



The Business & Law Readers Digest

**Due Diligence:
Ukrainian Perspective**

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Contents

Due diligence: goals and main issues	3
Different types of due diligence	4



Taking into consideration the rapidly growing market of mergers and acquisitions in Ukraine, over the last five years the external part of due diligence procedure has become familiar in one way or another to all specialists involved in M&A activities. However, the specific types of due diligence process are not so well known to the buyers of assets or an existing business. It so happens that the question of choosing the proper type

of due diligence procedure seems rather complicated for a decision-making owner or manager meeting with a specific type of transaction to be carried out.

This brochure covers the aims and objectives of due diligence procedures depending on the type of transaction, trends of due diligence procedure in the Ukrainian market, and aspects of vendors due diligence.

Due diligence: goals and main issues

What are the goals of a due diligence review? The main purposes of the due diligence procedure are, certainly, to receive true and impartial information and data with regard to the target company or business, to make an unbiased appraisal of the target company, including its assets, and, finally, to minimize various risks which may emerge after the transaction is completed. This list can, for sure, be extended depending on the situation and the requirements of the specific purchaser.

Furthermore, the type and scope of due diligence review to be performed shall be determined on the basis of the type of transaction planned, taking into consideration the size of the transaction, the legal structure and the type of target company. On the basis of the above, the purchaser's goals and objectives and the type of due diligence review should be chosen by the purchaser.

It should also be noted that notwithstanding the goals of the purchaser and type of due diligence, there are certain obligatory assignments of any due diligence review. There should be specific focus in the report on these tasks, which include the following issues.

Firstly, the financial records of the target company or business are to be carefully reviewed. Such a review includes verification of balance sheets, income and expense statements, various tax issues, liabilities, accounts payable, operating budgets and forecasts. This part of a due diligence review is to be performed by skilled financial and tax analysts. However, we believe that looking through a company's accounts may also help a lawyer to get better understanding of company's assets which are core issue in the due diligence.



Secondly, the existing contracts and agreements of the target company are to be checked. This stage of due diligence procedure includes verification of all contractual rights and obligations for the target entity to be properly evaluated. Such existing contracts and agreements shall include any and all sales and supply contracts, joint venture and partnership agreements, as well as other existing material agreements which the company is involved in. Closely related to this stage is verification of any and all agreements related to the target company's property and assets. This includes all existing lease agreements, pledge and mortgage agreements, loans, contracts and the company's rights with respect to intellectual property. Such the verification procedure is much more simplified since the official state registers of

pledges, mortgages, and other encumbrances were implemented in 2003. However, some disadvantages of the existing encumbrance registration system often force lawyers who carry out due diligence to use unofficial information sources.

Thirdly, all files on existing litigations, to which an acquiree is a party, are to be checked by the due diligence team. With respect to this part of the due diligence review, all pending or threatened litigation, arbitration and disputes where the target company or business is in any way involved in, are to be examined.

Then, depending on the type of target business planned for the purchase, employment and environmental issues are to be taken into account.

Different types of due diligence

The types of due diligence commissioned by clients have become more varied in Ukraine over the last 1-2 years. A vendor's due diligence is now more widespread than ever. The sellers of certain assets or companies are aware that due diligence of assets being conducted by their lawyers may be more efficient in some situations inasmuch as the seller would be able to detect all potential deal-breakers and other legal defects before they are discovered by the purchaser. After such due diligence the seller's

managers have some time to present assets in the best light so that they can be sold at the highest possible price. Vendor's due diligence is becoming more and more widespread as Ukrainian companies make more initial public offers in Ukraine and abroad and carry out private placements.

Sometimes vendors arrange a special dataroom for purchasers and their consultants where they can review the necessary documents. However, the rules



of a dataroom are usually quite strict and lawyers have limited time for investigation and the volume of documents presented is defined by the vendor's consultants.

Due diligence commissioned by the seller is also one of the mechanisms which allows access to a company's documents to be limited. Bidders would be able to see the due diligence report prepared by a seller's lawyers and adjoined documents which are specified by the owner of the asset. This would especially suit situations where there is no determined purchaser but several bidders who are competing for the asset.

Due diligence during certain transactions which are not linked to the acquisition of companies are now quite often carried out by lawyers. Companies which are parties to such transactions want to know more about their counterparts, so they ask lawyers to investigate the titles to a company's assets which are the subject of the deal, clear up the contractor's financial situation or litigation of their partners.

One of the best examples is due diligence of real estate which is due to be sold. This process is becoming more and more popular alongside the rise of the real estate market. The due diligence process includes title clearance and review of multiple permits, licences, and authorizations which are necessary in Ukraine for designing and constructing a building.

Also limited-scope legal due diligence is often conducted when a potential investor is interested in certain aspects of a target company's business. Pre-due diligence reviews of a company's documents are commissioned by businessmen who want to know more about a certain enterprise so as to be able to make a commercial decision on whether to invest in this company. In such a case lawyers should provide an outline of the company's business and point out general major risks borne by the target entity (assets, litigation, government relations, etc.). After such preliminary reviews standard due diligence may follow as part of the acquisition transaction. One of the core problems of due diligence in Ukraine is the lack of public resources which can assist in the independent reviews of a company's business. Therefore, lawyers often need to rely upon documents presented by the company subject to review. The absence of a comprehensive register of land and real estate is one of the main deterrents on the path to a civilised market economy and one which harms the legal business a great deal. There are registers of titles to land and other immovable property, but they are run by local agencies in every separate region of Ukraine and have not been merged yet into a unified register. So as to avoid the said difficulties, and, of course, if it is required by the purchaser, the due diligence team often faces the need to use resources which are not accessible for the public. Such unofficial sources of information may not produce some documents proving anything, but may provide



a lawyer with precious information which can give him a clue where the main problems of a company are.

The results of due diligence frequently have a decisive effect on a transaction itself. Therefore, in order to avoid any dif-

ficulties and risks while carrying out the transaction and after it is completed, it is strongly recommended that the purchaser choose the due diligence team of lawyers very carefully, taking into consideration their specialization and relevant experience.

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