



# 3rd Meeting of the Eurasian Corporate Governance Roundtable

President Hotel "Kyivsky"  
Kyiv, Ukraine  
17-18 April 2002



## *SHAREHOLDER RIGHTS, EQUITABLE TREATMENT AND THE ROLE OF THE STATE*

*Shareholder rights in Ukraine*

**By**

**Mr. Oleg Batyuk  
Managing Partner  
Salans Hertzfeld & Heilbronn**

hosted by  
**Securities and Stock Market State Commission of Ukraine  
State Property Fund of Ukraine  
PFTS**

with the support of  
**The Government of Japan**



**The Global  
Corporate  
Governance  
Forum**

### *Corporate ownership structures*

Corporate governance is a relatively new concept in Ukraine. Before 1991, Ukrainian corporate law had been based primarily on a Soviet legal and economic doctrine that the state, as represented by various governmental organizations and authorities, acted as the owner of the majority of large- and medium-sized enterprises and companies in Ukraine. An exception applied to small private companies and “cooperatives” that could be founded by private parties.

The year 1991, in which Ukraine declared its independence, saw new developments in the area of corporate law in Ukraine. They were precipitated by the country’s feeble attempts to build a market economy, and to develop a corporate framework which would help companies and enterprises to restructure their methods of doing business that were originally based on Soviet-style, administratively commanded economic principles. On 7 July 1992, the Ukrainian Parliament adopted Law No. 2544-XII, amending Law No. 697-XII, “On Ownership in Ukraine”, dated 7 February 1991, whereby private ownership was recognized and permitted along with state and other forms of ownership. Private parties – legal entities and individuals – became entitled to own property and property interests, including shares (participation interests) in companies. Also, in 1991, the Parliament enacted three major corporate laws and a securities law that laid down the basics of the corporate governance framework in Ukraine, namely:

- Law of Ukraine “On Enterprises in Ukraine” of March 27, 1991, No. 887-XII;
- Law of Ukraine “On Entrepreneurship” of 7 February 1991, No. 698-XII;
- Law of Ukraine “On Business Companies” of September 19, 1991, No. 1576-XII;
- Law of Ukraine “On Securities and Stock Exchange” of June 18, 1991, No. 1201-XII;

While containing broad pronouncements, general principles and numerous ambiguities, and lacking in efficient enforcement mechanisms, these Laws reflected Ukraine’s willingness to develop an effective system of corporate governance, and were aimed to fill gaps existing in the area of corporate and securities regulation, and to bring order to the fast developing corporate sector in Ukraine.

The Law of Ukraine “On Business Companies”, as amended (the “Company Law”), is the fundamental corporate statute governing matters of foundation, establishment and liquidation of companies in Ukraine, and listing basic rights and obligations of shareholders. A detailed list of laws and regulations is provided in the annex hereto.

Under the Company Law, companies in Ukraine may be incorporated in the following forms:

1. joint stock companies;
2. limited liability companies;
3. additional liability companies;
4. full liability companies (general partnerships); and
5. differentiated liability companies (limited partnerships).

The two most widely used corporate forms in Ukraine are joint stock companies and limited liability companies. The other forms are rarely used.

Pursuant to the Company Law, a joint stock company is a company whose charter capital is divided into a certain number of shares with an equal nominal value. Such a company is liable for its

obligations only to the extent of its assets. Shareholders are liable for the obligations of the company only to the extent of their respective shareholdings. Joint stock companies may be of the open type, i.e., publicly listed, and of the closed type – with their shares being distributed among founders thereof. Joint stock companies are subject to fairly detailed securities and corporate regulations.

A limited liability company is a company whose charter capital is formed with contributions of founders thereof. Founders of the limited liability company are liable for the obligations of the company to the extent of their respective contributions. Limited liabilities companies and other forms of companies<sup>1</sup> are basically private companies that do not issue shares. Rather, participation interests in such companies are distributed among their members, and are not regarded as securities on the stock market.

This Report focuses on open joint stock companies.

### *Profiles of Shareholders*

Enterprises, institutions, organizations, and private individuals in Ukraine (including foreign nationals, stateless persons, foreign legal entities and international organizations, unless otherwise provided by Ukrainian law), may be shareholders, founders and/or participants of Ukrainian companies. The state as represented by its specialized body, the State Property Fund, may be a founder/holder of shares in companies. Ukrainian law envisages a number of provisions applicable to certain individuals and legal entities, restricting their rights to be founders/owners of companies in Ukraine. As a general matter, underage persons and government officials may not be founders of companies, and their rights to own shares are subject to restrictions. Special Ukrainian legislation restricts rights of state-owned enterprises to found and/or participate in companies.

Shares of joint stock companies in Ukraine may be acquired:

1. directly from issuers (i.e., joint stock companies) of shares;
2. on the secondary market;
3. from private parties on a civil law contractual basis; and
4. at auctions and tenders held in the course of privatization.

#### 1- Protection of shareholder rights:

Understandably, effective mechanisms for the protection of shareholders' rights are an indispensable and crucial factor to build up shareholder confidence and secure the ability of joint stock companies to raise capital. As part of measures to further develop its securities market and corporate sector, Ukraine has undertaken legislative and regulatory efforts to ensure adequate safeguards and

---

<sup>1</sup> The three other forms of companies are as follows:

- 1) an additional liability company is an entity whose charter capital is formed with contributions of founders thereof. Founders of such partnership are held liable for the obligations of the partnership to the extent of their contributions and, if such contributions do not suffice, with their personal property in proportion to their holdings in the charter capital. The limits of liability of founders are laid down in the constituent documents.
- 2) a full liability company (general partnership) is a company whose founders do business jointly, and are held jointly liable for the obligations of the company with all their property.
- 3) a differentiated liability company (limited partnership) is a company in which one or more founders do business on behalf of the company, and are liable for the obligations of the company with all of their property, whereas the liability of other founders is limited to their respective contributions to the company's charter capital.

protections of shareholder rights, especially in light of the fact that the vast majority of shareholders in Ukraine lack sophistication and professional advisory support, and can easily be defrauded and abused in transactions involving securities.

Ukraine has enacted a number of laws and regulations establishing a corporate governance framework, which constantly develops to accommodate needs presented by modern Ukrainian corporate practices. Notably, joint stock companies are capable of reinforcing their “internal” corporate governance structure with additional safeguards for shareholders’ rights that may be embodied in their constituent documents and by-laws. As a practical matter, companies who by law are granted a fair amount of discretion in structuring their corporate governance policies face a risk that some safeguards contained therein may be challenged on the ground that they are not adequately supported by, or are inconsistent with, applicable corporate law in Ukraine.

Generally, remedies available to shareholders seeking redress may be divided into three groups: corporate, administrative and judicial:

Corporate remedies: shareholders may seek protection of their rights at general shareholders’ meetings, and/or by applying to the company board (supervisory board). Usually, constituent documents and by-laws of companies specify procedures that are to be followed by shareholders that want to use corporate remedies.

Administrative remedies: shareholders may resort to government authorities to vindicate their shareholder rights. Such government authorities include:

- the State Commission on Securities and Stock Market (“Securities Commission”) and its regional offices<sup>2</sup>;
- law enforcement agencies, including prosecutors’ offices<sup>3</sup> in Ukraine, in the event of criminal offenses involving companies and securities.

These authorities are discussed in greater detail below.

Judicial remedies: shareholders may bring action in civil court or commercial court to obtain redress for violations of their rights pursuant to civil and criminal procedural laws. Ukrainian law does not contain any special rules or procedures applicable specifically to shareholder suits.

#### *a) Ownership rights*

Pursuant to Ukrainian law, owners of shares in open joint stock companies may freely sell, transfer, pledge, assign, bequeath, or otherwise dispose of any and all of their shares, for the benefit of any persons or entities, and for any price, subject to certain limitations as prescribed by Ukrainian law<sup>4</sup>. To accomplish the above, a shareholder generally does not need any consent or approval from the concerned joint stock company and/or other shareholders.

---

<sup>2</sup> See, Articles 7, 8, 11, 12, 13, 14 of Law of Ukraine No. 448/96-VR, “On the State Regulation of the Securities Market in Ukraine”, dated October 30, 1996.

<sup>3</sup> See, generally, Law of Ukraine No.1789-XII, “On the Prosecutor’s Office”, dated November 5, 1991; *also see*, Articles 202, 223, 224, 256 of the Ukrainian Criminal Code, 5 April 2001, No. 2341-II.

<sup>4</sup> For instance, persons acquiring shareholdings in a company exceeding 25%, 50% of the company’s charter fund must prior obtain approval for the transaction from the Antimonopoly Committee of Ukraine, if certain thresholds are met.

It should be noted that in Ukraine securities, including shares, may be of two types: registered and bearer, and circulate in two forms: “documentary” (in the form of paper share certificates), and “non-documentary” (in the form of electronic entries at custodian securities accounts). Different procedures for ownership registration and transfers of shares apply to different types and forms of securities.

Thus, registered securities, issued in documentary form (unless conditions of the issuance thereof expressly provide that they may not be transferred), are transferred to a new owner by virtue of full endorsement. If registered shares being disposed of are immobilized<sup>5</sup>, the title thereto transfers to a new owner as from the moment such securities are recorded on such owner’s custodian securities account. Shareholder rights, e.g., rights to participate in corporate governance, receive profits etc., arising in connection with registered securities, may be exercised as of the date on which relevant changes are made in an applicable share registry.

Title to bearer securities, issued in documentary form, is transferred to a new owner as of the moment of transfer (delivery) of securities. If bearer securities being disposed of are immobilized, the title thereto transfers to a new owner as from the moment such securities are recorded on such owner’s custodian securities account.

Title to securities, issued in non-documentary form, is transferred to a new owner as of the moment such securities are recorded on such owner’s custodian securities account.

Title to securities in documentary form is evidenced by certificates and, if securities are immobilized or issued in non-documentary form, title to securities is evidenced by extracts from securities accounts, which extracts must be provided to owners by the custodians. Notably, an extract from a securities account may not be the subject matter of transactions involving the transfer of title to securities.

Finally, agreements involving securities, including shares, are not subject to compulsory notarial attestation, unless otherwise provided by law or agreement of the parties.

As noted above, shareholder rights arising in connection with registered securities vest in a shareholder as of the date on which the applicable share registry is changed, i.e., information on that shareholder is entered in the registry.

Share registries maintained by registrars are important corporate instruments, wherein information on identities of shareholders, amounts of their shareholdings, nominal value, and share categories is kept.<sup>6</sup> Basically, a share registry (or shareholder registry) is a list of shareholders (owners of registered securities) and nominal holders of shares<sup>7</sup> compiled as of a certain date.

#### *b) Dividends*

Applicable Ukrainian law vests in shareholders the right to participate in the distribution of company profits, and to receive dividends. Also, it mandates that the constituent documents of a joint stock company, specifically its charter, establish, *inter alia*, basic profit distribution procedures.

---

<sup>5</sup> “Immobilized securities” mean securities that are maintained as electronic entries at the depository system.

<sup>6</sup> For further detail on share registry maintenance, See, the Regulation on Share Registry Maintenance Procedures, as approved by Decision No. 60 of the Securities Commission, dated 26 May 1998.

<sup>7</sup> Under Ukrainian law, a nominal holder of securities means a depository or a securities custodian who is registered in the share registry as a legal entity, and to whom securities are transferred as proxy, and who acts in the interests of the owner of the securities for the accomplishment of transactions in the National Depository System in Ukraine.

Pursuant to the Company Law, approval of profit distribution procedures and terms and procedures for the distribution of a portion of profits (dividends), lies within the *exclusive* competence of general shareholders' meetings, and may not be delegated to any other governing bodies of the company. In general, only a certain portion of the company's profits is distributed to its shareholders as dividends, whereas the remaining profits are used for other purposes, including, but not limited to, modernization of production facilities, investments, real property acquisitions, funding of the company's development, social and other programs etc.

Ukrainian law contains no express requirement obligating a joint stock company to annually declare and distribute dividends, nor does it contemplate any limitations on dividend amounts due and payable by a company to its shareholders on the basis of annual operating results. Legislative provision is, however, made that dividends due and payable on outstanding preferred shares ought to be paid in the amount as specified in such shares, irrespective of the amount of a company's profits for the year concerned. Should such profits not suffice, dividends on preferred shares are paid out from the company's reserve fund.<sup>8</sup>

Individuals and legal entities that are registered as shareholders as of the date on which the distribution of dividends commences are entitled to receive dividends. Paid out dividends are subject to taxation as provided by the Law of Ukraine "On the Company Income Tax", dated 28 December 1994, No. 334/94-VR<sup>9</sup> (the "Company Tax Law"). Notably, the Company Tax Law differentiates between dividends paid out to Ukrainian residents and those paid out to foreign residents. Ukrainian residents may be paid out dividends by a company, irrespective of whether the operations of such company were profitable for the covered period, should the company have other sources to distribute dividends. However, it is expressly provided that this provision does not apply to foreign residents receiving dividends from Ukrainian companies, i.e., dividends are paid out to foreign residents only if a company has posted profits for a particular year.

Dividends payable to Ukrainian residents are subject to a tax of 30% withheld at the time of actual payment of dividends. This 30% withholding tax does not apply if dividends are distributed in the form of shares (participation interests), issued by a dividend-paying company, on condition that amounts of shareholdings (participation interests) held by owners in the company are not in any way changed as a result of such distribution, or in the event that dividends are paid to registered investment funds or non-residents. Dividends payable to non-residents are taxed at the rate of 15%, unless otherwise provided by effective double taxation treaties.

*c) Participation in major corporate changes*

Under Ukrainian law, shareholders of joint stock companies have the following rights:

1) to participate in the management of a company's affairs in accordance with procedures specified in its constituent and internal documents. Primarily, this shareholder right is exercised through participation in general shareholders' meetings (the "GS Meetings"), which right consists of:

- a right to be notified in due course of the time and date of the GS Meeting;
- a right to make proposals for the agenda of the GS Meeting;
- a right to review documents relating to the agenda of the GS Meeting prior to the date of the GS Meeting;

---

<sup>8</sup> See, Article 4 of the Law on Securities and the Stock Exchange.

<sup>9</sup> As restated by Law of Ukraine No. 283/97-VR, dated 22 May 1997.

- a right to vote at GS Meetings;
  - a right to elect members, or to be elected as member, of the company's governing bodies (the management board, the supervisory board, and the audit committee);
  - a right to delegate the authority to attend and vote at GS Meetings to another person;
  - a right to review minutes of GS Meetings, company documents, records etc.
- 2) to participate in the distribution of the company's profits, and to receive dividends;
  - 3) a right of first refusal (pre-emptive right) to buy shares additionally issued by the company;
  - 4) to sell any or all of their shares to any person or entity, for any price, without the consent of the company or other shareholders;
  - 5) to withdraw from the company in the established manner (through disposal of all the shares, their redemption by the company);
  - 6) to obtain information about the company's activity (information pertaining to annual balances, reports on the company's operations, minutes of GS Meetings etc.); and
  - 7) to obtain a portion of the company's assets in the event of liquidation thereof.

Also, Ukrainian law allows a considerable degree of discretion with respect to matters of corporate governance to shareholders, who may prescribe required corporate procedures and determine other rights in the constituent documents, by-laws, and other corporate documentation of the company.

Shareholders exercise their decision-making powers at GS Meetings. The GS Meeting is the highest governing body of a joint stock company, and is authorized to deliberate and decide on any matters relating to or involving the company. Ukrainian legislation reserves to the GS Meeting the following specific powers:

- 1) determination of the main directions of operations of the company, approval of its plans and reports on their fulfillment;
- 2) amendments to the charter of the company;
- 3) election and removal of members of the supervisory board;
- 4) election and removal of members of the executive body (management), and the audit committee;
- 5) approval of annual results of the company's activity, approval of reports and conclusions of the audit committee, approval of profit distribution and loss coverage procedures;
- 6) establishment, reorganization and liquidation of subsidiaries, branches and representative offices, and approval of their charters and by-laws;
- 7) decisions regarding pursuant of financial claims against officers and other employees of the company;
- 8) approval of rules of procedure and other internal regulations of the company, determination of structural organization of the company;
- 9) decisions for the company to redeem its outstanding shares;
- 10) determination of terms and conditions for remuneration of officers of the company, its subsidiaries, branches and representative offices;
- 11) approval of agreements (transactions) for the value exceeding amounts set out in the charter of the company;
- 12) termination of the company's activities, appointment of the liquidation commission, and approval of the liquidation balance sheet; and
- 13) appointment of a share registrar.

Please note that authorities listed in Items 2, 5, 6, 12, and 13 belong to the *exclusive competence* of the GS Meeting, and may not be delegated to the company's other governing bodies. The charter of the company may provide for other matters referred to the competence of the GS Meeting.

The Company Law provides that the following fundamental corporate changes affecting the company as a whole shall require a qualified majority of 75% of shareholders participating in a duly convened GS Meeting:

- a) to amend the charter of the company;
- b) to terminate activities of the company;
- c) to establish and terminate subsidiaries, branches and representative offices of the company.

Other decisions are taken by simple majority vote of shareholders participating in a meeting, in the presence of a quorum. A quorum is established by the presence in person or by proxy of more than 60% of shares entitled to vote.

Also, shareholders participate indirectly in corporate decision-making through a supervisory board which represents the shareholders' interests as a whole. By law, the supervisory board must be established, and its members elected by the GS Meeting, if the company has more than 50 shareholders.

#### *d) Shareholder meetings and access to information*

As noted above, shareholders exercise their decision-making powers at GS Meetings. Therefore, the basic shareholder rights include the rights to effectively attend and vote at GS Meetings. The Company Law provides for the "one share/one vote" principle, and such principle applies to all GS Meetings. Any shareholder may file with the company's management its proposals for inclusion in the agenda of a GS Meeting not later than 30 days prior to the date of such Meeting. Notably, proposals filed by shareholders holding in the aggregate more than 10% of shares must be included in the agenda.

Unless otherwise provided by the charter of a joint stock company, a GS Meeting should be convened at least once per year. Extraordinary GS Meetings may be convened in the event of insolvency of the company, circumstances enumerated in the company's charter, or in any other case if the interests of the company as a whole so require. Shareholders holding in the aggregate more than 10% of shares have the right to convene extraordinary GS Meetings at any time and for any reason.

All individuals and legal entities holding shares in a joint stock company as of the date of a GS Meeting, and registered in the company's share registry, may attend and vote at such Meeting in person or by proxy. A shareholder may issue a power of attorney, designating any person as his proxy to attend and vote at the GS Meeting. A proxy may be appointed for a permanent or temporary term, and the designating shareholder may at any time change or recall such proxy by providing notice thereof to the company's management. Ukrainian law does not require that a proxy be a shareholder.

Shareholders or their proxies who arrive to participate in a GS Meeting are registered prior to the GS Meeting. Holders of registered shares are registered in accordance with the share registry. Holders of shares in bearer form are registered upon production of share certificates or extracts from securities accounts. A GS Meeting is deemed legitimate if attended by shareholders (their proxies) holding more than sixty percent (i.e., 60%+1) of the shares pursuant to the charter.

The basic shareholder rights also include a right to obtain information about operations of the company. Pursuant to this right, a shareholder may demand that such shareholder or his proxy (representative) be granted access to, and be provided with, information and documentation relating to annual balance sheets, company operation reports, minutes of GS Meetings etc.

## 2- Equitable treatment of shareholders:

From the very outset it should be noted that Ukrainian legal doctrine, being based on civil law concepts, does not support equitable treatment or equitable remedies as they are understood and applied in the common law system. As a general matter, shareholders who believe that their rights have been violated in any manner may seek legal remedies in court. However, applicable Ukrainian law does not contemplate any causes of action by shareholders against the company or other shareholders on grounds that decisions adopted by the company's GS Meeting or supervisory board, although in conformity with formal legal requirements, are inequitable. As a general matter, Ukrainian law does contain an 'equity' principle applicable to judicial proceedings, pursuant to which courts must treat litigating parties equitably.

*a) Treatment of minority shareholders*

With the exception of the rights of shareholders holding in the aggregate 10% or more of the company's shares to:

- (1) convene extraordinary GS Meetings at any time and for any reason,
- (2) have their proposals obligatorily included in the GS Meeting's agenda, and
- (3) request the audit committee to audit company operations,

Ukrainian law does not provide any other substantial protections and remedies for minority shareholders as compared with majority shareholders. Therefore, minority shareholders are fairly unprotected vis-à-vis majority shareholders in terms of their ability to object to, challenge or block validly adopted decisions on a variety of matters. Please note that special safeguards are granted to shareholders (although not necessarily minority shareholders), in the event of corporate reorganization of a joint stock company and disposal of its assets. Thus, the Procedure of Registration of Share Issuance in the Course of Reorganization of Companies, as approved by Decision No. 221 of the Securities Commission, dated 30 December 1998, provides that in order to protect shareholder rights, a joint stock company that has adopted a decision to reorganize must value and redeem shares of shareholders upon demand, in the event that such shareholders did not vote in favor of the reorganization decision at the GS Meeting, and filed written statements with the company. Shares are redeemed at the price agreed by the parties, but not less than the nominal value of the shares.

*b) Treatment of foreign shareholders*

Foreign shareholders are vested with the same rights and bear the same obligations as their Ukrainian counterparts. Ukrainian law does not contain any restrictions or limitations on rights of foreign shareholders of Ukrainian companies. In addition to the general shareholder and other rights, foreign investors enjoy special safeguards provided by Ukrainian foreign investment laws. Shareholdings acquired by foreign nationals and foreign entities in Ukrainian joint stock companies are regarded under Ukrainian law as foreign investments and, if registered as such, are subject to foreign investment protections<sup>10</sup>. It should be noted that Ukrainian law provides for limitations on the rights of foreign shareholders to own shareholdings in certain companies in Ukraine, such as TV and radio broadcasting companies, in excess of the legislatively prescribed amounts.

*c) The state as a shareholder*

---

<sup>10</sup> E.g., foreign investors in Ukraine enjoy national treatment, guarantees against changes in laws, guarantees against expropriation and unlawful actions of government authorities and officials, the right to compensation and reimbursement of losses incurred, guarantees in the event of termination of investment activities, guarantees of remittance of revenues, profits and other amounts obtained in connection with foreign investments. For further detail, *see*, the Law of Ukraine "On the Regime of Foreign Investments", dated 19 March 1996, No. 93/96-VR.

The State as a shareholder enjoys the same rights and bears the same obligations as any other shareholders. The State as a shareholder is represented by its specially designated agency, the State Property Fund of Ukraine. This government agency and its territorial divisions are responsible, *inter alia*, for management of state-owned shares in privatized companies, representation of the State's interests in privatized companies, and for privatization and corporatization of state-owned enterprises.

### *3- Violation and abuse of shareholder rights:*

Ukrainian corporate laws and practices are only in the stage of development, and legislative and regulatory efforts are constantly undertaken to fill in gaps in Ukrainian law permitting violations of shareholder rights. Most frequent violations of shareholder rights are concerned with violations of GS Meeting procedures, rights to company-related information and dividends, abuse by company officers, illegal disposal of assets, and failure to pay out dividends.

#### **Violations of GS Meeting Procedures**

##### *Failure to provide adequate notice of a GS Meeting to shareholders*

This violation occurs frequently in Ukrainian corporate practice. Ukrainian law contains a requirement that a joint stock company must provide notice of a GS Meeting personally to the owners of registered shares, and publish a GS Meeting notice, with an agenda thereof, in an official newspaper, no later than 45 days prior to the GS Meeting. It should be noted that very often such violations are committed by joint stock companies that have been established as a result of privatization, with their shares having been distributed among a large number of individual shareholders whose numbers total from several hundreds to several thousands. Usually, these companies have huge operating debts and balance on the verge of bankruptcy. As a consequence, they cannot afford mailing and other expenses relating to notices of GS Meetings, and knowingly breach the "notice" requirement.

##### *Failure to provide an agenda and documents relating to a GS Meeting to shareholders*

By law, a company is required to provide to its shareholders an agenda and documents related thereto prior to the GS Meeting. This requirement is oftentimes violated; however, the law does not provide aggrieved shareholders with adequate remedies and, as a practical matter, they stand little, if any, chance in court or otherwise to secure the invalidation of decisions adopted by a duly convened GS Meeting on grounds of failure to provide adequate notice of the Meeting's agenda.

##### *Failure to provide notice of changes in the agenda of a GS Meeting to shareholders*

Not infrequently it happens that the agenda of a GS Meeting is changed after the 45-day notice and newspaper publications have been given. In such case, a company is required to provide all shareholders with notice of the change as specified in its charter not later than 10 days prior to the GS Meeting. This requirement occasionally is breached by companies.

##### *Ungrounded denial of registration to shareholders or their proxies who have arrived at a GS Meeting*

As a general requirement, shareholders or their proxies who have arrived to attend a GS Meeting must be registered on the day of the Meeting by the company's management or an independent registrar pursuant to the share registry (for owners of registered shares), or pursuant to presented share certificates

and extracts from securities accounts (for holders of bearer shares). This requirement may be manipulated by the management or an interested party to deny registration to certain shareholders (proxies), in order to tamper with the results of voting. Theoretically, an affected shareholder (proxy) may challenge the denial of registration as ungrounded, and seek invalidation of the GS Meeting's decisions in court. However, Ukrainian law does not contemplate any remedies for an aggrieved shareholder to seek temporary relief and/or request the court to enjoin the holding of the GS Meeting until the shareholder's claim has been adjudicated. After the GS Meeting, the shareholder's chances of succeeding in *de facto* challenging the adopted decisions are insignificant, if there was a quorum (60% + 1) at the GS Meeting.

## **Rights to Company-Related Information and Dividends**

### *Denial of access to Company information and records to shareholders*

By law, companies are required to provide information and copies of company documents and records to shareholders upon their request. For numerous reasons, such as unwillingness to reveal allegedly confidential or sensitive information, or attempts to conceal information that would disclose abuses by company officers etc., shareholders are denied the requested information, documents and records. Interested shareholders may apply to the company's supervisory board or bring action in court to vindicate their right of access to and review of the company's information and records.

### *Violation of rights of shareholders to dividends*

Pursuant to Ukrainian law, dividends are distributed by a joint stock company once per year following the decision of, and the approval of the audit committee's report by, the GS Meeting. The complexity of corporate finances and drawbacks of corporate accounting, audit and financial reporting systems ensure plenty of opportunities for manipulation of the company's finances so that a portion of profits that could be potentially paid out as dividends to shareholders is directed to other uses, e.g., to cover losses (not infrequently artificially caused by management), pay off debts to entities related to management, etc.

### *Abuse by Company Officers*

Insufficient shareholder control and organization, as well as lack of financial and corporate sophistication by a large number of shareholders create a fertile soil for abuse by company officers. Ukrainian law sets forth only general requirements for company officers who are obligated to protect interests of the company and its shareholders, and to observe the requirements of law. No express provision is legislatively mandated imposing some sort of a care/prudence duty or a loyalty duty on company officers. Consequently, company officers, who formally comply with the law, and are not bound by any standard of care/prudence, loyalty or similar duty, may engage in various "conflict of interest" practices.

#### *a) Asset stripping and self dealing, related party transactions, insider trading and share dilution*

All these practices are not directly forbidden by Ukrainian law, and shareholders practically have no cause of action against deals involving any of asset stripping, self dealing, related party transactions, insider trading and share dilution practices, on condition that formally such deals are in conformity with the law and appear to be "arm's length" deals.

### *Wrongful Disposition of Assets*

Disposition of assets by companies in breach of shareholder rights are a common violation in Ukraine. Although the Company Law effectively provides that charters of joint stock companies may set forth thresholds on the value of agreements and asset disposition transactions which, when exceeded, require shareholder approval, this safeguard is frequently bypassed or omitted. For instance, the value of assets may be understated or diminished through the use of various accounting methods and practices, or written off the company's books etc. In addition, a company's assets may be transferred into 'free use' (e.g., to related parties), leased for token consideration, donated, exchanged, pledged etc. In such cases, deals are structured in such a way as to appear "arm's-length", do not exceed the prescribed maximum thresholds applicable to the value of agreements (transactions), and consequently they do not trigger the 'shareholder approval' requirement. Shareholders have rather limited means at their disposal to challenge such deals involving the ambiguous disposition of assets, as in most cases the deals are prepared and closed in strict compliance with law and, as a practical matter, shareholders have little, if any, chance to discover or obtain from the company any evidence to prove any wrongdoing.

### *Violations of Securities Law*

Ukrainian securities law sets forth a large number of requirements that should be observed by issuers – companies that issue and publicly offer their shares. These requirements in the first instance deal with the form of shares, registration of information on shares and share issuances with the Securities Commission, registration of title to shares, maintenance of share registries, reporting requirements, reorganization procedures etc. The Securities Commission and its territorial divisions are vested with supervision and control of issuers' compliance with the requirements of securities laws.

#### 4- Enforcement and legal redress:

In Ukraine, any person or entity whose rights have been violated has a number of remedies to seek to vindicate its rights. Pursuant to Article 6 of the Ukrainian Civil Code, rights are protected under the prescribed procedures by courts, commercial courts or arbitration tribunals by virtue of:

- recognition of rights of the affected party;
- reinstatement of the affected party to the position such party would have held had its right not been violated, and suppression of actions violating the right;
- in-kind (specific) performance of the obligation;
- compensation of moral damages;
- termination (rescission) or change of a transaction;
- award of damages and, as and when provided by law or contract, of liquidated damages (penalties, fines), and as otherwise may be provided by law.

All these remedies are available to aggrieved shareholders. As a practical matter, however, not all such remedies are effective in particular situations, given the specifics of shareholder rights. Set forth below is a list of remedies as well as the most typical situations in which they are used:

1) recognition of rights of an affected shareholder – violations of shareholders' pre-emptive rights to purchase additionally issued shares, rights of access to information and records, rights to dividends etc.;

2) reinstatement of the affected party to the position such party would have held had its right not been violated, and suppression of actions violating the right –contracts (agreements), abuses by company officers etc, reimbursement of losses suffered by companies etc.

3) in-kind (specific) performance of the obligation – enforcement of shareholders’ pre-emptive rights to purchase additionally issued shares, rights of access to information and records, rights to dividends, contracts and agreements;

4) compensation of moral damages – this remedy is used in all sorts of actions brought by shareholders, who wish, in addition to damages relating to “property” interests at stake, to obtain compensation of moral damages suffered as a result of the violation;

5) termination (rescission) of transactions – termination (rescission) of transactions (agreements, contracts), affecting the shareholder and other rights, (e.g., a shareholder may file suit to terminate (rescind) an asset sale agreement for a value requiring prior shareholder approval). It should be noted that this remedy may be ineffective in situations when assets are sold to bona fide buyers;

6) award of damages and, as and when provided by law or contract, of liquidated damages (penalties, fines), and as otherwise may be provided by law – various violations of shareholder and other rights.

Shareholders seeking redress may appeal to the following authorities:

1. The Securities Commission and its regional offices;
2. Law enforcement agencies, including prosecutors’ offices, if criminal charges are brought against company officers and employees;
3. Civil courts and commercial courts.

The Securities Commission and its regional offices are vested with broad regulatory and enforcement authorities in the securities area, including among others :

- ◆ Control and supervision of compliance with securities laws and regulations;
- ◆ Suspension and/or termination of special licenses (permits), issued by the Securities Commission to securities traders and issuers (i.e., joint stock companies);
- ◆ Action in case of issuance or circulation of shares in violation of securities law;
- ◆ Control over the securities market;
- ◆ Audits and inspections of issuers (i.e., joint stock companies), securities traders, securities exchanges and self-regulatory organizations;
- ◆ Furnishing of information and records to law enforcement agencies with respect of facts of offenses punishable by criminal and administrative sanctions;
- ◆ Furnishing of information and records to the Antimonopoly Committee in the event of uncovering of antimonopoly law violations;
- ◆ Imposition of administrative fines, penalties and other sanctions for violation of applicable law on securities traders, up to cancellation of licenses.

Shareholders may appeal to the Securities Commission and its regional offices, in order to bring to light violations of securities laws committed by joint stock companies, securities traders and other entities. However, the Securities Commission does not have authority to adjudicate cases involving complaints filed by individual shareholders, which is the prerogative of courts.

Law enforcement agencies, including prosecutors' offices, are vested with authorities to investigate and prosecute criminal cases involving violations of securities laws. The authorities of the law enforcement agencies and prosecutors' offices are regulated in detail by criminal law statutes in Ukraine.

Finally, aggrieved shareholders may file actions in civil courts and/or commercial courts. The remedies available to shareholders have been described above. Ukrainian courts have broad judicial powers, including, *inter alia*, powers to summon parties and witnesses, and examine and cross-examine witnesses, demand and review evidence, render decrees, orders and judgments, review cases on appeal etc.

Ukrainian law does not envisage any arbitration procedures to resolve disputes arising between shareholders and their companies. However, shareholders entering into various shareholder agreements, as well as founders of joint stock companies entering into founders' agreements may include arbitration clauses therein, and agree to submit their disputes arising out of or in connection with such agreements to arbitration, including international tribunals.

#### *a) Regulatory enforcement*

Decisions of the Securities Commission and its territorial divisions are binding on all operators on the securities market, including joint stock companies, and are enforced by the Securities Commission and its territorial divisions. If a violator does not comply with orders and decisions of the Securities Commission or its territorial divisions, they may impose penalties as prescribed by applicable law, report violations to law enforcement agencies, and bring an enforcement action in court.

Law enforcement agencies, including prosecutors' offices, investigate violations and prepare criminal cases for trial. In addition, prosecutors represent interests of the State and support allegations against defendants in court. Notably, under Ukrainian law, legal entities (companies) may not be criminally prosecuted and/or punished. Instead, officers of legal entities (companies) guilty of criminal offenses are held criminally liable in court. Civil lawsuits against defendants in criminal cases may be tried together as part of proceedings in such criminal cases.

#### *b) Self-regulatory enforcement*

Shareholders of a company may appeal to the company's supervisory board for protection of their interests and rights. While Ukrainian law does not list specific authorities of supervisory boards for joint stock companies, the companies' charters delegate, as a general matter, broad authorities to these governing bodies. For instance, the supervisory board is oftentimes authorized by the charter to investigate cases of abuse and violations committed by company officers and to determine whether to bring financial claims against such company officers.

Audit committees which, pursuant to law, must be established in all joint stock companies also may be used by shareholders to indirectly protect financial interests arising from their shareholder rights. Thus, shareholders holding in the aggregate more than 10% of the company shares may request the audit committee to audit financial and business operations of the company's management. In conducting audits and investigations, the audit committee has significant authority and must be provided, upon its request, with all files, accounting and other documentation, and personal explanations of company officers. It is obligated to demand the convening of an extraordinary shareholders' meeting in the event of a threat to essential interests of the company or uncovering of abuses committed by the company's officers.

#### *c) Access to legal redress and its impact*

As noted above, shareholders may seek legal redress in court on a wide range of violations of their property and non-property rights. Any aggrieved shareholder or its/his representative has standing to take legal action.

#### 5- Shareholder awareness and shareholder associations

It is difficult to judge to what extent shareholders are aware of their rights, but it will be safe to state that many shareholders in Ukraine need better information of such rights. A large number of individual Ukrainian shareholders, who acquired shares through the process of privatization of state-owned companies, own small shareholdings in the privatized companies. Usually, they are unsophisticated, lack basic knowledge of their shareholder rights and corporate life, and are inactive and poorly organized. Poor shareholder understanding of corporate governance matters and lack of control encourage the commitment of violations and abuses by management and other interested parties. Oftentimes, more sophisticated shareholders, such as investment companies or corporate entities, use petty shareholders to advocate their interests, to the detriment of the latter's interests.

#### **Conclusion:**

In our view, legislative efforts should be undertaken along the following priorities in order to improve shareholder rights, by:

- ◆ providing that shares should be redeemed from shareholders at their market value, rather than balance sheet value;
- ◆ providing that a joint stock company should be charged with an obligation to furnish notice to shareholders entitled to demand the redemption of their shares of the pending redemption and redemption conditions;
- ◆ providing that a joint stock company should follow certain time limits for the redemption of shares;
- ◆ forbidding payment of dividends if the company does not post profits for the year concerned;
- ◆ improving mechanisms for the enforcement of shareholders' rights to attend and vote at shareholders' meetings;
- ◆ authorizing minority shareholders to elect a certain number of members of supervisory boards and management;
- ◆ defining consequences in case of non-approval by the GS Meeting of agreements exceeding the amount set in the company's charter;
- ◆ defining consequences for decisions of a GS Meeting in case of denial of registration to certain shareholders on arguable grounds;
- ◆ expanding rights of minority shareholders, including their right to demand the redemption by the company or other shareholders of their shareholding at market price;
- ◆ defining and expressly forbidding such practices as asset stripping, self dealing, related party transactions, insider trading and share dilution;
- ◆ detailing and expanding a range of sanctions to be applied to company officers whose actions or inaction have resulted in the bankruptcy of or significant losses for the company.
- ◆

## Annex:

### **Principal laws and normative acts**

1. Law of Ukraine "On Business Companies" of September 19, 1991, No. 1576-XII;
2. Law of Ukraine "On Enterprises in Ukraine" of March 27, 1991, No. 887-XII;
3. Law of Ukraine "On Entrepreneurship" of 7 February 1991, No. 698-XII;
4. Law of Ukraine "On Securities and Stock Exchange" of June 18, 1991, No. 1201-XII;
5. Law of Ukraine "On the State Regulation of the Securities Market in Ukraine", dated October 30, 1996, No. 448/96-VR;
6. Law of Ukraine "On the National Depository System and Specifics of Electronic Circulation of Securities in Ukraine", dated 10 December 1997, No. 710/97-VR;
7. Law of Ukraine "On Ownership in Ukraine", dated 7 February 1991, No. 697-XII;
8. Law of Ukraine "On Company Income Tax", dated 28 December 1994, No. 334/94-VR;
9. Law of Ukraine "On the Regime of Foreign Investments", dated 19 March 1996, No. 93/96-VR;
10. Civil Code of Ukraine;
11. Code of Commercial Arbitration of Ukraine;
12. Code of Civil Procedure of Ukraine;
13. Regulation on Share Registry Maintenance Procedures, as approved by Decision No. 60 of the State Commission on Securities and the Stock Exchange, dated 26 May 1998;
14. Procedure of Registration of Share Issuance in the Course of Reorganization of Companies, as approved by Decision No. 221 of the State Commission on Securities and the Stock Exchange, dated 30 December 1998;
15. Regulation on Procedures for the Transformation of Registered Securities Issuance into Non-Documentary Form, approved by Decision of the State Commission on Securities and the Stock Exchange, dated 30 June 2000, No. 98.