

**TEARING APART Shareholder Agreements in Ukraine:
Recent Developments and Possible Trends**

**Timur Bondaryev
Markian Malskyy
Arzinger Law Firm
Kyiv, Ukraine**

Introduction

Shareholder agreements between business owners have long ago entered the commercial practice in the world. Although not every jurisdiction accepts this notion and frequently certain particularities apply, lawyers throughout the world face the necessity to legally frame the arrangements of shareholders. “Side” or “gentlemen” agreements may often interfere with mandatory corporate legislation and therefore their possible invalidity may have adverse effect on the substance of such arrangements.

As Ukraine for the last couple of years has been facing a considerable increase of investments coming from abroad, large and medium scale business being the main playmakers, an escalating interest of the use of shareholder agreements has appeared. This article provides the analysis of the latest developments of corporate court practice in Ukraine, which most certainly will have a negative effect on concluded shareholder agreements as well as on the international commercial arbitration proceedings and choice of foreign governing law options in corporate relations.

Recent developments

The Presidium of the Highest Commercial Court of Ukraine issued Recommendations “Regarding the practice of the implementation of legislation during litigation proceedings occurring from corporate relations”¹ (hereinafter – “HCCU Recommendations”). The content of the HCCU Recommendations included 6 sections, mainly outlining current legislation and providing considerations of eliminating conflicts and directing the courts towards a unified approach. The last section “Contractual regulation and exercise of foreign law in corporate relations and in resolving cases, which occur from corporate relations”, has become a basis of intensive legal debate. The particularities of the conclusions reached by the Highest Commercial Court of Ukraine have also been confirmed by the Supreme court of Ukraine, putting an end to discussions whether the HCCU Recommendations may be withdrawn in the nearest future.

A. Content of the HCCU Recommendations

¹ #04-5/14 of 28.12.2007

Mandatory corporate legislation

According to para.6.1 of HCCU Recommendations the following activities are regulated solely by the laws and related normative acts of Ukraine: i) the activity of a joint stock company, registered in Ukraine, ii) relations between shareholders and the joint stock company, and iii) between the shareholders of the joint stock company regarding the activity of the latter. In case of conclusion of an agreement by a shareholder being a foreign legal entity or foreign national, the choice of a foreign governing law between the shareholders, as well as between the shareholders and the joint stock company regarding the activity of the company, is considered to be null and void.

In addition, in the view of the Highest Commercial Court of Ukraine, the relations between the founders (members) of an economic entity regarding its incorporation, formation of its bodies, determination of their authorities, procedures for convening a general shareholder meeting and order of its decision-making are regulated by the provisions of the Civil Code of Ukraine² and the Law of Ukraine “On economic entities”³. Under their content those provisions are mandatory, and their infringement constitutes violation of public policy in accordance to Art.228 of the Civil code of Ukraine.

The HCCU has stated that the commercial courts shall impose the laws of Ukraine, and any applicable normative acts, when hearing cases involving relations between shareholders, as well as the shareholders and the joint stock company regarding the management of the company, and the charter of the company in those cases where registration of the entity is Ukraine. Therefore, the issues of corporate governance may only be regulated contractually in cases explicitly provided for under the legislation of Ukraine. The result is that any agreements not in accordance with the aforesaid may be considered null and void.

In order to provide clarity regarding particular aspects of corporate governance, the HCCU created a non-exclusive list of arrangements that includes such areas as establishment of specific order of voting procedures at the general shareholders meeting, obligations of one or several shareholders to vote in a certain manner, obligations of all shareholders to take part and vote in the general shareholders meetings, as well as other agreements. Arrangements on specific voting procedures in other bodies of the company (board of directors, supervisory board *etc.*), are treated by analogy. Using the same reasoning regarding public policy, agreements for formation of the executive body and supervisory board not in compliance with the Laws of Ukraine and normative acts can be held as null and void.

² #435-IV as of 16 January 2003.

³ #1576-XII as of 19 September 1991.

International commercial arbitration

According to par.6.2 of the HCCU Recommendations, members of economic entities acting independently from their subjective characteristics of shareholders are also not allowed to refer to international commercial arbitration the settlement of corporate disputes which relate to the activity of the companies, if they are incorporated in Ukraine. Specifically, the HCCU is referring to disputes which relate to issues of corporate governance. This conclusion will most certainly make arbitral awards in corporate cases unenforceable in Ukraine.

Choice of foreign governing law

HCCU in par.6.2 has concluded that an agreement (or any legal deed) regarding the choice of foreign governing law for the relations of corporate governance of an economic entity, incorporated in Ukraine is null and void, meaning that it creates no legal consequences except those connected to its nullity. The basis of the HCCU's opinion is that this infringes the public policy of Ukraine.

In addition, shareholders of a company, incorporated in Ukraine, are not permitted to choose foreign governing law regarding the validity of such shareholder agreements, as the norms concerning the invalidity of legal deeds in Ukraine are mandatory and cannot be deviated from.

Competition infringement

According to para.6.5 of the HCCU Recommendations, the shareholders of a company, by an agreement between them, may not establish rules other than those provided for under the mandatory provisions, with particular emphasis in the area of antitrust regulation. Legal deeds directed towards the limitation or elimination of competition on commodity and other markets of Ukraine are null and void.

Legal force of the HCCU Recommendations

Although the HCCU Recommendations do not have specific legal force, it is rather doubtful that under such explicitly expressed opinions the lower courts will disobey them. In fact, as current trends show, courts are inclined to follow the unification of practice as they see lower court decisions reversed based upon such similar recommendations. While even earlier shareholder agreements governed by foreign law were almost impossible to enforce in Ukraine, lawyers have been, nevertheless, attempting to achieve any result possible.

The recommendations themselves lack legal analysis; but, rather contain answers to questions, without showing the logic upon which the answers were reached. Further, there is also a clear lack of reference to cases or current legislation.

Feasible alternative

A. Corporate structuring outside of Ukraine

Corporate structuring outside of Ukraine will require additional operational costs; however, this alternative permits the parties to reach stronger arrangements between them. The main idea is if one jurisdiction does not permit free conclusion of shareholders agreements, a sort of “jurisdiction/forum shopping” may be feasible for the parties. In this situation, the parties could jointly create a holding company in a specific jurisdiction (Company A). The shareholders agreement between the owners in such a jurisdiction would provide for the management of a subsidiary company in Ukraine (Company B) containing the desired provisions. In this way Company A governs the activity of Company B, based on a shareholder agreement between the parties.

The choice of a jurisdiction can be made based on the existing tax treaties, which could provide tax benefits for the parties. The choice may also depend on the legal system of a country, as common law countries provide greater flexibility for such commercial agreements. This alternative requires extensive legal support in drafting of necessary documents, however, in our view, allows achieving the desired result, including effective choices towards international commercial arbitration and foreign governing law for corporate relations.