

Public Disclosure Authorized

CONFORMED COPY

LOAN NUMBER 4722-UA

Loan Agreement

(Second Programmatic Adjustment Loan)

between

UKRAINE

and

**INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT**

Dated December 17, 2003

LOAN NUMBER 4722-UA

LOAN AGREEMENT

AGREEMENT, dated December 17, 2003, between UKRAINE (the Borrower) and the INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (the Bank).

WHEREAS (A) pursuant to the loan provided to the Borrower under the Loan Agreement dated September 20, 2001 (Loan No. 4639-UA) the Bank has provided assistance to the Borrower in support of the first phase of the Borrower's program of actions, objectives, and policies for the reform of the Borrower's economy (the Program) as such program was described in the letter, dated August 10, 2001, from the Borrower to the Bank;

(B) the Bank has received from the Borrower a letter, dated November 12, 2003: (i) describing its macro-economic framework and the Program as revised since the date of the letter referred to in (A) above, which Program consists of actions taken under the first phase referred to in (A) above, and actions and policies that the Borrower has taken or intends to take and adopt in the near future (the Second Phase of the Program); (ii) declaring the Borrower's commitment to the execution of the Program; and (iii) requesting assistance from the Bank in support of the Program during the execution thereof; and

(C) on the basis, *inter alia*, of the foregoing, the Bank has decided in support of the Second Phase of the Program to provide such assistance to the Borrower by making the Loan, in two tranches, as hereinafter provided;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The "General Conditions Applicable to Loan and Guarantee Agreements for Single Currency Loans" of the Bank, dated May 30, 1995 (as amended through October 6, 1999), with the modifications set forth below (the General Conditions) constitute an integral part of this Agreement:

(a) Section 2.01, paragraph 18, is modified to read:

“ ‘Project’ means the Program, referred to in the Preamble to the Loan Agreement, in support of which the Loan is made.”;

- (b) Section 4.01 is modified to read:

“Except as the Bank and the Borrower shall otherwise agree, withdrawals from the Loan Account shall be made in the currency of the deposit account specified in Section 2.02 of the Loan Agreement.”;

- (c) Section 5.01 is modified to read:

“The Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in accordance with the provisions of the Loan Agreement and of these General Conditions”;

- (d) The last sentence of Section 5.03 is deleted;

- (e) Section 9.07 (c) shall be modified to read:

“(c) Not later than six months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Bank, the Borrower shall prepare and furnish to the Bank a report, of such scope and in such detail as the Bank shall reasonably request, on the execution of the program referred to in the Preamble to the Loan Agreement, the performance by the Borrower and the Bank of their respective obligations under the Loan Agreement and the accomplishment of the purposes of the Loan.”; and

- (f) Section 9.05 is deleted and Sections 9.06, 9.07 (as modified above), 9.08 and 9.09 are renumbered, respectively, Sections 9.05, 9.06, 9.07 and 9.08.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Comprehensive Action Plan” means the action plan to be adopted by the Borrower’s Cabinet of Ministers and stipulating dated actions aimed at bringing fuel and energy companies to financial solvency and eliminating further accumulation of arrears of tax and/or other payment obligations;

(b) “CFAA Action Plan” means the action plan adopted by the Borrower’s Cabinet of Ministers on November 14, 2001, setting forth actions aimed at implementing the recommendations of the Bank’s Country Financial Accountability Assessment;

(c) “Deposit Account” means the account referred to in Section 2.02 (b) of this Agreement;

(d) “IFRS” means the International Financial Reporting Standards published by the International Accounting Standards Board;

(e) “KAZNA” means an automated treasury system being established by the Borrower’s State Treasury for the purposes of recording and controlling all expenditures and receipts of the central and local governments;

(f) “Memorandum of Understanding” means the Memorandum of Understanding concluded among the Borrower, the OJSC Savings Bank (as hereinafter defined in paragraph (k) of this Section) and the National Bank of Ukraine (as hereinafter defined in paragraph (g) of this Section) on July 21, 2003, with the aim of setting forth the process of improving the performance of the OSJC Savings Bank;

(g) “NBU” means the Borrower’s Central Bank, the National Bank of Ukraine;

(h) “New Approach” means the regulatory strategy laid down in the Resolution of 1985 of the Council of the European Union regarding the new approach to technical harmonization and standardization;

(i) “*Oblast*” means each and any of the Borrower’s administrative and territorial units consisting of a region;

(j) “*Oblenergos*” (power suppliers) means participants of the wholesale market of electricity of the Borrower that purchase electricity in this market with the purpose of sale thereof to consumers;

(k) “OJSC Savings Bank” means the state banking institution established pursuant to the Directive of the Borrower’s President No. 106 of May 20, 1999 and Resolution of the Cabinet of Ministers No. 876 of May 21, 1999 and functioning pursuant to its Charter approved by Resolution of the Cabinet of Ministers No. 261 of February 25, 2003;

(l) “SCRFSM” means the State Commission for Regulation of Financial Services Markets of the Borrower, a central body of the Executive with special status in the area of the regulation of financial services markets, established pursuant to the Decree of the Borrower’s President No. 1153/2002 of December 11, 2002;

(m) “Short-term Action Plan” means the action plan developed by the Borrower to facilitate the financial solvency of energy companies and the elimination of further accumulation of tax arrears and other financial liabilities; and

(n) “TRIPS” means the agreement of the World Trade Organization on “Trade-Related Aspects of Intellectual Property Rights”.

ARTICLE II

The Loan

Section 2.01. The Bank agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Loan Agreement, an amount equal to two-hundred fifty million dollars (\$250,000,000).

Section 2.02. (a) Subject to the provisions of paragraphs (b), (c) and (d) of this Section, the Borrower shall be entitled to withdraw the proceeds of the Loan from the Loan Account in support of the Second Phase of the Program.

(b) The Borrower shall open, prior to furnishing to the Bank the first request for withdrawal from the Loan Account, and thereafter maintain in its central bank, a deposit account in dollars on terms and conditions satisfactory to the Bank. All withdrawals from the Loan Account shall be deposited by the Bank into the Deposit Account.

(c) The Borrower undertakes that the proceeds of the Loan shall not be used to finance expenditures excluded pursuant to the provisions of Schedule 1 to this Agreement. If the Bank shall have determined at any time that any proceeds of the Loan shall have been used to make a payment for an expenditure so excluded, the Borrower shall, promptly upon notice from the Bank: (i) deposit into the Deposit Account an amount equal to the amount of said payment, or (ii) if the Bank shall so request, refund such amount to the Bank. Amounts refunded to the Bank upon such request shall be credited to the Loan Account for cancellation.

(d) No withdrawals shall be made from the Loan Account after the aggregate of the proceeds of the Loan withdrawn from the Loan Account shall have reached the equivalent of \$77,500,000, unless the Bank shall be satisfied, after the exchange of views as described in Section 3.01 of this Agreement based on evidence satisfactory to the Bank: (A) with the progress achieved by the Borrower in the carrying out of the Program; (B) that the macro-economic policy framework of the Borrower is satisfactory, as measured on the basis of indicators agreed between the Borrower and the Bank; and (C) that the actions described in Schedule 3 to this Agreement have been taken.

If, after said exchange of views, the Bank shall have given notice to the Borrower that the progress achieved and actions taken are not satisfactory, and within 90 days after such notice, the Borrower shall not have taken steps satisfactory to the Bank, in respect of (A), (B), and (C) above then the Bank may, by notice to the Borrower, cancel the unwithdrawn amount of the Loan or any part thereof.

Section 2.03. The Closing Date shall be December 31, 2004 or such later date as the Bank shall establish. The Bank shall promptly notify the Borrower of such later date.

Section 2.04. The Borrower shall pay to the Bank a fee in an amount equal to one percent (1%) of the amount of the Loan. On or promptly after the Effective Date, the Bank shall, on behalf of the Borrower, withdraw from the Loan Account and pay to itself the amount of said fee.

Section 2.05. The Borrower shall pay to the Bank a commitment charge at the rate of three-fourths of one percent ($3/4$ of 1%) per annum on the principal amount of the Loan not withdrawn from time to time.

Section 2.06. (a) The Borrower shall pay interest on the principal amount of the Loan withdrawn and outstanding from time to time, at a rate for each Interest Period equal to LIBOR Base Rate plus the LIBOR Total Spread.

(b) For the purposes of this Section:

- (i) "Interest Period" means the initial period from and including the date of this Agreement to, but excluding, the first Interest Payment Date occurring thereafter, and after the initial period, each period from and including an Interest Payment Date to, but excluding the next following Interest Payment Date.
- (ii) "Interest Payment Date" means any date specified in Section 2.07 of this Agreement.
- (iii) "LIBOR Base Rate" means, for each Interest Period, the London interbank offered rate for six-month deposits in single currency for value the first day of such Interest Period (or, in the case of the initial Interest Period, for value the Interest Payment Date occurring on or next preceding the first day of such Interest Period), as reasonably determined by the Bank and expressed as a percentage per annum.
- (iv) "LIBOR Total Spread" means, for each Interest Period: (A) three-fourths of one percent ($3/4$ of 1%); (B) minus (or plus) the weighted average margin, for such Interest Period, below (or above) the London interbank offered rates, or other reference rates, for six-month deposits, in respect of the Bank's outstanding borrowings or portions thereof allocated by the Bank to fund single currency loans or portions thereof made by it that include the Loan; as reasonably determined by the Bank and expressed as a percentage per annum.

(c) The Bank shall notify the Borrower of the LIBOR Base Rate and the LIBOR Total Spread for each Interest Period, promptly upon the determination thereof.

(d) Whenever, in light of changes in market practice affecting the determination of the interest rates referred to in this Section, the Bank determines that it is in the interest of its borrowers as a whole and of the Bank to apply a basis for determining the interest rates applicable to the Loan other than as provided in said Section, the Bank may modify the basis for determining the interest rates applicable to the Loan upon not less than six (6) months' notice to the Borrower of the new basis. The basis shall become effective on the expiry of the notice period unless the Borrower notifies the Bank during said period of its objection thereto, in which case said modification shall not apply to the Loan.

Section 2.07. Interest and other charges shall be payable semi-annually on May 15 and November 15 in each year.

Section 2.08. The Borrower shall repay the principal amount of the Loan in accordance with the amortization schedule set forth in Schedule 2 to this Agreement.

ARTICLE III

Particular Covenants

Section 3.01. (a) The Borrower and the Bank shall from time to time, at the request of either party, exchange views on the progress achieved in carrying out the Program.

(b) Prior to each such exchange of views, the Borrower shall furnish to the Bank for its review and comment a report on the progress achieved in carrying out the Program, in such detail as the Bank shall reasonably request.

(c) Without limitation upon the provisions of paragraph (a) of this Section, the Borrower shall exchange views with the Bank on any proposed action to be taken after the disbursement of the Loan which would have the effect of materially reversing the objectives of the Program, or any action taken under the Program including any action specified in Schedule 3 to this Agreement.

Section 3.02. Upon the Bank's request, the Borrower shall:

(a) have the Deposit Account audited in accordance with appropriate auditing principles consistently applied, by independent auditors acceptable to the Bank;

(b) furnish to the Bank as soon as available, but in any case not later than four months after the date of the Bank's request for such audit, a certified copy of the report of such audit by said auditors, of such scope and in such detail as the Bank shall have reasonably requested; and

(c) furnish to the Bank such other information concerning the Deposit Account and the audit thereof as the Bank shall have reasonably requested.

ARTICLE IV

Additional Event of Suspension

Section 4.01. Pursuant to Section 6.02 (p) of the General Conditions, the following additional event is specified, namely, that a situation has arisen which shall make it improbable that the Program, or a significant part thereof, will be carried out.

ARTICLE V

Termination

Section 5.01. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
12/2 Hrushevsky St.
Kyiv, 01008
Ukraine

Telex:

131450

Facsimile:

(380-44) 253-8243

For the Bank:

International Bank for
Reconstruction and Development
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

INTBAFRAD
Washington, D.C.

Telex:

248423 (MCI) or
64145 (MCI)

Facsimile:

(1-202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Kyiv, Ukraine, as of the day and year first above written.

UKRAINE

By /s/ Mykola Yanovych Azarov
Authorized Representative

INTERNATIONAL BANK FOR
RECONSTRUCTION AND DEVELOPMENT

By /s/ Luca Barbone
Country Director
Ukraine, Belarus and Moldova
Europe and Central Asia Region

SCHEDULE 1

Excluded Expenditures

For purposes of Section 2.02 (c) of this Agreement, the proceeds of the Loan shall not be used to finance any of the following expenditures:

1. expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;
2. expenditures for goods or services supplied under a contract which any national or international financing institution or agency other than the Bank or the Association shall have financed or agreed to finance, or which the Bank or the Association shall have financed or agreed to finance under another loan or a credit;
3. expenditures for goods included in the following groups or subgroups of the Standard International Trade Classification, Revision 3 (SITC, Rev.3), published by the United Nations in Statistical Papers, Series M, No. 34/Rev.3 (1986) (the SITC), or any successor groups or subgroups under future revisions to the SITC, as designated by the Bank by notice to the Borrower:

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
112	-	Alcoholic beverages
121	-	Tobacco, unmanufactured, tobacco refuse
122	-	Tobacco, manufactured (whether or not containing tobacco substitutes)
525	-	Radioactive and associated materials
667	-	Pearls, precious and semiprecious stones, unworked or worked

<u>Group</u>	<u>Subgroup</u>	<u>Description of Items</u>
718	718.7	Nuclear reactors, and parts thereof; fuel elements (cartridges), non-irradiated, for nuclear reactors
728	728.43	Tobacco processing machinery
897	897.3	Jewelry of gold, silver or platinum group metals (except watches and watch cases) and goldsmiths' or silversmiths' wares (including set gems)
971	-	Gold, non-monetary (excluding gold ores and concentrates)

4. expenditures for goods intended for a military or paramilitary purpose or for luxury consumption;

5. expenditures for environmentally hazardous goods (for purposes of this paragraph the term "environmentally hazardous goods" means goods, the manufacture, use or import of which is prohibited under the laws of the Borrower or international agreements to which the Borrower is a party, and any other goods designated as environmentally hazardous by agreement between the Borrower and the Bank);

6. expenditures: (i) in the territories of any country which is not a member of the Bank or for goods procured in, or services supplied from, such territories; or (ii) on account of any payment to persons or entities, or any import of goods, if such payment or import is prohibited by a decision of the United Nations Security Council taken under Chapter VII of the Charter of the United Nations; and

7. expenditures under a contract in respect of which the Bank determines that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement or execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation.

SCHEDULE 2

Amortization Schedule

<u>Date Payment Due</u>	<u>Payment of Principal (Expressed in dollars)*</u>
May 15, 2009	7,375,000
November 15, 2009	7,435,000
May 15, 2010	7,495,000
November 15, 2010	7,560,000
May 15, 2011	7,620,000
November 15, 2011	7,685,000
May 15, 2012	7,750,000
November 15, 2012	7,810,000
May 15, 2013	7,875,000
November 15, 2013	7,945,000
May 15, 2014	8,010,000
November 15, 2014	8,075,000
May 15, 2015	8,140,000
November 15, 2015	8,210,000
May 15, 2016	8,280,000
November 15, 2016	8,345,000
May 15, 2017	8,415,000
November 15, 2017	8,485,000
May 15, 2018	8,555,000
November 15, 2018	8,625,000
May 15, 2019	8,700,000
November 15, 2019	8,770,000
May 15, 2020	8,845,000
November 15, 2020	8,915,000
May 15, 2021	8,990,000
November 15, 2021	9,065,000
May 15, 2022	9,140,000
November 15, 2022	9,215,000
May 15, 2023	9,295,000
November 15, 2023	9,375,000

* The figures in this column represent the amount in dollars to be repaid, except as provided in Section 4.04 (d) of the General Conditions.

SCHEDULE 3

Actions Referred to in Section 2.02 (d) of this Agreement

1. The Borrower has reduced the accumulation of arrears to the budget, by: (i) maintaining a no net increase in active tax arrears, without the use of tax amnesties, by the non-energy enterprise sector since January 1, 2002, and by the energy enterprise sector since January 1, 2003; (ii) carrying out a satisfactory implementation of the Short-term Action Plan; and (iii) adopting, through its Cabinet of Ministers and, thereafter, publishing in the official gazette of the Cabinet of Ministers (*Uriadovy Courier*), the Comprehensive Action Plan.
2. The Borrower has continued to improve the payment discipline in the electricity and gas sector through the satisfactory implementation of debt resolution, as evidenced by: (i) the adoption by the Parliament (*Verkhovna Rada*) of a comprehensive law on debt resolution in the energy sector; and (ii) the obligatory participation of enterprises, in which the state has a controlling share, in the debt resolution mechanism established by the said law.
3. The Borrower has improved the regulatory framework in the financial sector, by: (i) the satisfactory implementation of the agreed-upon schedule on phasing in of the Basel Core Principles for connected lending; (ii) taking adequate actions to enforce the procedures to ensure all bank external auditing is compliant with the International Standards of Auditing or the application of the appropriate sanctions within the powers of the NBU *in lieu* thereof; (iii) the continued progress in the satisfactory implementation of the Memorandum of Understanding; and (iv) the provision of adequate funding for the continued establishment of the SCRFMS.
4. The Borrower continues to make progress towards its accession to the World Trade Organization, by: (i) the adoption, by its Cabinet of Ministers, of eleven (11) technical procedures based on the New Approach; (ii) the adoption, by its Cabinet of Ministers, of one thousand five hundred (1500) technical standards; and (iii) the development of a legal framework in correspondence with the requirements of TRIPS.
5. The Borrower has transformed the ownership and organizational structure in the agriculture sector through the enactment of a law which forms the legal basis for establishment of an unified system of registration for legal rights to land and real estate within a single agency.
6. The Borrower has achieved further progress in the transparent privatization of large energy enterprises, by: (i) engaging the financial advisor for the privatization of a group of remaining state-owned *Oblenergos* and the launching of the corresponding privatization tender; and (ii) continuing the progress towards the completion of an unqualified audit of the consolidated financial statements of Naftogaz for 2004 on the basis of the IFRS.

7. The Borrower has improved the use of public resources through the implementation of the CFAA Action Plan, by: (i) adopting, through its Cabinet of Ministers and, thereafter, publishing a white paper on internal financial control; (ii) establishing an external oversight body for the State Tax Administration; and (iii) satisfactorily implementing KAZNA in all *Oblast* treasury offices for the state budget, including for twelve (12) which shall also handle the local budgets.

8. The Borrower shall have introduced a more effective tax and revenue system through the reduction, since January 1, 2002, of no less than fifty-five percent (55%) of sector/industry specific tax exemptions and privileges, as measured by the resultant increase in the tax base.