

A copy of this Offering Memorandum (together with the Appendices attached hereto, the "Offering Memorandum"), comprising listing particulars relating to the Global Offering in accordance with the Listing Rules made under Section 142 of the Financial Services Act 1986 of the United Kingdom, has been delivered to the Registrar of Companies in England and Wales for registration in accordance with Section 149 of that Act. This document is only being distributed to persons of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996.

RAO Gazprom accepts responsibility for the information contained in this Offering Memorandum. To the best of the knowledge and belief of RAO Gazprom (which has taken all reasonable care to ensure that such is the case) the information contained in this Offering Memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

No person is authorized to give any information or to make any representation in connection with the offer or sale of the Offered ADSs other than as contained in this Offering Memorandum and, if given or made, such information or representation must not be relied upon as having been authorized by RAO Gazprom or either of the Global Coordinators or any of the Managers or any other person. No representation or warranty, express or implied, is made by either of the Global Coordinators or any of the Managers as to the accuracy or completeness of the information contained in this Offering Memorandum or the adequacy of any investigation which any investor may make, and nothing contained in this Offering Memorandum is, or shall be relied upon as, a promise or representation by either of the Global Coordinators or any of the Managers. The delivery of this Offering Memorandum shall not under any circumstances imply that the information contained herein is correct as of any time subsequent to the date hereof or that there has been no change in the affairs of RAO Gazprom or any of its enterprises or subsidiaries since the date hereof.

This Offering Memorandum does not constitute an offer to sell, or a solicitation of an offer to buy, any Offered ADSs in any jurisdiction where it is unlawful to make such offer or solicitation. The distribution of this Offering Memorandum and the offer and sale of the Offered ADSs in certain jurisdictions is restricted by law. Persons into whose possession this Offering Memorandum may come are required by RAO Gazprom, the Global Coordinators and the Managers to inform themselves about and to observe such restrictions. This Offering Memorandum may not be used for, or in connection with, any offer to, or solicitation by, anyone in any jurisdiction or under any circumstance in which such offer or solicitation is not authorized or lawful (including any public offering). Further information with regard to restrictions on offers and sales of the Offered ADSs and the distribution of this Offering Memorandum is set forth under "Underwriting."

RAO Gazprom has agreed that, for so long as any of the Offered ADSs are restricted securities (as defined in Rule 144(a)(3) under the Securities Act), RAO Gazprom will, unless it is subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or becomes exempt from such reporting requirements pursuant to Rule 12g3-2(b) thereunder, provide to each holder of such restricted securities and to each prospective purchaser (as designated by such holder) of such restricted securities, upon the request of such holder or prospective purchaser, the information required to be provided by Rule 144A(d)(4) under the Securities Act. This covenant is intended to be for the benefit of the holders, and the prospective purchasers designated by such holders, from time to time of such restricted securities.

RAO Gazprom will furnish to The Bank of New York, as depositary, all notices of shareholders' meeting and other reports and communications that are made generally available to shareholders. Upon receipt thereof, the Depositary will promptly send copies of such documents to record holders of ADSs. See "Description of the American Depositary Shares."

RAO Gazprom is an open joint-stock company organized under the laws of the Russian Federation, and its directors and executive officers all reside in Russia. Substantially all the assets of RAO Gazprom and of such persons are located in Russia. As a result, it may not be possible for investors to effect service of process outside Russia upon RAO Gazprom or such persons or to enforce in Russia judgments rendered against them by courts outside Russia. Judgments rendered by a court in any jurisdiction outside Russia will be recognized by courts in Russia only if an international treaty providing for the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered. No such treaty exists between the Russian Federation and the United States or the United Kingdom.

NOTICE TO NEW HAMPSHIRE RESIDENTS ONLY

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER RSA 421-B WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF THE STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY, OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

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IN CONNECTION WITH THE GLOBAL OFFERING, MORGAN STANLEY & CO. INTERNATIONAL LIMITED MAY, TO THE EXTENT PERMITTED BY APPLICABLE LAW, OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICES OF THE SHARES AND THE OFFERED ADSS AT PRICES THAT MIGHT NOT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZATION, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

DEFINITIONS

"bcm"	billion cubic meters
"\$" or "dollars"	United States dollars
"Eastern Europe"	Albania, Bosnia, Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, Slovakia, Slovenia and Yugoslavia
"Europe"	Eastern Europe and Western Europe
"FSU"	The countries that comprised the former Soviet Union, being Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kirgizstan, Latvia, Lithuania, Moldova, the Russian Federation, Tajikistan, Turkmenistan, Ukraine and Uzbekistan
"Gazprom" or the "Company"	RAO Gazprom and its subsidiaries and enterprises (as described under "The Company—Corporate Structure of the Company")
"Government"	The Government of the Russian Federation
"mtoe"	million metric tonnes of oil equivalent
"km"	kilometer
"Rbl" or "rubles"	Russian rubles
"Russia"	The Russian Federation
"Soviet Union"	The Union of Soviet Socialist Republics
"tcm"	trillion cubic meters
"Western Europe"	Andorra, Austria, Belgium, Cyprus, Denmark, Finland, France, Germany, Gibraltar, Greece, Greenland, Iceland, Republic of Ireland, Isle of Man, Italy, Liechtenstein, Luxembourg, Madeira, Malta, Monaco, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey and the United Kingdom

EXPECTED TIMETABLE

October 22, 1996	Announcement of offer price and allocation
October 22, 1996	Conditional dealings commence on the London Stock Exchange at 9:30 a.m. (London time)
October 25, 1996	Settlement
October 28, 1996	Unconditional dealings commence on the London Stock Exchange at 8:30 a.m. (London time) following admission of the Offered ADSs to the Official List

All dealings between the commencement of conditional dealings and the commencement of unconditional dealings will be on a "when issued basis." If the Global Offering does not become unconditional in all respects, all such dealings will be of no effect and will be at the sole risk of the parties concerned.

SUMMARY

The following summary is qualified in its entirety by the more detailed information appearing elsewhere in this Offering Memorandum.

Prospective investors should carefully consider the information set forth under "Risk Factors" before making a decision to invest in the ADSs. In particular, they should note that RAO Gazprom has prepared a consolidated balance sheet at December 31, 1995 in accordance with International Accounting Standards ("IAS"), which is included in "Financial Information," but has not prepared any other financial information in accordance with IAS or any financial information in accordance with any other internationally recognized generally accepted accounting principles. The consolidated financial information for 1995 presented in accordance with the Regulation on Accounting and Reporting of the Russian Federation ("RAR") and included in "Financial Information" is materially different from that which would be presented under IAS with respect to the effect of inflation and other important matters and should not be relied upon by investors who do not understand the specific application of RAR.

RAO Gazprom has also prepared Aggregated Financial Reports ("AFRs") for 1993, 1994 and 1995 as required by Russian regulations, and the 1993 and 1994 AFRs are included in Appendix D hereof solely for purposes of obtaining admission of the Offered ADSs to the Official List of the London Stock Exchange. The AFRs represent a summation of the assets, liabilities and results shown by the individual accounting reports prepared in accordance with RAR by RAO Gazprom and its enterprises and subsidiaries; transactions and balances between such entities were not eliminated from the AFRs, investments in partly owned ventures were included at historical cost (rather than being consolidated, where appropriate) and no adjustments were made to take account of the general effect of inflation. Accordingly, the AFRs do not present the consolidated assets and liabilities, financial position or profits and losses of RAO Gazprom, do not give any meaningful indication of trends over time (due in significant part to high inflation rates in Russia during the relevant periods) and cannot be compared in any meaningful way to the consolidated financial information included elsewhere herein. Thus, the AFRs should not be relied upon by anyone considering an investment in the ADSs.

The Company has not prepared or published any interim consolidated financial statements in accordance with IAS, any other internationally recognized generally accepted accounting principles or RAR in respect of any period in 1996. RAO Gazprom expects to publish by the end of the third quarter of 1997 a complete set of consolidated financial statements prepared in accordance with IAS for the year ending December 31, 1996. See "Financial Review" for a discussion of the principal differences between RAR and IAS as they apply to the Company.

Prospective investors should also note that the information relating to gas, gas condensate and oil reserves contained herein has been prepared solely on the basis of Russian classifications and methodologies, which differ from standard international classifications and methodologies, in particular with respect to the manner in which and the extent to which commercial factors are taken into account. Moreover, such reserves information has not been the subject of a reserves audit by internationally recognized independent reservoir engineers. Accordingly, the reserves information contained herein is subject to the adjustments that would result from their being prepared on the basis of standard international classifications and methodologies and may also be subject to the adjustments that could result from a reserves audit by internationally recognized independent reservoir engineers. All reserves information contained herein relates to reserves in categories A, B and C₁ (or "explored" reserves). See "Appendix A—Overview of the Russian Gas Industry and its Regulation—Reserves Classifications" for a discussion of Russian reserves classifications and methodologies.

The Company

Gazprom is one of the world's leading integrated natural gas companies and the world's largest producer of natural gas, with total production of 559.5 bcm of gas in 1995. Gazprom estimates that it supplied approximately

21% and 56% of the natural gas consumed in Western Europe and Eastern Europe, respectively, in 1995 and also supplied substantially all the natural gas consumed in Russia and certain other countries in the FSU in that year. The Company exported 117.4 bcm of natural gas to Europe, and a further 73.2 bcm to the FSU, in 1995. Gazprom estimates that it accounted for approximately 94% of Russia's natural gas production, and approximately 23% of the world's natural gas production, in 1995. As of January 1, 1996, Gazprom had long term contracts for the supply of 1,578 bcm of gas to Europe through 2010.

At December 31, 1995, wholly owned Gazprom enterprises held production licenses for 28.6 tcm of A, B and C₁ natural gas reserves and majority owned subsidiaries of Gazprom held production licenses for another 4.4 tcm of A, B and C₁ gas reserves. Gazprom's total A, B and C₁ gas reserves of 32.9 tcm is equivalent to approximately two thirds of Russia's estimated total A, B and C₁ gas reserves. In addition, wholly owned Gazprom enterprises held production licenses for approximately 1.2 billion tonnes of A, B and C₁ gas condensate reserves, or approximately two thirds of Russia's estimated total A, B and C₁ gas condensate reserves, and approximately 627.4 million tonnes of A, B and C₁ oil reserves. For a breakdown of Gazprom's reserves between A, B and C₁, see "Appendix B—Competent Person's Reserve Report." At December 31, 1995, Gazprom operated approximately 4,700 producing wells and 116 installations for preparing gas.

Gazprom owns and operates Russia's Unified Gas Supply System, which includes the world's largest gas transmission network owned by any company. Gazprom's pipeline network transports substantially all the natural gas that is produced in Russia and includes approximately 144,563 km of pipelines. The network is powered by 245 compressor installations with a total capacity of approximately 40,256 megawatts. Gazprom also operates underground gas storage sites in Russia with a total active capacity of approximately 54.0 bcm.

For a description of the origins of the Company and its corporate structure, see "The Company."

Strategy

The Company's primary medium term strategic objective is to increase profits and cash flow. In the current situation, where gas consumption in Russia and the FSU is not growing, the Company plans to do this by expanding its sales to Europe, capturing additional European downstream marketing and distribution margins, securing payment in full for the gas it supplies to customers in the Russian Federation and elsewhere in the FSU and improving the operating efficiency of its transportation business. To the extent that demand for gas recovers in Russia and elsewhere in the FSU, the Company expects to be able to expand production on the basis of existing plans.

Expand Sales to Europe: Gazprom is currently the leading supplier to the expanding European gas market. The Company plans to expand its sales to Europe through an integrated strategy which includes the following:

- *Additional contracted sales through direct marketing:* Through its network of strategic joint ventures with European gas companies, Gazprom is negotiating new long term contracts directly with major industrial end-users and regional and municipal distributors.
- *New export capacity under construction:* To enable increased exports to Europe, Gazprom is currently constructing new trunk pipelines from the northern part of the Tyumen region of Russia through Belarus and Poland to Germany. These pipelines, generally referred to as the Yamal-Europe project, will be completed in sections and will offer greater security of delivery by providing a new export route.
- *Large reserve base and low-cost production:* With a large reserve base and relatively low production costs (as compared to offshore and liquified natural gas production), Gazprom is able to maintain its margins in a competitive environment and expand production in response to increased demand at relatively low marginal cost. The Company plans to meet future supply obligations to Europe through

the development of deeper horizons in producing fields, West Siberian satellite fields and, at a later stage, new fields in the Yamal peninsula and through improved transmission efficiencies.

Capture additional European downstream marketing and distribution margins: Since the 1970's, Gazprom and its predecessors have sold gas to European distributors, such as Ruhrgas in Germany and Gaz de France in France. Since 1990, Gazprom has been operating in the European domestic transmission and distribution markets through joint ventures, thereby capturing additional downstream margins. Gazprom's Wingas joint venture with BASF has been constructing alternative transmission and distribution networks in Germany and has already constructed approximately 1,200 km of pipeline. Similar projects are being considered elsewhere.

Payment for gas supplies in Russia and elsewhere in the FSU: The Company has delivered significant amounts of gas to customers in Russia and elsewhere in the FSU for which it has not yet been paid. As of September 1, 1996, gas with a sales value of approximately Rbl 48,350 billion (including charges for late payment) had been delivered to Russian customers for which payment had not been received, and gas with a sales value of approximately \$1,268 million (including charges for late payment) had been delivered to customers elsewhere in the FSU for which payment had not been received. Gazprom has two principal strategies for securing payment from its customers in Russia and elsewhere in the FSU. First, the Company is seeking to develop closer relations with its Russian customers by maintaining the proportion of gas it supplies directly to consumers in Russia (as opposed to distribution companies) and by increasing the number of tri-partite contracts it enters into with distribution companies and consumers pursuant to which it is paid directly by the consumers. Secondly, the Company increasingly is accepting payment in forms other than cash, including negotiable promissory notes, bonds, equity interests in gas distribution companies and goods and services. In addition, discussions are continuing with certain countries of the FSU, including Moldova, Ukraine and Belarus, in order to reach agreements on a permanent framework for the supply of, and payment for, Gazprom's gas exports.

Improved efficiency of gas transportation: The Company has initiated a number of programs to improve the efficiency of its gas transportation network. Reconstruction of compressor stations and pipelines is expected to result in an increase of transportation capacity of in excess of 3.0 bcm of gas in 1996 and in a total increase in annual transportation capacity of 15 bcm by the end of the year 2000. Enhanced efficiency of Gazprom's pipeline network should also increase the Company's export capacity.

Summary Consolidated Financial Information

The following summary consolidated financial information is qualified in its entirety by, and should be read in conjunction with, the more detailed consolidated financial information included elsewhere herein. See "Financial Review" and "Financial Information." The summary consolidated financial information set forth below has been derived from RAO Gazprom's consolidated balance sheet at December 31, 1995 prepared in accordance with IAS and from its consolidated profit and loss account for the year ended December 31, 1995 prepared in accordance with RAR. RAR is materially different from IAS with respect to the effect of inflation and other important matters. Accordingly, the sales information set forth below prepared in accordance with RAR is not comparable to sales information that would be prepared under IAS. RAO Gazprom expects to publish by the end of the third quarter of 1997 a complete set of consolidated financial statements prepared in accordance with IAS for the year ending December 31, 1996. See "Financial Review" for a discussion of the principal differences between RAR and IAS as they apply to the Company.

	In billions of rubles	In millions of dollars(1)	
IAS—Financial position at December 31, 1995			
Accounts receivable and prepayments	48,941	10,548	
Property, plant and equipment	282,776	60,943	
All other assets	36,026	7,764	
Total assets	367,743	79,255	
Accounts payable, accrued charges and short term loans and current portion of long-term borrowings	43,562	9,388	
Long-term borrowings	6,754	1,456	
All other liabilities	9,240	1,991	
Shareholders' equity (including retained earnings and other reserves)	308,187	66,420	
Total liabilities and shareholders' equity	367,743	79,255	
RAR—Consideration received in respect of sales recognized in the year ended December 31, 1995 (net of sales and excise taxes) (2)			
Gas sales			% of gas sales
Western Europe	23,020	4,961	34.8
Eastern Europe	6,736	1,452	10.2
FSU (excluding Russia)	12,123	2,613	18.4
Russia	24,201	5,216	36.6
Total gas sales	66,080	14,242	100%
Other sales	7,280	1,569	
Total sales	73,360	15,811	

- (1) The dollar amounts shown above have been translated from the ruble amounts at the rate of Rbl 4,640 = \$1.00, which is the rate published by the Central Bank of the Russian Federation (the "Central Bank") on December 29, 1995. These dollar amounts are provided for convenience only and should not be construed as representations that the ruble amounts have been or could be converted into dollars at that or any other rate.
- (2) This sales information is based on RAO Gazprom's consolidated RAR profit and loss account included in "Financial Information." Adjustments have been made, however, to eliminate sales and excise taxes and to add back amounts credited directly to shareholders' equity pursuant to arrangements with respect to the Stabilization Fund (as defined below). As required under RAR, sales figures include consideration received in 1995 with respect to goods and services delivered in prior years (except that \$1.1 billion of the \$1.4 billion face amount of Ukrainian government bonds received in 1995 in settlement of obligations relating to \$1.4 billion of gas deliveries made in prior years has not been included but has been treated as deferred revenue), do not include consideration to be received in future years with respect to goods and services delivered in 1995 and have been affected by arrangements with respect to the Yamburg Agreement and the Federal Share (each as defined below). See "Financial Review."

Summary Statistical Information

	Year Ended December 31,		
	1993	1994	1995
Gas Deliveries (in bcm)(1)			
Western Europe	64.9	69.2	75.1
Eastern Europe	35.9	36.7	42.3
FSU (excluding Russia)	78.5	78.4	73.2
Russia	349.5	317.8	306.1
Total Gas Deliveries	528.8	502.1	496.7
Gas Production (in bcm)	577.7	570.7	559.5
A, B and C₁ Gas Reserves at December 31 (in tcm)(2)	33.5	33.4	32.9

- (1) Gas deliveries cannot be correlated with the sales reflected in the consolidated financial information as such sales are based on consideration received as opposed to when gas deliveries are made. Includes significant deliveries to certain export customers for which Gazprom receives no direct revenues but is reimbursed to a certain extent by the Government. These deliveries relate to gas supply contracts (which are collectively referred to as the "Yamburg Agreement") signed by Soviet authorities with East European governments beginning in 1985, prior to the creation of RAO Gazprom. In 1995, 13.8 bcm of gas were delivered under the Yamburg Agreement (3.5 bcm to Germany and 10.3 bcm to Eastern Europe). With respect to Western Europe, also includes deliveries of 2.8 bcm of gas to Turkey that are subject to arrangements with respect to the Federal Share. Finally, includes significant deliveries to Russian and other FSU customers for which payment has not yet been received. See "Financial Review."
- (2) Includes all the A, B and C₁ gas reserves of subsidiaries in which Gazprom has majority interests. These reserves were 4.4 tcm at December 31, 1995.

The Global Offering

The Global Offering:

RAO Gazprom is offering 23,700,000 Offered ADSs, each representing 10 Underlying Shares, in a Global Offering outside Russia which is being underwritten by the several Managers named herein. It has also granted the several Managers an option, exercisable by the Global Coordinators for up to 30 days after the date of this Offering Memorandum, to purchase Shares represented by up to an additional 3,555,000 Offered ADSs, solely to cover over-allotments, if any, in the Global Offering. Offers and sales of the Offered ADSs are being made by the Managers in the United States pursuant to Rule 144A under the Securities Act and outside the United States pursuant to Regulation S under the Securities Act.

Price:

\$15.75 an ADS.

Reasons for the Global Offering and Use of Proceeds:

RAO Gazprom is offering the Offered ADSs in the Global Offering in order to establish an international market for its ADSs, and thus to facilitate access to the international capital markets in the future, and to finance certain capital investments. See "Reasons for the Global Offering and Use of Proceeds."

The Offered ADSs:

The Offered ADSs are being issued by The Bank of New York, as depositary (the "Depositary"), under a Rule 144A Deposit Agreement and a Regulation S Deposit Agreement, each to be dated as of October 25, 1996 (the "Deposit Agreements"), between RAO Gazprom, the Depositary and the owners and beneficial owners from time to time of the ADSs. The Offered ADSs will be evidenced by American Depositary Receipts ("ADRs") in global form. The Offered ADSs sold in the United States under Rule 144A will be evidenced by a Rule 144A Global ADR, and the Offered ADSs sold outside the United States under Regulation S will be evidenced by a Regulation S Global ADR. The Rule 144A Global ADR and the Regulation S Global ADR will each be registered in the name of Cede & Co., as nominee for DTC.

The Underlying Shares:

The Underlying Shares to be represented by the Offered ADSs comprise approximately 1% of the outstanding share capital of RAO Gazprom. The Underlying Shares were acquired by RAO Gazprom from Gazfund, a retirement fund which holds assets for the benefit of Gazprom employees, on October 2, 1996.

Limitations on Deposits and Withdrawals:

Subject to certain limited exceptions, after the deposit of the Underlying Shares and the issuance of the Offered ADSs in connection with the Global Offering, additional Shares may be deposited and additional ADSs issued only with the written consent of the Management Committee of RAO Gazprom, which generally is not expected to be given except in connection with subsequent offers and sales of ADSs by RAO Gazprom. See "Risk Factors—Risks Related to the Global Offering—Shares Eligible for Future Sale." Underlying

Shares Eligible for Future Sale and
Lock-up:

Shares may not be withdrawn from the deposit facilities, except in connection with a sale in Russia to a Russian resident. See "Description of the American Depositary Shares—Deposit, Transfer and Withdrawal—Rule 144A ADRs" and "—Deposit, Transfer and Withdrawal—Regulation S ADRs."

Under Government Decree 138 and RAO Gazprom's Charter, not more than 9% of RAO Gazprom's voting share capital may be owned by foreign investors. The Charter may be amended in this respect only by a vote of 75% of the Shareholders present and voting at a general meeting, subject to the agreement of the Government.

The Charter affords to RAO Gazprom certain pre-emptive and approval rights, including over transfers of Shares by Russian Shareholders to foreign investors (see "Description of the Shares—Transfer of Shares"), and the Deposit Agreements will provide that Shares may not be deposited into the deposit facilities against the issuance of ADSs without the written consent of the Management Committee of RAO Gazprom, which generally is not expected to be given except in connection with subsequent offers and sales of ADSs by RAO Gazprom (see "Description of the American Depositary Shares—Deposit, Transfer and Withdrawal—Rule 144A ADRs" and "—Deposit, Transfer and Withdrawal—Regulation S ADRs"). For so long as Shares are legitimately owned by foreign investors, they are not subject to the pre-emptive and approval rights which RAO Gazprom has under its Charter (other than the right, described below and under "The Trading Market for RAO Gazprom Shares," to approve acquisitions giving a transferee more than 3% of its voting shares), and the ADSs will not be subject to such rights (although in the future the exercise of voting rights may be affected by certain provisions set forth in the Deposit Agreements relating to the Management Committee's approval right referred to above), regardless of whether they are owned by Russian or by foreign investors.

Currently, approximately 0.83% of the Shares (the "Certified Shares") are recognized by RAO Gazprom as being owned by foreign investors. All the ADSs will be considered by RAO Gazprom to form part of the 9% of the voting share capital that may be owned by foreign investors (regardless of whether the ADSs are actually owned by foreign or by Russian investors).

RAO Gazprom intends to use the pre-emptive, approval and consent rights referred to above to preserve for itself the ability to sell to foreign investors the remaining Shares permitted by the Charter to be owned by foreign investors. RAO Gazprom plans to do this through the Global Offering and subsequent offerings of ADSs in the international capital markets over the next several years, subject to market conditions.

In connection with the Global Offering, RAO Gazprom has agreed not to offer or sell additional Shares or ADSs (or certain other securities and instruments), directly or indirectly, for a period of 180 days from

the date of this Offering Memorandum without the consent of the Global Coordinators; *provided, however*, that this limitation does not apply to offers or sales of securities or other instruments in privately negotiated transactions with strategic investors and offers or sales of securities or other instruments in Russia other than to foreign investors. See "Underwriting." As noted above, RAO Gazprom intends to make subsequent offerings of ADSs in the international capital markets, subject to market conditions.

This agreement does not affect the Russian Federation, which owns 40% of the Shares and, in accordance with a Presidential Decree, is to retain its holding until February 1999 (although the President is free to change this policy at any time). Nor does this agreement affect any other holder of Shares. However, three such holders (the "Certified Holders"), who control substantially all the Certified Shares, have agreed with RAO Gazprom that they will convert all such Certified Shares into ADSs promptly after the Global Offering and will not dispose of any such ADSs or Certified Shares until January 1, 1998, except as is agreed. The agreements permit the Certified Holders to sell Certified Shares or related ADSs prior to 180 days from the date of this Offering Memorandum only with the consent of the Global Coordinators (and, in certain cases, RAO Gazprom), and thereafter until January 1, 1998 only subject to certain volume limitations. See "The Trading Market for RAO Gazprom Shares—The International Market."

Following the Global Offering, 1.83% of the Shares will be recognized by RAO Gazprom as being owned by foreign investors (1.98% if the over-allotment option is exercised in full).

Trading Market:

The Shares are not listed on any securities exchange, but organized auctions in the Shares are conducted in Russia through the Federal Stock Corporation. Application has been made to the London Stock Exchange for the Offered ADSs to be admitted to the Official List. The Offered ADSs are expected to be quoted on SEAQ International and to be eligible for trading in the PORTAL market. Prior to the Global Offering, there has been only limited trading in the Shares and no trading in the ADSs.

Separation of Russian and
International Trading Markets:

It is RAO Gazprom's policy to maintain as complete a separation as is practicable between the Russian and international trading markets for its Shares and ADSs through the application of its pre-emptive, approval and consent rights. Any scheme to bridge the gap between the two markets, for example through the purchase of Shares in Russia and the issuance of derivative instruments internationally, will be examined very carefully by RAO Gazprom. See "Risk Factors—Risks Relating to the Global Offering—Shares Eligible for Future Sale" and "The Trading Market for RAO Gazprom Shares."

Voting Rights:

Each Share entitles the holder thereof to one vote at RAO Gazprom's general meetings of shareholders. See "Description of the Shares—Voting Rights." The Depositary will vote Shares represented by ADSs

	<p>upon the instructions (or deemed instructions) of the owners thereof. The Charter of RAO Gazprom provides that any transfer of Shares by any Shareholder to another investor requires the approval of the Management Committee of RAO Gazprom if the transferee would acquire more than 3% of the voting rights in RAO Gazprom as a result of the transfer. The Management Committee of RAO Gazprom may decide in the future to approve the transfer to the Depositary of additional Shares that would result in the Depositary owning more than 3% of the Shares, on the condition that certain provisions are set forth in the Deposit Agreements with respect to the voting of such Shares. See "Description of the American Depositary Shares—Voting of Deposited Securities."</p>
Dividends:	<p>Owners of the ADSs will be entitled to any dividends paid on the Shares represented thereby. See "Dividends" and "Description of the American Depositary Shares—Dividends, Other Distributions and Rights."</p>
Delivery and Payment:	<p>It is expected that delivery of the Rule 144A Global ADR and the Regulation S Global ADR will be made through the facilities of DTC, on or about October 25, 1996, against payment in dollars in immediately available funds. Purchasers of the Offered ADSs outside the United States may hold their interests in the Regulation S Global ADR through the facilities of the Euroclear System or Cedel Bank, société anonyme ("CEDEL"). See "Description of the American Depositary Shares—Deposit, Transfer and Withdrawal—Rule 144A ADRs" and "—Deposit, Transfer and Withdrawal—Regulation S ADRs" for a discussion of transfers of interests in the Global ADRs between DTC and the European clearing systems.</p>
Representation Letters:	<p>Each purchaser of Offered ADSs in the Global Offering will be required, prior to the written confirmation of sale, to execute and deliver to RAO Gazprom and the Managers a representation letter in the form to be provided by the Managers. See "Transfer Restrictions."</p>
Risk Factors:	<p>An investment in the ADSs involves a high degree of risk. See "Risk Factors."</p>

RISK FACTORS

An investment in the ADSs involves a high degree of risk and, in this connection, prospective investors should carefully review this entire Offering Memorandum and, in particular, should consider the information set forth below before making a decision to invest in the ADSs.

Risks Relating to the Company

Sales of Gas in Europe and Russia

Gazprom sells a substantial portion of its natural gas in Europe, which is the Company's primary source of foreign currency revenues. For over 25 years, Gazprom and its predecessors have sold natural gas to Western Europe, generally pursuant to long-term contracts providing for payment on the basis of current international gas prices. Such prices can fluctuate and are determined by supply and demand and other factors over which the Company has no control. Gazprom is subject to competition in Europe from other gas suppliers, including those in Norway and Algeria, and this competition could affect the prices and volumes of Gazprom's sales to Europe. See "Business—Gazprom's Principal Markets."

In Russia, gas prices are subject to extensive control by governmental authorities. See "Appendix A—Overview of the Russian Gas Industry and its Regulation—Regulation—Price Regulation." As of October 1, 1996, the standard price of gas in Russia for industrial users, inclusive of excise tax but prior to distributor's margin and VAT, was Rbl 260,232 per 1,000 cubic meters (\$48.13 at the then current exchange rate of Rbl 5,407 = \$1.00), the price to households, prior to distributor's margin and VAT, was Rbl 45,000 per 1,000 cubic meters (\$8.32 at such exchange rate). The standard wholesale price of gas for industrial users has been fixed for the remainder of 1996 at the price as of October 1, 1996. The Government is expected to introduce, from January 1, 1997, wholesale gas prices for industrial users which will be determined by reference to the cost of transit of gas to the user (as opposed to being based on a single standard price). See "Business—Gazprom's Principal Markets—Russia."

Delayed and Uncollectible Payments by Customers

In common with many Russian enterprises, the Company is experiencing significant difficulties in obtaining timely payment for shipments to customers in Russia and certain other countries in the FSU. RAO Gazprom estimates that it received payments (or other settlement) in 1995 equivalent to approximately 62% of the total amount invoiced to Russian customers for gas delivered in 1995. Such payments (or other settlement) include amounts with respect to shipments made in prior years, as well as in 1995, and thus do not indicate the collectibility of the sales value of gas shipped in 1995. As of September 1, 1996 gas with a sales value of approximately Rbl 48,350 billion (including charges for late payment) had been delivered to Russian customers for which payment had not been received, and gas with a sales value of approximately \$1,268 million (including charges for late payment) had been delivered to customers elsewhere in the FSU for which payment had not been received. Of the amount owed by customers elsewhere in the FSU, substantially all was due from customers in Moldova, Ukraine and Belarus. Payment for a portion of these deliveries may be uncollectible. The Company is implementing measures to increase the proportion of gas supplied to Russian and other FSU customers for which it is paid on time, but the impact of such measures on total outstanding debts to the Company is likely to be constrained by the limited ability of these customers to pay. Furthermore, the Company often considers it necessary to continue to supply late paying customers in Russia due to national security considerations or concerns relating to the social consequences of cutting supply. Delays in payment have reduced the real value of the Company's ruble-denominated receivables (due to high inflation rates in Russia) and have also adversely affected the Company's ability to make certain payments and fund certain capital expenditures. See "—Taxation" and "—Capital Requirements." Presidential Decree No. 1451, dated October 17, 1996, requires the Government to establish a procedure to partially extinguish the debts of Russian customers to Gazprom, subject to those customers continuing to make timely contractual payments for gas deliveries. See "Business—Gazprom's Principal Markets—Russia."

Operational Risks

The Company owns and operates the Unified Gas Supply System, which is responsible for the gathering, processing, transportation and storage of substantially all gas supplies in Russia. This extensive system of

approximately 144,563 km of pipelines and 245 compressor installations was largely developed over the past 30 years. Approximately 66% of the total length of this pipeline system is over 10 years old and approximately 12% is over 30 years old. A significant proportion of the total length of the pipeline system is protected by chemical processes of limited duration and effectiveness. While RAO Gazprom believes it has adequately maintained its pipeline network in recent years, due to financial constraints it has not been able fully to upgrade its network. There were 0.210 breakdowns per 1,000 km of pipeline in 1995, mainly attributable to defective construction and defective steel and to external, internal and stress corrosion in the pipeline. See "Business—Gas Transportation and Storage."

Gazprom is dependent on the links between its pipeline network and pipeline networks elsewhere for the export of gas. Although it is the Company's strategy to diversify its export routes, the Company is currently dependent on Ukraine to deliver substantially all its gas to Europe and for a significant amount of its storage capacity. At the same time, Ukraine is dependent on Gazprom to meet its domestic requirements for gas. Accordingly, this interdependence is taken into account in negotiations over a number of matters, including the terms of payment for gas supplied by the Company and transit fees.

The Company exported 117.4 bcm of gas to Europe in 1995, which represented substantially all the capacity of its pipeline network for the export of gas. The Company plans to expand its export capacity and, as noted above, to diversify its export routes, through capital investments in the Yamal-Europe project and other export-oriented pipelines. It is expected that these capital investment projects will increase the Company's export capacity to 124 bcm of gas by year-end 1996, 142 bcm of gas by year-end 1997 and 154 bcm of gas by year-end 1998. It is possible, however, that this schedule will be affected by demand for gas in Europe, the Company's ability to obtain external financing on acceptable terms and other factors and, accordingly, that the Company's export capacity may not increase as planned. See "Business—Strategy, Joint Ventures in Europe and Other Investments."

Capital Requirements

The Company faces significant requirements for capital expenditures. RAO Gazprom currently estimates that approximately \$40 billion of capital expenditures will be required over a ten-year period to maintain its gas, gas condensate and oil operations, to meet anticipated demand for gas, gas condensates and oil and to construct the two parallel pipelines comprising the Yamal-Europe project. The Company expects to fund these capital expenditures through both internal sources and external financing. There is, however, a significant degree of flexibility in respect of these planned expenditures, and the actual amount and timing of the expenditures may vary depending on commercial factors, contractual commitments and Gazprom's ability to obtain external financing on acceptable terms. See "Business—Strategy, Joint Ventures in Europe and Other Investments" and "Financial Review."

Taxation

The taxation system in Russia is still evolving and is subject to varying interpretations and to constant changes which may be retroactive in effect. Moreover, the Company is subject to a broad range of taxes imposed at the federal, regional and local levels, and it is a significant source of tax revenues at each such level. As of September 1, 1996, Gazprom had total tax liabilities to federal, regional and local tax authorities of approximately Rbl 15,300 billion, due in large part to the significant delays the Company has experienced in collecting revenues from customers in Russia and elsewhere in the FSU. See "—Delayed and Uncollectible Payments by Customers." Several regional tax authorities have been pressing their claims against Gazprom in respect of certain of these liabilities, including, in three such cases, by imposing temporary liens over certain insignificant assets of the Company. RAO Gazprom does not consider these cases to be material, and in two of the cases the liens have been lifted.

The Company is continually responding to changes in the taxation system in order to comply with applicable requirements and to optimize its tax position. The Company currently bears a significant tax burden, and no assurance can be given that changes in Russia's taxation system, including recognition of revenue on an accrual rather than a cash basis for tax purposes, will not result in an increased burden or adversely affect the profit margins or cash flows of the Company. For a detailed discussion of the taxes to which Gazprom is subject and certain taxation factors that investors should consider, see "Financial Review—Taxation" and "Financial Review—Taxation Factors for Investor Consideration."

Relationship with the Government

The Government of the Russian Federation has exercised and can be expected to continue to exercise significant influence over the Company's operations. The Russian Federation currently owns 40% of the Shares, and under the Decree of the President No. 399 of March 20, 1996, the Russian Federation is to continue to hold these Shares until February 1999 (although the President is free to change this policy at any time). RAO Gazprom is entitled, however, to vote 35% of the Shares at shareholder meetings under a trust agreement with the Government, the term of which was extended in April 1996 to February 1999. Three members of RAO Gazprom's Board of Directors hold positions in federal bodies, giving the Government and other federal bodies a certain amount of influence over the policies and operations of the Company.

The Government's influence over the Company derives from other sources as well. Among other things, the Government requires Gazprom to supply gas to certain consumers in the Russian Federation, to supply gas to certain consumers outside Russia pursuant to inter-governmental agreements and to maintain and operate the Unified Gas Supply System; the Government regulates the price of gas supplied to Russian consumers; Gazprom is one of the largest sources of tax revenue to the federal authorities, as well as to the regional and local authorities where it operates; and Gazprom's production licenses are granted by federal and local authorities and are subject to renewal or extension by them, and to revocation by them in the event that Gazprom fails to comply with the requirements contained therein. For a discussion of Gazprom's relationship with the Government and other authorities, see "Financial Review," and for a discussion of Gazprom's licenses, see "Business—Production" and "Appendix A—Overview of the Russian Gas Industry and its Regulation—Regulation—Prospecting and Production Licenses."

RAO Gazprom believes that it has good relations with the current federal, regional and local authorities. RAO Gazprom has consistently supported President Yeltsin and Prime Minister Chernomyrdin, the former head of State Gas Concern Gazprom, RAO Gazprom's immediate predecessor.

Possible Restructuring of the Company

In contrast to the oil industry, which during the course of Russia's privatization program was divided into a number of vertically integrated oil companies, the production and transport of natural gas is largely controlled by Gazprom. There have at times been calls for the Company to be divided into a number of companies, or for particular functions to be re-allocated to other entities. For example, in 1995 the Anti-Monopoly Committee of the Russian Federation recommended the separation of ownership of gas production and gas transportation. The Company believes that it will continue to exist as a vertically integrated gas production and transportation business but, if a restructuring were to occur, there can be no assurance that adequate compensation would be provided.

In common with many Russian companies, Gazprom can be affected by changes in the political climate in Russia. See "—Risks Relating to the Russian Federation—Political Risks."

Environmental Risks

The Company's operations, and in particular its production, processing and transportation of natural gas and construction of pipelines, are subject to the risk of liabilities arising from environmental damage or pollution and the ensuing cost of remediation. The Company has developed an environmental plan and actively monitors its operations to meet environmental standards. Accordingly, the Company has provided in its IAS balance sheet for those environmental liabilities where it is probable an obligation exists and the amount can be reasonably estimated. Such provision has been made in accordance with a reasonable and prudent policy that takes into account payments made in prior years, among other factors. However, in Russia in particular, federal, regional and local authorities may enforce existing laws and regulations more strictly than they have done in the past and may impose stricter environmental standards than those now in effect. Accordingly, the Company is unable to estimate the ultimate financial impact of its environmental obligations with a high degree of certainty, particularly in the light of the possibility of stricter enforcement of existing laws and regulations or of the possibility that additional laws or regulations may be adopted in the future. See "Business—Environmental Matters."

Exchange Rate Risks

From 1991 through the first half of 1995, the ruble depreciated significantly against the dollar and was subject at times to extreme volatility. See "Exchange Rates and Exchange Controls." In October 1994, the value of the ruble against the dollar fell by more than 30% in two days and then temporarily rebounded by a greater amount. In an effort to reduce the volatility of the ruble, the Central Bank introduced a ruble/dollar band of Rbl 4,300 - Rbl 4,900 to \$1.00 in July 1995, which was to remain in effect for three months and then was extended to the end of that year. The band was revised to Rbl 4,550 - Rbl 5,150 and extended for six months commencing January 1, 1996. On May 16, 1996, the Central Bank announced a target for the ruble/dollar exchange rate of between Rbl 5,000 and Rbl 5,600 from July 1, 1996 through the end of 1996 and between Rbl 5,500 and Rbl 6,100 from January 1, 1997. Since the introduction of the band in July 1995, the value of the ruble has stabilized against the dollar, and has appreciated on an inflation-adjusted basis. The Government's ability to maintain the stability of the ruble will depend on many political and economic factors, including its ability to control inflation and the availability of foreign currency to support the band. The Company's financial results may be positively or negatively affected by fluctuations in the value of the ruble against other currencies, particularly the dollar, depending on the Company's mix of exports and imports at the time.

Limited Availability of Financial Information

RAO Gazprom is one of the few Russian companies that have prepared consolidated financial information in accordance with IAS. RAO Gazprom has prepared a consolidated balance sheet at December 31, 1995 in accordance with IAS, which is included in "Financial Information," but has not prepared any other consolidated financial information in accordance with IAS or any consolidated financial information in accordance with any other internationally recognized generally accepted accounting principles. The consolidated financial information for 1995 presented in accordance with RAR and included in "Financial Information" is materially different from that which would be presented under IAS with respect to the effect of inflation and other important matters and should not be relied upon by investors who do not understand the specific application of RAR.

RAO Gazprom has also prepared Aggregated Financial Reports (AFRs) for 1993, 1994 and 1995 as required by Russian regulations, and the 1993 and 1994 AFRs are included in Appendix D hereof solely for purposes of obtaining admission of the Offered ADSs to the Official List of the London Stock Exchange. The AFRs represent a summation of the assets, liabilities and results shown by the individual accounting reports prepared in accordance with RAR by RAO Gazprom and its enterprises and subsidiaries; transactions and balances between such entities were not eliminated from the AFRs, investments in partly owned ventures were included at historical cost (rather than being consolidated, where appropriate) and no adjustments were made to take account of the general effect of inflation. Accordingly, the AFRs do not present the consolidated assets and liabilities, financial position or profits and losses of RAO Gazprom, do not give any meaningful indication of trends over time (due in significant part to high inflation rates in Russia during the relevant periods) and cannot be compared in any meaningful way to the consolidated financial information included elsewhere herein. Thus, the AFRs should not be relied upon by anyone considering an investment in the ADSs.

New financial reporting systems are currently being studied and are expected to be introduced in the future to facilitate the efficient preparation of consolidated financial statements. Accordingly, RAO Gazprom has neither prepared nor published any interim consolidated financial statements in accordance with IAS, any other internationally recognized generally accepted accounting principles or RAR in respect of any period in 1996. RAO Gazprom expects to publish by the end of the third quarter of 1997 a complete set of consolidated financial statements prepared in accordance with IAS for the year ending December 31, 1996. See "Financial Review" for a discussion of the principal differences between RAR and IAS as they apply to the Company.

Russian Reserves Classifications and Methodologies

The information relating to gas, gas condensate and oil reserves contained herein has been prepared solely on the basis of Russian classifications and methodologies, which differ from standard international classifications

and methodologies, in particular with respect to the manner in which and the extent to which commercial factors are taken into account. Moreover, such reserves information has not been the subject of a reserves audit by internationally recognized independent reservoir engineers. Accordingly, the reserves information contained herein is subject to the adjustments that would result from their being prepared on the basis of standard international classifications and methodologies and may also be subject to the adjustments that could result from a reserves audit by internationally recognized independent reservoir engineers. All reserves information contained herein relates to reserves in categories A, B and C₁ (or "explored" reserves). See Appendix A "—Overview of the Russian Gas Industry and its Regulation—Reserves Classifications" for a discussion of Russian reserves classifications and methodologies.

Risks Relating to the Global Offering

Shares Eligible for Future Sale

Under Government Decree 138 and RAO Gazprom's Charter, not more than 9% of RAO Gazprom's voting share capital may be owned by foreign investors. The Charter may be amended in this respect only by a vote of 75% of the Shareholders present and voting at a general meeting, subject to the agreement of the Government.

The Charter affords to RAO Gazprom certain pre-emptive and approval rights, including over transfers of Shares by Russian Shareholders to foreign investors (see "Description of the Shares—Transfer of Shares"), and the Deposit Agreements will provide that Shares may not be deposited into the deposit facilities against the issuance of ADSs without the written consent of the Management Committee of RAO Gazprom (see "Description of the American Depositary Shares—Deposit, Transfer and Withdrawal—Rule 144A ADRs" and "—Deposit Transfer and Withdrawal—Regulation S ADRs"). For so long as Shares are legitimately owned by foreign investors, they are not subject to the pre-emptive and approval rights which RAO Gazprom has under its Charter (other than the right, described under "The Trading Market for RAO Gazprom Shares," to approve acquisitions giving a transferee more than 3% of its voting shares), and the ADSs will not be subject to such rights (although in the future the exercise of voting rights may be affected by certain provision set forth in the Deposit Agreements relating to the Management Committee's approval right referred to above), regardless of whether they are owned by foreign or by Russian investors.

Currently, approximately 0.83% of the Shares, referred to as Certified Shares, are recognized by RAO Gazprom as being owned by foreign investors. All ADSs will be considered by RAO Gazprom to form part of the 9% of the voting share capital that may be owned by foreign investors, (regardless of whether the ADSs are actually owned by foreign or by Russian investors). Following the Global Offering, 1.83% of the Shares will be recognized by RAO Gazprom as being owned by foreign investors (1.98% if the over-allotment option is exercised in full).

RAO Gazprom intends to use the pre-emptive, approval and consent rights referred to above to preserve for itself the ability to sell to foreign investors the remaining Shares permitted by the Charter to be owned by foreign investors. RAO Gazprom plans to do this through the Global Offering and subsequent offerings of ADSs in the international capital markets over the next several years, subject to market conditions.

In connection with the Global Offering, RAO Gazprom has agreed not to offer or sell additional Shares or ADSs (or certain other securities and instruments), directly or indirectly, for a period of 180 days from the date of this Offering Memorandum without the consent of the Global Coordinators; *provided, however*, that this limitation does not apply to offers or sales of securities or other instruments in privately negotiated transactions with strategic investors and offers or sales of securities or other instruments in Russia other than to foreign investors. See "Underwriting." As noted above, RAO Gazprom intends to make subsequent offerings of ADSs in the international capital markets, subject to market conditions.

This agreement does not affect the Russian Federation, which owns 40% of the Shares and, in accordance with a Presidential Decree, is to retain its holding until February 1999 (although the President is free to change this policy at any time). Nor does this agreement affect any other holder of Shares. However, the Certified

Holders, who control substantially all the Certified Shares, have agreed with RAO Gazprom that they will convert all such Certified Shares into ADSs promptly after the Global Offering and will not dispose of any such ADSs or Certified Shares until January 1, 1998, except as is agreed. The agreements permit the Certified Holders to sell Certified Shares or related ADSs prior to 180 days from the date of this Offering Memorandum only with the consent of the Global Coordinators (and, in certain cases, RAO Gazprom), and thereafter until January 1, 1998 only subject to certain volume limitations. See "The Trading Market for RAO Gazprom Shares—The International Market."

It is RAO Gazprom's policy to maintain as complete a separation as is practicable between the Russian and international trading markets for its Shares and ADSs through the application of its pre-emptive, approval and consent rights described above. Any scheme to bridge the gap between the two markets, for example through the purchase of Shares in Russia and the issuance of derivative instruments internationally, will be examined very carefully by RAO Gazprom. No assurance can be given, however, as to how effective the separation of the markets will be.

Significant transactions involving Shares, ADSs or related derivative instruments could affect the market prices of the Shares and ADSs.

Limited Trading Market

To date, there has been only a limited trading market for the Shares and no trading market for the ADSs. There can be no assurance that an active trading market will develop for either the Shares or the ADSs or, if an active trading market for the Shares or the ADSs does develop, that prices at which the Shares or the ADSs trade will accurately reflect their respective values. The current trading market for the Shares in Russia consists of the over-the-counter market and the auctions organized since March 1996 by the Federal Stock Corporation which are usually held once a week. See "The Trading Market for RAO Gazprom Shares."

Exchange Rates and Exchange Controls

Any dividends declared by RAO Gazprom on the Shares represented by the ADSs (less any withholding taxes) will be paid in rubles and converted by the Depositary into dollars for distribution to holders of the ADSs. See "Description of American Depositary Shares—Dividends, Other Distributions and Rights." Accordingly, fluctuations in the value of the ruble against the dollar will affect the amount of any dollar dividends that are paid on the ADSs. Similarly, such fluctuations in the value of the ruble against the dollar will also affect the dollar value of any ruble proceeds received from a sale in Russia to a Russian resident of ADSs, or of Shares that are withdrawn from the deposit facilities in accordance with the terms of the Deposit Agreements. Finally, Russia's currency control laws and regulations will affect the ability of a holder of ADSs to sell such ADSs or the Shares they represent to a Russian resident in Russia and to repatriate in dollars (or another hard currency) the proceeds of any such sale. Finally, the ability of the Depositary and other persons to convert rubles into dollars (or another hard currency) is also subject to the availability of dollars (or such other hard currency) in Russia's currency markets. See "Exchange Rates and Exchange Controls."

Risks Relating to the Russian Federation

Political Risks

Since 1991, Russia has been evolving from a socialist state with a centrally planned economy to a pluralist democracy with a market economy. The process of political and economic reform has been difficult, but President Yeltsin and his Government have consistently promoted the reforms, and RAO Gazprom believes that the re-election of President Yeltsin should result in a continuation of the reforms. It is possible, however, that certain adjustments may be made to the course of reform in some areas, including a redistribution of authority between federal, regional and local bodies, an increase in state control over the activities of large enterprises,

more stringent controls over foreign investment in strategic industries and greater protection of domestic producers. See “—Economic Risks.”

Under its Constitution, the Russian Federation is a federation of regions or subjects, some of which exercise considerable power over their internal affairs pursuant to agreements with the federal authorities. For many regions of Russia, the allocation of powers and responsibilities to regional authorities has yet to be established, a situation which potentially could lead to political instability and harm to the economy. In one republic, Chechnya, a separatist movement has openly defied the powers of the federal government, resulting in a military confrontation. No definitive allocation of powers and responsibilities has been made regarding the regulation, licensing and taxation of natural resource industries, including hydrocarbons, and a more assertive attitude by regional authorities where the Company extracts or transports gas or otherwise conducts operations cannot be ruled out. See, e.g., “—Risks Relating to the Company—Taxation.”

Economic Risks

The transition in Russia over the past five years from a centrally planned economy to a market economy has in large part succeeded. Nevertheless, the Russian economy still has several significant weaknesses. Russia's real gross domestic product declined by approximately 6% in 1993, 11% in 1994, 2% in 1995 and 5% in the first half of 1996. Industrial production declined by approximately 14% in 1993, 21% in 1994 and 3% in 1995. Consumer price inflation was approximately 2510% in 1992, 840% in 1993, 215% in 1994, 131% in 1995 and 15% in the first six months of 1996. While significant progress in reducing inflation has been made, achieving further price stability may be difficult, especially in light of the current federal budget deficit, which is above projections due in significant part to lower than anticipated tax revenues. Having only recently established itself, the Russian banking sector is weak, as evidenced by three of Russia's largest banks having either been closed or reorganized during 1996, and it has not been a consistent source of liquidity to Russian companies. Due to the tight money supply in Russia, the persistence of certain elements of the command economy and high taxes, a significant problem of payment arrearages exists in the Russian economy, as many companies are unable to make timely payments for goods or services purchased from other companies and owe large amounts of overdue taxes to the federal budget. Many companies have resorted to paying their debts through barter arrangements or through the use of promissory notes. As noted above, Gazprom has been affected by this inter-enterprise debt crisis to a significant extent, as many of its Russian customers are currently unable to pay for the gas Gazprom has sold to them. The failure of many Russian companies to pay full salaries on a regular basis in many sectors of the economy and the failure of salaries to keep pace with inflation have led in the past, and could lead in the future, to a certain amount of social tension. See “—Political Risks.”

The International Monetary Fund has agreed to lend the Russian Federation \$10.2 billion pursuant to an Extended Financing Facility granted in February 1996. The Facility provides for the funds to be disbursed in monthly installments provided that certain macroeconomic targets are met. In July 1996, the International Monetary Fund decided not to disburse that month's installment on the basis that certain of the targets were not met, but it subsequently resumed its monthly disbursements. Government officials have stated that they may seek to re-negotiate certain of the targets.

Legal Risks

Russia is developing the legal framework required by a market economy. Significant legislation has been enacted recently, including two parts of the Civil Code, the Joint Stock Company Law and the Law on the Securities Market. Federal laws, regulations and decrees have also been passed in a number of other areas, including antitrust, privatization, production sharing agreements, property, banking, mining, the environment and bankruptcy. In many instances, however, these enactments establish broad principles and general frameworks, anticipating further legislation, decrees or regulations, which have yet to be enacted. The Law on the Securities Market, for example, anticipates that regulations regarding the securities market will be issued, but this has yet to occur. Certain provisions of a number of laws, regulations and decrees are ambiguous and thus subject to a

variety of different interpretations, the Constitution allows the President to adopt measures having the force of law in the absence of legislation and fundamental legislation remains to be enacted in a number of areas. As a result, there is a degree of legal uncertainty in Russia. Like other Russian companies, Gazprom is continually responding to changes in the legal environment in Russia, and attempting to ensure that all requisite formal documentation is in place.

The Russian judicial system is generally untested and may not be fully independent of outside social, economic or political forces, and Russia has no system of derivative or class action litigation. Accordingly, an investor may find it difficult to seek redress by pursuing an action in Russian courts.

Public Reporting and Registration of Share Transfers in the Russian Securities Market

As noted above, the Law on the Securities Market, which regulates the Russian securities market, has only recently been adopted, and many of its provisions are only beginning to have practical effect. While the Law on the Securities Market contemplates that any company that issues securities to the public will provide periodic reports to the market, regulations implementing this requirement have not yet been adopted; as a result, public information about Russian companies is relatively limited. Under the terms of the Deposit Agreements, RAO Gazprom will provide to the Depositary all the information that RAO Gazprom makes generally available to holders of the Shares, and the Depositary will in turn make such information available to the registered owners of the ADSs. See "Description of the American Depositary Shares—Reports and Other Communications."

Ownership of shares in Russian companies (including the Shares) is established solely by reference to the company's register of shareholders or the records of a depositary. Accordingly, a shareholder's ownership rights are dependent on the accuracy of the register or the records of the depositary and title passes to a transferee only upon registration of the transfer in the register or records, as appropriate. The Shares underlying the ADSs will be registered in the name of a nominee for The Bank of New York, as the ADR Depositary, and no re-registration of Shares underlying the ADSs will be required upon a transfer of the ADSs. If a holder of ADSs exchanges ADSs for Underlying Shares for resale in Russia to a Russian resident, as permitted by the Deposit Agreements, those Shares would have to be re-registered in the name of the transferee.

THE COMPANY

Formation of RAO Gazprom

RAO Gazprom was formed in 1993 in accordance with Decree No. 1333 of November 5, 1992 of the President of the Russian Federation ("Decree No. 1333"). Under Decree No. 1333, RAO Gazprom was made responsible for ensuring the efficient operation and development of Russia's Unified Gas Supply System, which had been vested in its predecessor organization, State Gas Concern Gazprom. RAO Gazprom also was given responsibility for exports of gas, principally through Gazexport, which had become part of State Gas Concern Gazprom in 1991.

Decree No. 1333 charged RAO Gazprom with the following principal tasks:

- ensuring a reliable supply of gas to consumers in the Russian Federation and to foreign customers;
- undertaking a coordinated policy for rebuilding and developing the Unified Gas Supply System;
- financing and constructing gas pipelines and high pressure outlets for bringing gas to the Russian countryside;
- controlling the operation of the Unified Gas Supply System; and
- providing access to the transportation system for any producer of gas in proportion to the amount of gas produced by such producer in the Russian Federation, on condition that the producer observes regulations governing the pricing of gas.

Decree No. 1333 provided for the transfer to RAO Gazprom of the assets of the enterprises comprising the Unified Gas Supply System and the enterprises themselves (which also had rights to hydrocarbon reserves in Russia). In addition, certain entities outside the Unified Gas Supply System were to be converted into joint stock companies in which RAO Gazprom was to have not less than 51% interests. Decree No. 1333 also provided for the transfer to RAO Gazprom of interests in the foreign subsidiaries of State Gas Concern Gazprom.

The Charter of RAO Gazprom was approved by Order No. 138 of the Council of Ministers of the Russian Federation of February 17, 1993, and RAO Gazprom was registered as an open joint stock company on February 25, 1993. All the assets of State Gas Concern Gazprom comprising the Unified Gas Supply System, and its enterprises (with their rights to hydrocarbon reserves in Russia (including all rights to natural gas reserves in Western Siberia)), were transferred to RAO Gazprom, and the remaining assets of State Gas Concern Gazprom were transferred to other companies (including Norilskgazprom and Yakutgazprom, two producers of natural gas in Russia). New licenses with respect to hydrocarbon reserves were issued to Gazprom in 1993 and 1994 under the Subsoil Resource Law of February 1992. In addition, 51% interests in a number of newly formed joint stock companies engaged in activities supporting the Unified Gas Supply System were also transferred to Gazprom. Pursuant to Decree No. 2116 of December 6, 1993 of the President of the Russian Federation, RAO Gazprom was appointed "the State contractor for export deliveries of gas."

Privatization of RAO Gazprom

All RAO Gazprom shares were initially owned by the Russian Federation. As part of RAO Gazprom's privatization, shares representing 15% of RAO Gazprom's capital were sold on preferential terms to Gazprom employees in 1993, and shares representing a further 1.1% of its capital were contributed to Rosgazifikatsiya, the organization responsible for supervising the supply of gas to Russian consumers by regional distribution companies.

Between April and June 1994, Shares representing 33.9% of RAO Gazprom's capital were offered by the Russian Federal Property Fund, on behalf of the Russian Federation, to individual investors in a closed auction in exchange for vouchers. Of this total, Shares representing 28.7% of RAO Gazprom's capital were offered on a regional basis, weighted according to the extent of Gazprom's operations in each of 61 regions. Holders of Soviet Union passports who had been living continually in these regions were eligible to apply for Shares in the auction;

investment trusts, corporate entities and foreign investors were not eligible to participate. Shares representing a further 5.2% of RAO Gazprom's capital were offered in exchange for vouchers to the indigenous people of the Yamal-Nenetsk autonomous region in North Western Siberia, to employees of organizations financed by the budget of the Yamal-Nenetsk region and to employees of organizations contributing to the development of gas fields in the Yamal-Nenetsk region.

The allocation of Shares to specific regions was completed in September 1994, when it was confirmed that 33.03% of the outstanding Shares had been sold through the closed auction to approximately 747,000 individuals. Shares representing the remaining 0.87% of the capital are owned by the Russian Federation, but are not fixed in federal ownership. Since September 1994, a number of the individuals who purchased Shares in the closed auction have resold them to other Russian investors.

On October 2, 1996, RAO Gazprom acquired Shares from Gazfund, pursuant to the pre-emptive rights contained in RAO Gazprom's Charter, for the purpose of offering and selling such Shares in the Global Offering. Gazfund had acquired these Shares in the Russian market.

The following table sets forth the ownership structure of RAO Gazprom at April 1, 1996, in advance of RAO Gazprom's Annual General Meeting on May 31, 1996.

<u>Shareholders</u>	<u>%</u>
Russian Federation(1)	40.87
Russian Shareholders(2)	58.30
Foreign Shareholders	0.83
Total	<u>100.00</u>

- (1) Includes 0.87% of the Shares that are not fixed in federal ownership. Pursuant to a trust agreement, RAO Gazprom is entitled to exercise voting rights on behalf of the Russian Federation with respect to 35% of the Shares.
- (2) At April 1, 1996, entities within Gazprom owned or had interests in 15.87% of the Shares, and Gazprom employees owned or had interests in approximately 13% of the Shares over which Gazprom exercised effective voting influence at the Annual General Meeting held on May 31, 1996.

Corporate Structure of the Company

In accordance with the Government's policy of maintaining an integrated gas industry, RAO Gazprom owns all the transportation assets necessary for the operation of Russia's Unified Gas Supply System and, through certain of its wholly owned "enterprises" described below, has rights with respect to a substantial portion of Russia's gas and gas condensate reserves and certain of its oil reserves. RAO Gazprom is organized into a number of entities, or wholly owned "enterprises," including gas production enterprises, gas transportation enterprises and other enterprises. The "enterprises" are legal persons, but are not joint stock companies. In addition, RAO Gazprom has numerous wholly owned and majority owned subsidiaries.

The head office of RAO Gazprom, located in Moscow, exercises a substantial degree of managerial and financial control over the operations of RAO Gazprom's enterprises and subsidiaries. Head office functions include strategy, planning, external financing, financial reporting, the allocation within the group of financial resources for capital expenditures, and the supervision of principal areas of operations, such as construction, drilling, transportation, gas sales in Russia and the FSU and equipment procurement. Exports to Western and

Eastern Europe are the responsibility of Gazexport, one of the enterprises of RAO Gazprom, which acts as the agent for the head office in respect of sales of gas to these markets. The substantial proportion of cash receipts which arise from Gazprom's export activities through Gazexport reinforce the centralized function of the head office in allocating financial resources for investment throughout the Company.

Operational information, including data on gas volumes produced and transported, is centralized in the head office, which contains a control room monitoring continuously the Company's entire pipeline system within Russia. Financial reporting systems within the Company provide for the preparation of aggregated accounts, and for monitoring of the cash receipts and cash requirements of enterprises and subsidiaries. New financial reporting systems are currently being studied and are expected to be adopted in due course in order to facilitate the efficient preparation of consolidated financial statements in conformity with IAS.

RAO Gazprom's gas and gas condensate production enterprises engage in the exploration for gas and the development and operation of gas fields and related gas processing facilities. The four largest of these enterprises, Urengoigazprom, Yamburggazdobysha, Nadyngazprom and Surgutgazprom in Western Siberia, accounted for approximately 92.8% of Gazprom's total gas production in 1995. In addition to its primary functions, Surgutgazprom also engages in gas transportation.

Each of the specialized gas transportation enterprises is responsible for the transportation of gas along the trunk pipelines, and the supply of gas to customers, within its region. The remaining enterprises are responsible for a number of other functions, including control of the pipeline system as a whole, research and development, and data processing and other functions.

RAO Gazprom's wholly owned and majority owned subsidiaries are engaged in engineering, research and other activities supporting the operations of the Unified Gas Supply System, as well as other businesses such as manufacturing, construction and banking. Gazprom also participates in a number of gas transportation and marketing joint ventures involving foreign partners. See "Business—Strategy, Joint Ventures in Europe and Other Investments."

The enterprises which form the core of Gazprom's business are shown below:

Gas production enterprises

Astrakhangazprom*
Kubangazprom*
Nadyngazprom
Orenburggazprom*

Severgazprom*
Surgutgazprom*
Urengoigazprom
Yamburggazdobysha

* Also engages in gas transportation.

Gas transportation enterprises

Bashtransgaz
Dagestangazprom
Kavkaztransgaz
Lentransgaz
Mostransgaz
Permtransgaz
Samaratransgaz

Tattransgaz
Tomsktransgaz
Tyumentransgaz
Uraltransgaz
Volgogradtransgaz
Volgotransgaz
Yugtransgaz

Other enterprises supporting the core gas operations (activity)

Central Industrial Dispatching Division	<i>Gas transportation control</i>
Central Technological Telecommunication	<i>Telecommunications</i>
Gas Supervision Department	<i>Inspection of pipelines</i>
Gazexport	<i>Gas exports to Western and Eastern Europe</i>
Gazflot	<i>Offshore construction</i>
Gazkomplektimpex	<i>Import of equipment</i>
Gazkompromselstroj	<i>Supply of goods for employees, construction</i>
Gazobezopasnost	<i>Safety and security services</i>
Information and Advertising Centre	<i>Public relations, trading</i>
Informgaz	<i>Data processing</i>
Novyi Urengoi Gas Chemical Complex	<i>Ethylene project</i>
Tyumenburgaz	<i>Drilling</i>
Tyumengazsnabkomplekt	<i>Equipment supply</i>
Tyumengazsvyaz	<i>Telecommunications</i>
Tyumenniigiprogaz	<i>Research institute</i>
Vniigaz	<i>Research institute</i>

Management

RAO Gazprom is governed by its Board of Directors and its Management Committee. The Board of Directors includes three members who hold positions in federal bodies, one representative of the Yamal-Nenetsk autonomous region and five representatives of RAO Gazprom, including the Chairman of its Management Committee, Mr. R. Vyakhirev.

The Board of Directors of RAO Gazprom is responsible for the general management of the Company, except for those matters that, as a matter of law, are within the exclusive competence of the shareholders. The Board of Directors, among other things, has certain powers that it may not delegate to others. These include the power to determine the priorities for the development of RAO Gazprom; to call shareholders' meetings and determine their agendas; to determine the record date for shareholders' meetings and dividends; to increase the charter capital of RAO Gazprom by increasing the nominal value of existing Shares, by issuing authorized but unissued shares or by converting other RAO Gazprom securities into shares; to issue bonds or other securities of RAO Gazprom; to form the executive bodies of RAO Gazprom (including the Management Committee), to decide on the early termination of the powers of these bodies and to determine the remuneration of their members; to repurchase securities of RAO Gazprom by tender offer; to declare interim dividends and recommend annual dividends; to use the reserve fund and other funds; to open branches and representative offices; to adopt decisions on certain major transactions and certain interested-party transactions; to approve the contract with any person that will carry out the powers of any executive body of RAO Gazprom; and to approve the regulations of the Management Committee.

Members of the Board of Directors are elected by the Shareholders, through a system of cumulative voting, for terms of one year and may be re-elected without limitation. The Shareholders also have the power to terminate the authority of members of the Board. Under the Charter of RAO Gazprom, the Board of Directors cannot include a majority of Directors who are also members of the Management Committee, and there must be at least nine Directors at all times. The Chairman of the Board of Directors is elected by the Board itself from among its members, by a two thirds' majority. The Chairman of the Management Committee cannot also serve as the Chairman of the Board of Directors.

The Management Committee, together with its Chairman, is the executive body for RAO Gazprom and generally is charged with responsibility for the implementation of the decisions of the shareholders' meetings and of the Board of Directors. Members of the Management Committee are elected by the Board of Directors for periods of five years. The Board has the right to terminate the authority of the Management Committee and

its Chairman. The competence of the Management Committee includes preparation and submission to the Board of Directors of the long-term projects and fundamental programs of RAO Gazprom; management of gas flows and supervision of the functioning of the Unified Gas Supply System; decisions on contributions by subsidiaries of RAO Gazprom to the financing of production, scientific, technical, social and ecological programs; determination of price levels and certain other matters relating to the supply of gas and other products; approval of certain matters relating to the trading of the Shares in the secondary market; approval of certain matters relating to the Company's accounts; and timely submission of financial reports and other information to the relevant bodies, including regulatory authorities, shareholders, lenders and the mass media.

The Chairman of the Management Committee may act on behalf of RAO Gazprom without a power of attorney. He may issue orders and other internal documents of RAO Gazprom, approve personnel and decide when to hold meetings of the Management Committee, and he is generally empowered to decide on questions that are not within the exclusive competence of the shareholders or the Board of Directors, or the competence of the Management Committee.

In practice, the Board of Directors is responsible for the strategic direction of Gazprom, and the Management Committee is responsible for implementing these strategies and for the overall management of the Company.

Membership of the Board of Directors is as follows:

<u>Name</u>	<u>Year of Birth</u>	<u>Position</u>
A Kazakov	1948	Chairman of the Board of Directors (and Deputy Head of the Presidential Administration of the Russian Federation)
R Vyakhirev	1934	Deputy Chairman of the Board of Directors (and Chairman of the Management Committee of RAO Gazprom)
A Vavilov	1961	First Deputy Minister of Finance of the Russian Federation
V Dinkov	1924	Deputy Head of the Secretariat of the Intergovernmental Council on Oil and Gas, Chairman of the Tender Committee
L Mironov	1943	Chairman of the Board of the Union of Workers of the Oil and Gas and Construction Sectors
N Mocherniouk ..	1935	Director General of the Belarus state enterprise Beltransgaz
Y Neelov	1952	Head of the Administration of the Yamal-Nenetsk Autonomous Region
P Rodionov	1951	Minister of Fuel and Energy of the Russian Federation
V Chumakov	1936	Director General of Yugtransgaz (a subsidiary of RAO Gazprom)
V Sheremet	1941	Deputy Chairman of the Management Committee of RAO Gazprom
V Shugorev	1936	Director General of Astrakhangazprom (a subsidiary of RAO Gazprom)

The Management Committee of RAO Gazprom consists of the following senior executives of RAO Gazprom and certain major enterprises of Gazprom (with main areas of responsibility):

<u>Name</u>	<u>Year of Birth</u>	<u>Position</u>
R Vyakhirev	1934	Chairman of the Management Committee
V Sheremet	1941	Deputy Chairman of the Management Committee (Capital Investments)
B Budzulyak	1946	Management Committee Member (Transportation)
S Derezhov	1932	Management Committee Member (Foreign Economic Activities)
N Guslisty	1933	Management Committee Member (Construction), General Director of Gazkompromselstroi
B Nikitin	1940	Management Committee Member (Drilling), General Director of AO Rosshelf
V Pochinkin	1936	Management Committee Member (Equipment and Technical Supplies)
A Pushkin	1952	Management Committee Member (Gas Sales)
V Rezenenko	1935	Management Committee Member (Planning of Long-Term Development)
V Remizov	1948	Management Committee Member (Strategy)
A Semenyaka	1965	Management Committee Member (Securities)

The following are brief biographies of the members of the Management Committee of RAO Gazprom:

Vyakhirev, Rem Ivanovich—Since 1987, Mr. Vyakhirev has held positions as First Deputy Minister of the Gas Industry of the USSR, Deputy Chairman of the Management Committee of State Gas Concern Gazprom and Acting Chairman of the Management Committee of State Gas Concern Gazprom. He currently is Chairman of the Management Committee and a member of the Board of Directors of RAO Gazprom.

Sheremet, Vyacheslav Vasilievich—Since 1987, Mr. Sheremet has held positions as Deputy Minister of the Gas Industry of the USSR, First Deputy Minister of the Gas Industry of the USSR, Deputy Chairman of the Management Committee of State Gas Concern Gazprom and Head of the Capital Construction Division of State Gas Concern Gazprom. He currently has responsibility for capital investments and is Deputy Chairman of the Management Committee and a member of the Board of Directors of RAO Gazprom.

Budzulyak, Bogdan Vladimirovich—Since 1987, Mr. Budzulyak has held positions as General Director of Severgazprom, member of the Management Committee of State Gas Concern Gazprom and Head of the Production Division of State Gas Concern Gazprom. He currently has responsibility for gas transportation.

Derezhov, Stepan Romanovich—Since 1987, Mr. Derezhov has held positions as Deputy Minister of the Gas Industry of the USSR and member of the Management Committee, Head of the Foreign Economic Department and General Director of Gazexport. He currently has responsibility for foreign economic activities.

Guslisty, Nikolai Nikiforovich—Since 1987, Mr. Guslisty has held positions as Head of the Senior Division for Supplies to Employees of the Ministry of Gas Industry of the USSR, member of the Management Committee of State Gas Concern Gazprom and Head of the Senior Division for Supplies to Employees of State Gas Concern Gazprom. He is currently General Director of Gazkompromselstroi, which is involved in construction activities.

Nikitin, Boris Alexandrovich—Since 1987, Mr. Nikitin has held positions as Deputy Minister of Geology of the RSFSR, Deputy Head of the Senior Division for the Exploration and Development of Offshore Oil and Gas Deposits, Deputy Minister and First Deputy Minister of the Oil Industry and Vice President of the Russian State Corporation Rosneftegaz. He currently has responsibility for the drilling activities of the Company. He is also General Director of AO Rosshelf.

Pochinkin, Valentin Vladimirovich—Since 1987, Mr. Pochinkin has held positions as Deputy Head of the Senior Division for the Exploration and Development of Offshore Oil and Gas Fields, Head of the Senior Logistics Division and member of the Collegium of the Ministry of Gas Industry of the USSR, member of the Management Committee of State Gas Concern Gazprom and General Director of Gazkomplektimpex, which is involved in the importation of equipment. He is currently responsible for equipment and technical supplies.

Pushkin, Alexander Alexeyevich—From 1987 to 1994, Mr. Pushkin was General Director of Surgutgazprom. He is currently responsible for gas supplies to the Commonwealth of Independent States and for sales of condensate and oil products to that region.

Rezunenko, Vladimir Ivanovich—Since 1987, Mr. Rezunenko has held positions as Deputy Head and Chief Engineer of the Ukgazprom industrial association, Head of the Senior Division of Geology, Development and Production of Gas and member of the Collegium of the Ministry of Gas Industry of the USSR, and Head of the Division for Prospective Development of State Gas Concern Gazprom. He is currently responsible for the planning of long-term development.

Remizov, Valeri Vladimirovich—From 1987, Mr. Remizov was General Director of Nadymgazprom. He is currently responsible for strategy.

Semenyaka, Alexander Nikolayevich—Since 1988, Mr. Semenyaka has held positions as a leading specialist of the National Market Research Institute of the Ministry of Foreign Economic Relations of the USSR and the Russian Federation, President of an information agency, Analysis, Consulting and Marketing (AK&M), President of the Federal Stock Corporation and President of "Gorizont" Investment Company. He is currently responsible for securities.

Compensation and Share Ownership

The total aggregate remuneration, including base salary, bonuses and benefits in kind, paid, accrued or granted by Gazprom to all members of the Board of Directors and members of the Management Committee for services rendered during the last financial year was approximately Rbl 900,000,000. At September 30, 1996, the total of the interests of the members of the Board of Directors and of the Management Committee in the share capital of RAO Gazprom, together with any options in respect of such share capital, was 15,935,000 Shares, approximately 0.07% of the share capital.

Employees

The Company employed approximately 375,000 people at December 31, 1995. The approximate number of employees at December 31, 1995 by business activity is given below:

<u>Type of Activity</u>	<u>1995</u>
Drilling	20,000
Production and processing	200,000
Transportation	60,000
Construction	70,000
Other businesses	25,000
Total	<u>375,000</u>

The total number of employees of Gazprom was approximately 330,500 and 367,000 at December 31, 1993 and 1994, respectively.

REASONS FOR THE GLOBAL OFFERING AND USE OF PROCEEDS

RAO Gazprom is offering the Offered ADSs in the Global Offering in order to establish an international market for its ADSs, and thus to facilitate access to the international capital markets in the future, and to finance certain capital investments.

The total proceeds of the Global Offering are expected to be approximately \$373.3 million (or approximately \$429.3 million if the over-allotment option is exercised in full), prior to the deduction of underwriting commissions of 4.2% and expenses of approximately 1%. Any gain realized by RAO Gazprom on the sale of the Underlying Shares as part of the Global Offering will be included in RAO Gazprom's income and is likely to be subject to profits tax. On this basis, the after-tax net proceeds of the Global Offering are expected to be in the region of \$200 million (or in the region of \$230 million if the over-allotment option is exercised in full). RAO Gazprom intends to use these proceeds in order to increase its capacity for exporting gas to Europe and, in particular, towards the cost of constructing the two parallel pipelines comprising the Yamal-Europe project.

DIVIDENDS

RAO Gazprom may declare annual dividends on the Shares by resolution of a simple majority of the Shareholders up to the amount recommended by the Board of Directors. In addition, the Board of Directors may declare interim dividends on the Shares, without the vote of the Shareholders. Dividends may only be paid in respect of any year from the net profit of RAO Gazprom for that year, determined on an unconsolidated basis (parent company only) in accordance with RAR. RAO Gazprom declared a dividend of Rbl 20 (\$0.004) per Share in respect of each of 1995 and 1994 and no dividend in respect of 1993. The amount of any future dividends will depend on RAO Gazprom's results of operations, cash requirements and other factors.

Owners of ADSs will be entitled to any dividends paid on the Shares represented thereby. Cash dividends will be paid to the Depositary in rubles (after deduction of withholding tax) and, except as otherwise described under "Description of the American Depositary Shares—Dividends, Other Distributions and Rights," will be converted by the Depositary into dollars and distributed to owners of ADSs. Owners of ADSs must rely on the procedures of DTC and its participants (including the Euroclear System and Cedel Bank, société anonyme) for the distribution of cash dividends. See "Taxation" for a discussion of the tax consequences for owners of ADSs of the payment of dividends by RAO Gazprom.

CAPITALIZATION

The following table sets forth RAO Gazprom's consolidated short-term loans and current portion of long-term borrowings and capitalization at December 31, 1995 based on RAO Gazprom's consolidated balance sheet prepared in accordance with IAS and included in "Financial Information."

	At December 31, 1995	
	(in billions of rubles)	(in millions of dollars(1))
Short-term loans and current portion of long-term borrowings	1,721	371
Long-term borrowings	6,754	1,456
Shareholders' equity		
Share capital	237	51
Retained earnings and other reserves	307,950	66,369
Total shareholders' equity	308,187	66,420
Total capitalization	314,941	67,875

(1) Totals may not add due to rounding. The dollar amounts shown above have been translated from the ruble amounts at the rate of Rbl 4,640 = \$1.00, which is the rate published by the Central Bank on December 29, 1995. These dollar amounts are provided for convenience only and should not be construed as representations that the ruble amounts have been or could be converted into dollars at that or any other rate.

Consolidated cash and cash equivalents were Rbl 6,179 billion (\$1,332 million) at December 31, 1995. Consolidated long-term borrowings of RAO Gazprom at June 30, 1996 were approximately Rbl 10,372 billion.

There has been no material change in the consolidated short-term loans and current portion of long-term borrowings and capitalization of RAO Gazprom since December 31, 1995. RAO Gazprom has not prepared any interim consolidated financial statements in respect of any period in 1996. See "Risk Factors—Limited Availability of Financial Information."

EXCHANGE RATES AND EXCHANGE CONTROLS

The value of the ruble depreciated significantly against the dollar from 1991 through the first half of 1995, but has stabilized since then, in part due to new policies adopted by the Central Bank. See "Risk Factors—Risks Relating to the Company—Exchange Rate Risks." The ruble/dollar exchange rate, published by the Central Bank and expressed as a number of rubles per \$1.00, was Rbl 167, Rbl 416, Rbl 1,247, Rbl 3,550 and Rbl 4,640 at year-end 1991, 1992, 1993, 1994 and 1995, respectively. The rate on September 30, 1996 was Rbl 5,396 per \$1.00.

Any dividends declared by RAO Gazprom on the Shares represented by the ADSs will be paid in rubles and converted by the Depositary into dollars for distribution to owners of the ADSs. See "Description of the American Depositary Shares—Dividends, Other Distributions and Rights." Accordingly, fluctuations in the value of the ruble against the dollar will affect the dollar amount of any dividends received by the holders of the ADSs. Similarly, such fluctuations will also affect the dollar value of any ruble proceeds received from a sale in Russia to a Russian resident of ADSs or Shares that are withdrawn from the deposit facilities in accordance with the terms of the Deposit Agreements. See "Description of the American Depositary Shares—Deposit, Transfer and Withdrawal—Rule 144A ADRs" and "—Deposit, Transfer and Withdrawal—Regulation S ADRs."

Under Russian currency control laws, ruble dividends on the Shares may be paid to the Depositary (or its nominee) and converted into dollars by the Depositary for distribution to owners of ADSs without restriction. Moreover, ADSs may be sold by a non-resident of Russia for dollars outside Russia without regard to Russian currency control laws so long as the buyer is not a Russian resident.

Under the terms of the Deposit Agreements, there is no restriction on the sale of ADSs in Russia to Russian residents (except that, because the ADSs are foreign securities, Russian residents must obtain a Central Bank license to purchase them), and Shares may be withdrawn from the deposit arrangements only in connection with a sale in Russia to a Russian resident. Conversion of ADSs into Shares will require a Central Bank license. Russian currency control laws will affect the ability of a non-resident of Russia to sell Shares in Russia to a

Russian resident. Russian residents generally must purchase securities for rubles (unless a Central Bank license is obtained), and rubles may not lawfully be transferred out of Russia. In order for a non-resident of Russia to repatriate the ruble proceeds derived from sale of securities in Russia, the ruble proceeds must first be converted into dollars (or another hard currency) through a special account opened at a bank in Russia. Accordingly, a non-resident of Russia who intends to sell ADSs or Shares in Russia will be required to open such an account in order to repatriate the proceeds from such a sale. These arrangements, together with applicable conversion fees, may increase the cost of repatriation. Furthermore, the actual transfer within, and the remittance of funds out of, Russia can be delayed due to weaknesses in the existing banking infrastructure.

The ability of the Depositary and other persons to convert rubles into dollars (or another hard currency) is also subject to the availability of dollars (or such other hard currency) in Russia's currency markets.

THE TRADING MARKET FOR RAO GAZPROM SHARES

The Russian market in equity securities began with the trading of privatization vouchers, which were issued in connection with the mass privatization program launched by the Government in 1992. There are now several stock exchanges in Russia, but most transactions in shares (in terms of value) are effected in the over-the-counter ("OTC") market. Most trading in the OTC market is effected through Russian investment institutions or banks, which have access to manual and computerized quotes, can register trades and can facilitate transfers of shares in the issuer's share register. A significant portion of all OTC trading in Moscow is carried out in the Russian Trading System (the "RTS"), an electronic system in which the shares of more than 100 companies are traded. The RTS is managed mainly by the National Association of Stock Market Participants ("NAUFOR", formerly PAUFOR), a self-regulatory body that has developed rules for trading in the RTS. One NAUFOR rule requires members to make firm price quotations and report trades within 10 minutes.

In general, foreign investors may engage in transactions in equity securities on the same terms as Russian investors, although in some cases foreign participation is restricted by legislation or by the charter or operating procedures of the issuer of the securities. The purchase, sale and repatriation of profits is regulated by the Central Bank, and non-residents must use special accounts when conducting these transactions. See "Exchange Rates and Exchange Controls."

The Law on the Securities Market, adopted in early 1996, codified the legal framework for Russia's securities market. Under this law, the Federal Commission on the Securities Market was given significant regulatory responsibilities.

RAO Gazprom's Charter gives RAO Gazprom pre-emptive and approval rights over transfers of Shares by a Russian Shareholder to a foreign investor, pre-emptive rights over transfers of Shares by a Russian Shareholder to a Russian investor and approval rights over transfers of Shares by any Shareholder to another investor if the transferee would acquire more than 3% of the voting rights in RAO Gazprom as a result of the transaction. See "Description of the Shares—Transfer of Shares." In addition, the Deposit Agreements will provide that Shares may not be deposited into the deposit facilities against the issuance of ADSs without the written consent of the Management Committee of RAO Gazprom. See "Description of the American Depositary Shares—Deposit, Transfer and Withdrawal—Rule 144A ADRs" and "—Deposit, Transfer and Withdrawal—Regulation S ADRs." For so long as Shares are legitimately owned by foreign investors, they are not subject to the pre-emptive and approval rights which RAO Gazprom has under its Charter (other than the right, described above, to approve acquisitions giving a transferee more than 3% of its voting shares), and the ADSs will not be subject to such rights, regardless of whether they are owned by foreign or by Russian investors. The Management Committee of RAO Gazprom may decide in the future to approve the transfer to the Depositary of additional Shares that would result in the Depositary owning more than 3% of the Shares, on the condition that certain provisions are set forth in the Deposit Agreements with respect to the voting of such Shares. See "Description of the American Depositary Shares—Voting of Deposited Securities." If the Underlying Shares are withdrawn from the deposit facilities for sale in Russia to a Russian resident they will, upon such sale, become subject to all such rights.

RAO Gazprom did not exercise its pre-emptive rights in 1995, and it exercised its pre-emptive rights with respect to 0.125% of the Shares in the first eight months of 1996 (including in connection with the Federal Stock Corporation (the "FSC") auctions described below). Other purchases of Shares by RAO Gazprom or its enterprises or subsidiaries in 1996 were immaterial.

It is RAO Gazprom's policy to maintain as complete a separation as is practicable between the Russian and international trading markets for its Shares and ADSs through the application of its pre-emptive, approval and consent rights described above. Any scheme to bridge the gap between the two markets, for example through the purchase of Shares in Russia and the issuance of derivative instruments internationally, will be examined very carefully by RAO Gazprom.

The Russian Market

RAO Gazprom Shares have traded in Russia primarily in the OTC market, which is unorganized. In early 1996, however, an organized auction market was established by the FSC. The FSC is an open joint stock company established in 1994 with the participation of Russian governmental authorities for the purpose of supporting, at the federal level, investment in Russian companies at the cash privatization stage and monitoring such investment in the regions. FSC shareholders include a number of state-owned entities, such as the Russian Federal Property Fund and regional property funds, as well as some of the more experienced investment companies which participate in Russia's stock market. The FSC operates by organizing nationwide and interregional specialized auctions to sell packages of shares in privatized Russian companies by way of both open and closed tenders. The FSC has 120 regional partners who support the operation of the market, and information on the auctions is supplied to the Russian press and international news agencies.

In March 1996, the FSC commenced a program of auctions in RAO Gazprom Shares. Participation in the FSC auctions is limited to Russian residents. The auctions have increased in regularity and size and are usually held once a week. It is expected that the frequency of the auctions will increase further, and as a result a more liquid market for the Shares in Russia may develop.

The following table sets forth the average prices and the volume of Shares sold in each of the auctions held through September 30, 1996:

<u>Date of Auction</u> <u>(1996)</u>	<u>Average Price per Share</u> <u>(Rbl)</u>	<u>Number of Shares</u> <u>(thousands)</u>
March 6	406.60	2,500
March 21	448.73	3,750
April 4	432.93	3,750
April 11	436.20	3,750
April 25	432.75	4,000
May 15	455.67	3,750
May 21	463.37	3,750
May 29	466.78	4,500
June 5	501.05	5,000
June 11	534.48	6,250
June 18	774.28	6,250
June 26	1,343.83	7,500
July 2	1,420.00	7,500
July 8	1,438.00	7,500
July 17	1,517.97	7,500
July 24	1,637.66	8,750
August 2	2,082.20	10,000
August 9	2,535.71	11,250
August 16	2,871.20	11,250
August 22	2,891.00	11,250
August 29	2,901.48	10,000
September 4	2,902.05	10,000
September 12	2,922.55	10,000
September 19	2,941.48	10,000
September 30	2,946.93	10,000

Source: Federal Stock Corporation

The auctions are managed by the FSC in coordination with RAO Gazprom. Based on the results of the previous auction, the FSC announces the number of lots of 250,000 Shares each that may be sold in the next auction. By not later than an established day (usually four days before the auction), Shareholders may submit to the FSC offers to sell Shares, specifying the number of lots and the minimum price at which they are prepared to sell. By not later than three days before the auction, the FSC compiles the offers and presents them to RAO Gazprom, omitting the names of the Shareholders. RAO Gazprom must decide by not later than two days before the auction which lots it will purchase pursuant to its pre-emptive rights (although its pre-emptive rights do not apply to Shares to be traded in an auction if they have been traded in a previous auction). Lots not purchased by RAO Gazprom are selected for an auction in accordance with a regulated procedure which takes into account a number of factors, including the number of lots to be sold, the number of lots traded in previous auctions and thus not subject to pre-emptive rights and the prices proposed by prospective sellers. Each lot is initially offered at a price equal to 95% of the average price in the previous auction and is sold to the highest bidder.

Any Shares to be sold through the auctions must be deposited with a depositary, currently Gazprombank. Settlement through the depositary is guaranteed, and re-registration of the Shares at the depositary in the names of the winning bidders is effected immediately upon the transfer of cash by the buyer and generally within five days of the auction.

Once a Share is permitted by RAO Gazprom to be sold in an FSC auction it may thereafter be sold in subsequent auctions without being subject to pre-emptive rights. If, however, a Shareholder wishes at some later time to sell such Shares otherwise than in an auction, the pre-emptive rights would then apply to that sale.

Pursuant to Article 38 of the Charter, RAO Gazprom's Management Committee has issued a temporary regulation defining the procedures to be followed in trading RAO Gazprom Shares in Russia. These procedures are intended to implement the provisions of the Charter. See "Description of the Shares—Transfer of Shares."

The International Market

RAO Gazprom has given its consent to the transfer to foreign investors of Shares representing approximately 0.83% of RAO Gazprom's capital. These Certified Shares are not subject to the pre-emptive and approval rights which RAO Gazprom has under its Charter (other than the right, described above, to approve acquisitions giving a transferee more than 3% of its voting shares), so long as they are legitimately owned by foreign investors.

The Certified Holders, who control substantially all the Certified Shares, have agreed with RAO Gazprom that they will convert all such Certified Shares into ADSs promptly after the Global Offering and not dispose of any such ADSs or Certified Shares until January 1, 1998 except as follows. Prior to 180 days from the date of this Offering Memorandum, Certified Shares or related ADSs may be sold only with the consent of the Global Coordinators (and, in certain cases, RAO Gazprom). After 180 days from the date of this Offering Memorandum, after a further 180 days and on January 1, 1998, approximately 65,400,000 Certified Shares and the related ADSs will be freed from the restriction and thus will be freely tradeable by the Certified Holders. The Certified Holders have also agreed not to sell any derivative instruments relating to the Certified Shares or related ADSs or to pledge the Certified Shares or related ADSs for financing purposes, unless the pledgee agrees to the restrictions set forth above, in each case until January 1, 1998.

On October 2, 1996, the Management Committee of RAO Gazprom gave its consent to the transfer to the Bank of New York, as Depositary, of the Underlying Shares to be represented by the Offered ADSs. The Underlying Shares are expected to be transferred to the Depositary (or its custodian and agent) on October 25, 1996.

The Shares described above are the only Shares that RAO Gazprom has agreed form part of the 9% of its voting share capital which may be owned by foreign investors. Following the Global Offering, 1.83% of the Shares will be recognized by RAO Gazprom as being owned by foreign investors (1.98% if the over-allotment option is exercised in full). These Shares and the related ADSs are not subject to pre-emptive and approval rights under RAO Gazprom's Charter (other than the right, described above, to approve acquisitions giving a transferee more than 3% of its voting shares). As described above, Shares may only be deposited into the deposit facilities with the written consent of the Management Committee of RAO Gazprom (which generally is not expected to be given except in connection with subsequent offers and sales of ADSs by RAO Gazprom) and may only be withdrawn from the deposit facilities in connection with a sale in Russia to a Russian resident; moreover the Certified Holders have accepted certain restrictions on disposals of Certified Shares and related ADSs as described above.

RAO Gazprom intends to use the pre-emptive, approval and consent rights referred to above to preserve for itself the ability to sell to foreign investors the remaining Shares permitted by the Charter to be owned by foreign investors. RAO Gazprom plans to do this through subsequent offerings of ADSs in the international capital markets over the next several years, subject to market conditions.

BUSINESS

Gazprom is one of the world's leading integrated natural gas companies and the world's largest producer of natural gas, with total production of 559.5 bcm of gas in 1995. Gazprom estimates that it accounted for approximately 94% of Russia's natural gas production, and approximately 23% of the world's natural gas production, in 1995. Gazprom is the largest supplier of gas to both Western Europe and Eastern Europe, and supplies substantially all the gas consumed in Russia and in certain other countries of the FSU. The Company exported 117.4 bcm of natural gas to Europe, and a further 73.2 bcm to the FSU, in 1995.

At December 31, 1995 wholly owned Gazprom enterprises held production licenses for 28.6 tcm of A, B and C₁ natural gas reserves and majority owned subsidiaries of Gazprom held production licenses for another 4.4 tcm of A, B and C₁ gas reserves. Gazprom's total A, B and C₁ gas reserves of 32.9 tcm is equivalent to approximately two thirds of Russia's estimated total A, B and C₁ gas reserves. In addition, Gazprom held production licenses for approximately 1.2 billion tonnes of A, B and C₁ gas condensate reserves, or approximately two thirds of Russia's estimated total gas A, B and C₁ condensate reserves, and approximately 627.4 million tonnes of A, B and C₁ oil reserves. At December 31, 1995, Gazprom operated approximately 4,700 producing wells and 116 installations for preparing gas.

Gazprom owns and operates Russia's Unified Gas Supply System, which includes the world's largest gas transmission network owned by any company. Gazprom's pipeline network transports substantially all the natural gas that is produced in Russia and includes approximately 144,563 km of pipelines. The network is powered by 245 compressor installations with a total capacity of approximately 40,256 megawatts. Gazprom also operates underground gas storage sites in Russia with a total active capacity of approximately 54.0 bcm.

For a description of the origins of the Company and its corporate structure, see "The Company."

Gazprom's Principal Markets

Gazprom estimates that it supplied approximately 21% and 56% of the natural gas consumed in Western Europe and Eastern Europe, respectively, in 1995 and also supplied substantially all the natural gas consumed in Russia and in certain other countries of the FSU in that year. Germany, Italy and France accounted for Gazprom's largest deliveries in Western Europe; the Czech Republic and Slovakia accounted for Gazprom's largest deliveries in Eastern Europe; and Ukraine and Belarus accounted for Gazprom's largest deliveries in the FSU.

The following table sets forth Gazprom's deliveries of gas in each of Gazprom's markets. For additional information on volume and revenue, see "Financial Review."

Gas Deliveries	Year Ended December 31,			
	1993 (bcm)	1994 (bcm)	1995 (bcm)	1995 (%)
Western Europe	64.9	69.2	75.1	15.1
Eastern Europe	35.9	36.7	42.3	8.5
Total Europe	100.8	105.9	117.4	23.6
FSU (excluding Russia)	78.5	78.4	73.2	14.8
Russia	349.5	317.8	306.1	61.6
Total FSU (including Russia)	428.0	396.2	379.3	76.4
Total (1)	528.8	502.1	496.7	100%

- (1) Gas deliveries cannot be correlated with the sales reflected in the consolidated financial information as such sales are based on consideration received as opposed to when gas deliveries are made. Includes significant deliveries to certain export customers for which Gazprom receives no direct revenues but is reimbursed to a certain extent by the Government. These deliveries relate to gas supply contracts (i.e., the Yamburg Agreement) signed by Soviet authorities with East European governments beginning in 1985, prior to the creation of RAO Gazprom. In 1995, 13.8 bcm of gas were delivered under the Yamburg Agreement (3.5 bcm to Germany and 10.3 bcm to Eastern Europe). With respect to Western Europe, also includes deliveries of 2.8 bcm of gas to Turkey that are subject to arrangements with respect to the Federal Share. Finally, includes significant deliveries to Russian and other FSU customers for which payment has not yet been received. See "Financial Review."

According to Cedigaz, in 1995, imports of gas to Europe from outside the region accounted for approximately 36% of gas consumed in Europe in that year and Russian gas accounted for approximately 75% of all the gas imported from outside the region. As of January 1, 1996, Gazprom had long term contracts for the supply of 1,578 bcm of gas to Europe through 2010.

Assuming export capacity increases as planned, RAO Gazprom believes that it has a long term competitive advantage as a supplier of gas to Europe based on the high proportion of total annual production of gas by Gazprom to the amount of gas required to meet export commitments. The high proportion of total gas production to exports provides Gazprom with the resources to continue to supply export customers in the event of a significant interruption to production. By contrast with gas exports from Russia, gas exports from the Netherlands, Algeria and Norway, the other principal sources of gas traded in Europe, account for a substantially higher proportion of total gas production in each of those countries.

Exports of gas to Europe are controlled by Gazprom through Gazexport, the Company's specialized foreign trading enterprise. Gazexport, which became part of Gazprom in 1991, is the successor organization to Soyuzgazexport, formerly an agency of the Soviet Ministry of Foreign Economic Relations. Gazprom's exports of gas condensate, oil and oil products are also made through Gazexport.

Penetration Levels

Gas penetration of energy markets is critical to the success of gas suppliers. In Europe, gas consumption as a percentage of energy consumption has increased in recent years, primarily due to its price relative to competing fuels, its attractiveness as a controllable and reliable fuel, the growth in gas-fired power generating capacity, an increase in the use of gas in the domestic sector (particularly in Eastern Europe), the decline in the attractiveness of nuclear power and environmental considerations (which have reduced the attractiveness of fuels such as coal). The following table sets forth the levels of consumption of energy and gas for 1993, 1994 and 1995 in each of the markets in which Gazprom delivers gas and the percentage of gas consumption relative to energy consumption in each of those years and markets:

	1993	1994	1995
	(mtoe, except where %)		
Western Europe(1)			
Energy Consumption	1,426.7	1,420.1	1,448.3
Gas Consumption	259.1	261.9	281.2
Gas Consumption as Percentage of Energy Consumption	18.2%	18.4%	19.4%
Eastern Europe(2)			
Energy Consumption	276.0	271.6	276.9
Gas Consumption	54.6	53.9	57.9
Gas Consumption as Percentage of Energy Consumption	19.8%	19.8%	20.9%
FSU (excluding Russia)			
Energy Consumption	383.0	338.3	318.9
Gas Consumption	173.6	158.6	152.2
Gas Consumption as Percentage of Energy Consumption	45.3%	46.9%	47.7%
Russia			
Energy Consumption	735.8	664.5	624.2
Gas Consumption	360.7	335.0	317.9
Gas Consumption as Percentage of Energy Consumption	49.0%	50.4%	50.9%

Source: BP Statistical Review of World Energy 1996

(1) Excluding Andorra, Cyprus, Gibraltar, Greenland, Isle of Man, Liechtenstein, Madeira, Malta and Monaco.

(2) Including the countries referred to in footnote (1) above.

Although trends in demand for gas vary from country to country in Western Europe, average overall demand for gas in Western Europe has increased over the last three years. Gas consumption in Western Europe increased

by 1.1% from 1993 to 1994 and by 7.4% from 1994 to 1995, and it also increased as a percentage of primary energy consumption during each of those years. In 1995, gas penetration of primary energy consumption ranged from 7% in Spain to 43% in the Netherlands. Germany and Italy, Gazprom's major Western European markets, are among the most gas intensive countries in Western Europe with gas accounting for 20% and 28%, respectively, of total energy consumption in those countries in 1995. The share of gas in total energy consumption in Western Europe is projected by the International Energy Agency to continue to increase, principally as a result of greater gas usage in power generation.

While energy consumption in Eastern European markets was relatively stable from 1993 to 1995, gas consumption increased slightly in 1995, which led to an increase in the share of gas in the overall energy market in that year.

Gas consumption in Russia and elsewhere in the FSU represented 25.0% of worldwide gas consumption in 1995. In the FSU, excluding Russia, energy consumption decreased by 16.7% from 1993 to 1995, and gas consumption decreased by 12.3%. In Russia, energy consumption overall decreased by 15.2%, and gas consumption decreased by 11.9%, from 1993 to 1995, mainly as a result of a significant decline in real GDP. The share of gas in total energy consumption has therefore increased in Russia and elsewhere in the FSU.

Western Europe

In Western Europe, the United Kingdom, Italy, Germany, the Netherlands and France are the largest gas markets, with the United Kingdom and Germany being the largest contributors to growth in demand over the past ten years. Gazprom estimates that it had a market share of approximately 21% of total gas consumed in Western Europe in 1995, with estimated market shares of approximately 35% in Germany, 26% in Italy and 34% in France. In Austria, Gazprom estimates that it had a market share of approximately 80% in 1995. Gazprom is the sole supplier of gas to Finland.

The following table sets out Gazprom's gas export volumes to Western European countries for the years 1991 to 1995:

<u>Country</u>	<u>1991</u>	<u>1992</u>	<u>1993</u> (bcm)	<u>1994</u>	<u>1995</u>
Germany	24.4	22.9	25.7	29.6	32.1
Italy	14.5	14.1	13.8	13.8	14.3
France	11.4	12.1	11.6	12.2	13.0
Austria	5.2	5.1	5.3	4.7	6.1
Turkey	4.1	4.5	5.0	5.1	5.7
Finland	2.9	3.0	3.1	3.4	3.5
Switzerland	0.4	0.4	0.4	0.4	0.4
Total	<u>62.9</u>	<u>62.1</u>	<u>64.9</u>	<u>69.2</u>	<u>75.1</u>

Gazprom and its predecessors have delivered gas to Western Europe since the 1970s, and its long record of dealings with Western Europe has given the Company a significant amount of commercial experience. Gazprom supplies its Western European customers through marketing and distribution joint ventures with Western European gas companies, and through long-term contracts, generally for initial periods in excess of 20 years, with Western European gas distributors. See "—Strategy, Joint Ventures in Europe and Other Investments." Outstanding long term gas supply contracts with major Western European customers have remaining terms of between 12 years and 21 years. Most of these contracts contain similar features, including take-or-pay clauses and prices determined by reference to international gas prices, and do not allow for unilateral termination or the re-export of gas. Gazprom's principal Western European customers are Ruhrgas (Germany), SNAM (Italy), Gaz de France (France), and OMV (Austria). Gazprom is paid in hard currency for the gas it sells in Western Europe.

European gas markets are undergoing significant restructuring as a result of increased competition, pressure from large industrial users for more competitive pricing and attempts by the European Union to introduce access by third party producers and distributors to gas pipelines. The rapid expansion of the gas pipeline network in Western Europe, in which Gazprom has played a significant part, has resulted in increased competition among distributors to serve major customers, such as large industrial users and municipal distribution companies. Large industrial users have supported development of alternative sources of supply and the formation of European Union policy on access to pipelines. The European Union is seeking to introduce a policy of limited third party access as an initial stage in the deregulation of the gas industry, but implementation of this policy may take several years.

The development of a more extensive European pipeline network may increase competition between the major sources of gas for meeting European demand, notably Russia, Norway and Algeria. Gazprom's substantial reserves and, in the longer term, the proximity of major Russian gas fields to Europe as compared to the large but more distant gas reserves of Iran and other Middle Eastern countries, are expected to give Gazprom a competitive advantage in the Western European market.

Eastern Europe

In 1995, Gazprom estimates that it had a market share of approximately 56% of total gas consumption in Eastern Europe, with estimated market shares of approximately 96% in its largest market, the Czech Republic and Slovakia, 61% in Poland, and 56% in Hungary. In Romania, Gazprom's estimated market share was approximately 25%. Gazprom is the sole supplier of natural gas to Bulgaria.

The following table sets out gas export volumes to Eastern European countries for the years 1991 to 1995:

<u>Country</u>	<u>1991</u>	<u>1992</u>	<u>1993</u> (bcm)	<u>1994</u>	<u>1995</u>
Czech Republic & Slovakia	13.7	12.8	13.2	13.8	14.9
Poland	7.2	6.7	5.9	6.2	7.2
Hungary	6.0	4.8	5.7	5.3	6.3
Romania	5.4	4.6	4.6	4.5	6.1
Bulgaria	5.7	5.2	4.8	4.7	5.8
Slovenia, Croatia, Bosnia	4.3	3.0	1.7	2.2	2.0
Total(1)	<u>42.3</u>	<u>37.1</u>	<u>35.9</u>	<u>36.7</u>	<u>42.3</u>

(1) Totals may not add due to rounding

Gazprom's supply contracts with its Eastern European customers are typically shorter in length than its contracts with its Western European customers. Gazprom supplies gas in Eastern Europe principally to state-owned gas distribution companies and in certain countries through joint venture gas marketing and distribution companies. Gazprom is paid in dollars for the gas it sells in Eastern Europe. In 1995, 13.8 bcm of gas were delivered under the Yamburg Agreement, of which 3.5 bcm were delivered to Germany and the remainder were delivered to Eastern European countries. See "Financial Review."

The potential for increased competition for Gazprom in Eastern Europe arises mainly from the possibility that state-owned gas distribution companies in the region may seek to add other geographic sources of supply to the Russian gas they purchase from Gazprom.

The FSU (other than Russia)

In 1995 Gazprom exported 73.2 bcm of gas to six countries of the FSU: Ukraine, Belarus, Moldova, Estonia, Latvia and Lithuania. Of this total, approximately 72% constituted exports to Ukraine.

The following table sets out gas export volumes to FSU countries for the years 1991 to 1995:

<u>Country</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
			(bcm)		
Ukraine	78.1	78.1	54.7	57.0	52.8
Belarus	17.3	17.3	16.4	14.3	12.9
Moldova	3.4	3.4	3.1	3.0	3.0
Estonia	0.9	0.8	0.4	0.6	0.7
Latvia	1.6	1.6	0.9	1.0	1.3
Lithuania	3.3	3.2	1.8	2.1	2.5
Kazakhstan	2.0	0.7	1.2	0.4	—
Total(1)	<u>106.6</u>	<u>105.1</u>	<u>78.5</u>	<u>78.4</u>	<u>73.2</u>

(1) Totals may not add due to rounding

Prices in current annual contracts for gas supplied by Gazprom to other FSU countries are based on international market prices. In 1995, prices generally charged by Gazprom (including transit fees) were approximately \$80 per 1,000 cubic meters of gas.

Ukraine, Gazprom's largest FSU customer, is traversed by the major pipeline routes from the gas fields of Western Siberia to export markets in Western Europe and is the source of substantial amounts of industrial supplies for Gazprom, including pipes. Gas exports from Russia to Ukraine are based on annual inter-governmental agreements concerning prices and export volumes. Gazprom is currently dependent on Ukraine to deliver substantially all its gas to Europe and for a significant amount of its storage capacity. At the same time, Ukraine is dependent on Gazprom to meet its domestic gas requirements. Accordingly, this interdependence is taken into account in negotiations over a number of matters, including the terms of payment for gas supplied by Gazprom and transit fees. In 1995, Gazprom contracted to supply gas at a price of \$80 per 1,000 cubic meters from which transit fees were deducted in respect of Russian gas transported to European countries through Ukraine. The agreement provides for partial settlements of Ukraine's payments for gas in industrial equipment exported to Gazprom from pipe mills and other engineering facilities in Ukraine.

The failure of a number of FSU customers to pay Gazprom for supplies delivered has resulted in substantial debts to Gazprom being accrued. See "Financial Review." As of September 1, 1996, gas with a sales value of approximately \$1,268 million (including charges for late payment) had been supplied to customers in the FSU (other than Russia) for which payment had not been received. Substantially all of the amounts owed were due from customers in Moldova, Ukraine and Belarus. In July 1996, Moldova settled \$52 million of arrears by contributing a 50% shareholding to Gazprom in a joint venture, Gazsnabtransit, which owns and operates a gas export pipeline to Bulgaria, Romania and Turkey. Moldova also committed to settle \$140 million of arrears with Government bonds. During 1995, a portion of Ukrainian arrears equal to \$1.4 billion was settled through the issuance to Gazprom of \$1.4 billion face amount of Ukrainian government bonds. Substantially all of these bonds were used by RAO Gazprom in 1996 in settlement of taxes owed to the Russian Federation. Under a recent arrangement with the Government of Belarus, the Russian Government has assumed the debt obligations of customers in Belarus. As recompense, Gazprom expects to receive a tax exemption from the Russian Government for a significant proportion of the debt it was owed.

In other countries of the FSU, Gazprom is arranging for settlement of debt through the acceptance of equity interests in gas distribution companies. For example, an agreement was reached in 1993 under which Gazprom, purchased a 30.6% shareholding in the Estonian gas distribution company Estiigaz in partial settlement of debts for gas supplied by Gazprom. In addition, Gazprom is in negotiations with Belarus regarding the possibility of acquiring an equity interest in Beltransgaz, a gas transportation company, in settlement of certain debts.

Gazprom faces virtually no competition in the FSU countries to which it supplies gas.

Russia

In 1995, Gazprom delivered 306.1 bcm of gas to Russian consumers, which represented 54.7% of Gazprom's total production of 559.5 bcm. During the period from 1992, when Russian gas consumption reached a peak, to 1995, the share of gas in primary energy consumption rose from 46.8% to 50.9%. RAO Gazprom believes that the continuing substitution of natural gas in Russia for other fuels, particularly oil, could offset in part the decline in gas consumption which may result from the emergence of less energy intensive industries in Russia.

In contrast to most other major industrial economies where gas is primarily used for household consumption, in Russia gas is sold principally for use in electricity generation and heavy industry. Electricity generation accounted for 41% of total gas consumption in Russia in 1995, heavy industrial users accounted for 30%, municipal gas companies and other users accounted for 20% and direct consumption by households accounted for 9%.

The distribution activities of Gazprom in the domestic market are focused on delivery to wholesalers rather than final consumers. Approximately 80% of the volume of gas sold by Gazprom within Russia is distributed through third party regional gas distribution companies. The remainder is sold direct to consumers by Gazprom. The transportation enterprises of Gazprom supply gas under three types of contract: (i) contracts with regional distribution companies, (ii) contracts directly with consumers, principally major industrial users such as district heating plants, and (iii) tri-partite contracts between gas transportation enterprises of Gazprom, regional gas distributors and consumers. Gazprom introduced these tri-partite contracts in 1993 in order to develop closer relations with consumers of gas. It is the intention of Gazprom to maintain the proportion of gas it supplies direct to consumers and to increase the proportion of gas it supplies under tri-partite contracts pursuant to which it is paid directly by consumers, although this strategy is generally resisted by the regional distribution companies. Gazprom's supply contracts in Russia have terms of one year.

Gas prices in Russia are regulated by the Government under Presidential Decree No. 220 dated February 28, 1995 and the Resolution of the Russian Government No. 239 dated March 7, 1995. The regulation of wholesale gas prices for industrial consumers in Russia was delegated to the Federal Energy Commission by Government Resolution No. 863 of July 17, 1996. Government Resolution No. 296 of March 27, 1993 established the wholesale prices for industrial consumers, which account for approximately 91% of gross domestic gas sales, and provided for the indexation of such prices in accordance with an established procedure. Wholesale gas prices for households, which account for approximately 9% of gross gas sales in Russia, are also fixed by the Government.

From September 1, 1995 until February 1, 1996, gas prices for industrial consumers were frozen (Government Resolution No. 997 of October 13, 1995).

To improve the economic condition of the general public and certain other energy consumers, Presidential Decree No. 598 of April 22, 1996 introduced certain concessions for households, enterprises providing electricity and heat to the general public and for communal needs, defense enterprises manufacturing equipment for the gas industry, and producers of fertilizers and agrochemicals. Gas was supplied to these categories of consumers at the April 1, 1996 wholesale price (non-indexed) or at a discount.

From April 1, 1996 until August 1, 1996, the indexing of gas prices was suspended. From August 1, 1996, gas prices were indexed to 100% of the wholesale industrial price index pursuant to Government Resolution No. 869 of July 17, 1996.

As of September 1, 1996, the wholesale gas price for industrial consumers (the sales price to gas distributors) was Rbl 251,858 per 1,000 cubic meters and the sales price for households was Rbl 45,000 per 1,000 cubic meters.

Presidential Decree No. 1451, dated October 17, 1996, "On Additional Measures to Limit the Growth of Prices for Products of Natural Monopolies and to Create Conditions for Stabilization of Industries" requires the Government to introduce from January 1, 1997 wholesale gas prices for industrial consumers which will be determined by reference to the cost of transit of gas from production sites through to the consumers (as opposed to being based on a single standard price). Until that date, the wholesale price of gas will be fixed at the indexed price as at October 1, 1996 (Rbl 260,232 per 1,000 cubic meters). The Decree provides that there will be no change in the sales price to households.

Although the details of the new pricing regime for industrial consumers will need to be finalized over the remainder of 1996 (including the relevant transit fees), RAO Gazprom believes that the weighted average of the new wholesale gas prices immediately following the introduction of the regime will not be substantially different to the wholesale gas price as of October 1, 1996.

Delayed payment by Russian customers for deliveries of gas remains a major concern for the Company. Gazprom has supplied gas with a sales value of approximately Rbl 48,350 billion (including charges for late payment) to domestic customers for which payment had not been received at September 1, 1996. RAO Gazprom estimates that it received payments (or other settlement) in 1995 for approximately 62% of the total amount invoiced to Russian customers for gas delivered in 1995. Such payments (or other settlement) include amounts with respect to shipments made in prior years, as well as in 1995, and thus do not indicate the collectibility of the sales value of gas delivered in 1995.

Presidential Decree No. 1451 also requires the Government to establish a procedure to partially extinguish the debts of Russian customers to Gazprom, subject to those customers continuing to make timely contractual payments for gas deliveries. The procedure is to include, among other debts, those in respect of gas delivered to avoid emergencies during the period from November 5, 1995 to April 1, 1996 pursuant to Government Resolution No. 1089 dated November 5, 1995 and in respect of gas delivered prior to October 1, 1996 to ensure the continuous functioning of entities that provide for the security of the state under Presidential Decree No. 1173 dated November 23, 1995. For the purposes of the procedure, taxes (including excise taxes) in relation to the gas deliveries represented by the relevant debts will be levied on the actual amounts received, but not less than the cost of production and transit of the gas delivered.

Gazprom faces virtually no competition in the gas market in Russia, but it is subject to certain obligations imposed by the Government of the Russian Federation to supply gas even in circumstances where payment is not made. See "Financial Review."

Reserves and Exploration

The Company estimates its hydrocarbon reserves in accordance with Russian classifications and methodologies. For a discussion of Russian reserves classifications and methodologies, see "Appendix A—Overview of the Russian Gas Industry and its Regulation—Reserves Classifications." Russian reserves classifications and methodologies differ significantly from standard international classifications and methodologies, in particular, with respect to the manner in which and the extent to which commercial factors are taken into account. To date no audit of the reserves of the Company has been conducted in accordance with internationally accepted standards for estimating hydrocarbon reserves. All reserve figures quoted in this document are Gazprom's own reserve figures and are therefore based on Russian classifications and methodologies.

Gazprom's wholly owned enterprises held production licenses for 28.6 tcm of A, B and C₁ gas reserves and its majority owned subsidiaries held production licences for another 4.4 tcm of A, B and C₁ gas reserves. For a breakdown of Gazprom's reserves between A, B and C₁, see "Appendix B—Competent Person's Reserve Report." Gazprom's total A, B and C₁ gas reserves of 32.9 tcm is equivalent to approximately two thirds of Russia's estimated total A, B, and C₁ gas reserves.

Substantially all exploration and production licenses held by Gazprom were granted to the Company in accordance with the Law on Subsoil Resources and the Regulation on the Licensing and Usage of the Subsoil, both of which were adopted in 1992, and were issued in 1993 and 1994. Gazprom currently holds 85 production licenses with terms of 20 years, 14 combined exploration and production licenses with terms of 25 years, and 36 exploration licenses with terms of five years. Extension of licenses upon expiration is subject to approval by the federal and local authorities which are signatories to the licenses. The licenses impose obligations on the Company to provide employment, develop local infrastructure, pay certain local and federal taxes on gas revenues and meet certain requirements relating to environmental matters. Licenses may be revoked if the licensees fail to comply with their terms. See "Appendix A—Overview of the Russian Gas Industry and its Regulation—Regulation—Prospecting and Production Licensing." RAO Gazprom believes the Company is in substantial compliance with all its material licenses.

The Company has a 51% shareholding in a consortium known as AO Rosshelf which was awarded a production license in 1993 in respect of the Shtokmanovskoye gas field in the Barents Sea, with A, B and C₁ reserves of 2.8 tcm of gas. The Company has a majority shareholding in Zapsibgazprom which holds a production license to develop the Yuzhno-Russkoye gas field in the Tyumen region with A, B and C₁ gas reserves of 0.683 tcm. A further 0.91 tcm of A, B and C₁ gas reserves are controlled by the Company through its majority shareholdings in three other companies; (i) Tarkosalineftegaz, which has a production license for 0.407 tcm of A, B and C₁ gas reserves in the East Tarkosalinskoye field, (ii) AO Nordgaz, which has a production license for 0.336 tcm of A, B and C₁ gas reserves in the North Urengoiyskoye field, and (iii) Rospan which has a production license for 0.166 tcm of A, B and C₁ gas reserves in the East Urengoiyskoye field.

Of the total A, B and C₁ gas reserves of 32.9 tcm for which Gazprom's enterprises and its majority owned subsidiaries hold production licenses, 26.0 tcm, or 79%, are located in Western Siberia. Of this total, the Nadym-Pur-Taz region, where most of the gas in Russia is currently produced, accounts for 20.2 tcm, and the Yamal peninsula for 5.8 tcm. The majority of these reserves are located in a few very large gas fields, notably Urengoiyskoye, Bovanenkovskoye, Yamburgskoye, and Zapolyarnoye. The production licenses held by Gazprom include the right to exploit A, B and C₁ gas condensate reserves of 1,254 million tonnes, of which 710.4 million tonnes (56.7%) are located in Western Siberia, and A, B and C₁ oil reserves of 627.4 million tonnes.

The following table sets out a summary of A, B and C₁ reserves of Gazprom for which production licenses had been awarded as at January 1, 1996:

<u>Region</u>	<u>Gas (A+B+C₁) (tcm)</u>	<u>Gas Condensates (A+B+C₁) (million tonnes)</u>	<u>Oil (A+B+C₁) (million tonnes)</u>
Nadym-Pur-Taz	20.2	605.9	244.9
Yamal	5.8	104.5	227.0
Western Siberia Total	26.0	710.4	471.9
Urals-Volga	3.7	485.2	89.7
North European Russia	0.3	34.6	10.9
Northern Caucasus	0.1	3.7	5.3
Barents Sea	2.8	20.1	49.6
Total	<u>32.9(1)</u>	<u>1,254.0(2)</u>	<u>627.4(3)</u>

(1) Includes 4.4 tcm of gas reserves of subsidiaries in which Gazprom has majority shareholdings.

(2) Includes 86.1 million tonnes of gas condensate reserves of subsidiaries in which Gazprom has majority shareholdings.

(3) Includes 105 million tonnes of oil reserves of subsidiaries in which Gazprom has majority shareholdings.

The following table sets out A, B and C₁ gas reserves for which Gazprom held production licenses as at January 1, 1996, by major producing field:

<u>Gas Field</u>	<u>Reserves (A+B+C₁) (tcm)</u>
Western Siberia:	
Urengoiyskoye(1)	7.00
Yamburgskoye	4.00
Medvezhe	0.85
Komsomolskoye	0.70
Urals-Volga region:	
Astrakhanskoye	2.60
Orenburgskoye	1.03

(1) Includes the related fields of North Urengoiyskoye, Pestsovoye and Yen-Yakhinskoye.

The following table sets out A, B and C₁ gas reserves as at January 1, 1996 of Gazprom's major fields which are under development:

<u>Gas Field</u>	<u>Reserves (A+B+C₁) (tcm)</u>
Nadym-Pur-Taz region:	
Zapolyarnoye	3.53
Yamal peninsula:	
Bovanenkovskoye	4.37
Kharasaveiskoye	1.26
Barents Sea:	
Shtokmanovskoye	2.80

Production from the Zapolyarnoye field, located to the east of the Urengoiskoye field, is expected to start from the fourth quarter of 1998. Production from Bovanenkovskoye and Kharasaveiskoye fields, located in the Yamal peninsula, is not expected to begin until 2001 or later, depending on commercial factors.

The most recent substantial addition to the A, B and C₁ reserves of Gazprom is the Shtokmanovskoye field in the Barents Sea. A license to produce gas from the Shtokmanovskoye field, estimated to have A, B and C₁ reserves of 2.8 tcm of gas and 20.3 million tonnes of condensate, was awarded in 1993 to the AO Rosshelf consortium. The Shtokmanovskoye field is not expected to be developed until after the year 2001.

The following table sets out A, B and C₁ gas condensate and oil reserves for which Gazprom held production licenses as at January 1, 1996 by region:

<u>Region</u>	<u>Gas Condensates (A+B+C₁) (million tonnes)</u>	<u>Oil (A+B+C₁) (million tonnes)</u>
Western Siberia:		
Nadym-Pur-Taz region	605.9	244.9
Yamal Peninsula	104.5	227.0
Urals-Volga region	485.2	89.6
Other regions	58.4	65.9
Total	<u>1,254.0</u>	<u>627.4</u>
of which:		
under development	982.6	176.6
prepared for development	271.4	450.8

The availability of substantial A, B and C₁ gas reserves enables Gazprom to maintain a stable approach to exploration based on long-term planning. Exploration of new fields and gas-bearing horizons is carried out close to existing infrastructure in order to maintain production levels and to provide adequate supplies for existing pipelines.

Over the past three years, Gazprom has drilled 115 exploration wells, which Gazprom believes have added approximately 206.7 bcm to its A, B and C₁ gas reserves. The following table sets out the number of wells explored by Gazprom from 1993 to 1995, the number of such wells that are productive and the total A, B and C₁ gas reserves of such wells:

	<u>1993</u>	<u>1994</u>	<u>1995</u>
Number of exploration wells drilled	37	40	38
of which: productive	23	20	19
Addition to gas reserves (bcm)	70.8	65.7	70.2

The Competent Person's Reserve Report set out in Appendix B confirms that the Company's current mineral base would allow Gazprom to achieve increasing production through 2010 according to the production schedule set out in that report. The authors of that report are Vasily A. Ponomarev, the head of the Geology and Development Department of RAO Gazprom, and Lydia A. Shulzhenko, the head of the Reserves Subdivision of the Geology and Development Department of RAO Gazprom.

Production

Gas

In 1995, production by Gazprom of 559.5 bcm of gas accounted for approximately 94% of gas produced in Russia. The remainder of gas production in Russia is undertaken by gas producers independent of Gazprom and by oil companies.

The following table sets out the production balance of Gazprom and Russia by reference to gas transported for the five years 1991 to 1995:

	<u>1991</u>	<u>1992</u>	<u>1993</u> (bcm)	<u>1994</u>	<u>1995</u>
Total gas transported(1)	682.1	647.8	633.2	597.3	586.1
of which: Gazprom production	595.2	596.2	577.7	570.7	559.5
Storage:					
withdrawals	32.5	30.5	28.3	28.6	35.8
additions	34.7	32.4	41.1	47.4	51.7
Changes in gas transit	(0.8)	(0.7)	—	0.6	—
Exports:					
Western Europe	62.9	62.1	65.0	69.2	75.1
Eastern Europe	42.3	37.1	35.9	36.7	42.3
FSU(2)	138.2	129.7	112.8	97.8	92.5
Own consumption/losses(3)	63.5	59.5	57.1	56.3	54.2
Deliveries within Russia	373.8	358.3	349.5	317.8	306.1

(1) Includes gas transported from certain FSU countries.

(2) Export totals to the FSU include deliveries of gas from non-Russian sources, notably Turkmenistan. For exports of Russian gas to FSU countries, see "—Gazprom's Principal Markets—The FSU (other than Russia)."

(3) Within Russia.

Total gas production by Gazprom declined in 1995 by 11.2 bcm, or 2.0% compared with 1994. This decline resulted primarily from a continued reduction in demand for gas from industrial enterprises (including power generators), the major users of gas in Russia. During the period 1991 to 1995, gas production by Gazprom declined by 6% from 595.2 bcm in 1991 to 559.5 bcm in 1995. Deliveries within Russia have declined more than production as a result of a reduction in the amount of gas transported into Russia from other countries of the FSU and an increase in the amount of gas exported and stored.

Output from Western Siberian gas fields accounted in 1995 for 92.8% of total production of gas by the Company. The two largest gas fields, Urengoi and Yamburgskoye, produced 420.7 bcm of gas, or 75.2% of total production by Gazprom in 1995. The following table sets out gas production for Gazprom's major fields for the period 1991 to 1995:

	<u>1991</u>	<u>1992</u>	<u>1993</u> (bcm)	<u>1994</u>	<u>1995</u>
Nadym-Pur-Taz					
Urengoi	291.1	287.6	262.8	249.4	242.9
Yamburgskoye	166.8	178.2	174.0	179.3	177.8
Medvezhe	70.8	69.1	61.1	55.8	49.1
Komsomolskoye	—	—	16.9	26.2	26.0
Yubileinoe	—	—	6.9	8.5	15.2
Vyngapurov	16.3	14.8	11.9	9.8	8.0
Others	0.2	0.2	0.1	0.1	0.3
Total Western Siberia	545.2	549.8	533.7	529.1	519.3
Orenburg	39.5	36.7	34.6	32.6	30.8
Other	10.5	9.7	9.4	9.0	9.4
Total Gazprom	<u>595.2</u>	<u>596.2</u>	<u>577.7</u>	<u>570.7</u>	<u>559.5</u>

Gazprom has the capability to restore production from its Nadym-Pur-Taz gas fields to approximately 550 bcm annually within a short period if demand is sufficient. Gazprom's medium term production strategy is to produce gas in the deeper horizons of existing fields and in a large number of satellite fields. Gazprom is developing new gas fields in the Nadym-Pur-Taz region close to existing transportation and other infrastructure. The largest of these new fields, Zapolyarnoye, has A, B and C₁ reserves of 3.53 tcm. With the addition of the Zapolyarnoye field in 1998, production from the Nadym-Pur-Taz region is expected to be sufficient to meet Gazprom's obligations to export gas through the Yamal-Europe pipelines and to continue to meet domestic requirements. Production in the Yamal peninsula is not expected to begin until 2001 or later, depending on commercial factors.

Gas Condensates

Gas condensate production in 1995 was 7.8 million tonnes, 70% of which was produced from the Urengoi and Yamburgskoye fields. Other major sources of gas condensate production are the Orenburgskoye and Astrakhanskoye fields. The Company's production of condensates in 1995 was equivalent to less than 0.5% of its total reserves of condensates. Gazprom plans to increase production of condensates at the Yamburgskoye field, and to begin production at the Yen-Yakinskoye and North Urengoi fields. The North Urengoi condensate reserves will be developed by Nordgaz, a joint venture in which Gazprom has a 51% shareholding, principally between Gazprom and Bechtel Energy Resources Corporation.

Gazprom processes gas and/or gas condensates at five locations: Orenburg, Astrakhan, Novy Urengoi, Sosnogorsk and Surgut. Gazprom is also constructing a major polyethylene plant at Novy Urengoi, and is evaluating a project to construct a methanol plant at Arkhangelsk.

The Orenburg gas processing plant, constructed during the period 1974 to 1979, processes gas from the Orenburg field and from the Karachaganak gas condensates field in Northern Kazakhstan. The Orenburg plant produces dry purified gas, and is also a major producer of sulfur, propane and butane. The Astrakhan plant is principally involved in producing sulfur from the high-sulfur content gas of the Astrakhanskoye field. At Novy Urengoi, ethane is separated from the gas condensates produced at the Urengoi and Yamburgskoye fields. Gas-free condensates are mixed with crude oil and then transported by a 700 km pipeline to a refinery owned and operated by Surgutgazprom at Surgut where they are stabilized and refined. Some condensate stabilization and processing also takes place locally at Novy Urengoi.

Oil

Gazprom produced approximately 0.89 million tonnes of oil in 1995 from the perimeters of the Urengoiyskoye and Orenburgskoye gas fields. Gazprom plans to increase oil production from these two fields, and production of oil from the Novoportovskoye field in the south east of the Yamal peninsula is envisaged in the medium term.

Gas Transportation and Storage

Gazprom owns and operates Russia's Unified Gas Supply System, which includes the world's largest transmission network owned by any Company, with a total length of 144,563 km of high pressure pipelines. The transmission of gas through the pipeline system is centrally controlled from the Company's central dispatch center in Moscow. Gas for domestic consumption and export is transported an average distance of approximately 2,500 km within Russia, by means of compressor installations with a total installed capacity of approximately 40,256 megawatts. Total gas consumed by the pipeline system (own consumption and losses) was approximately 54 bcm in 1995, of which approximately 85% was accounted for by own consumption and the remainder by technical losses (including leakages). Gas is distributed from the Company's pipeline system to local distribution systems through 3,151 gas distribution stations.

The pipeline system of Gazprom transports gas principally from the large Western Siberian fields westward towards the heavily populated regions of the country, the main export markets of Western and Eastern Europe and certain FSU countries. Other major parts of the pipeline system originate in the smaller but older established gas fields in the Volga-Urals region, including Orenburgskoye and Astrakhanskoye. Several large pipeline systems also enter Russia from gas fields in the Southern Republics, including Azerbaijan, Kazakhstan, Kirgizstan, Tajikistan, Turkmenistan and Uzbekistan.

Substantially all the gas exported by Gazprom to Europe must travel through international transmission systems maintained by other countries, primarily Ukraine. Gazprom pays transit fees for the use of these pipelines, and its negotiations of these transit fees and access to these pipelines are important elements of Gazprom's export business. Transit fees are a significant element of the gas price to end users in Europe.

There are 19 pipelines originating from Western Siberian fields, principally Yamburgskoye, Urengoiyskoye and Medvezhe, which follow three main routes. Of these pipelines, 16 are laid in a similar direction as far as the district around Punga, where the pipes branch into separate northern and central routes. Three other major pipeline systems transport gas towards the main population centers of Russia and its export markets. One system, the Soyuz export pipeline, carries gas from the Orenburgskoye field towards Ukraine. These pipelines pass through the northern edge of Kazakhstan, joining a pipeline system carrying gas from Turkmenistan. A third major pipeline system connects the Moscow region with the Northern Caucasus.

The gas transportation business of Gazprom is organized on a regional basis through specialized gas transportation enterprises and certain production enterprises which also operate pipelines. The gas transportation enterprises are responsible for operating and maintaining the pipelines which pass through their territory, and for supplying gas to regional and local distribution companies and directly to end users. Gazprom has only limited participations in regional and local distribution companies.

The high degree of integration of the pipeline network of Gazprom, achieved by means of interconnectors, parallel pipelines and pipeline systems and underground storage, has contributed to reliability in delivering gas to distributors, export customers and consumers. RAO Gazprom believes that there have been no significant supply interruptions to consumers resulting from pipeline failures within the past 10 years, despite the occurrence of a number of such failures.

The majority of the Company's pipeline system was constructed during the period from 1970 to 1990. The age of the pipeline system as of January 1, 1996 is shown below:

<u>Year Since Construction</u>	<u>Length</u> (km)	<u>%</u>
Up to 10 years	48,903	33.8
10-20 years	49,722	34.4
20-30 years	28,924	20.0
Over 30 years	17,014	11.8
Total	144,563	100.0%

The speed at which pipelines were constructed, at an annual rate of up to 11,000 km, the climate and geographical conditions in areas through which the pipes pass and some of the construction methods used have contributed to the need for continual repair and replacement. Repair and maintenance programs have reduced the incidence of pipeline failures (defined as malfunctions which interrupt transmission of gas) per 1,000 km of pipeline from 0.58 in 1985 to 0.21 in 1995 although most of the improvement occurred in the first five years of this period. Pipeline failures in 1995 arose principally from defective construction and defective steel (35.5% of incidents) and from external, internal and stress corrosion (33.0% of incidents). The external corrosion problems are primarily attributable to an incorrect application of polymeric coating which was used to protect approximately 50% of Gazprom's pipelines. To date, approximately 17,000 km out of 70,000 km protected this way have been repaired, and the pace of future repairs will depend upon the availability of financial resources.

Gazprom is undertaking a number of investment programs to enhance the efficiency and reliability of the pipeline system, based on rehabilitation of pipelines and modernization or replacement of compressors. In the period from 1996 to 2000, Gazprom plans to increase the gas transportation capacity of its pipeline system by a total of 15 bcm per year, through compressor upgrades (11.7 bcm) and pipeline repairs or replacements (3.3 bcm). The equivalent capacity increase achieved during the period from 1991 to 1995, when investment was constrained by the widespread failure of Russian and FSU customers to pay for gas deliveries, was 2 bcm. In 1996, Gazprom expects to achieve efficiencies in excess of 3 bcm of gas through reconstruction of compressor facilities and approximately 530 km of pipelines. Enhanced efficiency of Gazprom's pipeline network should also increase the Company's export capacity.

The efficiency of compressors is being improved through technical co-operation with Russian and international manufacturers of compressor equipment. Under an agreement with an Italian consortium Tragaz, whose members include the gas distribution company SNAM and the compressor manufacturer Nuovo Pignone, Gazprom is modernizing or replacing 161 compressor units. The Company expects to achieve total efficiencies of 5.5 bcm annually when the program is completed in 1998. The investment required is being financed principally on the security of additional gas supplies to Italy made possible by the improved efficiency of the Company's pipeline system.

The status of the Gazprom pipeline system was assessed in September 1995 in a report prepared by 13 specialist international gas consultancies working with Russian specialists nominated by Gazprom. The report was intended to provide an independent Western assessment of the pipeline system, and to identify projects for improving the performance of the pipeline system. Based on the report's conclusions, Gazprom believes that its transportation network is a fundamentally sound system. The multiplicity of pipelines, strengthened by major cross-connections and the integration of excess capacity, comprise a strong system capable of withstanding outages which would adversely affect systems designed to minimize downtime. However, in the course of the development of the pipeline system, access to the latest technology, equipment and know-how was limited and construction was undertaken quickly. As noted above, this has led at times to serious deficiencies in quality and to subsequent maintenance and rehabilitation costs.

Gazprom has active gas storage capacity of 54.0 bcm at 18 locations in Russia, equivalent to 9.5% of aggregate gas production in Russia by Gazprom for 1995. The Company also owns storage capacity in Ukraine of approximately 40 bcm. Transfers in and out of storage in Ukraine are monitored from Russia.

Strategy, Joint Ventures in Europe and Other Investments

Strategy

The Company's primary medium term strategic objective is to increase profits and cash flow. In the current situation, where gas consumption in Russia and the FSU is not growing, the Company plans to do this by expanding its sales to Europe, capturing additional European downstream marketing and distribution margins, securing payment in full for the gas it supplies to customers in the Russian Federation and elsewhere in the FSU and improving the operating efficiency of its transportation business. To the extent that demand for gas recovers in Russia and elsewhere in the FSU, the Company expects to be able to expand production on the basis of existing plans.

Expand Sales to Europe: Gazprom is currently the leading supplier to the expanding European gas market. The Company plans to expand its sales to Europe through an integrated strategy which includes the following:

- *Additional contracted sales through direct marketing:* Through its network of strategic joint ventures with European gas companies, Gazprom is negotiating new long term contracts directly with major industrial end-users and regional and municipal distributors.
- *New export capacity under construction:* To enable increased exports to Europe, Gazprom is currently constructing new trunk pipelines from the northern part of the Tyumen region of Russia through Belarus and Poland to Germany. These pipelines, generally referred to as the Yamal-Europe project, will be completed in sections and will offer greater security of delivery by providing a new export route.
- *Large reserve base and low-cost production:* With a large reserve base and relatively low production costs (as compared to offshore and liquified natural gas production), Gazprom is able to maintain its margins in a competitive environment and expand production in response to increased demand at relatively low marginal cost. The Company plans to meet future supply obligations to Europe through the development of deeper horizons in producing fields, West Siberian satellite fields and, at a later stage, new fields in the Yamal peninsula and through improved transmission efficiencies.

Capture additional European downstream market and distribution margins: Since the 1970's, Gazprom and its predecessors have sold gas to European distributors, such as Ruhrgas in Germany and Gaz de France in France. Since 1990, Gazprom has been operating in the European domestic transmission and distribution markets through joint ventures, thereby capturing additional downstream margins. Gazprom's Wingas joint venture with BASF has been constructing alternative transmission and distribution networks in Germany and Wingas has already constructed approximately 1,200 km of pipeline. Similar projects are being considered elsewhere.

Payment for gas supplies in Russia and elsewhere in the FSU: The Company has delivered significant amounts of gas to customers in Russia and elsewhere in the FSU for which it has not yet been paid. As of September 1, 1996, gas with a sales value of approximately Rbl 48,350 billion (including charges for late payment) had been delivered to Russian customers for which payment had not been received, and gas with a sales value of approximately \$1,268 million (including charges for late payment) had been delivered to customers elsewhere in the FSU for which payment had not been received. Gazprom has two principal strategies for securing payment from its customers in Russia and elsewhere in the FSU. First, the Company is seeking to develop closer relations with its Russian customers by maintaining the proportion of gas it supplies directly to consumers in Russia (as opposed to distribution companies) and by increasing the number of tri-partite contracts it enters into with distribution companies and consumers pursuant to which it is paid directly by the consumers. Secondly, the Company increasingly is accepting payment in forms other than cash, including negotiable promissory notes, bonds, equity interests in gas distribution companies and goods and services. In addition, discussions are continuing with certain countries of the FSU, including Moldova, Ukraine and Belarus in order to reach agreements on a permanent framework for the supply of, and payment for, Gazprom's gas exports.

Improved efficiency of gas transportation: The Company has initiated a number of programs to improve the efficiency of its gas transportation network. Reconstruction of compressor stations and pipelines is expected to result in an increase of transportation capacity of in excess of 3.0 bcm of gas in 1996 and in a total increase in annual transportation capacity of 15 bcm by the end of the year 2000. Included in this total are projected annual efficiencies of 5.5 bcm of gas arising from an agreement with an Italian consortium Tragaz, under which 161 compressor units will be modernized or replaced by 1998. The investment required is being financed principally through additional shipments of gas made possible by the compressor modernization program. Enhanced efficiency of Gazprom's pipeline network should also increase the Company's export capacity.

Joint Ventures in Europe

Gazprom is implementing a strategy of supplying an increasing proportion of gas to the Western and Eastern European markets through transportation and marketing companies in which it has equity participation. This strategy has progressed furthest in Germany, the Company's largest European market.

The first initiative by Gazprom in Germany followed the announcement in October 1989 by Wintershall AG, a 100% owned subsidiary of BASF AG, of plans to build the 617 km MIDAL pipeline in Western Germany to deliver natural gas from the North Sea to a chemical plant at Ludwigshafen owned by BASF. In 1990, Gazprom and BASF agreed to undertake joint marketing of gas supplied by Gazprom in Western Europe, and to build and operate gas pipelines and supply networks. This agreement led to the construction of a second gas pipeline, known as STEGAL, with a total length of 317 km, which connects MIDAL with the Czech gas pipeline system.

Gazexport, through its German gas import and distribution subsidiary Zarubezhgaz Erdgashandel GmbH ("ZGG") owns a 35% shareholding in Wintershall Gas GmbH ("Wingas"). Wingas owns MIDAL-STEGAL and a gas storage facility at Rehden with a current active capacity of 2.6 bcm. Gazexport and Wintershall AG each has a 50% shareholding in the gas trading company Wintershall Erdgas Handelshaus GmbH (WIEH). WIEH purchases its gas supplies exclusively from Gazexport under long term supply contracts. Sales by WIEH are to Wingas, Verbundnetzgas AG, a major gas distributor in Eastern Germany in which ZGG owns a 5% shareholding and BASF Schwarzheide. Gas sales of Wingas are to municipal undertakings, gas utilities and industrial corporations which are located primarily along the corridor of the STEGAL and MIDAL pipelines. Wingas has approximately 30 customers and supplies in excess of 10 bcm of gas annually under long-term supply contracts.

Gazprom, through Wingas and directly, is undertaking substantial additional investment in gas transportation in order to integrate the Wingas pipeline network into the expanding European gas transportation system. In Germany, Wingas has undertaken construction of a 330 km pipeline, known as the YAGAL pipeline, to connect the new export pipeline route through Poland with the STEGAL pipeline. In addition, Wingas is constructing a new pipeline, known as WEDAL, to connect the MIDAL-STEGAL system with the Belgian pipeline system. The current active storage capacity of Wingas of 2.6 bcm of gas will be expanded to 4.2 bcm by 1998. In 1995, Gazprom took a 10% interest in the UK-Belgium Interconnector pipeline (the "Interconnector"), which is due to be completed in 1998.

These investments will enable Gazprom to supply new customers directly with additional volumes of gas available through the Yamal-Europe pipeline. In 1996 Gazprom announced an agreement with Gasunie to supply 1 bcm of gas in 2001 increasing to 4 bcm annually from 2004 to 2020. The integration of the Wingas pipeline system with other major European pipelines will also enable Wingas to contract for new sources of gas and to provide customers with security of supply from diverse production and transportation sources, which should improve its competitive position. Wingas has agreed to purchase 1 bcm of gas from Conoco and 2 bcm of gas from British Gas through the Interconnector following its completion.

In addition to these activities in Germany, Gazprom has also established joint ventures to transport and to market gas in its other European markets. In certain countries, subsidiaries or affiliates of Gazprom also distribute gas.

The following table summarizes the main gas transportation and marketing joint ventures in which Gazprom participates in other selected European markets:

Country	Entity	Interest	Joint Venture Partner	Description
Austria	GWH Gas und Warenhandels-gesellschaft mbH	50%	OMV	Gas marketing and general trading company.
Bulgaria	Top Energy	50%	Bulgargaz	Gas transportation and marketing of Russian gas in Balkan countries.
Finland	Gasum Oy	25%	Neste	Gas transportation and marketing.
France	F.R.A. Gaz	50%	Gaz de France	Gas trading and general trading company.
Greece	Prometheus Gas	50%	Copeluzos Group	Gas marketing and gas transport management.
Hungary	Panrusgas	50%	MOL	Gas marketing.
Italy	Promgas	50%	SNAM	Gas marketing.
	Volta	49%	Edison	Gas marketing.
Poland	Europol Gaz	48%	PGNiG 48% AO Gas Trading 4%	Gas transportation and trading; construction, ownership and operation of the Polish section of the Yamal-Europe project.
	AO Gas Trading	35%	PGNiG	Gas marketing.
Romania	Wirom	25%	BASF 25% WIEH 50%	Gas trading.
Serbia	Progress Gas Trading Ltd.	50%	Progress	Gas marketing.
Slovenia	Tagdem	85%	Kovinotechna	Gas trading.

The Company's strategy of securing equity in gas transportation companies in addition to gas marketing companies, which has been successfully implemented in Germany, has been applied in other European markets. In Finland, Gazprom acquired in 1994 a 25% interest in the national gas distribution system through the formation of a joint venture with Neste Oy, known as Gasum Oy ("Gasum"). Gasum is the sole distributor of natural gas in Finland, and is supplied exclusively by Gazprom. In Poland, the joint venture company Europol Gaz, in which Gazprom has a total direct and indirect ownership of 49.4%, is undertaking the construction within Poland of the Yamal-Europe project. Europol will market and distribute gas supplied through the new pipelines to customers in Poland.

Yamal—Europe Project

In order to expand its capacity for exporting gas to Europe and to reduce its dependence on Ukraine's pipeline network, Gazprom is undertaking significant capital expenditures to construct a new pipeline route to European markets. This new pipeline route, the Yamal-Europe project, will comprise pipelines from the northern part of the Tyumen region of Russia to Germany, and will be constructed in four geographical sections: Germany, Poland, Belarus and Russia. The total distance from the Western Siberian gas fields to Germany is 5,892 km.

The German section, the YAGAL pipeline referred to above, will connect the new export pipelines through Poland with the STEGAL pipeline and will be owned and operated by Wingas, the joint venture between Gazprom and Wintershall. The YAGAL pipeline is due to be completed in 1999.

The Polish section will include two parallel pipelines covering a distance of 682 km and will require the construction of five compressor stations. The initial section of the first pipeline will allow small deliveries into Poland and is expected to be completed in 1996. The remaining section of the first pipeline is due to be

completed in 1997. The second pipeline is scheduled to start construction in 1997 and to be completed in 2001. The owner of these pipelines is Europol Gaz, a joint venture between Gazprom and PGNiG, the Polish national oil company.

The Belarussian section will also include two parallel pipelines covering a distance of 575 km and will require the construction of five compressor stations. Similar to the plan in Poland, this section will be built in stages, with construction of the first pipeline expected to begin in December 1996 and to be completed in 1998.

Finally, construction of the Russian section is expected to begin in 1997. The first bidding round for constructing the 402 km section of the pipeline from Smolensk to Torzhok, which will require four compressor stations, is expected to take place in 1997, and construction is expected to be completed in 1998. Torzhok is a key pipeline junction north of Moscow where several of Gazprom's main trunklines converge. In 1998 Gazprom plans to create further links between Torzhok and the Nadym-Pur-Taz region through a new pipeline which will have an initial capacity of 35 bcm.

To date, Gazprom has firm commitments to deliver approximately 25 bcm of gas annually through the first of the two Yamal-Europe pipelines; commitments relating to the second pipeline are currently under negotiation. If these negotiations are concluded successfully, a substantial portion of the export capacity of the pipelines, which is expected to be 67.4 bcm at the border of Belarus and Poland, will already be accounted for. Additional export capacity at the German/Polish border is expected to be 51.7 bcm annually. The Company's agreement with Gasunie referred to above provides for Gasunie to supply Gazprom with certain amounts of gas, at Gazprom's option. This source of supply is available to be called upon if for any reason Gazprom is unable to meet its schedule for the construction of the Yamal-Europe project and thus is not able to deliver the committed amounts of gas through the new pipelines when required. For a discussion of capital expenditures anticipated for the Yamal-Europe project, see "Financial Review—Liquidity and Capital Expenditures."

Further development of the pipeline network to the Yamal peninsula will be determined on the basis of demand in Europe in the future.

Investments in Supporting Operations

Gazprom and its enterprises and subsidiaries engage in a variety of activities in order to ensure security of supply for a broad range of goods and services necessary to support the production and transportation of gas. RAO Gazprom and the gas production and gas transportation enterprises comprising the Unified Gas Supply System generally hold investments in, or have subsidiaries engaged in, construction, food production, transport services (including vehicles and aviation), the manufacture of equipment for the gas industry, production of building materials, trading, and communications services.

Gazprom has made a number of investments in Russian banks in order to facilitate its operations in the context of the limited liquidity available in the Russian economy. Gazprom owns directly and indirectly substantially all the shares in Gazprombank, and substantial shareholdings in a number of other national and regional banks.

Environmental Matters

As is typical of gas and oil businesses, Gazprom's operations are subject to various laws and regulations relating to the protection of the environment. Gazprom's environmental policy, developed on the basis of international standards, involves attention to environmental matters in all of the Company's areas of activity. In carrying out its policies, Gazprom generally seeks to adhere to international standards for environmental protection, and monitors compliance with these principles. Gazprom generally estimates the impact of each significant project on the environment at the planning stage and takes this impact into account when making a decision on that project.

Gazprom is developing a system for monitoring harmful leaks, water contamination, and the quality of air, water and soil in the Russian regions in which it operates, and that system is expected to become a part of Russia's Unified State Ecological Monitoring System. In 1995, RAO Gazprom's Board of Directors approved the main provisions of a feasibility study on the environmental monitoring of the Russian gas industry. Approximately Rbl 561 billion were allocated for the development of Gazprom's environmental monitoring system through 2007. Gazprom, together with experts of the U.S. Environmental Agency, Gaz de France and Ruhrgas, has prepared an international program in order to investigate gas leakage during transportation and to develop effective measures for its reduction. Russian experts and specialists from the Oil and Gas Institute (Germany) have investigated the radioactivity level of Russian gas, and the results of this investigation confirmed its acceptable level of radiation.

In order to improve Gazprom's environmental activities, a decision was taken to conduct a systematic environmental audit, and a program covering all aspects of Gazprom's environmental activities was prepared. In 1995, an environmental audit with the participation of Russian independent experts was carried out with regard to Severgazprom and Tyumentransgaz, and recommendations were made on the basis of the analysis of the environmental impact of the activities of those enterprises.

In accordance with the requirements of Russian environmental legislation, Gazprom made payments in connection with environmental protection in the amount of Rbl 1.5 billion in 1993, Rbl 8 billion in 1994 and Rbl 13.8 billion in 1995, paid penalties in the amount of Rbl 364.5 million in 1994 and Rbl 540 million in 1995, and made obligatory allocations to funds for environmental protection in the amount of Rbl 124 billion in 1994 and Rbl 290 billion in 1995. The increase in penalty payments was the result of inflation and an increase in payment rates.

The Company has provided in its IAS balance sheet for those environmental liabilities where it is probable an obligation exists and the amount can be reasonably estimated. Such provision has been made in accordance with a reasonable and prudent policy that takes into account payments made in prior years, among other factors. Nonetheless, the Company is unable to estimate the ultimate financial impact of its environmental obligations with a high degree of certainty, particularly in light of the possibility of stricter enforcement of existing laws and regulations or of the possibility that additional laws or regulations may be adopted in the future. See "Risk Factors—Risks Relating to the Company—Environmental Risks."

FINANCIAL REVIEW

This Financial Review describes the differences between RAR and IAS as they apply to the Company, analyzes the Company's results of operations for 1995 as reported under RAR, describes certain aspects of the Company's relationship with the Government and the taxes to which it is subject, provides information with respect to the Company's research and development, describes certain recent developments and discusses the Company's planned capital expenditures and certain other matters.

RAO Gazprom has prepared a consolidated balance sheet at December 31, 1995 in accordance with IAS, which is included in "Financial Information", but has not prepared any other financial statements in accordance with IAS or any financial statements in accordance with any other internationally recognized generally accepted accounting principles. The other consolidated financial information for 1995 included in "Financial Information" is presented in accordance with RAR.

Accounting Framework in the Russian Federation

Financial statements of Russian companies, including Gazprom, are prepared in accordance with RAR. RAR accounting principles are based on a uniform chart of accounts and are designed primarily to comply with taxation reporting requirements. Included in "Financial Information" are the Company's January 1, 1996 consolidated RAR balance sheet and consolidated RAR profit and loss account for the year ended December 31, 1995.

International Accounting Standards

IAS are those accounting standards promulgated by the International Accounting Standards Committee and are designed to result in the fair presentation of an entity's financial position and the results of its operations. Included in "Financial Information" is the Company's December 31, 1995 consolidated IAS balance sheet.

Summary of RAR/IAS Differences

RAR is materially different in many respects from those accounting principles prescribed under IAS, including many classification and disclosure differences. RAR does not, for example, require the specific disclosure of accounting policies or analysis of balance sheet accounts typical to IAS. Significant measurement differences between the two bases of accounting, as related to Gazprom, are as follows:

Effects of Inflation

RAR mandates that fixed assets be revalued using industry specific indices to reflect the effects of inflation, but such revaluation is only reflected in the opening balance sheet of the subsequent year and not in the closing balance sheet of the year for which the inflation indices apply. This revaluation with respect to fixed assets is the only consideration given under RAR to the effects of inflation.

IAS requires that in hyperinflationary economies a general price index be applied to restate both the results of operations and the financial position in terms of the equivalent purchasing power of the currency unit at the balance sheet date.

This difference has a substantial effect on reported financial position and results of operations due to inflation in Russia of approximately 131% in 1995 and in excess of 6,000% for the three-year period ended December 31, 1995.

Income and Cost Recognition

In 1995, RAR permitted, and Gazprom employed, a modified cash basis of accounting whereby sales are recognized when cash (or other settlement) is received irrespective of when the gas is shipped. Direct costs



associated with sales made but not settled are deferred in the balance sheet. Substantially all other costs and expenses are recognized when the liability for payment has been incurred. Certain costs are, however, charged directly to reserves rather than to the profit and loss accounts as would be customary under IAS. These costs relate to a number of areas including social expenditures and penalties imposed by tax authorities. In addition, the impact of the Unified Stabilization and Development Fund (the "Stabilization Fund"), which is specific to Gazprom, results in certain other revenues and costs being recognized in reserves rather than the profit and loss account, as further described below.

Diminution in Carrying Value

RAR does not permit the use of valuation allowances in cases of diminution in carrying value of assets such as accounts receivable, inventories, or investments unless and until the asset is deemed wholly worthless from a tax or a legal perspective (generally when all chance of recovery has been exhausted). IAS generally requires the use of valuation allowances when it is likely that the carrying value of certain classes of assets will not be realized.

Deferred Taxation Accounting

RAR requires that income taxes be accrued as a liability and recognized as expense when the taxes are legally incurred; it does not recognize the concept of deferred taxation. In contrast, IAS requires a comprehensive basis of income tax expense recognition whereby the income tax effects of temporary differences, between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, are considered when determining income.

Contingencies

RAR requires that claims, penalties and other contingencies be recorded when recognized as legally payable. IAS mandates that contingencies be accrued when it is both probable the asset has been impaired or a liability incurred and a reasonable estimate can be made of the loss.

Dividends

RAR requires that dividends be accounted for when they are declared. IAS allows dividends to be accounted for in the year to which they relate regardless of when declared.

Depreciable Asset Lives

Under RAR asset lives are dependent upon specific regulations and may be as long as 250 years for certain categories of assets. IAS requires that the asset life be the period of time over which the asset is expected to be used by the enterprise, which in the case of Gazprom may be as long as 50 years.

Lack of Comparable Historical Financial Information

RAO Gazprom was established in 1993 as the successor to State Gas Concern Gazprom of the Soviet Union and prepared consolidated financial information when first required to do so, for the year ended December 31, 1995. Such consolidation was prepared in accordance with the Ministry of Finance of the Russian Federation Order No. 81 entitled "Requirements for the accounting reflection of certain transactions associated with the commencement of Part 1 of the Civil Code of the Russian Federation." Prior to 1995, the Company's financial information was only prepared on an "aggregated" rather than a consolidated basis, as was then required under Russian regulations. Aggregation represents the summation of assets, liabilities and results shown by the individual Statutory Accounting Reports of RAO Gazprom and its enterprises and subsidiaries prepared in accordance with RAR; transactions and balances between such entities were not eliminated, investments in partly owned ventures were included at historical cost (rather than being consolidated, where appropriate) and no adjustments were made to take account of the general effect of inflation. Accordingly, the Aggregated Financial

Reports do not present the consolidated assets and liabilities, financial position or profits and losses of RAO Gazprom, do not give any meaningful indication of trends over time (due in significant part to the high inflation rates in Russia during the covered period) and cannot be compared in any meaningful way to the consolidated financial information prepared elsewhere herein. Thus, the Aggregated Financial Reports should not be relied upon by anyone considering an investment in the ADSs. The Aggregated Financial Reports for 1993 and 1994 have been included in Appendix D hereof solely for purposes of obtaining admission of the Offered ADSs to the Official List of the London Stock Exchange.

Limitations of Available Financial Information

As explained above, certain of the available financial information has been prepared in accordance with RAR accounting principles and those principles differ in a number of important respects from those prescribed under IAS. The limited purpose of the RAR financial information, which is primarily a basis of accounting for tax reporting purposes rather than a basis of accounting appropriate for the purpose of making investment decisions, must be recognized by a potential investor.

Results of Operations for 1995

Sales Analysis

The RAR consolidated profit and loss account for 1995 records sales on a cash (or other settlement) basis of Rbl 71,440 billion, including VAT of Rbl 9,704 billion and excise duty of Rbl 11,739 billion. As noted above, sales under RAR in 1995 were recognized when cash or other settlement was received. Approximately two-thirds of sales recorded in 1995 related to cash receipts, the residual element reflecting receipts of a wide range of forms of settlement, including goods, bonds and settlement by way of mutual cancellation of debts. The most significant individual example of a non-cash settlement in 1995 related to the mutual settlement of debt between Gazprom (for gas deliveries to Ukraine) and Ukragaz (for an equivalent value of transit charges in respect of gas transported through the Ukrainian pipeline system).

Sales included compensation payments received of \$243 million (Rbl 1,125 billion) under the Yamburg Agreement and Rbl 443 billion received under the Federal Share, but excluded Rbl 23,363 billion revenues credited directly to reserves as a result of transfers to the Stabilization Fund. Details of these arrangements are given below. In the absence of information relating to consolidated receivables at January 1, 1995, it is not possible to determine the adjustment which would be appropriate to compute total revenues for 1995 on the basis of amounts billed (as opposed to amounts settled).

Approximately 90% of sales recognized on a RAR basis in 1995 relate to gas, 10% relate to gas condensate, oil and other sales, including transit services. Set forth below is a summary of gas volumes shipped to particular markets:

	Year Ended December 31, 1995
	(bcm)
Western Europe	75.1
Eastern Europe	42.3
Total Europe	117.4
Russia	306.1
FSU (excluding Russia)	73.2
Total	496.7

The average annual realizations on RAR sales (settled) to Western Europe, Eastern Europe and the FSU (excluding Russia) have been estimated at Rbl 311,693, Rbl 166,032 and Rbl 176,759 per 1,000 cubic meters, respectively. These numbers are stated exclusive of excise tax and VAT. The average annual realizations include consideration received in 1995 for shipments made in prior years, but do not include revenues for shipments made in 1995 for which consideration is expected to be received in future periods. In addition, the realizations

for Western Europe and Eastern Europe reflect that 13.8 bcm of shipments were made pursuant to the Yamburg Agreement under which Gazprom receives no direct compensation (3.5 bcm to Germany and 10.3 bcm to Eastern Europe). In addition, with respect to Western Europe, 2.8 bcm were shipped to Turkey subject to the Federal Share arrangements. See "—Yamburg Agreement" and "—Federal Share."

The revenues reported in the consolidated RAR profit and loss account were reduced by three elements of the relationship with the Government: the Yamburg Agreement; the Federal Share and the Stabilization Fund.

Yamburg Agreement

The Yamburg Agreement is the generic term used to refer to a series of contracts signed between the duly empowered authorities of the former Soviet Union and the governments of several Eastern European countries between 1985 and 1992.

On privatization, Gazprom inherited the obligation to meet the supply terms of the Yamburg Agreement. This involves a commitment to deliver significant volumes of gas to certain export customers through the end of 1998 without receiving any direct revenues. At the termination of the period of free supplies, the recipient countries have the right to exercise an option to prolong deliveries for a further period of 10 years, but such deliveries will be made on normal commercial terms.

The countries involved in receiving supplies under the terms of the Yamburg Agreement include: Bulgaria, Hungary, Poland, Germany (which inherited the entitlement from the German Democratic Republic), and the Czech and Slovak republics. The supply of goods and services that gave rise to the obligations to supply gas under the Yamburg Agreement included the following: construction of pipelines; supply of goods and equipment; construction of houses; and making of hard-currency loans to FSU countries.

The following is an analysis of the gas delivery obligations under the Yamburg Agreement:

	Actual	Budgeted		
	1995	1996	1997	1998
			(bcm)	
Bulgaria	3.3	3.3	3.3	3.3
Hungary	2.0	2.0	—	—
Poland	2.5	2.0	—	—
Germany	3.5	3.5	3.5	3.5
Czechoslovakia (now Czech and Slovak Republics)	2.5	5.0	5.0	5.0
Total	13.8	15.8	11.8	11.8

Gazprom has been pursuing negotiations to reduce its obligations under the Yamburg Agreement on the grounds that not all the assets or services supplied under the agreement were received by Russia, but rather were received elsewhere in the FSU.

The agreement on settlements with the Government for gas supplied in 1995 under the Yamburg Agreement was concluded on October 6, 1995.

In accordance with the terms of the agreement, in respect of volumes of gas supplied in 1995 the Government reimbursed the Company with \$243 million in the form of tax exemptions to compensate for Gazprom's expenses connected with the free supply of gas. The implied effective level of compensation for the volumes supplied in 1995 was \$18 per 1,000 cubic meters.

The compensatory payments received in respect of the volumes of gas shipped by the Company in accordance with the terms of the Yamburg Agreement have been recognized as revenues within the Company's RAR basis financial statements.

The terms of the compensatory payments for gas supplied in 1996 under the Yamburg Agreement have yet to be finalized.

Federal Share

The Federal Share is an allocation to the Government of a portion of deliveries of gas to certain non-FSU countries determined on the basis of annual contracts negotiated with the Government.

In accordance with a 1995 Governmental Decree, 50% of the gas shipments made to Turkey were nominally allocated to the Federal Share for 1995. Under the terms of the Decree, revenues received in respect of the Turkish sales allocated to the Federal Share were automatically transferred on receipt to the Government. Gazprom received compensation for the costs associated with making the shipments to Turkey at the rate of \$33.3 per 1,000 cubic meters.

In fact, 2.8 bcm of gas was supplied in 1995 to Turkey as the Federal Share allocation and \$261 million (approximately Rbl 1,210 billion) was paid to the Government in respect of receipts from these sales. The average price realized on the sales was \$93 per 1,000 cubic meters. Based on the budgeted supply of 3 bcm of gas, over the course of the year a series of compensation payments were made by the Government to Gazprom totaling Rbl 443 billion.

In its RAR financial statements, the Company reflects as revenue only the compensatory payments received in respect of the gas supplied to Turkey.

The terms of the compensatory payments for gas supplied in 1996 in respect of the Federal Share provide for 3 bcm of gas deliveries to Turkey and compensation at a rate of \$65.37 per 1,000 cubic meters.

Stabilization Fund

The Stabilization Fund was created by Decree No. 1333. The method by which the Stabilization Fund operates was extended by Decree No. 2116 issued on December 6, 1993.

Essentially, the existence and operation of the Stabilization Fund represented a tax concession to Gazprom that allowed it to shelter revenues or introduce additional, notional costs to the RAR profit and loss account and take the associated credits direct to reserves, thus reducing taxable revenues and profits and consequently taxes payable. This was accomplished following two procedures. In the first case, debits to cost of sales in excess of actual costs were allowed to be recorded based upon percentages of revenues. Such percentages were agreed in advance with the Government. Under the second method, Gazprom was permitted to make debits to sales for the excess of actual export gas sales values over the revenues which would have been associated with similar volumes if they had been calculated using the Russian industry prices.

Once the funds were nominally in the reserves, they were theoretically available to finance a number of different types of expenditure, most of which were of a capital nature. When funds were expended on a qualifying type of expenditure, a nominal accounting entry was made across the reserves of the Company to recognize that the funds had been "utilized."

Decree No. 1333 provided that the main objective of the Stabilization Fund was to enable investment in maintaining and increasing gas production volumes and in the development of the unified gas transportation system of the Russian Federation. The Decree dictated that the resources of the Stabilization Fund should be applied to support:

- a reliable gas supply to consumers in the Russian Federation, as well as gas supplies for delivery beyond the borders of the Russian Federation in accordance with interstate and intergovernmental agreements;
- a unified scientific-technological and investment policy throughout the Company; and
- construction and financing of gas pipelines to end users.

All transfers of funds or assets arising from the operation of the Stabilization Fund are free from taxes, including VAT, as long as they are for certain specified uses that fall within the objectives of the Stabilization Fund.

In accordance with RAR, the reported profit and loss account of the Company for the year to December 31, 1995 excluded Rbl 23,363 billion of revenues from the revenue line as a result of transfers to the Stabilization Fund. Further, the cost of sales line included Rbl 4,448 billion of costs generated by means of credits being taken to the Stabilization Fund.

Thus, the operation of the Stabilization Fund in 1995 sheltered Rbl 23,363 billion of revenues from VAT (only applicable to a portion), excise tax, profits tax and a number of more minor taxes; the net effect of these taxes would be approximately 60% of the marginal revenue concerned. Further, the additional costs of Rbl 4,448 billion recorded as a result of the operation of the Fund reduced the amount of profits tax payable by approximately 35% of that amount.

Decree No. 894 dated September 1, 1995 abolished the debits to cost of sales method of generation of Stabilization Fund with immediate effect. Decree No. 461 dated April 1, 1996 abolished the debits to sales method of generation. Consequently, no further credits can be generated to the Stabilization Fund with effect from that date.

Cost Analysis

The RAR consolidated profit and loss account for 1995 records costs relating to settled sales of Rbl 30,453 billion. Expenses amounting to approximately Rbl 11,000 billion were not charged to profit in 1995 but taken directly to reserves; in contrast, Stabilization Fund transfers of Rbl 4,448 billion were charged to expense, but do not represent expense incurred. Costs deferred at December 31, 1995 (relating to sales not settled) are included in the RAR consolidated balance sheet at January 1, 1996 in the amount of Rbl 14,041 billion; in the absence of equivalent consolidated information at January 1, 1995 it is, however, not possible to determine the adjustment necessary to record total consolidated costs incurred for 1995 on an accruals basis.

Gazprom enterprises do, however, prepare summary cost information on an accrual basis on internal statistical forms. Only costs allowable as deductions from taxable revenues are recorded on these forms and consequently they exclude all costs charged directly to reserves. The forms are prepared for statistical purposes only and, principally because of different bases of preparation, cannot be directly agreed to either the financial statements or the financial records of the underlying enterprises.

Transportation and production costs are the most significant to Gazprom, with transportation costs being by far the largest component of total costs. The table below contains an analysis of the transportation and production activity costs recorded by Gazprom for the year ended December 31, 1995, according to the statistical forms. The costs recorded in respect of production relate only to those costs associated with the extraction of gas.

	Year Ended December 31, 1995			
	Transportation Enterprises		Production Enterprises	
	(Rbl billion)	(%)	(Rbl billion)	(%)
Materials	3,530	14.4	326	5.8
Works and services	8,847	36.1	840	15.0
Payroll expenses	2,171	8.9	591	10.6
Depreciation	4,307	17.6	1,447	25.8
Stabilization Fund	4,448	18.2	—	—
Deductible taxes	453	1.8	1,701	30.3
Other	744	3.0	702	12.5
Total	<u>24,500</u>	<u>100.0</u>	<u>5,607</u>	<u>100.0</u>

A further breakdown of the works and services category included above is set out below:

	<u>Transportation Enterprises</u>	<u>Production Enterprises</u>
	(Rbl billion)	
Payment for transit	6,049	—
Transport	439	282
Installation works	90	24
Repairs	1,706	534
Services to external companies	508	—
Bank services	56	—
Total	<u>8,848</u>	<u>840</u>

Set out below is a breakdown of the figures included above for deductible taxes:

	<u>Transportation Enterprises</u>	<u>Production Enterprises</u>
	(Rbl billion)	
Mineral restoration tax	—	599
Payments for extraction of minerals (royalty) ...	—	1,024
Payments for land	12	9
Environmental payments	4	1
Road funds	<u>437</u>	<u>68</u>
Total	<u>453</u>	<u>1,701</u>

Transportation entities also incur significant costs for gas purchased; however, as this element of costs is largely simply a transfer within the company rather than an external cost, this component has been excluded from the analysis in the tables above.

Materials costs include the expenses associated with electricity consumption, gas used for power generation for own needs and the cost of gas lost in transit through the transportation system.

As noted above, works and services costs include amounts paid in respect of transit charges on gas transported by non-Gazprom enterprises. The most significant of these costs are the costs recorded in respect of transit charges for gas transported through Ukraine.

Included within payroll expenses are the costs associated with various payroll based taxes and social payments.

Reflecting the highly capital intensive nature of the business, depreciation is a major element of expense. Care should be taken in interpreting the level of this expense as reported in the table above as it is dependent on the asset values recorded under RAR. To reflect the effect of inflation on the underlying asset bases within the economy, the Government has periodically dictated that plant and equipment should be revalued using defined indices based on the type of assets held. The effect of revaluations on depreciation expense are only recognized under RAR prospectively. The last statutory revaluation to affect the level of depreciation expense recorded under RAR for the year ended December 31, 1995, was that which took effect on January 1, 1995. Consequently the level of depreciation expense reflected in the table above is based on the statutory revaluation effective at that date. The result of these facts is that, although accurately reflecting the level of expense available for relief for tax purposes, the reported depreciation expense understates the actual importance of depreciation as an economic expense to the business. Fixed asset carrying values in the RAR balance sheet at December 31, 1995 were Rbl 173,729 billion; under IAS, the indexed carrying values at the same date were Rbl 282,776 billion.

As discussed in more detail above, the costs recorded in respect of the Stabilization Fund do not represent actual cash expenses to the Company, being instead allowable tax deductions from revenues; the credits

associated with these debits to the profit and loss account are transferred to the reserves of the Company. With effect from September 1, 1995, such deductions were abolished.

The high proportion of production enterprises' costs accounted for by deductible taxes reflects the expense of energy producers royalty and mineral restoration tax. These are discussed below.

Relationship with the Government and Taxation

The relationship between Gazprom and the Government involves many components. The depth of the relationship reflects both the history of the Company and its importance within the Russian economy.

The Government derives revenues from Gazprom in a number of ways, many of them unique to that business. It also imposes a number of obligations on the Company that either increase expenses or reduce revenues. Conversely, the Company has benefited from a number of significant factors that have reduced the effective taxation charge.

The net burden placed on the business by the Government depends on the many constituent elements of the relationship between Gazprom and the Government.

The most important elements of the relationship between the Company and the Government are:

- Obligations to Deliver Gas
- Taxation
- Yamburg Agreement
- Federal Share
- Stabilization Fund

The Yamburg Agreement, the Federal Share and the Stabilization Fund were discussed above. Social obligations and direct taxation are dealt with below.

Obligations to Deliver Gas

Gazprom occupies an important role within the Russian economy and as such its successful operation is of primary importance to both the Russian economy and Russian society. The provision of an uninterrupted supply of gas to both the domestic and international markets has been a significant contributory factor to the relative social and political stability within the country as it underwent the changes associated with the dissolution of the Soviet Union.

Recognizing the importance of the hard currency earnings of Gazprom to the economy and the social significance of continuity of supply of gas to the domestic market, the Government imposed on Gazprom an obligation to maintain the integrity of supply as a condition of the Company's privatization under Decree No. 1333.

In the case of the domestic market, that obligation to supply has, with limited exemptions, been imposed irrespective of a record of delayed and uncollectible payment from customers. As at January 1, 1996 gas with a sales value of Rbl 29,908 billion (including charges for late payment) had been supplied to domestic customers for which payment had not been received. At June 30, 1996, payment had not been received for gas with a sales value of Rbl 48,720 billion (including charges for late payment) and at September 1, 1996, payment had not been received for gas with a sales value of approximately Rbl 48,350 billion (including charges for late payment).

Presidential Decree No. 1451, dated October 17, 1996, requires the Government to establish a procedure to partially extinguish the debts of Russian customers to Gazprom, subject to those customers continuing to make timely contractual payments for gas deliveries. See "Business—Gazprom's Principal Markets—Russia."

The Government has imposed an indirect economic charge on the Company by strictly regulating the prices which the Company is able to charge for wholesale gas sales to the domestic market. Whilst these prices have tended to rise over time, they have remained well below world prices. Further, despite continued high levels of inflation within the domestic Russian economy, the Government has tended to dictate that gas wholesale prices should rise at a much lower rate.

Taxation

As noted above, the taxation system in Russia has been in place only a short time and is subject to varying interpretations and to constant change which may be retroactive in nature. As a consequence of the scale of Gazprom's activities, it is subject to a broad range of taxes imposed at the federal, regional, and local levels.

The following is a brief summary of the more significant taxes and duties applicable to the Company.

Profits Tax

A tax charge of Rbl 7,369 billion was recorded as a utilization of profit in the RAR consolidated balance sheet for 1995. Of this charge, Rbl 6,157 billion is related to profits tax (also included was excess wage tax of Rbl 1,212 billion—see below). Profits tax is assessed on the taxable profits of an enterprise as determined under Russian tax and accounting rules. The rate of profits tax for 1995 was between 35% and 38%, depending on the region within Russia in which a business operated. The profits tax rate in 1996 is generally 35%.

Article 7 of the Profits Tax Law provides a number of concessions to reduce the profits tax. The most significant of these concessions provides a tax shelter in the form of a deduction based on capital investments in plant and equipment made during a fiscal year. This deduction is in addition to the normal depreciation allowance for plant and equipment. The capital investment deduction is available only during the year in which capital investments are made and may not be carried forward to the extent it is not utilized. This tax deduction is intended to represent an incentive for the reinvestment of profits, and is therefore available only to the extent of the enterprise's retained profits. Further, only the excess of capital investments over current year depreciation is treated as deductible from the profits of an enterprise. The total benefit from the capital investment deduction and other concessions provided under Article 7 cannot exceed 50% of a company's taxable profits before considering such concessions.

In 1995 the capital investment deduction was not significant to Gazprom due to the operation of the Stabilization Fund concession (see above). However, since the Stabilization Fund concession has been abolished with effect from April 1, 1996, the capital investment deduction represents a potentially significant future benefit.

Excise Tax

Excise tax totaling Rbl 11,739 billion was charged to the RAR consolidated profit and loss for 1995.

Excise tax is imposed on sales of natural gas and hydrocarbons by Gazprom to commercial gas suppliers and industrial customers. The excise rate was increased from 15% to 25% on March 28, 1995 and to 30% on September 1, 1995. Gas prices were increased correspondingly to compensate for this increase.

Although most products are not subject to excise tax when exported, the excise tax on mineral raw materials is imposed on exported gas supplies. However, in 1995 the excise tax was calculated based on industry wholesale prices (similar to domestic supplies) rather than actual export prices. At that time industry wholesale prices were lower than export prices and thus the expense associated with the excise tax was, consequently significantly reduced. Effective from March 1, 1996, excise tax is calculated based on actual export prices net of custom duties and transportation expenses.

Labor Taxes

Businesses are obliged to make compulsory payments of a social nature (in essence taxes), which are calculated on the basis of payroll costs. Such payments include payments to the State Pension Fund, Employment Fund, Social Insurance Fund and Medical Insurance Fund. These payments amount to a total of 38.5% of labor costs. In addition, enterprises pay transport tax of 1% calculated on the basis of an enterprise's total labor costs. All such payments are charged to cost of sales.

Excess Wage Tax

Prior to January 1, 1996, if an employee's wages exceeded six times the minimum salary level (defined by the Government on a per employee basis) the employer was liable to pay tax on the excess at rates equal to the profits tax rate for the enterprise. Consequently, in 1995 this tax applied to wages in excess of approximately \$700 per annum per employee. A significant proportion of the Company's work force earned in excess of this amount in 1995.

The excess wage tax was eliminated with effect from January 1, 1996.

Energy Producers' Royalty

A royalty ranging from 6% to 16% is imposed on enterprises producing oil and natural gas. The tax is computed based on volumes of production valued at sales value. As almost all gas production is sold directly to Gazprom enterprises, the sales value of production is determined using the prices set internally within the Company.

The actual rates of the royalty are dictated in field licenses and are based on various factors.

Mineral Restoration Tax

Those enterprises responsible for the production of gas are liable to pay a mineral restoration tax imposed at the rate of 10% of the wholesale price. The tax may be recaptured to the extent there are expenditures made for geological and geophysical studies. Recapture is affected via a reduction of amounts payable to the budget in respect of Mineral Restoration Tax. This recapture results in a reduction in the level of payments made in respect of this tax of approximately 50% for Gazprom. The tax was payable based on receipts of cash from customers, but with effect from March 15, 1995 became payable based on production rather than cash receipt.

Export Tariff

An export tariff was applicable in 1995 to sales of natural gas supplied by Gazprom to Western and Eastern Europe, and the FSU (excluding Russia).

The rate of export tariff was two European Currency Units per ton. However, certain gas supplies were exempted from the export tariff. Such volumes included exports made under the Yamburg Agreement. Similarly, gas supplies made as payments for goods purchased for state needs, and payments for transit costs of Russian gas through other territories or states other than the FSU, are also exempt.

The export tariff was abolished with effect from April 1, 1996.

Value Added Tax ("VAT") and Import Customs Duties

VAT was imposed at the rate of 23% (representing 20% VAT and 3% special tax). This rate remained in effect up to April 1, 1995. On that date the rate at which the special tax was levied fell to 1.5%. The special tax component of VAT was abolished with the effect from January 1, 1996. VAT is not charged on sales of gas to customers outside of the FSU, nor is it payable on technological equipment imported by the Company.

The Company was exempt from the payment of customs duties on imported equipment, materials and other goods purchased for the stabilization and development of the gas industry. This exemption, as well as other similar benefits, expired on May 15, 1995. Currently custom duties are 5% on practically all types of imported equipment.

Road Use and Housing Fund Tax

There are two major turnover-based taxes applied in most regions of Russia: the road use tax and housing fund tax. The road use tax and housing fund tax rates applied to Gazprom enterprises vary by region and locality but generally do not exceed 2.5% and 1.5%, respectively, of the enterprise's turnover.

Gas pipeline transportation companies pay road use tax only on the difference between total sales value of gas to customers and the purchase price of that gas. As a result, only the established mark-up on each intercompany sale is subject to the road use tax.

In most cases, the same treatment is stipulated by local authorities for the housing tax calculation. Housing tax can be reduced by the expenses relating to maintenance of housing, social facilities and cultural objects. Most transportation and production enterprises within Gazprom use this concession to achieve a significant reduction of tax.

Property Tax

In accordance with current legislation, the average annual net book value of the Company's property is subject to property tax assessment. The definition of "property" in this context includes fixed assets, intangible assets and goods. The maximum tax rate is 2%, but it can be stipulated by local authorities at a lower value. Legislation provides a number of tax concessions. The Company is allowed to reduce its tax base by the net book value of trunk pipelines. As the trunk pipelines are significant components of Gazprom's asset base, payments of property tax to the budget are greatly reduced.

Other Taxes

There are other regional and local taxes of varying significance not included in the explanation set out above, including education and advertising taxes. However, the cost of these to the Company tends to be relatively minor by comparison with that of those previously discussed.

Hard Currency Conversion Requirement

Russian currency regulations generally require that Russian companies convert 50% of hard currency receipts to rubles. This general requirement is applicable to the Company. However, during 1993 and 1994, a special procedure was applicable within the framework of the Federal Share which exempted hard currency proceeds received as state compensation for Federal Share shipments from the mandatory conversion requirement. The 50% conversion rule then applied only to the residual hard currency receipts.

The benefits associated with this privilege were very limited since Gazprom had to convert significant amounts of hard currency revenues to rubles in order to provide funding to production and transportation companies within the Company which needed Rubles to finance working capital requirements.

During 1995, with the exception of revenues relating to gas exports to Turkey, most of Gazprom's hard currency receipts have been subject to the hard currency conversion requirement. In the case of gas exports to Turkey, provisions similar to those discussed above, in respect of 1994, remain in force.

Taxation Factors for Investor Consideration

As noted above, the taxation system in Russia has been in place only a short time and has been subject to a high level of volatility when compared to the more mature structures in many western economies. Any potential investor would need to consider the following matters as they relate to the taxation status of the Company. Potential investors should also consider the information contained in "Risk Factors—Risks Relating to the Company—Taxation".

Governmental Needs

The Russian energy sector currently represents a major source of revenue (hard currency revenue in particular) to the Government which has broad discretion to adjust the levels of certain major taxes and levies such as the excise tax and customs duties applicable to the sector.

Lack of Consolidated Tax Reporting

As at January 1, 1996, Gazprom comprised approximately 1,000 business units. Many of these business units perform their own accounting functions for tax purposes. Gazprom enterprises are spread over a large geographical area, and are therefore subject to taxation in many different regions and localities in Russia.

The tax reporting procedures in Russia essentially prohibit enterprises from consolidating the financial results of the separate enterprises and reporting units for the purposes of profits taxation. As a result, the taxable losses from unprofitable enterprises and reporting units cannot be offset against the taxable profits of other enterprises and reporting units, and no immediate tax benefit can be claimed for tax losses.

Penalty Risks

The Government assesses substantial penalties and interest expense for late or incorrect payment of taxes. Such expenses are normally included within the RAR financial statements as utilization of profit. However, such expenses are not included within the figure quoted for payments to the budget which is disclosed on the face of the RAR balance sheet.

The interest rate in 1994 and 1995 was stipulated at the amount of 0.7% per day. Effective from May 20, 1996 it was reduced to 0.3% per day. Interest for late payment of taxes in 1994 and 1995 was not accrued by Gazprom (as for most Russian industrial companies) until October 16, 1995, in accordance with a Government resolution.

Recent Developments in Taxation

Following the cessation of the ability to create credits to the Stabilization Fund from April 1, 1996, as noted above, Gazprom will seek to compensate for the loss of the associated tax advantages. In 1996 Gazprom anticipates making greater use of the concessions available in relation to capital investment, as discussed above. Such concessions were not applicable to capital expenditure financed from the Stabilization Fund. In addition, Gazprom will be seeking to negotiate an increase in the level of compensatory payments received from the Government for volumes supplied in 1996 in respect of the Yamburg Agreement and the Federal Share.

Gazprom has to date recognized revenue for tax purposes on a cash (or other settlement) basis. Point 7 of Decree No. 685 of May 8, 1996 of the President of the Russian Federation stipulates that an accrual basis be used for revenue recognition for tax purposes with effect from October 1, 1996. It is uncertain how this Decree would be implemented in practice, and tax authorities have yet to issue transition rules. The Ministry of Finance and State Tax Service of the Russian Federation officially clarified on October 7, 1996 that Point 7 will not come into force until further clarification is provided. As a result it is unclear as to the precise impact the change will have on the Company except that it will likely result in an acceleration of tax payments to the Government.

Research and Development

Gazprom has pursued a policy of investing in research and development in a wide variety of technical areas. However, the principal focus for such activity has been the development of high efficiency gas compressor units with the object of improving the capacity and the efficiency of gas transportation in the existing pipeline system. Total spending on research and development in 1995 amounted to Rbl 561 billion.

Liquidity and Capital Expenditures

A consolidated statement of cash flows has not been prepared.

In common with other Russian commercial enterprises, the Company is subject to liquidity constraints due in part to non-payment by domestic and FSU customers and the effect of barter transactions. At December 31, 1995, current assets other than inventory exceeded current liabilities under IAS. The Company has limited access to general purpose borrowings; at December 31, 1995 hard currency borrowings of Rbl 2,302 billion were related to specific projects and secured by gas export sales contracts.

Like other large gas companies, the Company has significant capital expenditure requirements. RAO Gazprom develops its plans for capital expenditure on the basis of projected demand for gas in Russia and in the Company's export markets, and on the basis of its contractual commitments to deliver gas to its customers; Gazprom's capital expenditure plans are subject to adjustment as its projections are revised in the light of experience and as its contractual commitments change.

In 1995, Gazprom's capital expenditures were approximately Rbl. 22,900 billion, substantially all of which related to the production and transportation of gas. In the first eight months of 1996, the Company made capital expenditures of approximately Rbl. 16,700 billion. RAO Gazprom currently estimates that approximately \$40 billion of capital expenditures will be required over a ten-year period to maintain its core gas, gas condensate and oil operations, to meet anticipated demand for gas, gas condensates and oil and to construct the two parallel pipelines comprising the Yamal-Europe project. Of the estimated \$40 billion, approximately \$16 billion is required to maintain production, commission new fields and upgrade pipelines and compressor stations, and for general maintenance and repair, and approximately \$12 billion is required for each of the two parallel Yamal-Europe pipelines. RAO Gazprom is examining plans for additional possible capital expenditures across all its operations, a significant portion of which would relate to the development of gas fields in the Yamal peninsula, the timing of which will depend on commercial factors.

Gazprom expects to fund these capital expenditures through both internal sources and external financing, including borrowings and share issues. There is, however, a significant degree of flexibility with respect to these planned expenditures, and the actual amount and timing of the expenditures may vary depending on commercial factors, contractual commitments and Gazprom's ability to obtain financing on acceptable terms.

Effect of Inflation on Financial Position and Results

Russia experienced inflation of approximately 131% for 1995 and cumulative inflation in excess of 6,000% for the three years ended December 31, 1995. The results presented in the RAR consolidation profit and loss account have not been indexed for inflation except as relating to depreciation (but with a one year timing delay as described above). Application of IAS in a hyper-inflationary economy requires the results of operations all to be restated in terms of the equivalent purchasing power of the currency unit at the year end (using a general price index).

DESCRIPTION OF THE SHARES

Set forth below is summary information concerning the Shares, certain provisions of the Charter of RAO Gazprom in effect on the date hereof and certain provisions of Russian law. This summary does not purport to be complete and is qualified in its entirety by reference to the Charter of RAO Gazprom and to the provisions of Russian law referred to in such summary. Copies of RAO Gazprom's Charter are available for inspection at RAO Gazprom's offices at 16 Namyotkina Street, 117884 GSP Moscow, V420, Russian Federation.

General

RAO Gazprom's initial share capital was established in the amount of 89.3 billion rubles, divided into 89,255,660 ordinary registered shares with a nominal value of 1000 rubles each (issuance of shares accounting for this charter capital was never registered). Later the charter capital was increased to 236.7 billion rubles. The Ministry of Finance of Russia registered issuance of 236,735,129 ordinary shares with a nominal value of 1,000 rubles each on May 20, 1993. RAO Gazprom's ordinary registered shares of 1,000 rubles each were each subdivided into 100 ordinary registered shares with a nominal value of 10 rubles each by a decision of the Privatization Voucher Auction Commission on September 22, 1994. The charter capital of RAO Gazprom of 236.7 billion rubles divided into 23,673,512,900 shares with nominal value 10 rubles each was registered by the Moscow Registration Chamber on July 26, 1995. RAO Gazprom's share capital is currently approximately 236.7 billion rubles, divided into 23,673,512,900 ordinary registered shares of 10 rubles each. RAO Gazprom currently has no authorized but unissued ordinary registered shares outstanding. RAO Gazprom currently does not have any preference shares authorized, issued or outstanding. Upon completion of the Global Offering, there will be no change in the number of outstanding Shares.

The Charter of RAO Gazprom contains certain specific provisions, including those whereby RAO Gazprom is permitted to purchase Shares pursuant to the exercise of pre-emptive rights, that arose out of the special features of the privatization of RAO Gazprom as recognized by Article 1, Part 5 of the recently adopted Joint Stock Company Law. Under that Article, the specific features of the legal status of a privatized joint stock company remain effective "from the moment of the privatization decision until the state . . . disposes of 75% of its shareholding . . . but no later than the expiration of the privatization period established by the privatization plan of the respective enterprise." Although the privatization plan for RAO Gazprom did not specify a date on which the privatization period would expire, Decree No. 1210 of the President of the Russian Federation of August 18, 1996 clarified that a company's privatization period may continue for as long as a specified portion of shares is required to remain fixed in federal ownership. In the case of RAO Gazprom, 40% of RAO Gazprom Shares are required to remain fixed in federal ownership until February 1999 under a Presidential Decree (although the President is free to change this policy at any time). Accordingly, the special provisions of RAO Gazprom's Charter are still in effect and will remain effective for so long as a certain percentage of Shares is required to remain fixed in federal ownership.

Authorization of Other Shares

New ordinary shares may be issued up to the number of ordinary shares authorized, but unissued, by RAO Gazprom (i.e. declared shares) by a resolution of a shareholders' meeting or a decision of the Board of Directors. As the Charter does not provide for any authorized but unissued ordinary shares of RAO Gazprom, RAO Gazprom must convene a shareholders' meeting to authorize new ordinary shares and amend the Charter accordingly.

RAO Gazprom may also authorize issuance of other classes of shares which may have preferential rights as to dividends, liquidation, or otherwise. To authorize such shares, RAO Gazprom has to have the approval of the general meeting of the Shareholders.

Dividends

RAO Gazprom may declare annual dividends on the Shares by resolution of a simple majority of the Shareholders up to the amount recommended by the Board of Directors. In addition, the Board of Directors may declare interim dividends on the Shares, without the vote of the Shareholders. Dividends may only be paid in respect of any year from the net profit of RAO Gazprom for that year, determined on the basis of Russian accounting standards. The amount of annual dividends may not fall below the amount of interim dividends already paid out, if any.

RAO Gazprom may not pay dividends until the charter capital is paid in full (which has been done) or, in the event of a Share buy-back, all Shares have been repurchased by RAO Gazprom.

RAO Gazprom must create a reserve fund of an amount not less than 15% of its charter capital. The reserve fund is to be formed by annual contributions of an amount not less than 5% of the net profits of RAO Gazprom, until it reaches 15%. The reserve fund may only be used to extinguish losses of RAO Gazprom, or cancel bonds or redeem shares, if RAO Gazprom has no other source of financing available.

A special Company share acquisition fund for employees may be established from net profit by the Board of Directors. This fund will be used by RAO Gazprom to acquire Shares sold by shareholders for distribution to employees.

Designated funds shall be established at the cost of RAO Gazprom's profit and other proceeds to secure the obligations of RAO Gazprom and its industrial and social development.

Voting Rights

Each Shareholder is entitled to one vote per each fully paid Share of which he is a holder. Holders of Shares and, subject to the provision of the Federal Law on Joint Stock Companies, holders of preference shares who are either present at the general meeting or represented by proxy may vote their shares.

As a registered Shareholder, the Depositary (or its nominee) will be entitled to vote the Shares underlying the ADSs. The Deposit Agreement requires the Depositary (or its nominee) to accept voting instruction (or deemed instruction) from owners of ADSs and to execute such instructions to the extent permitted by law. See "Description of the American Depositary Shares—Voting of Deposited Securities."

The rights of the existing Shares in RAO Gazprom can be varied only by amendment of the Charter.

The Board of Directors shall in accordance with the Shareholders' register compile a list of Shareholders who have the right to vote at the general meeting. The Board may not compile this list on a date earlier than the date of the decision to hold the general meeting; nor may they compile the list earlier than 60 days prior to the date of the meeting itself.

General Meetings

General meetings of Shareholders are required to be held once a year not earlier than two months and not later than six months after the completion of the fiscal year of RAO Gazprom.

Notice of general meetings of Shareholders and any additional information must be published in the press media as determined by the Shareholders at a general meeting. Additional notice can also be given by RAO Gazprom through television, radio, or other mass media. The notice must set out the name and the address of RAO Gazprom, the date, time and venue of the meeting, the agenda, the date on which the list of voting Shareholders is to be prepared and the procedure of disclosing information to Shareholders. The notice and any additional information must be published in a newspaper not later than 30 days before the meeting is to be convened.



The Depositary will send to all record holders of ADSs a notice containing a summary of all information included in any notice of a Shareholders' meeting received in English by the Depositary. See "Description of the American Depositary Shares—Voting of Deposited Securities."

The initial quorum for a general meeting is met if at the close of registration of participants in the general meeting, Shareholders (or their representatives) holding more than 50% of the voting shares of RAO Gazprom have registered. In the absence of a quorum, a date for the meeting will be set, and that meeting will be considered quorate, if Shareholders with at least 30% of the voting shares of RAO Gazprom are present.

The general meeting of Shareholders has competence over certain matters including the following:

- alteration of the Charter;
- re-organization and liquidation of RAO Gazprom;
- election of the members of the Board of Directors and establishing their remuneration;
- creation of declared shares;
- increase and decrease of the charter capital of RAO Gazprom (excluding cases when an increase of the charter capital may be carried out pursuant to a decision of the Board of Directors);
- election of the Audit Committee;
- appointment of an external auditor of RAO Gazprom;
- approval of the annual reports, balance sheets and profit and loss accounts;
- payment of annual dividends;
- approval of the conclusion of transactions with interested persons of RAO Gazprom; and
- approval of the conclusion of substantial property transactions.

The above matters are within the exclusive competence of the general meeting of Shareholders and may not be delegated to the Board of Directors (with the exception of resolutions increasing the charter capital of RAO Gazprom).

Holders of 2% or more of the Shares may propose items for inclusion in the agenda of an annual general meeting of Shareholders or may propose candidates for the Board of Directors and Audit Committee. Such Shareholders may propose up to two items for inclusion in the agenda or a candidate for each position on the Board or in the Audit Committee within a period of 30 days after the end of the financial year of RAO Gazprom. The Board of Directors must decide whether to include the proposed items in the agenda or the candidates in the ballot list within 15 days after the expiry of that period. The Board must send its decision to the Shareholder within 3 days from the day of the decision. The Shareholder may challenge the decision of the Board in court.

Resolutions to alter the Charter, reorganize or liquidate RAO Gazprom, create declared, i.e. authorized but unissued, shares, approve substantial property transactions and dismiss members of the Board of Directors and the Audit Committee require a majority of not less than three quarters of the votes of Shareholders who are represented at the meeting, although according to the Federal Law on Joint Stock Companies, a simple majority of votes is sufficient to dismiss members of the Board or the Audit Committee. All other resolutions of the general meeting of Shareholders require a simple majority of votes of Shareholders who are represented at the meeting. A resolution on transfer of the functions of the executive organ of RAO Gazprom to another entity or a registered entrepreneur or an external manager requires a majority of 95% of votes of Shareholders registered at the meeting.

Extraordinary general meetings of Shareholders may be held either (i) pursuant to the decision of the Board of Directors or (ii) at the request of the Audit Committee, an external auditor, or holders of not less than 10% of the Shares counted on the day of the presenting of such request. The Board of Directors must convene the extraordinary general meetings of Shareholders not later than the expiration of 45 days from the day of the request.

Transfer of Shares

Subject to RAO Gazprom's right of pre-emption and the ownership restrictions referred to below, any Shareholder may transfer all or any of his Shares pursuant to procedures set out in RAO Gazprom's Charter. The transferor shall be deemed to remain the holder until the transferee's name is entered in the register of Shareholders.

Legal or natural persons and their affiliates may not acquire more than 3% of the Shares of RAO Gazprom without the prior written consent of the Management Committee of RAO Gazprom.

A Russian legal or natural person may not sell Shares in RAO Gazprom to a foreign (non-Russian) legal or natural person without the prior written consent of the Management Committee. (In the event that a Russian natural person changes his or her citizenship, the Shares in RAO Gazprom acquired by that person prior to his or her change in citizenship may not be transferred without the prior written consent of the Management Committee.) Foreign persons who have acquired Shares in RAO Gazprom with the consent of the Management Committee may freely dispose of such Shares, subject to the 3% limit described above. Not more than 9% of the voting securities in RAO Gazprom may be owned by foreign persons.

The Charter also contains pre-emptive rights in favor of RAO Gazprom which entitles it to acquire any Shares to be transferred by Russian Shareholders. The procedures to be followed with respect to these pre-emptive rights were recently clarified by the Temporary Regulations published by RAO Gazprom's Management Committee pursuant to Article 38 of the Charter. Prior to effecting any sale of Shares, Russian Shareholders must first offer them to RAO Gazprom on the basis of documentation attached to the Temporary Regulations. The offered Shares are then "blocked" for up to 30 calendar days, during which RAO Gazprom may (i) accept the offer and purchase the Shares (no additional instruments of transfer being required), (ii) issue a written notice rejecting the offer or (iii) remain silent. If RAO Gazprom rejects the offer or remains silent, the Russian Shareholder has 90 days (beginning either on the day the offer is rejected or on the date that the 30-day period expires, as applicable, and after the registrar or depositary was issued a written permission to sell) to dispose of the Shares. If the Shares are not sold within this 90-day period they become subject once again to RAO Gazprom's pre-emptive rights.

Once a Share is permitted by RAO Gazprom to be sold in an FSC auction it may thereafter be sold in subsequent auctions without being subject to pre-emptive rights. If, however, a Shareholder wishes at some later time to sell such Shares otherwise than in an auction, the pre-emptive rights would then apply to that sale.

Transactions in the Shares concluded in breach of the above restrictions shall be deemed null and void.

A person intending independently or jointly with its affiliated persons to acquire 30% or more of the Shares must notify RAO Gazprom of its intention in writing not later than 30 days before such acquisition. A person who has acquired 30% or more of the Shares must, within 30 days from the acquisition, make an offer to the Shareholders to sell to such person their Shares at a price not lower than the average price of the Shares purchased by the acquirer during the six months prior to the date of the acquisition. The general meeting of Shareholders may relieve a person from this obligation by a resolution passed with a simple majority of votes excluding any votes cast by that person. The sanction for the violation of the above provisions is that any Shares acquired exceeding 30% of the Shares do not carry the right to vote.

Pre-emptive Rights

Holders of the Shares of RAO Gazprom are entitled, in proportion to their holdings of Shares, to subscribe for issues or securities convertible into Shares offered for cash by RAO Gazprom by way of public offering, unless such pre-emptive rights are waived by a resolution passed with a simple majority of votes of the Shareholders present in person or by proxy at a general meeting. There can be no assurance that holders of ADSs will be able to exercise fully any pre-emptive rights to which the holders of Shares may be entitled. If ADS holders were not able to exercise their pre-emptive rights, the Depositary would, to the extent possible, dispose of such rights for their account. See "Description of the American Depositary Shares."

Reports to Shareholders

RAO Gazprom must make available to Shareholders the following documents: the Charter of RAO Gazprom and all amendments to it, certificates of registration of RAO Gazprom, documents certifying the rights of RAO Gazprom to the property on its balance sheet, corporate records of RAO Gazprom, regulations on the branches and representative offices of RAO Gazprom, annual financial report, prospectus for share issues, documents of the financial reporting submitted to government regulators, lists of RAO Gazprom's affiliates, and reports of the Audit Committee, the external auditor of RAO Gazprom or state municipal bodies for financial control. Accounting documents and minutes of the Management Committee are not subject to disclosure.

RAO Gazprom must also annually publish the following documents in mass media: RAO Gazprom's annual report, balance sheet, profit and loss account, any prospectus to issue Company shares, any notice of the general meeting of Shareholders, lists of affiliates of RAO Gazprom and certain other information specified by law.

Liability of Shareholders

The liability of Shareholders of RAO Gazprom for RAO Gazprom's losses is generally limited to their shareholding in RAO Gazprom. Under Russian law, shareholders in general meeting may increase the charter capital of a joint stock company by increasing the nominal value of its shares. This power may be delegated to the company's board of directors under the company's charter, and the Charter of RAO Gazprom delegates this power to the Board of Directors. It is generally understood that the nominal value of shares in a company may be increased through the capitalization of retained earnings or certain other elements of shareholders' equity. Russian law and RAO Gazprom's Charter, however, fail to specify the means by which such an increase may be effected; and the possibility of increasing the nominal value of shares through a compulsory assessment of Shareholders is not expressly prohibited. The effectiveness of any attempt to make a compulsory assessment of Shareholders is uncertain, since Russian law neither contemplates such an action nor provides a mechanism to enforce any such attempt. In any event, even if it has the authority to do so and could enforce any such decision, RAO Gazprom has no intention of increasing the nominal value of the Shares through a compulsory assessment of Shareholders.

Rights on Liquidation

On a liquidation or winding-up, the assets of RAO Gazprom will be divided amongst holders of shares in accordance with the rights attaching to such shares, after satisfaction of the claims of creditors, and holders of preference shares that have preferred rights in liquidation. RAO Gazprom currently does not have any such preference shares authorized or outstanding.

Purchase of Shares by RAO Gazprom

RAO Gazprom may buy back Shares for cancellation pursuant to a resolution of the general meeting of Shareholders to reduce the charter capital of RAO Gazprom.

RAO Gazprom may also buy back Shares pursuant to a decision of the Board of Directors, provided that the total nominal value of the Shares remaining outstanding after the buy-back is not less than 90% of the charter capital of RAO Gazprom. Such Shares are available for resale by RAO Gazprom for a period of up to one year from the date of their acquisition. During that period no voting rights shall be exercised in respect of and no dividends shall be payable on such Shares.

Each Shareholder holding Shares intended for repurchase by RAO Gazprom shall have the right to sell the specified Shares and RAO Gazprom is obligated to buy them. If the total number of Shares for which applications for repurchase by RAO Gazprom have been made exceeds the number of Shares that RAO Gazprom has the right to acquire, Shares shall be repurchased from the Shareholders on a pro rata basis.

Holders of Shares may demand that RAO Gazprom buy back all or part of their Shares if a general meeting of Shareholders adopts a resolution to:

- reorganize RAO Gazprom;
- conclude a substantial property transaction; or
- amend the Charter in a manner which limits their rights.

Shareholders must send an application to RAO Gazprom within 45 days from the day of the relevant resolution. RAO Gazprom must buy back these Shares within 30 days from the expiration of that period. The Shares must be bought at their market value, which is to be determined by the Board of Directors together with an independent auditor and a state controlling agency.

When buying back Shares, RAO Gazprom cannot spend more than 10% of the value of its net assets calculated as at the date of the general meeting. If Shareholders tender more shares than RAO Gazprom is permitted to purchase, RAO Gazprom must repurchase Shares on a pro rata basis.

The Shares purchased by RAO Gazprom must be resold within a year from the date of their acquisition. If such Shares are not sold within a year from the date of their acquisition, the general meeting of Shareholders must resolve to cancel the Shares and either reduce the charter capital of RAO Gazprom or increase the nominal value of the remaining Shares.

It is possible that a cancellation of Shares (with or without an associated reduction in the charter capital of RAO Gazprom) following a repurchase of Shares could result in more than 9% of the voting share capital being owned by foreign investors, with uncertain consequences. Prior to any cancellation of Shares that could have this effect, RAO Gazprom will use reasonable efforts to ensure that foreign investors are not adversely affected.

DESCRIPTION OF THE AMERICAN DEPOSITARY SHARES

The following is a summary of certain provisions of the Rule 144A Deposit Agreement (the "Rule 144A Deposit Agreement") to be dated as of October 25, 1996, among RAO Gazprom, the Depositary and the Rule 144A Owners and Rule 144A Beneficial Owners (as defined in the Rule 144A Deposit Agreement) from time to time of Rule 144A ADRs, pursuant to which the Rule 144A ADRs are to be issued and the Regulation S Deposit Agreement (the "Regulation S Deposit Agreement") to be dated as of October 25, 1996, among RAO Gazprom, the Depositary and the Regulation S Owners and Regulation S Beneficial Owners (as defined in the Regulation S Deposit Agreement) from time to time of Regulation S ADRs, pursuant to which the Regulation S ADRs are to be issued. This summary does not purport to be complete and is subject to and qualified in its entirety by reference to the Deposit Agreements, including the form of Rule 144A ADRs and Regulation S ADRs. Terms used in this description and not otherwise defined shall have the meanings set forth in the Deposit Agreements. Copies of the Deposit Agreements will be available for inspection at the Corporate Trust Office of the Depositary, currently located at 101 Barclay Street, New York, New York 10286, and at the principal Moscow office of Internationale Nederlanden Bank (Eurasia), the custodian and agent of the Depositary under each of the Deposit Agreements (the "Custodian"), currently located at 45 Krasnaya Presnya, Moscow, Russia. The Depositary's principal executive office is located at 48 Wall Street, New York, New York 10286. Unless the context otherwise requires, references herein to ADRs and ADSs shall apply equally to the Rule 144A ADRs and the Regulation S ADRs and to the Rule 144A ADSs and the Regulation S ADSs, respectively.

American Depositary Receipts

Rule 144A ADRs evidencing Rule 144A ADSs are issuable by the Depositary pursuant to the Rule 144A Deposit Agreement. Regulation S ADRs evidencing Regulation S ADSs are issuable by the Depositary pursuant to the Regulation S Deposit Agreement. Each Rule 144A ADR will evidence a specified number of Rule 144A ADSs, each Rule 144A ADS representing 10 Shares deposited with the Custodian and registered in the name of the Depositary or its nominee (together with any additional Shares at any time deposited or deemed deposited under the Deposit Agreement and any other securities, cash or other property received by the Depositary or the Custodian in respect of such Shares, the "Rule 144A Deposited Securities"). Each Regulation S ADR will evidence a specified number of Regulation S ADSs, each Regulation S ADS representing 10 Shares deposited with the Custodian and registered in the name of the Depositary or its nominee (together with any additional Shares at any time deposited or deemed deposited under the Regulation S Deposit Agreement and any other securities, cash or other property received by the Depositary or the Custodian in respect of such Shares, the "Regulation S Deposited Securities" and, together with the Rule 144A Deposited Securities, the "Deposited Securities"). Only persons in whose names Rule 144A ADRs or Regulation S ADRs, as the case may be, are registered on the books of the Depositary as owners of the Rule 144A ADRs or Regulation S ADRs, as the case may be, will be treated by the Depositary and RAO Gazprom as Rule 144A Owners or Regulation S Owners, respectively.

Settlement—Rule 144A ADRs

RAO Gazprom and the Depositary will make application to DTC for acceptance of the Rule 144A ADRs in DTC's book-entry settlement system. If the application is accepted, the Global Rule 144A ADR will be issued to DTC and registered in the name of Cede & Co., as nominee of DTC, and may be held by the Depositary, as custodian for DTC. Thereafter, Cede & Co. will be the holder of record of all such Rule 144A ADRs. Accordingly, each person owning a beneficial interest in the Global Rule 144A ADR must rely upon the procedures of the institutions having accounts with DTC to exercise or be entitled to any rights of a Rule 144A Owner. So long as any Rule 144A ADRs are traded through DTC's book-entry settlement system, or unless otherwise required by law, ownership of beneficial interests in the Global Rule 144A ADR will be shown on, and the transfer of that ownership will be effected only through, records maintained by (i) DTC or its nominee (with respect to participants' interests) or (ii) institutions that have accounts with DTC. Where the context requires, the term "Rule 144A ADR" includes the Global Rule 144A ADR.

If such application is not accepted, or if DTC ceases to make its book-entry settlement system available for the Rule 144A ADRs, RAO Gazprom will consult with the Depositary regarding other arrangements for book-entry settlement. In the event that it is impracticable without undue effort or expense to continue to have the Rule 144A ADRs available in book-entry form, RAO Gazprom will instruct the Depositary to make Rule 144A ADRs available in physical, certificated form to all Rule 144A Beneficial Owners, with such modification to the form of Rule 144A ADRs and the Rule 144A Deposit Agreement as RAO Gazprom and the Depositary may agree, subject to the terms of the Rule 144A Deposit Agreement.

The Global Rule 144A ADR and any Rule 144A ADR delivered in physical, certificated form will be endorsed with a legend regarding certain restrictions on transfer in substantially the form set forth under "Transfer Restrictions."

Settlement—Regulation S ADRs

RAO Gazprom and the Depositary will make application to each of DTC, Euroclear and CEDEL for acceptance of the Regulation S ADRs in their respective book-entry settlement systems. If the applications are accepted, the Global Regulation S ADR will be issued to DTC and registered in the name of Cede & Co., as nominee of DTC, and may be held by the Depositary, as custodian for DTC. Thereafter, Cede & Co. will be the holder of record of all such Regulation S ADRs. Accordingly, each person owning a beneficial interest in the Global Regulation S ADR must rely upon the procedures of the institutions having accounts with DTC to exercise or be entitled to any rights of a Regulation S Owner. Initial settlement of the Regulation S ADRs will take place through Euroclear and CEDEL in accordance with customary settlement procedures in the Euromarket. Until the later of 40 days after the last closing date with respect to the ADRs and the completion of the distribution of the ADRs in the Global Offering (the "Restricted Period"), Euroclear and CEDEL will hold the Regulation S ADRs on behalf of their participants through their respective depositaries, which are participants in DTC, and transfers will be permitted only within Euroclear and CEDEL in accordance with the usual rules and operating procedures of the relevant system. Thereafter, transfers within DTC, Euroclear and CEDEL will be in accordance with the usual rules and operating procedures of the relevant system. Cross-market transfers will be effected in DTC through the respective depositaries of Euroclear and CEDEL. Because of time zone differences, credits of securities received in Euroclear or CEDEL as a result of a transaction with a DTC participant will be made during the subsequent securities settlement processing date on the business day following the DTC settlement date and such credits or any transactions in such securities settled during such processing will be reported to the relevant CEDEL or Euroclear participant on such business day. Cash received in CEDEL or Euroclear as a result of sales of securities by or through a CEDEL participant or a Euroclear participant to a DTC participant will be received with value on the DTC settlement date, but will be available in the relevant CEDEL or Euroclear cash account only as of the business day following settlement in DTC. Where the context requires, the term "Regulation S ADR" includes the Global Regulation S ADR.

If such applications are not accepted or if DTC or, during the Restricted Period, Euroclear or CEDEL ceases to make its respective book-entry settlement systems available for the Regulation S ADRs, RAO Gazprom will consult with the Depositary regarding other arrangements for book-entry settlement. During the Restricted Period, only in the event that it is impracticable without undue effort or expense to continue to have the Regulation S ADRs available in book-entry form will RAO Gazprom instruct the Depositary to make Regulation S ADRs available in physical, certificated form to all Regulation S Beneficial Owners, with such modification to the form of Regulation S ADRs and the Regulation S ADR Deposit Agreement as RAO Gazprom and the Depositary may agree, subject to the terms of the Regulation S ADR Deposit Agreement.

DTC, Euroclear and Cedel will not monitor compliance with any transfer or ownership restrictions.

Prior to the Effective Time, the Global Regulation S ADR and any Regulation S ADR delivered in physical, certificated form will be endorsed with a legend regarding certain restrictions on transfer in substantially the form set forth under "Transfer Restrictions."

Available Information

RAO Gazprom expects to be exempted from the registration requirements of Section 12(g) of the Exchange Act pursuant to Rule 12g3-2(b) thereunder. RAO Gazprom will agree in the Rule 144A Deposit Agreement that if, at any time prior to the termination of the Deposit Agreement, RAO Gazprom is neither a reporting company under Section 13 or 15(d) of the Exchange Act nor exempt from reporting pursuant to Rule 12g3-2(b) of the Exchange Act, RAO Gazprom will provide to any Owner, Beneficial Owner or any holder of Shares underlying ADSs, and to any prospective purchaser of ADRs or of Shares underlying ADSs, upon request of any such Owner, Beneficial Owner, holder of Shares or prospective purchaser of ADRs or of Shares, the information required by Rule 144A(d)(4)(i) of the Securities Act and otherwise comply with Rule 144A(d)(4) of the Securities Act.

Deposit, Transfer and Withdrawal—Rule 144A ADRs

Each Owner and Beneficial Owner of a Rule 144A ADR shall be deemed to acknowledge, that, immediately following the initial closing in respect of the ADRs, the Management Committee of RAO Gazprom intends to instruct the Depositary in writing to accept no Shares for deposit pursuant to the Rule 144A Deposit Agreement other than (i) Shares or other Rule 144A Deposited Securities received by the Depositary as a dividend or free distribution pursuant to the provisions of the Rule 144A Deposit Agreement, (ii) Shares or other Rule 144A Deposited Securities received by the Depositary upon any change in nominal value, change in par value, split-up, consolidation or any other reclassification of Shares, or upon any recapitalization, reorganization, merger or consolidation or sale of assets affecting RAO Gazprom pursuant to the provisions of the Rule 144A Deposit Agreement, (iii) Shares or other Rule 144A Deposited Securities that have been withdrawn pursuant to the Regulation S Deposit Agreement against the surrender of Regulation S ADRs solely for deposit pursuant to the Rule 144A Deposit Agreement and (iv) as directed by the Management Committee of RAO Gazprom in writing from time to time.

The Depositary has agreed, subject to the provisions of the Rule 144A Deposit Agreement described in the preceding paragraph and the other terms and conditions of the Rule 144A Deposit Agreement and the terms and conditions of the Charter of RAO Gazprom, that upon delivery to the Custodian of Shares (or evidence of rights to receive Shares), accompanied by appropriate instruments of transfer (which may consist of (a) extracts from the Share Register and, where applicable, share certificates evidencing ownership of the Shares, (b) a transfer deed or other similar document authorizing registration of the Shares in the name of the Depositary, the Custodian or their respective nominees, or endorsement, in a form satisfactory to the Custodian, and (c) where applicable, a purchase/sale contract or other similar document relating to the transfer of the Shares), the Depositary will, upon payment of the fees, charges and taxes provided in the Rule 144A Deposit Agreement, execute and deliver at its Corporate Trust Office to, or upon the written order of, the person or persons named in the notice of the Custodian delivered to the Depositary or requested by the person depositing such Shares with the Depositary, a Rule 144A ADR or Rule 144A ADRs, registered in the name or names of such person or persons, and evidencing any authorized number of ADSs requested by such person or persons.

Any deposit of Shares for Rule 144A ADSs must be accompanied by a written certification ("Depositor's Certificate") by or on behalf of the person who will be the beneficial owner of the Rule 144A ADS or Rule 144A ADSs to be issued upon deposit of such Shares, to the effect that it (a) is a QIB, acquiring such beneficial ownership for its own account or for the account of one or more QIBs, and (b) will comply with the restrictions set forth under "Transfer Restrictions" on transfers of the Rule 144A ADRs, the Rule 144A ADSs evidenced thereby and the Shares represented thereby. The Depositary will refuse to accept Shares for deposit whenever it is notified in writing that such deposit would result in any violation of applicable laws. The Depositary will also comply with written instructions of RAO Gazprom that the Depositary shall not accept for deposit under the Rule 144A Deposit Agreement any Shares identified in such instructions at such times and under such circumstances as may reasonably be specified in such instructions in order to facilitate RAO Gazprom's

compliance with the securities laws of the United States. The Depositary will also refuse to accept certain Shares for deposit if notified in writing that the Shares are listed on a U.S. securities exchange or quoted on a U.S. automated inter-dealer quotation system, unless accompanied by evidence satisfactory to the Depositary that any Shares presented for deposit are eligible for resale pursuant to Rule 144A.

Upon surrender at the Corporate Trust Office of the Depositary of a Rule 144A ADR for the purpose of withdrawal of the Deposited Securities represented by the Rule 144A ADSs evidenced by such Rule 144A ADR, accompanied by such documents as the Depositary may require (including a purchase/sale contract relating to the transfer of the Shares), and upon payment of the fees, expenses, governmental charges and taxes provided in the Rule 144A Deposit Agreement, and subject to the terms and conditions of the Rule 144A Deposit Agreement, the Charter of RAO Gazprom and the Rule 144A Deposited Securities, the Rule 144A Owner of such Rule 144A ADR will be entitled to delivery, to him or upon his order, as permitted by applicable law, of the amount of Deposited Securities at the time represented by the Rule 144A ADS or Rule 144A ADSs evidenced by such Rule 144A ADR. The forwarding of share certificates or other documents evidencing title (including extracts from the Share Register), other securities, property, cash and other documents of title for such delivery will be at the risk and expense of the Rule 144A Owner.

Notwithstanding the foregoing, no Rule 144A Deposited Securities may be withdrawn in the manner described in the preceding paragraph unless, at or prior to the time of surrender, the Depositary shall have received a written certificate and agreement by or on behalf of the person surrendering such Rule 144A ADR who after withdrawal will be the beneficial owner of the Shares withdrawn, acknowledging that such Shares have not been registered under the Securities Act, certifying as to whether or not such Shares will remain restricted securities within the meaning of Rule 144(a)(3) under the Securities Act upon withdrawal and, in the case of Shares that will remain restricted securities within the meaning of Rule 144(a)(3) under the Securities Act, agreeing (a) not to offer, sell, pledge or otherwise transfer such Shares except in a transaction that complies with the restrictions on transfer set forth under "Transfer Restrictions" and (b) not to deposit or cause to be deposited such Shares into any unrestricted depositary receipt facility established or maintained by a depositary bank (including another facility maintained by the Depositary) relating to such Shares unless such Shares are no longer deemed to be restricted securities within the meaning of Rule 144(a)(3) under the Securities Act. **In addition, no Rule 144A Deposited Securities may be withdrawn in the manner described in the preceding paragraph unless, at or prior to the time of surrender, the Depositary shall have received a written certificate by or on behalf of the person surrendering such Rule 144A ADR who after such withdrawal will be the beneficial owner of such Rule 144A Deposited Securities (a) that such person is a resident of Russia at the time of such withdrawal or (b) that (i) such person is not a resident of Russia at the time of such surrender and withdrawal, and (ii)(x) has sold or otherwise transferred, or agreed to sell or otherwise transfer and at or prior to the time of withdrawal will have sold or otherwise transferred, the Rule 144A Deposited Securities to a person that is a resident of Russia at such time, or (y) has sold or otherwise transferred, or agreed to sell or otherwise transfer, the Rule 144A Deposited Securities pursuant to Rule 904 of Regulation S to a person who has agreed to promptly deposit such securities pursuant to the Regulation S Deposit Agreement against the issuance of Regulation S ADRs.**

Neither the Depositary nor the Custodian under the Regulation S Deposit Agreement, nor any nominee or person acting on their behalf, shall accept Rule 144A ADRs evidencing Rule 144A ADSs issued pursuant to the Rule 144A Deposit Agreement or Shares withdrawn from the Rule 144A Deposit Agreement for the purpose of deposit under the Regulation S Deposit Agreement, or issue Regulation S ADSs against delivery thereof, as long as such Rule 144A ADSs, Rule 144A ADRs or Shares are or may be deemed to be restricted securities within the meaning of Rule 144(a)(3) under the Securities Act.

Deposit, Transfer and Withdrawal—Regulation S ADRs

Each Owner and Beneficial Owner of a Regulation S ADR shall be deemed to acknowledge, that, immediately following the initial closing in respect of the ADRs, the Management Committee of RAO Gazprom intends to instruct the Depositary in writing to accept no Shares for deposit pursuant to the Regulation S Deposit Agreement other than (i) Shares or other Regulation S Deposited Securities received by the Depositary as a dividend or free distribution pursuant to the provisions of the Regulation S Deposit

Agreement, (ii) Shares or other Regulation S Deposited Securities received by the Depositary upon any change in nominal value, change in par value, split-up, consolidation or any other reclassification of Shares, or upon any recapitalization, reorganization, merger or consolidation or sale of assets affecting RAO Gazprom pursuant to the provisions of the Regulation S Deposit Agreement, (iii) Shares or other Regulation S Deposited Securities that have been acquired pursuant to Rule 904 of Regulation S and have been withdrawn pursuant to the Rule 144A Deposit Agreement against the surrender of Rule 144A ADRs solely for deposit pursuant to the Regulation S Deposit Agreement and (iv) as directed by the Management Committee of RAO Gazprom in writing from time to time.

The Depositary has agreed, subject to the provisions of the Regulation S Deposit Agreement described in the preceding paragraph and the other terms and conditions of the Regulation S Deposit Agreement and the terms and conditions of the Charter of RAO Gazprom, that upon delivery to the Custodian of Shares (or evidence of rights to receive Shares), accompanied by appropriate instruments of transfer (which may consist of (a) extracts from the Share Register and, where applicable, share certificates evidencing ownership of the Shares, (b) a transfer deed or other similar document authorizing registration of the Shares in the name of the Depositary, the Custodian or their respective nominees, or endorsement, in a form satisfactory to the Custodian, and (c) where applicable, a purchase/sale contract or other similar document relating to the transfer of the Shares), the Depositary will, upon payment of the fees, charges and taxes provided in the Regulation S Deposit Agreement, execute and deliver at its Corporate Trust Office to, or upon the written order of, the person or persons named in the notice of the Custodian delivered to the Depositary or requested by the person depositing such Shares with the Depositary, a Regulation S ADR or Regulation S ADRs, registered in the name or names of such person or persons, and evidencing any authorized number of Regulation S ADSs requested by such person or persons.

Following completion of the Global Offering, a registration statement on Form F-6 under the Securities Act relating to the Regulation S ADSs issued pursuant to the Regulation S Deposit Agreement subsequent to the effectiveness of any such registration statement (the "Effective Time") may be filed with the SEC. Any such registration statement may not be filed and would not be declared effective prior to the later of 40 days after the last closing date with respect to the ADRs and the completion of the distribution of the ADRs in the Global Offering. There can be no assurance that a registration statement under the Securities Act relating to the Regulation S ADSs will be filed or, if filed, will be declared effective under the Securities Act by the SEC, nor can there be any assurance as to the timing of the filing of any such registration statement or the timing of the effectiveness thereof under the Securities Act.

Prior to the Effective Time, any deposit of Shares for Regulation S ADRs must be accompanied by (a) a written acknowledgment and certification by or on behalf of the person who will be the beneficial owner of the Regulation S ADS or Regulation S ADSs to be issued upon deposit of such Shares that (i) the Regulation S ADRs, the Regulation S ADSs evidenced thereby, and the Shares represented thereby have not been registered under the Securities Act, (ii) it is not a U.S. person (within the meaning of Regulation S) and is located outside the United States (within the meaning of Regulation S) and acquired, or has agreed to acquire and will acquire, the Shares to be deposited outside the United States, (iii) it is not an affiliate of RAO Gazprom or a person acting on behalf of such an affiliate and (iv) it is not in the business of buying and selling securities or, if it is in such business, it did not acquire the Shares to be deposited from RAO Gazprom or any affiliate thereof in the Global Offering and (b) an agreement that, during the Restricted Period, (i) it will comply with the restrictions on transfer set forth under "Transfer Restrictions" on transfers of the Regulation S ADRs, the Regulation S ADSs evidenced thereby and the Shares represented thereby and (ii) if it sells or otherwise transfers the Regulation S ADSs evidenced by the Regulation S ADRs or the Shares represented thereby during the Restricted Period in accordance with such Regulation S ADR transfer restrictions to a person it reasonably believes is a QIB in a transaction meeting the requirements of Rule 144A it will cause such Shares to be withdrawn in accordance with the terms and conditions of the Regulation S ADR Deposit Agreement and deposited under the Rule 144A Deposit Agreement for issuance of Rule 144A ADSs in accordance with the terms and conditions of such Deposit Agreement.

The Depositary will refuse to accept Shares for deposit whenever it is notified in writing that such deposit would result in any violation of applicable laws. The Depositary will also comply with written instructions of RAO Gazprom that the Depositary shall not accept for deposit under the Regulation S Deposit Agreement any Shares identified in such instructions at such times and under such circumstances as may reasonably be specified in such instructions in order to facilitate RAO Gazprom's compliance with the securities laws of the United States. During the Restricted Period, the Depositary will also refuse to accept certain Shares for deposit if notified in writing that the Shares are listed on a U.S. securities exchange or quoted on a U.S. automated inter-dealer quotation system, unless accompanied by evidence satisfactory to the Depositary that any Shares presented for deposit are eligible for resale pursuant to Rule 144A.

Upon surrender at the Corporate Trust Office of the Depositary of a Regulation S ADR for the purpose of withdrawal of the Regulation S Deposited Securities represented by the Regulation S ADSs evidenced by such Regulation S ADR, accompanied by such documents as the Depositary may require (including a purchase/sale contract relating to the transfer of the Shares), and upon payment of the fees, expenses, governmental charges and taxes provided in the Regulation S Deposit Agreement, and subject to the terms and conditions of the Regulation S Deposit Agreement, the Charter of RAO Gazprom and the Regulation S Deposited Securities, the Regulation S Owner of such Regulation S ADR will be entitled to delivery, to him or upon his order, as permitted by applicable law, of the amount of Regulation S Deposited Securities at the time represented by the Regulation S ADS or Regulation S ADSs evidenced by such Regulation S ADR. The forwarding of share certificates or other documents evidencing title (including extracts from the Share Register), other securities, property, cash and other documents of title for such delivery will be at the risk and expense of the Regulation S Owner.

Notwithstanding the foregoing, during the Restricted Period, no Regulation S Deposited Securities may be withdrawn in the manner described in the preceding paragraph unless at or prior to the time of surrender, the Depositary shall have received a written certificate and agreement by or on behalf of the person surrendering such Regulation S ADR who after withdrawal will be the beneficial owner of the Shares withdrawn, (a) acknowledging that such Shares have not been registered and will not be registered under the Securities Act, (b) certifying as to whether or not such Shares will remain restricted securities within the meaning of Rule 144(a)(3) under the Securities Act upon withdrawal and, in the case of Shares that will remain restricted, agreeing (i) during the Restricted Period, not to offer, sell, pledge or otherwise transfer such Shares except in a transaction that complies with the restrictions on transfer set forth below under "Transfer Restrictions" and (ii) during the Restricted Period, if such Shares are being transferred to a QIB, that it will cause such Shares to be deposited under the Rule 144A Deposit Agreement for issuance of ADSs in accordance with the terms and conditions of such Rule 144A Deposit Agreement. **In addition, no Regulation S Deposited Securities may be withdrawn in the manner described in the preceding paragraph unless, at or prior to the time of surrender, the Depositary shall have received a written certificate by or on behalf of the person surrendering such Regulation S ADR who after such withdrawal will be the beneficial owner of such Regulation S Deposited Securities (a) that such person is a resident of Russia at the time of such withdrawal or (b) that (i) such person is not a resident of Russia at the time of such surrender and withdrawal, and (ii)(x) has sold or otherwise transferred, or agreed to sell or otherwise transfer and at or prior to the time of withdrawal will have sold or otherwise transferred, the Regulation S Deposited Securities to a person that is a resident of Russia at such time, or (y) has deposited or will promptly deposit the Regulation S Deposited Securities so withdrawn pursuant to the Rule 144A Deposit Agreement against the issuance of Rule 144A ADRs.**

The following description applies equally to the Rule 144A Deposit Agreement and the Regulation S Deposit Agreement, except as specifically indicated.

Dividends, Other Distributions and Rights

Subject to any restrictions imposed by Russian law, regulations or applicable permits, the Depositary is required to convert or cause to be converted, as promptly as practicable after its receipt thereof, into dollars, to the extent that in its judgment it can do so on a reasonable basis and can transfer the resulting dollars to the United States, all cash dividends and other cash distributions denominated in a currency other than dollars, including Rubles ("Foreign Currency"), that it receives into its foreign investment account in the Russian Federation in respect of the deposited Shares, and, after fixing a record date in respect thereof, to distribute, as



promptly as practicable, the resulting dollar amount (net of reasonable and customary expenses incurred by the Depositary in converting such Foreign Currency and of the fees of the Depositary) to the Owners entitled thereto, in proportion to the number of ADSs representing such Deposited Securities evidenced by ADRs held by them, respectively. Such distribution may be made upon an averaged or other practicable basis without regard to any distinctions among Owners on account of exchange restrictions or the date of delivery of any ADR or ADRs or otherwise. The amount distributed will be reduced by any amount on account of taxes to be withheld by RAO Gazprom or the Depositary. See "Liability of Owner for Taxes" herein. If any such conversion or distribution can be effected only with the approval or license of any government or agency thereof, the Depositary will file, as promptly as practicable, an application for such approval or license, but will be entitled to rely on local Russian counsel in such matters. If any Foreign Currency received by the Depositary or the Custodian is not, pursuant to applicable law, convertible in whole or in part, or if any approval or license of any government or agency thereof which is required for such conversion is denied or in the opinion of the Depositary cannot be promptly obtained, or if any such approval or license is not promptly obtained, the Depositary will, (a) as to that portion of the Foreign Currency that is convertible into dollars, make such conversion and, if permitted by applicable law, transfer such dollars to the United States in accordance with the Deposit Agreement and (b) as to the nonconvertible balance, if any, (i) if requested in writing by an Owner, distribute the Foreign Currency received by it to such Owner and (ii) if not so requested by an Owner, hold such Foreign Currency uninvested and without liability for interest thereon for the respective accounts of the Owners entitled to receive the same. If any such conversion of Foreign Currency, in whole or in part, cannot be effected for distribution to some of the Owners entitled thereto, the Depositary may in its discretion make such conversion and distribution in U.S. dollars to the extent permissible to the Owners entitled thereto, and may distribute the balance of the Foreign Currency received by it to, or hold such balance uninvested for the respective accounts of, the Owners.

If RAO Gazprom declares a dividend in, or free distribution of, Shares, the Depositary may, and will if RAO Gazprom so requests, distribute, as promptly as practicable, to the Owners of outstanding ADRs entitled thereto, in proportion to the number of ADSs evidenced by the ADRs held by them, respectively, additional ADRs evidencing an aggregate number of ADSs that represents the amount of Shares received as such dividend or free distribution, subject to the terms and conditions of the Deposit Agreement with respect to the deposit of Shares and the issuance of ADSs evidenced by ADRs, including the withholding of any tax or other governmental charge and the payment of fees of the Depositary. The Depositary may withhold any such distribution of ADRs if it has not received satisfactory assurances from RAO Gazprom that such distribution does not require registration under the Securities Act or is exempt from registration under the provisions of such Act. In lieu of delivering ADRs for fractional ADSs in the event of any such dividend or free distribution, the Depositary will sell the amount of Shares represented by the aggregate of such fractions and distribute the net proceeds in accordance with the Deposit Agreement, but no such distribution will be unreasonably delayed by any action of the Depositary or any of its agents. If additional ADRs are not so distributed, each ADS shall thenceforth also represent the additional Shares distributed upon the Deposited Securities represented thereby.

Each beneficial owner of Rule 144A ADRs (and, prior to the Effective Time, each beneficial owner of Regulation S ADRs) or Shares so distributed shall be deemed to have acknowledged that the Shares have not been registered under the Securities Act and to have agreed to comply with the restrictions on transfer set forth under "Transfer Restrictions."

If RAO Gazprom offers or causes to be offered to the holders of any Deposited Securities any rights to subscribe for additional Shares or any rights of any other nature, the Depositary, after consultation with RAO Gazprom to the extent practicable, will have discretion as to the procedure to be followed in making such rights available to any Owners of ADRs or in disposing of such rights for the benefit of any Owners and making the net proceeds available in dollars to such Owners or, if by the terms of such rights offering or for any other reason, the Depositary may not either make such rights available to any Owners or dispose of such rights and make the net proceeds available to such Owners, then the Depositary shall allow the rights to lapse; *provided, however*, if at the time of the offering of any rights the Depositary determines in its discretion that it is lawful and feasible to make such rights available to all Owners or to certain Owners but not to other Owners, the Depositary may, and at the request of RAO Gazprom will, distribute to any Owner to whom it determines the distribution to be lawful and feasible, in proportion to the number of ADSs held by such Owner, warrants or

other instruments therefor in such form as it deems appropriate. If the Depositary determines, after consultation with RAO Gazprom to the extent practicable, that it is not lawful and feasible to make such rights available to all or certain Owners, it may, and at the request of RAO Gazprom will use its best efforts that are reasonable under the circumstances to, sell the rights, warrants or other instruments in proportion to the number of ADSs held by the Owners to whom it has determined it may not lawfully or feasibly make such rights available, and allocate the net proceeds of such sales for the account of such Owners otherwise entitled to such rights, warrants or other instruments, upon an averaged or other practical basis without regard to any distinctions among such Owners because of exchange restrictions or the date of delivery of any ADR or ADRs, or otherwise. Such proceeds will be distributed as promptly as practicable. The Depositary will not be responsible for any failure to determine that it may be lawful or feasible to make such rights available to Owners in general or any Owner or Owners in particular.

In circumstances in which rights would not otherwise be distributed, if an Owner of ADRs requests the distribution of warrants or other instruments in order to exercise the rights allocable to the ADSs of such Owner, the Depositary will promptly make such rights available to such Owner upon written notice from RAO Gazprom to the Depositary that (a) RAO Gazprom has elected in its sole discretion to permit such rights to be exercised and (b) such Owner has executed such documents as RAO Gazprom has determined in its sole discretion are reasonably required under applicable law. Upon instruction pursuant to such warrants or other instruments to the Depositary from such Owner to exercise such rights, upon payment by such Owner to the Depositary for the account of such Owner of an amount equal to the purchase price of the Shares to be received in exercise of the rights, and upon payment of the fees of the Depositary as set forth in such warrants or other instruments, the Depositary will, on behalf of such Owner, exercise the rights and purchase the Shares, and RAO Gazprom will cause the Shares so purchased to be delivered to the Depositary on behalf of such Owner. As agent for such Owner, the Depositary will cause the Shares so purchased to be deposited, and will execute and deliver Receipts to such Owner, pursuant to the Deposit Agreement.

The Depositary will not offer rights to Owners unless both the rights and the securities to which such rights relate are either exempt from registration under the Securities Act with respect to a distribution to all Owners or are registered under the provisions of such Act. If an Owner of ADRs requests the distribution of warrants or other instruments, notwithstanding that there has been no such registration under such Act, the Depositary will not effect such distribution unless it has received an opinion from recognized counsel in the United States for RAO Gazprom upon which the Depositary may rely that such distribution to such Owner is exempt from such registration. Notwithstanding any terms of the Deposit Agreement to the contrary, RAO Gazprom will have no obligation to prepare and file a registration statement for any purpose.

Whenever the Depositary shall receive any distribution other than cash, Shares or rights in respect of the Deposited Securities, the Depositary will, as promptly as practicable, cause the securities or property received by it to be distributed to the Owners entitled thereto, after deduction or upon payment of any fees and expenses of the Depositary or any taxes or other governmental charges, in proportion to their holdings, respectively, in any manner that the Depositary may reasonably deem equitable and practicable for accomplishing such distribution; provided, however, that if in the opinion of the Depositary such distribution cannot be made proportionately among the Owners entitled thereto, or if for any other reason (including any requirement that RAO Gazprom or the Depositary withhold an amount on account of taxes or other governmental charges or that such securities must be registered under the Securities Act in order to be distributed) the Depositary reasonably deems such distribution not to be feasible, the Depositary may, after consultation with RAO Gazprom to the extent practicable, adopt such method as it may deem equitable and practicable for the purpose of effecting such distribution, including the sale (at public or private sale) of the securities or property thus received, or any part thereof, and the net proceeds of any such sale will be distributed by the Depositary to the Owners entitled thereto as in the case of a distribution received in cash, but no such distribution will be unreasonably delayed by any action of the Depositary or any of its agents.

In connection with any distribution to Owners, RAO Gazprom will remit to the appropriate governmental authority or agency all amounts (if any) required to be withheld by RAO Gazprom and owing to such authority

or agency by RAO Gazprom; and the Depositary and the Custodian will remit to the appropriate governmental authority or agency all amounts (if any) required to be withheld and owing to such authority or agency by the Depositary or the Custodian. If the Depositary determines that any distribution of property (including Shares and rights to subscribe therefor) or any deposit of Shares, transfer of ADRs or withdrawal of Deposited Securities under the Deposit Agreement is subject to any tax or other governmental charge which the Depositary is obligated to withhold, the Depositary may dispose of all or a portion of such property in such amounts and in such manner as the Depositary deems necessary and practicable to pay any such taxes or charges, by public or private sale, and the Depositary will distribute the net proceeds of any such sale after deduction of such taxes or charges to the Owners entitled thereto in proportion to the number of ADSs held by them, respectively. The Depositary will forward to RAO Gazprom such information from its records as RAO Gazprom may request to enable RAO Gazprom to file necessary reports with governmental authorities or agencies, and either RAO Gazprom or the Depositary may file any such reports necessary to obtain benefits under any applicable tax treaties for Owners.

Upon any change in nominal or par value, split-up, consolidation or any other reclassification of Deposited Securities, or upon any recapitalization, reorganization, merger or consolidation or sale of assets affecting RAO Gazprom or to which it is a party, any securities that shall be received by the Depositary or Custodian in exchange for, in conversion of, or in respect of Deposited Securities will be treated as new Deposited Securities under the Deposit Agreement, and the ADSs will thenceforth represent, in addition to the existing Deposited Securities, the right to receive the new Deposited Securities so received in exchange or conversion, unless additional ADRs are delivered pursuant to the following sentence. In any such case the Depositary may, in its reasonable discretion, after consultation with RAO Gazprom to the extent practicable, and will, if RAO Gazprom so requests, execute and deliver additional ADRs as in the case of a distribution in Shares, or call for the surrender of outstanding ADRs to be exchanged for new ADRs specifically describing such new Deposited Securities.

As described in more detail above (see "Description of the Shares—Liability of Shareholders") under Russian law the possibility of increasing the nominal value of Shares or other Deposited Securities through a compulsory assessment of the holders thereof is not expressly prohibited, and, accordingly, holders of Shares or other Deposited Securities could be required to make an additional capital contribution to RAO Gazprom. As noted above, RAO Gazprom has no intention of increasing the nominal value of the Shares through a compulsory assessment of shareholders. If, however, any such assessment is made, RAO Gazprom agrees that under no circumstances shall any assessment on Shares or other Deposited Securities constitute an assessment against, or debt or obligation of, the Depositary, directly or indirectly, and that any such assessment shall be exclusively for the account of the Owners and Beneficial Owners. RAO Gazprom, any Owner or Beneficial Owner will have no recourse against the Depositary with respect to any such assessment.

The Deposit Agreement provides that, prior to any reduction in the total number of Shares that would result in more than 9% of the voting share capital of RAO Gazprom being owned by foreign investors (who, prior to the proposed date of such reduction, were eligible to own Shares), RAO Gazprom will use its reasonable efforts to ensure that such foreign investors are not adversely affected by such reduction.

Record Dates

Whenever any cash dividend or other cash distribution shall become payable or any distribution other than cash shall be made, or whenever rights shall be issued with respect to the Deposited Securities, or whenever for any reason the Depositary causes a change in the number of Shares that are represented by each ADS, or whenever the Depositary shall receive notice in English of any meeting of holders of Shares or other Deposited Securities, or whenever the Depositary shall find it necessary or convenient, the Depositary will fix a record date, which date shall be, or be as close as possible to, the record date applicable to the relevant Deposited Securities, (a) for the determination of the Owners who will be (i) entitled to receive such dividend, distribution or rights, or the net proceeds of the sale thereof, or (ii) entitled to give instructions for the exercise of voting rights at any such meeting, (b) for fixing the date on or after which each ADS will represent the changed number of Shares or

(c) for the determination of the Owners who shall be responsible for the fee assessed by the Depositary pursuant to the Deposit Agreement for inspection of the Share Register maintained by the Russian Share Registrar, all subject to the provisions of the Deposit Agreement.

Voting of Deposited Securities

RAO Gazprom will send notice of any meeting or solicitation of consents or proxies in respect of holders of Shares or other Deposited Securities to the Depositary at least 30 Business Days prior to the relevant meeting or, with respect to any solicitation of consents or proxies, any relevant final response date. Upon receipt of such notice, if requested in writing in English by RAO Gazprom, the Depositary will, as soon as practicable thereafter, mail to all Owners a notice containing (a) the information included in such notice of meeting in English received by the Depositary from RAO Gazprom (or if requested by RAO Gazprom, a summary of such information provided by RAO Gazprom in English), (b) a statement that the Owners as of the close of business on a specified record date will be entitled, subject to any applicable provision of the law of the Russian Federation and of the Charter of RAO Gazprom and the provisions of the Deposited Securities, to instruct the Depositary as to the exercise of the voting rights, if any, pertaining to the amount of Shares or other Deposited Securities represented by their respective ADSs and (c) a statement as to the manner in which such instructions may be given, including an express indication that such instructions may be given or deemed given in accordance with the last sentence of this paragraph if no instruction is received, to the Depositary to give a discretionary proxy to a person designated by RAO Gazprom. Upon the written request of an Owner of a Receipt on such record date, received on or before the record date established by the Depositary for such purpose, the Depositary has agreed that it will endeavor, insofar as practicable and permitted under applicable law, the Charter of RAO Gazprom and the provisions of the Deposited Securities, to vote or cause to be voted the amount of Shares or other Deposited Securities so represented in accordance with any nondiscretionary instructions set forth in such request. There can be no assurance that the Owners generally or any Owner in particular will receive the notice described in this paragraph sufficiently prior to the date established by the Depositary for the receipt of instructions to ensure that the Depositary will in fact receive such instructions on or before such date. The Depositary will not vote or attempt to exercise the right to vote that attaches to the Shares or other Deposited Securities, other than in accordance with such instructions or deemed instructions. If no such instructions are received by the Depositary from an Owner on or before the date established by the Depositary for such purpose, the Depositary will deem such Owner to have instructed the Depositary to give a discretionary proxy to a person designated by RAO Gazprom with respect to the Deposited Securities underlying such Owner's ADR or ADRs, and the Depositary will give a discretionary proxy to a person designated by RAO Gazprom to vote such Deposited Securities, but no such instruction will be deemed given and no such discretionary proxy will be given with respect to any matter as to which RAO Gazprom informs the Depositary (RAO Gazprom having agreed in the Deposit Agreement to provide such information as promptly as practicable in writing) that (x) RAO Gazprom does not wish such proxy given, (y) substantial opposition exists or (z) such matter materially and adversely affects the rights of holders of Shares.

The Charter of RAO Gazprom provides that any transfer of Shares by any Shareholder to another investor requires the approval of the Management Committee of RAO Gazprom if the transferee would acquire more than 3% of the voting rights in RAO Gazprom as a result of the transfer. The Management Committee of RAO Gazprom may decide in the future to approve the transfer to the Depositary of additional Shares that would result in the Depositary owning more than 3% of the Shares, on the condition that certain provisions are set forth in the Deposit Agreement with respect to the voting of such Shares. Accordingly, the Deposit Agreements provide that the Depositary will not exercise any voting rights on behalf of any Owner with respect to more than 3% of the total voting rights in RAO Gazprom, *provided that*, the Depositary may in its sole discretion, but shall not be required to, seek the consent of the Management Committee of RAO Gazprom, who, in its sole discretion, may approve the voting by the Depositary of more than 3% of the total voting securities of RAO Gazprom, in which case the Depositary may, as practicable, exercise the voting rights granted by the Management Committee of RAO Gazprom. In situations where the approval of the Management Committee has not been obtained and Owners of Receipts together owning more than 3% of the total voting securities of RAO Gazprom have instructed the

Depository to exercise their voting rights, the Depository will endeavor to prorate such vote such that not more than 3% of the voting securities of RAO Gazprom are voted by the Depository.

Reports and Other Communications

The Depository will make available for inspection by ADR Owners at its Corporate Trust Office any reports and communications, including any proxy soliciting material, received from RAO Gazprom, which are both (a) received by the Depository as the holder of the Deposited Securities and (b) made generally available to the holders of such Deposited Securities by RAO Gazprom. The Depository will also send to the Owners (i) copies of such reports when furnished by RAO Gazprom pursuant to the Deposit Agreement, (ii) copies of any communications provided to the Depository by the Russian Share Registrar as described under "—Registration of Shares" and (iii) copies of any notices given or required to be given by the Depository as described under "—Registration of Shares." All of these reports and communications required to be furnished in English by the London Stock Exchange or otherwise by law will be furnished in English.

Amendment and Termination of the Deposit Agreement

The ADRs and the Deposit Agreement may at any time be amended by agreement between RAO Gazprom and the Depository without the consent of the Owners or Beneficial Owners of ADRs; *provided, however*, that any amendment that imposes or increases any fees or charges (other than taxes, other governmental charges, delivery and other such expenses), or which otherwise prejudices any substantial existing right of Owners, will not take effect as to outstanding ADRs until the expiration of 30 days after notice of any amendment has been given to the Owners of outstanding ADRs. Every Owner of an ADR at the time any amendment so becomes effective will be deemed by continuing to hold such ADR to consent and agree to such amendment and to be bound by the Deposit Agreement as amended thereby.

The Depository shall at any time at the direction of RAO Gazprom terminate the Deposit Agreement by mailing notice of such termination to the Owners of the ADRs then outstanding at least 30 days prior to the date fixed in such notice for such termination. The Depository may likewise terminate the Deposit Agreement by mailing notice of such termination to RAO Gazprom and the Owners of all ADRs then outstanding, such termination to be effective on a date specified in such notice not less than 30 days after the date thereof, if at any time 30 days have expired after the Depository shall have delivered to RAO Gazprom a written notice of its election to resign, a successor depository shall not have been appointed and accepted its appointment, in accordance with the terms of the Deposit Agreement. If any ADRs remain outstanding after the date of termination of the Deposit Agreement, the Depository thereafter will discontinue the registration of transfers of ADRs, will suspend the distribution of dividends to the Owners thereof and will not give any further notices or perform any further acts under the Deposit Agreement, except the collection of dividends and other distributions pertaining to the Deposited Securities, the sale of rights and other property and the delivery of underlying Shares, together with any dividends or other distributions received with respect thereto and the net proceeds of the sale of any rights or other property, in exchange for surrendered ADRs (after deducting the fees of the Depository and other expenses set forth in the Deposit Agreement). At any time after the expiration of one year from the date of termination, the Depository may sell the Deposited Securities then held thereunder and hold uninvested the net proceeds of such sale together with any other cash, unsegregated and without liability for interest, for the pro rata benefit of the Owners that have not theretofore surrendered their Receipts, such Owners thereupon becoming general creditors of the Depository with respect to such net proceeds. After making such sale, the Depository will be discharged from all obligations under the Deposit Agreement, except to account for net proceeds and other cash (after deducting the fees of the Depository and other expenses set forth in the Deposit Agreement and any applicable taxes or other governmental charges) and certain obligations to RAO Gazprom.

Charges of Depository

The Depository will charge any party depositing or withdrawing Shares, any Owner of Receipts or any party surrendering ADRs or to whom ADRs are issued (including, without limitation, issuance pursuant to a stock dividend or stock split declared by RAO Gazprom or an exchange of stock regarding the ADRs or Deposited

Securities or a distribution of ADRs pursuant to the Deposit Agreement) where applicable: (1) taxes and other governmental charges; (2) such registration fees as may from time to time be in effect for the registration of transfers of Shares generally on the Share Register of RAO Gazprom maintained by the Russian Share Registrar and applicable to transfers of Shares to the name of the Depositary or its nominee or the Custodian or its nominee on the making of deposits or withdrawals; (3) such cable, telex and facsimile transmission expenses as are expressly provided in the Deposit Agreement to be at the expense of persons depositing Shares or Owners; (4) such expenses as are incurred by the Depositary in the conversion of Foreign Currency pursuant to the Deposit Agreement; (5) a fee not in excess of \$5.00 per 100 ADSs (or portion thereof) for the issuance or surrender, respectively, of ADRs pursuant to the Deposit Agreement; (6) a fee not in excess of \$.02 per ADS (or portion thereof) for any cash distribution made pursuant to the Deposit Agreement; (7) a fee of \$.01 or less per ADS (or portion thereof) per year to cover such expenses as are incurred for inspections by the Depositary, the Custodian or their respective agents of the Share Register maintained by the Russian Share Registrar (which fee will be assessed against Owners of record as of the date set by the Depositary in accordance with the Deposit Agreement not more often than once each calendar year); (8) a fee for the distribution of securities other than Shares or rights pursuant to the Deposit Agreement, such fee being in an amount equal to the fee for the issuance of ADSs referred to above which would have been charged as a result of the deposit by Owners of such securities distributed to them pursuant to the Deposit Agreement (treating all such securities as if they were Shares), but which securities are instead distributed by the Depositary to Owners and (9) a fee not in excess of \$1.50 per certificate for a ADR or ADRs for transfers made pursuant to the Deposit Agreement.

Liability of Owner for Taxes

If any tax or other governmental charge shall become payable by the Custodian or the Depositary with respect to any ADR or any Deposited Securities represented by the ADSs evidenced by such ADR, such tax or other governmental charge will be payable by the Owner or Beneficial Owner of such ADR to the Depositary, and such Owner or Beneficial Owner will be deemed liable therefor. In addition to any other remedies available to it, the Depositary may refuse to effect any transfer of such ADR or any withdrawal of Deposited Securities underlying such ADR until such payment is made and may withhold any dividends or other distributions or may sell for the account of the Owner thereof any part or all of the Deposited Securities underlying such ADR and may apply such dividends, distributions or the proceeds of any such sale to pay any such tax or other governmental charge and the Owner of such ADR shall remain liable for any deficiency. The obligations of Beneficial Owners described in this paragraph will survive any transfer of ADRs, any surrender of ADRs and withdrawal of Deposited Securities or the termination of the Deposit Agreement.

Disclosure of Interests

To the extent that provisions of or governing any Deposited Securities (including RAO Gazprom's Charter or applicable law) may require the disclosure of beneficial or other ownership of Deposited Securities, other Shares and other securities to RAO Gazprom and may provide for blocking transfer and voting or other rights to enforce such disclosure or limit such ownership, Owners and Beneficial Owners will be required to comply with all such disclosure requirements and ownership limitations and to cooperate with the Depositary's compliance with RAO Gazprom's instructions as to ADRs in respect of any such enforcement or limitation.

The Depositary may from time to time request Owners to provide information as to the capacity in which such Owners own or owned ADRs and regarding the identity of any other persons then or previously interested in such ADRs and the nature of such interest and various other matters. The Deposit Agreements provide that each Owner agrees to provide any information requested by the Depositary pursuant to the Deposit Agreements.

Registration of Shares

RAO Gazprom will, at any time and from time to time: (i) take any and all action as may be necessary to assure the accuracy and completeness of all information set forth in the Share Register maintained by the Russian Share Registrar in respect of the Underlying Shares; (ii) provide or cause the Russian Share Registrar to provide to the Depositary, the Custodian or their respective agents unrestricted access to the Share Register during

ordinary business hours in Moscow, Russian Federation, in such manner and upon such terms and conditions as the Depositary may, in its sole discretion, deem appropriate, in order to permit the Depositary, the Custodian or their respective agents to regularly (and in any event not less than monthly) confirm the number of Deposited Securities registered in the name of the Depositary, the Custodian or their respective nominees, as applicable, pursuant to the terms of the Deposit Agreement and, in connection therewith, to provide the Depositary, the Custodian or their respective agents, upon request, with a duplicative extract from the Share Register duly certified by the Russian Share Registrar (or some other evidence of verification which the Depositary, in its sole discretion, deems sufficient); (iii) cause the Russian Share Registrar promptly (and, in any event, within 72 hours of the Russian Share Registrar's receipt of such documentation as may be required by applicable law and the reasonable and customary regulations of the Russian Share Registrar) to effect the re-registration of ownership of Deposited Securities in the Share Register in connection with any deposit or withdrawal of Shares or Deposited Securities under the Deposit Agreement; (iv) permit and cause the Russian Share Registrar to permit the Depositary or the Custodian to register any Shares or other Deposited Securities held under the Deposit Agreement in the name of the Depositary, the Custodian or their respective nominees (which may, but need not be, a non-resident of the Russian Federation); and (v) cause the Russian Share Registrar promptly to notify the Depositary in writing at any time that the Russian Share Registrar (A) eliminates the name of a shareholder of RAO Gazprom from the Share Register or otherwise alters a shareholder's interest in RAO Gazprom's shares and such shareholder alleges that such elimination or alteration is unlawful; (B) no longer will be able materially to comply with, or has engaged in conduct that indicates it will not materially comply with, the provisions of the Deposit Agreement relating to it; (C) refuses to re-register shares of RAO Gazprom in the name of a particular purchaser and such purchaser (or its respective seller) alleges that such refusal is unlawful; (D) holds shares of RAO Gazprom for its own account; or (E) has materially breached the provisions of the Deposit Agreement relating to it and has failed to cure such breach within a reasonable time.

RAO Gazprom will be solely liable for any act or failure to act on the part of the Russian Share Registrar and will be solely liable for the unavailability of Deposited Securities or for the failure of the Depositary to make any distribution of cash or property with respect thereto as a result of (i) any act or failure to act of RAO Gazprom or its agents, including the Russian Share Registrar, or their respective directors, employees, agents or affiliates, (ii) any provision of any present or future Charter of RAO Gazprom or any other instrument of RAO Gazprom governing the Deposited Securities, or (iii) any provision of any securities issued or distributed by RAO Gazprom, or any offering or distribution thereof.

The Depositary has agreed in the Deposit Agreement for the benefit of Owners and Beneficial Owners that the Depositary or the Custodian will regularly (and in any event not less than monthly) confirm the number of Deposited Securities registered in the name of the Depositary, the Custodian or their respective nominees, as applicable, pursuant to the terms of the Deposit Agreement. RAO Gazprom and the Depositary have agreed in the Deposit Agreement that, for purposes of the rights and obligations under the Deposit Agreement of the parties thereto and hereto, the records of the Depositary and the Custodian shall be controlling for all purposes with respect to the number of Shares or other Deposited Securities which should be registered in the name of the Depositary, the Custodian or their respective nominees, as applicable, pursuant to the terms of the Deposit Agreement. The Depositary will instruct the Custodian to maintain custody of all duplicative share extracts (or other evidence of verification) provided to the Depositary, the Custodian or their respective agents pursuant to the Deposit Agreement. In the event of any discrepancy between the records of the Depositary or the Custodian and the Share Register, RAO Gazprom has agreed that (whether or not it has received any notification from the Depositary) it will (i) use its best efforts to cause the Russian Share Registrar to reconcile its records to the records of the Depositary or the Custodian and to make such corrections or revisions in the Share Register as may be necessary in connection therewith and (ii) to the extent RAO Gazprom is unable to so reconcile such records, promptly instruct the Depositary to notify the Owners of the existence of such discrepancy. Upon receipt of such instruction, the Depositary will promptly give such notification to the Owners pursuant to the Deposit Agreement (it being understood that the Depositary may at any time give such notification to the Owners, whether or not it has received instructions from RAO Gazprom), and the Depositary will promptly cease issuing ADRs pursuant to the Deposit Agreement until such time as, in the opinion of the Depositary, such records have been appropriately reconciled.

General

Neither the Depositary nor RAO Gazprom nor any of their respective directors, employees, agents or affiliates will be liable to any Owner or Beneficial Owner if by reason of (a) any provision of any present or future law or regulation of the United States, the Russian Federation or any other country, or of any other governmental or regulatory authority or stock exchange or by reason of any act of God or war or other circumstance beyond its control, or (b) in the case of the Depositary only, (i) any act or failure to act of RAO Gazprom or its agents, including the Russian Share Registrar, or their respective directors, employees, agents or affiliates, (ii) any provision, present or future, of the Charter of RAO Gazprom or any other instrument of RAO Gazprom governing the Deposited Securities, or (iii) any provision of any securities issued or distributed by RAO Gazprom, or any offering or distribution thereof, the Depositary or RAO Gazprom or any of their directors, employees, agents, or affiliates shall be prevented, delayed or forbidden from, or be subject to any civil or criminal penalty on account of, doing or performing any act or thing which by the terms of the Deposit Agreement or the Deposited Securities it is provided shall be done or performed (including, in the case of the Depositary, delivery of any Deposited Securities or the distribution of cash or property in respect thereof pursuant to the Deposit Agreement); nor will the Depositary or RAO Gazprom incur any liability to any Owner or Beneficial Owner by reason of any nonperformance or delay, caused as stated in the preceding clause, in the performance of any act or thing which by the terms of the Deposit Agreement it is provided shall or may be done or performed, or by reason of any exercise of, or failure to exercise, any discretion provided for under the Deposit Agreement or the Charter of RAO Gazprom.

RAO Gazprom assumes no obligation nor will it be subject to any liability under the Deposit Agreement to Owners or Beneficial Owners of ADRs, except that it agrees to perform its obligations specifically set forth under the Deposit Agreement. The Depositary assumes no obligation nor will it be subject to any liability under the Deposit Agreement to Owners or Beneficial Owners of ADRs, except that it agrees to perform its obligations specifically set forth under the Deposit Agreement without negligence or bad faith.

The ADRs are transferable on the books of the Depositary, provided that the Depositary may close the transfer books, after consultation with RAO Gazprom to the extent practicable, at any time or from time to time when deemed expedient by it in connection with the performance of its duties or at the written request of RAO Gazprom. As a condition precedent to the execution and delivery, registration of transfer, split-up, combination or surrender of any ADR or withdrawal of any Deposited Securities, the Depositary or the Custodian may require payment from the person presenting the ADR or the depositor of the Shares of a sum sufficient to reimburse it for any tax or other governmental charge and any stock transfer or registration fee with respect thereto (including any such tax or charge and fee with respect to Shares being deposited or withdrawn) and payment of any applicable fees and expenses payable by the Beneficial Owners. The Depositary may refuse to deliver ADRs, to register the transfer of any ADR or to make any distribution on, or related to, Shares until it has received such proof of citizenship or residence, exchange control approval, evidence of payment of applicable taxes and other governmental charges, or other information as it or RAO Gazprom, upon written notice to the Depositary, may deem necessary or proper. The delivery, transfer and surrender of ADRs generally may be suspended during any period when the transfer books of the Depositary, RAO Gazprom or the Russian Share Registrar are closed or if any such action is deemed necessary or advisable by the Depositary or RAO Gazprom, at any time or from time to time.

Subject to the terms and conditions of the Deposit Agreement and any limitations established by the Depositary, and unless requested by RAO Gazprom to cease doing so, the Depositary may deliver ADRs prior to the receipt of Shares a ("Pre-Release") and deliver Shares upon the receipt and cancellation of ADRs which have been Pre-Released, whether or not such cancellation is prior to the termination of such Pre-Release or the Depositary knows that such ADR has been Pre-Released. The Depositary may receive ADRs in lieu of Shares in satisfaction of a Pre-Release. Each Pre-Release must be (a) preceded or accompanied by a written representation from the person to whom the ADRs or Shares are to be delivered that such person, or its customer, (i) owns the Shares or ADRs to be remitted, as the case may be, (ii) assigns all beneficial right, title and interest in such Shares or ADRs, as the case may be, to the Depositary in its capacity as such and for the benefit of the Owners

and Beneficial Owners, and (iii) will not take any action with respect to such Shares or ADRs, as the case may be, that is inconsistent with such transfer of beneficial ownership (including, without the consent of the Depositary, disposing of such Shares or ADRs, as the case may be) other than in satisfaction of such Pre-Release, (b) at all times fully collateralized with cash, U.S. government securities or such other collateral as the Depositary determines, in good faith, will provide substantially similar liquidity and security, (c) terminable by the Depositary on not more than five business days' notice and (d) subject to such further indemnities and credit regulations as the Depositary deems appropriate. Each deposit of Shares under the Rule 144A Deposit Agreement or, prior to the Effective Time, the Regulation S Deposit Agreement, in connection with a Pre-Release described above shall be subject to receipt by the Depositary of a duly executed and completed Depositor Certificate.

The Depositary will keep books, at its transfer office in The City of New York, for the registration and registration of transfer of ADRs, which at all reasonable times will be open for inspection by the Owners, provided that such inspection shall not be for the purpose of communicating with Owners in the interest of a business or object other than the business of RAO Gazprom, including but not limited to a matter related to the Deposit Agreement or the ADRs.

So long as ADSs are listed on the London Stock Exchange, if such ADSs are delivered in definitive form RAO Gazprom will appoint a registrar or paying agent in the UK and give notice to Owners of such appointment.

The Depositary may, after consultation with RAO Gazprom to the extent practicable, appoint one or more co-transfer agents reasonably acceptable to RAO Gazprom for the purpose of effecting transfers, combinations and split-ups of ADRs at designated transfer offices on behalf of the Depositary. In carrying out its functions, a co-transfer agent may require evidence of authority and compliance with applicable laws and other requirements by Beneficial Owners or Owners or persons entitled thereto and will be entitled to protection and indemnity to the same extent as the Depositary.

Governing Law

The Deposit Agreement, the Rule 144A ADRs and the Regulation S ADRs will be governed by the laws of the State of New York. Any dispute under such ADRs may be resolved in arbitration in London, England or in courts of England and Wales.

TRANSFER RESTRICTIONS

Each purchaser of the Offered ADSs from a Manager in the Global Offering will be required, prior to the written confirmation of the sale of the Offered ADSs to such investor, to execute and deliver to RAO Gazprom a representation letter (the "Representation Letter") in the form provided by the Managers. The Representation Letter contains, among other things, representations with regard to the status of the investor, acknowledgements with respect to certain other matters (including the investors understanding and acceptance of the risks associated with an investment in the Offered ADSs) and representations and agreements with respect to restrictions on resales of the Offered ADSs, which are substantially similar to those set forth in the legends below.

The Rule 144A Global ADR will bear a legend to the following effect:

THIS RULE 144A AMERICAN DEPOSITARY RECEIPT, THE RULE 144A AMERICAN DEPOSITARY SHARES EVIDENCED HEREBY AND THE ORDINARY SHARES, NOMINAL VALUE RBL 10 PER SHARE OF RAO GAZPROM (THE "SHARES") REPRESENTED THEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) TO A PERSON WHOM THE BENEFICIAL OWNER OR ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (B) IN ACCORDANCE WITH REGULATIONS UNDER THE SECURITIES ACT OR (C) IN ACCORDANCE WITH RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES. THE BENEFICIAL OWNER OF ORDINARY SHARES RECEIVED UPON CANCELLATION OF ANY RULE 144A AMERICAN DEPOSITARY RECEIPTS MAY NOT DEPOSIT OR CAUSE TO BE DEPOSITED SUCH ORDINARY SHARES INTO ANY DEPOSITARY RECEIPT FACILITY ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK (INCLUDING ANY SUCH FACILITY MAINTAINED BY THE DEPOSITARY FOR THE RULE 144A AMERICAN DEPOSITARY RECEIPTS), SO LONG AS SUCH ORDINARY SHARES ARE "RESTRICTED SECURITIES" WITHIN THE MEANING OF RULE 144(a)(3) UNDER THE SECURITIES ACT. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALE OF THE ORDINARY SHARES OR AMERICAN DEPOSITARY SHARES.

SHARES MAY NOT BE WITHDRAWN FROM THE DEPOSITARY ARRANGEMENTS EXCEPT IN CONNECTION WITH A SALE OF SHARES IN RUSSIA TO A RUSSIAN RESIDENT. A CERTIFICATE TO THE FOREGOING EFFECT MUST BE DELIVERED TO THE DEPOSITARY AS A CONDITION TO ANY SUCH WITHDRAWAL OF SHARES.

IT IS EXPECTED THAT ORDINARY SHARES DEPOSITED HEREUNDER WILL BE REGISTERED ON THE SHARE REGISTER MAINTAINED BY THE RUSSIAN SHARE REGISTRAR IN THE NAME OF THE DEPOSITARY OR ITS NOMINEE OR OF THE CUSTODIAN OR ITS NOMINEE. OWNERS AND BENEFICIAL OWNERS SHOULD BE AWARE, HOWEVER, THAT RUSSIA'S SYSTEM OF SHARE REGISTRATION AND CUSTODY CREATES CERTAIN RISKS OF LOSS THAT ARE NOT NORMALLY ASSOCIATED WITH INVESTMENTS IN OTHER SECURITIES MARKETS. THE DEPOSITARY WILL NOT BE LIABLE FOR THE UNAVAILABILITY OF ORDINARY SHARES OR FOR THE FAILURE TO MAKE ANY DISTRIBUTION OF CASH OR PROPERTY WITH RESPECT THERETO AS A RESULT OF SUCH UNAVAILABILITY.

THE DEPOSITARY HAS BEEN ADVISED BY RUSSIAN COUNSEL THAT COURTS IN THE RUSSIAN FEDERATION WILL NOT RECOGNIZE OR ENFORCE JUDGMENTS OBTAINED IN THE FEDERAL COURTS OF THE UNITED STATES OF AMERICA OR THE COURTS OF THE STATE OF NEW YORK.

UNDER RUSSIAN LAW, THE POSSIBILITY OF INCREASING THE NOMINAL VALUE OF SHARES THROUGH A COMPULSORY ASSESSMENT OF SHAREHOLDERS IS NOT EXPRESSLY PROHIBITED. THE EFFECTIVENESS OF ANY ATTEMPT TO MAKE A COMPULSORY ASSESSMENT OF SHAREHOLDERS IS UNCERTAIN, SINCE RUSSIAN LAW NEITHER CONTEMPLATES SUCH ACTION NOR PROVIDES A MECHANISM TO ENFORCE ANY SUCH ATTEMPT. RAO GAZPROM HAS PUBLICLY STATED THAT IT HAS NO INTENTION OF INCREASING THE NOMINAL VALUE OF THE SHARES THROUGH A COMPULSORY ASSESSMENT OF SHAREHOLDERS. OWNERS AND BENEFICIAL OWNERS OF AMERICAN DEPOSITARY SHARES SHALL IN NO EVENT HAVE RECOURSE AGAINST THE DEPOSITARY WITH RESPECT TO ANY SUCH ASSESSMENT. SEE PARAGRAPH 17 HEREOF.

THE RIGHTS OF OWNERS TO DIRECT THE VOTING OF SHARES AND OTHER DEPOSITED SECURITIES IS RESTRICTED AS PROVIDED IN PARAGRAPH 16 HEREOF.

The Regulation S Global ADR will bear a legend to the following effect:

THIS REGULATION S AMERICAN DEPOSITARY RECEIPT, THE REGULATION S AMERICAN DEPOSITARY SHARES EVIDENCED HEREBY AND THE ORDINARY SHARES, NOMINAL VALUE RBL 10 PER SHARE OF RAO GAZPROM (THE "SHARES") REPRESENTED THEREBY HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), AND, PRIOR TO THE EXPIRATION OF A RESTRICTED PERIOD (DEFINED AS 40 DAYS AFTER THE LATER OF COMMENCEMENT OF THE GLOBAL OFFERING AND THE CLOSING DATE, MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT, OR (2) TO A PERSON WHOM THE SELLER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL INVESTOR WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A (A "QIB"), IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES; PROVIDED THAT IN CONNECTION WITH ANY TRANSFER UNDER (2) ABOVE, THE TRANSFEROR SHALL, PRIOR TO THE SETTLEMENT OF SUCH SALE, WITHDRAW THE SHARES IN ACCORDANCE WITH THE TERMS AND CONDITIONS OF THE REGULATION S DEPOSIT AGREEMENT AND INSTRUCT THAT SUCH SHARES BE DELIVERED TO THE CUSTODIAN UNDER THE RULE 144A DEPOSIT AGREEMENT FOR ISSUANCE, IN ACCORDANCE WITH THE TERMS AND CONDITIONS THEREOF, OF A RULE 144A AMERICAN DEPOSITARY RECEIPT TO OR FOR THE ACCOUNT OF SUCH QIB.

UPON THE EXPIRATION OF THE RESTRICTED PERIOD, THIS REGULATION S AMERICAN DEPOSITARY RECEIPT, THE REGULATION S AMERICAN DEPOSITARY SHARES EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY SHALL NO LONGER BE SUBJECT TO THE RESTRICTIONS ON TRANSFER PROVIDED IN THIS LEGEND, PROVIDED THAT AT THE TIME OF SUCH EXPIRATION, THE OFFER OR SALE OF THE REGULATION S AMERICAN DEPOSITARY SHARES EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY BY THE HOLDER HEREOF IN THE UNITED STATES WOULD NOT BE RESTRICTED UNDER THE SECURITIES LAWS OF THE UNITED STATES OR ANY STATE OF THE UNITED STATES.

SHARES MAY NOT BE WITHDRAWN FROM THE DEPOSITARY ARRANGEMENTS EXCEPT IN CONNECTION WITH A SALE OF SHARES IN RUSSIA TO A RUSSIAN RESIDENT. A CERTIFICATE TO THE FOREGOING EFFECT MUST BE DELIVERED TO THE DEPOSITARY AS A CONDITION TO ANY WITHDRAWAL OF SHARES.

IT IS EXPECTED THAT ORDINARY SHARES DEPOSITED HEREUNDER WILL BE REGISTERED ON THE SHARE REGISTER MAINTAINED BY THE RUSSIAN SHARE REGISTRAR IN THE NAME OF THE DEPOSITARY OR ITS NOMINEE OR OF THE CUSTODIAN OR ITS NOMINEE. OWNERS AND BENEFICIAL OWNERS SHOULD BE AWARE, HOWEVER, THAT RUSSIA'S SYSTEM OF

SHARE REGISTRATION AND CUSTODY CREATES CERTAIN RISKS OF LOSS THAT ARE NOT NORMALLY ASSOCIATED WITH INVESTMENTS IN THE UNITED STATES SECURITIES MARKETS. THE DEPOSITARY WILL NOT BE LIABLE FOR THE UNAVAILABILITY OF ORDINARY SHARES OR FOR THE FAILURE TO MAKE ANY DISTRIBUTION OF CASH OR PROPERTY WITH RESPECT THERETO AS A RESULT OF SUCH UNAVAILABILITY.

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THE RIGHTS OF OWNERS TO DIRECT THE VOTING OF SHARES AND OTHER DEPOSITED SECURITIES IS RESTRICTED AS PROVIDED IN PARAGRAPH 16 HEREOF.

TAXATION

The following is a summary of certain tax considerations that may be relevant to a holder of ADSs or Shares. However, prospective investors should consult their own advisers regarding the tax consequences of an investment in the ADSs or Shares.

Russia

The following is a summary of certain Russian tax considerations relevant to the purchase, ownership and disposition of Shares by a holder that is not a citizen or resident of Russia or is not a corporation, partnership or other entity organized under Russian law and does not hold Shares in connection with the conduct of a business in Russia (a "nonresident holder"). The Russian tax rules applicable to nonresident holders of Russian securities are characterized by significant uncertainties and by an absence of interpretive guidance. In this regard, the Russian tax authorities have not provided any guidance regarding the treatment of ADS arrangements. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian tax authorities may be subject to more rapid and unpredictable change than in a jurisdiction with more developed capital markets.

Taxation of Dividends

Dividends paid to nonresident holders generally will be subject to Russian withholding tax, which will be withheld by RAO Gazprom, at a 15% rate (20% for individuals). This tax may be reduced or eliminated pursuant to the provisions of an applicable tax treaty. The tax treaty between the United States and the Russian Federation (the "Treaty") generally reduces the withholding rate to 10%. Under current regulations, the Russian tax authorities are in principle required to approve the use of reduced rates within 14 days following receipt from RAO Gazprom of special application forms accompanied by a certification from the holder's home country tax authorities. Nonresident holders wishing to claim treaty benefits should provide appropriate documentation to RAO Gazprom as soon as possible and in any event at least 30 days prior to the dividend payment date. The required certifications must be renewed annually.

If the documentation has not been approved by the Russian tax authorities prior to the dividend payment date, RAO Gazprom is required to withhold tax at the full rate, and holders eligible for a reduced rate under a tax treaty then would be required to file claims for refund within 12 months with the Russian tax authorities. Procedures for processing such claims have not been established, and there is significant uncertainty regarding the availability and timing of refunds.

Taxation of Gains

Nonresident holders generally should not be subject to any Russian income or withholding taxes in respect of gain or other income realized on the sale, exchange, or other disposition of Shares to a nonresident purchaser outside Russia. Disposition of Shares to Russian residents, however, will be subject to income or withholding taxes.

United States

The following is a summary of certain United States federal income tax considerations that may be relevant to a holder of ADSs or Shares that is a citizen or resident of the United States or a U.S. domestic corporation or that otherwise will be subject to United States federal income taxation on a net income basis in respect of ADSs or Shares (a "U.S. holder"). This summary is based on laws, regulations, rulings and decisions now in effect, all of which are subject to change. This summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular investor's decision to purchase ADSs or Shares. In particular, the summary deals only with U.S. holders that will hold ADSs or Shares as capital assets, and does not address the tax considerations relevant to investors that are subject to special tax rules, such as banks, insurance companies, securities dealers, persons that hold ADSs or Shares as part of an integrated investment

(including a "straddle") comprised of an ADS or Share and one or more other positions and persons that have a functional currency other than the dollar.

In general, for U.S. federal income tax purposes, beneficial owners of ADSs will be treated as the owners of the Shares represented by those ADSs.

Taxation of Dividends

The gross amount of any dividends received with respect to the Shares (including amounts withheld in respect of Russian tax) generally will be subject to taxation as foreign source dividend income, and will not be eligible for the dividends received deduction. Dividends paid in rubles will be includible in income in a dollar amount calculated by reference to the exchange rate in effect on the day the dividends are received by the U.S. holder (or by the Custodian, in the case of ADSs). If dividends paid in rubles are converted into dollars on the day they are received, U.S. holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. holder may be required to recognize foreign currency gain or loss on the receipt of a refund of Russian tax withholding tax pursuant to the Treaty to the extent the dollar value of the refund differs from the dollar equivalent of that amount on the date of receipt of the underlying dividend.

Russian withholding tax at the 10% rate provided under the Treaty will be treated as a foreign income tax. Subject to generally applicable limitations, foreign income taxes may be claimed as credits against a holder's U.S. federal income tax liability or, at the election of the holder, may be deducted in computing taxable income. In the event tax is withheld at a 15% or 20% rate, U.S. holders may not be entitled to credits for the excess of the amount withheld over the 10% rate provided in the Treaty, even though the procedures for claiming refunds and the practical likelihood that refunds will be made available in a timely fashion are uncertain.

Taxation of Gains

Gain realized on the sale, exchange or other disposition of ADSs or Shares will be capital gain if the U.S. holder held the ADSs or Shares as a capital asset and will be long-term capital gain if the ADSs or Shares were held for more than one year. Deposits and withdrawals of Shares by U.S. holders in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

United Kingdom

The following is a summary of the material UK tax implications, under current UK taxation law and practice, of the acquisition, ownership and disposal of ADSs or Shares. This summary is not exhaustive, and the precise taxation consequences for any particular holder of the acquisition, ownership or disposal of ADSs or Shares will depend on that holder's individual circumstances. This summary assumes that RAO Gazprom's register of shareholders and the Depositary's register of holders of ADSs are maintained outside the UK.

Taxation of Dividends

A holder of ADSs or Shares who is resident in the UK will generally be subject to UK income tax or corporation tax on dividends paid on the relevant Shares. In such a case, the gross amount of those dividends will be brought into account for UK tax purposes as income, but credit will generally be given for any unavoidable Russian Federation tax which has been properly deducted (and is not recoverable from the Russian Federation authorities) and for any UK tax which has been deducted.

A corporate holder of ADSs or Shares who is not resident in the UK will not be subject to tax in the UK on dividends paid on the relevant Shares, unless that person carries on a trade in the UK through a branch or agency to which the ADSs or Shares in question are attributable.

Any person in the UK (*a collecting agent*) who, in the course of a trade or profession (a) acts as a custodian for the ADSs or Shares and receives dividends thereon or directs that such dividends be paid to another person

or consents to such payment, (b) collects or secures payment of or receives such dividends for a holder of ADSs or Shares or (c) otherwise acts for another person in arranging to collect or secure payment of dividends thereon, will generally be required to deduct UK income tax at the lower rate (currently 20%) from the dividends, unless it is proved to the Inland Revenue that the person who is the beneficial owner of the relevant ADSs or Shares and entitled to the dividends is not resident in the UK or if one of certain other exceptions to the obligation to withhold tax applies; in each case, conditions imposed by regulations may need to be satisfied for the relevant exception to be available. Persons who do no more than clear or arrange to clear or check for dividends are not required to deduct tax. Regulations to be made may provide for deduction of tax by a collecting agent at a reduced rate to give credit for Russian Federation tax withheld.

Taxation of Capital Gains

A holder of ADSs or Shares who is resident or ordinarily resident in the UK may, depending on his individual circumstances, be liable to UK taxation on any capital gain arising on a disposal of those interests. Any such holder who is an individual and who is not domiciled in the UK will only be liable to UK taxation on capital gains to the extent he remits (or is deemed to remit) the proceeds of such disposal to the UK. Dealings in the ADSs on the London Stock Exchange may give rise to remitted profits which would therefore be taxable.

A holder of ADSs or Shares who is neither resident nor ordinarily resident in the UK will not be subject to tax in the UK on capital gains on a disposal of those interests.

Stamp Duty and Stamp Duty Reserve Tax

No UK stamp duty will be payable in connection with a transfer of ADSs or Shares executed outside the UK unless it relates to something done or to be done in the UK.

No UK stamp duty reserve tax will be payable in respect of an agreement to transfer ADSs or Shares.

UNDERWRITING

Subject to the terms and conditions set forth in an underwriting agreement, dated October 22, 1996 (the "Underwriting Agreement"), RAO Gazprom has agreed to sell to each of the Managers, and each of the Managers has agreed to purchase from RAO Gazprom, the respective number of Underlying Shares set forth opposite its name below:

<u>Managers</u>	<u>Number of Underlying Shares</u>
Morgan Stanley & Co. International Limited	75,840,000
Kleinwort Benson Limited	75,840,000
CS First Boston Limited	28,440,000
Baring Brothers Ltd	28,440,000
NatWest Securities Limited	14,220,000
Salomon Brothers International Limited	14,220,000
Total	<u>237,000,000</u>

Pursuant to the Underwriting Agreement, the Managers will, subject to certain conditions, jointly and severally purchase the Underlying Shares at the price per Offered ADS set forth on the cover page of this Offering Memorandum divided by 10, less commissions equal to 4.2% of the price per Offered ADS divided by 10, and are obliged to purchase all the Underlying Shares represented by the Offered ADSs to be offered in the Global Offering. The Managers propose to offer the Offered ADSs in the Global Offering at the price per Offered ADS set forth on the cover page of this Offering Memorandum. The obligations of the Managers under the Underwriting Agreement to purchase the Underlying Shares are subject to certain conditions, including the admission of the Offered ADSs to the Official List of the London Stock Exchange.

RAO Gazprom has granted to the Managers an option, exercisable by the Global Coordinators for up to 30 days after the date of this Offering Memorandum, to purchase up to an additional 35,550,000 Underlying Shares solely to cover over-allotments, if any, in the Global Offering. If the Global Coordinators exercise the over-allotment option, the Managers have severally agreed, subject to certain conditions, to purchase on the terms set forth above approximately the same proportion of additional Offered ADSs that the number of Offered ADSs to be purchased by each of them, as shown in the foregoing table, bears to the 237,000,000 Underlying Shares to be purchased by all of them, as shown in the foregoing table.

RAO Gazprom has agreed not to offer, sell, contract to sell or otherwise dispose of any Shares or ADSs, or any securities that are convertible into or exchangeable for, or that represent the right to receive, Shares or ADSs (except in the Global Offering), or derivative instruments relating, directly or indirectly, to Shares or ADSs for a period of 180 days from the date of this Offering Memorandum, without the consent of the Global Coordinators; *provided, however*, that this limitation does not apply to any offer, sale, contract of sale or other disposition of (i) securities or instruments in privately negotiated transactions with strategic (*i.e.* non-financial) investors, (ii) securities or instruments in Russia other than to foreign investors and (iii) securities or instruments relating to an index where Shares comprise less than 25% of the value of such index. This agreement does not affect any other holder of Shares. See "Risk Factors—Risks Relating to the Global Offering—Shares Eligible for Future Sale" and "The Trading Market for RAO Gazprom Shares—The International Market."

RAO Gazprom has agreed to indemnify the Managers against certain liabilities in connection with the offer and sale of the Offered ADSs in the Global Offering, including liabilities under the Securities Act.

Each Manager has agreed that neither it nor any of its affiliates nor any person acting on its or their behalf will offer, sell, contract to sell or otherwise dispose of any Shares, securities that are convertible into or exchangeable for, or that represent the right to receive, Shares (except in the Global Offering), or derivative instruments relating, directly or indirectly, to Shares for a period of 180 days from the date of this Offering Memorandum without the consent of RAO Gazprom; *provided, however*, that this limitation does not apply to

any offer, sale, contract of sale or other disposition of (i) American Depositary Shares outside Russia, (ii) securities or instruments in Russia in the ordinary course of business and (iii) after 30 days from the date of this Offering Memorandum, securities or instruments relating to an index where Shares comprise less than 25% of the value of such index.

Selling Restrictions

General

Each Manager agrees that it has complied and will comply with all applicable laws and regulations in each jurisdiction in which it offers, sells or delivers Offered ADSs or distributes the Preliminary Offering Memorandum, the Offering Memorandum (and any amendments thereof and supplements thereto) or any other offering or publicity material relating to RAO Gazprom, the Underlying Shares of the ADSs (it being understood that RAO Gazprom has not authorised the distribution of any such other offering or publicity material), in each case at its own expense.

Each purchaser of Offered ADSs in the Global Offering will be required, prior to the written confirmation of sale, to execute and deliver to RAO Gazprom and the Managers a Representation Letter in the form to be provided by the Managers. See "Transfer Restrictions."

Each Manager has agreed that neither it nor any of its affiliates nor any person acting on its or their behalf has offered or sold or will offer or sell any Underlying Shares in the Global Offering. All offers and sales in the Global Offering will be made in the form of Offered ADSs.

United States

The Underlying Shares and the Offered ADSs have not been and will not be registered under the Securities Act or under the securities laws of any state of the United States and may not be offered or sold within the United States except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act. Each Manager has represented and agreed that neither it nor any of its affiliates nor any person acting on its or their behalf has offered or sold or will offer or sell any Offered ADSs as part of their distribution except (i) in the United States to persons whom such manager reasonably believes to be qualified institutional buyers (as defined in Rule 144A under the Securities Act) in transactions meeting the requirements of Rule 144A under the Securities Act or (ii) outside the United States in offshore transactions (as defined in Regulation S under the Securities Act) meeting the requirements of Rule 903 of Regulation S under the Securities Act. In addition, until 40 days after commencement of the Global Offering, an offer or sale of Offered ADSs within the United States by any dealer (whether or not participating in the Global Offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than pursuant to Rule 144A.

United Kingdom

Each Manager has represented and agreed that it has (i) not offered or sold and, will not offer or sell any Offered ADSs to persons in the United Kingdom prior to the admission of the Offered ADSs to listing in accordance with Part IV of the Financial Services Act 1986 except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 or the Financial Services Act 1986, (ii) complied and will comply with all applicable provisions of the Financial Services Act 1986 with respect to anything done by it in relation to the Offered ADSs in, from or otherwise involving the United Kingdom, and (iii) only issued or passed on and will only issue or pass on in the United Kingdom any document received by it in connection with the Global Offering, other than any document which consists of or any part of listing particulars, supplementary listing particulars or any other document required or permitted to be published by the listing rules under Part IV of the Financial Services Act 1986, to a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment Advertisements) (Exemptions) Order 1996 or is a person to whom the document may otherwise lawfully be issued or passed on.

Netherlands

Each Manager has represented and agreed that it has not offered or sold, and will not offer or sell, any Offered ADSs to persons in The Netherlands except to individuals or legal entities who or which trade or invest in securities in the conduct of their profession or trade, which include banks, brokers, dealers, insurance companies, pension funds and other institutional investors, and commercial enterprises which regularly, as an ancillary activity, invest in securities.

Russia

Each Manager has represented and agreed that neither it nor any of its affiliates nor any person acting on its or their behalf has offered or sold or will offer or sell any Offered ADSs in Russia as part of their distribution.

LEGAL MATTERS

Certain matters of Russian law will be passed upon for RAO Gazprom by its legal department. Certain legal matters relating to the Global Offering will be passed upon for RAO Gazprom by Cleary, Gottlieb, Steen & Hamilton, United States counsel to RAO Gazprom, and for the Managers by Freshfields, English and Russian counsel to the Managers.

FINANCIAL INFORMATION

<u>Index To Financial Information</u>	<u>Page</u>
1. Consolidated balance sheet as at December 31, 1995 prepared in accordance with International Accounting Standards ("IAS"), together with an audit opinion thereon issued by Price Waterhouse on August 30, 1996	F-2
2. Consolidated balance sheet and profit and loss account ("The Consolidated Financial Reports") as at January 1, 1996 and for the year ended December 31, 1995, prepared in accordance with the Regulations on Accounting and Reporting adopted by the Decree of the Ministry of Finance of the Russian Federation dated December 26, 1994, No. 170, and the Order of that Ministry dated July 28, 1995, No. 81 ("RAR"). The report of Price Waterhouse AO, dated August 30, 1996, on the Consolidated Financial Reports indicates that, in their opinion, the basis of accounting used is in accordance with RAR but that this basis varies significantly from IAS. Accordingly, the Consolidated Financial Reports should not be relied upon by investors or users who do not understand the specific application of RAR	F-11
3. A reconciliation as at December 31, 1995 between the equity shown by the Consolidated Financial Report (balance sheet) under RAR and shareholders equity per the IAS balance sheet. Equivalent information at December 31, 1994 is not available. No profit and loss information has ever been prepared by the Company under IAS, and it is therefore not practicable to provide a comprehensive reconciliation for the differences between the financial information prepared under RAR and IAS ..	F-18

Potential investors should note that the Company has separately issued, for 1993, 1994 and 1995, Aggregated Financial Reports (AFRs) as required by Russian regulations. The AFRs represent a summation of the assets, liabilities and results shown by the individual accounting reports prepared in accordance with RAR by RAO Gazprom and its enterprises and subsidiaries; transactions and balances between such entities were not eliminated from the AFRs, investments in partly owned ventures were included at historical cost (rather than being consolidated, where appropriate) and no adjustments were made to take account of the general effect of inflation. Accordingly, the AFRs do not present the consolidated assets and liabilities, financial position or profits and losses of RAO Gazprom, do not give any meaningful indication of trends over time (due in significant part to the high inflation rates in Russia during the covered period) and cannot be compared in any meaningful way to the consolidated financial information included herein. Thus, the AFRs should not be relied upon by anyone considering an investment in the ADSs. AFRs for 1993 and 1994 have been included, in Appendix D hereof solely for purposes of obtaining admission of the offered ADSs to the Official List of the London Stock Exchange.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders of RAO Gazprom

- 1 We have audited the accompanying consolidated balance sheet of RAO Gazprom and its subsidiaries and associated undertakings (the "Group") as at 31 December 1995, expressed in the equivalent purchasing power of the Russian Rouble at 31 December 1995. This balance sheet is the responsibility of the Group's management. Our responsibility is to express an opinion on the balance sheet based on our audit.
- 2 We conducted our audit in accordance with International Standards on Auditing, which require that we plan and perform our audit to obtain reasonable assurance about whether the balance sheet is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the balance sheet. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
- 3 The Group has prepared a balance sheet in accordance with International Accounting Standards for the first time at 31 December 1995. Consequently, the accompanying balance sheet does not include comparative figures for the prior year nor are statements of income, shareholders' equity or cash flows presented, as required by IAS 5, "Information to be Disclosed in Financial Statements."
- 4 As explained in Note 14, the Government of the Russian Federation is a significant shareholder of the Group and governmental economic and social policies affect the Group's financial position.
- 5 In our opinion, the accompanying balance sheet expressed in the equivalent purchasing power of the Russian Rouble at 31 December 1995 presents fairly, in all material respects, the financial position of the Group as at 31 December 1995 in accordance with International Accounting Standards.

Price Waterhouse
Moscow, Russia
30 August 1996

To the potential investors in ADSs:

We draw to your attention that we have carried out no work in relation to the estimates of the Company's gas and oil reserves given elsewhere in this Offering Memorandum. Consequently we accept no responsibility in respect of this information.

Price Waterhouse
Moscow, Russia
22 October 1996

RAO GAZPROM**IAS CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 1995**

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

Notes Assets**Current assets**

10 Cash and cash equivalents	6,179
3 Accounts receivable and prepayments	48,941
4 Inventories	14,154
5 Other current assets	5,694
	<u>74,968</u>

Long-term assets

6 Property, plant and equipment	282,776
7 Investments	9,804
Other assets	195
	<u>292,775</u>

Total assets	<u>367,743</u>
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Liabilities and shareholders' equity**Current liabilities**

8 Accounts payable and accrued charges	41,841
9 Short-term loans and current portion of long-term borrowings	1,721
	<u>43,562</u>

Long-term liabilities

10 Long-term borrowings	6,754
11 Deferred income taxes	6,788
Provisions for liabilities and charges	1,348
	<u>14,890</u>

Minority interest in subsidiaries	<u>1,104</u>
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Shareholders' equity

12 Share capital	237
12 Retained earnings and other reserves	307,950
	<u>308,187</u>

Total liabilities and shareholders' equity	<u>367,743</u>
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See accompanying notes to consolidated balance sheet.

RAO GAZPROM

NOTES TO THE IAS CONSOLIDATED BALANCE SHEET

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

1 NATURE OF OPERATIONS AND BASIS OF PRESENTATION

RAO Gazprom was established as a Russian joint stock company by Presidential Decree No 1333, dated 5 November 1992.

RAO Gazprom and its subsidiaries and associated undertakings ("the Group") operate one of the largest gas pipeline systems in the world and are responsible for substantially all gas production and high pressure transportation in the Russian Federation. The Group is also a major exporter of gas, principally to European countries.

The Group is directly involved in the following activities:

- exploration and drilling for hydrocarbons;
- production of gas;
- transportation of gas and condensates;
- underground storage of gas; and
- domestic and export sale of gas.

The Group's gas reserve estimates were initially established by the Russian State Committee on Reserves, but are now estimated by in-house reservoir engineers. The reserve estimates have not been reviewed by an independent reservoir engineering firm.

The Group maintains its books of account and prepares its statutory financial reports in accordance with the Regulation on Accounting and Reporting of the Russian Federation. The accompanying consolidated balance sheet is based on the statutory records, which are maintained under the historical cost convention, with adjustments and reclassifications for the purpose of presentation in accordance with International Accounting Standards ("IAS") issued by the International Accounting Standards Committee.

The adjustments and reclassifications made to the statutory accounts for IAS presentation include the restatement for changes in the general purchasing power of the Russian Rouble ("RR") based on IAS 29 "Financial Reporting in Hyperinflationary Economies." IAS 29 requires that the consolidated balance sheet prepared in the currency of a hyperinflationary economy be stated in terms of the measuring unit current at the latest balance sheet date. The restatements were calculated from the conversion factors derived from the Russian Federation Consumer Price Index, published by the Russian State Committee on Statistics, and from indices obtained from other published sources for years prior to 1992.

The indices and the respective conversion factors used to restate the consolidated balance sheet, based on 1988 prices (1988=100) for the five years ended 31 December 1995, are:

Year	Index	Conversion Factors
1991	253	1,930
1992	7,564	65
1993	67,846	7
1994	211,612	2
1995	487,575	1

RAO GAZPROM**NOTES TO THE IAS CONSOLIDATED BALANCE SHEET—(Continued)**

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

The significant guidelines followed in restating the consolidated balance sheet are:

- all amounts are stated in terms of the measuring unit current at 31 December 1995;
- monetary assets and liabilities (items expressed in the monetary unit current at the balance sheet date) are not restated because they are already expressed in terms of the monetary unit current at the balance sheet date; and
- non-monetary assets and liabilities (items which are not expressed in the monetary unit current at the balance sheet date) and components of shareholders' equity are restated by applying the relevant conversion factors.

2 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies followed by the Group are set out below.

Consolidation

Significant subsidiary companies in which the Group, directly or indirectly, has an interest of more than one half of the voting rights in share capital have been fully consolidated. Separate disclosure is made of minority interests. Certain subsidiaries which it would be appropriate to consolidate have been included in investments on a restated historical cost basis due to their aggregate immateriality to the Group.

Associated undertakings

Investments in associated undertakings, being those in which the Group, directly or indirectly, has an interest of between 20 to 50 percent of the voting rights in share capital are accounted for using the equity method. These are undertakings over which the Group exercises significant influence, but which it does not control.

Deferred income taxes

Deferred income tax is provided, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes, except where there is reasonable evidence that such temporary differences will not reverse for some considerable period.

Foreign currencies

The balance sheets of foreign subsidiaries and associated undertakings and the monetary assets and liabilities which are held by the Group and denominated in foreign currencies are translated into Russian Roubles at the exchange rates prevailing on 31 December 1995. Foreign currency transactions are accounted for at the exchange rates prevailing at the date of the transactions.

Exchange differences arising on the retranslation of the net assets of foreign subsidiaries and associate undertakings are recognised as translation differences and included in shareholders' equity.

Property, plant and equipment

Property, plant and equipment are carried at historical cost restated to the equivalent purchasing power of the Russian Rouble at 31 December 1995 on the basis of indices included in Note 1 and not on the basis of independent appraisal. Oil and gas exploration and production activities are accounted for employing the successful efforts method. Under this method, costs of successful development and exploratory wells are

RAO GAZPROM

NOTES TO THE IAS CONSOLIDATED BALANCE SHEET—(Continued)

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

capitalised. Costs of unsuccessful exploratory wells are expensed upon determination that the well does not justify commercial development. Other exploration costs are charged to expense as incurred. Major renewals and improvements are capitalised and the assets replaced are retired. Maintenance, repairs and minor renewals are expensed as incurred.

Depreciation, depletion and amortization ("D,D&A") for wells and production equipment has been calculated on restated capitalized costs on a straight line basis rather than, as is the more generally accepted international industry practice, on the unit-of-production basis. As a result, gas production and reserves do not impact the computation of the Group's D,D&A. For all other assets, D,D&A is also computed on a straight line basis over the estimated useful lives of the assets as follows:

	<u>Years</u>
Pipelines	33
Wells and production equipment	12-40
Machinery and equipment	10-18
Buildings and roads	8-50
Social assets (includes housing, schools and medical facilities)	5-50

Assets under construction are not depreciated.

Investments

Long-term investments, excluding marketable securities, are reflected at cost restated to the year-end equivalent purchasing power of the Russian Rouble at 31 December 1995. Provision for impairment is only made where there is a permanent diminution in value.

Marketable securities are valued at the lower of restated cost or market value.

Inventories

Inventories are valued at the lower of weighted average cost (restated to year-end equivalent purchasing power of the Russian Rouble at 31 December 1995) or net realisable value.

Environmental liabilities

Liabilities for environmental remediation are recorded when it is probable that an obligation exists and the amounts can be reasonably estimated.

Pension and other post-retirement obligations

Contributions to the statutory pension scheme are expensed when paid. Discretionary pension and other post-retirement benefits are accounted for on the same basis due to the immateriality of such payments.

Research and development

Research costs are charged to the profit and loss account in the year in which they are incurred. Development costs are written off as incurred, except for major projects when it is reasonably anticipated that the costs will be recovered through commercial activities. Capitalized development costs are amortized over estimated useful lives.

RAO GAZPROM
NOTES TO THE IAS CONSOLIDATED BALANCE SHEET—(Continued)

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

3 ACCOUNTS RECEIVABLE AND PREPAYMENTS

Trade receivables, net of allowance for doubtful accounts	36,635
Prepayments and accrued income	10,529
Other receivables	1,777
	<u>48,941</u>

4 INVENTORIES

Materials and supplies	9,146
Gas (in pipelines and storage)	2,686
Goods for resale	1,790
Other	532
	<u>14,154</u>

5 OTHER CURRENT ASSETS

Other current assets include RR 5,104 of bonds issued by the Ukrainian government in settlement for gas sales made to Ukragas during 1994. These bonds are denominated in United States Dollars, carry an interest rate of 8.5% per annum and are redeemable in tranches commencing in 1997. In 1996 substantially all of these bonds were used in settlement of taxes due to the Government of the Russian Federation.

6 PROPERTY, PLANT AND EQUIPMENT

	Restated Cost	Restated accumulated D,D&A	Net book amount
Pipelines	186,243	66,660	119,583
Wells and production equipment	58,764	25,875	32,889
Machinery and equipment	68,060	42,991	25,069
Buildings and roads	69,063	35,429	33,634
Total operating assets	382,130	170,955	211,175
Social assets	27,854	6,207	21,647
	409,984	177,162	232,822
Assets under construction	49,954	—	49,954
	<u>459,938</u>	<u>177,162</u>	<u>282,776</u>

7 SUBSIDIARIES AND INVESTMENTS
Principal subsidiary companies

Gazexport	Permtransgaz
Gazkomplektimpex	Severgazprom
Gazkompromselstroi	Surgutgazprom
Gazprombank	Tyumentransgaz
Kavkaztransgaz	Uraltransgaz
Lentransgaz	Urengoi-gazprom
Mostransgaz	Volgotransgaz
Nadymgazprom	Yamburgazdobycha
Orenburgazprom	Zarubezhgaz Erdgashandel Gesellschaft mbH ("ZGG")

RAO GAZPROM**NOTES TO THE IAS CONSOLIDATED BALANCE SHEET—(Continued)**

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

All of the above consolidated companies are wholly owned and are domiciled and operate in the Russian Federation except for ZGG which is incorporated in Germany and acts as the holding company for the Group's interests in a number of gas distribution and transportation companies operating in Central Europe.

Principal associated undertakings

	<u>Country</u>	<u>Business</u>	<u>% of share capital held</u>
Gasum Oy	Finland	Gas distribution and transportation	25
Wintershall Gas GmbH ("Wingas")	Germany	Gas distribution and transportation	35

Other investments

Included in investments is an interest bearing loan of RR 3,195 receivable from Wingas.

8 ACCOUNTS PAYABLE AND ACCRUED CHARGES

Trade payables	12,355
Income taxes payable	1,761
Other taxes payable	22,457
Accruals and deferred income	511
Other payables	4,757
	<u>41,841</u>

9 SHORT-TERM LOANS AND CURRENT PORTION OF LONG-TERM BORROWINGS

Short-term loans	1,101
Current portion of long-term borrowings	620
	<u>1,721</u>

10 LONG-TERM BORROWINGS

	<u>Currency</u>	<u>Due</u>	<u>Amount outstanding</u>
Notes payable to: Japanese companies	U.S. Dollar	1996-99	1,553
an American bank	U.S. Dollar	1996-98	266
an Italian banking consortium	U.S. Dollar	2007	1,133
a German banking consortium	Deutsche Mark	1999-2007	1,169
an international banking consortium	Deutsche Mark	1998-2005	3,205
Other long term borrowings			<u>48</u>
Total long-term borrowings			7,374
Less: current portion of long-term borrowings			<u>620</u>
			<u>6,754</u>
Due for repayment			
Between one and two years			1,033
Between two and five years			2,907
After five years			<u>2,814</u>
			<u>6,754</u>

Included within cash and cash equivalents on the balance sheet are balances totalling RR 647 which are restricted as to withdrawal under the terms of the borrowings noted above.

These various borrowings bear interest at annual rates ranging from 4.5 to 6.6 percent at 31 December 1995 and, with the exception of the Japanese and American borrowings, are secured by contractual obligations to sell gas in Western Europe. The amount payable to an international banking consortium is also secured by the principal assets of ZGG.

11 DEFERRED INCOME TAXES

Deferred tax liabilities in the amount of RR 6,788 have been recognized in the balance sheet and arise principally from the use of a modified cash basis of accounting whereby sales are recognized for taxation purposes when cash (or other settlement) is received.

Deferred tax assets approximating RR 48,000 have not been recognized in the balance sheet and are primarily attributable to the statutory indexation of property, plant and equipment for taxation purposes at 1 January 1996. Such assets are not recognized as they are unlikely to reverse for some considerable period.

12 SHAREHOLDERS' EQUITY

Share capital

Share capital authorized and outstanding totals RR 237 and consists of 23.7 billion ordinary shares of ten Russian Roubles nominal value each.

At the Group's annual general shareholders' meeting held on 31 May 1996 a dividend of twenty Russian Roubles per share was approved for the year ended 1 January 1996. This dividend aggregated RR 473 and has been accrued in the balance sheet.

Retained earnings and other reserves

Included within retained earnings and other reserves are the effects of cumulative restatement to the equivalent purchasing power of the Russian Rouble, and translation differences of RR 965 arising on the retranslation of the net assets of foreign subsidiaries and associate undertakings. Other reserves in the amount of RR 137,071 are attributable to a statutory reserve that may be recharacterised as share capital upon approval of the Board of Directors.

13 COMMITMENTS AND CONTINGENT LIABILITIES

The Group is a named defendant in a number of lawsuits and a named party in various proceedings arising in the ordinary course of business. In addition, the Group has continuing discussions with tax authorities regarding various tax issues. While the outcomes of such contingencies, lawsuits or other proceedings against the Group cannot be determined at present, management expects that any liabilities arising will not have a materially adverse effect on the financial position of the Group.

The Group is unable to estimate the ultimate financial impact of its environmental obligations with a high degree of certainty, particularly in light of the possibility of stricter enforcement of existing laws and regulations or of the possibility that additional laws or regulations may be adopted in the future.

At 31 December 1995 the Group had no significant contractual commitments for the purchase of plant, property and equipment from third parties, nor had they given significant guarantees in favour of third parties or in favour of related parties.

RAO GAZPROM

NOTES TO THE IAS CONSOLIDATED BALANCE SHEET—(Continued)

(In billions of Russian Roubles in terms of the equivalent purchasing power of the Rouble at 31 December 1995)

At 31 December 1995 the Group held limited insurance policies in relation to its assets, operations, or in respect of public liability or other insurable risks. No provisions for self insurance are included in the accompanying consolidated balance sheet.

14 RELATED PARTIES

The Government of the Russian Federation is a significant shareholder of the Group and governmental economic and social policies affect the Group's financial position and operating results.

As a condition to privatisation in 1992, the Government imposed an obligation on the Group to provide an uninterrupted supply of gas to customers in the Russian Federation at government controlled prices. The prices are less than world market rates and the obligation to deliver remains in force despite wide spread non-payment by customers.

Furthermore, the Group is a party to a number of other agreements or subject to various decrees, such as the Stabilization Fund, the Federal Share and the Yamburg Agreement, which result in preferential tax treatment for the Group or require gas deliveries outside the Russian Federation at less than world market prices and impact the reported financial position.

**REPORT OF THE AUDITORS
on the Consolidated Balance Sheet and
the Profit and Loss Account
for the year 1995**

To the shareholders of RAO Gazprom

1. We have audited the attached Consolidated Balance Sheet of RAO Gazprom and its subsidiary enterprises as at 1 January 1996 and the related Consolidated Profit and Loss Account for the year 1995 (hereinafter "the Consolidated Financial Reports of the Group"). These Consolidated Financial Reports were prepared by the management of RAO Gazprom in accordance with the Regulation on Accounting and Reporting adopted by the Decree of the Ministry of Finance of the Russian Federation dated 26 December 1994, No.170, and the Order of that Ministry dated 28 July 1995, No.81. Such Consolidated Financial Reports differ to a significant extent from those prepared in accordance with International Accounting Standards. They also differ from those Aggregated Financial Reports of the Group which were approved by the Shareholders and on which we reported under date of 27 May 1996. The basis of consolidation and details of the other significant accounting policies used are set out in the Note to the attached Consolidated Financial Reports of the Group.
2. Preparation of the Consolidated Financial Reports of the Group is the responsibility of the management of RAO Gazprom. Our responsibility as auditors is to express our opinion on these Reports based on our audit.
3. We conducted our audit in accordance with the Temporary Rules of Audit Activity in the Russian Federation adopted by Decree of the President of the Russian Federation dated 22 December 1993, No.2263, and in accordance with International Standards of Auditing. International Standards of Auditing require that we plan and perform the audit to obtain reasonable assurance about whether the Consolidated Financial Reports are free from material misstatement. An audit includes examining on a test basis, at selected Group locations, evidence supporting the amounts and disclosures in the Consolidated Financial Reports. An audit also includes assessing the accounting principles used and significant estimates made by management of RAO Gazprom. We believe that our audit provides a reasonable basis for our opinion.
4. In our opinion, the attached Consolidated Financial Reports have been properly prepared to present fairly in all material respects the assets and liabilities of RAO Gazprom and its subsidiary enterprises as at 1 January 1996 and the results of its operations for the year ended 31 December 1995, in accordance with the basis described in paragraph 1 above.

B.D.Edwards
Director of Price Waterhouse AO
Partner of Price Waterhouse
30 August 1996

Price Waterhouse AO holds General audit licence No. 000113 issued by the Central Attesting and Licensing Audit Committee of the Ministry of Finance of the Russian Federation on 22 February 1995. The licence is valid until 22 February 2000.

Additionally, Price Waterhouse AO holds state registration certificate MRC No. 008.890, issued by the Moscow Registration Chamber on 28 February 1992.

Translated from the original in the Russian language, which is the official and binding version.

To potential investors in ADSs:

We draw to your attention the fact that the information in the Consolidated Financial Reports, prepared in accordance with the Regulations on Accounting and Reporting of the Russian Federation ("RAR"), varies significantly from that which would be presented under International Accounting Standards with respect to the effect of inflation and other important matters and should not be relied upon by investors or users who do not understand the specific application of RAR.

Price Waterhouse
Moscow, Russia
22 October 1996

CONSOLIDATED BALANCE SHEET
RAO GAZPROM
as of 1 January 1996
(bln Roubles)

ASSETS

As of the end
of the year

1. FIXED ASSETS AND OTHER NON-CURRENT ASSETS

Intangible assets:	
historical cost	171
accumulated depreciation	13
net book value	158
Fixed assets:	
historical cost	220,657
accumulated depreciation	82,694
net book value	137,963
Equipment for installation	1,603
Assets under construction	34,163
Long-term financial investments	13,101
Other non-current assets	37
TOTAL for Section 1	187,025

2. INVENTORIES AND EXPENSES

Production stock	7,394
Livestock	210
Low value and short-term assets:	
historical cost	634
accumulated depreciation	193
net book value	441
Work in progress	594
Expenses relating to future periods	85
Finished products	351
Goods	3,268
VAT and special tax on purchased items	1,062
Other inventories and expenses	28
TOTAL for Section 2	13,433

3. CASH, RECEIVABLES AND OTHER ASSETS

Debtors:	
accounts receivable	23,100
notes receivable	269
state budget receivables	1,957
other employees settlements	208
other debtors	1,301
Advances to suppliers and contractors	10,444
Short-term financial investments	1,730
Cash:	
petty cash in hand	15
cash in bank	748
hard currency in bank	2,467
other monetary assets	1,218
Other current assets	590
TOTAL for Section 3	44,047
TOTAL ASSETS	244,505

Translated from the original in the Russian language, which is the official and binding version.

CONSOLIDATED BALANCE SHEET
RAO GAZPROM

as of 1 January 1996 (continued)
(bln Roubles)

EQUITY	<u>As of the end of the year</u>
1. EQUITY	
Statutory capital	237
Additional capital	152,018
Legal reserve	26
Funds restricted for capital investment	10,689
Social fund	14,503
Special purpose financing from state budget	16,729
Retained earnings from previous years	725
Profit:	
profit for the reporting year	19,637
utilisation of profit (including payments to budget in the amount of 7,369 bln. Roubles)	18,070
retained earnings for the reporting years	1,567
Minority interest	1,104
TOTAL for Section 1	197,598
2. PAYABLES AND OTHER LIABILITIES	
Long-term bank loans	5,594
Other long-term loans	1,622
Short-term bank loans	422
Bank loans for employees	14
Other short-term loans	679
Creditors:	
accounts payable	17,459
salaries/wages/bonuses payable	903
social insurance and pension contribution payable	1,921
non-state budget payables	975
state budget payables	13,228
other creditors	3,013
Advances from customers	353
Revenues relating to future periods	356
Funds restricted for consumption	180
Provisions for future expenses and payments	188
TOTAL for Section 2	46,907
TOTAL EQUITY AND LIABILITIES	244,505

Translated from the original in the Russian language, which is the official and binding version.

CONSOLIDATED PROFIT AND LOSS ACCOUNT
RAO GAZPROM
for year ended 31 December 1995
(bln. Roubles)

	<u>Profit</u>	<u>Loss</u> <u>(expenses)</u>
1. FINANCIAL RESULTS		
Sales/gross margin	71,440	
VAT and Special tax		9,704
Excise taxes		11,739
Cost of goods sold		30,453
Operating profit/loss	19,544	
Profit/loss on other sales	223	
Recovered from budget	10	
Non-sale income and expenses—total	3,955	3,942
including:		
dividends	190	
foreign exchange gains and losses	2,830	2,501
TOTAL Profits and Losses	23,732	3,942
Minority interest in profit		153
Profit/Loss for the reporting year	19,637	

Translated from the original in the Russian language, which is the official and binding version.

NOTE TO THE CONSOLIDATED FINANCIAL REPORTS RAO GAZPROM

Significant accounting policies

Accounting principles

The Statutory Accounting Reports of each of RAO Gazprom and its subsidiary companies have been prepared by management in accordance with the Regulation of Accounting and Reporting adopted by the Decree of the Ministry of Finance of the Russian Federation dated 26 December 1994 No 170.

Basis of consolidation

The accompanying Consolidated Balance Sheet and Consolidated Profit and Loss Account of RAO Gazprom and its subsidiary enterprises ("The Consolidated Financial Reports of the Group") comprise a consolidation of the Statutory Accounting Reports of each of RAO Gazprom and its subsidiary enterprises performed in accordance with the Order of the Ministry of Finance of the Russian Federation dated 28 July 1995, No.81.

That Order introduced the methodology for preparation of consolidated statutory accounting reports by organisations which have subsidiary companies. This methodology, inter-alia, prescribes the elimination of all transactions between Group enterprises and the inclusion of investments in partly-owned enterprises in accordance with the proportionate share of underlying assets and liabilities arising from the degree of control exercised by the holding company.

As required, compliance with Order No.81 has been observed prospectively. Consequently no comparative balances are presented in the accompanying Consolidated Financial Reports of the Group for the prior year, 1994.

All significant investments in wholly-owned and partly-owned enterprises have been included in the Consolidated Financial Reports of the Group in compliance with the consolidation methodology. Insignificant investments which it would be appropriate to include on a consolidated basis have been accounted for on the basis of historical cost, except for those denominated in hard currency which were subject to statutory revaluation prior to 1 January 1995. These insignificant investments were not consolidated for the practical reason of their relative aggregate immateriality in relation to the consolidated assets reflected in the attached Consolidated Financial Reports; if they had been included therein on a consolidated basis, the resultant effect would have been similarly insignificant.

Accordingly, the Consolidated Financial Reports of the Group include subsidiaries engaged primarily in the production or transportation of natural gas and those engaged in administration, sales, procurement, and other functions. Also consolidated are the results and net assets of two associated undertakings, gas distribution businesses in Germany and Finland.

Revenue recognition

Revenue has been recognised on receipt of cash payments or other settlement for goods shipped.

Under the provisions of Presidential Decree dated 6 December 1993, No.2116, RAO Gazprom was able to recognise export revenues at official wholesale prices and allocate any excess of actual receipts over revenues recognised on this basis directly to its Stabilisation Fund a component of equity. In accordance with Presidential Decree dated 1 April 1996, No.461, this method of accounting is no longer valid with effect from 1 April 1996.

Translated from the original in the Russian language, which is the official and binding version.

NOTE TO THE CONSOLIDATED FINANCIAL REPORTS—(continued)
RAO GAZPROM

Cost of sales

Under the provisions of Presidential Decree dated 5 November 1992, No.1333, RAO Gazprom was able to include in cost of sales transfers of funds to the Stabilisation Fund. In accordance with Presidential Decree dated 1 September 1995, No.894, the ability to make such charges was withdrawn effective from 1 September 1995.

Inventories

Inventories are carried at cost determined using weighted average cost methods.

Translated from the original in the Russian language, which is the official and binding version.

RAO GAZPROM
Reconciliation of Consolidated RAR to Consolidated IAS Equity
31 December 1995

	<u>Rbl bln</u>
Consolidated RAR equity	197,598
Revaluation in accordance with IAS 29, "Financial Reporting in Hyperinflationary Economies"	112,347
Diminution in carrying value of certain assets	(11,506)
Accrual of sales, net of deferred income tax effects	12,620
Accrual of miscellaneous liabilities	(1,947)
Miscellaneous reclassifications	(925)
Consolidated IAS shareholders' equity	<u>308,187</u>

APPENDIX A

Overview Of The Russian Gas Industry And Its Regulation

The information set forth in this section is based on publicly available information.

General

The Russian gas industry was developed during the Soviet era and expanded rapidly after the discovery of significant reserves in the exceptionally large gas fields of Western Siberia in the 1960s. In the aftermath of the dissolution of the Soviet Union, as Russia experienced a profound crisis of the centralized planned economy and industrial production and GDP declined, demand for energy correspondingly declined. Total gas consumption declined by 12.6% between 1991 and 1995, but this decline was substantially less than other energy sources such as oil and coal which declined by 40% and 28%, respectively, over the same period. The resilience of demand for gas in comparison with demand for other energy products during this period resulted from government policies on industry structure and on prices. In contrast to the oil industry, which has restructured into regionally based enterprises, the structure of the Unified Gas Supply System was preserved as one single organization. The continued substitution of oil by gas occurred primarily because of low regulated domestic gas prices and consumer concerns over the security of supplies of crude oil.

Reserves Classifications

Russian methodologies for calculating reserves and Russian reserves classifications differ from accepted practices in the United States and other parts of the world. Reserve calculations performed using different methodologies cannot be accurately reconciled.

The following is a translation of an extract from the classification of deposit reserves and prospective and forecast oil and gas resources of the State Committee on Mineral Reserves of the Council of Ministers of the USSR, 1983.

Categories of reserves and of high potential and forecast oil and gas resources

Gas, condensate and oil reserves, and their components which have commercial value, are subdivided depending on their degree of substantiation into: explored reserves represented by the categories A, B, and C1; and preliminary estimated reserves represented by the category C2. Oil and gas resources are subdivided depending on their degree of substantiation into high potential resources represented by the category C3; and forecast resources represented by the categories D1 and D2.

Category A—Deposit reserves (or a portion of the deposit) which have been analyzed in sufficient detail to enable a comprehensive definition to be made as to the type, shape and size of the deposit, the effective thickness of the oil and gas saturation, reservoir type, the nature of changes in the characteristics of the reservoir, the oil and gas saturation of the productive strata of the deposit, the content and characteristics of the oil, gas and condensate, as well as major features of the deposit which determine the conditions of its development (mode of operations, well productivity, strata pressure, the oil, gas and condensate balance, hydro- and piezoconductivity and other features).

Category A reserves are calculated based on the portion of the deposit drilled in accordance with an approved development project for the oil or gas field.

Category B—Deposit reserves (or a portion of the deposit), the oil and gas content of which is determined on the basis of commercial flows of oil or gas from wells at various hypsometric marks. The type, shape and size of the deposit, the thickness of the effective oil and gas saturation, reservoir type, the nature of changes in the characteristic of the reservoir, the oil and gas saturation of the productive strata, the content and characteristics of the oil, gas and condensate under stratum and under standard conditions and other parameters,

and also other major features of the deposit which define the conditions for its development, are all analyzed to an extent sufficient for a deposit development project to be drawn up.

Category B reserves are calculated based on the portion of deposit drilled in accordance with an approved technological development plan for an oil field or under a trial commercial development project for a gas field.

Category C1—Deposit reserves (or a portion of the deposit), the oil and gas content of which is determined on the basis of commercial flows of oil or gas from wells (a number of wells are probed by exploration drilling) and on the basis of positive results from geological and geophysical analyses of untested wells. The type, shape and size of the deposit, and the conditions for bedding of the oil and gas bearing reservoir are determined by the results of the drilling of exploratory and operational wells, and verified for a given region by geological and geophysical analytical methods.

The lithological content, reservoir type, reservoir characteristics, the oil and gas saturation, the oil displacement rate, the effective thickness of the oil and gas saturation of the productive strata are determined through analysis of the core and materials from geophysical well testing. The content and characteristics of the oil, gas and condensate under stratum and standard conditions are analyzed according to test data on the wells. The commercial value of the oil "edge" is determined by the oil and gas deposit. Well productivity, hydroconductivity and piezoconductivity of the stratum, stratum pressure, temperature, and the oil, gas and condensate balance are analyzed through testing and analyses of the wells. The hydrogeological and geocryological conditions are determined by the results of well drilling and through analogy with neighboring explored fields.

Category C1 reserves are calculated based on the results of geological exploratory work and production drilling and are analyzed so as to enable preliminary data to be drawn up for a technological development plan for an oil field, or for a project for the trial commercial development of a gas field.

Regulation

At the federal level, the primary regulatory authority over the oil and gas industry was divided until recently between the Ministry of Fuel and Energy ("Mintopenergo") and the State Committee for Geology and the Use of Subsoil Resources ("Roskomnedra"). In general, Mintopenergo sets governmental policy for the industry and regulates the activities of gas companies, pipeline access and tariffs. Roskomnedra was involved in the licensing of subsoil resources, the licenses being for prospecting and production. Pursuant to Presidential Decree No. 1177 of August 19, 1996, Roskomnedra was dissolved and merged into the newly created Ministry of Natural Resources.

Federal legislation gives a measure of autonomy to regional and local authorities to exercise rights to the use of land and natural resources and provides that the use of subsoil is under the joint jurisdiction of the federal and regional authorities. In general, authorities at the regional and local level, with jurisdiction over the specific area in which an oil and gas development project, pipeline or refinery or other enterprise is located, have substantial powers. Such authorities granted subsoil resource licenses in co-operation with the relevant regional agency of Roskomnedra. In addition, such authorities usually control local land use transfers and have powers in respect of employee's health and safety, social security and certain fiscal matters. The conditions applicable to the operations of a gas company in a particular location will depend in large measure on the relationships among the relevant federal, regional and local authorities and between the company and each of such authorities.

Prospecting and Production Licensing

The Law of the Russian Federation On Subsoil Resources of February 1992 (the "Subsoil Resources Law") introduced a licensing system for prospecting for and producing natural resources. The Subsoil Resources Law includes a framework provision under which all operating, mining, extractive and other enterprises that had obtained and implemented the right to use subsoil resources prior to the enactment of the Subsoil Resources Law

could apply for and obtain subsoil licenses and land use permissions. Accordingly, during the course of implementation of the Subsoil Resources Law, Roskomnedra granted licenses in relation to fields where prospecting for and/or production of natural resources was already in progress. (Apparently, upon dissolution of Roskomnedra, a relevant department of the Ministry of Natural Resources will be in charge of licensing.) In relation to new fields, licenses are to be awarded by competitive auction or tender, although the Government retained some powers under the Subsoil Resources Law to intervene in the award of licenses. There are three types of license, for prospecting, for production, and combined licenses for prospecting and production. To date, two types of licenses have generally been issued: prospecting licenses and combined licenses for prospecting and production. The Subsoil Resources Law stipulates maximum terms of five years for prospecting licenses, twenty years for production licenses (with an option for extension) and twenty-five years for combined licenses. Licenses awarded in accordance with the Subsoil Resources Law cannot be sold or otherwise disposed of by the licensee, except in limited circumstances.

Generally, licenses were awarded by tender or auction procedures conducted jointly by Roskomnedra and a relevant regional or local authority. The winning bidder is that which submits the most technically competent and financially attractive (the highest bid) proposal which meets published tender terms and conditions.

In addition to being issued a formal license, the licensee enters into a licensing agreement the purpose of which is to set out the details relating to the operation of the license. There are usually three signatories to any licensing agreement: the regional authority where the resources are located, the relevant regional department of Roskomnedra and the proposed licensee. A license involving foreign investment must be registered with the federal agency of Roskomnedra.

Under a license, the licensee makes a number of commitments, including a commitment to extract an agreed amount of resources each year, to keep environmental pollutants within specified limits and to clean up environmental contamination. A license also normally requires the holder to return at its expense the associated land to a condition adequate for future use at the expiration of the license. A licensee can be fined for failing to comply with the license, and the license can be revoked in the event of repeated or significant violations of the license, or in the event that the license is not used for a substantial period.

A holder of a production license is subject to a royalty calculated as a percentage of the value (selling price) of extracted resources. Current regulations provide ranges for royalty rates. Specific rates are set by regional authorities for every license or company (e.g. for group of licenses held by a company). The rates vary for oil and gas between 6% and 16%.

In addition, the Subsoil Resources Law and related regulations provide for excise taxes for certain premium resources as well as a Mineral Restoration Tax. The Mineral Restoration Tax is levied at 10% of the value of produced gas and gas condensate and is calculated in the same manner as the royalty. Mineral Restoration Tax regulations provide relief for geological and geophysical expenses. In the gas industry, production companies are liable for excise tax only for gas condensate (currently about \$1.80 per barrel). Excise tax for gas is payable by the transport company. See "Financial Review." These royalties, mineral restoration and excise taxes do not replace, but are in addition to, the tax obligation that may be applicable to the license holder according to the tax legislation of general application.

The terms of production licenses may also include conditions for revising projected production levels, obligations of the licensee (for example, to develop regional infrastructures), a tax for development rights (3% of revenues) and a further tax on revenues imposed by regional authorities.

A licensee is generally granted rights to use the surface land that is associated with the licensed resources. The boundaries of the land allotment must be specified in the license and it is necessary to obtain an amendment to the license to expand the subsoil use and land use rights associated with the license in the event the subsoil resources are subsequently discovered to extend beyond the original scope of the license.

In March 1995 amendments were made to the Subsoil Resources Law. Although licenses cannot be held by more than one legal entity, transfers of licenses under certain limited circumstances, including to a spin-off company and subsidiaries in which the holder of the license retains at least one half of the charter capital, are now permitted.

An Order of Roskomnedra in June 1995 states that some 27 laws and regulations are necessary to implement the changes to the Subsoil Resources Law, including the Law on the Procedure to Identify Subsoil Areas as Objects of Federal Importance and the Law on the Procedure to License the Use of the Subsoil.

Transportation and Supply of Gas

Gazprom is responsible for the transportation and supply of gas to Russian consumers. Under Governmental Decree No. 1445 of December 30, 1994, Gazprom prepares annual programs of production and consumption throughout Russia. Once confirmed by Mintopenergo, and with the consent of the Ministry of Economy, the program is implemented by way of supply agreements concluded between gas suppliers (including the Company), on the one hand, and local gas distributors and industrial consumers, on the other hand. Model supply agreements must be approved by Gazprom. These provide for obligations both to supply and to off-take gas.

Price Regulation

Gas prices in Russia are regulated by the Government under Presidential Decree No. 220 dated February 28, 1995 and the Resolution of the Russian Government No. 239 dated March 7, 1995. The regulation of wholesale gas prices for industrial consumers in Russia was delegated to the Federal Energy Commission by Government Resolution No. 863 of July 17, 1996. Government Resolution No. 296 of March 27, 1993 established the wholesale prices for industrial consumers, which account for approximately 91% of gross domestic gas sales, and provided for the indexation of such prices in accordance with an established procedure. Wholesale gas prices for households, which account for approximately 9% of gross gas sales in Russia, are also fixed by the Government.

From September 1, 1995 until February 1, 1996, gas prices for industrial consumers were frozen (Government Resolution No. 997 of October 13, 1995).

To improve the economic condition of the general public and certain other energy consumers, Presidential Decree No. 598 of April 22, 1996 introduced certain concessions for households, enterprises providing electricity and heat to the general public and for communal needs, defense enterprises manufacturing equipment for the gas industry, and producers of fertilizers and agrochemicals. Gas was supplied to these categories of consumers at the April 1, 1996 wholesale price (non-indexed) or at a discount.

From April 1, 1996 until August 1, 1996, the indexing of gas prices was suspended. From August 1, 1996, gas prices were indexed to 100% of the wholesale industrial price index pursuant to Government Resolution No. 869 of July 17, 1996.

As of September 1, 1996, the wholesale gas price for industrial consumers (the sales price to gas distributors) was Rbl 254,880 per 1,000 cubic meters and the sales price for households was Rbl 45,000 per 1,000 cubic meters.

Presidential Decree No. 1451, dated October 17, 1996, "On Additional Measures to Limit the Growth of Prices for Products of Natural Monopolies and to Create Conditions for Stabilization of Industries" requires the Government to introduce from January 1, 1997 wholesale gas prices for industrial consumers which will be determined by reference to the cost of transit of gas from production sites through to the consumers (as opposed to being based on a single standard price). Until that date, the wholesale price of gas will be fixed at the indexed price as at October 1, 1996 (Rbl 260,232 per 1,000 cubic meters). The Decree provides that there will be no change in the sales price to households.

Environmental Regulations

A number of federal laws and regulations establish environmental rules and standards. Among the principal laws on environmental matters is the Law On Environmental Protection of December 12, 1991 (the "Environmental Protection Law"). The Environmental Protection Law establishes a "pay-to-pollute" regime administered by the Ministry of Ecology and local authorities. Fees are assessed for exceeding agreed limits on emissions and effluents and the revenues are divided between federal and local budgets. Currently these fees are generally small in relation to the cost of environmental protection equipment and it is generally less expensive to pay the fees than to install anti-pollution devices. Moreover, the Environmental Protection Law does not include clear clean-up requirements, and when clean-up is required, it is generally confined to superficial clean-up.

In connection with obtaining a license to explore or develop gas fields, gas companies are generally required to make environmental commitments. Such commitments may be stringent, but the fees for failing to comply are generally low and any clean-up requirements are generally limited.

It is widely expected that as the economic situation improves, enforcement of existing legislation and licenses will become more stringent and that more comprehensive legislation will be adopted.

Other Regulations

In August 1995, the Law on Natural Monopolies came into force. The Law on Natural Monopolies sets out, *inter alia*, a regime for the regulation of entities which have a natural monopoly over the transport of gas along pipelines, which includes Gazprom. It provides for an authority to be established to exercise control over:

- all transactions under which a natural monopoly entity acquires title (or rights of use) to the assets not related to the relevant natural monopoly, provided that their value exceeds 10% of the natural monopoly entity's own capital, as declared in its most recently published balance sheet;
- investments made by a natural monopoly entity in an industry not defined as natural monopoly provided that the value of such investments exceeds 10% of the natural monopoly entity's own capital as declared in its most recently published balance sheet;
- sales, leases or other transactions under which a natural monopoly entity disposes of its own natural monopoly-related assets provided that their value exceeds 10 per cent of its own capital as declared in its most recently published balance sheet;
- the draft capital investment plans of a natural monopoly entity. Natural monopoly entities are also obliged to submit periodic reports on their current business activities;
- prices (or tariffs) and the introduction of mandatory prices or price limitations; and
- supplies and the terms of agreements for mandatory supplies to specified customers.

Penalties may be imposed by the authority on a natural monopoly entity for its failure to comply with the law and the requirements of the authority. The authority has the right to access information held by the natural monopoly entity by executive government bodies on the activities of the natural monopoly entity.

APPENDIX B
COMPETENT PERSON'S RESERVE REPORT

The Directors, RAO Gazprom

The Directors, Dresdner Kleinwort Benson

The Directors, Morgan Stanley International

October 17, 1996

Dear Sirs,

Pursuant to your request, we have prepared this report regarding the reserves of Gazprom as of January 1, 1996.

The authors of this report are Vasilij A. Ponomarev, the head of the Geology and Development Department of RAO Gazprom, and Lydia A. Shulzhenko, the head of the Reserves Subdivision of the Geology and Development Department of RAO Gazprom. Mr. Ponomarev, a graduate of the Perm Polytechnical Institute, is a qualified mining and geology engineer with seventeen years' experience in the fields of Western Siberia where he was directly involved in field discovery and development, and in the introduction of new production technologies. Mrs. Shulzhenko, a graduate of the Grozny Oil Institute, is a qualified mining engineer, and has over thirty years' experience in the oil and gas industry, including fifteen years as an official expert on the assessment of reserves and drawing up the State Mineral Balance for Russia and the Former Soviet Union.

This report is divided into five sections as follows:

1. **Introduction:** Gazprom's reserve estimation and control system; reserve licensing and regulation in the Russian Federation; Russian reserve categories;
2. **Description of reserves:** includes descriptions of Gazprom's five major production regions;
3. **Estimated reserves:** includes Gazprom's total estimated reserves and reserve distribution by region;
4. **Geological and geophysical substantiation of fields:** the standard methodologies used to estimate Gazprom's reserves;
5. **Production:** includes Gazprom's production policy and a description of the technology and equipment used in production.

The exhibits to the report include a map of Russia showing the location of Gazprom's major production enterprises and producing areas, a map showing the location of Gazprom's major fields in Western Siberia, and nine exhibits containing maps and characteristics of Gazprom's nine major fields.

1. Introduction

1.1. Reserve estimation and control in Gazprom

In accordance with current Russian legislation, new gas and oil/gas deposits are estimated by the volumetric method and using reservoir parameters obtained during the assessment:

- field area (S);
- effective oil and gas saturation thickness (Hef);
- porosity (Kp), oil and gas saturation (Kog), taking into account the pressure and temperature conditions of the reservoir.

For gas deposits under development, both volumetric and material balance methods are applied by evaluating the time change for reservoir pressure reduction relative to the total volume of gas extracted and the volume of water influx.

The State Balance of the Russian Federation contains data on the balance reserves of gas as well as the balance and recoverable reserves of oil. Balance reserves are those quantities of oil and gas in the reservoir.

Almost all gas reserves of the Russian Federation are confirmed by the State Commission for Mineral Reserves under the Committee for Geology and the Use of the Subsoil of the Russian Federation.

The proportion of Gazprom's reserves confirmed by State experts amounts to 87% of Gazprom's total licensed reserves.

The State Commission for Mineral Reserves has regional commissions which carry out their functions on the same organisational and methodological basis as the State Commission.

Changes in the reserve volumes of gas, oil and condensate fields (deposits) are estimated annually based on geological exploration and production data.

Data summary and the calculation (and recalculation) of Gazprom's reserves are carried out by specialised subdivisions of Gazprom's scientific research institutes together with the geological service of Gazprom enterprises.

Control over reserve revisions and their estimation by specialised enterprises is exercised by Gazprom's Commission for Deposits and Underground Gas Storage Facilities, acting on the authority of a regulation approved by the Chairman of the Management Committee of Gazprom.

Exhibit I illustrates the current system for estimation and control of hydrocarbon reserves in Russia and of Gazprom.

1.2. Reserve Licensing and Regulation of the Use of the Subsoil in the Russian Federation

The use of the subsoil in the Russian Federation is regulated by the Law of the Russian Federation "On Subsoil" (No. 27-φ3 of March 3, 1995), by the Federal Law "On Production Sharing Agreements" (No. 225-φ3 of December 30, 1995), by the Regulation on the Procedure for Licensing the Use of the Subsoil (No. 3314-1 of July 15, 1992) and by instructions and rulings of the State Technical Inspection for the Mining Industry, the Russian Committee on the Subsoil, the Ministry of Economics, the Ministry of Finance and the Ministry of Fuel and Energy¹. The Subsoil is defined as everything beneath the surface of the ground.

The basic principles of the legislation on the use of the subsoil are as follows:

- joint disposal of the subsoil by the Russian Federation and the Subjects (i.e. constituent regional entities) of the Federation;
- payment for the right to use the subsoil;
- granting rights to use the subsoil on a licensing basis;
- single licensing procedure.

In a limited number of cases, licenses impose obligations on the Company to provide employment for the local population and to develop local infrastructure. The Company pays certain local and federal taxes on gas revenues and observes established environmental requirements.

Subsidiary enterprises and joint stock companies, with the consent of RAO Gazprom and in accordance with the legislation on the subsoil and other acts of law of the Russian Federation, pursue acquisition of licences for the use of subsoil in their operational regions. They conduct negotiations with the administration of the Subject of the Federation and regional geological committees, conclude licence agreements, obtain land allotments and present information on the status of licensing and their proposals regarding licensing programmes to Gazprom.

¹ To bring the Regulation on the Procedure for Licensing the Use of the Subsoil into compliance with the new Law "On Subsoil" (No. 27-φ3 of March 3, 1995), a Federal Law "On the Licensing of the Use of the Subsoil" is being considered, and all acts of law regarding the use of the subsoil are being reviewed.

The main considerations governing the participation of Gazprom's enterprises in tenders and auctions are as follows:

- the volumes of natural gas, gas condensate and oil reserves of the deposits under tender (it is expedient to get licences for deposits with large or medium volumes of reserves or for groups of neighbouring deposits);
- the degree of substantiation of the reserves and potential resources (the main volumes must be estimated to be at least category C2);
- the economics of the tender (tax rates, payments, fees, conditions of the licence agreement or the production sharing agreement, tax relief for the period required to repay capital investments, etc.);
- the calculated profitability of developing the deposit and the payback period for capital investments based on current and promising future programmes for developing production and processing capacities for the primary and by-product minerals and their useful components as well as the pricing and investment policy of the Company.

1.3. Russian Reserve Categories

Reserves of gas, oil and condensate, and of their commercially valuable components, are calculated and recorded in the State Balance of Russia by their degree of substantiation:

Explored reserves—in categories A, B and C1.

Preliminary estimated reserves—in category C2.

Category A.* The reserves of a field under development are calculated based on the deposits (or parts of deposits) drilled in accordance with the approved development project for the field.

Analysed in sufficient detail to enable a comprehensive determination to be made of the type, shape and size of the deposit, the nature of changes in the reservoir parameters, and the content and properties of the fluid; the operating regime and well productivity have been also analysed.

Category B.* Reserves are calculated based on deposits (or fields) drilled in accordance with a pilot commercial development project for a field.

Oil and gas bearing capacity is determined based on the commercial flows from the wells at various sub-sea depths; analysis has been completed of the type and size of the deposit, of the nature of changes in reservoir characteristics, of the content and properties of the fluids, and of the major features of the deposit which determine its development.

Category C1. Reserves are calculated based on the results of geological exploratory work and production drilling; must be analysed in sufficient detail to provide input data to draw up a development plan.

Oil and gas bearing capacity is established both through drill stem formation testing and by testing materials from formation testers and, if the results are positive, by geological and geophysical analysis of untested wells. The type, shape and size of the deposit and the bedding conditions of the reservoir are determined using the results of exploratory and operational well drilling, and by geological and geophysical research methods tested in the region. The content and characteristics of the fluid are analysed through testing. Well productivity, hydroconductivity, and stratum pressure and temperature are analysed by well testing and analysis.

Category C2. Reserves in unexplored sectors of the deposit adjacent to higher category sectors and reserves in intermediate and overlying untested strata of explored fields. The shape and size of the deposit, bedding conditions, thickness and reservoir properties, as well as the fluid properties, are established based on the results of geological and geophysical research taking into account data from the more substantiated portion of the deposit or by analogy with explored fields.

* The procedure used in the past for assessing the feasibility of field development provided no strict requirements for upgrading category C1 gas reserves into categories B and A.

Up to 50% of category C2 reserves are taken into account in drawing up a development plan.

Gas and oil resources, depending on their degree of substantiation, are subdivided into:

(a) high-potential resources:

Category C3—resources in identified deposits which are ready for deep drilling; and

(b) forecast resources:

Categories D1 and D2—resources in lithologic-stratigraphic complexes, which are within the borders of major regional structures with confirmed (D1) or unconfirmed (D2) commercial oil and gas bearing capacity.

2. Description of Reserves

The mineral base of Gazprom amounts to 32.9 trillion cubic meters of gas and 1.7 billion tonnes of liquid hydrocarbons concentrated in 98 deposits.

A high degree of reserve concentration is characteristic of the Company's deposits. 80% of Gazprom reserves are concentrated in six fields (Urengoi, Yamburg, Zapolyarnoye, Bovanenکو, Orenburg and Astrakhan).

Two major fields, Urengoi and Yamburg, accounted for approximately 75% of Gazprom's gas production in 1995.

Gazprom holds 135 production, prospecting and exploration licenses in five areas of the territory of the Russian Federation: Western Siberia, the Ural-Volga region, North European Russia, the offshore shelf of the Barents Sea and the Northern Caucasus. A map showing Gazprom's major production enterprises and producing areas is attached in Exhibit 2.

The licenses pertaining to Gazprom's nine major gas bearing fields, and their terms, are as follows:

<u>Field</u>	<u>Production Enterprise</u>	<u>License Number</u>	<u>License Issue Date</u>	<u>License Expiry Date</u>
Medvezhe	Nadymgazprom	10088 HЭ	May 13, 1993	May 12, 2018
Urengoi	Urengoi-gazprom	10146 HЭ	August 13, 1993	August 12, 2013
Yamburg	Yamburggazdobycha	10086 HЭ	May 13, 1993	May 12, 2018
Zapolyarnoye	Yamburggazdobycha	10144 HЭ	August 13, 1993	August 12, 2013
Bovankenko	Nadymgazprom	10144 HЭ	August 13, 1993	August 12, 2013
Kharasavei	Nadymgazprom	10276 HЭ	June 6, 1994	June 5, 2019
Orenburg	Orenburggazprom	10271 HЭ	March 18, 1994	August 1, 2013
Astrakhan	Astrakhangazprom	10241 HЭ	January 11, 1994	December 31, 2019
Shtokmanov	AO "Rosshelf"	ШБЦ 10036 HЭ	March 15, 1993	March 2018

A brief summary of the regions and the major characteristics of the nine major fields is presented below.

The majority of Gazprom's reserves are situated in Senomanian formations which are characterised by very high recovery rates, and dry gas.

2.1. Western Siberia

Western Siberia is a unique oil and gas bearing Russian province. It occupies the territory from the Urals in the west to the Yenisei river in the east. In the north it extends to the Kara Sea. The total area of high-potential gas-bearing territory amounts to about 2 million square km.

The peculiarities of the geological structure and the nature of the oil and gas bearing capacity in Western Siberia result in the central portion being mostly oil bearing and the north gas bearing. A map of Western Siberian Gas fields is attached in Exhibit 3.

The cross section that has been drilled reveals Jurassic, Cretaceous, Paleogene and Neogene rocks. In the northern area the Jurassic deposits bed over more ancient sedimentary deposits: Triassic and late Paleozoic.

The oil and gas reserves in the north of Western Siberia are part of three oil and gas bearing complexes: apt-Senoman, Neocomian and Jurassic.

The complexes are separated by clay shields with thicknesses of 100-400 meters and more.

The major gas bearing complex, the **apt-Senoman complex**, lies at a depth of 650-1,250 meters, and is overlain by a thick (up to 800 meters) layer of Turonian-Oligocene clay. It is formed by weakly bound sandstone and siltstone with very good reservoir parameters. The apt-Senoman complex includes the unique deposits of the Urengoi, Medvezhe, Yamburg, Zapolyaroye, Bovanenko, Kharasavei and other fields. The gas has a methane content of 85-99% with minor heavy hydrocarbons.

The Neocomian complex is formed by sandstone and siltstone. Gas condensate and oil and gas condensate deposits form the second gas bearing level in the northern part of Western Siberia at depths of 1,700-3,500 meters.

The deposits of the Jurassic complex form the third level of the oil and gas bearing complex and bed at depths of over 3 km. Gas-oil, gas and oil deposits have been discovered in the Gubkin, Vyngapur, Urengoi, Novo-Portov, Kharasavei and other fields. The reservoirs of this complex are characterised by lower reservoir parameters than the Senoman deposits, and by higher heterogeneity over the producing strata.

The geographical layout and peculiarities of the gas bearing territory of the northern part of Western Siberia result in three major geological-economic regions: Nadym-Pur-Taz, Yamal and Gydan.

The major fields under development and ready for development are located in the Yamal-Nenetsk autonomous region. In this region, Gazprom holds licences for 22 fields. The gas reserves of these fields constitute 79% of Gazprom's total reserves and account for 93% of the Company's annual gas production.

Maps and characteristics of six of Gazprom's major fields which are located in Western Siberia are attached in Exhibits 4-9.

2.2. The Volga Region and the Urals

The Ural-Volga region includes the territories of Tatariya, Bashkiriya, the Perm, Sverdlovsk, Orenburg, Saratov, Volgograd and Astrakhan regions and Kalmykiya.

The central part of the region is primarily an oil bearing area. The major European Russian fields have been explored and are now under development.

The gas fields are located in the southern and eastern edges of the Ural-Volga region: in the Cis-Ural trough and the Caspian Sea basin and its perimeter.

The Cis-Ural trough is a region where the crystalline basement sinks very deep, extending along the whole western slope of the Ural range. 56 small and medium gas fields have been discovered in the lower Permian and Carboniferous limestone and dolomites in Bashkiriya, and the Perm and Sverdlovsk regions, within the boundary of the trough. The gas contains up to 5% of hydrogen sulphide.

The Caspian Sea basin is a major sedimentary region. The bottom of the basin is estimated to be at a depth of 20 km, and its western (Russian) part is mostly gas bearing. The sedimentary mantle includes persalt Mesozoic, salt-bearing Kungur and subsalt lower Permian-carboniferous deposits.

Commercial gas bearing capacity is found in the subsalt sedimentary complex which beds at depths of 1.5-9.5 km. The major Astrakhan gas condensate field in the south and the Orenburg oil, gas and condensate field in the junction of the basin and the Cis-Ural trough have been explored and are currently under development.

Further exploration may confirm the existence of additional reserves of high-sulphur gas in the Astrakhan field.

Exploration for sulphur-free gas is pursued in persalt and Devonian sediments.

Gazprom is conducting active geological exploratory work in high-potential structures in the south of the Orenburg region. Gazprom holds licenses for 8 fields in this region.

Maps and characteristics of two of Gazprom's major fields which are located in the Ural-Volga region are attached in Exhibits 10 and 11.

2.3. North European Russia

The Timan-Pechora oil and gas bearing province includes promising oil and gas areas in the Nenets autonomous region and the Komi Republic.

In the north-east, the borders of the region are defined by the Ural mountain folding, and in the south-west by the Timan range. In the north, the region extends into the Barents Sea area.

The thickness of the sedimentary mantle in the Timan-Pechora region increases from south to north and from west to east and reaches 10-12 km in the Cis-Ural area.

Oil and gas bearing capacity is found in a wide stratigraphic range: from Ordovician to Triassic. There are two zones of gas accumulation: the Cis-Ural trough and the upheaval of the Shapkin-Yuryakhinski barrier located near the town of Naryan-Mar, the administrative centre of the Nenets region.

The largest gas condensate field in the region, Vuktyl, was discovered in Upper Visei carbonate sediments of the Cis-Ural trough in 1964, and has been under development since 1968. In the 1970s, a series of large gas fields with small (fractions of a percent) hydrogen sulphide content (Kumzhinskoye, Vasilkovskoye, Vaneivisskoye, Layavozhskoye and others) were explored in the Naryan-Mar region.

Gazprom holds licenses for eight fields in this region.

2.4. Northern Caucasus

Gas fields have been discovered in the Northern Caucasus in the territories of the Krasnodar, Stavropol and Rostov regions, Adygeya, Chechnya and Dagestan.

The peculiarities of the region's geological structure and oil and gas distribution result in three major oil and gas bearing regions: the Azov-Kuban, Tersk-Kum and Stavropol regions.

Oil and gas bearing capacity has been found in Mesozoic and Cenozoic deposits whose maximum thickness (of up to 10-12 km) is reached in the Azov-Kuban trough.

The Northern Caucasus is an old gas producing region. The major fields were discovered in the 1950s and 1960s. The maximum annual production level (44 billion cubic meters) was reached in 1968. 3.1 bcm were produced in 1995, 2.2 bcm of which by Gazprom enterprises. Field development prospects are dependent on the exploration of deep strata.

Gazprom holds licenses for fifty-eight fields in the Northern Caucasus.

2.5. Barents Sea

The subsoil of the Barents Sea shelf is one of the most promising regions in terms of oil and gas bearing capacity.

The southern part of the region (the Pechora Sea) is in itself the northern end of the Timan-Pechora oil bearing province. To date four hydrocarbon fields have been discovered in this area, including the Pirazlomnoye and Varandei-Sea oil fields.

The northern part of the Barents Sea shelf is primarily gas bearing. Five gas condensate fields, including Shtokmanov, have been discovered in this region.

Productive deposits in the marine part of the Timan-Pechora province have so far been discovered in deposits from the carboniferous to the Triassic periods (inclusive), and in the southern part of the East Barents Sea province from the Triassic to Jurassic periods (inclusive).

Gazprom is carrying out exploration and development activity in the Shtokmanov, Pirazlomnoye and Varandei-Sea fields.

A map and characteristics of the Shtokmanov field, which is located in the Barents Sea, is attached in Exhibit 12.

3. Estimated Reserves

3.1. Reserves by Category

The table below shows the estimated reserves (categories A, B, C1 and C2) of Gazprom as of January 1, 1996:

Category	Gas (tcm)	Gas Condensates (million tonnes)	Oil (million tonnes)
A + B	1.3	116.1	—
C1	31.6	1137.9	627.4
Total	32.9	1254.0	627.4
C2	3.9	439.8	379.2

The majority of Gazprom's A+B+C1 reserves are recorded as category C1 because historically it has not been necessary, for technical or commercial reasons, to upgrade gas reserves from C1 to higher categories. For gas reserves, development plans are drawn up on the basis of A+B+C1 plus up to 50% of C2 reserves. Gazprom now has a commercial incentive, from the financial markets, to carry out an independent technical audit of its reserves against international standards of categorization. As a first step in this process, the Company has launched a programme to upgrade its C1 reserves, since the data generated will be required for the technical audit.

3.2. Distribution of Reserves

Gazprom's wholly owned enterprises hold licenses to fields with reserves of 28.6 trillion cubic meters.

In addition, the Company has majority shareholdings in companies which hold production licenses for 4.4 tcm of gas, 86.1 million tonnes of gas condensate and 105 million tonnes of oil in the Shtokmanov, North Urengoi, East Urengoi and East Tarkosalinsk fields.

Gazprom currently holds 85 production licenses with terms of an average of 20 years, 14 combined prospecting and production licenses with terms of 25 years, and 36 prospecting licenses with terms of five years. For reserve estimation, it was assumed that these licenses would be renewed for the life of the reserve. The Russian Federal Law "On Subsoil" (article 10) anticipates that licenses will be renewed at the request of the

subsoil user provided that the latter has observed the conditions of the license. Extension of license terms is granted by the Federal and regional bodies which issued the licenses.

Of its total volume of gas reserves (32.9 tcm), Gazprom's enterprises hold production licenses for 26.0 tcm (79%) in Western Siberia. The main reserves are concentrated in five major fields (Urengoi, Yamburg, Medvezhe, Zapolyarnoye and Bovanenke).

Production licenses held by Gazprom include the right to develop 1.25 billion tonnes of gas condensate reserves, 710.4 million tonnes of which (57%) are located in Western Siberia; as well as the right to develop 627.4 million tonnes of oil reserves.

The table below shows a summary by region of the total reserves for which Gazprom has been issued production licenses (as of January 1, 1996):

<u>Region</u>	<u>Gas A+B+C1</u>	<u>Gas Condensates A+B+C1</u>	<u>Oil A+B+C1</u>
	(tcm)	(million tonnes)	(million tonnes)
Nadym-Pur-Taz	20.2	605.9	244.9
Yamal	5.8	104.5	227.0
Total Western Siberia	26.0	710.4	471.9
Volga-Urals region	3.7	485.2	89.7
North European Russia	0.3	34.6	10.9
Northern Caucasus	0.1	3.7	5.3
Barents Sea	2.8	20.1	49.6
Total ⁽¹⁾	32.9	1254.0	627.4

(1) Includes reserves of companies in which Gazprom has a majority shareholding.

The tables below summarise the reserves, as at January 1, 1996, of major gas bearing fields for which Gazprom holds licenses which are producing and prepared for development:

<u>Major Producing Gas Fields</u>	<u>Reserves A + B + C1</u>
	(tcm)
Western Siberia:	
Urengoi ⁽¹⁾	7.00
Yamburg	4.00
Medvezhe	0.85
Komsomolsk	0.70
Ural-Volga region:	
Orenburg	1.03
Astrakhan	2.60

(1) Includes North Urengoi, Pestsov, and Yen-Yahinsk fields

<u>Major Gas Fields Prepared for Development</u>	<u>Reserves A + B + C1</u>
	(tcm)
Nadym-Pur-Taz:	3.52

De Vries
Kharasevei

1.26

Barents Sea:

Shtokmanov

2.80

B-8



Production at the Zapolyarnoye field, which is located to the east of the Urengoi field, is expected to begin in the fourth quarter of 1998. The development of the Yamal peninsula—the Bovanenko and Kharasavei fields—is planned for 2000 at the earliest.

The distribution of liquid hydrocarbons by region:

<u>Region</u>	<u>Gas Condensates (A + B + C1)</u>	<u>Oil (A + B + C1)</u>
Western Siberia:		
Nadym-Pur-Taz	605.9	244.9
Yamal peninsula	104.5	227.0
Ural-Volga region	485.2	89.6
Other regions	58.4	65.9
Total	<u>1254.0</u>	<u>627.4</u>
of which:		
under development	982.6	176.6
prepared for development	271.4	450.8

3.3. Exploration

Gazprom has a long term plan for geological exploration and field development. Exploration for new fields and gas bearing strata is pursued in the vicinity of the Company's existing infrastructure, which makes it possible to maintain production levels and provide adequate gas supply to existing pipelines. The scale and efficiency of exploratory drilling are shown in the table below:

	<u>1993</u>	<u>1994</u>	<u>1995</u>
Number of exploration wells drilled	37	40	38
of which producing	23	20	19
Additions to reserves (bcm)	70.8	65.7	70.2

The Company plans to expand its geological exploratory activity in the high-potential territories of the Yamal-Nenetsk Autonomous region, and the Orenburg and Astrakhan regions.

4. Geological and Geophysical Substantiation of Fields

A wide variety of geophysical research methods has been applied to all fields under development and ready for development, including gravitational, magnetic, electric and seismic exploration.

In recent years, Gazprom has performed a significant volume of seismic exploration work using modern high-multiple methods including 3D seismic, in order to refine the geological models of its deposits.

Operating corrections to the geological models of the fields are made on the basis of new geophysical data and materials from newly drilled exploratory and operational wells.

A broad range of geological and geophysical information is used to estimate the hydrocarbon reserves in the wells of Western Siberia, North European Russia, and the Ural-Volga region. Core sample material is extracted in sufficient amounts to make reliable estimates of the reservoir characteristics and saturation. To calculate the reservoir characteristics, the absolute whetability, porosity and residual water saturation of the core sample are determined and its volume and mineral density are measured. To provide the petrophysical justification for the methodologies used to interpret the GIS ("geophysical well study"), the physical properties (electric, radioactive and acoustic) of the reservoir are measured on core samples under atmospheric conditions and under conditions reproducing stratum pressures and temperatures. To increase the reliability of the hydrocarbon reserve estimates, one or two wells are drilled in the field using special oil based drilling fluids to

extract core samples. These core samples are used to determine the unaltered residual water, saturation, mineralisation and specific electrical resistance of the formation waters.

Intervals of well sections with high gas and oil bearing potential are usually analysed using a number of electric, radioactive and acoustic GIS methods. GIS methods include all known standard and comprehensive procedures employed in well logging in Russia.

The specific application of these methods depends on the type of section being analysed and the technical properties of the drilling fluid.

To obtain the basic data needed to construct a field interpretation model, a number of wells are analysed using an extensive range of GIS methods including, in addition to the standard methods, the wave dielectric, nuclear-magnetic, density, gamma-gamma, impulse neutron-neutron and hydrodynamic methods of well logging. Some of the wells are analysed using special technologies (repeated measurement with different modifications, including the use of different drilling fluids with different physical properties and different resulting effects on reservoir strata).

Modern methodologies developed by leading Russian scientific research institutes are applied to interpret geological and geophysical data.

In the process of estimating hydrocarbon reserves on the basis of GIS data, the following has to be accomplished: the lithologic separation of sections, the identification of reservoir strata and determination of their mineral composition, the division of reservoirs by type of pore space, the determination of total (in terrigenous reservoirs), intergranular, interstitial and fractural (in carbonates) porosity, the determination of the type of reservoir situation and of the degree of water or gas saturation, and the locations of gas-liquid contacts.

In general, the North Caucasian fields are substantiated to a level corresponding to the GIS methods of the 1950s and early 1960s. New production wells are analyzed using modern GIS methods.

Continued periodic geophysical (well log) analyses of wells are performed during the exploration and production phases of development in all fields in Russia. These analyses are used to monitor changes in gas saturation during the development process, to determine the intervals of the gas-recovery sources, gas overflow and leakage routes, secondary gas accumulation intervals, the rise of the gas-liquid contact, the movement of the gas pool outline and the intervals of water encroachment into the deposit. In addition, the temperature and pressure conditions and phase composition of fluids along the shaft are determined, the state of liquid accumulation in the bottom of the shaft is checked, hydrate and salt formation in the well is monitored, the efficiency of the technological elements of subsurface equipment is determined, the integrity of all elements of the subsurface well equipment is analyzed, etc.

The above mentioned tasks are carried out using various radiometric, thermometric, barometric and other GIS methods.

All drilling and well analysis data is stored in the geological departments of the enterprises developing the fields as well as at the geophysical enterprises which conducted the research work.

The geophysical analyses are performed by specialised enterprises in each gas producing region. The primary interpretation of the data is done by the geophysical enterprises themselves. The calculation of the hydrocarbon reserves is usually done by scientific institutions of the industry such as Vniigaz, Tyumenniigiprogaz and other regional institutes of Gazprom. The Company has also engaged specialized Russian institutes such as VNIGIK.

Exhibits 13-16 illustrate the data-processed results of field assessment techniques applied to fields in Western Siberia and the Orenburg region.

5. Production

Gazprom's annual production will depend on demand in the Russian and international markets. Gazprom expects long term growth in demand both domestically and internationally, and the Company's current mineral base would allow Gazprom to achieve increasing production through 2010 (see table below). The Company can provide the production increase by bringing into production major fields already prepared for development, including Zapolyarnoye, Bovanenko, and others. To provide production growth in the longer term, the Company is expanding its mineral base by acquiring licenses for fields which have already been discovered and by conducting geological and exploration activities in high-potential areas.

	<u>1995</u>	<u>2000</u>	<u>2005</u>	<u>2010</u>
Gas, bcm	559.5	665.0	763.5	821.5
Condensate, million tonnes	7.7	9.6	12.5	16.7
Oil, million tonnes	0.9	2.4	5.3	5.6

The primary production method used by Gazprom is the standard method of gas extraction based on natural exhaustion.

Field development and gas production is managed in Gazprom by qualified engineers and scientists trained in specialised institutions throughout the Former Soviet Union.

The 559.5 bcm of gas produced by Gazprom in 1995 represented approximately 94% of the total volume of gas produced in the Russian Federation. The remaining gas production in Russia is provided by gas producing enterprises independent of Gazprom and by oil companies.

5.1. Technology and Equipment

The major regions providing natural gas supplies to the Russian Federation are: Western Siberia (more than 90% of production) and the Ural-Volga region (6%).

All the major fields in these regions (Urengoi, Yamburg, Medvezhe, Komsomolsk, Orenburg, Astrakhan and others) are equipped mainly with standard domestic equipment which is used for wells, industrial pipelines and installations for comprehensive gas and condensate preparation (UKPGs). In the Medvezhe field, five of the nine UKPG installations are made by the French firm "ENSA".

Gazprom's gas producing enterprises operate over 9,000 wells (comprising wells in producing fields, in fields prepared for production and service wells).

Absorption and adsorption methods and low-temperature separation (NTS) are used to prepare gas for transportation. The main UKPG equipment consists of absorbers, separators, heat exchangers, furnaces, gas AVOs (air-cooling units), turbo-detonators, pumps and such like, and totals over 3,000 units.

As the gas fields in the Far North were developed, the daily capacity of the UKPG technological line unit was increased from 3-5 up to 10 million cubic meters. The capacity of the imported UKPG at the Medvezhe field is a maximum of 8 bcm annually, whereas the increased unit capacity of the domestic technological lines made it possible to install UKPGs with a capacity of 15-20 bcm annually when the Urengoi field was developed. At the Yamburg field, the UKPG capacity was increased further to 26.5 bcm annually. Moreover, field development experience has shown the absorption technology used in domestic equipment to be more flexible than adsorption technology, especially in the operating conditions of the Far North.

More than 110 gas compressor units (GPAs) with a total power of 1,760 megawatts, are being used for in-field gas transportation, and the total length of collection pipelines, inter-field gas pipelines with a diameter of 1,000-1,400 mm, and product pipelines, amounts to more than 5,500 km.

Production technologies based on this equipment are capable of meeting the projected production volumes from existing fields through to 2015. The producing enterprises constantly reconstruct and modernise their technological equipment in order to increase production efficiency, reliability and safety.

For the development of new fields, the Company intends to rely on existing developed domestic technologies and equipment.

The book value of Gazprom's well and production equipment is presented in the Company's audited IAS balance sheet of December 31, 1995.

5.2. Special Factors

The varied geological, geographic and climatic characteristics of Gazprom's mineral base have determined the specific features of their industrial development. The major factors that complicate the production of hydrocarbons include:

- multi-phase saturation (gas, condensate, oil), typical of the lower Cretaceous and Jurassic deposits in Western Siberia and the Orenburg field;
- complicated reservoir type, abnormally high geo-pressure (AVDP) (Jurassic deposits in Western Siberia and the Astrakhan field);
- permafrost and difficult-to-reach fields (Western Siberia, especially Yamal);
- presence of acid components in gas (the Orenburg and Astrakhan fields).

Nevertheless, using a combination of domestic and global experience, technical and technological solutions are consistently found which make the efficient development of such fields possible now and for the future.

Vasiliy A. Ponomarev

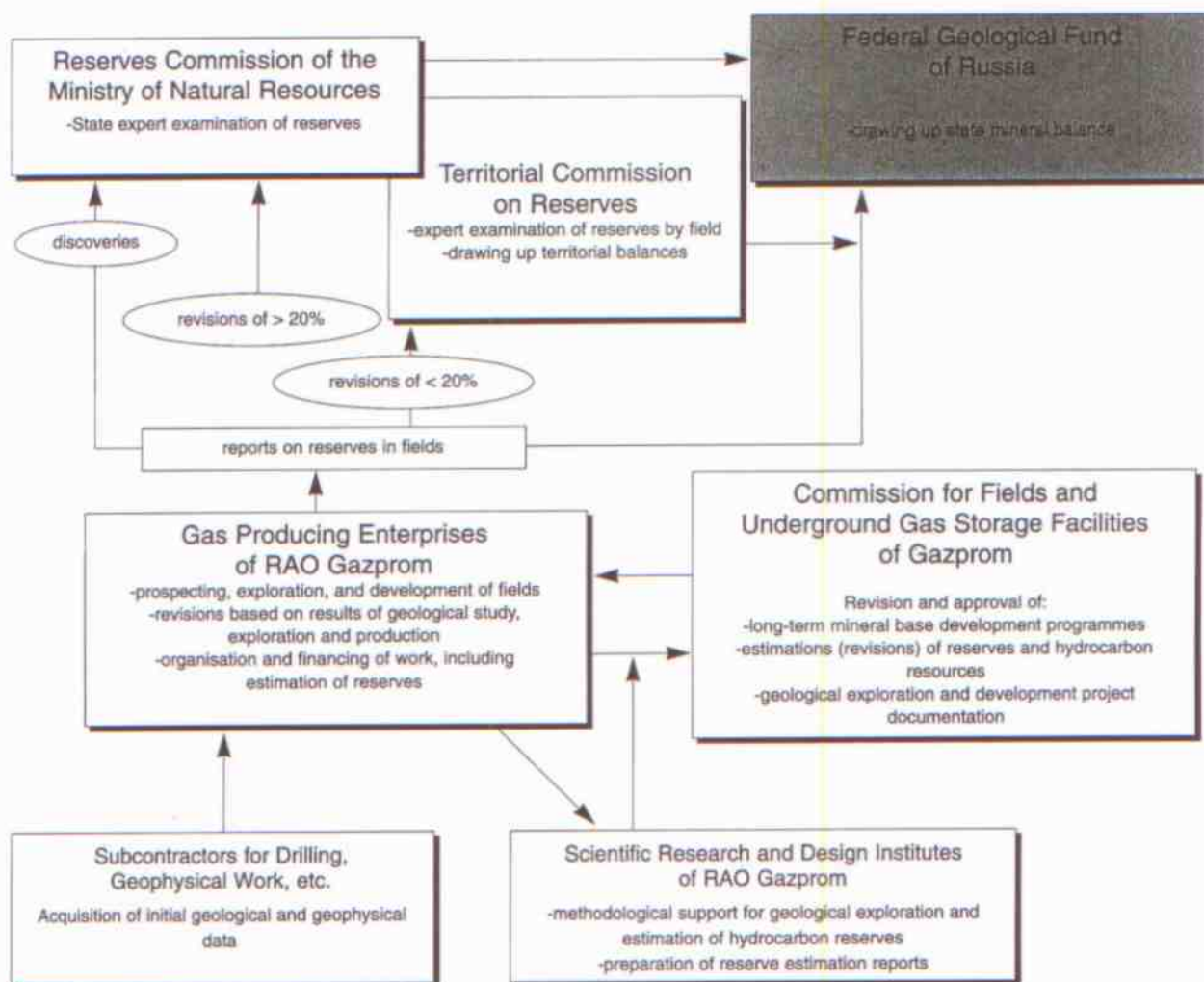
Lydia A. Shulzhenko

List of Exhibits

1. Estimation and control of hydrocarbon reserves of Gazprom.
2. Map of Russia showing production enterprises and main producing areas of Gazprom.
3. Map of the Yamal-Nenetsk Autonomous Region.
4. Medvezhe field. Map and geological characteristics.
5. Urengoi field. Map and geological characteristics.
6. Yamburg field. Map and geological characteristics.
7. Zapolyarnoye field. Map and geological characteristics.
8. Bovanenko field. Map and geological characteristics.
9. Kharasavei field. Map and geological characteristics.
10. Orenburg field. Map and geological characteristics.
11. Astrakhan field. Map and geological characteristics.
12. Shtokmanov field. Map and geological characteristics.
13. Well 707, Urengoi field, Tyumen region. Interpretation of GIS (geophysical well study) data. Geophysical-industrial characteristics of Achim deposits.
14. Zapolyarnoye field, Tyumen region. Seismic section of Neocomian deposits.
15. Zapolyarnoye field, Tyumen region. Isochronic map of Senomanian formation (reflecting horizon G).
16. Field under exploration, Orenburg region. Data-processed results of 3D seismic survey.
17. Glossary of terms.

Exhibit 1

Estimation and control of hydrocarbon reserves in Gazprom



Estimation and control of hydrocarbon reserves in Gazprom

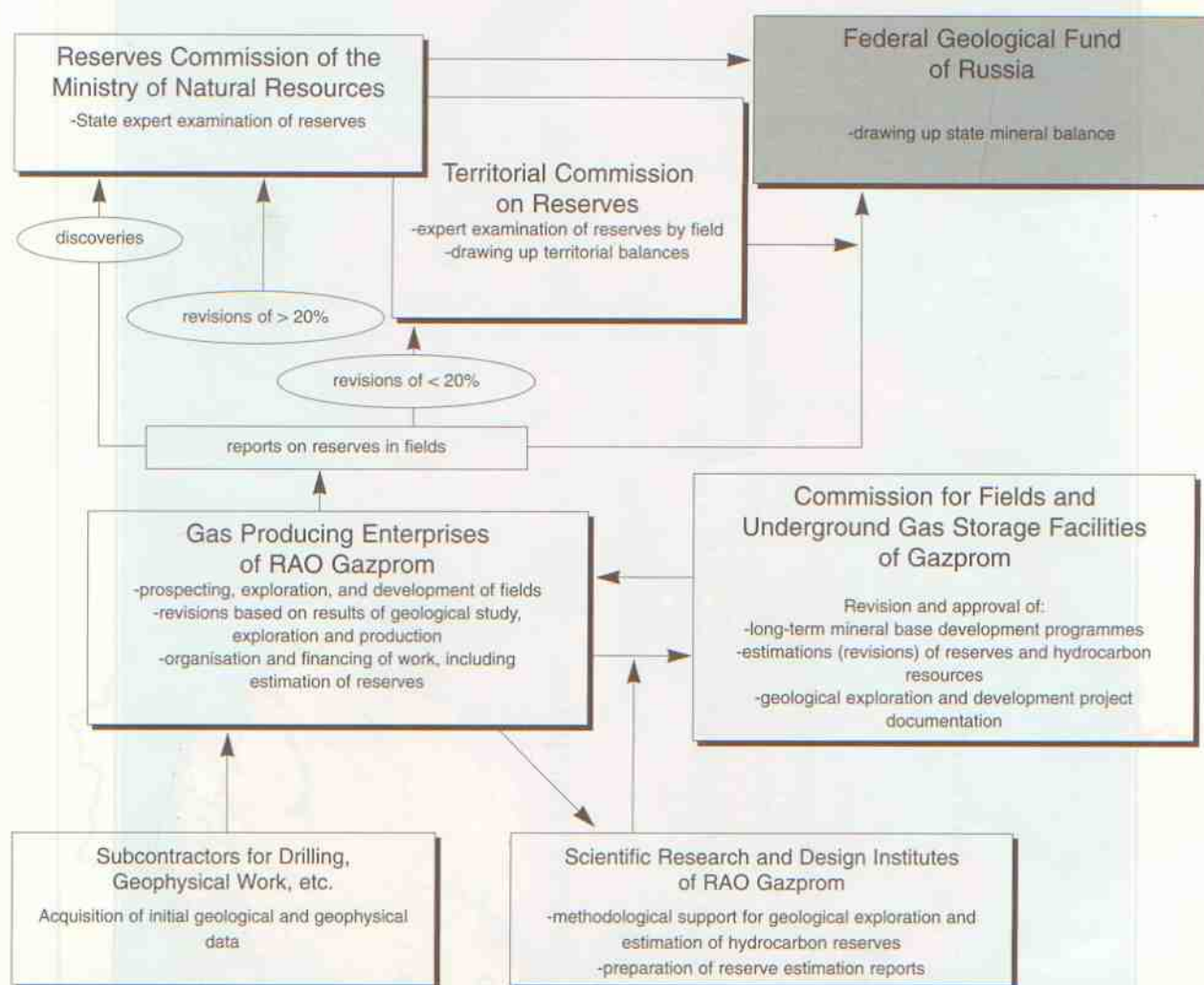
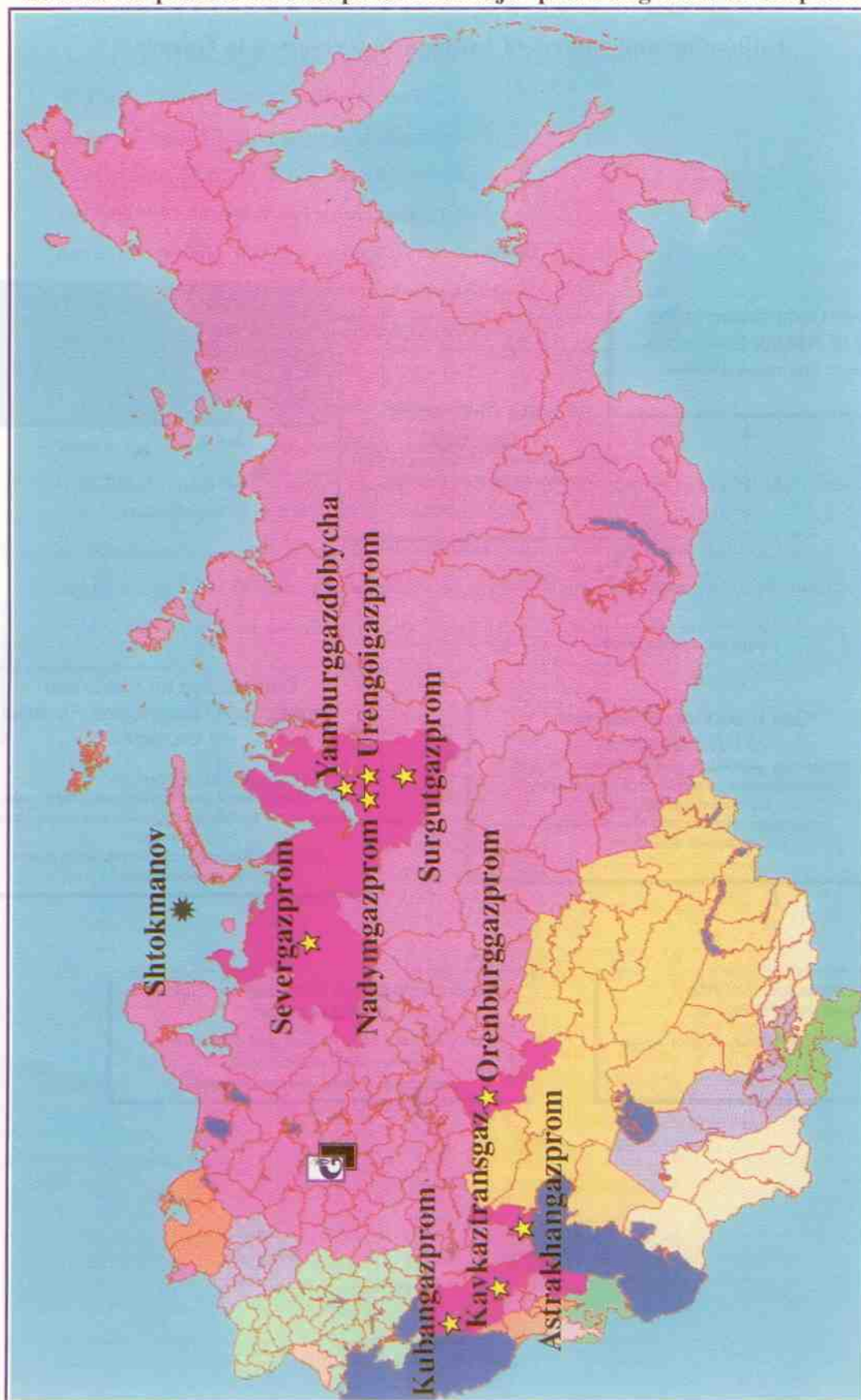
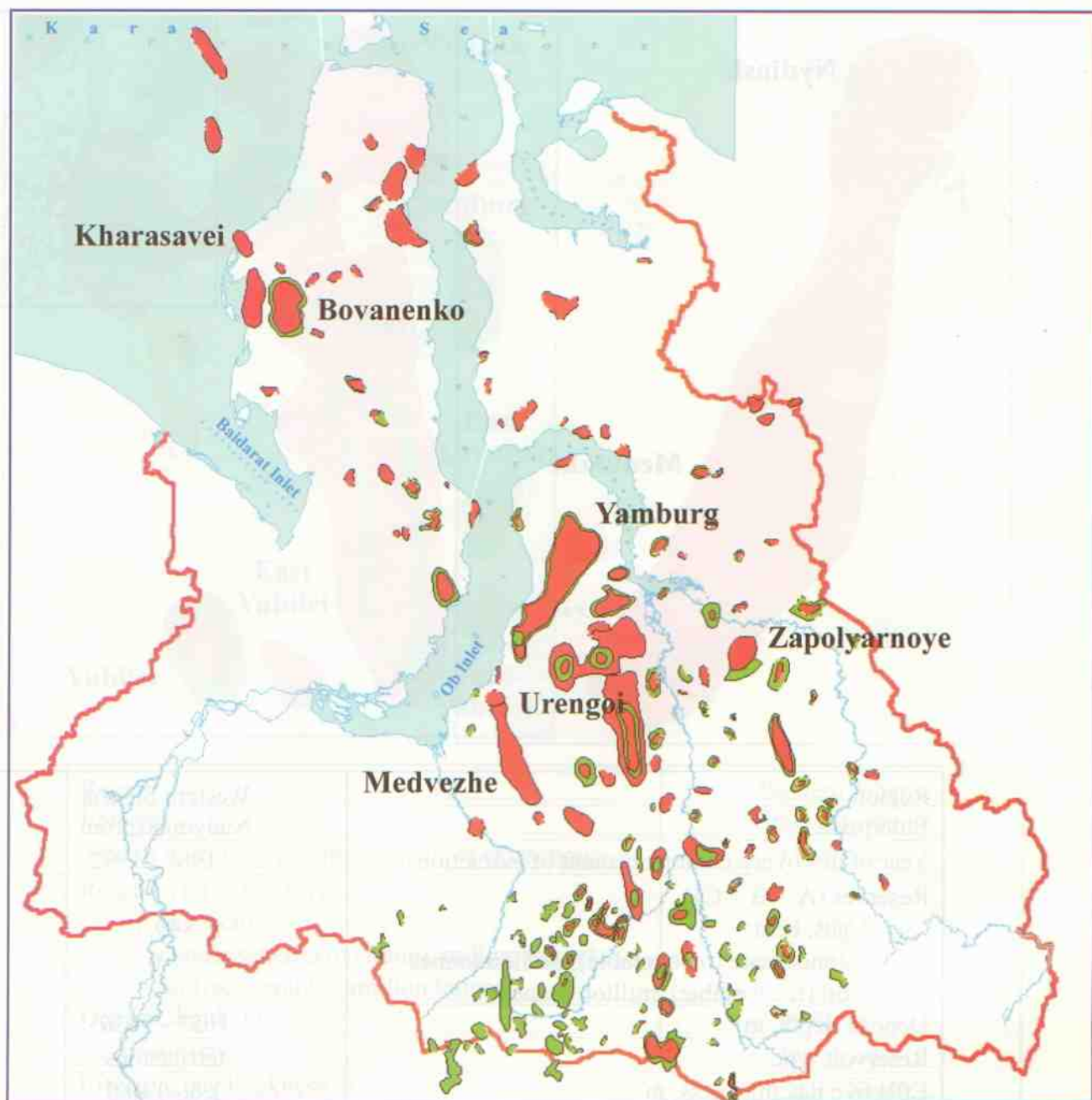


Exhibit 2

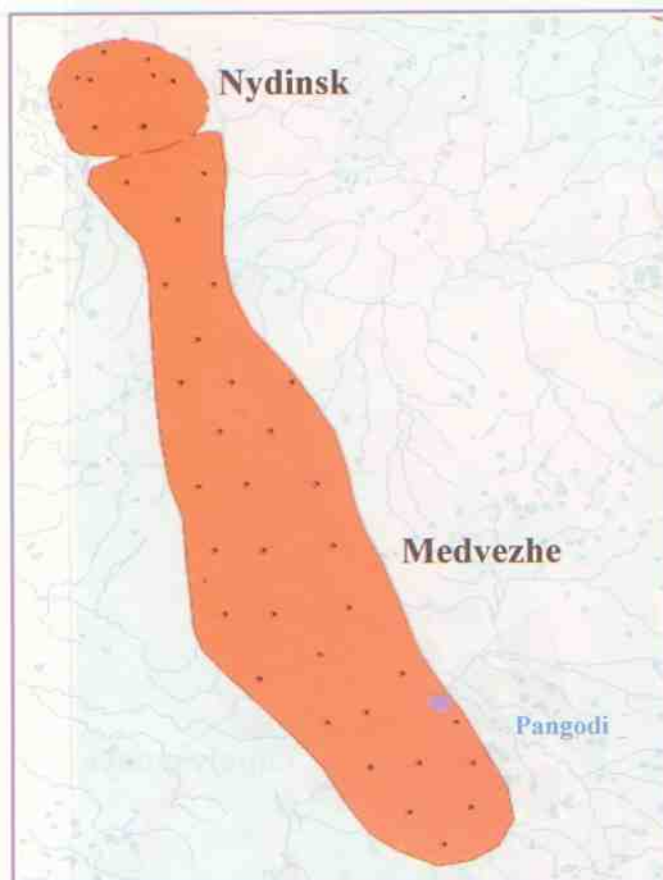
Location of production enterprises and major producing areas of Gazprom



The Yamal-Nenetsk Autonomous Region

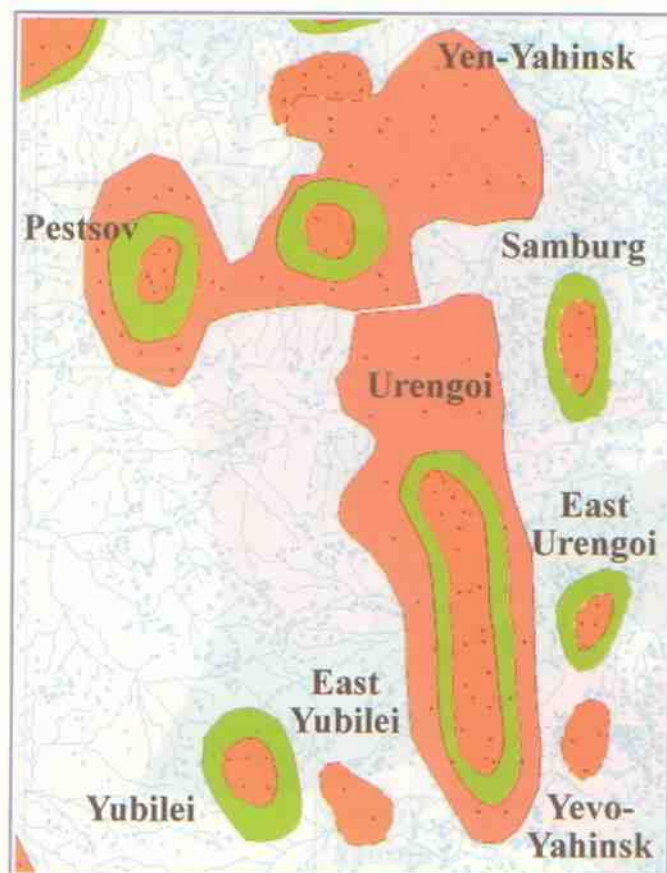


Medvezhe Field



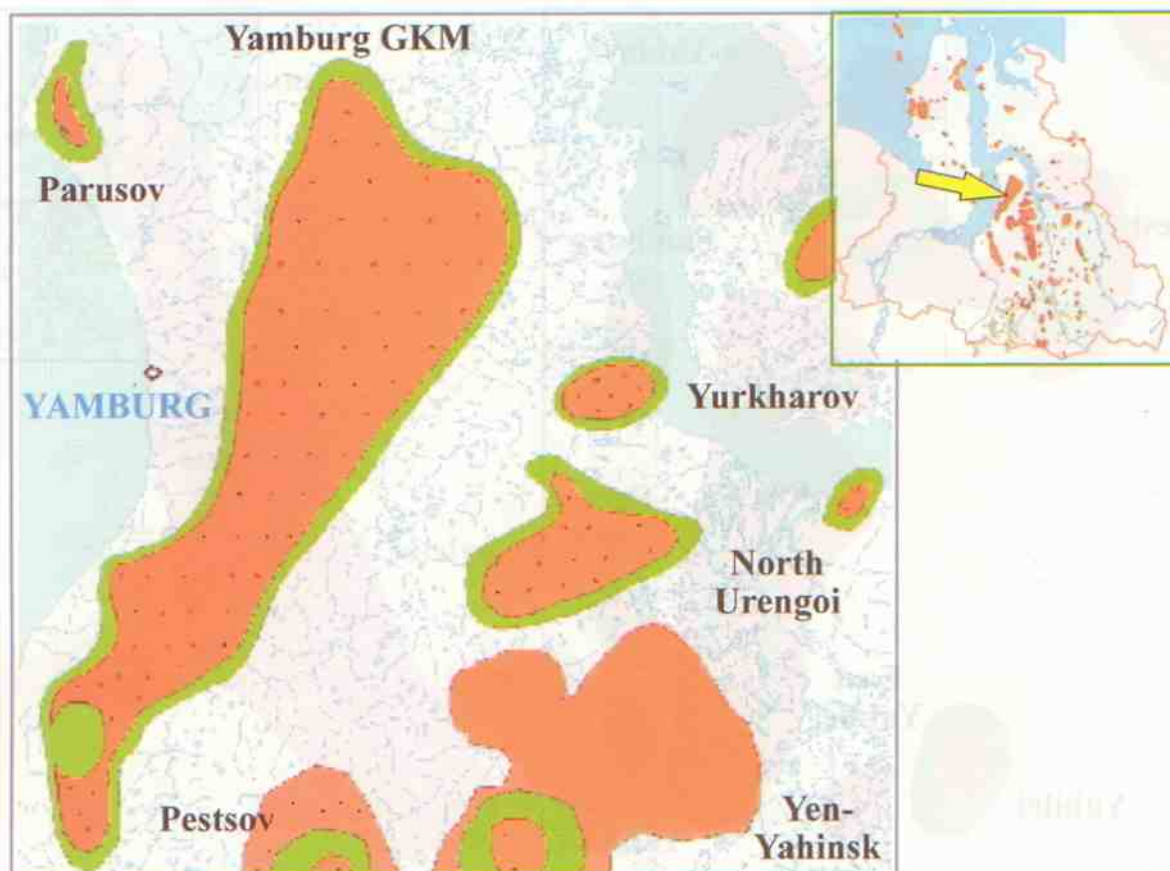
Region	Western Siberia
Enterprise	Nadymgazprom
Year of discovery/commencement of extraction	1967 / 1972
Reserves (A + B + C1)	
gas, bcm	849.7
condensate (recoverable), million tonnes	1.6
oil (recoverable), million tonnes	
Deposit depth, m	1057 - 3036
Reservoir type	terrigenous
Effective pay thickness, m	1.6 - 140.0
Porosity, %	20 - 27
Gas content	
methane, %	99.0
C5 + higher, g/m ³	150

Urengoi Field



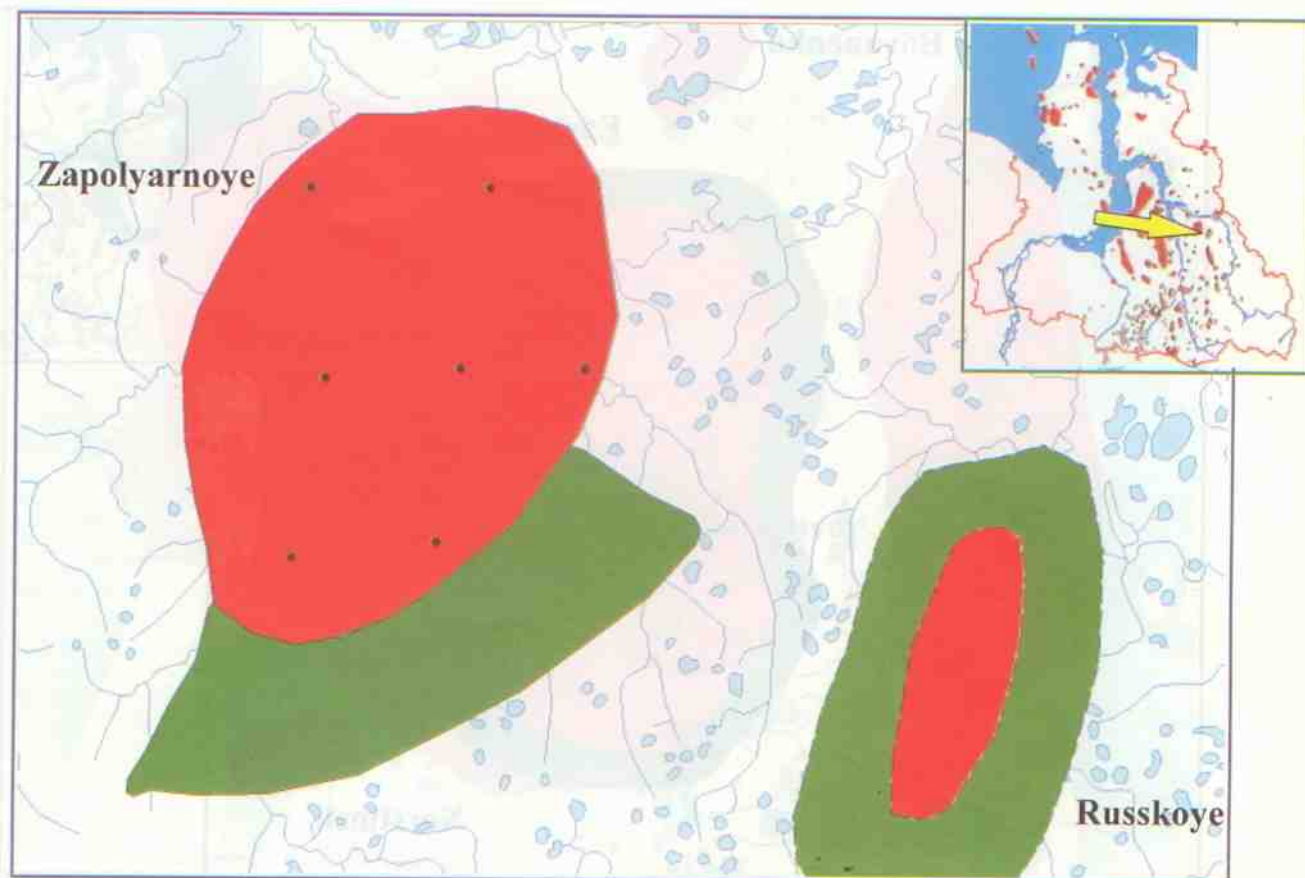
Region	Western Siberia
Enterprise	Urengoi Gazprom
Year of discovery/commencement of extraction	1966 / 1978
Reserves (A + B + C1)	
gas, bcm	6611
condensate (recoverable), million tonnes	410
oil (recoverable), million tonnes	139
Deposit depth, m	1040 - 3953
Reservoir type	terrigenous
Effective pay thickness, m	9.0 - 55.0
Porosity, %	13 - 30
Gas content	
methane, %	85.0 - 99.0
C5 + higher, g/m ³	8.8 - 500

Yamburg Field



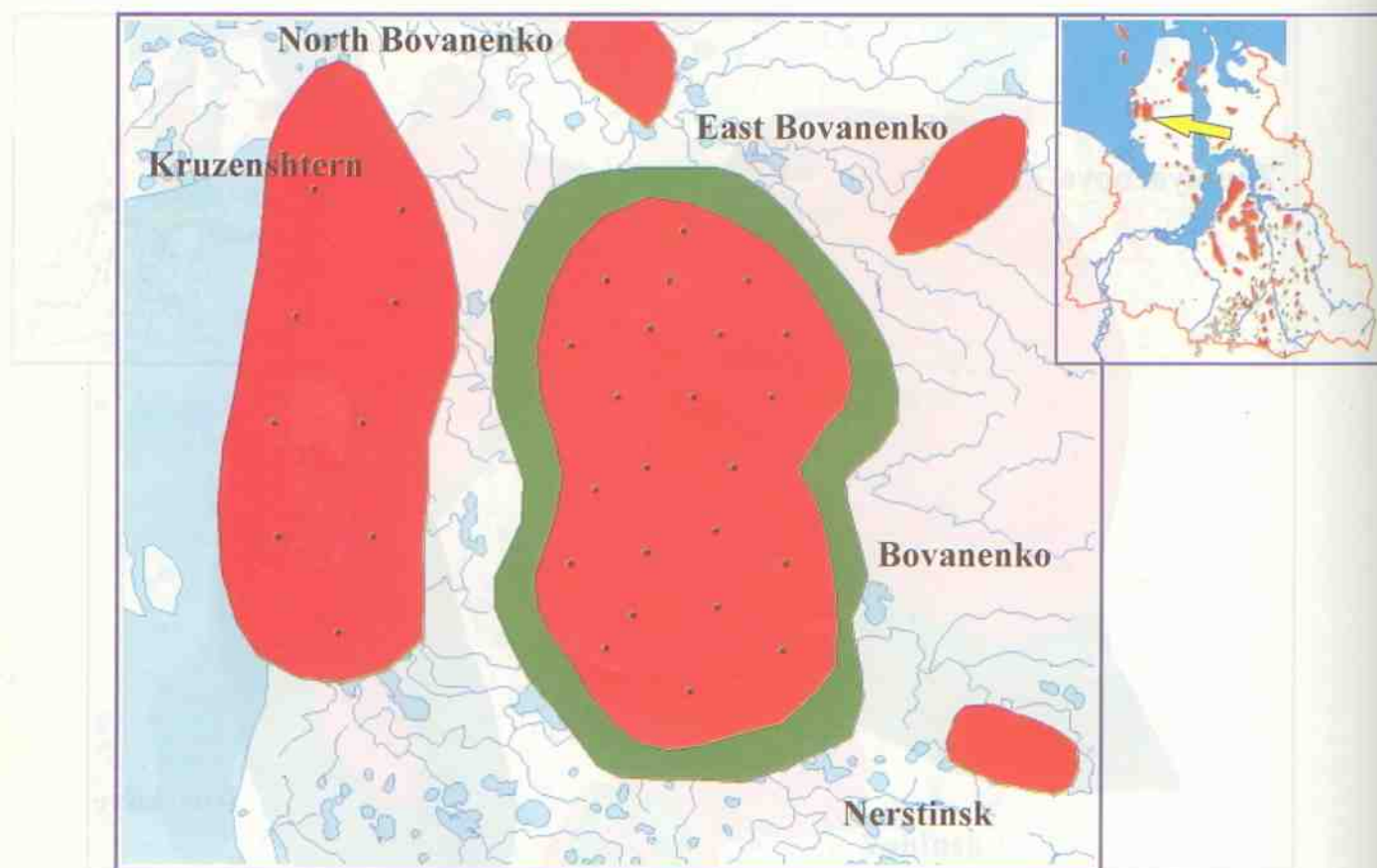
Region	Western Siberia
Enterprise	Yamburggazdobycha
Year of discovery/commencement of extraction	1969 / 1986
Reserves (A + B + C1)	
gas, bcm	4588
condensate (recoverable), million tonnes	61.8
oil (recoverable), million tonnes	0.15
Deposit depth, m	1000 - 3302
Reservoir type	terrigenous
Effective pay thickness, m	3 - 149
Porosity, %	14 - 30
Gas content	
methane, %	89.0 - 99.0
C5 + higher, g/m ³	94 - 150

Zapolyarnoye Field



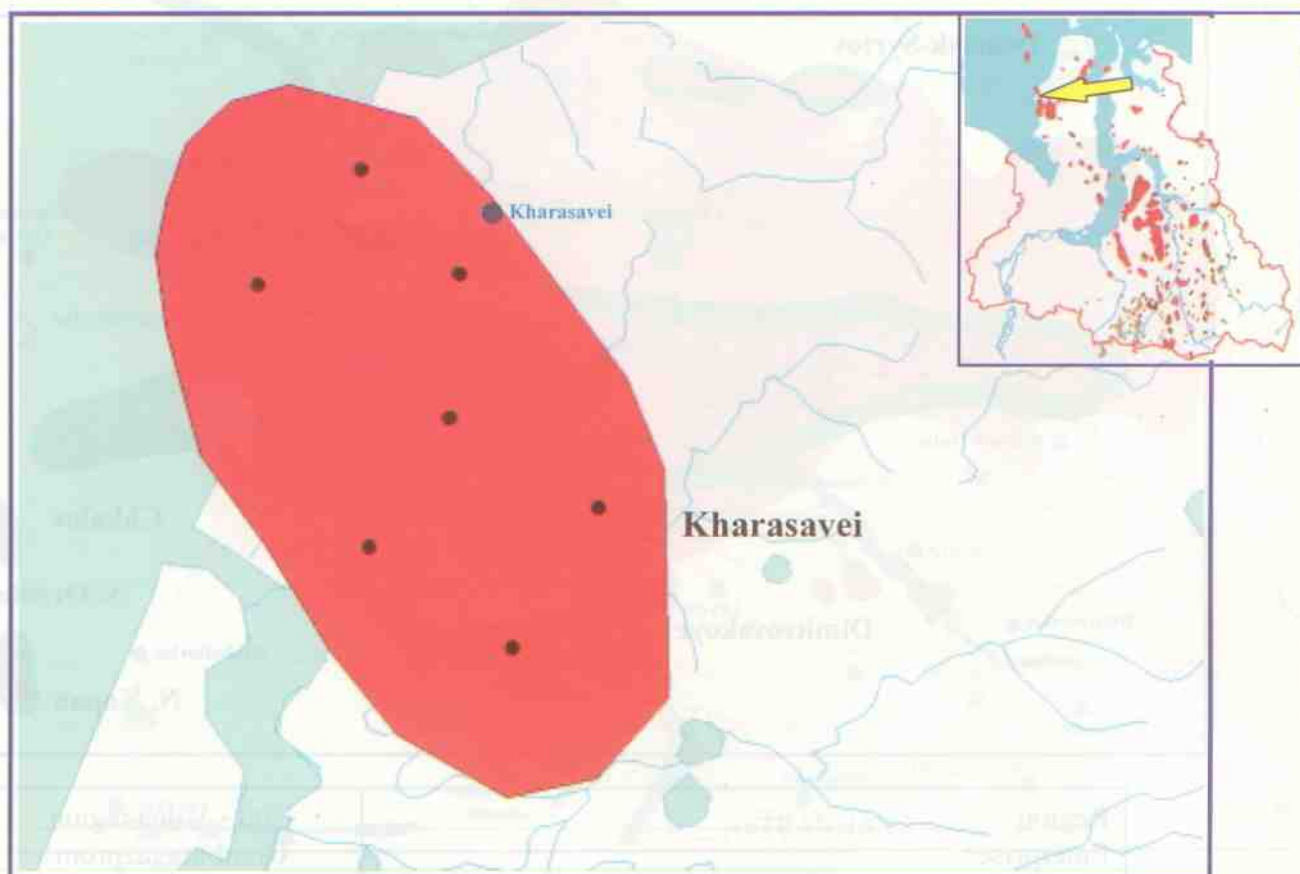
Region	Western Siberia
Enterprise	Yamburggazdobycha
Year of discovery/commencement of extraction	1965 / (1998)
Reserves (A + B + C1)	
gas, bcm	3532
condensate (recoverable), million tonnes	88
oil (recoverable), million tonnes	44
Deposit depth, m	1054 - 3282
Reservoir type	terrigenous
Effective pay thickness, m	4.8 - 64.4
Porosity, %	16.0 - 33.2
Gas content	
methane, %	87.0 - 99.0
C5 + higher, g/m ³	139 - 188

Bovanenko Field



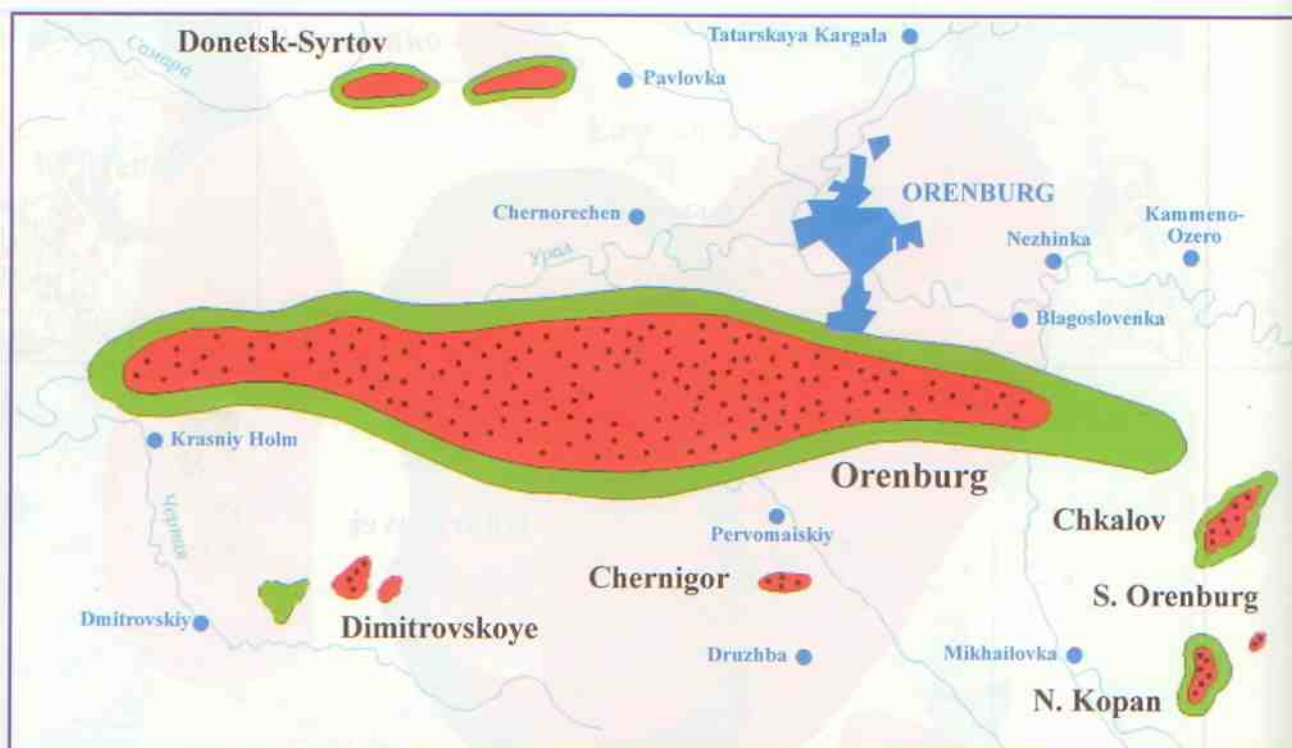
Region	Western Siberia, Yamal Peninsula
Enterprise	Nadymgazprom
Year of discovery/commencement of extraction	1971 / (2000+)
Reserves (A + B + C1)	
gas, bcm	4375
condensate (recoverable), million tonnes	57.0
oil (recoverable), million tonnes	4.7
Deposit depth, m	532 - 4008
Reservoir type	terrigenous
Effective pay thickness, m	3 - 148
Porosity, %	15 - 33
Gas content	
- methane, %	89.0 - 98.0
- C5+ higher, g/m ³	1 - 200

Kharasavei Field



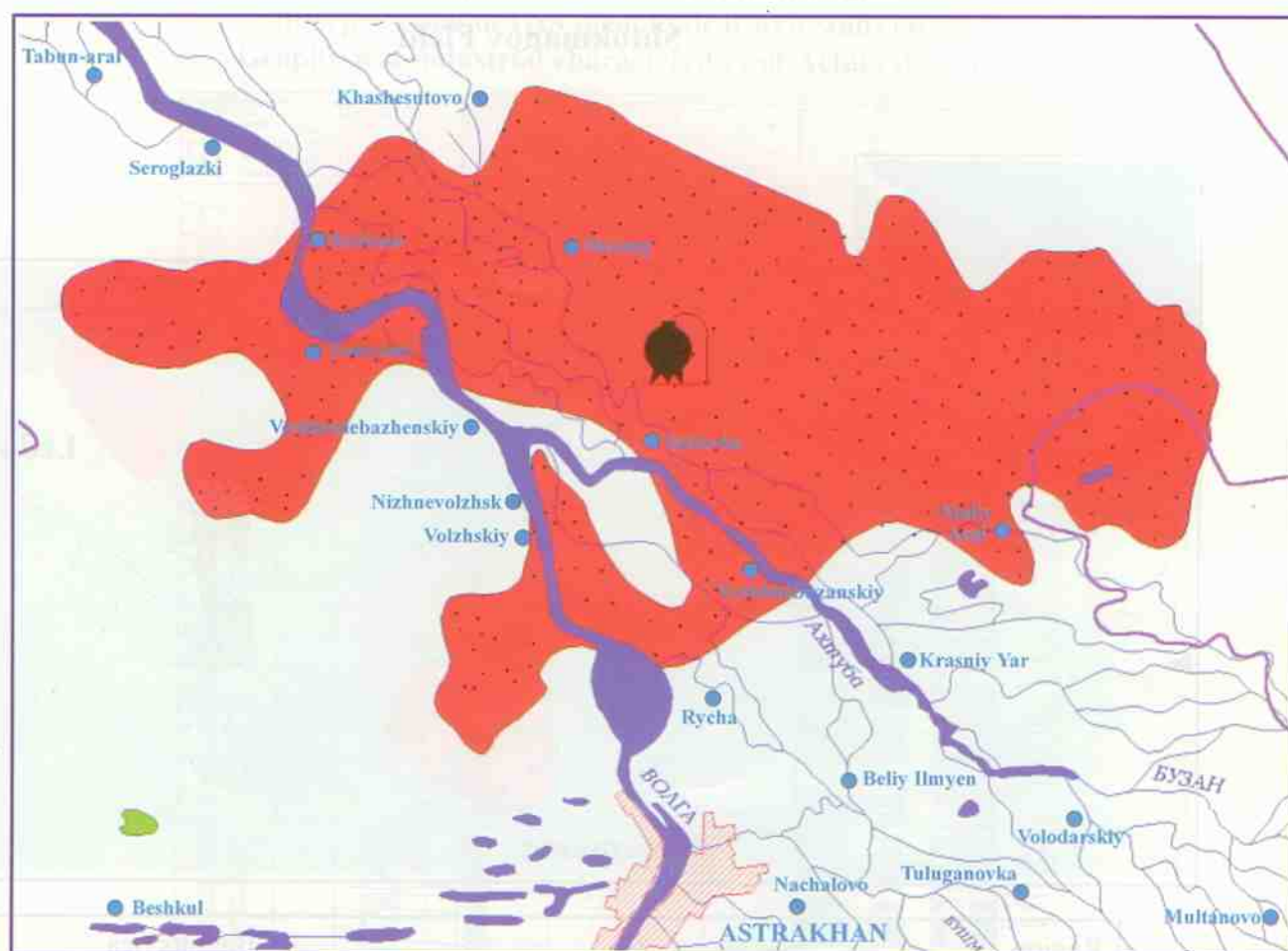
Region	Western Siberia, Yamal Peninsula
Enterprise	Nadymgazprom
Year of discovery/commencement of extraction	1974 / (2000+)
Reserves (A + B + C1)	
gas, bcm	1259.1
condensate (recoverable), million tonnes	31.8
oil (recoverable), million tonnes	-
Deposit depth, m	718 - 3335
Reservoir type	terrigenous
Effective pay thickness, m	2.4 - 59
Porosity, %	15 - 31.5
Gas content	
methane, %	88.0 - 98.8
C5 + higher, g/m ³	2.2 - 181

Orenburg Field

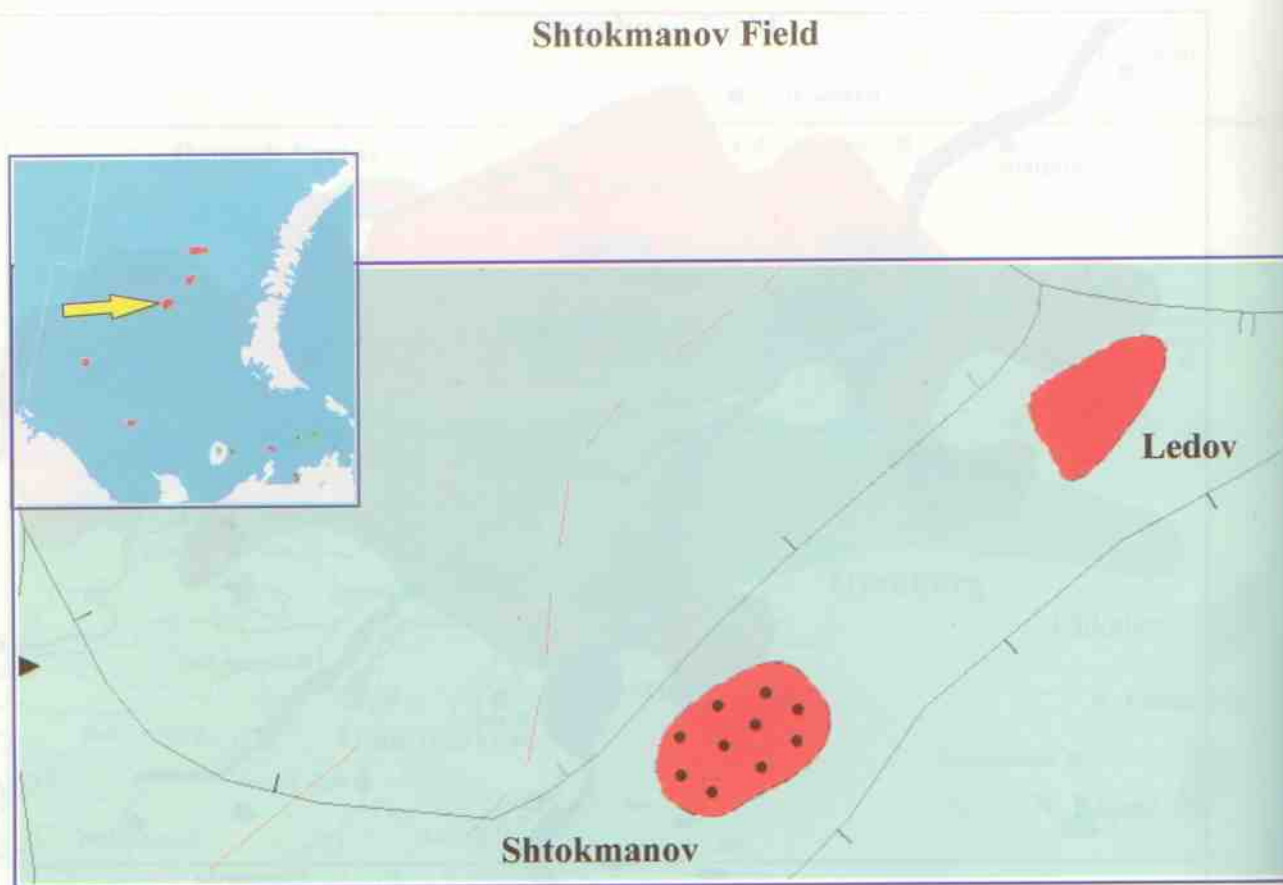


Region	Ural - Volga region
Enterprise	Orenburggazprom
Year of discovery/commencement of extraction	1966 / 1971
Reserves (A + B + C1)	
gas, bcm	1033.1
condensate (recoverable), million tonnes	63.2
oil (recoverable), million tonnes	89.6
Deposit depth, m	1300 - 2359
Reservoir type	carbonate
Effective pay thickness, m	208.2
Porosity, %	11 - 14
Gas content	
methane, %	83.6
C5 + higher, g/m ³	76.3
hydrogen sulphide, %	2 - 7

Astrakhan Field

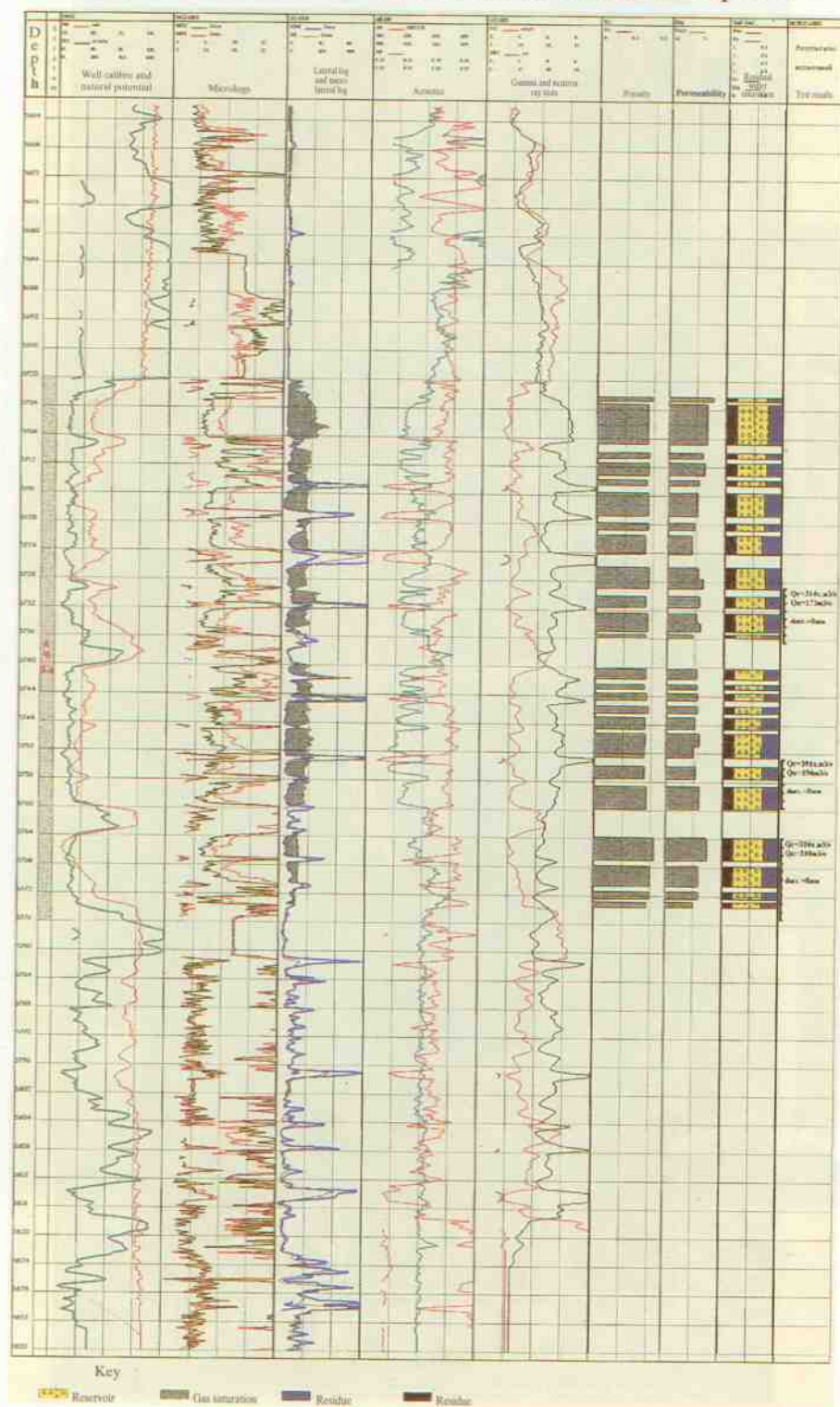


Region	Ural - Volga region
Enterprise	Astrakhangazprom
Year of discovery/commencement of extraction	1976 / 1986
Reserves (A + B + C1)	
gas, bcm	2592
condensate (recoverable), million tonnes	421.6
oil (recoverable), million tonnes	-
Deposit depth, m	3800 - 4100
Reservoir type	carbonate
Effective pay thickness, m	138
Porosity, %	10
Gas content	
methane, %	51.4
C5 + higher, g/m ³	224
hydrogen sulphide, %	27.6

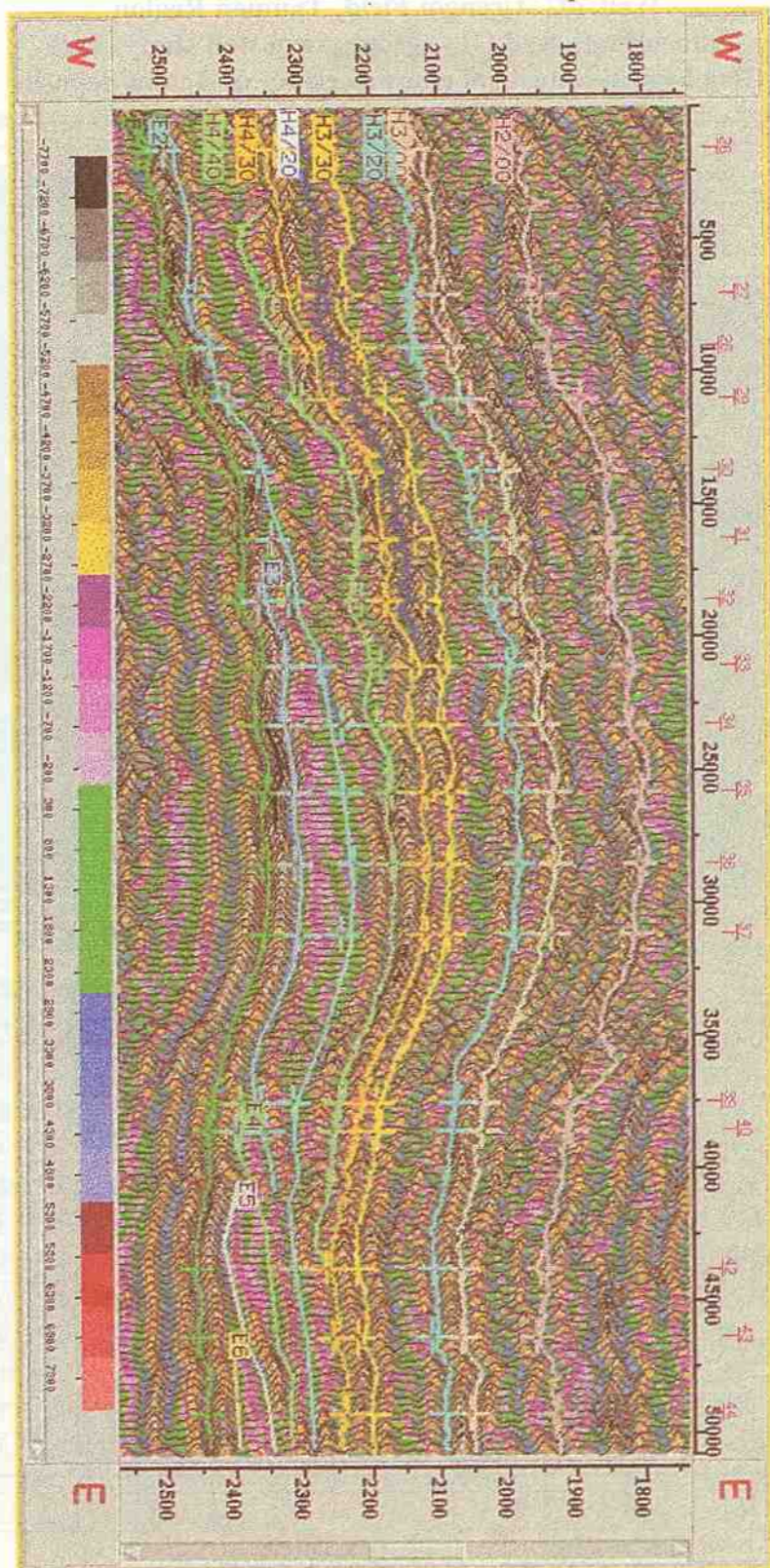


Region	Barents Sea
Enterprise	AO "Rosshelf"
Year of discovery/commencement of extraction	1988 / (2000+)
Reserves (A + B + C1)	
gas, bcm	2762.3
condensate (recoverable), million tonnes	20.3
oil (recoverable), million tonnes	-
Deposit depth, m	1814 - 2317
Reservoir type	terrigenous
Effective pay thickness, m	5.7 - 43.3
Porosity, %	17 - 24
Gas content	
methane, %	94 - 96
C5 + higher, g/m ³	4.8 - 12.4

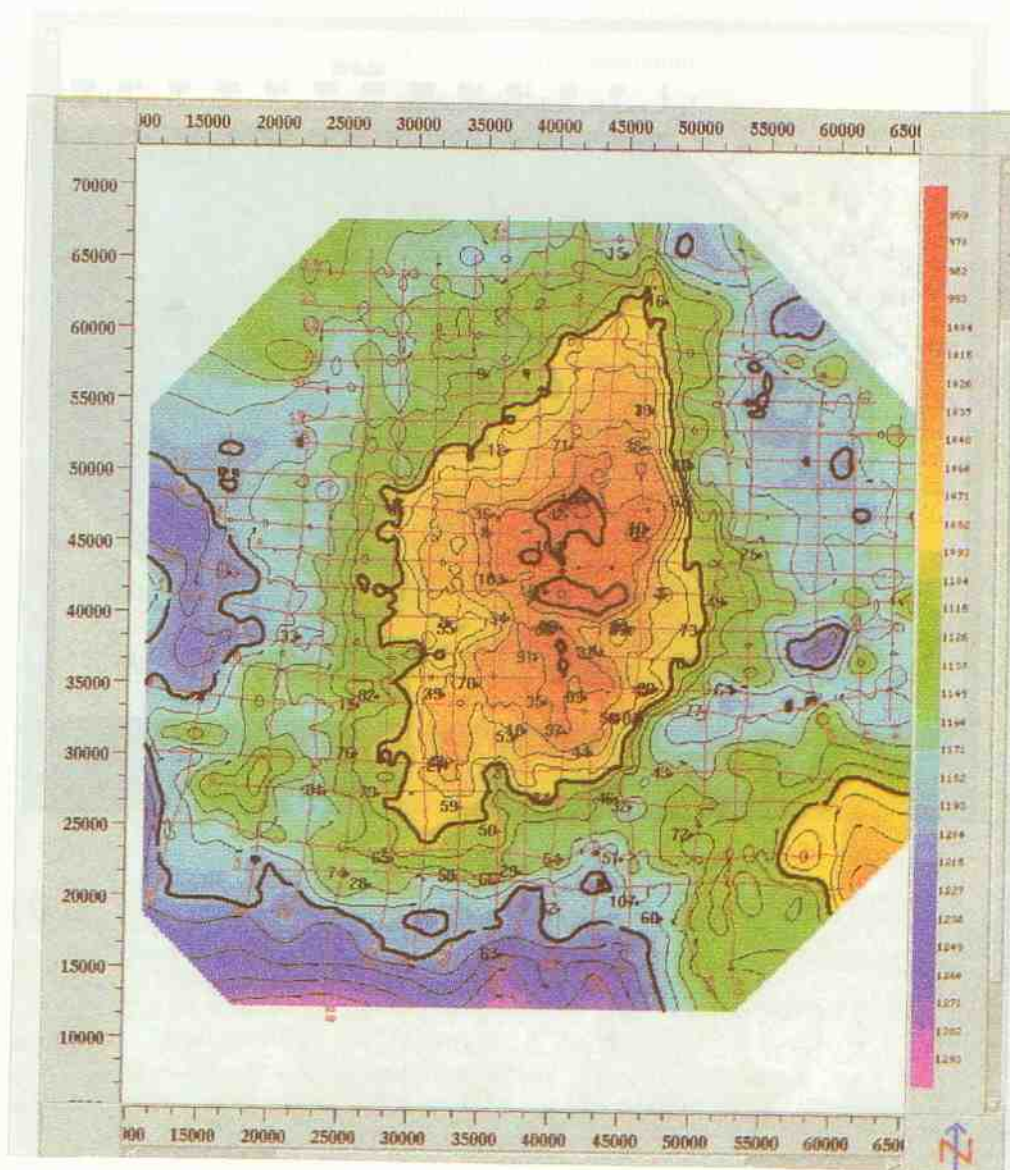
Well 707, Urengoi Field, Tyumen Region
Interpretation of GIS (geophysical well study) data
Geophysical-industrial characteristics of Achim deposits



Zapolyarnoye Field, Tyumen Region Seismic section of Neocomian deposits



Zapolyarnoye Field, Tyumen Region
Isochronic map of Senomanian formation (reflecting horizon G)



Field under exploration, Orenburg Region
Data-processed results of 3D seismic survey

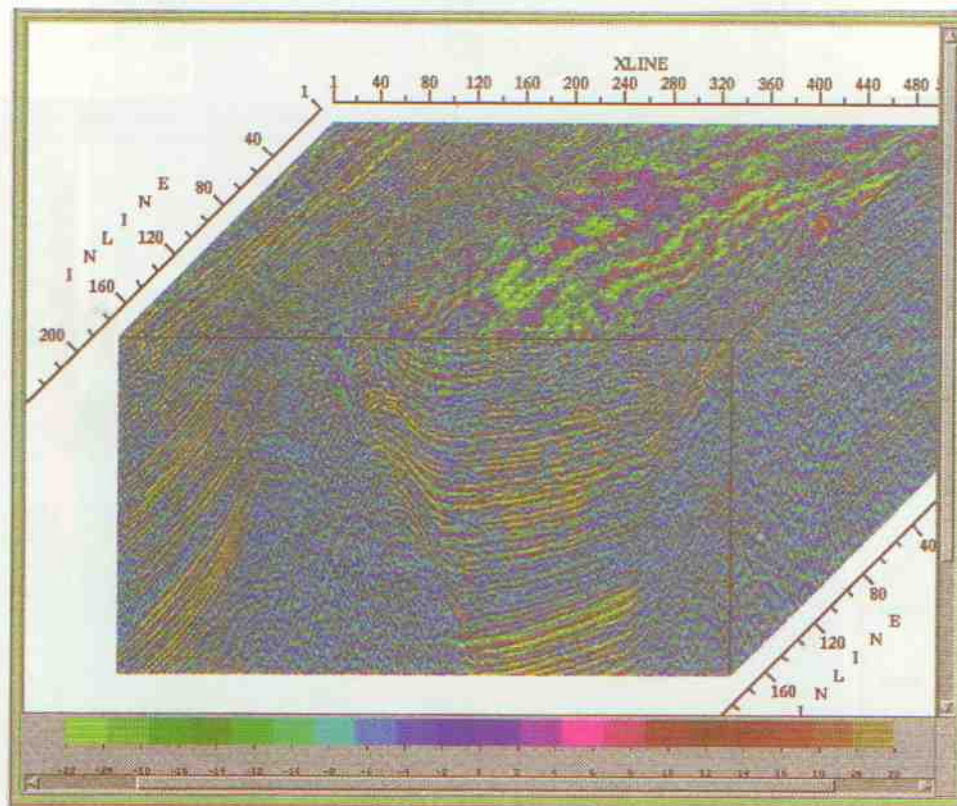


Exhibit 17

Glossary of terms

bcm	billion cubic meters
tcm	trillion cubic meters
GIS	geophysical well study
UKPG	installation for comprehensive gas and condensate preparation
NTS	low-temperature separation
AVO	air-cooling unit
GPA	gas compressor unit
AVDP	abnormally high geo-pressure
GKM	gas condensate field

APPENDIX C

GENERAL INFORMATION

Authorization

The sale of the Underlying Shares in the form of Offered ADSs and the issuance of this Offering Memorandum were authorized by the Management Committee of RAO Gazprom on October 2, 1996 and the Board of Directors on October 4, 1996.

Documents

Copies or translations in the English language of all notices, statements and documents which are issued to the holders of the Shares and which contain information having a material bearing on the interests of holders of the ADSs will be made available to the Depositary at its reasonable request.

Copies (in English) of the following documents will be available for inspection at the offices of Cleary, Gottlieb, Steen & Hamilton, 55 Basinghall Street, London, EC2V 5EH, during normal business hours on any weekday (Saturdays and public holidays excepted) for the period of 14 days following the date of this document:

- (a) the Charter of RAO Gazprom;
- (b) the Offering Memorandum;
- (c) the Deposit Agreements;
- (d) the Underwriting Agreement;
- (e) IAS consolidated balance sheet as at December 31, 1995 together with report thereon by Price Waterhouse;
- (f) RAR consolidated balance sheet and profit and loss account as at January 1, 1996 and for the year ended December 31, 1995 together with report thereon by Price Waterhouse AO; and
- (g) the Competent Person's Reserve Report.

Notices

So long as the ADSs are listed on the London Stock Exchange RAO Gazprom will publish all notices to holders of ADSs in the Financial Times in London.

Auditors

The consolidated balance sheet as at December 31, 1995, prepared in accordance with IAS, and the consolidated balance sheet and profit and loss account as of January 1, 1995 and for the year ended December 31, 1995, prepared in accordance with RAR, of RAO Gazprom have been audited by Price Waterhouse Ulyanovskaya St., 13 Moscow 109240, certified public accountants who have given and not withdrawn their written consent to the inclusion herein of their reports in the form and context in which they are included and have authorized such part of the listing particulars for the purposes of Section 152(1)(e) of the Financial Services Act 1986.

Fukap Audit has given and not withdrawn its written consent to the inclusion of its report in this Offering Memorandum in the form and context in which it is included and has authorised such part of the listing particulars for the purposes of Section 152(1)(e) of the Financial Services Act 1986.

Competent Person's Reserve Report

The Competent Person's Reserve Report has been prepared by Vasiliy A. Ponomarev and Lydia A. Shulzhenko who have given and not withdrawn their written consent to the inclusion of this report in this Offering Memorandum in the form and content in which it is included and have authorized the contents of that part of the listing particulars for the purposes of Section 152(1)(e) of the Financial Services Act 1986.

No Material Adverse Change

Except as disclosed in this Offering Memorandum, there has been no material adverse change in the financial position or prospects, and no significant change in the financial or trading position, of RAO Gazprom and its subsidiaries considered as a whole since December 31, 1995. RAO Gazprom has not prepared any interim consolidated financial statements in respect of any period in 1996. See "Risk Factors—Limited Availability of Financial Information."

Litigation

Neither RAO Gazprom nor any of its enterprises or subsidiaries is involved in any litigation, arbitration or administrative proceedings relating to claims, including claims in relation to exploration or extraction rights, which may have, or have had, during the 12 months prior to the date hereof a significant effect upon the financial position of RAO Gazprom and its enterprises or subsidiaries considered as a whole and, so far as any of them is aware, no such litigation, arbitration or administrative proceedings are pending or threatened.

Objects of the Company

The objects of RAO Gazprom are set out in full in Article 3 of its Charter. They include as objects carrying on the business of a commercial organization, the supply of gas, gas condensate, oil and refined products to customers in Russia and abroad and all activities which are not prohibited by law.

Governing Law

The Underwriting Agreement and the Deposit Agreements are governed by the laws of the State of New York.

Regulatory Authorities

All consents, approvals, authorizations or other orders of all regulatory authorities required by RAO Gazprom under the laws of the Russian Federation have been given for the issue of the Shares evidenced by the ADSs and for RAO Gazprom to undertake and perform its obligations under the Underwriting Agreement, the Deposit Agreements and ADSs.

Registered Office of RAO Gazprom

RAO Gazprom
16 Namyotkina St.
117884, Moscow
Russia

Address of Board of Directors and Members of the Management Committee of RAO Gazprom

RAO Gazprom
16 Namyotkina St.
117884, Moscow
Russia

Registrar

The details of RAO Gazprom's registrar are as follows:

DRAGa Company
63/2 Leninskiy Prospekt
Moscow 11296
Russia

Depositary

The Depositary is a state chartered New York banking corporation and a member of the United States Federal Reserve System, subject to regulation and supervision principally by the United States Federal Reserve Board. The Depositary was constituted in 1784 in the State of New York. It is a wholly owned subsidiary of The Bank of New York Company Inc., a New York Corporation. A copy of the Depositary's Articles of Association, as amended, together with copies of The Bank of New York Company Inc.'s most recent financial statements and annual report are available for inspection at the Corporate Trust Office of the Depositary and at The Bank of New York, 40 Berkeley Street, London W1X 6AA.

Global Coordinators' Addresses

Morgan Stanley & Co. International
25 Cabot Square
Canary Wharf
London E14 4QJ

Kleinwort Benson Limited
P.O. Box 560
20 Fenchurch St.
London EC3P 3DB

Managers' Addresses

CS First Boston Limited
One Cabot Square
London E14 4QJ

Baring Brothers Ltd.
60 London Wall
London EC2M 5TQ

NatWest Securities Limited
135 Bishopsgate
London EC2M 3XT

Salomon Brothers International Limited
Victoria Place
111 Buckingham Palace Road
London SW1W 0SB

Principal Establishment

The Gazprom group has one principal establishment, details of which are as follows:

<u>Property</u>	<u>Tenure</u>	<u>Approximate Square Meter Area</u>
Gazprom Head Office 16 Namyotkina St. 117884, Moscow Russia	49 year lease, from February 16, 1995	96,180

Expenses

The total costs and expenses of the Global Offering which are payable by RAO Gazprom are expected to amount to approximately \$19.6 million. The total amount payable to the Managers is expected to amount to approximately \$15.7 million.

APPENDIX D

AGGREGATED FINANCIAL REPORTS INCLUDED SOLELY FOR THE PURPOSE OF OBTAINING ADMISSION OF THE OFFERED ADSS TO THE OFFICIAL LIST OF THE LONDON STOCK EXCHANGE

Set out below are the 1993 and 1994 Aggregated Financial Reports of RAO Gazprom. These Reports were required to be prepared under Russian regulations and have been included herein solely for purposes of obtaining admission of the Offered ADSs to the Official List of the London Stock Exchange.

The Aggregated Financial Reports represent a summation of the assets, liabilities and results shown by the individual accounting reports prepared in accordance with RAR by RAO Gazprom and its enterprises and subsidiaries; transactions and balances between these entities were not eliminated, investments in partly owned ventures were included at historical cost (rather than being consolidated, where appropriate) and no adjustments were made to take account of the general effect of inflation. Accordingly, the Aggregated Financial Reports do not present the consolidated assets and liabilities, financial position or profits and losses of RAO Gazprom, do not give any meaningful indication of trends over time (due in significant part to the high inflation rates in Russia during the covered period) and cannot be compared in any meaningful way to the consolidated financial information included elsewhere herein. Thus, the Aggregated Financial Reports should not be relied on by anyone considering an investment in the ADSs.

The 1993 and 1994 Aggregated Financial Reports were audited by Audit-Service and Fukap Audit, respectively, in accordance with audit practices in Russia, which differ significantly from International Standards on Auditing. Since performing the audit on the 1993 Aggregated Financial Reports, Audit-Service has ceased operations. The opinion of Fukap Audit has been included herein. Fukap Audit, 50 Ozerkovskaya Naberezhnaya, 113532, Moscow, was certified by the Central Certification and Licensing Commission for Auditing under the Ministry of Finance of the Russian Federation on January 31, 1995, License No. 000010, and by the Central Bank of Russia on January 31, 1995, License No. 113.

Price Waterhouse has not reported in any capacity on the 1993 and 1994 Aggregated Financial Reports nor has it reviewed the work of the then auditors and accordingly accepts no responsibility for the financial information that follows.

BALANCE SHEET OF "GASPROM" CONCERN AS OF 01.01.1994

ASSETS

BILLION RUBLES

ASSETS	code page	as of the beginning of the year	as of the end of the year under review
I	2	3	4
1. Fixed capital and other non-circulating assets			
Intangibles:			
undepreciated value (04)	010	—	11
wear and tear (05)	011	—	—
depreciated value	012	—	11
Fixed capital:			
undepreciated value (01,03)	020	2,256	2,659
wear and tear (02)	021	764	852
depreciated value	022	1,492	1,807
Equipment to be installed (07)	030	13	47
Unaccomplished capital investments (08)	040	202	1,049
Long-term investments (06)	050	37	317
Settlements with the Founders (75)	060	—	—
Miscellaneous non-circulating assets	070	—	9
Total under Section I	080	1,744	3,240
II. Stocks and costs			
Stores and supplies (10,15)	100	23	206
Livestock breeding and fattening (11)	110	1	9
Articles of little value and fast wear			
undepreciated value (12)	120	2	20
wear and tear (13)	121	—	5
depreciated value	122	2	15
Unaccomplished production (20, 21, 23, 29, 30)	130	3	46
Anticipated expenses (31)	140	—	8
Ready products (40)	150	4	17
Goods:			
selling price (41)	160	32	280
marketing margin (42)	161	4	70
buying price	162	28	210
Remaining goods distribution costs (44)	170	24	359
Value-added tax on valuables acquired	175	3	270
Miscellaneous stocks and costs	176	—	7
Total under Section II	180	88	1,147
III. Money funds, accounts and other assets			
Receivables:			
for goods, works and services (45, 62, 76)	200	761	4,387
on bills received (62)	210	—	—
from subsidiaries (78)	220	2	127
from the State budget (68)	230	15	115
from the personnel on other operations (73)	240	—	23
Members' outstandings on the shares subscribed	245	—	2
miscellaneous	250	35	470
Payments in advance to suppliers and contractors (61)	260	35	605
Short-term investments (58)	270	4	164
Money funds:			
cash (50)	280	—	4
settlement account (51)	290	42	153
currency account (52)	300	272	848
miscellaneous (55, 56, 57)	310	60	235
Miscellaneous floating assets	320	5	301
Total under Section III	330	1,303	7,434
Losses:			
in the previous years (87)	340	2	—
in the year under review	350	—	69
Balance (total under the lines 080, 180, 330, 340 and 350)	360	3,137	11,890

LIABILITIES

BILLION RUBLES

LIABILITIES	code page	as of the beginning of the year	as of the end of the year under review
1	2	3	4
I. Sources of internal funds			
Authorized capital (85)	400	104	237
Reserves (86)	410	1	21
Special funds (88)	420	1,701	3,332
Purposeful financing and proceeds (96)	430	817	2,731
Rent and lease commitments (97)	440	—	—
Settlements with the Founders (75)	450	—	—
Retained profit in the previous years (87)	460	58	28
Profit:			
in the year under review (80)	470		1,742
allocated (81)	471		1,390
retained in the year under review	472		419
Internal settlements on the property allotted	473		236
Total under Section I	480	2,681	7,004
II. Long-term liabilities			
Long-term bank credits (90)	500	17	23
Other long-term loans (95)	510	1	2
Total under Section II	520	18	25
III. Payables and miscellaneous liabilities			
Short-term bank credits (90)	600	27	60
Bank credits to members of the staff (93)	610	—	4
Payments to the Authorized capital for shares	615	—	8
Short-term loans (94)	620	3	73
Payables:			
for goods, works and services (60)	630	219	3,524
on bills issued (60)	640	—	—
remuneration (70)	650	7	88
social security and insurance	660	4	61
property and private insurance	670	—	—
to subsidiaries (78)	680	4	123
extra-budgetary (67)	690	59	78
to the State budget (68)	700	76	394
miscellaneous	710	16	130
Payments in advance from customers and clients (64)	720	9	58
Anticipated earnings (83)	730	12	218
Reserve for probable expenses and payments	740	1	40
Provision for doubtful debts (82)	750	—	2
Other short-term liabilities	760	1	—
Total under Section III	770	438	4,861
Balance (total under the lines 480, 520 and 770)	780	3,137	11,890

**F-2 RECORD OF FINANCIAL PERFORMANCE AND DISPOSITION OF
PROFITS AS OF 01.01.1994**

I. FINANCIAL PERFORMANCE

BILLION RUBLES

INDICATOR	code page	Profits	Losses (expenses)
I	2	3	4
Proceeds (gross receipts) from the products (works, services) sold			
	010	14,134	
Value-added tax	015		1,478
Excise duties	020		222
Gas purchased	030		5,668
Sold products (works, services) manufacturing costs	040		5,302
Sales results	050	1,487	23
Compensation from economic authorities			
	051	26	
Miscellaneous sales results	060	66	3
Compensation from the State budget			
	061	2	
Extra-sales earnings and losses	070	281	101
including security yield and interest in joint ventures	071	3	
Difference in rates of exchange	072	148	3
Total profits and losses	080	1,862	127
Balance profit or loss	090	1,742	7
Information:			
Total excess (decrease) of manpower costs	100	183	
Retail turnover	101	256	
Currency rates margin	102	211	

I. DISPOSITION OF PROFITS

BILLION RUBLES

INDICATOR	code page	as of the end of the reporting period
I	2	3
Budgetary payment	200	607
Allocated to the reserve (insurance) fund	210	20
Allocated to:		
accumulation funds	220	485
consumption funds	230	116
charitable funds	250	4
miscellaneous	260	158
Information:		
Rental payments, less depreciation included in the above	270	

"FUKAP AUDIT" auditing firm

50 Ozerkovskaya naberezhnaya, 113532, Moscow
 Telex: 411081 TUR SU; Fax: 235-60-63
 Phone: 235-81-84, 235-95-89, 235-60-26

April 27, 1995 No. 87
 Ref. No. _____

AUDIT REPORT
on the financial and business auditing results of
the Russian Stock Company "Gasprom" in 1994

1. The auditing firm "FUKAP AUDIT", a limited liability company located at the above address, holder of the settlement account No. 467006 with a branch of the "Moskvoretsky" Public Business Bank, MFO 997919, participant HK, registered by the Moscow Registration Chamber on November 29, 1994, under No. 008.009, certified by the Central Certification and Licensing Commission for Auditing under the Ministry of Finance of the Russian Federation on January 31, 1995, License No. 000010, and by the Central Bank of Russia on January 31, 1995, License No. 113, acting in accordance with the Contract No. 36 of March 22, 1995, represented by the auditors Lukianov Yu.A., Zhuravliova N.A. and Novruzov F.K., has audited the financial and business performance of the Russian Stock Company "Gasprom" in 1994.

The audit was performed according to a certain program and pursuant to the Provisional Auditing Norms and Regulations in the Russian Federation, approved on 22.12.93 by the Decree No. 2263 of the President of the Russian Federation.

2. As the inspection revealed, the Russian Stock Company "Gasprom" is operating in compliance with its Bylaws confirmed by the Council of Ministers of the Russian Federation through the Resolution No. 138 of 17.02.93, and registered by the Moscow Registration Chamber on 25.02.93, entry No. 22726, as a public stock company.

According to the Bylaws, the Authorized Capital of the Company amounts to 89.3 billion rubles. By deliberation of the Board of Directors and with consent of the Ministry of Finance of the Russian Federation, the Authorized Capital was increased to 236.7 billion rubles, as stated in the emission program of the Russian Stock Company "Gasprom".

The main statutory object of the Russian Stock Company "Gasprom", as an integrated industrial and financial complex, is to assure regular contractual supplies of natural gas, condensed gas, crude oil and derivatives to customers within the Russian Federation, and to export natural gas under international and intergovernmental contracts and agreements.

The accounting and book-keeping in the Russian Stock Company "Gasprom" meet the requirements of the Norms and Regulations for Accounting and Book-Keeping in the Russian Federation, as approved by Order No. 10 of 20.03.92 of the Ministry of Finance of the Russian Federation, and are compliant to the Card Chart of Account in effect since January 1, 1992.

The annual accounting report (financial statement) for 1994, based upon the ledger balance, meets the norms prescribed by the Letter of the Ministry of Finance of the Russian Federation No. 91 of July 11, 1994, both in form and in content. The product and service cost value is duly confirmed by the corresponding documents. Figures of the profit reports conform to the data of the ledger, account books and balance sheets for 1994. The balance sheet items as of January 1, 1995, and the analytical accounting data are identical.

The budgetary (taxation) and extrabudgetary payments comply with the norms and regulations currently in force.

No offenses against the Law of the Russian Federation, harmful to the Company (or its stockholders), the State or third persons, were found in the financial and business operations of the Russian Stock Company "Gasprom".

The aggregated quarterly and annual statements of the Russian Stock Company "Gasprom" are based upon reports presented by the subsidiaries, affiliates and autonomous structure subunits, examined by the Board of "Gasprom" which has approved resolutions on the performance of the said production units and companies.

3. Considering the above, the auditing firm "FUKAP AUDIT" has found authentic and trustworthy the accounting statements and reports of the Russian Stock Company "Gasprom" for 1994, with balance value of 149074 billion rubles and balance profit of 5488 billion rubles. The said statements and reports show truly the Company's business performance in 1994 and its financial standing as of January 1, 1995.

President of the auditing firm,
 Master in Economics

(signature)

(Seal of the firm)

Auditors:
 Master in Economics
 Economist Emeritus

(signature)

Yu.A. Lukianov

(signature)

F.K. Novruzov

(signature)

N.A. Zhuravliova

FINANCIAL RECORDS
RAO GAZPROM'S BALANCE SHEET
as at 01.01.1995

		billion roubles	
		01.01.94	01.01.95
ASSETS			
1. FIXED AND OTHER ASSETS			
Intangible assets		11	43
Fixed assets			
initial cost		62,144	65,505
depreciation		22,083	24,275
residual cost		40,061	41,230
Equipment to be installed		222	368
Capital expenditures		6,848	10,508
Long-term financial assets		318	1,631
Other		2	6
Subtotal 1		47,462	53,786
2. STOCKS AND COSTS			
Production costs		219	1,396
Cattle breeding		11	58
Cheap and fast-wearing goods:			
initial cost		20	135
depreciation		5	35
residual cost		15	100
Uncompleted production		395	1,721
Future expenditures		7	35
Finished products		19	96
Commodities (goods)		213	1,393
VAT on assets acquired		277	2,653
Other stocks and expenditures		9	1
Subtotal 2		1,165	7,453
3. FINANCIAL SOURCES AND PAYMENTS			
Settlements with debtors:			
for goods dispatched, services rendered, etc		4,388	24,686
with subsidiary companies (dependent)		122	7,765
mercantile papers received		—	1,176
with state budget		115	360
with personnel		23	85
share subscription indebtedness		7	—
with other debtors		469	3,408
Advance payments to suppliers and contractors		550	1,817
Short-term financial assets		165	948
Financial resources:			
cash		4	11
account		154	410
currency account		848	1,263
other financial resources		235	999
Other current assets		237	44,386
Subtotal 3		7,317	87,314
Other assets		69	521
Grand Total		56,013	149,074

	billion roubles	
	01.01.94	01.01.95
LIABILITIES		
1. SOURCES OF OWN FUNDS		
Authorized capital fund	237	237
Additional fund	44,054	51,222
Reserve fund	20	24
Extra fund	2,729	4,103
Special financing and revenues	3,042	6,296
Unallocated profits from previous years	447	394
Interdepartment settlements due to additional property	—	44,192
Profit:		
year under review	—	5,488
allocated	—	4,343
unallocated in the year under review	—	1,565
interdepartmental settlements due to additional property allocation	172	172
Subtotal 1	50,701	108,206
2. LONG-TERM LIABILITIES		
Long-term bank loans	23	39
Long-term loans	2	2,200
Subtotal 2	25	2,239
3. SETTLEMENTS AND OTHER LIABILITIES		
Short-term bank loans	60	102
Bank loans for employees	4	11
Settlements for shares subscribed	7	—
Short-term loans	73	409
Settlements with creditors:		
for goods, works and services	3,537	20,021
labor payments	89	304
social support and welfare	61	405
subsidiary companies (dependent)	90	7,668
extra budget payments	79	387
state annual budget payments	394	2,943
other creditors	153	3,637
Advance payments received		
from buyers and suppliers	58	251
Future receipts	218	2,090
Consumption fund	421	331
Reserves for future expenditures and payments	41	65
Doubtful debts entered in reserve funds	2	—
Other short-term liabilities	—	5
Subtotal 3	5,312	40,868
Grand Total	56,013	149,074

**FINANCIAL RECORDS:
PROFITS AND EXPENDITURES**

as at 01.01.95
FINANCIAL RESULTS

	billion roubles	
	Profits	Expenditures
Proceeds (gross income) from marketing goods and services (work, services)	38,431	—
V A T	—	6,136
Indirect tax	—	1,517
Gas purchased	—	15,059
Production expenses of products sold (work, services)		11,163
Sales	4,697	141
Other sales	59	24
Budgetary compensation	5	—
Income and expenditure from nonsales transactions including:	2,536	1,726
securities purchased and shares in joint ventures	19	
exchange rate differences in foreign transactions	858	1,065
Total profit	7,297	1,891
Profits or losses	5,488	82
PROFIT ALLOCATION		
		01.01.95
State budget payments		1,973
Reserve (insurance) fund		4
Allocations:		
renovation fund		1,176
consumption fund		460
charitable fund		14
other		716