

PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: 89643

Project Name	Advisory Services and Technical Assistance to NJSC "Naftogaz of Ukraine" and the Government of Ukraine on the Reform of the Natural Gas Sector
Region	EUROPE AND CENTRAL ASIA
Country	Ukraine
Sector(s)	Oil and Gas
Theme(s)	Corporate Governance; State-Owned Enterprise Restructuring and Privatization; Regulation and Competition Policy
Lending Instrument	Single Donor (EC) Hybrid Trust Fund
Project ID	P151927
Recipient	Ukraine
Implementing Agency	NJSC "Naftogaz of Ukraine"
Environmental Category	C
Date PID Prepared/Updated	July 15, 2014
Estimated Date of Appraisal Completion	July 28, 2014
Estimated Date of Board Approval	N/a
Decision	August 15, 2014
Other Decision	N/a

I. Project Context

Country Context

The Government of Ukraine has launched an ambitious program to reform the gas sector and restructure and modernize the gas network infrastructure in Ukraine. The international community supported the appropriate measures and in 2009 the Government of Ukraine and the European Commission, World Bank, European Bank for Reconstruction and Development, and the European Investment Bank signed a Joint Declaration on gas sector reform in Ukraine. On 24 September 2010, Ukraine signed a Protocol on Ukraine's Accession to the Treaty Establishing the Energy Community, which was ratified by the Verkhovna Rada of Ukraine on 15 December 2010.

The National Action Plan for 2013 to implement the Economic Reform Program 2010 - 2014 "Prosperous Society, Competitive Economy, Effective State," approved with Decree of the President of Ukraine of 12 March 2013, defines a number of activities in the field of adaptation of energy legislation to the EU legislation in discharge of the obligations of the Government of Ukraine under the Energy Community Treaty, as well as structural changes to improve efficiency and investment attractiveness of the gas sector.

Sectoral and institutional Context

The commitments taken by Ukraine towards the Energy Community oblige Ukraine to implement the provisions of the EU “3rd energy package”. The key provisions of the 3rd energy package include requirements to: separate the functions of delivery and transit of energy; strengthen the role of national regulators; institute measures to improve interaction among operators of transit systems; and provide access to the gas transmission networks.

Ukrainian gas sector is dominated by NJSC "Naftogaz of Ukraine" whose current corporate structure is not in line with EU Directives. NJSC "Naftogaz of Ukraine" is a state-owned oil and gas company engaged in the production and transportation of oil and natural gas and related trading, as well as oil and gas processing and distribution and sale of certain petroleum products. The organizational structure of NJSC "Naftogaz of Ukraine" is complex and built around its technical functions. Hence, in order to comply with the 3rd energy package, NJSC "Naftogaz of Ukraine" requires the legal, managerial and accounting unbundling of the natural gas transmission, distribution and storage businesses.

Bound by its commitments within the Energy Community, the Government of Ukraine as well as the Ukrainian Parliament have made a number of important steps towards the start of reform in the gas sector. On 4 June 2014, the Cabinet of Ministers of Ukraine approved the Resolution no. 172 "On the urgent measures on the reform of the United gas transportation system of Ukraine". This Resolution allows to create the Public Joint Stock Company "Ukrainian Gas Transportation System" and Public Joint Stock Company "Ukrainian Underground Gas Storages", whose 100% of shares will be in the state property of Ukraine. On 4 July 2014, the Ukrainian Parliament adopted (in the first reading) a draft law "Amends some legal acts of Ukraine concerning the reforms of the management of the united gas transportation system of Ukraine", which allows the participation of investors from the EU and the USA in management of the Ukrainian gas transportation system. It is foreseen that Directive 2009/73/EC concerning common rules for the internal market in natural gas and Regulation 715/2009 on conditions for access to the natural gas transmission networks will be implemented by Ukraine by 1 January 2015.

More progress in implementing of Ukraine's international obligations is required. The proposed technical assistance will support the Government of Ukraine with the implementation of outstanding conditionalities towards the Energy Community related to the gas sector reforms and the corporate restructuring and financial transparency of NJSC "Naftogaz of Ukraine".

II. Project Development Objectives

The objective of the project is to provide advisory services and technical assistance to NJSC "Naftogaz of Ukraine" and the Government of Ukraine on the reform and restructuring of the natural gas sector through:

- providing support the Government of Ukraine to develop and implement the outstanding key reforms in the gas sector that are necessary for Ukraine to fulfill the legal commitments undertaken in the framework of membership of the Energy Community; and
- providing advisory services, in the form of a Project Implementation Unit (PIU), to NJSC "Naftogaz of Ukraine" to prepare bankable projects and to oversee their implementation together with the IFIs (EBRD and EIB).

III. Project Description

Component Name

The proposed project will consist of the following components:

Component 1 (Recipient-Executed): The purpose of this Component is to support the staffing of the Project Implementation Unit of NJSC "Naftogaz of Ukraine," which will be responsible for implementation of the Gas Transit System (GTS) modernization project being financed by EBRD and EIB. The objectives of strengthening the PIU are to ensure:

- Timely and effective preparation and implementation of the EBRD/EIB-financed Gas Transit System (GTS) modernization project , including design and all issues related to environment, procurement, financial and accounting management and disbursement according to the applicable EBRD and EIB rules for project implementation;
- Preparation of the broader GTS modernization project by supporting NJSC "Naftogaz of Ukraine" in finalizing the design and preparing the project including all issues related to technical design, environment, preparation of project documentation and loan negotiations etc.

Component 2 (Bank-Executed): The purpose of this Component is to provide advisory services to the Ministry of Energy and Coal Industries of Ukraine and National Electricity Regulatory Commission (NERC) in the implementation of outstanding conditionalities related to the gas sector reforms and the corporate restructuring and financial transparency of NJSC "Naftogaz of Ukraine".

The implementation of key reforms in Ukrainian gas sector would allow to the IFI's (EBRD, EIB) to be in a position to consider the financial support for the modernisation of Ukraine's Gas Transit System.

For this purpose, under this Component the Bank will assist the Government of Ukraine with the following tasks:

- (a) Preparing the set of legislation and regulations which aligns the structure of Ukrainian gas market with the provision of the EU 3rd Energy Package; and
- (b) developing comprehensive corporate and financial restructuring concept, together with the short-and medium term implementation plan to restructure transmission, storage and distribution businesses of NJSC "Naftogaz of Ukraine" including their financial transparency based on International Financial Reporting Standards (IFRS) requirements.

IV.

Financing (in EURO Million)

For Loans/Credits/Others	Amount
BORROWER/RECIPIENT	0
Single Donor (EC) Trust Fund	EURO 2,035,000
Financing Gap	0
Total	EURO 2,035,000

V. Implementation

The proposed activity would be implemented over two years, through a hybrid trust fund, financed by the European Union, represented by the Commission of the European Communities, in the total amount of EURO 2,035,000. The implementing agency for the recipient-executed component will be NJSC "Naftogaz of

Ukraine".

NJSC "Naftogaz of Ukraine" is in a process of establishing a PIU, using its existing staff. The PIU capacity will be increased by trainings on Bank procedures conducted by the Bank staff.

In order to ensure that the proposed program will not overlap with the work of other donors as well as enhance quality control of the outputs, a special coordination platform will be established to oversee the activity. As agreed with other IFIs and donors, the Steering Committee will be created that will include the appointed representatives of the Ministry of Fuel Energy and Coal Industry of Ukraine, NJSC "Naftogaz of Ukraine", Ukrtransgaz, National Electricity Regulatory Commission, the European Commission, World Bank, EBRD and EIB. It will meet regularly to discuss the progress of the project and related TA provided by other stakeholders.

VI. Safeguard Policies (including public consultation)

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		X
Natural Habitats OP/BP 4.04		X
Forests OP/BP 4.36		X
Pest Management OP 4.09		X
Physical Cultural Resources OP/BP 4.11		X
Indigenous Peoples OP/BP 4.10		X
Involuntary Resettlement OP/BP 4.12		X
Safety of Dams OP/BP 4.37		X
Projects on International Waterways OP/BP 7.50		X
Projects in Disputed Areas OP/BP 7.60		X

Comments (optional)

VII. Contact point

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