

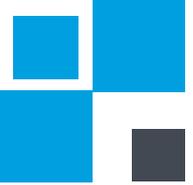


Unbundling Discussion

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26 June 2019





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What Naftogaz Group has achieved over the past six months

What Naftogaz Group plans to do going forward

Major criteria for successful TSO unbundling in Ukraine

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Making TSO LLC a fully fledged certifiable TSO is the primary focus of Naftogaz for the upcoming months

Before 01 July 2019

Step 1 TSO Branch

- Concentrate and prepare GTS assets that cannot be moved from UTG
- Teach to work as a separate entity

From July 2019 till December 2019

Step 2 TSO LLC

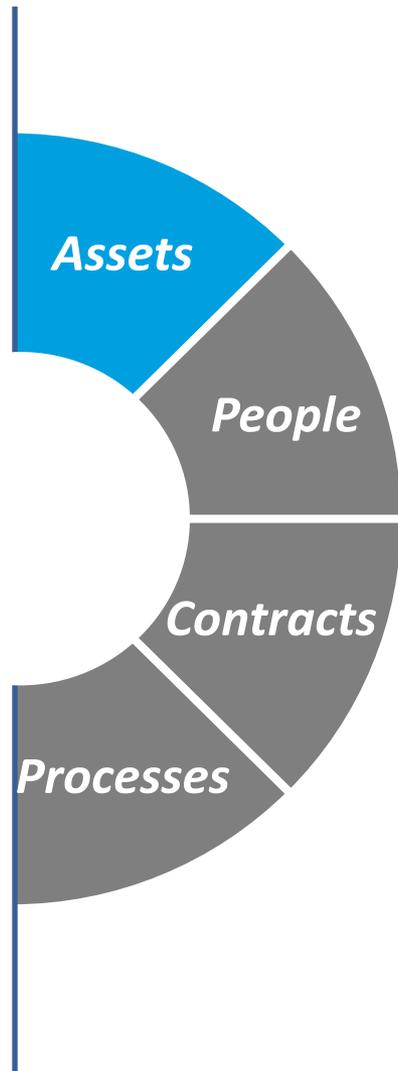
- Move all GTS related staff, secure permissions
- Prepare processes and IT
- Ensure certification process

Step 3 MGU

After 01 January 2020

- Transfer TSO LLC
- Transfer Assets
- Start operations as unbundled TSO

Unbundling is a restructuring project - Naftogaz Group has delivered on many preparatory tasks (1/4)



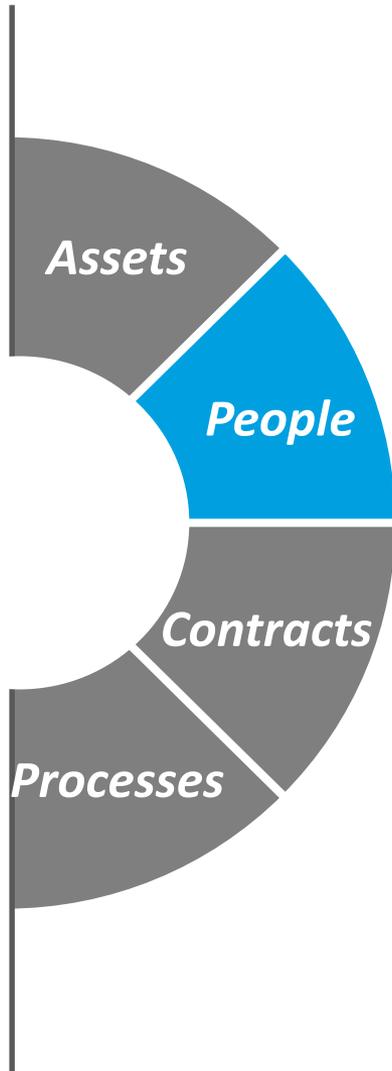
Prepare TSO related assets for transfer

- All TSO related assets confirmed by process owners (incl. non-current assets, CIP, inventories, intangibles etc.)
- Item-by-item analysis of 530 k assets + in performed and feasibility of transfer established
- **320k + SAP items** of assets (**UAH 95bln +**) transferred and reassigned to Branch TSO
- Legal & tax mechanism for transfer of different types of assets to a separate entity is currently being developed
- **152** internal assets related regulations (COY, CTΠ) aligned with the new org structure and amended

SSO related assets separation

- **48k + items in SAP** of assets (**UAH 125bln+**) of SSO related assets transferred to the Branch SSO
- Plan of modernization of GMSs at connection points agreed

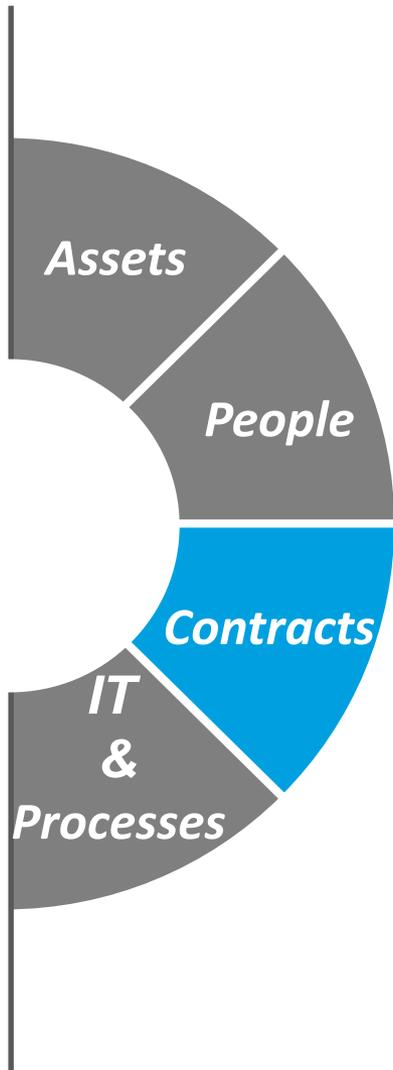
Unbundling is a restructuring project - Naftogaz Group has delivered on many preparatory tasks (2/4)



Build new organization

- 2-level org. structures for Branch TSO and TSO LLC adopted
- Changes of structure communicated throughout the organization
- Impact of people transfer to TSO LLC on UTG's licenses and permits assessed to avoid and mitigate risks of disruptions
- **Ca. 10 400** employees acquired licenses for hazardous work for TSO LLC
- **5k+** business unit profiles, job descriptions & internal instructions for TSO LLC are currently being developed
- Transfer of Ca. 10 400 employees full-time to TSO LLC to be completed by 01 July
- Issues related to materially responsible persons being handled
- Transfer to TSO LLC before transit contract expiration cleared with arbitration counsel

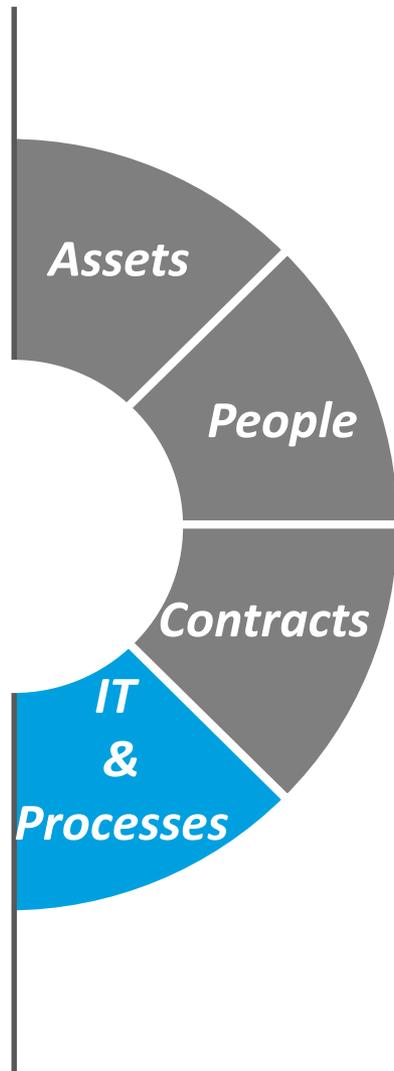
Unbundling is a restructuring project - Naftogaz Group has delivered on many preparatory tasks (3/4)



Prepare contracts for transfer

- General legal analysis of cost, revenue and non-financial contracts performed, incl. options for transfer
- Contracts list expected for the transfer confirmed and refined with regional branches and linear units
- Credit Banks informed of potential internal reorganization due to TSO LLC creation and launch
- **5 618** one by one contracts analyzed:
 - **2 829** recommended for transfer in Branch TSO
 - **434** recommended for transfer in Branch SSO
 - **553** to stay or be transferred to UTG HQ
 - **187** to follow employees transfer
 - **22** to be divided between TSO and SSO branches
 - **1 592** recommended for closing

Unbundling is a restructuring project - Naftogaz Group has delivered on many preparatory tasks (4/4)



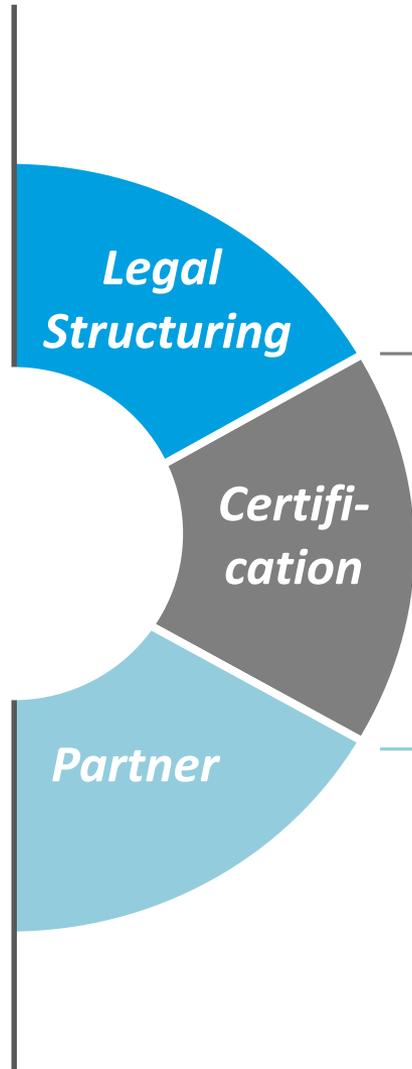
Ensure that processes are fit for the new organization

- **23** key target operational processes required for 01 Jul designed (10 regulations prepared, 13 in progress)
- Additional **23** target processes to be ready by 01 Jan 2019
- Regulatory docs of UTG regarding TSO to adapt to new structure (COY, НПАОП etc.) are amended
- Interfaces with SSO developed

Ensure that IT environment is fit for the new organization

- Branch TSO business area configuration in SAP (accounting, assets and people movement, etc.) performed
- Dispatching systems for Extended Branch TSO prepared
- **66** SAP processes and user roles for TSO LLC to be ready by 01 July
- Microsoft and other desktop applications for TSO LLC to be ready by 01 July

Crucial tasks on legal unbundling have also been delivered on by Naftogaz Group



Structure unbundling given legislative and legal limitations

- Comprehensive legal analysis on options delivered
- A full set of necessary contracts prepared (SLA-1, SLA-2, SPA, Concession contract)
- Alignment with current arbitration is ensured

Prepare for certification

- Work with the Regulator on certification and on tariffs for the new TSO
- Certification package will be ready by 01 July

Prepare for partnership

- Framework agreement with the EU TSOs concluded
- EU experts already work with TSO to develop its capabilities
- Financial model developed

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The new unbundling resolution makes Naftogaz responsible for preserving its position in Stockholm



As requested by the 484 Resolution, Naftogaz submitted a detailed plan to CMU on June 21

To achieve compliant unbundling, Naftogaz shall continue to:

- Protect Naftogaz and Ukraine's interests in Stockholm arbitration
- Post 2019 transit negotiations
- Prepare UTG for the restructuring
- Work with potential TSO partners
- Work with MGU to enhance its corporate governance and to prepare for smooth transfer

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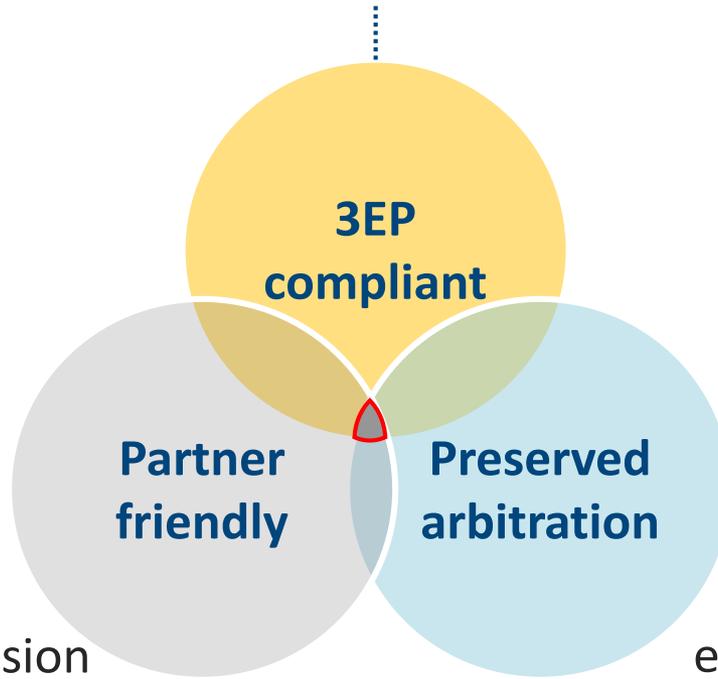
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The Gas Market Law and the new CMU resolution set the following compliance criteria to Naftogaz

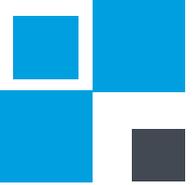
... Ensure full operational independence of the TSO (compliance to be confirmed by the NRA)



... Secure either concession or ownership rights

... Maintain future economic benefit (criteria set by arbitration counsel)

Only the ISO model meets all three criteria



To achieve all three goals we have to change the laws

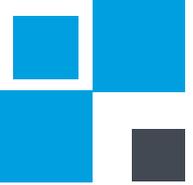
... and provide for compliant unbundling, securing Naftogaz legal position in arbitration and engaging a reputable GTS partner



We understand that the current members of the Parliament will not be able to adopt the necessary legislation



We expect that the next composition of the Parliament will choose vote for them



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Amendments to the laws are required under both models

ISO

Following the government's decision to implement ISO

Allow concession (foreseen in CMU Unbundling Plan #496)

To make some amendments and adopt the draft Law On concession approved by the government and by the Parliament in the first reading in 2018



OU

Allow privatization of the GTS

to the Law On privatization
to the Law On pipeline transport (article 7)
in order to transfer the GTS ownership to the TSO
to the Law On natural gas market
In order to engage a GTS Partner

or

Allow a similar right based on operational control

to the Law On pledge
in order to enable pledging the GTS
to the Law On natural gas market
to enable OU for an entity that is not the GTS owner
to the Law On pipeline transport, the Commercial Code in order to enable the GTS partnership



Changes needed regardless of the selected model:

- to the laws and CMU rules on the Cabinet of Ministers and on central executive bodies in order to ensure independent decision-making by an executive body acting on behalf of the state as MGU shareholder
- to Law On Permits system and the Law On Permits system Licensing in order to ensure uninterrupted gas transmission until new permits and supplementary licenses are granted

ISO through concession is a feasible option to achieve compliant unbundling

Concession

No need to transfer **GTS ownership from the state**

Higher chances to be passed through the Parliament and Cabinet of Ministers in the election year

Ukraine's interests **protected in arbitration against Gazprom**

Attractive for **GTS Partner**

Ownership

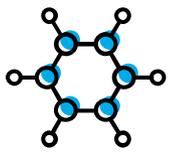
The Parliament must **allow privatization**

Was a "No-go" since the adoption of the Unbundling resolution in 2016

Naftogaz tariff revision claim against Gazprom is **likely to be removed**. Naftogaz can lose over USD 12 bn

Property rights, such as "commercial use" cannot be easily explained to GTS Partners **and assets can be at any time taken back by the state**

Naftogaz will be in position to claim up to USD 14.8 bn from Gazprom if Naftogaz continues to receive economic benefits from GTS past 2019



Implementation of the unbundling model should not prejudice Naftogaz claims in the current arbitration proceedings against PJSC Gazprom, including as regards the revision of the gas transit tariff for 2018-2019

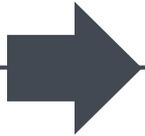
Conceptual Framework for Financial Reporting requires that an asset to be recorded on the balance-sheet must foresee **future economic benefits** to the entity

In view of this arbitration Naftogaz (as a group) needs to continue to receive economic benefits from the GTS past 2019



Naftogaz cannot claim compensation of reduction in value of asset if it is not entitled to receive future economic benefits from such an asset

If Naftogaz loses economic benefits from GTS as of 01.01.2020, it can lose its right to claim major part of USD 11.58 bn tariff revision claim against PJSC Gazprom in this arbitration



Naftogaz claims that the tariff should be revised and aligned with the generally accepted and transparent tariff setting rules in the EU, this tariff should compensate all of Naftogaz costs associated with gas transit through Ukraine, including costs related to investments in the infrastructure. Such costs include the reduction in value of an asset due to expectation of zero transit beyond 2019 (i.e. through accelerated depreciation or economic obsolescence)

Relationships between asset owner and the ISO need to be carefully structured

Asset Owner

Requirements

- No prerogatives in investment planning
- Obligation to finance/approve external financing of investments decided by the ISO & approved by NRA
- Provide guarantees to facilitate financing

Safeguards

- Tailored concession agreement terms
- Contracts b/t between ISO and VIU are reviewed by NEURC
- Joint services/outsourcing from VIU allowed for up to 24 months

ISO

Requirements

- Develop the transmission system
- Ensure long-term ability of the system to meet reasonable demand
- Investment planning

Safeguards

- Need to assure ISO has sufficient resources to plan, execute and monitor investments on its own
- develop the external contractor's market to be ready to serve TSO