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TO: Clients and Friends of the Firm

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RE: Doing Business in Ukraine in 2010

In the early 1990's, investing in Ukraine depended heavily on politics. During the Kravchuk and Kuchma eras, large foreign investors worked closely with the government structures such as the State Property Fund, and were always cognizant of the importance of preserving that relationship. Then came the Orange Revolution, and the role of the government became practically irrelevant to foreign companies. For the local businessmen, the Orange Revolution also created a unique environment where near-complete lack of supervision by the government authorities put Ukraine firmly onto the Sicilian economic path. Ordinary businessmen, both foreign and local, became wealthy practically overnight.

Of course, these developments were excellent news for the lawyers, and so in a short few years the Kiev legal scene changed rapidly to accommodate the growing segment of newly rich businessmen. Foreign law firms started to dominate the market. In a few short years, at least four German law firms entered Ukraine to compete for German-speaking clients, including CMS McKenna, Norr Stiefenhofer Lutz, Beiten Burkhardt and Arzinger. Numerous English-speaking law firms have also opened their offices, including London's heavyweight, Clifford Chance. The bulk of the work revolved around numerous "hot deals," creating massive M&A and real estate practices throughout Kiev-based law firms.

And then came "the perfect storm:" first, the global economic crisis emasculated M&A and real estate, the two most lucrative practice areas that generated so much profit for lawyers. Second, the Ukrainian Presidential elections stalled most large-scale investment deals until the election of the new President. The effects of this perfect storm can still be felt in almost all Kiev law firms. The two factors, responsible for this lingering effect, remain the same: (a) lack of economic recovery and (b) the arrival of the new Yanukovych administration (i.e., politics).

Today, the slow pace of economic recovery is frustrating for both businessmen and lawyers alike. At the same time, the tools necessary for improvement are in place: for better or for

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worse, the new administration consists of wealthy businessmen and former Kuchma administration officials, who know very well how to run a country. Unlike the previous schizophrenic government, which was co-headed by Yulia Tymoshenko and Victor Yuschenko, the current leadership has no real opposition. This is vital to foreign investors, who were previously held hostage to the constant in-fighting amongst members of the same government.

The new government arrived during the global economic crisis, but for investors there are two sides to this coin: on the one hand, the Ukrainian economy is in a terrible state (though not as bad as Greece). On the other hand, it is precisely at this time that foreign investors can afford to purchase the assets they could not have dreamed about only a few short years ago. The sad reality, however, is that investors are not rushing into Ukraine as they once did. Instead, today the single biggest foreign investor appears to be Russia, a large and aggressive neighbor that is quickly acquiring Ukraine's strategic industries such as oil/gas and nuclear power by any means possible (to assure re-unification).

In the oil and gas sector, for instance, the M&A transaction envisions either a merger of Ukrainian Naftogaz into its Russian counterpart, Gazprom, or the break-up of Naftogaz into separate companies that will be controlled by Russia and various Ukrainian businessmen close to the current administration. In the nuclear sector, the enormous M&A deal will involve unification of the two countries' nuclear sectors. From a legal standpoint, at least one joint venture will be set up to unite generation, nuclear engineering and nuclear fuel cycles, plus Russia will extend a rather large loan (to be repaid by the future generations) for construction of two nuclear reactors and one plant that will produce nuclear fuel (which could be exported to other countries).

Under any other circumstances these M&A deals would result in a lot of lucrative legal work, but from a practical viewpoint, no private law firm will handle either of these highly political transactions. Moreover, at least one well-known foreign investor, namely Westinghouse, was promptly removed from competition against Russia's TVEL, proving once again that no private company (regardless of its size or fame) can compete with big-game politics. Subsequently

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IKEA, HP and Cargill cancelled their planned investments in Ukraine, complaining about the tough business climate.

So what does all this mean for the lawyers? Nothing good in the short run. The foreign investors are not coming in, and the Yanukovich administration is not doing very much to attract them. Admittedly, in the first few weeks after being elected Yanukovich has lowered the minimum capital of limited liability companies to an absurdly low level, encouraging formation of legal entities. He has also abolished the mandatory registration of foreign investments instilled by the former government, and relaxed rules regarding early repayment of certain loans. On the other hand, Yanukovich has been trying to significantly increase the thresholds for those companies who elect the unified tax, effectively prohibiting a number of small and mid-size companies from taking advantage of this low, flat tax rate. Naturally, none of these steps have attracted any investment.

As in the 1990's, politics once again plays a dominant role in Ukraine's business affairs, often without regard to business interests of foreign investors. For that reason, like in the good old Kuchma days, well-connected lobbyists and consultants will once again become an indispensible link between the investors and their lawyers (much like in Brussels and Washington D.C).