PROJECT INFORMATION DOCUMENT (PID)
CONCEPT STAGE

Report No.: 100538

Project Name	Ukraine Gas Supply Security Facility
Region	Europe and Central Asia Region
Sector	Energy and Extractives
Project ID	P155111
Borrower(s)	Naftogaz of Ukraine
Implementing Agency	
Environment Category	[ ] A [ ] B [ ] C [ ] FI [ ] TBD (to be determined)
Date PID Prepared	7/23/2015
Estimated Date of Appraisal Authorization	11/02/15
Estimated Date of Board Approval	12/17/15

1. Key development issues and rationale for Bank involvement

Ukraine faces a serious challenge of security of gas supply. To ensure uninterrupted gas supply in 2015/16 winter, Ukraine aims to have some 21 bcm (about 60 percent of total storage capacity) of gas stored by the end of October 2015. This level, including ongoing monthly purchases from Russia, was just enough during the 2014/15 winter, but not without hardship in a winter that was warmer than average. Current gas storage levels stand at about 12 bcm, with only 3 months left to increase storage levels by 8.7 bcm, of which 6.5 bcm is expected to be imported gas and 2.2 bcm is expected to be domestically produced. Following interruption of gas deliveries from Russia in June 2014, Naftogaz initiated a process of diversification of its gas import sources by purchasing gas from European suppliers. However, this diversification effort is constrained by the weak credit standing of Naftogaz as a gas purchaser. European gas suppliers are not willing to take payment risk on Naftogaz (or on Ukraine) and consequently Naftogaz must pre-pay for gas on a month-to-month basis. The follow-on effect of this arrangement is that substantial working capital must be committed by Naftogaz, gas volumes and prices are uncertain, spot costs for gas and transport are higher than contracted rates and there is a general loss of commercial flexibility.

The proposed Bank project would provide an urgently needed credit enhancement support to Naftogaz to increase volumes of gas in the storage and support purchases of gas during winter months. Naftogaz does not have adequate financing for gas purchases. However, on July 25, 2015 the Ukraine parliament passed a law approving the issuance of state guarantees in the amount of US$1 billion for gas purchases. The intention is that the guarantees would be applied to the proposed joint facility with EBRD and that the joint facility would amount to US$800 million. The support would offer greater security of supply through diversification of suppliers and longer-term contracts; greater flexibility in pricing mechanisms by allowing Naftogaz to fix prices for longer periods; net savings on the cost of transportation and possible margin discount on longer-term contracts; savings in working capital by moving from current pre-payment arrangements to post-payment; and establishment of a track record with European suppliers and international commercial banks. This track record could set the basis for future contractual relationships beyond the duration of the guarantee.

2. Proposed objective

The Project's objective is to increase Ukraine's security of gas supply. Gas supply security would be improved by facilitating Naftogaz's access to a wider suite of suppliers and improving the commercial terms of that supply.

3. Preliminary description

IBRD and EBRD have collaborated in designing a financing structure that supports Naftogaz in ensuring security of gas supply in Ukraine. The structure involves a US$500 million rolling Payment Guarantee from IBRD and a US$300 million working capital facility from EBRD. Discussions with Naftogaz and several gas suppliers indicate that such Payment Guarantee for gas supplies would incentivize longer-term contracts on better terms for Naftogaz. EBRD's facility would allow Naftogaz access to short-term funding at highly competitive terms and improve its ability to meet an escrow funding requirement that is part of the IBRD guarantee scheme. The World Bank and EBRD facilities would cover the same gas purchase contracts resulting in a total of up to US$800 million of monthly gas supplies being secured at better contract terms.

The expected cost savings to Naftogaz from using the facility would be up to US$270 million per year and US$800 million over the project's life. The considerable savings result from the lower cost of working capital due to both the IBRD guarantee and EBRD credit line. Without IBRD and EBRD support, Naftogaz would have no option but to prepay for gas and fund the resulting working capital requirement from its existing, costly short-term credit lines.

4. Safeguard policies that might apply

Subject to clarifying that the existing gas supply in the system will remain substantially the same with or without the Guarantee, the project have an assessment rating of Category C. It is expected that gas suppliers would be required to make a series of representations and warranties to the Bank with respect to environmental standards compliance. For European suppliers, it is anticipated that they will comply with EU directives regulations. An assessment will be made to determine the extent to which those directives and regulations are aligned with the Bank's performance standards. For non-European suppliers, it is expected that performance standards will be applied.

5. Tentative financing

Source:		(US$m.)
IBRD Guarantee		500.00
EBRD Loan		300.00
	Total	800.00

6. Contact point

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