

JANUARY 2007

M&A NEWS**MOL Group significantly increased its crude oil reserves by securing a 100% stake in BaiTex LLC**

MOL Group placed a winning bid for the purchase of a 100% stake in BaiTex LLC (Russia) from Texas-based VF-NEFT Development LLC and RusOil LLC.. The transaction has already been approved by the Federal Antimonopoly Service.

According to the reserve audit provided by DeGolyer and MacNaughton (as of 31 December 2005) BaiTex had 66.7 million barrels of proven and probable reserves of crude oil, i.e. more than 20% of the present reserves of MOL Group.

Zoltán Áldott, Executive Vice President for Exploration and Production of MOL Group, said: "The purchase of this company is an excellent fit with MOL Group's upstream strategy in the Russian Federation. Relying on our past experience in handling Russian fields MOL Group's main goal with BaiTex is to maximize its recoverable reserves in order to achieve a balanced, long-term production profile for the field."

BaiTex LLC owns the subsoil license for the Baituganskoye oil producing field in the Volga-Ural region, one of Russia's main oil producing provinces. The general infrastructure in the area is good and the field has direct pipeline connection to the Transneft pipeline system.

The present level of production is 1,800 bbl/day of crude with 26° API and low sulphur content. In order to maximize BaiTex' recoverable reserves and achieve a balanced, long-term production profile, MOL Group will spend more than USD 200

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.

Restrictions on foreign investments**1 Current Subsoil Law**

In principle, there are no restrictions under the current Subsoil Law for a purchase by foreign investors or Russian companies controlled by foreign investors of shares in Russian companies holding subsoil use licences (except previously for Gazprom shares, for whom, however, the restrictions for foreign ownership were abolished in December 2005). Unless a special federal law establishing such restrictions is adopted, neither the Government of the Russian Federation nor the Ministry of Natural Resources of the Russian Federation may establish any restrictions on the purchase of shares in Russian subsoil users.

However, there is a special restriction (under the current Subsoil Law, Article 17.1) that a licence transferee joint venture company must be a Russian company and 50% or more of it owned by the transferor licence holder at the time of transfer. Similarly there are Russian content rules for PSAs which allow on the one hand foreign ownership of oil and gas companies but require 80% employment of Russian citizens.

A further restriction was introduced with the State Secrets Law. Access to State secrets is granted to Russian citizens only. Foreigners may have access to the information which is considered a State secret only with a permit of the appropriate State body and Federal Security Service. The State Secrets Law considers the quantity and volume of reserves and levels of extraction of Russia's strategic fossil-fuels to be State secrets. Government Decree No. 210 lists "strategic natural resources" and includes information on the balance of subsurface reserves of oil and gas dissolved in oil, also of non-ferrous and rare metals (such as nickel, cobalt, tantalum, niobium, beryllium). The State Secrets Law may create, and has actually created in the past, issues for foreign managers working in the oil and gas industry in Russia.

million on field development during the next eight to nine years and plans to increase the daily production to app. 14,000 bbl/day by 2014.

MOL Russ will coordinate the three main projects of MOL Group in the Russian Federation: the Zapadno-Malobalykskoye oil field which contains 20 million tons of proved crude oil reserves (operated together with the Russian oil company RussNeft), the Surgut-7 exploration project (recoverable reserves are estimated at 1.9 million tons) and the newly purchased BaiTex LLC.

The purchase price remained confidential, however, Sandor Fasimon, the Managing Director of MOL Russ, said it reflects the fair market value of Russian oil producing assets with similar characteristics, maturity and development potential.

8 January 2007

GazpromNeft acquired South-Toraveyskoye oil and gas field

The company won an auction for the South-Toraveyskoye field with estimated oil and gas reserves of 12.3 million tons and 343 mcm of gas under C1+C2 category.

The field is located in the Timan Pechora Region, not far from Gazprom's offshore license blocks, which GazpromNeft will develop in the nearest future as an operator.

The company believes that the acquisition will add appr. 1.5% (3 million bbl p.a.) to its current production levels and 2.4% to the proven reserves of the company.

2 Draft Subsoil Law

Article 60 (5) of the Draft Subsoil Law contains the following restrictions with respect to the participation of foreigners in auctions for subsoil use rights¹: to ensure the defence and security of the Russian State, in particular its economic security, a specially appointed federal executive body may prepare a motivated explanation to the effect that legal entities in which foreign citizens, stateless persons and/or foreign legal entities:

- (i) are entitled to appoint the chief executive officer (CEO) and/or more than 50% of the management board and/or more than 50% of the supervisory board (also referred to as the board of directors) or any other collective managing body; or
- (ii) hold more than 50% of the voting shares; or
- (iii) are entitled to divest directly or indirectly more than 50% of the total number of votes represented by voting shares of such companies,

shall be prohibited from participating in an auction for subsoil use rights. Such restrictions may not, however, apply to restrict the freedom of the economic activity and to create unjustified preferences for certain companies; they also may not be applied on a discriminatory basis. An unjustified application of such restrictions may be appealed in court. Furthermore, the above restrictions do not apply to Russian legal entities, i.e. entities in which more than 50% of the total number of votes of each foreign company being a shareholder of such Russian company are controlled directly or indirectly by Russian individuals or legal entities.

If the auction winner meets the above criteria, the results of such auction may be cancelled and consequently the subsoil use rights granted to such subsoil user terminated early. The draft law is expected also to contain criteria for "strategic fields" to which the restrictions apply. Only deposits of a certain size or which have a particular importance for security and defence are considered "strategic reserves" and limited for foreign investment. Discussions on the exact numbers for the thresholds are still ongoing and it is premature to report on the possible

¹ See also Jon Hines, Status of Proposed Restrictions on Foreign Investment in Mineral Resource Development, in: 2005 AmCham News, pp. 8-9.

The purchase price was RUR 1.17 billion (app. US\$ 45 million) which we believe to be a very reasonable price (appr. US\$0.5/barrel of oil) given the significant amount of recoverable reserves of the South-Toraveyskoye field.

22 December 2006

Gazprom, Shell, Mitsui, Mitsubishi sign Sakhalin II protocol

On 21 December 2006 Gazprom, Royal Dutch Shell, Mitsui & Co., Ltd and Mitsubishi Corporation signed a protocol to bring Gazprom into the Sakhalin Energy Investment Company Ltd. (SEIC) as a leading shareholder.

Under the terms of the protocol, Gazprom will acquire a 50% stake plus one share in SEIC for a total cash purchase price of US \$7.45 billion. The current SEIC partners will dilute their stakes each by 50% to accommodate this transaction and each receive a share of the purchase price which is proportionate to their shareholdings. Shell will retain a 27.5% stake, with Mitsui and Mitsubishi holding 12.5% and 10% stakes, respectively.

SEIC will remain the operator of the Sakhalin II project. Gazprom will play a leading role as majority shareholder while Shell will continue to contribute significantly to the SEIC management and remain the Technical Advisor. The key focus for SEIC is to complete the project on schedule allowing LNG to be delivered to customers in Japan, Korea and the North American West

outcome of these discussions.²

A **purchase of shares** in violation of the restrictions may be declared **invalid** by a competent court. However, the law does not provide for the automatic retransfer of shares the purchase of which was declared invalid. As a result, it will be crucial for foreign investors to pay special attention to the transaction structure pursuant to which foreign investors purchase shares in, or enter into a shareholders' or other agreements with, companies so as not to trigger revocation of the subsoil use licence as a result of such transaction.

Practice note: The 50% requirement may also impact Russian listed companies. Under the rules they would have to demonstrate that Russian citizens are the true beneficiaries of at least 50% of their outstanding shares. This is difficult to establish for companies with traded shares.

Hence, it is still possible for foreign investors to acquire shares in Russian oil and gas companies. However, the participation in tender procedures whilst still possible may require careful structuring in future. The State Secrets Law applies in parallel to the Subsoil Law and should also be considered.

Legal due diligence

Any investment will require a comprehensive due diligence process. Legal due diligence will be an important part of the overall due diligence process. We set out below the main issues which should be considered during the legal due diligence process.

1 Legal status of the target company and proper establishment

1.1 Privatisation

If shares were originally issued by way of a privatisation it

² According to recent publicly available statements (Vedomosti, 3 July 2006), the deposits that have crude oil reserves in excess of 70 million tonnes, natural gas reserves in excess of 50 billion cubic meters, gold reserves in excess of 50 tonnes or copper reserves in excess of 500,000 tonnes shall be considered "strategic". Pursuant to these criteria, approximately 70 oil and gas deposits may be qualified as strategic ones.

Coast. All existing LNG sales contracts will remain in force.

Another question is how Gazprom will generate funding for the acquisition. The US\$ 20 billion investment programme of the company for the year 2007 does not include the acquisition of a controlling stake in the Sakhalin II project. The net debt of the company comprised appr. US\$ 25.3 billion at the end of October 2006 and announced acquisition may further increase it to up to US\$ 30 billion. Earlier Gazprom announced its plans to acquire former YUKOS assets which will be sold in an auction in 2007. To finance its acquisitions Gazprom needs new borrowings but the raising of financing will hardly be a big problem for the gas major.

21 December 2006

FINANCIAL ADVISORY NEWS

Russneft will place RUR 14 billion in bonds

The board of directors of Russian oil company Russneft confirmed the planned placement of 2 bonds issues in the total amount of RUR 14 billion. The exclusive arranger will be Gazprombank.

The details of the issue will be kept confidential until the registration of the issue with the Federal Service for Financial Markets. The company management only indicated that raised funds will be used for exploration and maintenance purposes and also for increasing the current production levels of the company.

27 December 2006

is necessary to review carefully the privatisation documents for compliance with the tender requirements thus ensuring that the initial transaction conveyed valid ownership to the purchaser. Risks are substantially mitigated by the decrease of the statute of limitation for null and void transactions from previously 10 to now 3 years.

In this context it is also important to review carefully who legally obtained which precise assets of a former State enterprise in a privatisation process. Often there are questions as to the ownership of particular assets.

1.2 Incorporation

It should be ensured that the corporate documents comply with the requirements of the Law on Limited Liability Companies or the Law on Joint Stock Companies, as the case may be.

The corporate documents may contain certain limitations on foreign ownership or limitations on the transfer of shares in the company which have to be checked against the intended transaction.

The company must be properly registered in the company register.

In the next issue of the ACP Monitor more on: 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:

- **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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