concerned with:

- sale of gas and operatorship services with respect to the transit pipeline to EUROPOL GAZ S.A.
- interest on loans receivable from EUROPOL GAZ S.A.
- dividend from GAS-TRADING S.A.

Purchase transactions include:

- purchase of gas transmission service from EUROPOL GAZ S.A.
- purchase of maintenance and overhaul services from gas equipment maintenance companies (ZRUG)
- purchase of property management services from BUD-GAZ PPUH Sp. z o.o.
- purchase of field exploration services from GAZOMONTAŻ S.A.

2. Financial Management

The PGNiG Group has the necessary funds to cover the current and planned expenses related to the ongoing operating and investing activities. There is no risk of liquidity loss. The Group's good financial standing supports the performance of planned investment projects. The balance of available funds allows PGNiG S.A. for some flexibility with regard to execution of the investment projects. Owing to the limited financial leverage and positive assessment of the PGNiG S.A.'s risk, as confirmed by the rating agencies, along with the creditworthiness, it is possible to finance the planned investment projects with bank loans advanced on favourable conditions or issue of debt securities.

The measures undertaken to mitigate the risk of losing financial liquidity include:

- entering into agreements providing access to overdraft facilities
- conclusion of a revolving facility agreement
- cash flow projections at the Group level;
- estimation of the condition and the value of assets available for sale;
- ensuring high liquidity of the financial assets.

Excess cash is invested in instruments involving minimum credit risk, i.e. treasury securities and bonds issued by the National Bank of Poland. It is also deposited with commercial banks with investment grade rating.

2.1. Loans

In 2007, the use of external financing sources by the companies of the PGNiG Group was limited. The balance of loans and debt securities as at 31 December 21007 was PLN 138.1m. These are mostly current liabilities under overdraft facilities and lease agreements.

In 2007, the PGNiG S.A. had active overdraft facilities for total amount of PLN 280m, and a syndicated revolving loan of EUR 900m. The syndicated loan agreement was concluded on July 27th 2005 between PGNiG S.A. and a group of banks, with Bank Handlowy w Warszawie S.A. as their agent. The credit facility was divided into a five-year term loan of EUR 600m and a three-year revolving loan of EUR 300m. On April 27th 2007, PGNiG S.A. executed an annex to the agreement, whereby the term loan of EUR 600m was changed into a revolving multicurrency loan (PLN, EUR, USD). As at December 31st 2007, both loans remained fully available.

In 2007, the PGNiG Group did not extend any loans.

2.2. Guarantees and sureties

As at 31 December 2007, the balance of contingent receivables under guarantees and sureties received by the PGNiG Group stood at PLN 67.9m. The bulk of the contingent receivables is constituted by operational guarantees received by PGNiG S.A. for the value of PLN 62.4m.

As at 31 December 2007, the value of the Group's contingent liabilities under provided guaranties and sureties totalled PLN 7,902.1m.

The main item of contingent liabilities is the loan repayment guarantee provided by the Gas Distribution Companies in the amount of PLN 4,477.5m (EUR 1,250.0m). The guarantee secures the EUR 900msyndicated loan extended to PGNiG S.A. by a consortium of banks. The guarantee agreement was executed on 22 September 2005 and will remain in force until 27 January 2012. As of October 1st 2007, the liabilities under the guarantee, by way of succession, were assumed by the Distribution System Operators.

In addition, PGNiG S.A. disclosed the following guarantees and sureties:
- bank guarantees issued at request of PGNiG S.A. (PLN 1,085m)
- a guarantee to secure the performance of PGNiG Norway AS' potential obligations towards the Norwegian government and certain Norwegian entities under the licence agreement or under applicable laws.
- loan surety provided to SGT EUROPOL GAZ S.A.

The guarantees and sureties provided by and issued at request of PGNiG S.A. are presented in the following tables.

The reminder of contingent liabilities is constituted by the obligations of the Group companies in respect of guaranties related to their operations.

Bank guarantees issued at the request of PGNiG S.A.

Guarantee beneficiary	Guarantee-issuing bank	Issuance date	Expiry date	Guarantee limit (USD m)	Guarantee limit (PLN m)
The President Islamic Republic of Pakistan	Societe Generale SA Branch in Poland	20.11.2000	31.12.2008	2.3	5.6
OOO „Gazprom-export"	Societe Generale SA Branch in Poland	12.12.2006	08.02.2008	90.0	219.2
OOO „Gazprom-export"	Bank Pekao SA	12.12.2006	08.02.2008	90.0	219.2
Egyptian General Petroleum Corporation	Societe Generale SA Branch in Poland	24.06.2007	28.02.2012	0.5	1.2
National Oil Corporation Libya	Societe Generale SA Branch in Poland	29.11.2007	15.05.2008	10.8	26.3
OOO „Gazprom-export"	BNP Paribas S.A. Branch in Poland	14.12.2007	08.02.2009	210.0	511.3
OOO „Gazprom-export"	Bank PKO BP S.A.	14.12.2007	08.02.2009	42.0	102.2

Guarantees and sureties provided by PGNiG S.A.

Guarantee/surety beneficiary	Primary obligor	Issuance date	Expiry date	Valid until	Guarantee /surety amount (EUR m)	Guarantee /surety amount (PLN m)	Type of guarantee/ surety
Bank Gdański S.A. (currently Millennium SA)	SGT „EUROPOL GAZ" S.A.	08.10.1996	30.09.2009	30.09.2012	-	56.0	Loan surety
State of Norway	PGNiG Norway AS	19.10.2007	01.01.2050	01.01.2050	627.6	2,247.9	Guarantee

2.3. Financial Risk Management

In 2007, the PGNiG Group used the following financial instruments to manage the price volatility risk:

- FX forwards,
- purchased foreign exchange call options,
- option strategies – generally representing combinations of at least two FX options,
- cross currency interest rate swaps.

The following was undertaken by the PGNiG Group to mitigate the credit risk:

- investing excess cash in instruments with a minimum credit risk (treasury bills, treasury bonds and bonds issued by the National Bank of Poland);
- cooperation with the leading commercial banks holding an investment rating;
- restructuring of debt (simplification of documentation, elimination of a substantial number of covenants, significant cost reduction);
- conclusion of framework agreements with business partners, which expressly define the rights and obligations of the parties;
- diversification of business partners;
- cooperation with rating agencies, which led to an upgrade of the PGNiG's rating; on February 5th 2007, the S&P agency increased the rating of the Company from BBB to BBB+.

The measures undertaken by the PGNiG S.A. to mitigate the risk of cash-flow disruptions included:

- diversification of e-banking systems;
- on-going control of credit/debit operations on bank accounts;
- gathering information on cash flows at the Group level;
- consolidation of bank accounts;
- conclusion of overdraft facility agreements.

To mitigate the risk of losing financial liquidity, the Company undertook measures which included:

- conclusion of overdraft facility agreements and a revolving facility agreement;
- cash flow projections at the Group level;
- estimation of the condition and the value of assets available for sale;
- ensuring high liquidity of the financial assets.

The main objective of the PGNiG Group's financial risk management policy is to limit the volatility of the cash flows related to the Group's operations to the acceptable levels in the short and medium term and building the Company value in the long-term.

The Group limited the volatility of the cash flows resulting from payments under gas purchase agreements and the payments resulting from repayment of the Group's credit liabilities in 2007 by concluding transactions hedging the foreign exchange risk (FX forwards, FX options, option strategies, cross currency swaps).

In 2007, the Group did not apply hedge accounting, therefore the changes in the fair value of hedged financial instruments and hedging instruments were disclosed in the profit and loss account for the given accounting period. However, most of the concluded transactions are effective in terms of hedge accounting.

3. Projected Financial Situation

The development of the petroleum product prices on international markets and, what follows, the prices of imported gas will be the key driver for the future results of the PGNiG Group. The global market for such products is characterised by a significant uncertainty and volatility. In 2007, the dynamics of the domestic price increases did not keep up with the increases in the import prices.

The key factor affecting the 2008 results will be the position of the President of the Polish Energy Regulatory Office on the approval of new tariffs. By the date of this Report, the tariff rate for gaseous fuel, effective since January 1st 2007, had not changed. Given the fact that the current tariff was approved at the time when the crude oil price was around USD 55 per barrel, and the current price exceeds USD 100 per barrel, deterioration of the Company's financial performance should be expected. As prices of imported gas strongly correlate with crude oil prices, any further delay in approving the new tariffs by the President of the Polish Energy Regulatory Office will lead to further deterioration of the financial standing of the Group. Since the sales forecast for Q1 2008 represent over 30% of the total sales, the inability to apply new tariffs as of January 1st 2008 will have an adverse effect on the Group's financial performance. This could mean that the results in 2008 will be worse relative to the previous year.

The prices for petroleum products have an effect on the profitability of crude oil production which was a major source of revenue for the Group in 2007 contributing PLN 777.9m. In 2008, the Group plans to sustain a high profitability of its production operations and intensify its investment activity in order to increase domestic production of natural gas and crude oil.

The financial situation of the PGNiG Group is significantly exposed to the developments on the foreign exchange markets. The foreign exchange market is characterised by significant volatility. In 2007, the difference between the lowest and highest US dollar exchange rate was over 20.2%. In the case of euro the difference in 2007 amounted to over 9.5%. It should be noted that in the case of increases in the purchase prices of imported gas (and also in foreign exchange rates) of up to 5% from the levels assumed in the tariff approval request, PGNiG S.A. has no formal legal grounds to apply to the Polish Energy Regulatory Office for a tariff change and pass on such increase on its customers. The risk related to a significant increase in foreign exchange rates and, what follows, the cost of acquisition of imported gas is mitigated by a proactive hedging policy.

Good financial standing of PGNiG S.A. is conducive to the execution of the planned investment projects. The balance of available funds allows PGNiG S.A. for some flexibility with regard to execution 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.

Management Board Members

President	Michał Szubski	
Vice-President	Mirosław Dobrut	
Vice-President	Radosław Dudziński	
Vice-President	Sławomir Hinc	
Vice-President	Mirosław Szkałuba	