LEGAL ISSUES
WITH REGARD TO BUSINESS OPERATIONS AND INVESTMENT IN UKRAINE
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The Project’s overall objectives are:

First, to contribute to Ukraine’s efforts to improve the environment for enterprise development and investment and foster job creation, innovation and global competitiveness of private sector enterprises by addressing the regulatory and legal structures, institution-building and support policies and programs at national, regional and local levels; and

second, to focus on how best to build indigenous capacities at central, regional and local governmental levels to face the challenges of globalisation and promote further transition to a market economy on par with the European Union, notably with regard to the environment for private sector development (including domestic and international investments). This would also help to better identify, formulate and agree on common objectives between central and local actors as well as donors within a well-established overall strategic framework.

The main authors of this Report are Dr. Irina Paliashvili, Ms. Tamara Lukanina and Messrs. Dmytro Syrota, Serhiy Dzis and Richard Smith, from the law firm Russian-Ukrainian Legal Group, P.A. The Report has benefited significantly from input by Rainer Geiger (OECD), Engin Göksu (OECD), Costas Masmanidis (Black Sea Economic Co-operation – Business Council) and Jaroslav Kinach (advisor to the former Ukrainian Prime Minister).

The final editing and printing preparations were undertaken by Georgiana Pop (OECD).

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While the Executive Summary of this Report is endorsed by the OECD Secretariat, it is noted that the background analysis remains under the main authors’ responsibility. Thus, the views expressed in this Report do not necessarily reflect the views of the OECD and its Member countries.

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PREFACE

Ukraine’s continuing efforts to improve the investment climate in the country are commendable. However, although much has been achieved, there remain major challenges.

The Ukrainian Government and the OECD Secretariat co-operate based on their established and efficient relationship. This Report is the successful continuation of the work previously done by the OECD with regard to Ukraine. The OECD published in 2001 the Investment Policy Review of Ukraine and in 2002 the Investment Policy Review – Progress in Investment Reform. Thus, this Report is another successful step in the ongoing dialogue between the OECD and Ukraine with regard to the improvement of the investment climate for domestic as well as for international investors.

Ukraine has made good progress across a broad front of legal and regulatory issues concerning the general business climate, but the country still needs to address major challenges. From the perspective of investors and legal analysts, a lack in consistency and coherence of legislation can affect investment decisions. Another issue is the institutional capacity of Ukrainian authorities and the judiciary to implement the legislation. The Report reviews these issues in important areas of legislation and puts forward suggestions for improvement.

OECD will continue this fruitful dialogue with the Ukrainian authorities to adopt a clear legal framework for businesses of all sizes. It is hoped that future actions will be taken to raise the confidence of private investors.

OECD is committed in supporting the Government’s efforts and is looking forward to shaping the future agenda on investment climate issues.

I would like to thank the European Union for its generous support, the Ukrainian authorities for their valuable input and co-operation and all other stakeholders who have provided their views and opinions to make this Report happen. Special thanks go to Dr. Irina Paliashvili and her team from RULG for the legal analysis which provided the basis for the Report which is published under the responsibility of the Secretary General of the OECD.

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I. Executive Summary

1. Introduction

The Organization for Economic Cooperation and Development ("OECD"), with the support of the European Union, is currently conducting a multi-year project on investment and enterprise development in Ukraine. This Project builds on the results of the OECD’s previous reviews of the legal framework for investment in Ukraine conducted in 2001 ("Investment Policy Review") and in 2002 ("Progress in Investment Reform"), and takes into account the most recent developments in Ukraine’s legal and business climates. As part of this Project, the OECD commissioned a Survey of international and domestic businesses operating in Ukraine, drawn from different sectors of the economy and different regions of the country (the "Survey"), to identify issues of concern to these businesses regarding key issues of legislation, the legislation’s interpretation and legislative gaps affecting investment and enterprise development in Ukraine.

Accordingly, in April and May of 2004, at the OECD’s behest, the Russian-Ukrainian Legal Group organized a series of interviews with international and domestic small, medium and large businesses operating in Ukraine, to identify the legal issues of greatest concern to them. The Survey, combined with a comprehensive review of Ukraine’s civil, company, antimonopoly and other business laws and regulations, was compiled into this present Report.

Based on the results of the Survey, this Report focuses on Ukraine’s new Civil and Commercial Codes, company laws, antimonopoly legislation and other areas of law that are most important for the investment climate in Ukraine. Together with the Survey, this Report played an integral role in framing the issues that were later discussed at a Roundtable conference held on 19 May 2004 in Kiev (the "Roundtable"), focused on how best to improve the situation for enterprise development and the investment climate for domestic and international investors in Ukraine. Indeed, the Roundtable’s findings very closely tracked the observations and suggested courses of action described and laid out in the Survey and in this Report.

The Roundtable discussions highlighted the importance of this Project. Roundtable participants described the present-day legal situation in Ukraine as needing crucial and timely improvements in order to satisfy the requirements of the domestic business sector and attract needed foreign investments. Following up on the ideas and comments expressed in the opening remarks by the representatives of the OECD, the Delegation of the European Commission, the Ministry of Justice of Ukraine and the Verkhovna Rada of Ukraine, all Roundtable participants agreed that establishing a transparent, stable and fair national legal system is essential to attracting a stable flow of foreign investments into Ukraine’s economy as well as ensuring equitable “rules of the game” for all businesses.

The Roundtable participants also identified the improvement of the implementation of laws in practice as a point of concern, for writing a law is just the first step in a long process. Until a law can be effectively, fairly and consistently implemented, it is not yet a useful part of the legal system. This last issue is crucial, because foreign investors, as well as domestic businesses, are interested not only in a law’s contents, but also in the results that flow from a law’s passage, effective implementation and application. It is for this reason that the recommendations flowing from this Project do not just begin and end with identifying laws that need to be amended or passed. Rather, it will be an ongoing process of identifying legal problems that should be repaired, developing laws, procedures and mechanisms to fix those problems, and then following through to the laws’ practical implementation. These tasks will require close cooperation and collaboration between the private sector and the Ukrainian government, with attendant support and
guidance from experts from the OECD, the EU and other international organizations. It is for this reason encouraging that many Ukrainian government representatives have already acknowledged the importance of this Project and expressed their readiness to work cooperatively in implementing its recommendations.

The Roundtable identified four separate areas of Ukrainian law that appear ripe for legislative improvement:

- civil legislation (specifically, the Civil and Commercial Codes);
- company law;
- antimonopoly law; and
- other areas of law and regulations that create unnecessary legal obstacles or hidden charges on doing business.

The specific findings of the Survey, Roundtable and Report were as follows:

2. Civil legislation

On 1 January 2004, Ukrainian civil legislation underwent a fundamental transformation. The adoption of new Civil and Commercial Codes signified a new age for the national legal system, as these two legislative acts became the new basis for the development of some of the key legal spheres in Ukraine. There is a downside to this, however, because any defects in the Codes will be magnified in their importance through the promulgation of subordinate legislation built upon them. That is the reason why the Civil and Commercial Codes must be unambiguous, clear and flawless, and consistent with each other.

Months of experience in using the Codes suggest that they are in need of significant improvement. The potential for conflicts, both internal to the Codes and among the Codes and other laws, is substantial. The Survey and the Roundtable focused on the following major problems with the Codes:

- Each Code contains provisions that conflict with other provisions of the same Code. As examples, private sector representatives cited conflicting requirements for the form that contracts should take and conflicting rules on identifying the moment various types of contracts take legal effect.
- Substantial conflicts exist between many provisions of the Civil and Commercial Codes that regulate the same issues. For example, some corporate forms recognized in the Civil Code are not recognized by the Commercial Code, and vice versa.
- Numerous conflicts exist between provisions of the Codes and subordinate laws. For example, the Civil Code requires a contract, to which a legal entity is party, to bear the legal entity's corporate seal in order to be valid. This requirement undermines the effectiveness of Ukraine’s new laws on the subjects of electronic documents and digital signatures.
- Some good ideas contained in the Codes cannot be implemented in practice because of gaps within the subordinate legislation. For example, the Civil Code requires that purchases of land be registered with a government agency, in accordance with an unnamed law, before a buyer can obtain title. Such registrations theoretically should help to bring order to the country’s real estate market, simplify the process of title searching, etc. However, no government agency has yet been empowered to register such purchases of land, and no law on the procedure for registration has been passed.

The above problems hinder the normal operation of businesses in most spheres of the economy, rendering the legal system incapable of regulating certain relationships and protecting the interests of participants in the economy. Moreover, the large number of legislative gaps in Ukrainian civil legislation gives broad grounds for regulatory agencies and courts to interpret the meanings of the laws and facilitates corruption among the regulators and unfair competition among business competitors. In this regard, the Commercial Code appears to present an obstacle to the development of the free market in Ukraine because its nature and methods of regulation do not support Ukraine’s nascent market economy.

For the above reasons, Ukrainian civil legislation requires improvements. The Roundtable focused on:
• how best to resolve conflicts between provisions of the Codes that regulate civil relationships, considering whether conflicts among the Civil Code, the Commercial Code and subordinate legislation should be decided in favor of the Civil Code or the Commercial Code; and

• how best to enact into law the implementing legislation referred to in the Civil Code, which has not yet been passed, most importantly, the bill on private international law (which covers conflicts of laws rules) currently pending before the Supreme Rada.

Several Roundtable participants argued that the Codes were essentially contradictory in their natures. It was noted that the Civil Code, while containing some problems, can be improved; on the other hand, the Commercial Code embodies concepts that simply do not work within a market economy. It was generally agreed that the conflicts and inconsistencies between the two Codes are so numerous as to make it impossible to bring them into compliance with each other.

It was suggested that the Commercial Code could perhaps be transformed into an act that regulates only legal relations between the State and private companies. Another participant expressed the belief that setting up separate legal regulations for each of the private and public sectors would be dangerous, and that both State-owned and private businesses should be subject to the same legal regulations. Incidentally, this was a point also raised in the Survey. The representative from the Delegation of the European Commission argued that Ukraine should move towards a unified system of legislation, as the EU is doing, with the aim of both eliminating conflicts among legislative acts and simplifying the process of enforcing laws – which is currently one of Ukraine’s primary problems. Another participant pointed out that the Civil Code is already an all-encompassing document, echoing a sentiment expressed by respondents to the Survey. Thus, the Commercial Code was not needed at all and should be abolished.

Ultimately, the majority of the Roundtable participants agreed that the Civil Code must be amended and that this can be done without undue difficulty. In contrast, the Roundtable participants cited the Commercial Code’s decided tendency towards re-establishing a command economy, for example, its empowerment of the government to dictate the actions of companies and to deprive companies of various benefits and privileges when they do not comply with government demands, should be abolished.

3. Company law

The OECD’s 2001 Investment Policy Review: Ukraine noted several weaknesses in Ukraine’s company law regulation, embodied in the Law on Enterprises and the Law on Companies. Ukraine has repaired some of these problems by annulling the Law on Enterprises. Yet, serious problems with Ukraine’s company laws continue to disrupt the economic life of the country. In the OECD’s 2001 Investment Policy Review: Ukraine, the observation was made that it would be desirable to: “develop entirely new legislation for various types of businesses based on relevant provisions of the draft civil code”. That, too, has been accomplished by passing the new Civil Code.

Nonetheless, the businesses surveyed feel that Ukrainian company laws can still be improved. Based on comments gleaned from the Survey, the Roundtable focused on the following three issues:

• how to resolve overlapping and uncoordinated provisions of the Civil and Commercial Codes that regulate the same issues; clarifications of ambiguous terminology; and problems with the effective application of many of the Codes’ important provisions;

• the possible removal of incongruous provisions and legislative gaps in the Law on Companies, which is the primary Ukrainian law regulating companies; and

• the possible removal of impractical and unreasonable provisions found in the Codes.

All of these problems hinder enterprise development and business operations in Ukraine. They often create bureaucratic obstacles to the free operation of companies, open the door to unscrupulous competitors using legal loopholes to compete unfairly and create a fertile ground for corruption to grow within government agencies and the courts.
At the Roundtable, the following legislative improvements were considered as means to promote enterprise development and operation in Ukraine:

- analyzing company law, especially where regulated by the Codes, to identify both internal contradictions within individual laws and conflicts between different laws. While the Report identifies many of the most important contradictions and conflicts, further study and time would be necessary to do a thorough inventory of all desirable revisions;
- repealing the Commercial Code, which currently contains internal contradictions and conflicts with other laws regulating the company law sphere; and
- taking the OECD's 2001 *Investment Policy Review: Ukraine* recommendation to “develop entirely new legislation for various types of businesses” one step further than was done when these provisions were added to the Civil Code. As has already been successfully accomplished in Russia, separate, new laws should be enacted in Ukraine to regulate each of the most important corporate forms, for example: joint stock companies, limited liability companies, full partnerships, etc. Each such law should accord with the provisions of the Civil Code (as the subordinate Law on Companies often fails to do now) while also providing further details on the workings of the separate types of corporate forms. (Please note that, although the OECD's 2001 *Investment Policy Review: Ukraine* noted that a bill on joint stock companies was due to be submitted to Parliament “shortly”, that bill has still not been passed).

In general, the Roundtable participants agreed that the contradictions between, and discrepancies within, the provisions of the different legislative acts in the company law sphere were especially harmful to enterprise development and the investment climate in Ukraine. Thus, the laws need to be brought into harmony with each other. The Roundtable participants concluded that the most effective means of accomplishing this would be to adopt specialized laws regulating each of the several different kinds of companies.

In this regard, it was pointed out that the current version of the bill “On Joint Stock Companies” still lacks several key provisions. For example, measures to protect minority shareholders’ rights still need to be added. Another legal expert added that, as a rule, Ukrainian bills undergo substantial amendment between their introduction to Parliament and their eventual adoption, and that when they ultimately become law, they often do not much resemble their original wording as bills.

The Roundtable participants also identified practical problems caused by regulations affecting the authorized funds of companies, problems with the foundation of corporate branches and limited liability companies, the minimal regulation of joint stock companies in the Civil Code, and discrepancies between legal requirements for founding companies and how these requirements are in fact implemented (as highlighted in the Survey).

4. Antimonopoly law

Fair competition is essential to any healthy market economy. Antimonopoly laws seek to ensure that businesses are monitored in the interests of limiting monopolistic and anti-competitive developments, for enterprises develop best and operate most efficiently in an atmosphere of free and fair competition. To promote such competition, the anti-competitive tendencies from economic concentrations, unfair trade practices and coordinated actions among businesses must be restrained.

For these reasons, Ukraine has created a legislative basis for protecting competition and established an independent state body responsible for this sphere of law – the Antimonopoly Committee of Ukraine (“AMC”). Antimonopoly law in Ukraine thoroughly regulates many aspects related to protecting and monitoring competition in Ukraine. It also provides a mechanism for preventing and eliminating monopolistic and unfair competitive acts. Many large, medium and sometimes even small foreign and domestic enterprises doing business in Ukraine have faced the practical consequences of Ukraine’s robust antimonopoly laws more than once. For many such companies, dealing with the AMC has become a part of their day-to-day business life in Ukraine.
After reviewing the comments contained in the Survey, the Roundtable identified a few issues as requiring significant reform:

- clarifying ambiguous and limiting overbroad definitions of violations;
- reviewing the rules against coordinated actions and economic concentrations; and
- eliminating conflicts between certain provisions of Ukraine's Commercial Code and its antimonopoly laws. For example, Article 30 of the Commercial Code seems to ban coordinated actions between companies outright, whereas the antimonopoly laws only subject such actions to regulatory review, and only in certain instances (where the parties to the actions in question meet certain thresholds for size, turnover, etc.). And Article 126 of the Commercial Code calls for Antimonopoly Committee regulation of all acquisitions of control over Ukrainian companies, whereas the antimonopoly laws again regulate only transactions that meet certain thresholds.

Aside from the above issues, the Roundtable participants generally felt that Ukraine's antimonopoly laws reflected the philosophies expressed in European Union and other Western antimonopoly laws fairly well. However, at least one Roundtable participant reported that staffers at the Antimonopoly Committee have expressed reservations regarding Ukraine's low thresholds for antimonopoly review of certain transactions, and a belief that the laws in this sphere were somewhat overbroad. Roundtable participants shared reservations about the Commercial Code, and noted that the Antimonopoly Committee's internal policy was to ignore the Commercial Code where it conflicts with the antimonopoly laws and to prevent other government agencies from attempting to enforce it.

5. Miscellaneous hidden charges and unnecessary obstacles

Many other Ukrainian laws create obstacles to enterprise development and require businesses operating in Ukraine to incur unanticipated costs (hidden charges). These unnecessary obstacles and hidden charges generally exert a negative influence on the investment climate in Ukraine, creating an impression that the government is: (i) creating rules that serve little purpose and (ii) hiding the true cost of doing business in the country.

The Survey's results confirmed the existence in practice of the obstacles and hidden charges described below, all of which were discussed extensively by the Roundtable.

5.1 The “90 days rule”. Ukraine imposes severe fines and sanctions when a Ukrainian business fails to receive hard currency proceeds from sales (in case of export contracts), or goods (in case of import contracts), under its international contracts within 90 days of the due date. Moreover, the fines are not limited to the amounts that the Ukrainian business in question failed to receive within 90 days, meaning that the imposition of fines continues indefinitely and can exceed the original unreceived amount by many times. Creation of a procedure permitting a resident to prove its innocence of capital flight; lowering and limiting (establishing a cap on) fines for violating the law and comprehensively clarifying various ambiguities concerning said rule might all be desirable actions.

5.2 Corruption and over-regulation. The level of corruption in Ukraine remains high. While preparing a strategy to combat corruption in Ukraine is beyond the scope of this Project, the Roundtable participants nonetheless felt it necessary to emphasize that the problem of corruption in Ukraine damages the overall business climate and hinders enterprise development. To illustrate, one of the Roundtable participants offered an extremely disturbing description of how this Roundtable participant was at one point “invited” to meet with three government tax and law enforcement officials, who all demanded that the Roundtable participant's business pay more taxes – despite the fact that it was already up to date on all of the taxes it was required to pay by law.

Additionally, Ukrainian law heavily regulates certain types of business activity. For instance, the businesses surveyed cited Ukraine's numerous state inspections and reporting requirements to State
agencies as particularly burdensome. Essentially every business interviewed as part of the Survey echoed this point. Indeed, even the government acknowledges the problem. A representative of the State Committee for Regulation & Entrepreneurship pointed out that their Committee routinely receives complaints from many businesses concerning the great number of licenses and permits that companies must obtain in order to do business in Ukraine. The average Ukrainian company undergoes in the neighborhood of 20 different inspections by various regulatory agencies, every year. The bill on the licensing system in the sphere of commercial activity, currently being considered by the Ukrainian Government, may help alleviate this problem. Roundtable participants were invited to provide comments on this bill.

These problems of over-regulation and corruption, unfortunately, go hand-in-hand, for the greater the “red tape”, the greater the opportunity for unethical government functionaries to offer to cut the red tape for a fee – another point on which both the Survey respondents and the Roundtable participants were in essentially unanimous agreement.

5.3 Financing. Many Ukrainian businesses have problems obtaining financing for their projects through bank loans and equity flotations. Banks rarely loan money for more than a one-year term. They also dislike accepting movable property as security for loans, due to a lack of clarity in the rules on pledging and registering pledges of movable property contained in Ukraine’s new Law “On Securing Creditors’ Claims and Registration of Encumbrances”. Meanwhile, the stock market remains poorly developed and in need of improvement. As a result, respondents to the Survey pointed out, financing business activities through equity flotations was not a real option in Ukraine. Both of these problems require attention.

5.4 Notarization. Many respondents to the Survey complained about the burdens Ukraine’s notarization requirements place on their respective businesses. Many actions performed by Ukrainian companies in their day-to-day business require the involvement of notaries. Sometimes the reason for such involvement is not clear; often, the fees involved are unreasonably high, with no correlation between the price of notarization and the amount of work involved in the notarization. Transaction costs in many cases equal 1% of the value of the transaction described in the document being notarized, and many ordinary, day-to-day transactions, for example, leasing premises for more than one year, require notarization.

5.5 Other problems. The above four examples of obstacles and hidden charges are far from the only important ones. But a detailed investigation of every such hindrance to enterprise development is beyond the scope of this Project. Nonetheless, two particularly troublesome problems should be highlighted: a poor system for adopting and implementing laws and problems with taxation. How laws are adopted and how businesses are taxed both exert great influence on business, and improvements in both of these processes would have immediate benefits on the Ukrainian economy. Every businessman interviewed as part of the Survey specifically named Ukraine’s tax system as a primary obstacle to Ukraine’s investment climate and promoting enterprise development.

In conclusion, the Roundtable produced the following main findings:

• Ukrainian civil law would be improved by abolishing the Commercial Code, and with it its conflicts with the Civil Code and subordinate legislation, and considerably amending the Civil Code.
• Ukrainian civil law also contains many other conflicts between its fundamental acts, which must be eliminated.
• In the sphere of company law, the activities of joint stock companies and limited liability companies should be regulated in separate legislative acts.
• Ukrainian antimonopoly law seems to be one of the most advanced branches of Ukrainian legislation. However, antimonopoly regulation still needs to be made more predictable and its scope made more focused in order to avoid creating unnecessary regulatory obstacles to doing business in Ukraine.
• Miscellaneous hidden charges and unnecessary obstacles abound in Ukrainian law. Close cooperation between private parties, the OECD, EU, international organizations and the Ukrainian government, especially Ukraine’s Ministry of Justice and the State Committee for Regulation & Entrepreneurship, will be required if these hidden charges and obstacles are to be removed. In this respect, the OECD
and other international organizations are ready to provide comments on drafts of legislative acts, to advise the Ukrainian government on further steps it can take to improve the implementation of Ukrainian legislation and to render any other assistance that the Ukrainian government thinks helpful.

Clearly, given the scope of the work that remains to be done, the Project will need to be an ongoing effort. Fortunately, the Roundtable participants are all aware of this need and have expressed their willingness to continue to support this Project.
II. General Observations on the Modern Ukrainian Legal Environment for Business Activity

For all the progress that Ukraine has made in the decade since it became independent, much work remains to be done. While it is disappointing to point out, it is nonetheless a fact that the explosion of new legislation that has issued from Ukraine’s Parliament over the past several years has resulted in many new codes and laws that are riddled with ambiguities, internal conflicts and conflicts with other pieces of legislation. Moreover, the very volume of the new laws tends to re-create the same problem with the over-regulation of business that existed under the pre-1991 command economy. Both foreign and domestic businesses are consequently forced to fight through a sea of red tape on a daily basis, in an effort to do business.

These problems must be addressed. For just as ineffective enforcement of laws, ambiguous legal definitions and conflicting provisions among different pieces of legislation complicate doing business in Ukraine today. On the other hand, effective enforcement, clear definitions of terms and laws that work in harmony with each other can provide a sound foundation for further development of Ukraine’s economy. Experience shows that when a country’s legal “rules of the game” are clear, this makes both domestic and foreign businesses more willing to invest in that country.

Fortunately, the foundations for establishing fair and coherent rules of the game exist in today’s Ukraine. Ukrainian legislation broadly adheres to the same legal principles that prevail in modern market economies. What needs to be done in the current phase of Ukraine’s legal development, is to first clear away the remnants of the pre-1991 legal system, embodied in the Ukrainian bureaucracy’s tolerance of red tape, its predilection towards government over-regulation and its common requirement of political support to get anything done. Second, it will be necessary to replace those elements of the legal system with the building blocks necessary to support entrepreneurship, investment and ordinary business activity so as to permit the economy to continue its upward trend.

Case in point: Ukraine recently enacted two pieces of crucially important legislation – one embodying the principles of the market economy; the other embodying much that was wrong about the pre-1991 legal system. The new Civil Code, while it of course has its faults and could use some improvement, nonetheless is a useful document that has considerable potential for supporting Ukraine’s market economy, making investment in Ukraine more attractive and allowing business to be performed more freely. In contrast, the new Commercial Code, which in theory should be expected to support and expand on the principles embodied in the Civil Code, actually often contradicts these principles. As discussed further in Section III of this Report, the Contributors believe that the Commercial Code should be annulled, as was recently also recommended by the European Business Council1.

In regard to Ukraine’s company law, it, too, has serious drawbacks and the Contributors recommend that it be revised in order to remove certain conflicts that were created between it and the new Codes, when the latter entered into force. And whereas in large part the pre-Civil Code company law was inferior to the provisions introduced in the Civil Code, for example, the Contributors suggest that in resolving the conflicts discovered so far, Ukraine’s subordinate company legislation should in most cases (with a very few exceptions) give way to, or be brought into line with, the provisions of the Civil Code, rather than vice versa. The Contributors also recommend that Ukraine’s Law on Companies be annulled and replaced with several legal issues with regard to business operations and investment in Ukraine - © OECD 2004

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1. An association comprised of representatives of businesses operating in Ukraine.
new, separate laws, each addressing and regulating a different type of corporate form, as was done in Russia and other CIS countries a few years ago.

In regard to Ukraine's antimonopoly legislation, while in spirit it is progressive and intended to promote competition and a free market in Ukraine, in practice it has proved itself somewhat problematic. The Contributors recommend that Ukraine's antimonopoly legislation be amended in order to eliminate any unnecessary obstacles to business development that this legislation creates. Much of the terminology employed in the antimonopoly legislation could benefit from clarification. The formalistic, overly broad and over-regulative nature of this legislation is not necessary to achieve its purposes, and could well be replaced with more practical, business-friendly, yet still objective criteria for regulation. Also, the Ukrainian Parliament should review the amounts of the fines and penalties established for violations of antimonopoly legislation, as well as the powers delegated to the Antimonopoly Committee of Ukraine, the supreme state agency in the sphere of competition.

Finally, numerous other areas of Ukrainian law that tend towards over-regulation and an over-fondness for red tape, are in need of some restructuring. In particular, such specific issues as the “90 days rule”, problems with bank financing and stock market regulation, the unnecessary requirements and high fees charged for notarization of documents, certain tax issues, and such matters as corruption, over-regulation in general, the poor system for adopting laws, etc., require urgent review and improvement.

In the succeeding Sections of this Report, we will further explore each of these spheres of law and note the recommendations that have been suggested by the Contributors. For ease of use, each Section of this Report will be preceded by a short executive summary. Supporting details and additional discussion of each sphere of law will follow each summary in greater depth.
III. Civil Legislation

A. Executive Summary

On 1 January 2004, Ukrainian civil legislation underwent a fundamental transformation. The adoption of new Civil and Commercial Codes signified a new age for the national legal system, as these two legislative acts became the new basis for the development of some of the key legal spheres in Ukraine. There was a downside to this, however: any defects in the Codes assume crucial importance because all subordinate legislation must be built upon them. That is the reason why the Civil and Commercial Codes must be unambiguous, clear and flawless.

The experience so far in using the Codes suggests that they indeed contain serious problems. The potential for conflicts, both internal to the Codes and among the Codes and other laws, is substantial. As a result, the following major problems have arisen:

- Each Code contains provisions that conflict with other provisions of the same Code.
- Substantial conflicts exist between many provisions of the Civil and Commercial Codes that regulate the same issues.
- Conflicts exist between provisions of the Codes and subordinate laws.
- Some good ideas contained in the Codes cannot be implemented in practice because of gaps within the subordinate legislation.

The above problems hinder the normal operation of businesses in most spheres of the economy, rendering the legal system incapable of regulating certain relationships and protecting the interests of participants in the economy. Moreover, the large number of legislative gaps in Ukrainian civil legislation forces regulatory agencies and courts to interpret the meanings of the laws and enables corruption among the regulators and unfair competition among business competitors. In this regard, the Commercial Code presents the greatest threat to the development of the free market in Ukraine because its nature and methods of regulation relate back to the country’s former command economy, rather than supporting Ukraine’s new market economy.

For the above reasons, Ukrainian civil legislation requires improvements, most importantly:

- thorough revision of the most crucial conflicts between provisions of the Codes, to establish order in the legal regulation of civil relationships. In most cases, conflicts among the Civil Code, the Commercial Code and subordinate legislation should be decided in favor of the Civil Code. But in some cases, the Civil Code, too, requires amendment;
- enactment into law of all implementing legislation referred to in the Civil Code, which has not yet been passed; most importantly, the bill on private international law (which also covers conflicts of laws rules); and
- repeal of the Commercial Code in its entirety.

B. Introduction

A country’s civil legislation forms the basis for its legal system in general. In regard to a country’s commercial life, it lays out the primary legal principles essential to supporting a market economy, for
example: the organization of contractual relations, the principles of property rights and rights of ownership and the legal status of companies and individuals. It is to this framework that the rest of a country's laws attach, and on which they depend for their proper functioning.

Until 1 January 2004, the old Soviet Civil Code of 1963 was the primary act of civil legislation in Ukraine. Although it is true that Ukraine's Parliament made attempts to revise the bits and pieces of the old Soviet Civil Code in the years following Ukraine's independence in 1991, these ad hoc attempts by and large failed to change the nature of the document sufficiently to allow the smooth functioning of a market economy in a country that had known only a command economy prior to 1991. Attempts to remedy the problems that arose from attempting to base a market economy's legal system on a command economy's primary law, by enacting subordinate legislation in a similarly ad hoc process, also failed.

Ukraine eventually realized that in order to build the legal infrastructure necessary to sustain a market economy, it was essential to change the basis of that legal infrastructure. It was for this reason that Ukraine adopted two new codes of law (the Commercial Code and the new Civil Code) and put them into force earlier this year.

The two new Codes, however, create certain problems, which can be divided into three groups:

• Conflicts between the provisions of the Civil and Commercial Codes;
• Internal contradictions within each Code; and
• Conflicts between the different natures of the Civil and Commercial Codes.

Despite their different names, both the Civil Code and the Commercial Code regulate some of the same business matters. The Civil Code is, of course, broader in scope than the Commercial Code, regulating everything from the legal definition of personality to property law to business relationships (please see Annex 1, p. 63 for a list of the subjects covered by the Civil Code). On the other hand, the Commercial Code focuses specifically on business relationships (please see Annex 2, p. 64 for a list of the subjects covered by the Commercial Code). Logically, therefore, the Commercial Code's provisions should track and expand on those of the Civil Code. But this is not the case. For the two Codes also take different approaches to how they regulate business. Whereas the Civil Code aims to support a market economy, with freedom of contract, fair competition and protection of businesses' rights, the Commercial Code often seems to be trying to impose a planned economy on the nation. Numerous conflicts exist between provisions of the two Codes, regulating the same subjects. As a result, businesses are often forced to choose to follow one Code or the other – for being in compliance with both Codes at once is sometimes not possible. As a result, there are times when, whatever a business does, a regulatory agency or court can find fault with it. The business winds up in a no-win situation, in which it has no certainty how it can avoid fines, loss of its license or other unjustified demands by the authorities.

C. Conflicts between the Provisions of the Civil and Commercial Codes

1. Conflicting views of ownership rights

Prior to 1991, Ukrainian law tended to favor a property rights concept termed "collective ownership", whereby property rights were vested in a group of individuals or companies and no one individual or company had exclusive rights to the property. Part 10 of the Commercial Code adopts this form of ownership for property that any participant in a business contributes to the business's authorized fund in exchange for its equity interest in the business. The property, once contributed, becomes the collective property of all the participants in the business, yet at the same time it remains "distinct" and identifiable as the former property of the participant that contributed it. When the participant withdraws from the business, however, his contributed property is returned to him, loses its collective ownership status and again becomes his private property.

Part 1 of Book 3 of the Civil Code takes a different approach. Property contributed to a business becomes the private property of the business itself. Once contributed, it does not remain distinct and identifiable,
as something that was contributed by a specific contributor. And upon the participant’s withdrawal from the business, there is little guarantee that the specific property he contributed, will be returned to him upon his withdrawal. Rather, the business must pay out to a withdrawing participant the value of his contribution, as appraised by the business itself.

This creates a certain amount of risk for any participant in a business: when the time comes to withdraw from the business, such participant must depend on the good faith of his business partners to honestly appraise his contribution and pay it out to him in full upon his withdrawal. There is also a clear potential for disputes arising among business partners over which concept, return of the property or payment of the value of the property, should be adopted towards the withdrawing partner. On this issue, the Civil Code’s provisions are more in line with Western legal practice. However, it might be worthwhile to consider how to allay the concerns expressed by the businessmen surveyed as part of this Project, regarding dishonest business partners improperly paying out, or failing to pay out altogether, a withdrawing participant’s contribution. For example, the Civil Code might be supplemented with provisions securing a participant’s rights to an independent and honest appraisal of his property rights upon withdrawal from a business and/or a guarantee of a participant’s right to receive back his contributions upon withdrawal in kind, rather than in cash.

2. Types of businesses

Given that the Civil Code overlaps the Commercial Code and that the two acts therefore regulate many of the same matters, it is essential that their definitions of the subjects they regulate be identical. This is not presently the case, as exemplified in the divergence of their provisions regarding the types of businesses that they allow to be established in Ukraine:

- Article 79 of the Commercial Code lists the types of businesses that it allows to be established in Ukraine, as does Article 113 of the Civil Code, but the definitions used in these two articles are not the same.

- The Commercial Code contains definitions for: “business” and “economic organization”. The Civil Code does not. Therefore, the validity of these definitions can be disputed.

- Article 115 of the Commercial Code describes a business called a “leasehold company”. The Civil Code does not authorize the existence of any business by that name.

- Several provisions of the Commercial Code, for example, Articles 63.1, 113 and 128.3, refer to a business called a “private company”. The Civil Code does not authorize the existence of any business by that name.

When one Code says a certain business can exist, but the other Code does not acknowledge such a business as being a valid corporate form, the business’s validity is put in question. The most market-friendly solution to this problem is probably to abolish the Commercial Code, but to ensure that any corporate forms that it permitted to exist, which are not yet defined (and thus permitted to exist) by the Civil Code, be added to the Civil Code. Thus, market participants have their choices of corporate form made more secure, by resolving the conflict between the Codes, and broadened, by increasing the number of choices of corporate form allowed by the Civil Code.

3. Other conflicts between the Civil and Commercial Codes

We provide below a few examples of the lack of coordination between the Civil and Commercial Codes that have been identified by the Contributors. These examples demonstrate the need to harmonize many essential provisions of both Codes that regulate the same civil legal relationships. But it is important to note that, due to the short history of both Codes, little practice has been built up with use of their provisions. Thus, it is possible that the following examples are not the only conflicts between the two documents, and that more potential conflicts will be discovered in the near future..
**a. Ambiguity of some provisions of the Codes**

The reason a code of law is usually compiled is to ensure comprehensive regulation of the code’s subject area. Ukraine now has two Codes that overlap: a Civil Code that encompasses business law, but which is not limited to it; and a Commercial Code that is limited to business law. The result is that business affairs are subjected to dual-regulation. Yet neither one of the Codes does this in a comprehensive manner. Thus, answering many questions that arise in day-to-day business requires consulting both Codes simultaneously. While illogical, that could still be a workable arrangement if the Codes did not overlap at some times, leave legislative gaps at others, and generally contain vague and ambiguous provisions – which is unfortunately the case. For example:

- Article 291.3 of the Commercial Code permits the early termination of lease agreements on the grounds envisaged by the Civil Code but in accordance with the procedure established by Article 188 of the Commercial Code. According to Article 291.4 of the Commercial Code, the consequences of such termination are stipulated in the Civil Code.
- Article 265.6 of the Commercial Code says that procurement relations not regulated by the Commercial Code are regulated by the Civil Code’s provisions on purchase and sale contracts. However, the Commercial Code fails to specify what “procurement relations” it does not regulate.
- In several other cases, the Commercial Code makes vague reference to certain matters being regulated by the Civil Code rather than the Commercial Code itself, but fails to provide references to precisely what Civil Code articles are being referred to.

Thus, in many instances, the Commercial Code abdicates its basic purpose as a code of law: to thoroughly cover and give clear answers to legal questions in a given sphere of activity. Rather, it requires a business to search through both the Commercial Code and the Civil Code to try to learn what “the law” requires of it. Worse, there is no guarantee that the answer the business seeks is even contained in either Code. Yet whether the answer is there or not, the penalty for failing to find it and correctly interpret it is certain to be a fine or other serious sanction, such as:

- confiscation of the profit earned by the business as a result of violating the law, with the possible addition of a fine of two to three times the amount of the confiscated sum (Article 240.1 of the Commercial Code);
- freezing of the business’s bank accounts (Article 243 of the Commercial Code); or
- cancellation of the business’s State registration (Article 247 of the Commercial Code).

Imposing strict sanctions for the violation of ambiguous and poorly organized laws seems unfair. The more so when not only do the businesses not know what the law is, but many times neither the regulatory agencies that enforce the laws nor, one suspects, the legislators who wrote the laws, know what the laws are. It would be difficult to imagine a more discouraging environment in which to require a business to operate, or one less conducive to enterprise development.

**b. Conflicts in connection with the regulation of securities**

Chapter 14 of the Civil Code describes the types of securities that may circulate in Ukraine, and the procedure for carrying out transactions in these securities. The Chapter classifies securities as bearer, registered or order securities. Article 197.5 of the Civil Code provides that only an order security can be transferred by endorsement.

Article 163.3 of the Commercial Code directly contradicts the Civil Code, acknowledging only two types of securities: registered and bearer. It further states that only a registered security can be transferred by endorsement.

Here the conflict between the two Codes is obvious. The Contributors recommend that the Civil Code’s provisions here be left unchanged, and the Commercial Code be annulled, as also recommended elsewhere in this Report.
c. Conflicts in connection with the regulation of bank accounts

Chapter 72 of the Civil Code provides detailed regulations on opening bank accounts and making settlements. But Articles 342.3, 342.4 and 342.6 of the Commercial Code appear to dispute the Civil Code’s authority to regulate these matters, stating that the National Bank of Ukraine ("NBU") regulates opening bank accounts and making settlements. At best, this state of affairs makes either the Civil Code provisions or the NBU’s regulations superfluous, for they regulate one and the same thing. At worst, it opens the door to the possibility that the NBU will promulgate regulations based on the authority given it by the Commercial Code, which regulations contradict the regulations contained in the Civil Code.

Another conflict between the Codes relates to when funds can be transferred from a client’s bank account. Article 1071 of the Civil Code requires either an instruction from the client, a court order, or a contract between the client and the bank as authorization for such transfers of funds. However, Article 236.1.2 of the Commercial Code permits transfers – without the bank’s client’s permission – to refund money to a buyer who paid the bank’s client for goods that turned out to be of poor quality. Leaving aside the question of whether unauthorized refunds of money should be legal at all, there is a clear conflict here, in that the Commercial Code is expressly permitting transfers on a basis not permitted by the Civil Code.

In both of the above cases, the Contributors suggest that the Commercial Code’s provisions are superfluous and inferior to the Civil Code’s corresponding provisions, and should accordingly be abolished.

d. Conflicts in connection with the regulation of contracts

One of the most fundamental underpinnings of a market economy is the sanctity of contracts. It is simply impossible to conduct business without having a thoroughly well-regulated system of contract law. Unfortunately, the Civil and Commercial Codes do a poor job of regulating contract law:

- One problem, somewhat theoretical but important nonetheless, is that the Commercial Code in several places defers to the Civil Code’s rules on contract law. However, in doing so, the Commercial Code requires that the Civil Code’s rules be applied in the context of the Commercial Code’s “specifics”. The Civil Code, however, fails to make any mention of this function that is purportedly delegated to it. Thus, it is often difficult to interpret precisely what applying the Civil Code’s rules to the Commercial Code’s “specifics” entails. This problem arises in the context of:
  - Article 175.1 of the Commercial Code, which employs this scheme of regulation to property obligations between businesses; and
  - Article 179.7 of the Commercial Code, which employs this scheme of regulation to the procedures for concluding commercial contracts;

- Article 22 of the Civil Code permits parties to a contract to include provisions on liquidated damages for breach of contract (i.e., to agree that certain violations of rights will be compensated with predetermined monetary sums, rather than by amounts derived from a court’s appraisal of the actual economic harm caused by the violation). Article 224 of the Commercial Code, however, appears to exclude this possibility;

- Article 306 of the Commercial Code disagrees with Article 908.2 of the Civil Code, in that while both Codes agree that the Civil Code regulates the movement of passengers and luggage, both Codes claim to (presumably exclusively) regulate the movement of cargo, whether by their own rules on the subject or by other legislation based on the respective Codes. A situation whereby multiple regulations of a single subject area can be based on either of two Codes, each so different in its nature, seems ripe for confusion.

From the above examples, it appears that in most cases the Civil Code either ascribes to itself, or has delegated to it by the Commercial Code, the ultimate responsibility for regulating contract law. Moreover, the Civil Code’s provisions are more liberal and better uphold the principle of freedom of contract (e.g., by allowing liquidated damages to be contracted for) than are the Commercial Code’s provisions. Given
this state of affairs, the best solution would probably be to improve the Civil Code’s provisions to more thoroughly regulate what needs to be regulated, and to abolish the Commercial Code as inferior and incomplete.

e. Different periods of limitation

This Section closes with one final example of the conflicts between the Civil and Commercial Codes. Article 925.3 of the Civil Code and Article 315 of the Commercial Code provide different statutes of limitations for the filing of claims for lost or damaged cargo. This is really a very specific conflict and probably not a major concern to all businesses. But in the event a dispute over lost or damaged cargo does arise, it can become crucial. For while the Civil Code allows an injured party to file a claim against a shipper for up to one year (when this statute of limitations begins to run is not clear), the Commercial Code requires the same claim to be filed within six months. Aside from the ambiguity on the matter of the start-date for the limitations period, there is simply no reason why both Codes need to regulate this issue, or why the Codes’ drafters could not have ensured that both acts allowed for the same statute of limitations. The result of this oversight, is that an injured party may now have trouble getting restitution for its injury if it waits longer than six months to file a claim, and the court with which it files decides to apply the Commercial Code’s six-month deadline. Again, the best solution is probably to abolish the Commercial Code and keep the more liberal Civil Code provision on this subject.

D. Problems with the Commercial Code

I. The Commercial Code permits too much State involvement in business

For all that the Commercial Code often conflicts with the Civil Code, this is not in fact the most compelling argument in favor of annulling the Commercial Code. Rather, the main problem with the Commercial Code is that it permits the State and its functionaries to engage in business to the detriment of private enterprise development in Ukraine. Whereas the Civil Code establishes a legal framework that supports a free-market economy and limits the State’s involvement in business, the Commercial Code often takes the opposite approach, permitting and facilitating the State’s interference in the economy.

To illustrate the above statement, it is worth scrutinizing Chapter 8 of Part II of the Commercial Code, which regulates the operation of State-owned companies on the Ukrainian market. The problem with this Chapter 8 is that it is often difficult to determine when the Code is discussing government agencies entitled to exercise government power and when, State-owned companies participating in the market. The two concepts tend to merge, with the effect being that the Code essentially authorizes the State to operate on the market itself, even if only via a proxy State-owned company: for example, the State is authorized to hire and fire the heads of State-owned companies and to direct the actions of these companies in the State’s capacity as their owner.

As a result, the Commercial Code proposes a modern version of the old “socialist enterprise” concept, where government agencies both regulate and participate in the market. This situation was common before 1991, when most companies were State-owned. However, today, the market is filled with private enterprises competing in a supposedly free market, a development that in theory the government should be trying to promote and encourage. Yet the Commercial Code does the opposite. When government agencies become business competitors of private companies, it is almost a foregone conclusion who will win. The State, after all, is not only limited to, for example, lobbying to create regulations beneficial to it – the State can actually create the regulations itself. The State can grant itself (i.e., its State-owned companies) credits, grants, tax exemptions, and any number of other monetary and non-monetary advantages. The result is that State-owned and private companies compete on a non-level playing field, a situation that one Contributor specifically complained of.

The structure that the Commercial Code creates for operating State-owned companies is actually quite opaque. Article 142.3 of the Commercial Code, for example, requires only that profits of State-owned
enterprises be used in compliance with the law. But this definition is so vague as to be meaningless, as no reference to the “law” referred to is given. The result, one presumes, will be that profits of State-owned enterprises can be used without any oversight at all, given that no effective oversight mechanism exists, and even if one did, there is no real law regarding the use of such profits, the compliance of which can be overseen.

This situation in which the State itself competes, via its State-owned companies, for profits against private companies, also creates a conflict of interest among the State's representatives. For once the State places itself in the position of making profits, government employees may be tempted to “enhance” their government salaries and make some “profit” themselves, also at the expense of private companies. For example, services rendered by State-owned companies can be charged at inflated rates. Government agencies that own State-owned companies can be asked to pressure private companies to pay the inflated rates, threatening administrative investigations, sanctions and other pressure tactics to induce compliance with their demands.

Article 43.4 of the Commercial Code is instructive in this regard. It permits government officials to engage in business with only one exception: they can be required to suspend their business activities during a state of emergency or war. This provision would appear to violate the rule laid out in the second paragraph of Article 42 of the Constitution of Ukraine, which prescribes that the business activities of government agencies are “restricted by law”.

2. Other anticompetitive provisions of the Commercial Code

Unfortunately, the above problem is not unique in the Commercial Code. The Commercial Code contains many other provisions that are more consistent with a planned, than with the market economy described in Article 6 of the Commercial Code. For example, Article 11 of the Commercial Code envisions the State passing laws on forecasting economic developments and preparing government programs to manage the development of the Ukrainian economy. Article 11.5 of the Commercial Code permits the State to deprive companies, that do not adhere to the State's plans for the economy, of certain statutory benefits and privileges. And Article 13.4 of the Commercial Code empowers the Cabinet of Ministers and government agencies to mandate that businesses perform certain tasks for the State. All of the above are telltale signs of a planned economy.

Such provisions are inimical to enterprise development in a market economy. They virtually handcuff the “invisible hand” of the market and force it to move as the State dictates. Consequently, private businesses will be hindered in choosing the best allocations of their capital if these kinds of provisions are permitted to remain in force.

Any remaining doubt that this is the true purpose of the Commercial Code must be dispelled upon reading the Code’s Article 142.4. This Article authorizes the State to employ standards, taxes, tax benefits and economic sanctions specifically to influence private businesses’ choice of how they use their funds. While such “incentivization” is not unheard of in Western market economies, for example, we should point out that in the Ukrainian context, with its planned economy history, “incentives” may well become less benign than their Western counterparts. For example, nothing in the wording of Article 142.4 would prevent the State from influencing a business's behavior by imposing prohibitive levels of taxation on profits from disfavored business activities. Rather, the Commercial Code essentially gives the State free rein to use economic incentives as it sees fit, to force private companies to take the actions that the State thinks best.

The Commercial Code contains many other provisions antithetical to a market economy. But there is no need to list them all. The examples already provided sufficiently illustrate the nature of the Commercial Code and provide convincing arguments for its wholesale annulment. When a document, supposedly created to promote a free market (see again Article 6 of the Commercial Code) contains entire Chapters devoted to the imposition of a planned economy, that document clearly requires revision. Rather than repeat
the mistakes made by the Ukrainian Parliament, when it attempted to make ad hoc repairs to the old Soviet Civil Code in order to turn it into a modern, “capitalist” Civil Code, the Contributors suggest it would be more efficient to proceed immediately to the ultimate solution that the Parliament found necessary – repeal the document in its entirety and start again from a clean slate.

3. Ambiguities, contradictions and legislative gaps in the Commercial Code

In addition to the problems discussed above, the Commercial Code has several other problems with its regulation of business activity in Ukraine.

a. Regulation of trade

Chapter 30 of the Commercial Code imposes strict requirements on trade:

- Article 264 requires any kind of wholesale trade (sale of products and goods) between businesses to be based on a supply contract, and thus eliminates from commercial trade the possibility of using commonly accepted “sale-purchase” contracts; moreover, the Commercial Code’s Article 271 allows the Cabinet of Ministers to interfere in business relations and restrict the fundamental principle of the freedom of contract by adopting “regulations for the supply” of various types of goods (which can essentially mean any types of goods, at the Cabinet’s discretion).
- at the same time, pursuant to Article 265.4, a supply agreement must comply with the International Rules for Interpretation of Terms (“Incoterm”), which are not designed to be used for domestic transactions.

There does not appear to be any valid reason for the Commercial Code to limit the rights of businesses to enter into the kinds of contracts that they think best suited to their needs. Especially when the Code does not even provide complete regulations on this subject; it rather restricts businesses’ rights and then refers businesses to one set of international rules and one set of non-existent domestic rules for further guidance. This regulation appears arbitrary and capricious, as well as incomplete, and should be abolished.

b. Regulations on setting up branches, departments, representative offices and other separate subdivisions

Article 64.4 of the Commercial Code requires a business to petition a local government before setting up a branch, representative office, department or other separate subdivision (a “branch”) within that local government’s jurisdiction. Such petitions must be submitted in accordance with a procedure established by law – but this is another instance in which the procedure referred to has never been promulgated. The effect of this legislative gap is that, technically, no business can set up a branch anywhere in Ukraine, because there is no way to comply with the requirement to correctly petition for permission to set up a branch. In the interests of both resolving this dilemma and promoting the free market, the Contributors recommend that when the Commercial Code is annulled, this Article not be reintroduced into, for example, the Civil Code.

c. Poor legal regulation of subsidiaries

The Commercial Code is not always clear on what constitutes a “subsidiary” of a company. To illustrate this problem, consider that:

- according to Article 63.8 and Article 126, a subsidiary is a business that depends on another business that holds a controlling interest in it;
- Articles 116 and 117 define both an “enterprise with foreign investment” and a “foreign enterprise” in a manner that makes it clear that both types of businesses should be defined as “subsidiaries” of foreign companies. Yet the Commercial Code does not treat either an “enterprise with foreign investment” or a “foreign enterprise” as if it was a subsidiary of any parent company. For example,
Article 396 prescribes special procedures for setting up and operating both “enterprises with foreign investment” and “foreign enterprises”. Neither is treated like any other subsidiary.

This is important because, whether a company is a subsidiary or an independent company, has implications for how it must be registered, taxed, etc. Yet the Commercial Code’s provisions fail to make it clear whether these kinds of businesses are subsidiaries, thus putting in doubt their status under the law in several different respects. The Contributors therefore recommend the addition of a clear explanation of this issue in the Civil Code.

**d. Conflicting provisions on unilateral termination of contracts**

The Commercial Code takes two contradictory stances on the legality of unilateral contract termination. On the one hand, Article 188.1 allows the unilateral termination of a contract unless the contract stipulates otherwise. On the other hand, Article 207.2 says that if a contract contains a clause permitting its unilateral termination, this is illegal and makes the contract voidable at will. The Contributors recommend that the rule embodied in Article 188.1 be preserved and incorporated into a revision to the Civil Code, while the rule embodied in Article 207.2 be allowed to expire when the Commercial Code is annulled.

**E. Ambiguities and Internal Contradictions within the Civil Code**

Enacting the new Civil Code was a real step forward in the process of developing Ukraine’s legal system. Its principles support the country’s progress towards having a true free market economy. The primary purpose of the Civil Code is to lay out a detailed framework for regulating the main areas of civil legislation, upon which framework subordinate legislation can be built. Because it serves as the underpinning for much of Ukraine’s legislation, therefore, it is essential that the Civil Code’s provisions be unambiguous, clear and flawless – else any other legislation based upon the Civil Code becomes more difficult to implement effectively.

The past few months of practical application of the Civil Code, however, have shown that it is far from being a perfect document. In addition to its conflicts with the Commercial Code, already discussed above, the Civil Code also contains numerous ambiguous and internally contradictory provisions that create obstacles to enterprise development and operation in Ukraine. In this sub-section, we shall address a few of the more important shortcomings that have been brought to light so far.

**1. Freedom of contract**

Article 6 of the Civil Code generally permits parties to vary the terms of a contract from the provisions of Ukrainian law in order to better suit their business purposes, unless such provisions of Ukrainian law are mandatory. Article 627 elaborates that Ukrainian law, “rationality” and “justice” be taken into consideration when agreeing on the terms of a contract.

This raises two issues. First, freedom of contract is circumscribed somewhat by the requirements of law. While Western legal systems, too, place some restraints on what can be agreed to in a contract, they generally are more explicit in explaining their restraints. The provisions contained in Ukraine’s Civil Code, however, are often insufficiently clear to allow parties to know for certain what can and cannot be agreed to in a contract. Second, two rather vague terms: “rationality” and “justice” are introduced as legal norms that can trump the right of the parties to contract as they see fit. The introduction of these two undefined terms takes away even further from the right to freedom of contract because both terms are subjective and subject to interpretation. So long as these terms remain in the Civil Code, there will be a risk that provisions of a contract can be challenged on the basis that they are not rational or just. While use of such principles in a common law state may be acceptable, due to the large body of precedent and binding case law available to interpret the terms, such subjective terms have no place among the laws of a state such as Ukraine, which has no binding case law. The Contributors recommend that both of these terms be either defined or removed from the Civil Code.
2. Form of contracts

The provisions of the Civil Code regulating the form that contracts must take are in large part contradictory. On the one hand, according to Article 203.4, transactions must be effected in the form established by law. According to Article 208.1.1, contracts between companies must be made in writing. However, Article 206.1 permits any contract to be concluded orally, except for the following three groups of contracts:

- contracts that must be notarized;
- contracts that must undergo State registration; and
- contracts that are invalid if concluded orally.

Note that “contracts between companies” is not one of the three categories that Article 206.1 forbids being concluded orally, unless it is included under the third category of contracts that are invalid if concluded orally.

Additionally, Article 218.1 states that the failure to conclude in writing a contract that the law requires to be in writing does not invalidate it unless the law specifically states that it is thereby invalidated.

It is not easy to make sense of how the above provisions interrelate. Certainly the rules could be laid out in a clearer manner, and that is a change that the Contributors recommend be made. Otherwise, parties entering into oral contracts run the risk of having their contracts invalidated by virtue of Article 215.3, which says that if a contract is not made invalid because it fails to adhere to the form required of it by law, but one of the parties (or even a third party) objects to its validity on grounds established by the law (a vague provision itself, but one that the ambiguity of the above provisions can certainly support), then the contract may be voided by court order. The effect of this Article 215.3, combined with the ambiguity of the previously discussed articles, makes essentially any oral contract subject to challenge and invalidation in court.

Another contract form rule in need of change is embodied in Article 207.2 of the Civil Code. Prior to the new Civil Code’s entry into force, a contract was valid in Ukraine if its parties agreed, in writing or orally as appropriate, on certain essential terms and conditions. However, Article 207.2 now requires that a written contract bear the imprint of a corporate seal in addition to the signature of an authorized signer for any company party to the agreement. According to Article 218.1, failure to imprint a company’s signature with its corporate seal can invalidate the contract.

Another signature rule worth discussing is contained in Article 207.3 of the Civil Code, which regulates contracts signed with “faxed” signatures, electronic digital signatures or other substitutes for handwritten signatures. For such signatures to be valid, they must be either specifically authorized by law or by a prior agreement between the parties, which prior agreement contains samples of the relevant “substitute” for handwritten signatures. However, the law does not provide further detail on how a “sample substitute” of a faxed signature, electronic digital signature or, certainly, “other substitute” for a handwritten signature, should be depicted in the prior agreement authorizing signing with “substitute signatures”. Furthermore, the law contains no guidance on how or whether a fax, electronic digital or other representation of a corporate seal can satisfy the legal requirements for affixation of corporate seals, when applicable. Finally, should the validity of such a “substitute corporate seal” on a “substitute signature” be challenged in court, proving such a seal’s validity would be difficult due to Ukrainian law not specifically authorizing a court to conduct expert evaluations of “substitute seals”.

Thus, the Civil Code’s provisions on the forms of contract pose several problems for businesses operating in Ukraine:

- Regarding corporate seals, it is now necessary for a company that does business over a wide swath of territory to manufacture multiple copies of its corporate seal, so that its representatives can validly sign contracts on its behalf. This entails additional costs for doing business in Ukraine, both in time needed to file for permission to manufacture corporate seals, in the application fees for such permission
and in manufacturing costs to manufacture such corporate seals. Also, the more copies of a corporate seal that need to be made, the greater the risk of loss of corporate seals and the resulting risks of corporate “identity theft”. More than one Contributor criticized the corporate seal requirement for these reasons, and therefore, the Contributors recommend that the corporate seal requirement be canceled.

- Regarding “substitute signatures”, while Ukraine is to be commended for moving forward into the digital age with these regulations, they still need some work to clarify the questions we have highlighted on how to authorize the use of “substitute signatures” and how to apply the corporate seal requirement to the use of substitute signatures. Preferably, as noted above, the corporate seal requirement should be canceled. And any revisions to the provisions on substitute signatures should be checked for their conformity to the two primary laws dealing with the subject, that have already been enacted: Law of Ukraine “No. 852-IV On Electronic Digital Signature” dated 22 May 2003 and Law of Ukraine No. 851-IV “On Electronic Documents And Electronic Documents Circulation” dated 22 May 2003.

3. Multiple sources of law

Another recurring problem concerns the Civil Code's referring to numerous legal acts as regulating certain types of contracts. For example, Article 908.2 of the Civil Code, which regulates transportation contracts, states that general conditions of transportation are established by the Civil Code, as well as by other acts of legislation, transport codes or other regulatory documents and rules issued in compliance therewith. While subordinate legislation is certainly necessary, because a single code cannot contain all of the minutiae needed to regulate every sphere of law in Ukraine, we suggest that spreading regulations on a single issue among: “other acts”, unnamed “transport codes”, unnamed “regulatory documents “ and unnamed “rules” is simply too much. Ideally, the Civil Code should lay out the broad rules for transportation contracts, and refer to a single new “transportation code”, for example, which should be enacted to contain all of the more detailed rules for this sphere of business.

4. Real estate transactions

Ukraine has received much praise recently for enacting a Land Code. Unfortunately, certain provisions of the Civil Code undo much of the good that the Land Code's passage should have created. Article 334.4 of the Civil Code requires that a contract for the sale of real estate be registered with the State before the purchaser can acquire title. Article 210.2 of the Civil Code says that a law should exist that lists the agencies responsible for State registration of real estate transactions. However, no such a law exists; no agency officially authorized to register real estate transactions exists; and no procedure for registering real estate sales contracts exists either.

Finally, Article 640.3 of the Civil Code says that any contract that by law must be notarized or registered with the State can only be deemed concluded once notarized or registered with the State, as appropriate. Contracts for which both steps are necessary are deemed concluded only after State registration. Transactions with real estate, according to Article 657 of the Civil Code, must be both notarized and registered with the State. Therefore, under these articles, too, real estate transactions cannot be validly registered, and therefore cannot be legally entered into at this time.

Until the necessary implementing laws are passed, Ukraine’s potentially large real estate market, the ability to develop a working mortgage market, etc., must remain untapped because the legal bases for protecting one’s rights to real estate do not yet exist. The Contributors therefore recommend that the implementing legislation referred to in the above articles of the Civil Code be enacted as soon as practicable, and that the two separate registrations, of a contract and of a title, be harmonized.

5. Uncompleted constructions

Article 331.2 of the Civil Code stipulates that ownership of newly-constructed improvements to real estate arises as of the moment of completion of the construction or, if the law so requires, as of the moment the construction is put into operation. This leaves a legislative gap: while the Civil Code regulates ownership
of unimproved real estate and of completed improvements to land, at present, there are no provisions regulating
the ownership of uncompleted constructions. As a consequence, there is no legal way to sell, inherit,
pledge, etc., uncompleted construction. Clearly, this oversight must be rectified and provisions regulating
ownership rights to uncompleted construction must be added to the Civil Code.

6. Custom as a source of law

Article 7 of the Civil Code recognizes custom, including industry practice, as constituting a source of law
independent of codified law. While this principle is well-established in common law states, in a civil law
country such as Ukraine, it poses some difficulties because the country is much more used to having all of
its laws “on the books”. It lacks experience in applying flexible, changing or subjective standards of law.
Additionally, the country only began building a market economy a little over a decade ago. Therefore, it
has little history of free-market customs available to serve as a source of law.

The Contributors therefore recommend that the Civil Code clarify the point already made in Article 7.2,
to the effect that custom can only be used by a court adjudicating a dispute, the subject matter of which
is not regulated by any codified law. Additionally, a new Article 7.3 might be added to the Civil Code, allowing
custom to be used by a court to interpret the meaning of a codified law when its meaning is ambiguous or
otherwise disputed.

7. Enterprises

Article 191 of the Civil Code defines an enterprise as an integral property complex, and says that an
enterprise can be an object of purchase and sale, pledge, lease and other transactions. However, Chapter
7 of the Civil Code, which regulates legal entities, does not mention the concept of “enterprise” at all. Indeed,
for a word used so often in Ukrainian law, there is no separate legal entity or corporate form that is specifically
and exclusively termed an “enterprise”. Therefore, considerable doubt as to what precisely an enterprise
is, remains prevalent in Ukraine to this day.

The Civil Code also fails to provide any practical application for the definition of an enterprise given in
Article 191. Part One of Book Three of the Civil Code, which regulates ownership rights, does not describe
an enterprise as being an independent object that can be owned. This conflicts with Article 191.4 and makes
it difficult to understand precisely how an enterprise can be purchased as envisioned in Article 191.4.
Amendments should therefore be made to Part One of Book Three of the Civil Code to make it clear that
an enterprise can be owned, that ownership rights to an enterprise can be transferred, etc. Similarly,
Chapter 7 of the Civil Code should perhaps be amended to include a description of an enterprise and describe
it as a separate corporate form.

8. Letters of credit

Article 1096 of the Civil Code regulates payments on letters of credit. However, the provisions of Article
1096 do not comply with the general rules on consequences arising from breach of contract stipulated in
Article 611 of this Code.

The problem manifests itself when a bank issues a letter of credit to a beneficiary, and that beneficiary
convinces another bank to pay on the letter of credit, but the paying bank does not strictly adhere to the
conditions for payment indicated in the letter of credit (e.g., by not requiring presentation of all documents
that it is supposed to require be presented). The issuing bank can invoke Article 1096.3 of the Civil Code
to demand that the paying bank refund to the issuing bank the full amount improperly paid out on the
letter of credit – even if neither the issuing bank nor any other party incurred any loss from the improper
payment.

The result of Article 1096.3 is to place form over function. A violation of the terms of the letter of credit,
even if the proper person receives the proper amount of funds despite the violation of form, is punished
by making the paying bank pay a second time. This permits the unjust enrichment of the issuing bank. More importantly, unless Article 1096.3 is amended to correct this defect, it will have an adverse effect on banking business in Ukraine. The risk of being required to pay twice for a mere mistake as to formalities will make banks hesitate to honor, and pay on, letters of credit generally.

9. Conflicts of laws

The Civil Code contains no provisions regulating conflicts of laws, an essential area of law for any country that wishes to participate, and allow its businesses to participate, in the global economy. Absent such regulations, it is difficult for any foreign participant in Ukraine's market, and even for Ukrainian participants in foreign markets, to be certain which country's laws might apply to any international transactions the participant takes part in. We should point out that conflicts of laws regulations were intentionally excluded from the Civil Code because Parliament planned to enact a separate law to specifically regulate international private law issues, including conflicts of laws issues. This is clearly stated in Clause 3 of the “Closing and Transitional Provisions” at the end of the Civil Code. However, while a bill on this sphere of law has been introduced in Parliament, it has not yet been adopted.

The bill on conflicts of laws is a specialized and unified law concerning international private law. It regulates private legal relations when they are subject to more than one jurisdiction's legal systems. Specifically, it:

- lays out the principles and concepts necessary to regulate legal relations involving foreign participants;
- establishes rules for determining which jurisdiction's laws apply to various legal relations involving foreign participants;
- determines the civil and procedural status of foreigners, stateless persons and companies;
- delineates the jurisdiction of Ukrainian courts over disputes involving foreign parties;
- establishes the rules for recognizing and executing foreign courts’ awards in Ukraine; and
- establishes the rules for Ukrainian courts recognizing and executing foreign courts’ and administrative agencies’ decisions in Ukraine.

Ukraine urgently needs to get this bill passed and signed by the President in order to make it possible for Ukrainian companies and foreign companies doing business with Ukraine to better participate in the global economy. Until this bill is passed, Ukraine must make do with the inadequate and ambiguous conflicts of laws provisions contained in Law of Ukraine No. 959-XII “On Foreign Economic Activity” dated 16 April 1991.
IV. Company Law

A. Executive Summary

The OECD’s 2001 Investment Policy Review noted several weaknesses in Ukraine’s company law regulation by the Law on Enterprises and the Law on Companies. Ukraine has repaired some of these problems by annulling the Law on Enterprises. Yet serious problems with Ukraine’s company laws continue to disrupt the economic life of the country. In the OECD’s 2001 Investment Policy Review, the observation was made that it would be desirable to: “develop entirely new legislation for various types of businesses based on relevant provisions of the draft civil code”. That, too, has been accomplished by passing the new Civil Code.

Nonetheless, Ukrainian company law still has need of improvement. In this Section, we review the effects that Ukraine’s Civil and Commercial Codes have on its company laws and examine some of the most important problem areas remaining in this sphere. Summarized, the major problems are:

- overlap and lack of coordination between provisions of the Civil and Commercial Codes that regulate the same issues; use of ambiguous terminology; and problems with the effective application of many of the Codes’ important provisions;
- outdated provisions and legislative gaps in the Law on Companies, which is the primary Ukrainian law regulating companies;
- impractical and unreasonable provisions found in the Codes; and
- the generally outdated nature of the Commercial Code, which fails to acknowledge the realities of Ukraine’s modern free-market economy.

As discussed below and elsewhere in this Report, all of these problems hinder enterprise development and operations in Ukraine. They often create bureaucratic obstacles to the free operation of companies, open the door to unscrupulous competitors using legal loopholes to compete unfairly and create a fertile ground for corruption to grow within government agencies and the courts.

The importance of the issues described below convinced both the Contributors and the Roundtable participants that the following legislative improvements are needed to promote enterprise development and operation in Ukraine:

- Company law, especially where regulated by the Codes, should be analyzed to identify both internal contradictions within individual laws and conflicts between different laws – some of which have gone unnoticed, uncommented upon and unrepaired for years already. While this Section and other Sections of this Report identify many of the most important contradictions and conflicts, further study and time will be necessary to do a thorough inventory of the revisions that need to be made. Subsequently, amendments should be made to the problematic laws in order to minimize the contradictions and conflicts;
- the Commercial Code should either be repealed or undergo wholesale revision. In its present form, the Commercial Code’s internal contradictions and conflicts with other laws regulating the company law sphere cause more problems than they resolve, and pose a real obstacle to Ukraine’s economic development and its integration into the world economy; and
- the OECD’s 2001 Investment Policy Review recommendation to “develop entirely new legislation for various types of businesses” should be taken one step further than was done when these provisions were added to the Civil Code. As has already been successfully accomplished in Russia, the Contributors
recommend that in Ukraine, separate, new laws should be enacted to regulate each of the most important corporate forms that operate in Ukraine, for example: joint stock companies, limited liability companies, partnerships, etc. Each such subordinate law should accord with the provisions of the Civil Code (as the current Law on Companies often fails to do now) while also providing further details on the workings of the various types of corporate forms. (Please note that, although the OECD's 2001 Investment Policy Review noted that a bill on joint stock companies was due to be submitted to Parliament “shortly”, that bill has still not been passed. Moreover, the Roundtable participants pointed out that before it is passed, the bill requires further amendment to elaborate several specific areas of law, including, for example, measures to protect the interests of minority shareholders in joint stock companies).

B Philosophy of company law

A country's company laws, in their entirety, comprise a form of “business constitution” for all of the participants in the country’s economic life. Like the country's constitution and civil laws, they should at the highest level (e.g., at the Civil or Commercial Code level) guarantee certain basic freedoms for the individuals and legal entities that they regulate: the freedom of contract, the enforcement of contracts, the right of businesses to be free from unwarranted governmental intrusions, among others.

On a more practical level, company law that is subordinate to the country's codes of law should be straightforward, clear, transparent, universal and, to the extent practicable, adopt a laissez faire attitude towards government regulation of business. In short, company laws should lay out the “rules of the game” that all participants in a country's business life can know will be applied consistently, and on which they can depend in conducting their business. On the other hand, lawmakers should refrain from enacting laws that will become obstacles to doing business.

Unfortunately, Ukrainian company law in many respects still does the latter. As a result, in many instances its requirements distort the economic paradigm within the country. Ukrainian corporate law can force companies to either waste time, effort and money on adhering to the “letter of the law” (while the spirit of the law falls is forgotten) in order to circumvent legislative obstacles, or ignore the law and risk the consequences. In either case, this creates economic inefficiencies and increases the cost of doing business: either by forcing companies to expend resources on legislative compliance, or to maintain reserves, charge higher prices to their customers, etc., in order to be financially prepared in the event they are fined or forced into court to defend their violations of the law.

C. History

Ukraine's first major effort to overhaul its company law was the enacting in 1991 of both the Law on Enterprises and the Law of Ukraine “On Economic Societies” No. 1576-XII dated 19 September 1991 (the “Law on Companies”). Since then, the Law on Enterprises has been annulled and the Law on Companies has undergone extensive amendment. But Ukraine's company law still contains numerous defects in need of repair. The cause of these defects lies primarily, as pointed out in The OECD's 2001 Investment Policy Review, in the manner in which subordinate company legislation has been enacted. Specifically, laws are generally passed on an ad hoc basis, with each new law or regulation coming into being to address a specific problem, but little thought apparently being invested in how the various laws are to interrelated.

This disorganized approach to lawmaking is hardly limited to Ukraine—on the contrary, it occurs on occasion in many countries. But it is particularly harmful to businesses operating in Ukraine because new legislation is so rarely analyzed by the Ukrainian authorities to ensure that it integrates well into the existing system of laws. This gives rise to conflicts among laws that are newly passed and laws already on the books.

Moreover, while legislators within the Parliament sometimes recognize the risk of conflicts among laws, the method they often use to try to avoid these conflicts is all too often to just make the new laws' provisions
vague. For example, rather than ensure that a new law integrate well with an existing law as regards punishments for violations of the new law, the new law will simply say that violations will be punished “in accordance with existing laws”. This lack of “quality control” by the Parliament makes it difficult for businesses to know with any certainty what the consequences of their actions might entail if they are found to have violated a law. They know there are consequences for certain actions, but they have no idea where to look to find out what these consequences might be. Furthermore, many laws include ambiguities, internal contradictions and, as already mentioned, substantive conflicts with other laws, which make it difficult for businesses to even be certain when they might be violating the law.

It is true, of course, that to some extent Ukrainian legislators are working to repair these problems on their own. The enaction of the new Civil and Commercial Codes, for example, were in large part an attempt to introduce changes to subordinate company law en masse, and both Codes contained provisions requiring, in general terms, that subordinate legislation be brought into compliance with the relevant Codes. (Which, however, has not been fully accomplished.)

Parliament has also passed a new Law of Ukraine “On State Registration of Legal Entities and Individual Entrepreneurs” No. 755-IV dated 15 May 2003 (the “Registration Law”), which entered into force on 1 July 2004. This law is intended to bring order into the system of subordinate company laws that regulate the State registration of businesses operating in Ukraine.

Below, we examine a few of the most troubling aspects of Ukrainian company law, which we propose be addressed through cooperation among the Parliament, Cabinet of Ministers, President and the various international organizations, including the OECD, which have assisted Ukraine in its various efforts to bring its legislation into line with international standards in the past. This section of the Report will concentrate primarily on the two corporate forms most prevalent in Ukrainian business: limited liability companies (“LLCs”) and joint stock companies (“JSCs”).

D. Documents needed for State registration of businesses

Businesses in Ukraine often encounter problems with Ukrainian company law before the businesses even technically exist. For example, it is not always clear what documents must be submitted to state regulators in order to register a new company. Confusion continues to exist as to when, if ever, it is necessary to draw up and present to regulators a “founding agreement” (a document describing the rights and obligations existing among the founders of a company) when registering a new business.

In practice, some government agencies do not require the presentation of a founding agreement. For example, the National Bank of Ukraine, in its Letter No. 25-118/148-754 “On the Procedure for Opening Accounts to Create the Authorized Fund of an Economic Society” dated 2 February 2004, declares that a company does not need to produce its founding agreement in order to open a temporary bank account to pay contributions to such a company’s authorized fund. This, however, is only one step in the process of registering a company, and other agencies, at other times, may require different combinations of documents to be presented at the other steps in the registration process.

On this point, Article 82.1 of the Commercial Code does not require submission of a founding agreement. In contrast, Article 4 of the Law on Companies requires that both a Charter and a founding agreement be submitted. The Civil Code’s position is less clear: Article 87.2 of the Civil Code says that “either the Charter or the founding agreement” needs to be submitted when registering a company “unless the law stipulates otherwise”. Articles 142.2 and 154.1 of the Civil Code can be interpreted as either contradicting or clarifying Article 87.2 of the Civil Code, in that they do not require the submission of founding agreements to register, respectively, an LLC or a JSC.

Thus, in this instance (and such instances are rare), the Commercial Code presents the most “business-friendly” approach: it requires less paperwork than the Law on Companies, and its position is clearer than the Civil Code’s uncertain position that founding agreements are not needed unless certain unnamed laws
say that they are. The desirable solution to this confusion would be to bring the Civil Code into conformity with the Commercial Code’s view here (i.e., while as discussed elsewhere in this Report, the Contributors are recommending that the Commercial Code and Law on Companies both be annulled, this particular provision of the Commercial Code should be preserved in a revised Civil Code).

The very first encounter that a prospective business has with Ukrainian law, will be one of confusion, with one Code containing internal contradictions and references to unnamed laws (one of the Contributors pointed out that the Code contains references to upwards of 400 different legislative acts), another Code saying something encouraging (less paperwork is needed to set up a new company), but a more specific, subordinate law, saying something completely different (more paperwork is necessary). And the result being that before it even gets off the ground, a new business is presented with an unnecessary legislative stumbling block.

Ukraine’s State registration agencies generally lack formal oversight to ensure that they interpret government laws and regulations correctly in their work. As a consequence, given the ambiguity of the relevant legislation, these agencies can demand presentation of a founding agreement, a charter, or both when companies come to them for registration. At least one Contributor expressed frustration at this ambiguity. Registration agencies really have very wide discretion as to what documents they may demand, and companies generally are forced to accept this uncertainty as to what they will be asked to present when registering. As a consequence, they often choose to prepare documents that may not even be necessary – incurring unnecessary expense and time delays in getting documents drawn up, approved, notarized, legalized and translated – just to be sure that they have something that may or may not ultimately be needed.

It should also be noted that the Registration Law, mentioned above, which should sort out these kinds of ambiguities, does not. It is silent on whether a founding agreement or a charter needs to be submitted.

E. Number of participants in an LLC

Another ambiguity exists in regard to the setting up of an LLC in particular. According to Article 50 of the Law on Companies, an LLC is a company with an authorized fund divided into parts. This “division” element suggests than an LLC cannot be comprised of a sole participant – it must, by definition, have at least two participants.

Article 140.1 of the Civil Code, however, expressly permits an LLC to have either multiple participants or a sole participant. This rule is more liberal than the one codified in the Law on Companies, because it supports an owner’s right to choose for itself how it organizes its business.

Even so, the registration agencies often follow the Law on Companies’ rule and refuse to register an LLC with only one participant. Generally, businesses are able to placate the registration agencies by having an employee or a related company serve as a “second” participant with a nominal participatory interest. But the principle of the dilemma is what is important: a conflict among the company laws is creating unnecessary obstacles to doing business, complicating what should be a relatively simple process. Moreover, by forcing companies to take on unwanted “partners”, this conflict among the company laws is forcing countless companies to assume the risk that, in the future, they will run into some disagreement with their token co-participant that might affect their business – a risk that would not exist if the businesses were simply permitted to set themselves up as their real, single owner wishes.

(On a related matter, one Roundtable participant pointed out an internal problem with the Civil Code’s provisions. According to Article 141.2 of the Civil Code, if an LLC has a sole participant, that participant cannot simultaneously participate in any other “company”. Now, the word “company” encompasses not only LLCs, but also JSCs, among other corporate forms. And shares in JSCs are often traded freely, even anonymously. As a result, it is a practical impossibility for any regulator to know for certain whether an LLC’s sole participant also owns shares in a JSC – and thus is in violation of the law. The Roundtable participant
suggested that this provision of the Civil Code either be modified so as to make it easier to enforce, or be deleted.)

F. Composition of LLCs’ management bodies

Even if an LLC with a sole participant succeeds in getting registered, it still faces other problems. The Law on Companies requires each LLC to have an audit committee. And Article 63 of the Law on Companies specifically states that an audit committee must: (i) be composed of representatives of the participants in the LLC; and (ii) have at least three members. In the event that an LLC is formed with only one (as permitted by the Civil Code) or two (as permitted by both the Civil Code and the Law on Companies) members, however, there would appear to be an insufficient number of participants to fill the three required seats on the audit committee.

The effect of this legislative gap (for the situation described above hardly seems to have been intended) is that each LLC must have a minimum of three participants – a result not stated as a requirement in any Ukrainian law, but one necessitated by the gaps between the laws. Any fewer participants, and the audit committee cannot have the required minimum number of members.

The desirable solution to this dilemma would be to amend the Law on Companies to either make the establishment of the audit committee optional, or to permit the audit committee to have fewer than three members in certain cases, for example, when there are only one or two participants. Alternatively, the Law on Companies could be annulled and a specific Law on LLCs could be enacted incorporating this provision.

One final point bears mentioning in this regard. Article 63 of the Law on Companies imposes a separate and special burden on sole proprietorships and other small businesses, especially when they are owned by individuals rather than companies. Article 63 forbids any corporate officer from serving as a company’s director (or member of the board of directors) while simultaneously serving on the audit committee. If an LLC has only an individual as its sole participant, for example, then that participant must serve on his company’s audit committee. Yet, as a practical matter, that obligation, plus the ban on one person serving on both the audit committee and as a company’s director, means that an individual who owns an LLC must hire some other person to serve as his own business’s director and run his business. This is really a very unreasonable burden, both financial and organizational, to impose on small businesses, and should be repealed for that reason.

G. Selling a participatory interest in an LLC to a third party

A very discreet, yet not unimportant, conflict found within Ukrainian company law exists in regard to the right of a participant in an LLC to sell its participatory interest, whether exiting the LLC entirely or not.

Taking this ambiguity piece by piece, Article 147.3 of the Civil Code restricts a participant’s right to sell its participatory interest to anyone at all; the second paragraph of Article 53 of the Law on Companies, on the other hand, only regulates sales to third parties (i.e., it does not restrict one participant selling part or all of its interest to another existing participant.)

As regards what exactly a participant can sell, the Civil Code permits the sale of any amount of participatory interest that has already been paid for in full. So if a participant owns a 1000 stake in an LLC’s authorized fund, but has paid in 500 worth of its required contribution, that participant can only sell half of its participatory interest.

The Law on Companies, on the other hand, requires that a participant have already paid for its entire participatory interest before it can sell any portion of that participatory interest.
The result of this conflict between the Civil Code and the Law on Companies is that when a participant relies on the Civil Code and tries to sell only the paid-for part of its participatory interest, but it has not yet paid for its entire participatory interest, this action can be challenged in court as being in violation of the Law on Companies.

Whether sales prior to payment for a participatory interest are restricted altogether or only when the sale is to a third party is a rather minor issue. But it would certainly be desirable to clarify whether one must pay for the entire participatory interest before selling any part of it, by making the appropriate legislative amendments.

H. Distribution of a participant's interest upon withdrawal from an LLC

One problem area within Ukrainian company law that does not arise from a conflict among laws is the issue of how to distribute to a participant, which is withdrawing from an LLC, the participant's due share of the LLC's authorized fund.

Article 54 of the Law on Companies requires that when a participant withdraws from an LLC, the LLC must pay to that participant its fair share of the LLC's authorized fund, plus any profits the participant is due from the LLC's operations. However, this payout may be issued as late as 12 months after the participant has withdrawn. This delay gives unethical former business partners – whose very lack of ethics perhaps inspired the exiting participant to withdraw in the first place – a wide window of opportunity to deprive the withdrawing participant of its rightful payout. For example, once the withdrawing participant is gone, the remaining participants can “asset strip” the LLC with transfers to affiliated companies, drive the LLC into bankruptcy, and then claim there are no assets remaining with which to fund the withdrawing participant's payout.

As negative as this scenario sounds, it is not unheard of in Ukrainian business practice. The Contributors therefore recommend that amendments be introduced to drastically shorten the timeframe required for transferring to a withdrawing participant its due payout. Ideally, payout should occur on the date the withdrawing participant's withdrawal becomes official.

I. Amount of a business' authorized fund

Article 144.4 of the Civil Code contains a provision very similar to the corresponding provision of Russia's Civil Code (Article 90). Essentially, what Article 144.4 requires is that a company must maintain assets equal to or exceeding the declared level of its authorized fund. If, in a company's second or subsequent fiscal year, the value of the company's net assets falls below the level of its declared authorized fund, as registered with the registration agencies, the company must reduce its declared authorized fund and register corresponding amendments to its charter; alternatively, the company's participants can make additional contributions to bring the authorized fund up to its declared level.

This provision poses serious complications for both domestic and foreign businesses operating in Ukraine. For domestic firms, while the minimum requirement established by Ukrainian law for an LLC's authorized fund may seem low (approximately €3,600), this sum can constitute a relatively large investment for a Ukrainian small businessman. It could, in fact, be all the money a small businessman is able to gather together to create a new business. Requiring a business to essentially hold this money in reserve to protect it against loss inhibits the kind of risk-taking that is necessary to grow a business. And because small businesses are often accurately described as the “engine of growth” for any market economy, the Contributors recommend that legislative provisions that discourage such risk-taking, and the resulting benefits for the Ukrainian economy, be reconsidered.

For larger, international businesses, it is important to keep in mind that Ukrainian law encourages large foreign investments in Ukrainian companies’ authorized funds by allowing such sums to be invested tax-free. Consequently, foreign businesses often set up Ukrainian subsidiaries with relatively large declared
authorized funds. But just because their authorized funds are larger does not mean that foreign companies
have any less desire to put them to effective use in growing their businesses. Yet Article 144.4 of the Civil
Code dissuades foreign businesses from risk-taking just as it does domestic small business.

As another practical matter, one Roundtable participant pointed out that businesses often take on
debts, much larger than their authorized funds, to fund their expansion. Preserving an authorized fund at
a given level, therefore, does not even provide the benefit of ensuring that creditors will be repaid any
loans they extend to a company. If this was the rationale for the Civil Code’s rule that the authorized fund
must be inviolable, then it lacks a rational basis for existence.

This rule seems superfluous from a legal perspective as well. Ukrainian law already requires companies
to maintain specialized reserve funds to ensure that they can continue operating in “bad years” when their
assets decline. Yet Article 144.4 of the Civil Code seems to ignore this fact, and requires companies to treat
their entire authorized fund as a sort of super-reserve fund that must remain intact and not fluctuate (at
least not downwards.) Because the rule is superfluous and the risk against which it is designed to protect,
is already insured against by the existence of specialized reserve funds, therefore, this rule should be repealed.

J. Establishing separate subdivisions of a company

This Report does not specifically address problems with Ukrainian tax law (there are many), but
insofar as at least one tax law issue affects Ukrainian company law as well, it should be highlighted here.
This issue concerns the procedure for registering separate subdivisions of a company. According to
Article 28 of the Registration Law, when a company establishes separate subdivisions of itself, it must
notify the registration agencies of this fact. The registration agencies are then responsible for passing
this information on to any other government agencies that need to know about this.

However, Article 4.2 of the Instructions on the Procedure for Registering Taxpayers, adopted by State
Tax Administration of Ukraine Order No. 80 dated 19 February 1998 (the "Registration Instructions"),
requires separate subdivisions to independently inform the tax agencies of the fact of their establishment.
Although the Registration Instructions are far less authoritative than the Registration Law, the tax agencies
have essentially been given free rein to ignore the latter and invoke the former to levy fines against
companies that fail to promptly inform the tax agencies when separate subdivisions are established.

There was hope that the Registration Law, which entered into force on 1 July 2004, would correct this
situation. The Registration Law attempts to unify all registration procedures for companies dealing with
the State into a “one-stop shopping” procedure. In other words, the Registration Law establishes a single
State registrar responsible for handling all State registrations that a company is required by law to conduct.

In theory, this means that companies are no longer burdened by compliance requirements such as the
Registration Instructions. But in practice the tax agencies continue to enforce the Registration Instructions
in spite of the fact that they are subordinated to the Registration Law – yet no one appears to be providing
oversight of the tax agencies, requiring them to obey the law. Thus, the fact is that the Registration Law’s
entry into force has not solved the problem.

If the tax agencies continue to operate in contravention of the law, it might be worth considering enacting
a law to create a sort of ombudsman for the government – an agency specifically tasked with investigating
complaints from businesses that believe various Ukrainian government agencies are not correctly interpreting
and/or applying the laws. Such an office could greatly improve the business environment in Ukraine, by
demonstrating the government’s commitment to dealing fairly with businesses and hearing out their
concerns. Moreover, by fixing legal violations by government agencies as soon as they are discovered by
a single business, such an office could introduce “global” efficiencies into the Ukrainian marketplace,
eliminating the need for multiple companies to go to court multiple times to contest one and the same
type of legal violation by a government agency.
K. Problem of overlong notification periods

Another issue that needs to be addressed, is the term for notifying participants of meetings of companies' supreme management bodies.

In an LLC, the supreme management body, whose competence includes the entire range of issues that an LLC can consider and actions that an LLC can take, is the general meeting of participants (the “General Meeting”), which is comprised of all the LLC’s participants. Article 61 of the Law on Companies currently requires an LLC to provide 30 days’ prior notice before it can hold a General Meeting. This is not at all an unreasonable period ordinarily, and is designed for use with large companies with multiple participants, to ensure that each participant has adequate time to review information on issues to be discussed at a General Meeting. However, in smaller companies – sometimes with as few as a single participant – it constitutes an unnecessary restriction that can be extremely inconvenient when issues are at stake where time is of the essence. The categorical nature of the 30-day notice period is the real problem. The Contributors therefore suggest that the law be amended to permit the notice period to be waived entirely or in part, upon the written consent of all participants, which is currently not an option.

Similarly with JSCs: Article 43 of the Law on Companies requires 45 days’ prior notice before a general shareholders meeting (a “GSM”, which is the corresponding supreme management body in a JSC) can be called. Given that JSCs as a rule have more shareholders than LLCs do participants, there is a valid reason for usually requiring advance notice of a GSM so that shareholders can consider the issues on the agenda beforehand. Still, it is not unheard of for a JSC to have very few shareholders, and in such situations, the 45-day notice period can be just as much a burden for a JSC, as the 30-day notice period is for an LLC. The Contributors recommend that here, too, the law be changed to permit waiver of all or part of the notice period, with the written consent of all shareholders.

L. Problem with removing a company from the State register

The second paragraph of Article 58.15 of the Commercial Code permits a company to be liquidated if it has been removed from the State register of companies. Logically, the reverse should be true: once a company has been liquidated, it should be removed from the register. How the order of these two events came to be reversed during the legislative process, however, and how this mistake was allowed to become law, is a mystery. While the mistake was probably innocent, its consequences can be anything but innocent, due to the multitude of grounds Ukrainian law provides for canceling a company’s State registration and striking it from the register.

This provision has become a powerful potential weapon in the hands of unscrupulous business competitors, who can petition the State to cancel a company’s registration for failure to comply with any number of formalities – many of which are based on legislation that is ambiguous and open to interpretation – and then demand the liquidation of the company based on its being stricken from the register. Due to certain legislative gaps, the status of the property of a liquidated company is uncertain and subject to the risk of seizure by the State or other parties.

The solution, in any case, is relatively simple. The order of events should be reversed so that liquidation becomes a basis for removing a company from the register, rather than vice versa.

M. Additional miscellaneous conflicts among corporate laws and regulations

Inconsistencies between how the Law on Companies and the Civil Code regulate other aspects of the functioning of LLCs create additional problems for these businesses. Most significantly:

1. Article 61 of the Law on Companies accords participants, controlling at least 20% of an LLC’s authorized fund, the right to call extraordinary General Meetings. However, Article 98.4 of the Civil Code sets the threshold for calling extraordinary General Meetings at only 10%.
2. The Law on Companies and Civil Code also disagree on what matters fall within the exclusive competence of an LLC's General Meeting. Article 98.2 of the Civil Code permits the alienation of 50% or more of the property of an LLC upon a three-quarters majority vote of the LLC's participants. The Law on Companies, on the other hand, is completely silent on this issue. State regulators take a third view, and consider a simple majority vote in favor of such alienation to be sufficient. Clearly, this divergence of views must be resolved.

3. The Civil Code and the Law on Companies also require different majority votes to liquidate an LLC. Article 98.2 of the Civil Code sets the threshold at a three-quarters vote of participants; Article 59 of the Law on Companies, however, requires only a simple majority vote.

4. Another ambiguity exists in regard to the procedure for companies paying in their contributions to a new LLC's authorized fund. Ukrainian law requires that a certain percentage of a participant's interest in an LLC's authorized fund must be paid in before the LLC is registered. However, the Law on Companies and the Civil Code currently disagree on what exact percentage must be paid in: Article 52 of the Law on Companies says 30 percent; Article 144.3 of the Civil Code says 50 percent.

The Contributors believe that the Civil Code's position on each of the four above issues is preferable to the position (or lack thereof) taken in the Law on Companies. One desirable solution, therefore, would be to amend the Law on Companies to bring its provisions into compliance with the Civil Code's provisions. An even better solution, would be the one that the Contributors advocate elsewhere in this Section and in this Report: to replace the Law on Companies with several new laws, each tailored to a specific corporate form (e.g., LLCs, JSCs, partnerships, etc.) and each having provisions that accord with those contained in the Civil Code generally, even as they may expand on the basic principles contained in the Civil Code in regulating the detailed aspects of the several corporate forms with which they are concerned.

This is the approach that Russia, for example, has taken with its separate Law on Joint Stock Companies and Law on Limited Liability Companies. Both of these laws have been in force now for some years, and in general, legal practitioners and businessmen working in Russia view the operation of the two laws favorably.

In this regard, one Roundtable participant pointed out that the bill on joint stock companies that is still being considered by the Parliament does not adequately protect this interests of minority shareholders in joint stock companies, especially in the situation where a JSC is being taken over. This Roundtable participant suggested that amendments to protect minority shareholder rights need to be incorporated into the bill, and that representatives of Ukraine's business community should be consulted during the amendment process.
V. Antimonopoly Law

A. Executive Summary

Fair competition is essential to any healthy market economy. Antimonopoly laws seek to ensure that businesses are monitored in the interests of limiting monopolistic and anticompetitive developments, for enterprises develop best and operate most efficiently in an atmosphere of free and fair competition. To promote such competition, anticompetitive tendencies from economic concentrations, unfair trade practices and coordinated actions among businesses must be restrained.

For these reasons, Ukraine has created a legislative basis for protecting competition and established an independent state body responsible for this area – the Antimonopoly Committee of Ukraine (the “AMC”). Antimonopoly law in Ukraine thoroughly regulates many aspects related to protecting and monitoring competition in Ukraine. It also provides a mechanism for preventing and eliminating monopolistic and unfair competitive acts. Many large, medium and sometimes even small foreign and domestic enterprises doing business in Ukraine have faced the practical consequences of Ukraine's robust antimonopoly laws more than once. For many such companies, dealing with the AMC has become a part of their day-to-day business life in Ukraine.

The Roundtable participants generally agreed that Ukraine's antimonopoly laws reflect the philosophies expressed in European Union and other Western antimonopoly laws fairly well. That said, several problematic issues were also addressed. For example, at least one Roundtable participant reported that staffers at the Antimonopoly Committee have expressed reservations regarding Ukraine’s low thresholds for antimonopoly review of certain transactions, and a belief that the laws in this sphere were somewhat overbroad. Roundtable participants shared reservations about the Commercial Code, and noted that the Antimonopoly Committee’s internal policy was to ignore the Commercial Code where it conflicts with the antimonopoly laws and to prevent other government agencies from attempting to enforce it.

After reviewing the comments contained in the Survey, the Roundtable participants identified the following issues as requiring significant reform:

- clarifying ambiguous and limiting overbroad definitions of violations;
- reviewing the rules against coordinated actions and economic concentrations; and
- eliminating conflicts between certain provisions of Ukraine's Commercial Code and its antimonopoly laws.

Due to the effects of the above features, Ukrainian law sometimes deems legal actions to violate antimonopoly law when these actions are caught up in the law's ambiguous and overbroad definitions of violations. At other times, unnecessary rules that attempt to regulate coordinated actions and economic concentrations force companies to seek AMC prior approval of actions that really have no bearing on competition in the Ukrainian market at all, and that could easily be replaced with notification requirements. The monetary thresholds for transactions requiring AMC prior approval are also overbroad, formalistic and low. Finally, Ukraine's Commercial Code contains provisions that tend to interfere with the progressive nature of Ukraine's antimonopoly laws.

All of the above defects found in Ukrainian antimonopoly law are further compounded by the high costs to alleged violators of such law, both in compliance costs and in penalties, when they are found to have violated the law – as interpreted by the AMC with little oversight – at great cost to the Ukrainian economy as a whole.
The Contributors recommend that the defects in Ukraine’s antimonopoly laws, as outlined below, be repaired in order to allow Ukrainian businesses and foreign companies operating in Ukraine to go about their business without being over-burdened by high compliance costs or placed at heightened risk of arbitrary punishment by the AMC, to the detriment of enterprise development in this country.

B. Definitions of violations

The Laws of Ukraine “On Protection from Unfair Competition” (the “Unfair Competition Law”) and “On Protection of Economic Competition” (the “Economic Competition Law”), as well as the Commercial Code, define the main types of antimonopoly and unfair competition violations. Some of these definitions are ambiguous, however, and thus become subject to interpretation by the AMC. The effects of this situation are described below.

1. Tying

Article 9 of the Unfair Competition Law states that imposing “tying” conditions when selling goods, fulfilling works, and rendering services is against the law. According to the law, “sales and purchases of goods, carrying out of works, and rendering of services with compulsory tying shall be understood to mean sales and purchases of certain goods, carrying out of works, and rendering of services conditioned on sales and purchases of other goods, carrying out of [other] works, and rendering of [other] services that are not needed by the consumer or counterparty.”

Article 34.3 of the Commercial Code has a similar rule, defining a “tying” violation as the “purchase and sale of one product, execution of [one] work, or providing of [one] service on the condition [that a consumer or contractor] purchase other products, works and services not needed by the consumer or contractor”.

Both of the above rules are unclear, because they do not explain how to decide when goods, works, or services are not needed. For instance, if two parties enter into a sales contract, on the condition that the purchaser also buy certain accessories to the primary product, this may or may not be an arms-length negotiation in which the seller sells and the purchaser buys products and accessories that the purchaser needs. It would be difficult for the seller to prove to the AMC that the negotiations that led up to the sales contract did not include a demand by the seller that the purchaser buy the accessories to the main product.

The lack of guidelines on how to decide when goods, works, or services are not needed creates the possibility of an unscrupulous purchaser challenging what was, in fact, an arms-length transaction in which the seller sells and the purchaser buys products and accessories that the purchaser needs. It would be difficult for the seller to prove to the AMC that the negotiations that led up to the sales contract did not include a demand by the seller that the purchaser buy the accessories to the main product.

In order to solve this problem, it is essential to define a process for determining when goods, works, and services are “not needed” by a consumer or counterparty. It might also be helpful for the law to create a cause of action in a purchaser, such that if a seller refuses to sell certain goods to the purchaser unless the purchaser also buys certain other, “tied”, goods, the purchaser can immediately file a complaint against the seller for “attempted tying”. In such a case, a presumption should also be created, that any time a seller enters into a contract for multiple goods, works, or services, it is presumed that the purchaser entered into this contract willingly – because the purchaser had the option of complaining, but waived it.

2. Instigating a boycott

According to Article 10 of the Unfair Competition Law and Article 34.4 of the Commercial Code, instigation of a boycott against a business is against the law. The law defines this violation as “a competitor’s actions,
aimed at instigating a third party, directly or via an intermediary, to refuse to enter into a contract with a
given business.” The Commercial Code has a similar definition, namely: “A competitor discouraging a
person’s contractual relationship with a business, directly or through an intermediary, shall be deemed
instigation to boycott the business”.

The term “instigating” is not defined, but the way the term is used seems to violate the principles of
competition doctrine. For example, if Company A produced high-quality goods and advertised this fact to
a consumer. The consumer decided to buy Company A’s goods because of their high quality. But in doing
so, the consumer consequently refused to buy similar goods from Company B. Thus, the consumer “refused
a contractual relationship with” Company B. Due to the ambiguity of the term “instigating”, the very common
business practice of advertising one’s own goods, without even any mention of any competitor’s goods, can
be interpreted as a violation of Ukrainian antimonopoly law.

In order to cure the above ambiguity, the term “instigating” must be defined in detail. Ukraine’s
Parliament should amend the relevant laws to adopt either a comprehensive list of actions constituting
“instigation”, or define the concept clearly and provide illustrative examples of what constitutes “instigation”.

3. Instigating a supplier

The reverse of Article 10 of the Unfair Competition Law is Article 11 of the Unfair Competition Law.
Article 11 states that “instigating a supplier to discriminate against a buyer (a customer)” means “actions
by a buyer’s (customer’s) competitor aimed at instigating, directly or via a representative, a supplier to
give the buyer’s (customer’s) competitor certain unjustifiable advantages over the buyer (customer)”
and says that this, too, is also against the law. Again, the Commercial Code repeats that this is against
the law, explaining that: “persuasion of a supplier, directly or through an intermediary, to provide certain
unreasonable benefits to the competitor shall be deemed instigation of the supplier to discriminate
against a buyer”.

This situation closely resembles the previous one, as again it is not clear what “instigating” means. It is
also unclear what criteria should be used to determine when advantages are “unjustifiable” or benefits are
“unreasonable”.

For example, one Contributor advises that many of the multinational tobacco companies doing business
in Ukraine (e.g., BAT, Philip Morris) offer discounted prices to distributors that agree to buy a certain amount
of goods over a certain period of time. Although this is a well-established quantity-discount marketing technique
worldwide, in Ukraine, because of Article 11 of the Unfair Competition Law, it can be deemed anticompetitive.
After all, the distributor who offers to buy large quantities of goods at a discount will receive price advantages
over its competitors who do not receive such discounts. Theoretically, by so doing, the favored dealer could
run afoul of the law. So here, too, the Contributors recommend that the term “instigating” be defined in
detail.

4. Unlawful advantage in competition

Article 15 of the Unfair Competition Law and Article 25 of the Commercial Code both contain a rule that
is so vague as to be potentially dangerous to any business operating in Ukraine. Both the Unfair Competition
Law and the Commercial Code outlaw “gaining unlawful advantage in competition”, which they define as
“gaining advantage over another business by infringing any of the laws currently in effect and acknowledged
in a decision of a competent state body”.

The primary danger here is that “a competent state body” is not defined. If, for example, the AMC believes
itself to be “competent”, then this rule might grant the AMC the power to (i) decide when any law has been
broken and (ii) turn such broken law into an antimonopoly law violation – all on its own initiative. This would
certainly constitute overreaching, and in order to ensure that this kind of scenario does not take place, the
rule needs to be amended to limit its scope drastically, and explain such limitation.
5. Conflicts with the Commercial Code

The Commercial Code resurrected many provisions of Ukrainian antimonopoly law that were abolished few years ago in the interests of modernizing Ukraine’s antimonopoly system. In so doing, the Commercial Code has complicated the implementation of many beneficial provisions of the more modern laws.

For example, Article 30 of the Commercial Code absolutely prohibits certain coordinated actions, rather than taking the more modern approach of just requiring such actions to be reported to the AMC for prior clearance. In taking this stance, the Commercial Code contradicts the Economic Competition Law (Article 10).

Moreover, unlike the Economic Competition Law, the Commercial Code does not appear to permit the coordinated use of intellectual property rights, or coordinated actions of small and medium-sized companies that are of too small a scale to affect competition in Ukraine.

The Commercial Code’s Article 126 also imposes an unreasonable restriction, in that it requires all companies, regardless of their size or market share, to obtain the AMC’s prior approval before obtaining control of (or even a blocking stake in) any other company. Also, unlike the Economic Competition Law, Article 126 of the Commercial Code makes no exception for changes of control relations internally within the same group of companies.

On the other hand, the Commercial Code contains only a limited list of antimonopoly-related violations. So while the restrictions it imposes are often unreasonable ones, it simultaneously fails to encompass all the protections necessary to ensure adequate levels of competition in Ukraine.

These problems worry not only businesses, but also the AMC itself. It was revealed at the Roundtable that the AMC prefers not to enforce the rules of the Commercial Code if they conflict with more specialized laws, such as the Economic Competition Law or Unfair Competition Law. Nonetheless, the Commercial Code’s rules remain “on the books” and so, whatever approach the AMC itself may take in practice to minimize their ill effects, its policies do not bind either other state agencies or the Ukrainian courts. Therefore, it is necessary to change the law as well, preferably (as noted elsewhere in this Report) by abolishing the Commercial Code.

C. Rules against coordinated actions and economic concentration

1. General description

When businesses merge, acquire other businesses, agree on how to price their goods, agree on how to divide up markets for their goods, or take certain other actions, this can significantly influence competition in a market. Government regulators in many states therefore closely regulate these kinds of actions and in this, Ukraine is no exception. Ukrainian law generally classifies these kinds of market-influencing actions as falling into one of two groups:

- **coordinated actions**, e.g. price fixing; restricting production; dividing up sales or supply markets by territory; rigging auctions; restricting entry into or operation within a market by other businesses; and similar actions; or
- **economic concentrations**, e.g., mergers and acquisitions, obtaining control over companies, including when setting up a new company, etc.

Both coordinated actions and economic concentrations require the prior approval of the AMC if the following three elements are satisfied (the “Thresholds”):

- a. Either the worldwide assets or the worldwide turnover of all participants, combined, exceeds €12 million; and
b. At least two of the participants have worldwide assets or worldwide turnover of over 1 million; and
c. At least one participant has assets or turnover in Ukraine exceeding 1 million.

As already mentioned above, Ukrainian antimonopoly law regulating coordinated actions and economic
concentrations has many problems. These problems negatively affect the investment climate and conditions
for enterprise development, as specifically described below.

2. Low and formalistic thresholds

The low level of the Thresholds prescribed by Ukrainian law and their formalistic nature create unnecessary
obstacles for enterprise development and operation. Moreover, the Thresholds established are not in line
with existing practice in other developed countries, for the following reasons:

• The Thresholds are so low that they often catch even small companies, which are incapable of seriously
  affecting competition on the Ukrainian market. This forces such small companies to seek AMC prior
  approvals when there is no objective necessity for this.
• Although Ukraine has repeatedly stated its intention to bring its legislation into line with EU law, the
  thresholds existing in the EU are substantially higher than those in Ukraine (5 billion worldwide combined
  turnover of all parties to a transaction; or 250 million turnover within the EU). Thus, raising the
  Thresholds would not only remove unnecessary limitations on Ukrainian business operations and
  enterprise development, but also accord with Ukraine's stated policy of harmonizing its laws with those
  of the EU.
• The Thresholds are very formalistic. Many Contributors commented on this, and their comments can
  be summarized as follows: Most mergers and acquisitions carried out in the world do not specifically
  affect competition on Ukrainian markets – certainly not materially. However, if a large international
  company, with billions of euros in business outside of Ukraine, sells as little as 1 million worth of
  products in Ukraine, Ukraine seeks to subject that company to Ukrainian antimonopoly law. This
  would make little sense if, for example, the company's ties to Ukraine are slight and its market within
  Ukraine is dominated by other companies. None of those other factors, however, are given any weight
  in Ukraine's formalistic Thresholds test.

Due to the above, the Contributors recommend amending the Thresholds test as follows:

• The Threshold amounts should be raised (at least tripled);
• An additional Threshold category should be introduced, requiring that at least one party to a transaction
  control, or be about to gain control over, a certain percentage of the Ukrainian market (e.g., 25%) in
  which it operates, before the transaction becomes subject to AMC prior approval; and
• The formalistic approach should be modified. If it is objectively clear that coordinated actions or an
  economic concentration do not affect competition on the Ukrainian market, but the Thresholds are
  nonetheless met, Ukraine should require that the parties to the transaction being examined notify
  the AMC about the transaction – but not seek the AMC's prior approval. It seems this approach is more
  or less the one taken in Russia's Law "On Competition and Limitation of Monopolistic Activity on Goods
  Markets".

3. Regulation of coordinated actions

Ukrainian antimonopoly law unnecessarily regulates as “coordinated actions” some very ordinary
business actions. For example, Article 5.1 of the Economic Competition Law states that “the founding of a
legal entity that is directed towards or results in the coordination of competitive behavior between the legal
entities that established the legal entity, or between them and the newly-founded legal entity, shall also
be considered a coordinated action.” This rule is unnecessary for the following reasons:

• When a new company is just being set up, there may be a potential for its coordinating its actions
  with those of its founders, but that potential is not yet actual. It is unnecessary to regulate the setting-
up of a new company when the potential for coordinated actions always exists among all businesses, yet AMC prior approval is only required in respect of newly-established businesses.

- When two or more founders cooperate to establish a new company, they are of necessity coordinating their actions. Followed to its logical conclusion, therefore, all creations of new companies with more than a single founder should require AMC prior approval (a conclusion the Contributors obviously do not advocate).
- Ukrainian law sometimes treats the establishment of a new company as an economic concentration issue, sometimes as a coordinated actions issue. Both types of actions are regulated, yet the law is not always clear on which action requires AMC prior approval. The result is that companies, to be thorough, often feel the need to seek AMC prior approval for a single action twice – once for each category.

For the above reasons, the Contributors believe that the act of founding a new company should be removed from the list of regulated coordinated actions.

Article 6.2.8 of the Economic Competition Law defines one impermissible coordinated action as “a substantial limitation of the competitiveness of legal entities on the market without objectively justified reasons therefore”. Yet the terms “substantial limitation” and “justified reasons” are not defined. Once again, this kind of ambiguity leaves a rule open to wide interpretation by the AMC, with the inevitable chilling effect on business actions and the tendency to force businesses to feel a need to seek AMC prior approval for things that really have no effect on competition in the Ukrainian market. These two terms need to be defined.

Another impermissible coordinated action is defined as “fixing prices or other conditions with respect to the purchase or sale of products” (Economic Competition Law, Article 6.2.1). If we consider the example of a company that is owned by one or more other companies, which in their capacity as owners instruct their subsidiary how to price its goods, then this is technically a coordinated action by several companies to fix prices, and thus subject to AMC prior approval. Yet owners of a company routinely must decide how to operate their businesses, including by deciding how to set the prices on the goods they sell. Here again, we see how AMC regulation can overreach and regulate matters that have little effect on competition in the Ukrainian market and that are really everyday business decisions. Again, the language of the law needs to be tightened in order to eliminate the chilling effect it has on the way companies run their day-to-day business.

Yet another impermissible coordinated action is defined as “application of different conditions to equivalent agreements concluded with other legal entities, which results in the creation of a disadvantage for these legal entities in terms of competition” (Economic Competition Law Article 6.2.6). And here, the law is so vague as to theoretically require AMC prior approval for almost any contract that any company enters into. Contracts with different parties, even regarding a single subject matter, routinely contain “different conditions”. Unless this provision can be amended to drastically limit its scope, it should probably be eliminated entirely.

4. Regulation of economic concentrations

As with the AMC regulation of coordinated actions, AMC regulation of certain types of economic concentrations also constitutes an obstacle for normal business operations in Ukraine.

According to Article 22.2.2 C of the Economic Competition Law, one type of economic concentration is the acquiring of control over a business “by means of establishing such a business by two or more than two businesses that will independently perform economic activities for a long period, whereas the mentioned formation does not result in the coordination of competitive behavior between the businesses which established the business or between them and the newly-established business”.

Given the convoluted language, it is probably easiest to illustrate how this rule operates in practice. The antimonopoly law regulates acquisition of control of a company (including by setting up the company) by two or more companies. For example, if a company is set up by several separate and unrelated founders,
no one of which has a controlling interest in the subsidiary. From a formalistic point of view, several
companies will acquire control over the subsidiary, therefore, the transaction must be regulated. The fact
that none of the founders has actual control over the subsidiary, however, is not considered relevant by
Ukrainian antimonopoly law. Let alone the question of whether the subsidiary affects competition on the
Ukrainian market at all. In such a situation, antimonopoly regulation of the transaction would appear to be
unnecessary, and the law should be amended to take this kind of common situation into account.

Article 22.2.2.B of the Economic Competition Law also regulates an economic concentration whereby
control is obtained over a business “by means of appointment or election of a chief or deputy chief of the
supervisory council, the board of directors, or other supervisory or executive body of the business, who
already occupies one or several of the mentioned positions in other businesses or creating a situation when
more than half of the members’ positions on the supervisory board, the board of directors, other supervisory
or executive bodies of two or more than two businesses are occupied by the same persons.”

As a practical matter, companies’ chiefs or the members of its management bodies may well influence
the operation of the company. However, influence is not control, and real control belongs to a company’s
owners. While executives simultaneously serving on the boards or other management bodies of more than
one company is a legitimate issue of corporate governance, it really does not appear relevant to antimonopoly
policy. The Contributors recommend that the appointment of such persons to such posts should at the most
t entail notification to the AMC, and not a requirement to obtain AMC prior approval.

5. Ambiguous terminology

The terminology used in Ukrainian antimonopoly law is often ambiguous and subject to interpretation.
Below, we illustrate several of the most glaring examples in this respect.

Article 23 of the Economic Competition Law defines participants in an economic concentration as:

- businesses in respect to which a merger or acquisition is being or will be carried out;
- businesses that acquire or intend to acquire control over a business entity and business entities with
  respect to which control is being or will be acquired;
- businesses, the assets or equity of which are being or will be acquired or received under management
  (use), rent, lease or concession, and the buyers or other recipients of such assets or equity;
- businesses that are or intend to be founders of (participants in) a newly-created business. A business,
  the assets or equity of which is contributed to the authorized fund of a newly-established business,
  is also considered a participant in a concentration if one of its founders is a member of the Ukrainian
  executive branch, a local self-government body or an administrative or economic management and
  control body;
- legal entities and individuals that control or are controlled by the participants in one of the concentrations
  mentioned above.

Therefore, if, for example, there is a merger between two large holding companies and the merger is
subject to AMC prior approval, all companies directly or indirectly controlled by these two holding companies
would be treated as participants in the merger. Thus, even if the holding companies control hundreds of
subsidiaries, technically, each such subsidiary would be considered a participant in the merger and in-depth
information on each such subsidiary would need to be provided to the AMC.

As impractical as this interpretation of the antimonopoly laws may seem, the Contributors have cited
more than one instance in which the AMC was very reluctant to grant any concessions in this regard,
preferring to require that all information it is technically entitled to, be provided to it.

True, companies that fail to fully inform the AMC of their subsidiaries, or that fail to provide the full amount
of information that the AMC is technically allowed to require, are not always required to provide this
information. However, failure to offer this information to the AMC creates a risk that at some future date,
the AMC may challenge a regulated economic concentration on the basis that it was not provided the information that it should have been provided. After all, the AMC is not bound by precedent, and it lacks effective oversight by any other government agency responsible for ensuring that its decisions are consistent over time. In fact, senior AMC officers are reshuffled on a fairly regular basis. Thus, given the AMC’s freedom to act unbound by precedent, each change in leadership carries with it the potential for the AMC to adopt more liberal, or more conservative, interpretations of the antimonopoly laws.

Returning to the Thresholds discussed above in Paragraph V.C.1.b of this Report, the terms used in the Thresholds are themselves somewhat ambiguous. For example, consider the Threshold element: “at least one participant has assets or turnover in Ukraine exceeding 1 million”. The meaning of “turnover in Ukraine” is not entirely clear. A foreign company involved in a Ukrainian acquisition may not have any physical presence in Ukraine. It may control no Ukrainian company, have no representative office, no warehouse or other assets in Ukraine. It may even not sell its products directly to anyone in Ukraine. Yet what if it has end users of more than 1 million worth of goods annually in Ukraine? For example, if it sells goods to a distributor outside of Ukraine, who resells the goods to Ukrainian importers, who resell the goods to end users in Ukraine? From the wording of the law, it is unclear whether the goods reaching these end users constitute “turnover in Ukraine exceeding 1 million”. And whenever there is a question such as this left unanswered, the result is additional time, expense, paperwork and other business inefficiencies that the business in question must incur. Thus, the wording used in the Thresholds needs to be clarified.

D. High penalties

Considering the above, it is clear that even compliant businesses working in Ukraine are constantly at risk of being accused of violating Ukrainian antimonopoly law. In the worst case, such businesses can be found guilty of the offenses and subjected to harsh penalties. Now, bona fide violations of antimonopoly law, whether through entering into anticompetitive economic concentrations, engaging in unfair trade practices and or coordinating actions to the detriment of competition in the market should all be strictly punished. To be clear, the problem we have identified in the Ukrainian context is concerned not with sanctions being meted out in response to genuine anticompetitive actions, but rather lies in the risk of such sanctions being levied against companies that are truly innocent of anticompetitive actions. We summarize the penalties that can be imposed below.

1. Fines

Ukrainian law prescribes relatively (in light of the generally small market capitalizations of the Ukrainian companies and subsidiaries of foreign companies working in Ukraine) large fines for certain violations. Some of these fines are as follows:

- violations of the Unfair Competition Law (in particular, those indicated in Sections V.B.1 - V.B.4) can result in fines of up to three percent of the business’s revenues from the sale of goods, works and services over the fiscal year preceding the year in which the penalty was imposed (if the AMC has access to information on such revenues), or up to 85,000 Ukrainian Hryvnias (UAH) (approximately €13,240) (if it does not have access to information on the business’ revenues. This dual-fine system applies in the subsequent examples as well);
- effecting an economic concentration without AMC prior approval can result in fines of up to five percent of the business’s revenues from the sale of goods, works and services over the fiscal year preceding the year in which the penalty was imposed, or up to 170,000 UAH (approximately €26,480);
- taking coordinated actions without AMC prior approval can result in fines of up to ten percent of the business’s revenues from the sale of goods, works and services over the fiscal year preceding the year in which the penalty was imposed, or up to 340,000 UAH (approximately €52,960); and
- submitting inadequate or incomplete information to the AMC can result in fines of up to one percent of the business’s revenues from the sale of goods, works and services over the fiscal year preceding the year in which the penalty was imposed, or up to 34,000 UAH (approximately €5450).
2. Administrative and criminal liability


Article 166-4 of the Administrative Code imposes only modest fines (up to 340 UAH or approximately 53) on companies’ officers and on entrepreneurs; but the Criminal Code provides strict penalties for certain types of antimonopoly violations, e.g., imprisonment for up to seven years, or for from seven to 12 years if the guilty party is a repeat offender or if a group of persons conspired to commit the violation.

3. Civil and other liability

Article 24 of the Unfair Competition Law and Article 255 of the Commercial Code grant to any person the right to demand reimbursement for losses and damages caused by antimonopoly law violations.

Moreover, Article 253 of the Commercial Code prescribes that profit that a business obtained as a result of antimonopoly violations can be collected by court order for the State Budget of Ukraine. (The Commercial Code does not elaborate on either who should file a claim for such collection or whether a court order, once issued, is appellable. However, in our experience, when these sorts of legislative gaps exist, a trial court will entertain a claim from any interested party and an appellate court will be willing to hear an appeal of the trial court’s ruling.)

In addition, Ukrainian antimonopoly law also permits other penalties to be imposed for antimonopoly violations. Companies can be forced to split or to reverse the actions that the AMC has found fault with, and can also be forced to obey other binding orders from the AMC.

E. Broad powers of the AMC

While many of the above-mentioned problems may seem hypothetical when read about in a report, these are not just theoretical, “paper” rules. On the contrary, Ukrainian law provides powerful instruments that the AMC can use to enforce its decisions, and little restriction on how the AMC chooses to interpret the antimonopoly laws.

The main law defining the AMC’s powers is the Law of Ukraine “On the Antimonopoly Committee of Ukraine” dated 26 November 1993 (the “AMC Law”). The Unfair Competition Law, the Economic Competition Law, the Commercial Code and many other laws and regulations also affirm and expand on the AMC’s powers.

Among other rights, the AMC, being the supreme regulator of antimonopoly law in Ukraine, has the following important powers:

• to consider applications regarding and cases of possible violations of antimonopoly law (including administrative violations), carry out investigations, adopt binding decisions and provide official interpretations in their regard;
• to inspect businesses and state and local agencies to confirm their compliance with antimonopoly law and to request necessary information from them, including confidential information;
• when permitted by law, to carry out searches of businesses’ premises, seize or carry away items, documents and information media which may be evidence or sources for evidence of violations of antimonopoly law;
• if an AMC officer is resisted in attempting to enforce the AMC’s powers, to call on officers from the internal affairs agencies to overcome such resistance; to require assistance from the internal affairs agencies, customs agencies, other law-enforcement agencies, officers of State and local agencies, enterprises, institutions, organizations and deputies of local councils;
V. Antimonopoly Law

- to order the suspension of commercial operations and request government agencies to cancel licenses in cases of violations of antimonopoly law;
- to render official interpretations of antimonopoly law; and
- to impose fines and other penalties for violations of antimonopoly law.
VI. Miscellaneous: Hidden Charges and Unnecessary Obstacles

A. Executive Summary

Many other Ukrainian laws create unnecessary obstacles to enterprise development and require foreign
and domestic businesses to incur unanticipated costs (hidden charges). These unnecessary obstacles and
hidden charges generally exert a negative influence on the investment climate in Ukraine, creating an impression
that the government is: (i) out of touch, for creating rules that serve little purpose and (ii) rigging the game
against entrepreneurs by hiding the true cost of doing business in the country.

The Contributors to this Report, who represent a wide cross-section of large, medium and small
companies doing business both in Kiev and other regions of Ukraine, uniformly confirm the existence in
practice of the unnecessary obstacles and hidden charges that we have discovered “on paper” within
Ukraine’s laws.

The following problems have been highlighted as particularly troublesome and in need of immediate
attention:

1. The “90 days rule”. Ukraine imposes severe fines and sanctions when a Ukrainian business fails to
receive hard currency proceeds from sales (in case of export contracts), or goods (in case of import
contracts), under its international contracts within 90 days of the due date. Moreover, the fines are
not limited to the amounts that the Ukrainian business in question failed to receive within 90 days,
meaning that the imposition of fines continues indefinitely and can exceed the original unreceived
amount by many times. Creation of a procedure permitting a resident to prove its innocence of capital
flight, lowering and limiting (establishing a cap on) fines for violating the law and comprehensively
clarifying various ambiguities concerning said rule might all be desirable actions.

2. Corruption and over-regulation. The level of corruption in Ukraine remains high. While preparing
a strategy to combat corruption in Ukraine is beyond the scope of the Project and of this Report,
it needs to be mentioned that the problem of corruption in Ukraine damages the overall business
climate and hinders enterprise development. Additionally, Ukrainian law over-regulates certain
types of business activity. For instance, state inspections and reporting requirements to State
agencies are particularly burdensome and in need of substantial simplification. These two
problems unfortunately go hand-in-hand, for the greater the “red tape”, the greater the opportunity
for unethical government functionaries to offer to cut the red tape for a fee. The Roundtable
participants were nearly unanimous in their opinion that these two problems were in the most
urgent need of attention.

3. Financing. Many Ukrainian businesses have problems obtaining financing for their projects through
bank loans and equity flotations. Banks rarely loan money for more than a one-year term. They also
dislike accepting movable property as security for loans, due to a lack of clarity in the rules on
pledging and registering pledges of movable property contained in Ukraine's new Law “On Securing
Creditors’ Claims and Registration of Encumbrances”. The stock market remains poorly developed
and in need of improvement. The Roundtable participants ranked this issue close behind the
difficulties with corruption and over-regulation in importance.

4. Notarization and notary fees. Many actions performed by Ukrainian companies in their day-to-day
business require the involvement of notaries. Sometimes the reason for such involvement is not clear;
often, the fees involved are unreasonably high, with no correlation between the price of notarization
and the amount of work involved in the notarization. Transaction costs in many cases equal 1% of the
value of the transaction described in the document being notarized, and many ordinary, day-to-day transactions, for example, leasing premises for more than one year, require notarization.

5. **Other problems.** The above four examples of hidden charges and unnecessary obstacles are far from the only ones we could name. But a detailed investigation of every such hindrance to enterprise development is beyond the scope of the Project. Nonetheless, we should highlight the following two, particularly troublesome problems: a poor system for adopting laws and problems with taxation. How laws are adopted and how businesses are taxed both exert great influence on business, and improvements in both of these processes would show immediate benefits for the Ukrainian economy.

The above-mentioned aspects related to hidden charges and unnecessary obstacles are discussed below in detail.

**B. The “90 days rule”**

1. **General Description**

   The Law of Ukraine “On the Foreign Currency Payments Procedure” (the “Foreign Currency Law”) is aimed at a practical purpose – curbing capital flight. However, in practice, it imposes unreasonable burdens on Ukrainian enterprises in the event that they are honestly incapable of forcing foreign buyers (or sellers) to pay for their goods (or deliver goods paid for) in a timely fashion. This problem arises out of the “90 days rule” prescribed by the Foreign Currency Law, which basically can be described as follows:

   Hard currency received by Ukrainian residents in payment for their exports must be deposited in the residents' hard currency bank accounts as soon as the sums stated in the relevant sales contracts come due. In any case, such hard currency must be deposited in the bank accounts within 90 calendar days after the date of customs clearance (the issuance of an export cargo customs declaration) of the exported goods.

   When hard currency is received in payment for exported works, services or intellectual property rights, rather than goods, it must be deposited in the bank accounts as soon as the sums stated in the relevant works, service or intellectual property rights contracts come due, but not later than 90 calendar days after the moment of signing a statement certifying the completion of the relevant works, provision of the relevant services or transfer of the relevant intellectual property rights.

   The same “90 days rule” applies also to imports of goods into Ukraine, i.e., after payment has been transferred out of Ukraine, the goods purchased must arrive in Ukraine within 90 days.

   Please also note that between February 1993 and September 1994, the maximum term for the receipt of hard currency payments and delivery of imported goods was not 90, but only 30 days.

   The only time when the “90 days rule” does not apply is when the Ukrainian resident subject to the rule, has obtained an “individual” license from the National Bank of Ukraine (the “NBU”), permitting the 90-day term to be exceeded. To obtain such an individual license, an applicant must first obtain a conclusion from the State Tax Administration of Ukraine (the “Tax Administration”), confirming the advisability of extending the 90-day term for a given foreign economic contract.

2. **Penalties for violation of the “90 days rule”**

   If a Ukrainian resident fails to comply with the “90 days rule”, it can be penalized – first when its non-resident partner fails to pay its debts (or deliver paid-for goods) on time; and a second time when the Tax Administration fines the resident for failure to deposit the sum due, but never paid (or prove of delivery of goods which were not delivered on time), —within 90 days of the due date.

   The Foreign Currency Law makes no provision for exonerating a Ukrainian resident when it is incapable of complying with the law's requirements due to no fault of its own. The law further subjects Ukrainian residents
to the risk of incurring unlimited liability to fines imposed by the Tax Administration, with no chance of showing their innocence of any implied capital flight scheme and no real ability to bring themselves back into compliance with the requirements of the law. This issue is further commented on below.

a. General rules concerning fines

The Foreign Currency Law imposes a draconian fine of 0.3% of any sum, not timely deposited in a resident's hard currency bank account, per day of delay. When non-delivery of imported goods is at issue, the 0.3% fine is levied on the customs value of the undelivered goods (the amount of the fine has varied in the past, rising from 0.3% in 1993; to 1.0% from 1 January 1994 through 5 October 1994; before returning to 0.3% on 1 January 1995, where it remains today).

The Tax Administration is authorized to levy the fine on residents at its own initiative and without first obtaining a court order. However, imposition of a fine can subsequently be challenged in court.

b. No cap on fines that can be imposed

Before May 1996, the fines described above could not exceed the amount of the principal debt. But that cap on the amount of the fines that can be imposed no longer exists.

Moreover, prior to 28 May 1999, if a non-resident buyer failed to pay a sum due to a resident seller, while the resident could be fined regardless of its lack of fault, the fines stopped being assessed on the date when the resident wrote off the unpaid sum as a bad debt. That cap on the amount of the fines that can be imposed, too, no longer exists.

c. Special sanctions

In addition to fines, a Ukrainian resident that violates the “90 days rule” may face other sanctions, termed “special sanctions”. Upon issuance of a court order or a request from the Tax Administration, Customs, law enforcement or the NBU, the Ministry of Economy and European Integration Issues (the “Ministry of Economy”) can subject both residents and non-residents to an individual licensing regime – requiring them to obtain individual licenses for every foreign economic transaction they enter into; absent such a license, neither a resident nor a non-resident would be able to engage in foreign economic transactions involving Ukraine. Alternatively, the Ministry of Economy can suspend either a resident’s or a non-resident’s right to engage in such transactions).

After completely discharging all of its obligations to its counterparty under a foreign economic contract, the party, against which a special sanction has been imposed, can petition the Ministry of Economy to cancel the special sanction.

Before it can grant an application to cancel a sanction, the Ministry of Economy must review “original documents issued by the State bodies which certify that the business has applied practical means to bring its activity into line with the requirements of current Ukrainian legislation”. The Ministry of Economy interprets this requirement broadly. It requires that original documents covering essentially all steps involved in the transaction be presented to it as evidence for its review. As for what it does with the documents, and how it comes to its decisions to grant or reject such applications, this procedure is not at all transparent.

3. Staying the “90 days rule”

A resident may be given a stay (temporary suspension of sanctions) on the 90-day term in two cases:

a. When a court, the International Commercial Arbitration Court (the “International Arbitration”) or the Maritime Arbitration Commission under the Chamber of Commerce and Industry of Ukraine (the
“Maritime Arbitration”), accepts a statement of claim from a resident demanding payment by a non-resident of a debt, which arose because of the non-resident’s failure to comply with the terms stipulated by the export or import contract.

If the court, International Arbitration or Maritime Arbitration accepts said claim, the “clock stops ticking” on the 90-day term pending the resolution of the claim. However, if said institutions reject the claim, refuse to accept the claim in full or in part, terminate legal proceedings on the claim, or decide not to hear the claim, the “clock is re-wound” as if no stay had ever been granted. Thus, any fines imposed on the resident for exceeding the 90-day term become payable as if no claim had ever been made (i.e., fines will be assessed even for the time when the claim was being considered before being rejected, refused, etc).

b. When a force majeure exists, as proven by a reference issued by a chamber of trade and commerce or other authorized organization in the country where the non-resident party to the foreign economic transaction resides, or in a third country if this is provided for in the relevant contract (this exception is quite new; it entered into force on 19 January 2004).

4. Ambiguous provisions of the Foreign Currency Law

There are a number of grey areas pertaining to the application of sanctions under the Foreign Currency Law, such as:

a. Exactly when a court, International Arbitration or Maritime Arbitration “accepts” a claim is unclear.

The Supreme Court has ruled that, for the purposes of the Foreign Currency Law, a claim is deemed accepted when filed with the court. However, this interpretation contradicts the Tax Administration’s interpretation. The latter differentiates “filing” from “acceptance”, and believes a claim has not been “accepted” until a judge has initiated proceedings. There have been no clarifications issued, regarding when a claim is deemed to have been accepted by the Maritime Arbitration. This difference in interpretation is important because the residents must continue to pay the 0.3% per day penalty while the issue of when the temporary suspension of sanctions actually takes effect is debatable.

b. It is unclear whether a resident and a non-resident entity may offset “homogeneous counterclaims” without penalty.

Both Ukraine’s NBU and Supreme Court are of the opinion that fulfillment of obligations under export and import agreements between residents and non-residents by means of offsetting “homogeneous counterclaims” is permissible under Ukrainian foreign currency legislation.

However, this position contradicts the Tax Administration’s interpretation, which is that the payment to the resident must be deposited in the resident’s bank account regardless of any arrangement to offset homogeneous counterclaims. The Tax Administration argues that, because the requirement to deposit hard currency in the bank account is established by public rather than by civil law, it cannot be varied by contract between private parties.

c. Another disputed issue, is which party must bear responsibility for non-receipt or deposit of commission proceeds in its bank account.

The Tax Administration considers that the responsibility stipulated by the Foreign Currency Law for performance of commission contracts is assigned to the party, which exports or imports goods, i.e., a principal. However, the NBU says that the responsibility for infringement of the 90-day term shall be placed on an agent, by citing Article 397 of the pre-1 January 2004 version of the Civil Code, according to which it is an agent who receives rights and obligations under the agreement concluded by the agent with the third party. That version of the Civil Code has lost force. However, both normative acts (of the Tax Administration and the NBU) remain in force and contradict each other.
5. Need to revise the Foreign Currency Law

For the above reasons, the Foreign Currency Law is patently unfair and, in its current version, creates substantial obstacles for enterprise development and operations in Ukraine. Moreover, it can negatively affect both Ukrainian companies and foreign companies working with Ukrainian partners under international contracts.

Therefore, the law should be revised to: (i) prescribe a clear mechanism to permit a resident to prove its innocence of capital flight; (ii) lower and limit (establish a cap on) fines for violating the law and (iii) comprehensively clarify all ambiguities described above.

C. Corruption and over-regulation

Both the Contributors and the Roundtable participants have highlighted numerous obstacles, hidden charges and other practical problems for doing business in Ukraine. However, all of them stressed two crucial inter-related problems as creating the greatest obstacles to enterprise development and operations in Ukraine, to wit:

- a high level of corruption and
- over-regulation.

1. Corruption

While preparing a strategy to combat corruption in Ukraine is beyond the scope of the Project and of this Report, the obstacles that corruption poses to enterprise development and operation in Ukraine must be addressed, if only briefly. It is practically impossible to successfully implement any medium or large business project in Ukraine without first lining up so-called “political support”. Nowadays, a businessman can hardly find any State agency that fairly and fully complies with its obligations and duties prescribed by the law. Almost all such agencies rather go out of their way to throw up obstacles and roadblocks to doing business, so that the agencies can then remove those obstacles for a “fee”. Sometimes the fee is “official”, such as a filing fee for a petition to solve the problem; sometimes the fee is “unofficial”. Another solution can be more all-encompassing – most obstacles can quickly disappear if a business can “come to agreement” with a sufficiently highly-placed government official.

Thus, corruption remains endemic in Ukraine, especially in business. A good example is the purchase or lease of land from local authorities. Contributors described cases occurring in both Kiev and in a regional city, in which businessmen were unable to implement transactions within the timelines that such transactions were to be completed within pursuant to the laws on the books. The only way to achieve success in this respect was to obtain “political support” for their projects.

Petty corruption is also prevalent in Ukraine. A few examples:

- Obtaining a refund of value-added taxes that a business is entitled to is not automatic. It usually requires paying a kickback to a tax officer to facilitate the repayment.
- Foreign companies that need to obtain work permits for their expatriate employees are given a choice of jumping through numerous hoops and waiting a long time for issuance of such permits, or paying “facilitation” fees to obtain accelerated processing of their applications.
- It is widely believed that certain judges in some Ukrainian courts, especially trial-level courts, are prone to outside influence. Many Contributors confirmed this state of affairs orally and “off the record”. Others criticized the courts’ ineffectiveness, inconvenience of use and excessive devotion to formalities.

Whether large-scale or petty, corruption is a serious problem for enterprise development in Ukraine. In addition to the frustration factor it causes for businesses, it is particularly troublesome because the cost of dealing with corruption cannot be predicted.
The Contributors suggest that Ukraine consider the possibility of revising its Criminal Code to make legal entities subject to criminal liability. At present, the fact that only individuals can be held accountable for criminal acts – bribery and other acts of corruption included – makes it more difficult to combat corporate corrupt acts in Ukraine. Instituting this change would also bring Ukrainian legislation closer into line with the concepts embodied in the United States’ Foreign Corrupt Practices Act and the OECD’s Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

2. Over-regulation

Ukrainian law often creates obstacles for enterprise development by minutely regulating certain businesses and/or by making its regulations so complicated that there ultimately becomes no “right” answer to any legal question. Such regulations are not objectively necessary and often serve no legitimate purpose. Their real purposes are to (i) create opportunities to charge official and unofficial fees and (ii) maintain State control over business (at the expense of free markets).

One example of such over-regulation is the system of reporting business activities to State agencies. Ukrainian law requires every business in Ukraine to file numerous reports with State bodies for all sorts of reasons. The reports required by the tax inspectors alone number in the dozens. Businesses must also file separate reports with several “State-funds” (e.g., pension, social security, employment and work safety). Many companies must also file reports with environmental, land, sanitary, waste utilization and other agencies, depending on the business. According to several Contributors, this system complicates the day-to-day operation of every Ukrainian company.

In addition to all of this paperwork, businesses are also subject to inspection by various State agencies, for example, tax agencies, Customs, fire and sanitary safety, ecology, economic crimes, antimonopoly, labor, certification and licensing, intellectual property, land and other agencies. One Roundtable participant pointed out that the average Ukrainian company annually hosts approximate 20 different inspections.

Another Roundtable participant cited Ukraine’s licensing requirements as yet another burden on doing business in the country. This Roundtable participant, a government official, stated that her department has received complaints over this issue from all regions of Ukraine. She did point out, however, that there is a new bill on the permit system in the sphere of commercial activity currently being considered by the Ukrainian Government, which may be able to offer some relief on this score.

Between the filing requirements, inspections and license applications, each Ukrainian business has an enormous amount of regulation to deal with. This eats up the time of the businesses’ management and accountants, distracting them from growing their businesses. It imposes legal and other costs spent both on outside counsel and accountants and their in-house counterparts. And all of this expense is required not so much for the good of the economy, as simply to defend businesses against the government’s bad faith in using the laws’ ambiguities and contradictions, combined with State agencies’ discretion to interpret the laws, to extract fines and other sanctions from businesses.

Almost any changes to simplify the system described above, whether by decreasing the number of reports that must be filed or inspections undergone, or simply reducing their frequency, would show immediate benefits to companies’ bottom lines, and help enterprise development throughout the Ukrainian economy.

One final example of over-regulation needs to be highlighted: the Law of Ukraine “On Financial Services and State Regulation of Financial Services Markets” adopted on 12 July 2001 (the “Financial Services Law”). The Financial Services Law prescribes that financial services can only be rendered by registered financial institutions. The term “financial services” includes financial leasing, money borrowing, and providing suretyships and guarantees. There seems little justification for preventing businesses from engaging in these activities, for example, for the benefit of their subsidiaries or business partners. Yet that is the case today. If an automaker wants to guarantee a single loan to its subsidiary, for example, it must register itself as a financial services company. This is another example of over-regulation that should be abolished.
Another example of over-regulation is NBU Resolution No. 597 “On Remitting National and Foreign Currency for the Benefit of Non-Residents Under Certain Operations” dated 30 December 2003. This Resolution imposes significant burdens on Ukrainian companies’ ability to do business with their foreign partners, obliging Ukrainian companies to present a statement of expert evaluation of prices issued by the State Information and Analytical Center for Monitoring Foreign Commodity Markets for all contracts exceeding 50,000 in value. One Contributor in particular cited this Resolution as posing serious difficulties for her business.

D. Financing

Many Ukrainian companies, especially small and medium companies, experience problems with obtaining financing for their businesses through either bank loans or floatations on the stock market. Several Contributors mentioned this problem.

1. Bank loans

In practice, Ukrainian banks often refuse to provide loans for terms exceeding one year. They view domestic companies as bad credit risks due to the generally unfavorable business environment existing in Ukraine. While the Contributors do not recommend passage of a new law to, for example, compel banks to issue longer term loans, they do suggest that making any of the other legislative improvements discussed in this Report, by improving the business environment generally, should over time have the effect of improving banks’ willingness to provide longer-term loans.

Another problem with financing, is that banks are generally reluctant to accept moveable property as security for a loan. Ukrainian banks were, in the past, willing to grant loans secured by both moveable and immovable property. But with the entry into force of the new Law of Ukraine “On Securing Creditors’ Claims and Registration of Encumbrances” (the “Encumbrances Law”) on 1 January 2004, this situation changed. The Encumbrances Law’s provisions on pledging and registering pledges of movable property are not clear, creating questions about how to perform these actions in practice. Banks have reacted to this lack of clarity by refusing to accept moveable property as security for loans. One Contributor encountered this problem personally. One way to resolve this problem, and to re-open this means of financing to small and medium businesses, is to revise the Encumbrances Law to clarify its rules on pledging movable property.

2. Stock market

A well-regulated and liquid stock market, populated by companies with clear and transparent filings, can be a great boon to a country’s efforts to create a market economy. It enables small investors to put their capital to work for themselves and their country. It enables small entrepreneurs to obtain financing for their businesses. And it generally facilitates the flow of capital to its most efficient uses, benefiting the economy as a whole.

Ukrainian law has several laws and regulations establishing the basis of the Ukrainian stock market, e.g., the Laws “On Securities and the Stock Exchange”, “On State Regulation of the Stock Market in Ukraine” and “On the National Depository System and Specifics of the Electronic Circulation of Securities in Ukraine”. However, these regulations are not actively enforced in Ukraine. Combine that fact with the problems with company law, civil law and commercial law, the lack of a law specifically regulating joint stock companies and other problems with the investment climate and business operations discussed elsewhere in this Report, and the result is that the development and growth of the stock market in Ukraine is impeded.

Thus, in contrast to Russia’s stock market, which has made great regulatory strides and enjoyed enormous gains in capitalization in recent years, the Ukrainian stock market remains essentially moribund. Ukrainian companies rarely avail themselves of the stock market as a source of financing. It thus has little influence on, and accordingly creates few benefits for, the Ukrainian economy.
In order to improve this situation, first of all, it is desirable to improve the investment climate in general, so as to attract investors to Ukraine. But at the same time, work should continue on developing effective stock market regulations, drafting a law on joint stock companies, improving corporate governance rules and practices, etc., to prepare for the day when Ukraine's stock market will become useful as a means of financing enterprise development in Ukraine.

E. Notarization and notary fees

Many actions performed by Ukrainian companies during their day-to-day business require the involvement of notaries. Sometimes the reason for such involvement is not clear; often, the fees involved are unreasonably high.

For example, the fee for mandatory notarization of founding agreements is 1% of a company's authorized fund, which can be a substantial amount of money. And there is no difference between the work performed to notarize a document for a billion euro company and a million euro company. The 1% standard is therefore unreasonable and should be replaced with a flat fee for this service.

Another example of unnecessary hidden charges in this sphere is the mandatory notarization of all building lease contracts (Article 793 of the Civil Code) for terms of one year or more. Notarization seems superfluous in instances when, for instance, one company leases a building to another company, and both companies certify the lease with their corporate seals. In the event that the corporate seal requirement is not abolished (as we have recommended above) the notarization requirement for leasing buildings when both parties are companies should be abolished.

Many Contributors complained about Ukraine's burdensome notarization requirements.

F. Other hidden charges and obstacles

The hidden charges and unnecessary obstacles to enterprise development described above are the most significant to businesses in Ukraine. But the Contributors reported a number of other problems that need to be addressed as well:

1. Taxation

This Report does not focus on issues of taxation, which is a matter requiring its own separate and in-depth review. But we would be remiss in not reporting that nearly every Contributor specifically mentioned that Ukraine's tax system was a primary obstacle to improving the investment climate and enterprise development.

2. System for adopting laws

From the observations made elsewhere in this Report regarding such issues as legislative gaps, internal contradictions within laws and conflicts between laws, it should by now be clear that Ukraine has serious problems with the way it enacts laws. Thus, it is reasonable to conclude that the system for enacting laws in Ukraine needs significant improvement. Laws are enacted on an ad hoc basis for the most part, at the behest of private interests, and with little thought given by the legislators to how well new laws will interact with, or how badly contradict, existing laws. The Contributors confirmed that this situation is high on their list of desired reforms.

Some of these problems, however, could perhaps be avoided at little additional cost in time and work to the government, by improving the manner in which the government solicits the private sector's views on legislation under review. Essentially, the government could to a large extent “outsource” the valuable
function of reviewing laws’ interaction with existing legislation to the parties with the most intimate
knowledge of existing laws and the greatest motivation to ensure that all laws work well and transparently.

The Contributors therefore recommend requiring the government to greatly improve its own review process
to ensure that new laws work well with existing laws, while simultaneously creating a system for soliciting
thorough review of laws in the works by private industry, and ensuring that these views are incorporated
into laws before they are voted on.
ANNEX I

Civil Code

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Subsection 2. Legal Entity
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Book Two – Personal Non-Property Rights of an Individual

Section I. Personal Non-Property Rights Providing for the Natural Existence of an Individual
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Book Three – Right of Ownership and Other Real Rights

Section I. Right of Ownership
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Book Four – Intellectual Property Rights

Book Five – Law of Obligations

Section I. General Provisions Concerning Obligations
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Book Six – Law Of Succession
ANNEX 2

Commercial Code

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Chapter 31. Commercial intermediary activities (agency relations) in the sphere of economic activity
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Section VII. Foreign-Economic Activity

Chapter 37. General provisions
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Section VIII. Special Regimes of Economic Activity

Chapter 39. Special (free) economic zones
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Section IX. Final Provisions