

Acquisition of Ukrainian Companies by Non-Residents



Valery FEDICHIN, LLM, is a partner at Poberezhnyuk & Partners Law Group

A non-resident would typically seek to acquire a Ukrainian company where he wants to establish a presence in Ukraine or make an investment. Many investments or other asset acquisitions involve the purchase of a Ukrainian company either as a productive unit or a vehicle for holding assets.

A company, being a legal entity, cannot, obviously, be acquired and owned as such. What one acquires is corporate rights regarding the company. That is, a bundle of rights including, in particular, the rights to take part in the company's management and to receive its dividends. Depending on the form of company, corporate rights are either evidenced by shares (in a joint stock company) issued by the company or exist in the form of participation interests (in a limited liability company) in the capital of the company as specified in the company's charter (the main constitutional document of the company). Corporate rights represent a claim to the company's capital, and so its extent is determined by a member's contribution to its capital.

The method of acquisition would, in the first instance, depend on the type of company. The two main types of business companies under Ukrainian law are the limited liability company (LLC) and the joint stock company (JSC). Both have a capital fund divided into parts distributed among the company's members consistent with their capital contributions. They are, however, different in their structure and how they operate. An LLC has a small number of members, whose participation interests in the company's capital are defined in the company charter. The company does not issue shares that can be placed among the general public. By contrast, a JSC issues shares and so can raise capital on the market by selling them to the public. A JSC is more complex to organize and operate, and its share issuances must be approved by the Ukrainian Securities Commission, while the company itself is subject to various disclosure requirements.

Corporate rights in both an LLC and a JSC may be acquired from an existing member (shareholder) or from the company itself. In the first case, shares are bought from a shareholder and the company receives no money. Under the second scenario, one acquires shares from the company in exchange for payment representing a capital contribution to the company.

Acquisition of an LLC

As noted, an LLC does not issue shares, and the participation interests of members are specified in the company's charter. Ac-

cordingly, their transfer involves amending the charter to reflect the changed distribution of the interests. The parties to a transaction may agree on any time for the transfer of the interests, but as against third parties it only becomes valid upon the amendment's registration with the authorities. Beside, a new member cannot exercise his corporate rights, (e.g. vote at the members' general meeting) until the charter has been amended.

Participation interest transfers are subject to some restrictions. First, by law they are subject to the right of first refusal



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by other LLC members. An interest to be transferred to a third party must first be submitted to other members for purchase, and it may be sold to others only if they refuse to exercise their priority right of purchase. Second, a company's charter may prohibit transfers of participation interests to third parties altogether. Third, the company's charter amendment necessary to reflect the change of members must be approved by a majority of votes, thereby making the transfer essentially subject to the consent of the majority members.

Acquisition of a JSC

Corporate rights in a JSC are represented by shares. These are, as a rule, freely transferable, and so require no consent of the company or other shareholders for the transfer. In Ukraine companies issue dematerialized shares whose ownership is evidenced by statements from securities accounts with depository institutions. Share transfers occur by respectively debiting the securities account of the seller and credit-

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ing the account of the buyer for the appropriate number of shares, in a way similar to wire transfers of money by banks.

Acquisition process

Both in an LLC and an JSC the acquisition process involves two basic stages: entering into a corporate rights acquisition contract and then performing the contract.

The parties first enter into an acquisition contract, such as a purchase-sale agreement, for the transfer of the corporate rights. The agreement sets out the essential terms of the acquisition (e.g. the shares and the price to be paid, the time and method of transfer and payment), as well as other terms and conditions as may be agreed by the parties (conditions precedent to the transfer, warranties and representations regarding the shares sold, etc). The contract's execution and performance are subject to the rules of general contract law as well as company law rules relative to the transfer of corporate rights.

Second, the parties perform the contract by carrying out the actions agreed by them: transferring the shares and paying the price, conducting a due diligence review of the company, obtaining the necessary permits and approvals for the acquisition, and taking other agreed steps. The mechanics of corporate right transfer would depend on the nature of the rights being transferred. In a JSC the seller will order his depository institution to transfer the shares from his securities account to the securities account of the buyer. In the case of an LLC the seller will arrange for the company to pass the necessary resolutions (e.g. to amend the company charter) to admit the buyer to the company. The parties may agree an escrow mechanism where the price is held by a third party pending the transfer of corporate rights.

Other considerations

There are number of special issues to be considered by a non-resident acquiring a Ukrainian company:

Full or partial acquisition

An important issue for an investor is whether to acquire substantially all or a part of a company. While this is a commercial matter, a buyer would normally seek a majority stake as it affords greater security of ownership; a minority shareholder faces a greater risk of being pushed out of the company by partners and, therefore, losing his investment.

Permits and licenses

The buyer would want to ensure that the company has all the required permits and licenses to conduct its business. Ukrainian law imposes licensing requirements for a range of business activities, such as banking, securities and financial operations, and a number of industrial and service activities.

Competition issues

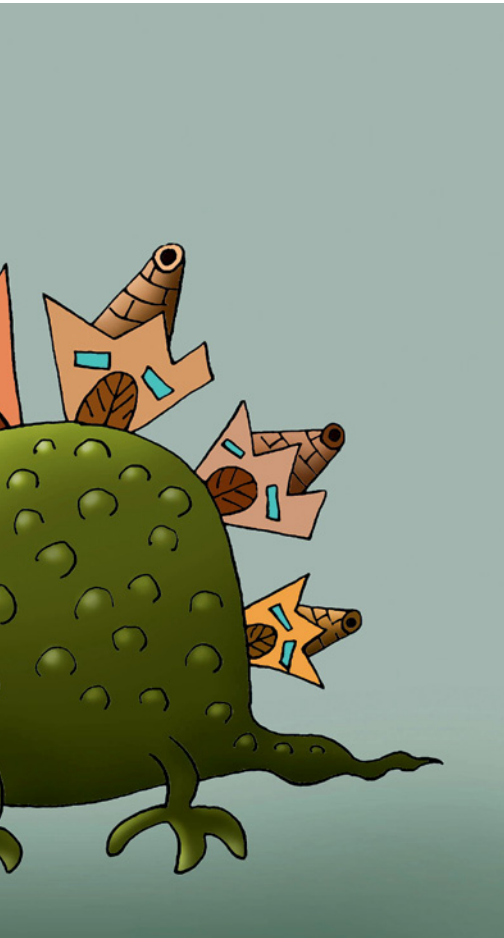
Acquisition of Ukrainian assets, including company shares or assets held by a company, may require approval from Ukraine's antitrust authorities. It must, in particular, be sought where the parties to a transaction exceed certain thresholds specified by law as to their sales or value of their assets. Failure to obtain the approval where required may result in the transaction being challenged by the authorities.

Securities broker participation:

Ukrainian securities law requires the participation of a Ukrainian securities broker in the case of sale of shares in a JSC. If this requirement is not met the transaction may potentially be invalidated under Ukrainian law.

Foreign investment

The acquisition of corporate rights in a Ukrainian company qualifies as a foreign investment under Ukrainian law. Foreign investors benefit from certain special rights and protections under Ukrainian law. For example, they can repatriate profits from Ukraine (e.g. dividends paid by the company) and their investments may not be expropriated. There are no special formalities to be completed to obtain foreign investor status (such as a registration), but the investor should be able to show that the funds used to acquire the company came from abroad.



Structuring

Foreign investors sometimes opt for indirect acquisitions of Ukrainian companies. Here what is acquired is not a Ukrainian company itself, but a foreign company (typically from an offshore jurisdiction) holding it. This has a number of advantages. Sometimes, it may be easier to transfer the shares in a foreign company and thus complete the acquisition abroad, without showing a change of ownership in the Ukrainian company. Furthermore, the parties can structure their relations more effectively at the foreign holding company's level by entering into a shareholders' agreement governed by foreign law, avoiding the application of inflexible Ukrainian rules on shareholder relations.

Applicable law

Under Ukrainian law the parties may choose foreign law to govern their contract if the transaction contains a sufficient foreign element, such as where one party is a non-resident. Ukrainian law would still apply regardless of the choice of foreign law

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to matters subject to Ukrainian mandatory rules. For example, the way in which the transfer of the shares to the buyer takes place.

Shareholder agreements

Ukrainian law restricts the ability of shareholders to agree on how to govern their relations by contracting out of statutory rules. As a result, the scope within which the parties may contractually regulate their dealings is quite limited. Essentially, this means that the parties cannot enter into meaningful shareholder agreements under Ukrainian law. This has the effect of forcing them to organize their relations offshore, at the level of holding companies.

Dispute resolution

One feature of Ukrainian company law is that shareholders may not agree to submit their disputes to resolution by international arbitration. Thus, non-residents in Ukrainian companies are restricted to Ukrainian courts with regard to the resolution of their disputes with local and even with foreign partners. For many foreign investors this is a major disadvantage, and yet one more reason for indirect acquisition of Ukrainian companies.

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12, Khreschatyk Str., 2nd floor, Kyiv, 01001, Ukraine
tel./fax.: +38 044 390 09 20/21
office@antikalaw.com.ua
www.antikalaw.com.ua