

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Options for Establishing Local Production Facilities

The August 1998 crisis caused many foreign investors to halt their projects or withdraw altogether. This resulted in a sharp drop in real estate prices, especially for industrial plants (whose asking prices decreased by as much as 40%). Since then, however, the prices for real estate, including production facilities, have risen once again.

In light of the integration of several former Soviet block countries into the European Union in 2004, Ukraine is quickly becoming an attractive target for companies looking to move east due to the rising prices of labor and real estate in their own territories. For example, many Polish and Hungarian companies are looking to move their production facilities into Ukraine, which offers lower wages and cheaper production costs than the European Union requirements allow.

Today, many of the Ukrainian mid-size enterprises are already privately owned and, therefore, the State Property Fund (and its notorious bureaucracy) is no longer an impediment to acquiring stock in production facilities. As a result, many foreign investors (primarily Russian companies) are returning to snap up the bargains, which have become relatively wide-spread and fairly easy to take advantage of.

As always, with more than 48 million product-hungry people, Ukraine continues to provide a significant market for consumer goods. It is no wonder, therefore, that many foreign companies are reviewing their long-term positions in the vast yet vacant market with a view to establish inexpensive local production facilities in Ukraine. Unlike a few years ago, today the foreign investor has several options in establishing local production facilities, including:

- I) The acquisition of shares of stock in a Ukrainian enterprise;
- II) The establishment of a joint venture (with private and/or state-owned enterprises);
- III) The leasing of local factory space;
- IV) The undertaking of a greenfield project; and
- V) The establishment of local assembly of goods (including software programs and/or components thereof) on a contractual basis.

Below we discuss in brief detail each of the above options.

I. Stock Acquisition in a Ukrainian Enterprise

As a legal matter, the standard open joint stock company charter allows foreign and Ukrainian private legal entities, as well as natural persons, to purchase its existing stock. The shareholders can include any number of parties, such as former employees who purchased stock on preferential terms for privatization certificates and any third party purchasers who have acquired stock on a competitive basis through a tender or on a stock exchange, among others.

The transfer of existing shares to a foreign investor normally takes place on the basis of a sale-purchase agreement, but theoretically can be effectuated also by a barter agreement, inheritance certificate or a court decision. Such shares must be subsequently re-registered in the name of the purchaser by submitting a transfer order and a certified, notarized copy of the agreement (which will be kept by the registrar), indicating that the title is transferred to the new owner. If the agreement is concluded by a third party or the documents are submitted by a third party, the original documents confirming the authorized powers of such third party, or a certified copy thereof, should be submitted to the registrar as well.

A proper legal review of the foundation documents of any given Ukrainian enterprise will reveal the procedure, and any potential restrictions, regarding employee stock transfer rights. As a practical matter, purchasing existing stock (a) usually results in a very limited control by the foreign stock purchaser over significant matters of the enterprise and (b) a Ukrainian enterprise's management can easily view such attempt to purchase the existing stock as a hostile takeover attempt.

Instead, most factory management bodies prefer to issue and sell additional stock to investors by offering a significantly larger stock package because private factory administrations are usually interested in obtaining an immediate infusion of capital and know-how. Therefore, strategic investors usually are asked to increase the company's capitalization in lieu of (or in addition to) acquiring existing stock.

In summary, the procedure for issuing additional stock begins with a general meeting of the shareholders. At the general meeting, the shareholders officially resolve in a protocol form to issue additional stock and approve the information and conditions of the public subscription. The information is then registered with the State Commission for Securities and Stock Markets (the "SCSSM") and, thereafter, it is published in one of the official governmental newspapers.

After such publication, an open subscription period allows foreign investors to purchase the additionally issued stock of the joint stock company after existing shareholders have exercised their rights of first refusal. Finally, the issuance results are published with the SCSSM and the general meeting of shareholders must formally approve the results of the subscription. Note that in consideration for the issued shares, the foreign investor can contribute virtually anything of value,

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