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## ANNUAL REPORT

*of the Nomination and Remuneration Consulting Committee  
concerning the remunerations of the Administrators and of the  
Director General of SNTGN TRANSGAZ SA  
for the year 2015*

### ***I. Legal framework concerning the remuneration policy and criteria for administrators and general manager of SNTGN TRANSGAZ SA:***

- Art.15. point 3 let (d) of the Articles of Incorporation of SNTGN Transgaz SA, updated on March 27<sup>th</sup> 2012, providing that the main duty of the GMS is, ***establishing the monthly remuneration of the board members;***
- Art.111, line (2), let. c) of Companies Law no. 31/1990, with the further amendments and supplementing, in addition to the debate of other items on the agenda, the GMS is obliged ***“to establish the remuneration due for the current year to the members of the Board of Administration , unless otherwise established in the articles of incorporation”;***
- Art.153^18, line (1) of Companies Law no. 31/1990 with the further amendments and supplementing, providing that ***“The remuneration of the members of the Board of Administration is established by the articles of incorporation or by decision of the general meeting of shareholders”;***
- Art. 37, line (1) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, amended by GEO no. 51/May 29<sup>th</sup> 2013, providing that ***“The remuneration of the members of the Board of Administration is established by the general meeting of shareholders”.***
- Art. 37 line (2) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, amended by GEO no. 51/May 29<sup>th</sup> 2013, providing that ***“The remuneration of the members of the Board of Administration consists in a fixed monthly compensation and a variable component consisting in a share of company’s net profit, a pensions scheme or another form of remuneration based on performance indicators”;***
- Art. 37, line (3) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, introduced by GEO no. 51/May 29<sup>th</sup> 2013, providing that ***“The fixed monthly compensation of non-executive members may not exceed the average of the past 12 months of the average gross monthly earning in the field in which the company performs its activity,***

*communicated by the National Institute of Statistics previous to the appointment”;*

- Art. 37 line (5) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, introduced by GEO no. 51/May 29<sup>th</sup> 2013, providing that *“the level of variable component is established by the board of nominee according to grounded recommendations formulated based on a compared study on the remuneration conditions for similar positions within companies having the same object of activity, in which the state holds the majority or entire capital, from Romania or other European countries...”*
- Art. 37 line (6) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, introduced by GEO no. 51/ May 29<sup>th</sup> 2013, providing that *“the GMS shall ensure the set up of the monthly fixed compensation of each member of the Board of Administration , that it is justified as concerns the specific tasks, the tasks within consulting committees, the number of meetings, objectives and performance criteria established in the mandate agreement”;*
- Art. 39 line (1) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, introduced by GEO no. 51/ May 29<sup>th</sup> 2013, providing that *“the remuneration and other benefits offered to administrators shall be recorded in the yearly financial statements and in the yearly report of the nomination and remuneration committee”;*
- Art. 39 line (2) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, *according to which the policy and criteria for remunerating administrators and managers in case of an unitary system are made public on the Internet page of the public undertaking by care of the Board of Administration ;*
- Art.20. point 1 let (d) of the Articles of Incorporation of the company updated on March 27<sup>th</sup> 2012, providing that *the main task of the Board of Administration and the duty to appoint, suspend or revoke the general manager of Transgaz and to establish his/her remuneration;*
- Art.142, line (2), let. c) of Companies Law no. 31/1990, with the further amendments and supplementing, provides that the Board of Administration has, in addition to the basic competencies, that can not be delegated to managers, *the competence to appoint and revoke the managers and to establish their remuneration;*
- Art.143, line (1) corroborated with Art.143 line (4) of Companies Law no. 31/1990 with the further amendments and supplementing and corroborated with Art. 19. point 7 of the updated Articles of Incorporation of the company, providing that the *Board of Administration will delegate company’s management to the Director General of SNTGN Transgaz SA who is not the president of the Board of Administration ;*
- Art.143, line (5) of Companies Law no. 31/1990 with the further amendments and supplementing, *the manager of a joint stock company may only be the person to whom the company's management duties have been delegated according to art. 143, line (1) of the Law no. 31/1990;*
- Art.153<sup>^</sup>18, line (2) of Companies Law no. 31/1990, with the further amendments and supplementing, providing that *the remuneration of directors in a unitary system is established by the Board of Administration.* The articles of incorporation or general meeting of shareholders establishes the general limits of all remunerations granted in this respect;
- Art. 38 line (1) of the Government Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, introduced by GEO no. 51/ May 29<sup>th</sup> 2013, providing that *“The remuneration of directors is established by the*

*Board of Administration and may not exceed the level of the remuneration established for the executive members of the Board of Administration . This is the only form of remuneration of directors who are also administrators”.*

- Art. 38 line (2) of the Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, amended by GEO no. 51/ May 29<sup>th</sup> 2013, providing that “*the remuneration consists in a fixed monthly compensation and a variable component consisting in a share of company’s net profit, a pensions scheme or another form of remuneration based on performance indicators*”;
- Art. 37 line (4) of the Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, introduced by GEO no. 51/ May 29<sup>th</sup> 2013, providing that “*The fixed monthly compensation of executive members may not exceed 6 times the average of the past 12 months of the average gross monthly earning in the field in which the company performs its activity, communicated by the National Institute of Statistics previous to the appointment*”;
- Art. 34 line (2) of the Emergency Ordinance no. 109/2011 on the corporate governance of public undertakings, providing that *The nomination and remuneration committee formulates proposals on the remuneration of directors/members of the Board of Administration and other management positions.*

## **II. The structure of the remuneration of administrators and director general of SNTGN TRANSGAZ SA**

Based on the norms enumerated above and on the mandate contracts concluded the following amounts of the remuneration have been established:

### **Fixed remuneration**

The monthly gross fixed remuneration for each non-executive member of the Board of Administration is of lei 4,037 and has been approved by Decision of the General Ordinary Meeting of Shareholders no. 8 of July 10<sup>th</sup> 2013, art. 3.

The monthly gross fixed remuneration of the Director General (executive administrator) is of lei 24,224 and has been approved by Decision of the Board of Administration no. 12 of July 11<sup>th</sup> 2013, art. 5.

The fixed remuneration is paid to the **ATTORNEY-AT-FACT** during the last working day of the month for which it is due.

### **Variable remuneration**

Variable remuneration has been approved by Decision of the General Ordinary Meeting of Shareholders no. 9 of September 23<sup>rd</sup> 2013, art. 2, respectively once with the approval of the form of the Mandate contract to be concluded by the members of SNTGN Transgaz SA’S Board of Administration, form agreed by the majority shareholder, the Romanian State, represented by the Ministry of Public Finance, and published on SNTGN TRANSGAZ SA webpage by means of letter no. 5917/August 28<sup>th</sup> 2013.

Therefore, at art. 3 the Mandate contract provides the following:

In addition to gross monthly compensation, the Attorney-at-fact has the right to receive a variable annual component of the remuneration calculated based on the Performance indicators provided in the Table “PERFORMANCE CRITERIA AND OBJECTIVES IN ORDER TO CALCULATE VARIABLE COMPENSATION” at Appendix no. 1 to this report, as follows:

***Variable annual remuneration = Annual bonus for performance indicator referring to EBIDTA + Annual bonus for performance indicator referring to “Operating expenses (excluding depreciation)” + Annual bonus for performance indicator referring to “Investments”***

The annual bonus for performance indicator referring to EBIDTA is due to the ATTORNEY-AT-FACT only to the extent the level of EBIDTA indicator achieved during the year for which the determination is made is equal to or higher than the EBIDTA indicator of the concerned year, respectively assumed through the Administration plan and is in the following **net amount**:

- lei equivalent of the amount of euro 40,000 for the member of the Board of Administration occupying the position of Director General of the Principal;
- lei equivalent of the amount of euro 10,000 for the President of the Board of Administration ;
- lei equivalent of the amount of euro 8,000 for each of the other non-executive members of the Board of Administration .

The annual bonus for performance indicator referring to “Operating expenses (excluding depreciation)” is due to the ATTORNEY-AT-FACT only to the extent the difference between the level of the indicator “Total operating expenses” and the level of the indicator “Depreciation” achieved during the year for which the determination is made is lower than the level of the indicator “Operating expenses (excluding depreciation)” assumed through the Administration plan for the concerned year. The bonus is calculated by applying a 3% coefficient to net saving obtained during that year due to reaching a level of expenses lower than the one assumed through the administration plan; the net amount is established through the formula:

*Annual bonus for the performance indicator referring to “Operating expenses (excluding depreciation)” = 3% x (“Operating expenses excluding depreciation” assumed during that year through the Management Plan – (“Total operating expenses” made during that year – “Depreciation” achieved during that year).*

The annual bonus previously provided shall be distributed among the members of the Board of Administration in percentage according to the following calculation formula:

- 54% of the annual Bonus to the member of the Board of Administration also occupying the position of Director General of the Principal;
- 13% of the annual Bonus to the President of the Board of Administration;
- 11% of the annual Bonus to each of the other non-executive members of the Board of Administration.

The annual bonus for performance indicator referring to “Investments” is due to the ATTORNEY-AT-FACT only to the extent the level of “Investments” indicator achieved during the year for which the determination is made is higher than the “Investments” indicator of the concerned year assumed through the Administration plan. The bonus is calculated by applying a 3% coefficient to the additional investments value achieved during that year, value established as difference between the level of “Investments” indicator achieved and the indicator “Investments” assumed through the Administration plan; its net amount is established according to the formula:

*Annual bonus for the performance Indicator referring to “Investments” = 3% x (“Investments” made during that year – “Investments” assumed for that year through the Administration plan)*

The annual bonus previously provided shall be distributed among the members of the Board of Administration in percentage according to the following calculation formula:

- 54% of the annual Bonus to the member of the Board of Administration also occupying the position of General Manager of the Principal;
- 13% of the annual Bonus to the President of the Board of Administration;
- 11% of the annual Bonus to each of the other non-executive members of the Board of Administration .

The level achieved during that year of „EBITDA”, „Total operating expenses” and “Depreciation” indicators serving as calculation basis of the provided bonuses is given by the corresponding level of that indicator within the yearly financial statements drafted according to the International Financial Reporting Standards adopted by the European Union applied to the concerned year, audited according to the law, and the assumed level of „EBITDA” respectively “Operating expenses excluding depreciation” indicators shall be the one provided in the Table “General Result” in the Management Plan.

The level achieved during that year for “Investments” indicators serving as calculation basis of the provided bonus is given by the corresponding level of “Investment expenses” indicator within the budget drafted for that year as ascertained in the Inspection report of the Ministry of Public Finance concerning the framing of economic-financial indicators resulted during that year (row 80) and the assumed level of that indicator is the one provided in the Table “Investment sources” row 2.1 of the Management Plan.

The payment of the Bonus for „EBITDA” performance indicator shall be effected in four equal quarterly installments payable during the fiscal year for which it is established and the regulation shall be done depending on the results obtained during that year within 30 days as of the approval by the GMS of the audited yearly financial statements, the ATTORNEY-AT-FACT following to entirely reimburse the value of the bonus if the concerned performance indicator is not fulfilled.

The payment of the bonuses for the performance indicator referring to “Operating expenses (excluding depreciation)” and for the performance indicator referring to “Investments” shall be effected within 30 days as of the approval by the GMS of the audited yearly financial statements corresponding to the year for which the concerned bonuses are granted.

In 2015 the remunerations for the non-executive and executive members of the Board of Administration of SNTGN TRANSGAZ SA are:

***Fixed remuneration (net values):***

President of the BA – lei 32,650

Non-executive members (three) –  $34.167 \times 3 =$  lei 102,272

Executive member (general manager) – lei 216,598

***Variable remuneration:***

***I. Bonus for „EBITDA” performance indicator***

“EBITDA” performance indicator was fulfilled in proportion of 126% respectively at a value of 619,625 thousand lei assumed in the Administration plan, being obtained an amount of 779,579 thousand lei.

The variable component related to the bonus for this indicator has been paid during the year 2015 as follows (net values):

- President of the BA – lei 44,670
- Non-executive members (three) – lei  $35,454 \times 3 =$  lei 107,205
- Executive member (General Director) – lei 178,678

## ***II. Annual bonus for “Operating expenses (excluding depreciation)” performance indicator***

This compensation criterion, that rewards the administrators by 3% of the additional savings to the ones estimated in the Management Plan is essential for the shareholders and for the company’s clients, considering that all savings made have a positive effect for the decrease of SNT transportation rates, with direct impact on the industrial and household consumers of natural gases and on all players on Romanian gas market. Moreover, such savings lead to a substantial benefit for the state and the company’s shareholders by increasing the level of dividends.

In 2015, such savings were significant and clearly suggested the sustained effort of the administrators to eliminate a high degree of inefficiency that existed within the company during the previous management teams.

For the “Operating expenses (excluding depreciation)” indicator the Management plan included a level of 1,077,002 thousand lei corresponding to the year 2015. According to the financial situation, audited, related to 2015, the total operating expenses registered summed up 883.818 lei excluding the level of the depreciation thus representing a degree of accomplishment of the assumed level of 122%.

Under these conditions, the annual bonus for 2015 related to "Operating expenses (excluding depreciation)" indicator is calculated by applying the percentage of 3% to the difference between the level assumed in the plan (1,077.002 thousand lei) and the real level achieved (883.818 lei), resulting a net amount of the bonus of lei 795.519.

The net variable component related to the bonus for this indicator is distributed between the members of the Board of Administration, according to the provisions of the mandate contract, as follows:

- President of the BA – lei 753,417
- Non-executive members – lei 1,912,521
- Executive member (Director General) – lei 3.129.580.

## ***III. Annual bonus for „Investments” performance indicator***

“Investments” performance indicator was fulfilled in proportion of 68% respectively at a value of 352,200 thousand lei assumed in the management plan, being obtained an amount of 239,554 thousand lei.

Under these conditions, the members of the Board of Administration do not have the right to receive for 2015 an annual bonus related to “Investments” performance indicator.

This performance criterion rewards the administrators by 3% of the investments made in addition to the ones included in the Management Plan starting from the presumption that such new investments are vital to the future development of the system especially for special projects of national interest associated to new gas sources. These future investments must be carefully managed so that no non-sustainable price increases occur. Thus, due to the rating system based on fixed profit ratios applied to the regulated assets base, any increase of the assets base (result of investments) not accompanied by a corresponding increase of the transported volumes may automatically lead to increases of transportation rates.

We mention that the current Board of Administration has decided to approach this objective with maximum responsibility, even if such an approach has negative effects on management teams' compensation. Thus, there was decided the maintenance of the investments program within optimum limits, considering the possible negative effects resulting from:

- The performance of investments outside the legal frame (At the level of the company there are many cases of tens of kilometers of works started by the previous administrations that did not have the necessary authorizations and that at this moment are either suspended or under different dispute stages). The company’s administrators suspended such investments and collaborate with the Romanian state in order to rectify some of the legal deficiencies such as the easement right of public interest companies.

- Performance of investments at overvalued values. Company's administrators prevalently and decisively treated the deficiencies pointed out in the report of the Control Body of the Prime Minister by the performance of a transparent and proper procurement process materialized in substantial savings to the starting prices. All such savings that, even if at a first glance would lead to a decrease of the investment program's accomplishments, result into a substantial benefit for the company and national rates.
- Performance of investments without European financing. Some of the investment forecasts in the Management Program are correlated to EU financing. The change of EU financing methodology resulted into major delays in accessing these funds. The assumption of such investments, necessary for a long time but not essential on a short term would lead to an unjustified increase of the natural gas transmission rates.
- The performance of investments without future contributions of new natural gas sources. Some forecasts in the Management Plan include the transportation of natural gas extracted from the Black Sea. Such investments may be assumed only when the beneficiaries Exxon/Petrom undertake the financial liability of transportation. Delays in undertaking such a liability postponed such investments up to the consortium's FID (final investment decision).

Without considering such aspects, through a rational adjustment to the gas market situation, some of the planned investments may lead to a non-sustainable increase of SNT rates without tangible benefits for the system. In order to limit any negative effect upon tariffs, the company's administrators have avoided to force the artificial fulfillment of this indicator, limiting any expense that is not absolutely necessary and that can not be associated either to an urgent need of the system, or to European financing or to new natural gas sources for transportation.

Limiting the tariffs increase by an extreme limiting of costs, within reasonable limits, and any investment which is not profitable or absolutely necessary, represents a basic objective of the present administrators who wish to limit the possible overwhelming effects of the rates upon the country's economy which already faces a difficult adapting process to the gas price liberalization. It is worth mentioning that such investments shall be initiated once the conditions undertaken for such a start are met, either new gas sources or EU financing. These two aspects will ensure us that the future development of the system shall not lead to a non-sustainable increase of rates.

Moreover, 2015 financial year proved that savings made during 2014 are sustainable and that non-performed investments are solidly substantiated in favor of the company and the shareholders.

## **CONCLUSIONS:**

- Considering the performance indicators' achievement degree, the quarterly payment of the bonus for the "EBITDA" indicator results that, the annual bonus for 2015 owed to the Board of Administration according to the mandate contract sums up the total net amount of lei 5.795.519 to be distributed per each member of the Board of Administration, as follows:
  - Chairman of the BA: Mr. Ion Sterian –lei 753.417;
  - Non-executive members:
    - Mr. Cernov Radu – lei 637.507,
    - Mr. Iliescu Bogdan lei 637.507 and
    - Mr. Rizoiu Andrei – lei 637.507

Executive member (General Manager): Petru Vaduva – lei 3.129.580

Nevertheless, compared to the variable remuneration value in accordance with the contract of mandate arisen from the application of the calculation formulas provided by the contracts of

mandate at the level of undertaken performance indicators and, respectively, actually fulfilled, also taking into consideration the “Compared study for setting out the variable component of the remuneration of the members of the Board of Administration and the Director General of SNTGN TRANSGAZ SA” prepared in accordance with the Government Emergency Ordinance no.109/2011, Article 37 (5) by the human resources recruitment company whose services were contracted for the selection of the members of the Board of Administration, **the net amount of the annual bonus that would be due to them for 2015 shall be paid within the range below:**

President of the BA: Mr. Ion Sterian –lei 610.438;

- Non-executive members: Mr. Cernov Radu lei 238.998,
  - Mr. Iliescu Bogdan lei 238.998 and
  - Mr. Rizoiu Andrei –lei 238.998.
- Executive member (Director General): Petru Vaduva –lei 1.491.206

We mention that the remunerations described above are the only forms of remuneration of the members of the Board of Administration and that no member benefits from other bonuses, benefits in kind or additional or anticipated pension schemes.

The mandate contract concluded with each member of the Board of Administration has a term of 4 (four) years starting with the date of the Decision of the General Ordinary Meeting of Shareholders through which the Attorney-at-fact has been chosen as administrator.

#### *Nomination and Remuneration Committee*

*Ion Sterian*

*Radu Cernov<sup>1</sup>*

*Bogdan Iliescu*

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<sup>1</sup> Mr Cernov declares the following: “*I do not agree with the inclusion of the statement related to comparative study for setting the variable component of the remuneration ...*” *this study cannot produce any legal effects upon the relation of the administrators with the company*”



**PERFORMANCE CRITERIA AND OBJECTIVES  
FOR CALCULATING THE VARIABLE COMPONENT OF REMUNERATION  
2015**

Order no	PERFORMANCE CRITERIA	PERFORMANCE OBJECTIVE
1	EBIDTA	Achievement of EBIDTA target assumed in the administration plan 779.579 thousand lei
2	Operating expenses excluding depreciation	Decrease of operating expenses (excluding depreciation expenses) actually made reported to the level undertaken in the Administration plan 883.818 thousand lei
3	Investments	Increase of the level of investments made reported to the level undertaken in the Administration plan 239.554 thousand lei

**PERFORMANCE CRITERIA AND OBJECTIVES  
UNDERTAKEN THROUGH THE ADMINISTRATION PLAN  
2015**

Order no	PERFORMANCE CRITERIA	PERFORMANCE OBJECTIVES
1	EBIDTA	Achievement of EBIDTA target assumed in the administration plan 619.625 thousand lei
2	Operating expenses excluding depreciation	Decrease of operating expenses (excluding depreciation expenses) actually made reported to the level undertaken in the Administration plan 1.077.002 thousand lei
3	Investments	Increase of the level of investments made reported to the level undertaken in the Administration plan 352.200 thousand lei