FRISHBERG &PARTNERS
ATTORNEYS AT LAW

10 Gorky Street, Suite 8
01004 Kiev, Ukraine
Tel: +38(044) 585-8464; 585-8465
Fax: +38(044) 235-6342; 289-1406
office@frishberg.com.ua
www.frishberg.com

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TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Anti-Crisis Measure #1: Cutting Labor Costs – Ukraine

Admittedly, the current economic crisis has dealt a severe blow to the foreign business community in Kiev. As a result, most companies are taking radical anti-crisis measures in order to survive. And cutting labor costs is at the top of everyone's list.
In some ways, life in Kiev resembles the good old days, before the arrival of all those black Mercedes 600 series. The streets are less crowded with traffic, no reservations are required to visit top restaurants on Friday nights and the astronomical lease rates have fallen drastically (Leonardo at $35 per meter!). Even office furniture and supplies are reasonably priced.

At the same time, massive lay-offs are taking place. Some employees are terminated because of the economic crisis, while in other cases the economic crisis provides a company with the opportunity to rid itself of unwanted employees who perform their duties in a formal manner but with no professional effect or creativity. At long last, there is a vast increase in the amount of top-quality job candidates, who wish to fill any vacant position in any company, with modest requirements, which makes it easier for a company to choose a new, more efficient workforce. In many cases, economic crisis allows the companies to terminate unprofitable employees while optimizing the workforce.

Immediately below we discuss the various issues involved in cutting labor costs and downsizing workforce.

(A) Cutting Labor Costs

In addition to terminating employees, a company usually considers alternative ways to optimize personnel-related expenses. For example, a company may transfer a part of its workforce to part-time work and/or simply reduce salaries. In such cases, it is important to keep salaries above the legal minimum monthly salary rate. Moreover, such measures should be presented as temporary crisis-related measures until the crisis passes. In addition to reducing salaries a company may reduce incentive and social benefits as such measure is usually more acceptable to employees than outright dismissal.

Another option is to send employees on lengthy unpaid holidays. These employees are still considered to be employees of the company, and if the company survives the hard times, the employee will return from the unpaid holiday to his or her position. Importantly, an employer may not send an employee on a lengthy unpaid holiday without his or her consent. However,

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in case of a work stoppage at the fault of the employer, (e.g., financial difficulties) the employer is obliged by law to pay compensation in the amount of two thirds of the employees' average salary.

(B) Downsizing Workforce

A crisis can lead to a fall in production in any company which, in turn, can lead to the restructuring and/or reorganization of production and the company's workforce. In order to dismiss employees due to reorganization of the workforce, a company must take the following legal actions:

1) inform the labor union or workers' representative of the company in writing regarding the planned reduction of the workforce due to reorganization of production no later than three months before the planned dismissals;

2) offer to the dismissal candidates any other vacancies available in the company (no later than two months before the planned date of dismissals);

3) if an employee refuses the offered vacancy or no vacancies are available, then the company must issue a so-called "order on the reorganization of production and reducing the workforce" no later than two months before the planned date of dismissal. At the same time, the company should also formally notify all employees, with their signature affixed to the written notice, as well as the state employment authority regarding such dismissals;

4) submit to the state employment authority a list of dismissed employees within ten days term after dismissal;

5) return to the dismissed employees their labor books (signature required) with the corresponding dismissal entries. At the same time, the company must completely pay out all severance payments in the amount of one average monthly salary per employee and compensation for any unused vacation time (if applicable).

Importantly, any reorganization must bear the consequences of an actual reorganization, not simply a formality. If, after reorganization, an employee discovers that his position was maintained in the company and occupied by a new employee, then the dismissed employee has grounds to submit a labor claim to restore him or her to that position within the company and collect moral damages.

However, during an economic crisis, it may be harmful to the company to wait two or three months to reduce its workforce due to the strict adherence to the requirements of notifying the

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labor union, employees and the state employment center. Instead, many Ukrainian companies attempt to reduce their workforce by negotiating with the redundant employees to accept dismissal "upon mutual consent of the parties" or "at their own accord". Such negotiations are completely legal and commonly practiced in Ukraine. The most vital aspect of these types of negotiations is to find a personal approach to each employee.

In practice, Ukrainian companies usually offer a severance package of one to three average monthly salaries for dismissal at an employee's "own accord" despite the fact that dismissal at one's "own accord" does not legally entitle the employee to severance pay. With respect to dismissal upon "mutual consent of the parties," Ukrainian companies usually offer anywhere from 1 to 12 average monthly salaries, although the legislation is silent as to the minimum severance pay amount in such cases.

In both types of dismissals, the risk lies within the correct formal execution of the dismissal. If the dismissal is not properly documented and executed, the employee may prove in a court that the company intentionally violated his or her labor rights. As with any improper dismissal, the court will reinstate the employee to his former position and may award moral damages, too.

To reiterate, most Ukrainian companies experience the above types of dismissal negotiations when the workforce reduction is rather small in scale and the company has the possibility to negotiate individually with each employee regarding an agreed upon compensation. Such factors as an employee's tenure, position, access to confidential information and ability to compete with the company influence the amount of compensation offered to the employee.

It is also important to note that the relevant entry into the dismissed employee's labor book also plays a role, as the entry "mutual consent of the parties" may seem a bit more of a forced dismissal to a potential future employer than the entry "at the employee's own accord". The employee will often want to know whether he will have the possibility to receive references in the future from his or her former employee before deciding on the type of dismissal. Naturally, the employer may use this negotiation point to its advantage.

Notably, the crisis has had its influence on the archaic labor legislation of Ukraine. In January of 2009, Law No. 799-VI "On Introduction of Amendments to Certain Laws of Ukraine in Relation to Decreasing the Impact of the Global Financial Crisis in the Sphere of Employment of the Population" was passed. Before Law No. 799-VI came into force, employees dismissed "upon mutual consent of the parties" or "at one's own accord without good reason" could claim unemployment benefits from the state employment authority after the 8th day of their dismissal. Law No. 799-VI stipulates that such employees may only claim unemployment benefits after the 91st day of their dismissal. This amendment significantly reduced the

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motivation of employees to resign “upon mutual consent of the parties” or “at their own accord without good reason”.

Nevertheless, even in crisis conditions, there are certain categories of employees, who have a priority status and cannot be dismissed before others upon a reduction of the workforce. The following categories of employees enjoy such preferred treatment within their respective work positions:

1) employees with two or more dependents;

2) employees in families with no other independents, who earn a salary;

3) employees with an uninterrupted term of employment in the company;

4) employees who simultaneously work and study in higher or secondary special scientific institutions;

5) military veterans, invalids of wars, and individuals who are subject to the Law of Ukraine “On the Status of Veterans of War, Guarantees and Social Securities”;

6) employees who received work-related injuries or illnesses at the company;

7) employees who have formerly served in the military or have served in other alternative (non-military) organizations - within two years from their completion of service;

8) other individuals who have such priority right in accordance with special legislation.

Importantly, however, if all subdivisions of a company are subject to complete reduction as a consequence of reorganization, then all employees within such subdivisions may be dismissed regardless of whether they have a priority right to remain within the company.

Finally, in order to dismiss incompetent employees, a company must adhere to a careful and strict procedure. This begins with documenting an employee’s incompetent or bad behavior in an internal decree. This is the first step to proving an employee’s incompetence or insufficient qualifications. Of course, in order for employees to understand and know their competence and what is expected of them at the workplace, the employee should familiarize them with the rules (internal company rules, company policies, terms and conditions of employment, etc.).

Once an employee’s incompetent behavior has been discovered and documented, the employer must reprimand the employee in writing by stating the facts surrounding the

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employee's actions. This is done by issuing an internal decree, which the employee must read and sign. If this is the employee's first "offence", the employer will most likely not be able to dismiss the employee outright, unless the "offence" involves gross misconduct such as theft or fraud. Thus, the offending employee's actions should be carefully observed and documented in the future in case of repeat offenses.

Some companies use other tactics at the workplace, such as instituting testing of employees to evaluate their qualification. If a certain employee fails to pass "the test", then there are grounds for a reprimand or, in case of repeated failure, dismissal. Importantly, employees should be forewarned that testing is involved in their employment conditions. Another caveat: any employee not satisfied with the results has the right to dispute the testing procedure and claim reinstatement.

In conclusion, a close reading of the Ukrainian Constitution reveals that Ukraine is a socialism-inclined country where the right to work is a constitutional right of every citizen. Therefore, even during an economic crisis, any violation of an employee's right to work under Ukrainian labor legislation can lead to the situation when a court reinstates an employee to his or her pre-dismissal position. In such cases, the company can be forced to pay for the entire time of the employee's absence from work due to dismissal and, not uncommonly in Ukraine, for a usurious amount of moral damages. However, a proper approach to dismissal decreases expenses and risks, and allows companies to survive the economic downturn.

Frishberg & Partners is a full service, Kiev-based law firm, specializing in Ukrainian law since 1991 (for more information please see www.frishberg.com).
If you have any questions, please contact office@frishberg.com.ua

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