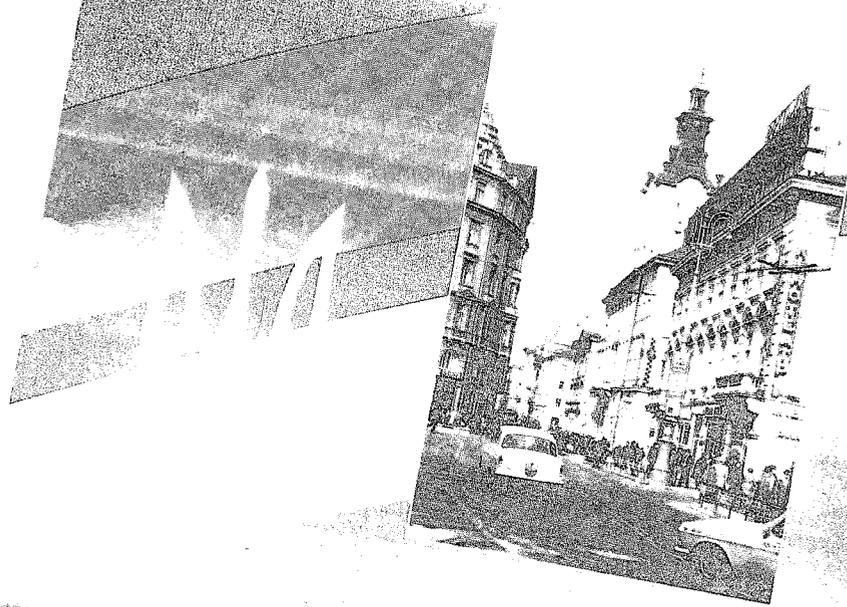


PN-ACA-251  
93354



SMALL SCALE PRINTING

# **SMALL-SCALE PRIVATIZATION IN UKRAINE**

**The L'viv Model**

## *An Official's Guide*

Prepared by

**IFC**

International  
Finance  
Corporation

Financed by



Agency for  
International  
Development

**©1993 INTERNATIONAL FINANCE CORPORATION**

*1818 H Street NW, Washington, D.C. 20433*

All rights reserved. May not be reproduced in whole or in part by any means without the written consent of the International Finance Corporation.

This information, while based on sources that the IFC considers to be reliable, is not guaranteed as to accuracy and does not purport to be complete.

This information shall not be construed, implicitly or explicitly, as containing any investment recommendations and, accordingly, the IFC is not registered under the U.S. Investment Advisers Act of 1940. This information does not constitute an offer of or an invitation by or on behalf of IFC to purchase or sell any of the enterprises mentioned, nor should it be considered as investment advice.

The denominations and geographical names in this publication are used solely for the convenience of the reader and do not imply the expression of any opinion whatsoever on the part of the IFC, the World Bank, or other affiliates concerning the legal status of any country, territory, city, area, or its authorities, or concerning the delimitation of its boundaries or national affiliation.

Any views expressed herein are those of the authors and do not necessarily represent the views of the World Bank or the International Finance Corporation.

Published in the United States of America, June 1993

3

# Contents

|   |      |
|---|------|
| <b>Foreword</b> by Victor Pynzenyk .....                      | iv   |
| <b>Foreword</b> by Volodymyr Pryadko and Vadim Vasilyev ..... | v    |
| <b>Foreword</b> by Sir William Rynie .....                    | vi   |
| <b>Preface</b> .....  | vii  |
| <b>Acknowledgments</b> .....                                  | viii |
| <b>Abbreviated List of Annexes</b> .....                      | ix   |
| <b>PART ONE: Guiding Principles</b> .....                     | 1    |
| <b>Privatization</b> .....                                    | 3    |
| <b>Small-Scale Privatization</b> .....                        | 3    |
| <b>Small-Scale Privatization in Ukraine</b> .....             | 4    |
| <b>Small-Scale Privatization in L'viv</b> .....               | 5    |
| <b>Guiding Principles</b> .....                               | 6    |
| <b>PART TWO: Program Design and Implementation</b> .....      | 11   |
| <b>Introduction</b> .....                                     | 13   |
| <b>Program Design</b> .....                                   | 14   |
| Legislation .....   | 14   |
| Suggested Privatization Method: Auction .....                 | 18   |
| Administration .....  | 21   |
| <b>Implementation</b> .....                                   | 25   |
| Preparing Enterprises for Privatization .....                 | 25   |
| The Auction .....   | 31   |
| After the Auction .....                                       | 34   |
| Auction Proceeds .....  | 35   |
| <b>CONCLUSION</b> .....                                       | 36   |
| <b>Explanatory Note</b> .....                                 | 37   |
| <b>Box</b>  |      |
| 1. <i>Guiding Principles</i> .....                            | 7    |
| <b>List of Figures</b>  |      |
| 1. <i>Privatization Administration</i> .....                  | 23   |
| 2. <i>Preparing Enterprises for Privatization</i> .....       | 27   |
| 3. <i>Auction Procedures and Documents</i> .....              | 33   |

## **Foreword** *by Victor Pynzenyk*

The first step is the most important one. And it has been made. This step is the first auction for privatization of small-scale enterprises in Ukraine held on February 20, 1993, in the city of L'viv. Thus, the process of transfer of state property to private ownership, which constitutes an important part of economic reforms in Ukraine, has been launched.

The auction sale of small enterprises of trade, consumer services and public catering is considered to be the main form of their rapid, effective, transparent and competitive privatization, a method of real estimation of privatized objects' value. Wide participation of the population in privatization ensures the transfer of property to those who, with private means, achieve its most effective use encouraging the attraction of new unconventional investment resources in the economy. The first auction demonstrated that privatization turns out to be an important factor of stabilization of the national currency, decreases the effect of the excessive money on the consumer market, allows to increase revenues of local budgets that should be allocated towards the implementation of regional social programs.

I hope that the materials dealing with the auction sale of objects of small-scale privatization in L'viv will be useful for those who are involved in small-scale privatization. These materials provide necessary explanations regarding the issues of legal framework and organization of auction bidding.

I would like to express my thanks to those who took part in the organization of the first Ukrainian auction as well as to those who prepared this Manual.

**Victor Pynzenyk**  
Deputy Prime Minister of Ukraine

5

---

**Foreword** by *Volodymyr Pryadko and Vadim Vasilyev*

This first auction which took place on February 20, 1993 in L'viv marked the beginning of "small privatization" process in Ukraine.

The results of the auction testify that the hopes for the successful implementation of privatization on a competitive basis through auction are not in vain. The applied mechanism of auctioning off the objects of privatization in L'viv certifies that this process can be rapid, socially favorable and economically efficient. The property has been transferred to the hands of energetic entrepreneurs and the local budget has got significant income.

Thus, after the L'viv auction the implementation of the small-scale privatization program, constituting an important part of the tasks of the Ukrainian Government action plan on developing and realization of the "The Groundwork for the National Economic Policy for 1993", became more realistic.

The successful holding of the auction and the publication of this Manual became possible mostly thanks to efforts of the International Finance Corporation, to the staff of which we are very grateful.

The review and the study of the first auction experience in L'viv is important for all citizens of Ukraine, and especially for those who work in privatization bodies and state government.

We express deep gratitude to all those whose support contributed to the successful holding of the L'viv auction.

**Volodymyr Pryadko**

Head of the State Property Fund of Ukraine

**Vadim Vasilyev**

Head of the Department, the State Property Fund

## **Foreword** *by Sir William Ryrie*

**P**rivatization in Ukraine started in L'viv on February 20, 1993. The public auctions that took place on that day were an important signal that change had begun.

Privatization of small state enterprises is the key area of privatization. It leads to fast, visible change. It demonstrates clearly to the man on the street that change is happening. Furthermore, small-scale privatization based on auctions captures the elements of market reform – competition, fairness and openness. The open auctions that started in L'viv are now being copied in other towns and cities in Ukraine.

In this Manual IFC documented its work in L'viv in order to help other city leaders begin the privatization process. As the chief executive of IFC, I am proud that we are involved in these reforms and I hope the Manual we have prepared will help in some way move the reform process forward throughout Ukraine.

None of this vital work could have happened without the leadership of L'viv city officials, especially Mayor Shpitser and Deputy Mayor Kachur, or without the strong personal support of Prime Minister Kuchma and Deputy Prime Minister Pynzenyk. Finally, I would like to thank the United States Government for financing the costs of printing the Manual and helping IFC make it available to Ukraine's mayors and municipal leaders.

**Sir William Ryrie**

Executive Vice President, IFC

## Preface

This manual is intended to help Ukrainian regional and city officials conceive and implement programs to privatize small, state-owned businesses on a local level. It is based on the approach used in Ukraine's first such "small-scale" privatization effort, an auction-based procedure developed by L'viv city authorities and IFC staff during seven months of extensive planning and analysis. The first auction took place on February 20, 1993, and marked the start of privatization in Ukraine.

Following the successful introduction of small-scale privatization in L'viv, Prime Minister Leonid Kuchma and Deputy Prime Minister Victor Pynzenyk have declared small-scale privatization a priority for 1993 and accordingly have asked IFC to help other Ukrainian cities start their own privatization programs. L'viv was chosen for the first privatization program primarily because of the support for the privatization process by the L'viv city administration. The successful demonstration of privatization in L'viv has led to requests to IFC from many Ukrainian cities for help. This itself illustrates the willingness of other Ukrainian cities to introduce reform.

This Manual documents a practical approach to small-scale privatization, incorporating the L'viv experience. The Manual comprises two parts. Part One discusses the benefits of privatization and suggests fundamental principles that should guide program design. Part Two reviews the legal and administrative framework necessary for such a program to occur, then draws on the L'viv experience in detailing techniques of actual planning and implementation. Copies of relevant national and local legislation appear alongside other pertinent documents in the accompanying volume of *Annexes*.

## Acknowledgments

IFC would like to express its gratitude to those who took part in the preparation of this publication, and also to those who directly organized and carried out the small-scale privatization program documented in this publication:

For those who worked closely on the planning and implementation of the L'viv privatization program, we are grateful to Head of the L'viv City Council **Vasil Shpitser**, Deputy Head for Privatization Issues **Pavlo Kachur**, Deputy Head for Organizational Issues **Igor Karpinsky** and Head of the Communal Property Fund of L'viv city **Taras Pakholyuk**.

For their collaboration in the preparation of the L'viv privatization program, Head of the State Property Fund of Ukraine **Volodymyr Pryadko** and Head of the Department of Strategy and Methodology of the Transformation of Property of the State Property Fund **Vadim Vasilyev**.

For the support given throughout IFC's work on this project, Deputy Prime Minister of Ukraine **Victor Pynzenyk**, Deputy Minister **Roman Shpek**, and also Economic Advisor **Walter Popiel**.

For his invaluable contribution and full support for the small-scale program in Ukraine and his assistance in explaining principles and nature of the process, Dr. **Leszek Balcerowicz**, the former Deputy Prime Minister of Poland.

For its generous financial assistance, the **United States Agency for International Development (USAID)**. For their assistance and support, United States Ambassador to Ukraine **Roman Popadyuk** and Economics Section Chief **Natalie Jaresko**, and the **Regional USAID Mission in Kiev**.

For their assistance in realizing this project, **John Hewko** and **Borys Dackiw** of Baker & McKenzie.

For the experience and knowledge provided throughout the implementation of this program, the **Warsaw Consulting Group** and Associate Director of the Project on Economic Reform in Ukraine **David Snelbecker**.

For public relations assistance, **Young & Rubicam**, especially **Natalya Lotra**.

For producing this Manual, IFC staff, especially **Roberta Feldman**, **Anthony Doran**, **Dean Austin**, **Alica Henson**, **Krzysztof Kuzbik**, **Saida Rzayeva**, and **Konstantin Malinovsky**.

For editorial and translation work, **Zhanna O'Clery**, **Chris Marquardt**, **Elena Kasyanenko**, **Alexander Zeltser**, **Evgeny Gusyev**, and **Elena Voloshina**. For design and production, **J.Gibson & Company**.

## **Abbreviated List of Annexes**

For ease of reference, the following list of annexes has been abbreviated according to usage in the main text. A complete list can be found in the separate volume of *Annexes*.

### **National Privatization Legislation**

1. **State Program**
2. **Small-Scale Enterprise Law**
3. **Large-Scale Privatization Law**
4. **Certificate Law**
5. **Lease Law**

### **Local Legislation**

6. **City Decree on Commercialization**
7. **City Privatization Program**
8. **Calculations for Lease Payment**
9. **Privatization Account**

### **Auction Documentation**

10. **Public Notice**
11. **Auction Rules**
12. **Legal Documents**

**PART ONE:**

**THE GUIDING  
PRINCIPLES**

## **Privatization**

**P**rivatization is defined as the transfer of ownership of state-owned enterprises and assets to the private sector. In practice, the government may either sell all or part of an ongoing enterprise or liquidate an enterprise and sell all or part of its assets.

Worldwide, privatization is considered to be the most effective method of enhancing the productivity of underutilized state-owned assets and creating competitive, efficient industries. For countries in transition from centrally-planned to market economic systems, privatization is a crucial step in creating private businesses that provide private-sector employment and an increased level of goods and services.

In recent months, both the legislative and executive branches of the Ukrainian government have recognized the importance of implementing privatization at all levels. Ukraine has undertaken a review of laws affecting privatization and has supported regions that are beginning to implement privatization programs. An auction of small enterprises was held in L'viv on February 20, 1993, marking the start of privatization in Ukraine.

## **Small-Scale Privatization**

**S**mall-scale privatization is the transfer to private hands of small, state-owned retail outlets such as food and goods shops, restaurants, and consumer services. These enterprises are the key to an efficient market economy since they generate demand for finished and processed goods. By privatizing small-scale shops, a country in transition creates private-sector demand for processed goods. Small private businesses, through competition, sell better-quality goods at lower prices improving the standard of living for consumers.

While privatization of medium- and large-scale enterprises can be difficult and time-consuming, countries in transition, including Eastern Europe and Russia, have found small-scale privatization relatively simple and fast to implement. As a result of successful small-scale privatization, the Czech Republic, Slovakia, Poland, Hungary and Russia are being transformed by shops that are full of consumer goods, that provide friendly efficient service and that change the character of local neighborhoods.

## **Small-Scale Privatization in Ukraine**

All three levels of the Ukrainian government – municipal, oblast, and national – own small-scale enterprises which the 1992 **State Privatization Program** defined as “Group A” enterprises. This Manual presents an **auction-based** model for privatizing municipal enterprises that was in large part used in the design and implementation of the L’viv municipal small-scale privatization program. Most elements of this model may be used by other government branches in their small-scale privatization programs.

Auction-based small-scale privatization offers the following benefits:

### **Benefits to the Public**

- Auction-based privatization is fair to both employees and the general public
- Shops increase in efficiency (e.g. the amount of goods on sale, operating hours, level of service)
- Increase in competition between shops reduces prices, increases quality and quantity of goods on sale
- All citizens are free to participate in privatization.

### **Benefits to Enterprises**

- Employees can participate in privatization with special advantages
- Owners can earn higher profits
- Employees can earn higher wages.

### **Benefits to the Municipal Government**

- Immediate revenue from auction proceeds can be used to finance the city budget
- Future revenue from taxes on privatized enterprises can be used to finance future city budgets
- Revenue from privatization can be used to finance city programs for the unemployed and pensioners
- The administrative and cost burden of owning and managing municipal enterprises will be reduced
- Creates jobs paying higher wages.



## **Small-Scale Privatization in L'viv**

National privatization legislation defines "small businesses" as (a) consumer product and food shops, (b) service outlets, and (c) restaurants and restaurants suppliers.

There are approximately 1500 state-owned consumer-product and food shops in L'viv. Nearly seven hundred of these businesses are under the direct ownership and control of the city. Consumer-goods shops comprise two-thirds of the total, with food stores making up the rest.

Similarly, there are also at least 700 state-owned service units operating in different branches in L'viv. Some of these service outlets also perform limited manufacturing and trading activity. 387 outlets attached to manufacturing enterprises also perform services, primarily in the form of construction and repair for their enterprises.

Finally, L'viv contains approximately 800 state-owned restaurants and restaurant food suppliers. While some restaurants serve the public, most are "closed", i.e., serve specific factories or other places of work.

With IFC assistance, the L'viv city government designed and implemented an auction-based small-scale privatization program during 1992-93. The first auction was held in L'viv on February 20, 1993. In the first auction 17 enterprises were auctioned to the highest bidder. 9 enterprises were bought by workers' collectives with the aid of incentives and discounts provided for in the 1992 L'viv **Small Privatization Program**. Gross revenues of 784 million karbovantsi (\$392,000 equivalent) will accrue from the auction. The L'viv government plans to institute a bi-weekly auction system, with the goal of privatizing all eligible small enterprises through this method.

## Guiding Principles

Guiding the design of the L'viv privatization program was a set of principles that may be adapted by other authorities developing small-scale privatization programs in Ukraine. The principles are based on the key objectives of **fairness, transparency, and speed.**

Some of these principles evolved in response to specific social, economic, and legal factors in L'viv and Ukraine as a whole. Others are derived from IFC's work on small-scale privatization programs for Russian cities such as Nizhny Novgorod, Volgograd, and Tomsk, as well as from IFC's experiences elsewhere in Central and Eastern Europe. It should be noted that an assumption of political commitment on the part of the administering authorities underlies each principle. Without such a commitment, the shift to a market economy will be considerably more difficult, if not impossible.

### **GUIDING PRINCIPLE 1. Auction-Based Method of Sale.**

Using a single, uniform method to privatize small businesses will lessen potential confusion and keep administration to a minimum. The **State Privatization Program** permits three such methods:

- *Auction*, or the sale of enterprise assets through open, competitive bidding
- *Tender*, or sale through closed bidding
- *Employee buy-out*, or noncompetitive sale of an enterprise to enterprise employees acting as a workers' collective.

Successful small-scale programs throughout Central and Eastern Europe have generally employed an auction method requiring that enterprises be liquidated, after which only their assets are sold at auction. Property values are determined solely through bidding at auction, thus avoiding the need for unreliable and time-consuming valuation procedures. Initial bidding prices are set at relatively low book values, and discretionary systems of valuation involving floor prices are avoided.

The city of L'viv, on IFC's advice, also chose the auction option. The auction system achieves the three underlying objectives of privatization – fairness, transparency and speed.

## *Guiding Principles*

- PRINCIPLE 1.** Auction-Based Method of Privatization.
- PRINCIPLE 2.** Anti-Monopoly Commercialization.
- PRINCIPLE 3.** Going Concern Method.
- PRINCIPLE 4.** Sale of Leases for Properties in Multiple-Purpose Buildings.
- PRINCIPLE 5.** Sale of Stand-Alone Buildings.
- PRINCIPLE 6.** Open Auctions.
- PRINCIPLE 7.** Special Privileges for Employees.
- PRINCIPLE 8.** The Immediate Transfer of Property.
- PRINCIPLE 9.** No Restrictions on New Owners.
- PRINCIPLE 10.** Incentives to New Owners.
- PRINCIPLE 11.** A System of Regular Auctions.
- PRINCIPLE 12.** Public Awareness.
- PRINCIPLE 13.** Valuation Determined Solely by Auction.
- PRINCIPLE 14.** Fixed, Public Auction Rules.

### **GUIDING PRINCIPLE 2. Anti-Monopoly Commercialization.**

In order to create a competitive retail structure, the existing wholesale or torg structures which incorporate retail outlets and create local monopolies need to be broken up. Through commercialization, retail outlets need to acquire individual legal identity and be auctioned separately.

### **GUIDING PRINCIPLE 3. Going Concern Method.**

In the L'viv system, small-scale businesses are sold as going concerns and are not liquidated before sale. To assist new owners, though, the city took responsibility for all enterprises' liabilities up to the point of sale. A discussion of the going concern versus the liquidation method is included in an Explanatory Note at the end of this volume.

**GUIDING PRINCIPLE 4. Sale of Leases for Properties in Multiple-Purpose Buildings.**

When a business is located in a multiple-purpose building, then the assets of the business and a transferable 5-year lease right to the premises are sold. This avoids delays in arranging the privatization of a multi-purpose building involving as it does many owners and many users. Following the initial sale of the lease, the city should undertake plans to fully privatize the building taking account of the special rights of the new lease-holders.

**GUIDING PRINCIPLE 5. Sale of Stand-Alone Buildings.**

When the business is in a stand-alone building, then the building is sold outright through auction.

**GUIDING PRINCIPLE 6. Open Auctions.**

The system allows all Ukrainian citizens to participate. A small good-faith deposit is required to enroll for the auction. By being open to all Ukrainian citizens the privatization process is fair. By allowing non-bidders to witness the auction the system is also transparent (auction tickets for the general public are available).

**GUIDING PRINCIPLE 7. Special Privileges for Employees.**

To take account of the rights of employees in the privatization process, workers' collectives are given special privileges in the auction of the businesses in which they work. Firstly, workers' collectives receive a 30 percent discount in the bidding process. Secondly, employees benefit from an installment system, paying for the enterprise they successfully bid over a 6-month period.

**GUIDING PRINCIPLE 8. The Immediate Transfer of Property.**

The physical transfer of property should take place on the day following the auction, with the keys of the business handed over to the winning bidder. This facilitates immediate change in the operation of the business.

**GUIDING PRINCIPLE 9. No Restrictions on New Owners.**

New private owners should be free to operate their businesses with minimum interference. The municipal authorities should not require new owners to retain employees or continue selling existing product lines or maintain existing hours of operation. It is also important that there are no price controls imposed on goods and services sold by the new private shops and businesses. In a limited number of cases – e.g. when an enterprise sells such basic foodstuffs as bread or milk – new owners may be obliged to continue sales for a limited period of time. When such conditions are imposed, new owners should be allowed to expand the other product lines.

17

**GUIDING PRINCIPLE 10. Incentives to New Owners.**

City officials should offer special incentives to new business owners – for example, tax incentives and reductions in lease payments connected to investments or improvements in property.

**GUIDING PRINCIPLE 11. A System of Regular Auctions.**

An ongoing system of regular auctions enables a mass transfer of state enterprises to the private sector in the shortest time possible. Weekly auctions are recommended, with 20-25 properties sold at each auction. As a minimum, bi-weekly auctions should be established.

**GUIDING PRINCIPLE 12. Public Awareness.**

The underlying objectives of fairness and transparency require that all citizens have the right to understand the privatization process since it will affect them as consumers and since they need information to decide whether or not to participate in the auctions. For these reasons, city officials should implement a well organized public awareness program that informs citizens in advance of the general nature of the privatization program, of the specific properties on sale and of the detailed procedures for participation.

**GUIDING PRINCIPLE 13. Valuation Determined Solely by Auction.**

City officials should avoid imposing discretionary valuation systems and setting reserve prices for businesses. The valuation of businesses through the auction itself guarantees a market approach to valuation. Setting reserve prices, whereby properties are withdrawn if a reserve price is not reached, slows down the privatization process, leads to artificial discretionary valuation and damages the reputation of the privatization process.

**GUIDING PRINCIPLE 14. Fixed, Public Auction Rules.**

City officials should adhere strictly to a fixed and publicly known set of auction rules. Fairness and transparency require that auction rules do not change or appear to change on an ad hoc basis. Personal discretion by officials during the auction offers the possibility of corruption.

**PART TWO:**

**PROGRAM  
DESIGN AND  
IMPLEMENTATION**

## **Introduction**

**B**uilding on the Guiding Principles established in Part One, this part of the Manual explains how local privatization officials may design and implement a small-scale program tailored to the needs of their municipality. Although Ukrainian law permits several privatization options, IFC recommends the auction method as the fastest, most fair, and simplest way to implement small-scale privatization.

Officials should be aware that, although the framework described below is intended as a model for other cities in Ukraine, it is derived in part from circumstances particular to L'viv. Officials should work within national legal and administrative guidelines to create a program that best suits their particular needs and constraints.

Whatever method is chosen, both national and local governments are advised that political commitment is absolutely essential if any lasting progress is to be made in privatizing municipal enterprises. Governments should take courage from successful examples of privatization throughout Central and Eastern Europe and Russia. The following discussion consists of two sections, Program Design and Implementation, subdivided as follows:

### **► Program Design**

#### **Legislation**

National Legislation

City Regulations

**Suggested Method of Privatization: Auction**

**Administration**

### **► Implementation**

**Preparing Enterprises for Auction**

**The Auction**

**After the Auction**

**Auction Proceeds**

The two sections contain sufficient information to allow full program implementation. While circumstances differ in each municipality, cities should be able to adapt many of the procedures and methods described below. If additional details or specific help is required, IFC is willing to provide assistance. Contact addresses are provided at the end of the Manual.

Throughout the text, references are made to existing legislation. Complete copies of the relevant legislation can be found in the accompanying volume of *Annexes*.

Ukrainian municipal officials contemplating a small-scale privatization program should work to design a legal and administrative framework incorporating a combination of (a) the Guiding Principles outlined in Part One, (b) the constraints and privileges stemming from national and local legislation, and (c) the record of practical experience offered by the L'viv program. This section addresses first legislative, then administrative considerations.

### Legislation

The legislative framework for small-scale privatization programs in Ukraine consists of both national and local laws. Summarized below are (a) the major national laws under which any local program must operate and (b) municipal regulations passed by the L'viv City Council in accordance with Ukrainian state law, as well as further suggestions for local lawmakers. A final section discusses the recommended privatization method – the auction – along with two related issues (a) employee participation and (b) the legal status of enterprises to be sold.

Laws and legal documents appear in full in the *Annexes* where marked.

### National Legislation

Five major laws establish the basis for small-scale privatization at the national level:

- 1992 State Privatization Program, as amended, hereafter referred to as **State Program** (see *Annex 1*)
- The Law of Ukraine on Privatization of Small-Scale State-Owned Enterprises, as amended, hereafter referred to as the **Small-Scale Enterprise Law** (see *Annex 2*)
- The Law of Ukraine on Privatization of Assets of State-Owned Enterprises, as amended, hereafter referred to as the **Large-Scale Privatization Law** (see *Annex 3*)
- The Law of Ukraine on Privatization Certificates, as amended, hereafter referred to as the **Certificate Law** (see *Annex 4*)
- The Law of Ukraine on Leasing, as amended, hereafter referred to as the **Lease Law** (see *Annex 5*).

## **State Program**

**1992 State Privatization Program**, dated July 7, 1992, was amended by the Decrees of the Cabinet of Ministers of Ukraine of December 15, 1992, and February 19, 1993 (see *Annex 1*). Due for revision in 1993, the **State Program** regulates privatization of small-scale enterprises owned by any of the three levels of government. The law defines small-scale ("Group A") enterprises, describes which enterprises are eligible for privatization, and outlines privatization methods (auction, tender, employee buy-out) as well as conditions that determine which method will be employed. The law also establishes quotas for the use of privatization certificates and the participation of foreign investors, and outlines the responsibilities of local privatization programs.

## **Small-Scale Enterprise Law**

The **Small-Scale Enterprise Law**, dated March 6, 1992, and amended July 7, 1992, and February 19, 1993, further defines small-scale enterprises and procedures for their privatization (see *Annex 2*).

## **Large-Scale Privatization Law**

The **Large-Scale Privatization Law**, dated March 6, 1992, and amended July 7, September 18 and December 15, 1992, and February 19, 1993, primarily regulates large-scale privatization, but addresses certain issues relevant to small-scale privatization (see *Annex 3*). The law regulates buyers' associations and the participation of intermediaries and describes the division of privatization responsibilities between the State Property Fund and local privatization and administrative bodies. The law also covers social protection issues, including the rights of employees displaced by privatization.

## **Certificate Law**

The **Certificate Law**, dated March 6, 1992, and amended July 7, 1992, sets forth the intended use, distribution, and redemption of "privatization certificates" and creates an organizational structure for implementing the privatization certificate program (see *Annex 4*).

NOTE: As of May 1993, this law has not been implemented. However, as an interim measure in temporary place of the official certificates, on November 25, 1992, the Cabinet of Ministers issued Directive No. 655 "On the Issuance of Privatization Certificates". According to that Directive, the certificates were to be introduced on an interim basis on December 1, 1992, in the form of "privatization deposit accounts." The value of each deposit account, equal to the nominal value of one privatization certificate, is 30,000

Karbovantsi. The Savings Bank of Ukraine was instructed to provide each citizen with a nominal privatization deposit account. The value of these accounts is to increase in proportion to the rate of inflation and must be applied to the purchase of state assets by January 1, 1995.

### **Lease Law**

The **Lease Law**, dated April 10, 1992, was amended by the Decree of the Cabinet of Ministers of Ukraine of December 15, 1992 (see *Annex 5*). The amended **Lease Law** restricts the ownership rights of employees to acquire property on an exclusive or non-competitive basis. Since the 1993 amendment to the **Lease Law**, only lessees who submitted applications before January 15, 1993, to exercise a "buy-out option" contained in their lease agreements may noncompetitively buy out their enterprises.

In addition, the amended **Lease Law** allows leases obtained on a noncompetitive basis to be reversed. It allows a privatization body to privatize leased enterprises by terminating leases on enterprises or premises, provided that the privatization body complies with applicable law when terminating the leases.

For leases obtained on a competitive basis the **Lease Law** allows lessees to transfer their lease rights to other entities if the lessor permits the transfer. Therefore, if a privatization body sells an enterprise but retains ownership of its premises (as in the case in L'viv when the enterprise is located in a multi-purpose building), the privatization body can essentially create "ownership conditions" for the lessee by permitting the unrestricted buying and selling of leased premises between private operators.

### **City Regulations**

In order to establish a privatization program, local city councils should implement the following types of regulations:

- Regulations creating an administrative structure for privatization implementation. For IFC suggestions on creating this structure, please refer to the section on Administration later in this Manual.
- A regulation mandating the commercialization of small-scale communal enterprises, i.e., endowing each business with separate legal status. Enterprises must be commercialized before they can be privatized. The L'viv city **Resolution No. 133 on Commercialization** appears in *Annex 6*.

- ▶ A regulation creating the city privatization program. The 1992 L'viv **City Privatization Program** appears in *Annex 7*. The program should mandate the following elements:
  - ▶ Goals of privatization
  - ▶ Objects of privatization
  - ▶ Participant eligibility in privatization
  - ▶ Preparation of enterprises for privatization
  - ▶ Determination of the method of privatization
  - ▶ Privatization chronology
  - ▶ Procedures for the sale of objects
  - ▶ Workers' collective incentives and social protection measures
  - ▶ Privatization norms
  - ▶ Forecast of how privatization revenues will be spent
  - ▶ Any further supporting regulations necessary to implement the privatization program.
- ▶ A regulation creating the means for leasing non-residential premises necessary to auction transferrable leaseholds for those premises located in shared ("multi-purpose") buildings. IFC's suggested lease procedure appears in *Annex 8*. These lease recommendations should be considered carefully.
- ▶ A regulation opening an extrabudgetary privatization account for privatization revenues. The L'viv regulation on the extrabudgetary privatization account appears in *Annex 9*. IFC suggests this account be managed by the city Executive Subcommittee on Privatization (see the section on Administration later in this Manual).
- ▶ A regulation creating contracts and other legal documents, establishing rights and obligations of the buyers and sellers of privatized enterprises. Legal documents used in the L'viv auction program appear in *Annex 12*.
- ▶ Regulations designating lists of enterprises to be privatized. These lists should be created by the Privatization Commission and approved by the Executive Subcommittee on Privatization (see Administration section) on a quarterly basis.

## **Suggested Privatization Method: Auction**

As of May 1993, national law allows city officials to privatize small retail enterprises through any of three methods: auction, tender, or employee buy-out. As mentioned in Part One, IFC recommends that sale at auction is the best method for several reasons. Auctions:

- Allow all Ukrainian citizens the opportunity to participate in privatization
- Minimize the possibility and/or perception of government corruption because the process is open and public
- Are the most efficient method available
- Constitute a significant source of revenue for city governments
- Create new owners with incentive to provide more and higher-quality goods at lower prices, thus improving the population's living standards
- Have been the main method of privatization throughout Eastern Europe and Russia.

On the advice of IFC, the L'viv government created an auction method providing discounts to workers' collectives participating in auctions; mandating historical preservation in some cases; and requiring maintenance of enterprise specialization in a few cases. If no outside entities express interest in acquiring an enterprise, the L'viv program allows noncompetitive sale of the enterprise to its workers' collective at the book value of assets adjusted for inflation, of assets and liabilities.

### **Employee Participation in Auctions**

Although employees may initially object to small-scale privatization, city officials should make a strong effort to involve them in the privatization process while maintaining a commitment to open, competitive privatization. Workers' collectives command far more financial resources than their members would as individuals, allowing them a strong advantage in the auction procedure. Further, owner-employees will be less likely to sell government-produced goods "under the counter". Finally, workers' collectives constitute a potent political force.

Armed with incentives, workers' collectives are financially competitive with other buyers; in Russian auction-based privatization, workers' collectives who were offered the incentives described below purchased approximately 40 percent of enterprises sold.

The L'viv program allows workers' collectives two strong incentives to participate in auction-based privatization. First, they receive a 30-percent discount from the final bid price.

Second, they are permitted to pay the remainder in installments, with 30 percent due within

25

the first 30 days following the auction; 30 percent within six months after the auction; and 40 percent within 12 months after the auction. Due to high inflation in Ukraine, IFC suggests that cities require all installments to be paid within six months after the auction.

### **Legal Status of Workers' Collectives**

Legally, a workers' collective is not a labor union *per se*. Rather, it can be defined as a group of natural persons currently employed at an enterprise. This group may also include retirees, who in accordance with labor legislation, are still considered employees of the enterprise. To participate in privatization, members of the workers' collective must establish a "buyers' association" in accordance with state legislation.

Unfortunately, existing legislation is unclear about requirements for creating such a "buyers' association". IFC suggests that workers' collectives form a legal entity currently recognized under Ukrainian law to participate in the privatization process, i.e., a joint-stock company or a limited-liability company.

### **Commercializing Enterprises to Be Sold**

Before a business may be sold at auction, it must be "commercialized", i.e., given a legal status separate from the government. It is very important to break up local monopoly structures that are created by leaving wholesale or *torg* units intact (up to 100 retail outlets can be combined as one group under a wholesale or *torg*). The new legal entity should be the individual retail business unit which should then be auctioned separately.

### **Method of Sale**

Given the existing legislation, L'viv authorities had the option of selling enterprises at auction as any of the following:

- ▶ Liquidated enterprise assets (see Explanatory Note)
- ▶ A "going concern" comprising both assets and liabilities to the new owner (see Explanatory Note)
- ▶ A "going concern" for which the local government guarantees the settlement of all liabilities existing prior to the auction for the benefit of the new owner.

Ultimately, L'viv officials chose the last option, wherein the buyer obtains an operating business freed from liabilities. In this case, the employees are the city's responsibility (see Employee Severance Pay and Benefits below), and the enterprise is not sealed until a few days before the auction.

In the future, liabilities may be transferred to new buyers along with assets. In this case, both assets and liabilities will be combined and adjusted for inflation to determine the initial bid price.

26

### **Sale as a Going Concern**

When, as in L'viv, an enterprise is sold as a "going concern", the enterprise is transferred to the new owner as legal entity along with all enterprise assets; the city undertakes to pay all obligations to employees and guarantees the payment of all other liabilities incurred prior to the date of the auction; and the enterprise is not sealed until a few days before the auction. (For a discussion of alternative methods to selling as a going concern, see Explanatory Note at the end of this volume.)

The city government must create an organizational structure to respond to creditors' claims. Because the enterprise continues to operate after the auction, separating liabilities incurred before the auction (which the city must pay off) and those incurred after the auction (which are the responsibility of the new owner) may be difficult. The city government, rather than the new owner, will be the target of resentment from dismissed workers. Determining the enterprise's starting value is not difficult because liabilities need not be taken into account. The city can avoid the time-consuming tasks of dissolving the enterprise's legal status and closing its bank account. Auction participants will bid higher because the city will undertake the obligation to pay off the debt and other liabilities of the enterprise that arise before the auction. Because the city will pay off disclosed and undisclosed liabilities, the risk that buyers will renege due to unforeseen liabilities is minimized.

### **Employee Severance Pay and Benefits**

No matter what method of privatization is chosen, or which legal status option a municipality may prefer, Ukrainian law mandates severance pay and notice requirements for enterprises terminating employees. According to the Ukrainian Labor Law, employees must be given at least two months' notice before they are terminated. After two months, the entity responsible for enterprise liabilities (either municipal authorities or the new owner, depending on whether the enterprise is sold as a going concern or in liquidated form) is required to pay severance to the dismissed worker equal to one month's wages and thereafter must continue to pay wages for an additional two months or until the worker is reemployed, whichever occurs earlier. In addition, pursuant to the Employment Law, the State Employment Agency guarantees certain extended benefits to dismissed workers in the event that they are unable to be reemployed within three months of being dismissed. After that, it is the responsibility of the municipality to design and implement its own social protection provisions. IFC recommends that all costs associated with social protection of displaced employees be paid from privatization revenues (see Auction Proceeds section).

## **Administration**

Following the City Council's approval of a local legislative basis for privatization, the local administration should create a structure to implement privatization. (See Figure 1 "Privatization Administration".)

### **Overview of Structure**

The Executive Committee of the City Council (or whatever body is responsible for city administration) should create an Executive Subcommittee on Privatization to manage all practical aspects of privatization. This body should consist of the member of the Executive Committee who is in charge of privatization issues and two or three members of the City Council who have expressed support for mass privatization.

The Subcommittee should be responsible for the following tasks:

- ▶ Approving quarterly lists of enterprises to be privatized
- ▶ Overseeing interaction between the Privatization Commission and the City Property Fund and other sources of data on enterprises to be privatized
- ▶ Managing the City Council's extrabudgetary account for privatization revenues (see Auction Proceeds section)
- ▶ Creating a Privatization Commission to carry out day-to-day privatization activities.

### **Privatization Commission**

The Privatization Commission should be headed by an administrator with a record of achievement in the city government and known as a proponent of rapid privatization. The Commission should hire at least 25 staff members to ensure that the "privatization pipeline" flows smoothly and rapidly. Commission staff should not be members of the Executive Subcommittee on Privatization, nor should they participate in decision-making or supervisory activities of the Subcommittee.

The Commission should be responsible for the following tasks:

- ▶ Preparing quarterly lists of enterprises to be privatized for submission to the Subcommittee on Privatization
- ▶ Valuating enterprises to be privatized
- ▶ Accepting and processing applications from potential participants in auctions
- ▶ Informing the public about privatization
- ▶ Organizing auctions.

In order to fulfill these tasks, the Subcommittee should require the Privatization Commission to create the following departments:

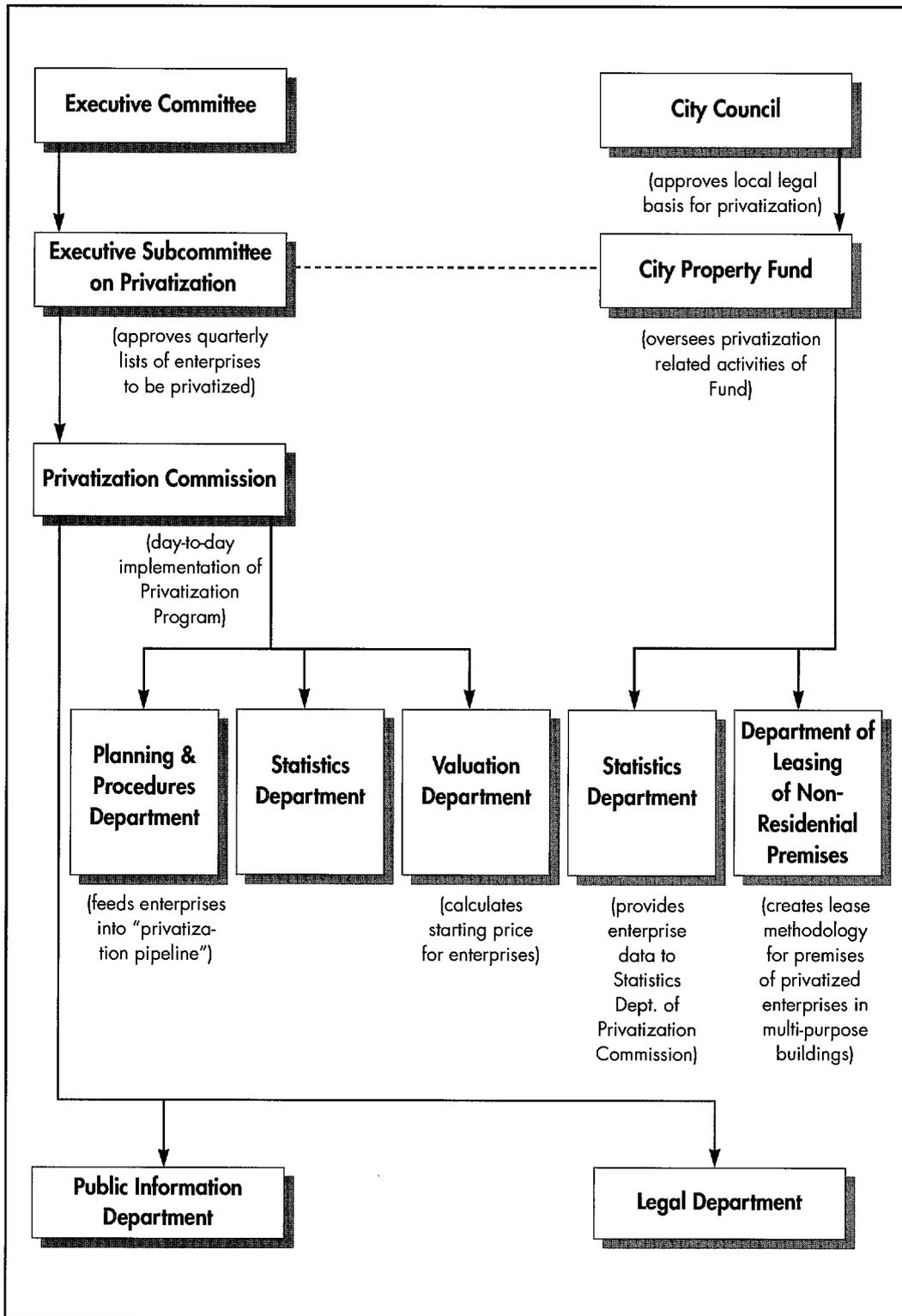
- ▶ **Planning and Procedures Department.** This department submits quarterly lists of enterprises slated for privatization to the Subcommittee for approval. It is also responsible for administering the flow of enterprises to be privatized, or "privatization pipeline", from the initial approval of the lists of enterprises to be privatized to the actual sale of enterprises. The pipeline should allow bi-weekly auctions of enterprises. The Department of Planning and Procedures works closely with all other departments of the Commission. It should also submit approved lists of enterprises to be privatized to the City Property Fund's Departments of Statistics and Leases on City-Owned Premises of Privatized Enterprises (see below).
- ▶ **Statistics Department.** This department collects data on enterprises to be privatized, e.g. enterprise location, specialization, number of employees, square meterage, and raw financial data. The department works with the Statistics Department of the City Property Fund (see below) and other data-gathering municipal entities. The department submits data to the Department of Planning and Procedures for use in lists of enterprises to be privatized. It also submits data to the Public Information Department (see below). Finally, it submits financial data to the Valuation Department (see below).
- ▶ **Valuation Department.** This department analyzes financial data submitted by the Statistics Department in order to determine the auction starting price for each enterprise. If the city sells enterprises as going concerns and does not transfer liabilities to the new owner, the starting price is derived from the book value of assets adjusted at the official inflation rate. The department should submit data to the Public Information Department (see below).

NOTE: Accurate financial data on an enterprise are often difficult to gather and analyze because of lack of information and high inflation. Fortunately, the starting price becomes virtually irrelevant when an enterprise is sold at auction, as the final bid price is usually 25 to 100 times higher than the starting price.

- ▶ **Legal Department.** This department is responsible for cancelling existing lease agreements in accordance with the **Lease Law** and notifying workers of their impending termination and social protection rights in compliance with Ukrainian Laws on Assets and Labor. It also creates all legal documents between buyer and seller (see examples in *Annex 12*). The department should work closely with the Subcommittee and the City Property Department of Leasing of Non-Residential Premises (see below).
- ▶ **Public Information Department.** This department informs the public about privatization activities. It is responsible for preparing and publishing lists of enterprises to be privatized, including all relevant data (gathered from the Statistics and Valuation

29

**Figure 1: Privatization Administration**



Departments). It is also responsible for designing and implementing an ongoing relations campaign to explain how privatization works and why it is important for the general public (see Public Relations Campaign section below).

- **Department of Social Protection.** This department will work closely with the Subcommittee to ensure that a large portion of privatization revenues is used for the social protection of workers displaced by the privatization process. Buyers' associations of workers' collectives not succeeding in acquiring their enterprises should receive 10 percent of the proceeds from the sale of their enterprises, to be distributed by the buyers' associations. Severance pay as mandated by Ukrainian labor law should also be paid out to workers displaced by privatization. This department should also design retraining programs for displaced workers. (See Auction Proceeds section below for a proposed breakdown of total privatization revenues.) The department should submit descriptions of its activities to the Public Information Department on an ongoing basis.

### **City Property Fund**

The City Council should create a City Property Fund (if one does not already exist) to administer city-owned properties and leases on privatized enterprises whose premises are still owned by the city. The Fund will also be responsible for gathering data on enterprises to be privatized and submitting it to the Privatization Commission. Fund staff should not be members of the Executive Subcommittee on privatization, nor should they participate in decision-making or supervisory activities of the Subcommittee.

The Fund should contain the following departments related to privatization:

- **Department of Leases for City-Owned Premises of Privatized Enterprises.** This department manages city-owned premises of privatized enterprises located in multi-purpose buildings. It should create a methodology for setting lease payments for these enterprises (see *Annex 8*), as well as collect lease payments from privatized enterprises. It should submit projected lease payments for enterprises to be privatized to the Privatization Commission's Planning and Procedures, Legal, and Public Information Departments.
- **Statistics Department.** This department collects data on enterprises to be privatized, including location, specialization, number of employees, square meterage of enterprises, and raw financial data, for submission to the Privatization Commission's Statistics Department. The department should collect information from its own records and from former wholesale administrative structures, enterprises themselves, and other relevant departments of the city administration for submission to the Statistics Department of the Privatization Commission.

## IMPLEMENTATION

With the legal and administrative apparatus in place, local authorities may begin the privatization process. As mentioned in the previous section, national legislation allows the three options of auction, tender, and employee buy-out. In the case of L'viv – and as is recommended here – implementation meant the inauguration of the series of public auctions around which all other privatization activities revolve. In the rare case that an enterprise advertised for sale attracts no potential buyers other than the enterprise workers' collective, the employee buy-out method is used as a last resort.

On the assumption that officials from other cities will adopt a variation of the auction method, the following discussion divides into four areas the "privatization pipeline" extending from the initial identification of suitable enterprises through to their sale at auction and transfer of ownership:

- ▶ Preparing enterprises for privatization
- ▶ The auction
- ▶ After the auction
- ▶ Auction proceeds.

Local officials should work to develop a regular, ongoing routine of weekly or bi-weekly auctions, each involving 20 to 25 city-owned enterprises, in order to speed up the overall privatization process. Integral to this process is the training of local officials.

### Preparing Enterprises for Privatization

The initial steps towards privatization include commercialization, determining the method of privatization, soliciting auction applications and creating organizational support for auctions. (See Figure 2 "Preparing Enterprises for Privatization".)

#### Commercialization

As mentioned previously, national law requires that enterprises in the spheres of trade, services, and food supply must be "commercialized" (endowed with the status of a separate legal entity) before they may be privatized. The City Council should pass a commercialization decree before the privatization process begins.

In accordance with Resolution No. 133 of the L'viv City Council on the Implementation of Commercialization of Trade, Services and Catering, enterprises are commercialized the

moment they register with the City Council Registration Division. In addition to registering, enterprises must complete the following:

- Preparation of their charter and articles of association
- Signing of an employment contract with the general manager of the enterprise
- Stamp preparation and establishment of a bank account.

### **The Quarterly Privatization List and Weekly Auction List**

The privatization process lasts six to eight weeks, measured from the moment a preliminary list is approved until the auction occurs.

Each quarter the Privatization Commission should prepare a *Quarterly Privatization List* of approximately 150 enterprises. The Privatization Commission should then submit the list to the Executive Subcommittee on Privatization for approval. Any enterprise not yet commercialized should be commercialized at this stage.

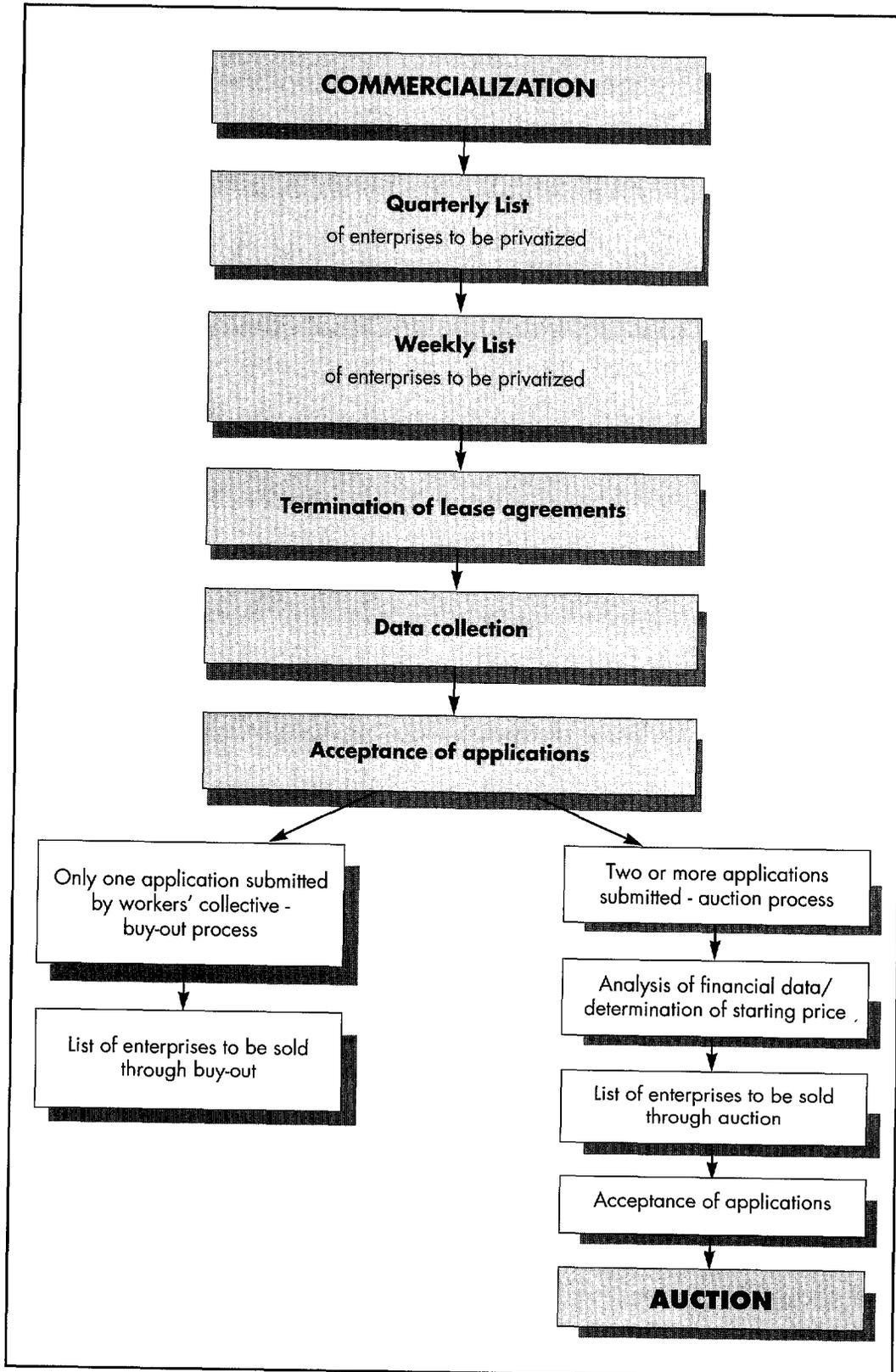
Next, a *Weekly Auction List* of enterprises to be sold at a specified auction date approximately six weeks later is prepared by the Privatization Commission. Any leases on enterprises (except in cases where enterprise lessees applied for buy-out before January 15, 1993) should be cancelled by the Executive Subcommittee at this stage in accordance with the **Lease Law** amendment of January 15, 1993 (see Lease Law in Part One). All privatization lists should immediately be published in the official publication of the City Council.

Publication signifies that the enterprise is officially eligible but not assured for purchase at auction. The *Quarterly List* should include the name, location, type of business, number of employees, and square meterage of each enterprise. The Commission may also include on the lists additional sale conditions, such as temporary maintenance of enterprise specialization (in the case of stores selling basic foodstuffs) or maintenance of an enterprise's historic facade or interior. In order to be fair to applicants, these conditions should not be changed after the privatization list has been published.

### **Pre-Registration**

The Privatization Commission should publish *Weekly Lists* of enterprises eligible for privatization. Enterprises from the *Quarterly List* should be placed on *Weekly Lists* based on availability of enterprise financial data and interest expressed by potential buyers. A *Privatization Application* should be published along with each *Weekly List*. Also, a deadline of a maximum of one month should be published for interested potential buyers to submit the *Privatization Application* to the Privatization Commission. Applicants should pay an *Application Fee* which should not exceed half the minimum monthly salary.

**Figure 2:** *Preparing Enterprises for Privatization*



## **Determining the Privatization Method**

The following is the procedure for the standard case:

If, by the deadline, two or more *Privatization Applications* have been submitted for any single enterprise, that enterprise should be placed on the *Weekly List* of enterprises to be sold at auction. This list should include the information specified in Article 16.1 of the **Small-Scale Enterprise Law**, particularly the enterprise starting price.

The following is the procedure for nonstandard cases:

If, by the deadline, no one has submitted a *Privatization Application*, or if one *Application* was submitted and the workers' collective did not apply, then the enterprise should be listed in the next *Weekly List* with a discounted starting price. If only the workers' collective has submitted a *Privatization Application*, the enterprise should automatically be placed on the *Buy-Out List of Enterprises* to be privatized through employee buy-out.

This procedure should be repeated weekly until enough applications are submitted to make the enterprise eligible for auction or workers' collective buy-out. Note that by Ukrainian law, total discounts to the starting price cannot exceed 30 percent. If the enterprise remains unsold at the end of the quarter, the commission should ask the Executive Subcommittee to determine whether the enterprise should be excluded from the next *Quarterly List* and managed as a communal property, or whether other steps should be taken.

## **Soliciting Auction Applications**

After the expiration of the deadline for *Privatization Applications*, the Privatization Commission should publish *Auction* and *Buy-Out Lists*, with the date of sale announced for approximately one month after publication. The lists should include the enterprise data from the *Quarterly List*, as well as the initial starting price of the enterprise (derived from the value of assets indexed for inflation assuming that the city takes responsibility for all liabilities). To be fair to applicants, no information published at this time, especially the auction date and the starting price, can be changed before sale of the enterprise. Along with the list, the *Auction Application* should be published, with a reminder that potential buyers should submit the *Application* a minimum of two days before the auction.

If, by the deadline, at least two potential buyers have submitted *Auction Applications* to the Privatization Commission, the Commission should prepare the enterprise to be sold at auction. If not, the enterprise should be placed on the next *Weekly List* for sale at auction a month later (but a previously submitted application should remain valid). This

135

procedure should be repeated weekly until at least two applications have been submitted. If the enterprise remains unsold at the end of the quarter, the Commission should ask the Executive Subcommittee to determine whether the enterprise should be excluded from the next *Quarterly List* and managed as a communal property, or whether other steps should be taken.

Applicants should submit the *Auction Application* to the Privatization commission. Along with the application, they should pay a *Pre-Registration Deposit* of 10 percent of the starting price of the unit(s) for which applications were submitted, but only in those instances where the starting price of the units at auction exceeds 20,000 Karbovantsi. If the applicant did not previously submit a *Privatization Application*, he or she should also pay the fee associated with that application (one-half the minimum monthly salary). Unsuccessful buyers will be refunded the *Pre-Registration Deposit*.

When the applicant has submitted the *Auction Application* and associated fees), the Privatization Commission should issue him/her an *Auction Packet*. This packet should contain:

- ▶ A *Pre-Registration Receipt*
- ▶ Instructions for participating in the auctions (see *Annex 11*)
- ▶ A sample of the legal documents bidders will be asked to execute during and after the auction (see *Annex 12*).

The Privatization Commission should prepare a *Participant List* of those people submitting applications. The list should be checked against participants arriving at the auction to determine whether enough participants (a minimum of two) have arrived to put the enterprise up for auction.

Different application forms exist for the following:

- ▶ Legal persons representing legal entities, such as private companies or workers' collectives, participating in open auctions
- ▶ Natural persons participating in open auctions.

NOTE: In accordance with Ukrainian law, any buyers' association or legal entity which is more than 25 percent state-owned is excluded from participation in the auction process.

Logistical support for privatization includes choosing auction premises, initiating a public relations campaign about privatization, and identifying and recruiting needed personnel.

### **Auction Premises**

Typically, between two and twelve participants will bid for any one property. An auditorium should be selected keeping this ratio in mind. The premises should have a podium for the auctioneer and a number of rooms for registration of participants and signing of contracts by buyers.

### **Public Relations Campaign**

A public relations campaign should accompany the privatization process in general and the auction in particular in order to inform both the general population and potential participants about privatization activities.

The auction campaign should include wall displays and advertisements in newspapers and on radio and television. At a minimum, they should specify:

- ▶ Date, time, and place of pre-registration, registration and auction
- ▶ Telephone numbers to call for information
- ▶ "Objects" (enterprises) to be sold.

Examples of basic advertisements appear in *Annex 10*.

Privatization officials and political leaders should also give interviews to the media discussing the privatization program and its effects on the population. The Privatization Commission should provide information to journalists and encourage them to write informational articles on privatization.

In addition, the public relations campaign should also address such concerns as:

- ▶ Risk of unemployment
- ▶ Workers' collectives being excluded or not granted preferential treatment
- ▶ Higher prices for goods
- ▶ Foreign domination
- ▶ Mafia domination
- ▶ Government corruption.

## Personnel

The Commission should designate and train personnel in each stage of the auction process. For example, the following personnel are necessary to implement the auction itself:

- ▶ An experienced auctioneer to lead the bidding
- ▶ One auctioneer's assistant
- ▶ A Commission official to witness the signing of legal documents following each sale
- ▶ Three secretarial assistants to deal with logistical support, provide an official record of the proceedings, and fill out auction documents.

## The Auction

This section describes events occurring on the day of an auction, including registration of participants and the auction procedure itself. Contracts and other legal documents to be signed by the new owner and the city are also briefly described. (See Figure 3 "Auction Procedures and Documents".)

### Registration

Registration occurs on the day of the auction. The Privatization Commission should supply:

- ▶ *Enterprise Displays* giving essential data including a floor plan of the premises, starting price, records of equipment and inventory, and other pertinent information.
- ▶ *A Participant's Ticket and Number Card* (identifying the participant to the auctioneer) to be used during the bidding. These items should be handed out to participants after they present their *Pre-Registration Receipt*. A Commission official records on the *Ticket* the participant's name, seat number, lots on which he/she is bidding, and auction number(s).
- ▶ An *Auction Program* describing each property's name and address, type (i.e., leasehold or stand-alone building), starting price, and other information, including the order in which it will be auctioned. The auction program should also contain *Auction Rules* describing correct bidding protocol. *L'viv Auction Rules* appear in *Annex 11*.

When registration is completed, the Commission officials should check the number of *Tickets* issued against the number of *Applications* to ensure that all participants have arrived. If some participants are absent, this may affect an enterprise's eligibility for

auction since at least two bidders for an individual enterprise must be present for the auction of that enterprise to take place.

### **Bidding**

Before the bidding begins, the auctioneer reviews aloud the rules for bidding listed in the *Auction Program*. The auctioneer should also mention the penalties for violating auction rules and for renegeing on a promise to buy. These penalties should be determined well in advance of the auction, and published in the local press. They may include fines as well as banning winning bidders who renege on payments from participation in further auctions.

During the actual bidding, the auctioneer's assistant sits next to the auctioneer, verifying that bidder and property numbers are correct for each round of bidding and noting the final sale price for each property.

As each round of bidding begins, the auctioneer states the enterprise name; number; what is to be sold (i.e., assets plus leasehold or assets plus entire building); and starting price, and proceeds to invite bids. Participants wishing to bid raise their *Number Cards* so that they are visible to the auctioneer. The auctioneer recognizes each bid. Bids should rise by a percentage stated in the *Auction Rules* (ideally between 8 and 12 percent). Bidding continues in this manner until no one is willing to bid higher. At this point the property is awarded to the highest bidder.

The Privatization Commission should return both *Pre-Registration Deposits* to unsuccessful bidders within ten days following the auction.

### **Documentation**

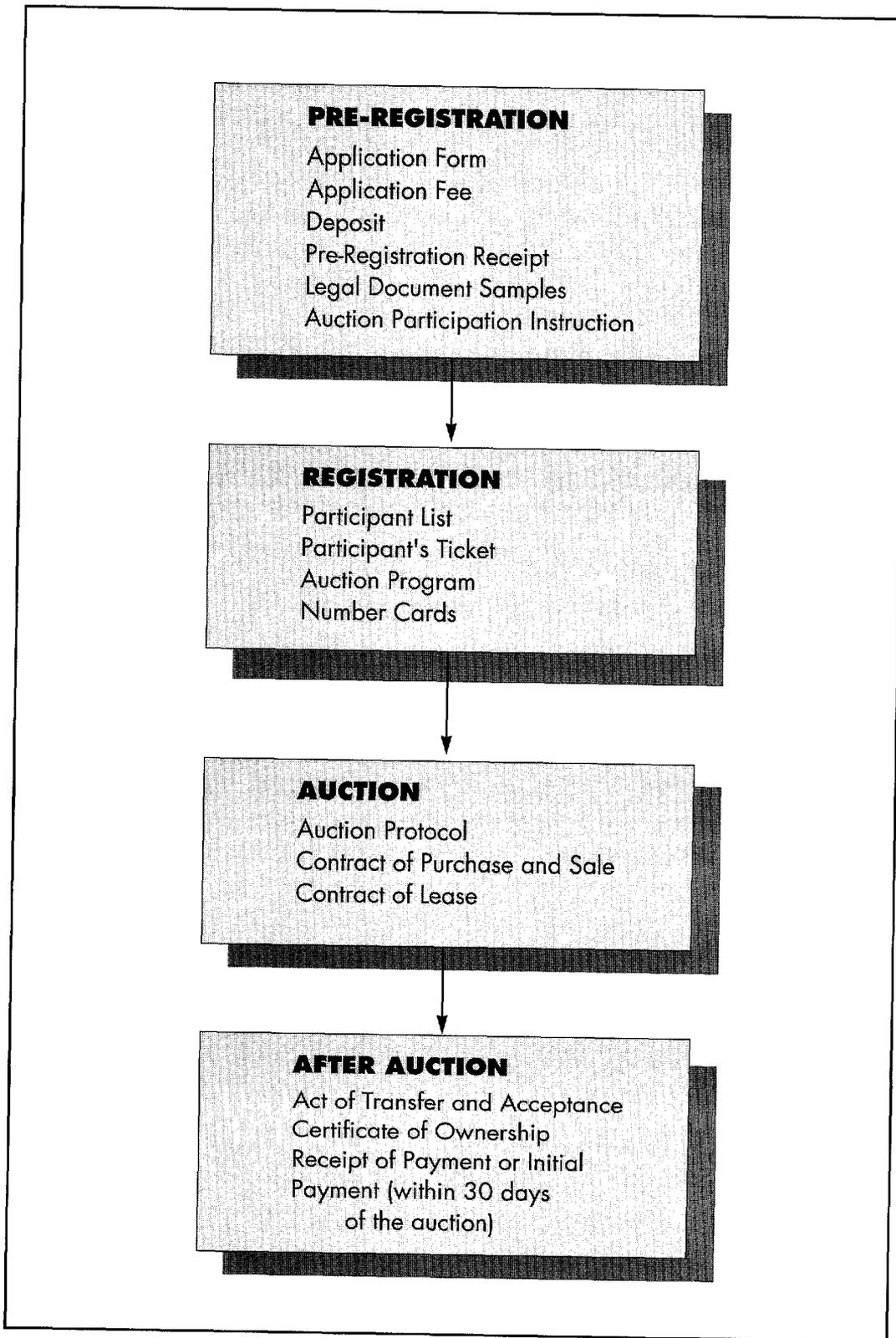
(NOTE: Examples of the documents mention below appear in *Annex 12*.)

After each sale, the Commission prepares a *Record of Purchase* summarizing the results of the auction of that object. The document is signed by the buyer, the Commission official (acting as seller), and the auctioneer immediately after the announcement of the sale of the object.

In a separate room, the successful bidder and a Commission official should then sign a *Contract of Purchase and Sale*. If the property is a leasehold, the *Contract of Lease* is included in the *Contract of Purchase and Sale* as an appendix.

39

**Figure 3:** *Auction Procedures and Documents*



## After the Auction

Buyers are told before and during the auction that they must purchase not only the assets for which they bid at auction, but also the leasehold (if the premises remain the property of the city). On the first working day following the auction, the buyer and a Commission official meet to sign the *Act of Transfer and Acceptance*. This act gives the buyer possession of, and legal responsibility for, the building (or leased space) and all related equipment and inventory. At the conclusion of signatures, the buyer receives the keys to the enterprise.

Upon signing the *Act of Transfer and Acceptance*, the buyer may freely operate an enterprise. However, the buyer cannot sell enterprise assets until full payment has been made to the city. Further, the associated lease right cannot be transferred until 12 months from the date of the signing of the *Contract of Purchase and Sale*. According to Ukrainian legislation, the transfer of the lease right must be complete and cannot be partial (as in sub-leasing). Buyers that are not workers' collectives must pay in full within 30 days following the auction. Workers' collective buyers must pay within six months.

Official ownership rights of the properties (in the form of a *Certificate of Ownership*) sold during the privatization process can be obtained only after full payment has been received.

Should a buyer fail to pay within the required time period, the Commission should fine the buyer a sum equivalent to 20 percent of the purchase price and, in addition, keep the 10 percent *Pre-Registration Deposit*.

Supporting legislation should be in place stating the penalties resulting from non-compliance. For instance, in case of failure to pay, the participant should be excluded from taking part in privatization in the future.

## **Auction Proceeds**

In 1993, the central government is expected to require that 50 percent of privatization revenues from the sale of municipal property be used for paying off the municipality's budget deficit. The draft 1993 L'viv Privatization Program directs the remaining revenues to be paid into an extrabudgetary privatization account managed by the Executive Subcommittee on Privatization and suggests the following norms for their use:

- ▶ 40 percent will be used for three measures of social protection for workers displaced by privatization. First, buyers' associations of workers' collectives not succeeding in acquiring their enterprises will receive 10 percent of the proceeds from the sale of their enterprises, to be distributed by the buyers' associations. Second, severance pay as mandated by Ukrainian labor law will also be paid out to workers displaced by privatization. The remainder of these funds will be used for retraining of displaced workers.
- ▶ 30 percent will be issued as credits to newly-privatized enterprises for structural repairs and purchases of equipment.
- ▶ 20 percent will cover privatization-related expenses such as paying off liabilities of enterprises to be privatized, hiring staff, renting auction facilities, and running a public relations campaign.
- ▶ 10 percent will be distributed as incentives to city government workers involved in privatization.

## Conclusion

The Lviv privatization program is only the beginning of the crucial process of small-scale privatization in Ukraine. In order to realize privatization's considerable potential, other Ukrainian cities and oblasts need to move decisively forward in designing and implementing their own small-scale privatization programs. The information presented in this Manual and its accompanying *Annexes* is intended to help them achieve that goal.

Although national law permits several different privatization options, IFC has here recommended the use of the auction method as the fairest, fastest, and most equitable alternative. It remains the responsibility of local officials to first start privatization and then to create a regular routine of weekly or bi-weekly auctions. IFC is willing to assist Ukrainian city privatization officials in achieving their objectives. For more information, readers are invited to contact the following IFC staff:

**Anthony Doran**

*IFC Manager for the Newly-Independent States*

1850 I Street, N.W.

Washington, DC 20433

USA

Phone: (202) 473-3988

Fax: (202) 676-9593

**Roberta Feldman**

*IFC Ukrainian Small-Scale Privatization Project*

26 Karl Liebknecht Street #6

Kiev, Ukraine

252024

Phone: (7-044) 226-3539

Fax: (7-044) 226-3536

## Explanatory Note

This manual is based on the sale of a going concern where the city authorities accept responsibility for existing liabilities. Two alternative options are available: the liquidation of enterprises with a corresponding sale of assets; or the sale of a going concern where the new buyer is responsible for existing liabilities. They are discussed below.

### Sale as Liquidated Assets

The main features of liquidation are:

- ▶ Sealing off an enterprise and ordering it to cease its activities
- ▶ Dismissing employees, with the city taking responsibility for their severance and notice rights
- ▶ Notifying other creditors that they have a limited time to come forward to present claims to the city
- ▶ Satisfying creditors' claims and closing the enterprise's bank account
- ▶ Cancelling the enterprise's status as legal entity.

According to the Law on Enterprises, the primary legislative act governing the liquidation and reorganization of enterprises in Ukraine, liquidation should proceed as follows:

1. A Liquidation Commission if formed by the owner of the enterprise or by an organ empowered by the owner or, in the event of bankruptcy, by a court or arbitration panel. Alternatively, responsibility for the liquidation of an enterprise can be delegated by any of the foregoing to the governing body of the enterprise.
2. The procedure and timing of enterprise liquidation, as well as the period for the filing of creditor claims (which period shall not be less than two months from the date of the announcement of the liquidation) is determined by the entity authorizing the liquidation of the enterprise.
3. The Liquidation Commission (or other entity liquidating the enterprise) publishes an announcement concerning the liquidation of the enterprise, together with the schedule of the liquidation and the period for filing creditors' claims, in the official press in circulation in the area or at the place of business of the enterprise.
4. The Liquidation Commission begins the process of liquidating the debts of the enterprise and settling the claims of creditors. The Liquidation Commission values the assets of the enterprise and prepares a "liquidating balance" which it provides to the owner of the enterprise or the organ that appointed the commission.
5. The claims of creditors are settled out of the assets of the enterprise after the payment of extrabudgetary debts and compensation of costs incurred for the clean-up of environmental damage caused by the enterprise. Creditors' claims that exceed available assets are denied by the Liquidation Commission and that are not appealed in court or in an arbitration within one month of the denial of the claim are also extinguished.
6. The contribution of the workers' collective shall be returned in the form of currency or securities after the satisfaction of creditors' claims.

### **Positive Aspects**

Determining the enterprise's starting price is less difficult because liabilities need not be taken into account. Auction participants will bid higher because enterprises have no existing debts. The relationship between the owner and the city government essentially ends after the auction, thus minimizing the risk to the city that buyers will renege due to unforeseen liabilities. In general, this is the "cleanest" form in which enterprise assets can be sold.

### **Negative Aspects**

The city government must create an organizational structure to respond to creditors' claims. Liabilities submitted after the auction may prove to be unexpectedly large. The city government, rather than the new owner, will be a target of dismissed worker resentment. Enterprises must be closed within one month of the auction, thus losing extra revenue and stopping production of goods. Cancelling the enterprise's legal status and its bank account require administrative work.

### **Sale as a Going Concern Transferring Assets and Liabilities**

When an enterprise is sold as a "going concern" with the subsequent transfer of both assets and liabilities, the enterprise is transferred to the new owner as a legal entity; employees remain on the staff of the enterprise; and the enterprise is not sealed until a few days before the auction.

### **Positive Aspects**

The city government is not responsible for paying enterprise creditors. Enterprise workers have a chance of remaining employed because the new owner "inherits" them. Severance and other costs associated with dismissed workers will be paid by the new owner. Any worker resentment resulting from the displacement will be directed at the new owner rather than at the government.

### **Negative Aspects**

Liabilities must be published and included in the starting price in order to be fair to prospective buyers and minimize the possibility of buyer lawsuits against the city. However, according to the Small-Scale Enterprise Law, the enterprise starting price and liability information must be published one month before the auction, when the enterprise is included in the auction list. Therefore, the city must recalculate and publish the starting price and liability information immediately before the auction. This procedure is of questionable legality and risks refusal by registered potential buyers to participate in the auction. It is also extremely time-consuming and labor-intensive.

46