

EXPERT PANEL DETERMINATION
PURSUANT TO

THE AGREEMENT FOR DETERMINATION BY EXPERT OF CERTAIN DISPUTES RELATED
TO COST RECOVERY (PATOS MARINZA OILFIELD)

DATED FEBRUARY 24, 2016

BETWEEN

THE MINISTRY OF ENERGY AND INDUSTRY OF ALBANIA, REPRESENTED BY THE
NATIONAL AGENCY OF NATURAL RESOURCES

AND

BANKERS PETROLEUM ALBANIA LTD.

DISSENTING OPINION OF:

MICHAEL A. ABALA,

EXPERT PANELIST,

NAVIGANT CONSULTING

August 5, 2016

Reported at

Miriam Harwood, Esq.
Curtis, Mallet-Prevost, Colt & Mosle LLP
101 Park Avenue
New York, NY 10178

Martin J. Valasek, Esq.
Norton Rose Fulbright Canada LLP
Suite 2500, 1 Place Ville Marie
Montreal, Quebec H3B 1R1
Canada

Dear Ms. Harwood and Mr. Valasek:

The purpose of this report ("Navigant Decision Letter") is to present Navigant's decision regarding the disputes between Bankers Petroleum Albania LTD ("BPAL") and the Ministry of Energy and Industry of Albania, represented by the National Agency of Natural Resources of Albania ("AKBN") in accordance with the *Agreement for determination by expert of certain disputes related to Cost Recovery (Patos Marinza Oilfield)* entered into by BPAL and AKBN (collectively, "the Parties") on February 24, 2016 ("Terms of Reference").

1 BACKGROUND OF THE DISPUTE

This dispute is between BPAL and AKBN. BPAL is a wholly-owned subsidiary of Bankers Petroleum Ltd ("BPL"), which is based in Calgary, Canada.¹ BPL's operations are primarily linked to BPAL's operations in Albania.² BPAL was originally incorporated as Saxon International Energy Ltd ("Saxon") and changed its name to BPAL in 2006.³ AKBN is the successor to the National Petroleum Agency ("NPA") and was established in 2006.⁴ AKBN's stated mission is to develop, supervise and monitor the use of natural resources in the mining, petroleum and energy sectors in accordance with government policy.⁵

BPAL operates the Patos-Marinza oilfield that is located in the Republic of Albania and is one of the largest onshore oilfields in continental Europe. BPAL's operation of the Patos-Marinza oilfield is governed by two related agreements: the License Agreement and the Petroleum Agreement (the "Agreements").

- The License Agreement was entered into in June 2004 between the Ministry of Energy and Industry (represented at the time by the NPA and now by AKBN) and Albpetrol Sh.A. ("Albpetrol").⁷ Albpetrol is a state-owned oil company that explores, develops

¹ Written submission of Bankers Petroleum Albania Ltd dated April 20, 2016 ("BPAL Submission"), page 2.

² Ibid.

³ Written submission of the Ministry of Energy and Industry of Albania, represented by the National Agency of Natural Resources ("AKBN Submission"), page 1.

⁴ BPAL Submission, page 2.

⁵ www.akbn.gov.al/minish/?lang=en

⁶ AKBN Submission, page 14.

⁷ License Agreement for the Development and Production of Petroleum in Patos-Marinza Oilfield between The Ministry of Industry and Energy as represented by The National Petroleum Agency and "Albpetrol" Sh. A., Fier dated June 7, 2004 ("License Agreement").

and produces crude oil and natural gas.⁸ Albpetrol is also responsible for the administration of the existing Albanian oil fields and some of the exploration blocks.⁹

- The Petroleum Agreement was executed in June 2004, after the License Agreement, between Albpetrol and Saxon (later renamed to BPAL).¹⁰ As part of the Petroleum Agreement, Albpetrol and Saxon executed an Instrument of Transfer that transferred Albpetrol's rights, privileges and obligations under the License Agreement to Saxon.¹¹ As a result, BPAL became a party to the License Agreement. The License Agreement provides that should there be a conflict or disagreement between the provisions of the Petroleum Agreement and of the License Agreement, the License Agreement will prevail.¹²

The Petroleum Agreement was approved by Albania's Council of Ministers in July 2004 and the License Agreement and Petroleum Agreement simultaneously went into effect. The License Agreement provides for a 25-year term, ending in 2029, with the option for 5-year extensions thereafter.¹³

The Agreements allow BPAL to recover certain costs incurred for the project from the revenues generated by the sale of crude oil production (after the deduction of certain royalties).¹⁴ However, as part of the Agreements, BPAL must prepare an annual Work Plan and Budget ("WP&B") that outlines its estimated capital and operating costs and revenues for the upcoming year. The WP&B requires approval from both Albpetrol and AKBN. BPAL also provides monthly and quarterly progress reports to both AKBN and Albpetrol. Among other items, compare actual performance to the WP&B.¹⁵

Additionally, the Agreements provide AKBN the right to inspect and audit BPAL's books of account and accounting records for three years after the end of the subject year. Albpetrol also has the right to audit BPAL's cost account statements. In March 2014, AKBN began the audit of BPAL's costs for 2011 and 2012.¹⁷ As part of the audit, AKBN worked with BPAL personnel to obtain documentation related to the costs incurred. AKBN also recoverable.¹⁸ In December 2014, AKBN issued its initial audit report for 2011 and 2012 ("Preliminary Audit Report").¹⁹ In the Preliminary Audit Report, AKBN stated that it considered \$255 million of costs in 2011 to be non-recoverable (out of total costs of \$384 million).²⁰ In 2012, BPAL issued a report responding to the

⁸ BPAL Submission, page 3.

⁹ *Ibid*, page 3.

¹⁰ Petroleum Agreement – Document dated June 19, 2004 between Albpetrol Sh.A. and Saxon International Energy Ltd ("Petroleum Agreement").

¹¹ AKBN Submission, page 49; Petroleum Agreement, Annex E – Instrument of Transfer.

¹² License Agreement, Article 11.

¹³ AKBN Submission, page 49.

¹⁴ *Ibid*.

¹⁵ BPAL Submission, pages 15 and 16.

¹⁶ *Ibid*, page 16.

¹⁷ Letter from AKBN to BPAL dated March 21, 2014 (Prot 2526).

¹⁸ AKBN Submission, page 49.

¹⁹ Technical-Financial Audit Report for the Expenses of the Petroleum Operations Performed from the Company Bankers Petroleum Albania Ltd for the Year 2011, dated December 24, 2014 ("Preliminary Audit Report").

²⁰ *Ibid*, pages 4 and 33.

objections noted in the Preliminary Audit Report (“BPAL Observations”).²¹ In July 2015, AKBN issued its final audit report (“2011 Audit Report”).²² The 2011 Audit Report accepted BPAL’s explanation for certain costs (approximately \$51 million) but concluded that \$248 million of costs from 2011 were not recoverable.²³

In September 2015, the Albanian Tax Authority issued a tax assessment to BPAL for unpaid profit taxes resulting from the adjustments noted in the 2011 Audit Report.²⁴ The amount assessed included taxes of 7 billion lek (approximately US\$56 million) and fines of 458 million lek (approximately US \$4 million).²⁵ BPAL disputed the assessment and the Parties initially planned to submit the dispute to an independent expert.²⁶ However, in September 2015, BPAL submitted the dispute over the 2011 Audit Report as well as other matters to the International Chamber of Commerce (“ICC”) for arbitration.²⁷ As such, the Parties did not proceed with the initial expert proceeding. In January 2016, the Parties agreed to stay the ICC Arbitration and submit the dispute over the recoverability of the costs identified in the 2011 Audit Report to an independent expert.²⁸ Accordingly, in February 2016, the Parties agreed to the Terms of Reference for this expert proceeding (see **Appendix I**).²⁹ The Terms of Reference include the following mandate for the Expert Panel:

1.3 The Mandate. *The Expert shall determine whether the Cost Account items maintained by Bankers for Fiscal Year 2011 to which AKBN objected in the Audit Report (the “Disputed Costs”) qualify as recoverable Petroleum Costs under the terms of the License Agreement and, to the extent applicable, the Petroleum Agreement and the Arbitration Procedure (together, the “Agreements”), and were incurred reasonably and in conformity with generally accepted practices in the international petroleum industry.”*³⁰

Article 1.2 of the Agreement references the Parties’ agreement to jointly appoint an expert to decide the dispute and provides for a process to be followed by the expert which is set out in Schedule 1 to the Agreement (“Schedule 1”).³¹

²¹ Patos-Marinza Development Project, Observations of Bankers Petroleum Albania Ltd. on AKBN Findings on the Audit Report No. 671/5 Prot., dated 24.12.2014 (“the Preliminary Audit Report”) Sent upon Letter of AKBN No. 11142 Prot, dated 24.12.2014 (“BPAL Observations”).

²² 2011 Audit Report.

²³ *Ibid*, page 87.

²⁴ Notice on Tax Assessment Liability dated September 8, 2015, Prot. no. 10501/1 (included as Exhibit 10 to the BPAL Submission).

²⁵ *Ibid*, page 6. Based on the tax assessment issued on September 8, 2015 (\$1 USD/125.2 lek). The calculation of taxes owed was based on classifying the costs identified in the 2011 Audit Report as non-deductible expenses, and rolling forward the impact of these reductions over the 2011 and subsequent years. Fines were calculated only on profit taxes from 2011.

²⁶ Terms of Reference for determination by expert of certain disputes related to Cost Recovery (Patos Marinza Oilfield), dated September 24, 2015 (included as Exhibit 48 to the AKBN Submission).

²⁷ Request for Arbitration dated September 25, 2015 between Bankers Petroleum Albania Ltd (Cayman Islands), Claimant, vs. The Ministry of Energy and Industry represented by the National Agency of Natural Resources (Republic of Albania) and Albpetroil Sh.A. (Republic of Albania) Respondents (included as Exhibit 44 to the AKBN Submission).

²⁸ AKBN Submission, page 54.

²⁹ Agreement for determination by expert of certain disputes related to Cost Recovery, dated February 24, 2016 (“Terms of Reference”).

³⁰ *Ibid*, page 2.

³¹ *Ibid*, page 7.

Schedule 1, Section A.1 – **Expert**, references the individuals from PricewaterhouseCoopers (Annex A) and Navigant Consulting (Annex B) agreed upon by the Parties to serve as the Expert Panel. They include Messrs. Albert Vondra, Doug Branch, and Jason Wardell from PricewaterhouseCoopers (“PwC”) and Mr. Peter Badala from Navigant Consulting (“Navigant”), hereinafter “the Expert Panel”. Engagement Letters with PwC and Navigant were signed in March 2016 and the expert proceeding commenced.

Schedule 1, Section A.2 - **Decision** sets out the following expectations by the Parties on how the members of the Expert team shall interact:

2. Decision: The members of the Expert team shall work together to issue a Decision concerning the Dispute, each member having full participation in the process outlined in Section B below, including review of the Parties’ Written Submissions, access to any and all documents and information provided in the course of the Expert Proceeding, including Bankers’ books and records, issuing questions and requests for documents, conducting the Hearing, and preparing and issuing a reasoned Decision, which shall be signed jointly by one individual from Annex A hereto (PWC) and one individual from Annex B hereto (Navigant). The Expert members shall make every effort to achieve unanimity. If unanimity cannot be achieved, the Decision shall be issued by PWC, and such Decision shall be binding on the Parties. In that case, the individual from Annex B hereto (Navigant) who disagrees with the Decision, or any part thereof, shall give the reasons for such disagreement in a separate written document and shall file a dissenting opinion to the Decision but shall be communicated to the Parties (the “Dissenting Opinion”).

Navigant and PwC engaged their respective wider organizations to support the appointed Expert members work. Throughout this process the Navigant and PwC Experts met routinely to discuss the issues presented by both sides. Regular joint or alternate face-to-face meetings and common access to key documents including reports and data enabled effective collaboration. There was a high degree of engagement, open challenge, and resolution of differing views between the Experts during the process.

2 Navigant’s Expert Determination

2.1 Amounts in Dispute

The initial amount in dispute was US\$147,584,845, based on the costs considered by AKBN to be non-recoverable in the 2011 Audit Report.³²

In its written submission in support of this proceeding, BPAL accepted US\$187,179 of the costs identified in the 2011 Audit Report as non-recoverable.³³ As such, the amount in dispute in this proceeding is US\$21,407,666, which is as follows:

³² 2011 Audit Report, page 87.

³³ Bankers Submission, pages 80-81. The Submission notes that the amount accepted for items considered out of scope was \$42,021 and the amount accepted for items considered to have insufficient supporting documentation was \$145,158, which totals \$187,179 (rather than \$175,597 as shown in the Submission).

Table 1: Initial claim as reduced by items accepted by BPAL³⁴

Initial amount in dispute		\$ 247,584,845
Less: Items accepted by BPAL as non-recoverable		
Portion of insurance payments (Connecticut, Zurich, Cigna)	\$ 14,912	
Contract Accountant	13,016	
Boga Shpk	620	
Various expenses	13,331	
Penalty payment	142	
Donations and Sponsorships	145,158	
Total items accepted by BPAL		(187,179)
Final amount in dispute		\$ 247,397,666

The Parties grouped the US\$247.4 million of disputed costs into five cost categories in their Submissions. Although similar, certain of the summarized items used by the Parties differed. For the purposes of the Expert Panel's Determinations, items are presented under the categories used by BPAL as presented below.

Table 2: Final amount in dispute by Category³⁵

Category	Disputed Amount
Competitive Bidding	\$ 114,316,923
HOH	73,210,233
Inventory	25,372,000
Diluent	19,330,000
Other – Out of Scope	8,168,135
Other – Insufficient	7,000,375
	\$ 247,397,666

³⁴ Reference PwC Report page 11

³⁵ Reference PwC Report page 12

2.2 Navigant's Expert Determination

Navigant actively participated in drafting the PwC Report entitled *Expert Panel Determination Pursuant to The Agreement for Determination by Expert of Certain Disputes Related to Cost Recovery (Patos-Marinza Oilfield) dated February 24, 2016 between The Ministry of Energy and Industry of Albania, Represented by the National Agency of Natural Resources and Bankers Petroleum Albania Ltd, dated August 5, 2016* (the "PwC Report").

Navigant and PwC have reached near unanimity on the recoverability of the disputed costs set forth in Tables 1 and 2 above. However Navigant disagrees with PwC's conclusions with respect to the recovery of disputed costs related to Competitive Bidding for the reasons discussed in 2.2.1 below. A summary of Navigant's Expert determination on the recovery of disputed costs and the basis for its determination by category of disputed costs is summarized in Table 3 below.

Table 3: Navigant Expert Determination by Category³⁶

Category	Disputed Amount	Navigant Expert Determination		
		Recoverable	Non-Recoverable	Basis for Decision
Competitive Bidding	\$ 114,316,923	\$ 91,409,754	\$ 22,907,169	2.2.1 below
HOH	73,210,233	73,210,233	0	PwC Report, Pages 27 – 32
Inventory	25,372,000	25,372,000	0	PwC Report, Pages 32 – 36
Diluent	19,330,000	19,330,000	0	PwC Report, Pages 36 – 40
Other Costs – Out of Scope	8,168,135	0	334,730	PwC Report, Pages 40 – 59
Other Costs – Insufficient Support	7,000,375	35,600	4,712	PwC Report, Pages 60 – 72
TOTAL	\$ 247,397,536	\$ 224,351,055	\$ 23,246,611	

2.2.1. Navigant's Dissent on Regarding Recovery of Costs – Competitive Bidding

2.2.1.1. Albstar Costs of US\$22,907,169 are Non-recoverable

Navigant refers to pages 2 through 27 of the PwC Report. Navigant and PwC agree that BPAL's intention was to sole source US\$22.9M in work performed by Albstar in 2011, and that Albstar competitively bid the work as required by Article 21.2 of the Petroleum agreement. There is no Willful Default.

³⁶ Reference PwC Report page 5

However, Navigant disagrees with PwC's determination that the US\$22.9M in Albstar costs that flow from the Willful Default are recoverable. This determination is contrary to the language in Article 10.2(c) of the License Agreement which states:

"Costs and expenditures which are incurred as a result of Willful Default of LICENSEE or Operator shall not be considered as Petroleum Costs and shall not be recoverable pursuant to this Section 10.2."

Navigant believes the language of Article 10.2(c) of the License Agreement is clear, the costs incurred as a result of Willful Default are not considered as Petroleum costs and therefore shall not be recoverable. Moreover, the language in Article 10.2(c) is consistent with Navigant's experience with other government to private party contract arrangements and industry practice that provide for the exclusion or disallowance of all costs incurred as a result of a Party's violation of contract terms.

Based on the Expert Panel's unanimous decision that BPAL's failure to competitively bid the scope of work Albstar was paid more than US\$22.9M in 2011 represents Willful Default, and the clear language contained in Article 10.2(c) which is consistent with industry standard, Navigant concludes Albstar costs of US\$22,907,169 are non-recoverable.

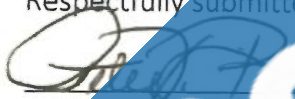
2.2.1.2 Remaining eight vendors

Navigant agrees with PwC that the costs of the remaining eight vendors are recoverable.

3 Conclusion

In accordance with the Mandate given to the Expert Panel in the Terms of Reference, Navigant reviewed and analyzed all of the data and information submitted by the Parties including the written submissions, documents produced in response to questions posed by the Expert Panel, and results of the Hearing conducted by the Panel. For the reasons stated in Section 2 of this Report, Navigant concludes that the total recoverable costs are US\$224,151,055 and the total non-recoverable costs are US\$22,907,169.

Respectfully submitted,


Peter B. [illegible],
Expert Panelist,

Navigant Consulting Group

August 5, 2016