27 March 2003

Polish Tsy Min Resigned Over PZU Share Buyback Plan

By Malgorzata Halaba and David McQuaid
OF DOW JONES NEWSWIRES

WARSAW (Dow Jones) -- Treasury Minister Slawomir Cytrycki turned in his resignation on March 20 after discovering a government-controlled insurer's covert attempt to hijack Treasury plans to privatize it, according to people familiar with the situation.

The secret project, code-named "Humble Pie" and signed by the insurer's president, could have blocked the Treasury's commitment to sell a controlling stake in leading insurer Powszechny Zaklad Ubezpieczen SA (R.PZU) to two minority investors.

Netherlands-based Eureko B.V (N.EUR) and Poland's Bank Millennium SA (N.EUR) hold a combined 31% stake in PZU, while the Treasury holds 55%.

The Treasury has pledged to privatize big chunks of Poland's business establishment, but it has been at odds with government officials unwilling to give up enormous nationalized assets.

According to documents reviewed by Dow Jones Newswires, Zdzislaw Montkiewicz, PZU's president, hired an international bank to arrange the buyback of minority shares. Treasury ministry officials say they weren't informed, in breach of their rights as majority owners.

The purchases were to be from minority shareholders, which include the Eureko-Millenium consortium and company employees, who hold 14% stake.

After learning of the plan, Cytrycki approached Polish Prime Minister Leszek Miller on March 20 and demanded that Montkiewicz be fired, three government officials told Dow Jones Newswires.

After Miller refused, Cytrycki quietly turned in his resignation. The news was first disclosed on Tuesday by Dow Jones Newswires. Cytrycki has been on sick leave since then and it's unclear who is running Poland's Treasury Ministry.

The PZU privatization affair calls into question the Polish government's already tenuous commitment to privatization. It's also another blow to Miller, whose minority cabinet has been weakened by the departure of its coalition partner, a bribery scandal and plunging popularity.

The revived parliamentary opposition has already filed motions of no-confidence in two key ministers. On Saturday, in an abrupt about-face, President Aleksander Kwasniewski suggested Miller should resign if his unpopularity threatens passage of a nationwide referendum on European Union entry in June.

Triggering Cytrycki's decision to resign was his discovery of documents, signed Dec. 3, 2002, in which PZU's Montkiewicz hired the local branch of HSBC to buy shares back from minority shareholders, according to the three government officials.

The documents, copies which were reviewed by Dow Jones, turned up in an audit of PZU's books performed in late February or early March, and was brought to Cytrycki's attention, the officials said.

Cytrycki told Miller at the March 20 meeting that Montkiewicz should be ousted for exceeding his prerogatives and acting without shareholder approval, according to the officials.

Cytrycki couldn't be reached for comment Thursday.

Montkiewicz, a Miller protege and former communist-era intelligence officer, was installed as PZU's president over the protests of Treasury Minister Wieslaw Kaczmarek in late 2001.

He quickly ran afoul of the Eureko-led investor group, which withdrew in protest from PZU's management board last October.

The Eureko consortium has been pushing the Treasury to honor an April 2001 sales agreement granting them the right to raise their PZU stake to 51% through an initial public offer.

Frustrated by government foot-dragging, Eureko complained to the European Commission and then filed for international arbitration at Stockholm in October.

Treasury Minister Kaczmarek said he would honor the sales agreement, but was suddenly fired by Miller on Jan. 6.

By then, Montkiewicz had hired HSBC to open talks about a possible buy-out. The text of the Dec. 3 agreement refers to "minority shareholders," without specifying which ones.

The confidential agreement entrusted HSBC with conducting talks with shareholders and managing a special-purpose vehicle, or SPV, to execute the transaction. HSBC was also promised the mandate to advise PZU on a future initial public offer of company shares.

In return, HSBC was to collect a monthly fee of $100,000 starting in January 2003, reimbursal of costs, and a success fee of $1.4 million (less monthly fees) on completion of the buy-back, according to the documents.

The agreement also awarded HSBC a success fee set at 1% of the value of shares sold in a planned IPO of up to 50% of PZU's equity. Even at current depressed market levels, that fee would probably exceed several million dollars, since the Eureko-led group paid the equivalent of $750 million for a 30% PZU stake in 1999.

Contacted Thursday, PZU said the documents included a standard contract for financial advisory services and was discussed at a management board meeting "attended by representatives of strategic shareholders." The insurer said Montkiewicz wasn't available.

HSBC declined comment on the contract. But a person close to the bank said it was a preliminary outline of responsibilities for organizing the purchase of employee shares. A final contract, covering a much wider range of services for the same $100,000 monthly fee, was signed in late December, the person said.

The person added that Kaczmarek, then still in charge at the Treasury, was informed of the agreement.

"I was not informed," Kaczmarek told Dow Jones Newswires Thursday.

Another official close to PZU said the generous terms cast doubt on whether the proposed transaction covered just the 14% employee stake.

"Why such an expensive contract for shares employees want to sell anyway? And why would PZU pay an IPO success fee when the money is going to go into State Treasury coffers?" the official said.

Thursday, Eureko and Bank Millennium said they don't want to exit PZU.

"We're not interested in selling our shares. We're interested in executing the agreement we have with the Polish government," Ernst Jansen, executive director of Eureko, told Dow Jones Newswires.

Since taking over the treasury portfolio in January, Cytrycki seemed determined to resolve the two-year dispute with Eureko and to take PZU public this year. He told reporters at his maiden press conference on Jan. 23 that he intended to honor the 2001 sales agreement with the Eureko group.

That may have led to the clash with Miller and Montkiewicz. PZU's president is reportedly pushing an alternative plan to keep the insurer out of Eureko's control by engineering a merger with state-owned bank PKO BP (R.PKO).

In the past, state-controlled PZU has allegedly been used as a source of political patronage - chiefly via corporate sponsorships and services contracts with well-connected local firms.

Former PZU President Wladyslaw Jamrozy and the ex-chief of PZU's life insurance arm, Grzegorz Wieczerzak, were both arrested and have been investigated by public prosecutors for more than a year on charges they siphoned funds out of the company into a number of risky property deals.
-0-

2 April 2003

Polish PM Has Accepted Tsy Min Resignation - Source

By Malgorzata Halaba and David McQuaid
Of DOW JONES NEWSWIRES

WARSAW -(Dow Jones)- Polish Prime Minister Leszek Miller has accepted the resignation of the country's top privatization official, two weeks after a row over a covert plan to buy back shares of Poland's leading insurer, two government sources told Dow Jones Newswires Wednesday.

The two officials said Treasury Minister Slawomir Cytrycki's Mar. 20 letter of resignation was accepted by the prime minister. Cytrycki is to be replaced later Wednesday by Deputy Treasury Minister Piotr Czyzewski.

Cytrycki's departure marks the second cabinet resignation in two days from Poland's tottering minority government, which has been rocked by a major bribery scandal, a coalition breakup, and skyrocketing unemployment.

Tuesday, Health Minister Marek Balicki resigned in protest at the appointment of a dismissed health ministry official as head of the country's new National Health Fund.

An official announcement on the reshuffle at the Treasury Ministry is expected at 1530 GMT, the officials said.

Dow Jones Newswires reported Cytrycki's resignation on March 25, but the report has been consistently denied by government spokesmen.

Wednesday's sudden move at the Treasury could signal the imminent ouster of Zdzislaw Montkiewicz, head of state-controlled insurer Powszechny Zaklad Ubezpieczen SA (R.PZU), the government officials said.

In December, Montkiewicz signed a confidential agreement with investment bank HSBC Holdings PLC (U.HSB) to arrange a buy-out of minority shareholders in PZU. That would include company employees, who hold a 14% stake, along with an investor group of Netherlands registered Eureko BV (N.EUR) and Poland's Bank Millennium (R.BML), which owns 31% of PZU.

Poland's Treasury, PZU's leading shareholder with a 55% stake, was not informed of Montkiewicz's plan until the text of the agreement was discovered in a routine audit last month. A buy-back would likely undercut the Treasury's pledge to sell a controlling stake to Eureko-Bank Millennium, which has taken its case to international arbitration in Stockholm.

Several independent government sources have said an enraged Cytrycki demanded Montkiewicz's dismissal at a Mar. 20 meeting with the prime minister. When Miller refused, Cytrycki submitted his own resignation before leaving on extended sick leave.

Later Wednesday, PZU's supervisory board meets to hear Montkiewicz's explanation of the buy-back agreement.

The Treasury has said it will decide whether to dismiss the PZU president after learning the opinion of the board.

Wednesday, a government source said the new treasury minister-designate shared Cytrycki's opinion that Montkiewicz had overstepped his powers.

"Czyzewski's position on Montkiewicz will be precisely the same as his predecessor's," the official said.

The Polish daily Rzeczpospolita reported Wednesday that Cezary Stypulkowski, president of U.S.-based Citigroup's Polish unit Bank Handlowy (R.BHW), is being considered as a possible replacement for Montkiewicz at the helm of PZU.

The government officials said they expected Czyzewski's appointment to be announced at 1530 GMT, when Czyzewski and new Health Minister Ewa Kralkowska are to be confirmed in office by Polish President Aleksander Kwasniewski.

-By Malgorzata Halaba and David McQuaid; Dow Jones Newswires, +4822 622 2766; david.mcquaid@dowjones.com

(Marek Strzelecki also contributed to this report.)
-0-

28 April 2003

Polish PZU CEO Hangs On To Post, But May Still Get Ax

By Malgorzata Halaba
Of DOW JONES NEWSWIRES

WARSAW (Dow Jones)--Poland's most controversial CEO has won an endorsement from his key shareholders, including the state treasury, but treasury officials said Monday that he won't keep his job for long.

The man in question is Zdzislaw Montkiewicz, president of scandal-plagued Powszechny Zaklad Ubezpieczen SA (R.PZU). He got off the hook Monday when a meeting of PZU's shareholders formally approved management's 2002 activities and agreed to legal advice that the management board's term expires next year, rather than this month.

On Friday, Treasury Minister Piotr Czyzewski said Montkiewicz would likely be replaced this week, so Monday's vote amounts to a reprieve for Montkiewicz.

But a senior official at the treasury - which controls the state's 55% stake in PZU - said Monday that Czyzewski remains determined to replace Montkiewicz with Cezary Stypulkowski, now president of U.S.-based Citigroup's (C) Polish unit, Bank Handlowy SA (R.BHW).

"Nothing has changed. PZU will have a new president, hopefully soon," the official told Dow Jones Newswires.

Since taking over the treasury ministry on April 2, Czyzewski has repeatedly said he wants to cut short a PZU-linked scandal that triggered the resignation of his predecessor.

The scandal erupted in March, when then-Treasury Minister Slawomir Cytrycki discovered Montkiewicz had kept the treasury in the dark about a confidential agreement between PZU and investment bank HSBC Holdings PLC (U.HSBC).

The agreement required HSBC to arrange a buyout of PZU's minority shareholders, including Netherlands-based insurer Eureko BV (N.EUR) and Polish lender Bank Millennium (R.BML), which together hold 30% of PZU.

The covert scheme appeared aimed at circumventing a treasury agreement to sell Eureko an additional 21% of PZU, giving the Eureko-Millennium investor group a controlling stake in the insurer.

After a routine audit uncovered, Cytrycki told Prime Minister Leszek Miller on March 20 that he planned to fire Montkiewicz, reportedly a key Miller protege. When Miller refused to go along, Cytrycki handed in his resignation, government sources told Dow Jones Newswires.

PZU Chief Has Refused To Give Up

Cytrycki's departure became official on April 2. But treasury sources said his replacement, Czyzewski, shares a dim view of Montkiewicz's actions at PZU, which prompted the company's supervisory board to conclude he had not acted in the best interests of PZU.

But while people familiar with the situation say Montkiewicz's fate is sealed, the PZU president has shown no signs of giving up.

Over the past three weeks Montkiewicz has held two press conferences denying allegations that he had done anything but defend PZU against attempts to drain assets from the insurer. On Friday, company trade unions weighed in to support the embattled president.

Monday's shareholders meeting did resolve a legal dispute over whether the current management board's three-year term began on February 2002, when Montkiewicz took office, or in early 2000, when his predecessor Zygmunt Kostkiewicz was appointed.

But even the ruling in Montkiewicz's favor leaves him vulnerable to dismissal at any time, since PZU company statutes give the treasury minister exclusive power to hire and fire the management board and president.

Thus, Czyzewski doesn't need a resolution from the supervisory board or shareholders to give Montkiewicz the heave-ho.

The real issue is whether a ready replacement can be found.

According to treasury officials, Czyzewski considers the 47-year-old Stypulkowski the best candidate because of his long experience in managing large financial institutions. Stypulkowski has run Bank Handlowy, Poland's flagship corporate lender, since 1991.

During that 12-year span, Stypulkowski saw Handlowy through an initial public offering in 1997 and the bank's acquisition by Citigroup in 2000.

It looks now that the latter transaction has become a liability rather than an asset on his resume, at least in the eyes of Prime Minister Miller.

"Miller is balking at Stypulkowski because of accusations he allowed the bank to be swallowed by Citigroup," a senior treasury official said.

The official said Czyzewski has been hard-pressed to ease Miller's suspicions, despite the fact that Stypulkowski is one of the most respected figures in Polish financial circles and perhaps uniquely qualified to calm the fracas at PZU and make peace with Eureko - which is now in international arbitration to get its claim for a controlling stake enforced.

Now that the lawyers have persuaded company shareholders that Montkiewicz's term didn't end on Monday, Czyzewski has gained a little time to push Stypulkowski's candidacy.

That means Montkiewicz has won only a brief stay of execution, no matter how vigorous his effort to fight the inevitable.

-By Malgorzata Halaba; Dow Jones Newswires, +4822 622 2767; malgorzata.halaba@dowjones.com

(David McQuaid in Warsaw also contributed to this report.)
-0-

30 October 2003

Aide Alleges PKN Orlen CEO Behind Placing Of False Story

By Marek Strzelecki and Malgorzata Halaba
Of DOW JONES NEWSWIRES

WARSAW (Dow Jones)--The president of Poland's largest oil company, PKN Orlen (PKN.WA), was involved in a scheme to depress the company's share price, according to a memo written by one of his top aides, now under investigation in the case.

Krzysztof Rogala, an advisor to PKN Orlen President Zbigniew Wrobel, admitted in an e-mail that he was the source for a Polish press report that knocked the company's share price lower, according to people who have seen the note.

Rogala also alleged Wrobel instructed him to arrange the leak that led to the story, the people said. In the same e-mail, Rogala said he lied to prosecutors about Wrobel's involvement in the leak.

One PKN Orlen executive said Rogala's admission that he lied to investigators raises the question whether his allegation about Wrobel is true.

The allegations at PKN Orlen are the latest to hit companies in which the state has a large stake. The government has already been weakened by a year-long series of corruption scandals, including corruption and influence-peddling at the state-owned companies. The problems have fed a sell-off in Poland's currency and debt markets.

The revelation by Rogala concerns a May 15 Polish Press Agency story that said the Treasury Ministry had rejected PKN Orlen's bid - with a U.K. partner - to buy Polish oil company Rafineria Gdanska. The story that PKN Orlen wouldn't get the deal caused its share price to tumble 3% before the Treasury denied it had made a decision.

Poland's Securities and Exchange Commission launched an investigation of the event and, determining there were grounds for a criminal investigation, handed over to Warsaw prosecutors in July.

PKN Orlen's shares are among the most liquid in Poland and are a favorite of foreign investors. Many analysts have ranked its stock among the most likely to show price gains.

Rogala has been an adviser to Wrobel since he was removed as spokesman in June. He is currently on vacation abroad and couldn't be reached for comment. A company spokesman said Wrobel was not available.

Rogala's memo admitting his and alleging Wrobel's role in the planted story was sent via e-mail to a PKN Orlen management board member, who forwarded it to prosecutors and to a company panel examining the incident.

The memo also circulated widely within the top levels of PKN Orlen and reached government officials and others outside the company. Four senior government officials and executives who have read the document independently confirmed its contents to Dow Jones Newswires.

The aim of the May 15 leak is unclear. But two people familiar with PKN Orlen said it was meant to revive a stalled bid for Gdanska by warning the Treasury that its 28% stake in PKN Orlen would fall in value if the bid were rejected. The same people speculated it may also have been intended to help friendly investors accumulate PKN Orlen shares.

Under Polish securities law, causing an artificial move in a share price is punishable by up to three years imprisonment and a maximum fine of 5 million zloty ($1PLN4.060).

Rogala's memo, apparently written in mid October, says the effort to plant a story in the Polish press was approved by Wrobel, said all four people.

"Rogala said his testimony(to prosecutors) had kept silent about the fact he had acted on the president's instructions," said one executive.

"I did this to protect the company and Zbyszek (Wrobel)," was how three people quoted a key passage in Rogala's e-mail.

The memo's text suggests Rogala was worried his contract with PKN Orlen would be ended Dec. 31, people said. Noting that his contract was winding down, Rogala said in the memo that "everybody's expecting him to call a press conference and attack Wrobel," according to an executive who saw the e-mail.

"These aren't threats, but I have enough material to (expletive) into the stratosphere." The quote was specifically recalled by one person and corroborated by the other three.

The e-mail now raises questions about Rogala having more than one version of the May 15 event and story.

"He admits lying to the prosecutors," said a senior PKN Orlen executive said. "The question is, if Rogala lied then, how can we be sure he's telling the truth now? He'd better have pretty solid evidence."

A spokesman for the Warsaw prosecutor's office said he couldn't comment on an investigation. "I can only say new witnesses are being questioned," said Maciej Kujawski, adding that prosecutors have already taken testimony from Wrobel and Rogala.

"If investigators confirm these allegations, it could be the first instance of securities fraud in Poland to produce an actual arrest. But I'm hoping it's not true," said Wieslaw Walendziak, chairman of the parliamentary committee that oversees privatization and capital markets.

CEO Says Ouster Would Scare Investors

The deepening scandal at PKN Orlen comes at a difficult time for its embattled CEO and Poland's Treasury, the company's biggest shareholder.

Treasury Minister Piotr Czyzewski is headed for Budapest Friday to discuss a proposed merger between PKN Orlen and Hungarian oil company MOL (MOL.BU).

The idea is to create a regional downstream group with the heft to fend off acquisitive Russian companies while giving Poland's revenue-starved budget a chance to cash out its PKN Orlen stake.

The Hungarian government and MOL have warmed to a tie-up before Poland's and Hungary's May 1, 2004 entry to the European Union, but have reservations about waste and mismanagement at PKN Orlen.

"From Czyzewski's point of view, this is definitely going to weaken his negotiating position in Budapest," said Malgorzata Ostrowska, a ruling party deputy who stepped down as deputy treasury minister in January.

Meanwhile, Wrobel's position atop PKN Orlen has become increasingly shaky. He crossed swords with the Treasury Ministry over the bid to acquire Gdanska, now called Grupa Lotos (R.GLT), before eventually losing the deal in July.

He has also attracted media scrutiny for high rebranding costs and questionable real-estate transactions in Orlen's retail network.

The disclosure of Rogala's memo could hurt Wrobel as he faces a Nov. 5 supervisory board meeting to discuss possible changes in company management.

Treasury officials and oil industry executives don't expect Wrobel to be ousted immediately, at least in part because there is no obvious candidate to replace him.

"Allegations like this would usually result in a CEO being suspended until the matter's cleared up, but not necessarily in this case," said an energy industry source who has read the memo.

Several supervisory board members contacted by Dow Jones Newswires Thursday declined comment on a possible management change.

Wrobel, meanwhile, has been working to keep his job. In a report Wrobel submitted to PKN Orlen's supervisory board on Oct. 2 and seen by Dow Jones Newswires, he warned that ousting top management would put the company's shares into a tailspin.

In a comment apparently aimed at Treasury representatives on the board, Wrobel said any shakeup would worsen Poland's fiscal problems and send investors bolting for the door.

"Meddling with PKN Orlen's management team could give investors the signal to flee Polish capital markets," the report concluded. "In that case, a fall in PKN Orlen's share price could easily spill over to other listed companies, damage pension and mutual fund assets, and once more prompt foreign investors to steer clear of Poland."

-By Marek Strzelecki and Malgorzata Halaba; Dow Jones Newswires, +4822 622 2767; marek.strzelecki@dowjones.com

(David McQuaid in Warsaw also contributed to this report.)
-0-

4 November 2003

FOCUS: PKN Orlen's Wrobel Faces New Allegation

By Marek Strzelecki
Of DOW JONES NEWSWIRES

WARSAW (Dow Jones)--PKN Orlen (PKN.WA) Chief Executive Zbigniew Wrobel tried to hamper a special audit of company spending by Ernst & Young, people close to the company and the Treasury Ministry told Dow Jones Newswires.

The allegation about Wrobel comes the day before the company's supervisory board meets to discuss reports of management misconduct at PKN Orlen, the country's largest oil refiner.

Coming after previous allegations of misbehavior by Wrobel, including one that he was involved in a plan to move the share price in May, the latest could bring tough questioning at the board meeting.

One member of the supervisory board told Dow Jones Tuesday that the board would address "signals we've received" that PKN Orlen's management tried to hamper an audit by Ernst & Young.

Wednesday's agenda doesn't include a discussion of changes to management, PKN Orlen spokesman Krzysztof Mikolajczyk said Tuesday. Wrobel wasn't available for comment.

Wrobel isn't expected to lose his job Wednesday, at least in part because replacing him would require high-profile political consultations that could take days or even weeks.

But the State Treasury, which owns 28% of PKN Orlen and is its largest shareholder, is losing patience with the atmosphere and may soon demand Wrobel's suspension as well as those of some top executives, said two people familiar with the company.

The latest allegation is that Wrobel tried to influence an audit undertaken by Ernst & Young at the instruction of the supervisory board on Oct. 21. The board told the auditor to look at real-estate acquisitions for Orlen's retail network, spending for marketing and legal services, and supply contracts for non-fuel products and services.

The decision to hire an auditor followed media reports that PKN Orlen overpaid to rebrand half its 2,000 Polish gas stations and made questionable real-estate transactions to expand the retail network. Some stories reported Wrobel had personal links to shareholders of companies winning the contracts.

Two people said Wrobel tried to forestall the board's Oct. 21 decision by arguing the auditor should be chosen by a tender process.

Several people said PKN Orlen managers then sought to hamper Ernst & Young after it had been chosen.

Public relations companies working for PKN Orlen sent information packs to journalists and others questioning Ernst & Young's integrity as an auditor, people who have seen the packets told Dow Jones.

The packs suggested a conflict of interest between Ernst & Young's auditing work and advisory work Anderson Business Consulting did for PKN Orlen, said several people who saw them.

Ernst & Young bought Arthur Anderson's Polish auditing business after the international auditing and consulting giant collapsed in the wake of the Enron Corp. (ENE) accounting scandal in the U.S.

Anderson's Polish consultancy was spun off independently and operates as Anderson Business Consulting.

Ernst & Young said Tuesday any allegations about a conflict of interest were groundless. "None of our partners has shares in Andersen Business Consulting," it said.

Wrobel also faces the allegation that he was involved in a scheme in May to leak a false report to the press that knocked the company's share price lower. People familiar with the incident told Dow Jones last week that Wrobel's aide, Krzysztof Rogala, made the allegation in an e-mail to a board member.

Poland's Securities and Exchange Commission launched an investigation of the event and, determining there were grounds for a criminal investigation, handed over to Warsaw prosecutors in July.

-By Marek Strzelecki; Dow Jones Newswires, +4822 622 2767; marek.strzelecki@dowjones.com

(Malgorzata Halaba in Warsaw contributed to this story.)
-0-

27 November 2003

PKN Orlen Executive Admits Problem With Fuel Quality

By Marek Strzelecki and David McQuaid
Of DOW JONES NEWSWIRES

WARSAW (Dow Jones)--Poland's dominant refiner PKN Orlen (PKN.WA) acknowledged Thursday that it has substandard fuels in its retail network after Dow Jones Newswires asked a top executive about internal documents describing the problem.

Although the executive, Deputy President Slawomir Golonka, said the problem was contained and measures were taken to fix the problem, other PKN Orlen executives complained that senior management has been slow to correct a problem that some allege could extend to most of the company's 2000 service stations.

The admission of quality problems comes as PKN Orlen (PKN.WA) is spending heavily to persuade customers it's monitoring fuel quality at every stage of its supply chain, "Like the eagle," as it says on its logo.

According to documents reviewed by Dow Jones Newswires, an internal investigation of 22 Orlen service stations in southern Poland revealed company employees had bypassed monitoring systems to sell gasoline of unknown origin and pocket the proceeds.

And an October quality check at 13 regional offices of PKN Orlen's liquefied petroleum gas unit, Orlen Gaz, found LPG sold in 12 branches didn't meet minimum Polish norms, most likely due to blending with inferior imported stock.

Orlen blames the problem on a communist-era legacy of pilfering in the state-owned retail system it absorbed in a 1999 merger. They said the situation has been contained and they are studying countermeasures.

"We don't believe the scale is dramatic or that management is tolerating the problem," Golonka told Dow Jones Newswires. "I think we're dealing with a limited phenomenon, which we'll be able to diagnose when we receive internal reports in a few days."

Golonka said the company had to keep a sense of proportion, since estimates that it might be losing 100 million zlotys ($1=PLN3.9173) via bootleg sales pale against annual sales revenue of PLN16.8 billion last year.

"We're not hiding that many areas need deep restructuring," he said.

Golonka said PKN Orlen had notified local prosecutors of the fuel scam on Oct. 3.

An Oct. 9 letter written by PKN Orlen President Zbigniew Wrobel, reviewed by Dow Jones, refers to "an organized criminal operation involving illegal intrusion in PKN Orlen's fuel sales system." Wrobel's letter said employees at three local subsidiaries - responsible for fuel pumps, transport, and equipment maintenance - were involved.

Despite Wrobel's letter, none of Orlen's top decision-making bodies - including the crisis management committee, the board of directors, and the supervisory board - have discussed the matter, two senior executives told Dow Jones Newswires.

They said senior management has been too distracted by other internal scandals - including a prosecutor's investigation of a false leak in May that sent company shares tumbling, and allegations of cronyism and kickbacks in rebranding 900 Polish and German service stations - to deal with the issue.

"It hasn't come up at the board level," said a high-ranking executive at PKN Orlen. "We've got so many scandals in (the sales) division that the story was simply hidden."

Fuel quality is a vital issue for PKN Orlen, whose nearly 2,000 stations account for almost 60% of the automotive fuels sold in Poland and an estimated 20% to 25% of the LPG market.

Any blow to consumer confidence in Orlen's brand quality could depress sales and retail margins, now climbing after a painful three years of economic slowdown. The Polish government controls 28% of the company.

It might also set back a costly, two-year effort to replace the dowdy image of the state-owned CPN network - whose faded orange logo brings back memories of the long queues and surly service of the communist era - with the spiffy, red-and-white Orlen brand.

Half a dozen experts inside and outside PKN Orlen, ranging from top company executives to IT contractors and fuel-market specialists, say gaps in Orlen's system to track retail sales is a key part of the problem.

The system, which is in 1,600 stations, is outdated and could allow individual stations to input key data without supervision or means to verify accuracy.

Golonka acknowledged that employees could sell bootleg gasoline thanks to customized software - known at PKN Orlen as McSPAL - that allows them to reset fuel pump monitors.

In essence, employees could take delivery of black-market fuel, evading the excise tax. The software allows them to reduce, say, a 20-liter purchase, to a one-liter one, and pocket the revenue from the 19-liter difference.

"There's still no fix for it," said a PKN Orlen executive. "The hope is we caught it really early and the problem didn't spread."

Orlen's IT director Jerzy Bielec said the McSPAL system isn't the problem. "If you're an insider with the passwords, you can do anything," he told Dow Jones Newswires.

Documents seen by Dow Jones show that Orlen's retail managers have been warning about McSPAL's vulnerability since June 2000. "Orlen's basic software system hasn't changed for three years and has not yet met the requirements set for 2000," said one manager.

After entering talks with a systems integrator for a system that would permit close monitoring of the stations, PKN Orlen let the negotiations lapse last summer after its technology department said it was unnecessary and too expensive.

Such remote systems are in place at some of Orlen's foreign rivals, such as Norway's Statoil ASA (STL.OS), which also employs outside auditors to monitor sales and fuel quality at its 200 Polish service stations.

Statoil said some affiliated stations acquired in 2002 still use McSPAL, but will convert to the company's NCR monitoring platform after attaining franchise status.

Leaky Gateway For LPG

PKN Orlen isn't alone with its LPG quality problem.

State inspectors found in a summer survey that 30% of 214 stations sampled had deficient fuel quality. It was especially common at independent, rural stations. Of the 392 stations where measuring equipment was checked, 60% had faulty or uncertified fuel gauges, the survey found.

Industry sources estimate that up to 30% of LPG sold in Poland is blended with a bootleg product available at half the wholesale price because it evades excise taxes.

Black market supply comes mostly via imports from the former Soviet Union. To solve the quality problem, the country would have to choke off the illegal imports or bring rigorous quality control to the retail chain, say industry experts.

A PKN Orlen executive said the company's Orlen Gaz unit, which relies on outside supplies because the company's own production is too small, lacks quality controls.

"Orlen Gaz is the leakage point. We can stop it by preparing internal control procedures, but the cooperation from senior management is not so special," the executive said.

Even some Orlen stations don't use Orlen Gaz supplies because of quality concerns, said an owner of Orlen gas station.

"We've found some quality problems in our LPG blending plants," Golonka said.

-By Marek Strzelecki and David McQuaid, Dow Jones Newswires; +48 22 622 2766; marek.strzelecki@dowjones.com

(Malgorzata Halaba contributed to this report.)
-0-

10 December 2003

PKN Orlen CEO Scrutinized On German, Polish Rebranding

By Marek Strzelecki and Mathilde Richter
OF DOW JONES NEWSWIRES

WARSAW (Dow Jones)--PKN Orlen (PKN.WA) awarded lucrative contracts to rebrand 650 service stations in Poland and Germany to at least one former business associate of Chief Executive Zbigniew Wrobel, according to documents seen by Dow Jones Newswires and people familiar with the situation.

Poland's largest oil company, already under fire for Wrobel's management, awarded contracts to rebrand domestic stations to a firm controlled by Andrzej Sasal, Wrobel's former business associate.

An unsigned and undated company memo also shows an effort to position Sasal and Ryszard Piegrzyk, another former Wrobel business partner, in key jobs at an Orlen construction unit, and then to give the German rebranding contract to that company.

In the event, the rebranding of 150 German service stations went to Connnecting Visions GmbH, a firm that has little track record and the same street address in Hamburg as a company owned by Piegrzyk. Other firms were discouraged from bidding, people familiar with the contracts said.

Wrobel's role in the deals is the subject of special audits by two accounting firms hired by PKN Orlen's supervisory board. The board is scheduled to discuss management's role in them Thursday.

The agenda for the Thursday meeting includes a reshuffle of top management, but people at the company and the Treasury say Wrobel will probably keep his job at least until January.

There is no evidence Wrobel personally benefitted from the deals, and it's not known whether laws were broken. But there is evidence the chief executive influenced internal guidelines to steer some business toward Sasal.

The contracts also raise questions about whether PKN, a company in which the state owns 28%, got the best price for the rebranding project.

PKN Orlen said Wrobel was not available for comment. Piegrzyk could not be reached, and Sasal told Dow Jones Newswires Tuesday that no firms linked with him were involved in German rebranding.

In an interview in September with the newspaper Rzeczpospolita, Wrobel was quoted as saying, "I can't and won't give tender commissions in my company a full list of my acquaintances and request they not be allowed to place bids, because that would be illogical and not in keeping with the law."

Dow Jones Newswires' investigation of the Polish rebranding contracts reached the same conclusion as that of the Polish edition of Newsweek in an early August report. But Dow Jones' examination also found a similar pattern in contracts in Germany.

The 150 stations involved in the German rebranding are about a third of the 494 German stations PKN Orlen bought from BP PLC (BP.LN) in December 2002.

Dow Jones canvassed potential suppliers for rebranding in both countries. Some said they weren't invited to bid and others said they didn't know of tenders, which weren't advertised.

Both rebrandings are largely complete, but have caught the eye of auditors Ernst & Young LLP (EYG.XX) and Deloitte & Touche (DET.XX), according to people who saw the auditors' reports to Orlen's supervisory board last week.

"The whole management board should be fired immediately," a senior PKN Orlen executive told Dow Jones Newswires. "You don't need any more evidence than what was in (Ernst & Young's) preliminary report."

Sasal's company, Recon Service Center, took the lion's share of 100 million zlotys ($1PLN3.80) earmarked for rebranding 500 Orlen stations in Poland, according to a local newspaper Wednesday, citing the auditors' report.

Orlen and RSC signed the contract in July 2002, two months after Wrobel sold his 10% stake in another Sasal venture, credit card distributor Recon Direct Sales.

Documents seen by Dow Jones show RSC charged a 20% fee on the value of every billable invoice for the work on the stations. The work was performed by a complex network of subcontractors, some of which were linked to Sasal.

One subcontractor wrote Sasal an angry letter, seen by Dow Jones Newswires, reminding Sasal that he had once described the fee as "a luxury tax."

Connecting In Hamburg

In Germany, the rebranding of 150 Orlen stations was awarded to Connecting Visions GmbH, a firm described by Orlen Deutschland CEO Jean-Jacques Verschueren as "an established player on the German market."

Connecting Visions is described in its registration papers as a consulting and public relations business. The company has no website and isn't listed in German business directories.

But its Hamburg address is Schottweg 5, the address of Contracthotel GmbH, a company that was once a subsidiary of New Hotel. Wrobel and Piegrzyk were joint owners of New Hotel until Wrobel sold his 19.6% stake to his wife, Aleksandra, less than three weeks after taking the top PKN Orlen job in February 2002.

Aleksandra later sold her stake to Piegrzyk, making him sole owner.

Orlen Deutschland's CEO Verscheuren said Connecting Visions beat 10 rivals for the deal thanks to a previous contract to inventory Orlen's German stations. It won that contract on a recommendation from PKN Orlen's corporate headquarters, he said.

"They had an advantage," Verscheuren told Dow Jones Newswires. "If anyone else had done the installation, there could have been problems." He declined to identify the other bidders.

One prominent German supplier eyeing business with Orlen Deutschland told Dow Jones it had inquired about the project, had been promised information, but failed to receive it.

Polish Doings Under Scrutiny

Orlen's practice of not publicizing tenders is coming under criticism from auditors. People familiar with the Ernst & Young audit said such procedures inflate prices, abet cronyism, and favor suppliers with access to inside information.

PKN Orlen managers have been reluctant to adapt to the emerging norms of good corporate governance in Poland. The company declined in June to sign a voluntary code requiring top managers to tell supervisory boards of potential conflicts of interest.

The Warsaw Stock Exchange drafted the code and most of its members signed it. PKN Orlen's refusal was notable in part because it's one of Poland's most liquid blue chip stocks, whose global depository receipts are listed on the London Stock Exchange.

The company said its internal rules are adequate and that it has questions about some of the exchange's guidelines.

But in awarding business to Sasal, Wrobel at least contradicted the choice of a tender committee. The company's public relations director, Katarzyna Majchrzak, told Wrobel in a letter March 24, 2003 that the committee favored a rival firm.

In a March 31 annotation seen by Dow Jones, Wrobel said "perhaps both companies should be included to ensure competition."

People familiar with the situation said the auditors found an unsigned PKN Orlen document proposing to install Piegrzyk as chief executive of construction unit Orlen Budonaft, and to make Sasal a project adviser. Budonaft would then get a role in the German gas station rebrandings, the document says.

The author of the document is unknown. The plan was never enacted and Budonaft wasn't invited to do any work in Germany.

Piegrzyk, like Sasal, has long ties with Wrobel. Both belong to a 68-member club for whisky and cigar fanciers, the Connoisseur's Association, founded by Wrobel. The members' list reads like a who's who of top government aides and Orlen business partners.

-By Marek Strzelecki and Mathilde Richter, Dow Jones Newswires; +48 22 622 2766; marek.strzelecki@dowjones.com

(David McQuaid in Warsaw also contributed to this report.)
-0-