

## **FIRM BROCHURE**

### **SEP MANAGEMENT I, LLC**

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**This brochure provides information about the qualifications and business practices of SEP Management I, LLC. If you have any questions about the information contained in this brochure, please contact us at (713) 783-8000. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the “SEC”) or by any other regulatory authority.**

**This brochure does not constitute an offer, solicitation or recommendation to sell or an offer to buy any securities, investment products or investment advisory services. Such an offer may only be made to eligible persons by means of delivery of applicable offering and/or governing documents that contain a description of the material terms relating to such investments, products or services.**

**Additional information about SEP Management I, LLC also is available on the SEC’s website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).**

MARCH 25, 2013

## Item 2: Material Changes

The date of our initial firm brochure was February 13, 2012. A summary of certain changes that have been made to our firm brochure since the date of our initial firm brochure is set forth below:

- We share offices and certain administrative staff with Nilgai Capital Management, LLC, a private investment advisory firm that is managed and operated by Herman I. Silber (“Nilgai”). Nilgai is separately registered as an investment adviser with the Texas State Securities Board. Nilgai is operated separately and independently from SEP. **See “Item 10: Other Financial Industry Activities and Affiliations.”**
- In May 2012, we relocated our principal office to 1111 Bagby, Suite 1800, Houston, Texas 77002.

The information set forth in this brochure is qualified in its entirety by the applicable offering and/or governing documents. In the event of a conflict between the information set forth in this brochure and the information in the applicable offering and/or governing documents, such documents will control.

We encourage all clients and investors to carefully review this document in its entirety.

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## Item 4: Advisory Business

### FIRM DESCRIPTION

SEP Management I, LLC, a Delaware limited liability company (“SEP,” “we,” “us” or “our”), was organized in 2007. We provide investment management services to an affiliated private pooled investment vehicle (together with its wholly owned subsidiaries, the “Fund”) primarily with respect to direct and/or indirect investments in oil and natural gas properties, assets and related interests (including equity securities). Our investment advice is provided in accordance with the investment objectives and strategies described in the offering and governing documents of the Fund, and the information in this brochure is qualified in its entirety by the information set forth in such documents.

### PRINCIPAL OWNERS

Sanchez Oil & Gas Corporation, our affiliate (“SOG”), is the sole member of SEP. SANTIG, Ltd. and Antonio R. Sanchez, Jr. are stockholders of SOG. Mr. Sanchez, Jr. also is a limited partner of SANTIG, Ltd.

### TYPES OF ADVISORY SERVICES

We provide investment management services to the Fund primarily with respect to direct and/or indirect investments in oil and natural gas properties, assets and related interests (including equity securities). In addition, the Fund may also enter into hedging contracts in an attempt to reduce its sensitivity to oil and natural gas price volatility. We have full discretionary power and authority with respect to the investment of the Fund’s assets, including the location, acquisition, management and liquidation of investments.

Pursuant to the terms of a management services agreement by and among SOG, the Fund and certain direct and indirect wholly-owned subsidiaries of the Fund, SOG provides certain management and general and administrative support services with respect to the Fund and its subsidiaries, including, without limitation, management and technical expertise and consulting services for the development and implementation of the operational and financial plans of the Fund and for strategic planning and decisions of the Fund, lease and land administration services, marketing, gas control and contract administration services. **See Item 10.**

We provide investment management services with respect to the Fund and not to any investors in the Fund, and no investor should look to us or our affiliates for advice regarding any of its own investment decisions, including any decision to invest in the Fund. Accordingly, we treat the Fund, and not any of the investors in the Fund, as our “client” for purposes of the the Investment Advisers Act of 1940, as amended (the “Advisers Act”), and other applicable laws and regulations, to the extent permitted under such laws. Among other things, this generally means that disclosures required to be made by us to our clients are made to the Fund, and not to the investors, and that necessary consents may be given by us on behalf of the Fund and its investors. **See Item 8 below.**

### INVESTMENT RESTRICTIONS

We provide investment advice to the Fund in accordance with the investment objectives and strategies set forth in its offering and governing documents, and not in accordance with the individual needs or objectives of any particular investor in the Fund. Investors are not permitted to impose restrictions or limitations on the management of the Fund.

### ASSETS UNDER MANAGEMENT

As of December 31, 2012, we had approximately \$145.5 million in regulatory assets under management. All of these assets were managed on a discretionary basis.

## Item 5: Fees and Compensation

### DESCRIPTION OF COMPENSATION AND FEE SCHEDULE

In consideration of our services, SOG is entitled to receive management fees and we are entitled to receive carried interest distributions with respect to the Fund. While such fees and carried interest distributions are described in detail in the Fund's governing and offering documents, a summary of such fees are set forth below.

#### Management Fees

The Fund pays SOG (indirectly through wholly owned subsidiaries) a management fee from time to time equal to SOG's actual general and administrative costs and expenses incurred in connection with the management and operation of the oil and natural gas properties, assets and related interests owned by the Fund and various other management and administrative services provided with respect thereto.

#### Carried Interest Distributions

In addition, any net cash flow generated by the Fund (other than net cash flow attributable to certain excluded properties) is re-allocated between each "new investor" (as defined in the partnership agreement of the Fund) and us and distributed as follows:

- First, to the new investor, until it has received distributions equal to eight percent (8%) per annum, cumulative and compounding, of the investor's unreturned deemed capital contributions (as defined in the partnership agreement of the Fund);
- Second, to the new investor, until it has received distributions equal to its unreturned deemed capital contribution; and
- Third, (i) seventy-five percent (75%) to the new investor and twenty-five percent (25%) to us as a carried interest distribution, until that new investor has received an internal rate of return on its deemed capital contribution equal to fifteen percent (15%); and (ii) then sixty-five percent (65%) to the new investor and thirty-five percent (35%) to us as a carried interest distribution thereafter.

Notwithstanding the foregoing, any net cash flow attributable to "excluded properties" is distributed, subject to certain restrictions, solely to the "initial phase I investors" (as defined in the partnership agreement of the Fund) and is not considered for purposes of the distributions described above.

The management fees and carried interest distributions applicable with respect to the Fund generally are not negotiable.

### PAYMENT OF FEES

Management fees generally are payable by the Fund in arrears promptly after receipt by the Fund of invoices from SOG. Management fees generally are deducted directly from any cash flow received by the Fund. In the event of termination of the management services agreement with SOG, the management fee and any reimbursements of expenses will be paid up to and through the date of termination.

Carried interest distributions are distributed from time to time, in our discretion, out of the net cash flow of the Fund. Carried interest distributions are re-allocated directly from the capital accounts of new investors to our capital account.

### OTHER FEES AND EXPENSES

In addition to the management fees and carried interest distributions, the Fund bears all costs, expenses or charges incurred in connection with its day-to-day operation and any costs and expenses arising from or related to the retention, engagement or retainer of third party consultants, advisers, accountants, auditors and attorneys. **See Item 12 below.**

### COMPENSATION FOR THE SALE OF SECURITIES OR OTHER INVESTMENT PRODUCTS

Neither we nor any of our supervised persons accept compensation for the sale of securities or other investment products.

## **Item 6: Performance-Based Fees and Side-By-Side Management**

### **PERFORMANCE-BASED FEES**

As noted under Item 5 above, we are entitled to receive carried interest distributions with respect to the Fund. Carried interest distributions could motivate us to make investment decisions that are riskier or more speculative than would be the case if these arrangements were not in effect. Certain of our individual employees, agents and affiliates may be compensated to some extent based upon investment profits for which they are responsible and, accordingly, may face the same potential conflict. The method of calculating the carried interest may result in conflicts of interest with respect to the management and disposition of investments, including the sequence of dispositions. We attempt to address these conflicts through full and fair disclosure in the offering and governing documents of the Fund and this brochure.

### **Item 7: Types of Clients**

We only provide investment management services to the Fund, our affiliate and sole advisory client.

## Item 8: Methods of Analysis, Investment Strategies and Risk of Loss

### METHODS OF ANALYSIS AND INVESTMENT STRATEGIES

Our primary objective is to achieve capital appreciation primarily through (directly or indirectly) the acquisition, operation and development of oil and natural gas properties, assets and related interests (including equity securities). We believe that a significant opportunity exists to secure substantial amounts of prospective acreage in the onshore Texas Gulf Coast region for high resolution seismic data, which will lend itself to extensive exploration and development drilling. We further believe that this data will enable exploration teams to secure better images of prospective drilling opportunities in the region.

We invest heavily in 3D seismic data, leading edge interpretive technology and our exploration and production staff. Our philosophy is to leverage proprietary 3D seismic data, coupled with advance exploration techniques, to achieve higher success rates in our exploration and development programs, and thus higher returns on equity. The key to the success of this strategy is continued access to new proprietary 3D seismic surveys, which provide a first look at prospective drilling opportunities. Our affiliate, which generally operates our properties, employs leading-edge interpretive and advanced seismic processing techniques that enable it to discern subtle hydrocarbon attributes that may be indicative of the existence of oil and natural gas. Our affiliate tests formations during drilling and completes the well by installing such equipment, gathering pipelines, heaters, separators, compressors, etc. as are necessary and normal in the area where the wells are to be drilled. We are responsible for selling the Fund's oil and natural gas production, if any.

For more information regarding our investment strategies and methods of analysis, please refer to the offering memorandum of the Fund. The foregoing summary is qualified in its entirety by the information contained in the Fund's offering documents.

### CERTAIN RISK FACTORS

*There can be no assurance that the Fund will achieve its investment objectives or that an investment in the Fund will be profitable. The Fund's investment strategies involve a substantial degree of risk, including risk of complete loss. Nothing in this brochure is intended to imply, and no one is or will be authorized to represent, that an investment in the Fund is low risk or risk free. The Fund's investment strategies and program are appropriate only for sophisticated persons who fully understand and are capable of bearing the risks of investment. Prospective investors should consider the following risks, among others, before making any investment decisions. The various risks outlined below are not the only risks associated with the Fund's investment strategies and processes. The following risks are qualified in their entirety by the risks set forth in the Fund's offering documents.*

**Substantial Leverage.** Through credit facilities, the Fund has incurred, and may in the future incur, substantial indebtedness to fund its drilling program. As a result, certain of the Fund's assets are encumbered under the credit facility and cash flow from these assets will be dedicated to the repayment of this indebtedness for an indeterminate period.

**Future Need for and Availability of Capital.** We may seek additional debt financing for the Fund's drilling activities. We cannot give any assurances as to the level and structure of such debt financing or if we can obtain such financing. In recent years, global economic and market conditions have made financing much more difficult to obtain. Future cash flows and the availability of credit are subject to a number of variables, such as the success or failure of drilling and production programs, the availability of gathering, transportation and storage facilities, the level of production from wells, prices of oil and natural gas and our success in directly or indirectly locating and economically producing oil and natural gas reserves. There can be no assurance that such additional financing can be obtained or, if so, obtained on terms acceptable to us or the Fund.

**Commodity Prices.** The revenues generated by the Fund's operations and interests are highly dependent upon the prices of, and demand for, oil and natural gas. Historically, the prices of oil and natural gas have been volatile, and are likely to continue to be volatile in the future, and are dependent upon numerous factors such as weather, domestic and foreign political and economic conditions, the overall level of international and domestic demand for oil and natural gas, regulatory developments, severance and excise taxes, competition from other sources of energy and the availability of pipeline capacity. The volatile nature of the energy markets and the unpredictability of actions of OPEC members make it impossible to predict future prices of oil and natural gas with any certainty. Prices of oil and natural gas are subject to wide fluctuations in response to relatively minor changes in circumstances, and there

can be no assurance that future prolonged decreases in such prices will not occur. All of these factors are beyond the control of us and the Fund. Any significant decline in oil and natural gas prices would have a material adverse effect on the value of the Fund's reserves and its revenues, profitability and cash flows from operations.

In recent years, oil and natural gas prices have fluctuated drastically. The downturn in the United States and worldwide economy could cause oil and natural gas prices to further decline, perhaps significantly so. It is impossible to predict future oil and natural gas price movements, and this reduces the predictability of our investment strategy.

*Dependence on Distribution and Processing Systems.* If we are successful in identifying, acquiring and developing marketable amounts of hydrocarbons, the production and marketing thereof will depend upon the availability and capacity of oil and natural gas gathering systems, pipelines and processing and storage facilities that are not owned by the Fund or us. The unavailability or lack of capacity thereof could result in the shut-in of producing wells or the delay or discontinuance of development plans for properties. Moreover, a substantial portion of the Fund's properties may rely on the same gathering systems, transportation line, processing plants and storage facilities. In addition, federal and state regulation of oil and natural gas production and transportation, general economic conditions and changes in supply and demand could adversely affect the Fund's ability to produce and market its oil and natural gas on a profitable basis. Any significant change in the Fund's ability to produce and market its oil and natural gas production could have a material adverse effect on its financial condition and results of operations. There can be no assurance that adequate natural gas gathering systems, pipelines and processing and storage facilities will exist, will be constructed or will be available to the Fund on pricing terms that will allow the Fund to economically produce and market any hydrocarbons located by the Fund.

*Operational Hazards and Uninsured Risks.* Oil and natural gas drilling activities are subject to numerous risks, many of which are beyond our control, including the risk that no commercially productive oil or natural gas reservoirs will be encountered. The cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including unexpected drilling conditions, pressure irregularities information, equipment failures or accidents, adverse weather conditions, title problems and shortages or delays in the delivery of equipment. Our future drilling activities may not be successful and, if unsuccessful, such failure will have an adverse effect on future results of operations and financial condition of the Fund.

In addition, oil and natural gas operations involve hazards such as fire, explosion, blowout, pipe failure, casing collapse, unusual or unexpected formation pressures and environmental hazards such as oil spills, gas leaks, ruptures and discharges of toxic gases, the occurrence of any one of which could result in substantial losses to the Fund due to injury or loss of life, severe damage to or destruction of property, natural resources and equipment, pollution or other environmental damage, cleanup responsibilities, regulatory investigation and penalties and suspension of operations. To the extent the Fund engages in any offshore operations, it will be subject to a variety of operating risks peculiar to the offshore and marine environment, such as hurricanes, or other adverse weather conditions, more extensive governmental regulation, including regulations that may, in certain circumstances, impose strict liability for pollution damage, and to interruption or termination of operations by governmental authorities based on environmental or other considerations.

Although the Fund maintains insurance against certain risks that we believe are customarily insured against by companies in the industry of comparable size and scope of operations, such insurance does not cover all of the risks and hazards involved in oil and natural gas exploration, drilling and production, because either insurance is unavailable at reasonable rates, there are limitations in the insurance policies or for other reasons. Even if coverage does exist, it may not be sufficient to pay the full amount of liabilities incurred, and there can be no assurance that such insurance will continue to be available on terms acceptable to the Fund. Any uninsured loss could have a material adverse effect on the Fund's financial condition and results of operations.

*Regulatory and Environmental Risks.* Oil and natural gas operations are subject to various federal, state and local governmental regulations, which may be changed from time to time in response to economic or political conditions. From time to time, regulatory agencies have imposed price controls and limitations on production in order to conserve supplies of oil and natural gas. In addition, the production, handling, storage, transportation and disposal of oil and natural gas, byproducts thereof and other substances and materials produced or used in connection with oil and natural gas operations are subject to regulation under federal, state and local laws and regulations.

Currently, federal regulations provide that drilling fluids, produced waters and other wastes associated with the

exploration, development or production of oil and natural gas are exempt from regulation as “hazardous waste.” From time to time, legislation has been proposed to eliminate or modify this exemption. Should the exemption be modified or eliminated, wastes associated with oil and natural gas exploration and production would be subject to more stringent regulation. On the federal level, the Fund’s operations may be subject to various federal statutes, including the Natural Gas Act, the Comprehensive Environmental Response, Compensation the Liability Act, the Solid Waste Disposal Act, as amended by the Resource Conservation and Recovery Act, the Clean Air Act, the Federal Water Pollution Control Act and the Oil Pollution Act, as well as by regulations promulgated pursuant to these statutes.

These regulations subject us and the Fund to increased operating costs and potential liability associated with the use and disposal of hazardous materials. These laws and regulations may have a material adverse effect on the Fund’s financial condition and results of operations, because there can be no assurance that the Fund will not be required to make material expenditures in the future. Moreover, we anticipate that such laws and regulations will become increasingly stringent in the future, which could lead to material costs for environmental compliance and remediation by us and the Fund.

To the extent that we engage in offshore operations, we and the Fund also may be subject to the Outer Continental Shelf Lands Act, and regulations promulgated thereunder, which regulate the activities of offshore service vessels, require vessel owners and operators to demonstrate financial and operational responsibility and provide for certain limitations on the liability of vessel owners and operators. Our operations are also subject to the Clear Water Act, which imposes strict controls against the discharge of oil and other pollutants into surface waters within its jurisdiction.

Any failure by us and the Fund to obtain required permits for, to control the use of or to adequately restrict the discharge of hazardous substances under present or future regulations could subject the Fund to substantial liability or could cause its operations to be suspended. Such liability or suspension of operations could have a material adverse effect on the business, financial condition and results of operations of the Fund.

*Demand for Oil and Gas.* The Fund’s success is materially dependent upon the demand for oil and gas. The availability of a ready market for the Fund’s oil and gas production depends on a number of factors beyond the Fund’s control, including the demand for and supply of oil and gas, the availability of alternative energy sources, the proximity of reserves to, and the capacity of, oil and gas gathering systems, pipelines or trucking and terminal facilities. The Fund may also have to shut-in some of its wells temporarily due to a lack of market or adverse weather conditions including hurricanes. In addition, federal and state regulation of oil and natural gas production and transportation, general economic conditions and changes in supply and demand could adversely affect the Fund’s ability to produce and market its oil and natural gas on a profitable basis. Any significant change in the Fund’s ability to produce and market its oil and natural gas production could have a material adverse effect on the Fund’s financial condition and results of operations.

*Drilling Risks.* The revenues and operating results of the Fund will be dependent upon the success of the Fund’s exploitation, development and drilling activities. Oil and natural gas drilling involves numerous risks, including the risk that no commercially productive oil or natural gas reservoirs will be encountered. The timing and cost of drilling, completing and operating wells is often uncertain, and drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including unexpected drilling conditions, pressure or irregularities in formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment. Oil and natural gas drilling remains a speculative activity notwithstanding our use of 3-D seismic data. Even when fully utilized and properly interpreted, 3-D seismic data and other advanced technologies only assist geoscientists in identifying subsurface structures and do not enable the interpreter to know whether hydrocarbons are in fact present in such structures. In addition, the use of 3-D seismic data and other advanced technologies requires greater pre-drilling expenditures than traditional drilling strategies, and the Fund could incur losses as a result of such expenditures. Furthermore, completion of a well does not assure a profit on the investment or a recovery of any portion of drilling, completion or operating costs.

Unsuccessful drilling activities could have a material adverse effect on the Fund’s results of operations and financial condition. There can be no assurance that the Fund will achieve a satisfactory overall drilling success rate or a satisfactory drilling success rate within a particular time period or project area. We may choose not to acquire option and lease rights prior to acquiring seismic data and, in many cases, we may identify a prospect or drilling location before seeking option or lease rights in the prospect or location. There can be no assurance that identified prospects

will ever be leased or drilled (or drilled within the scheduled or budgeted time frame) or that oil or natural gas will be produced from any such prospects or any other prospects. In addition, prospects may initially be identified through a number of methods, some of which do not include interpretation of 3-D or other seismic data. Actual drilling and results are likely to vary from such statistical results, and such variance may be material. Similarly, the Fund's drilling schedule may vary from its capital budget because of future uncertainties, including those described above.

*Ability to Develop Reserves.* Among other things, the Fund's economic success depends upon our ability to develop proved undeveloped, probable and possible oil and natural gas reserves on the properties to be leased by the Fund. Development of these reserves likely will require significant capital expenditures, and there can be no assurances regarding the development results.

*Shortages of Drilling Rigs, Equipment, Supplies and Personnel.* In the past, there have been periods where general shortages of drilling rigs, equipment and supplies have occurred. Shortages of drilling rigs, equipment or supplies could delay and adversely affect our exploration and development operations, which could have a material adverse effect on the Fund's business, financial condition and results of operations. The demand for, and wage rates of, qualified rig crews in the drilling industry tend to fluctuate in response to the number of active drilling rigs in service. The oil and natural gas industry may in the future experience shortages of qualified personnel to operate drilling rigs, which could delay our drilling operations and adversely affect the Fund's business, financial condition and results of operations.

*Risks Associated with Potential Acquisitions of Producing Properties.* The successful acquisition of producing properties requires an assessment of recoverable reserves, future oil and natural gas prices, operating costs, potential environmental and other liabilities and other factors. Such assessments are necessarily inexact. In connection with our assessment of a potential acquisition, we perform a review of the subject properties that we believe to be generally consistent with industry practices, including examination of contingencies associated with the properties. Such a review, however, will not reveal all existing or potential problems nor will it permit a buyer to become sufficiently familiar with the properties to fully assess the deficiencies and capabilities of such properties. Inspections may not always be performed on every well, and structural and environmental problems are not necessarily observable even when an inspection is undertaken. Even when problems are identified, the seller may be unwilling or unable to provide effective contractual protection against all or part of such problems. There can be no assurance that we will be able to identify acquisition opportunities, obtain financing for acquisitions on satisfactory terms or successfully consummate such acquisitions. Furthermore, there can be no assurance that competition for acquisition opportunities would not escalate, thereby increasing the cost to the Fund of making acquisitions or causing the Fund to refrain from making acquisitions. In addition, there can be no assurance that any acquisition of property interests by the Fund will be successful and, if unsuccessful, that such failure will not have a material adverse effect on the Fund's future results of operations and financial condition.

*Competition in the Oil and Natural Gas Industry.* We encounter competition from other oil and natural gas companies in all areas of their operations, including the acquisition of exploratory prospects and proven properties. Securing leases or necessary permits and approvals for 3-D seismic shoots depends heavily on developing and maintaining favorable relationships with operators and regulatory bodies. Our competitors include major integrated oil and natural gas companies and independent oil and natural gas companies, individuals and drilling and income programs. Most of our competitors are large, well-established companies with substantially larger operating staffs and significantly greater capital resources than ours and which, in most instances, have been engaged in the oil and natural gas business for a much longer time than us. Such companies may be able to pay more for oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties than we could, given our limited financial and human resources. There can be no assurance that we will be able to secure the necessary financing or industry partners or evaluate and select suitable properties and consummate transactions in this highly competitive environment.

*Technological Advances.* The oil and natural gas exploration, drilling and production industry is subject to rapid and significant advances in technology and practices, including the introduction of new drilling or extraction technologies. We believe that the Fund can utilize new technologies to increase production and efficiency on many properties. As competitors use or develop new technologies, we may be placed at a competitive disadvantage, or we may be required to adopt such new technologies at significant cost. In addition, our competitors may have greater financial, technical and personnel resources that may allow such competitors to enjoy technological advances and may allow such competitors in the future to implement new technologies before we can do so. There can be no

assurance that we will be able to implement new technologies on a timely basis or at a cost that is acceptable to us.

*Hedging.* The Fund may seek to reduce exposure to the volatility of oil and gas prices by actively hedging a portion of production. Hedging also prevents the Fund from receiving the full advantage of increases in oil or gas prices above the fixed amount specified in the hedge agreement. In a typical hedge transaction, the Fund has the right to receive from the hedge counterparty the excess of the fixed price specified in the hedge agreement over a floating price based on a market index, multiplied by the quantity hedged. If the floating price exceeds the fixed price, the Fund must pay the counterparty this difference multiplied by the quantity hedged even if the Fund had insufficient production to cover the quantities specified in the hedge agreement. Accordingly, if the Fund has less production than it has hedged when the floating price exceeds the fixed price, the Fund must make payments against which there are no offsetting sales of production. If these payments become too large, the remainder of the Fund's business may be adversely affected. In addition, hedging agreements expose the Fund to the risk of financial loss if the counterparty to a hedging contract defaults on its contract obligations.

*Environmental Liabilities.* The oil and gas business is subject to environmental hazards, such as oil spills, gas leaks and ruptures and discharges of petroleum products and hazardous substances, and historic disposal activities. These environmental hazards could expose the Fund to material liabilities for property damages, personal injuries or other environmental harm, including costs of investigating and remediating contaminated properties. In addition, the Fund also may be liable for environmental damages caused by the previous owners or operators of properties it purchases. A variety of stringent federal, state and local laws and regulations govern the environmental aspects of the oil and gas business. Any noncompliance with these laws and regulations could subject the Fund to material administrative, civil or criminal penalties or other liabilities. Additionally, compliance with these laws may, from time to time, result in increased costs of operations or decreased production, and may affect acquisition costs.

*Terrorism and War.* Terrorist attacks and the threat of terrorist attacks, whether domestic or foreign, as well as the military or other actions taken in response, cause instability in the global financial and energy markets. Terrorism, the war in Iraq, Afghanistan and other sustained military campaigns could adversely affect the Fund and the market price of oil and natural gas in unpredictable ways, or the possibility that the operations of the Fund could be a direct target or an indirect casualty of an act of terror.

*Limited Diversification.* The Fund invests primarily in oil and natural gas properties, assets and related interests. Consequently, the Fund investments are not diversified to any material extent. This limited diversification could expose the Fund to losses disproportionate to market movements in general.

*Potential Conflicts of Interest.* Actual and potential conflicts of interest exist between us, our affiliates and the Fund, and additional conflicts of interest may arise in the future.

**THE FOREGOING RISK FACTORS DO NOT PURPORT TO BE A COMPLETE DESCRIPTION OF ALL OF THE RISKS ASSOCIATED WITH THE FUND'S INVESTMENT PROGRAM. INVESTORS SHOULD REVIEW THIS BROCHURE AND THE OFFERING AND GOVERNING DOCUMENTS OF THE FUND IN THEIR ENTIRETY BEFORE MAKING ANY INVESTMENT DECISIONS.**

**Item 9: Disciplinary Information**

Not applicable.

#### **Item 10: Other Financial Industry Activities and Affiliations**

As described in item 4 above, the Fund (and certain direct and indirect wholly-owned subsidiaries of the Fund) has entered into a management services agreement with SOG, its affiliate, pursuant to which SOG provides certain management and general and administrative support services with respect to the Fund and its subsidiaries. In addition, the Fund has entered into a joint operating agreement with SOG, whereby SOG operates certain of the Fund's properties during the drilling and production phases of the Fund's operations in exchange for fees, as set forth in the joint operating agreement. Due to our relationship with SOG, we may have an incentive to select it to serve as operator for the Fund's properties. We will make determinations regarding the selection of operators in a manner that is consistent with our fiduciary duties to the Fund.

Antonio R. Sanchez III, our principal, currently serves as Chairman and Chief Executive Officer of Sanchez Energy Corporation, a publicly traded company in which the Fund invests ("Sanchez Energy"). Sanchez Energy invests directly and/or indirectly in oil and natural gas properties, assets and related interests. Mr. Sanchez's activities on behalf of Sanchez Energy may present actual and/or potential conflicts of interest (including conflicting fiduciary duties). To address these actual and/or potential conflicts, we provide full and fair disclosure of such activities to investors.

We currently share offices and certain administrative staff with Nilgai Capital Management, LLC, a private investment advisory firm that is managed and operated by Herman I. Silber ("Nilgai"). Nilgai is separately registered as an investment adviser with the Texas State Securities Board. While Antonio R. Sanchez III, our chief executive officer, currently owns an indirect minority equity interest in Nilgai, he is a passive owner and does not participate in its day to day management and operation. Nilgai is operated separately and independently from SEP.

## **Item 11: Code of Ethics, Participation or Interest in Client Transactions and Personal Trading**

### **CODE OF ETHICS**

We have adopted and implemented a code of ethics, which sets forth standards of business conduct for our employees. Our code of ethics is primarily designed to educate employees about our philosophy regarding ethics and professionalism, emphasize our fiduciary duties to the Fund, encourage employees to comply with applicable laws, prevent the misuse of material non-public information, restrict the circulation of rumors and other forms of market abuse and address conflicts of interest that arise from personal trading by employees. Among other things, we impose restrictions on employees relating to the purchase or sale of certain securities for their own accounts and the accounts of certain affiliated persons. Employees are required to submit quarterly reports disclosing personal securities transactions in covered securities and annual reports disclosing personal holdings of covered securities. Such reports are reviewed by our Chief Compliance Officer or his designee. We also maintain certain policies and procedures designed to prevent employees and principals from misusing material non-public information or trading the same security ahead of the Fund. We will furnish a copy of our code of ethics to our clients upon request.

### **ADVISORY BOARD**

We have appointed a limited partner advisory board (the “Advisory Board”) for the Fund, which consists of representatives of the limited partners. Pursuant to the partnership agreement, the Fund may not take any of the following actions without the approval of the Advisory Board:

- (i) determine any valuations of any assets in any transactions between the Fund and us and/or our affiliates, other than certain excluded properties;
- (ii) enter into any contracts with us or our affiliates that are not specifically approved the partnership agreement, or make any material amendment to any such existing or future contracts;
- (iii) enter into certain substantial acquisitions or dispositions as described in the partnership agreement;
- (iv) create, incur, refinance or make any material amendment to any indebtedness of the Partnership in certain situations as described in the partnership agreement; or
- (v) take any other action that we and the Advisory Board agree requires Advisory Board approval.

### **CO-INVESTMENTS**

We may make available to certain persons, including investors and our affiliates, opportunities to co-invest alongside the Fund. Subject to certain limitations set forth in the partnership agreement, we will set the terms of any co-investment with the Fund. We generally are not required to offer any co-investment opportunity to any person; *provided, however*, to the extent (i) we or our affiliates seek third party equity investments in any energy-related asset or pooled investment vehicle acquiring or investing in energy-related assets, excluding any energy-related assets owned by us or our affiliates prior to February 29, 2008, and (ii) we or our affiliate(s) co-invest alongside the Fund in such investment, we must notify each investor of the terms of such investment and give each investor the opportunity to co-invest alongside the Fund in a percentage equal to the investor’s percentage interest in the Fund.

## Item 12: Brokerage Practices

### **BROKERAGE PRACTICES**

We do not expect to be called upon to select or recommend broker-dealers or other counterparties to the Fund.

### **Item 13: Review of Accounts**

#### **REVIEWS OF ACCOUNTS**

Our Chief Executive Officer conducts reviews of the Fund and its investments on at least a monthly basis. With respect to accounting matters, we have engaged an independent public accounting firm to conduct an annual audit of the Fund.

We provide investment advice primarily with respect to direct and/or indirect investments in oil and natural gas properties, assets and related interests (including equity securities). In monitoring the performance of the Fund and its investments, we perform various levels of review. Among other items, we may consider the following, among others, operating results of the Fund, the profitability and performance of individual oil and gas properties, periodic engineering reviews of oil and gas reserve values and reserve reports.

#### **ADDITIONAL REVIEWS**

While we generally conduct reviews of the Fund and its investments on at least a monthly basis, we may conduct additional or more frequent reviews under certain circumstances, including in the event a well is drilled or begins producing.

#### **REPORTS TO INVESTORS**

We generally provide investors in the Fund with the following reports and information: (i) quarterly unaudited balance sheets and related statements of income and loss; (ii) annual unaudited balance sheets and related statements of income and loss; and (iii) annual audited financial statements (prepared in accordance with generally accepted accounting principles). In addition, we will furnish to any investor, within thirty days after the investor's reasonable request, information regarding the Fund's estimated and anticipated production. All of these reports are written.

#### **Item 14: Client Referrals and Other Compensation**

##### **THIRD PARTY COMPENSATION**

Except as otherwise disclosed herein, we currently do not receive any economic benefit from any non-advisory client for providing advisory services with respect to the Fund.

##### **REFERRALS**

We do not compensate any third party for client or investor referrals.

### **Item 15: Custody**

We have custody of the Fund's cash and securities for purposes of Rule 206(4)-2 under the Advisers Act. Accordingly, the Fund's cash and securities are held with one or more qualified custodians (to the extent required by Rule 206(4)-2). We may change custodians at any time and from time to time without the consent of, or notice to, investors. In addition, an independent public accounting firm conducts annual audits of the Fund, and audited financial statements (prepared in accordance with U.S. generally accepted accounting principles) are provided to investors on an annual basis. We generally provide such statements to investors within 120 days, as applicable, after the end of each fiscal year, but there can be no assurance that we will be successful in this regard. Qualified custodians do not provide statements directly to investors in the Fund.

## **Item 16: Investment Discretion**

### **DISCRETIONARY AUTHORITY**

We have discretionary power and authority over the types of investments to be bought or sold, as well as the amount to be bought or sold, on behalf of the Fund, subject to the limitations set forth in the applicable governing documents of each Fund. While we have broad authority to select brokers and other counterparties on behalf of the Fund, we do not expect to be called upon to do so.

### **LIMITED POWER OF ATTORNEY**

Each investor in the Fund generally grants us a limited power of attorney to enable us to execute the Fund's partnership agreement and certain other related documents on its behalf.

### **Item 17: Voting Client Securities**

We generally have the authority to vote proxies on behalf of the Fund. In the event that we are called upon to vote proxies, we will vote proxies in accordance with proxy voting policies and procedures in our compliance manual. In general, proxy proposals, amendments, consents or resolutions are required to be voted in a manner that serves the best interests of the Fund, as determined in our discretion. We will attempt to identify all material conflicts of interest between our interests and those of the Fund and the investors. Where a material conflict of interest is identified, we generally will attempt to resolve the conflict before voting a proxy. We may determine not to vote proxies in respect of securities of an issuer if we determine that it would be in the Fund's overall best interest not to vote. Investors generally may not direct or otherwise influence our vote with respect to any particular proxy solicitation. Copies of our proxy voting policy, together with information regarding how we have voted past proxies, will be made available to the Fund upon request.

## Item 18: Financial Information

Not applicable.