

Role of the Corporate Centre in improving the management of subsidiaries

The Corporate Centre of the Gazprom Neft Group is Gazprom Neft PJSC, which ensures effective control over all processes. As of 31 December 2018, Gazprom Neft comprised 133 Russian and foreign legal entities.

The corporate governance structure of the Gazprom Neft Group's subsidiaries is aligned with that of Gazprom Neft PJSC. In the majority of subsidiaries there are retaining a three-tiered structure of governance bodies: the meeting of shareholders (members), the Board of Directors and the sole executive body.

For the list of material companies within Gazprom Neft Group, see appendix 4 on p. 315

SUBSIDIARIES' DECISION-MAKING MATRIX

The Board of Directors of Gazprom Neft PJSC adopts resolutions on the following matters of subsidiaries' operations:

- increase or reduction in the subsidiary's authorised capital;
- contributions to the subsidiary's assets;
- acquisition, disposal, or encumbrance of shares/stakes in other entities;
- contributions to the assets of other entities;
- issue and allocation of shares;
- reorganisation or liquidation.

The Management Board of Gazprom Neft PJSC considers the matters of subsidiaries' strategic development.

General Meeting of Shareholders/Members of a subsidiary

The legally prescribed responsibilities reserved exclusively to a subsidiary's General Meeting of Shareholders/Members regarding key operational decisions are supplemented by the need to approve any transactions exceeding a certain threshold. The latter is determined on a case-by-case basis for each subsidiary based on its financial and economic performance.

The **Board of Directors** of a subsidiary has a broader scope of authority compared to what is provided by law to enhance control over the remit of the sole executive body with respect to transactions that involve:

- borrowings or issue of loans, guarantees or sureties;
- sale, other disposal, or encumbrance of immovable property;
- lease of key immovable property;
- acquisition, disposal or encumbrance of interests in authorised capital, shares, bonds, mortgages or promissory notes.

Furthermore, the remit of a subsidiary's sole executive body is limited and is subject to prior approval of the Board of Directors or the General Meeting of Members when it comes to the decisions on:

- transactions that involve gratuitous disposal of property;
- corporate contracts and other joint operating agreements;
- any transactions exceeding a certain threshold;
- participation or termination of participation in other entities;
- predetermined votes on matters that are reserved to the General Meeting of Shareholders/Members of companies in which the subsidiary is a shareholder (member).

Regardless of the structure of its authorised capital, Gazprom Neft PJSC is the parent company with respect to the Gazprom Neft Group's subsidiaries, as duly recorded in their respective charters. One of the means used to ensure effective corporate governance and monitoring of subsidiary operations is the review of subsidiaries' key operational matters by the Gazprom Neft PJSC governance bodies.

The Company has developed and approved procedures that allow for coordinating and monitoring the subsidiaries' operations under the guidance of the Corporate Centre as part of the Company's Development Strategy.

Participation of any entity of the Gazprom Neft Group in another entity, whether commercial or non-commercial, is only approved via collective decision-making by a group of duly authorised persons. Matters pertaining to subsidiaries' strategic development are submitted for preliminary approval to Gazprom Neft's Management Board.

The General Meeting of Shareholders/Members and the Board of Directors of a Gazprom Neft subsidiary have an established procedure for making decisions. The Company's representatives participating in the governance bodies of the Group's entities exercise a prudent and professional approach to their duties to maximise the effectiveness of decision-making.

The joint ventures in which the Gazprom Neft Group's entities hold a stake have a formalised and approved governance structure. To efficiently manage these ventures, the Company established the role of an asset supervisor who is responsible for coordinating the management efforts.

Nominees to the Board of Directors and Internal Audit Commission of a subsidiary are subject to annual approval by Gazprom Neft's Corporate Centre. A subsidiary's Board of Directors is formed based on the established functional reporting lines.

Executive bodies of the Gazprom Neft Group's entities (including the CEO) are appointed to their position subject to approval by the Corporate Centre, irrespective of the level of corporate ownership and authorised capital structure of a subsidiary.

KEY CHANGES TO THE CORPORATE STRUCTURE OF THE GAZPROM NEFT GROUP

January 2018 saw the completion of Arcticgas reorganisation, which established equal participation (50/50) of Gazprom Neft and NOVATEK.

Arcticgas holds a licence for the Samburgsky licence block that includes the Samburgskoye, Urengoyskoye, Vostochno-Urengoyskoye, and Severo-Yesetinskoye fields. It also holds licences for the Yaro-Yakhinsky, Yevo-Yakhinsky, and Severo-Chaselsky licence blocks.

The 50/50 shareholding split creates the perfect synergy, making it possible to reap the benefits of shared access to vast expertise in hydrocarbon production, regional experience and infrastructure. An additional economic benefit of the change in the Arcticgas shareholding comes to Gazprom Neft in the form of lower overheads and administrative expenses on the back of streamlined structure.

On 6 July 2018 Gazprom Neft established LLC Bazhen Technology Centre, whose key purpose will be to develop commercially viable domestic technologies to develop the Bazhenov Formation. The new legal entity is located in the Khanty-Mansi Autonomous Area, and its asset portfolio will consist of licence blocks previously held on the balance sheet of Gazpromneft-Khantos and having good prospects in terms of the development of Bazhenov Formation reserves. The Bazhenov cluster will comprise the Palyanovskaya area within the Krasnoleninskoye field, five licence blocks within the Nyalinskaya group of fields, and three blocks in the Salymsk field.

The search for ways to develop hard-to-recover reserves in Russia represents a strategic priority for Gazprom Neft. The project to create a range of domestic technologies for developing the Bazhenov Formation was initiated by the Company, having been awarded the status of a national project in May 2017. It brings together oil companies, R&D centres, service providers and industrial equipment manufacturers that are interested in getting involved.

In August 2018, Gazpromneft Bitumen Materials acquired 100% of Bitumen Terminals, which, in turn, holds a 100% stake in the authorised capital of Trans-Real, the owner of the Salsk bitumen terminal.

The Salsk bitumen terminal is a modern automated bitumen terminal in the Rostov Region. The terminal has facilities for receiving, storing, compounding and loading bitumen, as well as for manufacturing polymer-bitumen binders. The acquisition of this asset will boost the Gazprom Bitumen Materials share in the market of the Southern Federal District with annual transshipment volumes of up to 140 ktpa.

In September 2018, Gazprom Neft closed the sale of 49% in Gazpromneft-Vostok to Mubadala Petroleum and the Russian Direct Investment Fund.

Gazpromneft-Vostok holds subsoil licences for Shinginsky, Zapadno-Luginetsky, Yuzhno-Pudinsky, Archinsky, Urmansky and Krapivinsky licence blocks.

In 2017, the company obtained subsoil licence for the exploration of the Parabelsky block.

Following the deal, Gazprom Neft retained 51% in the joint venture, while Mubadala Petroleum and RDIF got 44% and 5%, respectively.

Under the deal terms, the Gazprom Neft Group will be able to continue to fully consolidate Gazpromneft-Vostok in its IFRS statements. The joint venture that emerged from the Gazpromneft-Vostok transaction was the first investment project of Mubadala Petroleum in the Russian oil and gas sector.

In October 2018, Gazprom Neft acquired a 100% stake in the authorised capital of Enercom, a company holding a licence for geological exploration, prospecting and production of hydrocarbons from the Solnechny block (Tashlinsky District, Orenburg Region).

This acquisition will be the launch pad for a separate production cluster in the southwest of the Orenburg Region, which will significantly expand Gazprom Neft's resource base in a key development region.

On 23 November 2018, Gazpromneft-Prirazlomnyye was incorporated as a new legal entity responsible for the Prirazlomnaya platform operation and crude oil production. Gazpromneft-Prirazlomnyye was established as part of organisational transformation of the Offshore Development Division. As a result of the transformation, Gazprom Neft Shelf will become the competence and decision-making centre responsible for managing all of the Company's offshore projects, while Gazpromneft-Prirazlomnyye will focus on offshore oil and gas projects.

In December 2018, the Garant-Service joint venture was established by Gazprom Neft and Sberbank Leasing, each holding a 50% stake. It is meant to maximise financial access to state-of-the-art drilling equipment and services for Gazprom Neft Group.

In December 2018, Gazpromneft-NNG was reorganised via a merger with the Zapolyarneft subsidiary. The aim of the merger was to streamline the corporate structure of Gazprom Neft's subsidiaries, making them easier to manage. To that end, operator relations between the reorganised subsidiaries were abolished.

In late 2018 Gazprom Neft and Repsol acquired 100% of ASB GEO, which holds a geological exploration licence for the Karabashsky 10 block in the Khanty-Mansi Autonomous Area. The company will be managed on a parity basis.

Karabashsky 10 is located in the Kondinsky District, in the southwest of the Khanty-Mansi Autonomous Area – Yugra. It is now at an early exploration stage. The block adjoins the Karabashsky zone licence blocks that are already controlled by Eurotek-Yugra, another joint venture of Gazprom Neft and Repsol.

The following companies were liquidated as part of the Group's corporate structure optimisation:

- > Gazprom Neft Adria d.o.o.;
- > Tzar Petrol Investment Limited;
- > LLC West-Siberian Investment Consortium.

REORGANISATION OF SALES COMPANIES

Due to a change in its regional sales model, in 2018, Gazprom Neft Group continued to reorganise its sales operations, intending to create a retail business centre from one of the Group's companies.

Reorganisation objectives

- > make petroleum product sales more economically viable;
- > expand business;
- > increase the quality of managerial decisions;
- > facilitate innovation and business automation;
- > reduce administrative costs;
- > establish centralised control over regional oil depots via a dedicated company of Gazprom Neft Group.

2018 saw the following initiatives designed to reorganise the Group's sales assets:

- > LLC Gazpromneft-ZS (Retail) was reorganised via spin-off of LLC Gazpromneft-ZS (AZS), which was then merged into LLC Gazpromneft-Centre;
- > LLC Gazpromneft-ZS (Retail) was reorganised via spin-off of LLC Gazpromneft-ZS (NB), which was then merged into JSC Gazpromneft-Terminal;
- > LLC Gazpromneft-ZS (Retail) was reorganised via merger into JSC Gazpromneft-Novosibirsk;
- > LLC Gazpromneft-Novosibirsk (AZS) was reorganised via merger into LLC Gazpromneft-Centre;
- > JSC Gazpromneft-Novosibirsk was reorganised via spin-off of LLC Gazpromneft-Novosibirsk (NB), which was then merged into JSC Gazpromneft-Terminal;
- > LLC Gazpromneft-Centre was reorganised via spin-off of LLC Gazpromneft-Centre (NB) and its merger into JSC Gazpromneft-Terminal;
- > PJSC Gazpromneft-Tyumen was liquidated. After liquidation, PJSC Gazpromneft-Tyumen's 100 % stake in the authorised capital of LLC Gazpromneft-Tyumen was distributed to Gazprom Neft PJSC.

COMMITMENT TO BETTER CORPORATE GOVERNANCE

The Company closely monitors corporate laws and best practices both in Russia and globally in an attempt to improve its corporate governance framework.

In 2018, the steps taken to enhance corporate governance were as follows:

- > the Extraordinary General Meeting of Shareholders approved amendments to the Company's Charter to reflect changes in the Federal Law On Joint-Stock Companies pertaining to major and interested-party transactions, as well as the Company's policy to align applicable corporate procedures with the thresholds set for transactions subject to approval by the Board of Directors;
- > the Extraordinary General Meeting of Shareholders approved new versions of the Regulation on the General Meeting of Shareholders, Regulation on the Board of Directors, Regulation on the Management Board, and Regulation on the Chief Executive Officer. The updated documents take into account the recommendations of the Corporate Governance Code and best practices followed in Russia. For example, the new version of the Regulation on the Board of Directors:
 - provides a list of matters reserved exclusively to the Board meetings held in person in line with the recommendations of the Corporate Governance Code;
 - allows the directors staying away from the meeting venue to participate in deliberations and vote remotely via conference calls and video conferencing;
 - describes cases that can be qualified as a conflict of interest for a director and sets out a procedure for notifying the Company about them;
- > the Board of Directors approved amendments to the Company's Transaction Handling Procedure and Procedure for Interaction with Investee Entities. These amendments are designed to increase applicable transaction value thresholds with a view to improving efficiency of the Board of Directors by transferring the authority to oversee day-to-day operations to the CEO;
- > the resolution of the Board of Directors dated 20 December 2018 approved the Regulation on the Secretary of the Board of Directors, with the Secretary's responsibilities fully aligned with the recommendations of the Corporate Governance Code;

- > the Human Resources and Compensation Committee approved new criteria to assess performance of the Board of Directors and deemed it advisable to engage a qualified independent service provider (consultant) for the Board's review at least once in three years;
- > the Company's shareholders have an opportunity to use two e-voting solutions provided by the National Settlement Depository (NSD) and DRAGA, the Company's registrar.

CORPORATE GOVERNANCE FRAMEWORK DEVELOPMENT IN 2018

Approval of a new strategy for the period until 2030 triggered a full-fledged transformation of the Company's corporate governance framework.

In 2018, the Company began to automate its corporate procedures to streamline the setup of governance bodies, information disclosure processes, transaction approvals and control over subsidiaries and joint ventures.

For example, an automated corporate governance solution is in the works to ensure centralised management of business processes in both Gazprom Neft and its subsidiaries through the tightening of control over the Group of companies and enforcement of compliance with the corporate procedures. The solution aims to improve corporate governance efficiency by enabling workflow automation, quick access to information, and stronger corporate controls over the subsidiary operations.

"2018 was the first year the Company's shareholders could use new e-voting solutions. The implementation of remote voting systems confirms the Company's commitment to introducing advanced digital technologies in both production processes and business communications, as the new solutions make corporate governance more transparent and accessible, while also facilitating the exercise of shareholder rights".

Elena Ilyukhina
Deputy CEO for Legal and Corporate Affairs

Focus on the protection of shareholder rights includes efforts to:

- > improve disclosure transparency;
- > update the shareholder register and upgrade the Online Shareholder Account.

Focus on greater efficiency of the Company's governance bodies includes efforts to:

- > improve operating procedures;
- > enhance controls over corporate procedures.

Focus on information disclosures includes efforts to:

- > improve the procedure for information transfer and approval all the way through from any given event actually taking place to its disclosure in the securities market;

- > update the Company's by-laws and processes to align them with the latest inside information statutory requirements;
- > launch the Single Disclosure Window interface for mandatory notices and corporate news.

Focus on corporate governance improvements and adoption of best practices includes efforts to:

- > enhance corporate governance framework in subsidiaries;
- > update Group-wide corporate governance by-laws and procedures.

Corporate governance framework

The key targets, goals and principles underpinning Gazprom Neft's corporate governance framework include preserving and growing the Company's asset base, increasing its market value, maintaining financial stability and profitability of the Company, and respecting the rights and interests of its shareholders, investors and other stakeholders.

A highly professional management team and an effective system of corporate governance and control are a prerequisite for the successful management of a complex multi-tiered vertically integrated oil company with domestic and foreign upstream and downstream assets. The Company currently has a well-defined organisational structure encouraging seamless interaction between its governance bodies and clear distribution of governance and control roles to guarantee progressive growth of the shareholder value in the long term.

Accountability and financial transparency (with adjustments made for the Company's concerns about the protection of trade secrets and other confidential data) play a pivotal role in Gazprom Neft's corporate governance system.

The Company's website offers access to the latest news, financial and operating results, reports and other useful information, while also making available the documents on Gazprom Neft's governance and control bodies, including the Charter, Regulation on the General Meeting of Shareholders, Regulation on the Board of Directors, Regulation on the Management Board, Regulation on the Chief Executive Officer, and Regulation on the Audit Commission.

To ensure equitable access to information for all stakeholders, the materials at Gazprom Neft's official website are available in both Russian and English.

KEY COMMUNICATION CHANNELS AVAILABLE TO A WIDE RANGE OF STAKEHOLDERS

- the Company's official website <https://www.gazprom-neft.com/>
- Annual and sustainability reports <https://ar2018.gazprom-neft.com/>
- IR section of the website <http://ir.gazprom-neft.com/>