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Toxic Rains of Ukraine's State Guarantees – Acid-Proof Umbrella Is Needed

In 2009 Ukraine's government announced a storm of state guarantees for various projects. In all, the government adopted 19 resolutions (the Investment Resolutions) regarding implementation of investment projects to be financed by non-Ukraine-based lenders with state guarantees. The largest investment projects include road construction (8 billion UAH); development of EURO 2012 infrastructure (2.4 billion UAH); purchase of medical equipment and transport from companies from Austria (€500 million), the United States (US$1.3 billion) and China (US$500 million); and purchase of agricultural and energy-saving equipment from suppliers from Ukraine (1.3 billion UAH) and other countries (US$1 billion). Among the financial institutions that Ukraine's government has named as potential lenders are the Export-Import Banks of China, the United States and Korea; Private Export Funding Corporation (USA); UniCredit; Canada-based export agency EDC; the Japan Bank for International Cooperation; and others.

Why the Guarantees May Be Toxic

With the flood of Investment Resolutions, Ukraine's government has announced a willingness to issue state guarantees up to 53.8 billion UAH (approximately US$6.56 billion) (not including the state guarantee of approximately 16.4 billion UAH [approximately US$2 billion] for the debt restructuring of the state oil and gas company Naftogaz). At the same time, the 2009 State Budget Law limits the government to issuing a

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maximum of 37 billion UAH (approximately US$4.62 billion) in state guarantees. It is not clear exactly how much the government has guaranteed to date, as the Investment Resolutions speak to a maximum issuance for certain projects and are not guarantees in themselves.

Nevertheless, if state guarantees in excess of the US$4.62 billion are issued in 2009, the next government (if it is formed by a political party adverse to the current prime minister) may refuse to satisfy the claim of a lender based on such state guarantees. In addition, if there is a change in the next government, a Ukraine court may find reason to refuse enforcement in Ukraine of a guarantee-based arbitration award granted in favor of a lender.

The president may suspend an Investment Resolution (as any other government resolution) if he believes that such resolution is "unconstitutional." Using this right, as of November 2009 the president already has suspended seven Investment Resolutions equal to approximately 17.3 billion UAH (US$2.11 billion); the last two were suspended on 10 November 2009. The suspensions are disputable from a legal point of view, and the ultimate authority for resolving the issue, the Constitutional Court of Ukraine, may disagree with the president's actions and uphold the legality of the Investment Resolutions. Nevertheless, with presidential election campaigns underway, the president has been willing to veto or suspend much legislation proposed by the current prime minister, which means that suspension of other Investment Resolutions is possible. The question of whether such acts by the president are legitimate will not likely be resolved before 2010.

Acid-Proof Umbrella

In such an environment, the main questions for potential lenders and suppliers relying on guarantees are (i) whether they should devote time and money to negotiate investment projects with the government and (ii) if so, how they can protect themselves from the risk that a respective Investment Resolution will be suspended, cancelled or invalidated.

Timing is the key for answering the first question. All Investment Resolutions provide that loan agreements must be signed and state guarantees issued by the end of 2009. This is despite the fact that a majority of the Investment Resolutions were adopted only in the second half of 2009 (four resolutions in July, two in August, two in September and four in October). Therefore, if lenders or suppliers need the state guarantee component for their project to succeed, they

should strive to ensure that a loan agreement is signed and a state guarantee is issued by year-end.

Understanding that suspension, cancellation or invalidation of an Investment Resolution may suspend or terminate the whole investment project is the key to answering the second question. To mitigate such risks, they should be shifted to the state. In the case of traditional project finance schemes, the lender may achieve such protection by including in the loan agreements such events of default as suspension, cancellation and invalidation of a respective Investment Resolution. For the supplier of goods the same events should be included in the supply agreements as the basis for suspension or termination of the supply of goods. In addition, the text of a state guarantee should provide a warranty that such state guarantee will be issued within the limits provided by the 2009 State Budget Law (37 billion UAH).

Because almost all Investment Resolutions provide for prepayments for goods, proper attention also should be paid to how such prepayment should be applied in case of early termination of a supply agreement. The parties should keep in mind the "180 days rule," which provides that goods must be delivered and imported into Ukraine within 180 days of prepayment. Otherwise, if the prepayment is not returned, a Ukraine-based buyer would be subject to penalties of 0.3 percent of the prepayment amount each day following the 180-day period.

Basics of Ukraine State Guarantees

In pursuing a state guarantee, along with the advice listed above, the lender should keep in mind the following basic rules and principles to ensure protection:

- A state guarantee is a guarantee issued by the government to secure fulfillment of debt obligations of Ukraine-based entities.
- For the purposes of issuance of a state guarantee, the government is represented by the Ministry of Finance.
- A state guarantee may be issued only within the limits set by the State Budget Law for a particular calendar year.
- A state guarantee is not free. A borrower whose obligations are secured by a state guarantee must pay an interest to the state for issuance and maintenance of such guarantee.
- A state guarantee is always a term guarantee. It may not be issued for an indefinite period of time.
- A borrower whose obligations are secured by a state guarantee must provide to the state a

counter-guarantee of banks. Such guarantee is irrevocable and unconditional, and an issuing bank must comply with the economic norms established by the National Bank of Ukraine for the period of 2007 to 2009. Alternatively, such borrower may provide some other appropriate security (mortgage, shares pledge, etc.).

If you have questions about the Investment Resolutions, Ukraine state guarantees or other related issues, please contact your principal Squire Sanders lawyer or one of the lawyers listed in this Alert.
