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MEMO

To **National Joint-Stock Company “Naftogaz of Ukraine”
Mr. Andrey Kobolev & Ms. Elena Korotchuk**

From Gert Weidinger (ext. 2107)

Date 15th April 2019

Ref 14072169/Vickie Shore

SUMMARY OF ENGAGEMENT

Contract 87/1 of 2 May 2018 (Request #5 of 22 March 2019)

With this engagement, KPMG sought to answer three key questions:

1. Were the sales transactions from underground gas storage (UGS) in November-December 2018 in line with market pricing at the time (to the extent that this can be assessed based retrospectively)? What role did Mr Favorov have in either the UGS sales or Ukrtransgaz's (UTG's) gas purchasing contracts?
2. How did Naftogaz manage the real or perceived conflict of interest of Mr Favorov's new role at the company?
3. Were the controls and procedures in place at Naftogaz Trading (NGT) in line with Group internal control standards and accepted commodity trading industry standards?

On the first issue, we found that, while the UGS sales prices were set below import parity prices (we referenced prices against Net Connect Germany (NCG), which was higher prices but had highest trade volume), there were a number of critical factors that would have a negative impact on domestic prices at the time – including gas oversupply, market capacity and liquidity for high-volume operations, and a noticeable downward price trend due to warm winter weather conditions.

We also found that Mr Favorov had no formal authority to direct NGT or UTG to trade or not trade with any of the companies involved in transactions in November-December 2018, nor did he set the price or delivery volumes for any company involved. We did not identify any preferential treatment for any single customer/supplier in these transactions.

On the second issue, there was a conflict of interest for Mr Favorov's new role at Naftogaz, given that he previously owned a company that already had contracts in place with both NGT and UTG. Nonetheless, we have identified no information indicating that Mr Favorov acted illegally, in violation of Naftogaz's policies, or against the interests of the company in relation to the issues under review in this report. We also identified that Naftogaz's own policies and procedures in relation to conflicts of interest were followed in relation to this issue.

On the third issue, we identified that NGT was set up without the control processes and procedures that would be expected standards in the commodity trading industry. Further, some of Naftogaz's group controls were not implemented at this company since it was founded in September 2018.

We have recommended a fuller review of NGT's governance, as well as a number of improvements to NGT's trading controls and Naftogaz group's conflict of interest policies and procedures.

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