

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Privatization via Depository Receipts

I. Introduction

Some argue that it was ING's threat to hold Ukraine in default (declaring the nation to be insolvent) which finally forced Ukraine into an interesting series of economic reforms, leading to privatization of its large enterprises. Regardless of the rumors, the Ukrainian Cabinet of Ministers approved the procedure for selling state-owned shares in open joint stock companies on international markets. This theoretically allowed foreign investors to assemble their portfolios by simply buying shares of a Ukrainian enterprise on international stock exchanges without investing the enormous time and energy in finding Ukrainian partners.

While it sounded good, cynics justifiably asked: is it finally possible to follow the stock exchange rates of Ukrainian enterprises and freely buy and sell Ukrainian stocks as the market rises and falls? Optimists resoundingly declared "yes, of course," exemplifying their blind faith in the effectuation of Resolution No. 1320 of the Cabinet of Ministers of Ukraine "On the Procedure for the Sale of State-owned Packets of Shares of Open Joint Stock Companies, Created in the Process of Privatization, in the Form of Depository Receipts on International Stock Exchanges," dated July 21, 1999 (the "Resolution").

Until the publication of the "Schedule of the Selection of Advisors to Provide Services for Preparing and Conducting Tender Sale of Packets of Shares in the Year 2000," however, this optimistic viewpoint seemed absurd. Immediately below, we review Resolution No. 1320, and discuss its impact on foreign investors.

II. Discussion

In an effort to find funds for the cash-strapped State budget (which was supposed to come from privatization), the Cabinet of Ministers passed the Resolution, making it possible for foreign investors to buy stock in Ukrainian open joint stock companies on international markets in the form of depository receipts. Attached to the Resolution was an announcement of the Schedule, containing 43 enterprises in need of advisors to help with the sale of their shares of stock. This attachment, more than the Resolution itself, revealed that Ukraine had finally chosen its product and put it up for sale.

Procedurally, the State Property Fund (the “SPF”) must first make a formal decision to sell shares of an open joint stock company in the form of depository receipts on international stock exchanges. A depository receipt is the security which confirms the right of an investor to shares of stock located in a specific depository institution, and gives the receiver the right to own the securities to which they hold the receipt.

After rendering its final decision to sell shares in the form of depository receipts, the SPF must appoint a so-called “advisor” to organize the sale of such shares. The advisor is chosen on the basis of a tender held by the SPF, and it concludes an agreement with the SPF regarding its specific obligations. The advisor must be a legal entity which will prepare a plan of distribution of the depository receipts onto the international market. The advisor is responsible for such matters as advertising the shares to potential investors, substantiating the best market and form of depository receipts for sale, estimating the price ratio between the actual shares and the depository receipts and approximating the expenses related to effectuating the final stock sale.

Upon performing its obligations under the contract with the SPF, the advisor presents its conclusions to the SPF for approval of the program for issuing the depository receipts and the minimum price of the block of shares to be sold. Thereafter, the SPF chooses an international depository institution on the basis of the advisor’s suggestion and the proposal of the open joint stock company whose shares will be sold. The SPF then must choose a share distribution agent (the “Agent”) based on the advisor’s conclusions.

The function of the Agent, similar to the function of an underwriter in the west, is to find a buyer for the shares according to the program set forth by the advisor. The Agent can be a legal entity or a group of legal entities. The chosen Agent must conclude an agreement with the SPF for the sale of shares of the specific enterprise targeted for share distribution on international stock exchanges.

Before the sale of the shares is commenced, the SPF and the foreign depository institution must select a custodian of the shares. A custodian is appointed for each regional department of the SPF to hold securities until the stock is sold. Custodians can be commercial banks or duly-licensed securities traders. All shares that will be sold must be in the possession of the custodian before actually commencing the procedure for sale of the shares on international stock exchanges. If the shares are in documentary (paper) form, they must be deposited by the SPF with the custodian, where the shares are kept under lock and key. For this purpose, the SPF and the foreign depository institution must open securities accounts with the custodian.

At this point, the Agent may begin to search for any interested buyers of the targeted shares. The Agent must finalize the execution of sale-purchase agreements with any interested investors. If an investor decides to buy a Ukrainian open joint stock company’s shares, it must also open an account

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