

# ENCLOSURE # 1

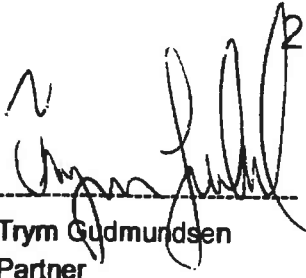
Confidential

# FINAL REPORT

## #4

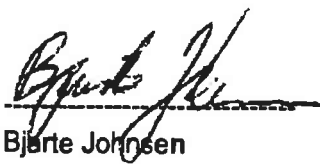
Discover Petroleum International AS

26.11.2008



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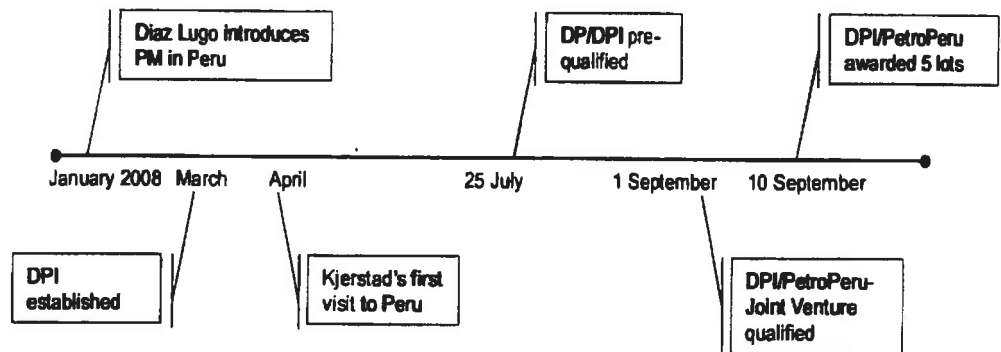
## 2. Summary of observations

### 2.1 Introduction

Our review has revealed observations that we would like to bring to the attention of the DP Board of Directors. This summary should only be read in conjunction with chapter 1.3 "Our engagement, assumptions and scope limitations". Please also refer to chapter 4 for further details regarding the presented observations.

DP, through DPI, got pre-qualified 25 July 2008. On 10 September 2008 DPI and PetroPeru was awarded 5 lots in Peru.

The process that led to the award included presentation of the PM technology, foundation of DPI, prequalification of DP through DPI, founding of a DPI and PetroPeru joint venture and participation the bid process in September:



*Timeline: Extract of PM and DPI's activities in Peru from January to October 2008*

When DPI entered the Peruvian market, it also set up a local branch and hired local advisors. We have reviewed payments, contracts and use of advisors as well as the processes that led to the lots award.

Our review has shown that a total of USD 330 957 (ex. Norwegian law firm Steenstrup Stordrange's NOK fees of 90 473) is paid from DPI and DP to advisors in the period from January 2008 to 3 October 2008. The total includes USD 185 000 in bank bails. In addition, DPI has paid USD 100 000 to its advisor Mario Diaz Lugo (see details in chapter 2.4, item 3 below).

Please note that our review has included payments not only from DPI, but also DP, PM and EMTV – herein referred to as related parties. PM and EMTV have paid approximately USD 205 000 to its advisors Mario Diaz Lugo and Manuel Hurtado Cardador in 2008. Please note that this

amount according to DPI is limited to PM's business activities in Mexico and Peru.

## 2.2 Overall observations regarding payments

Overall, the review of payments from DPI and related parties has not identified direct payments to PeruPetro or PetroPeru representatives or other government officials in Peru.

### 2.2.1 Peru related costs

Our review of payment has shown that payments are initiated by either agreements or by cost claims, i.e. invoices. Some exceptions exist, i.e. expired contracts and not full supportable documentation. Please refer to chapter 4.2 for payment details and observations.

DPI has explained that it considers the amount spent on pursuing Peruvian business opportunities as reasonable. Our review has shown that DPI's total Peru related cost is USD 330 957 (excluding legal expenses in Norway, and a USD 100 000 payment to DPI's Mexican advisor). If we look at the amount alone, the USD 330 957 comprise the following:

- USD 63 900 to its local representative Leon Alegria
- USD 76 637 to its legal representative Arias Schreiber (including USD 13 000 in branch capital)
- USD 185 420 to its legal representative for banking bails
- USD 5 000 to a Peruvian law firm (advance payment)

It is difficult for EY to give a conclusive opinion on whether the cost seems reasonable or not, as the nature of the services delivered (consulting services) is hard to quantify and measure. Based on EY's experience from assisting in similar establishments abroad the DPI costs related to the establishment in Peru does not appear unreasonable.

Please note that EY's review does not include how funds have been spent by the receiving parties, nor if funds have been transferred further to other parties.

### 2.2.2 Alberto Quimper's role

The review has identified what can be considered indirect payments to Alberto Quimper, member of the PeruPetro board of directors, in return for professional legal services rendered. His services are rendered after 5 May 2008. From this date, DPI was aware of his role in PeruPetro.

## 2.3 Overall observations regarding the pre-qualification, the DPI and PetroPeru joint venture and the lot award ceremony

DP, through DPI, got pre-qualified 25 July 2008. From what we have been presented with and learned through interviews, a zero business rating score is of no legal obstacle to pre-qualify in Peru.

Both DPI and PetroPeru has explained that the joint venture was based on a mutual business rationale, and that both companies would benefit from a joint venture.

The joint venture was awarded 5 lots in September. We see that 4 lots were won without competition and that the royalty percentage offered for one of the lots was the highest lot winning bid.

According to DPI, the award ceremony itself was not possible to manipulate as it comprised sealed bid envelopes, live and public bid opening and real-time scoring in accordance with pre-defined criteria.

Except for these facts, it has not been part of EY's mandate to further evaluate the processes that led up to the lot awards in September.

## 2.4 Summary of observations

In the following we summarize our observations. Please refer to chapter 4 for details, including payment details in chapter 4.2:

1. Alberto Quimper is not contracted by DPI and has not received direct payments from DPI. However, Quimper, according to work descriptions in payment documentation from DPI's legal representative, Ernesto Arias Schreiber, seems to have received payments through Schreiber. DPI seems to have paid approximately USD 12 000 (including approximately USD 2 000 for expenses) for legal services rendered by Alberto Quimper, including a tax report issued in June 2008 which states Quimper's name. Quimper was at the time of service delivered a PeruPetro board member, which came to DPI's attention 5 May. In an interview with Ernst & Young, Schreiber claims that he has not paid Quimper.
2. a) The pre-qualification process  
DP, through DPI, received a zero business rating score when it got pre-qualified. Our review of the pre-qualification process has shown that a zero business rating score is of no legal obstacle to pre-qualify in Peru. A low rating will imply some constraints, though, i.e. limit the number of licenses a company can apply for,

and access to apply for what is considered the most promising lots is not granted. In DPI's case, the zero score would have left the company with an option of bidding for maximum 3 lots. When it comes to our review of the formal correspondence, we have noted some issues in terms of dates and versions of letters. Please refer to chapter 3.1, item 7, for details.

**b) The DPI and PetroPeru joint venture**

Both DPI and PetroPeru has explained that the joint venture was based on a mutual business rationale, and that both companies would benefit from a joint venture.

PetroPeru has not had any exploration activity for the last decade. For this reason, we have learned that PetroPeru did not meet the requirements in the previous bid process in 2007 and hence did not participate. When DPI and PetroPeru teamed up in a formal joint venture, it is said that DPI would benefit from a higher business score rating, and PetroPeru would benefit from access to modern technology and exploration experience allowing it to participate.

**c) The bid process/lot award ceremony**

In the bid process, the DPI and PetroPeru joint venture chose to pursue 7 lots and won 5. Four of DPI and PetroPeru's wins were without competition, one was won in competition with Petro-Tech and the last two were lost to Petro-Tech.

Our high-level review of the bid process has shown that the requirements set out were subject to changes following the 2007 bid process. We are familiar with the allegations in Peru saying that the changes favored smaller companies like DPI. The allegations is not in line with the explanation of PetroPeru's Cesar Gutierrez Peña, who has stated that the reason for the changes in evaluation criteria is that PeruPetro wanted to attract larger companies than the ones that won the competitive bidding process in 2007. It has not been part of EY's mandate to review or verify these changes.

During the award process ceremony, all participating companies received a real-time scoring for their submitted bids made up of three pre-defined elements (Business Score, Technical Bid Score and Royalty Bid Score). The award process took place live and the sealed bid envelopes were opened in public.

3. One of DPI's advisors, Mario Diaz Lugo, has received monthly payments from related parties of DPI since July 2007 that is not governed by a written contract. Prior to that, he had a contract with PM effective 12 months from July 2006. These payments are related to his Latin America work. Since January 2008, Diaz

Lugo has also been working towards Peru to open the market for PM and later DPI.

4 July 2008 Diaz Lugo received a USD 100 000 payment from DPI. Jostein Kjerstad has explained that this was a personal loan granted to Diaz Lugo upon request. Diaz Lugo has confirmed to us that he asked for a loan in order to settle the last remaining payment on his new apartment in Mexico City.

Our review of this transaction has showed that it is unclear whether this transaction is a personal loan or a payment to Diaz Lugo for services rendered. The reason for this uncertainty is that the supporting documentation do not correspond what we are told in interviews. When Kjerstad had agreed to grant Diaz Lugo a loan, the latter sent Kjerstad an invoice reading "loan". This was by Kjerstad's request altered, and Diaz Lugo sent a new invoice, now reading "Start up and open the market in Latin America" as instructed by Kjerstad. Diaz Lugo has explained that, although he had asked for a loan, he after the second invoice and at the time of transfer was under the impression that the loan now was to be considered a payment for his services in Mexico and also Peru. This is not in line with what Kjerstad has explained – he claims that the transaction still was to be considered a loan although the invoice text had changed.

Our review has shown that the parties did not enter into a written loan agreement. Furthermore, the accounting records shows that the transaction in DPI is recorded as a cost and not as a loan.

Diaz Lugo has presented bank documentation supporting his apartment explanation; USD 65 000 is credited to the apartment seller, and USD 35 000 was at the time of our review still deposited and unused in his account (EY has not performed any verification or inquire related to this transfer or to the participant's identification of the property sale, as well as to the property information).

DPI has explained that this transaction do not relate to its Peru activities and hence that is why the USD 100 000 payment is not included in its 8 October press release (please refer to appendix 4 and 5 for details). Jostein Kjerstad has emphasized that this transaction was a personal loan to Diaz Lugo and never a payment for his work in Peru.

Upon finalization of our report we were told that Diaz Lugo and Kjerstad recently has entered into a written agreement that the USD 100 000 is to be paid back by June 2009.

4. Prior to what happened in Peru in October this year, DPI was in a process of a stock issuance that was terminated, in which Diaz Lugo was to receive a 5 % ownership in DPI, based on his contract with PM and verbal agreements with DPI.
5. We have not found that Fortunato Canaan at any point in time has been engaged by DPI or related parties nor received any direct payments. DPI denies that Canaan assisted DPI in any way in the pre-qualification process. However, Canaan has played a role in introducing DPI to Peruvian authorities, i.e. Kjerstad's meeting with the Peruvian President 26 April, but such arrangements have been executed through and in coordination with Diaz Lugo and not DPI. EY did not observe evidence in the available information which shows that these coordinations have had any pre-approval of DP or DPI. Canaan has tried to collect remuneration from DPI because of his claimed efforts in helping DPI in the process of getting pre-qualified. His claim was expressed in a letter to Discover Petroleum S.A. dated 30 September 2008. This claim was rejected 2 October by DPI through a letter from its legal advisor in Norway. Kjerstad has explained that he met Canaan for the first time in Peru on 26 April, and that he then decided not to engage Canaan. At that time, Kjerstad claims that he was not aware of the fact that it was Canaan who had arranged the meeting with the Peruvian president.
6. DPI's legal representative, Ernesto Arias Schreiber, 22 May 2008 entered into a contract with DPI, which entitles him a monthly fee of USD 10 000 + USD 1 000 to cover taxes. In addition, he was to be paid an annual amount of USD 17 000 for taxes at end of fiscal year (every March). For his 6 months of service Schreiber has been paid USD 60 000. We have not found that DPI has covered taxes as set out in the contract, but merely paid the invoices from Schreiber which did not claim the USD 1 000 amount. Schreiber has in an email to DPI requested that the word "invoice" should be left out in the DPI bank payment documentation as this would invoke taxes on his services. DPI's legal advisor in Norway has advised DPI against complying with Schreiber's instructions. We see that payments for September and October are not labeled "invoice". DPI explains that the company in September was in process of hiring professional tax advisors and legal advisors. On 15 September EY Peru sent two draft engagement letters for DPI's signature for acceptance for the services for establishment of the legal vehicle in Peru and for tax continued services. These draft engagement letters were not signed by DPI. No work has been performed by EY in this matter.
7. Prior to pursuing Peruvian business opportunities, DPI has explained that it did execute due diligence steps and inquired about potential local advisors. Despite its efforts, DPI seems to



have entered into formal or informal business relationships with advisors that do not comply with good practice standards.

8. Romulo Leon Alegria, a former Peruvian minister, was engaged by DPI through a contract dated 3 June this year. The contract entitles Alegria to monthly payments of USD 15 000 plus expenses. The parties agreed that the terms of the contract should start upon the written notification from PetroPeru that DPI has been awarded the concession of Lot 56 in coordination with PetroPeru and/or PetroBras. DPI halted its participation in the award process connected to Lot 56 and instead chose to focus on other lots coming up in the bid process in September 2008.

DPI has explained that it still wanted to render Alegria's services, but due to time pressure the contract was not altered to reflect the change in scope. We see that Alegria has been paid for services in May, although the contract is effective from 3 June. Prior to the contract dated 3 June, Alegria presented a draft contract to DPI which in addition to a monthly fee (sum not stated in the draft) also would give Alegria a success fee (to be agreed) for opening the market plus a monthly bonus corresponding to 1 % value of each barrel extracted. The draft states no exact date, only the month of May. According to DPI, this draft was rejected because such ways of compensation was unacceptable. The contract signed on 3 June 2008 does not comprise any success fee based remuneration.

Furthermore, Alegria in September made another draft labeled "Success fee contract addendum", with reference to the 3 June contract. This draft exists in two versions, the only difference being the fee sections. In one version, Alegria repeats his claim for a monthly bonus corresponding to 1 % value of each barrel extracted. In addition, the draft states an advance fee of USD 300 000 upon signing. An additional USD 200 000 shall be granted within thirty days from the start of the exploration process. Finally, until the production of oil starts, Alegria is to receive USD 300 000 every six months thereafter as an advance fee. The other version is identical with the exception that the percentage of each barrel extracted is not stated as it is to be determined by the characteristics of each oil well.

These success fee addendums has never been presented to DPI, according to Kjerstad. The two versions came to DPI's attention because the translator Lily LeMasters had copies which she delivered to EY in the cause of this review.

Alegria also on one occasion allegedly needed USD 500 000 to pay off people in both PeruPetro and PetroPeru. DPI has expressed that all claims for success fee have been rejected, and EY has not observed any trace of promises or identified

transactions or payments that indicate that DPI has accepted such claims.

9. Payments of USD 13.000 (10.000 + 3.000) in branch capital and advance payments have been made to the DPI legal representative Ernesto Arias Schreiber. We have not been able to identify further supporting invoices or receipts that can document how these funds have been used. It is a possibility that funds still are deposited in the bank as it is working capital for the branch, but this we have not verified due to Schreiber's limited availability.
10. In compliance to the bidding process documentation, DPI, through its legal representative, issued bank bails corresponding to the number of lots it applied for, totaling USD 140 000 for 7 lots. All the funds to cover the bank bails have been transferred to the DPI legal representative's account in a Peruvian bank, Scotiabank. According to DPI's executives, due to a misunderstanding, DPI at first only transferred one bank bail of USD 20 000. As a result, DPI's legal representative had to guarantee for the remaining 6 lots in order to meet the deadline, 8 September 2008. DP completed the balance of US\$120 000 on September 10, 2008.

## 2.5 Recommendations

We will recommend the following actions for the DP Board of Directors:

- Obtain a legal evaluation regarding the observations presented in this report.
- Further examine the status of DPI fund deposits held by Ernesto Schreiber in Peru