

Legal due diligence of Ukrainian agricultural assets

Legal due diligence of agricultural assets in Ukraine has definite characteristics. In particular, such an asset audit requires an examination of agribusiness-specific information and circumstances, along with general issues.

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It is worth considering the following features inherent in the Ukrainian agricultural industry:

- the typical structure of a Ukrainian agricultural asset usually includes a land operator company and an elevator operator company;
- the major share of industrial real estate and infrastructure of Ukrainian agricultural companies was obtained by them in the process of privatization and division of state and collective property;
- the vast majority of agricultural companies do not own land, but use it on a lease basis;
- the vast majority of agricultural companies in Ukraine rent not large plots of land but thousands of small patches of land (from 1 to 8 hectares) from thousands of owners- individuals;
- different taxation regimes may apply to companies within the same production group (for example, the simplified taxation system applies to the land operator company, and the general taxation system applies to the elevator operator company);
- the vast majority of agricultural companies that own agricultural production assets and land use rights, have quite a long and often improperly documented corporate history.

In practice, these features are reflected in the specific issues that should be investigated during the legal due diligence of agricultural assets in Ukraine.

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The legal due diligence definitely cannot be limited to the study of these features and also covers other issues necessary for a high-quality and in-depth study of the legal aspects of any asset. It should be borne in mind that the legal due diligence of agricultural assets usually requires the analysis of extreme array of information, consequently it requires careful planning, organization, and deep understanding by lawyers conducting audits of the specifics of the agricultural industry in Ukraine.

The issues to be studied during the legal due diligence of agricultural asset

1. Corporate issues

2. Property

3. Regulatory information

4. Obligations

5. Personnel relations

6. Infrastructure and energy supply

7. Litigation

8. Personal data and confidential information protection

9. Relations with law enforcement agencies

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1. Corporate issues

The vast majority of agricultural companies in Ukraine were founded when the transfer of state and collective property to private ownership was poorly regulated by law. Many people were involved in the processes, and while performing the procedures often failed to comply with the legal requirements.

Besides, over the long period of its existence, the structure of participants in such companies has frequently changed, and again, without proper formalization. Such basic conditions established the possibility of claims and requirements from both former participants and persons who participated in the division or privatization processes (former employees, their heirs, the state).

For instance, a violation of the procedure for making a decision on the transfer of shared property to a successor company may entail the termination of the legal right to use such property in an agricultural company. A successor company created in the process of privatization may have additional obligations to preserve activities (for example, bread production) that are unprofitable for the company in modern conditions.

The issues of compliance with the Ukrainian antimonopoly legislation should also be investigated separately when conducting legal due diligence of an agricultural asset. Usually, if we are talking about small groups of companies that do not have a significant market share, such issues may be given insufficient attention to. Still, it should be borne in mind that even small agricultural companies in the market sense can have a significant asset value and sales volumes. This is primarily due to the specifics of the agricultural business – large volumes of sales of agricultural products in Ukraine.

Moreover, a significant part of such companies have on their balance sheet a great number of illiquid or even non-existent property obtained in the process of division or privatization (currents, open granaries, silos, social facilities, old equipment, etc.). The companies, whose real value as a business is low, may have sufficient assets value and sales volume to meet the requirements for obtaining a permit from the Antimonopoly Committee of Ukraine at the time of their acquisition by the owner of the Target Asset.

When researching corporate issues of agricultural assets, one should pay attention to the following:

- circumstances of the reorganization (division) of the former collective agricultural enterprise into a Target Asset company;

- circumstances of privatization of the Target Asset company (usually, this applies to the elevator operator);
- obligations incurred by successor companies as a result of reorganization (division) or privatization;
- history of relations between participants of limited liability companies;
- history of formation (purchase) of a controlling stake in a joint-stock company;
- history of agricultural asset concentration;
- payment of the authorized capital of the Target Asset companies;
- management structure of the Target Asset enterprises;
- history, status and procedure for paying dividends;
- procedure for alienation of shares in the authorized capital (sale of shares) of the Companies of the Target Asset;
- necessity to obtain permission from the Antimonopoly Committee of Ukraine to acquire Target Asset companies and to comply with antimonopoly legislation in previous transactions with Target Asset companies;
- issue of the status of owners of shares in the authorized capital (shares) of the companies of the Target Asset (whether they are on the register of debtors, bankruptcy proceedings, open criminal cases, the residency/citizenship, whether they are in debt to the state, etc.).

2. Property

The main feature of legal due diligence of the ownership of agricultural assets in Ukraine is the status of property obtained as a result of the reorganization of collective agricultural enterprises (shared property) and privatization, as well as the lease of agricultural land.

Related article: [Land Market Opening in Ukraine](#)

In the course of legal due diligence, the information about the shared property (or property acquired as a result of operations with shared property) should be separately examined. This is because the procedures for allocating and registering ownership of shared property are not sufficiently regulated by the current legislation of Ukraine. Moreover, the process of allocating shared property affects the interests of many people (former members of a collective agricultural enterprise – CAE), who can always put forward their own demands. Violation of the procedures for dividing and allocating property creates reasonable grounds for the emergence and satisfaction of claims of former members of the CAE to recognize transactions with such property as invalid.

The issue of privatization in most instances is related to the acquisition of grain elevators by agricultural companies. The complex and sometimes opaque privatization procedure often leads to violations, insufficient or improper documentation. Such circumstances cause, for example, the risk of declaring the results of privatization invalid and, as a result, the burden of legal proceedings on the capacities necessary for the production and provision of bank financing.

Legal due diligence of land lease rights in the case of an agricultural asset is complicated by the great number of contracts that formalize such rights. Land with an area of, say, 20,000 hectares can be leased on the basis of 5 to 10 thousand contracts.

For the most part, such contracts are concluded in different periods, under different conditions, for different terms; in addition, many such contracts contain

additional agreements. Each of these agreements and additional agreements thereto must be accompanied by a package of documents (identification documents of owners, documents on land ownership, registration documents, land management documentation, etc.). Technically, this is the most complicated part of the legal due diligence of agricultural enterprises in Ukraine. At the same time, taking into account that the land is a basic asset in the agricultural industry, the practice of random verification of land lease agreements is not a sufficient method of the high-quality legal due diligence.

When conducting legal due diligence, it is necessary to investigate the following:

- agricultural land lease rights and accounting systems in land operator companies;
- circumstances of obtaining for use or ownership of the property of former CAE (shared property);
- circumstances of transfer of property in the process of privatization;
- real and movable property owned by companies of the Target Asset;
- real and movable property used by companies of the Target Asset;
- property that is owned by companies of the Target Asset under leasing conditions;
- construction in progress carried out by companies of the Target Asset;
- intellectual property objects of the Target Asset companies;
- encumbrances on the property of Companies of the Target Asset and other restrictions on the exercise of ownership to the property of Companies of the Target Asset;
- retrospective studies of property issues, for example, procedures for privatizing property, procedures for dividing former agricultural enterprises, Target Asset companies acquiring a property at auctions, etc.

3. Regulatory information

When analyzing regulatory information regarding Ukrainian agricultural assets, it is necessary to take into account the specifics of the tax status (in relation to enterprises that produce agricultural products) and production activities.

In the first case, it is necessary to study the actual fulfillment by the enterprise of the requirements that are necessary for obtaining and maintaining the special tax status of agricultural taxpayer in Ukraine .

In the second case, it should be taken into account that the production cycle of an agricultural enterprise usually includes activities that require separate permits, licenses, and certificates. Some works on the elevator, with grain dryers, and other works related to grain storage, drying, and shipment are dangerous and require appropriate registration in Ukraine. A laboratory may also be involved in order to work with reagents that require an appropriate permit (license). Separate operational permits are required for the legitimate operation of breeding farms, slaughterhouses, and feed mixing facilities.

In addition to the mentioned issues it is also necessary to investigate the:

- registration and accounting of companies of the Target Asset as the payers of taxes, mandatory payments, including VAT;
- status of settlement of the Target Asset companies with budget and social

- funds;
- results of inspections of the Target Asset companies by fiscal and other authorized state bodies of Ukraine;
- resolutions, instructions, decisions, notifications of fiscal and other authorized state bodies based on the results of inspections;
- licenses and permits for certain types of activities;
- special environment management permits;
- permits to start business;
- operational permits;
- licenses, permits, approvals, manufacturer's declaration, other permits, all kinds of certificates, including certificates of conformity, HACCP, ISO certificates, etc.

4. Obligations

For any Ukrainian agricultural enterprise that uses leased land, the fulfillment of land lease obligations is critical. The proper attention should also be paid to the obligations that the enterprise has in the social sphere, such as agreements on sponsorship of a local football team, obligations to cultivate land of landowners, clear roads in the community from snow, etc.

This is due to the fact that the conclusion and extension of land lease agreements requires a stable relationship between the enterprise and the rural community, where the land is leased. Such obligations (promises, agreements signed with communities) can be significant.

Information on liabilities that are subject to separate study in connection with the agricultural specifics of the Target Asset should include the following:

- bank loans;
- non-bank financing (issue of securities, loans to legal entities and individuals, etc.);
- securing the fulfillment of obligations (pledge, guarantee of third parties, etc.);
- encumbrance on property;
- terms and conditions of performance of obligations under agreements;
- obligations arising from joint activity agreements;
- obligations arising from the participation of companies of the Target Asset in tenders, competitions, etc.;
- non-contractual obligations (compensation for damage, compensatory reliefs, etc.);
- status of obligations fulfillment under the land lease;
- availability, maintenance, and status of fulfillment of social obligations (agreements with the local community for the reconstruction of roads, kindergartens, expenses for the maintenance of rural infrastructure, charitable assistance, etc.);
- availability, maintenance and status of fulfillment of obligations to former members of the CAE, the legal successor of which are the enterprises of the Target Asset.

5. Personnel relations

The presence of seasonal workers is typical for the agricultural production cycle. The local positions in the company are often held by relatives of the managers. For example, the director's spouse works the company accountant, the director's close friend works as the chief agronomist, etc. Such circumstances may negatively

affect the exercise of control over the Target Asset company.

While conducting legal due diligence, you should, among other things, focus on studying the following:

- procedure for registering relationships with seasonal employees;
- availability and terms of collective agreements in the Target Asset companies;
- relations with trade unions;
- standard employment agreements;
- status of payroll calculations;
- existence and circumstances of labor disputes and disputes with the trade union;
- presence and circumstances of industrial accidents and the obligations of the companies of the Target Asset arising from them;
- existence and circumstances of conducting an internal investigation into the actions of officials and employees of the Target Asset companies;
- availability, management, and status of agreements execution with individual entrepreneurs performing work or providing services on a regular basis;
- labor relations with members of the management bodies of enterprises of the Target Asset;
- employment relations with participants of the Target Asset companies or related persons.

6. Infrastructure and energy supply

The issue of infrastructure and energy supply is extremely important for agricultural companies. This is due to the high energy dependence of critical production processes (drying grain, heating farms) and the critical importance of communications for shipping agricultural products to customers (access roads, railway lines, access to grain storage facilities in ports, etc.).

Although such issues are typical for any asset, in the case of the legal due diligence of a Ukrainian agricultural company, they are of ultimate importance. For instance, a distribution transformer to which a farm is connected may belong to a neighboring company or be located on its territory. It is enough for the transformer's owner to terminate the agreement for the use of the transformer in order to endanger the operation of the whole farm. Such circumstances are likely to be used as instruments of competitive pressure on the Target Asset company.

When analyzing infrastructure and energy-saving issues, it is advisable to focus, in particular, on the following issues:

- availability and terms of energy supply agreements;
- availability, location, conditions for connecting and using power supply infrastructure (electrical substations, transformers, gas distribution units, power lines, pipelines, etc.);
- conditions for using access roads and railway tracks;
- availability, terms and conditions of execution of agreements with carriers;
- grounds and conditions for using production sites (tractor crews, silos, currents);
- grounds and conditions for using field roads;
- availability and terms of use of cargo terminals of grain elevators, ports, grain hubs, third-party granaries, etc.

7. Litigation

While analyzing the issues of litigation, it is necessary to take into account not only the cases in which proceedings are underway during the legal audit period but also the cases where the decisions have already been made and can be appealed within the procedural time frame.

Given the large number of land lease agreements, there can be a significant number of such disputes. The importance of a detailed analysis of litigation is also due to the fact that even the presence of one such dispute can lead to a massive submission of claims. For example, if there is at least one dispute in the proceedings about invalidating a lease extension agreement based on the fact that the landowner's signature was forged, there is a possibility that there may be a great number of such agreements.

In addition to these issues, you should also investigate the:

- existence and circumstances of litigation involving enterprises of the Target Asset;
- existence and circumstances of court decision enforcement proceedings involving enterprises of the Target Asset.

8. Personal data and confidential information protection

On the surface it seems that the issue of personal data protection is not specific to the analysis of agricultural assets. But one needs to understand that a company that enters into hundreds or thousands of land lease agreements with individuals receives a huge bulk of personal data at its disposal. If this array fails to be processed in compliance with the requirements of the current Ukrainian legislation, there is a risk of claims from landowners. Such claims can be used, in particular, for raider attacks on a company.

It is also necessary to take into account the importance of maintaining confidential information in agricultural asset companies. Take, for example, the consolidated databases of land lease rights: once in the hands of competitors, they can significantly facilitate their work with landowners of companies of the Target Asset. With consolidated data on the amount of land payment, lease expiration dates, and details of landowners, competing companies can obtain the immediate influence on landowners and conclude land lease agreements with them in their own favor.

When conducting the analysis, it is necessary to investigate the following:

- availability and compliance with the current legislation of the personal data protection policy in the Target Asset companies;
- composition of personal data, the processor or controller of which are the companies of the Target Asset;
- availability and compliance with the current Ukrainian legislation of personal data protection clauses in agreements and documents of the Target Asset companies;
- a list of information that is classified as confidential and the mode of access to it.

9. Relations with law enforcement agencies

Production features of agricultural assets (availability of fields, peculiarities of the mentality of the local population, large volumes of consumable resources (fuel, seed materials), unprejudiced difficulties in controlling the volume of products lead to a relatively high level of theft and abuse in Ukrainian agricultural companies. Such abuses are often extremely specific. For example, carriers or combine harvesters can manipulate fuel consumption.

The legal due diligence undoubtedly can't detect them. However, a buyer of an asset can inherit a large number of criminal cases related to such. Analysis of relations with law enforcement agencies allows to assemble information, so that the buyer of a Ukrainian asset can soberly evaluate the level of the theft prevention system in companies of the Target Asset, the system of monitoring the actions of officials and employees.

To do this, it is necessary to include the following in the issues under study:

- existence and circumstances of criminal and administrative cases opened against officials and employees of the Target Asset companies;
- existence and circumstances of criminal cases involving officials and employees of the Target Asset companies;
- presence and circumstances of theft and other illegal actions of officials and employees of companies of the Target Asset, which are the basis for applying to law enforcement agencies.