

NO 25988/ 05 October 2016

NOTE
on proposal for amending the performance indicators included in the Directors Agreement

I. Directors Agreement and Governing Plan

By Resolution no 12 on **July 26, 2013**, The General Meeting of Shareholders, approved the form of **Director Agreement** which shall be concluded with the Directors of the Board.

Director Agreement also includes clauses concerning the revision/updating of the performance indicators, as follows:

- ✍ *Article 4: “...The Director will execute all acts required.... in order to achieve the objectives and performance criteria established in Annex 1 to this document, and/or as annually amended, as the case may be, together with the other Directors of the Board, within 30 days from the approval/rectification of the income and expenditures budget.”*
- ✍ *Article 9: “The Director undertakes, together with the other Directors, to fulfil the governing plan and GMS resolutions, in order to achieve the objectives and performance criteria established in Annex 1 to this Director Agreement. Performance criteria and objectives are applicable during the entire assignment of the Director, and the values of the performance indicators will be updated annually in accordance with the provisions of the income and expenditure budget”.*

By Resolution no 16 as of **September 25, 2013**, The General Meeting of Shareholders approved the **Governing Plan of the company for the period 2013-2017**, presented and prepared by the Board of Directors.

The Governing Plan also provides the possibility to amend the performance indicators, mentioning the fact that the achievement of the indicators initially assumed by the directors is conditioned upon assignments undertaken by the state authorities, as follows:

- ✍ *“The performance indicators provided in this plan, resulting from the strategic objectives and the plan of measures to be achieved for fulfilling such objectives, shall be reviewed in order to be approved by the General Meeting of Shareholders, if it is found that for reasons beyond the director’s control, for external factors (the decline of the natural gas market and the electricity market, changes in the legal and regulatory frame etc.) or as a result of restating the financial statements in compliance with the International Financial Reporting Standards (IFRS) the objectives and the performance indicators cannot be fulfilled”- Summary of the Governing Plan (last paragraph);*
- ✍ *“The fulfilment of the performance indicators is conditioned upon:*

- *Compliance with the country's commitment to gradually increase the Romanian market sale price for domestic gas production to reach the convergence with the Romanian market sale price for import gas until December 31, 2018. The Commitment has been undertaken by the Letter of Intent signed with the International Monetary Fund, and by the Memorandum of Understanding signed with the European Commission, integral part of the Precautionary Stand-By Arrangement signed with the International Monetary Fund and the European Commission;*
- *ANRE compliance with legal provisions on adjusting the regulated income and underground gas storage tariffs.*

.....

In case, other circumstances or events beyond Romgaz control require it, the Governing Plan shall be amended/modified/supplemented accordingly as regards the level of the performance indicators” – item 4.7 Performance criteria and objectives of the Governing Plan (page 76 – last paragraph);

Although, (1) the country's commitment to gradually increase the Romanian market sale price failed to comply with, (2) the Romanian Government introduced a series of fiscal regulations with a significant impact on the company's performance and (3) the national gas consumption recorded a significant decrease, the company's management fulfilled its performance criteria and objectives initially assumed until March 31, 2016, as shown in the table below:

	3 months	6 months	9 months	12 months
2014	112.21%	122.25%	112.18%	113.62%
2015	143.36%	126.64%	110.98%	103.38%
2016	101.97%			

II. Measures undertaken as a result of contingencies which require the modification of performance indicators.

From the first year of the mandate, a number of contingencies arrived beyond the control of the board of directors or of the company's management that impede the fulfillment of the objectives and performance indicators included in the Directors Agreement and Governing Plan, respectively, such as:

- ✍ non-compliance of the calendar related to the gradual increase of the market sale price for domestic gas production considered when preparing and approving the Governing Plan;
- ✍ fiscal regulations with a significant impact on the company's performances, such as:
 - extending after December 31, 2014 the period for applying the windfall tax for gas producers as a result of price deregulation;
 - the tax on special constructions as of January 1, 2014, the so called “pole tax”
- ✍ reduced national gas consumption,

As a result, in accordance with the provisions of the Governing Plan and the Directors Agreement, the company's management requested to shareholders to amend the calculation method of performance indicators included in the Directors Agreement. The request was

substantiated by the Note no 13293 on May 16, 2016 presented to shareholders and discussed during the ordinary meeting on **June 16, 2016**.

Further the analysis of the substantiated requests within the note, by item 1 of Resolution no 5 as of June 16, 2016, the General Meeting of Shareholders approved “*the amendment of calculation method of performance indicators, namely by eliminating the effects of the influence of external factors that are beyond the control of the company’s management*”. By Item II of the same Resolution, the General Meeting of Shareholders approved “*the conclusion of an Adendum to the Directors Agreement for amending the calculation method of performance indicators, namely by eliminating the effects of the influence of external factors that are beyond the control of the company’s management*”, mandating the representative of the majority shareholder to sign the Adendum to the Directors Contract (item III).

Further the request of the Ministry of Energy, as a majority shareholder, the agenda of the Ordinary General Meeting of Shareholders on **August 11, 2016** was completed with the proposal for revocation of the approvals of the GMS during the meeting held on June 16, 2016 concerning the amendment of calculation method of performance indicators, conclusion of an Adendum to the Directors Agreement and mandating the representative of the majority shareholder to sign it. By Resolution no 7 as of August 11, 2016, GMS approved the requests formulated by the Ministry of Energy.

III. The effects of the provisions of GMS Resolution NO5/2016 on the performance indicators

In accordance with the provisions of Article 9, paragraph (1) letter c) of Emergency Ordinance no 26 as of August 26, 2013 on strengthening the financial discipline at the level of economic operators where the state or the administrative-territorial units are sole shareholders or majority or hold directly or indirectly a majority participation, **for the substantiation of the income and expenditures budget the following are taken into consideration:** “*the specific performance criteria and quantified objectives on reducing the outstanding payments and debts, reducing the losses, increasing the profit, revenue and labour productivity as well, as provided in the mandate contracts established in connection with the management strategy of the Board of Directors/Supervision Commission and governing plan of the directors/members of economic operators directorate*”.

As a result, the income and expenditure budget for the year 2016 has been prepared taking into consideration the amendment of calculation method of performance indicators, namely by eliminating the influence of the external factors that are beyond the control of the company’s management. The income and expenditure budget was subject to the shareholders analysis during the meeting on June 16, 2016 (Item IV on the agenda), when Item 1 concerning the approval for the amendment of calculation method of performance indicators was included.

The General Meeting of Shareholders approved the amendment of the performance indicators calculation method (Item I), the conclusion of an Addendum of the Directors Agreement including the amendment from Item I (Item II) and the mandating of the majority shareholder representative to sign the Addendum of the Directors Agreement (Item III), **as well as** the Income and Expenditure Budget as it was presented by the company’s management, respectively by taking into consideration the amendment of the performance indicators calculation method (Item IV).

Due to the fact that by Resolution No. 7/August 11, 2016 of the General Meeting of Shareholders the approvals included in Items I, II and III and Resolution No. 5/ June 16, 2016 were revoked, we consider that along with the revocation the directors have no longer performance indicators.

IV. Request

Due to:

- ↳ The provisions of the Directors Agreement which offer the possibility to an annual update of the performance indicators value;
- ↳ The approval by the General Meeting of Shareholders from June 16, 2016 to amend the performance indicators calculation method, to conclude an Addendum of the Directors Agreement and to mandate a representative of the majority shareholder to sign the Addendum of the Directors Agreement;
- ↳ The approval by the General Meeting of Shareholders of the Income and Expenditure Budget for 2016 which was substantiated taking into account the amendment of the performance indicators calculation method.

The Income and Expenditure Budget basically represents the main instrument for programming the financial results as well as the necessary funds, the budget's elaboration and performance, based on the principles of maximum efficiency and financial equilibrium. The role of the Income and Expenditure Budget is to reflect the modality of formation, administration and use of financial means and to ensure the provision of the information necessary to substantiate the decisions regarding the enterprise's management.

At the same time, the Income and Expenditure Budget may be considered a complex of actions materializing in a final document expressing the efficiency of the general activity of the enterprise by cumulating the income, expenses and results of a financial year. Consequently, the Income and Expenditure Budget appears as a system of correlated annexes reflecting the objective of the economical-financial strategy of the company.

The Income and Expenditure Budget is drawn up, based on the substantiation of each indicator in its smallest detail, by the company's management of the company and after that it is analysed and endorsed by the Board of Directors, analysed for approval by shareholders during the General Meeting of Shareholders, as according to the legal provisions in force¹ and the company's Articles of Incorporation².

Once approved by shareholders, the Income and Expenditure Budget indicators are the tasks of the Board of Directors and the company's management. Consequently, the accomplishment of the Income and Expenditure Budget indicators should go hand in hand with the remuneration system of the board of directors and the company's management.

¹ According to the provisions of Article 4, paragraph (1) letter d) of the Government Ordinance No. 26/August 21, 2013 as amended by Government Ordinance No. 11/January 2016, the income and expenditure budgets of the economic operators are approved by „*the Resolution of the General Meeting of Shareholders [...] in the case of economic operators whose shares are admitted to trading on a regulated market [...]*”.

² According to the provisions of Article 4 letter d) of the company's Articles of Incorporation, the Ordinary General Meeting of Shareholders is empowered to „*establish the Income and Expenditure Budget, for the next financial year*”.

↵ Revocation by the GMS on August 11, 2016 of the previous resolution regarding the amendment of the performance indicators calculation method, the conclusion of an Addendum of the Directors Agreement and the mandating of the representative of the majority shareholder to sign it.

we propose a new approach as far as regards the application of the provisions of Article 9 of the Directors Agreement on the modification of the performance criteria and objectives, as follows:

- Amendment of the calculation method, as presented in Chapter 4.7 of the Governing Plan approved by Resolution no. 12/July 26, 2013 of the General Meeting of Shareholders, modification of performance criteria in order to substitute the reporting base represented by the average for the previous three years with quarterly allocation afferent to the Income and Expenditure Budget, as well as amendment of the performance weighting coefficient, as according to Annex 11 of this Note;
- Establishing the performance indicators at Income and Expenditure Budget level as approved by Resolution No. 5/June 16, 2016 of the GMS.

In this respect, in order to eliminate the effects of the revocation of Resolution No. 5/2016 of the GMS provisions regarding the performance indicators, we hereby submit the following, when applying the provisions of Article 9 of the Directors Agreement, to analysis and approval:

- **Amendment of the calculation method of the performance indicators weighting coefficients as provided above, as well as the amendment of the Governing Plan, in this respect;**
- **Approval of the performance criteria and objectives as presented in Annexe 2 to this Note.**

**CHAIRPERSON OF
The BOARD OF DIRECTORS
Aurora NEGRUȚ**



**Performance Criteria and Indicators
(Weighting Factors)**

No.	Indicator	M.U.	Performance Criterion	Actual Weighting Coefficient	Proposed Weighting Factor
0	1	2	3	4	5
1.	EBITDA	thousand RON	increasing	0.25	0.20
2.	Revenue	thousand RON	increasing	0.20	0.15
3.	Labour productivity	RON/person	increasing	0.10	0.10
4.	OPEX to RON 1,000 operating income	RON	decreasing	0.10	0.15
5.	Geological resources	million m ³	decreasing	0.10	0.15
6.	Natural gas production decline		maintaining	0.15	0.15
7.	Outstanding payments	thousand RON	maintaining	0.10	0.10

**Performance Criteria and Indicators
(as according to the Income and Expenditure
Budget approved by Resolution No.5/2016 of the GMS)**

No.	Indicator	M.U.	Performance Criterion	Proposed Weighting Coefficient	Q1 2016	Q2 2016	Q3 2016	Year 2016
0	1	2	3	5	6	7	8	9
1.	EBITDA	thousand RON	increasing	0.20	714,448	1,087,379	1,259,681	1,941,255
2.	Revenue	thousand RON	increasing	0.15	1,270,295	1,955,882	2,386,580	3,495,859
3.	Labour productivity	RON/person	increasing	0.10	199.57	306.94	374.26	547.60
4.	OPEX to RON 1,000 operating income	RON	decreasing	0.15	520.84	607.86	687.71	645.95
5.	Geological resources	million m ³	increasing	0.15	750.00	1,400.00	2,000.00	2,600.00
6.	Natural gas production decline		maintaining	0.15	1,378	2,433	3,181	4,567
7.	Outstanding payments	Thousand RON	maintaining	0.10	0	0	0	0