

M&A NEWS**Gazprom's foreign acquisitions**

Recent months were very active for the Russian gas monopoly in terms of signed deals and acquired foreign assets.

In the beginning of June 2007 Gazprom announced the acquisition of a 20% interest in the North Sea offshore block 44/42b from Wintershall. Acquisition price and reserves of the block were not disclosed.

At the end of May 2007 Gazprom signed a sale and purchase agreement with the Property Committee of Belorussia on the acquisition of a 50% interest in Beltransgas (the country's major pipeline operator) for US\$ 2.5 billion. The consideration will be paid in 4 tranches, US\$ 625 million each.

In February 2007 the Russian gas giant signed a memorandum of understanding with YPFB, the Bolivian state oil and gas company, for the joint development of Bolivia's discovered hydrocarbon assets and for conducting new exploration works in the country. Bolivia has the third largest gas reserves in Latin America. Its oil reserves are estimated to be appr. 450 million tones.

Gazprom is actively looking for new foreign upstream and downstream assets. The company has already acquired a 25% stake in the Emeralds and Middelie blocks offshore the UK and has expressed interest in European gas distribution and power generation companies.

5 June 2007

A trip to Libya

Libya is becoming more and more attractive for Russian oil and gas companies. In March 2007 Tatneft signed a production sharing

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.

Acquisitions and divestitures**Corporate documents**

A new shareholder of a company, particularly if it is a majority shareholder, will review the existing corporate documents and may want to introduce changes.

Loan agreement

The loan agreement will focus on the following provisions:

- Parties of the agreement
- Loan purpose, amount and currency
- Interest payable on the loan and repayment of the loan
- Conditions precedent for a drawdown under the loan, in particular satisfactory financing documentation and drawdown notice
- Representations and warranties of the borrower in particular with respect to his financial and legal situation
- Covenants
 - Obligations to create agreed security rights (see also Security agreement section below)
 - Obligations to provide certain information about the borrower's financial situation
 - Obligations to keep the company's activities within a pre-agreed framework
 - Financial covenants: Critical in any modern financing are so-called financial covenants which allow financial institutions to monitor the financial performance of their borrower on an ongoing basis. The following ratios can be found in financing documentation for acquisition financings of oil and gas companies:
 - Senior debt to EBITDA ratio: ratio of (i) amount of the target company's (and NewCo's, if an indirect acquisition structure is

agreement ("PSA") with Libya's National Oil Company (NOC) for three license blocks located in the Sirt and Gadames basins.

The same month Gazprom signed with NOC a PSA for the offshore license block #19 located in the Mediterranean Sea. Both companies also discussed possible cooperation programmes including new acquisitions in Libya.

Lukoil Overseas established a representative office in the country and intends to participate in the forthcoming license auctions.

Since the cancellation of the UN's sanctions, Libya presents attractive opportunities for foreign investments in the oil and gas sector. The country has significant oil and gas reserves, large upside potential and a favorable location to key European energy markets.

5 June 2007

Gazprom Neft and Statoil sign cooperation agreement

Gazprom Neft and Statoil have established a joint working group to start evaluating possible joint exploration and production projects in Russia and overseas.

This cooperation is organised under a Memorandum of Understanding ("MoU") signed on 2 April 2007 by Alexander Dyukov, president of Gazprom Neft, and Peter Mellbye, executive vice president of Statoil responsible for international exploration & production.

"Joint work of Gazprom Neft and Statoil provides the opportunity to exchange the acquired expertise in oil exploration and production areas, and to integrate efforts of both companies in order to achieve the good results," said Gazprom Neft's Alexander Dyukov.

"The MoU with Gazprom Neft, one of the leading oil companies in Russia, is an important building block in our pursuit of seeking

chosen) senior debt to (ii) the target company's (and NewCo's, if an indirect acquisition structure is chosen) earnings before interest, taxes, depreciation and amortisation (= EBITDA) on a calculation date

- Loan life coverage ratio: ratio of (i) projected net cash flow (on a discounted present value basis) from proved reserves of all fields in the block until final loan maturity to (ii) principal, interest and other amounts due on all outstanding long-term debt on a calculation date
 - Field life coverage ratio (which can be compared to the project life coverage ratio used in typical project financings): ratio of (i) projected net cash flow (on a discounted present value basis) from proved reserves of all fields in the block over the longest life of any such field to (ii) principal, interest and other amounts due on all outstanding long-term debt on a calculation date
 - Debt-to-equity ratio: ratio of (i) the target company's (and NewCo's, if an indirect acquisition structure is chosen) amount of debt to (ii) the target company's (and NewCo's, if an indirect acquisition structure is chosen) equity on a calculation date.
 - Note that certain covenants may apply not only to the borrower but also to the borrower's shareholders. Such clauses of a loan agreement are enforceable only if such shareholders are a party to the loan agreement.
- The loan agreement will also deal with the events of default, in which the lender will have the right to terminate early the loan and accelerate the loan repayment.

Where the amount of a loan exceeds 25% of the value of the company's balance sheet assets at the time of execution of the loan agreement the investor should check whether an approval by the internal board of directors was given to the decision to take on the loan which is considered a "**major transaction**" under Russian law. If the amount of a loan exceeds 50% of the value of the company's balance sheet asset an approval of the company's shareholders is required.

exploration and production opportunities not only in Russia," said Kristoffer Marø, president of Statoil Russia. "With Gazprom Neft and Statoil bringing together complementary technologies and operational experience, we aim to build on this MoU to realise tangible business opportunities in Russia and abroad."

Russian offshore territories contain appr. 100 billion barrels of hydrocarbon reserves. Russian companies have so far no tested offshore drilling and production technologies for the Arctic region, and Statoil believes that its main contribution to the cooperation will be its leading offshore technology, especially in the area of exploration as well as its experience in Arctic developments and the execution of large scale projects.

5 June 2007

Sky Petroleum acquires a minority interest in a Russian oil field

Sky Petroleum, Inc. acquired a 3.9% interest in Pechora Energy (PE) from its parent company Concord Oil and Gas. Pechora Energy holds a production license for the Luzskoye oil field located in the Komi Republic, where it is carrying out appraisal drilling works. The field contains appr. 33 million barrels of oil under 3P classification. In 2006 the field produced at an average rate of 245 bbl/day (12,250 tones a year). The existing production is intended to be increased through the work-over of four existing wells.

A conditional contract to acquire Pechora Energy company for a consideration of appr. US\$ 25 million was signed in March 2006 by Concorde Oil & Gas Plc.

4 June 2007

Security agreements

There are a number of security rights which will typically be an element of an acquisition financing, in particular

- Pledge of shares in NewCo (if an indirect acquisition structure is chosen)
- Pledge of shares in the target company
- Assignment of rights under a PSA or a regulated subsoil contract under the Draft Subsoil Law
- Assignment of rights to obtain proceeds from sales of crude oil or gas under offtake agreements and other agreements (as far as they are not taken as security by lenders to the target company)

Practice note: Russian law does not contain an exhaustive list of legal instruments to secure debts. The most typical ways of taking security are guarantees (an independent obligation which can only be issued for consideration by banks), suretyships (which can be issued by corporate entities or private individuals), performance bonds, retention of ownership, assignment of receivables, promissory notes and repurchase obligations.¹

There are doubts as to the validity of a pledge of rights under bank accounts. However, a pledge of rights under bank accounts may be substituted under Russian law by the right of the bank to withdraw money from the borrower's bank accounts. The borrower thereby agrees that the bank shall have the right to debit from the borrower's accounts maintained with such bank any and all amounts due to the bank pursuant to the loan agreement, without the borrower's prior consent. Please note, however, that this withdrawal right may be terminated early by the borrower at any time. Under Russian law, account holders cannot be validly restricted from closing the accounts which limits the reliability of this security tool.

- Security right over produced crude oil (or other hydrocarbon products)
- Security right over other moveable property
- Security right over immovable property (or lease agreements if the company leases the land)

¹ See in detail Röver, Secured Lending in Eastern Europe, Oxford 2007.

Lukoil and Gazprom Neft to establish a JV

At the end of May 2007 the presidents of Lukoil and Gazprom Neft, Vagit Alekperov and Alexander Dyukov, signed a memorandum of understanding on the establishment of a joint venture company to operate in the East Siberia and Timan Pechora regions as well as in the Caspian sea. Pursuant to the agreement, Gazprom Neft will hold 51% in the JV; however the company will be managed on a parity basis.

Timan Pechora is declared to be the first region of joint operations. Gazprom Neft will obtain significant synergy effects due to Lukoil's infrastructure available in the region. Lukoil, in return, can get support in forthcoming license auctions in the region. The company is extremely interested in the Trebsa and Titova oil fields which will be auctioned in the nearest future.

28 May 2007

FINANCIAL ADVISORY NEWS

Gazprom approves its investment programme for 2007

The Gazprom's Management Committee approved the updated key figures of the company's investment programme and draft budget (financial plan) for 2007. Said draft documents are pending endorsement by the Board of Directors.

According to the draft investment programme, the total investments are earmarked at RUR 762.3 billion, which is RUR 232.92 billion up on the investment programme approved in January 2007. The

Practice note: There are a number of practical limitations of security rights under Russian law. In particular, there are a number of issues with **pledges** such as the requirement to make perfect identification of the pledged assets, the absence of a floating charge concept similar to English law, the complexity of enforcement, the inability to seize the assets and the requirement to sell the pledged assets at a public auction for Roubles. Similarly there are issues with **assignments** (there is e.g. an unclear court position with respect to partial assignment as compared to a complete withdrawal from a contractual obligation).

In relation to financial assistance (in particular in the form of financial support provided e.g. by way of guarantees or other types of security by the target company to a loan borrowed by a NewCo) Russia may offer more flexibility than certain Western jurisdictions including continental Europe since there are no express rules in Russia restricting financial assistance. However, care must be taken to ensure compliance with (i) the provisions of the Civil Code of the Russian Federation prohibiting gifts between commercial organisations and (ii) rules requiring approval by the board of directors or shareholders' meeting if the assistance given constitutes either an interested party or a major transaction (Articles 78-84 Law on Joint Stock Companies). In addition, Article 71 Law on Joint Stock Companies requires directors and officers of a company to operate in the interests of that company as well as to perform their duties reasonably and in good faith. Although Article 71 Law on Joint Stock Companies has not been widely tested in the courts, it should be taken into account by any directors or officers of a company asked to give financial assistance.²

Suretyships

It may not be possible to base the debt financing only on the cash flows of the acquired company (i.e. not to have any financial recourse to the purchaser). Financing

² For the issues of interested-party transactions and major transactions as well as the respective corporate approvals see Corporate approval section in the April issue of ACP Monitor.

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capital investments are estimated at RUR 319.78 billion (RUR 40.78 billion less compared to the investment programme approved in January 2007); long-term investments will make up to RUR 442.52 billion (RUR 273.7 billion more than approved in the investment programme of January 2007).

According to the updated draft budget the overall cash income and revenues will be up to RUR 2,277 trillion, which is RUR 289 billion less compared to the budget approved in January 2007. The necessity to update the investment programme and the budget was driven mainly by the acquisition of shares in Sakhalin Energy, Beltransgaz and Mosenergo. In addition, the investment programme modification steem in particular from the need to adjust a list of investment projects and investment scope. The budget adjustments can also be explained by lower gas marketing volume due to the unusually warm winter 2006-2007, as well as changes in the macroeconomic forecasts.

Source: Information Division,
OAO Gazprom
31 May 2007

institutions may, therefore, require additional security in the form of a suretyship by the purchaser of the target company. Please note that under Russian law there is a difference between a guarantee (an independent obligation which can only be issued for consideration by banks) and suretyships (which can be issued by corporate entities or private individuals). Suretyships may be terminated early if, among other things, the surety disagrees with an increase of the secured obligations. Another issue is whether or not the issuance of a suretyship requires consideration.³

In the next issue of the ACP Monitor more on: Notifications, registrations and approvals (and related disclosure requirements) for acquisitions and divestitures

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, 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.

Most recent conferences where ACP was invited as a speaker:

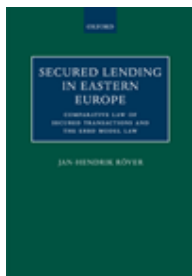
- **3rd International Conference: Trade & project finance in Russia**
Adam Smith Conferences
Moscow, 19-22 March 2007
<http://www.assetcapitalpartners.com/public/conferences.php>
- **1st International Russian Alternative Investment Forum: Examining the rise of private equity, hedge funds & other alternative investment tools**
Adam Smith Conferences
London, 21-23 February 2007
Vladimir Matias: "Financing options for leveraged deals and exit strategies"
<http://www.assetcapitalpartners.com/public/conferences.php>
- **6th International Pipeline Forum: Pipeline Transport 2007**
RPI, Transneft
Moscow, 17-18 April 2007
<http://www.rpi-inc.com/PF2007/index.html>

Upcoming conferences:

- **The Performance Theatre**
The Performance Theatre Foundation
St.Petersburg, 20-21 June 2007
www.theperformancetheatre.com

The Performance Theatre Foundation Partners:



Recent publications by Asset Capital Partners:
Jan-Hendrik Röver, Secured Lending in Eastern Europe. Comparative Law of Secured Transactions and the EBRD Model Law (Oxford 2007)


This new work is the first comparative study of central and eastern European secured transactions laws to be written in English. It gives a valuable insight into the legal reforms taking place in the transition economies of central and eastern Europe (and elsewhere), by explaining the general mechanics of secured transactions law in a helpful and practical way.

The book explores the characteristics that make security law useful from a practical point of view, the purpose being not merely to describe existing rules on security but to concentrate on the question of how those rules can apply in practice. The author concentrates on seven central and eastern European secured transactions laws in Bulgaria, the Czech Republic, Hungary, Poland, Romania, the Russian Federation and the Slovak Republic. These laws are contrasted with the EBRD's Model Law on Secured Transactions and the EBRD's Core Principles for a Modern Secured Transactions Law. In addition, English, German and US law (which, among others, influenced the EBRD's work) are used as further reference sources.

The descriptions of eastern European laws were reviewed by Nörr Stiefenhofer Lutz, a leading European law firm, thus ensuring an up-to-date introduction to central and eastern European secured transactions laws.

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