ACC
UKRAINE
THE CHAMBER OF COMMERCE

THE CHAMBER

COUNTRY PROFILE

2012

The American Chamber of Commerce in Ukraine

Uniting Leading Companies from over 50 Nations Across the Globe


Carlsberg
COPENHAGEN
1847
UEFA
EURO2012
POLAND-UKRAINE
Офіційне пиво чемпіонату
УЄФА ЄВРО 2012™
За це варто підняти Carlsberg™

My bank is Crédit Agricole.
It makes sense

Crédit Agricole Corporate and Investment Bank was back in 1993 the first fully operational Western bank in Ukraine under Crédit Lyonnais brand and since 2004 under Calyon brand.

18 years of experience, 4 more years of any other western bank in an environment where experience is a key, made and still makes Crédit Agricole Corporate and Investment Bank the foreign bank of reference.

Crédit Agricole Corporate and Investment Bank:

- Has the best ratings assigned by FITCH.
- Three years in a row (2008, 2009, 2010) named the most trustable bank in Ukraine (the Expert, Ukrainian economic weekly).
- №1 bank in terms of cash management for western corporations and big locally-owned groups.
- A leader in Foreign Exchange and local currency Money Market transactions performed for international companies.
- A leader in M&A transactions servicing.

"CREDIT AGRICOLE BANK" PJSC is a successful bank with foreign investments which has been working on the financial market of Ukraine since 1993.
CREDIT AGRICOLE renders the whole range of modern banking services to private and corporate customers in all the parts of the country. Regional network of the bank covers all Ukraine and consists of more than 200 points of sale.
"CREDIT AGRICOLE BANK" PJSC holds a strong position in the car lending market, satisfies the needs of private customers in cash loans for consumer purposes, grants loans for residential real estate purchase, accepts deposits from population at beneficial rates, services payment cards, performs cash remittances and renders a range of other services to private individuals including insurance.
Relying on experience and knowledge of the parent group, which has been the №1 bank for farmers in France for more than 100 years, "CREDIT AGRICOLE BANK" PJSC renders the whole range of services for business paying special attention to cooperation with agricultural companies.
Reliability and business reputation of "CREDIT AGRICOLE BANK" PJSC is confirmed by almost 370 000 private and over 25 000 corporate customers who have entrusted it with their financial affairs.

Crédit Agricole Corporate and Investment Bank and Crédit Agricole Bank belong to Crédit Agricole Group. Crédit Agricole is retail bank leader in France and in Europe. Crédit Agricole is a first-class partner for the economies in which it operates. More than 160 000 employees work to satisfy the banking requirements of 54 million customers in 70 countries.

«CIB Crédit Agricole» PJSC
Volodymyrska Str. 23-A, Kyiv, phone: (044) 490 14 00
www.ca-cib.com.ua
License №111 dd. 11.10.2011 issued by NBU

"CREDIT AGRICOLE BANK" PJSC
42/4 Pushkinska str., Kyiv, phone.: 0 800 30 5555
www.credit-agricole.com.ua
License №99 dd. 12.10.2011 issued by NBU

CRÉDIT AGRICOLE
CORPORATE & INVESTMENT BANK

CRÉDIT AGRICOLE

Contents

EURO 2012

What does Ukraine expect from EURO 2012?

EURO 2012 is generating lots of expectations, hopes, and concerns for the whole country. Preparations for the championship have had a major influence on the economic situation in Ukraine since 2010.

According to a report on macroeconomic trends prepared by UMG International, there is an optimistic outlook in such sectors as tourism, the hotel business, services, and infrastructure.

Governmental spending on EURO 2012 preparations has had a positive impact on the construction industry. Enterprises specializing in building bridges, overpasses, tunnels, and underground facilities have seen their business grow 3.7 times; enterprises specializing in roads, air facilities, and sports surfaces have seen their business grow 1.6 times.

In general, approximately 83 percent of all work in the construction sector is concentrated on new construction, reconstruction, and technical re-equipment for the event.

In addition, EURO 2012 will have a positive effect on the country's image and will attract more foreign investment. In the previous year, Ukraine's reputation among the "Big 8" (USA, Japan, Germany, Britain, France, Italy, Canada, and Russia) increased by 6.7 percent (according to a Reputation Institute study).

According to the forecasts of the Cabinet of Ministers of Ukraine, holding EURO 2012 should accelerate GDP growth by 1.5 percent points, while holding inflation and the hryvnia stable. In 2012 nominal GDP will reach 1.475 trillion UAH. If government predictions come true, by the end of 2012 the Ukrainian economy will almost have returned to pre-crisis levels, reaching 99.3 percent of the index for 2008.

Many experts, however, are more pessimistic about the effect this sporting event will have. In their view, EURO 2012's effect on the economy will have a local character. Impact on GDP growth is expected to be no more than 4.5 percent. Private investors are already reluctant to invest, and the total amount of public investment in EURO 2012 preparation is 70–80 percent of the required amount. Additionally, the issue of the overvaluation and non-transparency of championship expenditures is creating public indignation and raising doubts about Ukraine's ability to host EURO 2012.

Economic growth, the country's positive image abroad, and a positive attitude in society at large are three key elements that are interesting experts when it comes to hosting EURO 2012.

So what are social attitudes in Ukraine towards the football tournament?

According to research conducted by UMG International during August — September 2011, based on a sample of 1,751 respondents, 80.9 percent of Ukrainians think that EURO 2012 will have a positive impact on Ukraine in general, while 19.1 percent have the opposite opinion. 43.5 percent of respondents claim that EURO 2012 will influence the economic situation in Ukraine positively, 10.9 percent expect a negative impact, and 45.6 percent think that the situation will not change at all. Asked about politics, 16.2 percent answered that EURO 2012 will improve the political situation in Ukraine, while 6.9 percent expect deterioration and 76.9 percent think that the situation won't change. 77 percent of those surveyed think that EURO 2012 will have a positive effect on Ukraine's image abroad, while 23 percent have a negative attitude about this issue.

UMG — International®:
Leadership, Innovations, Success

www.umg.ua

OVERVIEW
BY SECTORS

1. AGRICULTURE

Agriculture Sector Overview

2011–2012 Partnership for Successfully Competing in the Global Economy Report

The development of the agricultural market is essential for the overall growth of the Ukrainian economy. Ukraine's agricultural sector did relatively well during the recent economic crisis. This is true even though the Ukrainian government intervened in key market operations by introducing export limitations and price regulations. Agriculture accounted for 7.2 percent of GDP and 13.7 percent of export in 2010.

The State Statistics Service of Ukraine reported that agricultural production in 2010 was 98.5 percent of what it was in 2009. The decrease in output was induced mainly by a decrease in crops, while livestock production increased. Production fell both at agricultural enterprises and in private households. Production of grain crops, as can be seen in Table 1, was 15 percent lower than in 2009 and 26 percent lower than in pre-crisis 2008. The main reason for the decline in grains was unfavorable weather conditions. At the same time, production of sugar beets increased by 37 percent compared to the same period in 2009.

Table 1. Main types of agricultural output of Ukraine in 2010

Type of output	*2010 in % to* **2008**	**2009**
Grain and leguminous plants	74	85
Sugar beets	102	137
Sunflower seeds	104	106
Potatoes	96	95
Vegetables	102	97
Meat	108	107
Milk	96	97
Eggs	114	107
Wool	112	102

Source: State Statistics Service of Ukraine

As can be seen in Table 2, the number of pigs and poultry increased in 2010 by 5 and 6 percent, over 2009. The number of cattle, sheep and goats slightly decreased. As reported by the State Statistics Service of Ukraine the profitability of agriculture in 2010 was 21.1 percent (26.7 percent for crops and 7.8 percent for livestock), which is substantially higher than it was in 2009 (13.8 percent). Considering the sector's performance results for the last three years, we are expecting a positive development trend in the agricultural sector in the future.

Table 2. Cattle stock of Ukraine in 2010

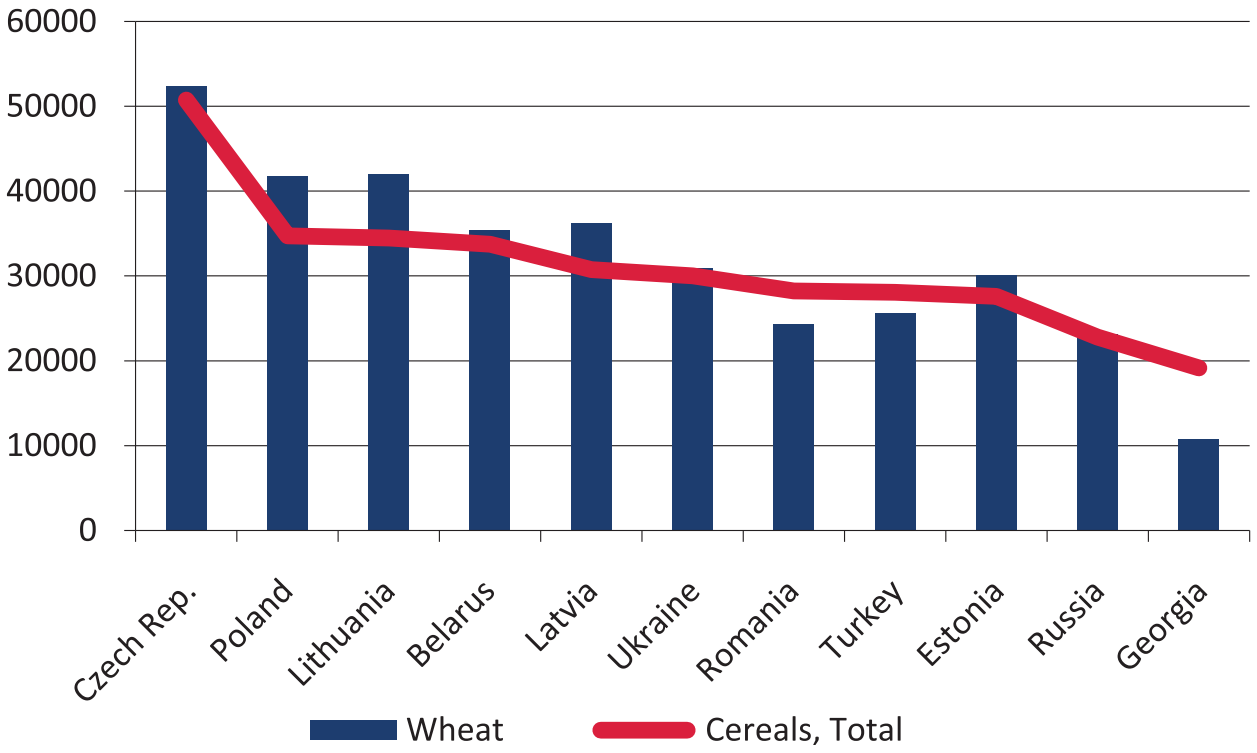
Type of output	*2010 in % to* **2008**	**2009**
Cattle	88	93
Pigs	122	105
Sheep and goats	100	94
Poultry	115	106

Source: State Statistics Service of Ukraine

Ukraine's agriculture production has a substantial effect on the world markets. Even though the agriculture markets are dominated by price competition, Ukrainian producers tend to have an influence on world prices. A temperate climate, large intact tracts of land, fertile soils, proximity to different markets, skilled and relatively abundant labor, and the low price of productive inputs together offer a global competitive advantage for the development of Ukraine's agricultural sector. Ukraine established itself as the third largest grain exporter worldwide in the 2008–09 and 2009–10 seasons. Only the USA and the EU export more grain. Thus Ukraine is an important player in the world grain trade, alongside Russia, Australia, Argentina, and Canada.

A low agriculture yield is one of the main limiting factors preventing Ukraine from utilizing its agro potential more efficiently. Due to a lack of technology and capital in the sector, Ukraine is characterized by lower agriculture productivity than are other countries of the region – the Czech Republic, Poland, Lithuania, Belarus, and Latvia (See Figure 1).

Figure 1: Cereals yield in selected countries in 2009, hectogram/hectare



Overall, the agricultural sector's export capacity is quite impressive. According to FAS USDA data, in the 2009/2010 marketing year Ukrainian agricultural producers controlled 36.3 percent of the world's barley exports, 5.2 percent of corn, 6.9 percent of wheat, and 22.6 percent of sunflower seeds. They were also the leaders in sunflower oil exports, providing 58.1 percent of the world's total. In the 2010/2011 marketing year, due to the introduction of export quotas by the Ukrainian government, exports of some cereals (barley, rye and wheat) decreased twofold.

On the whole, the sector is contributing substantially to the country's overall exports and in the 2011/2012 marketing year Ukraine will remain a key player on the world grain market. The main factors contributing to the positive trends are:

- The agricultural sector has generally become more efficient and competitive. Ukrainian farmers are adopting modern management and production technologies. Foreign investors are bringing capital and new technologies into the sector.
- The downstream sector, especially processing, logistics, and trade, has undergone substantial changes. Currently, competition in grain and oilseed trade and processing is very strong, and both domestic and foreign companies have invested substantially in inland and port storage and logistics infrastructure, making the latter more efficient.

A more efficient agricultural industry must be based on free market principles and on the abolishment of restrictions. Government involvement in the market has to be minimized and instead non-governmental organizations have to proactively participate in market regulation activities. The principal negative factors influencing Ukrainian agribusiness in 2010–2011 were:

- Direct state interventions into the functioning of agricultural markets (export restrictions, introduction of minimal prices etc.)

- Recent amendments to the tax code, to which markets were forced to spend a certain amount of time adjusting in the 2010–2011 marketing year;
- Inadequate regulation of agricultural markets;
- Lack of an agricultural market infrastructure, which negatively affects market links between producers, intermediaries, and customers;
- Dominance of asymmetric and unreliable market information;
- Low credit availability;
- Low level of labor and land productivity;
- Absence of a land market.

Introduction of a land market is considered to be the major factor for improving agriculture sector investment attractiveness. Currently the Draft Law "On the Land Market" (#9001–1 of July 19th) is under consideration in the Verkhovna Rada. However, the legislation related to the establishment of a fully functional land market cannot be limited to one law, will be quite complicated in terms of drafting and practical implementation, and must include a system of laws that have yet to be adopted. The adoption of the Law "On the State Land Cadaster" on July 7th is a major step towards the establishment of a fully functioning land market. However, the new legislation and the recent amendments to the tax code are tending to decrease the confidence of market agents. Therefore, the expert and business community has been watching the legislation closely and would like to reiterate the need to inform businesses in advance of any changes and new mechanisms that will be implemented, as well as to ask for professional feedback from the private sector — feedback that is based on the best international practices.

Improvement of legislation, elimination of administrative barriers and burdens, fundamental reform of the VAT refund system, predictable and transparent grain export regulations, completion of land reform, and an equitable and transparent distribution of Government Domestic Loan Bonds for VAT Reimbursement to exporters and producers are acutely required. Some reforms, especially those related to VAT regulations, have been launched, which is discussed in more detail in the tax policy section of this document. However, these issues have been and will remain important ones, and they will require constant monitoring by the Ukrainian and international business communities. There should be identified a clear list of basic conditions that are both simple and effective enough to attract investment into the Ukraine agricultural sector, such as:

- Ensuring of minimum government interference in the sector, based on clear and transparent national food security policy mechanisms and implementation of state programs aimed at decreasing transactional costs for all market participants, especially producers;
- Justification and probable abolition of some state authorities, like the Grain Bread Inspection and the Quarantine and Veterinary Inspections, thereby minimizing possibilities for corruption and unfair treatment of market participants;
- Equal treatment of all market participants;
- Further improvement and simplification of the tax system and of tax administration and collection, including implementing of an effective non-discriminatory VAT refund system;
- Finalizing all the necessary legislation to launch an agro-land market.

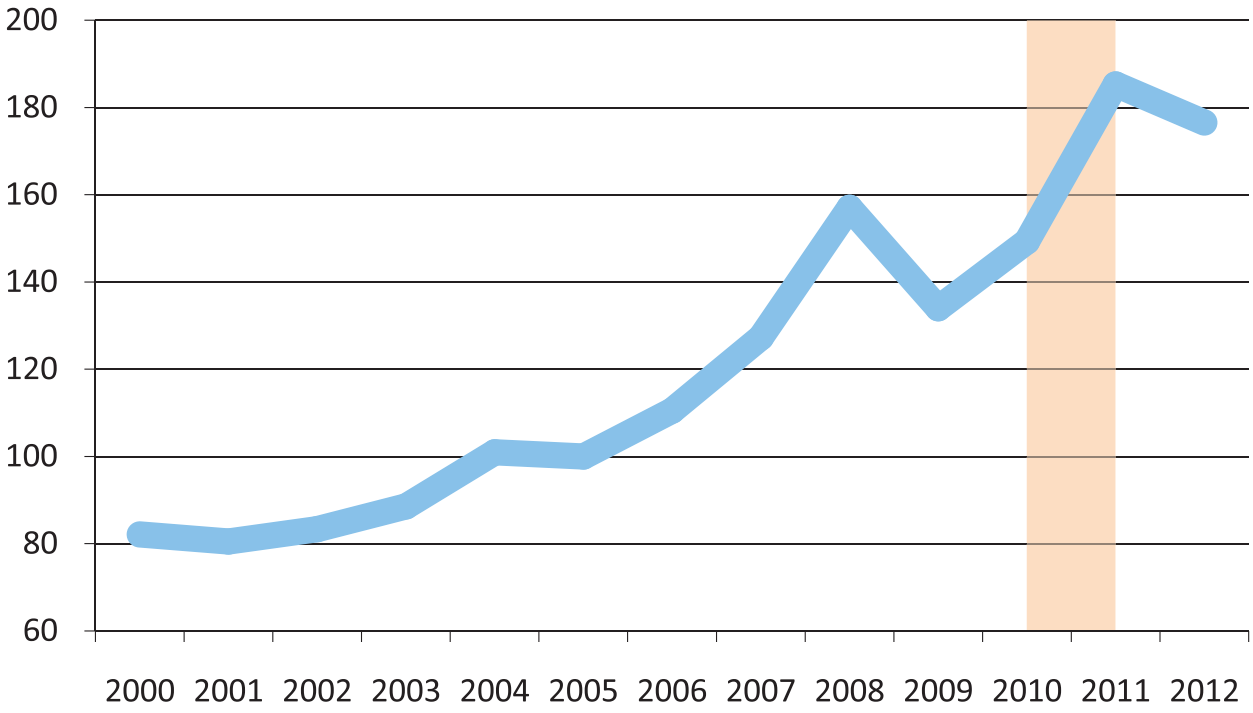
The Ukrainian government still needs to send a strong signal to foreign investors by reducing government interference in the markets and eliminating such negative factors as poorly drafted and conflicting legislation.

It is expected that world grain and food consumption as well as food price indices will continue to increase in the nearest future, increasing the attractiveness of the agricultural sector of Ukraine to foreign investors. If serious reforms are intelligently implemented in Ukraine, the country's agricultural sector will

maximize domestic investments and involve new technologies in the sector.

The American Chamber of Commerce in Ukraine will continue to conduct a wide advocacy campaign and maintain a working dialog with relevant government authorities and representatives of the investment community. It will also work with partner organizations and international financial institutions to address all the issues and problems in this sector, to update policy and to promote adequate, clear, and transparent rules for business operations in Ukraine.

Figure 2: Food price index — includes cereal, vegetable oils, meat, seafood, sugar, bananas, and oranges price indices for the world, index, 2005=100.



Source: EconomyWatch

2. BANKING & FINANCIAL SERVICES

The Banking Sector. The Currency Control Regime. The Anti-Money Laundering Set-Up

CRÉDIT AGRICOLE CORPORATE & INVESTMENT BANK

1. Banking Sector

Overview

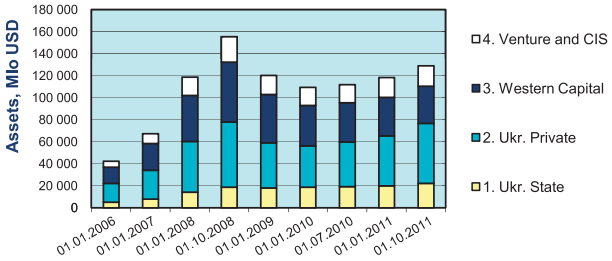
Total Assets

Interim data

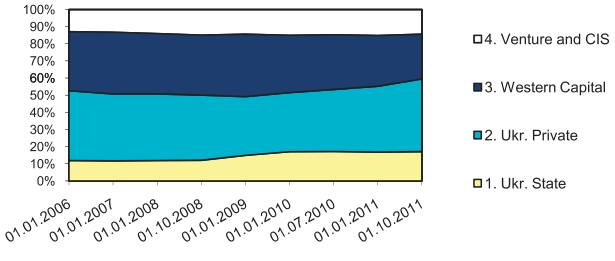
Total Assets, Mio UAH	Date								
Group by Ownership	01.01.2006	01.01.2007	01.01.2008	01.10.2008	01.01.2009	01.01.2010	01.07.2010	01.01.2011	01.10.2011
1. Ukr. State	25 595	40 088	71 643	91 599	139 103	149 733	152 824	159 599	176 952
2. Ukr. Private	87 095	132 654	233 210	287 486	316 909	300 686	320 284	361 692	435 882
3. Western Capital	73 651	122 590	210 783	264 393	337 083	292 527	282 439	278 374	268 464
4. Venture and CIS	27 537	44 848	83 760	112 126	132 991	130 504	129 708	142 419	147 865
Total	**213 878**	**340 179**	**599 396**	**755 604**	**926 086**	**873 450**	**885 256**	**942 084**	**1 029 163**
+/-, %		*59,1%*	*76,2%*	*26,1%*	*54,5%*	*-5,7%*	*1,4%*	*7,9%*	*9,2%*
Share of Western Banks:	*34,4%*	*36,0%*	*35,2%*	*35,0%*	*36,4%*	*33,5%*	*31,9%*	*29,5%*	*26,1%*
Total Assets, Mio USD									
1. Ukr. State	5 068	7 938	14 187	18 843	18 065	18 752	19 328	20 046	22 195
2. Ukr. Private	17 247	26 268	46 180	59 140	41 157	37 656	40 506	45 429	54 672
3. Western Capital	14 584	24 275	41 739	54 390	43 777	36 635	35 720	34 964	33 673
4. Venture and CIS	5 453	8 881	16 586	23 066	17 272	16 344	16 404	17 888	18 546
TOTAL	**42 352**	**67 362**	**118 692**	**155 439**	**120 271**	**109 386**	**111 958**	**118 327**	**129 086**

Share	*Y-to-D*	
%	%	*Mio UAH eq.*
17,2%	*10,9%*	***24 128***
42,4%	*20,5%*	***115 597***
26,1%	*-3,6%*	**-13 976**
14,4%	*3,8%*	***18 157***
100,0%	*9,2%*	***143 907***

Ukrainian Banking System Assets Growth



Ukrainian Banking System Assets Structure (change)



- As of October 1st, 2011 Ukraine has 175 active banks (Russia: ~1000).
- Total Assets of the banking system as of October 1st, 2011 amounts to 1,029bn UAH (USD 129bn eq.). Since the beginning of the year growth of assets was +87bnUAH or 9 percent. Top 50 banks represent ~90 percent of assets and 86 percent capital of the banking system.

- Top 10 banks constitute ~55 percent of the banking system assets and capital concentration level is stable over past 3–5 years and lags behind EU zone and neighboring Poland and Russia, where ~50 percent are covered by Top 5 banks.
- Assets growth in 2011 was driven mostly by extensive lending to big corporate clients (+12 percent), including big state corporations. Otherwise the banks continued to use spare liquidity to buy Ukrainian Government T-bills.
- Two banks are historically state-owned: the savings bank — Oschadny and UkrExImbank, an ex-part of USSR Vnesheconombank, now a universal bank with a focus on export/import operations and a financial arm of the Ukrainian government in relations with international financial institutions.
- 3 more banks — Rodovid Bank, UkrGazBank and Bank Kyiv — have been saved by the government to calm crisis waves on the market in 2008. Strategy of privatization, merger for each of them is still being discussed by government and regulator.
- Historically, Credit Agricole CIB came in 1993 (at that time under Credit Lyonnais brand). Six other western banks came during the late 1990s: ING, Citibank, Raiffeisen, HVB, Unicredito and PKO. If ProCredit Bank Ukraine started in 2001, as MicroFinance bank, a wave started in 2005: SEB purchasing Bank Aggio, Raiffeisen purchasing Aval, BNPP purchasing 51 percent of UkrSibbank (now controlling 85 percent, 15 percent in the hands of EBRD) Credit Agricole purchasing in 2006 Index Bank, OTP purchasing the "historical" Raiffeisen.
- In 2007 Swedbank purchased two banks of TAS Group, merged by the end of 2009 into Swedbank. In 2011 the bank abandoned SME & retail business and focuces on bigger clients. In 2008 Commerzbank entered Ukrainian market via purchase of 60 percent of Bank Forum, still operating under such name but 100 percent are in Commerzbank's hands. Two Italian banking groups — Intesa and Unicredit — purchased in 2008 Pravex Bank and UkrSotsbank respectively.
- 2007 and 2008 have been marked by massive coming of regional and neighboring countries banks with a business model similar to previously mentioned Western banks dwelling on cheap external funding for further development of consumer, car and mortgage lending. Such banks established presence via 2nd Tier banks like Universalbank (EFG Eurobank Ergasias), Piraeus Bank, Astra Bank, Marfin Bank, Bank of Cyprus (both — Greece), Credit Europe Bank, Credit West Bank (Turkey).
- Separate group is represented by leading Russian banks that moved to Ukraine to follow their clients, get market share and touch the ground in retail business outside Russia (Alfa-Bank, VTB Bank and Sberbank). Two banks are now in Top 10 (Alfa — # 7, VTB — # 10). VEB, Russian state-owned bank, entered the Ukrainian market at the end of 2008 by purchasing the "troubled" Prominvestbank (# 8 at the moment) that focuses on corporations.
- Current dynamics in foreign banks explicitly reflects the global credit and liquidity crises as well as Ukraine's low attractiveness, today. Some banks either consider exit from non-strategic markets or scaling down their business. The consequences of decisions taken by international banks to mitigate global risks should be most probably seen in Ukraine in 2012.
- 2011 has seen the resolution of the most burning issue of banking sector — the future of the banks in NBU receivership, Nadra and Rodovid. Bank Nadra has got powerful private investor — Mr. Firtash, owner of businesses in gas & energy, agriculture and chemistry. In its turn Rodovid is poised to become government's "bad" bank for toxic assets of Ukrainian banking system.

Table 1. Western-Owned Banks

Data as of: ***01.10.2011*** *1 USD = 7,973 UAH* ***Data in Mio USD***

Rank by Assets	Bank Name	Country of Origin	Total Assets	Total Capital	Rank by Capital	Net P/L
4	Raiffeisenbank Aval	AT	53 168	6 601	4	24
5	Ukrsibbank (BNP Paribas Group)	FR	42 235	3 629	10	-1 395
6	Ukrsotsbank (UniCredit Group)	IT	39 619	6 570	5	6
12	OTP Bank	HU	22 826	3 255	11	445
19	Forum (Commerzbank Group)	DE	12 453	1 833	18	- 430
20	ING Bank Ukraine	NL	10 843	1 734	19	203
22	Erste Bank	AT	10 437	1 365	24	- 26
25	Swedbank	SE	8 589	1 560	20	87
26	UniCredit Bank Ukraine	IT	8 509	896	30	28
31	Universal	GR	6 680	554	44	- 319
32	Credit Agricole Bank	FR	6 603	764	32	39
34	Pravex (Intesa Group)	IT	5 855	1 168	26	- 22
35	Citibank Ukraine	US	5 425	635	36	270
37	Marfin Bank	CY	4 704	513	48	0
38	Piraeus Bank ICB	GR	4 686	561	42	- 641
40	Credit Agricole CIB	FR	4 283	558	43	136
42	Kredobank Ukraine	PL	4 149	578	40	- 53
52	Platinum Bank	US	3 215	379	55	7
58	SEB Bank	SE	2 932	440	51	- 13
59	Volksbank	AT	2 879	300	65	28
61	Procredit Bank	DE	2 573	262	72	13
64	Bank of Cyprus	CY	2 268	692	34	- 87
75	Astra Bank	GR	1 624	1 084	28	15
88	Plus-Bank	PL	1 313	205	88	6
144	Deutsche Bank DBU	DE	335	173	96	- 21
150	ProFinbank (Societe Generale)	FR	264	116	116	1
	Grand Total		268 464	36 423		-1 699

Table 2. Banks under NBU Temporary Administration

Data as of: ***01.10.2011*** ***Data in Mio USD***

Rank by Assets	Bank Name	Country	Total Assets	Account of Individuals	Corporate Accounts
116	Inprombank	UA	609	220	364,816
170	Stolytsya	UA	119	36	12,319

Table 3. Banks closed since 01-Oct-2008

Data as of: ***01.10.2011*** ***Data in Mio USD***

# by Assets	Name_eng	Country	Total Assets	Accounts Individuals
15	UkrPromBank	UA	14 646	7 992
54	European	UA	1 872	613
61	BIG Energy	UA	1 575	572
67	Ipobank	UA	1 357	13
68	Dnister	UA	1 311	460
74	Transbank	UA	1 144	467
79	National Standard	UA	1 076	211
85	Eastern European Bank	UA	995	304
87	Bank of Regional Development	UA	957	430
99	Arma-Bank	UA	742	244
116	Odesa Bank	UA	549	142
132	Prytchornomorya	UA	380	144
137	Ukrainian Financial Group	UA	338	114

Assets Evolution

In 2010–2011 Banks experienced modest growth of loans portfolio and assets. Total assets growth was +7.9 percent in 2010 (+69bn UAH), and may reach +12 percent percent by the end of 2011 (+9.2 percent or + 87bn UAH by October 2011).

This "adjustment" is coming after the period of boom and bust: during 3 pre-crisis years total bank assets grew from +/- 42bn USD (December 2005) to 120bn USD (December 2008). Overall 3 times growth (USD), peak reached in October 2008 –155bn USD (just before UAH devaluation).

Commercial loans grew up even faster between 2006 and 2009: 3.7 times — loans in UAH; 4.6 times — loans in foreign currencies, from USD 12bn in 01/2006 to 60bn USD in October 2008.

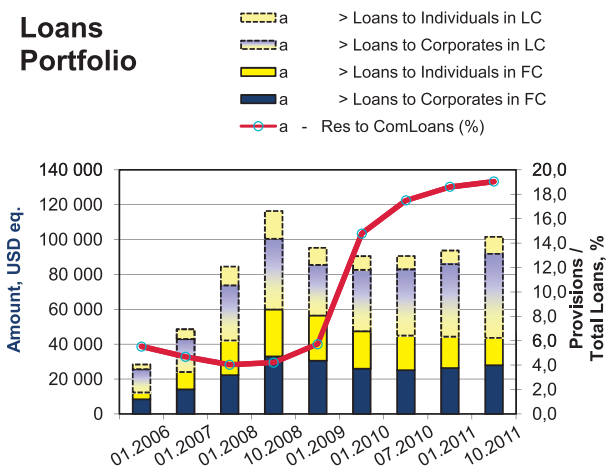
Development of loans portfolio in 2009–2011:

- UAH denominated loans total amount continued to grow in 2009, mainly driven by massive state support of state companies and banks: +9 percent in 4Q 2008, +14 percent in 2009, +15 percent in 2010, +17 percent in 2011 so far.
- FC loans, if accounted in USD eq., show slide of -6 percent (-24 percent p.a.) in 4Q 2008 and -16 percent in 2009, and -6 percent in 2010, just -1 percent in 2011 so far.

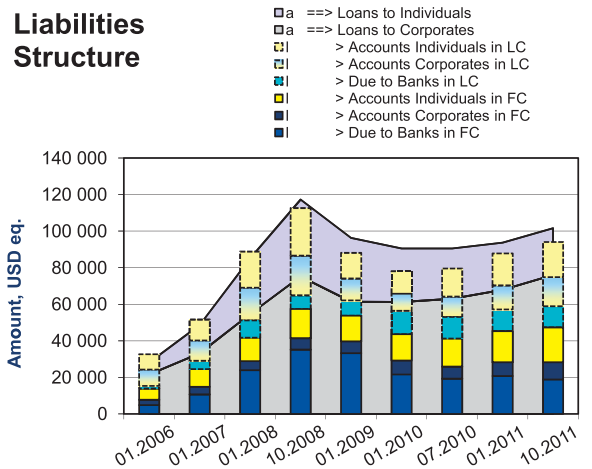
Loans Structure

	Units	01-2006	01-2007	01-2008	10-2008	01-2009	01-2010	07-2010	01-2011	10-2011
Total Clients' Loans	**Mio UAH**	**142 277**	**245 523**	**430 052**	**570 395**	**741 816**	**726 296**	**719 570**	**750 536**	**815 320**
Total Clients' Deposits	**Mio UAH**	**147 094**	**202 929**	**318 389**	**404 320**	**436 727**	**349 636**	**383 483**	**439 446**	**506 879**
Total Loans / Total Deposits	*%*	*97%*	*121%*	*135%*	*141%*	*170%*	*208%*	*188%*	*171%*	*161%*
FC Part of Clients' Loans	**Mio USD**	**12 305**	**24 047**	**42 191**	**59 849**	**56 336**	**47 352**	**44 941**	**44 334**	**43 670**
FC Part of Clients' Deposits	**Mio USD**	**9 034**	**13 892**	**17 795**	**22 240**	**20 460**	**22 064**	**21 955**	**24 553**	**28 448**
FC Loans / FC Deposits	*%*	*136%*	*173%*	*237%*	*269%*	*275%*	*215%*	*205%*	*181%*	*154%*
Total Loans to Corporates	***Mio USD***	***21 608***	***33 221***	***54 737***	***75 229***	***61 423***	***61 267***	***63 051***	***67 893***	***76 077***
Growth (per period)	*%*		*53,7%*	*64,8%*	*37,4%*	*-18,4%*	*-0,3%*	*2,9%*	*7,7%*	*12,1%*
Growth rate (Y-to-D)	*%*		*53,7%*	*64,8%*	*37,4%*	*12,2%*	*-0,3%*	*2,9%*	*10,8%*	*12,1%*
- FC Share Loans to Corporates	%	39%	42%	41%	44%	50%	42%	40%	39%	37%
Total Loans to Individuals	***Mio USD***	***6 565***	***15 397***	***30 422***	***42 110***	***34 916***	***29 291***	***27 537***	***25 852***	***25 552***
Growth (per period)	*%*		*134,5%*	*97,6%*	*38,4%*	*-17,1%*	*-16,1%*	*-6,0%*	*-6,1%*	*-1,2%*
Growth rate (Y-to-D)	*%*		*134,5%*	*97,6%*	*38,4%*	*14,8%*	*-16,1%*	*-6,0%*	*-11,7%*	*-1,2%*
- FC Share Loans to Individuals	%	60%	65%	65%	64%	74%	73%	72%	70%	62%
Total Loans to Fis + Securities	***Mio USD***	***7 838***	***11 128***	***21 597***	***23 821***	***16 876***	***9 385***	***11 857***	***15 352***	***15 961***
Growth (per period)	*%*		*42,0%*	*94,1%*	*10,3%*	*-29,2%*	*-44,4%*	*26,3%*	*29,5%*	*4,0%*
Growth rate (Y-to-D)	*%*		*42,0%*	*94,1%*	*10,3%*	*-21,9%*	*-44,4%*	*26,3%*	*63,6%*	*4,0%*
Loans Loss Provision	***Mio USD***	***-1 811***	***-2 556***	***-3 891***	***-5 590***	***-6 136***	***-14 170***	***-16 958***	***-18 606***	***-20 697***
- as of Total Commercial Loans	*%*	*5,5*	*4,7*	*4,0*	*4,2*	*5,7*	*14,8*	*17,5*	*18,6*	*19,0*

Loans Portfolio



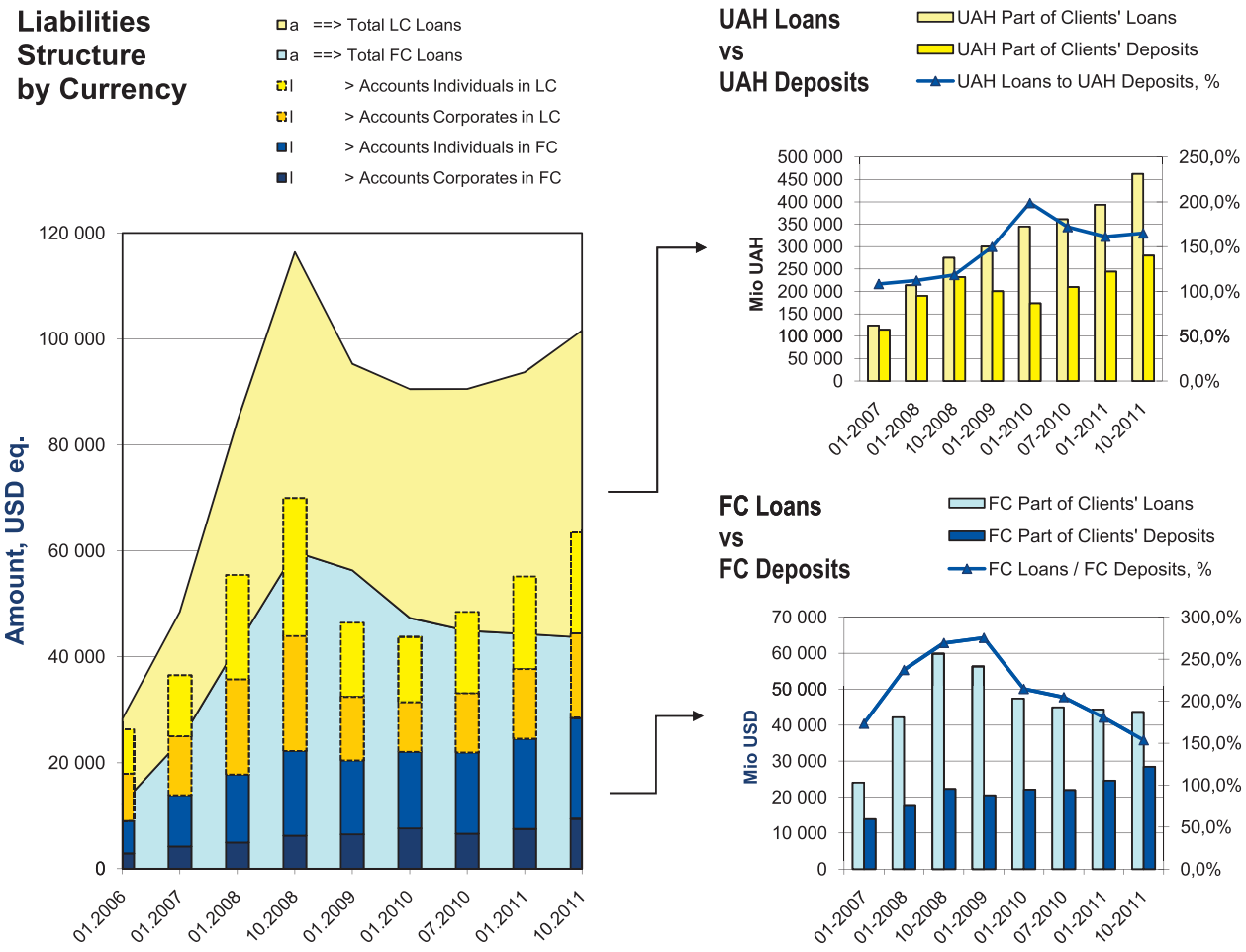
Liabilities Structure



Overall Commercial loans in USD terms increased 8 percent since the beginning of 2011. Loans are massively prolonged when borrowers appear to be incapable to repay them in the current market slide of activity, or restructured in exchange for partial repayment. Some FC loans to individuals, on advice and with the support of the National Bank of Ukraine, are converted into local currency to ease the burden of interest payments.

Rating agencies mention that as of mid of 2010 the banks that they rate have restructured loans on average for more than 35 percent. On top of such loans, overdue loans exceed 10 percent of the loans. It is not a single case when foreign banks sell their loans portfolio to collection companies.

Assets/Liabilities Imbalances



Non-performing loans is a major problem of the banking system for all categories of banks. Reserves accumulated by banks are building up quickly: from 4 percent of loans portfolio in October 2008 to 14 percent in October 2009 to 18.7 percent in 2010, 19.2 percent in October 2011. Yet many analysts estimate that loans portfolio remains under-provisioned.

The rally for deposits was launched by banks after 2008 financial crisis dried out the flow of foreign financing from abroad. By raising rates, marketing new short-term & bonus products the banks reached visible stabilization of domestic funding. The banks have kept and even increased deposit base since 1 January 2009: population deposits have grown up

~60bn UAH to reach 275bn UAH as of January 1st, 2011, and almost half of that amount has been deposited by individuals in 2011. During the same period (Year–to Date 2011) corporate accounts are up 38bn UAH and total 136bn UAH.

But some banks achieved it at a price…their funding became expensive!

Lending did not restart really: banks still have to provision their assets, the economy is progressing at a small pace, the legal environment remains a plague for banks. In 2011, however, loans to individuals have almost stabilized (first 9 months: –1.2 percent, –2bn UAH, to 203bn UAH). This is the result of a significant increase in UAH loans (+24 percent to 77bn UAH) and continuing decrease of "old" foreign currency loans (–12.5 percent to UAH 126bn). Banks do not lend in foreign currencies since the 2008 crisis. Loans to corporations increased to 606.5bn UAH as of October 1st, 2011 or + percent, +UAH 66bn, since January 1st, 2011. The increase over the last 10 months is the result of loans to Naftogaz, Ukrainian Railways, Ukravtodor, Energoatom…

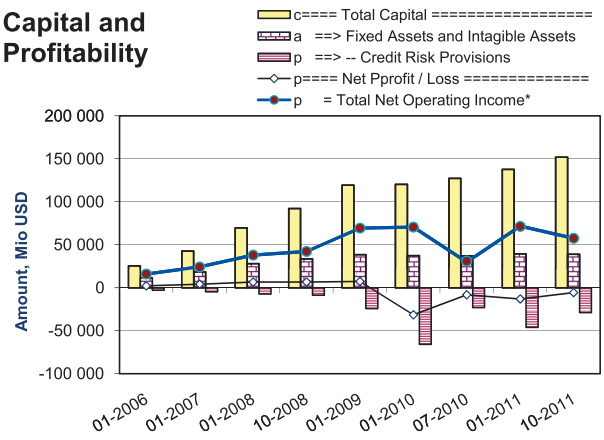
The banks' loans to deposits ratio is improving: 2.19 as of January 1st, 2010, at 1.85 on January 1st, 2011 (but at 2.05 in FC!) now at 1.61 as of October 1st, 2011. To be noted that the FC borrowing from banks abroad decreased from 42bn USD at the start of the crisis to + 30bn USD now, Western–owned banks being the biggest beneficiaries of such funding.

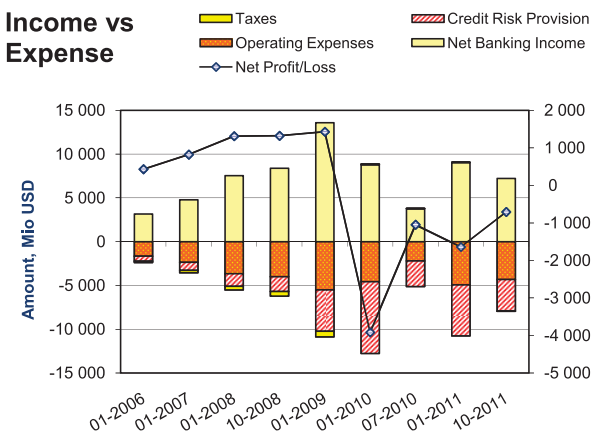
Excess of funds went in 2010 into securities market where banks' outstandings have grown twice from 38.5bn UAH at the end of 2009 to 83.7bn UAH by the end of 2010. In 2011 liquidity deficit was such that total portfolio of securities held by banks even decreased to 80.6bn UAH.

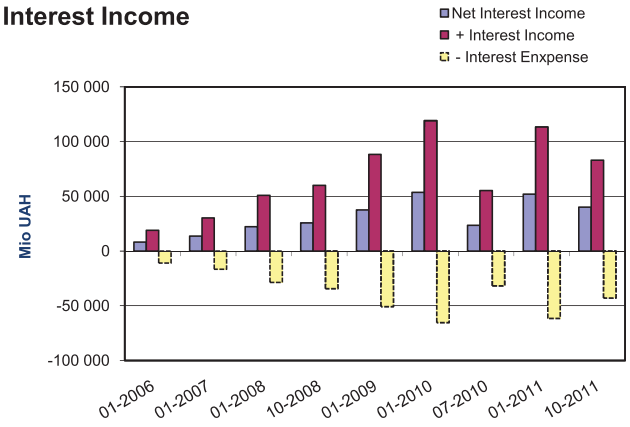
Income and Expenses

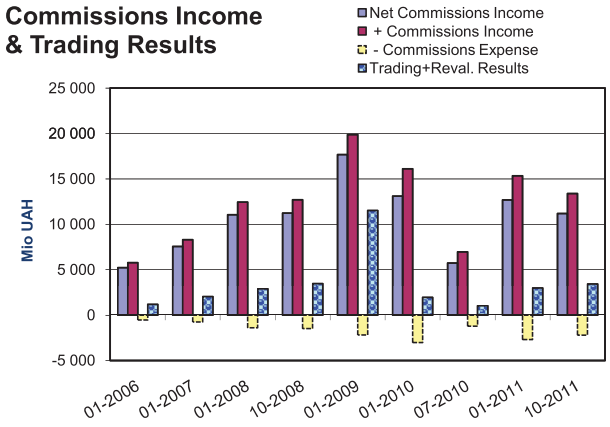
Capital / Results

	Units	01-2006	01-2007	01-2008	10-2008	01-2009	01-2010	07-2010	01-2011	10-2011	Share	Avg Monthly Income 2010	Avg Monthly Income 2011
Capital	Mio USD	5 040	8 429	13 778	18 249	23 326	14 959	16 051	17 365	19 072			
Growth (per period)	%		67,2%	63,5%	32,5%	27,8%	-35,9%	7,3%	8,2%	9,8%			
Growth rate (Y-to-D)	%		67,2%	63,5%	32,5%	69,3%	-35,9%	7,3%	16,1%	9,8%			
Total Assets	Mio USD	42 352	67 362	118 692	149 625	181 128	108 697	111 741	118 779	129 250			
Net Banking Income	Mio USD	3 153	4 790	7 536	8 379	13 598	8 793	3 774	9 052	7 226			
Operating Expenses	Mio USD	-1 659	-2 353	-3 668	-3 993	-5 506	-4 560	-2 191	-4 933	-4 314			
Credit Risk Provision	Mio USD	-550	-908	-1 437	-1 698	-4 718	-8 197	-2 917	-5 813	-3 613			
Taxes	Mio USD	-161	-278	-405	-516	-635	81	23	16	-8			
Net Profit/Loss	Mio USD	430	821	1 311	1 320	1 429	-3 919	-1 048	-1 642	-708			
*CAD Ratio	%	11,9%	12,5%	11,6%	12,2%	12,9%	13,8%	14,4%	14,6%	14,8%			
*ROE Ratio	%	8,5%	9,7%	9,5%	9,6%	6,1%	-104,8%	-13,1%	-12,6%	-5,0%			
*ROA Ratio	%	1,01%	1,22%	1,10%	1,2%	0,8%	-14,4%	-1,9%	-1,8%	-0,7%			
*Cost/Income Ratio	%	52,6%	49,1%	48,7%	47,7%	40,5%	51,9%	58,1%	54,5%	59,7%			
Net Banking Income	Mio UAH	15 925	24 190	38 059	42 312	69 526	70 658	29 902	71 795	57 537	100,0%	5 983	6 393
Net Interest Income	Mio UAH	8 122	13 680	22 229	25 720	37 552	53 726	23 577	51 925	40 126	69,7%	4 327	4 458
+ Interest Income	Mio UAH	19 029	30 259	50 842	60 061	88 370	119 083	55 335	113 334	82 993			
- Interest Exnpense	Mio UAH	-10 907	-16 579	-28 613	-34 341	-50 818	-65 358	-31 757	-61 409	-42 867			
Net Commissions Income	Mio UAH	5 238	7 562	11 056	11 230	17 685	13 097	5 732	12 674	11 181	19,4%	1 056	1 242
+ Commissions Income	Mio UAH	5 775	8 315	12 450	12 705	19 872	16 107	6 954	15 354	13 377			
- Commissions Expense	Mio UAH	-537	-753	-1 393	-1 475	-2 187	-3 010	-1 222	-2 680	-2 196			
Trading+Reval. Results	Mio UAH	1 187	2 047	2 896	3 483	11 523	1 965	1 035	2 988	3 427	6,0%	249	381
Other Income	Mio UAH	1 319	835	1 532	1 870	2 750	1 870	-441	4 208	2 803	4,9%	351	311
Operating Expenses	Mio UAH	-8 376	-11 884	-18 522	-20 163	-28 154	-36 639	-17 359	-39 123	-34 352		-3 260	-3 817
Credit Risk Provision	Mio UAH	-2 777	-4 585	-7 257	-8 574	-24 124	-65 866	-23 106	-46 107	-28 770		-3 842	-3 197
Taxes	Mio UAH	-815	-1 405	-2 045	-2 607	-3 246	652	186	129	-63			
Net Profit/Loss	Mio UAH	2 170	4 144	6 620	6 668	7 304	-31 492	-8 306	-13 027	-5 641		-1 086	- 627









Net Banking Income at banks stagnated in 2010: +1.6 percent, 71.8bn UAH vs 70.7bn UAH for 2009. Year 2011 should see a 1 to 10 percent growth: as of October 2011 NBI reached 57.5bn UAH versus 50.8bn UAH in October 2010, i.e. +6.8 percent on per annum basis.

Operating expenses surge despite closure and re-location of offices and staff expenses control. Operating Expenses' growth in 2010 -39.1bn UAH vs -36.6bn UAH in 2009 (+6.8 percent) would be extended in 2011: as of October 2011 Administrative & Staff expenses were -UAH 34.4bn (compare to -25.8bn UAH in October 2010). Cost-to-income ratio estimation deteriorates towards around 60 percent.

Net Result remains negative as loans loss provisions continue to eat into banks earnings, although slowly decreasing, showing the way out of the 2008 crisis: -28.8bn UAH for 9 months 2011, compared to -36bn UAH for 9 months of 2010, improved from -48.8bn UAH for 9 months of 2009.

Capital increase was a big concern for the banks. After urgent and "emergency" capital infusion of 35bn UAH in 2009, the banks continued the pace in 2010 by adding 27bn UAH in 2010 and further 22bn UAH in 2011. But banks are edequately capitalised today.

Market Regulator

The National Bank of Ukraine (NBU), staffed with more than 11000 employees, regulates since 1991 the banking activity, banks being subject to very significant constraints in their day to day activities, reporting "everything", but the NBU enforcement capacity is not perfect. As the NBU highlights it also, the Banking sector is faced, mostly for its non-western

owned portion, with challenges and issues such as fragmentation, including many small banks (whose minimum regulatory capital will have to be at 120m UAH as of January 1st, 2012), capital adequacy, insider loans, tax games and insufficient provisioning.

The change in the political landscape in 2010 led to a change also of the management team of the NBU. Thanks to the IMF support, some positive changes were decided, as minimum capital already mentioned, reinforcement of the NBU independence (a challenging task), the obligation to reveal beneficiary owners (in December 2011), a necessity to focus on inflation management and less on the "peg" between the UAH and the USD, which unfortunately is still being kept, and the capacity to transmit the foreign exchange risk to the economic sectors thanks to development of forwards, that was made possible mid-2011, but in very restrictive way, for a very small market which is one way sofar.

Conclusion

As of the end of November 2011, the Ukrainian banking sector remains one of the worst rated by the rating agencies. Its operating environment is "weak" because of its slow growth and could be hit by a possible recession in the west. Its profitability remains weak. The nonperforming loans, as well as restructured loans account for +/- 40 percent of its gross loans still. And the UAH currency funding is made difficult, because of devaluation fears and the decision by the authorities to prevent such event. All those reasons led all banks to stop to increase their loans for the time being.

Banks have evidenced their resilience in the 2008 crisis and have been provided with the required capital, their capitalization today being adequate.

Banks have developed again in 2011 their loans to the population, but in UAH only.

And the western banks present in Ukraine have continued to decrease their relative presence, having achieved a 10 percent market share drop over the last 3 years.

2012 will be a challenging year for banks in Ukraine, the increase of their lending activity being very probably limited.

2. Currency Control

In Ukraine, Currency Control is very strict and complex. It is governed by laws and by regulations of the National Bank of Ukraine (NBU). Regulations frequently change, therefore please consult your banker.

The purpose of Currency Control is to prevent the illegal export and import of valuables, goods, services, and the transfer of funds abroad, as well as to control the timely settlement of payments for goods and services under external trade contracts.

For individuals

Import/Export of cash:

- Residents and non-residents may export and/or import without declaration the equivalent of 10 000 EUR.

  Amount exceeding equivalent of 10 000 EUR should be accompanied with a written declaration. For amount exceeding 10 000 EUR the confirmation from the bank evidencing that funds were withdrawn from the individual's account should be presented.

- Funds at disposal (possibility to withdraw cash wired from abroad without account opening): disposable funds are limited per transaction and per day to the equivalent of 50 000 UAH (applicable for residents and non-residents).

Non-commercial transactions:

- Wire transfers in foreign currency are limited to equivalent of 15 000 UAH per day without account opening for residents and non-residents. But for residents – without supporting documents; for non-residents – with confirmation of the source of money.
- Wire transfers in foreign currency in amount which exceeds the equivalent of 15 000 UAH per day can be done by residents and non-residents from the current account (for residents with supporting documents, for non-residents – without supporting documents).

For more details, please ask your banker.

For commercial operations/ companies

The following administrations are involved in the currency control process:

- Customs – it controls the export/import of goods and valuables.
- Banks – authorised by the National Bank of Ukraine, control all operations and inform the NBU and State Tax Service (STS) in case of violations and are liable if such control is not executed properly.

Main types of activities subject to Currency Control and some key rules or constraints:

- Export/import of valuables, goods and services:
  - Exporting companies should receive payment within 180 days after shipment of goods.
  - Importing companies can pre-pay 100 percent but should receive goods or services within 180 days.
- Capital market operations (sale/purchase by non-residents of domestic securities; sale/purchase by residents of foreign securities; dividend payments abroad, etc.).
- Cross-border loans (loans granted by non-resident lenders).
- Currency purchases.

Main documents used to perform Currency Control:

For sales/purchases of goods: trade contracts, customs declarations, invoices.

For services (including royalties): contracts and documents proving that services were provided. When such services provided by same foreign supplier exceed equivalent of 100 000 EUR it is required to obtain in addition from a designated state entity (Derzhzovnishinform) a certificate on price relevance.

For capital market divestments incl. dividend payments: investment agreement and a document proving that investment was made and registered in Ukraine.

If shares are sold by a non-resident, or if a divestment originally was made in kind and the proceeds are to be repatriated, an "estimation certificate" issued by a licensed Ukrainian appraiser is required. In addition, cash divestments of investments made in kind must have been made possible by a treaty between Ukraine and the divestor's country.

For cross-border loans: loan agreement, NBU registration notice, and local bank's consent to service such a loan.

For currency purchases: contracts, invoices and custom declarations as mentioned above.

Purchased Foreign Currencies must be transferred within ten banking days.

3. Anti-money laundering set-up in Ukraine

Anti-Money Laundering measures are regulated by a new Law "On prevention and counteraction to the legalization (laundering) of the proceeds from crime" of May 18th, 2010, #2258-VI (hereinafter the Law) and for the banks by NBU Regulation #189 "On performance by the banks of financial monitoring" in the edition of NBU resolution #22 dated

January 31st, 2011 and registered in the Ministry of Justice of Ukraine on April 7th, 2011 (hereinafter the Resolution).

In the context of the Law "legalization (laundering) of the proceeds from crime" are any actions related to funds (property) received as result of a crime aimed at the concealment of the origin of said funds (property) or assistance to a person who is accomplice in said crime.

The Law excludes tax crimes from the list of crimes subject to it. Laundering in Ukraine is related to prostitution, drugs, arms, terrorism and other crimes. This "understanding" of the Law is still not perfect, i.e. authorities are inclined to include tax crimes also.

The system of financial monitoring consists of two levels: the initial and the state levels.

The following entities are involved in/subject of the initial level of financial monitoring:

- banks, insurance (reinsurance) companies, credit unions, pawn-shops and other financial institutions;
- payment organizations, members of payment systems, acquiring and clearing institutions;
- commodity, stock and other exchanges;
- professional operators in securities market;
- asset management companies;
- postal operators and other institutions executing the financial operations of funds transfers;
- branches and representative offices of the foreign subjects of economic activity rendering financial services in Ukraine;
- subjects of entrepreneurial business rendering the intercessory services during the execution of sale-purchase real estate operations;
- subjects of economic activity executing the trade of precious metals, precious stones and related goods for cash in case the amounts of related operations equal or exceed 150 000 UAH or its equivalent in foreign currencies;
- subjects of economic activity conducting lotteries and gambling games including casinos and electronic (virtual) casinos;
- notaries, law firms, auditors, audit companies, physical persons-entrepreneurs rending accounting services, subjects of entrepreneurial business rendering legal services; a 2010 novelty!
- physical persons-entrepreneurs and legal persons executing financial operations with goods (rendering services, performing works) for cash in case the amounts of said operations equal or exceed 150 000 UAH or its equivalent in foreign currencies; new in 2010!
- other legal persons rendering the financial services which are not financial institutions by their legal status. A 2010 novelty also!

The following entities are involved in the state level of financial monitoring:

- National Bank of Ukraine
- Ministry of Finance of Ukraine
- Ministry of Justice of Ukraine
- Ministry of Transport and Communication of Ukraine
- Ministry of Economy of Ukraine
- State Ukrainian Commission of Securities and Stock Market
- State Ukrainian Commission of Regulation of Financial Services Markets
- State Committee of Financial Monitoring or Financial Monitoring Unit (hereinafter FMU)

FMU is a 237 persons staffed central body of executive power whose head is nominated by the Cabinet of Ministers of Ukraine. FMU activity is directed and coordinated by the Cabinet of Ministers of Ukraine via the Minister of Finance of Ukraine.

Financial transactions subject to compulsory financial monitoring:

A financial transaction shall be subject to compulsory financial monitoring if its

amount equals or exceeds 150 000 UAH or its equivalent in foreign currencies (for subjects of economic activity conducting lotteries and gambling games – 13 000 UAH or its equivalent in foreign currencies) and if such financial transaction also has one or more of the specific features stipulated in the Article 15 of the Law, i.e. if certain objective criteria are being met. When both conditions are fulfilled, reporting to FMU is compulsory. All insurance related incomings or payments above 150 000 UAH must be reported, for instance.

Financial transactions subject to internal financial monitoring:

- A non-standard or a complicated financial transaction or several related financial operations that have no evident economic sense or obvious legal purpose.
- A financial transaction that is not compliant with the activity of the client of the subject of the initial level of financial monitoring.
- Repeated financial transactions the nature of which gives the grounds to believe that their purpose is to evade the procedures of compulsory financial monitoring.
- Financial operations defined by the typologies of the international organizations fighting against money laundering.

Internal financial monitoring (article 16 of the Law) can also be applied to other financial transactions when subjects of the initial level of financial monitoring have grounds to believe that such financial transactions are aimed at legalization of "laundered" proceeds.

Subjects of entrepreneurial business rendering the intercessory services during the execution of sale-purchase real estate operations have to perform internal financial monitoring in case the amounts of said operations equal or exceed 400 000 UAH or its equivalent in foreign currencies

Reporting to the FMU on a financial transaction subject to internal financial monitoring is the result of an assessment by the reporting institution, which is based on defined subjective criteria.

FMU has right to stop for up to five business days all debit operations on a customer's accounts in case said customer's operations are suspected to be related to money laundering.

Subjects of the initial level of financial monitoring are obliged to "know their customers" and able to prove it. I.e. in their files there should be the evidence that their customers-legal persons, physical persons, banks and other financial institutions have been identified according to the identification rules defined by the Law and, and for banks by the Resolution that includes also identification of the ultimate/beneficial owners ("controllers", >=50 percent ownership) of the customers, the shareholders ("owners of essential participation", >=10 percent ownership) and the managers/authorized persons of the customers. Identification rules also prescribe to identify non-resident politically exposed persons (PEP) among customers, their "controllers", their "owners of essential participation" and their managers/authorized persons.

Banks that are subjects of the initial level of financial monitoring are obliged to classify the customers by their risk appreciation for such customers to perform money laundering operations. Such classification has to be performed in accordance with the Resolution requirements considering the criteria defined by FMU. The Resolution also requested the banks to classify the customers by their reputation.

The Resolution requires from the banks the compulsory maintenance of electronic KYC forms ("anketas") of prescribed format in Ukrainian. Said "anketas" are to be stored and must contain all historical data of the banks' relationships with the customers. The levels of the customers' risk and reputation must be indicated in the customers' "anketas".

The Resolution also requested the banks to analyze quarterly the customers' operations as to their correspondence to the customers' financial state and activity nature. Results of such analyses must be fixed in the customers' "anketas".

The Resolution obliged the banks:

- to put into correspondence with the Resolution requirements their internal documents regarding financial monitoring (programs, rules etc.) within 1 month after the Resolution became effective;
- to make the identification of the customers with high risk in accordance with requirements of the Law and the Resolution within 2 months after the Resolution becomes effective;
- to make the identification of the customers with other risks in accordance with requirements of the Law and the Resolution within 6 months after the Resolution became effective.

The Law and the Resolution cover also "terrorism" related activities. Based on a list of terrorists provided by the FMU the subjects of the initial level of financial monitoring are required to prevent for up to two days a financial operation to be executed, if a participant or a beneficiary of a transaction is a person included in such list. FMU has the rights to extend such time to up to twelve business days.

The Law and the Resolution in many aspects respect international AML practice (for instance, the extension of the entities to be subjects of the initial level of financial monitoring, identification of PEP, customers risk-based classification) but they substantially increase, first, the volume of transactions that are subject to compulsory financial monitoring and mandatory reporting to FMU, and, second, the volume of processing work related to the customers' identification and their "anketas" maintenance. This is a questionable move for Ukraine, where counter powers need still to be developed, where the rule od law is not prevalent, and where the independence of State Regulators and Supervisors still is questioned.

* * *

After more than eight years of implementation, the anti-money laundering set-up in Ukraine resulted in 6 471 299 transactions reported to the FMU by the subjects of the initial level of financial monitoring as of December 31st, 2010.

As of December 31st, 2010 among the subjects of the initial level of financial monitoring registered by FMU there were 176 banks as well as 6329 non-bank institutions.

In 2010 819 542 transactions were reported to FMU, of which 787 912 (96.14 percent) transactions were reported by banks. 72 percent reported transactions were subject to the compulsory financial monitoring.

In 2010 188 857 reports received by FMU were taken into active work and resulted in the creation of 1706 dossiers. Following to further analyses only 667 dossiers were delivered to Ukrainian enforcement bodies in 2010. In 2010 only 106 criminal cases were initiated and delivered to the courts as a result of reporting to FMU.

As of December 31st, 2010 the courts considered only 65 cases. Court decisions led to the arrest of funds and property for the amount of 198.2m UAH and to the confiscation of funds and property for the amount of 15.2m UAH. The efficiennсy of such set-up is to be improved.

3. CUSTOMS REGULATION

Customs duty planning: practical aspects

Mr. Igor Dankov
Senior Manager and
Mr. Robert Zeldy,
Senior Consultant,
PwC Ukraine

In accordance with Ukraine's Law "On Unified Customs Tariff" and the Tax Code, customs duty is tax on goods moved across the Ukrainian border. Failure to pay the customs duty would disallow the person from importing goods into Ukraine.

Customs duties are non-recoverable, and their average rates are 11 percent for agricultural goods and 5 percent for industrial goods. Under the Tax Code, customs duties are deductible for corporate profits tax purposes.

The Ukrainian customs authorities control the payment of customs duties at the moment of customs clearance of the goods, or during post-entry customs audits. Underpayment of duty is subject to a 25 percent or 50 percent penalty plus late payment interest, as well as an administrative penalty to the company's officials (up to UAH 17,000) and criminal prosecution in case of a deliberate underpayment.

Careful customs duty planning would help reduce costs and avoid potential disputes with the customs authorities which may result in delays of customs clearance and penalties for non-compliance. This article attempts to discuss the practical aspects of customs duty planning with recommendations wherever appropriate.

Factors that impact the amount of customs duty payable

Customs duty planning starts with answering the following questions:

- Are the goods properly classified for customs purposes?
- Are there any expenses that can be excluded from the customs value?
- Should we accept the higher customs value defined by the customs authorities?
- Can we classify complex equipment under a single tariff code with a lower duty rate?
- Can we claim exemption from customs duties under a free trade regime?
- Is it possible to get a duty exemption by contributing property to the capital of a Ukrainian legal entity?
- Can we delay payment of duties by placing the goods in a customs bonded warehouse?
- Can we get an exemption from duties

through the use of the inward processing regime?

- Is there a full exemption from duty for temporarily imported goods?
- Is there prospective legislation which would help me to more effectively plan customs duty payment in the future?

If the answer to any of these questions is yes, all you need to do is implement planning opportunities!

We will discuss all of these opportunities in more detail below, and useful hints will be provided.

Proper classification of goods for customs purposes

The rate of duty depends on the tariff classification of goods. For example:

- Goods which are imported unassembled or disassembled are dutied as if they were complete or finished. So, if the duty rates on imported components are higher than the rate on the product that will be made from them, a lower duty might be paid if the article were imported in the form of a complete set of parts, than if the components were imported separately in bulk.
- Goods put up together in sets are classified as if they consisted of the component which gives them their essential character. However, if these components are imported separately in bulk for assembly after importation, they will be dutied separately and the overall total duty payable may be less.

In difficult cases, it may be prudent to request an advance classification ruling of the customs authorities. This process should be started well in advance, and prior to actual import of the goods, as the customs authorities will require up to 60 days to issue a ruling.

Important: while classifying goods for customs purposes, it is important to comply with the main classification rules laid out in the Customs Tariff. Failure to do so may result in an incorrect classification, and thus underpayment or overpayment of customs duties. If required, consult professional advisors.

Expenses that can be excluded from the customs value

Reducing the customs value by allowable deductions diminishes the amount of ad valorem customs duty.

In most cases, the customs value of imported goods is the transaction value, that is the price actually paid or payable for the goods sold for export to Ukraine, adjusted for certain expenses stipulated by the Customs Code. For instance, the following expenses may be deducted from the customs value:

- The cost of transport after importation. Important: the amount of the deduction should be properly substantiated and supported by documentation. If an excessive amount is deducted without proper justification, the customs authorities may challenge this;
- Loading, unloading and handling charges associated with the transport of the imported goods after the place of importation;

- Buying commissions. Important: buying commissions should represent fees paid by the importer to the importer's agent for the service of representing the importer abroad in the purchase of the goods being valued. In other cases, the charges would not qualify as buying commissions and would not be eligible for deduction from the customs value;
- Charges for construction, erection, assembly, maintenance or technical assistance, undertaken after importation of goods such as industrial plant, machinery or equipment. Important: these charges would not be includible in the customs value, provided that they are distinguished from the price actually paid or payable for the imported goods.

In case of frequent imports, duty savings may be substantial.

Acceptance of a higher customs value defined by the customs authorities

The customs authorities often challenge the declared customs value and define it at a significantly higher level. In case of a disagreement with such a decision, the declarant is entitled to ask the customs administration to release the declared goods into free circulation with the payment of taxes computed based on the customs value determined by the customs office. The customs authorities would keep these funds as the importer's guarantee obligations.

The term of guarantee obligations should not exceed 90 calendar days from the moment of the release of the goods into free circulation. During this period, the importer may submit additional documentation supporting the declared value to the customs authorities.

If the customs authorities accept the declared value, the amount of overpaid taxes will be returned to the declarant within 30 days after the customs authorities pass the relevant decision.

If the customs authorities do not accept the declared value, the declarant may appeal to the customs administration of a higher level and/or to the court. However, appeal by a judicial procedure can take a very long time — up to a year or longer.

Important: the procedure for releasing goods under guarantee obligations is recommended to be applied when a judicial appeal is anticipated. The release of goods under guarantee obligations will serve as additional evidence of the declarant's disagreement with the decision of the customs authorities on the determination of the customs value for the court.

Also, if the importer decides to go to court, it is necessary to document the impossibility to present additional documents to customs or to request the customs authorities to explain in writing how the customs value was defined, etc.

It is recommended to expedite the documents endorsing the customs value while clearing the goods in order to reduce the risk of disputes arising with customs on the determination of the customs value.

Classifying complex equipment under a single tariff code with a lower duty rate

Briefly, for customs purposes, complex equipment represents the set of units which, if assembled, should be classified under a single tariff code. The process works as follows:

- Obtaining an advance classification ruling from the customs authorities;
- All units should be imported within the period specified by the customs authorities;

- If import deadlines are not kept, the customs authorities would reclassify each unit under a separate tariff code and assess customs duties and VAT.

For example:

Description of goods	Tariff code	Customs duty
Classified under a single code:		
Packaging equipment	8422 400090	0%
Classified under multiple codes:		
Units: panels and consoles	8537 109990	5%
Motors, power units	8408 905100	5%
Belt conveyer	8428 339000	0%

This example demonstrates that the classification of equipment under a single code attracts a 0 percent duty whereas classification under multiple codes (per unit) attracts 5 percent duty on certain units.

Claiming an exemption from customs duty under a free trade regime

Ukraine has concluded free trade agreements which allow duty-free import of goods from the following countries: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Macedonia, Moldova, Russia, Turkmenistan, Uzbekistan and the European Free Trade Association (not effective yet).

In order to receive an exemption from Ukrainian customs duty, goods imported from CIS countries and Georgia should satisfy the following requirements:

- Preferential origin of goods from these countries should be supported by certificate ST-1;
- Goods should be imported into Ukraine based on a contract between a Ukrainian buyer and a seller resident in the relevant CIS country that signed the free trade agreement with Ukraine;
- The goods should be introduced into Ukraine directly from relevant country (i.e., without crossing other countries or if crossing the other countries – the goods must be under customs control all the time).

Important: if the duty rate is material, consider sourcing the goods from countries that have concluded free trade agreements with Ukraine. If possible, make sure that the conditions of free trade are met; otherwise, there will be no duty exemption in Ukraine.

Obtaining a duty exemption through contributing property to the capital of a Ukrainian legal entity

Property (except for goods for resale or own consumption) contributed by a foreign shareholder to the capital of a Ukrainian legal entity is exempt from customs duty as follows:

- During customs clearance of such property, the importer should issue a promissory note for the amount of the customs duty with a maturity period of 30 calendar days from the issue of the import customs declaration;

- The importer would need to record the property on its balance sheet within this period, and to receive confirmation from the tax authorities in writing;
- The customs authorities cancel the promissory note, and customs duty is not paid.

Important: if property is disposed off (except for export in case of company liquidation) within 3 years after being recorded in the accounts, the customs duty becomes payable.

Delaying payment of duty through placing goods in a customs bonded warehouse

A customs bonded warehouse is an appropriately equipped facility for the storage of goods under the control of the customs authorities. It is possible to store the imported goods in a customs bonded warehouse for three years. Customs duty and other import taxes are paid only upon the release of the goods from the warehouse. Therefore, in certain cases, the warehouse may be used for delaying payment of customs duties and other import taxes.

Important: the necessity of placing the goods in the customs bonded warehouse should be substantiated to the customs authorities. Otherwise, the customs will not issue the relevant authorization.

Obtaining an exemption from duties through the use of the inward processing regime

In Ukraine, the inward processing procedure is realized through the duty suspension system. This means that goods imported for processing are exempt from import duty. However, the amount of customs duty payable should be secured by a promissory note issued for a period not exceeding 90 days. When the processed products are re-exported, the promissory note is cancelled.

Important: Currently, duty exemption is available only for toll manufacturing (i.e., where the raw materials and finished goods are owned by a non-resident customer and the Ukrainian manufacturer renders processing services for a fee). It is advisable to consider the requirements of Ukraine's Tolling Law before the actual import of raw materials for processing in order to verify whether the processing would be qualified as toll manufacturing. If there are doubts as to whether the transaction qualifies as tolling, it may be prudent to obtain a written expertise of the Ministry of Economic Development and Trade of Ukraine.

Full exemption from the duty for goods imported temporarily

In general, a full exemption from customs duty is applied to the temporary import of goods qualifying for the Convention on Temporary Admission (also known as the Istanbul Convention) with certain additional items provided for by the present Customs Code (such as marine and river ships, aircraft imported for repair, and equipment used for repair or construction of these items).

Partial exemption is available only in respect of VAT, and for the temporary import of goods used for production or work projects. Partial exemption implies that VAT payable is computed as 3 percent of the total amount of VAT multiplied by the number of months of temporary admission. At the time of writing, partial exemption from customs duty is not available.

Goods or items imported temporarily which do not fall under the Istanbul Convention would be subject to regular customs duties and VAT.

Important: the customs authorities often challenge full exemptions from duty by claiming that the goods do not fall under the Istanbul Convention. It is recommended analysing eligibility for a full exemption from duty prior to the import of the goods.

Return of goods

Goods originating from Ukraine (except for sugar, confectionary, goods made in Ukraine based on tolling arrangements with a non-resident customer, etc.) are exempt from duty upon re-import into Ukraine. Thus, for instance, if the goods were exported from Ukraine and then are returned due to a contract breach, etc. such import would not be subject to customs duty.

Important: it would be necessary to evidence the Ukrainian origin of goods (e.g., through submission of the certificate of origin) to the customs authorities. Otherwise, the customs authorities would not grant exemption from customs duty.

Prospective legislation which would make planning customs duty payments more effective in the future

There is a draft Customs Code which offers dramatic changes to customs legislation and expands customs duty planning opportunities. Here is a selection of those opportunities:

- Goods imported temporarily which do not qualify for full exemption from duty would be eligible for a partial exemption from customs duty. Similar to VAT, the importer would compute duty payable as 3 percent of the whole amount, multiplied by the number of months of temporary import;
- In case of re-export, import customs duty may be reimbursed (but certain conditions should be satisfied). This provision may be applied to goods that were previously imported, and then returned due to a breach of the sale contract;
- The import of goods after warranty repairs abroad would be exempt from customs duty;
- For goods imported after outward processing customs duty would apply on value added abroad;
- Inward processing would become more flexible, allowing duty free import of raw materials for processing based on purchase contract; the term of processing may be extended to 365 days; the Ukrainian importer may process imported raw materials into finished goods that would be released into free circulation after payment of customs duty and VAT; equivalent goods may be used in processing. This would also allow for more opportunities.

It is recommended to consult with professional advisors in advance because correct application of the existing possibilities in the customs legislation may not only reduce the amount of customs duty paid, but may also help in avoiding future penalties for non-compliance.

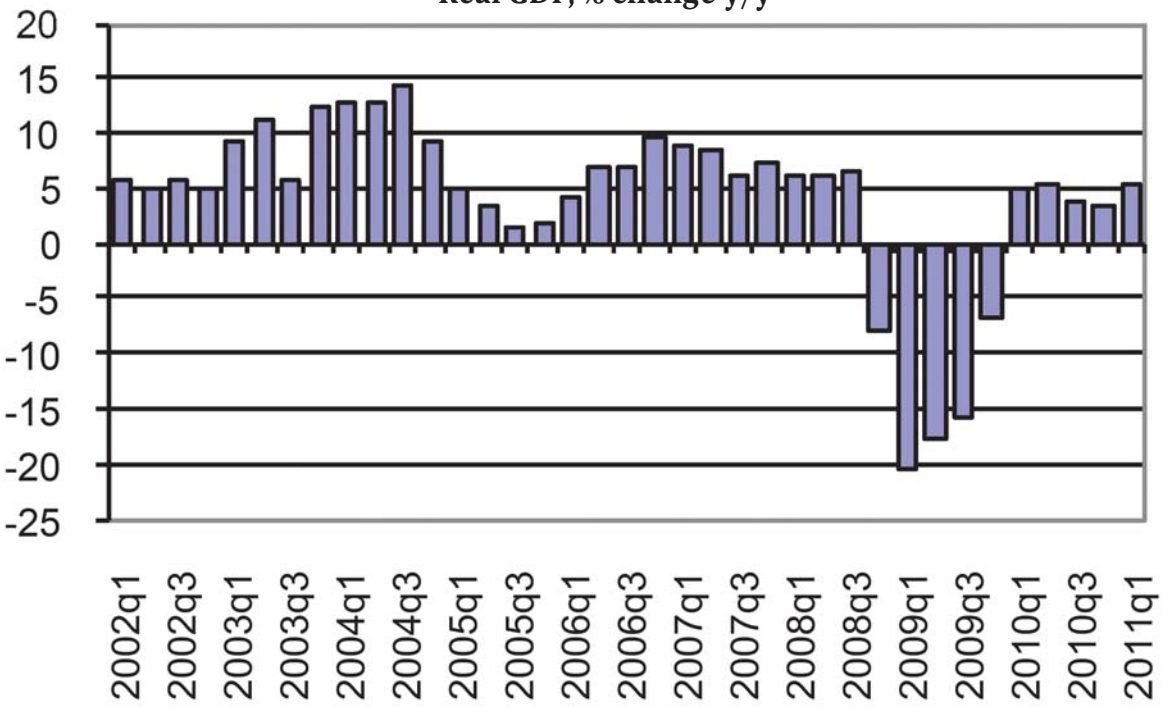
4. FMCG MARKET

Retail sector overview

1. Macroeconomic overview

The Ukrainian economy is gradually improving but the recovery remains fragile. In 2010 the country's GDP grew by 4,2 percent and in the first 6 months of 2011 the growth was 4,4 percent. According to the World Bank forecast made in June 2011 growth in 2011–2013 is expected to remain between 4–5 percent.

Real GDP, % change y/y

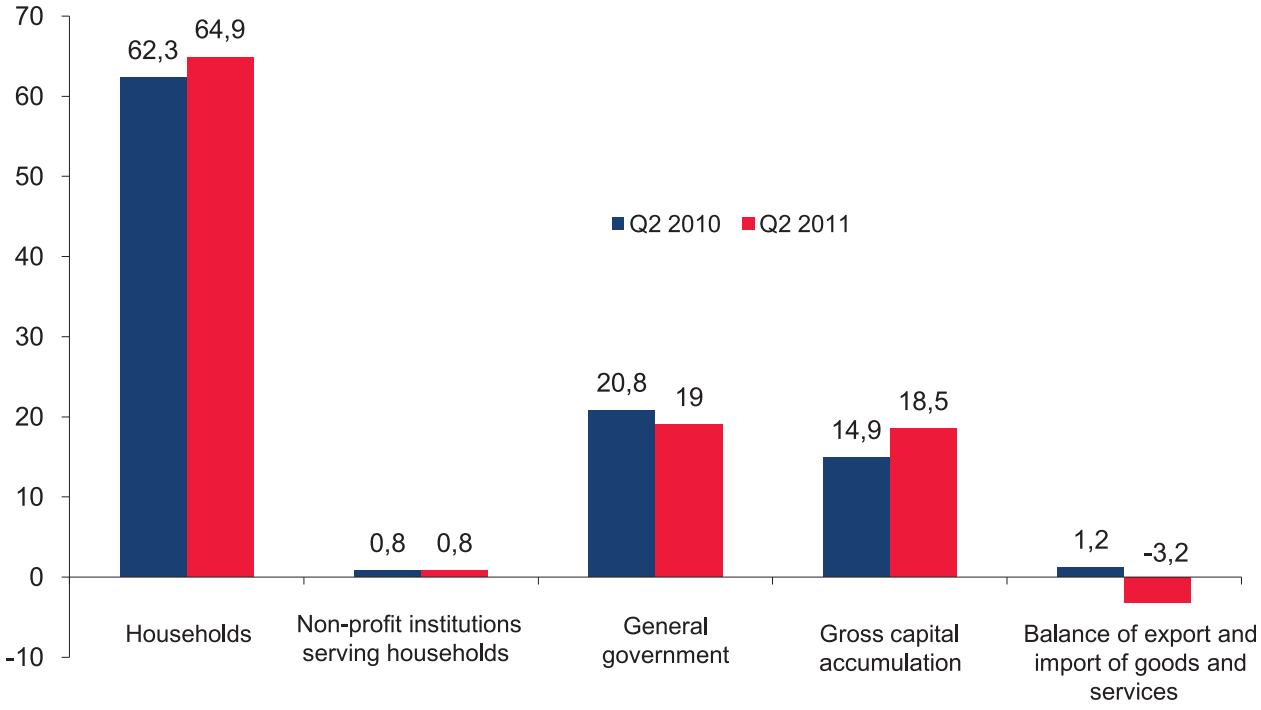


Source: World Bank

The structure of the GDP indicates the increasing role of the household consumption that makes up almost 65 percent of the national GDP.

According to the State Statistics Service in September 2011 the industrial output growth slowed down to 6,4 percent and its contribution to the overall economy growth decreased, whilst retail turnover grew by 15,2 percent on YoY basis and became one of the key sectors driving the economy development. At the same time the retail turnover growth is significantly

GDP structure by final consumption category



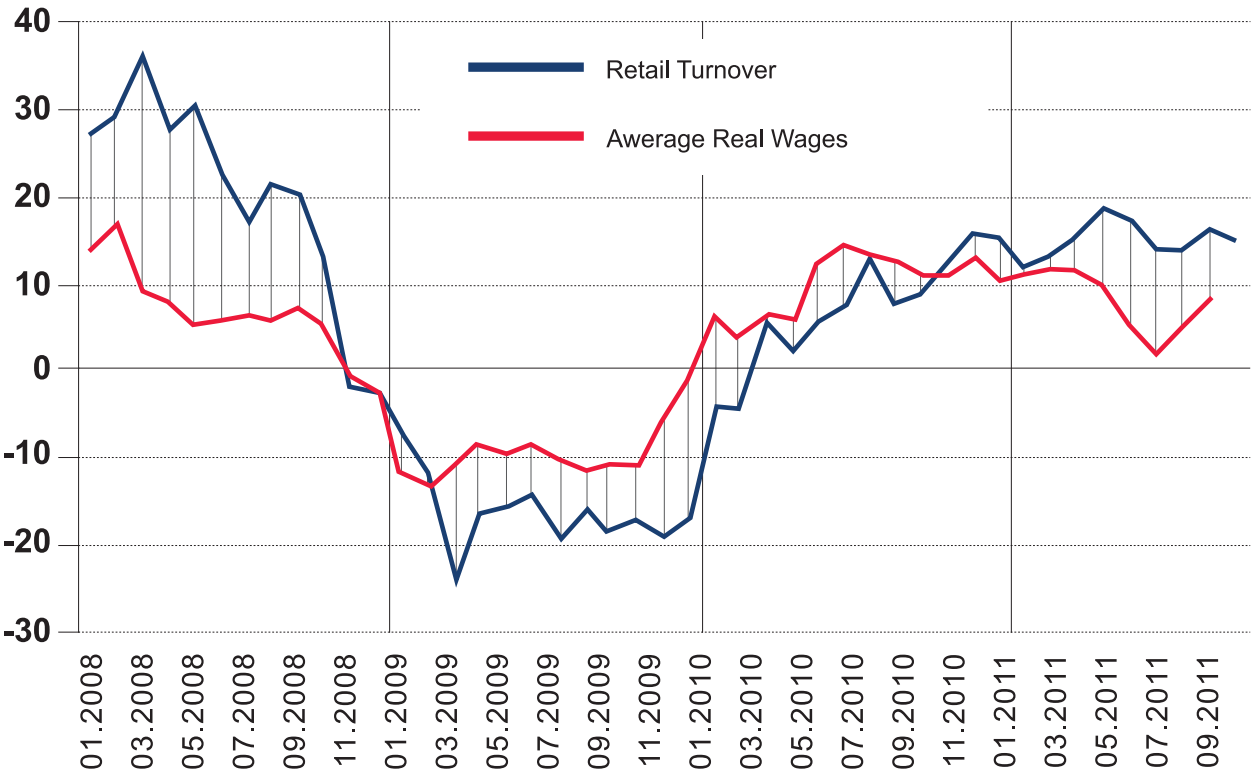
Source: State Statistics Service of Ukraine

ahead of the real wages growth which is an indicator of the high domestic demand.

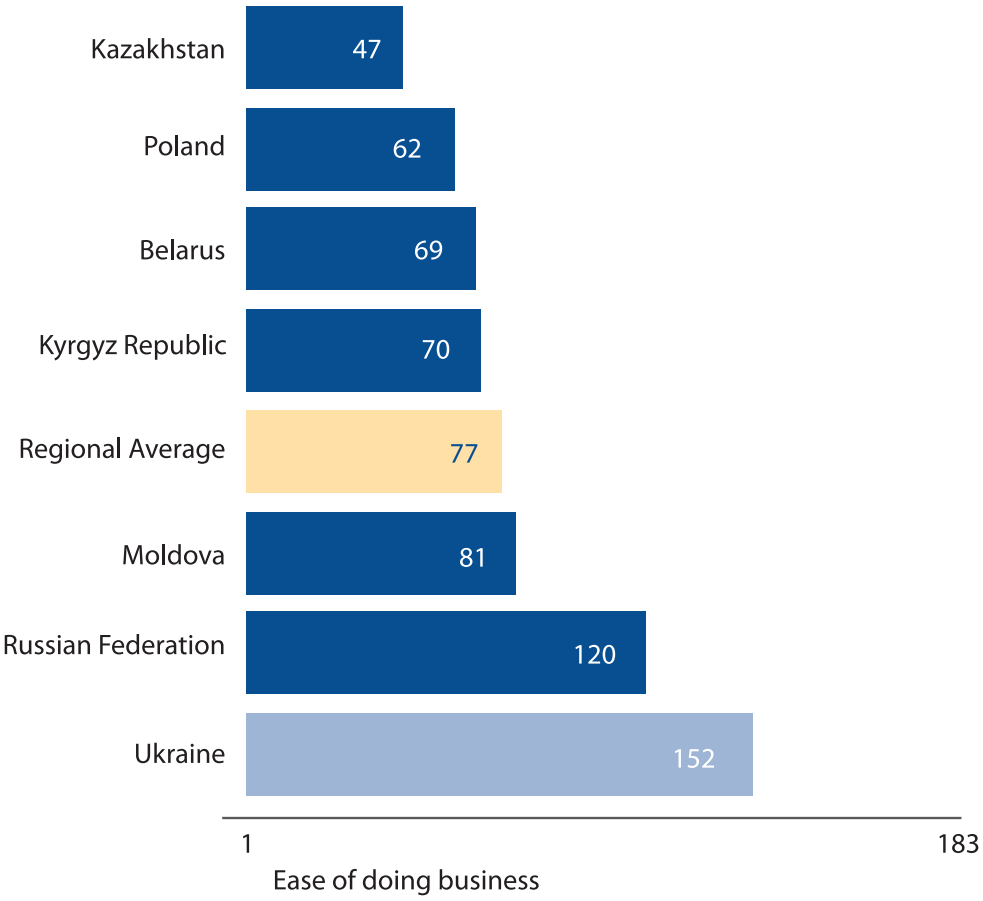
In 2011 so as in 2010 Ukraine was not listed in the annual ranking of the top 30 developing markets attractive for retail expansion by A. T. Kearney (Global Retail Development Index). In 2007 the country took the 5th position in the ranking and although in 2008 and 2009 in the peak of the financial crisis it dropped to the 17th place, A.T. Kearney stated it was high time to enter Ukrainian retail market due to a very low cost of entry. For the second year in a row according to A.T. Kearney the Ukrainian market has lost its attractiveness for the global retailers' expansion.

The overall investment appeal of the country was influenced by the economic and political instability as well as worsening of the investment climate which resulted in Ukraine being ranked 152 among the 183 countries in the World Bank's annual Doing Business 2012 ranking. Although the country has improved its position in terms of starting up a business it got bad ranking for getting the construction permits (180 out of 183) and paying taxes (181 out of 183) and worsened the position in protecting investors (111 out of 183).

National currency instability remains one of the key factors that makes conducting business in Ukraine less predictable. The country has entered the autumn of 2011 with high currency devaluation expectations. According to the regular National Bank of Ukraine research in the third quarter of 2011 almost 60 percent of the Ukrainian businesses were expecting national currency devaluation as compared to USD. The further national currency exchange rate depends on a complex of factors including the political situation, the situation with National Bank of Ukraine reserves and the conditions of the annual gas deal.



Source: National Bank of Ukraine



Source: World Bank

2. Consumer behavior

Ukrainian consumers adjusted to the post crisis conditions and became very rational and disillusioned due to the low trust to the government and deterioration of the quality of life due to the economic crisis (in September 2008 – May 2009 Ukraine took the 1st place in the global ranking of countries most affected by crisis done by Carnegie Endowment). According to Nielsen, Ukraine is now #12 of the most pessimistic countries out of 28 European countries with over 75 percent of people believing that it is "bad" and "not so good" time for spending money and making purchases (as of Q3 2011).

According to GFK Ukraine in October 2011 Consumer Confidence Index (CCI) has improved. The relevant index was 78.6 which is 3.9 p. higher than the indicator value in September. Index of the Current Situation was somewhat higher than Index of Economic Expectations for the first time since period before crisis in 2008.

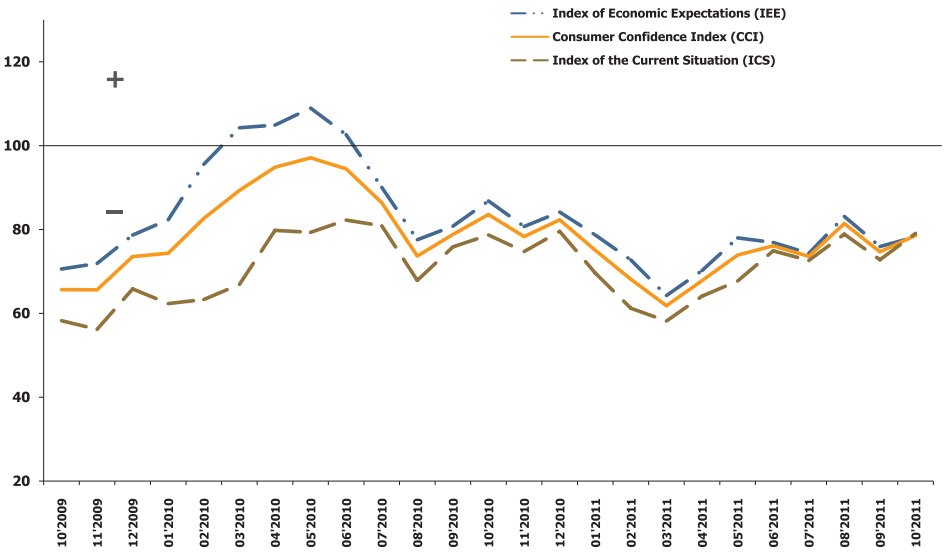
The main driver of the CCI improvement in October was considerable growth of the propensity to consume (x5); this trend was the most vivid among respondents with income higher than average. The growth of index x5 occurred along with small increase of Indices of the Current Situation and Inflationary Expectations. The last one was significantly affected by high expectations of the devaluation of Hryvnia. Along with the general increase of CCI, expectations in two groups declined: in the group of citizens with income lower than average – due to the decline in expectations over the next year; and in the group of citizens from Western Ukraine – due to higher pessimism regarding economic changes over the next year and the next five years as well.

Dynamics of the Consumer Confidence Index in Ukraine

Month, year	Consumer Confidence Index (CCI)	Index of the Current Situation (ICS)	Index of Economic Expectations (IEE)	Index of Inflationary Expectations (IIE)	Index of Expectations of Changes in Unemployment (IECU)
10'11	78.6	79.1	78.3	186.8	135.3
09'11	74.7	72.8	75.9	184.6	125.0
10'10	83.6	78.7	86.8	183.8	119.5

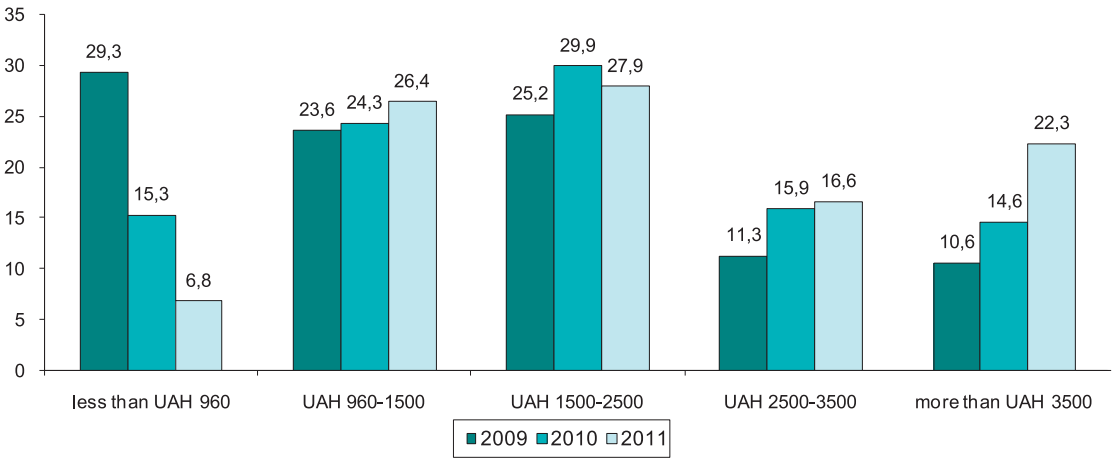
According to the State Statistics Service the average wages in Ukraine in January–September 2011 was 2571 UAH with the highest indicators in Kyiv, Kyiv oblast and Dnipropetrovsk oblast.

The overall well-being of the population remains quite low although the quantity of people that have higher wages gradually increases. In June 2011 over 22,3 percent Ukrainians earned more than 3500 UAH monthly. Still there are 6,8 percent of people who do not earn even the basic state fixed minimum wages which amounts to 960 UAH. The country still has high salary debt which according to the State Statistics Service in September 2011 amounted to almost 1,2 billion UAH but it is gradually decreasing.



Source: GFK Ukraine

Percentage of employees by average wages in June



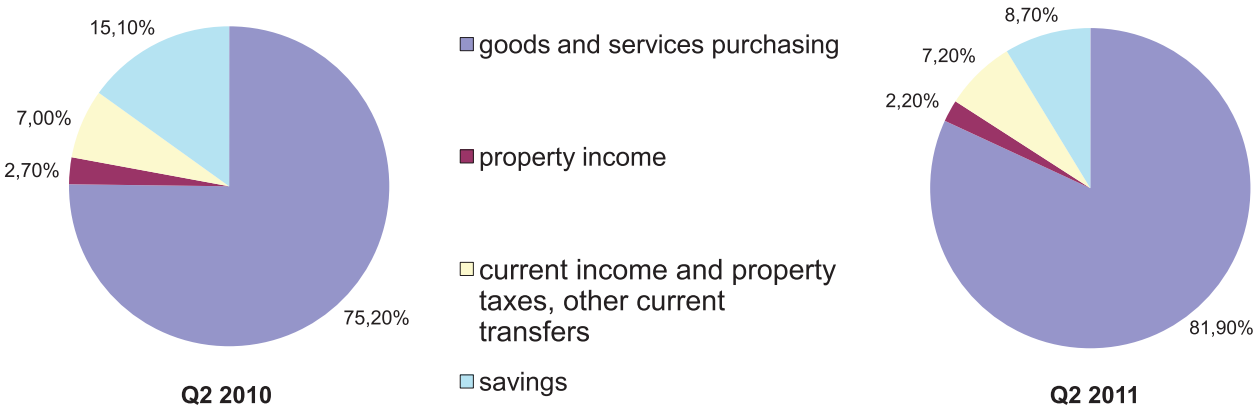
Source: State Statistics Service of Ukraine

According to the State Statistics Service Ukrainian households spend over 50 percent of their monthly budget for food and first need products which is one of the highest indicators in Europe.

The growth of prices for consumer goods and services remains the biggest pain for Ukrainian consumers. According to Nielsen in Q3 2011 28 percent of Ukrainians ranked the increasing food prices as the topic that worries them most of all, compared to 35 percent in the same period in 2010. The number two issue for Ukrainians is the health – 27 percent with increasing prices for utility services (gas, electricity, etc.) on the third place – 26 percent.

At the same time the prices for consumer goods and utility services remain the key inflation factors in Ukraine. According to the State Statistics Service in January–September 2011 the prices for food and soft drinks increased by almost 8 percent as compared to the same period in 2010. And the inflation for utility services amounted to 19,2 percent. The overall inflation in the country slowed down as compared to the crisis years of 2008–2009 and amounts to 9 percent (cumulative for January–September 2011).

Household expenditure and savings of Ukraine for Q2 2011



Source: State Statistics Service

3. Retail market overview

Ukraine still has quite low share of modern retail – around 25 percent. Mostly modern retail outlets are concentrated in the capital and big regional cities. The market is dominated by domestic retailers, most of which operate on a regional level.

There are still few international companies operating in Ukraine and the major investors are METRO GROUP, Auchan, Billa, Praktiker and OBI. METRO GROUP is one of the biggest international investor to the Ukrainian retail market having contributed around 500 million euro to the country's economy with 7200 jobs created since its entry to the market in 2003.

The overall retail turnover in Ukraine in January–October 2011 grew by almost 15 percent and amounted to 546,89 billion UAH. The retail turnover of the enterprises in the same period grew by 14,1 percent and amounted to 280,27 billion UAH which is around 51,2 percent of the overall retail turnover. According to the State Statistics Service in 2010 60,5 percent of the retail turnover was made up by the non food products.

Retail formats in Ukraine have different meaning as in Europe and are adapted to the specificities of the local market. For example, the 'cash&carry' format implemented

The top 5 retailers on the Ukrainian market according to Planet Retail in 2010.

	2010	2010	2010	2010	2010
Company	**Number Of Outlets**	**Total Sales Area SQM**	**Average Sales Area SQM**	**Grocery banner sales(EUR)**	**Grocery Market Share %**
Fozzy	350	284 220	812	1 249 960 783.34	4.84
ATB Market	457	297 050	650	1 043 849 421.94	4.04
Metro Group	27	236 200	8 748	663 476 646.39	2.57
Furshet	115	184 000	1 600	551 916 084.42	2.14
Retail Group	52	108 300	2 083	349 018 084.42	1.35
Grand Total	1 001	1 109 770	1 109	3 858 221 020.51	14.94

by Ukrainian companies means a substantial proportion of sales is made by end consumers. Hyper- and supermarkets often determine low prices to attract more customers. Discounters offer an expanded product range and have still a very low share of own brands in comparison, for example, to Germany's discounters. Convenient stores have higher floor space (150–550 sq. m.) and broader assortment (2–2.5 articles).

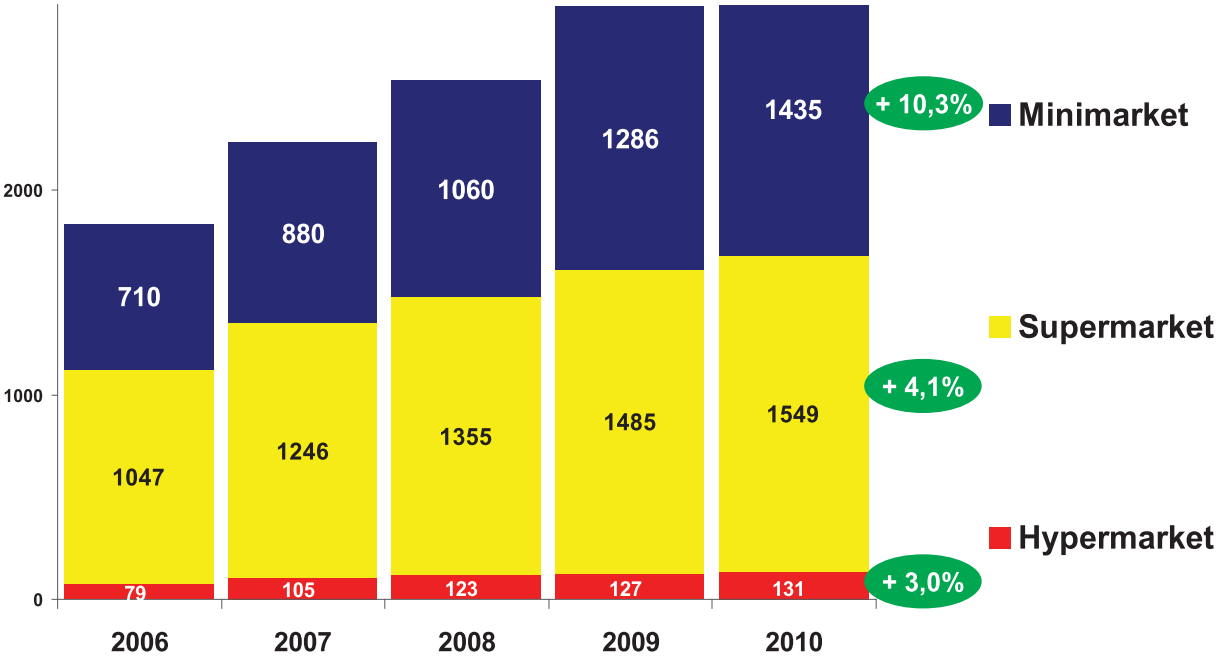
Supermarkets and neighborhood stores along with cash & carries are the leading formats in Ukraine but still the share of not organized trade (open markets, kiosks, not chained stores) is very high. The majority of stores are operated by local players such as Fozzy Group, ATB Market, Furshet and Velyka Kyshenia. Among foreign retailers, the key player is Auchan that is operating from 2008 in Ukraine and already opened 8 stores in major big cities. Other foreign investors are Rewe with its Billa outlets, followed by a tiny network of Perekrestok stores (X5 Retail Group) and SPAR outlets. Having a relatively limited quantity of stores Rewe is set to speed up its expansion and open around ten stores each year, predominantly in towns with over a million inhabitants. X5 does not plan any Perekrestok openings and may even divest from Ukraine, whereas SPAR intends to expand across the country through its franchisee.

Neighborhood stores are of immense importance to the national food supply. These outlets are usually supplied by thousands of regionally operating, small-scale wholesale businesses. Neighborhood stores are mostly Soviet-style outlets operated in a quite outdated manner with old equipment and no modern approach to marketing and merchandizing. METRO Cash & Carry Ukraine is running its Trader Support and Partnership program to help its professional Trader customers to develop their corner shops in line with the modern retailing standards.

Ukraine still has a relatively low quantity of hypermarkets and within the crisis 2008–2009 years it was majorly supermarkets and neighborhood shops that continued the expansion. According to Nielsen in 2010 the major numeric growth was displayed by the minimarkets channel.

The format which has become more and more popular within the recent years is the so-called discount store or economy supermarket which

Formats of modern trade



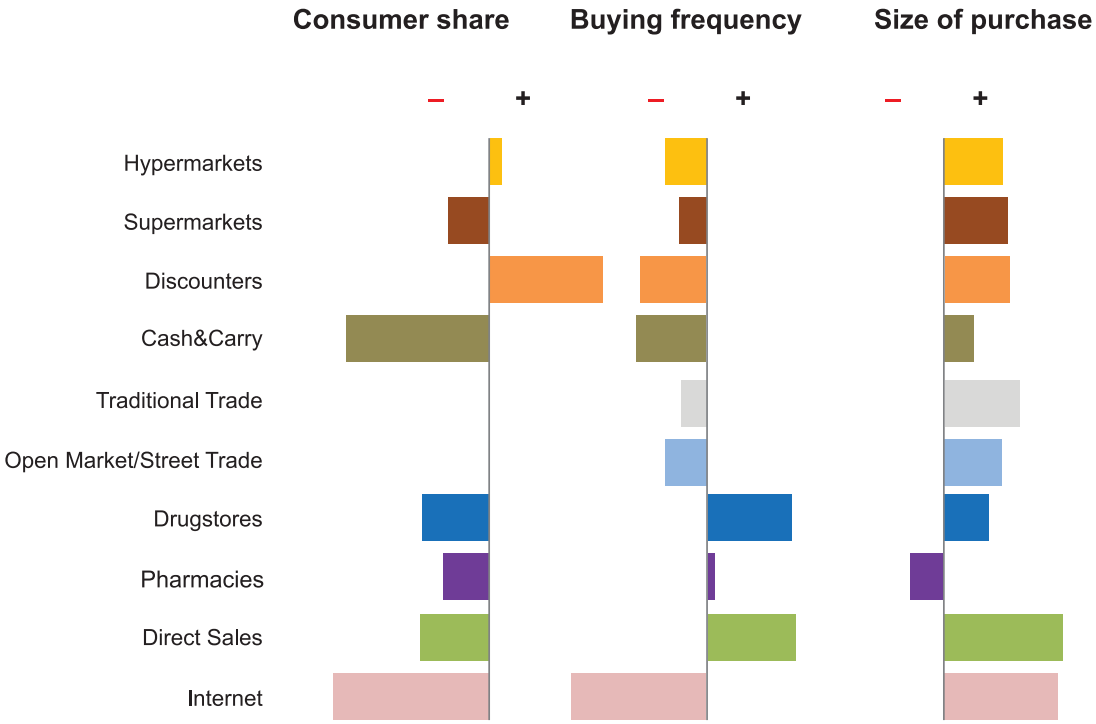
Source: Nielsen Ukraine

is actively developed by the market leaders Fora (belongs to FOZZY Group) and ATB Market. According to GFK research discounters become more and more popular increasing the quantity of customers and the volume of the purchase.

The financial crisis has stimulated the retailers to develop new store formats and react to the regional needs more flexibly. In 2010–2011 almost all the key market players continued their expansion. According to the GT Partners in 2010 Ukrainian grocery retailers opened 245 new stores and within the first half of 2011 there were 177 more stores opened. The leader in expansion is ATB Market that in the first 6 months of the year opened 36 new discount stores mostly in the Eastern Ukraine.

In the cash & carries segment there's a clear market leader METRO GROUP which is committed to continue the investment to the country planning to open up to 20 more stores investing 1 billion UAH by 2013. METRO Cash & Carry Ukraine has as well started to develop smaller format — METRO Baza — opening two new stores in Western Ukraine in 2011.

Along with the expansion in 2011 there has been market drop outs. In summer 2011 the regional hypermarkets operator Rainford from Dnepropetrovsk decided to leave the Ukrainian retail market, selling or leasing some of their stores to FOZZY Group.



Source: GFK Ukraine

4. Future of the market

Although due the effect of the financial crisis and current economy instability Ukrainian retail market has lost its high attractiveness it still looks very potential with regard to the low share of chained retail trade and significant room for growth for the modern retail formats.

The big hope for Ukrainian economy overall and the retailing industry in particular is the coming EURO 2012 football championship that will be hosted by the country in June–July 2012.

If the country will be able to overcome economic instability, administrative barriers and low consumer spending retail market development might speed up. At the same time the market might see more merges and acquisitions due to the fact that small retailers face

more and more problems with their liquidity and access to funds and are forced to put their businesses up for sale. In the mid-term perspective the market would still be dominated by the local players but one can not exclude the interest on behalf of the Western retailers, especially when they will explore the neighboring Russian market's potential to the full.

Big potential for the Ukrainian retailers lies in the development of own brands. According to Nielsen Ukraine own brands sales share in Ukraine is on the level of 5,4 percent (Nielsen Key Accounts Index, Q1 2011) which is significantly lower than on developed markets of the European Union. At the same time own brands demonstrate high dynamics of sales growth which according to Nielsen Ukraine exceeds 64,2 percent (Nielsen Key Accounts Index, Q1 2011 vs. Q1 2010). According to Nielsen Ukraine in such popular food categories as sun flower oil, mayonnaise, ketchups, dried fish snacks the share of own brands is growing even in case when the prices are not lower than those of the A-brands. While in non food own brands are growing due to the lower prices.

The biggest growth is seen in those categories where the prices of own brands are significantly lower than that of the A-brands (up to 30 percent).

METRO Cash & Carry Ukraine is one of the market leaders in terms of own brands development having introduced its own brands in 2003 – from the very start of the operations in Ukraine. The wholesaler has over 2000 own brand articles under the 6 strategic own brands – SIGMA, ARO, H-line, HoReCa Select, Fine Food \ Fine Dreaming and Rioba. In 2011 METRO Cash & Carry Ukraine launched the unique own brand solution Rioba providing everything needed to operate a branded café – from high quality coffee to coffee machine, branded crockery and outfit for the staff. The first Rioba coffee bar was opened in summer in the biggest national airport Boryspil and the wholesaler plans to expand the concept.

Beer & Kvas Market Overview

1. Review of the Ukrainian beer market

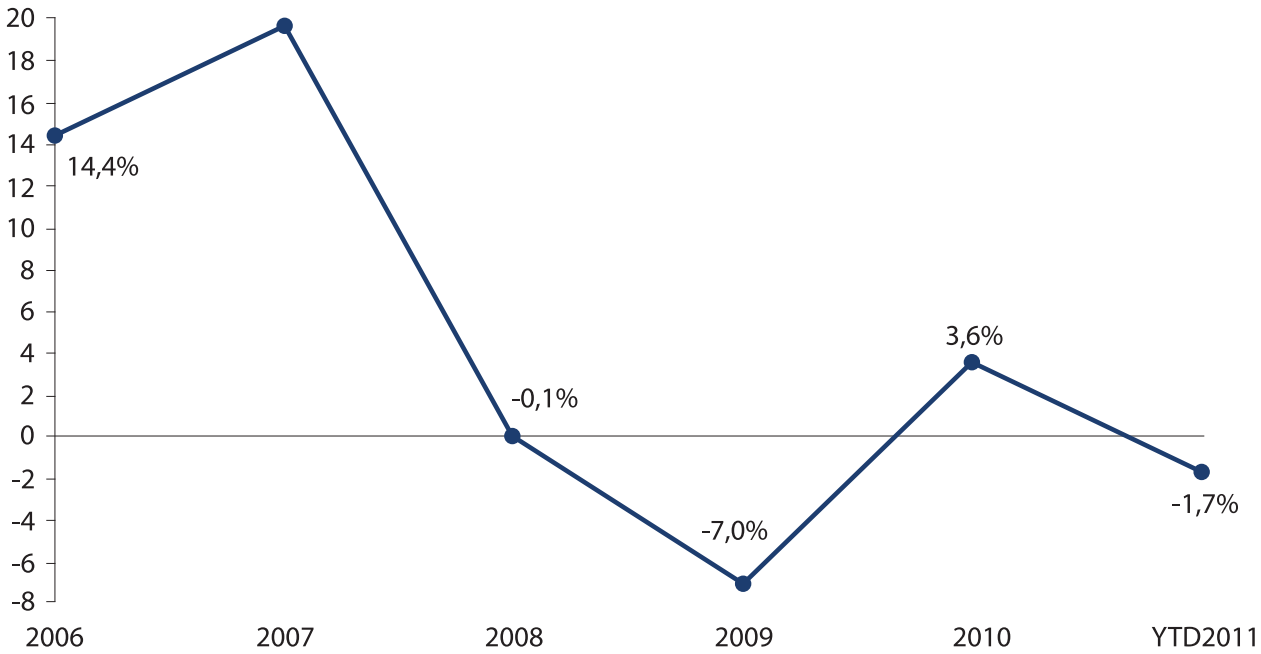
Since 2008, the beer market has been experiencing stagnation period. The first increase at the beer market was observed in 2010 — then the market growth made +3.6 percent. In 2011, it again experienced a drop at –1.7 percent.

Unfavorable weather conditions were one of reasons of the market drop. Besides, the market situation was affected by the growth of commodity prices, which was due to poor harvest.

Compared to last year, beer consumption per capita has not been changed. It was 57 liters of beer per 1 person as in 2009–2010, although, before the crisis, the number constituted 60 liters per 1 person.

In 2011, middle-price segment suffered the most. It has been showing decline over the last few years. At the same time, premium and lower middle segment continued to grow.

Dynamics of beer market 2006–2011, mln liters



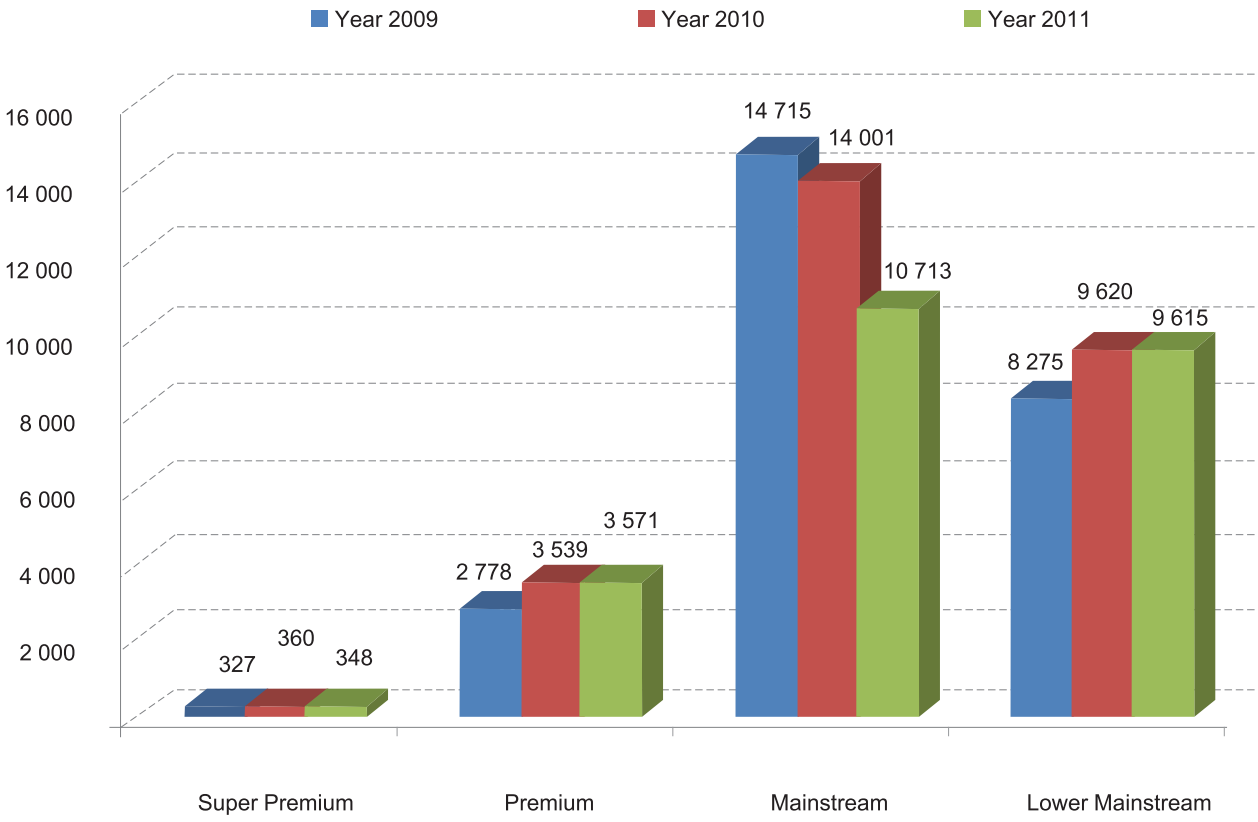
Source: analytical company AC Nielsen

Beer consumption per person

Year	2005	2006	2007	2008	2009	2010	2011
Beer consumption per person, liters	45	50	60	61	57	57	57

Source: inner data of Carlsberg Ukraine

Segments of beer market volume, KHL

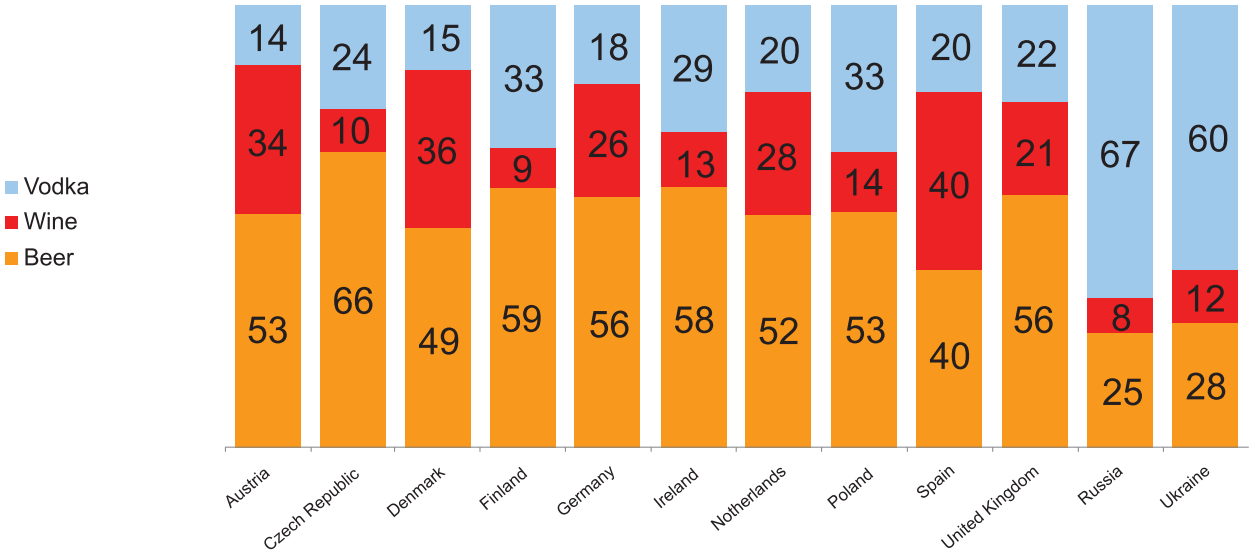


Source: Ukrbeer Association

In correlation of packaging, which consumers prefer, the situation has not changed since last year. According to internal data of Carlsberg Ukraine, consumer preferences for types of packaging can be evaluated as follows: 40 percent glass bottle, 7 percent – can, 11 percent – keg, 42 percent – PET (plastic bottle).

In Ukraine, people consume 13 liters of pure alcohol per capita, which makes 60 percent of vodka, 12 percent of wine and 28 percent of beer. These figures almost coincide with neighboring Russia, but there both volume of alcohol consumption per capita and the share of consumption of vodka are much higher than Ukrainian indices. Comparing with the data of European countries, we can conclude that uneven structure of alcohol consumption leads not only to excessive alcohol consumption in the country, but also to mortality growth due to alcohol consumption (unfortunately, according to this indicator, both Ukraine and Russia are the leaders).

Structure of alcohol consumption in 2009, percent of pure alcohol consumption per capita



Consumption per capita (liters)												
Alcohol in 100% ethanol	10	12	10	8	10	9	8	8	10	9	18	13
Beer	109	159	93	85	107	110	73	90	79	81	70	58

Source: Euromonitir, Canadean, Carlsberg, Business Analytica

One percent of absolute alcohol in beer for the domestic consumer is much more expensive than in vodka – this ratio is one of the largest in Europe.

In 2011, there was increase of the beer price up to 12 percent. The main reason for this growth was the increase of commodity prices (particularly for barley) and increase of the tax on hop growing. Currently, retail price of beer in Ukraine is on the level of Middle European prices, at the same time vodka price is one of the lowest in Europe.

In 2011, the brewing industry faced with increasing duty on hop-growing from 1 percent to 1.5 percent of company's turnover.

In 2012, the brewing industry will face a number of legal constraints that will have a strong influence on the industry. Thus, already from January 2012 there will be a significant increase in tax on the use of water resources, 17.9 percent, to 30.18 UAH.

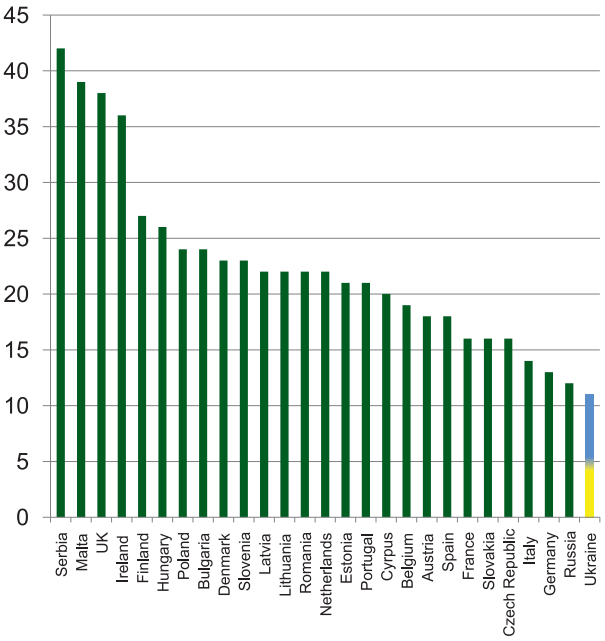
In addition, the expected increase in excise tax of 9 percent, respectively, from 0.74 UAH per 1 liter of beer to 0.81 UAH.

In comparison with countries, Ukraine ranks 11th in volumes of beer sales.

1.4 percent of global beer volumes are sold in Ukraine.

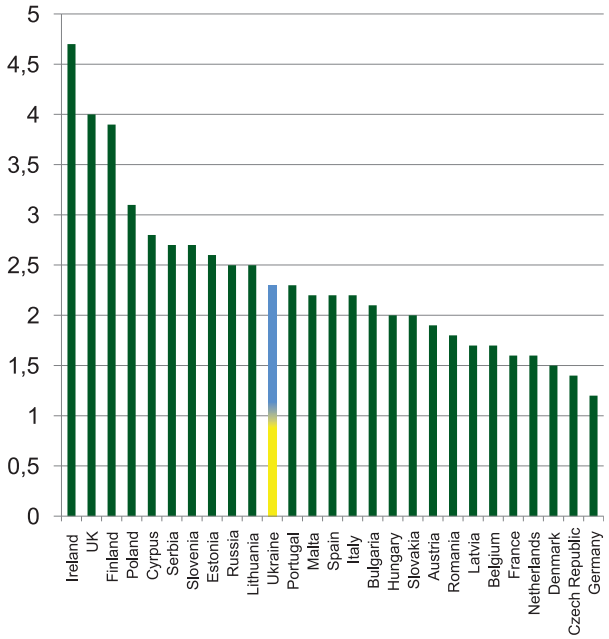
The Ukrainian beer market among the major players, there are three acting foreign companies: AB InBev (1 place); Carlsberg Ukraine (2nd place); SABMiller (4th place), and local company – "Obolon" (3rd place).

Retail price of vodka per liter /USD (purchasing power parity)



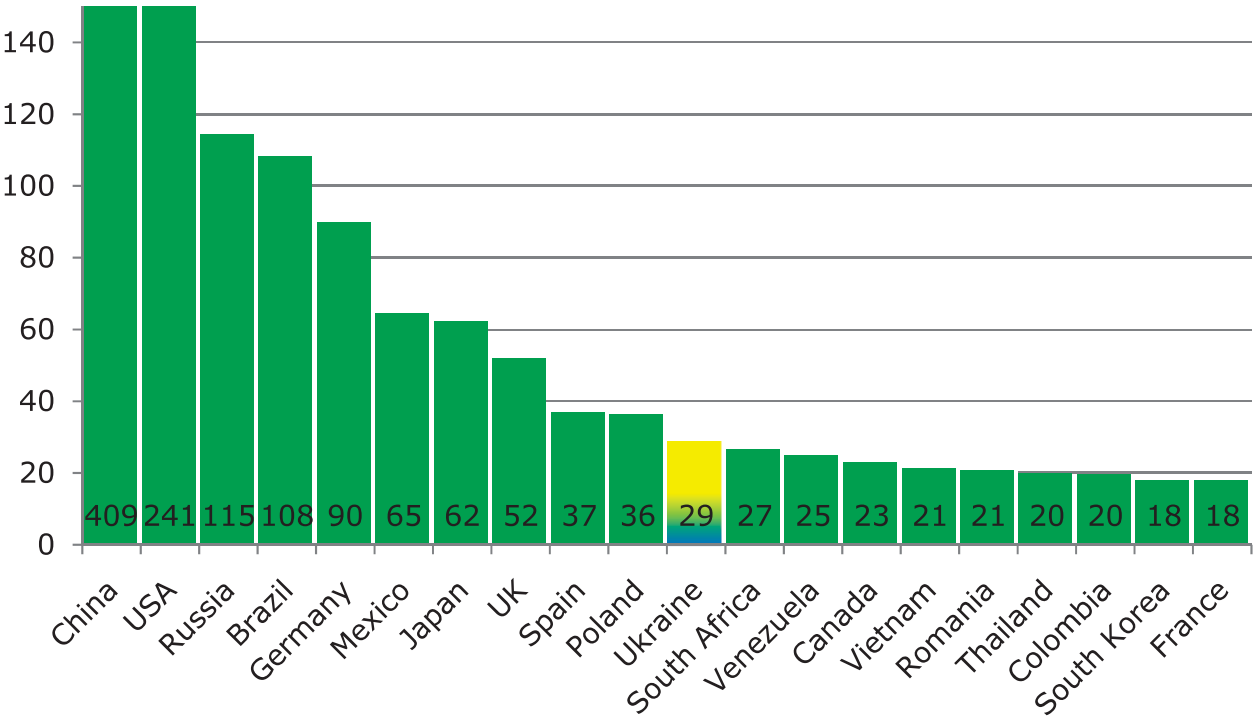
Source: "Review of brewing industry market in 2010", PWC

Retail price of beer per liter /USD (purchasing power parity)



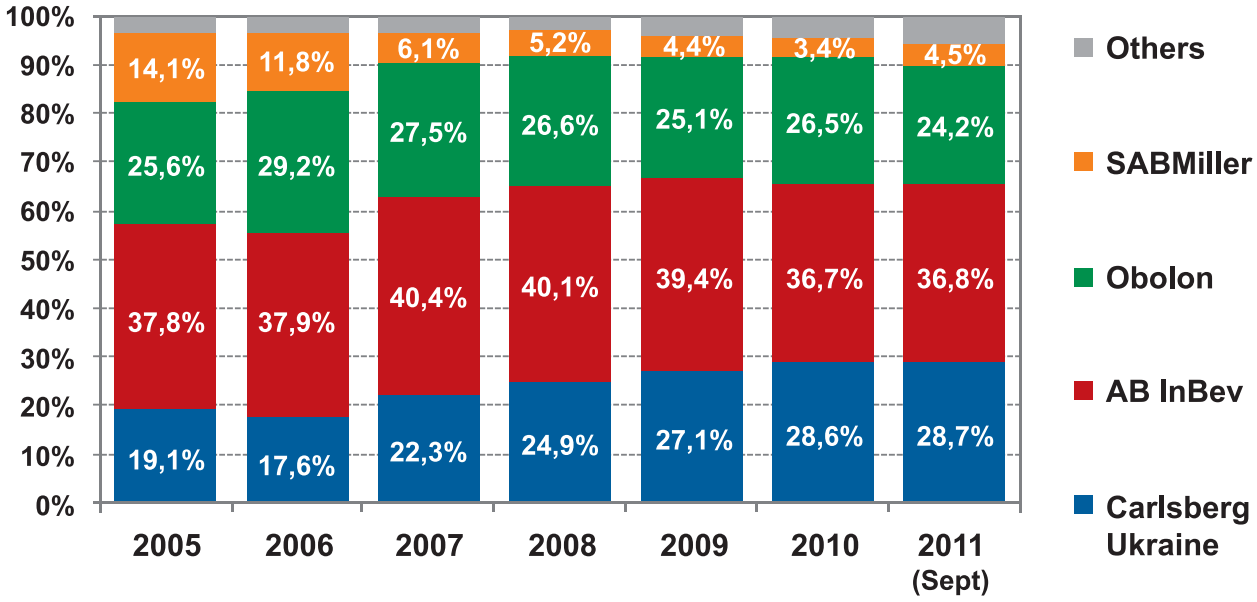
Source: "Review of brewing industry market in 2010", PWC

Volume of European beer market in 2010, KHL



Source: Ernst&Young

Share of the major manufacturers on the beer market in Ukraine



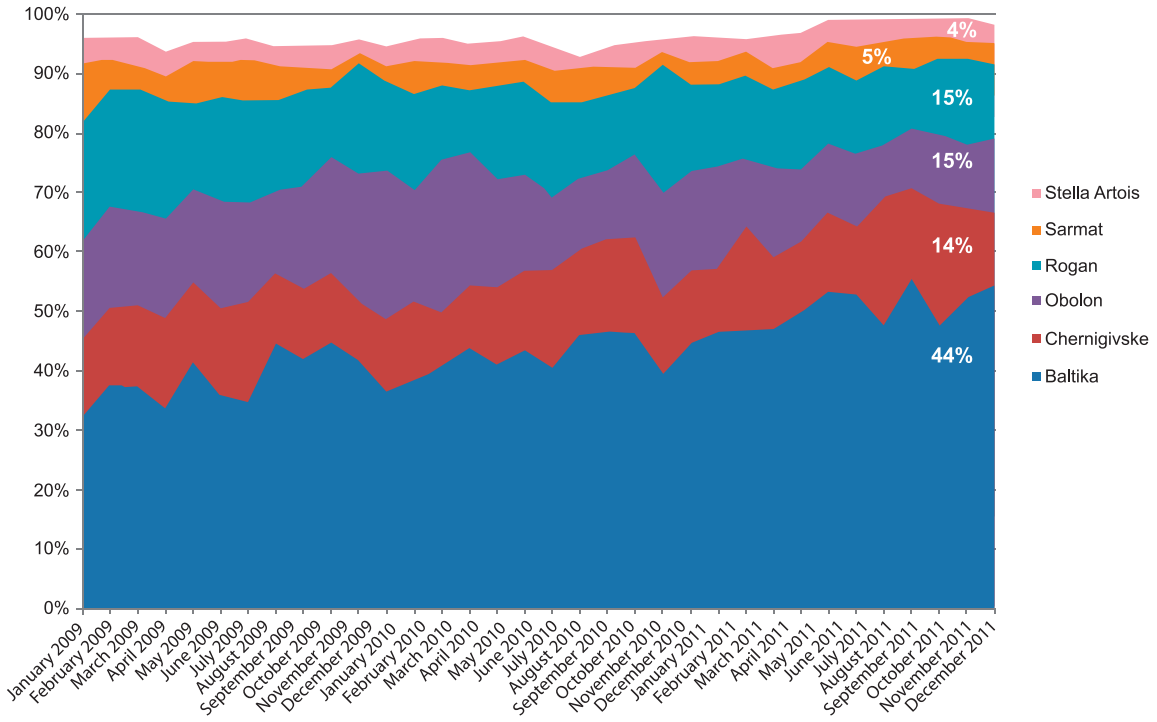
Source: AC Nielsen

Distribution on segments of the major players on beer market

Segment	Share
Superpremium	1.4 %
Premium	14.9 %
Middle priced	44.1 %
Low priced	39.6 %

Source: Ukrbeer Association

Non-alcoholic beer (NAB) market in Ukraine



Source: Ukrbeer Association

2. Review of kvass market in Ukraine

Kvass market in Ukraine is currently still in the process of formation, and repeats development of beer market, which was observed 10 years ago.

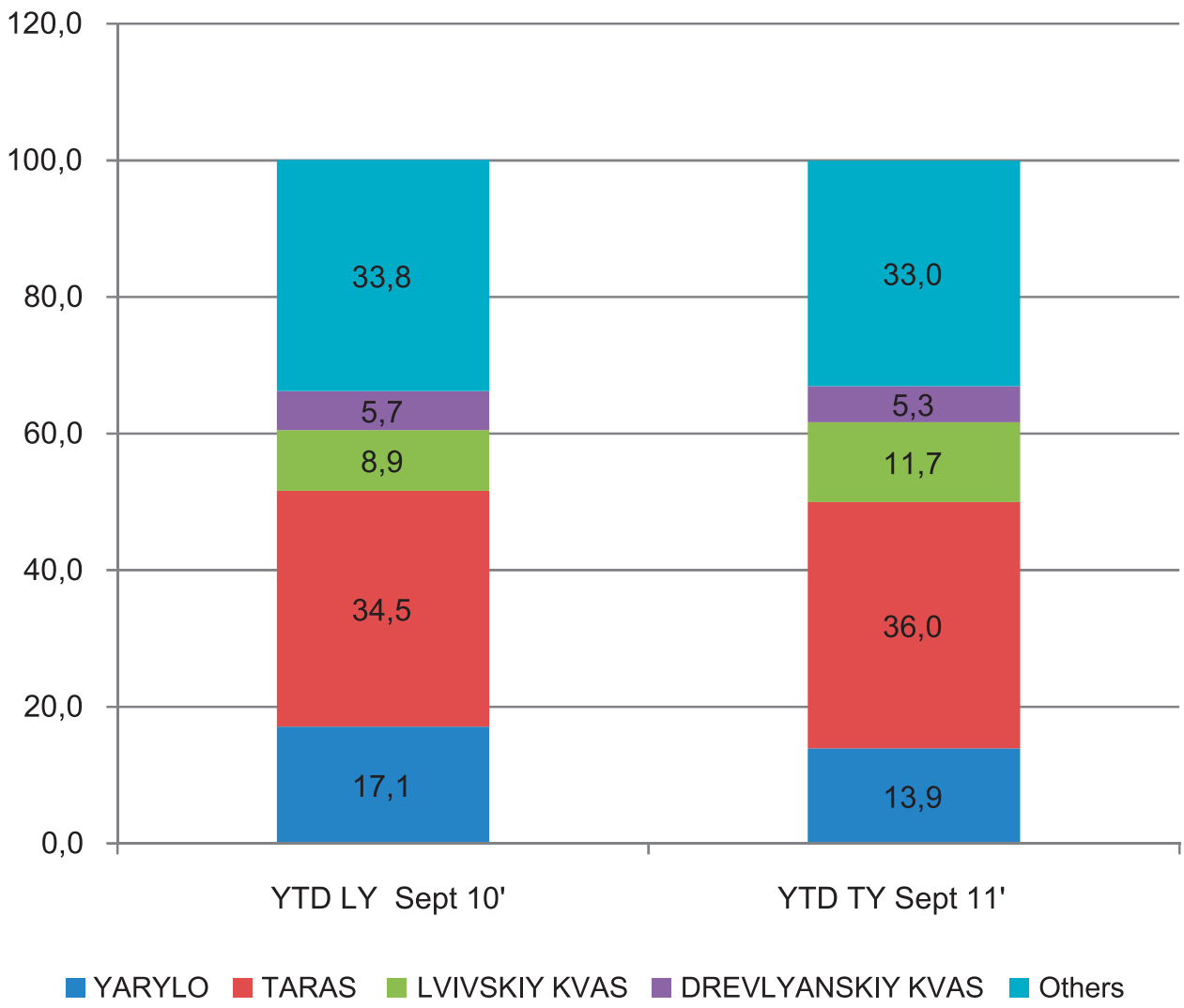
In 2011, kvass market decreased by 16 percent, which should be associated with adverse weather conditions in summer.

Despite this, kvass market in Ukraine has great potential because trend of healthy lifestyle is gaining popularity in Ukraine. Kvass is a drink of natural fermentation, production of which does not imply using any preservatives, flavors or substitutes. It is totally natural product made from 100 percent natural ingredients.

The current market volume of kvass is 122 million liters. In other words, Ukrainian people consume about 2.6 liters of kvass per capita per year, while in Russia people consume 3.2 liters, and in Belarus – 6.4 liters. In the Soviet Union people consumed 18 liters, which indicates the potential for market growth in the future.

Kvass market is becoming more structured, proportion of small, regional players is reducing.

Kvass market by volume:



Source: AC Nielsen as of September 2011.

5. FUEL AND ENERGY

Electricity Sector of Ukraine

The Ukrainian energy sector infrastructure is extremely high (up to 60—80 percent[1]) depreciated.

Sizeable lack of investments into the networks development made the energy sector unreliable which causes low quality of supplied electricity and customers' low satisfaction. On the other hand, distribution companies' (DistCos) networks being designed and constructed in 1960th and 1970th (more than 40 years of operation) cannot meet constantly increasing demand for new capacities, thus, DistCos became a limiting factor for industry and business development. Energy sector is required to be at least two years ahead of other industries in its development to fully meet the consumption (capacity) needs.

An effective tool attract investments into the ageing networks' development is an incentive regulation directed on (i) stimulation of investments, (ii) improvement of the quality of provided services and (iii) constant improvements of efficiency of DistCos' operations. Stimulating or incentive tariff regime (RAB-regulation) is the best practice in tariff regulation for the electricity distribution networks, water supply, communication systems.

The so-called RAB-regulation was first used in Great Britain at the end of 1980's during the electricity network privatization and electricity market liberalization. It proved to be highly effective as energy companies reduced costs and increased investments into the network utilities. In the middle of 1990's Canada, the USA, Australia and some countries of Western Europe started to adopt incentive regulation practices. In 2002 Eastern European countries switched to incentive tariff regime. Also in 2011 the transfer to RAB was completed in all Russian electricity distribution companies.

In 2005 the detailed recommendations on pricing reform in Ukraine were provided to the National Electricity Regulatory Commission of Ukraine by KEMA Consulting GmbH supported by the European Bank for Reconstruction and Development and the World Bank. The benefits of the incentive regulation implementation in the Ukrainian energy distribution sector are:

- promotion of capital investments into networks development;
- stimulation of metallurgy, engineering and construction sectors development as more than 90 percent of DistCos's construction materials suppliers are Ukrainian based;
- constant improvement of service quality;
- significant increase of DistCos availability to meet constantly growing demand for capacity, thus industries and small business development;
- jobs creation and higher employment, increase of people welfare;
- promotion of higher taxes to state budget and others;
- incentives for energy efficiency.

However, the incentive tariff regulation is still not implemented.

1 *President's program of economic reforms for 2010–2014, page 57*

The important obstacle of the stimulating tariff regime approval is the cross-subsidizing practiced in the Ukrainian energy distribution sector. Retail tariffs for households are currently set disregarding the principle of real energy cost recovery (electricity generation, transmission, distribution and supply). During 2006–2010 the Ukrainian households' tariffs remained fixed. Approved back in 2006 the households' tariffs covered 60 percent of the economically justified level. In 2011 the covering level reached the threshold level — 28 percent of the economically justified level. Such pricing distortion causes huge cross-subsidies in energy sector. The difference of real energy cost and the price that is paid by households is covered by industrial customers and at the same time effects the DistcCos' working capital deficit.

The growth of actual consumption by the Ukrainian households by 10 percent in 2008–2009 (financial crisis!) shows that the households have no incentives for energy efficiency. EU member-countries and Post Soviet countries have an average households' electricity tariff of around 5–6[2] times higher than the Ukrainian level of tariffs.

Current system of cross-subsidies makes pricing in energy sector nontransparent and unpredictable, at the same time it is a strong constraint for new electricity market model implementation — bilateral agreements and balancing market.

The way to abolish the cross-subsidization system is to bring households' tariffs up to the economically justified level. Recent increase of electricity tariffs for households in February and April of 2011 failed to have any substantial impact on covering economically justified level as the tariff covering level increased only by 1 percent. Estimations show the required 4 times increase of currently fixed households tariffs in order to reach the sound level which will:

- stop shifting cross-subsidies on industrial and small business customers which will improve the competitiveness of Ukrainian goods on international markets;
- stop negatively effecting the DistCos' working capital;
- give a possibility to implement new market model — bilateral agreements and balancing market;
- bring strong incentive for energy efficiency by residential customers;
- give an opportunity to implement incentive tariff regime and increase investments into the sector;
- improve the system of targeted social assistance to low income population strata.

Ukrainian legislation does not settle the process of new connections to the grid which creates constraints for new business development and renewable generation construction — without connection to the network new business or renewable generation will not functioning. The way to resolve such lack in legislation is to adopt the Connection Rules and Connection fee methodology.

Ukrainian government recognizes problems in energy sector and solutions of all problematic questions are reflected in the official President's program of economic reforms for 2010–2014[3].

Unfortunately, declared plan of reforms is delayed in implementation which exacerbates the current problems of the energy sector of Ukraine. Thus, implementation of the full scope of declared reforms is vitally important for energy sector and Ukrainian economy in the whole. Success in reforms will bring the sector to the new stage with prospects of further energy independency, efficiency and conservation.

2 *ERRA data*

3 *http://www.president.gov.ua/docs/Programa_reform_FINAL_2.pdf*

Securing the Land Rights and Implementation of the Alternative Energy Projects

BEITEN BURKHARDT

Dr. Oleksiy Feliv, LL.M.
Partner
BEITEN BURKHARDT Attorneys-at-Law

For over the last two years, development of the alternative energy projects has become a new and extremely dynamic sphere of energy industry that is of intense interest for both foreign and Ukrainian investors. Development in the sphere was accelerated after supplementation of the Law of Ukraine "On Electric Power Industry" in April 2009, with a new Article 17–1 promoting the electricity generation from alternative sources. Not any alternative energy projects appear to be potentially attractive at that, but rather those which are specifically promoted by the law. Such promotion lies in so called "green"[4] tariff applicable to electricity generated from the alternative sources. The green tariff rates apply to the electricity generated from the wind, biomass, solar radiation or water energy (provided that the hydropower plants are up to 10 MWt). Taking into account the legal restrictions on the capacity of hydropower stations as well as limited nature of biomass plants, wind and solar plants enjoy the main industrial significance and are therefore prime targets for investment.

Whereas the size of land plots for solar plants remains rather moderate (on average, 10 hectares), land sites for wind farms may extend up to 1–5 thousand hectares. Areas with the best potential for wind farms and solar plants are mainly located in southern regions of Ukraine. The majority of these areas are paibased (privatized and shared) agricultural lands. Alienation or change of the designated use of such lands is prohibited by a moratorium pursuant to section 15 of the Transitional Provisions of the Land Code of Ukraine. To avoid the moratorium, a number of alternative instruments for acquiring (securing) such lands have been elaborated and partially implemented in practice.

Below are the most common schemes for implementation of the alternative energy projects.

1. Securing land plots by servitude agreement

It is a common practice, especially in the Autonomous Republic of Crimea, that servitude agreements secure land plots for wind farms or solar plants. Though as to Ukraine, the land servitude is a comparatively new legal phenomenon; in the context of the history of law, the land servitude is one of the oldest legal institutes, dating back to the ancient Greek

4 *Pursuant to the effective laws, the "green" tariff is a special tariff applied for purchase of the electricity generated by the plants using alternative energy sources (except for the blast furnace gas and close-burning gas, and if a use of hydroenergy — only those generated by small hydropower stations up to 10 MWt).*

or Roman law. Most likely, two thousand and a half years ago, a Roman lawyer would reply undoubtedly in the negative to the question, whether a building, facility or wind farm could be built on the basis of a servitude agreement, since that would contradict the nature of the servitude. The same reply must be also given by the Ukrainian lawyer nowadays. Pursuant to Article 98 of the Land Code of Ukraine, land servitude is the right to restricted use of another's land plot. Thus, the main difference between a servitude and a lease lies in the restrictions over use. The restrictions of the servitude are caused by a third party's necessity to use another's land plot or real estate (for instance, such as a right of passage through somebody's land plot or the right of laying utilities through the land plot owned by another person). As a consequence, the servitude as a restricted right to use a third party's land plot is a certain auxiliary element, enabling the owner to exercise, in full, the rights arising out of the ownership to his/her own land plot. It would be more correct to define a servitude as a restricted right in rem to the land plot, which consists in the right to request the owner of the land plot to refrain from certain actions (installation of a fence on the land plot) or tolerate certain actions (allow passage through the plot or laying of utility lines), rather than the right to restricted use of somebody's land plot. It is not without a reason, that in the theory of the law we speak about so called "dominant" and "auxiliary" land plots. The auxiliary land plot is the land plot with respect to which the servitude is established.

Bearing in mind the above idea of a land servitude, in case of alternative energy projects, there exists both (i) the dominant land plot, owned by the project developer and which is dedicated for implementation of the project itself, and (ii) the auxiliary land plot, for which the restricted use rights are requested by the owner of the dominant land plot to enable project implementation on its own land plot. It is crucial that the establishment of the land servitude with regard to the auxiliary land plot should not lead to termination of the owner's right to use or possess the land plot. As an example, the construction of an access road to the wind farm through the land plot, which renders use of such land plot impossible, has nothing to do with servitude, since the construction leads to an exhaustive use of the land plot, rather than the restricted one. In such instances, the right of land lease, superficies, or ownership are appropriate.

With adoption of the Law of Ukraine "On Lands of the Energy Sector and Legal Regime on Special Zones for Energy Objects" it became obvious that a power plant cannot be built based on a servitude. Pursuant to Article 16 of the Law, fixed-term or permanent land servitudes may be executed solely with respect to electricity transmission lines and not with respect to the power stations.

In addition, the construction of power plants without changing the designated use of land is permissible in accordance with part 2 of Article 14 of the aforesaid Law only for construction of electricity transmission lines. The fact that servitudes are established on agricultural land plots does not resolve, therefore, the issue of compliance with the designated use of such land plots.

Securing land plots for the construction of alternative energy projects based on a servitude contradicts with the legal nature of a servitude as well as the new Law. At the same time, construction of separate elements of the power plant infrastructure (roads, transmission lines) is possible on the basis of a servitude.

2. Renunciation of the land plot

Pursuant to Article 140 of the Land Code of Ukraine, one of the grounds for termination of the right of ownership to a land plot is the owner's voluntary renunciation of the right to a land plot. The renunciation of the right of ownership does not fall under the moratorium pursuant to Article 15 of the Transitional Provisions of the Land Code of

Ukraine. The renunciation shall take place in accordance with Article 142 of the Land Code of Ukraine on the basis of an application filed by the owner of the land plot and the respective agreement with the state or local self-government body. At this point, the land plot becomes communal or state property. That being said, pursuant to part a) of Article 15 of the Transitional Provisions of the Land Code of Ukraine, the purchase or sale of the agricultural land plots in the state or communal property are not allowed, it is possible to lease such plots. Therefore, the land plots renounced by the owner may be referred to as "reserve lands", which may be let out on lease for implementation of the alternative energy projects.

In practice, the voluntary renunciation of a land plot is rather an exception. It is obvious that the owner will not renounce its land plot without expecting a compensation for such renunciation. In practice, compensation is an obligatory element of a renunciation and is paid on the basis of the respective agreements and the time of its payment is linked to the moment of renunciation and assignment of the right of ownership to the community or the state.

From a legal viewpoint, "voluntary" renunciation of the right of ownership, along with the compensation for such renunciation and subsequent transfer of the land plot to the person who paid the aforesaid compensation is arguably an illusory transaction. Pursuant to part 1 of Article 235 of the Civil Code of Ukraine, an illusory transaction is a deal made by the parties in order to conceal another transaction which the parties made in reality. In such instances, the "other legal transaction" is the agreement regarding alienation (purchase) of the land plot in favor of the interested party. Pursuant to part 2 of Article 235 of the Civil Code of Ukraine, if the transaction is made by the parties in order to conceal another legal transaction, the parties' relationships shall be governed by the rules applicable with respect to the transaction which the parties intended in reality.

Thus, the renunciation plus compensation should be classified as a purchase agreement which is invalid as of the moment of its execution due to the moratorium imposed by Article 15 of the Transitional Provisions of the Land Code of Ukraine.

3. Implementation of the alternative energy projects on the agricultural lands

An absolutely new trend in the field of allocation of the land plots is the execution of lease agreements with owners of pais and substantiation of construction of energy-generating plants without change of the land plot designation. For the substantiation Article 23 of the Land Code of Ukraine will be applied, according to which primarily non-valuable agricultural lands or agricultural lands of a lower quality can be appraised for construction of industrial enterprises, housing and communal buildings, railroads and motor roads, electricity transmission and communication lines, main pipelines, and for other buildings not related to the agricultural production. Correspondingly, the plan provides for change of the lands from the agricultural to the non-valuable agricultural[5], or declaration of such lands as the land of poor quality[6].

As a practical example for the implementation of a construction project on the non-valuable agricultural part of agricultural land plot, one

5 *Pursuant to the Law of Ukraine "On the State Land Cadastre", information regarding the land plots valuables should be introduced into the State Land Cadastre on the basis of the land respective projects.*

6 *Due to the absence of the legislative procedures for declaration of lands as the lands of poor quality, it will be proposed to ensure such acknowledgement via filing of A respective suit to the court. One may assume that the respective court award will be delivered. In such cases, it is obvious in our opinion that the court will take over the functions of the body responsible for determining the quality of the land. According to the court practice of the Supreme Court of Ukraine, it is not allowed for the courts to take over the functions of the respective state bodies, bodies of local self-government or the authorized enterprises, establishments or organizations, when resolving disputes.*

may look to the construction of hypermarkets. Such construction is indeed possible pursuant to the provisions of part 2, Article 22 of the Land Code of Ukraine, whereby the lands of the agricultural designation may be allocated to the wholesale markets of agricultural products for location of their own infrastructure, which may include a hypermarket for the sale of agricultural products. The transfer of the agricultural lands to non-agricultural companies is allowed pursuant to part 2 of Article 22 of the Land Code of Ukraine solely for auxiliary agricultural farm facilities.

It should be emphasized that Article 14 of the Law of Ukraine "On Lands for the Energy Sector and the Legal Regime of Special Zones for Energy Objects" provides for the possibility to construct on the only electricity transmission lines on agricultural lands. Correspondingly, the location of electricity generating plants on the agricultural lands is prohibited without changing the designation.

It is obvious that advocates of the idea regarding construction of the alternative power plants on agricultural lands without changing the designated use do understand the risk of having such construction declared a non-designated use of the land plot, which may lead to involuntary termination of rights (ownership or use) to the land plot pursuant to Article 143 of the Land Code of Ukraine. Opponents argue, however, that the risk is minimal in the case a power plant is constructed as a part of integral property complex of an agricultural enterprise[7] and that the risk is mitigated as of the moment when the object is built and the right of ownership is registered. Indeed, the fate of the real estate object located on the land plot to which the use right is determined, is not regulated by the Land Code of Ukraine. Simultaneously, demolition of a real estate object located on withdrawn land would violate the rights guaranteed by Article 41 of the Constitution of Ukraine. On the other side, the use of the land plot after withdrawal may be deemed an unauthorized occupation of the land plot. According to part 2 of Article 212 of the Land Code of Ukraine, arbitrarily occupied land plots may be brought into the original condition, including demolition of premises and buildings at the expense of the person who arbitrarily occupied the same. In any case, there is a real risk of ceasing operation of the power plant on the basis of the respective order from the state land inspector since the use of the land plot would be in violation with its designation.

In addition to the listed risks, it is doubtful that one will have the construction project approved, the state expertise passed and the green tariff obtained with respect to the power plants (which are industrial in their nature) located on non-valuable agricultural parts of agricultural lands.

4. Buy-out of lands for public needs

Pursuant to Article 15 of the Transitional Provisions of the Land Code of Ukraine, the moratorium on land transfers is not applicable when alienation of the agricultural lands takes place for a public need. According to Article 7 of the Law of Ukraine "On Alienation of the Land Plots, and Other Real Estate Objects Located Thereon…", a public need, includes, inter alia, construction and servicing of the energy infrastructure (electricity transmission lines, power plants). Thus, the land plots for construction of alternative power plants may be bought out from private owners. If the owners refuse to the buy-out, the respective land plots may be alienated on an involuntary basis by means of a court award, since in accordance with Article 15 of the aforesaid Law, construction of the transmission lines and power plants is deemed to be a public need. The priority of a public needs, in connection with the energy-related lands, over the private property needs is acknowledged by Article 3 of the Law of Ukraine "On Lands of the Energy Sector and Legal Regime of the Special Zones of Energy Objects". Article 14 of the

7 *In practice, it is hard to imagine that an industrial object — wind farm with the capacity of 200 MWt — is built "in the complex of an agricultural enterprise". On the opposite, there would be no objections, if an agricultural enterprise puts a wind turbine on the agricultural land in order to provide the farm with electricity.*

Law confirms the possibility of a buy-out of the land plots which are in private property, for construction of the energy-related objects pursuant to the established procedures.

It should be noted that allocation of the land plots for implementation of the alternative energy projects via their buy-out for public needs is a rather complicated and long-term process, which shall include participation of the district state administrations (as a rule, potentially attractive plots are located outside of the settlements and allocation of such land falls within the competence of the district state administration), which according to the effective laws enjoy exclusive rights to buy out the land plots for public needs, with their subsequent transfer to the interested person. As a rule, local state administrations have no funds to buy out such land plots and, in contradiction to the local self-government bodies, which are not allowed to use borrowed funds for such purposes. These are the main obstacles one may face by using the buy-out scheme for securing the land for alternative energy projects.

5. Conclusions

Despite the fact that the green tariff was introduced quite recently, practice shows that there is a considerable investor interest in this field. Given that any construction commences upon resolution of the land-related issues, it is no wonder that certain schemes have been elaborated in practice in order to secure land plots of the agricultural designation restricted by the moratorium. Nevertheless, results of the analysis of such schemes on their conformity to the effective laws are open to criticism. The only lawful, and, at the same time, the most complicated plan is the buy-out of such land plots for public needs.

It should be pointed out that, even when other schemes for securing the land plots may work out in the process of approval of a project, one should not forget that the prerequisite for securing funding for construction by a private or institutional investor entails a complex legal analysis of the respective documents. One should expect that such analysis should include evaluation of risks related to the non-conformity of the specific scheme with the effective laws, and, as a consequence, the investor's refusal to participate in financing such a project. Thus, prior to commencement of the project, one should decide, which scheme is to be chosen, giving due consideration to the related risks.

6. HEALTHCARE

Healthcare Policy Insights

2011–2012 Partnership for Successfully Competing in the Global Economy Report

During the 20 years of Ukraine's independence the life expectancy of Ukrainians at birth has deteriorated: from 70 years in 1990 to 68 in 2008, although it has returned to 70. Ukraine is the only country among its neighbors where this indicator in 2008 is the same as it was back in 2000. Moreover, Ukraine shares with Russia the lowest life expectancy value in Europe. It seems obvious that Ukraine's healthcare policy has to be significantly improved.

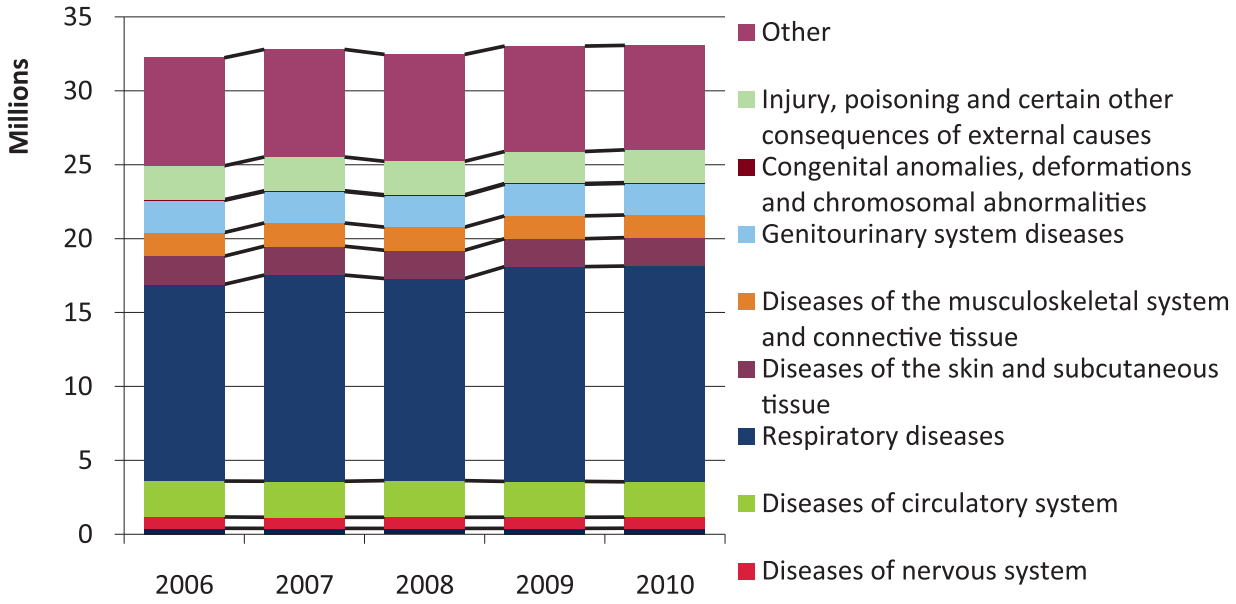
Reimbursement system and compulsory medical insurance system

Each year almost 33 million Ukrainians turn to hospitals for help. In up to 45 percent of all cases it is for a respiratory disease. Diseases of the circulatory and genitourinary systems, as well as injury, poisoning, and certain other consequences of external causes, each represent 7 percent of the total number of illnesses (see Figure 1). However, this figure does not make clear that in 2008 Ukraine was in 188th place out of 193 countries according to number of estimated total deaths per capita caused by cardiovascular diseases. In addition, Ukraine has the second highest percentage of HIV prevalence among adults aged 15 to 49 in Europe and the highest among the CIS countries; in 2009 it took 131st place among 145 counties in number of deaths due to AIDS, coming in between Ghana and China. According to the World Health Organization, Ukraine and Moldova were in 2009 the countries with Europe's highest numbers of deaths due to tuberculosis among HIV-negative people: 26 people per 100 000 population.

The market for medical services and the medical care system in general remain significantly underdeveloped. This is due, first of all, to lack of financing from state and local budgets and inefficient use of available funds. Moreover, the government's unclear vision and the lack of open discussion concerning a strategic plan for healthcare system development and declared reforms hold back sector competitiveness. While formally a country with free medical care, Ukraine remains the only European country without any reimbursement system in terms of expenses for ambulatory treatment and related medicines. This does not provide for the existence of facilities for improving quality of life or for increasing Ukrainians' life spans. We believe that step-by-step implementation of a reimbursement system on the basis of the experience of both post-communist countries and major world democracies will create the grounds for developing the system. Moreover, introduction of compulsory medical insurance should substantially improve the situation as regards financing healthcare.

The American Chamber of Commerce in Ukraine (Chamber) Healthcare Committee wishes to provide input into healthcare system reform that incorporates Committee members' expertise and experience from other countries.

Figure 1: The dynamics and structure of first-time registered diseases in Ukraine in 2010.



Source: State Statistics Service of Ukraine.

IPR and a transparent system of market authorization for medicines

Since 2008, when Ukraine became a WTO member, its legislation protecting the rights of intellectual property owners has developed significantly. This has been an important step towards the Ukrainian market's being competitive and attractive for foreign investors in the pharmaceutical and healthcare sector. In addition, the current market authorization (registration) system for medicines is acknowledged as advanced. Taking into account the recently announced plans to adopt the new version of the Law on Medicines, it is crucial to ensure a high level of intellectual property protection in the sector, the efficiency of enforcement mechanisms and the full transparency and efficiency of the market authorization system in the country. This protection should of course be in line with a modern approach to access to medicines and medical treatment, the sort of approach used in countries with market economies (which Ukraine has been for many years).

A transparent and efficient quality control system

Equal treatment and non-discrimination principles with respect to both locally produced and imported medicines should form the cornerstone of the quality assurance system for medicines in Ukraine. Despite numerous rumors that there is a significant amount of counterfeit products on the domestic market, there is no compelling evidence for that opinion. The role of the state as regulator, which is without a doubt very important, must in no case replace its role as a guarantor of the physical accessibility of medicines. Nei-

ther technical barriers to import nor unjustified bureaucracy or overregulation should start to characterize the Ukrainian market in terms of its quality control system. Moreover, increasing transparency in this sphere will strengthen Ukraine's competitiveness on global markets even more.

Medicine import substitution

There are certain risks to implementing an inadequate medicine import substitution policy for foreign pharmaceutical companies specializing in R&D based on the Draft Concept of the State Target Program "Development of Import Substitution Production in Ukraine and Substitution of Imported Medicinal Products by National, Including Biotechnological, Products and Vaccines" for 2011–2021. It is important that the program protect the intellectual property rights of foreign pharmaceutical companies and improve patients' health by guaranteeing their access to quality and safe medicines. The Draft Concept should exclude any possibilities for corrupt schemes in state procurement tenders and unjustified discrimination against foreign manufacturers.

The criteria to be applied in the governmental import substitution program are also important. Foreign companies are ready to provide price discounts at state procurement tenders; this document, however, does not provide for transparency in the realization of import substitution policy.

Draft Law #7412 "On the Amendments to Article 9 of the Law of Ukraine 'On Medicinal Products' Regarding Bringing the Registration Procedure for Medicinal Products into Correspondence with International Standards" (passed in the first reading on April 19th, 2011) indicated heightened government pressure on the import market for medicinal products.

It is important to include such terms as "data exclusivity" and "patients' rights" into the State Target Program.

There are also IPR risks involved in import substitution policy, in the plans for preferences for national medicine producers, in violations of GATT/WTO rules, etc.

The Chamber Healthcare Committee supports the idea of import substitution, which should be openly discussed and developed with the involvement of experts and all interested parties. In its current version, however, the Draft Concept does not protect the interests of patients or of foreign and Ukrainian pharmaceutical producers. It is important to establish a favorable climate for the development of a pharmaceutical market first. This is possible only after the adoption of the corresponding Law "On Medicinal Products."

The Chamber continues to follow the changes in the legislative and regulatory fields of healthcare policy. The members of the American Chamber of Commerce in Ukraine in conjunction with its partners are working to develop the comprehensive long-term policy position needed to improve healthcare in Ukraine – the pillar of the country's competitiveness.

7. HUMAN RESOURCES, LABOR AND EMPLOYMENT

Ukrainian Labor Market Overview: The Latest Trends

BRAIN SOURCE INTERNATIONAL
European standards of recruitment

This review will focus on the development of Ukrainian labor market in the post crisis year 2011. Throughout the year, Brain Source International recruitment experts have indicated the following trends:

- **Personnel demand increase** (compared to 2010 and the first quarter of 2011). One of the reasons – staff reductions during the crisis period, when some companies had to close down entire departments or regional network branches. Right now, as businesses are starting to feel more confident in a stabilizing environment and focus more on revenue growth than cost reduction, they demand more qualified personnel.
- **A growing trend to use social networks to look for personnel.** This trend appeared in 2010 and became very prominent in 2011. More companies are offering training services focused on effective usage of social networking tools.
- **Toughening employer demands towards a candidate's profile.** The companies are willing to hire professionals, who know all the job specifics in their industry field even before they are hired and are able to produce an outstanding result without additional training. Vacancies are mostly available to those already successfully employed in the demanded industry. This makes it substantially harder for professionals willing to change their field of specialization to try their hand at new activities. Today, fewer employers are granting development possibilities for newbies and inexperienced professionals.
- Willingness to invest in employee development. More and more organizations understand that it is less costly and more effective to invest in existing loyal employees than buy new talents.

Judging by the dynamics of candidate search requests, the sales in 2011 were most rapidly developing in FMCG, pharmaceutical, production, B2B and IT sectors. Speaking of highly demanded professionals, 2011 saw a stable demand for top-managers dedicated to creating and implementing the company strategy (most of all – general operation managers, logistics, marketing and business-development), and also sales specialists. The employee demand, instigated by the processes of sale and merges of some companies, was especially high on a pharmaceutical market.

As well as in recent years, the Ukrainian labor market shows a stable high demand for IT developers. The IT sector companies are ready to headhunt specialists or invest time and money in new prospective professionals.

To a certain extent, 2011 can be regarded as a season of hunting for blue-collar workers, especially in Western Ukraine, where there is a prominent presence of production companies with foreign investments.

At the same time, **the behavior of job applicants and prospective candidates underwent considerable changes.** Taught by the crisis, the candidates became more demanding in their search of an employer, the payment size is no longer the main attraction. More and more attention is paid to an organization`s stability, its history, image, and the level of success during the crisis. Also, the employees are more qualifies in terms of job search – they know how to impress a recruiter, and which character traits and professional competencies they have to demonstrate to become a successful candidate. Many feel free to ask for feedback after an interview, as well as for recommendations of how to become more interesting to their prospective employers.

Regarding the payment policy, there is a trend towards salary increase, but at the same time the compensation structure changes, its fixed part becomes larger. The salary expectations, as indicated by Brain Source International recruitment experts, have also increased, especially among industry professionals and managers. The latter are openly stating their salary demands and often speak of the linkage of salary increase/decrease to the results of the company activity. Regarding the currency preferences, euros, dollars and hryvnas are equally preferred.

Employers became more demanding towards candidates. Partly, due to concrete understanding of what kind of people they want to employ. The resume, besides an uninterrupted job list, should include the list of candidate`s specific achievements, preferably containing percentage and numbers. There is a growing trend to demand recommendations from the candidates` previous workplaces.

The year 2011 saw the growing rate of requests for personnel search via recruitment agencies. The employers are very deliberate in taking this course of action: the market is refocusing on revenue increases, and service functions are handed over to external providers.

Predicting the labor market dynamics of 2012 is rather complicated, because along with the favorable factors (such as consumer activity increase, investments due to the upcoming EURO 2012), there are also potentially disrupting ones such as political situation, a possible second wave of the financial crisis, etc. The most recent logical probability is that the labor market demand for qualified professionals will continue to grow.

The positive dynamics are likely to develop in agricultural sector, also in insurance (the latest trend of 2011), sales and IT sectors. The cities that will host Euro 2012 are likely to see the increase of demand for qualified HoReCa specialists.

Main Novelties in the Draft Labor Code of Ukraine

VASIL KISIL & PARTNERS
ATTORNEYS & COUNSELLORS AT LAW

Ms. Oksana Voynarovska,
Ms. Tetyana Ivanovych
Vasil Kisil & Partners Law Firm

New realities pose serious challenges for labor laws, which first of all need to find a balance between the necessity to protect the rights of employees and the necessity to ensure labor market flexibility and trigger an active social dialogue.

Apart from Poland, Ukraine is the only country among the Eastern European and Central Asian countries, which maintains in force the old Code of Labor Laws, the Code of Labor Laws of the USSR, dated December 10th, 1971 # 322–VIII (the "CLL of Ukraine"). Radical changes in the whole system of social relations that are taking place in Ukraine amid the formation of market relations and socio-economic transformations and more or less related to labor make it necessary to adopt a new codified legal instrument in this sphere.

According to the agenda of the ninth session of the Verkhovna Rada of Ukraine (the Ukrainian Parliament) of the sixth convocation, which will continue until January 13th, 2012, the Verkhovna Rada of Ukraine is planning to consider the Draft Labor Code under registration # 1108 (the "Draft Labor Code") in the second reading. This draft law is expected to be adopted at the current ninth session, i.e. in the nearest future.

The Draft Labor Code consists of **nine books**; each divided into separate chapters, and contains **444 articles**. For the first time in Ukraine's legislative history, the Draft Labor Code determines the **goals, objectives, and scope of regulation of the labor laws** (Articles 1, 2 of the Draft Labor Code).

The Draft Labor Code, similarly to the CLL of Ukraine currently in force, prohibits **the unreasonable refusal of employment** (part 1 of Article 31 of the Draft Labor Code). The Draft Labor Code upholds the principles of **prohibition of forced labor and the non-discrimination in employment**, including in respect of the suspected or actual HIV/AIDS disease (Articles 4, 5 of the Draft Labor Code). Part 2 of Article 4 of the Draft Labor Code expressly defines the notion of "gender discrimination".

It should also be highlighted that part 8 of Article 6 of the Draft Labor Code provides that **labor laws shall not apply** if any work is performed by an individual entrepreneur on his/her own; any work is performed by members of an individual farm at such farm; or if an individual is engaged in any work under a civil law contract. In addition, the Draft Labor Code permits the execution of a civil law contract with officials of business companies and in those cases where an individual performs his/her duties under a civil law contract that requires the performance by such individual of certain works for any other party to such contract.

The Draft Labor Code establishes the categories of foreign nationals who do not need **any employment permit**. Thus, part 6 of Article 20 of the Draft Labor Code assigns the following employees to such categories: 1) representatives of foreign maritime (river) fleet and foreign airlines that provide services to such organizations in the territory of Ukraine; 2) representatives of foreign mass media accredited in Ukraine; 3) actors and art workers to be employed in Ukraine in ac-

cordance with their professional qualification; 4) employees of emergency rescue services for performance of emergency works; 5) heads of representative offices of foreign business entities in Ukraine and chief executives of enterprises with foreign investment; 6) employees employed within and for the positions (areas of qualification) set out in a product sharing agreement.

One of the most significant novelties in the Draft Labor Code is introduction of **quotas for employment of persons in need of social protection.** Such quotas are set by local self-government bodies subject to approval by territory-based social dialogue authorities (Article 35 of the Draft Labor Code). The foregoing provision of the Draft Labor Code raises serious concerns since i) it introduces 5 schemes of quotas covering a wide range of employees, and ii) it envisages a single standard for employers without any regard to industry, region or company size.

Pursuant to part 2 of Article 38 of the Draft Labor Code, **employment relations arise**: 1) on the day the employee begins working according to an employer's order or permit; 2) on the day the employment begins according to an employment agreement (unless the employee concerned fails to begin working on such day due to his/her disease or for other valid reasons); 3) on the date set out in a court decision (if the court obliges an employer to employ a relevant employee).

Another new provision is part 2 of Article 39 of the Draft Labor Code, which provides that an employment agreement may be executed at any time before the beginning of employment. In other words, unlike the CLL of Ukraine currently in force, the abovementioned provision entitles an employee to enter into an employment agreement prior to his/her dismissal from his/her previous job.

Other novelties of the Draft Labor Code relate **to the content and form of the employment agreement**. Thus, Article 40 of the Draft Labor Code provides for the following terms and conditions of the employment agreement: 1) binding, 2) additional, and 3) other terms and conditions prescribed by applicable laws and by a collective bargaining agreement. Thus, as opposed to the currently effective CLL of Ukraine, the Draft Labor Code contains an exhaustive list of material terms and conditions of the employment agreement, failing which the employment agreement shall not be deemed executed. They, in particular, include the following terms and conditions: place of employment; effective date of the employment agreement; job duties, or profession in which the employee will work; remuneration conditions; work and rest time; occupational safety and health.

The Draft Labor Code provides that the employment agreement **must be made in writing** (Article 41 of the Draft Labor Code), which should surely improve the social protection of employees. However, as provided by the Draft Labor Code, the violation of this rule may not affect the already existing employment relations. Thus, subject to the foregoing provision and considering that, as stated above, the employment relations arise, in particular, on the date the employment begins, the actual admission to work is equal to the execution of the employment agreement, whether or not such agreement has been executed in writing.

Article 42 of the Draft Labor Code **classifies the employment agreements** into typical agreements, which shall be approved in the cases envisaged by law by a central executive authority in charge of employment issues and shall be legally binding, and model agreements, which shall be approved by a central executive authority in charge of employment issues and shall be advisory in nature. This novelty is hardly justified.

New provisions also include a **probation period for employment**. Thus, according to part 1 of Article 46 of the Draft Labor Code, the condition of probation shall be deemed approved if the agreement on this condition is set out in the employment agreement. Article 47 of the Draft Labor Code prohibits applying a probation period to the following additional categories of employees compared to the CLL of Ukraine currently in force:

- employees elected to a relevant position;
- winners of a competition to fill a vacant position and
- employees who completed training on probation outside regular working hours in their primary employment.

Meanwhile, it should be noted that unlike the currently effective CLL of Ukraine, the Draft Labor Code does not prohibit a probation period for disabled employees.

Furthermore, unlike the currently effective CLL of Ukraine, the Draft Labor Code provides a clear **list of documents to be submitted by a newly hired employee** (Article 58 of the Draft Labor Code). In addition to the passport, the employment record book and the education-related document currently required under the effective labor laws, the Draft Labor Code requires submission of the following additional documents: the application for employment (with the indication whether this will be full-time or part-time employment), the compulsory state social insurance certificate, the tax identification number and medical examination results (for some positions).

Like the currently effective CLL of Ukraine, the Draft Labor Code limits the scope of application of fixed-term employment agreements and provides that **fixed-term employment agreements** should be executed when respective employment relations cannot be established for an indefinite period of time.

In the employers' opinion, in view of the reforms currently underway in the global labor market, the Draft Labor Code should guarantee the right of the parties to employment relations to freely agree on the execution of a fixed-term employment agreement regardless of the grounds or the nature of the job. Meanwhile, since the limited scope of application of fixed-term employment agreements is one of the important guarantees of the employees' labor rights, the position of the Ministry of Social Policy of Ukraine and the trade unions on this issue remains unchanged. At the same time, a positive development is that Article 69 of the Draft Labor Code provides for an expanded and **clearer list of grounds for establishing employment relations for an indefinite period of time.**

The Draft Labor Code also provides for **an expanded list of grounds for terminating employment relations** with an employee, as compared to the currently effective CLL of Ukraine. Thus, such additional grounds are as follows:

- A gross violation of labor safety rules, fire safety rules or traffic safety rules (Clause 5 of part 1 of Article 104 of the Draft Labor Code);
- Disclosure of a state or commercial secret (Clause 2 of part 2 of Article 104 of the Draft Labor Code);
- **A violation by the director of the rules set by the founders** (Clause 6 of part 2 of Article 104 of the Draft Labor Code);
- The employee's absence from work, with no information available as to the reasons behind such absence, for more than four months (Article 108 of the Draft Labor Code);
- Decease of the employer (Article 113 of the Draft Labor Code);
- Death of the employee (Article 114 of the Draft Labor Code).

Evidently, such additional grounds for terminating employment relations as the decease of the employer and the decease of the employee are purely technical in nature.

The Draft Labor Code also introduces new rules governing the procedure for dismissing employees. Thus, it imposes **a ban on dismissal of employees while they are on a business trip** (part 2 of Article 116 of the Draft Labor Code).

Of great social importance are the provisions of Article 120 of the Draft Labor Code providing for the employees' **right to protection from unlawful dismissal.** Thus, in accordance with the said Article, prior to their dismissal, employees should first be given an opportunity to provide evidence of their level

of qualification, their work productivity, their diligent attitude towards the performance of their job duties, the legitimacy of their actions or omissions to act, and to give explanations regarding the committed violations or failures to properly perform their job duties.

The Draft Labor Code provides for the employers' **obligation to give references** at the employee's request in the event of his or her dismissal (part 1 of Article 125 of the Draft Labor Code), and **a ban on provision to any third parties of any information about the reasons behind the dismissal** or any other information about the employee (part 2 of Article 125 of the Draft Labor Code).

Unlike the currently effective labor laws (Article 11 and 14 of the CLL of Ukraine), the Draft Labor Code establishes **the principle of voluntary collective bargaining** in line with international practice. Thus, in accordance with part 4 of Article 349 of the Draft Labor Code, collective bargaining shall be mandatory if proposed by either party. Meanwhile, part 3 of Article 356 of the Draft Labor Code provides that the parties, who have agreed to enter into a collective bargaining agreement, shall execute it annually not later than February 1 of the current year. Therefore, Articles 349 and 356 of the Draft Labor Code allow the conclusion about the compulsory **annual execution of a collective bargaining agreement** regardless of the parties' will, provided that the parties agree to enter into such agreement at least once. And therefore, the legislators of the Draft Labor Code have failed to pursue the principle of voluntary collective bargaining to the end.

In the authors' opinion, **the term of a collective bargaining agreement** is, first of all, the prerogative of social partners, i.e. parties to the agreement, and therefore, it should be determined by them. The same conclusion is also supported by the International Labor Organization, which says in its comments to the Draft Labor Code that from a practical standpoint, it is not advisable to create a situation where every 12 months the parties inevitably find themselves in a conflict situation.

The Draft Labor Code radically **changes the legal status of the labor dispute commission**, in particular, out of the primary authority for consideration of individual labor disputes, **the labor dispute commission has been transformed into a conciliation body** set up for the purposes of "settling individual labor disputes through a search for mutually acceptable solutions and reconciling the parties to such disputes". The only authority authorized to consider individual labor disputes in accordance with the Draft Labor Code is the court, while the labor dispute commission performs only conciliatory functions.

In accordance with the Draft Labor Code, **the general limitation period for judicial recourse has been extended from three months to three years.** The limitation period for filing a statement of claim with the court against an unlawful dismissal has not been changed and is still set at one month. The same limitation period is prescribed by the Draft Labor Code for filing claims regarding transfer to another job or unlawful refusal of employment. In the authors' opinion, the positive novelty introduced by the Draft Labor Code is its provision saying that no limitation period shall apply only to the claims for recovery of accrued but delayed wages, and neither to any claims relating to labor remuneration (part 2 of Article 440 of the Draft Labor Code).

Subject to the foregoing, the authors believe that a majority of the novelties proposed by the Draft Labor Code will help to find balance between the interests of employers and those of hired employees. However, a complex analysis of the provisions of the Draft Labor Code allows the conclusion that Ukraine still has not shifted towards the radical reforms suggested by the international experience of labor law reforms, such as the alleviation of overly strict labor law requirements to simplify the procedures for hiring and dismissing employees, the extension of the term and the scope of application of fixed-term employment agreements, the provision of a variety of possible options for entering into employment agreements, the introduction of flexible work hours, and the introduction of apprenticeship wages.

8. INFORMATION & COMMUNICATION TECHNOLOGIES

Information and Communication Technologies Sector Overview

2011–2012 Partnership for Successfully Competing in the Global Economy Report

Information technology is an effective means of solving many social problems. It qualitatively determines new stages of economic, political, and socio-cultural activity. Moreover, the information and communication technology (ICT) sector offers huge opportunities for growth and investment.

The IT industry has been developing the most rapidly of all the areas of our social and economic life during the last 20 years. Ukraine has already become a fast-growing and recognized location for the IT outsourcing industry. Taking into account the importance and prospects for the development of this

Figure 1: Internet and major social networks penetration in selected countries as of Q2 2011, percent of population.

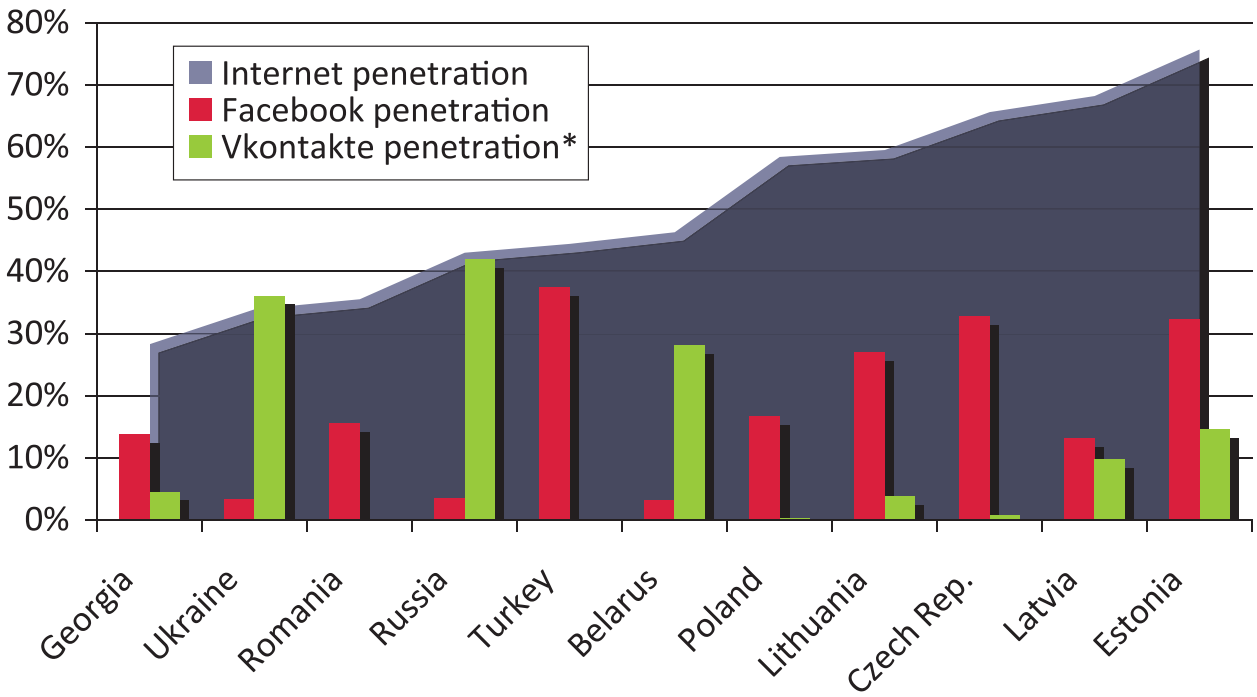


Figure 1: Internet and major social networks penetration in selected countries as of Q2 2011, percent of population.

** as of March 15th, 2011.*

sector, the American Chamber of Commerce in Ukraine (Chamber) IT Committee aims to enhance Ukraine's investment attractiveness in the regulatory and tax areas.

Ukraine has one of the highest growing Internet user communities in the region. The number of Internet users grew 76 times during 2000–2011. However, Ukraine remains one of those countries with the lowest levels of Internet penetration, with only 34 percent of population using the Internet. Ukrainian Internet users are very active in social networking in comparison to users in other nations in the region, which makes it possible to effectively use modern ICT in market related and e-government activities.

The Chamber is continuing to work on the further development of the Ukrainian ICT sector, which will provide a basis for socio-economic transformation, develop a functioning market economy, strengthen civil society, and promote the democratization of the Ukrainian state.

The Chamber monitors structural changes in this area on a regular basis. Over the first half of 2011 a number of positive developments in the ICT sphere took place.

Parliament, for example, in June 2011 adopted amendments to the Law of Ukraine "On Personal Data Protection" in order to strengthen responsibility for breaking the law. It does the following:

- Enhances conditions for the effective protection of personal data, and provides for the European concept of human rights and freedoms, by improving the balance between human rights, society, and the state in this area;
- Promotes information resource development, the strengthening of private ownership of information products, the provision of information sovereignty, economic prosperity, and national security;
- Enhances the ability to combat computer crime;
- Provides for the further development of the information society.

The Chamber is devoting special attention to this law and aims to achieve a balance between the rights of individuals and the interests of business.

The responsible governmental authorities are preparing draft laws that will significantly reduce the tax burden on companies in ICT. The Chamber is monitoring new legislative initiatives in this sphere and is continuing its ongoing dialogue with the Ukrainian government and business, with the aim of developing the most favorable tax regime for IT businesses.

It is very important for Ukraine to develop the ICT sector in line with global tendencies. The Chamber pays significant attention to developments in the EU ICT sector. The main concepts of the new Digital Agenda initiative of the EU, the i2010 strategy's successor, have to be implemented in Ukraine.

An essential role in ICT development in Ukraine will be played by e-government – a form of government in which there is active interaction between the state and local authorities, as well as with the information society, people, and businesses via information and communication technologies. This technology substantially increases the efficiency of government functions and can drastically decrease the midlevel corruption that is responsible for administrative burdens and excess transaction costs.

E-government is already functioning in all neighboring countries, providing much more comprehensive services to its users. Ukraine seems to lag behind in this process, which adversely affects its competitiveness. Taking into consideration the importance of establishing e-government, the Chamber is helping elaborate the Draft Concept of E-government in Ukraine for the period till 2015. The existing Committee on e-government within the FDIC under the President of Ukraine, on which the Chamber plays an active role, is also involved in this work.

Currently Ukraine is making significant progress in establishing an e-government system. Strong political will for moving in this direction has been expressed by top state officials. As the Head of the State Committee on

Science, Innovation, and Information reported in August 2011, the Ukrainian government will switch to using electronic documents in January 2012.

Considering all of the above, it is worth mentioning that ICT development in Ukraine will, first of all, contribute to Ukraine's European integration. ICT can also strengthen state information security, improve Ukraine's information environment, and avert the information wars and special operations that occur in other countries. The future of Ukraine depends on its ability to develop and implement public information policy, but this is impossible due to its lagging behind other countries in terms of technology and regulation.

The IT Committee, along with the Chamber's Telecom Committee, has become a collaboration platform for ICT businesses on both technical and business matters. The American Chamber of Commerce in Ukraine, having drawn on the experience of numerous experts and partners from the Public Council on ICT, has thus developed a comprehensive action plan for ICT development in Ukraine.

The 2011–2012 version of the "Partnership for Successfully Competing in the Global Economy" contains a special section entitled "The Role of ICT in National Competitiveness" that digs deeper into this subject and puts forward 10 concrete recommendations on how Ukraine can move forward in this regard.

9. INTELLECTUAL PROPERTY RIGHTS

Personal Data Protection in Ukraine: Legislative Innovations

GRISCHENKO & PARTNERS
LAW AND PATENT OFFICES

Protection of the interests of individual in the field of information is, in particular, includes the aspect of personal data protection which is relevant for any activity of an individual, society and the state generally. The understanding of the importance and necessity of an effective protection mechanism for the personal data affects well-being of an individual as well as of the state generally. The Ukrainian legislation, which regulates the legal relations in the field of protection of individuals' personal data is based on but not limited to the following legislative acts: the Constitution of Ukraine, the Convention for the Protection of Human Rights and Fundamental Freedoms of 1950", the First Protocol and the Protocols # 2, 4, 7 and 11 to the Convention, the Convention for the Protection of Individuals with Regard to the Automatic Processing of Personal Data and the Additional Protocol to the Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data regarding Supervisory Authorities and Trans-border Data Flows, the Law of Ukraine "On Information", the Law of Ukraine "On Access to the Public Information", the Law of Ukraine "On Personal Data Protection", the Law of Ukraine "On Amendments to the Certain Legislative Acts of Ukraine with Regard to Aggravation of Liability for the Violation of the Legislation on Protection of Personal Data" which will be effective since January 1st, 2012.

Thus, protection of the information about an individual is guaranteed by the Constitution of Ukraine. Section 2 of the Article 32 of the Constitution prohibits "gathering, storage, use and distribution of the confidential information about an individual without his/her consent, except the cases stipulated by the legislation and exclusively in the interests of national safety, economic well-being and human rights". Additionally, social relations connected with gathering, storage, use and distribution of information about an individual are regulated by the laws of Ukraine "On Information Protection in Software Systems" and "On the State Register of the Individuals – Taxpayers and Payers of Other Mandatory Fees", the Decree of the President of Ukraine # 12 as of January 11th, 2002 "On Measures in Connection with the Individuals' Registration".

Ukraine endeavors to harmonize with the standards of the European Union in the field of personal data protection. In this respect Ukraine made an important step having adopted the long-awaited Law of Ukraine "On Personal Data Protection" (hereinafter referred to as – the Law) which came into effect on January 1, 2011 and having ratified the Convention for the Protection of Individuals with Regard to the Processing of Personal Data and the Protocol to the Convention for the Protection of Individuals with Regard to Automatic Processing of Personal Data regarding Supervisory Authorities and Trans-border Data flows. The development of the draft Law "On Personal Data Protection" started in Ukraine in early 1996. However, the

draft in those times has not been adopted due to the major shortfalls. The adoption of the new Law and ratification of the Convention were aimed at approaching of the Ukrainian society to the European standards of informational protection, in particular, to the standards of protection of: personal data of individuals, harmonization of the Ukrainian legislation and bringing it into compliance with such statutory acts as the Conventions "On the Protection of Individuals with Regard to Automatic Processing of Personal Data" which was signed on January 28th, 1981 in Strasburg and the Directive 95/46/EU of the European Parliament and Counsel of October 24th, 1995 "On Protection of the Individuals while Processing of Personal Data and Free Transfer of Such Data". However, the adoption of the Law "On Personal Data Protection" gave rise to many discussions and disagreements around the Law. Some of its definitions allow quite a wide interpretation, thereby creating grounds for legal collisions. The problems which are currently raised by the individuals and legal entities engaged into personal data' legal relations are the following: scope of data governed by the Law; the criteria based on which information about an individual is defined as personal data; particularities and forms of granting consent by an individual for the processing of his/her personal data; legal grounds for third parties being entitled to use personal data of an individual, etc.

The Law defines the personal data of individual as any data or a set of data of any individual that lead or may have lead to the identification of the individual. The similar definition of the personal data is also granted by the Convention of the European Council "On the Protection of Individuals with Regard to Automatic Processing of Personal Data and Transfer of Such Data" dated October 24th,1995 (hereinafter referred to as — the Directive 95/46/EU). Article 11 of the new version of the Law of Ukraine "On Information" equates the definition of the personal data with information about an individual. The same article prohibits "gathering, storage, use and distribution of the confidential information about an individual without his/her consent except the cases stipulated by law and only in the interests of national security, economic well-being and protection of human rights". The following information is also pertains to the confidential information about an individual: "the data about his/her nationality, education, civil status, religion, health as well as address, date and place of birth".

Therefore, pursuant to the definition of "the personal data" the main criteria according to which information about an individual may be defined as the personal data are the following: "identification" or "possibility of identification". However, the law does not provide the definition of the wording "identification". The Directive 95/46/EU stipulates the following with regard to identification: "in order to establish whether an individual is the one which may be directly identified, it is necessary to take into consideration all possible factors which may be and will be most probably used by the owner of information as well as any third party for identification of such individual".

The Law also envisages the mandatory requirement for the registration of the personal databases[8]. Having analyzed the provisions of the Law we defined the following basic database criteria: title (a data base should have a name); plurality (a data base should contain personal data of more than one person); orderliness (personal data in a data base should be organized in some way); intended purpose (data contained in a data base should have a specific purpose of their processing).

The legislator clearly stipulated that consent of an individual for transfer of personal data is any documented, in particular, in writing, free declaration of will of an individual to allow processing of his/her personal data according to a formulated purpose of their processing. Therefore, the holders of personal databases[9] need to obtain a written consent of the individuals whose data is to be processed.

8 *A titled set of organized personal data in electronic form and/or in the form of personal data cards.*

9 *Personal database holder is an individual or legal entity authorized by law or by consent of the owner of a personal data for the processing of such data, which sets the purpose of personal data processing in corresponding database, composition of such data and procedures of their processing.*

Such consent may be executed as an unilateral instrument or a bilateral agreement and, for the avoidance of any possible claims of personal data subjects, supervising authorities or any third parties, it should contain the list of all types of processing of personal data[10], which are planned to be carried out as well as all types of data. If a personal database owner wishes to expand the list of actions with personal data and/or the purpose of such actions after a written consent is obtained, a written approval of such change should be granted by the owner of the personal data. The obligation to register personal databases as well as the execution of the state supervision for the legislative execution as for the personal data protection is imposed to the State Service for Personal Data Protection — the central body of the execution power, the activity of which is coordinated by the Cabinet of Ministers of Ukraine with the assistance of the Ministry of Justice of Ukraine.

Regardless to the numerous advantages of the abovementioned Law, it also contains some drawbacks and shortcomings which need to be eliminated. We consider that the Law of Ukraine "On Personal Data Protection" should be amended in order to stipulate the list of cases in which the state registration of personal databases is not required, in particular with regard to the following types of databases:

- databases containing only personal data of the individuals (employees) having labor relations with the owner of such personal database and which have been created exclusively for the purposes of exercising of labor relations between the owner of the personal databases and employees;
- databases obtained by the holder of personal database as the result of a legal agreement concluded with an individual (the owner of the personal data), in case when such personal data is used exclusively for the purposes of execution of such legal agreement;
- databases containing information from public sources.

We are of the opinion that it is necessary to expand the list of grounds for the use personal data, namely to amend to Article 11 of the Law the following grounds for the arising of the right to process the personal data of the individual:

- conclusion or execution or a legal agreement, a party of which is the owner of the personal data;
- necessity to protect vital interests of the owner of the personal data;
- necessity to implement governmental powers by the holder of a personal database or an individual to which personal data is disclosed;
- execution of a legal obligation by the holder of a personal database;
- obtaining of the personal data from public sources;
- processing of personal data is provided for statistical or other scientific purposes with the mandatory depersonalization[11] of personal data.

We are of the opinion that the written form of individual's (the owner of the personal data) consent for the processing of his/her personal data, which is the mandatory requirements of the Law significantly complicates the procedure of obtaining of such consent. Thus, the Law should envisage the possibility of obtaining of the individual's consent in oral form, for instance, with regard to employees databases kept by employers.

Therefore, summarizing the issues of personal data protection in Ukraine it is necessary to emphasize that the adoption of the special Law which regulates the issues of use and protection of individuals' personal data is a positive step. However, it is evident that aforementioned Law needs to be improved and amended in order to simplify the practical application of its provisions.

10 Personal data processing is any action or a set of actions with personal data connected with gathering, registration, storage, change, use, distribution, destruction, depersonalization of personal data, etc.

11 The exclusion of the data which gives the possibility to identify an individual.

10. INVESTMENT POLICY

The Most Promising Sectors for Investing in Ukraine

The most attractive sectors for investment at the moment are the following:

- Agriculture.
- The alternative energy sector.
- Retail.
- Pharmaceuticals.

Agriculture

Ukraine's agricultural sector makes up about 10 percent of the country's GDP and provides the population with 95 percent of its food, making for one of the highest rates in the world. Ukraine's agricultural products market has vast potential to grow in absolute numbers and to substitute many import positions.

According to UNO data Ukraine is among the three world leaders in terms of dynamics of agricultural production (after Brazil and Russia). The sector becomes even more attractive when we take into consideration the dynamic growth of food prices in 2010–2011 in the world as a whole and in Ukraine in particular.

5-year prospect:

- increase in internal consumption and export volumes;
- substitution of imports with domestic production;
- favorable conjuncture on the world markets over a prolonged period of time due to the increase of demand on the Asian market and due to the soft money policy of world central banks;
- improvement of conditions for enterprises' activity due to state support;
- increase of competition due to sector attractiveness;
- increase of competitiveness of domestic products compared to imported ones.

Sector risks:

- high competition from huge agricultural companies;
- unsolved issue concerning moratorium on selling lands.

Tax benefits for agrobusiness in Ukraine

Tax	Common enterprise	Agricultural enterprise
profit tax	23%	fixed agricultural tax (FAT) about 35–50/ha per year (3–5 EUR/ha per year) The Law of Ukraine "On fixed agricultural tax"
VAT	20%	0 percent an agricultural enterprise can choose a special tax regime The Law of Ukraine "On value added tax" According to the special tax regime, value added tax is not payable to the budget and remains in the full possession of the agricultural enterprise for operational purposes.
concessional lending	no	government budget every year provides funds to compensate a part of interest expenses on loans to the agricultural sector

We consider the agricultural sector of Ukraine to be the most profitable investment opportunity in the real sector at the moment.

We believe that in terms of investments/profits correlation, the most promising area in agriculture is poultry breeding and egg production. Next come pork/beef production and gardening. These are more cost-based types of investments.

Taking into account the high fertility of black soil in Ukraine, state support of agriculture, the considerable rise in grain crop prices in recent years, and the increasing world "food" crisis, which will push prices up, we see huge potential for grain growth and the growth of other cultures.

In our opinion the agricultural sector has huge room for growth, including full import substitution; domestic products, particularly ones that come from livestock, such as fresh meat, have considerable advantages over foreign ones.

Alternative Energy

On January 1st, 2009 Ukraine adopted a fixed "green" tariff for electricity produced from renewable electricity sources. The "green" tariff for enterprises that produce electrical energy using alternative resources of energy is fixed until January 1st, 2030.

The new Tax Code took effect on January 1st, 2011. According to it:

- manufacturers of electricity produced from renewable sources are exempted from income tax for 10 years (from January 1st, 2011 to January 1st , 2021);
- import of energy-saving equipment is exempted from taxes (VAT and customs duties);
- VAT will fall from 20 percent in 2010 to 17 percent in 2014.

In Ukraine, then, the most favorable conditions have been created for the development of the wind energy sector.

Considering all these factors, the payback period for a WPS construction project is 5–7 years, exactly in line with the benchmark for the European market.

"Green" tariff coefficients for different types of plants

Type of plant	Capacity, kW	Coefficient of "green" tariff	Fixed minimal amount of "green" tariff, EUR/kWh
wind power station	< 600	**1.2**	0.065
wind power station	> 600, < 2 000	**1.4**	0.075
wind power station	> 2 000	**2.1**	0.113
biomass	no restrictions	**2.3**	0.124
solar (land objects)	no restrictions	**4.8**	0.258
solar (installed on the roof of a house/building)	< 100	**4.4**	0.237
solar (installed on the roof of a house/building)	> 100	**4.6**	0.248
small hydro power station	no restrictions	**0.8**	0.043

"Green" tariff coefficients for different types of plants

Retail Sector

Retail is one of the most dynamically developing branches of the Ukrainian economy, contributing 16 percent to the GDP of the country. A rapid increase in personal income in the first decade of the new millennium promoted high rates of market development and the appearance on it of some big players. The financial and economic crisis of 2008–2009 struck the sector considerably, but also eliminated such problems as high prices for building land and high rents. Renewed growth in personal income in 2010 served as an impetus for economic redevelopment. The retail sector is exceedingly attractive for investment because the market is large and under-occupied.

Features of the Ukrainian retail market:

- the Ukrainian retail market is rather young and, as a result, is insufficiently filled in and formatted;
- in the big cities, the big grocery hypermarket niche is the least filled-in;
- e-retail is dynamically developing.

The retail sector in Ukraine is very young, leading to non-occupancy and thus to opportunities for investors. In 2010 prices for a wide range of food products increased in Ukraine (by 2–3 times); price increases for a range of other products were also noted. In the meantime, the actual volume of goods turnover increased (+7.8 percent).

The most unfilled segment is currently retail in big commercial centers. The range of big international players is unrepresented on the Ukrainian market, which is significantly weakening business. There are insufficient sales areas and the activation of home construction and the development of transport infrastructure before EURO 2012 are significantly increasing attraction of retail business.

Special attention will go to the non-competitive conditions outside the big regional centers. The most high-potential niches are food retail in the regions and e-retail.

The retail sector is considered to have a lot of potential due to an unfilled market, weak access barriers, and available growth potential.

Pharmaceuticals

The pharmaceutical industry plays a significant role in the Ukrainian economy, representing an important segment of the domestic market. During the last five years the industry has shown a strong upward tendency. Market size (medicines only) is around 2.4 bln USD.

The Ukrainian pharmaceutical market has grown rapidly for the last seven years. Almost all segments of the market have demonstrated double-digit CAGR rates, as follows: retail medicines – 25 percent, hospital medicines – 9 percent, PCS (patient care systems) – 21 percent, PAC (personal care products and cosmetics) – 110 percent, BAD (biologically active additives) – 73 percent.

Import. Foreign producers hold 74 percent of market share in money terms and 36 percent of market share in real terms. This discrepancy is explained by the high cost of import medicines, which creates unique possibilities for import replacement by domestic producers.

Distribution is highly concentrated among the top 10 companies, which have 80 percent of market share. Leading companies are demonstrating astounding growth.

Pharmacy market. As of January 1st, 2011 there were 22,123 valid licenses for medicine retail in Ukraine; such a license is obligatory for establishing a pharmacy. The licenses broke down as follows: 50.1 percent – pharmacies with a predominance of prescription medication; 34.9 percent – pharmacies with a predominance of over-the-counter drugs; 5.3 percent – pharmacies in hospitals; 9.6 percent – supermarket pharmacies. Notably, the share of supermarket pharmacies is growing rapidly, especially in the capital.

Conclusions:

- the pharmaceutical market is one of the most secure (protected) markets in conditions of crisis. Demand for medicine doesn't fall significantly. The Ukrainian population doesn't save on medicines;
- there are big opportunities as far as goes replacement of imported high-cost medicines;
- supermarket pharmacy chains are rapidly growing. They represent the most high-potential segment of Ukraine's pharmacy market.

INDIGO
Insurance Company

NATURE OF RENEWAL

Naberezhno-Khreshchatytska Str., berth 4, "DNIPRO PLAZA" Business Centre
04070, Kyiv, Ukraine, tel.: (044) 200 04 04, fax: (044) 200 04 05

Certificate of registration of financial institution ST series № 42, № 11101673 from 28.07.2008 year

10. LEASING

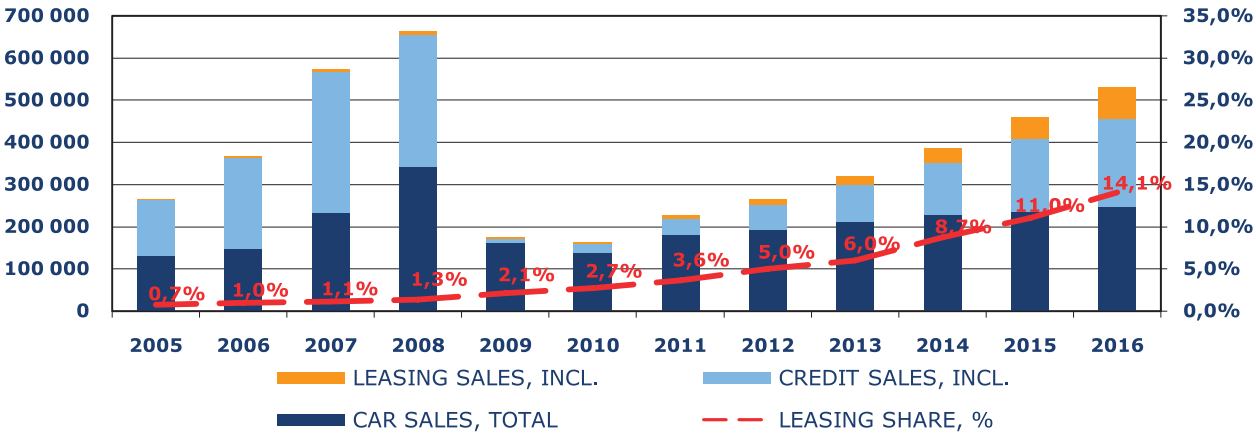
Leasing Market: Overview and Trends

EURO LEASING European financial service

Today, the leasing market is the third largest segment of the Ukrainian financial services market by the size of its assets, after banking and insurance. At the end of 2011 it is expected that the volume of the leasing portfolio (financial leasing) will have reached 35 billion UAH, showing 14 percent growth for the year. New leasing business has increased in comparison with 2010 by more than 140 percent. We thus expect a volume of new leasing contracts of more than 11 billion UAH. There have been significant results for the third quarter of 2011 — contracts were concluded amounting to 4.4 billion UAH (equaling 2,828 leasing agreements). These figures hold 3rd place in the rating of the quantity of contracts and 4th place in the rating of the volume of financing in cash equivalent during the entire period of Ukraine's leasing history. Growth of the leasing penetration rate of up to 6 percent (as against 2.7 percent in 2010) is expected due to leasing volume growth and to the quiet, temperate growth of investments in fixed assets.

Among financial leasing contracts in 2011, agreements in the transport sector still dominated, making up about 56 percent of the total. The share of leased vehicles was 3.6 percent in 2011; it could reach 5 percent by the end of next year.

Car sales in Ukraine 2005–2016, PCS



The banking sector met with difficulties at the end of 2011, which could activate growth of demand for leasing services in 2012. It is expected that next year the car leasing market volume will reach 26,000 vehicles and that the car leasing segment with service support will reach 4,500 cars at the end of 2012.

In competing for clients in 2011, market players offered various special programs in cooperation with dealer networks and added extra value to their services. Euro Leasing presented new leasing programs for the Fiat and GAS brands within the territory of Ukraine and offered great interest rates for car leasing. Also on offer was a special price for a limited quantity of Ford commercial vehicles. For every car it leases, Euro Leasing offers a unique multi-brand fuel card and access to Fleet-online (an on-line fleet reporting system) free of charge.

Euro Leasing specializes in financing transport for business with additional service support. It provides customers with one invoice for a whole range of products that a client can use for easy planning and budgeting. Euro Leasing offers transport solutions for successful management of client fleets:

- **Vehicle financing:** financial and operative leasing of cars, LCVs and trucks for clients' business needs
- **Fleet-online:** fleet management offering web access to fleet database support, a powerful tool for organizing efficient fleet operation, and the possibility of getting useful information online. In present market conditions, when optimization of business processes and expenditures is one of the most pressing issues, this product optimizes and improves the operations of large corporate fleets, which in turn increases their competitiveness. At the core of Fleet-online is a data information system reflecting fleet activity and providing for detailed reports about road accidents (including pictures), regular maintenance and repairs, and mileage and fuel consumption for each car as well as for the whole fleet.
- **Multi-brand fuel card:** discounts for fuel at six leading networks of Ukraine – WOG, TNK, Shell, LUKOIL, Parallel, and Neftek – with access to online fuel reports (date, time, address, volume, and cost of fuel).
- **Additional services:** every client can form an individual service package in accordance with his business needs (replacement cars, pick-up and delivery of the vehicle, seasonal replacement and storage of tires, driver services, technical support all over Ukraine, etc.)
- **Insurance** can be used not only by Euro Leasing clients but also by any other company; Euro Leasing offers vehicle insurance to protect against damages on the roads, theft, driver and passenger accidents, etc.

Euro Leasing is an expert in financing transport for business; our managers are always glad to assist with various questions (accounting, juridical etc.) to improve the efficiency of client fleet-management.

12. LEGAL SYSTEM OVERVIEW

The Role of Courts in Protection of Investors' Rights in Ukraine

ANTIKA LAW FIRM

Mr. Andrey Kuznetsov, Partner, Antika Law Firm

In August 24th, 1991, Ukraine became independent and set its course on development of the market economy. On one hand, this contributed to the development of Ukrainian companies due to the ability to attract foreign investments, and on the other – this allowed investors to receive long-term profit in Ukraine.

Such mutual interest promoted foreign businessmen to invest funds into the Ukrainian economy. For example, in 1995, according to the State Statistics Service of Ukraine, the total volume of foreign direct investments amounted only to 483.5 million dollars, while in 2011 it has increased to 44.7 billion. Whereby the main partners of Ukraine in attraction of investments from abroad are the countries of the European Union, the share of which is 35.32 billion (unfortunately the U.S.A. accounted for only 2.2 percent of foreign investments in Ukraine in 2011).

Despite the large number of investors, who are interested in making profit in Ukraine, one of the factors that hinder the flow of additional investments into the Ukrainian economy is the concern of a potential partner regarding protection of his/her rights and legitimate interests. Some investors still believe that the Ukrainian judicial system lacks transparency and publicity of litigation, and that litigation is unreasonably prolonged. Also, according to their opinion, the enforcement of judgments is rather difficult, and the Ukrainian judicial system stands out due to its very low predictability.

Though the government tries to deal with such flaws by improving legislative regulation in this area (e.g., judicial reforms in 2008 and 2010), the system still doesn't cause enough confidence, and thus most investors try to apply to international courts for protection. Such court instances are, for example, the International Centre for Settlement of Investment Disputes, the European Court of Human Rights, international arbitration institutions, arbitration courts and national courts of foreign jurisdictions.

However, it is necessary to consider that the role of the Ukrainian judicial system is the key measure of protection of foreign investments in Ukraine, since appeal to international courts usually requires the exhaustion of local administrative or judicial remedies, as defined by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States. Also, disputes in certain areas, as defined by the legislation of Ukraine (for example, in tax or corporate relations), are considered by the Ukrainian courts only. It should be noted that foreign investments are provided with the national status, and thus an investor is provided with the right for judicial protection on equal terms with domestic investors.

The modern Ukrainian judicial system consists of courts of general jurisdiction, namely, commercial, administrative and general (civil) courts.

Consideration of a particular case by a respective court depends on subjects of a dispute and the nature of a dispute and is regulated primarily by procedural codes.

The commercial courts consider disputes arising between businesses during exercising their activities (e.g., disputes regarding improper performance of a contract). The corporate disputes are also subject to the jurisdiction of commercial courts (e.g., disputes of members of a company with foreign investment with such a company, or with each other regarding the issues of management and operation of a company).

If the state is a party of a dispute, such a dispute is under jurisdiction of the administrative courts. The examples are disputes between a person or an entity with the tax authorities of Ukraine, or disputes regarding registration of investments, recognition of illegal actions of government agencies and etc.

General (civil) courts may hear all cases apart from the cases that are within jurisdiction of commercial and administrative courts.

According to the recent judicial reforms, each of the above branches of courts of general jurisdiction has four levels (instances) in accordance with the powers and functions envisaged by current legislation of Ukraine.

Local courts, as the courts of first instance, decide on the merits of the case, and therefore are entitled to establish factual circumstances of a case by examining evidence collected in a case on the basis of their own beliefs.

The courts of appeal are courts of second instance. Their authority includes review of cases received from the courts of first instance because of appeal against a judgment of a local court.

The third instance of courts of general jurisdiction are respective higher courts (the Higher Commercial Court of Ukraine, the Higher Administrative Court of Ukraine and the Higher specialized court of Ukraine on consideration of civil and criminal cases). The peculiarity of these courts is that they review cases in cassation proceedings and determine the correctness of application of the law by courts of first and second instance. The higher courts of Ukraine can adopt decisions on leaving the court decisions of previous instances in effect, their cancelling, and may also send the case back for reconsideration to the court of first instance, or to adopt another decision regarding the case themselves.

The Supreme Court of Ukraine is the highest authority in the state system of courts of general jurisdiction. It reviews cases in the order of exceptional proceedings, i.e. if there is an unequal application of law by the higher specialized courts in similar legal relationships, including in the investment area, or if an international judicial institution determined violation by Ukraine of international obligations during consideration of a case by the Ukrainian court (e.g., breach of agreements on mutual protection of foreign investments).

Usually, consideration of cases in the Supreme Court of Ukraine is allowed after admission by a court of cassation (i.e., if the case is a commercial dispute, the statement on initiation of proceedings in the Supreme Court of Ukraine must be submitted to the Higher Commercial Court of Ukraine only). If violation of international obligations of Ukraine by a Ukrainian court during consideration of a case is the basis for revision of a case, the issue of initiation of proceedings in such case is decided by the Supreme Court of Ukraine itself.

Thus, it is possible to conclude that the judicial system of Ukraine is developed enough for an investor to have the guaranteed by the state opportunities of protection of his rights and interests, although many believe that there are still some flaws. In particular, they indicate the lack of qualification and quantity of judges, the lack of unified practice on resolution of similar disputes, low quality and ef-

ficiency of legal proceedings; low transparency and publicity of courts. Also, it is believed that the legislation of Ukraine doesn't ensure all interests of potential investors in other areas of relations (e.g., in the tax area). Entrepreneurs' criticism is also caused by massive failures of enforcement of court decisions due to imperfection of enforcement legislation, lack of technical and human resources in the related services.

Despite all the flaws in the Ukrainian judicial system (and the law in general), it should be noted that the legislator is trying to streamline the judicial system and thus to improve the investment climate in Ukraine. For example, during recent years notable reforms were made, due to which the Ukrainian judicial system has obtained its modern form, and it became more responsive to the needs of today. Also, there have been changes in the powers of the Supreme Court of Ukraine, which were significantly enhanced in October, 2011. Particularly, the Supreme Court of Ukraine was entitled to adopt new decisions during revision of cases in the order of exceptional proceedings (it was deprived of such right before). Also, lower instance courts are now obliged to apply resolutions of the Supreme Court of Ukraine in their practice, which should facilitate the formation of judicial practice in Ukraine. This means that it is possible to see a positive trend in the development of the judicial system, which is aimed at protection of the rights and legitimate interests of both physical persons and legal entities.

Thus, an investor, despite the existing problems, provided that he abides by the applicable law, can effectively protect his/her investments in Ukraine with the assistance of experts in the field of judicial defense.

New Anti-Corruption Laws In Ukraine: a Beautiful Façade with Window Dressing?

BEITEN BURKHARDT

Dr. Daniyil Fedorchuk,
LL.M., Ph.D. Associate
BEITEN BURKHARDT Attorneys-at-Law

Ukraine, an emerging East-European economy with a population of 45 mln. lures investment from abroad by vast business opportunities, such as unique geographic location, well-educated but relatively inexpensive labor force, rich natural resources, tremendous agricultural potential, huge consumers market. However, Ukraine's investment attractiveness is greatly marred by a risky and unpredictable business environment, overly complex and contradictory laws, poor enforcement of contracts and – particularly – by staggering corruption, problems which have consistently kept Ukraine at the bottom of the country rankings in international ease-of-doing-business and corruption indices.

The 2004 Orange revolution inspired investors' hopes for comprehensive reform; however, the situation has not improved much, and arguably worsened in recent years. Investors continue to wade through massive red tape in dealings with state and municipal authorities (from receiving licenses, certificates, permits, approvals, complying with numerous reporting, filing, and renewal requirements, to seeking to lease or purchase land plots or trying to have court judgments duly and timely enforced), operate in a non-transparent closed business environment dominated by elite cartels and are forced to depend upon ineffective administrative machinery deeply eroded by corruption.

Despite a common perception that Ukraine lacked any anti-corruption regulation prior to 2011, Ukrainian criminal law has always contained provisions on bribery. Among those activities punishable by imprisonment include any proposal, payment, solicit of, and acceptance by or extortion of a bribe from a public servant, as well as by officials of private companies and organizations in connection with exercise of a bribees' official powers in the interests of a briber or any third parties. Absent any clear statutory definition, bribing was traditionally interpreted by the courts very broadly covering not only direct money payments but also any unlawful favours of pecuniary value (such as paying travel or accommodation costs, giving cars for use, gifts), including those in illusory form (such as conclusion of fictitious contracts, overpayment for services, etc.). As such, it is not the want of laws but rather their sluggish enforcement which has brought about wide-spread corruption in Ukraine.

In April 2011, in efforts to improve a gloomy country image, Ukraine adopted a long-awaited Law "On the Principles of Prevention and Countering of Corruption" (effective as of 01 July 2011) (the "2011 Law") which was enacted to tackle and eradicate wide-spread corrupt administrative and unfair commercial practices, in conformity with universally-recognized principles and the GRECO requirements.

Consistent with international anti-corruption treaties, the 2011 Law extends liability to corrupt offenses committed by public services providers (e.g., notaries, lawyers, arbitrators, appraisers, etc.), foreign public officers and international servants, all of which formerly fell outside of the scope of the Criminal Code bribery and abuse of powers provisions.

In addition, the 2011 Law forbids four prominent unfair practices, namely:

- undue use of office or position by officials (e.g., aiding and abetting in securing subsidies or in public procurement procedures) in exchange for unlawful benefits;
- undue combination of an office with other paid-for employment, commercial activities or with any positions in management bodies of corporations;
- undue gifts (except for gifts bestowed under the common hospitality customs, for the amount not exceeding 50 percent of minimum wages (EUR 45));
- nepotism in employment or public service (with some rather narrow exceptions).

Additionally, the 2011 Law introduced anti-corruption measures, such as (most importantly) mandatory annual declaration of income, expenditures and shareholdings by state and municipal officials, measures aimed at preventing conflict of interests, mandatory anti-corruption evaluation of draft regulatory acts. Last but not least, the 2011 Law envisages introduction of a public register of corrupt offenders which is to be set up and maintained by the Ministry of Justice as of 01.01.2012.

However, a closer look at the 2011 Law reveals that it is very likely to make anti-corruption actions in many respects more difficult and unpredictable. The 2011 Law blurs the borderline between totally different offences, such as unlawful enrichment, bribery, and unlawful receipt of a gift. "Unlawful benefit", as defined in the 2011 Law (any money or other assets, advantages, privileges, services of pecuniary or non-pecuniary nature), is hardly distinguishable from a well-established understanding of bribery (money, assets, property rights, acts or omissions of a pecuniary nature, including those in illusory form); and these two concepts are not easy to reconcile with a concept of an undue gift. For instance, prior to the 2011 Law entering into force, a favour valued at EUR 4,000 given by a private company officer to a public servant authorized to supervise the company's operations would unequivocally fall within the scope of bribery punishable, irrespective of its amount and would subject both parties to criminal liability (2 to 5 years in jail for the bribee and a considerable fine or restriction of liberty for the briber). After 01.07.2011,

the same gratuity may be deemed (i) a bribe (severe criminal punishment irrespective of amount), (ii) an unlawful benefit (in many cases criminally punishable, but this amount qualifying only for an administrative offense and leading to a moderate fine), or (iii) an undue gift (an administrative offense leading to even less serious consequences), the qualification of the gratuity being totally in hands of the state anti-corruption authorities. In the sad Ukrainian reality, such unlimited discretion to judge and prosecute in the absence of any clear application guidelines invariably means more corruption.

Moreover, a major role in facilitating circumvention of anti-corruption measures was earlier played by the Constitutional Court. In a very controversial decision on 06 October 2010 (case No. 1-27/2010) the court allowed public officials to pursue other paid-for activities (such as teaching, coaching, medical practice, etc.) during working hours (on the rather ridiculous ground that the Constitution guarantees to anyone a freedom of activities), as well as—much more importantly—prohibited family members of public officials from being subject to financial control regarding their personal sources of income, expenditures and corporate rights, on the ground that such control would unduly interfere with their private life. As a result, the Constitutional Court de facto granted unscrupulous public servants a path to freely engage their family members as formal beneficiaries of corrupt payments. This immunity remained undisturbed in the 2011 Law.

On the other hand, the 2011 Law related amendments to the Criminal Code banned any unlawful benefits to the officers of private companies in connection with their exercise of powers in the interests of a benefit giver. In view of the "catch-all" nature of the "unlawful benefit" definition, this prohibition may be interpreted far beyond paying kickbacks and comparable unacceptable practices, and deemed to customary business interaction such as invitation of a business partner (e.g., a supplier) for a lunch or a football game, which would be contrary to the very spirit of the anti-corruption regulation.

Thus, despite the introduction of very important anti-corruption measures (financial control, prevention of conflicts of interest), the 2011 Law is likely to hinder application of criminal and administrative laws due to its ambiguous nature, thereby creating a potential for increased corruption. At the same time, the private sector may face an unreasonable risk of criminal prosecution for normal business practices. Moreover, the 2011 Law allows a number of ways for its evasion, in particular, through involvement of close relatives who have been rendered immune from anti-corruption measures. And most importantly, the 2011 Law is unable to resolve the ultimate obstacle to every anti-corruption campaign in Ukraine – the lack of a genuine will to rigorously enforce the law against high level officials, those who are primarily responsible for the miserable image of Ukraine abroad.

As a result, the 2011 Law strongly smells of yet another state-sponsored masquerade aimed at constructing a nice-looking façade of a corruption-free mansion, but with rotten foundation and rats sneaking behind. We would love to be mistaken…

The shortened version of the article was published in Business Ukraine journal, November 2011

Ukrainian Competition Policy: a Glance over the Curtains

VASIL KISIL & PARTNERS
ATTORNEYS & COUNSELLORS AT LAW

Ms. Maria Nizhnik, Counselor,
Mr. Sergey Denisenko, Associate
Vasil Kisil & Partners Law Firm

The year 2011 has been fairly eventful for the Antimonopoly Committee of Ukraine (the "AMC"), both in terms of antitrust and competition legislation developments and organizational changes within the Committee.

Merger Clearance Issues

The AMC continued to intensify its control over the scope of information submitted by the parties to the concentration. Except for the special software introduced by the AMC in the early 2011 (which provides for increase of AMC's control over parties' historical transactions and identification of the reportable transactions closed without the AMC permit), the new developments were recently presented by the authority providing for broader disclosure of the information related to the applicants' relations of control.

Based upon respective developments to the Concentration Regulation, which entered into effect on August 19th, 2011, the parties to concentration incorporated in offshore jurisdictions are obliged to submit information regarding their beneficiary owner to the AMC as well as documents authorizing third parties to perform the powers of nominal shareholders and nominal directors. This requirement was presented in view of making the ultimate ownership structure of the applicants' businesses transparent. However, in practice, the list of the offshore jurisdictions is established by the Cabinet of Ministers of Ukraine (the "CMU") and may vary depending on the priorities of the latter. This means that certain jurisdictions (e.g. Cyprus), which are not yet on the list, may occasionally be included thereto causing additional complexities for the applicants.

In 2011 the AMC also introduced amended procedure regarding the payment of the state fee required for the consideration of the applications submitted to the authority. Based on respective amendments, foreign applicants are now allowed to pay filing fees in Euros or US Dollars. Earlier the payments on behalf of the applicants were practically paid in UAH by their Ukrainian representatives or affiliated companies, incorporated in Ukraine.

Filing Requirements.

No de minimis rule is still applicable in Ukraine, therefore there is no exclusion in case of absence of the substantive overlap. The applicable merger control rules require a substantive amount of information to be included in AMC filing forms. In particular, the notification must include detailed information on the transaction parties, taking into ac-

count their control relations, including registration data, contact details, officers, amount of shareholdings/votes and the Ukrainian turnover of each entity of the entire target and acquirer groups.

Despite the broad definition of the target group (extended to the sellers), the AMC, considering the international practice, has recently adopted a position allowing the parties to limit the definition of, and respectively the information on, a target group to companies that are subject to direct/indirect acquisition. Such limitation is only applicable if the seller loses any control over the target as of the date of closing and the parties provide sufficient information and documents confirming termination of such control. However, such position is not applicable for the purpose of calculation of triggering thresholds, i.e. in order to find out whether the transaction requires Ukrainian merger clearance or not (whether the thresholds envisaged by law are met), the entire seller group shall be considered.

Furthermore the notification shall necessarily include the definition of the relevant product and geographical markets, contact information of the Ukrainian competitors, customers and suppliers and the volume of sales/gains in respect of each customer/supplier. Having said that, notably, such information shall be filed with the AMC in respect of each company of the target/acquirer group, generating Ukrainian turnover regardless of the markets concerned. In other words, even in the absence of the overlapping markets, the parties are bound to file detailed information about their activities in Ukraine.

The applicable rules allow parties to request from the AMC to be exempted from filing certain information, if the latter does not affect the decision to be adopted by the AMC. However, in practice, the information regarding the parties' activities in Ukraine (including the above information regarding customers, competitors and suppliers) is treated by AMC officials as mandatory, even in the absence of substantial overlaps, and thus, receiving any exemption in respect of such information is highly unlikely.

Unfortunately the AMC still does not disclose its practice in respect of the merger clearance investigations, as well as approaches taken by the authority in terms of market definition and transaction assessment details. Therefore, respective information is generally limited to the practical experience gained by the applicants and their legal advisors. However, according to the AMC representatives, it is expected that the disclosure of the respective AMC practices (for the most distinguished cases) will become publicly available in the forthcoming year.

Draft Leniency Program

The AMC has introduced Draft Leniency Program[12] envisaging indemnity for the participant to anticompetitive concerted practices who assists the AMC in revealing and investigating of such concerted actions. Applicable Ukrainian legislation currently provides for the possibility of granting indemnity for the participant of the concerted actions who informed the authority on the respective arrangements. However, practically this opportunity has hardly ever been applied to because of the absence of efficient procedural mechanism of obtaining indemnity by the participants of concerted actions.

The Draft Leniency Program is designated to actually enforce the institute of indemnity in Ukrainian competition law. Based on the respective draft, the participant of the concerted actions may be exempted from liability in case the latter provides detailed information on all

12 Available in Ukrainian at http://www.amc.gov.ua/amc/control/uk/publish/article?showHidden=1&art_id=206722&cat_id=206716&ctime=1319611810939

participants of the cartel, its detailed description as well as evidences of the arrangements among the participants of the concerted actions. Moreover, draft program provides for reduction of the liability for the participant of concerted actions not being the first who informed the authority on cartel, however cooperated with the latter. The document is currently subject to the public discussion and comments of legal experts on its enhancement. It is expected that respective Leniency Program will be adopted in the coming 2012 year and will sufficiently increase the number of cartel cases initiated by the AMC following the leniency applications.

Revision of the AMC Decisions

Updated procedure for revision of the AMC decisions has recently been introduced by the authority. The amendments into the Rules on AMC's cases consideration[13] provide for more transparent requirements to the applications on revision of the AMC decisions including exhaustive list of conditions for return of the application without consideration as well as considerably specified requirements as to the substance of the application. Respective changes will certainly contribute to establishment of comprehensive and predictable procedure for revision of the AMC decisions.

New Standard Requirements for Exemption from Obtaining Clearance on Concerted Actions Regarding Supply and Use of Products

New Standard Requirements to Concerted Practices[14] regarding supply and use of products (i.e. vertical concerted actions) have been lately introduced by the AMC. Respective Draft Requirements envisage exemption from obligatory requirement of obtaining AMC clearance for the vertical concerted actions. At present, applicable legislation of Ukraine provides for certain exclusions from prohibition of the concerted actions regarding supply and use of products. However, current wording of the Law on economic competition establishes rather wide discretion of the AMC appraisal approaches to the concerted actions regarding supply and use of products. Respective approaches of the AMC may differ depending on the parties to concerted actions and direct circumstances of the case, leaving the burden of liability on the fact whether the parties fall under the established exclusion or not on the market players.

The Draft Standard Requirements to Concerted Practices appear to establish transparent conditions for the market players to be exempted from obligatory obtainment of the AMC clearance. Therefore, the document is anticipated by absolute majority of the market players applying distribution operation schemes in business organization. Respective draft is currently on public hearings and it is expected that shortly the draft will be finally completed and ready for implementation.

13 *Temporary rules on cases consideration re violation of the competition legislation approved by the AMC on April 19th 1994 #5*

14 *Draft Standard Requirements to Concerted Practices of the undertakings concerning the supply and use of products for exemption from the requirement to obtain prior AMC clearance.*

Draft Law On State Aid

Ukrainian move toward signing the Agreement on free trade area between Ukraine and the EU provides inter alia for the condition of development of effective institutional and legislation background in the sphere of state aid. Currently the system of state aid remains one of the most undeveloped spheres in the field of Ukrainian competition.

A number of steps were taken by Ukrainian authorities last year in order to give rise to the development of the efficient system of state aid, including (i) approval of the Concept on reforming of state aid system providing for gradual reformation of state aid system which should be fulfilled in 5 (five) years period; (ii) adoption of the program of Economic Reforms for 2010–2014, approved by the President of Ukraine which provided for development of the Law of Ukraine "On State Aid" by the end of 2011 year.

This year a number of Draft laws "On State Aid" have been publicly presented and widely discussed. The most recent Draft Law "On State Aid" provides answers to a number of questions on rendering of the state aid including: who may be the recipient of a state aid; forms of a state aid; liability for violation of state aid rules; authorities of the state body on state aid; procedure on cases initiated as a result of illegal provision of the state aid; monitoring over the granted state aid etc. It appears that respective Draft Law will build up the foundation for the system of state aid in Ukraine.

Fine Policies

The AMC has increased the amount of fines imposed for violation of economic competition legislation. As compared with 2010 year the fines for failure to obtain merger clearance permit when applicable for the parties, which admit the violation and cooperate with the authority increased on average up to 15 percent — 30 percent. The similar situation is observed in the sphere of provision of misleading information to the authority as well as for failure to provide the information requested by the AMC.

Moreover the scope of sanctions imposed by the AMC has extended as well. Recently the AMC has imposed obligation on the fuel market operator who failed to obtain merger clearance permit to terminate the contracts underlying the reportable transaction as those, which lead to monopolization of the regional market.

The AMC intensified investigations initiated for concerted actions. Moreover, the average number of defendants participating in the cases on anticompetitive concerted actions has increased. Food & beverage and fuel markets are still closely monitored by the AMC and remain among its top priorities. This year the AMC has imposed one of the largest fines in its practice. The amount of the fine imposed on three major fuel market operators for the anticompetitive concerted actions constituted UAH 150 mln. (equivalent to EUR 15 mln). The fine is currently being appealed in the commercial court.

Recently the AMC representatives have also declared that control over the market of non-food products will be intensified as well.

13. LOGISTICS AND TRANSPORTATION

2011 Air Code of Ukraine: What it Means for Business?

CHADBOURNE & PARKE LLP

Mr. Andriy Kirmach
Chadbourne & Parke LLP

In 2011, the Ukrainian parliament passed several important legislative acts that substantially revised the regulatory framework in certain industries, aviation being one of them. The new Air Code of Ukraine was finally passed by the parliament on May 4th, 2011 and came into legal effect on September 17th, 2011 (the "**Air Code**").

The prior Air Code of Ukraine existed for over 18 years and, after lengthy debates, it was modernized based on the current international norms and practical requirements of the aviation business. However, certain norms of the new Air Code demonstrate the recent trend of Ukrainian governmental authorities to exercise hands-on management of certain business areas and control over operations of private companies. The revised Air Code also introduced several important features and innovations that are outlined in the overview below.

New Authorities and Powers

The Air Code provided for establishment of a new agency – the Expert Agency on Investigation of Aviation Accidents and Incidents (the "**Investigation Agency**"). This Agency is expected to be independent from the State Aviation Agency of Ukraine (the "**SAA**") and deal exclusively with review and investigation of various aviation accidents and incidents. The independence of the Investigation Agency is expected to guarantee the objective and unbiased review of cases; however, it seems rather doubtful considering that the Agency will be funded primarily from the State Budget.

The Investigation Agency together with the SAA are scheduled to set up the system and criteria for mandatory notifications that airline companies must submit in relation to aviation incidents or accidents that require further review and analysis by the authorities. The Air Code envisaged creation of the Investigation Agency by January 1, 2012, although it did not happen until now, and no new rules were adopted as yet. It is also worth noting that until the Investigation Agency is established, the SAA would exercise the functions and rights of the Agency.

The other important news is that the Air Code significantly expands the authority of the SAA and vests it with a variety of discretionary powers. For instance, the SAA is authorized to develop and approve the new Aviation Regulations of Ukraine (the "**ARU**"). The ARU is supposed to be a complex document based on

the international and European Union ("**EU**") standards of the aviation industry; however, it also should be in compliance with applicable Ukrainian laws and regulations. From the practical standpoint, this balance is often impossible to archive.

The Air Code also contains an interesting provision about the applicability of ARU to all aviation market companies doing business in Ukraine. It particularly states that the Head of the SAA may waive certain technical or procedural requirements of the ARU for a particular aviation company[15], provided that such waiver does not impact the aviation safety and is made "in the interests of the society." While the detailed process for such a waiver shall be set up by the ARU itself, such discretionary authority allowed to the Head of the SAA might be viewed as creating an unfair treatment for certain aviation market players.

The SAA also has discretionary powers to review compliance of existing and new Air Operator Certificates[16] with the ARU. In this regard, the SAA can assign certain state-owned or private companies that would have authority to perform various inspections, checks, assessments or prepare expert reports necessary for obtaining or validating of the Air Operator Certificates. The Air Code does not refer to any limitations of this authority of the SAA which may also lead to unfair competition. Moreover, given the market practice, it is very likely that airline companies would be required to cover the cost of services rendered by inspection companies assigned by the SAA. Foreign investors or companies doing business in Ukraine should be particularly careful in relations with such appointed companies and ensure proper vetting of these contracts in light of international anti-bribery compliance requirements.

Further on, the Air Code provides discretionary powers to the SAA in matters of regular and irregular audits and inspections. The SAA seems to have an absolute discretion to defining grounds for irregular inspections. Unless the ARU would set up certain limitations to this provision, it may create the additional basis for unfair treatment of airline companies and other aviation market players.

On the positive side, the Air Code requires that airport services operators ensure equal treatment of all airlines and other aviation related companies (i.e., technical maintenance, ground handling, fuel supplies, etc.). It is expected that governmental authorities would review the market of aviation related services and define some ground rules for so-called natural monopolies of airport services. These ground rules should ensure transparent and equal treatment of all airlines and other businesses that operate or are willing to operate in a particular airport. On a related note, the airport operators should also establish special "airport committees" that would allow representatives of airport management, airlines based in the airport, ground handling and other services companies to meet and negotiate common terms and conditions of services provided in the airport. These basic requirements were long-awaited by the market players as they are staging the foundation for further development of the aviation services in Ukraine on a competitive basis.

15 The Air Code applies to airlines, airports, ground handling companies and other companies that operate in the aviation services market.

16 The primary document that confirms the airline status of the company.

Tariffs and Route Permits

The Air Code establishes new ground rules for air carriage tariffs and granting of route permits. The clear message is that the tariff cannot constitute price dumping or be discriminatory. On this basis, the SAA has the authority to cancel "too high tariffs if there is no adequate competition level or too low tariffs in case they are, inter alia, lower than net costs of the carriage." In order to exercise this clause, the SAA can request that the airline company provides the information necessary for adequate evaluation of its tariffs, including the information on the net costs. Failure to provide such information in time or in full may result in the tariff cancellation. While having good motives, this provision of the Air Code raises many concerns. The information about net costs of the tariff normally constitutes the commercial secret of the airline company. Thus, when submitting this data to the SAA the airline company may risk losing its commercially sensitive information as the Air Code does not set up any rules for ensuring the confidentiality of the commercial secrets transferred to the SAA.

The SAA is also authorized to manage airspace and use it "based on the interests of the national economy and safety." Given the broad definitions for this authorization, the SAA would likely to have practical discretion in influencing airspace use which may result in unequal distribution of airspace permits between different airline companies. While the detailed rules and procedures for issuance of Route Permits[17], approval of flight schedules, etc. should be defined by the ARU, the Air Code provides that when deciding on the Route Permit application the SAA shall consider "the social importance for such air carriage and need for development of the transportation system." The SAA also has the authority to decline the Route Permit application or limit the issued Route Permit based on "the need to ensure cost-effectiveness (profitability) on the existing routes." From these provisions of the Air Code, it looks obvious that the SAA would have the ultimate discretion to manage Route Permits on the ad-hoc basis, including their issuance, limitation or revocation. It also seems that this discretion would apply to competing routes, e.g., flights to main and secondary airports of the same designation point that could be limited or revoked for the benefit of ensuring the cost-effectiveness (profitability) on the main airport route.

One of the other important innovations of the Air Code is that it provides the possibility for foreign airline companies to get the Ukrainian Route Permits for regular flights on international or domestic routes not only on the basis of the bilateral agreements as was true before, but also based on the reciprocity principle, i.e., if Ukrainian airline companies enjoy the same rights in countries where such foreign airline companies are registered. The Air Code also allows foreign airline companies to obtain Ukrainian Route Permits for non-regular flights, if no Ukrainian airline is willing to perform such flights. These clauses significantly ease the possibility of foreign airline companies to access Ukrainian domestic routes and obtain better permits for international routes.

The Air Code also provides a separate regulatory framework for issuance of Route Permits for so-called socially important routes i.e., routes with low traffic, although important for the development of a city or region) (the "**Social Routes**"). When applying for a Social Route, the airline company should negotiate with the SAA and fix certain service conditions, i.e., route tariff, flights quantity, etc. In exchange, the SAA may grant to the airline company the exclusive right to operate such Social Route for the term up to three (3) years. If no airline company applies for the Social Route, the SAA can announce an open tender for Ukrainian and foreign airline companies. In such case, applicants can claim that the

17 Under Ukrainian law, each airline receives a special permit for operating on a particular domestic or international route.

SAA provides certain compensations or benefits for their operations on the Social Route and the SAA is supposed to select the most reasonable compensation claim.

Compensations and Penalties

The Air Code also provides the extensive list of new rules and procedures that govern compensations due to passengers in case of a flight delay or cancellation. These compensations are based primarily on relevant EU standards, so a majority of airline companies are already used to these requirements on flights originating from EU cities. What is important, however, is that these requirements are now applicable to all international and domestic flights operated by Ukrainian and foreign airlines.

The Air Code also sets out an extensive list of penalties for various violations of its provisions and requirements. Given the limited scope of this publication, it is difficult to provide an overview or analyze all such violations, but it should be noted that the Air Code provides economic sanctions which, depending on the violation, may vary from UAH 510 (approx. USD 65) to UAH 136,000 (approx. USD 17,000). As a result of the implementation of the new Air Code the Administrative Offences Code of Ukraine was amended with increased penalties for violations of the aviation safety rules, rules of conduct on-board of the aircrafts and rules of the international flights from UAH 85 (approx. USD 10) to UAH 8500 (USD 1,000). In addition, a separate criminal offence was introduced to the Criminal Code of Ukraine – performance of professional duties by aviation personnel under the influence of alcohol, drug or other psychotropic or psychoactive substance. This crime is subject to correctional (community) works for up to two (2) years or sentencing up to three (3) years.

On a related matter, after heated discussions, the Air Code also explicitly intense that airline companies shall be liable for verification of the passenger documents that are necessary for entering to the destination country. In particular, the airline company shall decline the carriage of a passenger who does not have necessary documents. Failure to comply with this requirement may result in a penalty that ranges from UAH 8,500 to 17,000 (approx. USD 1,000–2,000) per passenger.

Practical Implications

The 2011 Air Code is a clear step forward in the development of a regulatory framework for the aviation industry. It creates practical ground rules for foreign airlines and aviation services companies to access Ukrainian aviation market and even to operate on domestic routes. The new Air Code's other positive message is the review of monopolistic arrangements that currently exist in Ukrainian airports or on certain air carriage routes. The passengers would also benefit from implementation of EU based compensation norms and procedures.

On the other hand, the Air Code vests the SAA with many discretionary powers and authorities. While this approach appears to confirm the general trend for hands-on management and control that the current government has taken in relation to several industries, the practical implications of SAA's discretionary authorities may have an adverse effect on the business. The SAA's manual control over route permits and tariffs can put additional regulatory pressure on airline companies and other unrestricted powers may cause unfair treatment of aviation services providers.

Clearly, every airline or aviation services company should revise its policies and procedures in line with requirements of the new Air Code and many companies apparently already did so. However, what is more important is the further monitoring of the practical implementations of certain Air Code provisions that raise business concerns.

Obtaining of regulatory approvals and permits was never easy in Ukraine. However, in the new legislative environment it might become even a more challenging task. International and local companies should also keep in mind requirements of Ukrainian and foreign anti-bribery compliance requirements when dealing with governmental authorities or companies suggested or appointed by such authorities.

International Reach
Local Expertise

FOR MORE INFORMATION, PLEASE CONTACT:

Jaroslawa Z. Johnson
Managing Partner
jzjohnson@chadbourne.com

Oleg Mazur
International Partner
omazur@chadbourne.com

Sergiy V. Onishchenko
International Partner
sonishchenko@chadbourne.com

Chadbourne & Parke LLP
25B Sahaydachnoho Street
Kyiv 04070 • Ukraine
TEL: +380 (44) 461-75-75
FAX: +380 (44) 461-75-76
kyiv@chadbourne.com

Chadbourne's strong local presence in Ukraine since 1993, together with our international reputation and scope through our global network of offices, enable us to deliver seamless, world-class advice on cross-border and local matters.

The Kyiv office provides a full range of legal services to multinational, foreign and local clients, including:

- Corporate/M&A
- Banking and Finance
- Bankruptcy and Financial Restructuring
- Dispute Resolution
- International Compliance and Risk Management
- Real Estate
- Securities
- Employment
- Antitrust
- Energy
- Tax
- Insurance
- Intellectual Property

Our seasoned lawyers provide the depth and breadth of expertise in Ukraine to turn your problems into positive results.

www.chadbourne.com

CHADBOURNE & PARKE LLP

New York ▪ Washington ▪ Los Angeles ▪ Mexico City ▪ São Paulo ▪ London ▪ Moscow ▪ Warsaw ▪ Kyiv ▪ Almaty ▪ Istanbul ▪ Dubai ▪ Beijing

14. MEDIA

Ukrainian Media Overview

Ukraine's media sector experienced a relatively stable year in 2011 with advertising revenues throughout the sector remaining below pre-2008 crisis levels but continuing to post moderate gains on 2010's tentative recovery. Meanwhile, a number of new international projects appeared on the local horizon and one of the country's most widely-respected weekly current affairs journals changing hands.

The most talked about media acquisition of the past twelve months was the deal which saw American media figure Jed Sunden sell his controlling stake in KP Media to Ukrainian tycoon Petro Poroshenko for a reported USD 20 million in a move which was hailed by Ukraine's free press campaigners as safeguarding a modicum of media ownership plurality in the country. KP Media's flagship publication is Korrespondent magazine, which since its launch in 2002 has earned an unrivalled reputation as Ukraine's most editorially independent and credible weekly news magazine. Initially financed by the profits of Sunden's original media venture — English-language weekly newspaper The Kyiv Post — Korrespondent was the last in a long list of titles which Sunden has been forced to close down or sell off over the past three years due to the sharp decline in advertising sales revenues felt throughout the Ukrainian media market since the onset of the 2008 global Credit Crunch.

The biggest media arrival of 2011 was undoubtedly the launch of the new Euronews Ukrainian language service, which was officially unveiled on 24 August (Ukrainian Independence Day). The new Ukrainian language service is the eleventh language service to be added to the Euronews stable, joining English, French, German, Spanish, Italian, Polish, Turkish, Persian, Russian and Arabic services. The channel's domestic broadcast partner is Ukraine's national TV channel UT1, with UT1 Deputy President Walid Arfouch proving instrumental in pushing through the partnership. A full Ukrainian editorial team was appointed in spring 2011 and relocated to the Euronews central offices in Lyon, France, where they produce the Ukrainian language input for the 24hr Euro-centric video news channel. The new Euronews service attracted some initial criticism over the apparent decision of Ukrainian service editors to remove unflattering references to the Ukrainian government from news reports dealing with the country's EU integration talks, but on the whole the arrival of Euronews has been received as a sign that the country is on the international media map and being taken more and more seriously by major European media groups. It is noteworthy that the partly EU-funded channel has chosen to initiate a Ukrainian service prior to launching similar initiatives in other EU candidate regions such as the Balkans — one of precious few indications over the past twelve months that senior figures in Western Europe continue to take Ukraine's Euro-integration ambitions seriously.

2011's most surprising Ukrainian media arrival came in September with the launch of the world's first Jewish-themed 24hr news channel, Jewish News One (JN1). Based out of Kyiv and with bureaus in Tel Aviv, Jerusalem and Brussels, this new global video news initiative is the brainchild of Ukrainian

Jewish tycoons Igor Kolomoiskiy (also the current majority shareholder at leading Ukrainian TV channel 1+1) and Vadim Rabinovich, both of whom have long track records for investing in cultural projects in support of Ukraine's Jewish community. The channel broadcasts in English and Russian languages via satellite to North and Central America, Europe, North Africa and the Middle East, and is also available online in live view format. The project is a first for Ukraine and has been interpreted by media analysts as the latest indication of the mounting international ambitions of Ukraine's Jewish powerbrokers.

15. REAL ESTATE

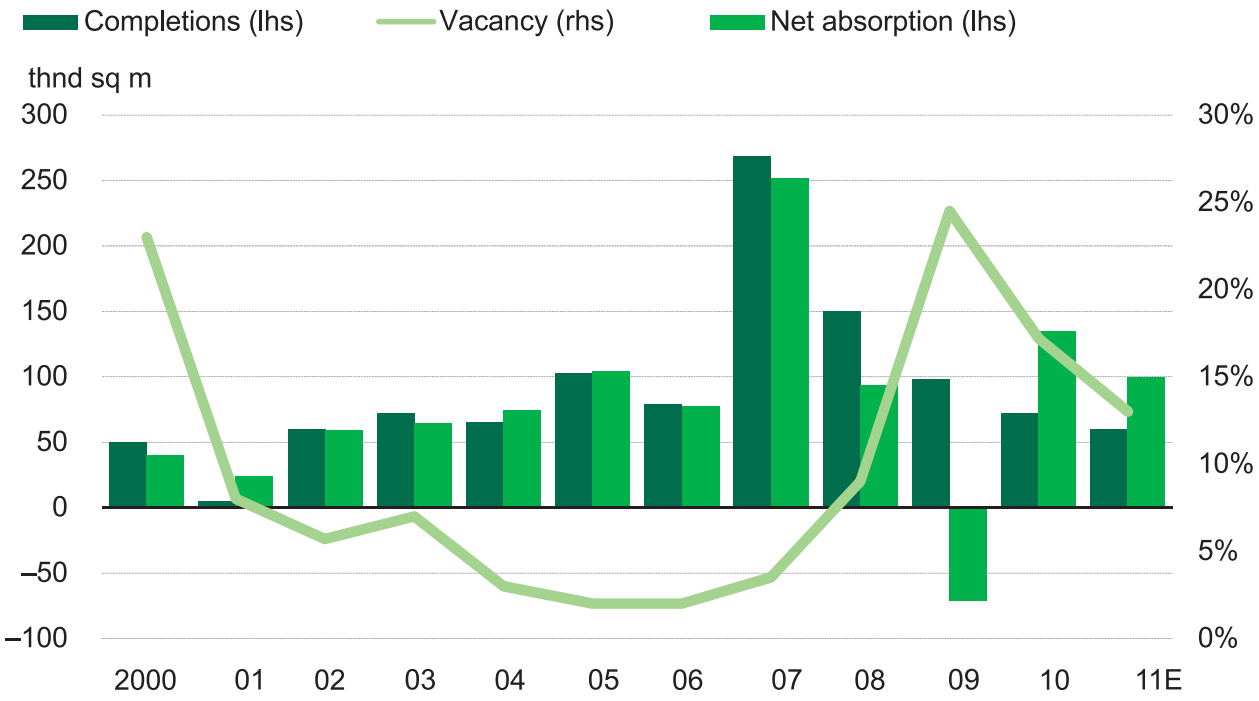
Office Market

CBRE

Fundamentals

In Q3 2011, previously ubiquitous relocation of occupiers from unclassified to competitive buildings is losing momentum while office leases driven by market entry remain rare. Demand is further daunted by weak economic growth and employment trends dragging absorption for Q1–Q3 2011 down to ca. 80,000 sq m (–23 pp y-o-y). Meanwhile, depressed rents continue fuelling demand for modern office premises with absorption for the three quarters outpacing projected development completions for 2011 and pushing down vacancy rates.

New Supply, Net Absorption and Vacancy Rate



lhs – left hand scale
rhs – right hand scale
E – estimate
Source: CBRE

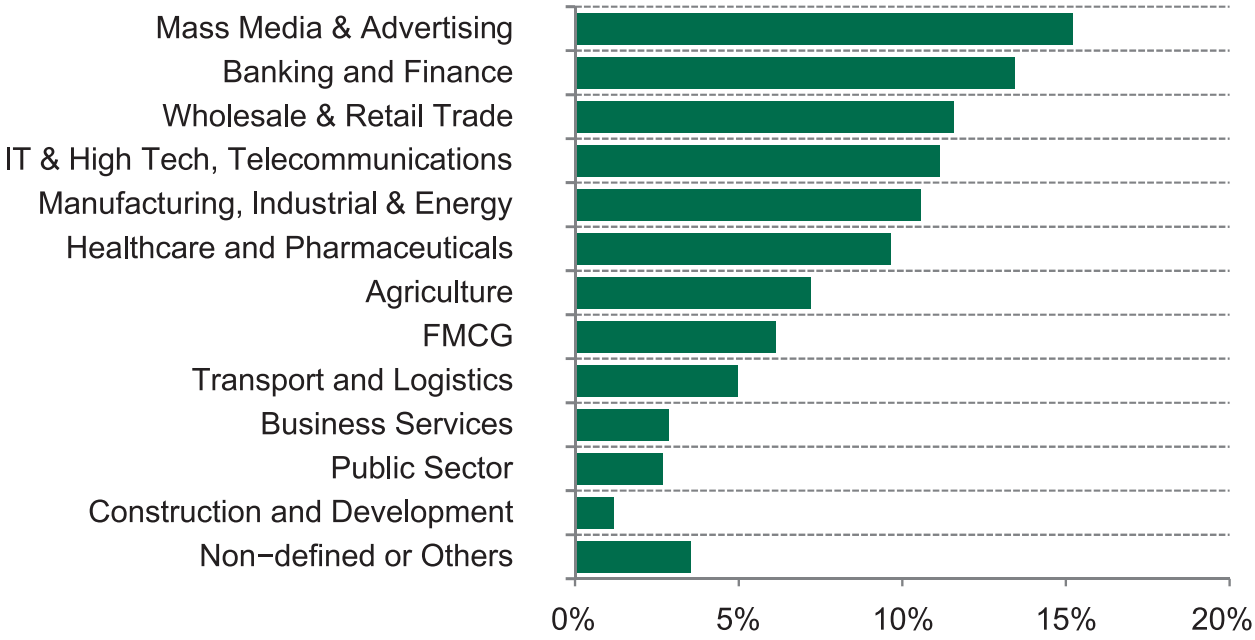
Demand

By the end of September, reported take-up totaled more than 100,000 sq m, a 14 percent y-o-y improvement. This relatively high transaction volume was due to several large deals – in excess of 2,000 sq m each – accounting for around 64 percent of total take-up.

Significant input was made by three notable owner acquisitions and large leasing transactions in the recently delivered Eleven and HPBC ST (Phase II) office schemes. Eleven can also boast the largest 6,000 sq m deal with TNK-BP, an oil company. The second largest lease transaction recorded in H1 2011 was for 4,400 sq m of space in a newly-built Rialto building, which went to Swedbank. The rationale behind most relocations was either consolidation with upgrade or expansion.

In terms of industry sector breakdown, mass media & advertising companies came first with a 15 percent share of the total take-up thanks to one-off acquisition of newly delivered office building in Podil district of Kyiv. The demand from finance services companies has been getting stronger as well and now accounts for 13 percent of total transactions by the end of September 2011. Also of note was higher activity on the part of wholesale & retail trade whose share in total take-up made up around 12 percent of all transactions.

Take-up by Industry in Q1-Q3 2011



Source: CBRE

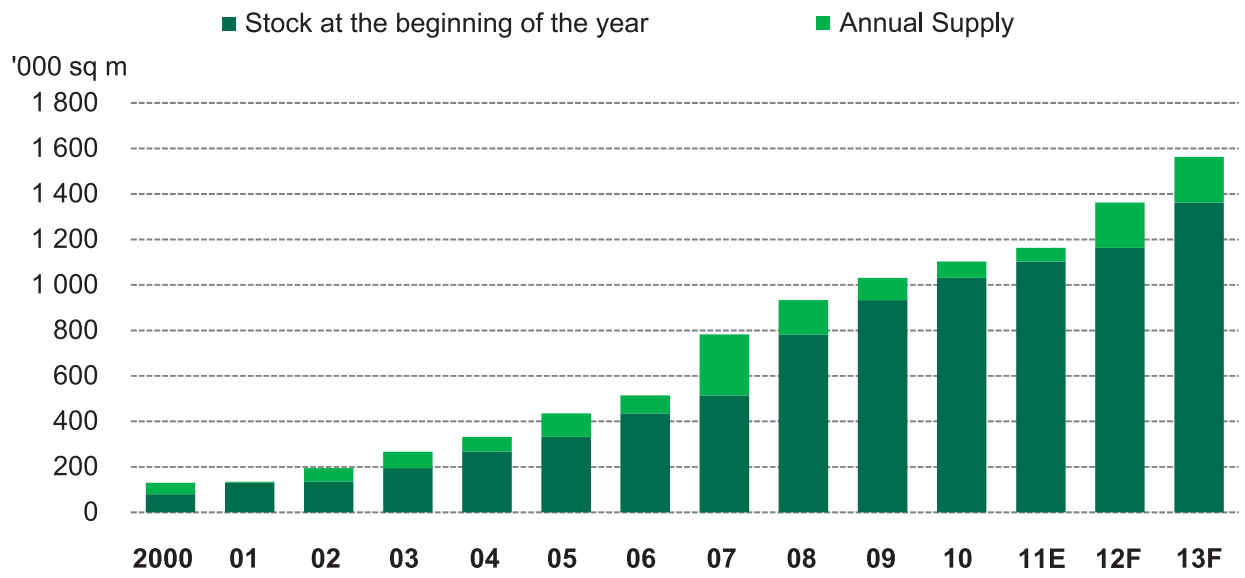
Supply

By the end of September, with the new additions of 2011 (ca. 35,300 sq m) the total competitive stock has reached 1.14 mln sq m. By the end of 2011, we expect completion of some more premises (14,000 sq m). In aggregate, therefore, annual new supply in 2011 is expected to hit an eight-year low, amounting to just under 60,000 sq m (-17 percent y-o-y).

In the first six months of 2011 developers have significantly stepped up their operations, prompting an upward revision to our previous forecast for future supply. We now expect 20 percent more space to be delivered in 2012 – i.e., 200,000 sq m, including only key office schemes currently under construction. Another 100,000 sq m of space is

expected to hit the market in 2013. It is noteworthy that new supply in 2012 is likely to be the most high-quality in history since around 70 percent of deliveries scheduled for that year are Class A premises. 2013, in contrast, will see mostly Class B premises, which are expected to have 60 percent share of new additions.

Kyiv Annual Development Completions and Total Competitive Stock



E – estimate
F – forecast
Source: CBRE

Rents and Vacancy

The benchmark prime rent in core areas demonstrated moderate growth in H1 2011, having increased from $32 to $35 sq m/month (net of VAT and OPEX) in six months and remained flat during Q3 2011. Therefore, the growth rate has slowed after accelerating in H2 2010. Due to still high vacancy in non-prime locations, average net effective rent for secondary office premises is almost identical to that recorded nine months ago – i.e., $23/sq m/month.

Because there was not enough new supply to compensate for the increased activity of occupiers, average vacancy rate fell 4.5 pp from December 2010 to 12.7 percent by the end of September 2011.

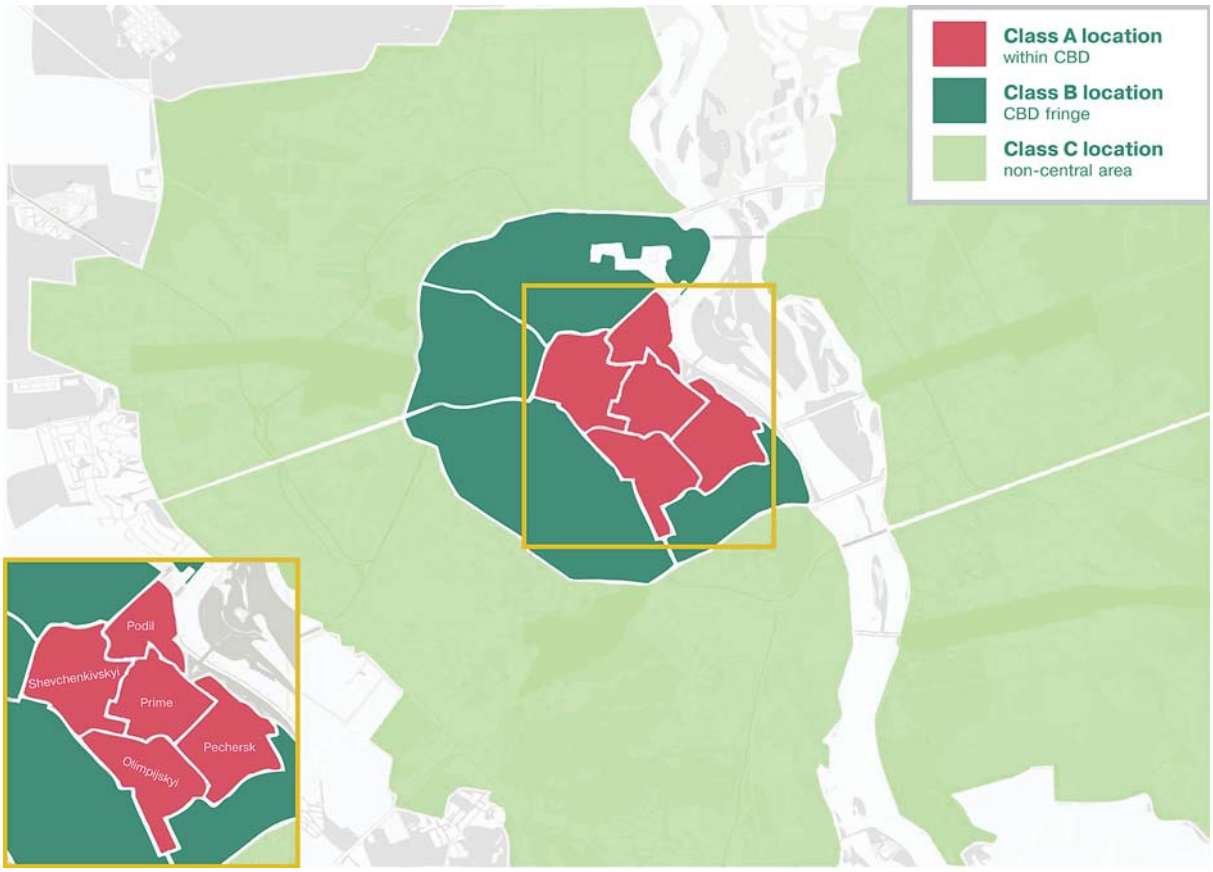
Rental rates and vacancy vary markedly across submarkets.

Kyiv Office Base Rental Range and Vacancy as of Q3 2011 (USD/sq m/month)*

Class A location	Quality A	Quality B	Vacancy
Prime	$35–42	$25–35	10.0%
Pechersk	$35–42	$25–30	4.2%
Podil	$28–38	$23–25	7.5%
Shevchenkivskyi	–	$22–30	10.4%
Olimpijskyi	$25–32	$23–27	16.1%
Class B location	Quality A	Quality B	Vacancy
CBD fringe	$20–25	$14–20	12.8%
Class C location	Quality A	Quality B	Vacancy
Non–central area	–	$12–15	17.9%

** data was presented according to expanded CBD boundaries and new business centers classification introduced by CBRE in September 2011*
Source: CBRE

Map of Office Submarkets in Kyiv



Source: CBRE

Outlook

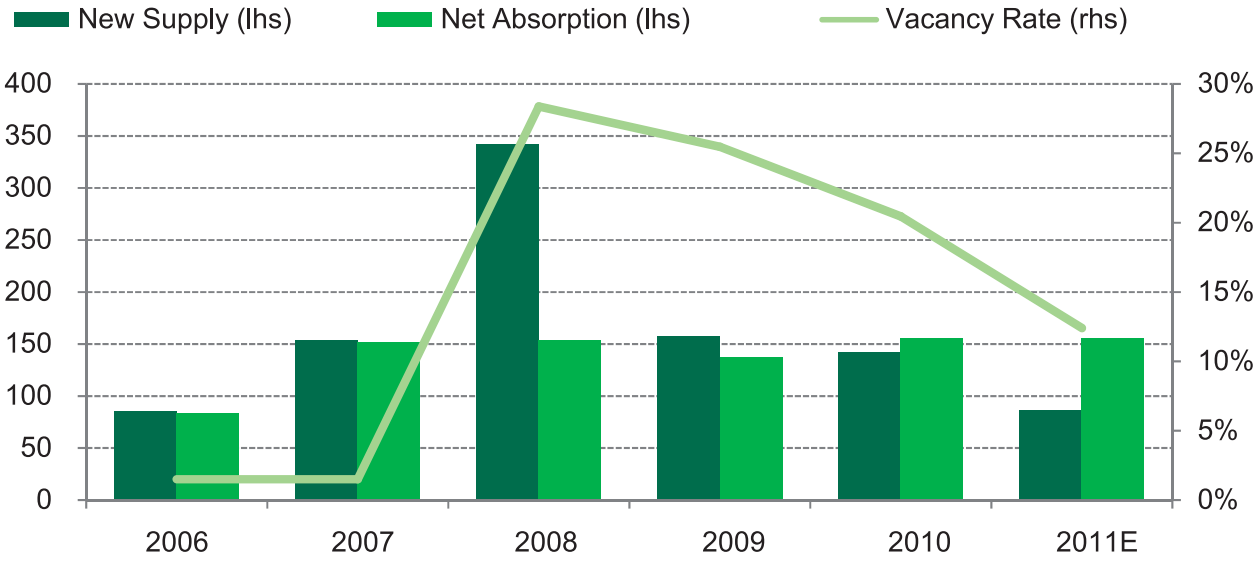
In 2012, market average vacancy will be rising fed by excess space in the newly delivered class A properties. Significant new additions to prime stock in 2012 will put downward pressure on rents. At the same time, since certain part of the announced grade A pipeline is available for sale it will have a lesser affect on the letting market, keeping rents from falling. With Class B office vacancy rates in mid–20s, secondary rents are likely to remain unchanged well into 2012.

Warehouse Market

Fundamentals

Towards year-end, conditions in the warehouse market recorded the third consecutive quarter of gradual improvement. Retail sector growth encouraged several developers to resume construction works on the previously halted projects, allowing us to estimate new supply of warehouse premises in 2011 at 86,400 sq m. Increased activity of tenants on the back of continued shortage of new supply boosted further absorption of available space over Q1–Q3 2011, markedly driving down vacancy rate to 11.5 percent. However, we anticipate vacancy to stay at two-digit level by year-end as delivery of new premises in Q4 2011 is likely to exceed the volume of expected net absorption during late 2011.

New Supply, Net Absorption and Vacancy Rate: Past and Future



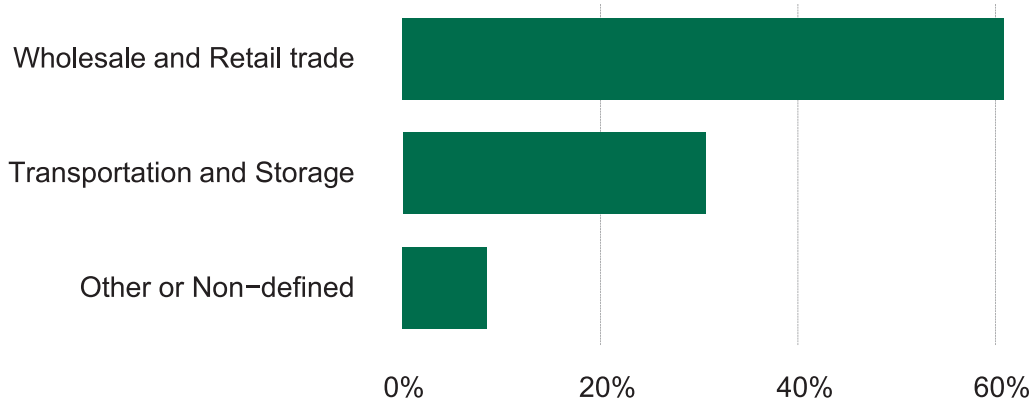
lhs – left hand scale
rhs – right hand scale
E – estimate
Source: CBRE

Demand

Slow recovery in demand for warehouse premises that began in 2010 was maintained in 2011. The users continued to consolidate their operations and also began to expand warehouse space. Their rising confidence is reflected in the take-up figures for Q1–Q3 2011, which is 68 percent higher from a year ago.

In terms of industry breakdown, wholesale and retail sector were responsible for the lion share (ca. 61 percent) of the take-up in Q1–Q3 2011. Transportation and Storage came 2nd with just under 31 percent of transacted space. These figures confirm the trend of the last 15 months, in which the relative activity of wholesale and retail sector (as measured by take-up numbers) has been steadily increasing, overcoming Transportation and Storage by December 2010 and maintaining the lead by the end of Q3 2011.

Take-up Structure by Industry in Q1–Q3 2011*



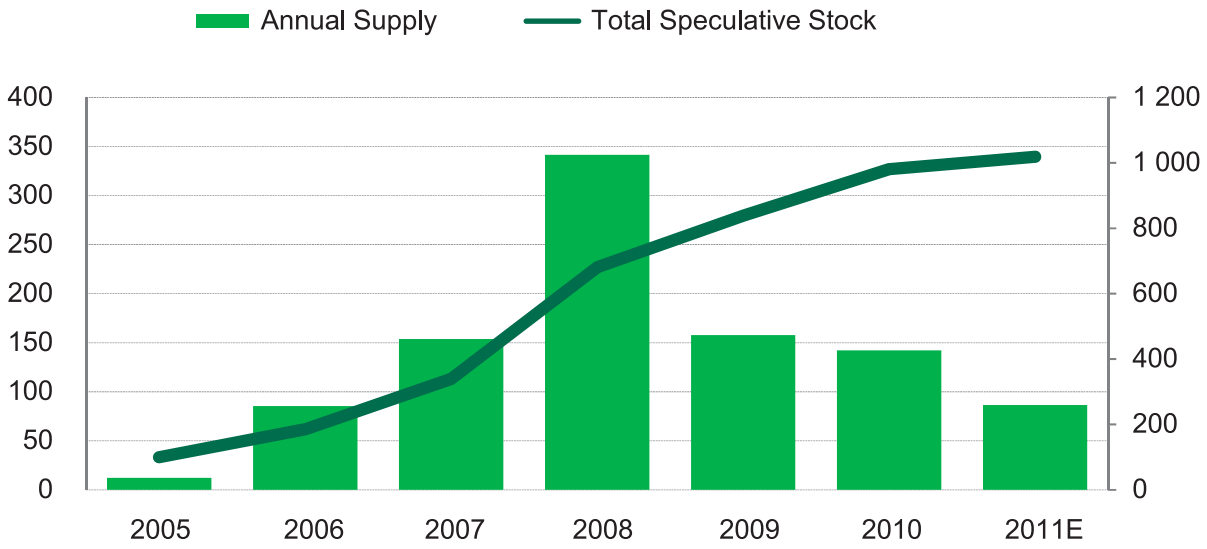
base — volume of transactions, sq m
Source: CBRE

Supply

By the end of September 2011, total professional warehouse came to the following:

- **total supply** — 1,477,800 sq m (new supply — 47,500 sq m);
- **total speculative supply** — in excess of 947,800 sq m (new supply — 15,500 sq m).

Kyiv Annual Development Completions and Total Speculative Stock ('000 sq m)*



* — *In Q3 2011, we reduced total competitive stock by 48,400 sq m due to three acquisitions for owner-occupation recorded in the first six months of 2011.*

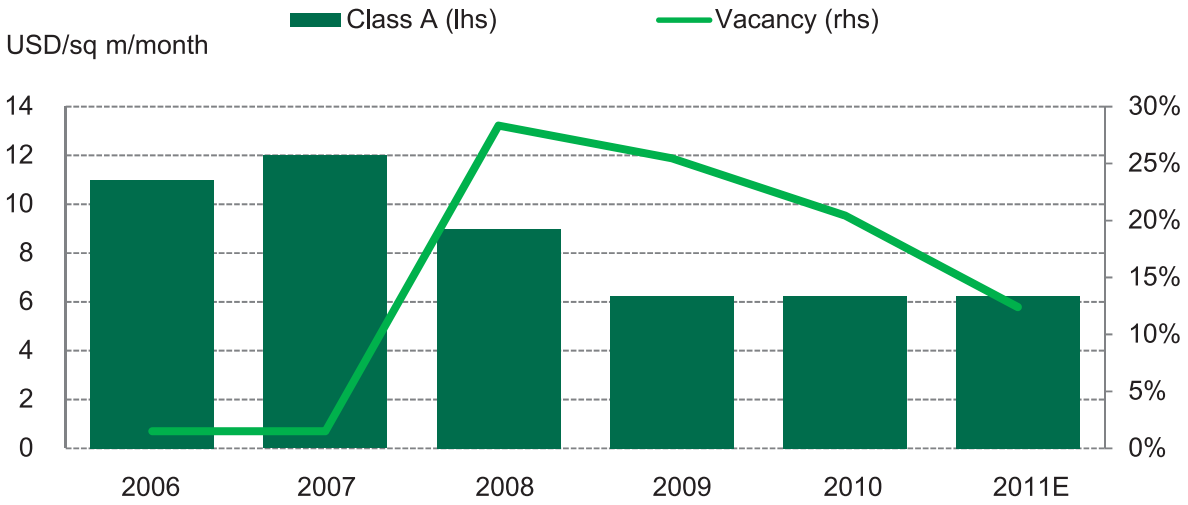
lhs — left hand scale
rhs — right hand scale
E — estimate
Source: CBRE

The most anticipated completion of 2011 is Phase I of warehouse complex, developed by Amtel-Properties — 37,000 sq m. Currently, there are ca. 212,600 sq m of warehouse space under construction (including premises for owner occupation) in Kyiv region with high delivery probability for Q4 2011–2012.

Rents and Vacancy

The absence of large completions in the greater Kyiv area over Q1–Q3 2011 made it easier for demand to contribute towards gradual absorption of available space on the market, pushing average vacancy down from 20.5 percent in December 2010 to 11.5 percent in September 2011.

Rental and Vacancy Rates



E – estimate
Source: CBRE

In terms of geographical breakdown, the lowest occupancy rates are observed on the East (Left) bank, where 31 percent of existing stock along Moscow highway (M–01, E–95) is vacant (64 percent of all vacant premises on the market). In contrast, warehouse premises along Kharkiv highway (M–03, E–40) are almost fully leased (vacancy rate is less than 5 percent). Availability rate along Zhytomyr highway (M–06, E–40), the most popular location, – is 3 percent. Premises along Warsaw highway (M–07, E–373) continue to experience high vacancy levels which make up ca.15 percent of the local stock there. The volume of vacant premises in other directions is low and does not have a major effect on average vacancy rate across the market.

Prime rents have remained mostly unchanged over the last nine months – $5.5/sq m/month to $6.5/sq m/month (net of VAT and OPEX). Asking rental rates in the most popular warehouse schemes in the vicinity of key road junctions showed slight growth in Q3 2011.

Outlook

Based on recent announcements of developers, we anticipate ca. 100,000 sq m of new premises to be delivered on the speculative market in 2012 (30 percent less than 7–year average). This figure implies that demand is still limited despite an increase in tenants' activity over 2011. Nevertheless, the number of warehouse projects is large and the volume of new supply may increase dramatically should developers see solid and broad–based increase in demand. Future demand for warehouse premises will rely heavily on the performance of Ukrainian economy and its trading partners, as well as growth in consumer spending. Taking into account current market trends and economic performance in late 2011, average vacancy is likely to stay at two–digit level next year, thereby keeping rental rates from major changes during 2012.

16. TAXATION

Intergovernmental Exchange of Tax Information Mechanism as a New Source of Additional Tax Revenues

BAKER & McKENZIE

The boom years of growth and rising commodity prices are over. The global financial and economic crisis continues adversely to affect the ability of the Ukrainian government to mobilize tax revenues as Ukrainian economy is one of those the most heavily hit by the crisis. At the same time, public expenditures continue their steep climb as Ukraine, in addition to financing its oversized and largely inefficient public sector coupled with aging population, is faced with the ever growing cost of servicing its sovereign debt, thus, further widening its public finances deficit. This is not to mention certain practices of confusing public finances with private ends.

The quest for higher tax revenues to curb budget deficits is further hindered by a limited access of the Ukrainian government to foreign resources. Sovereign borrowings have become prohibitively expensive even for the economies in a far better state of public finances than Ukraine. For various reasons, international financial institutions have also halted their cooperation with Ukraine.

These severe challenges to public finances force the Ukrainian government to seek new sources of tax revenues to mitigate the negative impact of the global financial and economic crisis on Ukrainian economy.

One of the mechanisms aimed at procuring higher tax revenues recently identified and put into operation by the Tax Office is the exchange of tax information procedure. Although the relevant pieces of legislation allowing such exchange have been in place for some time already, the ailing tax revenues have apparently precipitated the active reliance of the Tax Office on this mechanism.

The Tax Office is facing a hard task here. On the one hand, Ukraine gradually integrates into global economy in the light of irreversible globalization and the liberalization processes. This creates new challenges for Ukrainian businesses but also offers immense opportunities, including tax planning opportunities. Some of such tax planning techniques could be safely called aggressive being aimed at tax avoidance if not tax evasion.

This causes a major problem for Ukrainian tax authorities as their enforcement powers are constrained by national borders. Bank secrecy and other confidentiality regulations in many jurisdictions also do not contribute, if not prevent, the proper functioning of the mechanism of disclosure of relevant tax information. Tax havens, with their unfair tax practices, being heavily used by many Ukrainian businesses with international ramifications for the tax minimization purposes, neither align with the Tax Office's goal and efforts in preserving fiscal sustainability. On the top of it, Ukraine lacks even basic legislation on controlled foreign corporations (CFC) and thin capitalization rules as well as exceptionally unsophisticated transfer pricing rules, which even further restrict the Tax Office in countering artificial tax deferral and profit stripping techniques.

Despite these adverse factors, the exchange of fiscal information mechanism is likely to prove to be a rather potent and efficient tool in raising the tax revenues by the Tax Office

through adjusted tax base of Ukrainian businesses, with fiscal information procured from foreign governmental authorities serving as a ground for such adjustment.

In our discussion below we briefly comment on the legal sources permitting the Ukrainian tax authorities to engage into the intergovernmental exchange of fiscal information.

Ukrainian Legislation

As an initial comment, by law, the Ukrainian tax authorities may request tax information from the foreign governmental authorities only through the Department of the International Affairs of the State Tax Service of Ukraine.

This procedure has been established by Procedure No. 185 of the State Tax Administration of Ukraine for the Exchange of Information based on the Special Requests, dated on June 18, 1997 (hereinafter – the "Procedure"), as amended and restated.

The Procedure was adopted in order to establish the "uniform procedure for the exchange of information" and to prevent any unauthorized or groundless requests to be sent to the foreign state authorities by the Ukrainian local level tax offices.

The Procedure establishes the two level system of confirmation of the request. In particular, in case the lowest level Tax Office is interested in obtaining information from the foreign state authorities it is required to file the respective motion with the regional level Tax Office.

The discussed motion with the above information should be considered by the regional level Tax Office in order to identify whether there are legal means to receive the requested information in Ukraine. After the regional Tax Office confirms that it is appropriate to file the request, such regional Tax Office files similar motion with the State Tax Service of Ukraine, the Department of the International Affairs.

The State Tax Service of Ukraine, in turn, carries on similar internal investigation and confirmation procedures before authorizing the request in question.

International Legislation, as Incorporated into Ukrainian Legislation

Generally, the exchange of information may be conducted with the reliance on the mechanisms established by the following bilateral or multilateral instruments:

1. Bilateral Tax Conventions of Ukraine on Income and Capital (hereinafter the "Tax Treaties");
2. European Convention on Mutual Administrative Assistance in Tax Matters (hereinafter the "European Convention in Tax Matters");
3. CIS Conventions on Mutual Administrative Assistance in Tax Matters (hereinafter the "CIS Conventions in Tax Matters");
4. Agreements on Mutual Cooperation in the Tax Matters (hereinafter the "Mutual Cooperation Agreements"); and
5. Tax Information Exchange Agreements (hereinafter the "TIEAs").

Our analysis of the bilateral and multilateral instruments, to which Ukraine is the party, suggests that Ukrainian tax authorities have all required instruments to request and provide tax information related to the Ukrainian companies.

1. Tax Treaties

Ukraine has a wide network of the Tax Treaties, which covers more than 60 jurisdictions. Almost all Tax Treaties contain the Exchange of Information provision, i.e., Article 26 in most of the Tax Treaties.

Article 26 provides effective mechanist for the exchange of information related to the tax matters. Please note that Article 26 is applicable not only to the exchange of information related to the correct applicability of the provision of Tax Treaties, but also to the administration of domestic taxes, which are not related to the Tax Treaties, i.e., Corporate Income Tax , VAT, Personal Income Tax, etc.

Moreover, the contracting state can not refuse to provide information solely because it has no domestic tax interest in the information (paragraph 4) or solely because it is held by a bank or other financial institution (paragraph 5).

At the same time, almost each Tax Treaty provides trade and commercial secret protection, when the requested information should not be provided. In particular, most of the Tax Treaties provides that:

"In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

... to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (ordre public)."

In other words, the Contracting State may not be imposed to supply information, which would disclose trade or commercial secret of its taxpayers.

Moreover, the OECD Commentary to the Model Tax Convention provides that "Contracting States are not at liberty to engage in "fishing expeditions" or to request information that is unlikely to be relevant to the tax affairs of a given taxpayer".

In this connection, it may be reasonably stated that the Tax Treaties are the most effective legal instrument, which is widely used by the Ukrainian tax authorities in order to request information from the foreign tax authorities related to the administration of taxes by the Ukrainian taxpayers.

2. European Convention in Tax Matters

Since 2009 Ukraine is subject of European Convention in Tax Matters. Please note that the discussed European Convention in Tax Matters is effective in 17 countries and additional 15 countries are in the process of implementation of the discussed Convention.

The main purpose of the European Convention in Tax Matters is to establish cooperation between governmental authorities of member states for a better operation of domestic tax laws. Convention provides for different forms of administrative cooperation in the assessment and collection of taxes, in particular with the view to preventing tax evasion.

In particular, according to Article 4 of the Convention "the Parties shall exchange any information, in particular as provided in this section that is foreseeably relevant to:

a. the assessment and collection of tax, and the recovery and enforcement of tax claims;

b. the prosecution before an administrative authority or the initiation of prosecution before a judicial body".

As you may appreciate, the scope of the cited article is wide. According to the Explanatory Report to the Convention issued by OECD, the standard of "foreseeable relevance" is intended to provide for exchange of information in tax matters to the widest possible extent.

Moreover, the European Convention in Tax Matters provides the following five main methods of exchanging information:

- exchange on request (Article 5);
- automatic exchange (Article 6);

- spontaneous exchange (Article 7);
- simultaneous tax audits (Article 8);
- tax audits abroad (Article 9).

As you may appreciate, the European Convention in Tax Matters is more detailed document than the Tax Treaties, which provides for all possible forms of administrative cooperation between contracting states in the assessment and collection of taxes.

3. CIS Convention in Tax Matters

In addition to the European Convention in Tax Matters, Ukraine is a party to CIS Convention in Tax Matters, which is effective in 10 CIS countries.

Similarly to the European Convention in Tax Matters CIS Convention establishes cooperation between governmental authorities of member states for a better assessment and collection of taxes. Convention expressly provides for the mechanisms of exchange of information and scope of such information.

In particular, according to Article 3 of the Convention the contracting states may establish cooperation in the following forms:

- exchange of general information regarding the tax system and administration of taxes;
- exchange of specific information regarding the particular taxpayer, including information related to the violations of tax legislation.

As a result, the Ukrainian tax authorities may effectively use the CIS Convention in Tax Matters for the purposes of exchange of information related to the Ukrainian taxpayers.

4. Mutual Cooperation Agreements

Ukraine is subject to Mutual Cooperation Agreements with more than 25 jurisdictions. Most of the discussed agreements provide the exchange of information provision.

In particular, the Agreement on Mutual Cooperation and Exchange of Information in the Prevention of Tax Evasion, Unlawful Financial Operations and other Economic Criminal Offences with Slovak Republic (2001) provides the possibility of the exchange of information related to the tax evasion and unlawful financial operations. The provided information should only be used for the purposes of the tax audits and not for the purposes of the criminal case investigations. The exchange of information should be carried out between State Tax Service of Ukraine and Ministry of Internal Affairs of Slovak Republic.

Please also note that in practice, the Slovak state authorities are proactive in provision of tax information at the requests of Ukrainian tax authorities.

At the same time, according to the Agreement on Technical Assistance in the Administration of Taxes with Hungary (2009), the competent authorities may only exchange information of the general nature, i.e., regarding the tax system, administration of taxes etc. Information regarding the specific transactions or with respect to the exact taxpayer is out of the scope of the discussed Agreement.

5. TIEAs

Ukraine is not subject to TIEAs. We may not rule our that Ukraine may consider implementing this approach which, on many accounts, has proven to be rather efficient in procuring fiscal information especially in relationship with low-tax jurisdictions.

In a summary, collecting tax revenue, especially during economic crises, has proven to be difficult. The Ukrainian government is fighting a losing battle in collecting sufficient tax revenues to cover its public expenditures. Having generally become much more aggressive in administering and collecting taxes as well as in interpreting tax laws, the government is widely expected to embark on trying and testing other instruments aimed at raising tax revenues, the mechanism of exchange of fiscal information being just one of them.

Taxation of Transactions with Non-resident Legal Entities: CPT and VAT Aspects

BAKER TILLY UKRAINE

Dr. Roman Zharko, PhD
Senior Tax Consultant, Baker Tilly Ukraine

2011 is a landmark year for the Ukrainian tax system. Starting from the January 1st (and from April 1st for corporate profits tax), the brand new Tax Code entered into force bringing many dramatic changes in the tax rules. Many aspects of the tax law were changed not from mere technical standpoint, but amendments often impacted the underlying principles of tax accounting. Inevitably, the rules for taxing cross-border transactions were altered as well.

The aim of this article is to show main points which require particular attention when dealing cross-border considering new tax rules from the Corporate Profits Tax (CPT) and the Value-Added Tax (VAT) standpoint. Treatment of the permanent establishments is also concerned.

Corporate Profits Tax

From the CPT standpoint there are several areas of concern when dealing with tax treatment of operations with non-residents. These are as follows:

- Deduction for tax purposes of expenses of Ukrainian companies incurred due to operations with non-residents
- Taxation of outbound payments by withholding tax (WHT), and
- Use of benefits of double tax treaties provisions

Also the due regard should be given to local treatment of concept of permanent establishment (PE), as this is of significant importance both for residents and non-residents of Ukraine.

One of the most significant concepts which are new for the domestic law and reference to which is found in many provisions relating to cross-border operations is the concept of beneficial ownership. Despite the Tax Code operates with this term, it does not provide for its clear definition. The recent developments by OECD regarding giving more precise definition of who is a beneficial owner of the particular proceedings are unlikely to have any serious impact on the Ukrainian treatment of this term as Ukraine is not a member of OECD and its commentaries are not binding for Ukrainian authorities.

The Tax Code restricts the right to apply double-tax treaty (DTT) provisions only to cases where the non-resident receiving income is a beneficiary of that income. Otherwise, the tax authorities would challenge applicability of DTT benefits.

The Tax Code says that beneficial owner of the income is the entity which is entitled for this. However, even if the entity has a right for the income, it cannot be recognized as a beneficial owner if this entity is an agent or nominee or intermediary regarding the income. Such a broad definition put many cross-border operations under risk, as beneficial ownership for the income is one of the two requirements which are to be met in order to apply the relevant double tax treaty provisions rightfully. Thus, the parties should be ready to defend the lawfulness of use of treaty benefits as the tax authorities pay considerable attention to cross-border transactions and use of DTTs.

This is of particular importance in case of use of financing companies, multi-tier holding structures, etc. where the task of defining of the beneficiary may not be straightforward.

Continuing our analysis with deductibility of expenses for the CPT purposes it must be noted that expenses in order to be deductible must comply with the following general requirements:

- Relate with business activities of the taxpayer;
- Be properly evidenced by primary documents;
- Comply with transfer pricing rules (20 percent safe harbor is allowed).

As to expenses incurred due to operations with non-residents, the Tax Code provides for further restrictions. Thus, the law preserves provision limiting deductible amounts of expenses incurred due to transactions with offshore non-residents to 85 percent of their original value. Such non-residents are the entities with their residence in the countries defined as offshores for Ukrainian tax purposes. The list of offshore countries has been approved by the Government of Ukraine and includes 36 countries, where amongst others such countries as Isle of Man, Monaco, British Virgin Islands, etc.

Payments to other non-residents, i.e. not having the offshore status are generally deductible provided they comply with general rules of deductibility listed above. However, the Tax Code provides for upper limits as to amounts allowed to be deducted for certain expenses. These "restricted" expenses are follows:

- Royalties
- Consulting, marketing and advertisement services
- Engineering services

Deductibility of royalties, consulting, marketing and advertisement services is limited to 4 percent of paying company's revenues (without VAT) for the previous year. Thus, newly formed companies would not be entitled to less their taxable income for such expenses at all as those companies would not normally have the base for calculation of the threshold.

Engineering services are allowed for deduction at 5 percent of the custom value of the relevant imported goods. However, importing goods is not a necessary condition for engineering services to be purchased. And if the services do not relate to the imported goods, the respective expenses would not be deducted at full.

Also the Tax Code provides for other limitations of deductibility of the mentioned above expenses:

- The recipient of the proceeds should be their beneficial owner
- The recipient should not be a non-resident with offshore status

Furthermore, royalties are subject to two additional restrictions:

- The object of royalties should not be firstly registered in Ukraine
- The royalties must be taxable in the country of the recipient.

The above requirements aim at restriction of improper use of treaties' benefits and tax avoidance through artificial business structures without any real business reason except for minimizing of tax burden. However, the downside is that ambiguously worded provisions of the Code may put under risk a number of bona fide taxpayers.

Withholding tax

The main provisions relating to WHT remain in the Tax Code as they were in the former legislation. Specifically, the object to tax is primarily passive incomes, the main rate is 15 percent, and the tax should be remitted to the State prior or on the date of the relevant payment. Also the Tax Code denies gross-up provisions and preserves the requirement of availability of residence certificate

What is changed, that is the current law requires that the recipient of the income should be its beneficiary in order the DTT to apply. With this regard we would add to the matters already described above that vague law provisions will most likely trigger disputes between business and tax authorities as to lawfulness of treaty provisions application where the latter does not provide for the beneficial ownership requirement. In conjunction with this it is need to say that under the Ukrainian legislation international agreements prevail over domestic law.

Value-Added Tax

Amendments in rules of taxation by VAT are less significant than those relating to CPT. As it had been set up by the former VAT law, export transactions are been taxed at zero rate. However, the Tax Code exempted from VAT export of grains and technical crops until 2014. This deprives traders from claiming input VAT from the State.

Import of goods and services is taxable under the standard rate of 20 percent through reverse-charge mechanism.

When dealing cross-border, the matter of particular relevance is determination of place of supply of various services. As a general rule, the Code stipulates that place of supply for services would be a place of supplier's registration. However, the law provides for a limited and exclusive list of services whose place of supply would be place of registration of customer. Those are as follows (please note that the list provided is not comprehensive):

- Provision of intellectual properties rights, including those under license agreements;
- Advertisement services;
- Consulting, engineering, legal, accounting, audit, actuarial services, as well as services for development, supply and testing of computer software, other IT services;
- Telecommunication services;
- Agency services;
- Transport and auxiliary services.

The VAT base for imported goods is been determined at the contractual value but not less that customs value. For imported services the rule is that the VAT base would the contractual value of the services.

Permanent establishment

The concept of PE presented in the Tax Code has changed and became more specific. The new definition of PE distinguishes such types of PE as follows:

- Fixed place PE
- Installation PE
- Agency PE
- Service PE

Installation PE should be recognized as such if the installation project takes more than 6 months. The same duration within any 12-month period is enough for service PE to be created. The latter arises due to provision of services (including consultancy, but excluding provision of employees) in course of one project carried on in Ukraine through employees or other personnel hired for such purposes. Such a definition is rather vague and leaves a space to different treatment as to what is "in Ukraine", will the separate project be treated as a certain task within one contract, or all the tasks in the contract will be treated as one project etc. However, there are no clear further provisions as to determination of Service PE which might lead to potential disputes with tax authorities.

As to agency PE recently there were amendments in the Tax Code which made this definition more strict and now this kind of PE includes only dependent agents.

Permanent establishment is deemed to be a separate taxpayer and liable to tax its income by 23 percent (21 percent in 2012) of the Corporate Income Tax.

Creation of PE might have far-reaching consequences, as incomes of non-resident company, attributable to such a PE would be taxable by Ukrainian CPT. With regard to VAT, creation of PE will put under taxation by the Ukrainian tax services, whose place of supply otherwise would be out of customs territory of Ukraine.

Also, it worth to mention that failure to register PE as a taxpayer prior to starting activities in Ukraine would trigger treatment of proceedings received before registration as hidden from taxation. Therefore, risk of PE creation needs serious considerations.

Summarizing all the above below we provide a short list of issues to be considered when dealing cross-border in order to reduce tax risks:

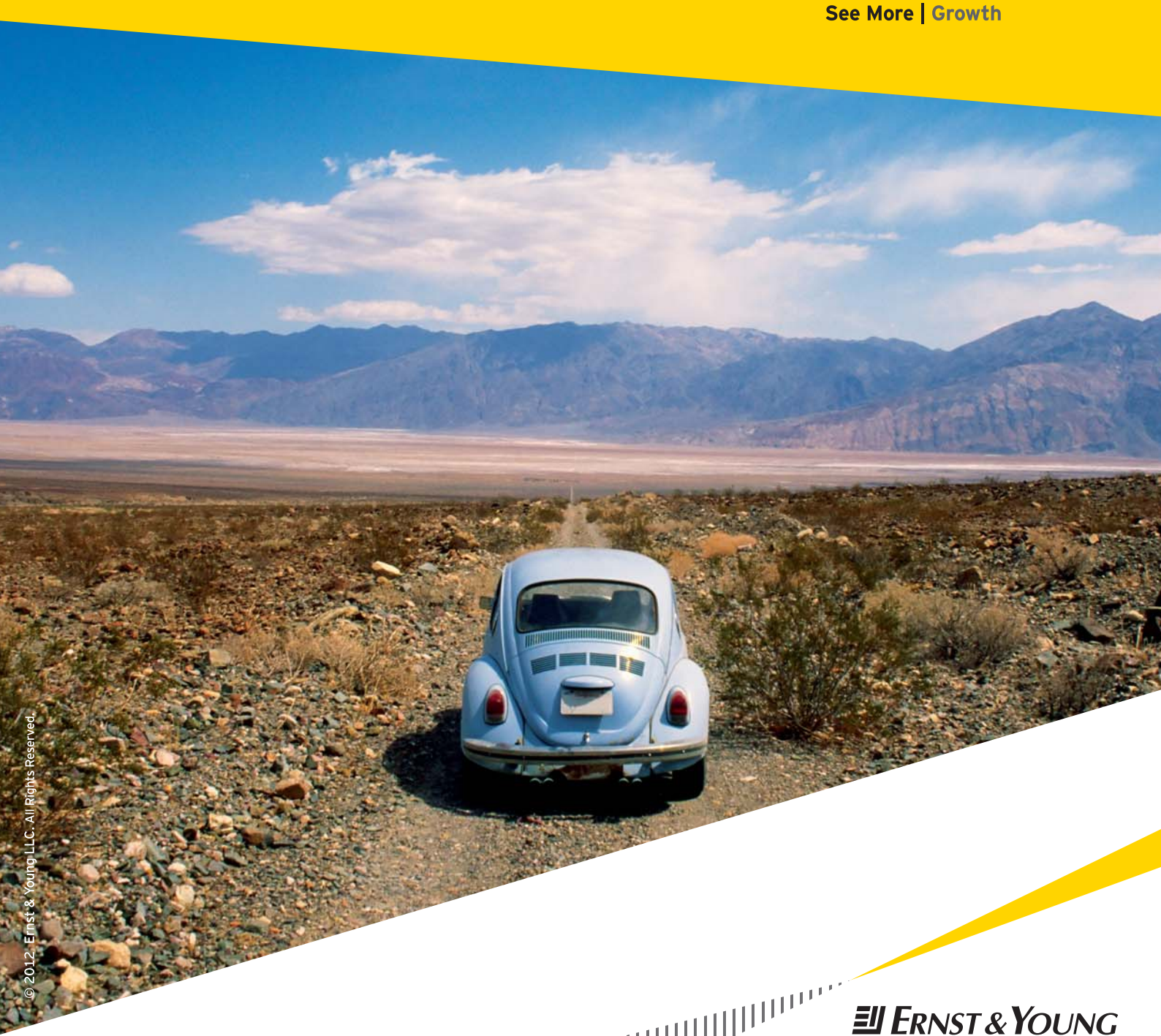
- Applicability of the double-tax treaties (DTT) provisions;
- Restricted deduction for certain expenses
- Place of supply for services and rules for determination of the VAT base
- Whether export of specific goods is VAT-able
- Risk of creation of permanent establishment

The first year of playing new rules proved that the Tax Code needs further developments. Relating to areas discussed in this article the amendments need to be done to the beneficial ownership concept in order to bring there some certainty. The same relates to definition of service PE, as vague wording of the law leaves large room for tax authorities to interpret transactions and their results from the fiscal standpoint.

What does it take to become a leader in an emerging market? Work with someone who already is.

Successful entry to new markets often depends on collaboration with trusted local advisors. Through extensive research with 2,200 senior executives around the world Ernst & Young has developed key insights into how the world's leading businesses are forging relationships with local partners to achieve profitable growth. To learn more visit ey.com/ua.

See More | Growth



ERNST & YOUNG
Quality In Everything We Do

Ukraine 2013: Transfer Pricing

Ernst & Young
Quality In Everything We Do

Ukrainian business will remember 2011 as the year of the new (and first-ever) Tax Code of Ukraine. The Code established a number of controversial rules, forcing taxpayers to change some of their long-established transactions and practices and created a lot of turmoil for many.

The period of change may not be over, however, as some of the Tax Code's provisions will take effect at later dates.

The year 2013 could be one of new transfer pricing rules in Ukraine, as the relevant provisions of the Tax Code are scheduled to take effect then.

Anticipating these changes, we looked into the new transfer pricing legislation and compared it with effective law. We aimed to identify the major changes in the regulations and foresee their impact on businesses.

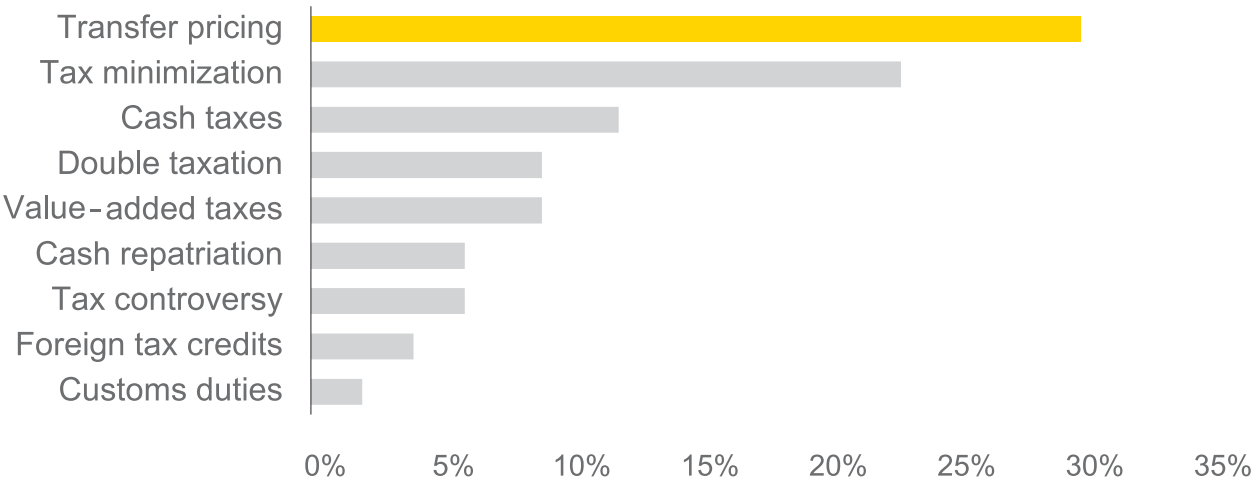
Why transfer pricing?

Transfer pricing (TP) primarily refers to the pricing of goods and services in intra-group transactions.

From a tax perspective, TP is particularly important in cross-border transactions, given the differences in income tax rates among countries around the world. Using transfer prices can allow multinational organizations to bring down their overall tax burden by keeping low margins in high-tax jurisdictions and shifting profits to low-tax countries. To combat these practices, many developed countries have introduced TP regulations that require multinational organizations to perform intra-group transactions at arm's length prices.

The Ernst & Young 2010 Global Transfer Pricing Survey (2010 Survey), which summarizes transfer pricing practices and audit experiences across 25 countries, shows that in developed nations transfer pricing is considered to be a leading tax issue. Because it has implications for each and every business process, transfer pricing creates significant challenges for taxpayers and attracts more and more attention from tax authorities. The 2010 Survey

Graph 1: "Most important tax issues for tax directors"



According to the 2010 Survey, today's transfer pricing is characterized by the following trends.

evidenced that taxpayers find themselves in the challenging position of documenting and defending their transfer pricing.

Meanwhile, the Organization for Economic Cooperation and Development (OECD), in defining the transfer pricing framework for the vast majority of its developed country members, continues to update its transfer pricing guidelines.

On balance, companies are facing conditions that dictate that adopting thorough transfer pricing policies and practices be at the top of their tax agendas. [Graph 1: "Most important tax issues for tax directors" – page 7 of the 2010 Survey]

Tax authority staffing

Tax authorities are taking steps to develop their approaches to managing transfer pricing reviews.

For example, in the United States, the Internal Revenue Service (IRS) has significantly increased its number of transfer pricing economists, with the goal of maintaining the highest number of them in its history. As part of its transfer pricing focus, the IRS announced a number of other changes, such as the creation of a Transfer Pricing Practice and the establishment of a Transfer Pricing Council to coordinate transfer pricing reviews.

In the United Kingdom, Her Majesty's Revenue and Customs (HMRC) has effected similar transfer pricing developments by issuing Guidelines for the Conduct of Transfer Pricing Enquiries. The Guidelines mandate the creation of a specialized Transfer Pricing Group and a transfer pricing review board.

Tightening disclosure requirements

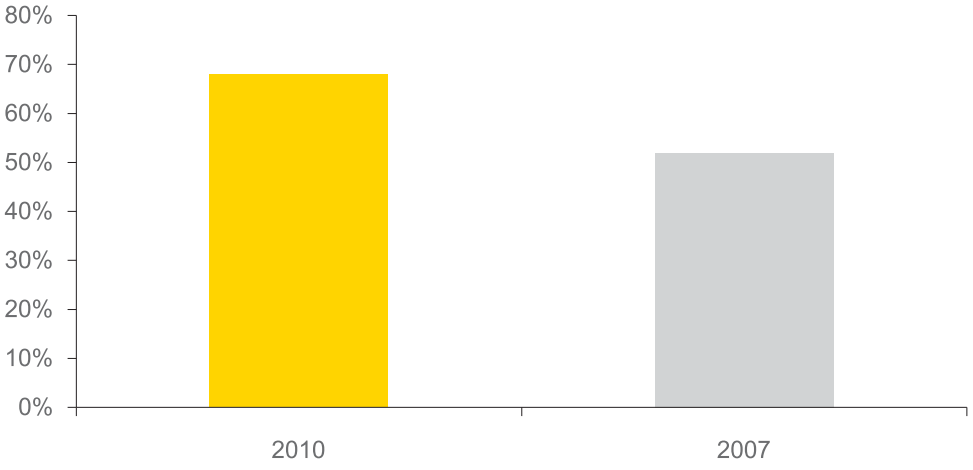
Along with increased transfer pricing staffing, tax authorities in developed countries are introducing new transfer pricing disclosure requirements. These requirements aim at increasing the transparency of taxpayers' intercompany transactions and their transfer pricing risks.

In the United States, the IRS has also increased penalties for failure to accurately file related party transactions. The IRS is also developing protocols for conducting joint transfer pricing audits with its treaty partners.

An increasing risk of challenges

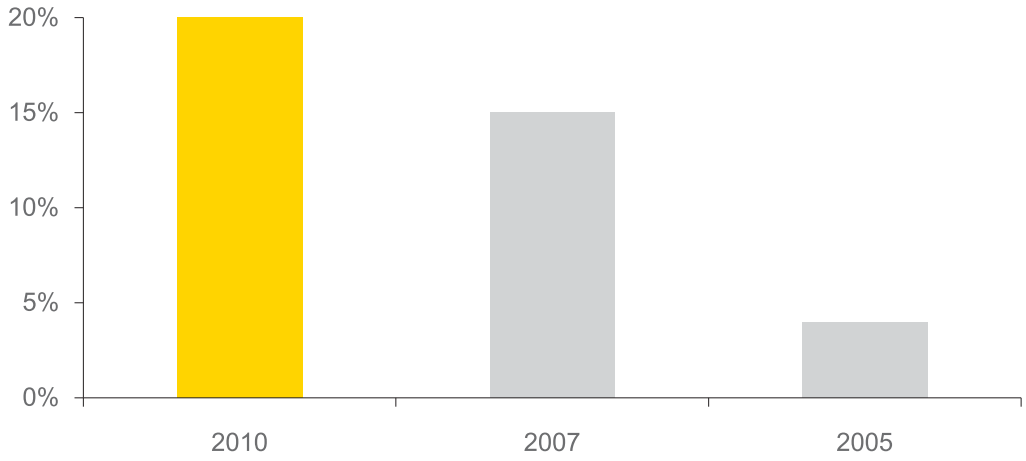
The 2010 Survey shows that the number of transfer pricing reviews has increased globally. [Graph 2: "Incidence of transfer pricing reviews"].

Graph 2: "Incidence of transfer pricing review"



The risk of a challenge by the tax authorities continues to increase. According to survey results, there is now a 1 in 5 chance of suffering a material penalty as a result of a tax audit review, compared with a 1 in 25 chance in 2005. [Graph 3: "Percentage of adjustments resulting in penalties"].

Graph 3: "Percentage of adjustments resulting in penalties"



Expansion of transfer pricing scope on emerging markets

As practice shows, the scope of transfer pricing is expanding not only in developed countries but in many emerging markets as well. Recent transfer pricing reform introduced in Russia confirms this trend.

In 2011 Russia adopted new transfer pricing legislation, which is to take force in 2012. The new transfer pricing law contains a number of provisions similar to the OECD ones. This means that Russia will start to exist in a new transfer pricing environment, moving in the direction of the worldwide transfer pricing practice discussed above.

Ukraine on the map of transfer pricing expansion

In Ukraine, TP rules have been underdeveloped for many years.

A little bit of history

For many years now, the Ukrainian TP rules have been limited to one paragraph, paragraph1.20 to be precise, in the Law of Ukraine On Taxation of Enterprises' Profit. The wording of this paragraph was upgraded in 2002 and has not changed much since then.

These effective provisions on TP contain some basic concepts; however, they lack methodology and guidance for practically implementing them. As a result, TP regulations have not yet functioned in full force in Ukraine.

In practice, the Ukrainian tax authorities usually challenge transactions in which sale prices are below the cost of goods (services). In these cases, the authorities often do not even question the arm's length level of the contract price,

but rather dispute the business nature of the transactions (as they arguably are not aimed at generating profit). In addition, the tax authorities sometimes initiate tax reassessments when taxpayers sell similar (identical) goods (services) to customers at prices that differ significantly. Purchases of goods (services) can also be challenged if the purchase prices differ.

As a separate area, the tax authorities sometimes view manipulations with prices as evidence of the absence of business substance. This gives the authorities a basis for claiming the invalidity of the relevant agreements and reversing their tax implications.

The tax authorities tend to avoid TP reassessments as such (i.e. when the reassessments are based solely on the argument that the contract prices are not at the arm's length level). The reason is that the authorities bear the burden of proof in these disputes and are not well-equipped to build strong cases. They lack resources and a methodology for searching out and analyzing comparables.

What's new in the new TP rules?

In the Tax Code, the TP rules are squeezed together into Article 39.

Similarly to the existing legislation, under the new TP rules the contract price is presumed to be at arm's length unless proved otherwise. To a great extent, the scope of transactions subject to TP rules remains unchanged under the new rules. The burden of proof in TP disputes still lies with the tax authorities.

At the same time, the Tax Code introduces significant changes to the TP rules. The major ones are:

1) *Methods:* Article 39 of the Tax Code contains a list of five methods for determining the arm's length price and a short description of each: comparable uncontrolled price, resale price, cost plus, profit split and transactional net margin. The comparable uncontrolled price method is described in the greatest detail (the description is similar to that in the existing legislation). Although all the methods are put in a certain order, the Tax Code does not mention that they have to be applied successively.

   In the effective TP provisions, only the comparable uncontrolled price method is expressly mentioned and described, while certain other methods are incorporated by way of reference to the statutory accounting standards and national standards for property evaluation.

2) *Covered transactions:* Unlike the effective law, Article 39 contains a list of transactions that are subject to arm's length price regulations. This list is non-exhaustive and refers to other provisions of the Tax Code.

   Similarly to the existing regulations, the new transfer pricing rules will apply not only to related party transactions and barter, but also to transactions with taxpayers that do not pay corporate profit tax under the general rate (e.g. non-residents). At the same time, transactions with individuals who are not entrepreneurs are specifically excluded from the covered transaction. This is a positive change compared to today's rules. It will affect, in particular, businesses' granting of discounts, the giving away of promotional gifts and other transactions with individual end customers.

3) *Sources of information:* The Tax Code provides for an open list of the official information sources to be used when determining the arm's length price. This list includes inter alia the state authorities' statistical data, commodity or stock exchange quotations and reference data in special publications. The Tax Code requires that only data from official sources be used. However, it does not specify how the official status of information sources should be confirmed and/or obtained.

The effective legislation does not contain any requirements as to the sources of information that can be used for TP purposes.

4) *Safe harbor:* The new TP rules allow for a 20 percent safe harbor. Tax reassessments are not permitted if the contract price deviates from the arm's length price by less than 20 percent.

   Historically, this safe harbor has applied for VAT purposes. The Tax Code, however, has changed that and introduced an allowable 20 percent deviation for corporate profit tax purposes (while cancelling it for VAT).

5) *Procedure for TP-related tax reassessments:* Under the Tax Code, the tax authorities need to bring a case to court only if the taxpayer appeals against the tax reassessment that was raised under the TP rules. This is in contrast to the effective legislation, which does not provide any rules for a procedure for these reassessments. Instead, reference is now made to the tax reassessment procedure under the so-called indirect method, despite that these methods have been abolished by the Tax Code in 2011. Therefore, until 2013 there is arguably no procedure for TP reassessment. Taxpayers might use this fact as a formal argument in TP disputes.

6) *Advance TP agreements:* Under the Tax Code, big taxpayers may enter into advance TP agreements with the tax authorities. The provisions on these agreements are very limited and thus require further development in relevant regulations.

7) *Arm's length price of imported goods:* The new TP regulations provide that the arm's length price for imported goods may not be lower than their customs value. Literally, this means that in all transactions with goods that were historically imported to the customs territory of Ukraine, the arm's length price may not be lower than the customs value. This provision does not allow for any flexibility for promotional discounts, reduction of price for damaged or slow moving goods, etc. We expect that this rule could have an adverse impact on taxpayers engaged in trade in imported goods. This impact would be aggravated in situations when the customs authorities reassess the customs value of imported goods to a level significantly higher than the contract price.

As compared to the more developed TP legislation of other countries, the new Ukrainian rules have no TP documentation requirement for taxpayers. At the same time, the new rules, like the effective law, allow the tax authorities to request from the taxpayers support and explanation for the prices they use, and taxpayers should be able to provide it. There are, however, no requirements about what documents can be used for these purposes.

Will it work?

Although representing a step forward in comparison to the effective regulations, the new TP rules that the Tax Code establishes are still far from the world's best practices. A major concern is that the new TP rules will not function and that, despite the changes in the law, TP will remain an underdeveloped area of taxation in Ukraine.

The following important elements are still missing from the Ukrainian TP system:

- The Ukrainian tax authorities do not possess appropriate knowledge and resources to be able to control compliance with the TP rules, and
- There is no detailed methodology for applying various methods for determining the arm's length price.

Both elements are crucial for a workable TP system and they could become an issue in Ukraine.

The Ukrainian tax authorities must invest a lot of effort and money in building up their TP expertise and resources. The TP rules may be promising in terms of tax collection, but there is a long way to go before the tax authorities can apply the TP rules and transform them into tax assessments.

Another element missing in Ukraine so far is a detailed methodology to be used in TP analysis. The Tax Code contains a very general description of the methods available for determining the arm's length price. These limited rules are insufficient in Ukraine, where there is no history or practice of applying these methods. Additional regulations are thus required to explain the mechanics of each method.

The year 2013 could become the year of TP in Ukraine. For this to happen, however, additional TP regulations must be developed and implemented and the tax authorities must make a huge investment in building up their TP expertise. Taxpayers, for their part, must pay more attention to TP matters and adjust their transactions and pricing approaches to the new tax rules and practice.

Ukrainian Tax Authorities are Ready to Challenge Double Tax Treaty Benefits

Mr. Oleg Chayka
Ms. Yuliya Nogovitsyna
KPMG

The Ukrainian withholding tax is an important consideration for foreign persons investing in or transacting with Ukrainian businesses. Historically, dividends, interest, royalties and certain other payments to foreign persons have been subject to a 15 percent Ukrainian withholding tax. The tax has been withheld from payments to foreign persons and remitted to the budget. An exception was if it was mitigated or eliminated under double tax treaties which Ukraine was party to.

However, the Tax Code that took effect this year has complicated the rules for claiming tax benefits under double tax treaties. And this, understandably, can and has already been affecting businesses. To enjoy double tax treaty benefits, an eligible foreign entity will now need to meet two key requirements. The foreign entity needs to be both a tax resident in a jurisdiction with which Ukraine has a double tax treaty and a beneficial owner of the Ukrainian-sourced income.

It is easy for most foreign persons to meet the first requirement by providing foreign tax residency certificates. But it is much more onerous for foreign persons to meet the second and to demonstrate beneficiate ownership of Ukrainian-sourced income.

In common legal terminology, beneficial ownership means de facto possession and/or benefits of ownership of a property even if the de jure title to this property is formally in the name of another person. This implies that agents, nominees, trustees and certain other intermediaries cannot be beneficial owners as they do not economically and otherwise benefit from assets that they hold for and on behalf of other persons. For instance, Cypriot companies that receive loans or licenses to use trademarks, and then on-lend these funds or sublicense trademarks (as the case may be) to Ukrainian companies may potentially be viewed as intermediaries that are not the beneficial owners of Ukrainian-sourced interest or royalties.

In practice, application of the beneficial ownership concept gets complicated. There is neither a Ukrainian nor internationally recognized definition of beneficial ownership when it comes to fiscal dealings. But there are numerous sources that help interpret the fiscal meaning of beneficial ownership, including foreign court rulings as well as papers and commentaries from international organizations.

The Ukrainian tax authorities are not experienced in dealing with this fact-driven tax concept. In the absence of a legislated definition and tax jurisprudence on beneficial ownership, Ukrainian tax authorities inevitably tend to take a fiscal approach and put the onus of proof on the Ukrainian taxpayers and their foreign counterparts.

The Ukrainian tax authorities have hinted that the intellectual property sublicensing structures would take the first hit as they are easily identifiable and challengeable. The intermediary financing and investment holding structures would likely follow the trend.

The Ukrainian tax authorities have recently stated that they would apply the beneficial ownership test even if a double tax treaty does not refer to the beneficial ownership status of the foreign income recipient. They have also

indicated readiness to challenge exemptions from withholding tax available under the Soviet Union–Cyprus double tax treaty that is honored by Ukraine and that does not provide for the beneficial ownership requirement. This position of the Ukrainian tax authorities is arguable and there are reasonable doubts that it would be sustainable in a court of law.

Introduction of the beneficial ownership requirement in the Tax Code will have a major impact on payers of dividends, interest, royalties, and, potentially, certain other payments to foreign entities.

Being tax agents responsible for withholding and remitting tax to the budget, Ukrainian payers will face an uneasy choice. They will have to deduct the 15 percent withholding tax and leave it up to the foreign income recipient to deal with the refund of overpaid tax, or apply the reduced treaty rates (exemptions) and then face a tax dispute with Ukraine's tax authorities on adequacy of this tax position.

The first option would inevitably aggravate business relations with foreign counterparts or shareholders, or invoke a gross-up clause that would boomerang back to the Ukrainian payer. This option does not usually work for intra-group payments.

Theoretically, a foreign income recipient can claim a refund of the excessively withheld tax. In practice, the tax refund procedure is overcomplicated and Ukrainian tax authorities are consistently failing to refund taxes on a timely basis. And now they can legitimately delay or even deny a tax refund on the basis that there is no adequate proof of beneficial ownership of Ukrainian-sourced income.

Presenting documentary evidence may not help as the tax authorities refused to provide even an indicative list of documents proving the beneficial ownership test. In the absence of such a list, there would often be a debate as to whether the presented evidence and documents are sufficient. With respect to the foreign income recipient, the latter may find it difficult to credit or deduct the overpaid Ukrainian taxes in the jurisdiction of tax residence. As a result, the overpaid Ukrainian withholding tax can become an additional cost of investing in or doing business with Ukrainian counterparts.

The second option inevitably puts the Ukrainian taxpayer at risk of being assessed to pay the 15 percent withholding tax and a tax penalty varying from 25 percent to 75 percent of the undeducted tax. The tax arrears interest can also be charged. As a result, the Ukrainian taxpayer can be held liable for taxes of the foreign income recipient, and this tax exposure can be significant.

To sum up, prospective foreign investors will have to pay more consideration to the beneficial ownership requirement and substance when structuring their investments in and transactions with Ukrainian businesses. The existing financing, sublicensing and investment holding structures may need to be revisited in light of recent tax developments in Ukraine. Ukrainian taxpayers should initiate and lead such discussions as it is often much easier to restructure the existing business model, ensure more substance abroad or even collect evidence of beneficial ownership in advance rather than to litigate this fact-driven tax issue in Ukrainian courts. Your tax advisors can assist in addressing this issue.

Mr. Oleg Chayka *is an M&A Tax Director at the Kyiv offices of KPMG. He is also a co-chair of the Tax Committee at the American Chamber of Commerce in Ukraine.*

Ms. Yuliya Nogovitsyna *is Senior Tax Manager, the Head of International Corporate Tax Group at the Kyiv offices of KPMG.*

This article was initially published in International Tax Review on October 1st 2011, and can be accessed at: ***www.internationaltaxreview.com***

17. TRAVEL AND TOURISM

Travel and Tourism Sector Overview

2011–2012 Partnership for Successfully Competing in the Global Economy Report

In 2010 Ukraine experienced increases in internal tourist flow and in incoming tourism. In 2010 Ukraine was visited by 21.1 million foreign tourists: 2 percent or 381.2 thousand more than in 2009.

Table 1. Rating of 10 major countries for incoming tourism in 2010.

		Persons	Share, %	2010/2009
1	Russia	7 881 321	37	+ 13%
2	Moldova	4 057 678	19	– 6%
3	Belarus	3 056 157	14	+ 2%
4	Poland	2 085 245	10	– 18%
5	Hungary	941 240	5	+ 16%
6	Romania	909 553	4	– 15%
8	Slovakia	609 279	3	+ 13%
7	Germany	225 356	1	+ 6%
9	USA	122 955	0,6	+ 2%
10	Uzbekistan	104 719	0,4	+ 9%
Total of 10 countries		**19 993 503**	**94**	

Source: State Service of Tourism and Resorts of Ukraine

The outgoing tourist flow of 2010 amounted to 17.2 million persons, which was 12 percent or 1.8 million persons more than in 2009.

Table 2. Rating of 10 major countries for outgoing tourism in 2010:

		Persons	Share, %	2010/2009
1	Russia	5 233 972	30	+ 5%
2	Poland	3 999 602	23	+ 35%
3	Moldova	1 889 724	11	– 5%
4	Hungary	1 789 308	10	+ 12%
5	Belarus	1 135 094	7	+ 9%
6	Romania	503 195	3	– 8%
7	Turkey	459 061	3	+ 4%
8	Slovakia	383 961	2	+ 2%
9	Germany	383 325	2	↑ in 2 times
10	Egypt	328 623	2	+ 39%
Total of 10 countries		**16 105 865**	**93**	

Source: State Service of Tourism and Resorts of Ukraine

Thus, during the first six months of 2010, entities in the tourism sector provided services in the amount of 3.4 bln UAH, which is 21 percent more than they provided in the same period of the previous year. They provided revenues to the state budget of 100.5 mln UAH, which is 17 percent more than during the first six months of the previous year.

As estimated by representatives of the State Service of Tourism and Resorts of Ukraine, the market for tourist services in the country has today seen a recovery from the fall that came after the world economic crisis.

Nevertheless, there are certain problems in Ukraine that pose a significant deterrent to economic growth in the tourist sphere. The lack of regular and substantial funding prevents Ukraine from achieving competitive positions in the world tourist market. Sector development is financed both by private investors and by state allocations.

State tourism sector development programs envision that the government will provide only 20 percent of the needed investment; the rest is expected to come from private investors. However, private businesses do not seem to be eager to invest in the Ukrainian tourism sector. There is widespread agreement among experts that a lack of political stability and poor or unenforced legislation, especially in the areas of taxation, land, construction, customs, and permit issuance are the key factors restraining private investors from investing. Yet many investors recognize the potential of Ukrainian tourism and would be interested in launching projects in this country if the legislation became more transparent and the political situation grew more stable.

In this regard it is worth mentioning that Ukraine's tourist industry has huge investment potential. The country has a rich historical and cultural legacy, diverse natural conditions for recreation, a favorable geographical location, a large number of recreational facilities, a market economy, aspirations for European integration, and substantial land resources that could be used by investors for developing the tourism infrastructure.

Obviously, to create incentives for investors and attract them to the Ukrainian tourism sector, it is necessary to create an enabling business environment overall and in the sector specifically. The government took some steps toward that in 2008 when the Cabinet of Ministers approved the "Tourism and Resorts Development Strategy," aimed at improving the investment climate in tourism. However, most state officials in charge of the tourism sector regulation admitted that there have been problems with the proper enforcement of this strategy, which undermines the achievement of its goals. In addition, the Draft Law "On Measures of State Support for Development of the Tourism Industry in Ukraine to Ensure Preparation for the EURO 2012 Football Championship," which is meant to remedy the situation in the sector, has yet to be adopted.

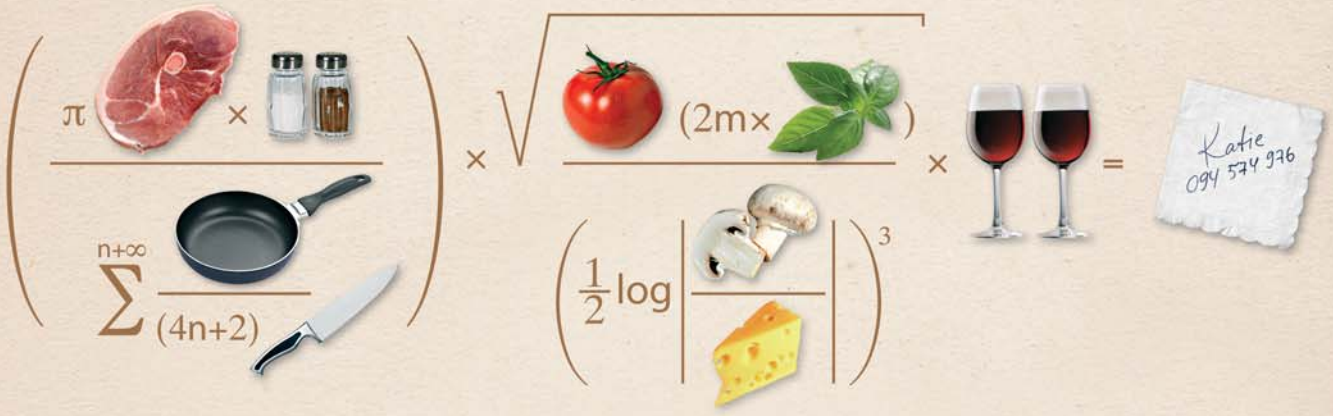
Further development of the travel and tourism sector and the enhancing of its competitiveness depend on reforming its legal and regulatory environment to create a business climate that is attractive for investment. In addition, several more steps are critical for growth in Ukrainian tourism:

- Improving the country's infrastructure;
- Ensuring that the level of tourist services in Ukraine corresponds to international standards;
- Developing new or enhanced diversified tourism products and destinations;
- Cultivating a skilled, educated, and motivated workforce with knowledge of English and other widely spoken languages;
- Building the country's brand and marketing it regionally, nationally, and internationally;
- Establishing a well-functioning network of information centers for visitors to ensure exchange and dissemination of complete and reliable information about Ukraine's tourism assets.

Without these reforms, significant development of the tourism sector in Ukraine is very unlikely.

Another important step for sector competitiveness development is improving the taxation of travel services. At present the elaboration of proposals and amendments to the Tax Code of Ukraine is the main objective and agenda of the American Chamber of Commerce in Ukraine Travel and Tourism Committee.

Tourism development in Ukraine means creating a favorable organizational, legal, and economic environment for the development of this industry, and the development and marketing of domestic tourist services, which are competitive regionally and internationally. All this can be accomplished using the natural, historic, and cultural potential of Ukraine, even while protecting Ukraine's social and economic interests, historic sites, and environmental security.



Chamber Gourmet Club

Formula for better dining

www.gourmetclub.ua

Some things are easy to understand everywhere.

As for the rest we'll help you figure it out...

The American Chamber of Commerce in Ukraine offers a direct link to leading businesses from over 50 nations across the globe.

We are a dynamic and effective organization that strives to address and resolve your company's advocacy needs at the same time providing a strong Networking and Information platform that contributes to your organization's success.

UKRAINE ACC
THE CHAMBER OF COMMERCE

www.chamber.ua

Euro Leasing – expert in financing of transport for your business

Medeya Uridiya,
Euro Leasing account manager

Operational and financial leasing

Fleet-online

Multi-brand fuel card

Insurance

Service products

(044) 490 10 87
www.lease.com.ua

EURO LEASING
European financial service

The 2012 Country Profile is an exclusive publication that provides a comprehensive overview of Ukraine's economy broken down by sector. This analytical publication provides unique insight and is developed with the help of leading experts among the American Chamber of Commerce membership. The electronic version is also available in English and Ukrainian on the Chamber web-site at: **www.chamber.ua** as well as partner online resources.

UKRAINE ACC
THE CHAMBER OF COMMERCE

Horizon Park Business Center
12 Amosova St., 15th Floor
Kyiv 03680, Ukraine
Phone: (380-44) 490-5800
Fax: (380-44) 490-5801
E-mail: chamber@chamber.ua
www.chamber.ua