

***The STRATEGY of hard coal
mining industry activities in Poland
for 2007 - 2015***

(The document adopted by the Council of Ministers on 31 July 2007)

Warsaw, 31 July 2007

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Introduction

The goal of the State policy towards the hard coal mining industry is to rationally and effectively manage the coal deposits located in the territory of the Republic of Poland so that these resources serve next generations of Poles.

The next stage of restructuring process of the hard coal mining industry in Poland, commenced in 2004, was continued in 2006. The program for execution of this restructuring stage based on the document “Restructuring of the hard coal mining sector during the period 2004 – 2006 and strategy for the period 2007 – 2010” adopted by the Council of Ministers on 27 April 2004.

On 22 June 2005 the European Commission adopted Decision No K(2005)1796 on notification of the state aid for the Polish coal industry in 2004 – 2006. In this decision the Commission recognized the restructuring plan as compatible with the common market and approved state aid for the Polish hard coal industry for 2004, 2005 and 2006.

In February 2007 Poland filed a simplified notification application to the European Commission for accepting the state aid in 2007, due to the need of uninterrupted carrying out by mining enterprises of some measures related to decisions made in previous years and extension of execution of some restructuring tasks. On 27 April 2007 the European Commission issued the decision No K(2007)1943 approving the aid for the hard coal mining industry for 2007.

The presented document does not specify detailed restructuring measures but sets directions with regard to the strategy of mining industry activities which should constitute the basis for construction of strategy by coal companies – hard coal producers.

Investments are an essential element included in the sector strategy. They should allow to maintain coal production at a level corresponding to the domestic demand and economically justified export, at the same time taking into account quality improvement of coal produced as an environmentally friendly fuel in terms of clean combustion technologies.

The present dynamics of coal price decline and production costs increase cause diminution of financial results of coal producers. Kompania Węglowa S.A. faces the most serious threat due to this reason, which substantiates the necessity of carrying further restructuring of the company. Coal mine restructuring companies require sorting out economic and financial as well as organizational problems and also further reorganizing.

It is assumed the only element besides generally applicable legal provisions is continuation of some provisions of the Law of 28 November 2003 on the hard coal mining sector restructuring during the period 2003 – 2006 (Journal of Laws No 210, Item 2037 as amended) hereinafter referred to as the mining law. The new law should enable financing of effects of decisions made in previous years (so called results brought forward) and to introduce specific provisions with regard to those areas of mining activities where such regulations are necessary.

The energy policy of the state, which in a great measure will base on use of hard coal to keep national energy security, directly influences the circumstances and the policy towards the hard coal mining sector. In the case of change in directions and rules of the energy policy followed in Poland the strategy of the hard coal mining sector activities will be subject to changes and adjustments.

1. The role of Polish hard coal in the European Union

So far the annual average consumption of the primary energy in 25 countries of the European Union was at the level of 2.4 billion tonnes of theoretical standard fuel units, including:

- 37% of primary energy from oil,
- 24% from natural gas,
- 18% from coal (hard coal and brown coal),
- 14% is nuclear energy,
- 7% from renewable energy sources.

It is projected that coal will maintain its role in the energy market within the European Union, which appears from the following facts.

1. The European Union has limited sources of energy carriers. There are resources of oil, gas, hard coal and brown coal in the EU however viability of the first two energy carriers is estimated about 25 years whereas viability of coal, at current state of resources identification is estimated about 100 years.
2. The oil and gas prices almost doubled in 2004 – 2005. It is expected that while the global demand for oil and gas increases their prices are likely to stay high.

According to forecasts included in the Communication from the Commission to the European Council and the Parliament of 10 January 2007 (KOM /2006/843) one should expect that coal will cover about one fourth of the global demand for primary energy. As in next twenty years the global primary energy consumption will increase by 60%, similar increase will concern coal.

Hard coal may still constitute a valuable contribution to ensuring security of energy supplies and into the EU and whole world economy, provided technologies enabling radical reduction of CO₂ emission, which is generated at combustion, are applied.

The only countries producing hard coal in the European Union are: the Czech Republic (annual output ca. 14 million tonnes), Spain (ca. 13 million tonnes), Germany (ca. 29 million tonnes, Poland (ca. 100 million tonnes in 2003, ca 99 million tonnes in 2004, 97.1 million tonnes in 2005, ca. 94.3 million tonnes in 2006), UK (ca 28 million tonnes).

Poland is the biggest hard coal producer in the European Union. 15.8 million tonnes of coal was sold for shipments to the European Union and third countries, while 16.9 million tonnes was shipped and exported (the difference results from sales of coal from stock of "Węglokoks" S.A. purchased from mining enterprises beforehand) in 2006.

Poland supplies to the EU market about 16 million tonnes of hard coal per year. Mainly steam coal is sold which accounts for 86% of total Polish coal shipments to the EU markets.

Hard coal output in Poland constitutes over 50% of the EU output while in the case of steam coal it accounts for about 59% and in the case of coking coal about 39%. Poland is the second, after Germany, coking coal producer in the European Union.

The role of Polish hard coal in the European Union will depend on Polish producers.

Only maintaining an adequate cost level will allow to compete in the common European Union market with coal imported by the EU countries from other directions and to compete with other energy carriers.

2. New opportunities for coal utilization

While the prices of primary energy carriers, especially oil and gas, stay at the high level, the role of coal as an energy carrier is very important for energy security of the state. Additional opportunities exist to use this raw material, by development and implementation of new effective combustion technologies, new technologies of coal processing into liquid fuels and of production of environmentally friendly high quality coal.

In this connection coal should start to be perceived in a different way, that is not just a fuel only suitable for burning.

While the oil and gas prices stay high increase in the hard coal role can be seen in processing it into liquid fuels and in clean coal technologies (*CCT*). Measures taken within the framework of *CCT*, including development of new technologies of production, enrichment, low or even zero-emission combustion aimed at production of an environmentally friendly fuel and clean energy get better and better effects in the whole world. In this regard Poland within the European Union will make efforts together with other European coal producers and users.

Development of new technologies of liquid fuel production (engine fuels, methanol, synthetic natural gas) can create opportunities for additional utilization of hard coal at the level of 5 – 8 million tonnes per year in 2015. New coal combustion technologies will also allow to more effectively use the energy contained in coal.

Thanks to domestic resources of hard coal, development of new technologies will strongly influence improvement of energy security of the state.

Technologies of liquid fuel production from coal have been known for many years. They were used on a commercial scale in Germany during the World War II and also in Poland in some chemical plants.

Methods of production of liquid fuels from coal based on the Fischer-Tropsch synthesis process are most intensively developed and used in the Republic of South Africa. It is related to the embargo placed on this country in previous years which resulted *inter alia* in lack of access to the global oil market.

Intensive work on new technologies of effective utilization of energy contained in coal has been carried out in the United States, where a significant part of electricity is generated from coal. Often these technologies have already been implemented on a commercial scale. Work related to production of fuels from coal has been also well developed in China.

At present due to high oil prices it is possible that production of fuels from coal will be profitable also in Poland.

When considering investment concepts it is necessary to meet the following conditions:

- access to large resources of coal „susceptible to gasification” in the area of the proposed location of a plant,
- a plant should be located in an area where coal strata are deposited, utilization of which in another way would be significantly difficult,

the proposed location should have suitable infrastructure (access to water, railway, roads etc.),

- the country should be an importer of energy (oil or other oil products),
- oil prices should be relatively high.

Investments in production processes of chemical materials (including liquid fuels) apart from obvious benefits for mining enterprises related to constant and certain collection of coal produced can also bring about benefits to the general public:

- improvement of energy security of the country by own production of part of consumed liquid fuels and getting partial independence from external supplies,
- resignation from uneconomical coal export by sea, related to transportation costs from the south of Poland to seaports, by utilization of coal in production processes in the immediate vicinity of production plants,
- stabilization of coal production and creation of new jobs,
- reduction of production unit costs thanks to utilization of the whole capacity and reduction of fixed cost contribution thus reducing energy production costs in the domestic economy,
- creating the basis for development of science and technology in the regions of Silesia and Małopolska, thus changing the image of these regions by development of modern technologies.

Production of deeply processed, environmentally friendly coal sizes opens another opportunity to use this raw material. Mining enterprises will intensify production and marketing efforts in order to maximize utilization of new coal products combustion in modern heating furnaces in households and small district heating stations.

The Government of the Republic of Poland, in particular the Minister of Economy within his competence and capabilities will support all efforts related to diversification of energy sources and the search for new possibilities for acquiring energy, including energy from hard coal.

The national energy system is based mainly on hard and brown coal combustion, which on one hand increases our energy security but on the other hand causes the need to incur even more expenses for development and implementation of modern coal technologies. Maintaining the coal position in power industry in a long-term prospect and its potential utilization for gaseous and liquid fuel production constitutes one of essential elements of the government strategy. Necessary support for the research and development phase will be provided for within the Innovative Economy Operational Program executed in 2007 – 2013. The Government in particular will support execution of the state policy on science and technology and innovations by partial founding of projects on the subject set out in the National Framework Program, where energy security takes an essential position.

The Minister of Economy will apply to the Council of Ministers for establishment of a long-standing program concerning clean coal technologies, where research part would be executed pursuant to the Act of 8 October 2004 on the principles of financing science (Journal of Laws No 238, Item 2390, as amended) or will apply to the Minister of Science and Higher Education for establishment of the strategic program of scientific research and development work.

3. Diagnosis of condition of the hard coal mining sector in Poland

3.1. Effects of the reforms carried out during the period 2003 – 2006

1. In 2003 – 2006 the hard coal mining industry was pursuing the alternative restructuring variant (included in the government program) assuming capacity reduction by 7.8 million tonnes per year and employment reduction by 19.5 thousand people in 2004 – 2006. In the years 2004 -2006 the total reduction of production capacity in the hard coal mining industry was about 6.6 million tonnes per year, which accounted for about 84.6% of planned capacity reduction. The industry capacity as at 31.12.2006 was 96.0 million tonnes per year compared to 94.8 ml tonnes assumed in the program.
2. Execution of the debt restructuring process in the sector in 2003 caused decommitment of liabilities of PLN 18.1 billion and postponement of division into installments of repayments of further liabilities of PLN 2.5 billion. As of decommitment and postponement of the above mentioned liabilities the interest on liabilities ceased to grow.
3. In the period 2003 – 2006 the hard coal mining industry made payments due to public entities (ZUS, FP, FGŚP, PFRON, national budget, local governments, national and provincial funds for environmental protection and water management) of PLN 25,865.9 million, including PLN 12,726.8 million due to the national budget (personal and corporate income taxes, goods and services taxes, payment of earnings by sole-shareholder companies of the State Treasury).
4. As at 31.12.2006 the employment in the hard coal mining industry was 119.3 thousand people (according to program assumptions at the end of 2006 the employment should be 117.0 thousand people). In the period 2004 – 2006 the employment was reduced by 17.1 thousand people, which accounted for about 88% of reduction assumed for this period. Measures, introduced by the mining law turned out ineffective, in particular the ones provided for surface mine employees.
5. In government documents: “Hard Coal Mining Sector Restructuring Programme for the period 2003 – 2006 using the Anti-crisis Laws and Initiating the Process of Privatisation of Certain Mines (as corrected in keeping with provisions of the Agreement concluded with the Trade unions on 11 December 2002 and including corrections required under the legal status of the sector, as on 10 January 2003)” and “Restructuring of the hard coal mining sector during the period 2004 – 2006 and strategy for the period 2007 – 2010” funds from the national budget for the hard coal mining sector for the period 2003 – 2006 were estimated at the level of PLN 6,305.8 million.

In the budgetary laws for the years 2003 – 2006 (taking account of the funds from a special reserve coming from the loan for hard coal mining industry restructuring) total amounts of PLN 4,098.0 million were put at disposal of the hard coal mining industry.

In the period 2003 – 2006 the hard coal mining industry used funds from the national budget of PLN 3,524.9 million for restructuring tasks. In particular the following tasks were funded by the national budget:

- complete closure of mines, tasks performed after completion of the process of mines closure, tasks related to repair of mining damages and tasks related to protection of

neighbouring mines against water inflow, gas and fire hazards and after completion of the mine closure process.

- employment restructuring and employees claims.

The amount of state subsidies for the hard coal mining industry compared to the payments to the public entities made by the mining enterprises in the period 2003 – 2006 is as follows:

Subsidy from the national budget	Payments to public entities, including:	<i>payments to the national budget</i>
PLN 3,542.0 million	PLN 25,865.9 million	PLN 12,726.8 million

6. Between 2004 and 2006 the total public aid for the hard coal mining sector was about PLN 3.87 billion, including capital increase of Kompania Węglowa S.A in the amount of about PLN 0.5 billion (i.e. less than assumed by about PLN 0.4 billion).
7. Measures were taken in relation to establishment of a coal and coke group on the basis of Jastrzębska Spółka Węglowa S.A.
8. Measures were taken in relation to preparation for the privatization process of Katowicki Holding Węglowy S.A. and Jastrzębska Spółka Węglowa S.A. Decisions on privatization have not been made.
9. The growing trend of hard coal prices in the global markets lasted in 2004. A noticeable price slump in the global steam coal markets occurred in 2005. This trend was stopped in 2006. In the entire year 2006 coal prices showed a growing trend reaching the level of USD 68.04 per tonne in the ARA seaports.

Detailed information on the situation of the entities producing hard coal is presented in the "Report on progress in restructuring of the hard coal mining sector in 2006 taking into account synthetic conclusions on incomplete performance of programme assumptions in the period 2004 – 2006".

3.2. Current organization of the hard coal mining sector

As of 01.01.2007 32 mines were operating in the hard coal mining industry and the organizational structure of the industry was as follows:

- a) Entities producing hard coal;
 - Kompania Węglowa SA. - **17** mines (4 production centres were established),
 - Katowicka Grupa Kapitałowa consisting of Katowicki Holding Węglowy S.A. comprising **5** mines, and **1** mine being a limited liability company, held solely by KWH S.A.
 - Jastrzębska Spółka Węglowa S.A. – **5** mines,
 - Południowy Koncern Węglowy S.A – **1** coal mine consisting of two operational units, whose 50.45% shares is held by Kompania Węglowa S.A. (33.73% of votes at the General Assembly) and 49.55% by Południowy Koncern Energetyczny S.A. (66.27% votes at the General Assembly)
 - KWK „Budryk” S.A.,
 - Lubelski Węgiel „Bogdanka” S.A.,

- Siltech Sp. z o.o. (100% shares held by a private owner).
- b) Restructuring companies established in 2000, performing physical closure of coal mines after termination of coal production by those mines and utilization of their non-core assets.
- Spółka Restrukturyzacji Kopalń S.A.,
 - Bytomska Spółka Restrukturyzacji Kopalń Sp. z o.o., 100% shares held by SCD S.A.
- c) Trade companies:
- Węglkokoks S.A.

The State Treasury is the sole shareholder of the above mentioned joint-stock companies, except of LW "Bogdanka" S.A., where the State Treasury holds over 90% shares as well as PKW S.A. and Siltech Sp. z o.o.

Minister responsible for economy exercises competences of the minister responsible for the State Treasury following from the shares held, except of LW "Bogdanka" S.A. and PKW S.A.

3.3. Contribution of hard coal to ensuring energy security of the country

Coal is the main fuel for electricity production in Poland. It provides about 95% of generated power, while in the overall power generation balance about 55% of power is generated from hard coal and about 40% from brown coal.

It can be assumed that no significant changes in power generation carriers will occur in next few years.

Hard coal cost accounts for about 18 - 20% of total electricity cost (between PLN 300 and 360 per MWh). As it is necessary to incur high investment outlays both in the power sector and in the hard coal mining sector, electricity prices may significantly increase in the coming years. Increase in hard coal production costs and consequently in electricity prices will result from further increase in depth of mining as well as from the necessity to reduce negative effects of mining activity on the environment.

The price of electricity generated from coal is at present one of the lowest compared to electricity generated from other sources. Taking into account the global situation in the oil and natural gas markets, in medium-term prospect the price of electricity generated from coal, compared to the price of electricity generated from other sources will still be one of the lowest.

Similar situation is in the case of price of heat generated from coal. Its price is lower than the price of heat produced from other sources.

Average price of heat generated from various fuels (without the transmission service)

Fuel	Average price of generated heat in PLN/GJ
Hard coal	22,61
Brown coal	17,07
Light fuel oil	53,08
Heavy fuel oil	23,75
High-methane natural gas	32,99
Biomass	23,82
Biogas	22,95
Municipal wastes	35,15

Source – Statistical study “Heating industry in figures – 2005” (Energy Regulatory Office)

The average price of generated heat = revenue on sales of generated heat [PLN thousand] / heat sales [GJ] (*average price calculated on the basis of 95% of all enterprises holding licenses for heating activity*)

To accomplish objectives set for the energy security system of the country, which is largely based on hard coal, it is necessary to undertake long-term measures to restrict dynamics of increase in coal production costs.

3.4. The amount of hard coal resources and their sufficiency

As of 31 December 2005 there were 15,716.7 million tonnes of viable reserves and 11,143.1 million tonnes of non-viable reserves in operating hard coal mines.

Out of the foregoing viable reserves - 6,004.4 million tonnes were classified as industrial reserves including 3,807.3 million tonnes of operational reserves. Operational reserves deposited in working horizons and horizons under construction amounted to 2,525.7 million tonnes.

The sufficiency of the operational reserves deposited in working horizons and horizons under construction is between 7.6 years (KWK “Polska-Wirek” and “73.8 years (KWK “Halemba”).

The average sufficiency of the operational reserves deposited in working horizons and horizons under construction, in conditions of the output level planned by coal companies for the period 2006 - 2015 is about 27 years. The average sufficiency of the operational reserves deposited in working horizons and horizons under construction, in conditions of the output level planned by individual coal mines for the period 2006 - 2015 is about 40 years.

In 2006 – 2015 as a result of the conducted mining, mining will cease in operational reserves in 18 working horizons, including 12 working horizons in Kompania Węglowa S.A.. four working horizons in Katowicki Holding Węglowy S.A. and two working horizons in Jastrzębska Spółka Węglowa S.A.

In 2006 – 2015 the coal companies plan to start production in nine working horizons under construction, including:

- three horizons in Kompania Węglowa S.A.
- two horizons in Katowicki Holding Węglowy S.A.

- two horizons in Południowy Koncern Węglowy S.A.
- one horizon in Jastrzębska Spółka Węglowa S.A.
- one horizon in the mine Lubelski Węgiel „Bogdanka” S.A.,

As a result of the conducted mining of deposits, about 2,830 million tonnes of operational reserves will remain at the end of 2015, including about 1,530 million tonnes in current working horizons and horizons under construction.

Hard coal reserves in coal companies in Poland as at 31.12.2005

(without Siltech Sp. z o.o.)

Specification	Reserves [thousand tonnes]			
	Extra-balance	Balance	Industrial reserves	Operational reserves
Total coal companies	9 279 377	12 360 194	4 728 215	2 973 358
Kompania Węglowa S.A.	6 178 779	8 385 126	3 224 813	1 979 493
Katowicka Grupa Kapitałowa S.A.	1 763 242	2 750 853	1 051 685	708 027
Jastrzębska SW S.A.	1 337 356	1 224 215	451 717	285 838
Coal mines - companies	1 863 728	3 353 187	1 273 639	832 662
Lubelski Węgiel „Bogdanka” S.A.	426 687	590 257	320 380	247 163
KWK „Budryk” S.A.	252 613	683 634	345 507	237 246
PKW S.A.	1 184 428	2 079 296	607 752	348 253
Total reserves	11 143 105	15 713 381	6 001 854	3 806 020

Operational reserves of hard coal in coal mines and coal companies as at 31.12.2005 and sufficiency of operational reserves.

Lp.	Mine - company	Output in 2005 [thousand tonnes]	Operational reserves as at 31.12.2005 [thousand tonnes]		Sufficiency of operational reserves [years]	
			total	in working horizons and under construction	total	in working horizons and under construction
0	1	2	3	4	5	6
1	KWK Bobrek - Centrum	2 789,0	66 946	66 946	24,2	24,2
2	ZG Piekary	2 987,2	25 259	25 259	11,3	11,3
3	KWK Bolesław Smiały	1 561,1	28 612	28 612	19,0	19,0
4	KWK Knurów	2 732,3	126 081	79 443	38,2	24,4
5	KWK Sosnica - Makoszowy	5 277,6	198 888	123 270	40,2	24,9
6	KWK Szczygłowice	2 744,7	205 468	100 820	73,4	36,0
7	KWK Brzeszcze - Silesia	3 204,8	114 966	98 172	35,5	30,3
8	KWK Piast	5 370,0	165 589	157 643	37,3	35,5
9	KWK Ziemowit	4 449,8	164 312	97 703	38,1	22,6
10	KWK Halemba	3 162,6	213 926	213 926	73,8	73,8
11	KWK Pokój	1 523,6	29 288	29 288	17,6	17,6
12	KWK Polska-Wirek	1 715,8	11 618	11 618	7,6	7,6
13	KWK Bielszowice	2 494,0	154 507	154 507	63,9	63,9
14	KWK Chwałowice	2 656,0	155 718	25 485	52,0	8,9
15	KWK Jankowice	3 908,5	139 695	49 836	39,9	14,2
16	KWK Marcel	2 496,0	104 774	73 092	32,3	22,7
17	KWK Rydułtowy - Anna	3 521,0	73 846	68 969	27,8	25,8
I	KOMPANIA WĘGLOWA S.A.	52 594,0	1 979 493	1 404 589	41,7	29,5
18	KWK Murcki	2 565,6	141 157	49 551	53,3	18,7
19	KWK Mysłowice	1 789,8	21 673	21 673	10,4	10,4
20	KWK Wesola	3 608,4	210 248	210 248	59,5	59,5
21	KWK Wieczorek	1 544,5	26 181	26 181	14,9	14,9
22	KWK Wujek	3 536,4	83 596	83 596	23,4	23,4
23	KWK Staszic	3 836,6	207 624	129 985	51,8	32,6
24	KWK Kazimierz-Juliusz sp. z o.o.	822,2	17 548	17 548	27,4	27,4
II	KATOWICKA GR. KAPITAŁOWA	17 703,5	708 027	538 782	39,6	30,1
25	KWK Borynia	2 227,3	37 208	37 208	19,3	19,3
26	KWK Jas-Mos	2 072,8	32 811	32 811	15,5	15,5
27	KWK Krupiński	2 243,9	32 728	32 728	15,7	15,7
28	KWK Pniówek	3 674,0	97 973	97 973	27,1	27,1
29	KWK Zofiówka	2 607,0	85 118	85 118	41,1	41,1
III	JASTRZĘBSKA SW S.A.	12 825,0	285 838	285 838	24,6	24,6
30	Lubelski Węgiel "Bogdanka" S.A.	5 373,4	247 163	204 763	25,3	21,4
31	KWK "Budryk" S.A.	3 208,3	237 246	90 925	71,6	27,4
32	PKW S.A.	5 282,3	348 253	94 273	56,4	15,5
32a	ZGE Sobieski - Jaworzno III	3 080,0	125 418	56 280	41,2	18,1
32b	ZG Janina	2 202,3	222 835	37 993	70,8	13,0
33	SILTECH Sp z o.o.	122,5	1 233	1 233	10,3	10,3
IV	Mines -companies [30 + 31 + 32 +33]	13 986,5	833 895	391 194	42,0	20,5
V	TOTAL (KW S.A.+ KGK+ JSW S.A. + mines -companies	97 109,0	3 807 253	2 620 403	39,5	27,1

3.5. Decline in sales and hard coal prices

Total hard coal sales in 2003 – 2004 had stayed at the same level, while in 2005 they declined by 4.6% compared to 2004. In 2006 total coal sales showed further decline to the level of 93.4 million tonnes (by 0.9% compared to 2005). Sales by directions and main domestic customers in 2003 – 2006 were as follows:

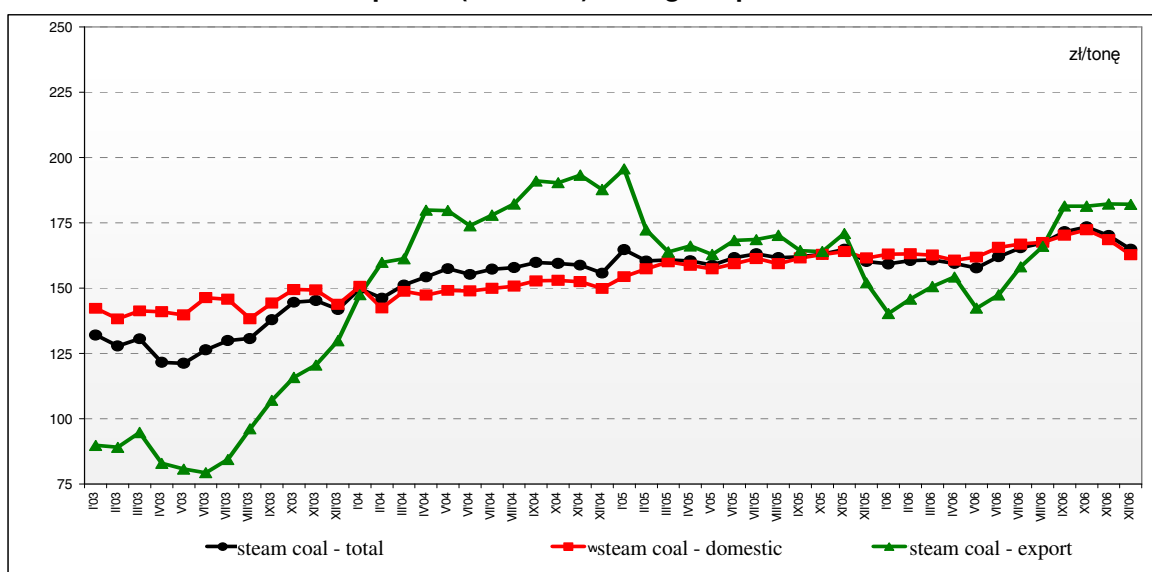
	Sales [thousand tonnes]				Dynamics	Dynamics	Dynamics
	2003	2004	2005	2006	2004/2003 [%]	2005/2004 [%]	2006/2005 [%]
Total sales	98 525,7	98 851,1	94 257,1	93 528,8	100,3	95,4	99,2
- shipments to the EU and exports	20 023,6	20 791,6	19 549,8	15 770,8	103,8	94,0	80,7
- home	78 502,1	78 059,5	74 707,3	77 758,0	99,4	95,7	104,1
including:							
- professional power generators	36 215,0	37 792,3	39 741,9	41 388,1	104,4	105,2	104,0
- industrial power generation	832,5	601,5	1 386,7	1 139,3	72,3	230,5	100,3
- industrial and district heating plants	2 045,1	4 547,4	4 884,6	4 720,8	222,4	107,4	96,6
- other industrial customers	2 055,7	1 884,9	1 269,0	1 025,1	91,7	67,3	80,8
- coking plants	13 367,2	13 129,8	10 649,8	11 138,7	98,2	81,1	104,6
- other domestic customers	23 986,6	20 103,6	16 775,3	18 094,0	83,8	83,4	107,9

Hard coal sales to the domestic market in 2003 – 2006 were characterised by an increase in sales to the professional power generators, industrial power generation, industrial and district heating plants and decrease in sales to the segment “other industrial customers”, to coking plants and to the segment “other domestic customers”. The group „other domestic customers” includes among others households, production and trade undertakings, arable farms, horticulture, state administration and others.

The average price of steam coal in overall (ex works) grew continuously in 2003 - 2006. The average sales prices of steam coal in there years were as follows:

- in 2003 – PLN 133.38 per tonne,
- in 2004 – PLN 155.36 per tonne (growth by 16.5%),
- in 2005 – PLN 161.87 per tonne (growth by 4.2%),
- in 2006 – PLN 164.48 per tonne (growth by 1.6%),

Steam coal prices (ex works) during the period 2003 – 2006



The **average price of coking coal in overall (ex works)** was continuously growing in 2003 - 2005. In 2006 it considerably declined. The average sales prices of coking coal in these years were as follows:

- in 2003 – PLN 192.99 per tonne,
- in 2004 – PLN 350.77 per tonne (growth by 81.8%),
- in 2005 – PLN 365.17 per tonne (growth by 4.1%),
- in 2006 – PLN 285.09 per tonne (decline by 21.9%),

The economic situation in global markets, mainly in West Europe seaports had a decisive effect on hard coal price level in Poland.

3.6. High dynamics of production cost increase.

Continuous growth of the unit production cost of coal has a definite effect on economic and financial circumstances of the hard coal mining industry. In 2003 – 2006 the hard coal unit production costs were as follows:

- in 2003 – PLN 140.81 per tonne,
- in 2004 – PLN 156.64 per tonne (growth by 11.2%),
- in 2005 – PLN 168.51 per tonne (growth by 7.6%),
- in 2006 – PLN 174.71 per tonne (growth by 3.3%),

It appears from the forgoing data that as of 2003 the dynamics of hard coal unit production cost increase has had a declining trend. As a result of the observed increases in unit costs, total increase in the unit cost in 2006 compared to 2003 was 24.1%, while the highest growth dynamics was shown at this time by unit costs of material consumption and depreciation. Payroll with related overheads account for the highest share in the unit production cost.

Unit costs of material consumption (growth by 64.0%) and depreciation (growth by 31.7%) showed the highest growth dynamics in this period. As a result the share of these costs in the unit production costs increased respectively from 11.0% to 13.9% and from 7.5% to 8.6%.

In 2003 payroll with related overheads were PLN 72.87 per tonne and accounted for 51.8% of total unit cost. By 2006 these costs increased to PLN 76.77 per tonne, i.e. by 5.3% while their share in the total unit production cost declined to 48.4%.

In entities mining hard coal lack of correct relationships between pay raise and increase in work productivity can be noticed. The productivity factor has little significance in applied remuneration systems. Maintaining incorrect relationships between pay raise and work productivity causes a threat of excessive increase of production costs and thus diminution of competitiveness of coal as an energy carrier.

External circumstances, in particular consisting in a very high increase in material costs and the necessity of mining in more and more difficult technical and geological conditions and at the same time observing more strict industrial safety regimes and surface protection cause that despite measures taken by mining enterprises in order to reduce costs one should not expect a decline in coal production costs.

In these circumstances gradual reduction of dynamics of increase in production costs, except for work safety costs would be a desirable trend.

In each mining enterprise its circumstances and financial capabilities should be a decisive factor of pay raise.

Too low dynamics of disposal of non-production assets and redundant production assets also have affected the high level of economic activity costs of mining enterprises. In production companies about 7% of their total fixed assets constitute non-production assets and can be subjected to further disposal. In many cases these assets are degraded by conducted economic activity, which diminishes its attractiveness to potential buyers. The level of disposal of these assets in a way favourable for coal companies pursuant to Article 66 of the Tax Ordinance i.e. against fiscal obligations redemption is additionally affected by the state and gmina budget circumstances, which only in a limited degree give consent to this form of repayment of fiscal obligations.

Restructuring efforts carried out in the 90-ties aiming at restricting the activities of mining entities to sheer production had contributed to the fact that production companies at the end of 2006 held stock and shares in 191 companies (part of stock and shares concerns the same companies). The measures taken in order to dispose stock and shares are far from satisfactory and should be intensified. Companies of strategic importance, the activities of which are production related or companies which bring certain return on capital in the form of a dividend should ultimately remain held by mining enterprises.

Excessive dynamics of production costs increase is an essential threat to economic and financial situation of mining enterprises and to competitiveness of Polish hard coal in relation to other global producers as well as other energy carriers.

3.7. Deterioration of economic and financial conditions of hard coal mining industry in Poland

The hard coal mining industry finished the year 2003 with a positive net financial result of PLN 9,666.6 million. If liabilities decommitment were not taken into account this result would be negative – PLN 3,984.4 million.

Improved demand for coal had started influencing the results of the hard coal mining industry as of the second half of 2003, which showed in stopped decline in coal sales prices and than in their rapid increase, which was maintained also in 2004.

As the coal sales in 2003 and 2004 are comparable (respectively 98.5 million tonnes and 98.7 million tonnes), in 2004 the Polish mining industry achieved significant increase in revenues from coal sales (from PLN 14.1 billion in 2003 to PLN 18.6 billion in 2004). The return on coal sales in 2004 was PLN 3,005.7 million and had a decisive effect on achieving by the companies in hard coal mining industry the net financial result of total value of PLN 2,594.6 million.

In 2005 the growing trend of hard coal prices was noticeably limited. In 2005 when the coal sales level dropped compare to 2004 and was 94.1 million tonnes (decline by 4.6 million tonnes), revenues on coal sales were PLN 18.0 billion that is by PLN 0.5 billion less than in 2004 and the net financial result was PLN 1,232.4.

Hard coal output in 2006 was 94.4 million tonnes (while sales were 93.5 million tonnes). As a result of reduction of the average coal sales price by 4.2% and a decline in the amount of the coal sold by 0.8%, the revenues on coal sales declined by PLN 0.9 billion (to the level of PLN 17.1 billion). In consequence the net financial result achieved by the hard coal mining industry in 2006 totalling PLN 404.6 million was lower than in 2005 by PLN 766.0 million.

The diminution of the net financial result affected diminution of net profitability ratio and II and III liquidity ratios, which compared to 2005 were respectively: 2.1% beside 5.8%, 0.79 beside 0.89 and 0.57 beside 0.67.

The average unit return on coal sales in 2006 was lower compared to 2005 by PLN 13.09 per tonne and it was PLN 8.08 per tonne. At the same time the average unit cost of the coal sold increased by 2.9% (from PLN 170.52 per tonne in 2005 to PLN 175.54 per tonne in 2006).

Decline in positive returns on coal sales due to decline in coal prices and increase in production costs constitutes a serious threat to maintaining good financial condition of mining enterprises.

3.8. Coal transport - costs

Costs of railway transport including transshipments account for 30.8% of the price of Polish steam coal in Polish seaports in the first 2006 – EUR 73.5 per tonne. Contrary to expectations, the changing organizational structure and emergence of new, smaller coal carriers reducing the share of the main carrier PKP Cargo in traffic does not cause reduction of coal transport costs.

The fact that in the 1st half of 2006 the average price of Polish steam coal ex works (in EUR per tonne) was lower than the price in the ARA (Amsterdam—Rotterdam – Antwerp) seaports by EUR 8.7 but after bringing coal from coal mines to Polish seaports the price was higher than the price of coal imported to the European Union by EUR 6.3 (in terms comparable to Polish seaports) can show the significance of the coal transport cost problem.

Such a high impact of transportation costs on competitiveness of Polish coal calls for urgent measures in order to minimize these costs. Utilization of the economies of scale should *inter alia* be the basis for negotiations of mining enterprises with coal carriers in order to agree favourable tables of fares for coal transport. Also increase in water transport share may be reasonable (river-borne transport)

Coal companies should also prepare price offers for coal deliveries to power plants taking into account transport costs according to the new negotiated rates.

High prices of Polish coal in Polish seaports and growing imports of coal to the European Union markets can cause that Polish coal will loose in competition in those markets. Elimination of Polish coal from the European Union markets will cause surplus coal in the domestic market, which cannot be utilized, which in turn can cause price decline below production costs.

Therefore it is also in a well understood interest of Poland to draw attention of the European Commission to the need of observation and detailed monitoring of hard coal imports to the EU. At the same time Poland, within its own means and capabilities, should monitor the impact of coal imports and analyse it in particular in terms of principles of fair competition.

4. Strategic analysis, vision and strategic objectives of the hard coal mining industry

Strategic analysis of the sector is a peculiar strategic audit in order to recognize internal factors or strengths and weaknesses of the industry and external factors or opportunities and threats from the environment of the sector.

4.1. Internal factors

Strengths:

1. Creating the basis for profitable activity of coal companies as a result of performing restructuring process of hard coal mining industry.
2. Experience in adopting capacities of mining sector to the capabilities of coal sales in domestic and foreign markets.
3. Significant identified and available hard coal resources in coal mines.
4. High level of work safety in Polish hard coal mines.
5. Skilled and experienced staff in coal mines.
6. Strong domestic research and development base of the hard coal mining sector.

Weaknesses:

1. Very diversified amounts of available hard coal resources in individual coal mines.
2. Necessity of repayment of liabilities by Kompania Węglowa S.A. resulting from the financial restructuring.
3. Restricted scope of investments in previous years with regard to construction of new working horizons.
4. Depreciated technical infrastructure of production enterprises.
5. Unfavourable breakdown of employment by seniority and age in mines and overemployment on the surface.

4.2. External factors

Opportunities:

1. Contribution of hard coal to ensuring energy security of the state.
2. High oil and gas prices in the global markets.
3. Increased application of clean coal technologies and utilization of hard coal for gaseous and liquid fuel production.

Threats:

1. Decline in demand for hard coal in the domestic market.
2. Decline in coal prices in the European and domestic markets.

3. Limitation of demand for hard coal in power sector as a result of high costs of greenhouse gases emission.
4. High transport costs.
5. Price competition of global coal producers, in particular from the East.
6. Environmental degradation of substantial post-mining areas.

4.3. Vision and strategic objectives of the hard coal mining sector

Having regard to the role and significance of native hard coal resources in satisfying power industry needs of the country, the state policy towards hard coal mining sector will ensure its competitiveness and successful operation in the market economy after 2015. Having achieved profitability mining enterprises should be characterized by a high degree of work safety, modernity and innovativeness of the production process and a low degree of negative impact on the environment as well as stability and flexibility of employment and work systems, which should support scientific and technological development of mining regions.

Rational utilization of hard coal deposits should contribute to ensuring of energy security of the country and to development of new technologies of obtaining energy based on hard coal. During execution of restructuring processes aiming at achieving competitiveness mining enterprises will obtain public aid for restructuring whereas after completion of these processes they will be able to exercise other forms of public aid for development.

Taking into account the hard coal mining sector diagnosis, in particular the analysis of the most important problems and the strategic analysis as well as the foregoing vision of sector operation after 2015, the strategic objective of the State policy towards the hard coal mining sector has been formulated as follows:

The objective of the State policy towards the hard coal mining sector is to rationally and effectively manage the coal deposits located in the territory of the Republic of Poland so that these resources serve next generations of Poles.

The strategic objective will be pursued by measures concentrated around the following specific objectives:

- **ensuring energy security of the country by satisfying the domestic demand for hard coal, including utilization of coal for production of liquid and gaseous fuels.**
- **maintaining competitiveness of Polish hard coal in conditions of free market economy.**
- ensuring stable deliveries of hard coal of the required quality to domestic and foreign customers,
- utilization of modern technologies in the hard coal mining sector to improve price competitiveness, occupational safety, environmental protection and to create the basis for technological and scientific development in particular in the Silesia and Małopolska regions.

Such determined strategic objective and specific objectives are in line with accomplishment of the objectives of the renewed Lisbon strategy currently pursued in Poland by the National Reform Programme for the period 2005-08. These objectives are also in line with the objectives of the Country Development Strategy for the period 2007 – 2015.

To achieve a certain strategic objective and specific objectives, performing of all necessary activities should take account of the following guidelines:

1. **Search for new possibilities of coal application and new customers;**
2. **Adapting production capacities of the mining industry to capabilities of hard coal sales in the market.**
3. **Maintaining production costs of coal in mines at a competitive level in relation to coal prices and thus maintaining economic viability by coal companies;**
4. **Maintaining satisfactory level of liquidity and creditworthiness by coal companies;**
5. **Ensuring stable and economically secure jobs in hard coal mines and rational job resource management;**
6. **Pursuing by the management boards of coal companies effective non-production fixed assets and long-term financial assets management policy.**
7. **Taking by coal companies measures related to increase in revenues by rational by-products and waste management (e.g. methane, waste rock, water, scrap);**
8. **Taking by coal companies measures in order to minimize costs arising between a producer and an ultimate consumer of coal (costs of services related to distribution and transport of coal);**

INDICATORS AND MEASURES OF ACCOMPLISHMENT OF INDIVIDUAL SPECIFIC OBJECTIVES

No	Objective	Indicator/measure	Base value (2006)*		Assumed target value (2015)	Frequency of measurement
1	Search for new possibilities of coal application and new customers	Drafting a feasibility study on clean coal technologies acc. to the schedule in section 9 of the Strategy	-		-	annually
		Development of production of eco-fuels from hard coal	778.0 thousand tonnes		In accordance with functional strategies of coal companies, as referred to in section 5.13.a of the Strategy	annually
2	Adapting production capacities of the mining industry to capabilities of hard coal sales in the market	Hard coal output	94,404.8 thousand tonnes		As in the forecast in Section 5.5 of the Strategy	annually
		Hard coal sales	93,528.8 thousand tonnes		As in the forecast in Section 5.5 of the Strategy	annually
3	Maintaining the production costs of coal in mines at a competitive level in relation to coal prices and thus maintaining economic effectiveness by coal companies	Unit return on current output	KW S.A.	PLN/t 1.08	Positive value	annually
			KGK	PLN/t 0.62		
			JSW S.A.	PLN/t 25.43		
		Unit return on coal sales	KW S.A.	PLN/t 0.15	Positive value	annually
			KGK	PLN/t 8.02		
			JSW S.A.	PLN/t 38.02		
		Net financial result	KW S.A.	PLN - 51.6	Positive value	annually

				million		
			KGK	PLN 102.2 million		
			JSW S.A.	PLN 284,4 million		
4	Maintaining satisfactory level of liquidity and creditworthiness by coal companies	I liquidity ratio	KW S.A.	0.05	In accordance with coal companies' forecasts as referred to section 5.13.(k) of the Strategy	annually
			KGK	0.30		
			JSW S.A.	1.04		
		Profitability of sales	KW S.A.	-0.60%		annually
			KGK	3.18%		
			JSW S.A.	7.31%		
		Payables	KW S.A.	PLN - 4,524.6 million		annually
			KGK	PLN 794.5 million		
			JSW S.A.	PLN 712.6 million		
		Receivables	KW S.A.	PLN - 604.9 million		annually
			KGK	PLN 341.2 million		
			JSW S.A.	PLN 398,1 million		
5	Ensuring stable and economically secure jobs in hard coal mines and rational job resource management	Percentage of underground employees in total headcount	KW S.A.	76.4%	In accordance with functional strategies of coal companies, as referred to in section 5.13.(e) of the Strategy	annually
			KGK	78.7%		
			JSW S.A.	78.8%		
		Change in underground employees compared to the previous year	KW S.A.	decline by 2,663 persons		annually
			KGK	decline by 373 persons		
			JSW S.A.	growth by 30 persons		
		Change in surface employees compared to the previous year	KW S.A.	decline by 761 persons		annually
			KGK	decline by 302 persons		
			JSW S.A.	decline by 147 persons		
6	Pursuing by the management boards of coal companies effective non-production fixed assets and long-term financial assets management policy	Pursuing by coal companies of functional strategies as referred to in section 5.13 (j) of the Strategy.				annually
7	Taking by coal companies measures related to increase in revenues by rational by-products and waste management (e.g. methane, waste rock, water, scrap);	Utilization of captured methane for power and heat generation	KW S.A.	54.1%	In accordance with functional strategies of coal companies, as referred to in section 5.13.(i) of the Strategy	annually
			KGK	46.6%		
			JSW S.A.	70.0%		
		Utilization of waste rock	KW S.A.	98.3%		annually
			KGK	99.8%		
JSW S.A.	96.4%					
8	Taking by coal companies measures in order to minimize of costs arising between a producer and an ultimate consumer of coal (costs of services related to distribution and transport of coal)	Effects of measures taken by coal companies in this regard				annually

5. Measures necessary to achieve strategic goals

The measures proposed below mostly aim at achieving by mining entities a situation, where they can conduct their activities on the basis of generally applicable law without the need of state support and restricting special legal solutions for the sector to a necessary minimum.

5.1. Organisational changes in the mining industry

Taking into account the current organizational structure of the hard coal mining industry, the expected restructuring measures and the situation in coal markets - the change in the organizational structure of the industry should be pursued. It seems appropriate to perform the following organizational changes:

- a. Completion of establishing of Grupa Węglowo-Koksowa on the basis of Jastrzębska Spółka Węglowa S.A.
- b. Incorporation of the company KWK "Budryk" S.A. into the structures of Jastrzębska Spółka Węglowa S.A.
- c. Concentration of activities performed by Spółka Restrukturyzacji Kopalń S.A. and Bytomska Spółka Restrukturyzacji Kopalń Sp. z o.o. in a single entity
- d. Separation of Centralny Zakład Odwadniania Kopalń (Central Mine Dewatering Plant) from Spółka Restrukturyzacji Kopalń S.A.
- e. In cases economically justified it is admissible to establish capital groups on the basis of coal companies and power companies and transmission grids, subject to agreements of the entities concerned forming a group with the public party.

The proposed organizational changes should allow to achieve the target organizational structure of the hard coal mining industry.

Completion of establishment of Grupa Węglowo-Koksowa

In the target condition JSW S.A. (100% shares held by the State Treasury) should hold a majority interest in the following companies:

- Koksownia „Przyjaźń” Sp. z o.o. – at present 88,08% stock held by JSW S.A.
- Polski Koks S.A. – at present 51% stock held by JSW S.A.
- Kombinat Koksochemiczny „Zabrze” S.A.
- Zakłady Koksownicze w Wałbrzychu.

Incorporation of the company KWK "Budryk" S.A. into Jastrzębska Spółka Węglowa S.A.

As of its establishment in 1993 KWK "Budryk" S.A. is a sole-shareholder company of the State Treasury. KWK „Budryk” S.A. has *inter alia* type 35 coking coal reserves, which will be mined in the nearest future. In this connection and because of little distance from mines belonging to JSW S.A. it seems appropriate to incorporate KWK "Budryk" S.A. into JSW S.A. structures. Accomplishment of this task will be performed as a result of take over by JSW S.A. of the company KWK "Budryk" S.A. pursuant to Article 492 (1)(1) of the Commercial Companies Code.

Concentration of activities performed by Spółka Restrukturyzacji Kopalń S.A. and Bytomska Spółka Restrukturyzacji Kopalń Sp. z o.o. in a single entity

Taking into account the identical scope of business of both companies and the fact that SCD S.A. holds 100% shares in BSRK Sp. z o.o. the current scope of business of BSRK Sp. z o. o. should be taken over by SCD S.A. This means bringing about a condition where only one company operates.

The Management Board of Spółka Restrukturyzacji Kopalń S.A. is preparing a concept of completion of tasks which so far have been performed by this company, i.e. activities related to closing down coal mines and the so called post wind-up measures by 2010.

Separation of Centralny Zakład Odwadniania Kopalń

Centralny Zakład Odwadniania Kopalń will be separated from Spółka Restrukturyzacji Kopalń S.A. as an independent company, whose shares or stock can be taken over inter alia by Kompania Węglowa S.A. and Katowicki Holding Węglowy S.A. beside SCD S.A.

Centralny Zakład Odwadniania Kopalń will take over tasks of the plants of Bytomska Spółka Restrukturyzacji Kopalń Sp. z o.o. and will take measures to take over tasks of Centralna Pompownia "Bolko" Sp. z o. o. [Pumping Station]

5.2. Privatization of mining industry

Legitimacy of potential privatization will be agreed with the social partner, separately for each company. In the case of potential privatization, it is assumed the following conditions should be met:

1. The method and course of the privatization process should guarantee to maintain the majority interest controlled by the State Treasury.
2. The privatization process may be carried out via the Stock Exchange to get capital for development and modernization of a privatized enterprise.
3. Lawfully the employees will get stock in a privatized company.
In the case of employees not entitled, subject to the financial condition of a given enterprise compensatory solutions should be prepared.

5.3. Legal changes

As of the end of 2006 most of the mining law provisions expired. There is the need to prepare a new law taking into account solutions proposed in this strategy. The provisions of the bill will aim at ensuring continuous funding of tasks resulting from decisions made in previous years as well as ensuring funding of some tasks resulting from this strategy (the scope of funding is presented in section 6).

5.4. Work safety in hard coal mines

Pursuant to the resolution of the Council of Ministers No 206/2006 of 29 November 2006 on taking measures concerning work safety in hard coal mines a Coordination Team for preparing a report evaluating work safety in these mines was appointed by the instruction No 88

of the Minister of Economy of 18 December 2006. The work of the Team resulted in conclusions recommending *inter alia* a review of:

1. legislation related to operation of a mining plant, under condition of not worsening work safety,
2. safety management systems, monitoring and warning against work safety hazards applied in coal companies.

The review and amendment of legislation by appropriate supervising authorities (including State Mining Authority) should also aim at streamlining organizational structure of mining plants.

Conclusions concerning evaluation of work safety in mines and measures proposed in this regard have been included in the "Report on evaluation of work safety in hard coal mines" approved by the Council of Ministers on 24 April 2007.

5.5. Capabilities of coal sales and adjustment of production capacities

Global forecasts

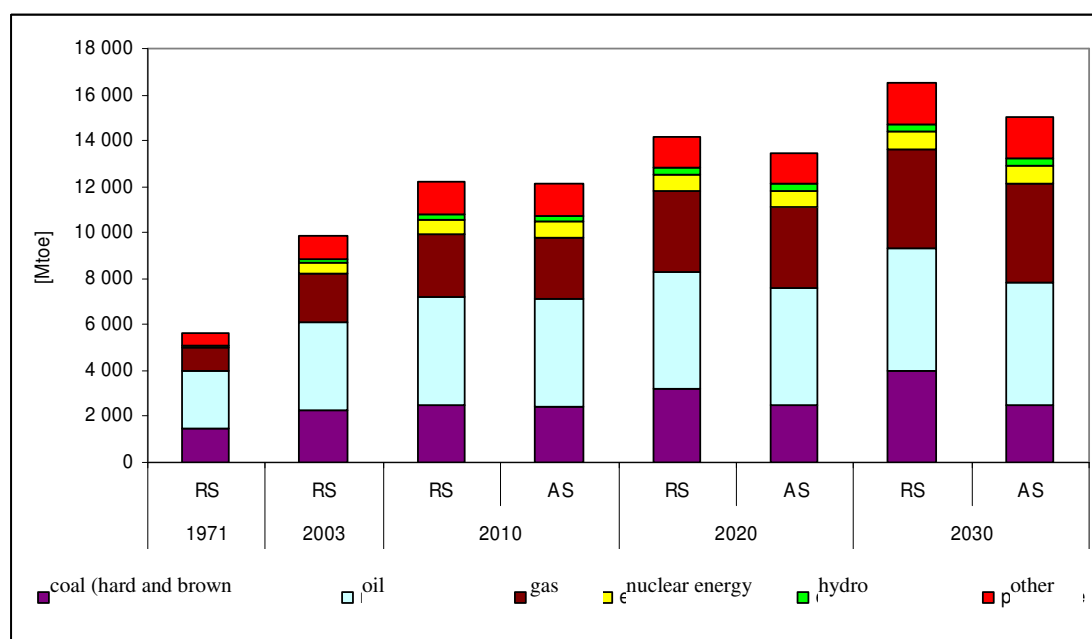
Available short- and medium-term forecasts indicate that in the prospect of the nearest decades coal will be a vital source covering demand for primary energy for the world. By forecasts in 2030 coal will cover 23% of global demand for primary energy and about 40% of electrical energy will be generated from coal.

International Energy Agency has developed two scenarios determining forecasts of global demand for primary energy up to 2030 - e.i a reference scenario and an alternative scenario.

In both scenarios it is anticipated that the global demand for primary energy will grow, while the growth dynamics is different in the scenarios. Over 2/3 of growth of global demand for primary energy will result from the growth of demand in developing countries where economic development will be the fastest. Solid fuels will prevail in demand accounting for over 80% of the forecasted growth in demand for primary energy (by the reference scenario). It is forecast that increase in oil consumption by 2/3 will only take place in the transport sector. Demand for gas will also grow, driven mostly by the power sector. Demand for gas will be larger than for coal, which by 2015 will be on the 2-nd position among primary energy sources.

In the alternative scenario it is expected that in 2030 global demand for coal will be similar as in 2020.

The forecast of global demand for primary energy up to 2030 by International Energy Agency (IEA)



One should expect that demand for coal in 2030 according to the reference scenario will be at the level of 8,687 billion tonnes in 2030. Demand for coal will be growing on average by 1.8 % per annum up to 2030, while for steam coal average annual growth is forecasted at 1.8 %, for coking coal 0.9% and for lignite 1.0%.

One should however note that coal demand forecasts considerably differ in a regional aspect. While especially high growth in demand for coal is foreseen for China, India, Indonesia and fairly high for the USA, no growth is assumed in Europe, in particular in the European Union.

The emission trading scheme within the EU states, concerning national limits of greenhouse gas emissions and trade in additional emissions within the EU could contribute to decline in demand for hard coal within the EU, taking into account high costs and gradual elimination of subsidies existing in majority of the EU countries. Among the 15 countries the EU imported about 50% of primary energy and in 2030 this import will be about 70%, at the same time the EU counts on large natural gas imports.

One should note the fact that in the EU a number of existing coal-fired power plants will certainly be closed down by 2015 because they do not meet the requirements of the new LCPD directive (large combustion plant directive) which require installation in European power plants FGD installations (flue gas desulphurization), eliminating sulphur dioxide emissions. European power plants not using this process will be subjected to restriction to 20,000 hours of operation. Assuming the directive will take effect in 2008 the power plants without this process will have to be closed down by 2015.

Forecasts for the Polish market

In Poland hard coal sales in 1998 – 2006 showed continuous declining trend - from 114.3 million tonnes to 93.5 million tonnes.

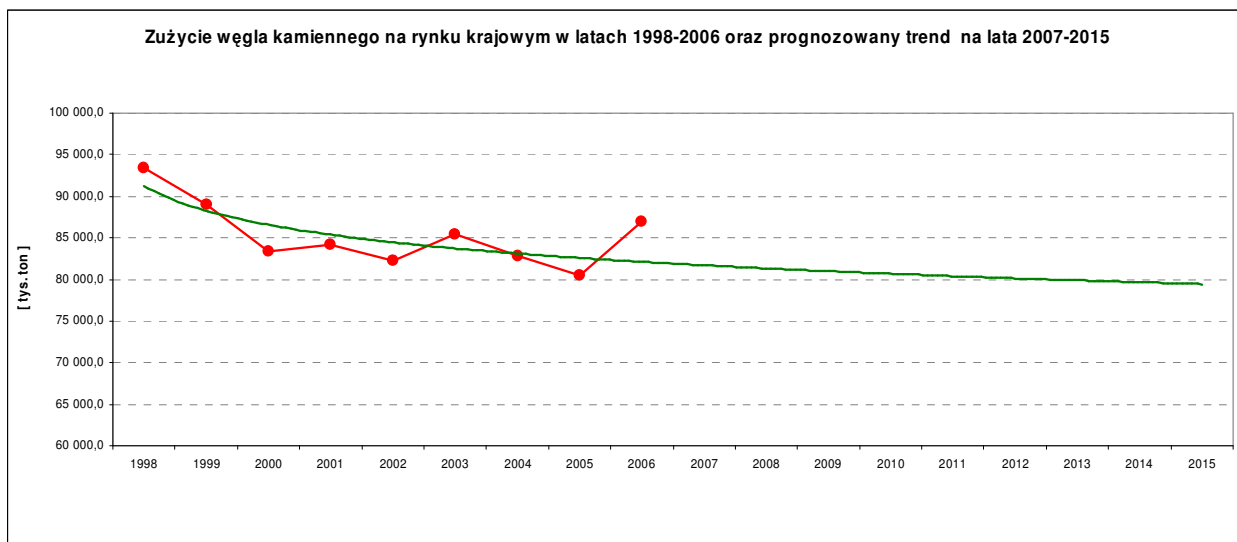
Domestic sales of steam coal declined in this period from 74.6 million tonnes to 66.6 million tonnes and of coking coal from 12.1 million tonnes to 11.1 million tonnes.

In connection with the fact that so far analysis and calculations concerning the forecast of hard coal balance have had no confirmation in demand shaped by the market, this document uses a method of setting the trend line in respect to hard coal consumption in the domestic market, output and sales based on the past years.

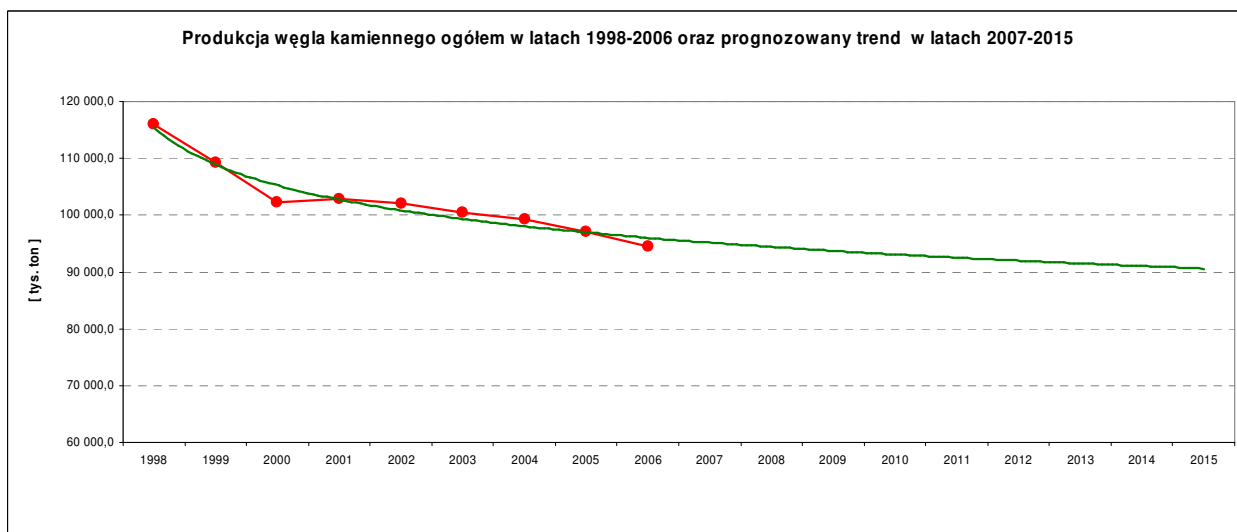
For determining the trend for coal output and sales data from the report by the Central Statistical Office G-09.1 "Report on hard coal trade" for the period 1998—2006 were used, whereas for determining the trend of hard coal consumption in the domestic market data for the years 1998—2006 presented in the report by Agencja Rynku Energii S.A. (Energy Market Agency) "Primary energy balances in the period 1990-2006" were used. The forecast for the years 2007-2015 was prepared by extrapolation of trends of 1998-2006.

Consumption of hard coal in the domestic market in the years 1998-2006 and the trend forecast for 2007 – 2015

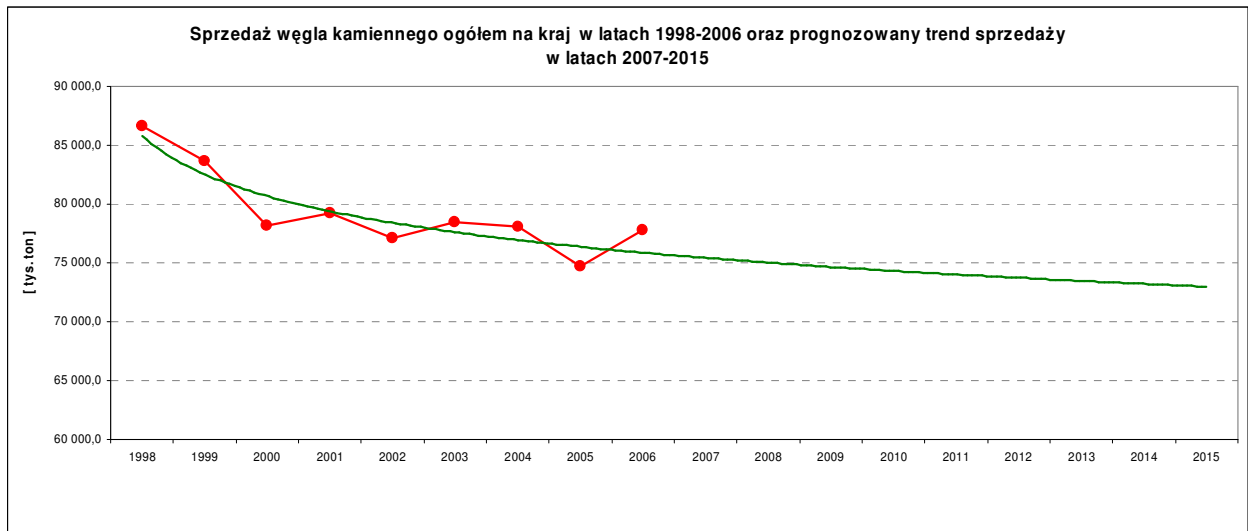
[thousand tonnes]



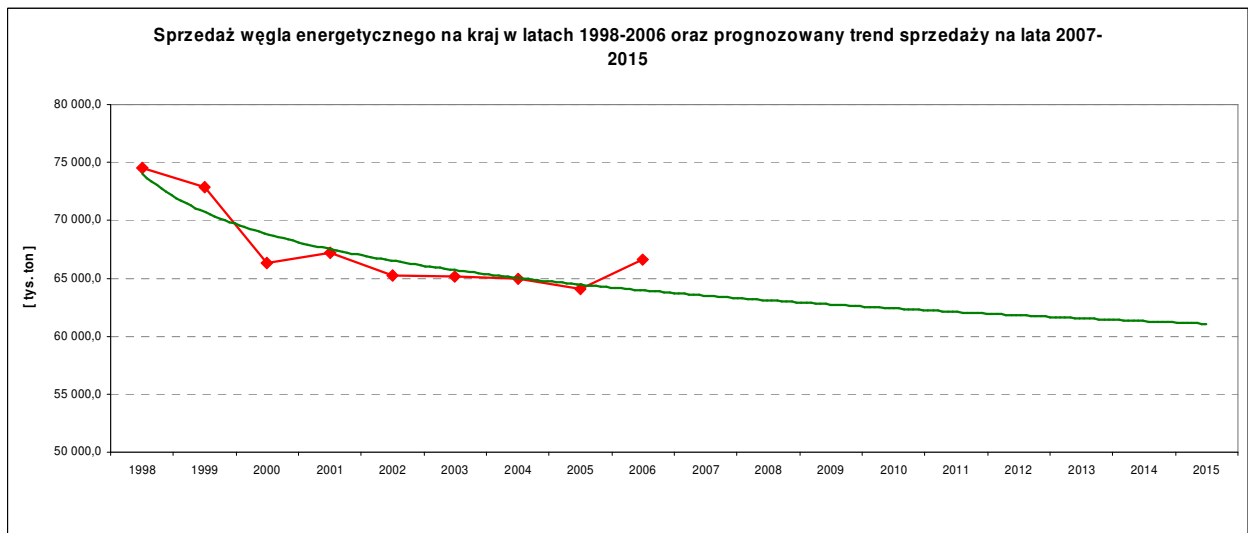
Total hard coal output in 1988 – 2006 and forecasted trend for 2007 – 2015 [thousand tonnes]



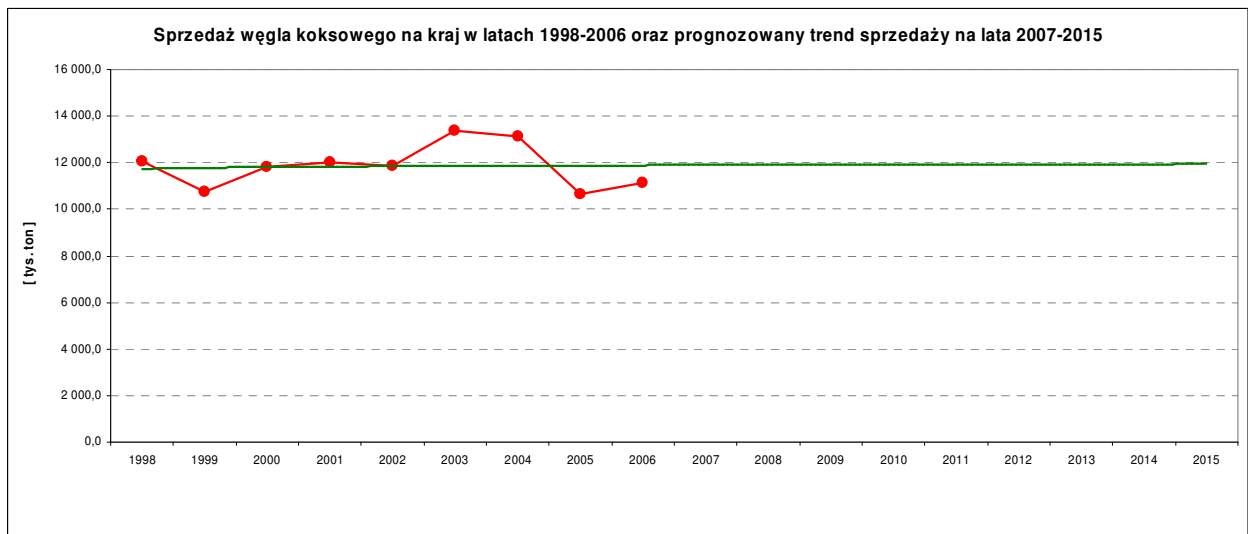
Total domestic sales of hard coal in 1998-2006 and forecasted sales trend for 2007 - 2015



Domestic sales of steam coal in 1988 - 2006 and forecasted sales trend for 2007 - 2015



Domestic sales of coking coal in 1988-2006 and forecasted sales trend for 2007 - 2015



Extrapolation to 2015 of the trends of steam coal sales in the domestic market determined for the years 1998 - 2006 indicates the possibility of decline in steam coal sales to the level of about 60.0 million tonnes.

In the case of coking coal the trend line shows a slight growth resulting from an unnatural situation, which occurred in the market in 2004. In fact one can expect gradual, slow decline in coking coal sales. As experience of the past three years has shown also the Polish coking coal market depends on behaviour of steel producers and global economic situation.

The forecasted consumption of coal in the domestic market in 2015, taking account of development of technologies of gaseous and liquid fuel production from coal, can be at the level of about 83 million tonnes.

In 2005 hard coal imports to Poland were about 3.4 million tonnes (from Russia about 2.4 million tonnes, from the Czech Republic about 0.6 million tonnes, from Ukraine about 0.2 million tonnes. Small amounts were also imported from Kazakhstan, Columbia, China and RSA. In 2006 imports of coal into the Polish market increased and were 5.2 million tonnes (including: from Russia about 3.3 million tonnes, from the Czech Republic 1.5 million tonnes). Due to the European Union regulations Poland cannot independently use measures for protection of the Polish market. Price competitiveness is the only real method of protection of Polish coal producers against excessive imports.

Exports of Polish coal will result from the difference between the output of Polish producers and imports and the actual demand in the Polish market.

Forecasted demand vs projected amount of hard coal available in Poland in the period 2006 – 2015.

million tonnes.

No	Specification	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015		
0	1	2	3	4	5	6	7	8	9	10	11		
I DEMAND SIDE IN THE DOMESTIC MARKET													
I	Total consumption of hard coal in the domestic market [I.1 + I.2 + I.3]	81,2	81,1	80,0	80,0	79,0	79,0	81,0	83,5	83,0	83,0		
I.1	including: consumption of hard coal in the domestic market (set on the basis of the trend line)	80,0	80,0	79,0	79,0	78,0	78,0	77,5	77,5	77,0	77,0		
I.2		internal consumption of mining enterprises and coal allowances	1,2	1,1	1,0	1,0	1,0	1,0	1,0	1,0	1,0		
I.3		consumption of hard coal for production of gaseous and liquid fuels	0,0	0,0	0,0	0,0	0,0	0,0	2,5	5,0	5,0		
II SUPPLY SIDE IN THE DOMESTIC MARKET													
II.1a	Supply of coal in the domestic market	bottom value [II.2a + II.3]		99,0	98,5	98,5	98,0	98,0	97,5	97,5	97,0	97,3	97,0
II.1b		top value [II.2b + II.3]		102,2	101,8	101,7	102,3	103,4	104,7	103,6	102,8	103,3	102,0
II.2a	including: hard coal output	bottom value (output based on the trend line taking account of coal for internal consumption and coal allowances and production of liquid and gaseous fuels)		95,0	94,5	94,0	93,5	93,0	92,5	92,0	91,5	91,3	91,0
II.2b		top value (determined on the basis of statements of mining enterprises)		98,2	97,8	97,2	97,8	98,4	99,7	98,1	97,3	97,3	96,0
II.3	Hard coal imports		4,0	4,0	4,5	4,5	5,0	5,0	5,5	5,5	6,0	6,0	
III SURPLUS OF HARD COAL IN THE DOMESTIC MARKET – SHIPMENTS AND EXPORTS													
III.1a	Exports	bottom value [II.2a - I]		17,8	17,4	18,5	18,0	19,0	18,5	16,5	13,5	14,3	14,0
III.1b		top value [II.2b - I]		21,0	20,7	21,7	22,3	24,4	25,7	22,6	19,3	20,3	19,0

Mining enterprises should adjust the output to the level of sales capabilities.

One should note that restrictions concerning environment protection, including greenhouse gas emissions will affect demand for coal from heat and power producers.

Moreover the Directive 2001/80/WE of 23 October 2001 on the limitation of emissions of certain pollutants into the air from large combustion plants aims at limitation of SO₂ , NO_x and dust emissions from sources of the capacity in fuel exceeding 50 MW. According to analyses conducted within the drafted National Plan for SO₂ Reduction the obligation to fulfil by 2008 individual emission standards without modernization work and without putting into operation new desulphurizing installations in large combustion facilities may cause limitation in hard and brown coal consumption.

So the demand for coal from energy producers in terms of environment protection will depend on modernization work performed as well as on the price and quality offered by coal producers.

One should expect that the forecast increase in electricity consumption will be compensated first by an increase in productivity of the existing power systems by utilization of renewable energy or nuclear energy.

Due to the gas and oil prices one cannot expect increase in energy generation from these carriers.

In addition, part of coal may be used for chemical coal processing if commercial technologies of processing coal into gaseous and liquid fuels are developed. Furthermore production of coal fuels characterized by high calorific value and low sulphur content intended for burning in low-emission boilers with retort or grate furnaces is a new, promising market for coal.

So, despite the forecasted increase in electricity consumption, the utilization of coal for its power generation in next years can remain on the same level or slightly decline.

If it were necessary to reduce capacities – related measures taken by mining enterprises would be financed by a mines closure fund, established for this purpose by a given mining enterprise.

Mining enterprises would avoid a situation, in which after completion of winding up a mining plant industrial coal reserves were trapped underground. Subject to technical capabilities in the coal mines where coal reserves are close to depletion phasing out of mining operations would be performed by merging of coal mines. Final decisions must be however preceded by a feasibility study.

5.6. Employment policy in mining industry

As a result of employment restructuring performed so far in the mining industry, employment in coal mines has significantly declined, in particular among underground employees, who at the end of 2006 accounted for 77% of the total employment (91.7 thousand people - as at 31.12.2006). Only during last 9 years employment has declined – in total by 124.0 thousand people.

Restructuring of employment caused that the breakdown of employees by seniority and age changed which resulted in the ageing process of staff of mines. At the end of 2006 68% of underground workers had seniority between 16 and 25 years. Current pension regulations will cause that by 2015 they all will acquire pension rights. Similar effect will occur in mechanical coal preparation worker group.

It is estimated that in 2007 – 2015 about 64.9 thousand people may leave coal mines due to attrition, including 62.8 thousand employees working underground and 2.1 thousand surface employees.

The analysis conducted show that leaving coal mines by employees, only due to attrition, may cause occurrence of significant shortages in underground employment. It is estimated that by 2015 there will be shortage of about 40 thousand people underground. Those are general data, however mining regulations require specific qualifications from workers employed in mines. Acquiring miner's qualifications require a few years of underground experience necessary to complete vocational courses. Supplementing employment among coal mechanical processing personnel is another problem.

Taking into account effects of employment changes and related problems and to prevent formation of generation and competency gaps, which can have very negative effect on mining plants operation security, the management boards of coal companies will pay special attention to human resource management and will take measures to ensure that people employed in coal mines are fully prepared for this job.

To acquire well educated and prepared staff for the hard coal mining sector cooperation of mining enterprises with universities will continue, which allow the universities to adjust their offer to the needs of mines. Similar cooperation will be continued with secondary and vocational schools.

The long-standing process of reforming the mining industry accompanied by restructuring of employment in hard coal mines caused considerable decline in employment in mining plants. The loss of experienced management and operation supervision staff and people having special skills can unfavorably affect the safety level of miner's work. Increase in the number of third parties providing services in mining plant operations of some companies observed in recent years and considerable increase in the number of people employed by these businesses increase the existing disproportions between employment at mining jobs of own and outsourced employees.

Moreover the average age of underground mine employees should be taken into account. At present this age is advanced and it is 41. This means a necessity to hire new – young employees for jobs underground and in mechanical coal preparation plants in order to rejuvenate the mining staff.

The employment restructuring process conducted will maximise utilization of natural attrition i.e. retirement.

Having regard to the above statements, the employment policy followed by the management boards of coal companies should base on the following assumptions:

1. By the end of 2007 the management boards of coal companies should set out the optimal employment level for each mine necessary on the grounds of technology and due to geological and mining regulations.
2. With regard to each mine the management boards of coal companies should follow an employment policy, which allows to:
 - a. achieve the optimal employment level underground and in a coal preparation plant **necessary on the grounds of technology and due to geological and mining regulations.**
 - b. not hire new employees for surface work, including mine and coal company administration, except of necessary school and university graduates.

Strict supervision of the employment policy pursued by the management boards of coal companies to the foregoing guidelines will be executed by Supervisory Boards.

A mining economic operator, when necessary, may use any system of incentives and protections which leads to reduction of employment, financed by current revenues of the economic operator or by a fund established for this purpose.

The employment policy of mining enterprises followed in the period 2007 – 2015 should be characterised by:

- 1. Optimization of internal reserves of human resources utilization.**
- 2. Correct relations between the increase in payroll and the economic account.**

5.7. Debt restructuring and capital increase of Kompania Węglowa S.A.

Payables of Kompania Węglowa S.A. due to ZUS at the end of 2006 covered by debt restructuring under the mining law amounted to PLN 1,548.4 million. In the cases of SCD S.A and BSRK Sp. z o.o. it is respectively: PLN 10.1 million and PLN 53.9 million.

Due to the deteriorating circumstances of the above mentioned companies it is necessary to prolong the payables to ZUS remaining due in equal annual installments until 2013 i.e. by three years. It means repayment of payables to ZUS in 2007 – PLN 203.4 million and in the period 2008 – 2013 about PLN 234.8 million each year. It should also be noted, the mining pensions are financed by the general social insurance scheme. Postponement of payment terms to ZUS causes increase in the state subsidy to the whole funding of the pension scheme.

Furthermore under the agreements signed with creditors Kompania Węglowa S.A. within restructuring of liabilities taken over pursuant to Article 42 of the mining law is obliged to pay in the period 2007 – 2009 payables due to operational fee and property tax. The total amount due in this period is PLN 145.7 million.

According to the government programme „Restructuring of the hard coal mining sector during the period 2004 – 2006 and strategy for the period 2007 – 2010” capital increase of Kompania Węglowa S.A. in the amount of PLN 900 million was planned for 2004.

Capital increase of Kompania Węglowa S.A. was executed in 2005:

- by financial contribution of PLN 200 million,
- by non-financial contribution in the form of CIECH S.A. stock of PLN 283,987,000.

Therefore capital increase of Kompania Węglowa S.A. of PLN 416 still remains to be executed.

5.8. Post-mining land utilization

As a result of current process of the hard coal mining sector restructuring, supply of areas which ceased to function as land related to economic activity becoming thus post-industrial lands, often degraded, systematically have been growing.

The balance sheet value of properties intended for sale in the mining industry is estimated at about PLN 1.3 billion. They are land plots, buildings, constructions (including residential property and amenities).

While not supporting directly the core business conducted by coal companies they generate fixed costs related *inter alia* with charges and taxes eg. on property, land, forest, perpetual usufruct, environmental fees.

In these circumstances measures should be taken concerning management system of lands degraded by mining activities and restore them to business. The objective of such measures should be:

- 1) **revitalizing and reclamation** of lands devastated and degraded by industrial activity while maintaining environmental sustainability,
- 2) development of the existing industrial assets and business infrastructure,
- 3) development of facilities of housing and technical infrastructure and amenities,
- 4) preparation of land and infrastructure for new investments.

It is necessary to perform stock taking and valorisation of post-mining lands. The developed methodology of efforts in this area should cover:

- indication of measures for collecting and updating information on these lands,
- guidelines for developing an appropriate database,
- the method of land classification on the basis of hazard assessment,
- categorization of suitability of these lands for development.

Furthermore in order to attract investor, post-industrial land managers should benefit from experiences and cooperate with Polish Foreign Investment Agency, Industrial Development Agency, Economic Zones and other specialized units.

5.9. Impact of hard coal mining industry on the environment

Following are fundamental problems related to reduction of negative impact of mining production on the environment, which need to be solved by 2015 and are continuation of measures taken before:

- reduction of the volume of mine waste generation including maximum waste utilization both on the surface and in the underground workings;
- increase in the scope of land reclamation works including utilization of mine waste dumps and other lands and grounds degraded by mining activities;
- minimizing effects of mining operations on the surface by performing mining operations in a way limiting surface deformation and use of a wide scope of mining prevention,
- intensifying repairs of surface infrastructure facilities, including: bridges, overpasses, roads, railway lines, facilities and structures damaged by the impact of mining operations,
- reduction of impact on surface waters of the sewage discharged, specifically in the case of effluents of excessive saline content from dewatering of mining plants,
- reduction of dust and gaseous emissions to the atmosphere, including in particular reduction of GHG emissions,
- elimination of sources of excess noise emission to the environment.

Due to implementation by Poland of the European Union law involving environmental protection issues, it is essential that mining entities should comply with the legal requirements of environmental protection, that means the coal mines should meet conditions of use of the environment set out in respective decisions and administrative permits.

All mining enterprises, within their business strategies for 2007 - 2015 should develop a strategy for limiting negative effects of hard coal mining industry on the environment and full adjustment of the sector to the European Union requirements. Maximization of output of coal of possibly least content of impurities, including in particular sulphur and ash should be one of the priorities of environmental policy of coal companies. The environment protection strategy should set the goals, which would be reflected in technological and economic plans and in business plans of coal companies.

5.10. Investments in the hard coal mining industry

Planned investment outlays in the hard coal mining industry in 2007 are at the level of PLN 2.2 billions. Investment construction accounts for over 55% of outlays. Other outlays constitute purchase of investment goods.

Investment activities carried out by 2015 should take account of the two aspects:

1. Ensuring continuous and failure-free operation of mines, including: adjusting and stabilization of capacities and output to market needs. Systematic reconstruction of production capacity losses and related necessity of construction of workings, modernization of transport and ventilation passages and replacement of machines and plant worn out.
2. Further restructuring of coal mines, including: technical and technological restructuring of coal mines in conditions ensuring safe work of workers, further increase in production concentration, coal quality improvement and measures to minimize unfavourable effect of mining industry on the environment.

Investment projects should concern mainly reconstruction and modernization investments in as much as necessary to maintain continuity of plant operations.

As it is vital to ensure long-term stable supplies of high quality coal, it is considered essential to execute investment projects related to reconstruction of the resource base of coking and steam coal.

Thanks to new investments it will be possible to maintain output ensuring energy security of the country and possibilities of increase in profitable export to the European Union and third party states will be created. Consequently, implementation of innovative solutions in the Polish coal mining industry will contribute to improved competitiveness of the sector thanks to the possibility of increasing its effectiveness and productivity. Moreover application of new and modern technologies will significantly influence improvement of work safety, whereas thanks to implementation of environmental solutions emission of noxious substances to the environment will fall considerably. Developmental trends in highly developed countries show that only building of a competitive edge based on knowledge and innovations can guarantee long-lasting development in short- and long-term prospect. Furthermore in Polish circumstances the innovativeness level translates directly into profitability of an enterprise. Innovative enterprises are definitely more profitable than the ones which do not invest in innovations. In consequence conditions to improve competitiveness of Polish hard coal in relation to other fuels will be created. Developed, modern Polish mining industry will allow substantially to make the economy of the country independent from external supplies of gas and oil.

Investment projects related to development of resources in 17 working horizons, in operation, under construction and being extended will be completed by 2015. The executed investment projects should ensure in particular reconstruction of the coking coal resource base as well as restricting sublevel mining operations, which currently account for 40% of coal produced and which are a source of hazards for mining crews.

The strategy also foresees execution of projects related to development of new coal processing technologies ensuring compliance with increasing requirements of its customers with regard to new, clean combustion processes. Production of qualified coal fuels will develop, which are characterized by high calorific value and low sulphur content intended for burning in low-emission boilers with retort or grate furnaces (e.g. fuels: EKORET, EKO-FINS, RETOPAL etc.)

It is expected that a state aid in the form of funding from the national budget may be granted for initial investments in the mining industry. This aid will be granted as laid down in Article 5 (2) of the Council Regulation (EC) No 1407/2002 of 23 July 2002 on state aid to the coal industry and will concern covering of the initial investment costs, i.e. fixed capital costs directly related to infrastructure work or to the equipment necessary for the mining of coal resources in the existing mines. Granting the state aid for initial investments in the coal mining industry shall be conditioned on the financial circumstances of the state. Minister responsible for public finance, during the national budget drafting process, each time performs an analysis to determine the possibilities to grant aid for funding initial investments. Potential granting of state aid for initial investments will require notification of the European Commission.

5.11.Dewatering of closed mines

Protection of operating coal mines against water hazard is related to the necessity of performing dewatering in closed mines. The problem concerns mostly the coal mines located in the Northern part of the Upper Silesian Coal Basin. There are almost 40 coal mines, operating and closed down, connected to each other hydrologically, forming a system of connected vessels. In these circumstances, to cease dewatering and to allow uncontrolled water swell in workings of a closed down mine can lead to a direct hazard to existing coal mines, where deposit is still mined. Efforts related to pumping out of water are performed by two plants of Bytomska Spółka Restrukturyzacji Kopalń Sp. z o.o. and by Centralny Zakład Odwadniania Kopalń (CZOK), which belongs to Spółka Restrukturyzacji Kopalń S.A. These efforts are made by maintaining a system of deep dewatering and of a stationary system in closed down mines. The total amount of water pumped out by CZOK is about 238.0 thousand m³ per 24 hours. Annual costs relate to dewatering are estimated in 2007 at about PLN 165.7 million.

Centralny Zakład Odwadniania Kopalń should be separated from the SCD S.A. structures as an independent company and should take over tasks of plants of Bytomska Spółka Restrukturyzacji Kopalń Sp. z o.o. and of Centralna Pompownia "Bolko" Sp. z o. o. [Pumping Station] Dewatering performed by CZOK within its responsibilities resulting from the provisions of the geological and mining law will be financed by a subsidy from the national budget and by special funds.

Estimated costs of protection of neighbouring coal mines against water hazard, incurred in 2007 by SCD S.A and BSRK Sp. z o.o.

No	Pumping region	Protected mine	Estimated annual cost (PLN thousand)
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Lp	Rejon pompowania	Ochroniana kopalnia	Szacunkowy roczny koszt (tys. zł)
0	1	2	3
1	"Sosnowiec"	KWK "Kazimierz-Juliusz"	3 360,3
2	"Porąbka - Klimontów"	KWK "Kazimierz-Juliusz"	10 155,8
3	"Paryż"	KWK "Kazimierz-Juliusz"	2 861,7
4	"Grodziec"	ZG "Piekary"	666,9
5	"Katowice"	KWK "Ślązic"	7 778,9
6	"Niwka-Modrzejów"	KWK "Mysłowice"	10 125,9
7	"Gliwice"	KWK "Sośnica-Makoszowy"	3 144,3
8	"Kleofas"	KWK "Wielki Ślężak" KWK "Polska-Wirek"	10 290,1
9	"Kleofas"	water retention retention wody	42,8
	Total depth pumping stations + water retention		
	razem pompownie głębinowe + retencja wody	x	48 426,7
10	"Saturn"	ZG "Piekary"	15 990,2
11	"Siemianowice"	ZG "Piekary"	24 283,7
12	"Jan Kanty"	PKE ZGE "Sobieski-Jaworzno III"	14 581,9
13	"Pstrowski"	KWK "Bobrek-Centrum"	19 217,2
14	"Szombierki"	KWK "Bobrek-Centrum"	9 065,5
15	"Powstańców Śląskich-Bytom I" (po byłym ZG "Bytom I")	KWK "Bobrek-Centrum"	9 164,5
16	"Debieńsko"	KWK "Szczygłowice"	19 647,1
17	Total stationary pumping stations in region KWK "Szombierki")	ZG "Piekary"	158,0
	Total SRK SA C		
	razem pompownie stacjonarne	x	112 108,1
	the area of KWK Powstańców Śląskich Bytom I (after the former mine KWK Miechowice)	x	160 534,8
18	the area of former KWK Juliusz	KWK "Bobrek-Centrum"	4 756,9
19	Total BSRK Sp. z o.o. KWK Powstańców Śląskich Bytom I	ZG "Piekary"	357,7
	Total SRK S.A. and BSRK Sp. z o.o. Powstańców Śląskich-Bytom I"	x	5 114,6
	Łgółem SRK S.A. i BSRK Sp. z o.o.	x	165 649,4

5.12. Application of hard coal for production of gaseous and liquid fuels

Experts estimate that the maximum of crude oil output is coming. Its resources are however limited and its prices are skyrocketing. Therefore alternative energy sources should be sought. One of the possibilities is production of gaseous and liquid fuels from hard coal.

According to the existing experience, one can say about 3 tonnes of hard coal are needed to produce 1 tonne of engine fuels. The possibility of production gaseous and liquid fuels in the country on the basis of hard coal produced in Polish mines should be seriously considered and the following assumptions should be made:

1. Gaseous and liquid fuel production from coal must be a business project.
2. The government will assume an inspiring role for coal gasification and liquefaction installations.
3. The Minister of Economy should initiate conducting of a feasibility study for an installation project for production of gaseous and liquid fuels from coal.
4. The feasibility study for the project should allow to determine strengths and weaknesses for various technological solutions for production of gaseous and liquid fuels from coal.
5. The Minister of Economy should assume a coordinating role in discussion of experts, politicians and investors with regard to the project execution.

5.13. Strategies of coal companies

Governmental hard coal mining sector restructuring programmes have set the business strategy of the whole sector and individual entities in the sector. These programmes have set out objectives of the mining industry restructuring in a strategic dimension and legal, financial and organizational measures to apply for accomplishment of these objectives. As of 2004 the role of governmental restructuring programmes has been clearly weakening and the centre of shaping strategies of individual companies has shifted towards their management boards.

However the state owner of coal companies should still shape the strategy of activities for the whole sector.

Directions of desired measures contained in this strategy should constitute general guidelines for forming strategies of individual companies.

Proposals and notes in provisions 5.1 to 5.11 should be treated in the same way.

Taking account of the foregoing, the management boards of coal companies should develop strategies of their activities in 2007 – 2015. The strategies should be created within three months as of the date of accepting this document by the Government. The strategies of individual companies should contain *inter alia* the characterization of functional strategies until 2015, that is the following items;

- a. Diagnosis of the current condition of a company, including:
 - achieved economic and financial results in the period 2001 – 2006, their analysis and evaluation,
 - the volume of coal reserves in individual coal mines – the volume of reserves available and to be made available, viability of mines,
 - market position of the company,
 - capacities,
 - employment and employment structure.
- b. Strategic analysis and strategic objectives of a company;
- c. Production strategy, including foreseen changes in capacities;
- d. Marketing strategy, including foreseen changes in coal sales and their breakdown;
- e. Human resource strategy, including foreseen changes in employment and its breakdown, employment policy;
- f. Investment strategy, including the projected material and financial scope of the investment, its effectiveness, sources of financing;
- g. Environment protection strategy, including methods and the scope of changes for reducing negative impact of mining production on the environment;
- h. Innovation strategy, including potential changes in the company management system, preferred directions (areas) and the scope of financing of research and development work;
- i. Waste and by-product management strategy.
- j. Restructuring and management of non-core assets, including stock and shares in other economic operators.
- k. Forecast of basic technical and economical and financial indicators of the company and individual mines up to 2010, assuming execution of the above six functional strategies.

In their functional strategies individual mining enterprises should define cost generating areas, taking account of the ones where reduction is possible and the ones where it is only possible to slow down the dynamics of their growth, and then define short- and long-term measures.

5.14. Monitoring of business strategy of the hard coal mining industry

A system of restructuring process execution monitoring operates in the Polish hard coal mining industry. It provides to the Ministry of Economy information on the course of restructuring of the mining industry. Agencja Rozwoju Przemysłu S.A. (Industrial Development Agency) - Katowice Branch is the organization that monitors the mining industry restructuring. Pursuant to the existing law ARP S.A. conducts monitoring and upon request by the minister responsible for economy, undertakes actions related to the restructuring of the hard coal mining sector with respect to:

1. Use of budget resources and public assistance provided, including debt restructuring;
2. Process of winding up of mining plants and of removing damages caused by operations of a mining plant;
3. Changes in employment in the hard coal mining industry;
4. Other activities relating to the hard coal mining sector restructuring, as requested by the minister responsible for economy, in particular:
 - monitoring of coal sales by producers, marking out quantity, qualitative parameters and coal prices,
 - analysing coal prices of domestic producers and prices of imported coal,
 - preparing documents for notification by the European Commission of state aid for the Polish hard coal mining sector.

The above mentioned tasks should be still performed by ARP S.A. Based on experiences in monitoring of restructuring of the hard coal mining industry, ARP S.A. will monitor business strategies of individual coal companies providing information on threats to execution of this strategy, assuming legal responsibility for the information presented.

Once a year the Minister of Economy provides the Council of Ministers with information on execution of the Strategy of hard coal mining industry operation, whereas every two years with an assessment of its execution with potential proposals to update the Strategy.

In conjunction with responsibility resting on the Minister of Economy related with the state energy security, including correct operation of the hard coal mining sector, the Minister of Economy retains the existing competences of the minister responsible for the State Treasury with regard to mining enterprises.

ENTITIES INVOLVED IN EXECUTION OF MEASURES NECESSARY FOR ACHIEVEMENT OF STRATEGIC GOALS

No	Measure	Entities involved									
		KW S.A.	KGK	JSW S.A.	KWK Budryk S.A.	LW Bogdanka S.A.	PKW S.A.	SRK S.A.	BSRK Sp. z o.o.	CZOK	ARP S.A.
0	1	2	3	4	5	6	7	8	9	10	11
1	Organisational changes in the mining industry	x	x	x	x			x	x		
2	Privatization of mining industry	x	x	x		x					x
3	Legal changes										x
4	Work safety in hard coal mines	x	x	x	x	x	x	x	x	x	x
5	Capabilities of coal sales and adjustment of production capacities	x	x	x	x	x	x				
6	Employment policy in mining industry	x	x	x	x	x	x	x	x	x	
7	Debt restructuring and capital increase of Kompania Węglowa S.A							x	x		
8	Post-mining land utilization	x	x	x	x	x	x	x	x	x	x
9	Impact of hard coal mining industry on the environment	x	x	x	x	x	x	x	x	x	
10	Investments in the hard coal mining industry	x	x	x	x	x	x				x
11	Dewatering of closed down mines	x	x							x	x
12	Application of hard coal for production of gaseous and liquid fuels	x	x			x					x
13	Strategies of coal companies	x	x	x	x	x	x	x	x	x	x
14	Monitoring of business strategy of the hard coal mining industry										x

6. Financing and public aid for the hard coal mining industry

The document „Restructuring of the hard coal mining sector during the period 2004 – 2006 and strategy for the period 2007 – 2010” and the law of 28 November 2003 on hard coal mining restructuring during the period 2003 – 2006 assume that after 2006 restructuring processes in the hard coal mining industry will be continued and supported by the national budget. The following tasks are expected to be financed by the national budget as of 2007:

- Payment of monetary equivalents due to the entitlement to free coal hold by pensioners from completely wound up coal mines, paid by Zakład Ubezpieczeń Społecznych (Social Insurance) - till expiration;
- Costs of payments of monetary equivalents due to the entitlement to free coal hold by pensioners from completely wound up coal mines, paid by Zakład Ubezpieczeń Społecznych (Social Insurance) - till expiration;
- Monitoring of restructuring processes in the hard coal mining industry by Agencja Rozwoju Przemysłu S.A. and other tasks ordered by the Minister of Economy related to restructuring of the hard coal mining industry restructuring.

Tasks related to:

- protection of the neighbouring mines against water, gas and fire hazard after wind-up of a mine and
- repair of damages caused by operations of a wound up mining plant, including damages resulted from reactivation of old abandoned workings

are financed by the national budget in 2007, while as of 2008 it is foreseen to finance them from the national budget and the National Environment Protection and Water Management Fund means granted in the form of subsidies. Tasks related to repair of mining damages which are not damages to the environment will be financed by the national budget. Tasks related to repair of mining damages to the environment will be financed by means of the National Environment Protection and Water Management Fund.

Furthermore, in order to complete the restructuring processes, the national budget is expected to fund:

- Measures performed during and after completion of mine closure.
- Initial investment costs of up to 30% of the investment value.
- Completion of the employment restructuring only in so far as it enables to work till the moment of acquiring pension entitlements for persons already exercising mining leaves or mining benefits.
- Costs of employee claims, including compensatory pensions and coal allowances for pensioners from coal mines completely wound up.

Execution of part of the above mentioned tasks will constitute public aid within the meaning of the Council Regulation (EC) No 1407/2002 on state aid to the coal industry, which causes Poland facing the necessity to draft a new aid programme.

Moreover mining enterprises, under Article 3(1) of the above mentioned regulation can obtain public aid granted within programmes of state aid for research and development, natural environment and education.

7. The position of the strategy of activities of the hard coal mining industry among other national strategic documents

Goals and priorities of the „Strategy of activities of the hard coal mining industry in Poland in 2007 – 2015” are in line with the general objectives of the Lisbon Strategy (LS), in particular with one of the four priorities of the updated LS, which assumes guarantee of secure and constant energy supplies. The energy issue is a global issue and require *inter alia*:

- ensuring better coordination between the European power grid and the gas pipeline system, better power market regulation and more competition,
- introduction of more tax incentives and other incentives to promote sustainable use of energy and directing scientific research towards energy effectiveness and clean and renewable energy sources,
- uniform EU position in negotiations with third party power suppliers, which will supply more and more of it.

Measures provided for in the “Strategy...” concerning the above mentioned priority are first of all measures for improvement of the energy security of the country and measures for limiting negative effects of hard coal mining industry on the environment.

The „Strategy...” is in line with the „**National Reform Programme for execution of the Lisbon Strategy for the period of 2005 – 2005**” (KPR), a document whose role is to create suitable conditions for execution of Lisbon priorities. The measures of the „Strategy...” become part of the market oriented projects in the NRP, assuming elimination of factors distorting competition, *inter alia* by reduction of the public aid scale (in particular for enterprise restructuring) with its simultaneous directing towards horizontal objectives. Measures provided for in the „Strategy ...” relating to the above mentioned NRP priority are first of all measures leading to acquiring profitability and financial independence of individual coal companies by 2015 and gradual phasing out of public aid for restructuring of the coal mining sector.

The „Strategy...” is also in line with another government document, that is the "**Strategy for Country Development 2007 – 2015**” (SCD) This document shows that the country energy security issues are among the priorities. Many documents, including SCD indicates on one hand the role and significance of issues of oil and gas supply diversification, and on the other hand of the issue of domestic resources, including hard coal. Various issues related to the environment protection, limitation of pollution of air, water, soil and investments in environmentally friendly projects, in particular in post-mining areas are among the SCD priorities.

The measures that accomplish objectives of the “Strategy...” and are in line with the SCD assumptions are as well:

- restructuring of traditional economy sectors, including the hard coal mining industry;
- transport infrastructure;
- power sector infrastructure;
- environment protection infrastructure;
- making the job market more versatile and increase in mobility of job resources by creating suitable incentives for people leaving the mining industry;
- adjustment of the education offer for job market needs.

The objectives set out in the „Strategy...” concerning improvement of competitiveness, economic and social cohesion and issues of financial aid for equal development opportunities are in line with the objectives of the regional policy of the state laid down in the SCD. In particular it concerns measures laid down in the SCD concerning the Silesia province:

- supporting environmental measures in degraded post-industrial areas,
- measures focused on improvement of the natural environment,
- creating investment incentives in reclaimed lands,
- improvement of technical infrastructure, including transport,
- supporting of the job market, facilities for people who want to re-skill after leaving the mining industry,

The „Strategy...” is also a document in line with the strategy “**Directions of increasing the innovativeness of the economy for the period of 2007 -2013**”, *which contains evaluation of the innovativeness of the Polish economy and recommends directions for activities, implementation of which enables to create knowledge-based economy in the Polish circumstances, when high innovativeness will be a strength of economic operators in competitive markets.* The strategic goal of innovation policy laid down in “Directions ...” was defined as: increased innovativeness of enterprises to keep the economy on a fast development track and to create new, better jobs. In „Directions...” it was indicated that because of the development level and the structure of the Polish economy, the proper strategy of achieving the knowledge based economy by Poland consists in simultaneous following of four developmental paths, where beside (1) creation of new businesses based on innovative solutions and development of small and medium enterprises by utilization of modern technologies and knowledge management methods, (2) stimulation of cooperation between businesses and businesses and business environment organizations with regard to innovations, (3) motivation of large businesses to carry out and implement results of research work and also (4) **utilization of new technologies for improving competitiveness of traditional sectors.** Moreover the document indicates that thematic and structural priorities in the R & D area **will be selected *inter alia* within the foresight programme**, having regard to the business environment (participation of *inter alia* technological platforms) and globalization challenges like threats to the environment (climate changes, environment pollution, forest management, depletion of water resources, soil degradation), supply of energy and raw materials.

8. Sources of financing of most important activities

In 2007 budgetary expenses of PLN 391,270 thousand, which are at disposal of the minister responsible for economy were earmarked in Article 34 (1) of the budgetary law for 2007 (Journal of Laws of 2007 No 15, Item 90) for performing tasks resulting from the the Law of 28 November 2003 on hard coal mining restructuring during the period 2003 – 2006 (Journal of Laws No 210, Item 34 as amended) In addition about PLN 50 million were provided for the mining industry in the budgetary law, in special reserves – part 83, item 46 – Long-term programmes of financial support for investments and restructuring of the mining industry.

Total costs of proposed solutions assuming their complete execution were estimated for performance of tasks resulting from the provisions of the bill on operation of the hard coal mining industry in 2008 – 2015 and special entitlements of mining communes (gmina).

Effects of decisions made in past years concerning mining industry employees will total PLN 1,202.0 million. The effects take into account:

- monetary equivalents due to the entitlement to free coal hold by pensioners from completely wound up coal mines, paid by ZUS (Social Insurance) along with costs of these equivalents,
- the entitlement to free coal hold by pensioners from completely wound up coal mines,
- equalization benefits due from closed mines,
- costs in arrears with regard to payment of benefits

The amount of PLN 1,450.0 million was earmarked for costs of restructuring of coal mines. These categories includes:

- tasks concerning closing down of coal mines and measures performed after completion of complete close down of coal mines executed in mining enterprises (concerns SCD S.A and BSRK Sp. z o.o.),
- tasks related to protection of neighbouring mines against water, gas and fire hazard during and after close down of a mine performed in mining enterprises,
- repair of damages caused by operations of a wound up mining plant, including damages resulted from reactivation of old abandoned workings

One should note that tasks concerning protection of neighbouring mines against water, gas and fire hazard during and after wind-up of a mine performed in mining enterprises and repair of damages caused by operations of a wound up mining plant, including damages resulted from reactivation of old abandoned workings will be financed by a budgetary subsidy and by means of the National Environment Protection and Water Management Fund granted in the form of a subsidy.

PLN 37.5 million was earmarked for obligatory tasks resulting from the provisions of the bill, including tasks related to monitoring of restructuring processes in the hard coal mining industry and a feasibility study on clean coal technology.

The national budget contribution to financing up to 30% of initial investments in the mining industry in 2008 – 2010 totaling PLN 240.0 million was also planned. So far this was not governed by restructuring regulations for the hard coal mining sector. However optional construction of the provision of the bill concerned (Article 25 (2)), the state contribution in potential funding of initial investments is related to the economic circumstances of the state in a given budgetary year.

Thus total state inputs during the term of the law will be PLN 2,689.5 million.

It should be added that all costs related to closing down a mine which was commenced after 31 December 2006 will be financed by the mining plant wind-up fund – within the meaning of geological and mining law.

Impact assessment of the Strategy on the national budget and NFOŚiGW in 2008 - 2015

No	Specification	Years								Total
		2008	2009	2010	2011	2012	2013	2014	2015	
1	2	3	4	5	6	7	8	9	10	11
1	Results brought forward 2008-2015^{*)}	152000.00	150000.00	150000.00	150000.00	150000.00	150000.00	150000.00	150000.00	1202000.00
2	Mine restructuring costs	210000.00	200000.00	190000.00	190000.00	190000.00	190000.00	190000.00	190000.00	1450000.00
2.1	Tasks concerning closing down of coal mines and measures performed after completion of complete closure of coal mines executed in mining enterprises (concerns SCD S.A and BSRK Sp. z o.o.)	20000.00	20000.00	20000.00						60000.00
2.2	tasks related to protection of neighbouring mines against water, gas and fire hazard during and after closure of a mine performed in mining enterprises	160000.00	160000.00	160000.00	160000.00	160000.00	160000.00	160000.00	160000.00	1280000.00
2.2.a	including funded by NFOŚiGW	16000.00	16000.00	16000.00	16000.00	16000.00	16000.00	16000.00	16000.00	128000.00
2.3	repair of damages caused by operations of a wound up mining plant, including damages resulted from reactivation of old abandoned workings	30000.00	20000.00	10000.00	10000.00	10000.00	10000.00	10000.00	10000.00	110000.00
2.3.a	including funded by NFOŚiGW	3000.00	3000.00	3000.00	3000.00	3000.00	3000.00	3000.00	3000.00	24000.00
3	Obligatory tasks resulting from the provisions of the bill	6000.00	4500.00	4500.00	4500.00	4500.00	4500.00	4500.00	4500.00	37500.00
Total costs of proposed legal regulations financed by NFO		19000.00	19000.00	19000.00	19000.00	19000.00	19000.00	19000.00	19000.00	152000.00
Total costs of proposed legal regulations financed by a subsidy from the national budget		349000.00	335500.00	325500.00	305500.00	305500.00	305500.00	305500.00	305500.00	2537500.00
Total costs of proposed legal regulations		398000.00	354500.00	344500.00	324500.00	324500.00	324500.00	324500.00	324500.00	2689500.00

*) the amount earmarked for the years 2008-2015 constitutes continuation of earlier legal regulations

Note:

1. The assessment does not take into account potential initial investment costs due to the optional provision in the bill. It is assumed that the cost of subsidy from the national budget for funding of initial investments in 2008-2010 would be PLN 240,000 thousand.
2. Expenses for repair of damages caused by operations of a wound up mining plant, including damages resulted from reactivation of old abandoned workings is subject to change due to emergence of damages or legally valid court judgments.
3. Expenses for protection of neighbouring mines against water, gas and fire hazard during and after close down of a mine performed in mining enterprises are subject to change in individual years due to a change in prices of energy carriers and material and payroll costs.

9. Schedule of performing of most important activities

No	Type of project	2007	2008	2009	2010	2011	2012	2013	2014	2015
1.	Establishment of Grupa Węglowo-Koksowa									
2.	Incorporation of KWK "Budryk" S.A. into JSW S.A.									
3.	Concentration of activities performed by SCD S.A. and BRSK Sp. z o.o. in a single entity									
4.	Separation of Centralny Zakład Odwadniania Kopalń from the SCD S.A. structures									
5.	Preparation and notification of public aid for the year 2008 - 2015									
6.	Adopting a new mining law taking into account solutions set out in this strategy.									
7.	Repayment by Kompania Węglowa S.A. of payables to ZUS									
8.	Completion of capital increase process of KW S.A.									
9.	Performance of post-liquidation measures and repair of mining damages.									
10.	Satisfying employees claims									
11.	Monitoring of restructuring processes in the hard coal mining industry carried out by Agencja Rozwoju Przemysłu S.A. (Industrial Development Agency) - Katowice Branch.									
12.	Feasibility study of a project concerning clean coal technologies									