

**M&A NEWS****Sintez wins subsoil license auction in Nenets Autonomous Region**

Negusneft, an upstream unit of Sintez Group, has won an auction for the Nercheyusky prospect. The license for geological prospecting, exploration and production of hydrocarbons will be issued for 25 years including 5 years exploration period.

The auction was contested by Surgutneftegaz, Tatneft, and Intergeo. Negusneft made a one-off payment for the subsoil use right in the amount of RUR412.5 million (US\$16.9 million).

The Nercheyusky subsoil section covers the area of 43.8 sq.km and is located in the southeastern part of the Nenets Autonomous Area, 175 km west of the city of Vorkuta. Negusneft is currently developing the Varynganskoye deposit in the Khanty Mansy Autonomous Area. The company produced over 8 million tones of crude oil from the start of deposit exploration.

*2 August 2007*

**Vostok Energy wins license auction in Irkutsk region**

Vostok Energy, a joint venture between Russian oil and gas company Rosneft and China National Petroleum Corp. (CNPC), has won an exploration and production license for two blocs located in Irkutsk region, East Siberia.

It is the first acquisition of Vostok Energy since its incorporation in October 2006. The company was set up to carry out oil and gas exploration projects in Russia. Rosneft controls 51% of the charter capital of the company while CNPC owns the remaining 49%.

The company paid RUR1.18 billion (US\$46 million) for the West Chonsky and Verkhneichersky

**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.

**Taxes and other payments to the State****Acquisitions and divestitures****Seller**

There is no separate capital gains tax in Russia. Capital gains are in principle subject only to corporate tax (24%) or income tax (13%). It should also be noted that there is no value added tax payable on the sale of assets or shares in the context of an acquisition.

**Buyer**

The buyer assumes no specific tax obligations in the context of an acquisition.

**Operations****General tax regime****Profit tax**

The corporate tax rate which has to be paid by companies is a maximum of 24% in Russia (which can be reduced by up to 4% depending on the region in which a company has its seat). Tax must be transferred to federal and regional budgets in the proportion of 6.5% and 17.5% respectively. There are in principle no regional or local taxes in addition to the general corporate tax. Profit tax is levied on a company's accrued gross tax profits, net of deductions (in particular operating expenses, depreciation and amortisation, interest and financings costs). **Losses** may be carried forward for ten years and offset up to 50%<sup>1</sup> of otherwise taxable profit per year. **Expenses** incurred by a taxpayer can only be deducted under Russian tax law if they are (i) "economically justified", (ii) "properly documented" and (iii) incurred in order to derive income. The list of expenses deductible only within specific limits includes, inter alia, certain types of advertising,

<sup>1</sup> From 1 January 2006; previously the maximum depreciation was 30% per annum.

fields. The first block is located 120 km from the East Siberia-Pacific Ocean (ESPO) pipeline which is currently under construction. The block contains appr. 30 million tones (appr. 225 million barrels) of oil and 15 bcm of gas under D1 category. Verkhneichersky field is located 90 km to the east of the pipeline and contains 50 million tones (375 million barrels) of oil and 90 bcm of gas under D1 category.

We believe that the company paid reasonable price of 4 cents per barrel of resources. Moreover, it is a good starting point for CNPC in Russia. Before the partnership was set up, the Chinese company was far less lucky in securing such access. First, under pressure from the Russian authorities, CNPC had to withdraw its bid in the Slavneft auction which took place in 2002. Then the Federal Antimonopoly Service (FAS) blocked the Chinese company's acquisition of Orenburg-based Stimul which was sold to Gazprom.

*1 August 2007*

#### **Halliburton enters into agreement to acquire 100% of OOO Burservice**

Halliburton has entered into a definitive agreement with the shareholders of OOO Burservice (Burservice) to purchase the entire share capital of the company. This agreement is still subject to the necessary regulatory approvals.

Founded in 2004, Burservice is a leading provider of directional drilling services in Russia. The company is headquartered in Usinsk, Republic of Komi, and has approximately 100 employees.

"Burservice, through its exceptional employees, has established an outstanding reputation for service quality in the Timano-Pechora region of Russia. We look forward to building on the company's historical growth through the addition of Halliburton technology,"

entertainment and insurance for employees.

Interest expenses accrued with respect to any kind of debts (loans and borrowings, as well as interest accrued on securities and other debt instruments) are deductible for tax purposes, regardless of the purpose of the borrowing obtained by the taxpayer, the use of the funds or the interest payment schedule. This deduction will only be available if the amount of such interest does not exceed 20% of the average interest rate charged for similar types of loans with comparable terms granted in the same quarter. In the absence of loans granted with comparable terms in the same quarter, the amount of the deductible interest expense should not exceed 1.1 times of the Central Bank refinancing rate (for Rouble loans) or 15% (for loans denominated in foreign currency). Certain double taxation treaties provide additional benefits with respect to interest deductions for Russian companies with foreign shareholders and/or Russian branches of foreign companies.

Chapter 25 of the Tax Code introduces "**thin capitalisation**" rules. Thin capitalisation rules are applicable to interest on loans granted by a direct or indirect foreign parent holding more than 20% of a Russian borrower, loans granted by a Russian affiliate of such a foreign parent and loans guaranteed in any form by a foreign parent or its Russian affiliate. Such interest expense is restricted if the outstanding principal amount of "controlled" debt instruments exceeds more than 3 times (or 12.5 times for banks and leasing companies) the difference between the company's assets and its liabilities (i.e. the net equity). The exceeding amounts will be disallowed as a deduction and reclassified as a (taxable) dividend which is subject to 15% Russian withholding tax on dividends (however, in certain cases partial double tax treaty relief arising from a participation exemption is available).

Federal tax holidays are permitted if set by federal law. Regional and local tax holidays are permitted if set by regional or local law.

#### **Mineral extraction tax**

A single natural resources tax (also referred to as production tax or unified production tax, UPT) provided in Chapter 26 of the Tax Code replaced three ad valorem taxes (excise, mineral royalty, mineral replacement).

said Brady Murphy, vice president of Sperry Drilling Services, Halliburton drilling division.

27 July 2007

### **JKX announces proposed acquisition of Russian gas field for US\$50 Million**

JKX Oil & Gas plc has agreed the conditional acquisition of 100% of the southern Russian Koshekhablskoye gas field (Field). The acquisition is subject to consent from JKX's shareholders and will be completed through wholly owned subsidiaries of JKX acquiring 100% of the Field's licensee Yuzhgazenergie LLC (YGE) for a cash consideration of US\$50 million. Miller and Lents Ltd, engaged by JKX, estimates that remaining proved gas reserves in the Field are 114 billion cubic feet (Bcf) and proved plus probable gas reserves are 216 Bcf. This would represent an increase of appr. 85% in JKX's proved plus probable oil and gas reserves.

The Field was discovered in 1972 and produced a total of 89 Bcf of gas before operations were suspended in January 2006. In June 2006, YGE was granted a new 20 year license to rehabilitate and further appraise and develop the Field. YGE expects to commence development operations on the Field before the end of 2007, with first gas planned for 2008. Peak production of 50 million cubic feet per day (MMcfd) is planned for 2011.

JKX will fund the transaction from existing cash resources.

Dr Paul Davies, Chief Executive of JKX, said: "This strategic acquisition represents a significant opportunity for JKX to increase its reserves and asset base and to capitalise on its proven experience of operating in the region. The purchase of the Koshekhablskoye Field will provide us with a timely entry into the dynamic Russian gas market."

24 July 2007

### **Notion of commercial minerals**

The tax is levied on so-called "**commercial minerals**" extracted from the subsurface within the territory of the Russian Federation or territories under the jurisdiction of the Russian Federation, including territories which are leased from foreign States or used on the basis of an international agreement. The "minerals" subject to mineral extraction tax include hydrocarbons such as

- Dewatered, desalted and stabilised oil (here referred to as "crude oil")
- Gas condensate for all types of deposits which has undergone separation and dewatering processes involving the separation of light fractions and other impurities
- Natural fuel gas from all types of deposits and associated gas (here referred to as "natural gas" or "associated gas").

### **Crude oil and gas condensate**

#### **Transitional provisions until end 2006**

For the period from 1 January 2002 until 31 December 2006 the legislation provides for **transitional provisions** according to which, from 1 January 2005 until 31 December 2006 the **taxable base** for mineral extraction tax on **crude oil** is determined as the quantity of extracted oil in physical terms and is taxable at the rate of Roubles 419 per tonne. In this respect, the tax rate is adjusted quarterly by a coefficient reflecting movements in world prices for Urals oil. This coefficient is determined by the taxpayer itself according to the following formula:

$$C = (P-9) \times R / 261$$

where: **P** is the average price of Urals oil for the tax period in US\$/barrel; and **R** is the average US\$/Rouble exchange rate established by the Russian Central Bank for the tax period

The tax amount can thus be calculated by the following formula:

$$T = 419 \times \text{oil extracted (tonnes)} \times (P-9) \times R / 261$$

### **SAGA Oil ASA obtains new license area and increases reserve base**

SAGA Oil ASA, an independent Norwegian oil producer with operations in Russia, has increased the licensed acreage by 16 sq. km by obtaining additional license for new acreage on an area that is adjacent to the northern border of the existing Rodnikovsky license.

The new license is a natural prolongation of the existing verified resources on the East-Shaltinsky oilfield that extends beyond the northern border. The main resources on the new acreage are the extension of the largest Rodnikovsky production zone, the Tournaisian, which has had a production setting of 355 boe per day.

Based on the 3D seismic interpretation at the northern border line and the ongoing production from the well on the northern border, SAGA estimates that there is a minimum of 6,25 million boe in place. The extractable P2 reserves are estimated to be around 1.5 million boe based on the 24% extraction factor used in last year's SPE reserve estimate for the East Shaltinsky extractable reserve base.

SAGA has after this a new preliminary Extractable Reserve Base (P1 and P2) on both licenses of 39.1 million boe before final interpretation of 3D seismic.

*19 July 2007*

### **FINANCIAL ADVISORY NEWS**

#### **EBRD ends talks on funding of Sakhalin II.**

The European Bank for Reconstruction and Development (EBRD) has officially confirmed that it ended negotiations on financing the giant US\$20 billion Sakhalin II natural gas project. In

### **Taxation from 2007**

From 1 January 2007 the **tax base** is determined as the value of extracted minerals calculated on the basis of the volume of extracted minerals and the valuation method used or as the quantity of the extracted minerals in physical terms. The value of minerals may be determined by the following methods:

- On the basis of the realisation (sales) prices prevailing for the taxpayer in the relevant tax period (typically a quarter) without taking into account State subsidies to cover the difference between the wholesale price and the calculated value of minerals, or
- On the basis of the realisation (sales) prices of the minerals prevailing for the taxpayer in the relevant tax period (typically a quarter) less value added tax, excise duty on excisable types of minerals (which is typically not the case for hydrocarbons), customs duties or transportation costs and insurance premiums for compulsory freight insurance,
- On the basis of the calculated value of the extracted minerals as determined using data in tax records which are maintained according to the rules established by Chapter 25 of the Tax Code (if it is impossible to use any of the preceding methods).

The main costs deductible from the tax base are transportation costs, marketing costs, export duties, transportation insurance and VAT for domestic sales.

The **tax rate** for gas condensate is set at 17.5% of the taxable base. The formula of tax rate for crude oil has remained unchanged.

### **Natural gas and associated gas**

From 1 January 2005 the tax arising from the extraction of natural (including liquefied natural gas [LNG]) and associated gas is determined as the quantity of the extracted mineral (tax base) to which the following rates apply:

- Natural gas: Roubles 147 per 1,000 cubic meters
- Associated gas (gas extracted via an oil well): Rouble 0

### **Tax calculation and payment**

The amount of tax on mineral extraction is calculated as

a carefully worded statement EBRD said the decision was made by "mutual agreement" with Russia's state owned Gazprom and the other shareholders of the project. According to EBRD, the reasons for this decision were unresolved environmental issues of the project and change in the shareholding structure at the end of the last year.

EBRD had been heavily criticised by environmentalists for participation in the project financing – a number of campaigns were launched to persuade the institution to change its mind. However, the decision to drop funding for the project was really driven by the change in shareholding that saw Gazprom take a majority stake in Sakhalin Energy, reducing the equity held by Shell, Mitsui, and Mitsubishi to 27.5%, 12.5% and 10%, respectively. The acquisition came after Russian environmental regulators threatened to revoke the project's license due to ecological concerns. The Russian authorities put the project for months under intense pressure last year, accusing Shell of causing serious environmental damage to Sakhalin including deforestation, dumping toxic waste and soil erosion.

EBRD loan would have paved the way to unlocking further funding from other state-owned lenders, including the Japan Bank for International Co-operation, the UK's Export Credit Guarantee Department (ECGD) and the Ex-Im Bank of the US. These other lenders -- including the ECGD -- have yet to make a decision on whether they will finance the project.

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the product of the tax base and the appropriate tax rate.

The amount of tax is calculated monthly for each extracted mineral. Tax is payable at the location of each subsurface site which has been provided to the taxpayer for use. In this respect, the amount of tax is computed based on the proportion of a mineral extracted on each site of subsurface resources to the total quantity of that type of mineral that has been extracted. The amount of tax calculated in respect of minerals extracted outside Russia is payable at the location of a company or at the place of residence of a private entrepreneur.

### **Changes to the tax regime**

In July 2006 the President of the Russian Federation signed a bill introducing changes to the Tax Code which lead to a differentiation of mineral extraction tax. The bill provides for a ten-year mineral extraction tax holiday for greenfield developments in East Siberia and adjacent regions with a combined exploration and production licence, and a fifteen-year holiday for greenfield developments with an exploration licence only. The tax breaks are to end once cumulative production reaches 25 million tonnes per licence. Fields with a depletion rate above 80% are to see a reduction of the mineral extraction tax of up to 70%. The tax holidays and lower taxation rates will become effective from 1 January 2007.

### ***In the next issue of the ACP Monitor more on: Taxes and other payments to the State and Currency law and export law***

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>
- **The Performance Theatre**  
The Performance Theatre Foundation  
St.Petersburg, 20-21 June 2007  
[www.theperformancetheatre.com](http://www.theperformancetheatre.com)

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

- **4<sup>th</sup> Annual Russian CFO Summit**  
Adam Smith Conferences  
Moscow, 22-25 October 2007  
<http://www.cfosummit-russia.com>
- **5<sup>th</sup> International Conference: "Medium and Small Oil & Gas Assets: Current Acquisition and Investment Issues"**  
RPI  
Moscow, 14 November 2007  
<http://www.rpi-inc.com/MA2007/index.html#bookmark1>

**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.

**Asset Capital Partners** is an international investment banking and financial advisory firm based in Munich and Moscow with a special focus on Russia and other CIS countries.

**Asset Capital Partners GmbH**

Prechistensky per. 14/1  
119034 Moscow, Russia  
p: +7 495 981 0791  
f: +7 495 981 0792

[moscow@assetcapitalpartners.com](mailto:moscow@assetcapitalpartners.com)

[www.assetcapitalpartners.com](http://www.assetcapitalpartners.com)

**Asset Capital Partners GmbH**

Bauerstrasse 20  
80796 Munich, Germany  
p: +49 89 242 246 910  
f: +49 89 242 246 990

[munich@assetcapitalpartners.com](mailto:munich@assetcapitalpartners.com)

[www.assetcapitalpartners.com](http://www.assetcapitalpartners.com)

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