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Law governing shares in Ukrainian closed joint-stock companies

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In Ukraine, the issue of the restriction on the right of shareholders to freely alienate their shares in closed joint-stock companies has been widely discussed, and has been the subject of many legislative debates and court disputes over the past years. Many closed joint-stock companies were formed through privatization, allowing employees to be shareholders of privatized companies. The aggregate shares of these, and other, minority shareholders form an attractive package to interested third parties, making such companies potential targets of hostile takeovers.

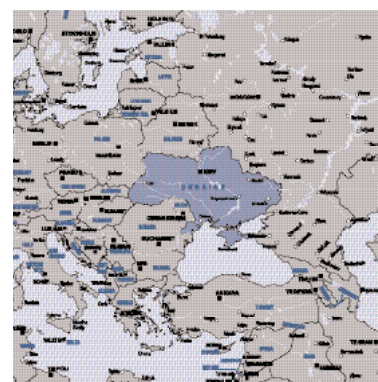
The above-referenced discussion and disputes were a direct consequence of deficiencies in relevant Ukrainian legislation. The principal distinction between closed joint-stock companies and open joint-stock companies under the Law of Ukraine on Business Associations, dated September 19 1991 (as amended) was, and continues to be, that closed joint-stock company shares may not be sold by open subscription or on a stock exchange. However, pursuant to Article 28 of the above law, shares may be acquired pursuant to an agreement with their owner or holder.

Until December 1997, Article 28 also contained the clause unless otherwise provided by the statutes of a business association. Therefore, the founding documents (that is, the founding agreement and statutes) of most joint-stock companies at that time either: (i) prohibited shareholders from alienation of their shares to any party other than the company and/or its other shareholders; or (ii) gave the company and/or its shareholders a priority right of acquisition of the company's shares based on their holdings before such shares could be offered to third parties.

When the above clause was removed from the Law on Business Associations, the legality of these provisions was questioned, primarily on the grounds that the right of an owner to freely dispose of his property could be restricted only by law, and heavily litigated in the courts. The dispute between Ukraine's two major brewing companies serves as a good example of such litigation. A final decision on the matter by Ukraine's highest court was not seen to be definitive, and it appeared reasonable to seek a legislative solution by either amending the Law on Business Association or the Law on Joint-Stock Companies, or incorporating the necessary provisions into a new civil and/or commercial code.

Ultimately, provisions aiming to clarify the issue were included in the new Commercial Code of Ukraine which became effective on January 1 2004. Specifically, Article 81 of the Commercial Code permits share transfer restrictions in closed joint-stock companies, while providing that:

- there are two types of joint stock companies – open and closed;



- shares of a closed joint-stock company must be distributed among its founders or other designated persons, such as employees or specific investors. They cannot be distributed through subscription or be bought or sold on the stock exchange;
- shareholders of closed joint-stock companies have a priority right to acquire shares offered for sale by other shareholders of the company (although the Commercial Code only stipulates the priority right, without setting out the procedure for its implementation, so shareholders of closed joint-stock companies are bound to outline the share transfer procedure in the statute of the company); and
- the founders of a joint-stock company must enter into an agreement that determines the procedure for their joint activities regarding the creation of a joint stock company.

At the first glance, the above provision gives shareholders of closed joint-stock companies (but not the company itself) complete control over the transfer of its shares. However, upon closer review, the narrowly drafted provisions of Article 84 (3) provide for the priority right of shareholders of closed joint-stock companies to buy out shares that are being sold by other shareholders of the company.

Such narrow interpretation does not prohibit shareholders of closed joint-stock companies from alienating their shares to third parties. By way of example, this can be done through:

- the execution of exchange agreements with third parties or deeds of gift;
- contributions of shares to the charter capital of a closed joint-stock company or LLC established and/or controlled by an interested third party. Consequently, the right of ownership is transferred to such company. Further, the third party can then buy out the shareholder in the closed joint-stock company that contributed the shares to the charter capital of the company established and/or controlled by this third party, and acquire the shares in such company;
- pledge of the shares to secure fulfillment of the shareholder's obligations under an agreement. For instance, a shareholder of a closed joint-stock company purchases commodities or property from a third party, but fails to pay the purchase price for such commodities or property. According to the legislation and/or an agreement between the parties, the seller of the commodities or property has the right to levy execution upon pledged shares and acquire ownership rights to them.

This greatly diminishes the practical significance of the restriction on a shareholders' right to freely alienate shares in a closed joint-stock company as provided for in Article 81 (3) of the Commercial Code.

Undoubtedly, closed joint-stock companies will take steps to protect themselves. Such actions may include incorporating language into their statutes to have a priority right to redeem or acquire shares from shareholders interested in alienating their shares to third parties, or by establishing an LLC and asking the shareholders to contribute their shares in closed joint-stock companies to its charter capital. However, these or other approaches may not ensure that a closed joint-stock company retains complete control over the transfer of its shares.

It worth keeping in mind that the Ukraine cabinet has submitted to parliament a draft paper, On Joint Stock Companies, which sets out different provisions on the subject. According to Article 7 (1) of the draft, the statutes of a closed joint-company may contain provisions regarding the priority right of shareholders as to shares, other securities issued by the company and options to buy the shares (a call option) of the company which are offered for sale to a third party. Again, the word sale, not alienation, is used. The second paragraph of Article 7 serves as a form of catch-all, and provides that statutes of closed joint-stock companies may incorporate provisions with respect to mandatory offers to buy company shares from individuals who became owners of such shares through other methods of legal succession.

Corporate and commercial

Recommended firms

Baker & McKenzie

Chadbourne & Parke

Salans

BC Toms & Co

Frishberg & Partners

Grischenko & Partners

Magister & Partners

Proxen

Sergiy Koziakov & Partners

Shevchenko Didkovskiy & Partners

The Silecky Firm

Vasil Kisil & Partners

Baker & McKenzie

Despite the odd gripe that Baker & McKenzie's dominance of the market is not quite what it used to be, most peers and clients agreed that it is still worthy of its top-tier rating, one rival stating that it is "the most famous and most experienced firm" operating in the country. The high quality of the legal advice available from Baker & McKenzie's team of western-experienced lawyers is most evident on the capital markets transactions it is involved in. Last year the firm advised Dresdner Bank and Merrill Lynch as managers of a \$600 million sovereign eurobond issue by Ukraine, acted as English and Ukrainian counsel to PrivatBank on the issuance of \$100 million in loan participation notes by Credit Suisse First Boston to finance a loan to CJSC CB PrivatBank, and advised the City of Kiev on a \$150 million issuance of loan

participation notes in the international capital markets to fund a loan to the City of Kiev.

The firm was the first foreign firm to set up in Kiev, in 1992, and has amassed a lot of experience since. It now has four partners and 12 associates in the city, among which managing partner Jim Hitch, partner Olexander Martinenko and real estate specialist Serhiy Piontskovsky are highly recommended. Serhiy Chorny heads the capital markets practice.

Key contact partners

Serhiy Chorny
James Hitch

Leading lawyers

James Hitch
Olexander Martinenko
Serhiy Piontskovsky

Chadbourne & Parke

US firm Chadbourne & Parke took on many of the lawyers from fellow American firm Altheimer & Gray when it collapsed last year. In Kiev it gained many skilled lawyers and made itself a major presence in the local market. Jaroslawa Johnson, an ex-Altheimer lawyer, is now the managing partner, supported by six associates and two other partners, Volodymyr Baibarza and Adam Mycyk. Mycyk is highly recommended for his banking and finance advice.

The firm's work has taken in representing various western banks in cross-border trade finance transactions with Ukrainian enterprises, acting for two telecommunications companies on their investments into and licensing of local operators, representing a consumer products packaging company in its due diligence and acquisition of a controlling stake in a Ukrainian glass container manufacturing joint venture, acting for an automotive company in structuring a joint venture for the distribution of automotive lubricants and representing a packaged foods company in its due diligence and acquisition of a potato chip factory.

Key contact partner

Jaroslawa Johnson

Leading lawyers

Jaroslawa Johnson
Adam Mycyk

Salans

Salans is primarily an eastern Europe and CIS network, with offices in Warsaw, Moscow, St Petersburg, Almaty, Baku and Kiev, though it also has offices in London, Paris and New York. The Ukraine office was set up in 1992, though Salans had been involved in the country since 1988, when it assisted a client in establishing one of the first joint ventures. Oleg Batyuk, who founded the firm, still heads it today, supported by two other partners and six associates.

The firm's work has taken in work for the State Property Fund of Ukraine on joint ventures in engineering, mining and telecommunications, as well as acting for the National Bank of Ukraine on its negotiations over the bank's sovereign debt obligations to non-Ukraine corporates and advising several US and European investment houses on the purchase of Ukrainian equities and Ukrainian state bonds.

Key contact partner

Oleg Batyuk

BC Toms & Co

Bate Toms is the founding partner of highly rated local law firm BC Toms. US-educated, he has built a strong firm of both western and Ukrainian lawyers that is particularly rated for its real estate advice. The firm advised on the biggest property development deal last year, the takeover of the Centre Kiev, which was also the first contested takeover of its kind in the country. A healthy project finance practice sits well alongside the real estate expertise, and the firm has worked on a number of important project financing deals with the European Bank for Reconstruction and Development in the energy, oil, gas and real estate sectors.

The firm has also advised a range of international banks on their involvement in Ukraine, including some from western Europe, the US and Japan. Examples include Crédit Lyonnais, Raiffeisen Ukraine and Goldman Sachs, while the work advised on has included a range of debt instruments and interest rate swaps. In mergers and acquisitions BC Toms & Co has advised a range of different companies, from Swedish telecoms companies to offshore investment funds.

Key contact partners

Vladimir Sayenko
Bate C Toms

Leading lawyer

Bate C Toms

Magister & Partners

Magister & Partners is a "well-organized, high-performance" firm in Ukraine, with three partners and 19 associates working on all types of corporate and commercial transactions. In banking it recently advised Gazprombank and Vneshekonombank on a syndicated credit facility, advised borrower UkrSibBank on a syndicated loan and acted as a legal counsel on a structured financing deal for WestLB. In capital markets it has advised the Ministry of Finance on several transactions, including a tap issue and an issue of eurobonds by Yuzhmash, the Ukrainian producer of aerospace technology. The firm also advised Naftogaz on its eurobond issue. Eugene Korniychuk heads the banking and finance team.

In mergers and acquisitions the firm has assisted one of the world's largest trading companies on its acquisitions and

investments in Ukraine, which totalled \$100 million, has worked on the transfer of assets from Seagram Ukraine to Pernod Ricard in connection with the \$5.5 billion acquisition of Seagram's worldwide spirits and wine business by Diageo and Pernod Ricard, and is engaged as a legal counsel to OJSC Silur, one of the world's largest manufacturers of steel ropes and wire, on the corporate reorganization of its Ukraine plant.

Key contact partner

Eugene Korniychuk

Proxen

Proxen's "strongest area is in corporate law". Examples of its work include advising the lead managers on reopening Ukraine's \$800 million sovereign Rule 144A eurobond issue and advising the Energy Alliance on its loan from the European Bank for Reconstruction and Development. The firm is also strong on litigation work, and has been involved with an investment dispute between a US investor and the Ukrainian government over \$9 billion in funds. Proxen worked alongside Grischenko & Partners on the dispute.

The firm has six partners and 14 associates working in its Kiev office. Past deals have also taken in work alongside Allen & Overy's Moscow office on a revolving credit facility for local company Natexis, advising both Natexis and Banques Populaires, and a credit facility provided by ING Bank to a local manufacturer.

Key contacts

Oleg Kanikovsky

Oleg Shevchuk

The Silecky Firm

Since the last edition of the *IFLR1000*, US firm Squire Sanders & Dempsey allied itself with The Silecky Firm in Kiev in September 2003. It now has one partner, Helen Krysthalowych, based with the associated office. Krysthalowych is a "very good lawyer," ably supported by the highly recommended partners at Silecky, including managing partner Markian Silecky, a lawyer whose work focuses on corporate, real estate, privatization and labour law in the energy, telecommunications, oil and gas, manufacturing and finance sectors.

Key contact partner

Markian Silecky

Other notable firms

Frishberg & Partners is a small firm "but with long experience of the domestic market," while fellow Ukrainian firm **Shevchenko Didkovskiy & Partners** is a capable firm whose best known deal was acting as legal advisers to the City of Kiev on its €150 million (\$184 million) eurobond

issue. The firm also counts Damen Shipyard Group and shipyard company Okean among its clients. Lastly, **Vasil Kisil & Partners** has one of the best lawyers in Ukraine in Vasil Kisil. He is "good on litigation work"