

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

Approved by the Board of Directors on 30 March 2022¹

UKRAINE

NAK EMERGENCY GAS FINANCE

[Redacted in line with the EBRD's Access to Information Policy]

[Information considered confidential has been removed from this document in accordance with the EBRD's Access to Information Policy (AIP). Such removed information is considered confidential because it falls under one of the provisions of Section III, paragraph 2 of the AIP]

¹ As per section 1.4.8 of EBRD's Directive on Access to Information (2019), the Bank shall disclose Board reports for State Sector Projects within 30 calendar days of approval of the relevant Project by the Board of Directors. Confidential information has been removed from the Board report.

As permitted by paragraph 2.6 of Section III of the Access to Information Policy, disclosure of this Board Report was deferred.

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ABBREVIATIONS / CURRENCY CONVERSIONS

BCM	Billion Cubic Meters (measurement of gas)
BCMA	Billion Cubic Meters per annum
BDS	Board Document
CAPEX	Capital expenditures
CGAP	Corporate Governance Action Plan
COO	Country of Operations
CRM	Concept Review Memo
DFI	Development Finance Institution
DHUs	District Heating Utilities
DTM	Debt Tracking Module
EBIT	Earnings before interest and taxes
EBITDA	Earnings before interest, taxes, depreciation and amortisation
EC	European Commission
EFET	European Federation of Energy Traders
EHS	Environmental, Health & Safety
EIA	Environmental Impact Assessment
EIB	European Investment Bank
ESAP	Environmental and Social Action Plan
ESDD	Environmental and Social Due Diligence
ETI	Expected Transition Impact
EU	European Union
EUR	Euro
FRM	Final Review Memo
G7	The Group of Seven
GDP	Gross Domestic Product
GET	Green Economy Transition
GSA	Gas Supply Agreement
GTS	Gas Transmission and Storage System
IBRD	International Bank for Reconstruction and Development
IFI	International Financial Institution
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IRR	Internal Rate of Return
LC	Letter of Credit
MCM	Million cubic metres (measurement of gas)
MFA	Macro Financial Assistance
MoU	Memorandum of Understanding
MT	Million Tonnes
NAK	PJSC “National Joint Stock Company Naftogaz of Ukraine”
NBU	National Bank of Ukraine
NEURC	National Commission which Performs State Regulation in the Energy and Communal Spheres
OCCO	Office of the Chief Compliance Officer
OGC	Office of General Council
PD	Probability of Default
PJSC	Public Joint Stock Company
PR&P	Procurement Rules and Policies
PRs	Performance Requirements
PSD	Project Summary Document

PSO	Public Service Obligation
RAROC	Risk-Adjusted Return on Capital
SB	Supervisory Board
SSF	Shareholder Special Fund
STCs	Standard Terms and Conditions
TC	Technical Cooperation
TCM	Thousand Cubic Meters (measurement of gas)
TPP	Thermal Power Plant
TSO	Transmission System Operator
TTF	Title Transfer Facility
UAH	Ukrainian Hryvnia
UGV	PJSC "Ukrgezvydobuvannya"
US / U.S.	United States of America
USD	United States Dollars
UTG	PJSC "Ukrtransgaz"
VAT	Value Added Tax
WB	World Bank

PRESIDENT’S RECOMMENDATION

This recommendation and the attached Report concerning an operation in favour of PJSC “National Joint Stock Company Naftogaz of Ukraine” (the “Company” or “NAK”), a Public Joint Stock Company incorporated in Ukraine, are submitted for consideration by the Board of Directors.

The facility will consist of a loan to the Company in the amount of up to EUR 300 million. The loan will be sovereign guaranteed by Ukraine. The EBRD will benefit from a guarantee covering 90 percent of the loan issued by a number of EBRD shareholders, expected to include countries from the G7 group and the European Union.

The operation is a part of EUR 1 billion financing requested by the Company for an up to 1bcm emergency gas purchase starting in April 2022, which is critical for the preparation of the heating season in the country. To support the Company’s financing request, the EBRD is proposing to form a coalition of multilateral and bilateral institutions and have initiated consultations with, among others, the World Bank Group, the European Investment Bank and the US Development Finance Corporation.

The expected transition impact of the project is driven by the need to support energy security in Ukraine through emergency gas purchases to compensate for the loss of natural gas production and imports (Resilient). The project will safeguard energy provision and access to vital services for people, whose livelihoods and economic security is at immense risk due to the war on Ukraine; the project will also include support to NAK in designing an approach to addressing workforce challenges caused to its staff by hostilities (Inclusive). In addition, this transaction will support reform objectives of previous engagements with NAK aimed at Ukrainian gas market integration with the EU. In particular, NAK will be able to source natural gas, using a competitive procurement mechanism, from its existing pre-qualified EU based gas traders. In addition, EBRD’s requirement for NAK to use contracts based on the standards of the European Federation of Energy Traders (“EFET”) provides protection for gas market reforms reversal.

TC support for this operation has been provided by SSF under the Gender & Economic Inclusion Technical Assistance Framework for Inclusion TC and legal due diligence.

I am satisfied that the project is in line with the War on Ukraine – EBRD Resilience Package endorsed by the Board. The operation is also consistent with the Bank’s Strategy for Ukraine and the Energy Sector Strategy 2019-2023, as well as the Bank’s Equality of Opportunity Strategy 2021-2025, the Strategy for the Promotion of Gender Equality and with the Agreement Establishing the Bank. [REDACTED].

I recommend that the Board approve the proposed loan substantially on the terms of the attached Report.

Odile Renaud-Basso

BOARD DECISION SHEET

UKRAINE – NAK Emergency Gas Finance - DTM 53626	
Transaction / Board Decision	Board approval ² is sought for a loan of up to EUR 300 million in favour of NJSC “Naftogaz of Ukraine” (the “Company” or “NAK”), a Public Joint Stock Company incorporated in Ukraine. The loan is a part of EUR 1 billion financing requested by the Company for an up to 1bcm emergency gas purchase starting in April 2022, which is critical for preparation to the heating season in the country. The EBRD loan is proposed to be 90% backed by guarantees from EBRD shareholders, expected to include G7 countries and the European Union, which are essential to structure the viable transaction. Disbursements will be made based on the amount of guarantees in place.
Client	NAK, 100% state-owned vertically integrated oil and gas holding in Ukraine is the country’s largest natural gas producer (accounting for 75% of domestic gas production), importer, wholesale trader and supplier of last resort for the needs of population and the district heating utilities. In 9M 2021, NAK had revenues of USD 4.9bn, EBITDA of USD 0.5bn, net loss of USD 0.16bn and a total debt of USD 2.3bn.
Main Elements of the Proposal	<p><u>Transition impact</u></p> <p>Primary Quality – Resilient: the project aims to support energy security in Ukraine through emergency gas purchases to compensate for the disruption of natural gas production and imports. The transaction will also support reform objectives of previous engagements with NAK aimed at Ukrainian gas market integration with the EU, in particular through application of competitive procurement mechanism and EFET based gas supply contracts.</p> <p>Secondary Quality – Inclusive: the project will help safeguard access to vital energy services for people, whose livelihoods and economic security is at immense risk due to the war in Ukraine. The project will also support NAK in tackling critical workforce challenges due to involuntary relocation, workforce losses and attrition.</p> <p><u>Additionality</u> – Innovative financing structure - as financing is not available in the market to close the Company’s funding gap; by using EBRD’s procurement expertise and client relationships to facilitate support from shareholder countries and EU; and standard-setting by assisting NAK in designing an approach to critical workforce challenges caused by hostilities.</p> <p><u>Sound banking</u> – Considering the exceptional context of the war on Ukraine and the EBRD’s existing exposure on NAK and Ukraine, the facility will benefit from a 90% guarantee issued by EBRD shareholders, including by countries from the G7 and the EU, in addition to a sovereign guarantee from Ukraine.</p>
Key Risks	Key risks include: (i) NAK’s credit and liquidity risk; (ii) commodity price; (iii) FX risk; (iv) integrity; (v) political and macro-economic risks. These risks will be mitigated by: (a) guarantees issued by EBRD shareholders; (b) transparent procurement allowing to achieve best possible gas purchase price; and (c) strong commitment from international partners (incl. G7, the EU, the IMF) to support Ukraine in the ongoing war situation and subsequent reconstruction.
Strategic Fit Summary	<ul style="list-style-type: none"> • War on Ukraine – EBRD Resilience Package endorsed by the Board. • Strategy for Ukraine: Strengthen energy security. • Energy Sector Strategy 2019-2023: Energy security. • Equality of Opportunity Strategy 2021-2025: Ensuring access to services. • Strategy for the Promotion of Gender Equality: Gender mainstreaming.

² Article 27 of the AEB provides the basis for this decision.

ADDITIONAL SUMMARY TERMS FACTSHEET

EBRD Transaction	<ul style="list-style-type: none"> Up to EUR 300 million revolving credit facility (“EBRD Credit Facility”) to NAK to finance emergency gas supply. The proposed transaction will be a part of EUR 1 billion package expected to be financed by a coalition of IFIs/DFIs to purchase up to 1bcm of gas starting in April, which is critical for Ukraine’s preparation of gas storages ahead of the heating season. The Bank will cooperate with other IFIs on the proposed financing but will also be ready to provide its loan expediently independently of the timing of other financiers coming on board. The strategic importance of the transaction is driven by the energy security objective to ensure uninterrupted gas supply in Ukraine. This is essential to safeguard basic needs and economic livelihoods of local population, industrial industries and utilities affected by the conflict.
Existing Exposure	<ul style="list-style-type: none"> EUR 52 million sovereign guaranteed loan to Ukgazvydobuvannya (“UGV”), 100% NAK subsidiary (DTM 49204); [REDACTED]. EUR 120 million investment in NAK Eurobonds (DTM 50809); [REDACTED].
Maturity / Exit / Repayment	<ul style="list-style-type: none"> Up to 2 years. [REDACTED].
Use of Proceeds	Energy security. The EBRD Credit Facility will disburse under Gas Supply Agreements (“GSAs”) satisfactory to EBRD [REDACTED].
Investment Plan	EUR 300m revolving credit facility for gas purchases
Financing Plan	SOURCES TOTAL: EUR 300m USES TOTAL: EUR 300m EBRD Financing: EUR 300m Natural gas imports: EUR 300m
Key Parties Involved	NAK, Ministry of Finance of Ukraine, 20 EU gas suppliers to NAK already pre-qualified based on the EBRD procurement rules.
Conditions to subscription / disbursement	[REDACTED]
Key Covenants	[REDACTED]
Security/Guarantees	<ul style="list-style-type: none"> Sovereign guarantee from Ukraine; A set of guarantees representing a combined 90% of the loan issued by EBRD shareholder countries expected to include the G7 countries and the European Union (EU) (“the Guarantors”). Such guarantees, in a form and substance satisfactory to the Bank, to cover 90% of any payment default pro-rata with the Bank. The sovereign guarantee from Ukraine and adequate G7 & EU guarantees would be a condition to loan effectiveness.
Technical Cooperation (TC)	Inclusion TC: Main objective of assignment is to support Naftogaz to tackle critical workforce challenges due to relocation, workforce losses and attrition. The Phase I TC will cover a combination of needed inclusive measures, including workforce mapping and emergency management in terms of recruitment and retention, as well as training of replacement staff and skills recovery and development programmes to support workers with the strengthening of their adaptability skills. The Phase II TC could cover medium-term strategic workforce planning solutions and the development of an Equal Opportunities Action Plan to support women’s access to economic opportunities and ensure that the share of women in the workforce does not decrease compared to the pre-conflict baseline, while gradually increasing during reconstruction (Please refer to TI objectives table).

	<p>Funding source and amount: up to EUR 150,000, likely divided in two phases, with the first EUR 75,000 funded by SSF funds already available under the Gender & Economic Inclusion Technical Assistance Framework.</p> <p>TC Programme for Project Preparation Support of Gender & Economic Inclusion Projects in the Corporate Sector</p> <p>Main objective of assignment: legal due diligence.</p> <p>Funding source: SSF.</p> <p>Amount/currency and funding status: EUR 200,000 earmarked.</p>
Other material agreements	

[REDACTED]

INVESTMENT PROPOSAL SUMMARY

1. STRATEGIC FIT AND KEY ISSUES

1.1 STRATEGIC CONTEXT

The National Joint Stock Company “Naftogaz of Ukraine”, a 100% state-owned vertically integrated oil and gas holding in Ukraine reporting to the Cabinet of Ministers of Ukraine, is the country’s largest natural gas producer. NAK accounts for 75% of domestic gas production and is a major gas importer, and a domestic gas supplier of last resort responsible for the energy service to the population and the district heating utilities. The war against Ukraine by the Russian Federation that commenced on 24 February 2022 has severely disrupted the energy sector in the country.

[REDACTED] [T]he EBRD and other multilateral institutions received a request from NAK to fast track a EUR 1 billion financing for an emergency purchase of up to 1bcm of gas from April 2022, which is critical for the preparation of the next heating season in the country. The continued ability to procure gas is strategically important for Ukraine’s energy security. Importing gas is critical for replenishment of gas stocks and to ensure uninterrupted gas supply for critical economic activities across many industrial sectors, as well as the population’s needs for heating and cooking. NAK faces critical gas storage injection season from April to October to prepare for the next heating season. The minimum required gas injection period is over six full months due mainly to limitation of import pipeline capacities and the disruption of production at some domestic gas fields. Depending on the winter conditions Ukraine’s usual annual gas needs are about 27-30bcm, which are covered by 20bcm of local gas production (including c. 14bcm produced by NAK) and 8-10bcm of gas imports. Currently 10% of the usual local gas production is disrupted, while up to 90% of the remaining production is at risk of disruption due to hostilities in the Kharkiv and Poltava regions. At the same time, gas consumption has increased by 0.4bcm driven mainly by thermal power plants switching to gas as coal supply is also disrupted. In addition, as of March 2022, the gas storages (which are located in Western Ukraine) have 44% less gas compared to the same time in 2021. Thus, the gas storages today hold 7.3bcm of NAK’s own gas (which is 75% of total stored gas), out of which 4.7bcm is a “technical buffer gas” that leaves only 2.6bcm, or 2 months, of gas available for use. Insufficient gas in storage will necessitate damaging cutbacks of the energy service to industry and the population in the next heating season.

In response to this request, the EBRD is proposing to form a coalition of multilateral and bilateral institutions and has initiated consultations with the World Bank Group, the European Investment Bank and the US Development Finance Corporation. As part of this international effort, the EBRD aims to lead with a EUR 300 million loan to NAK for gas imports during this and the next heating seasons. The transaction will be structured to ensure full transparency and traceability of proceeds. The Bank will work directly with pre-qualified EU based suppliers, selected by Naftogaz and agreed by EBRD in compliance with EBRD procurement rules. Loan disbursements will be made directly to such suppliers against invoices for dispatched gas.

The support of the G7 countries, the European Union (and potentially other counterparties of acceptable credit standing) as guarantors will be necessary to implement this transaction based on the EBRD’s sound banking principles. In the current high risk environment created by the war, the provision of a guarantee will be indispensable to increase EBRD’s credit exposure to NAK as well as attend to other needs in the country.

The project is in line with the War on Ukraine – EBRD Resilience Package endorsed by the Board and is expected to be fully consistent with the forthcoming EUR 2 billion War on Ukraine - EBRD Resilience Package - Resilience and Livelihoods Framework, which is to be submitted for approval by the Board and aims to help citizens, companies and countries affected by the war in Ukraine. The project specifically focuses on energy security in Ukraine through emergency energy purchases to compensate for the disrupted domestic gas production and gas imports. The project is also in line with Strategy for Ukraine and the Energy Sector Strategy 2019-2023 as it will strengthen energy security in

the country. The project further aligns with the Bank's Equality of Opportunity Strategy 2021-2025, which promotes access to services for all, and the Strategy for the Promotion of Gender Equality, which supports gender mainstreaming, especially in male-dominated sectors.

It should be noted that the Bank previously in 2015 supported NAK's gas import purchases with a USD 300 million sovereign loan, which was repaid, and participated in 2019 in NAK's Eurobond with EUR 120 million of financing, which remains outstanding.

1.2 TRANSITION IMPACT

The tables below set out the TI Objectives and details of the project.

Primary Quality: Resilient

Obj. No.	Objective	Details
1.1	<i>There is a serious and confirmed threat to security of supply and the project helps to address it, in full or in part.</i>	Due to the military actions, some gas treatment plants and gas fields are not operational, which has resulted in a decrease of gas production, while demand from thermal power plants has surged due to disrupted coal supplies from blockades of ports and disruptions of the railways. Skyrocketing energy prices have aggravated the security of supply situation and raised affordability concerns. Since NAK is directly responsible for domestic gas supply, this transaction represents critical support for energy security in Ukraine.
1.2	<i>The Project entails a policy dialogue initiative that has been assessed as Good by the sector economist.</i>	This transaction will allow keeping constructive contact with NAK during the war and supporting the reform objectives of the previous engagements aimed at Ukrainian gas market liberalisation and integration with the EU after the war.

Secondary Quality: Inclusive

Obj. No.	Objective	Details
2.1	<i>Safeguarding energy provision to maintain vital services for the population.</i>	The project will maintain reliable household supply of vital energy services to sustain livelihoods of people in Ukraine during the ongoing heating season through emergency energy purchases to compensate for disruption of domestic gas production.
2.2	<i>Supporting human capital resilience for the affected local workers.</i>	The project will support human capital resilience and adaptability for the 70,000 employees of NAK, 90% of who are located in the eastern part of the country most affected by the war. With the EBRD's assistance, NAK will be supported in tackling critical workforce challenges due to involuntary relocation, workforce losses and staff attrition caused by hostilities. In the initial phase, the Bank will help NAK with workforce mapping and emergency management in terms of consolidation and redeployment of existing staff resources to ensure the continuation of critical business functions and operations. This could also include training of replacement staff and skills recovery programmes to support workers with strengthening of their adaptability skills. In the second phase, the Bank's assistance would cover medium-term workforce support solutions for the reconstruction, including reintegration of staff returning to Ukraine, particularly women.

The TI delivery risks associated to the transaction mainly come from the unfolding military activity in Ukraine resulting in: (i) significant distractions, losses of connections to basic services, putting preservation of livelihoods at risk and (ii) increased threat to energy security and ability of NAK, the supplier of last resort, to maintain liquidity and financial stability in view of increased gas prices, declined revenue collection as well as current and potential production losses. The risks are mitigated by the resilience of Ukrainian population against the invasion, the support from the Western allies and the positive signals from the G7 countries, the EU, IFIs and DFIs to support the financing package required by NAK to deliver uninterrupted gas supply in Ukraine.

1.3 ADDITIONALITY

Identified triggers	Description
<i>A subsequent/consecutive transaction (issuance) with the same client/group either with the same use of proceeds or in the same destination country (repeat transaction).</i>	EBRD's financing to support NAK's emergency gas purchases is a follow-up on to the (i) EBRD's USD 300 million gas purchase loan signed in 2015 and fully repaid in January 2018; and (ii) EBRD's EUR 120 million investment in NAK's 2019 Eurobond. The current transaction for approval is thus a continuation of the Bank's support to NAK's application of transparent and competitive procurement procedures and practices. This transaction will be highly additional as it will aim to guarantee uninterrupted gas supply to the local population affected by the military actions in the country. The facility aims to be part of a EUR 1 billion financing package required by NAK to import up to 1bcm of gas from April 2022. This financing will allow injecting gas into storage required for the next heating season. The imminent need to begin gas storage injection is driven by import pipe limitations at border points, as well as reduced domestic gas production and increased gas consumption from thermal power plants, which have switched from coal to gas. All gas purchased under the EBRD facility will be procured under the EBRD procurement rules, developed with NAK during the previous engagements. As part of the transaction, the Bank will also support human capital resilience for the affected local workers by providing re-training programmes, equal opportunities practices, strategic workforce management, enhancing workforce adaptability skills.

Additionality sources	Evidence of additionality sources
Financing Structure - <ul style="list-style-type: none"> EBRD offers financing that is not available in the market from commercial sources on reasonable terms and conditions, e.g. a longer grace period. Such financing is necessary to structure the project. Public sector: EBRD investment is needed to close the funding gap. At the same time, EBRD does not crowd out other sources, such as from IFIs, government, commercial banks and/or complements them. 	<ul style="list-style-type: none"> EBRD is offering financing, which is not available in the market due to the unfolding war and high level of risk and uncertainty in Ukraine. To deliver USD 1 billion financing package for emergency gas purchase in Ukraine, EBRD facility will need to be complemented with the coordinated efforts from other IFIs / DFIs. The Bank is in discussion with them on joining the emergency package.
Innovative financing structures and/or instruments	<ul style="list-style-type: none"> Proposal to have a guarantee from EBRD shareholders, including countries from the group of the G7 and the EU is novel. The Bank's deep

<ul style="list-style-type: none"> EBRD offers an innovative financing structure (e.g. mezzanine financing, risk sharing, etc.) on commercial terms not available from other banks. 	<p>knowledge of NAK and its gas procurement system puts the EBRD in an enabling role for the international support provided from the G7, the EU and others.</p>
<p>Standard-setting: helping projects and clients achieve higher standards</p> <ul style="list-style-type: none"> Client seeks/makes use of EBRD expertise on best international procurement standards. Client seeks/makes use of EBRD expertise on higher Equality of Opportunity / inclusive standards (e.g. adherence to labour standards which goes beyond the provisions set in PR2 of the environmental and social policy, development of comprehensive and institutional corporate social responsibility programmes). 	<ul style="list-style-type: none"> NAK will be using EBRD facility to purchase gas on the basis of EFET contracts from the pre-qualified suppliers selected according to the Bank's PP&R under the previous transaction with NAK. In the medium term, following the suspension of the military actions, EBRD will support NAK in developing an Equal Opportunities Action Plan to ensure that the share of women in the workforce does not significantly decrease compared to the pre-conflict baseline.

1.4 SOUND BANKING - KEY RISKS

Risks	Probability / Effect	Comments
Project specific risks		
Counterparty credit / liquidity risk	High / Low	<p>NAK's financial position is weak and unpredictable due to the ongoing war in Ukraine. The military activities negatively affect NAK's production of natural gas with the vast majority of fields located in Poltava and Kharkiv regions, i.e. in the epicentre or close to the current hostilities. The war has also caused millions of people to migrate to Western Ukraine and the EU (mostly women and children) and that is expected will negatively affect NAK's collection rates for the sold gas. The war has also resulted in the destruction of some gas transportation infrastructure. There is further a risk that NAK (and the gas TSO) may not receive revenues from gas transit and will then need to buy additional gas to maintain the minimum technical gas volumes in gas pipelines.</p> <p><i>Mitigants: While the duration and outcome of the war are unpredictable, EBRD's credit risk is mitigated by the shareholder guarantees from the G7/EU and others for 90% of the financing. The loan, including the 10% EBRD portion, will further be covered by the sovereign guarantee from Ukraine.</i></p>
Commodity price risk	High / Low	<p>NAK will be importing 100% of the natural gas financed by this transaction from EU gas hubs and Moldova. NAK does not control the price risk which cannot be hedged. Due to the ongoing war in Ukraine the spot prices at EU gas hubs have skyrocketed above USD 3,000thcm compared to USD 800-1,000thcm on average during 2021/2022 winter season.</p> <p><i>Mitigants: It is difficult to for NAK to mitigate the price risk but its competitive procurement process will allow achieving best possible gas purchase price.</i></p>
FX Risk	High / Low	<p>While the currency of the imported gas as well as of the proposed transaction is in EUR, most of the NAK's revenues are in UAH and</p>

		<p>come from district heating companies and the population. Given the war, it is highly unlikely that NAK will be in a position to adjust the prices of the gas sold to its consumers in case of FX rate fluctuations.</p> <p><i>Mitigants: Under extreme war conditions, so far, the National Bank of Ukraine has skilfully managed macro-financial stability. It pledged to maintain fixed exchange rate of UAH and not return to inflation targeted policy until the end of the war. That is enabled by strict capital control measures that already resulted in increase of international reserves over February 24 - March 7, by USD 316 million. Immediate external financing gaps are already addressed with USD 1.4 billion of IMF Rapid Financing Instrument and EUR 0.3 billion MFA from EU. Additional EUR 0.9 billion MFA remains available as well as USD 0.5 billion from World Bank for urgent support of vulnerable groups and public health care. It is likely that external financing gap would further deepen in short to medium term because of high reconstruction costs after the end of war and time needed to renew the export potential in metals and grains sectors. This risk is likely to be mitigated by support of developed economies pledging significant financial aid for Ukraine. There are ongoing talks within the international community to create a Ukraine Trust Fund for the reconstruction phase.</i></p>
Integrity risk	Medium / Medium	<p>[REDACTED]. While significant steps to increase transparency have been taken, the Company's governance remains insufficient as evidenced by a recent conflict between the government and the ex-supervisory board, which resulted in Supervisory Board members resignation.</p> <p><i>Mitigants: EBRD will continue to work with the government on adoption of the new NAK's supervisory board once hostilities have ceased. After that, NAK's SB will implement the recommendations of an independent governance audit to be conducted in a post-war environment.</i></p>
Guarantor risk	Low / High	<p>EBRD may not recover the whole amount of its loan in case of the NAK or the state of Ukraine failure to fulfil their obligations.</p> <p><i>Mitigants: The EBRD loan will benefit from unconditional and irrevocable guarantee extended by the counterparties with acceptable credit rating for 90% of the financing. The probability of default of such guarantors is extremely remote. The remaining 10% will be covered by the Ukrainian sovereign guarantee, which will be provided for the full amount of the EBRD loan.</i></p>
External risks		
Political risk	High / Low	<p>Russia's military invasion of Ukraine has increased political risks to the extreme and made the overall situation unpredictable, having caused enormous suffering, death and destruction in Ukraine and having created an unparalleled security crisis in Europe.</p> <p><i>Mitigants: More than three weeks into the war, Ukraine at the same time continues to ensure critical functions, including heating, water, gas and electricity supplies on most of its territory. Ukraine remains resolved and united in defending its independence, sovereignty and territorial integrity. G7, the EU, the IMF and Ukraine's other international partners are strongly committed to supporting Ukraine and its people in the face of the Russian aggression, providing fast-tracked emergency assistance, financial and humanitarian.</i></p>
Macro-economic risk	High / Low	<p>[REDACTED]. Budget priorities are shifting toward security expenses crowding out public investments. Currently, the war is</p>

		<p>happening on territories that produce around 60% of Ukrainian GDP. Economic activity and trade have been seriously disrupted. This is severely weakening companies' finances, with some being even physically damaged, thus exposing banking sector to a drastic deterioration of asset quality. Physical infrastructure is being destroyed with airports bearing the most of the damage so far. Energy supply is under serious threat and major disruptions are only a matter of time. The local supply of electricity is under threat due to the rapid depletion of coal reserves and nuclear electricity plants being captured by the enemy forces. Under such conditions gas supplies from EU countries are becoming the only reliable energy source.</p> <p><i>Mitigants: This risk is likely to be mitigated by support of developed economies which are pledging significant financial aid for Ukraine. There are ongoing talks within the international community to create a Ukraine Trust Fund for the reconstruction phase.</i></p>
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2. MEASURING / MONITORING SUCCESS

Primary Quality: Resilient

Obj. No.	Monitoring indicator	Details	Baseline	Target	Due date
1.1	The project helps address security of supply, in full or in part.	Restoration of gas transportation volumes from Europe to Ukraine for a total of minimum 5 BCM per year or the minimum requirement necessary to preserve Ukraine's energy security volumes.	[REDACTED]	[REDACTED]	[REDACTED]
1.2	Recommended policy or strategy maintained by relevant stakeholders	The gas market structure remains in line with the gas sector reforms achieved post 2014 including: Ukrainian gas market integration with the EU, NAK unbundling and EFET contract as a standard on Ukrainian market.	[REDACTED]	[REDACTED]	[REDACTED]

Secondary Quality: Inclusive

Obj. No.	Monitoring indicator	Details	Baseline	Target	Due date
2.1	Service provision maintained in areas affected by the conflict	The project will maintain household supply of vital energy services to sustain livelihoods of people in Ukraine during the ongoing heating season.	[REDACTED]	[REDACTED]	[REDACTED]
2.2	Emergency workforce management programme developed and implemented	The project will promote human capital resilience for affected local workers by introducing a new re-training programme and enhancing workforce adaptability skills.	[REDACTED]	[REDACTED]	[REDACTED]

3. KEY PARTIES

3.1 BORROWER

NAK is a 100% state-owned company reporting to the Cabinet of Ministers of Ukraine. The Company is a vertically integrated oil and gas holding with activities including oil and gas production, oil transportation, oil and gas storage, and refining, as well as supply of fuels. NAK is directly responsible for domestic supply of gas to population and district heating utilities.

Unbundling was fully finalized in 2019 and starting from 1 January 2020 gas transmission system was transferred from NAK to newly created entity Gas Transmission System Operator of Ukraine LLC (TSO), indirectly owned by the Ministry of Energy of Ukraine. According to the unbundling terms, NAK retains economic benefits to the TSO for 15 years from the date of the transfer, though these cash flows are not defined and depend on a number of factors.

NAK employs more than 51,000 people across Ukraine. In 2020, natural gas production remained concentrated with up to 76% accounting for output coming from UGV (70%) and Ukrnafta (6%). In 2020, gross gas production was 15.4 bcm (76%), and 18.2 bcm of gas was sold (59% from total consumption).

In 9M 2021, NAK had revenues of USD 4.9bn, EBITDA of USD 0.5bn, net loss of USD 0.16bn and a total debt of USD 2.3bn. In March 2021, Fitch downgraded NAK's credit rating to 'CCC' from 'B' following Ukraine's full-scale military invasion by Russia.

3.2 GUARANTOR(S)

Beyond the sovereign guarantee extended by Ukraine, the EBRD is expected to benefit from guarantees from a number of EBRD shareholders, expected to include countries from the G7, the European Union and others.

The Group of Seven (G7) is an inter-governmental political forum consisting of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. Its members are the world's largest IMF advanced and wealthiest. The G7, originally G8, was set up in 1975 as an informal forum bringing together the leaders of the world's leading industrial nations. The annual G7 summits have over the years developed into a platform for determining the course of multilateral discourse and shaping political responses to global challenges.

The European Union (EU) is an economic and political union of 27 countries. It operates an internal (or single) market, which allows free movement of goods, capital, services and people between member states. The EU is rated AAA/Aaa/AAA/AAA (outlook stable) by Fitch, Moody's, DBRS and Scope and AA (outlook positive) by Standard & Poor's.

4. MARKET CONTEXT

Pre-war natural gas market snapshot.

Ukraine's domestic production of natural gas (19.8 bcm in 2021 or -2% y-o-y) is far below its consumption (26.8 bcm in 2021 or -7% y-o-y) making it dependent on imports. Ukraine switched from Gazprom (Russia) supply to purchases from the EU gas hubs completely starting from 2015 due to the Country's energy security reasons. In 2021, Ukraine imported 2.6 bcm (-84% y-o-y) with more than 90% of natural gas import carried out by private players. During 2021, the gas storage reduced by 10.0 bcm to 13.7 bcm as of YE 2021.

NAK's subsidiaries account for 75% or 14.8 bcm of domestic gas production, consisting of 13.7 bcm produced by UGV and 1.1 bcm produced by Ukrnafta. The remaining 25% (or 5.0 bcm) of natural gas

in Ukraine is produced over 20 much smaller privately owned companies most of which in turn are controlled by the oligarchs through non-transparent ownership structures.

NAK manages Ukraine's underground gas storage facilities of 31 bcm total capacity. These are the largest storage facilities in Europe and the third largest in the world after the U.S. and Russia. As of now, almost all the gas storages of UTG (100% NAK's subsidiary) are located in Western Ukraine and remain operational, apart from one minor storage located in Luhansk region.

Effect of war on Ukraine

Ukraine's total domestic gas production (including private producers) is currently 50.6 mcm/d, which was down 9% compared to the period prior to Russia's invasion. This includes the losses resulting from the destruction of the Ukrnafta facilities at Okhtyrka and thus decreasing domestic gas production by ~4% and disrupting more than 50% of domestic oil production. UGV is currently producing 35.2 mcm/d, which is down roughly 3.5% from the period before the war. Overall, 90% of all UGV production is at great risk due to potential need to stop production and evacuate personnel or the inability to deliver materials to maintain equipment and wells. Already, multiple sites have been temporarily shut down, including the main refinery in Kharkhiv oblast. Thus, Ukraine needs to be ready to replace lost production with new imports to sustain the last month of the heating season and to prepare for the next heating season.

In accordance with the Resolution of the Cabinet of MIU dated March 6, 2022 No. 222, 12 TPPs were transferred to natural gas instead of coal, as coal supplies are currently limited, including due to the damaged railroads. Thus, issues with coal supply may additionally increase gas consumption by 0.2-0.75 bcm per month.

Since 3 March 2022, Ukraine banned all gas exports to protect the technical viability of gas storages and ongoing domestic energy service. .

As of 9 March 2022, storage levels were at 9.8 bcm (44% below 2021 level), including NAK's 7.3 bcm. Out of this amount 4.7 bcm account for "technical buffer" gas in gas storages, which cannot be extracted for technical reasons. Therefore, NAK's remaining balance of gas available for supply to the population and district heating utilities amounted to only 2.6 bcm, which covers 2 months of the consumption. Before the war in Ukraine, it was originally planned to import 11 bcm in 2022, including 6.5 bcm by NAK. Since the beginning of 2022, Ukraine has imported only 0.5 mcm of gas, including 0.35 bcm by NAK. Gas imports were conducted mostly by private traders (both local and from EU based) during the last four years. With the outbreak of war, NAK will need to import gas as a supplier of last resort.

In order to prepare for the next heating season, and taking into account limited technical capacities for gas import at the border, NAK has to start importing gas immediately.

The prices for natural gas in EU skyrocketed following beginning of the war in Ukraine (exceeding USD 3,000/1000m3 on its high levels vs. USD 800-1,000m3 on average during 2021/2022 winter vs. ca. USD 100m3 in 2020FY). Thus, gas price dynamics pushes the gas bill for Ukraine and forces NAK to reach out to IFIs to finance emergency gas supplies. Please refer to Annex 4 for Gas Market Analysis.

By the end of the heating season NAK needs additional external financing in the amount of at least EUR 1 billion to purchase imported gas. The total amount of funding for the purchase of imported gas in 2022 depended on many circumstances and in a negative scenario could reach ca. USD 5-6 billion.

5. FINANCIAL / ECONOMIC ANALYSIS

5.1 FINANCIAL HIGHLIGHTS

The latest financial performance analysis is based on 2020FY consolidated IFRS financials audited by Deloitte and 9M 2021 unaudited consolidated IFRS financials. The 2020FY statements had unqualified audit opinion.

NAK IFRS Financials, USD mln	Audited			Unaudited	
	2018 (A)	2019 (A)	2020 (A)	9M 2020	9M 2021
Revenue	6,783	5,790	5,900	3,886	4,927
EBITDA	2,657	1,651	2,160	358	1,228
Adjusted EBITDA*	n/p	1,205	866	(47)	452
Net profit	424	2,447	(704)	(642)	(159)
Net Operating CF	2,629	4,252	752	634	(686)
Total Assets	21,720	24,495	15,754	17,155	14,129
Inventories	2,359	2,435	1,437	1,692	2,490
Receivables and other ST assets	2,669	7,805	2,464	2,554	2,015
Cash	512	3,274	1,311	1,618	223
Payables and other ST liabilities	2,740	4,017	1,386	2,067	1,397
Gross Debt	2,015	2,559	2,343	2,311	2,338
Debt/Equity, x	0.14	0.15	0.21	0.20	0.26
Current Ratio, x	1.27	2.95	3.01	2.56	2.20

*adjusted EBITDA
as per EUROBONDS agreement excluding impairment of PPE and income and expenses recognized per results of Gas Transit Arbitration

[REDACTED]

5.2 PROJECTED PROFITABILITY FOR THE BANK

[REDACTED]

6. OTHER KEY CONSIDERATIONS

6.1 ENVIRONMENT

Categorised B (2019) and rated Low-Medium risk. Use of proceeds will fund emergency gas purchase; therefore, the Project definition is limited to the trading activity only. The EBRD PRs shall apply to this activity and to the corporate environmental, social, labour and health and safety policies and management systems of NAK. It should be noted that, once the gas is purchased, the impacts associated with the actual physical transportation and storage of gas can be readily identified and mitigated. Given the emergency situation for this loan, project appraisal will rely on results of previous projects with this client, which concluded that the Company has the capability and resources to operate in line with the Bank's PRs. There is no GET component associated with this project. The project is considered Paris aligned for climate mitigation, but no assessment can be made on the Paris alignment for adaptation given that the source of gas and infrastructure used for shipping and storage is not known. Physical Climate Risk screening is not applicable for this project.

6.2 INTEGRITY

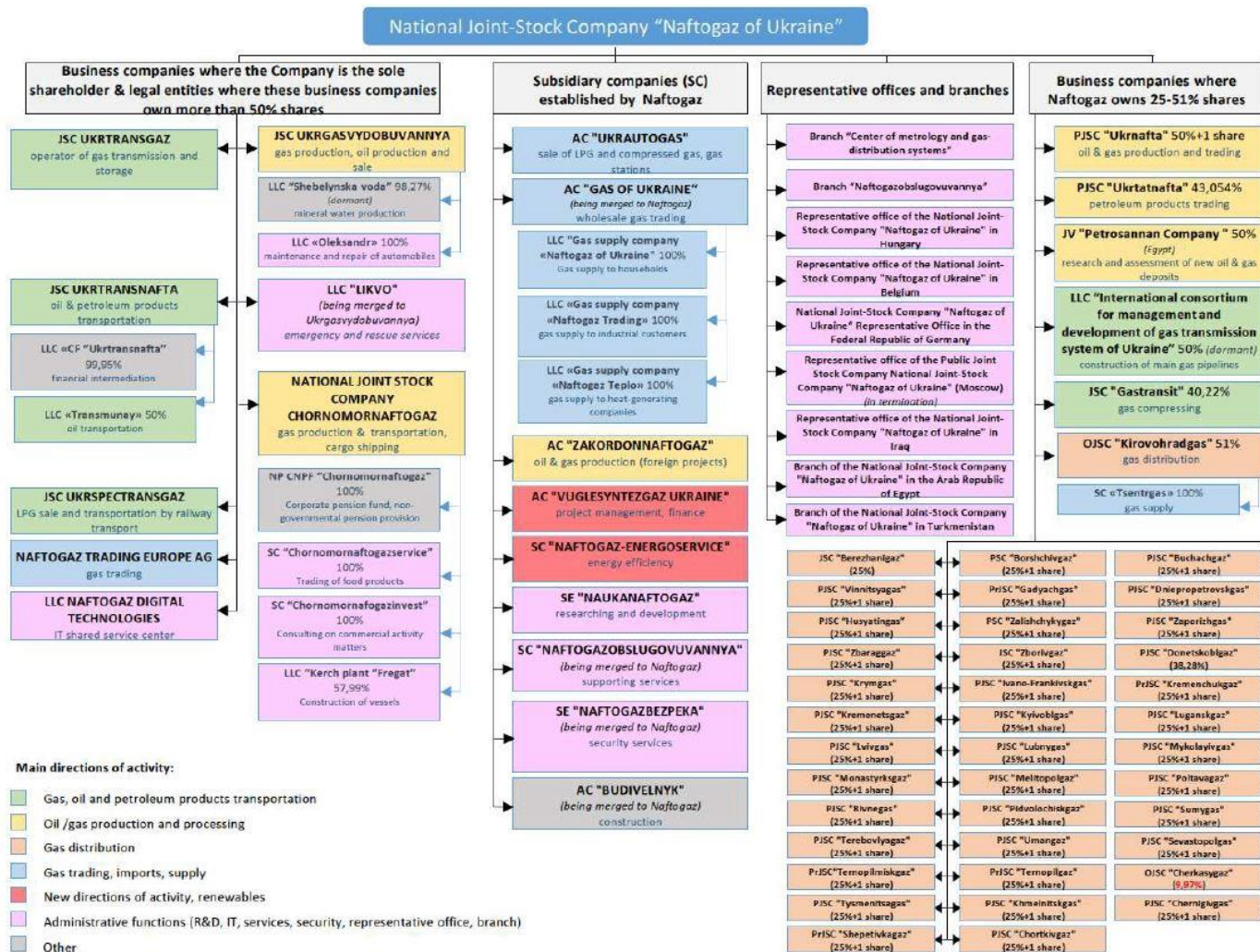
In conjunction with OCCO, updated integrity due diligence was undertaken on the Company (an existing Bank client), its shareholders, senior management and other relevant parties. [REDACTED] [I]t has therefore been concluded that this project does not present unacceptable integrity or reputational risks to the Bank. [REDACTED].

All actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the project, and the project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the project.

ANNEXES TO OPERATION REPORT

ANNEX 1	SHAREHOLDING STRUCTURE
ANNEX 2	GREEN ASSESSMENTS
ANNEX 3	FINANCIAL ANALYSIS SUMMARY
ANNEX 4	PROJECT IMPLEMENTATION

ANNEX 1 – SHAREHOLDING STRUCTURE



Domiciliation Annex is not required as the Company is registered in Ukraine and operates in Ukraine.

ANNEX 2 – GREEN ASSESSMENTS

Introduction

The Bank is financing a 2 years emergency revolving facility to ensure the availability of natural gas for Ukraine. This facility intent is to support Ukrainian natural gas market to limit as much as possible the disruption of the supply. Consequently, the facility will not result in a natural gas demand increase, short or long term.

Paris alignment assessment

General screening of alignment with the mitigation goals of Paris Agreement

- The project/economic activity is not included in the 'aligned list'.
- Regarding project/economic activity, there are no activities included in the 'non-aligned list'.

Specific assessments undertaken

This project is aligned with the mitigation goals of the Paris Agreement because of the following:

- The project is a revolving facility of short duration (2 years) that does not entail any capital investment. It will be only used to ensure the availability of natural gas that will be consumed anyway and to avoid any disruption of the supply. Consequently, the risk of carbon lock-in of this project is very low.
- The project is aligned with the implementation of Ukraine updated NDC :
 - Ukrainian NDC target corresponds to an economy-wide absolute greenhouse gas (GHG) emissions reduction of 65 % by 2030 (including the sector «Land use, land-use change and forestry» - LULUCF), compared to 1990 GHG emissions level. As of 2019, GHG emissions in Ukraine decreased by 62.4% from the level of 1990 (including LULUCF) and by 64.8% from the level of 1990 (excluding the sector LULUCF). Additionally, the project does not entail any capex investment directed to increase the consumption of fossil fuels. In consequence, the impact of the project on Ukraine NDC strategy is limited.
- Ukraine has committed to carbon neutrality by 2060:
 - Due to the duration of the revolving facility, this project will not have any material impact on the net-zero target in the second half of this century.
- Ukraine 2050 Low Emissions Strategy :
 - The project is aligned with the long-term decarbonisation strategy. This strategy envisages amongst others to facilitate the increase in efficient use of natural gas at the heat generation sources in the communal energy sector and the development of highly efficient cogeneration plants.
- The GHG emissions impact of the project is considered to be negligible:
 - The facility aims to support the purchase of natural gas to maintain a similar level of availability in the market, resulting in similar GHG emissions.
- Naftogaz has already set decarbonisation goals:
 - Reach net zero GHG operational emissions by 2040 – considerably more ambitious than the Country targets.
 - Monitor and reduce direct GHG emissions (Scope 1): by reducing methane leaks and well blow-downs.
 - Increase renewable energy generation for own consumption, as well as implement energy-efficient solutions to reduce indirect emissions (Scope 2).
 - Develop low-carbon businesses to reduce emissions from end user consumption (Scope 3): the Company prioritises bioenergy and hydrogen.

- Explore GHG removal options like carbon capture, utilisation and storage and carbon offsets.

Alignment with the adaptation goals of Paris Agreement

The Paris alignment for adaptation does not apply for this project:

- Exposure to physical climate risks is highly localised, meaning is a function of the specific climatic conditions present in a project location and the risk changes with location and time. In the absence of a specific project location – which is the case for this project – a project-level physical climate risk assessment as foreseen by the BB2 framework cannot be conducted. Thus, this project is not in scope for Alignment with Adaptation Goals of the Paris Agreement.

ANNEX 3 - FINANCIAL ANALYSIS SUMMARY

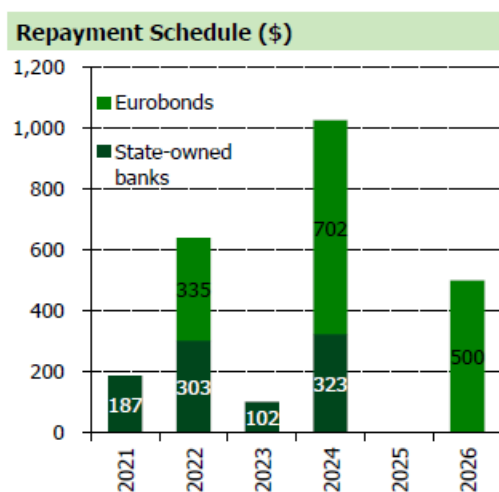
Income Statement, Millions USD	Audited			Unaudited	
	2018 (A)	2019 (A)	2020 (A)	9M 2020	9M 2021
Revenue	6,783	5,790	5,900	3,886	4,927
Cost of Sales	(4,092)	(3,619)	(4,179)	(3,024)	(3,230)
SGA and Other OpEx	(1,175)	(1,302)	439	(504)	(469)
EBITDA	2,657	1,651	2,160	358	1,228
D&A	(481)	(549)	(613)	(448)	(308)
EBIT	1,036	320	1,547	(90)	919
Interest Expense	(198)	(240)	(245)	(194)	(148)
Net Forex Gain/Loss	(16)	75	57	89	77
Other Costs/Income	16	35	(1,879)	(629)	(773)
Profit before tax	838	189	(520)	(824)	75
Tax incurred and other	(413)	2,258	(184)	182	(234)
Profit after tax	424	2,447	(704)	(642)	(159)

Balance Sheet, Millions USD	Audited			Unaudited	
	2018 (A)	2019 (A)	2020 (A)	9M 2020	9M 2021
Cash	512	3,274	1,311	1,618	223
Receivables	2,373	2,503	1,641	2,121	875
Inventories	2,359	2,435	1,437	1,692	2,490
Other current assets	296	5,302	823	433	1,141
Total Current Assets	5,540	13,513	5,212	5,863	4,728
Fixed Assets	15,628	10,147	7,458	8,253	8,536
Other Assets	553	834	3,084	3,039	865
Total Assets	21,720	24,495	15,754	17,155	14,129
ST Debt plus CPLT Debt	1,608	570	346	222	754
Payables	1,093	1,250	530	210	506
Other ST Liabilities	1,646	2,766	857	1,857	891
Total Current Liab	4,348	4,587	1,732	2,290	2,150
Long Term Debt	407	1,989	1,997	2,089	1,585
Other LT Liabilities	2,076	1,356	923	987	1,048
Total Liabilities	6,830	7,932	4,652	5,366	4,783
Equity	14,890	16,563	11,101	11,790	9,119
Total Liab & Equity	21,720	24,495	15,754	17,155	13,902

Cash Flow Statement, Millions USD	Audited			Unaudited	
	2018 (A)	2019 (A)	2020 (A)	9M 2020	9M 2021
EBITDA	2,657	1,651	2,160	358	1,228
Other Adjustments	1,648	4,612	129	236	163
Changes in Working Capital (+/-)	(799)	(1,148)	(676)	490	(1,849)
<i>Change in Inventories</i>	<i>(455)</i>	<i>(42)</i>	<i>645</i>	<i>306</i>	<i>(881)</i>
<i>Change in Trade Receivables</i>	<i>(997)</i>	<i>(630)</i>	<i>(263)</i>	<i>378</i>	<i>(491)</i>
<i>Change in Trade Payables</i>	<i>550</i>	<i>(6)</i>	<i>(55)</i>	<i>(28)</i>	<i>63</i>
Tax Paid	(877)	(862)	(861)	(450)	(227)
Net Operating CF	2,629	4,252	752	634	(686)
Interest Paid	(189)	(209)	(229)	(191)	(137)
Dividends Paid	(1,084)	(802)	(1,468)	(1,493)	(0)
Pre Investment CF	1,356	3,240	(945)	(1,049)	(823)
Capital Expenditure	(914)	(1,070)	(557)	(444)	(400)
Other CFI	(38)	105	(320)	(36)	152
Pre Financing CF	404	2,275	(1,823)	(1,530)	(1,070)
Debt repayment	(1,291)	(1,347)	(401)	(452)	(232)
Debt drawdowns	525	1,696	227	298	256
Post Financing CF	(363)	2,624	(1,996)	(1,683)	(1,046)
Cash End	459	3,274	1,311	1,618	223

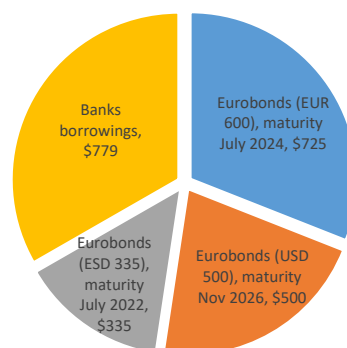
Segment results, Millions USD	2019	2020	9M 2021	2019	2020	9M 2021
	Revenue	Revenue	Revenue	EBITDA*	EBITDA*	EBITDA*
Exploration and production (gas production)*	3,010	2,072	2,436	1,698	1,038	1,265
Oil midstream and downstream	498	427	395	61	76	49
Commercial (imports, sales, trading and wholesale supply of natural gas)*	4,215	2,799	2,922	(371)	(583)	(918)
Gas transit organisation services	0	1,733	104	0	64	(102)
Gas storage includes 12 underground gas storage facilities located in mainland Ukraine.	126	191	907	59	122	216
Ukrnafta, the biggest oil producing company in Ukraine	1,090	1,318	920	(48)	357	21
Other	23	69	71	(184)	(208)	(79)
Elimination (IC)	(3,173)	(2,703)	(2,828)	0	0	0
TOTAL	5,790	5,905	4,927	1,205	866	452

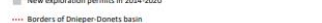
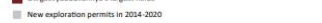
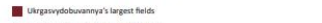
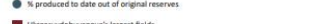
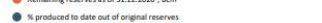
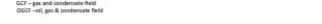
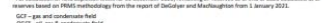
Note: (1) in Y2020, Naftogaz made the decision to split Integrated Gas into Exploration & Production and Commerce divisions; (2) Adjusted EBITDA excluding impairment of property, plant and equipment and income and expenses recognised per results of Gas Transit Arbitration



Sources: Naftogaz, Dragon Capital estimates

Debt as of 30 Sep 2021, USD 2.3 bln total





ANNEX 4 - PROJECT IMPLEMENTATION

Procurement classification – *Public sub-sovereign*

[REDACTED]. The Executing Agency for the project will be NAK which will be fully responsible for all procurement and implementation activities under the project.

Contracts risk assessment: Low

The project will finance contracts for natural gas. Contracts will be awarded to prequalified suppliers/traders solely based on lowest price.

Project implementation arrangements:

NAK has substantial experience in the procurement of gas financed under its own resources. In addition, NAK has previously successfully implemented similar projects financed by the Bank, in accordance with the Bank's Procurement Policies and Rules (PP&R), which involved the award of 65 contracts with a total value of circa EUR 1 billion over a three year period. The Bank conducted a post review of all contract awards and found no evidence of any red flags or irregularities in the award of any contract. Additionally, NAK has implemented similar projects financed by the World Bank.

Procurement arrangements:

The proposed operation is classified as public sector for procurement purposes. All contracts for natural gas to be financed under the project shall be procured in accordance with the Bank's PP&R and specifically para 3.12 - Commodities of the PP&R which covers the procurement of commodities such as natural gas. Para 3.12 requires the procurement procedures to be consistent with the Bank's key principles of transparency, accountability, economy and efficiency and to be acceptable to the Bank. The procurement procedures will be very similar to those applied under the Bank's previous projects with NAK. The final procurement procedures and project procurement plan will be subject to the sign-off of the Procurement Policy Department (PPAD) prior to the commencement of any procurement activity under the project.

The project is an extension of, and linked to, the previous gas purchase facilities arranged for NAK including the last Eurobond transaction where a) the Bank's outstanding exposure is EUR 120 million and b) pre-qualification phase remained open throughout the procurement phase (completed in September 2021). On this basis, it is proposed to use NAK's existing list of 20 pre-qualified tenderers (all selected in accordance with an open procurement procedure undertaken in accordance with the Bank's PP&R) for gas purchases financed by the loan. All 20 pre-qualified tenderers will be subjected to updated integrity checks to ensure continuing compliance with the Bank's eligibility requirements.

All contracts financed under the contract will be based on the industry standard European Federation of Energy Traders (EFET) conditions of contract and applicable provisions of Ukrainian law.