

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Privatization Programs

Virtually no privatization took place during President Kravchuk's three-year tenure: only the Ukrainian employees, uniting under a "leasing collective" umbrella, were allowed to buy out their place of employment, on non-competitive basis at that! These lucrative "buy-outs" occurred in accordance with special provisions in the lease agreements, signed between the leasing collective and the State Property Fund (the "SPF").

When President Kuchma came to power in 1994, real privatization efforts slowly began, three long years following Ukraine's independence. Today, most of Ukraine's small and most mid-size factories are privately owned due to so-called "mass privatization" efforts. Many of the large enterprises (some of strategic importance) are currently subject to privatization, hopefully with foreign investment (e.g., Oblenergo's).

Below we provide you with a brief historical overview of several Ukrainian privatization programs, each one containing its own set of peculiarities.

I. The 1994 Privatization Program

The long-awaited 1994 Privatization Program optimistically promised to privatize some 1,300 large and mid-size enterprises and about 9,000 so-called "small scale objects." At that time, large-scale privatization was planned to take place in two waves: 300 in February and 1,000 in August, 1994. Deadlines expired, but very little was privatized.

In fact, the year-end results revealed that only 28.4% of the factories slated for sale were actually privatized (with a total of 7,967 objects privatized in 1994, mostly small-scale). The short 6-month time frame for completion of the stock distribution, required by the Law "On Privatization of State-Owned Enterprises," was breached in the absolute majority of cases due to an unrealistically cumbersome distribution mechanism and the lack of qualified personnel.

Foreign investors quickly discovered that the 1994 Program applied an especially unfair exchange rate to foreign investors, requiring them to pay for shares of stock obtained in the privatization process, in foreign currency, at a rate of 420 karbovantsi to 1 U.S. dollar. In comparison, the official currency auction rate was about 40,000 to 1 U.S. dollar and the commercial rate was approximately 50,000

karbovantsi to 1 U.S. dollar. In contrast, Ukrainian residents could pay the final price in local currency, and without any “special” rates or other silly coefficients.

To artificially inflate the asking prices, valuation intentionally failed to take into consideration such factors as future profitability, which would significantly lower the price. Naturally, reasonable foreign investors were not interested in acquiring stock through the official privatization process. Instead, many chose to enter into joint ventures with the SPF, or for that matter, any private enterprise that would give them access to their industrial property for production purposes.

Clearly, competitive privatization did not work until 1995, as evidenced by the fact that most of the Ukrainian privatized enterprises escaped from state ownership through the back door. Some entered into leasing agreements with the SPF and promptly exercised their right to buy-out the property on a non-competitive basis. Others were transferred “from balance to balance.” In fact, these (and other non-competitive) privatization avenues became so widely abused, that the Parliament passed a resolution on July 29, 1994, ironically entitled, “On Perfecting the Mechanism of Privatization in Ukraine,” which officially placed a moratorium on all sale-purchase agreements with the SPF.

Of course, all privatization efforts of large and mid-size enterprises, including buy-outs by leasing associations, stopped dead in their tracks. In fact, only objects designated as “communal property” (small scale objects) were allowed to continue with their privatization. At this stage, only technical assistance projects (notably, the British Know-How Fund and TACIS) continued their privatization activities.

II. The 1995 Privatization Program

On January 17, 1995, the Cabinet of Ministers approved another overly ambitious draft privatization program for 1995, calling for privatization of 22,700 large, medium and small enterprises and 1,200 unfinished construction sites by the end of 1995. However, the Parliament rejected this program as insufficient and sent it for redrafting while it scrambled to prepare a list of “objects that are not subject to privatization” (which would then legally lift the moratorium on privatization).

The Parliament may have won a postponement, but the President won the battle when he executed an Edict “On Measures for Ensuring Privatization in 1995,” dated June 23, 1995, and effective July 5, 1995. This Edict served effectively as the 1995 Privatization Program, setting forth the planned numbers of privatization objects, classified in 6 groups (e.g., small scale, medium objects, foreign investment, unfinished construction, shares of state-owned stock in factories, etc.).

Baffling the Parliament and foreign observers alike in the breadth of its scope, the 1995 Privatization Program presented a simplified administrative system. The new, pro-active approach consisted of setting up a nationwide network of 26 regional privatization centers to facilitate the auctions where

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