

**M&A NEWS****Eni will spend at least €10 billion for new acquisitions in Russia**

Eni S.p.A. is ready to spend as much as €10 billion for two strategic acquisitions in Russia in partnership with Gazprom, Paulo Scaroni, the CEO of Eni, said at an investors' meeting in London. The Russian gas producer refused to provide any comments.

In November Eni and Gazprom extended the term of gas supply contracts to Italy. Moreover, from 2007 Gazprom will be able to deliver up to 3 billion cm of gas p.a. directly to Italian consumers. "Eni is ready to cooperate with Gazprom in gas distributing markets but in return we expect joint projects in Russia", Paulo said.

Earlier Italian weekly L'Espresso wrote that Eni can obtain the 19.4% Gazprom's interest in Novatek, an independent Russian gas producer, and receive support from Gazprom in the auction for the former YUKOS asset OAO Arcticgas. In return, the Russian company is said to be interested in a 40% stake in Enipower, an Italian power producing company, the Elephant field in Libya and an LNG plant in Egypt.

Novatek is an attractive takeover target. Analysts believe that from 2007 Russia will have a gas deficit on the local market. Gazprom's production capacities can not meet the increasing demand for gas, and independent producers would increase production only if local gas prices are high. The establishment of a gas exchange in Russia which had its first trading session in November 2006 is the first step towards the creation of a free gas market in the country. Independent

**M&A in the Russian oil and gas industry**

The following article is an excerpt from the M&A Guide for the Russian oil and gas industry published by ACP and the law firm Nörr Stiefenhofer Lutz in September 2006.

**Investment structures****1. Swap of shares**

In such cases the parties will not enter into a swap agreement (as is usual for financial derivatives) but rather into two separate sale and purchase transactions (with related sale and purchase agreements) or a barter agreement, combined with a set-off of the respective obligations to pay a purchase price. Since the assets subject to such a "swap" will rarely have an exactly equal value, one party will have an additional obligation to pay some part of the purchase price in cash or shares.

A swap of assets is possible. However, under the current licensing regime due to the fact that licences may not be transferred under Russian law this is of little attraction. This may change under the new regulated contracts regime once the Draft Subsoil Law comes into force.

**2. Greenfield projects**

Greenfield projects (i.e. projects with no major prior exploration work) are typically pursued by setting up a separate company (i.e. a limited liability company [LLC] or a joint stock company [JSC]). This company will enter into a regulated contract with the State under the Draft Subsoil Law (or hold a licence under the current Subsoil Law).

**3. Joint venture**

Joint ventures are vehicles of several companies for pursuing jointly an economic goal which may either be an existing or a new project. A joint venture between several companies may either be established in the form (1) of a simple partnership under Russian law (i.e. a non-corporate entity), alternatively called "joint activity agreement" (JAA) (which does not create a legal entity but has the nature of a contractual pooling of assets), (2) of a company under Russian law (i.e. a limited liability company [LLC] or a joint stock company [JSC]) or (3) a consortium-form investment

producers will definitely benefit from the gas exchange. According to a Troika Dialog forecast, Novatek will be able to sell via exchange ca. 1.48 billion cm of gas in 2007 and increase this number to 7.8 billion cm by 2012.

04 December 2006

#### RussNeft to sell 34% in Geoilbent

Russian oil company Lukoil shall close the acquisition of the remaining 34% shares in Geoilbent by February 2007, Ravil Maganov, Vice President of Lukoil said.

Geoilbent is developing the Severo-Gubkinskoe, Prisklonovoe and Yuzhno-Tarasovskoe oil and gas condensate fields and has exploration licenses for the Urabor-Yakhinsk and Vansko-Namyssk areas in the Yamal-Nenets Autonomous District, Russia. The proven reserves of the company stand at 70 million tons of crude oil.

In April 2005, RussNeft purchased 34% of Geoilbent from YUKOS. In June, Lukoil acquired 66% of the shares in the company from Novatek, a gas producing company for \$180 million. RussNeft tried to challenge the deal, referring to violation of rights of first refusal. Nevertheless, both companies managed to reach an agreement according to which RussNeft remains a minority shareholder and later will swap its interest in the company to an equal stake in a Lukoil producing asset.

We believe that this acquisition is in line with Lukoil's consolidation policy and recently declared production plans. On the other hand, the asset is an attractive target for a small or medium-size foreign upstream company willing to enter the Russian upstream market.

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under a joint operating agreement (JOA) governed e.g. by English law (Sakhalin 1 is the only example to date in Russia). Under a partnership structure, a joint activity structure and joint operating structure the subsoil use rights are held by one partner, the other partners do not have subsoil use rights; under a company structure the subsoil use right is held by the company.

#### 4. Acquisition of a contractual right to incremental production

In principle an investor could purchase a **proprietary** (*in rem*) share in the production of a company (without becoming a shareholder of the company). This is a usual investment structure e.g. in Kazakhstan or the United States. However, under Russian law this structure is possible only in the context of **production sharing agreements** where the shareholders of the project company hold interests in their respective share of the total hydrocarbons production.

Under **licences** or **regulated contracts** a proprietary share in the production can, however, not be agreed between the parties. In principle, a co-shareholder of an oil and gas company holding a licence or being a party to a regulated contract will have a right to receive dividends in cash. As far as possible payments of in-kind dividends from an oil and gas company are concerned, this is only theoretically possible in a joint stock company (the Law on Limited Liability Companies neither explicitly allows nor explicitly prohibits payment of in-kind dividends). But even in a joint stock company there is a potential significant tax issue as follows. The Law on Joint Stock Companies allows dividends to be paid from net profit, meaning after-tax profit (article 42 Law on Joint Stock Companies). If hydrocarbons are distributed to shareholders, the tax authorities may claim that this is a scheme to reduce the tax base for profit taxes. There are various technical problems arising from the need for the directors of the company to determine the market value of the assets being distributed, which is constantly changing. Thus, in practice payments of dividends in-kind – in particular in the form of crude oil or other hydrocarbons – does not appear to be a viable option.

However, an investor may purchase a **contractual** right to incremental production (which will provide him a right to claim a transfer of ownership in the production). Such a

### West Siberian Resources acquires Nortoil

West Siberian Resources Ltd acquired ZAO Nortoil, a Russian oil company operating in the Timan Pechora region. Through the acquisition, West Siberian Resources added proven and probable oil reserves of 138.9 million barrels.

West Siberian Resources Ltd acquired all outstanding shares of ZAO Nortoil for US\$ 115 million in cash. Part of the purchase price will be used to pay off Nortoil's debt. Through the acquisition, West Siberian Resources' presence in the Timan Pechora province is significantly increased. Oil production is expected to increase to approximately 25,000 barrels per day within three years from the start of production. By that time, the company expects to be producing oil from four fields in the Timan Pechora region whilst also pursuing several exploration leads.

"We continue to consolidate in our operating regions and this is another step towards becoming a sizable independent Russian oil producer. In the past year our oil production has more than tripled. We are now adding meaningful oil reserves and strategic development opportunities at attractive cost", Maxim Barski, West Siberian Resources' Managing Director said in a comment.

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### FINANCIAL ADVISORY NEWS

#### Lukoil will place RUR 14 billion in bonds

Russian oil company Lukoil will place on 14 December 2 bonds in the total amount of RUR 14 billion with a maturity period of 5 and 7 years. ABN AMRO Bank will act as an

right can be based e.g. on a service or operating agreement between an investor and an oil and gas company.

### 5. Acquisition of a contractual right to future sales proceeds or future profits

An investor may also decide to purchase future sales proceeds or a company's future profits against an upfront payment. Such rights can be based on a service or operating agreement. In addition, the right to receive profits may be based on a profit sharing agreement (if the company the profit of which shall be distributed is a Russian limited liability company or a foreign company since the profit in Russian joint stock companies is distributed in accordance with the shares held by the shareholders) or on a purchase of profit notes (provided foreign law applies to the latter since Russian securities law is not familiar with profit notes).

### 6. Corporate restructuring after acquisition

An acquirer may decide for many reasons to reorganise the corporate structure of a company after its acquisition.

- **Mergers and takeovers:** the reorganisation of an acquired company through merger (sometimes also referred to as takeover) where the company merged into another company ceases to exist as a legal entity and all of its rights and obligations are transferred to the successor (surviving) entity. The merger may be an "upstream" or a "downstream" merger, depending onto which entity the companies are merged.
- **Reorganisation of the acquired company by division or spin-off:** the reorganisation of the acquired company where the acquired company spins-off a new company to which the subsoil use licence or other subsoil use rights are transferred (which is possible under the current licensing regime), provided that the new company continues operation of the licence in accordance with the terms and conditions of the licence (which is the requirement under the current licensing regime).

### 4. Hostile takeovers

Investors may want to try to take over an oil and gas company without co-ordination with the target company's management board. This is referred to as a "hostile takeover". Companies will often try to protect against such a hostile takeover in a way which enables them to keep

underwriter of the issues. The exclusive arrangers and lead managers are ABN AMRO Bank, Dresdner Bank and Renaissance Capital Group.

The offering price is set at 100% of the bonds' nominal value. The bonds have 14 coupon periods. The coupon yield for the first coupon period will be determined based on the tender results among potential buyers. Early redemption rights are not envisaged. The bonds will be placed through an open subscription on the Moscow Interbank Currency Exchange (MICEX). The Ruble-denominated bond offering is implemented in accordance with the previously approved Lukoil debt program for 2006. In addition to that, these issues will allow reducing the company's bank loans.

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control of the business either in advance (preventive measures) or once the attempt of such a takeover is made (emergency measures). The field of protection against hostile takeovers is complex and we can give here only a few initial indications as to which measures can be taken.

**Preventive measures** of a company which could be subject of a hostile takeover include:

- Formation of a shareholding structure which prevents hostile takeovers (e.g. by introducing non-voting shares);
- Implementation of facilities to prevent uncontrolled purchase of shares in the target company (e.g. through option rights, pre-emptive rights, contractual penalties, tag along and drag along regulations, shooting-out procedures, Russian roulette);
- Design of a system to motivate the management for creating shareholder value and thus influencing shareholders not to sell shares in the target company;
- Implementation of methods considerably decreasing the attractiveness of the company subject to takeover (e.g. by limiting dividend payments).

**Emergency measures** of a company threatened by a hostile takeover include:

- Asset stripping;
- Litigation against the aggressor (e.g. on the grounds of competition law);
- Corporate restructuring;
- Blocking of the aggressor's equity stake;
- Arrangement of a white knight (i.e. friendly supporter of the target company) who buys shares in the target company;
- Issuance of additional shares (i.e. dilution).

***In the next issue of the *ACP Monitor* more on: restrictions on foreign investments and legal due diligence***

Based on its market knowledge and transactional experience, ACP has developed an M&A Guide for the Russian oil & gas industry in co-operation with the law firm Nörr Stiefenhofer Lutz. RPI, and Statoil ASA and LeBoeuf Lamb were involved in preparing the Guide. The Guide describes in detail legal and tax issues of mergers, divestitures and acquisitions in the Russian oil & gas industry, and shall be of assistance to companies and individual investors interested in acquiring or divesting Russian oil or gas assets with a focus on the upstream sector. The Guide is provided to our clients free of charge upon request.

**Upcoming conferences to which ACP is invited as a speaker:**

- **Russian Congress: Finance and Energy**  
Savor Group  
London, 18-19 December 2006
- **1st International Russian Alternative Investment Forum: Examining the rise of private equity, hedge funds & other alternative investment tools**  
Adam Smith Conferences  
London, 21-23 February 2007
- **3rd International Conference: Trade & project finance in Russia**  
Adam Smith Conferences  
Moscow, 19-22 March 2007
- **6th International Pipeline Forum: Pipeline Transport 2007**  
RPI, Transneft  
Moscow, 17-18 April 2007

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