

# ROMGAZ

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Societatea Națională de Gaze Naturale Romgaz S.A. - Mediaș - România

To: SNGN ROMGAZ SA General Meeting of Shareholders

## REPORT on the approval of Romgaz withdrawal:

- As partner in the partnerships concluded with Aurelian Oil&Gas Poland and Sceptre Oil & Gas for the performance of petroleum operations in Cybinka and Torzym blocks Poland;
- as limited partner in the two limited liability partnerships Energia Cybinka sp.z.o.o.sp.k and Energia Torzym s.z.o.o.sp.k

### a) History of contractual relationship

Romgaz is partner together with Aurelian OIL & GAS Poland SP. Zo.o (whose shareholder is San Leon Energy Ltd) and Sceptre Oil&Gas Limited LTD in two Partnership Agreements, hereinafter called JPA, for the performance of petroleum operations in Cybinka and Torzym blocks in Poland, following signing of a Farmout Agreement on 5 June 2008. This cooperation was aligned with Romgaz wish to take part in the discovery of new reservoirs outside Romania and with general interest of international companies in shale gas exploration in Poland, an interest similar to that in the USA. Participating interests held by partners in the rights and obligations under the Partnership Agreements are as follows:

Aurelian Oil&Gas Poland	45%
SNGN Romgaz SA	30%
Sceptre Oil&Gas	25%

In 2014 Aurelian Oil&Gas Poland was acquired by San Leon Energy, the latter being the main shareholder.

In order to perform petroleum operations and to comply with legal requirements in Poland, according to which an exploration license may be awarded to only one legal entity, the partners founded two limited liability partnerships, Energia Cybinka sp.z.o.o.sp.k and Energia Torzym s.z.o.o.sp.k..

To enter the two partnership Agreements and to become a limited partner in the two LLPs, Energia Cybinka and Energia Torzym, Romgaz paid the following amounts:

- Assignment of participating interests, namely EUR 64,095
- Participating interest in the share capital, namely EUR 44,924 (equivalent value of PLN 200,000)

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- Promote share (price paid to Aurellian and Sceptre representing historical costs) in amount of EUR 672,714  
TOTAL amount paid to enter the partnership = EUR 781,733

During the performance of the partnership agreements Romgaz contributed to the work programs with an amount of 2.881 million EUR for works in Torzym and with an amount of 1.073 million EUR for works in Cybinka, in total investing an amount of 3.954 million EUR.

Up to this report, Romgaz invested in projects in Poland 4,735,187.85 EUR, including all the obligations related to entering such projects and its contribution to work programs.

### b) Execution phase of work programs

Following are work programs undertaken by the partners up to 7 February 2014, through Energia Cybinka and Energia Torzym, in front of the environmental authorities in Poland:

Torzym Block	Works			
	Phase I (7.02.2008 - 7.02.2011)		Phase II (7.02.2011 - 7.02.2014)	
	Reprocessing and Interpretation (km)	Geophysics - 3D seismic (km <sup>2</sup> )	Drilling (m) no. of wells	
	200	110	2700/1	Optional 2700/1
Cybinka Block	Works			
	Phase I (7.02.2008 - 7.02.2011)		Phase II (7.02.2011 - 7.02.2014)	
	Reprocessing and Interpretation (km)	Geophysics - 3D seismic (km <sup>2</sup> )	Drilling (m) no. of wells	
	200	110	2700/1	Optional 2700/1

Between 5 June 2008 – 22 August 2013 seismic acquisition works were performed as well as the drilling of well 1 Sosna thus the Minimum Work Program for Torzym being fully accomplished, while for Cybinka one well still needed to be drilled. In accordance with the results of seismic acquisition works, Torzym block was rated with higher geologic success chances than Cybinka block, reason why partners developed a work strategy and decided to perform initially the drilling of a well on Torzym block and later the drilling of a well on Cybinka block.

After analyzing the information obtained by drilling of well 1 Sosna with respect to the general prospectivity of the exploration blocks and the geologic concepts followed in these blocks, the results, according to Romgaz technical team, have shown that *the geologic chances of success were considerably minimized*. Because of the unsatisfying result of drilling well 1 Sosna, Romgaz decided not to take part in other works proposed by the other

partners for said well. Nevertheless, Aurelian and Sceptre wished to continue, at their own risk, to perform casing, cementing and testings works on said well, the result of which strengthened Romgaz technical point of view.

Further to the unsatisfying result obtained by drilling well 1 Sosna in Torzym block, as well as to the fact that following the reanalysis of reprocessed seismic data Cybinka block was rated with low chances of geologic success while partners failed to agree on an approach regarding drilling of different plays (specific geologic context) within the block, drilling of a well in Cybinka block was postponed.

Up to 7 February 2014 the well in Cybinka block was not drilled. However, the fact that the well was not drilled in Cybinka block did not result in penalties imposed by the Polish authorities but in an increase of the exploration license fee by EUR 53,300, namely from EUR 88,900 to EUR 142,200.

On 7 February 2014 (the expiry date of the second exploration phase), at partners wish to continue activity in the two blocks and upon their request, the Environmental Ministry in Poland issued the decisions to extend the licenses for the two blocks as follows:

- Entering phase III of the exploration, February 2014 – February 2017, by extending the exploration license for Torzym block, and
- Extension, in time, of phase II of the exploration in Cybinka block for the period February 2011 – February 2017 ( phase extension of the exploration license)

Extension of licenses in the two blocks also implied undertaking additional obligations by the partners in front of the Environmental Ministry in Poland towards the work program that was not accomplished.

Thus, the exploration program for these phases, according to the Decisions of the Environmental Ministry, provides:

1. The obligation to drill a well in Torzym block;
2. Continuation of the Work Program in Cybinka block with the obligation to drill a well which should have been drilled up to 7 February 2014 and which was provided in the previously approved Minimum Work Program.

### **c) Partners decision to reduce the exploration risk**

Following the results of 1 Sosna well drilling, which reduced the geological success chance in both blocks, Romgaz decided, on the basis of the technical team decision, to reduce the exploration risk in both blocks by seeking a new partner to share this risk with.

In the meeting of 2 September 2013, the General Meeting of Shareholders approved, upon Romgaz proposal, to reduce the exploration risk in the blocks licensed in Poland, and approved to start the process of seeking a new partner to share the risk with by assigning 50% of Romgaz participating interest in both JPA's in Poland, namely 15% of the 30% owned in these partnerships.

Thus, Aurelian as Operator, through San Leon as shareholder, identified a potential assignee, namely the company Aspect, through Horizon as project subsidiary, having its seat in Denver, Colorado, USA, interested in acquiring 50% of the three partners participating interests. San Leon and Romgaz expressed their firm position as to assign a participating interest to Aspect, while Sceptre declared its interest in participating in the Farm-Out with Aspect, but still waiting to make a final decision, as they were willing to assign their participating interest to a third party.

Romgaz requested several times between 22 July 2013 and 2 October 2014 the proof of Aspect technical and financial capability to conclude a firm transaction, by providing a bank guarantee. According to JPA's provisions, the above mentioned transaction was not possible without Sceptre's agreement. Sceptre's ambiguous position both in relation to the assignment to Aspect (by Horizon) of an interest share and in relation to its agreement for the assignment of San Leon and Romgaz interest share to Aspect, has reached its peak in 2 October 2014 when Sceptre did not participate in the OCM meeting. This was the deadline established by Aspect for getting the approval of all partners to conclude the first phase of the transaction with San Leon. This approval was necessary because the terms of the JPA change when a new partner joins the partnership. Romgaz was ready to approve provided that Aspect proves, according to JPA, the technical and financial capability of its branch Horizon (a subsidiary of Aspect) as the company performing the transaction. Under these circumstances San Leon's efforts to transfer its participating interest to Aspect failed and any discussions on a potential transaction with Romgaz ended. We would like to stress that the due diligence period for the transaction between partners and Aspect was June 2013 – 2 October 2014.

From the moment when the assignment to Aspect failed differences of opinion occurred between Sceptre and San Leon, therefore San Leon declined the proposal submitted by Sceptre to Romgaz and San Leon for initiating a joint farm-out process for 50% of the participating interest by all partners. Romgaz considered the possibility to enter the farm-out process along with Sceptre by concluding a joint Farm-Out Agreement, but they could not reach an agreement on the terms and conditions; difficulties have also been generated by -the public procurement law which limits asset commitment with Sceptre on behalf of Romgaz outside the public procurement procedure.

In June 2015 Romgaz started the process of identifying a potential partner, therefore they submitted notifications accompanied by brief presentations of Poland's geological potential to 15 companies operating in Europe, such as MOL, Petrolinvest, PGNIG. Romgaz did not receive any proposal regarding the proposed project.

Meanwhile most international companies such as Marathon Oil, Tallman Energy, Eni and ExxonMobil, which performed petroleum operations in Poland, have withdrawn from this country due to the unsatisfactory results.

The unsatisfactory results obtained from 1 Sosna drilling and the misunderstandings between San Leon and Sceptre in 2013, 2014 and 2015 have determined the postponing of works provided under the mining usufruct agreements and concessions.

**d) Proposal for Romgaz withdrawal as partner and as limited partner in Poland.**

**1. Operator's proposal to relinquish both Cybinka and Torzym blocks**

Romgaz team considered the situation both from technical and economic and legal perspective, and requested the Operator in October 2015, under the JPA, to elaborate a work program for 2016. The Operator submitted the Work Program draft in 2 alternatives:

1. First alternative: „relinquishment of partners to both concessions”, until 7 February 2016, as recommended by the Operator, in order to avoid the payment of the mining usufruct tax for the last year of the current phase (7 February 2016 – 6 February 2017);
2. The second alternative: „continuing the activity in both blocks”.

Sceptre hesitated again after Operator's proposal, wishing to reinterpret the petrophysical data acquired from the well and the analyses of the cores sampled from well 1 Sosna.

According to the JPA the relinquishment is only possible if all partners agree upon it. If the other partners are not willing to relinquish Romgaz will stand on JPA provision related to withdrawal.

**2. Proposal of the Business Development Department on Romgaz withdrawal from Cybinka and Torzym concessions.**

Romgaz considered both alternatives of the Operator and asked for more details on both alternatives, including the relinquishment by both Aurelian and Sceptre, or withdrawal from the concessions of Aurelian only and Sceptre continuing the activity. The discussions on the withdrawal of one or other partner are ongoing and are we waiting for clarifications until the end of 2015/beginning of 2016.

**2.1. Considering the alternative of Romgaz continuing activity in Poland**

The Business Development Department and the technical-economic team involved in Romgaz project, before making a proposal on the decision for relinquishment or withdrawal of Romgaz from Poland blocks, considered the possibility to continue the activity in the two blocks. Thus, Romgaz performed once again the analyses of the technical and economic data using the “decision making tree” method for the period 2009-2041 and the result is the “mean” estimate (calculated on the basis of “3 point” estimation of the 3 probabilities and considered from statistical and mathematical perspective as the most plausible one). Thus, the Information considered was the following:

- Analysis period 2009 – 2041;
- Drilling of 7 wells, out of which 4 to be drilled in 2017 and 3 in 2018;

- Additional investment in infrastructure of USD 3 million for Cybinka and Torzym blocks;
- Historical costs incurred in the two blocks until 2015;
- Estimated year of start of production 2017;
- Crude oil estimated production to be exploited during the analysed period: 11.23 million barrels;
- Profitability analysis was performed for 4 analysis scenarios: high estimate (P10), best estimate (P50), low estimate (P90) and mean estimate (the probabilistic weighted average of the 3 mentioned probabilities P10, P50 and P90).

Thus „Romgaz“'s EMV (Earning Monetary Value - Expected Monetary Value) indicator was calculated based on commercial success probability (high geological risk) depending on the calculated NPV of „Romgaz“ in amount of EUR – 1.75 million, representing a loss for Romgaz.

The factors which determined the modification of results in the last alternative (October 2016) as compared to the previous alternative (February 2015) were:

- The crude oil estimated sale prices have dropped as compared to the previous alternative (February 2015), estimation made on the basis of the last forecast of the World Bank;
- Commercial success probability has been reduced from 11.8% (previous alternative) to 10.62% (current alternative), taking into account the geological risk which determines the commercial and economic success chance.

## **2.2. Analysis of the option for Romgaz to withdraw from the Polish concessions**

Considering the following:

1. The high geological risk and implicitly the high commercial/economic risk of the two blocks, and non-performing a transaction to a potential partner with the scope of mitigating such risk;
2. Misunderstandings between the other two partners, Aurelian and Sceptre, which persist from 2013 and have led to not concluding a work program (Romgaz by itself with its working interest share could not have proposed a work program, because the threshold for passing a vote is minimum 70%);
3. The negative result of the economic and financial analysis, namely the loss which would be recorded in Romgaz accounting records.

Romgaz considers that pursuing this activity cannot be taken into account anymore, and therefore has reviewed the consequences of Romgaz withdrawal from the aforementioned blocks.

According to the JPA's provisions, Romgaz withdrawal from the two Polish concessions consists of the following steps:

- Romgaz to notify the two partners on its decision to withdraw from the two concessions, which implies the withdrawal from both the JPA and the two limited

liability partnerships Energia Cybinka and Energia Torzym, where it is a limited partner;

- The assignment of Romgaz working interests to the two partners, in case only Romgaz withdraws (the other two partners decision is expected to be made in January 2016); according to JPA provisions at Article 13.6, such assignment shall be made to the other partners without any compensation from the partners receiving Romgaz current working interest;
  - Romgaz must bear all withdrawal and assignment costs, according to the JPA provisions (notarial formalities, assignment of working interests etc.);
  - Romgaz is required to pay all of its obligations for which it is liable up to the effective date of withdrawal, namely the work program to which Romgaz has agreed to participate by approving such in the OCM and the Minimum Work Program (works relating to the abandonment of well Sosna 1 estimated at a total of around EUR 0.4 million – out of this, Romgaz share is EUR 0.12 million, reports to environmental authorities etc.);
  - Payment of eventual damages to third parties, claimed by such third parties, arising from works performed in the field (only in the case all partners withdraw and abandonment works will be performed in 2016);
  - Romgaz withdrawal from the licenses relating to the Concessions and the relating Mining Usufruct Agreements, according to the provisions contained in these documents and the legislation in force (only upon unanimous decision of partners).
- From economic and financial perspective, Romgaz has already established in 2014 a total provision of EUR 4,735,187.85 consisting of:
  - Amounts Romgaz paid upon entering into the partnerships totalling EUR 781,733.02;
  - Amounts Romgaz has contributed to performing work programs, namely EUR 3,953,454.83.

For the obligations Romgaz is liable until the effective date of withdrawal, the company must establish another provision estimated at EUR 0.265 million, including well abandonment costs, costs incurred by notifying relevant authorities, required legal formalities.

#### **e) Romgaz Board of Directors Endorsement for Romgaz Withdrawal from the Polish Blocks**

In view of all of the above, Romgaz Board of Directors endorsed the proposal to withdraw from the two blocks in Poland both as partner under the Joint Partnerships Agreements concluded with Aurellan Oil&Gas Poland and Sceptre Oil & Gas and as limited partner in the two limited liability partnerships Energia Cybinka sp.z.o.o.sp.k and Energia Torzym s.z.o.o.sp.k.. In this respect, Board Resolution no. 24/December 18, 2015 endorses Romgaz withdrawal from Polish blocks.

In consideration of the above mentioned Romgaz requires:

***The approval for Romgaz:***

- ***to withdraw from the Partnership Agreements concluded with Aurelian Oil&Gas Poland and Sceptre Oil & Gas for performing petroleum operations in blocks Cybinka and Torzym in Poland;***
- ***to withdraw from the limited liability partnerships Energia Cybinka sp.z.o.o.sp.k and Energia Torzym s.z.o.o.sp.k. where it is a limited partner.***

**Chairperson of the Board of Directors  
Aurora Negruț**

