



PGNiG

**Polskie Górnictwo Naftowe
i Gazownictwo SA**

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

Warsaw, April 7th 2009

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Chapter I: General Information on the Company

1. Establishment of the Company

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

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

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

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

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

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

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

2. Core Business

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

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

- exploration, management and exploitation of crude oil and natural gas deposits as well as sulphur-containing minerals;
- production and processing of refined petroleum products;
- production and distribution of gaseous fuels;
- wholesale and retail sale of fuels;

- test drilling and boring;
- geological and exploration activities, geodetic and cartographic activities;
- generation, transmission and distribution of electricity;
- lease, management, purchase and sale of real estate;
- lease of particular items of the Company's property used for electricity and gas transmission;
- distribution of gaseous fuels through mains.

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

- ensuring continuity of gas supplies to consumers and maintaining necessary reserves;
- ensuring safe operation of gas networks;
- ensuring gaseous fuels balance, managing operations and capacity of power equipment connected to the common gas distribution network;
- engaging in gas production.

3. Organisational Structure

PGNiG S.A. has a number of branches. As at December 31st 2008, the organisational structure contained the Head Office and fifteen branches. The table below presents the core activities by individual units.

Business profiles of PGNiG S.A. organisational units

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

Business profiles of PGNiG S.A. organisational units – continued

Branch	Core activity
Lower Silesian Gas Trading Division in Wrocław	Supply of gaseous fuel to customers and comprehensive support of sales of natural gas, crude oil and other products and services offered by PGNiG SA.
Upper Silesian Gas Trading Division in Zabrze	Supply of gaseous fuel to customers and comprehensive support of sales of natural gas, crude oil and other products and services offered by PGNiG SA.
Carpathian Gas Trading Division in Tarnów	Supply of gaseous fuel to customers and comprehensive support of sales of natural gas, crude oil and other products and services offered by PGNiG SA.
Mazovian Gas Trading Division in Warsaw	Supply of gaseous fuel to customers and comprehensive support of sales of natural gas, crude oil and other products and services offered by PGNiG SA.
Pomeranian Gas Trading Division in Gdańsk	Supply of gaseous fuel to customers and comprehensive support of sales of natural gas, crude oil and other products and services offered by PGNiG SA.
Greater Poland Gas Trading Division in Poznań	Supply of gaseous fuel to customers and comprehensive support of sales of natural gas, crude oil and other products and services offered by PGNiG SA.
Storage System Operator in Warsaw	Storage of gaseous fuel
Branch in Algeria	Exploration of and production from hydrocarbon deposits in the licence areas in Algeria

As at December 31st 2008, PGNiG S.A. had foreign representative offices in Moscow (Russia), Brussels (Belgium), Kiev (Ukraine), Vysokoye (Belarus) and Sanaa (Yemen).

The following branches and representative offices were established in 2008:

- Representative office in Yemen – on January 22nd 2008,
- Branch in Denmark – on January 29th 2008,
- Lower Silesian Gas Trading Division in Wrocław – on August 1st 2008,
- Upper Silesian Gas Trading Division in Zabrze – on August 1st 2008,
- Carpathian Gas Trading Division in Tarnów – on August 1st 2008,
- Mazovian Gas Trading Division in Warsaw – on August 1st 2008,
- Pomeranian Gas Trading Division in Gdańsk – on August 1st 2008,
- Greater Poland Gas Trading Division in Poznań – on August 1st 2008,
- Storage System Operator in Warsaw – on October 9th 2008,
- Branch in Algeria – on December 2nd 2008.

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

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

In 2008, there were no changes in the Company's or the Group's key management policies.

4. Equity Links

PGNiG S.A. holds shares and equity interests in production and service companies. As at December 31st 2008, PGNiG S.A. had 41 related companies, of which:

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

Total par value of PGNiG S.A.'s equity interests in the related companies was PLN 7,228m as at December 31st 2008. The related companies of PGNiG S.A. are listed in the table below.

PGNiG S.A.'s related companies

		Share capital (PLN)	Shareholding of PGNiG S.A. (PLN)	% of share capital held by PGNiG S.A.	% of the total vote held by PGNiG S.A.
	Subsidiaries				
1	Poszukiwania Nafty i Gazu Jasło Sp. z o.o.	100,000,000.00	100,000,000.00	100.00%	100.00%
2	Poszukiwania Nafty i Gazu Kraków Sp. z o.o.	105,231,000.00	105,231,000.00	100.00%	100.00%
3	Poszukiwania Nafty i Gazu NAFTA Sp. z o.o.	60,000,000.00	60,000,000.00	100.00%	100.00%
4	GEOFIZYKA Kraków Sp. z o.o.	64,400,000.00	64,400,000.00	100.00%	100.00%
5	GEOFIZYKA Toruń Sp. z o.o.	66,000,000.00	66,000,000.00	100.00%	100.00%
6	Poszukiwania Naftowe Diament Sp. z o.o.	62,000,000.00	62,000,000.00	100.00%	100.00%
7	Zakład Robót Górniczych Krosno Sp. z o.o.	26,903,000.00	26,903,000.00	100.00%	100.00%
8	PGNiG Norway AS (NOK) ¹⁾	497,327,000.00	497,327,000.00	100.00%	100.00%
9	Polish Oil and Gas Company - Libya B.V. (EUR) ¹⁾	20,000.00	20,000.00	100.00%	100.00%
10	INVESTGAS S.A.	502,250.00	502,250.00	100.00%	100.00%
11	Dolnoślaska Spółka Gazownictwa Sp. z o.o.	655,063,000.00	655,063,000.00	100.00%	100.00%
12	Górnoślaska Spółka Gazownictwa Sp. z o.o.	1,288,680,000.00	1,288,680,000.00	100.00%	100.00%
13	Karpacka Spółka Gazownictwa Sp. z o.o.	1,484,953,000.00	1,484,953,000.00	100.00%	100.00%
14	Mazowiecka Spółka Gazownictwa Sp. z o.o.	1,251,738,000.00	1,251,738,000.00	100.00%	100.00%
15	Pomorska Spółka Gazownictwa Sp. z o.o.	614,696,000.00	614,696,000.00	100.00%	100.00%
16	Wielkopolska Spółka Gazownictwa Sp. z o.o.	978,287,000.00	978,287,000.00	100.00%	100.00%
17	B.S. i P.G. Gazoprojekt S.A.	4,000,000.00	3,000,000.00	75.00%	75.00%
18	BUG Gazobudowa Sp. z o.o.	39,220,000.00	39,220,000.00	100.00%	100.00%
19	Zakład Urządzeń Naftowych Naftomet Sp. z o.o.	23,500,000.00	23,500,000.00	100.00%	100.00%
20	Geovita Sp. z o.o.	86,139,000.00	86,139,000.00	100.00%	100.00%
21	Budownictwo Naftowe Naftomontaż Sp. z o.o.	44,751,000.00	39,751,000.00	88.83%	88.83%
22	Górnictwo Naftowe Sp. z o.o.	50,000.00	50,000.00	100.00%	100.00%
23	NYSAGAZ Sp. z o.o.	3,700,000.00	1,887,000.00	51.00%	51.00%
24	ZRUG Sp. z o.o. (Pogórska Wola)	4,300,000.00	4,300,000.00	100.00%	100.00%
25	BUD-GAZ PPUH Sp. z o.o.	51,760.00	51,760.00	100.00%	100.00%
26	PPUih TURGAZ Sp. z o.o.	176,000.00	90,000.00	51.14%	51.14%

PGNiG's related companies – continued

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

¹⁾ Figures shown in foreign currencies.

In 2008, the changes in the company names from Operator Systemu Dystrybucyjnego Sp. z o.o. to Spółka Gazownictwa Sp. z o.o. were registered.

5. Changes in Equity Interests

The following changes occurred in 2008:

- Registration of amendments to the articles of association of PGNiG Finance B.V. (the Netherlands, February 4th 2008); under the amended articles of association, the company's name was changed to Polish Oil and Gas Company - Libya B.V. and its business profile was redefined;
- Deletion of ZRUG Warszawa S.A. (in liquidation) from the Register of Entrepreneurs on March 31st 2008 (PGNiG S.A.'s share in the share capital was 49%);
- Conclusion of a share purchase agreement providing for the sale of 100% of shares in Polskie LNG Sp. z o.o. between PGNiG S.A. and OGP GAZ-SYSTEM S.A.; PGNiG S.A. sold to OGP GAZ-SYSTEM S.A. 50,000 shares in Polskie LNG Sp. z o.o., with a par value of PLN 1,000 per share, for the total price of PLN 52,000,000; the ownership title to the shares was transferred to the purchaser on December 8th 2008.

The following share capital increases were effected in 2008:

- Share capital increase at Polskie LNG Sp. z o.o. by PLN 11,000,000, to PLN 50,000,000; the increase was registered with the National Court Register on January 7th 2008;

- Share capital increase at Mazowiecka Spółka Gazownictwa Sp. z o.o. by PLN 286,531,000, to PLN 1,217,350,000; the increase was registered with the National Court Register on January 24th 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network; another share capital increase at the company: by PLN 34,388,000 to PLN 1,251,738,000; the increase was registered with the National Court Register on September 9th 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network with the total book value of PLN 32,868,262,60 and a cash contribution;
- Share capital increase at Karpacka Spółka Gazownictwa Sp. z o.o. by PLN 165,363,000, to PLN 1,476,112,000; the increase was registered with the National Court Register on February 12th 2008; another share capital increase at the company: by PLN 8,841,000 to PLN 1,484,953,000; the increase was registered with the National Court Register on August 22nd 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Pomorska Spółka Gazownictwa Sp. z o.o. by PLN 93,391,000, to PLN 596,141,000; the increase was registered with the National Court Register on February 29th 2008; another share capital increase at the company: by PLN 18,555,000 to PLN 614,696,000; the increase was registered with the National Court Register on August 4th 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at GEOFIZYKA Kraków Sp. z o.o. by PLN 30,000,000, to PLN 64,400,000; the increase was registered with the National Court Register on April 2nd 2008;
- Share capital increase at Dolnośląska Spółka Gazownictwa Sp. z o.o. by PLN 104,697,000, to PLN 651,145,000; the increase was registered with the National Court Register on April 9th 2008; another share capital increase at the company: by PLN 3,918,000 to PLN 655,063,000; the increase was registered with the National Court Register on October 30th 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Wielkopolska Spółka Gazownictwa Sp. z o.o. by PLN 131,128,000, to PLN 978,287,000; the increase was registered with the National Court Register on May 27th 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network;
- Share capital increase at Górnośląska Spółka Gazownictwa Sp. z o.o. by PLN 91,366,000, to PLN 1,288,680,000; the increase was registered with the National Court Register on June 25th 2008; the newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network; pursuant to its resolution of August 5th 2008, the Extraordinary General Shareholders Meeting of Górnośląska Spółka Gazownictwa Sp. z o.o. resolved to further increase the company's share capital by PLN 10,808,000 to PLN 1,299,488,000; the newly issued shares were acquired by PGNiG S.A.; as at the date of this report, the share capital increase has not been registered with the National Court Register;
- Share capital increase at ZRUG Zabrze Sp. z o.o. by PLN 2,500,000 to PLN 5,250,000; the increase in the company's share capital was registered with the National Court Register on May 29th 2008. PGNiG S.A. did not participate in the share capital increase and, consequently, the Company's share in the share capital of ZRUG Zabrze Sp. z o.o. decreased to 11.43%.

In 2008, the share capital of Wielkopolska Spółka Gazownictwa Sp. z o.o. was also increased by PLN 54,899,000 to PLN 1,033,186,000. The increase was registered with the National Court Register on January 22nd 2009. The newly issued shares were acquired by PGNiG S.A. in exchange for a contribution of non-current assets comprising the components of a transmission or distribution network.

Investments Outside PGNiG S.A.'s Related Companies

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

As at December 31st 2008, the total nominal value of PGNiG S.A.'s capital exposure outside PGNiG S.A.'s related companies was PLN 43.8m.

6. Employment

The table below presents the employment as at December 31st 2008, by segments. PGNiG S.A.'s Head Office provides services to all segments. Accordingly, it is disclosed separately.

Employment by segments (no. of staff)

	2008	2007
Head Office	837	604
Exploration and Production	4,223	4,087
Trade and Storage	3,702	3,705
Other activities	37	36
Total	8,799	8,432

From January 1st 2000 to December 31st 2008, PGNiG S.A. carried out the "Programme of employment restructuring and employee protection measures for PGNiG S.A. branches and subsidiaries". Over that period, as a result of various organisational and structural as well as employment restructuring efforts, the headcount at PGNiG S.A. decreased by 24,356. This figure concerns the persons employed under contracts for unspecified period and includes the effect of spin-offs of the Gas Companies and the transfer of 2,181 employees as part of the spin-off of OGP Gaz-System Sp. z o.o.

On December 11th 2008, the Extraordinary General Shareholders Meeting of PGNiG S.A. adopted the Programme for Streamlining of Employment and Redundancy Payments to the Employees of the PGNiG Group for 2009–2011 (phase III). The programme came into force in January 2009. Contrary to the previous employment restructuring programmes, it is based on a "stand-by" formula. It may be implemented in extreme circumstances and requires that individual Group members apply procedures which are uniform across the whole PGNiG Group. The programme may only be implemented when it is justified by the scale of the planned restructuring measures related to trimming of workforce and/or closing down of posts.

7. Gas Sales and Procurement

PGNiG S.A. recorded sales revenue of PLN 18bn, with 94% of that figure derived from sales and distribution of natural gas.

Sales revenue (PLNm)

	2008	2007
Natural gas, including:	16,962.1	13,955.0
- high-methane gas	15,568.9	12,755.3
- nitrogen-rich gas	1,393.2	1,199.7
Crude oil	775.6	777.9
Condensate	3.0	1.6
Helium	27.6	30.5
Propane-butane	42.6	39.5
Geophysical and geological services	64.9	33.5
Other sales	163.0	281.9
Total	18,038.8	15,119.9

In 2008, PGNiG S.A. sold 13.9bn m³ of natural gas, with 96% of that figure accounted for by revenues from the transmission and distribution systems and the balance – by direct sales of natural gas from deposits.

Natural gas sales volume (million m³)

	2008	2007
Trade and Storage	13,250.8	13,056.2
Exploration and Production	611.3	629.5
Total	13,862.1	13,685.7

In 2008, the volume of natural gas acquired by PGNiG S.A. reached 14.4bn m³, with 71.5% of that amount sourced from imports, mostly from Russia and the Middle East. Natural gas production from domestic deposits represented 28.4% of the total volume acquired. The table below sets forth the structure of natural gas supplies measured as high-methane gas equivalent.

Natural gas procurement (million m³)

	2008	2007
Imports	10,264.3	9,286.0
Domestic production	4,073.9	4,276.1
Domestic suppliers	22.1	13.5
Total	14,360.3	13,575.6

Chapter II: Regulatory Environment

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

- Polish Energy Law of April 10th 1997 (consolidated text: Dz.U. of May 30th 2006, No. 89, item 624, 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, as amended) – 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 PGNiG S.A. in the area of trade in gaseous fuels are regulated and require a licence granted and tariff approved by the President of URE. The tariff specifies prices of gaseous fuels.

The amendments to the Polish Energy Law introduced in June 2007 required that secondary legislation be adopted so as to enable the preparation of a tariff for the comprehensive service. On February 20th 2008, the Regulation of the Minister of Economy and Labour on detailed rules for preparing and calculating tariffs for gaseous fuels and on settlements in gaseous fuels trade (Dz. U. of February 20th 2008, No. 28, item 165) became effective. As the regulation was signed in February, the Company had to change its tariff application submitted in November 2007, which protracted the proceedings for approval of the tariff for gaseous fuels.

2008 saw continuation of the work on further changes to the Polish Energy Law and 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. By the date of preparation of this Directors' Report, the above instruments had not been implemented.

1.1. Licences

In 2008, the President of URE issued decisions on the expiry of the following licences granted to the Gas Trading Companies:

- six licences for trade in gaseous fuels (February 2008),
- two licences for international trade in natural gas (February 2008),
- one licence for trade in liquid fuels (September 2008),

as a result of the Companies' deletion from the relevant register.

On September 16th 2008, the President of URE issued a decision granting PGNiG S.A. an energy production licence, effective until September 18th 2018. The licence covers business activities consisting in electricity co-generation from a single source, to be carried out in Świdnik Duży, the Lublin province. On January 22nd 2009, the President of URE issued a decision expanding the licence by a source situated in Rzeszów, the Rzeszów province.

On November 17th 2008, the Company applied to the President of URE for appointment as the Storage System Operator. In the decision of December 31st 2008, the President of URE appointed PGNiG S.A. as the Storage System Operator for the area specified in the licence, excluding the part of the storage system used for production and the part used exclusively to perform the tasks of the Transmission System Operator, for the period January 1st 2009 – December 31st 2025.

As at December 31st 2008, the Company held the following licences granted by the President of URE under the Energy Law:

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

1.2. Tariff Policy

The crucial factor determining PGNiG S.A.'s regulated business is the dependence of the Company's revenue on tariffs which are subject to approval by the President of URE. Tariff prices are crucial for the Company's ability to generate revenue that can cover the incurred justified costs plus return on capital employed. The gas prices are directly connected with the applied tariff preparation methodology.

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

In the settlements with customers with which PGNiG S.A. had concluded agreements for sale of gaseous fuels with the delivery to points of acceptance were regulated by the settlement rules and charge rates specified in subsequent tariffs approved by the President of URE.

1.3. Changes in Tariffs

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

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

On November 15th 2007, PGNiG S.A. applied to the President of URE for approval of the Gaseous Fuel Tariff No. 1/2008 of Polskie Górnictwo Naftowe i Gazownictwo S.A. for the period from January 1st 2008 to March 31st 2008. On February 20th 2008, the Regulation of the Minister of Economy and Labour on detailed rules for preparing and calculating tariffs for gaseous fuels and on settlements in gaseous fuels trade (Dz.U. of February 20th 2008, No. 28, item 165) became effective, which necessitated changes in the application. On February 20th 2008, the Company amended the application in order to bring it to compliance with the new Tariff regulation.

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

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

- the prices, subscription fees and network rates applicable to settlements with customers receiving gaseous fuels from distribution networks.
- the manner of determining charges for failure to maintain quality parameters for gaseous fuels and quality standards in customer service, and the manner of determining the discount for exceeding the contractual capacity.

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

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

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

On August 12th 2008, PGNiG S.A. applied to the President of URE for approval of an amendment to Gaseous Fuel Tariff No. 1/2008, necessitated by PGNiG's changed business conditions, namely the increase in gas acquisition cost above the level assumed for the calculation of prices in the approved tariff; and for adjustment of the wording of the tariff. The amendment was intended to ensure harmonisation of the provisions of Gaseous Fuel Tariff No. 1/2008 with provisions of the tariffs of the Transmission System Operator and Distribution System Operators.

By virtue of the decision of October 17th 2008, the President of URE approved the amendments to Gaseous Fuel Tariff No. 1/2008. The tariff has been used in settlements with customers since November 1st 2008.

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

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m ³]	[PLN/month]
E1A-E4B	0.9983	600.00
Ls1-Ls4	0.6327	600.00
Lw1-Lw4	0.7385	600.00

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

- High-methane natural gas (E groups)

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m ³]	[PLN/month]
W-1	1.0500	4.30
W-2	1.0350	6.40
W-3	1.0215	7.10
W-4	1.0160	18.00
W-5	1.0100	110.00
W-6	1.0011	130.00
W-6A	1.0011	130.00
W-6B	1.0011	130.00
W-7	0.9993	270.00
W-7A	0.9993	270.00
W-7B	0.9993	270.00
W-8	0.9988	600.00
W-9	0.9988	600.00
W-10	0.9988	600.00

- Nitrogen-rich natural gas (Ls subgroups)

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m ³]	[PLN/month]
Z-1	0.6659	4.30
Z-2	0.6564	6.40
Z-3	0.6474	7.10
Z-4	0.6444	18.00
Z-5	0.6404	110.00
Z-6	0.6344	130.00
Z-7	0.6333	270.00
Z-7A	0.6333	270.00
Z-7B	0.6333	270.00
Z-8	0.6329	600.00
Z-9	0.6329	600.00

- Nitrogen-rich natural gas (Lw subgroups)

Tariff Group	Price of gaseous fuel	Subscription fee
	[PLN/m ³]	[PLN/month]
S-1	0.7770	4.30
S-2	0.7660	6.40
S-3	0.7560	7.10
S-4	0.7520	18.00
S-5	0.7481	110.00
S-6	0.7410	130.00
S-7	0.7397	270.00
S-7A	0.7397	270.00
S-7B	0.7397	270.00
S-8	0.7393	600.00
S-9	0.7393	600.00

On February 13th 2009, PGNiG S.A. applied to the President of URE for approval of Gaseous Fuel Tariff No. 1/2009 (during the proceedings the tariff's name was changed to Gaseous Fuel Tariff No. 2/2009). By the date of this Report, no decision had been issued by the President of URE regarding the tariff.

1.4. Regulatory Risks

Regulatory Risk

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

In 2009, further amendments may be made to the legal acts regulating operation of the gas sector. These amendments should be made, first and foremost, to the Polish Energy Law. Once the amended Law becomes effective, the tariff regulation will need to be amended.

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

Calculation Risk

PGNiG S.A.'s ability to cover costs of its core operating activities depends on the prices approved by the President of URE. While approving tariffs for a given period, the President of URE considers other external factors which are beyond PGNiG S.A.'s control. In an attempt to protect weaker customers,

while verifying costs of operating activities, the President of URE may consider certain cost unjustified or may reject the assumptions adopted by PGNiG S.A. with respect to main drivers of cost changes and profit targets allowing for business risk. The URE may also refuse to accept tariff prices and charge rates applied for by PGNiG S.A. Lower tariff prices and charges might adversely affect PGNiG S.A.'s profitability.

Forecasting Risk

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

Market Risk

Prices of imported gas are determined in USD or EUR, and are based on indexation formulae reflecting the prices of petroleum products. Changes in foreign exchange rates and prices of petroleum products materially affect acquisition cost of imported gas. The market of crude oil and petroleum products has recently been to a large extent unpredictable, given the continual price changes. These material changes in fuel prices on the international markets affect the prices of imported gas. Each, even accurate forecast of changes of natural gas prices is encumbered with a high error risk. There can be no assurance that, despite legal possibility of adjusting the prices approved for a tariff term, an increase in the price of imported gas may not be fully passed on customers or the changes in selling prices may lag behind the changes in import prices.

Risk of Competition

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

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 national fuel security is threatened or the petroleum market is disturbed regulates the issues related to ensuring the national fuel security, including the rules for creating, maintaining, and financing the reserves of natural gas by those energy companies whose business involves international trade in natural gas or which are importing gas for their own needs. The Act introduces certain changes with respect to the business activity conducted by PGNiG S.A.:

- It sets the timetable for creation of mandatory stocks of natural gas; it stipulates that in 2012, the volume of mandatory stocks will cover 30 days' average daily imports of gas;
- It provides for return on capital employed in storage activity of at least 6%;
- It stipulates that cost related to maintaining, releasing and supplementing reserves is 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:

- carrying out geological work,
- extracting minerals from reserves,
- storing waste matter in rock mass, including in worked-out caverns,
- protection of mineral reserves, underground waters and other environmental resources in connection with geological works and extraction of minerals.

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

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

Geological and mining activities are subject to the supervision of competent geological administration and mining supervision authorities. The Geological and Mining Law provides for criminal sanctions in case of failure to comply with its regulations and specifies the upper and lower limits of mining fees.

In 2008, the Ministry of Natural Environment granted PGNiG S.A. eight licences for exploration and prospecting of crude oil and natural gas reserves, and extended the term of 31 licences. In 2008, eight licences for crude oil and natural gas production were obtained, while four licences expired. In addition, during the year two licences for underground gas storage were granted, while one such licence expired. No changes occurred with respect to licences for waste matter storage in the reporting period.

As at December 31st 2008, PGNiG S.A. held the following licences, granted on the basis of the Geological and Mining Law:

- 75 licences for exploration and prospecting of crude oil and natural gas reserves;
- 217 licences for production of crude oil and natural gas from reserves;
- 9 licences for underground gas storage;
- 4 licences for waste matter storage.

Chapter III: Exploration and Production

The segment's key activity is the production of hydrocarbons from deposits and preparation of products for sale. The segment covers the entire process of exploration and production of natural gas and crude oil, starting from geological analyses, through geophysical studies and drills, to the development and operation of deposits. For its own purposes, the segment also partially uses the capacity of the Underground Storage Facilities in Brzeźnica, Strachocina and Swarzędów.

In 2008, the exploration and production segment was mostly engaged in off-tariff sales of natural gas, as well as sales of crude oil and other products. The main customers for natural gas represented the industrial sector, which accounted for 85.9% of the total sales volume. The table below sets forth the sales volumes of key products to external customers.

Sales of key products

	Unit	2008	2007
1. Natural gas, including:	million m ³	611.3	629.5
- high-methane natural gas	million m ³	47.3	51.0
- nitrogen-rich natural gas*	million m ³	564.0	578.5
2. Crude oil	thousand tonnes	497.2	540.6
3. Condensate	thousand tonnes	1.2	1.1
4. Helium	million m ³	2.2	2.4
5. Propane-butane mix	thousand tonnes	17.4	18.4
6. Nitrogen	thousand kg	1,246.0	488.2
7. Sulphur	thousand tonnes	20.3	23.4

* Million m³ measured as high-methane gas equivalent.

In December 2008, the Company and Zakłady Azotowe of Tarnów-Mościce S.A. signed an agreement for sale of nitrogen-rich gas from the Ryłowa, Rajsko, Szczepanów and Wierchosławice fields. The agreement was signed for 12 years and provides for supplies of approximately 50m³ p.a., starting from 2012.

In 2008 the Company executed agreements for the supply of crude oil to refineries of the Orlen Group, including Rafineria Trzebinia S.A. and Rafineria Nafty Jedlicze S.A. As far as supplies via pipelines are concerned, the agreement concluded with BP International for the sale of crude oil abroad was replaced with an agreement with TOTSА TOTAL OIL TRADING S.A. The terms of export sales of crude oil remain unchanged.

1. Exploration

In 2008, PGNiG S.A. conducted work related to exploration and prospecting for hydrocarbon reserves in Poland, in the Carpathians, Carpathian Foreland and Polish Lowlands. Drilling work covered 35 boreholes, including 24 exploratory boreholes and 11 prospecting boreholes. At six of the boreholes, drilling commenced in 2007. A total of 65,347 m of drillings were made.

From among the 30 boreholes with known deposit-related results, 11 (ten gas boreholes and one crude oil borehole) were classified as positive, while 19 other boreholes were classified as negative. The gas boreholes are located in the Carpathian Foreland and Polish Lowlands, while the oil borehole – in the Polish Lowlands.

In 2008, PGNiG S.A. conducted geophysical work in the Carpathians, Carpathian Foreland and Polish Lowlands, where:

- 1,538.5 km of 2D seismic surveys and
 - 602.6 km² of 3D seismic surveys were performed.
- were performed.

A total of PLN 599.5m was spent on work related to exploration and prospecting in 2008.

As at December 31st 2008, the volumes of proved reserves approved by the Minister of Environment was:

- 93.3bn m³ of natural gas measured as high-methane gas equivalent,
- 21m tonnes of crude oil.

In 2009, a 9.2bn m³ increase in producible reserves of natural gas (measured as high-methane gas equivalent) and a 230 thousand tonnes increase in producible reserves of crude oil are expected to be proved (respective figures as at December 31st 2008).

Joint Ventures in Poland

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

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

Under the Agreement on Settlement of Payments for Natural Gas Produced from the Klęka-11 Borehole, PGNiG extracted gas from the Klęka deposit. Additionally, the reprocessing and reinterpretation of seismic data were continued in the “Płotki” area. Furthermore, productivity was measured and the open hole tests were carried out on the Roszków-1 borehole (drilled in 2007). In 2008, the Roszków gas deposit, with producible reserves of 0.7bn m³ (high-methane equivalent), was documented.

In 2008, in the Poznań area, previous seismics were reprocessed and interpreted to identify new sites where drilling work could be performed in 2008 and the following years. In the same year, 2D seismic surveys were performed on Lutynia-Taczanów and 3D seismic surveys were carried out on Kórnik-Środa Wielkopolska and Żerków-Pleszew. In 2008, the drilling of three exploratory boreholes (Grundy-2, Kromolice-1 and Środa Wielkopolska-6) was completed and the drilling of the Kromolice-2 borehole was commenced.

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

In 2008, under the Bieszczady Joint Operations Agreement of June 1st 2007, PGNiG S.A., in cooperation with Eurogas Polska Sp. z o.o. and Energia Bieszczady Sp. z o.o., conducted studies and geological and geophysical surveys to identify sites within the “Bieszczady” area where hydrocarbon reserves may be prospected and explored. In the same year, 2D seismic survey on Kostarowce-Zahutyń commenced. The licences and mining usage right with respect to prospecting and exploration of crude oil and natural gas deposits in that area are held by the operator, i.e. PGNiG S.A.

Exploratory Work Abroad

PGNiG S.A. conducts exploratory work in Pakistan under an agreement between PGNiG S.A. and the Pakistani government dated May 18th 2005, concerning exploration and production of hydrocarbons in the area covered by the Kirthar licence. Exploratory work in the Kirthar block area is conducted in cooperation with Pakistan Petroleum Ltd. (interests/project cost participation: PGNiG S.A. – 70%; PPL – 30 %). Owing to the lack of relevant equipment, drilling of first exploration borehole Rahman-1 has been postponed until Q2 2009.

On December 6th 2007, PGNiG S.A. executed an agreement concerning assignment of an interest in the 1/05 exploration licence in Denmark and took over the operator functions. Interests held in the license: PGNiG S.A. – 40%, Odin Energi A/S – 40%, Nordsofonden – 20%. On April 5th 2008, by virtue of the decision of the Danish Energy Agency, the licence was extended until October 5th 2009, contingent on performing a 3D seismic shot covering an area of not less than 50 km². In 2008 archival 2D seismics has been reprocessed with a view to locating the 3D shot, whose performance is planned for 2009.

In 2007, PGNiG S.A. won a tender for the Bahariya exploration license (Block 3) in Egypt. The licence covers an area of 4,414.4 km². In July 2007, the Production Sharing Agreement was initialled. PGNiG S.A. will commence the performance of the licence agreement pending the ratification of the PSA by the Egyptian Parliament and its subsequent execution by the parties. In 2009, 1,450 km of 2D seismics is planned to be reprocessed.

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

2. Production

Two of PGNiG S.A.'s branches, the Zielona Góra Branch and the Sanok Branch, carry out production of natural gas and crude oil in Poland. The Zielona Góra Branch produces crude oil and nitrogen-rich natural gas at 20 mines (including 12 gas mines, and 8 oil and gas mines), while the Sanok Branch produces high-methane natural gas, nitrogen-rich natural gas and crude oil at 46 mines (including 26 gas mines, and 20 oil mines and oil and gas mines).

In 2008, PGNiG S.A. produced a total of 4,073.9m³ of natural gas (high-methane equivalent) and 487.4 thousand tonnes of crude oil. 2008 saw a 4.7% decrease in natural gas production over the 2007 figures. The decrease was caused by the natural fall in production capacity of the operated boreholes and less than expected volume of reserves of the fields being developed. Over the same time, the production of crude oil dropped by 5.9% owing to decreased production capacity and a technical failure at the Dębno mine. The table below sets forth PGNiG S.A.'s production in 2008.

Production structure

		Unit	2008	2007
1.	Natural gas	million m ³ *	4,073.9	4,276.1
	- Zielona Góra Branch	million m ³ *	2,297.4	2,391.0
	- Sanok Branch	million m ³ *	1,776.5	1,885.1
2.	Crude oil	thousand tonnes	487.4	518.2
	- Zielona Góra Branch	thousand tonnes	442.5	472.0
	- Sanok Branch	thousand tonnes	44.9	46.2
3.	Condensate	thousand tonnes	11.2	9.6
4.	Sulphur	thousand tonnes	21.3	23.3
5.	Propane-butane mix	thousand tonnes	17.4	18.2
6.	Helium	million m ³	2.2	2.3
7.	LNG	million m ³ *	20.1	21.7

* High-methane equivalent

In 2008, a total of 16 boreholes were put in operation in the Sanok Branch area; in the case of the Zielona Góra Branch, two new boreholes were commissioned. The new boreholes increased the natural gas production capacity by ca. 510 m³/min.

In 2008, PGNiG S.A. conducted a number of projects aiming to maintain natural gas and crude oil production from the existing fields. In order to increase hydrocarbon production, 7,772 m of operational drill holes were performed. In 2008, drilling of ten operational drills was completed in the following fields: Radlin, Sędziszów, Dzieduszyce, Cierpisz, Bonikowo, Strachocina, Rudka and Trzebowniko. With a view to limiting the natural decline in production, 42 non-producing boreholes were overhauled. Flow-rate intensification measures were taken to maintain or increase the production capacity of the operational boreholes.

In connection with the pressure decrease on the reserves in Palikówka and Kuryłówka, it was necessary to install compressors at interconnector terminal points. This prevented decommissioning of certain boreholes and enabled transfer of the produced gas to the transmission system. There are plans to install two more compressors on the Jodłówka reserve in 2009.

The exploration and production segment uses the Underground Storage Facilities in Brzeźnica, Strachocina and Swarzędów, to secure the necessary storage capacity to handle the produced gas during the low-demand periods. Besides, the underground storage facilities enable optimum production from domestic deposits during the year and provide tools for rational management of natural gas reserves. The table below sets forth the available capacities of the underground storage facilities as at the end of 2008.

Available capacities of the underground storage facilities used by the exploration and production segment

	million m ³
Brzeźnica	65.0
Strachocina	150.0
Swarzędów	90.0

In 2008, PGNiG S.A. worked on extending the existing Underground Storage Facility in Strachocina (for storing high-methane natural gas) to increase the available capacity to 330m m³, and on constructing the new underground storage facilities in Daszewo (for nitrogen-rich natural gas Ls) and Bonikowo (for nitrogen-rich natural gas Lw). The nitrogen-rich gas storage facilities are to help optimise the production of Ls nitrogen-rich gas from local sources in the seaboard region (Daszewo) and the production of Lw nitrogen-rich gas from sources in western Poland (Bonikowo).

3. Planned Exploratory Work

Exploratory Work in Poland

In 2009, PGNiG S.A. plans to conduct geophysical and drilling works at 29 exploratory boreholes (work at six boreholes to be conducted in cooperation with foreign companies) and at seven prospecting boreholes.

Exploratory Work Abroad

In 2008, PGNiG S.A. took a number of steps to acquire new sites for exploration and new licence areas in such countries as Algeria, Iraq, Iran, Morocco, Mongolia and Tunisia. All these efforts will be continued in 2009. Furthermore, PGNiG S.A. plans to press ahead with the exploratory work in the licence areas in Denmark, Egypt and Pakistan.

Underground Gas Storage Facilities

In 2009, PGNiG S.A. will proceed with the construction of the surface installations of the Daszewo facility. The Company also plans to commence construction work of the surface infrastructure for the gas storage facilities in Strachocina and Bonikowo.

Natural Gas Production

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

The plans for 2009 assume a natural gas production volume of 4.3bn m³ annually (high-methane equivalent) with a calorific value of 39.5 MJ/m³, which is to go down from the previously assumed production volume of 4.6bn m³. The lower volume of the forecast production is attributable to a decline in demand for nitrogen-rich gas from industrial customers receiving gas directly from deposits. It is also due to the rescheduling of the Capex plans related to development of new gas fields and a natural decrease in the production capacities from the reserves already in use. In order to improve the production volume to approx. 4.5bn m³, in the next few years PGNiG S.A. intends to develop and commence production on a number of documented natural gas deposits, including in Wielichowo-Ruchocice, Roszków and Międzychód (nitrogen-rich gas reserves in western Poland) as well as in Łukowa, Jasionka – Phase II, Kupno, Pilzno – Phase II and Rudka – Phase II (high-methane gas reserves in the Province of Rzeszów).

2010 is to see completion of the project of Grodzisk Nitrogen-Removal Plant, with the annual throughput capacity of feedstock gas amounting to 500m m³. The project provides for development of the reserves located in the Nowy Tomyśl-Grodzisk region and of the gas extracted from the Lubiatów-Międzychód-Grotów (LMG) reserves, as well as the construction of a second controller, besides the

Odolanów Branch, connecting the system for extraction of nitrogen-rich gas to the high-methane gas transmission network.

Crude Oil Production

In August 2008, PGNiG S.A. signed a PLN 1.4bn contract with the consortium of Poland's PBG S.A., Italy's Technip KTI S.P.A. and Canada's Thermo Design Engineering Ltd. to carry out the project "LMG Project – Central facilities, borehole areas, pipelines and other infrastructure". The commencement of work is scheduled for 2009.

Development of the Lubiatów-Międzychód-Grotów (LMG) reserve and intensified production from the Barnówko-Mostno-Buszewo (BMB) reserve are two projects aimed at increasing PGNiG's crude oil production output. The Company plans that in 2009 the crude oil production will reach more than 500 thousand tonnes. A significant increase in crude oil production is expected in 2013, when the LMG reserve is developed and placed in operation, and is to amount to approx. 0.9m tonnes annually.

4. Risks Related to Exploration and Production

Resource Discoveries and Estimates

The main risk inherent in exploration activity is the risk of no reserve discovery, i.e. the exploratory risk. This means that not all the identified potential reserve sites have sufficient deposits of hydrocarbons meeting the definition of the reserve. Whether or not such deposits exist depends on a number of geological factors. Furthermore, the actual quantity and quality of the accumulated hydrocarbons may differ from expected. When the results of successful exploration activity, in the form of documented new reserves, do not offset the production from the existing deposits, PGNiG S.A. documented producible reserves will decrease pro rata to the current production volumes.

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

Competition

Both on the Polish market and abroad there is a risk of competition from other companies with respect to acquisition of licences for exploration and prospecting of deposits i.e. implementation of a strategy providing for acquiring access to own hydrocarbon resources. Certain competitors of PGNiG S.A., especially those active globally, enjoy strong market positions and have financial resources larger than those of PGNiG S.A. Thus it is probable that such companies would submit their bids in tender offers and be able to acquire promising licences. Competitors are also able to define, value, offer and purchase numbers of fields (including the operation thereof and underlying licences) larger than it would be possible in the case of PGNiG S.A., given the Company's financial and human resources. This competitive edge of other market players is particularly important on the international market. However, in view of the growing intensity of the global financial crisis, the risk seems to be decreasing.

Delayed Work

Under the currently binding Polish legal regulations, obtaining a licence for exploration and prospecting of crude oil and natural gas deposits lasts from one to one and a half year. As regards business activity on foreign markets, it may take even two years from the time that the winning bid is awarded in a tender for licence until the relevant contract is ratified. Moreover, prior to the commencement of field work, the Company is obliged to arrange for numerous formalities, including obtaining formal and legal permits and approvals for entering the area, meeting environmental protection-related requirements and in some cases requirements related to protection of archaeological sites, and abiding by the regulations governing tenders for a work contractor. Under the currently binding legal regulations, another several months pass before an agreement with the work contractor is signed. In addition, companies must frequently wait for a very long time before their imported equipment receives customs clearance. These factors create the risk of delayed exploratory work.

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

- local governments' failure to adopt local land development plans (MPZPs)
- obstacles in incorporating projects into the MPZPs
- need to obtain and comply with administrative or other formal and legal decisions, including environmental decisions
- amendments to the current planning and development concept
- obstacles in obtaining permission from land owners to enter the site.

These factors significantly delay implementation of projects and commencement of on-site construction work. Concurrently, PGNiG S.A.'s obligation to comply with the Public Procurement Law frequently prolongs the tender procedure. Notices of appeal and complaints submitted by bidders lead to lengthy court proceedings and, consequently, to delays in implementing an entire project. A protracted investment process exacerbates the risk related to estimation of capital expenditure.

Cost of Exploratory Work

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

Legal Regulations Concerning Safety, Environmental Protection and Health

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

Qualified Personnel

The presence of foreign companies on the Polish market intensified the companies' takeover of highly qualified employees with vast professional experience. This risk is especially high with respect to

professionals specialised in the exploration of natural gas and crude oil deposits. In countries where PGNiG S.A. operates highly qualified staff is difficult to recruit.

Unpredictable Events

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

Changes in Legal Regulations

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

Political and Economic Situation

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

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

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

Chapter IV: Exploration and Production

The segment sells natural gas imported from other countries and produced from domestic deposits. Imported natural gas is purchased chiefly from eastern markets. The sale of natural gas through the distribution and transmission network is regulated by the Polish Energy Law, while gas prices are determined based on the tariffs approved by the President of the Polish Energy Regulatory Authority (URE). For the segment's purposes, three underground gas storage facilities are used: in Mogilno, Wierchowice and Husów.

1. Purchases

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

- Contract for sales of Russian natural gas to the Republic of Poland, executed with OOO "Gazprom Eksport", dated September 25th 1996, which will remain in force until 2022;
- Agreement on sales of the Lasów natural gas executed with VNG-Verbundnetz GAS AG, dated August 17th 2006, which will remain in force until October 1st 2016;
- Agreement on sales of natural gas executed with VNG-Verbundnetz GAS AG/E.ON Ruhrgas AG, dated September 15th 2004, which will remain in force until September 30th 2008;
- Agreement on sales of natural gas executed with ROSUKRENERGO AG, dated November 17th 2006, which will remain in force until January 1st 2010 and may be extended until January 1st 2012;
- Agreements on sales of the Lasów 2008 natural gas executed with VNG-Verbundnetz GAS AG, dated September 29th 2008, remaining in force from October 1st 2008 until October 1st 2011.

In connection with the expiry on September 30th 2008 of the agreement on gas sales executed with VNG-Verbundnetz Gas AG/ E.ON Ruhrgas AG and the change in the volume of gas supplied by VNG-Verbundnetz Gas AG, on September 29th 2008, PGNiG S.A. and VNG-Verbundnetz Gas AG executed the agreement on sales of the Lasów 2008 natural gas. Under the agreement, the Company will purchase 500 million m³ of natural gas annually.

The table below sets forth the structure of natural gas supplies measured as high-methane gas equivalent.

Structure of natural gas supplies (million m³)

	2008	%	2007	%
Imports, including:	10,264.3	99.8%	9,286.0	99.9%
- OOO Gazprom eksport	7,056.7	68.7%	6,219.2	67.0%
- ROSUKRENERGO AG	2,377.2	23.2%	2,279.3	24.5%
- Other foreign suppliers	830.4	8.1%	787.5	8.5%
Domestic suppliers	22.1	0.2%	13.5	0.1%
Total	10,286.4	100.0%	9,299.5	100.0%

In the early weeks of 2009, supplies of gas from the eastern markets were disrupted as a result of the conflict between Russia and Ukraine. Furthermore, gas supplies from ROSUKRENERGO AG have been suspended since January 2009, although the relevant agreement remains in force until January 1st 2010. As a result of reducing and then finally discontinuing gas supplies delivered through the Drozdovitse cross-border point, gas supply routes were changed and more gas has been delivered through the Vysokoye cross-border point. Gas supplies delivered through Drozdovitse were resumed, but gas volumes are lower, as a result of the failure of deliveries under the ROSUKRENERGO AG agreement. In order to secure a sufficient level of gas supplies to its customers, PGNiG S.A. increased the use of gas held in storage facilities. Following discussion with OOO Gazprom eksport, the Company secured a temporary increase in the volume of gas collected under the effective agreement.

2. Sales

In 2008, PGNiG S.A. signed comprehensive agreements for supply of gaseous fuel, from both transmission and distribution systems, to 92.9 thousand new customers, including 91 thousand households.

Pursuant to the provisions of the Polish Energy law, in 2008 PGNiG S.A. commenced replacement of commercial agreements with comprehensive agreements. The process is expected to be completed by December 31st 2009.

The key products sold by this segment are high-methane natural gas and nitrogen-rich gas. In 2008, sales of natural gas (high-methane equivalent) grew by approx. 1.5% (or 195 million m³) year on year. PGNiG S.A. sold gas both in Poland and on international markets. The structure of 2008 sales by the Trade and Storage segment is presented in the table below.

Sales structure of key products

	Unit	2008	2007
1 Natural gas, including:	million m ³	13,250.8	13,056.2
- high-methane gas	million m ³	12,437.8	12,233.1
- nitrogen-rich gas*	million m ³	813.0	823.1
2 Propane-butane	thousand tonnes	2.1	2.1

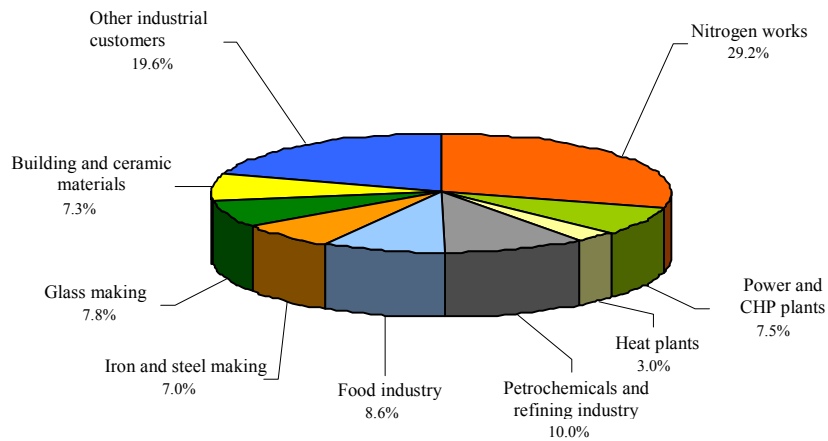
* Million m³ measured as high-methane gas equivalent

The Group's main customers who purchased natural gas included chemicals sector, the steel industry and the power sector, as well as households. Households make up the largest group of customers purchasing natural gas, accounting for 97% of the entire customer base (approx. 6.4m). Their share in the sales volume is 26%. The most prominent share in the natural gas sales was claimed by industrial customers (62%). The table below presents the structure of natural gas sales measured as high-methane gas equivalent broken down by major customers.

Sales of natural gas supplied via the transmission system (million m³)

	2008	%	2007	%
Industrial customers	8,064.5	60.9%	7,927.1	60.7%
Trade and services	1,390.8	10.5%	1,328.9	10.2%
Households	3,622.4	27.3%	3,641.2	27.9%
Wholesale customers	136.5	1.0%	119.2	0.9%
Exports	36.6	0.3%	39.8	0.3%
Total	13,250.8	100.0%	13,056.2	100.0%

Structure of sales of natural gas to industrial customers in 2008



3. Storage

The Trade and Storage segment uses a part of the capacities of underground storage facilities for its own purposes. Short-term fluctuations in the demand for natural gas are balanced out with the supplies from the Underground Gas Storage Cavern Facility Mogilno located in worked-out salt caverns, which is operating at full capacity. The capacities of the Underground Storage Facility Wierzchowice and the Underground Storage Facility Husów are used to minimise the effect of an uneven demand for natural gas in summer and winter seasons, to meet the obligations under the Take or Pay Contracts for imports, to safeguard the continuity and security of natural gas supplies and to meet the obligations under sales agreements providing for the delivery of natural gas to customers' premises.

In addition, the capacities of the Underground Storage Facility Wierzchowice, Underground Storage Facility Husów and the Underground Gas Storage Cavern Facility Mogilno help the Group comply with the obligation to maintain mandatory stocks, imposed by the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas, as well as on the Rules to be Followed in the Event of a Threat to National Fuel Security or a Disruption on the Petroleum Market, dated February 16th 2007.

In 2008, PGNiG S.A. continued efforts to expand available capacity of the existing Underground Gas Storage Facility in Wierzchowice and the Underground Gas Storage Cavern Facility in Mogilno (storing high-methane gas), and to prepare the construction of a new high-methane gas storage facility

at the Kosakowo Underground Gas Storage Cavern Facility. Available capacities of the storage facilities as at the end of 2008 are presented in the table below.

Available capacities of storage facilities in the Trade and Storage segment

	million m ³
Husów	400.0
Mogilno	380.2
Wierzchowice	575.0

4. Activities Planned in the Trade and Storage Segment

The Baltic Pipe Project

The objective of the project is to create a direct pipeline for the supply of natural gas from Denmark to Poland and also, in future, from Poland to Denmark. In 2008, pursuant to a cooperation agreement executed by PGNiG S.A., OGP GAZ-SYSTEM S.A. and Energinet.dk on November 15th 2007, the parties jointly conducted technical analyses and worked on the detailed arrangements relating to the execution of the Baltic Pipe project.

On December 16th 2008, PGNiG S.A. and OGP GAZ-SYSTEM S.A. executed Agreement on Acquisition of Documentation and Termination of Cooperation Agreement regarding the Baltic Pipe Project. On January 29th 2009, the Extraordinary General Shareholders Meeting of PGNiG S.A. decided to sell the documentation related to the implementation of the Baltic Pipe project to OGP GAZ-SYSTEM S.A. According to current plans, OGP GAZ-SYSTEM S.A. is to take responsibility for the execution of the project going forward.

In 2009, PGNiG S.A. and OGP GAZ-SYSTEM S.A. will jointly undertake geophysical studies of the seabed on specified alternative versions of the Baltic Pipe routes, with a view to selecting the optimum course.

The Skanled Project

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

In November 2008, Hafslund Varme & Infrastructure, holder of a 10% interest in the Skanled consortium, withdrew from the consortium. As a result of negotiations with external investors, it was agreed that VNG-Verbundnetz Gas AG would join the consortium. It was also decided that the new consortium member would acquire the 10% interest in the consortium and reserve capacity on the Skanled gas pipeline. The composition of the Skanled Consortium again changed in February 2009 when the state-owned Norwegian company Petoro AS joined the consortium. It acquired the interests of Ostfold Energi and Agder Energi, which withdrew from the consortium, and a part of the interest

held by Skagerak Energi. In total, Petoro AS acquired a 25% interest in the project, thus becoming the largest shareholder in the Skanled Consortium.

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

The Boernicke-Police Interconnection

Trade with the German market is the rationale for constructing the Boernicke-Police interconnection linking Poland and Germany. In October 2008, PGNiG S.A. launched the construction of a 14-kilometers gas pipeline Tanowo-Dobieszczyn.

Natural Gas Purchase

As a result of failure of gas deliveries under the ROSUKRENERGO AG contract, PGNiG S.A. is taking action to obtain gas from alternative sources. Therefore, the existing structure of gas imports may change. Furthermore, in 2009 the Company will seek to ensure LNG supplies and execute a long-term supply contract.

Natural Gas Sales

The projected rise in the natural gas sales volume is attributable to development investments of PGNiG S.A.'s strategic customers in the petrochemical, construction and steel sectors. In 2008, PGNiG S.A. continued cooperation, started in 2007, concerning possible gaseous fuel supplies with several major prospective customers, including companies operating in the power sector and planning to replace hard coal fired generating units with gas fired ones. Supplies of natural gas for the needs of the upgraded power/CHP plants are planned to commence in 2012-2013.

Underground Gas Storage Facilities

On November 19th 2008, PGNiG S.A. and consortium comprising PBG S.A. Przeźmierowo, Tecnimont S.p.A. (Italy), Societe Francaise d'Etudes et de Realisations d'Equipements Gaziers SOFREGAZ (France), Plynostav Pardubice Holding A.S. (the Czech Republic), and Plynostav – Regulace Plynu A.S. (the Czech Republic) executed an agreement on the project designated as the Construction of the Surface Section of the Wierzchowice Underground Gas Storage Facility, Phase: 3.5 billion nm³, Subphase: 1.2 billion nm³. The agreement's value is approx. PLN 1.1bn. In 2009, PGNiG S.A. will commence drilling and construction of the surface section of the Wierzchowice Underground Gas Storage Facility. Additionally, other plans provide for drilling and construction of a leaching plant at the Kosakowo Underground Gas Storage Facility and further development of the Mogilno Underground Gas Storage Cavern Facility.

5. Trade- and Storage-Related Risks

High Natural Gas Prices

The major risk factor posing a threat to gas market growth is the price of natural gas, which is high relative to the price of alternative energy sources, especially coal. This situation is a serious impediment to the growth of gas power business. As a result of the change to the PGNiG S.A. tariff and the economic slowdown in Poland, industrial customers scale down their production activities and reduce investments, which, to a large extent, affects the volume of gas sold by PGNiG S.A. Furthermore, given the rising prices of gas, some customers actively seek alternative energy sources.

Competition

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

Reduced Volume of Gaseous Fuel Sales

Due to the slower pace of economic growth, rising unemployment and deterioration in the financial standing of customers, there is a risk that sales of gaseous fuels may decline. Furthermore, lower sales may also result from reduced supplies of imported gas.

Gas Supplies

At the beginning of 2009 the deliveries of natural gas from the eastern markets were again disrupted as a result of a conflict between Russia and Ukraine. In addition, gas supplies under the ROSUKRENERGO AG contract have been suspended since early 2009. In Q1 2009, the demand for natural gas was wholly satisfied by temporarily increasing the volumes of gas supplied by OOO Gazprom eksport and expanding the use of gas from underground storage facilities. With a view to compensating for the lost volumes of gas under the ROSUKRENERGO AG contract, PGNiG S.A. works towards securing gas from alternative sources. Taking into consideration the policy pursued by the key supplier and the political and economic environment in the transit countries, disruptions in gas supplies are likely to reoccur in future.

LNG Terminal

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

Skanded Project

The construction of the Skanded Pipeline is conditional upon numerous factors, including principally the execution, by all Consortium members, of gas purchase agreements providing for sufficient quantities of natural gas. Furthermore, the execution of the Skanded Project in line with the timetable requires timely obtainment of necessary administrative permits. Moreover, PGNiG S.A.'s participation in the Project depends upon the final decision concerning implementation of the Baltic Pipe Project and PGNiG S.A. obtaining the required flow capacity in the Danish transmission system.

Storage

Since the provisions of the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas require the Company to increase mandatory stocks of gas, in the coming years PGNiG S.A. may be exposed to the risk of shortages of available capacity, output capacity and gas compression capacity. As a result, working output and available capacity used to meet PGNiG S.A.'s commercial needs may be insufficient during winter time. This situation may be further aggravated if the President of the Polish Energy Regulatory Authority refuses PGNiG S.A.'s request for temporary exemption from the obligation of gaseous fuels storage, and, additionally, if mandatory stocks are not excluded from the

storage facility definition. If storage facilities are lent for use to third parties, there is a potential risk of insufficient capacity and output to secure a sufficient level of mandatory stocks, as required under the Act on Stocks of Crude Oil, Petroleum Products and Natural Gas.

Another risk factor is a possibility of a deficit of funding required for the planned Capex. If the European Commission refuses to co-finance projects at the Mogilno Underground Gas Storage Cavern Facility, the Kosakowo Underground Gas Storage Cavern Facility, the Strachocina Underground Gas Storage Facility and the Wierzchowice Underground Gas Storage Facility, PGNiG S.A. will be required to seek additional funding in the amounts requested for the relevant projects (i.e. approx. PLN 410m, as specified in the List of Individual Projects for the Purposes of the Operational Programme Designated as Infrastructure and Environment 2007–2013).

Chapter V: Other Activities

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

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

- metrologic control of measurement systems on the Yamal-Europe transit gas pipeline (Polish section),
- verification of natural gas measurement systems for the purpose of evaluation of CO₂ emissions,
- measurement supervision of the process analyser systems for the evaluation of the quality of natural gases in the transmission grids,
- validations and supervision of measurements of the field laboratories controlling the quality of natural gases,
- cooperation with the Laboratory of Gas Standards of the Central Office of Measures (*Laboratorium Wzorców Gazowych Głównego Urzędu Miar*) on the project providing for the creation of the national quality standard for type E and type L natural gases.

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

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

Chapter VI: Investment Projects

In 2008, PGNiG S.A. carried out a number of projects in all of its business areas. According to the financial statements, capital expenditure on property, plant and equipment and intangible assets incurred by PGNiG S.A. in 2008 amounted to PLN 1,161.9m. The table below presents the expenditure structure by business segments.

Capital expenditure of PGNiG S.A. in 2008

	PLNm
Exploration and Production	935.0
Trade and Storage	226.7
Other	0.2
Total	1,161.9

1. Investment Projects in the Exploration and Production Segment

The expenditure on projects incurred in the Exploration and Production segment in 2008 amounted to PLN 935.0m. Below are described the major projects in the segment.

Exploration

In the area of exploration, capital expenditure totalled PLN 362.1m, including PLN 211.7m incurred mainly on positive boreholes and boreholes which were not completed. In 2008, eleven positive boreholes were drilled. The balance of PLN 150.4m was incurred on negative boreholes and was charged to costs of the financial year.

Lubiatów-Międzychód-Grotów Project

The objective of the project is to develop the Lubiatów-Międzychód-Grotów reserves of crude oil and natural gas and to facilitate transport, storage and sale of crude oil, natural gas, liquid sulphur and propane-butane mixture from the LMG Crude Oil and Natural Gas Mine. The LMG project involves:

- construction of the LMG Central Facility to serve as a hub for collection, distribution and treatment of reservoir fluids,
- construction of the Dispatch Terminal in Wierzbno to support collection and shipment of crude oil in rail tank cars and handle the pumping of crude oil collected from the LMG Crude Oil and Natural Gas Mine to the PERN Druzhba Pipeline,
- construction of a gas pipeline to the Denitrating Plant in Grodzisk to support the transmission of surplus gas from the LMG Mine to Grodzisk Denitrating Plant.

In 2008, the construction of the Dispatch Terminal was completed. The expenditure incurred in 2008 was PLN 26m. The total value of the project is estimated at approx. PLN 1.6bn.

The Grodzisk Project

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

The project provides for the development of the Wielichowo, Ruchocice and Paproć W reserves, connection of the Elżbieciny and Jabłonna boreholes, development of the Nowy Tomyśl 2k borehole, modernisation of the Paproć Natural Gas Mine (KGZ Paproć), construction of the Przyłek-KGZ Paproć gas pipeline network and construction of the Grodzisk Denitrating Plant. The total capacity of the Denitrating Plant will stand at around 35,000 m³/h. In 2008, the following tasks were completed: development of the Paproć W reserves, modernisation of KGZ Paproć and construction of the Przyłek-KGZ Paproć gas pipeline network. The expenditure incurred in 2008 was PLN 68.9m. The total value of the project is estimated at PLN 440m.

Gas Pipeline to KGHM

The project involves the construction of a high-pressure gas pipeline and optic-fibre cable along with infrastructure, from the Kościan Natural Gas Mine (KGZ Kościan) to KGHM Polkowice/Żukowice, in order to enable the Company to sell natural gas directly to KGHM Polkowice/Żukowice. The expenditure incurred in 2008 was PLN 74.9m. The total cost of the project is estimated at approx. PLN 220m.

Barnówko-Mostno-Buszewo Project

In 2008, the drilling of production boreholes on the BMB (Barnówko-Mostno-Buszewo) reserve was completed. The total expenditure incurred on the project amounted to PLN 116.8m. The investment is carried out in order to maintain crude oil production at the already exploited reserves on current levels and to ensure incremental extraction volumes following the incorporation of new reserves.

Other Investment Projects

Other projects provide for the development of documented or exploited natural gas reserves, maintenance and recreation of hydrocarbons production capacity or are related to the functioning of the production business segment. Key investment tasks performed in 2008 included:

- modernisation and extension of natural gas mines,
- development of the Ryłowa-Rajsko natural gas reserves,
- development of boreholes in Luchów and Wola Różaniecka,
- development of boreholes in Cierpisz,
- construction of the second section of the Kaleje-Mchy gas pipeline
- upgrading production installations at the Odolanów denitrating plant
- purchases of ready-to-use investment assets as well as backup and infrastructure.

Underground Gas Storage Facilities

In 2008, PGNiG S.A. carried out the extension of the Strachocina storage facility and launched the construction of two new nitrogen-rich gas storage facilities: Bonikowo and Daszewo. The expenditure incurred in 2008 totalled PLN 112.9m. The scope of work undertaken included:

- completion of the drilling of three horizontal boreholes and the beginning of the drilling of another borehole on the Underground Gas Storage Facility Strachocina;
- construction of a gas pipeline from the Kościan distributing centre and drilling of the Bonikowo 3H horizontal borehole; construction of the Underground Gas Storage Facility Bonikowo will allow the Company to better utilise the production capacity of its reserves and the Grodzisk blending plant;
- construction of the surface infrastructure of the Underground Gas Storage Facility Daszewo; the construction of the storage facility will ensure balanced production from local deposits.

2. Investment Projects in the Trade and Storage Segment

The projects carried out in the Trade and Storage Segment in 2008 included:

- extension of the working storage capacity of the Underground Gas Storage Cavern Facility Mogilno (a high-methane gas storage facility), modernisation of the Underground Gas Storage Facility Husów and preparatory work related to the construction of a new high-methane gas storage facility, Underground Gas Storage Cavern Facility Kosakowo (PLN 41.4m);
- projects involving transmission assets – in line with the investment plan of OGP GAZ-SYSTEM S.A. and the procedures specified in the agreement for the technical preparation and execution of projects for the purposes of the transmission system, PGNiG S.A. carried out projects involving transmission assets, which are subsequently incorporated in the register of tangible assets under lease agreements (PLN 43.6m);
- purchase of land and real property, purchase of tangible assets representing the assets of OGP GAZ-SYSTEM S.A. transferred to the Distribution System Operators and the settlement of the ownership title to and purchase of high-pressure gas pipelines (PLN 64.1m);
- telecommunications and data transmission projects and purchase of ready-to-use investment assets, vehicles, technical equipment, tools and machinery (PLN 36.8m);
- extension of the CNG fuelling station, expansion of the coverage of gas pipeline network in new regions, construction of connections to end-users and tasks related to the diversification of gas supply sources (PLN 20.6m).

3. Investment Projects in the Other Activities Segment

In 2008, the capital expenditure incurred in the Other Activities segment totalled PLN 0.2m and was related to investment projects carried out by the Central Measurement and Research Laboratory Branch.

Chapter VII: Environmental Protection

Liquidation of Boreholes

Pursuant to the Polish Geological and Mining Law, PGNiG S.A. is required to liquidate worked-out mining caverns, eliminate the danger and damages caused by mining activities and restore land to its original previous condition. Liquidation of boreholes and mining pits prevents leakage of crude oil and natural gas to the surface and to watercourses. In addition, there is a risk that escaping gas may accumulate in unliquidated gas boreholes, posing a fire hazard. Consequently, PGNiG S.A. liquidated 62 worked-out boreholes in 2008. The liquidated boreholes included drilling holes which were tens of years old and mining pits which dated back to the 19th century.

Carbon Credit Trade System

In 2008, in the National Plan for the Distribution of Carbon Credits for 2008–2012 (KPRU II) the facilities of PGNiG S.A. were allowed the total of 99,982 Mg CO₂ per annum. In that settlements period, the system included the plants of the Odolanów Branch, Zielona Góra Branch and the gas system of the Underground Gas Storage Cavern Facility in Mogilno

Under the existing carbon credit trading system (CCTS), in 2009 PGNiG S.A. reviewed the annual reports on carbon dioxide emissions for 2008 and brought the volumes of carbon dioxide emission in line with the amounts stipulated by the permit held. Following the cancellation of the carbon credits used in 2008, 26,597 Mg CO₂ credit units were retained.

Environmental Management System

In 2008, PGNiG S.A. started to implement the environmental management system meeting the requirements of PN-EN ISO 14001:2005 at its Warsaw head office. Within the framework of the undertaken actions, the Company carried out an initial inspection, developed a schedule concerning the implementation of the environmental management system, conducted trainings of employees and developed system procedures. In 2009, the environmental management system was implemented at the Company's head office.

REACH (Registration, Evaluation, Authorisation of Chemicals)

In order to ensure compliance with the new regulations concerning mandatory registration of chemical substances, evaluation of substances and authorisations for use of substances in production and trading, which came into effect in 2008, the Company pre-registered sulphur which is subject to the requirements of the REACH Regulation.

Natura 2000

In 2008, PGNiG S.A. continued to gather and update information on any potential environmental conflicts related to the already indicated and planned to be marked out areas of Natura 2000 and involving the planned exploration, prospecting, production projects and projects pertaining to the construction and maintenance of gas infrastructure.

Methane Emissions

In 2008, work commenced on the development of uniform CH₄ emission rates and unified calculations methods for the CH₄ emissions. The uniform and reliable methane emission rates will allow the Company to reduce the cost of environmental charges.

Chapter VIII: Other Information

Distribution of 2007 Profit

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

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

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

Approval for the Performance of Duties

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

Agreements Concluded with Management Board Members

The employment contracts concluded with the Management Board Members appointed in 2008 contain a clause in Par. 8, which reads: "In the event of removal from office or termination of the employment contract for reasons other than breach of basic responsibilities related to employment, the employee may be granted severance pay equal to three times monthly salary." Non-competition agreements covering the period of 12 months from the date of termination of the employment relation have also been concluded with the Management Board Members. In return for compliance with the non-competition agreement during its term, Management Board member is entitled to monthly compensation of 100% of the average gross remuneration for the last three months, received while under employed.

Remuneration of Members of the Management and Supervisory Boards

For information on the remuneration paid to the Members of the Management Board and Supervisory Board see the Annual Non-consolidated Financial Statements for the year ended December 31st 2008 (Note 46.4).

Shares held by Members of the Management and Supervisory Boards

As at December 31st 2008, the only person holding PGNiG S.A. shares or shares in PGNiG S.A.'s related undertakings was Mr Stanisław Rychlicki, who held 8,272 PGNiG S.A. shares with the aggregate par value of PLN 8,272.

Employee Shares

On June 25th 2008, the Ministry of State Treasury disposed of one share in PGNiG S.A. The transaction was concluded on market terms. Pursuant to the Commercialisation and Privatisation Act of August 30th 1996, eligible employees gained the right to acquire the Company shares free of charge as of October 1st 2008; the right will expire on October 1st 2010. The eligible employees have the right to acquire free of charge, on the Company registration date, up to 15% of the shares acquired by the State Treasury, i.e. up to 750,000,000 Series A1 bearer shares in PGNiG S.A., with a par value of PLN 1 per share. The Company shares acquired free of charge by the eligible employees may not be traded before July 1st 2010, and the shares acquired free of charge by members of the Company's Management Board may not be traded before July 1st 2011. Following the acquisition of 15% of the Company shares by its employees, the State Treasury's percentage share in the total vote in the Company will decline from 84.75% to 72.03%. The process of concluding agreements for the free of charge disposal of shares to the eligible employees commenced on April 6th 2009.

Actions Against PI GAZOTECH Sp. z o.o.

- On March 7th 2006, the Regional Court of Warsaw dismissed PGNiG S.A.'s action instituted against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolutions of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated April 23rd 2004, including the resolution whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 52m. In view of the dismissal, PGNiG S.A. filed an appeal against the court ruling, which was rejected by the Court of Appeals in Warsaw on January 10th 2007 on account of the Company's failure to duly paid the required fees. On March 1st 2007, PGNiG S.A. filed a complaint with the Supreme Court regarding the Court of Appeals' ruling. On July 20th 2007, the Supreme Court examined the complaint in closed session and overruled the Court of Appeals' decision to reject PGNiG's appeal. On February 4th 2008, the Court of Appeals dismissed PGNiG's appeal. The decision is final and binding. From the date of passing the verdict by the Court of Appeals the Company's claim is no longer secured by suspension of the resolution authorising the additional contributions. On July 8th 2008, a cassation complaint against the decision of the Court of Appeals of February 4th 2008 was filed. On February 26th 2009, the Supreme Court issued a decision to accept the cassation complaint for consideration.
- On December 7th 2006, the Regional Court of Warsaw dismissed PGNiG's action instituted against PI GAZOTECH Sp. z o.o. to confirm the non-existence of the resolution on redemption of shares, adopted by the General Shareholders Meeting of PI GAZOTECH Sp. z o.o. on April 23rd 2004. PGNiG S.A. filed an appeal against the ruling. The Court of Appeals in Warsaw dismissed the appeal at the hearing of February 5th 2008. The decision is final and binding. On May 27th 2008, a cassation complaint against the decision of the Court of Appeals of February 5th 2008 was filed. By virtue of its decision of December 5th 2008, the Supreme Court refused to accept the cassation complaint for consideration.
- The proceedings based on PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated January 19th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions in the amount of PLN 25,999,998, held before the Regional Court of Warsaw. On October 27th 2008, a hearing was held before the Regional Court of Warsaw. By virtue of its decision of October 31st 2008, the Regional Court dismissed the Company's claim. PGNiG S.A. filed an appeal from the decision. The claim remained to be secured until the decision becomes final.
- The proceedings based upon PGNiG S.A.'s action against PI GAZOTECH Sp. z o.o. to rescind or assert invalidity of the resolution of the General Shareholders Meeting of PI GAZOTECH Sp. z o.o., dated October 6th 2005, whereunder PGNiG S.A. is obliged to pay additional contributions

in the amount of PLN 6,552,000, instigated before the Regional Court of Warsaw were concluded in the first instance. On May 30th 2008, the Regional Court dismissed the Company's claim and reversed the decision on securing this claim. On July 22nd 2008, PGNiG S.A. lodged a complaint against the reversing of the decision on securing its claim, and on July 29th 2008, it filed appeal against the Regional Court's judgement. On November 12th 2008, the Court of Appeals accepted the Company's complaint against the reversing of the decision on securing its claim. On January 14th 2009, while reconsidering PI GAZOTECH Sp. z o.o.'s motion to reverse the decision on securing the claim (after the Court of Appeals overruled the decision on reversing the decision on securing the claim), the Regional Court of Warsaw again reversed the decision on securing the claim. On February 17th 2009, PGNiG S.A. lodged a complaint against the above decision of the Regional Court of Warsaw.

Dispute with Bartimpex S.A.

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

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

Both parties filed appeals against the ruling of the court of first instance. The Court of Appeals changed the Regional Court's decision. Accordingly, a fine of PLN 2,000,000 was imposed and PGNiG's appeal was dismissed. On September 1st 2008, PGNiG S.A. filed a cassation complaint against the decision of the Court of Appeals of March 27th 2008 was filed. The Supreme Court accepted the Company's cassation complaint for consideration.

Dispute with EUROPOL GAZ S.A.

The proceedings based upon PGNiG S.A.'s actions against EUROPOL GAZ S.A. to receive payment of interest due under agreement no. DF/33/95, dated September 25th 1995, on a loan and guarantee to finance the construction of a system of transmission pipelines, have been pending since February 27th 2004. On March 31st 2006, the Regional Court of Warsaw passed a decision whereby PGNiG S.A. was to receive PLN 32,699,276.36 with statutory interest accrued from February 27th 2004 to the payment date, and PLN 107,200 as costs of proceedings. EUROPOL GAZ S.A. appealed against the decision. On December 7th 2006, the Court of Appeals in Warsaw overruled the decision and submitted the case for re-examination by the Regional Court of Warsaw, which was also to decide on costs of the appellate instance. By way of submitting a letter of April 23rd 2007, PGNiG S.A. modified its claim to the effect that it demanded PLN 36,618,037.33 and withdrew its claim concerning payment of PLN 2,382,581.66, due to the statute of limitation. On July 2nd 2007, the Regional Court of Warsaw rejected the claim for payment of PLN 36,618,037.33, discontinued the proceedings concerning payment of PLN 2,382,581.66, and decided that PGNiG S.A. is to cover costs of proceedings of PLN 119,815 to EUROPOL GAZ S.A. On July 30th 2007, PGNiG S.A. appealed against this decision. On November 15 2007, the Court of Appeals in Warsaw dismissed the appeal. The decision is final and binding. On March 20th 2008, a cassation complaint was filed against the Court of Appeals' decision. By virtue of its decision of October 17th 2008, the Supreme Court dismissed the cassation complaint.

Dispute with EMFESZ NG Sp. z o.o.

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

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

Chapter IX: Financial Standing

1. Financial Performance in 2008

The 2008 financial statements of PGNiG S.A. and the 2008 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 table below shows the auditor's fee paid or payable for the years 2007–2008:

The auditor's fee (PLN)

	2008	2007
Audit of the annual financial statements	330,000	390,000
Other confirmation services, including review of financial statements	540,000	440,000
Tax advisory services	-	-
Other services	288,124	25,881

1.1. Key Business and Financial Information

The 2008 net profit of PGNiG S.A. stood at PLN 546.2m, down by PLN 1,608.7m (75%) compared with the figure posted in 2007.

Summary information on PGNiG S.A.'s financial standing in 2008, compared with 2007, is presented in the following financial statements prepared in accordance with the International Financial Reporting Standards:

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

Non-consolidated Balance Sheet (PLNm)

ASSETS	Dec 31st 2008	Dec 31st 2007
Non-current assets	17,194.6	17,021.4
Property, plant and equipment	9,038.7	8,568.9
Investment property	5.4	4.4
Intangible assets	60.1	33.1
Financial assets available for sale	5,690.9	4,787.4
Other financial assets	2,065.6	3,340.7
Deferred tax asset	301.2	261.2
Other non-current assets	32.7	25.7
Current assets	6,245.9	6,542.9
Inventories	1,579.7	1,061.2
Trade and other receivables	3,638.1	4,355.6
Current income tax receivable	39.6	-
Prepayments and accrued income	6.3	24.1
Financial assets held for sale	-	29.3
Derivative financial instrument assets	174.2	17.5
Cash and cash equivalents	807.9	1,055.0
Assets available for sale	0.1	0.2
Total assets	23,440.5	23,564.3

Non-consolidated Balance Sheet (PLNm) – continued

EQUITY AND LIABILITIES	Dec 31st 2008	Dec 31st 2007
Equity	17,181.4	17,796.0
Share capital	5,900.0	5,900.0
Currency-translation differences on foreign-currency undertakings	(0.6)	(1.5)
Share premium account	1,740.1	1,740.1
Other reserve funds	8,953.3	3,344.2
Retained earnings/(deficit)	588.6	6,813.2
Non-current liabilities	2,023.0	1,858.5
Loans, borrowings and debt securities	3.8	0.1
Provisions	1,248.8	901.1
Deferred income	6.1	7.6
Deferred tax liability	742.0	929.1
Other non-current liabilities	22.3	20.6
Current liabilities	4,236.1	3,909.8
Trade and other payables	2,790.7	3,174.0
Loans, borrowings and debt securities	763.2	4.3
Liabilities under derivative financial instruments	16.7	35.5
Current tax liability	-	187.2
Provisions	123.9	111.8
Deferred income	541.6	397.0
Total liabilities	6,259.1	5,768.3
Total equity and liabilities	23,440.5	23,564.3

Non-consolidated Income Statement (PLNm)

	2008	2007
Sales revenue	18,038.8	15,119.9
Total operating expenses	(17,745.9)	(13,001.9)
Raw materials and energy used	(11,119.3)	(7,837.2)
Employee benefits	(678.7)	(513.1)
Depreciation and amortisation	(577.1)	(577.6)
Contracted services	(5,365.1)	(3,871.6)
Cost of products and services for own needs	6.3	9.0
Other net operating expenses	(12.0)	(211.4)
Operating profit	292.9	2,118.0
Financial income	379.8	481.5
Financial expenses	(107.8)	(178.5)
Pre-tax profit	564.9	2,421.0
Corporate income tax	(18.7)	(266.1)
Distribution of profit	-	-
Net profit	546.2	2,154.9
Discontinued operations	-	-
Operating profit/(loss) from discontinued operations	-	-
Net profit for the year	546.2	2,154.9

Non-consolidated Cash Flow Statement (PLNm)

	2008	2007
Net cash provided by/used in operating activities	266.8	2,032.9
Net cash provided by/used in investing activities	(1,099.6)	(1,469.2)
Net cash provided by/used in financing activities	585.7	(2,501.9)
Change in net cash	(247.1)	(1,938.2)
Cash and cash equivalents at beginning of period	1,055.3	2,993.5
Cash and cash equivalents at end of period	808.2	1,055.3

Financial Ratios

Profitability Ratios

	2008	2007
EBIT (PLNm) operating profit	292.9	2,118.0
EBITDA (PLNm) operating profit + depreciation/amortisation	870.0	2,695.6
ROE (Return on Equity) net profit to equity at end of period	3.2%	12.1%
NET MARGIN net profit to sales revenue	3.0%	14.3%
ROA (Return on Assets) net profit to assets at end of period	2.3%	9.1%

Liquidity Ratios

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

Debt Ratios

	2008	2007
DEBT RATIO total liabilities to total equity and liabilities	26.7%	24.5%
DEBT/EQUITY RATIO total liabilities to equity	36.4%	32.4%

1.2. Overview of the Financial Performance

The Company's operating profit decreased by PLN 1,825.1m (or 86%) relative to 2007. The decrease is attributable to lower profit margins on high-methane gas, caused by the following factors:

- a 37% rise in unit purchase costs of imported gas,
- an 11% rise in the volume of imported gas,
- a mismatch between the tariff rates for gaseous fuels and purchase costs of imported gas.

The rise in unit purchase costs of imported gas was driven by the growing prices of crude oil and petroleum products on international markets, and the dollar exchange rates. The surge in crude oil prices peaked in June 2008. Despite a considerable fall in crude oil prices in the subsequent months, the highest increase in price of imported gas was recorded in Q4 2008. This followed from the fact that prices of imported gas are indexed to a nine-month moving average price of petroleum products. Another driver of imported gas prices were changes on the FX markets, in particular the depreciation of the zloty against the US dollar seen in H2 2008.

In the discussed period, the Company imported higher volumes of gas, which was driven by the following factors:

- a 2% rise in volumes of high-methane gas sold,
- a 38% decrease in use of gas from underground storage facilities,

- a 6% decrease in high-methane gas production.

Increased demand for gaseous fuels on the domestic market, caused by lower air temperatures in the 2008 heating season, translated into increased sales of high-methane gas. A significantly lower drawing of gas from the underground storage facilities relative to 2007 was caused by optimised management of import contracts, supply of sufficient amounts of gas during the interruptions in gas imports, and storage of larger volumes of gas to meet a possible rise in demand for gas in the following heating season. The decrease in high-methane production was an effect of natural deterioration of the geological conditions in the producing fields, including the flooding of boreholes, and launch of new, relatively small fields.

In 2008, the President of URE approved the changes in tariffs for gaseous fuels twice. This led to an increase in the selling price of gaseous fuels by 14.3% in April, and 11.1% in October. However, the selling prices defined in the new tariffs did not make up for the increase in the purchase costs of imported gas. As a result, the Company recorded a loss on sales of high-methane gas in 2008.

In 2008, the Company was able to maintain its stable financial position mainly due to the performance of its production business, despite the fact that production volumes for nitrogen-rich natural gas and crude oil decreased owing to natural deterioration of geological and mining conditions, a technical failure at the Dębno mine, and lower production forced by a technical failure at one of the customers'. Sales of nitrogen-rich gas decreased by 3% and of crude oil by 8%, year on year. The Company also recorded an increase in the cost of acquisition of natural gas and crude oil, attributable to higher expenditure on exploratory and geological projects and higher expenditure on boreholes classified as negative, charged to cost. Despite the smaller production, the Group was able to maintain its profitability owing to the higher prices of the produced hydrocarbons. The selling price of nitrogen-rich gas was increased twice, while the price of crude oil was tightly linked to crude oil prices on global markets.

The operating result was also significantly affected by a PLN 199.4m decrease in net other operating expenses relative to 2007. The decrease was attributable to significantly higher net gain from revaluation of tangible assets, mostly connected with the production activity, higher net foreign exchange gains, and the net result on valuation and execution of futures and forwards.

PGNiG S.A.'s weaker financial standing is reflected in the basic profitability ratios. Return on equity decreased from 12.1% to 3.2%, return on assets from 9.1% to 2.3%, while net margin fell from 14.3% to 3.0.

As at December 31st 2008, the balance-sheet total was PLN 23,440.5m, i.e. PLN 123.8m lower than at the end of 2007.

The largest item of assets represented property, plant and equipment, which, as at the end of 2008, stood at PLN 9,038.7m and was by PLN 469.8m (6%) higher than a year earlier. The increase was primarily attributable to the investment projects executed by PGNiG S.A., as well changes resulting from the revaluation of exploration- and production-related assets.

As far as non-current assets are concerned, the largest increase was recorded in financial assets available for sale, which rose by PLN 903.5m (19%) year on year. Such a significant increase follows from the fact that distribution-related assets excluded from operating lease were contributed to the Gas Companies. In exchange for the contribution, the Company received shares in the Gas Companies.

As at December 31st 2008, other financial assets were by PLN 1,275.1m (38%) lower than at the end of 2007, owing to lower non-current receivables under operating lease, resulting from excluding the distribution-related assets from operating lease, payment of non-cash dividend to the State Treasury, and continued repayment of lease instalments by OGP GAZ-SYSTEM S.A.

As at December 31st 2008, current assets stood at PLN 6,245.9m and were by PLN 297.0m (5%) lower than at the end of 2007.

Trade and other receivables decreased by PLN 717.5m (17%) between December 31st 2007 and December 31st 2008, primarily owing to a decrease in the receivables arising under received shares in the increased share capital of the Gas Companies.

In 2008, inventories increased by PLN 518.5m (49%). Inventories disclosed in the balance sheet principally represent gas stored in the underground storage facilities. The increase in inventories was brought about by the larger volumes of stored gas and the higher gas acquisition prices.

As at December 31st 2008, cash and cash equivalents stood at PLN 807.9m, PLN 247.1m (23%) down on 2007, owing to the disbursement of the second tranche of the loan advanced to PGNiG Norway AS and significant operating losses incurred in Q4 2008. In order to maintain its current liquidity, the Company used PLN 760 m from its credit line.

The deteriorated financial standing of the Company affected liquidity ratios. The current ratio dropped from 1.7 to 1.5, while the quick ratio fell from 1.4 to 1.1. Despite the decline in liquidity ratios, the value and structure of current assets held by the PGNiG Group still enables it to settle all its current liabilities in a timely manner.

The main financing source of the Company's assets was equity, whose value dropped by PLN 614.6m (4%) relative to December 31st 2007. The change was largely caused by net profit generated during the year (PLN 546.2m) and distribution of the previous year's profit in the form of non-cash and cash dividend (PLN 1,121.0m).

Non-current provisions disclosed in the balance sheet were by PLN 347.7m (39%) higher than a year earlier, mostly due to the increased provisions for borehole liquidation.

As at December 31st 2008, current liabilities were by PLN 326.3m (8%) higher than at the end of 2007, which was mainly caused by contracting a short-term loan under the syndicated loan agreement and increased deferred income on estimated future gas sales. The increase in current liabilities was accompanied by a decrease in liabilities arising under the contribution in kind made in exchange for shares in the increased share capital of the Gas Companies.

The ratios reflecting the relation between capital and other items of equity and liabilities did not change materially between 2007 and 2008. As at the end of December 2008, total debt-to-equity ratio advanced from 32.4% to 36.4%, while the debt ratio (total liabilities to total equity and liabilities) increased from 24.5% to 26.7%.

The Use of Issue Proceeds until December 31st 2008

As a result of the Public Offering, in 2005 PGNiG S.A. earned issue proceeds totalling PLN 2,682.0m Net of the amount of PLN 41.9m representing the issue's costs, net proceeds amounted to PLN 2,640.1m. The aggregate expenditure of the funds obtained from the public issue of shares at the end of 2008 totalled PLN 2,158.4m, which accounted for 82% of total proceeds. The breakdown of the expenditure was as follows: PLN 31.8m was spent by the end of 2005, PLN 1,292.3m was spent in 2006, PLN 525.6m in 2007, and PLN 308.7m in 2008.

The use of proceeds from the public issue of shares in individual business segments:

- upstream – PLN 1,078.5m
- trade, transmission and storage – PLN 578.0m
- distribution – PLN 369.9m
- debt repayment (5% of the issue proceeds) – PLN 132m.

The key projects implemented with the use of issue proceeds in 2008 were:

- increasing the capacities of underground gas storage facilities in Swarzędów, Mogilno, Wierzchowice and Strachocin, 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 Issue Prospectus for expenditure on upstream activities was exhausted.

Feasibility of Investment Plans

PGNiG S.A. holds financial resources in the form of bank deposits as well as current investments in treasury debt securities, which are easily available for sale. The balance of available funds lends flexibility to the Group in implementing its investment plans. A low financial leverage and positive assessment of the PGNiG S.A.'s risk, as confirmed by the rating agencies, combined with appropriate creditworthiness, enable the Group to finance potential further projects using bank loans and debt issues.

Transactions concluded on terms deviating from the market terms

In 2008, PGNiG S.A. and its subsidiaries did not enter into any material related party transactions on terms deviating from the market terms (Note 46.2. to the Annual Non-consolidated Financial Statements for the Financial Year Ended December 31st 2008).

Explanation of discrepancies between the actual results and forecasts for 2007

In 2008, the Company did not publish any forecasts.

2. Financial Management

The funds at the disposal of PGNiG S.A. guarantee the financing of all current and planned expenses related to the Company's current and investing activities. Although no risk of liquidity loss occurs, in order to enhance security the Company has concluded current account loan agreements (for a total of PLN 230m), as well as a syndicated loan agreement (dated July 27th 2005) providing for a revolving multi-currency credit facility of EUR 600m. As at December 31st 2008, the debt under the syndicated loan amounted to EUR 191.3m.

2.1. Current Investments

In 2008, free cash was invested in instruments involving minimum credit risk, i.e. treasury securities and deposits with commercial banks with investment grade rating. Investments in debt securities issued by the State Treasury represented approximately 77% of the transaction volume. The financial investments made in 2008 were current investments, maturing in up to three months, which was consistent with PGNiG S.A.'s financial investment policy and the objectives specified in the issue prospectus.

2.2. Loan Agreements

In 2008, PGNiG S.A. concluded agreements for current account loans totalling PLN 110m. The Company did not disclose any liabilities under current account loans. The table below presents loan agreements concluded by the Company in 2008.

Loan agreements concluded by PGNiG S.A. in 2008

Bank	Loan amount [PLNm]	Interest rate	Type	Repayment date
Bank Handlowy S.A.	40.0	WIBOR T/N + 0.8%	working capital loan	Dec 31 2009
Millennium S.A.	40.0	WIBOR 1M + 0.8%	working capital loan	Dec 18 2009
PKO BP S.A.	30.0	WIBOR 1M + 0.2%	working capital loan	Apr 22 2009
Total	110.0			

The aggregate amount of loans advanced in 2008 by PGNiG S.A. to its related undertakings was PLN 157.1m and USD 25m. The loans were granted to finance day-to-day operations and investment projects involving: the construction and expansion of the high-pressure transmission grid, construction and upgrade of the distribution network, connection of new customers to the supply system, as well as to finance prospecting work and payments under licence in Libya. The table below contains detailed information on the loans advanced by PGNiG S.A. to its related undertakings.

Loans advanced by PGNiG S.A. to its related undertakings in 2008

Company	Loan amount (million)	Currency	Interest rate	Type	Maturity date
Wielkopolska Spółka Gazownictwa Sp. z o.o.	31.2	PLN	WIBOR1M +0.7%	investment loan	Dec 31 2012
Geovita Sp. z o.o.	3.5	PLN	WIBOR1M +0.7%	investment loan	Jun 30 2012
Poszukiwania Nafty i Gazu Kraków Sp. z o.o.	15.0	PLN	WIBOR1M +0.7%	operating loan	Dec 31 2009
POGC Libya B.V.	25.0	USD	LIBORUSD3M + 2.2%	operating loan	Nov 20 2018
GEOFIZYKA Kraków Sp. z o.o.	12.0	PLN	WIBOR1M +1.475%	operating loan	Jun 30 2013
Geovita Sp. z o.o.	11.0	PLN	WIBOR1M +1.1%	investment loan	Sep 30 2014
Mazowiecka Spółka Gazownictwa Sp. z o.o.	54.4	PLN	WIBOR1M +1.47%	investment loan	Dec 31 2019
Pomorska Spółka Gazownictwa Sp. z o.o.	30.0	PLN	WIBOR1M +1.1%	operating loan	Jun 30 2012

2.3. Guarantees and Sureties

In 2008, PGNiG S.A. provided a guarantee to National Oil Corporation Libya, for PLN 319.9m (USD 108m), to secure the performance of licence obligations by POGC Libya B.V.

In 2008, PGNiG S.A. was issued guarantees for a total amount of PLN 251.8m. The most important of the guarantees were those granted by:

- PBG S.A. – PLN 85.2m as performance bond for the project named “LMG Project – Central facilities, borehole areas, pipelines and other infrastructure”.
- Consortium comprising PBG S.A. Przeźmierowo, Tecnimont S.p.A., Societe Francaise d’Etudes et de Realisations d’Equipements Gaziers SOFREGAZ, Plynostav Pardubice Holding A.S., Plynostav-Regulace Plynu A.S. – PLN 66.4m as performance bond concerning the project named “Construction of the Above-Ground Part of the Wierchowice Underground Gas Storage Facility, phase: 3.5bn nm³, sub-phase: 1.2bn nm³”.
- K.D.P. Sp. z o.o. – PLN 28.5m, as security for natural gas supplies.

2.4. Financial Risk Management

The main objective of PGNiG S.A.'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 mid term and building the firm value in the long term.

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

In 2008, PGNiG S.A. used the following financial instruments to manage the price risk:

- purchased foreign exchange call options,
- option strategies – generally representing combinations of at least two FX options,
- cross currency interest rate swaps – securing the loan advanced to PGNiG Norway AS.

The following was undertaken by the Company to mitigate the credit risk:

- investment of free cash in instruments with a minimum credit risk (treasury bills and treasury bonds);
- cooperation with the leading commercial banks;
- 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, the outcome of which includes improvement in the Company's rating.

The measures undertaken by 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 Company/the Group;
- consolidation of bank accounts;
- conclusion of current account facility agreements.

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

- conclusion of current account loan agreements;
- projections of cash flows at the Company/the Group;
- estimation of the condition and the value of assets available for sale;
- maintenance of highly liquid financial assets;
- cooperation with rating agencies.

In 2008, PGNiG S.A. did not apply hedge accounting. However, most of the concluded transactions were effective in terms of hedge accounting (according to IAS 39).

3. Financial Forecasts

The main factors impacting PGNiG S.A.'s financial performance will include crude oil prices on international markets, position of the President of URE on gaseous fuel tariffs, as well as the situation on foreign-exchange markets.

Since August 2008, the fuel market has witnessed a steep fall in crude oil prices, which will contribute to a reduction in import prices of gas in the coming months.

The tariff approved in October 2008 did not offset the sharp increases in imported gas prices observed in Q4 2008 and the resulting substantial losses on sales of high-methane natural gas incurred by the Company. Despite the fall in imported gas prices anticipated since January 2009, the sales of high-methane natural gas will continue to be unprofitable. Lower gas prices may positively contribute to the financial results of PGNiG S.A. no sooner than in Q3 2009.

On February 13th 2009, PGNiG S.A. applied to the President of URE for a change of the gaseous fuel tariff. The financial standing of the Company in the coming quarters will largely depend on whether the President of URE approves new tariffs, providing cover for the costs of imported gas.

PGNiG S.A.'s financial performance is materially affected by the situation on foreign-exchange markets. The second half of 2008 saw a clear rise in the exchange rate of the US dollar against the Polish zloty. The stronger dollar has an adverse effect on the cost of imported high-methane natural gas. As the risk related to fluctuations in exchange rates is high, the Company will seek to mitigate its impact through active and consistent financial risk management.

The volume of natural gas sales is determined by the pace of the country's economic growth. A potential drop in gas demand may have a positive bearing on the financial performance of PGNiG S.A.

PGNiG S.A. still assumes that production of natural gas will be highly profitable; the level of own production should be similar to the volumes reported in the previous year. The profitability of crude oil sales will depend on oil prices on international markets.

In 2009, PGNiG S.A. plans to increase capital expenditure, chiefly on projects aimed at increasing the production capacity, diversifying gas supply sources and expanding underground gas storage facilities. The Company plans to increase capital expenditure on power projects using natural gas. Moreover, it will also intensify its efforts designed to search for and prove new oil and gas reserves. The wide-ranging investment activities will be financed from operating cash flows and available credit facilities.

Members of the Management Board

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