

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: High-Tech Acquisitions

I. Introduction

There are still many disappointing aspects to direct foreign investment in Ukraine. The large companies, which have taken the risk in investing in Ukraine, have been increasing their profit margins greatly over the past few years. Alas, the small and mid-size companies are still a bit weary about investing in Ukraine. Most of these companies claim that their lack of investment is due to Ukraine's uncertain political climate, tarnished international image and reputation as a bed of corruption. Admittedly, this may be the case in some business sectors.

There is, however, one relatively unnoticed sector of foreign investment, which has, for the past few years or so, quietly attracted foreign investors to Ukraine. This new investment comes in the area of high technology. Some of these technology-related investments fall within the realm of defense conversion or genetic engineering. The goal of most such investments, however, is to utilize the relatively low cost of Ukraine's well-educated work force for the development of software code, which will later be sold to private clients in the West.

Fifteen or twenty years ago, such 'offshore software developers' set up their practices in Ireland. As Ireland began to attract greater quantities of foreign investment, the compensation needed to employ quality programmers increased to a point where Ireland was no longer a viable jurisdiction for offshore software development. In their continued quest for inexpensive, but well-educated labor, these high-tech entrepreneurs moved their sphere of operations to India and Pakistan. This too was a viable option for ten or fifteen years.

The fall of the Soviet Union and the development of faster e-mail and Internet connections, however, brought new opportunities to this group of entrepreneurial software developers. Russia and Ukraine held a wealth of highly-skilled programmers, eager to supplement their meager incomes. In the early days of the game, it was possible to hire good programmers for mere hundreds of dollars per month.

Now, of course, the wages demanded by all individuals with high-tech expertise have risen significantly in both Russia and Ukraine. Still, this underdeveloped region and sector hold numerous opportunities for the savvy entrepreneur. Before stepping into deep waters, however, one

must be versed in the legislation and regulations that govern high-technology transactions. Below we provide our insight into Ukrainian high-technology law and practice. We hope you find our analysis both useful and interesting.

II. Discussion

As the Internet is becoming more and more available to the average Ukrainian citizen, foreign-based Internet surfers are coming into contact with the offers and propositions of Ukrainian entrepreneurs looking to sell their technology to the highest bidders. The typical situation is quite simple: a Ukrainian company offers to conclude a sale-purchase agreement for its product with a foreign company willing to pay for the product to an offshore account. Sometimes, the foreign company even wishes to hire some of the Ukrainian company's employees. As this scenario is increasingly becoming in vogue, foreign companies should be aware of the Ukrainian laws regulating such technology transfers.

Obviously, the first step in acquiring high-tech from Ukraine is to find out exactly with whom you are dealing. For rather simple, one-time transactions, a bit of background research on the Ukrainian company should be sufficient. As the transactions become more complex, such as the acquisition of the Ukrainian company itself, a larger degree of due diligence is required. This may entail sending experts to the company, where they review all the legal documents and query management and employees with respect to company structure, registration, financial statements, management structure, marketing strategy, etc. The three most important aspects of this process involve asset valuation, verification of legal status and ownership rights, and the detection of both real and contingent liabilities.

For smaller companies or transactions with individual entrepreneurs, background research on the shareholders/participants or the creator(s) of the product may prove invaluable in cases when the foreign company has minimal contact with the target. Such background research mainly applies to assessing the legal capacity of the seller. Pursuant to Article 225 of the Civil Code of Ukraine, all transactions concluded by a citizen who is recognized as legally incapacitated will be deemed null and void.

According to Article 216 of the Civil Code, each party to such transaction will be obliged to return to the other party all that was received from such transaction. If such return is impossible, in particular if that which was received is expressed as the use of property, the fulfillment of work or the provision of services, the party which received such use, works or services must compensate the other party the value of the use, works or services pursuant to the prices effective at the moment of compensation.

Once the foreign company has concrete information on its Ukrainian counterparts and their legal capacity to conclude the transaction, negotiations for the conclusion of the sale-purchase agreement

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