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newsletter

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EU ASSOCIATION AGREEMENT

The Association Agreement which was finally signed by Ukraine and the European Union on 27 June 2014 has already been named the most comprehensive treaty ever concluded by Ukraine in its history. The Agreement is expected to cause fundamental re-building of the Ukrainian economy on the new principles and standards helping it deeply integrate with the EU market.

The economic part of the Association Agreement is based on the core principles of national treatment, removal of all excessive and unnecessary barriers to commerce and entrepreneurship, and approximation of the Ukrainian economic regulations to the EU standards and *acquis communautaire* and covers numerous areas of economy to be harmonized within the set transitional periods (3 to 5 years) starting from the Agreement's ratification.

Below, there is a summary presentation of some of the key areas covered by the EU Association Agreement, which are of high interest for many economic operators in Ukraine.

We encourage you to provide us with aspects of the implementation of the Association Agreement which are important for your company, to be specifically addressed in our further communications.

Competition

The Association Agreement reaffirms the importance of application of the competition laws in a transparent, timely and non-discriminatory manner under the principles of procedural fairness. In particular, any sanctions or remedies for competition infringements are to be subject to review at the person's request by a court or other independent tribunal.

The Association Agreement requires Ukraine to implement, within 3 years after the Agreement has come into force (ratified), Articles 1 and 5 (1) and (2) of the Council Regulation (EC) #139/2004 as of 20 January 2004 and to the Council Regulation (EC) No 1/2003 of December 16, 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the EC Treaty on the control of concentrations between undertakings, to lower administrative barriers, especially for merger transactions having *Community dimension*, and to improve predictability of application of sanctions for infringements.

Most notably, this will require Ukraine to introduce a number of important amendments into the competition laws:

- In determining the thresholds for anti-trust control, to rely on the turnover volume approach (and get rid of the existing assets value approach which effectively subjects to control commercially inactive companies without any turnover).
- To exempt large-scale merger transactions having *Community dimension* from the requirement of a separate approval by the Ukrainian competition authority, unless the volume of turnover generated in Ukraine exceeds two thirds of the aggregate turnover by each respective participants of concentration, taking into account the relations of control.

  As a matter of reference, the *Community dimension* is available if and where: the aggregate volume of turnover by the participants of concentration, taking into account the relations of control, exceeds the equivalent of 5 billion Euros, and the aggregate volume of turnover in the European Union by each of at least two unrelated participants of concentration, taking into account the relations of control, exceeds the equivalent of 250 million Euros.
- To introduce clear rules and procedures for calculation and imposition of fines for unfair competition, with due regard to the gravity and to the duration of the infringement (currently, the existing procedures are non-transparent and unpredictable in application).

Public Procurement

The Association Agreement requires its Parties to open up public procurement markets for mutual access on the basis of the principles of transparency and national treatment (non-discrimination) at national, regional and local level for public contracts and concessions in the traditional and the utilities sectors, for procurement contracts above value thresholds of EUR 133,000 for public supply and service contracts (awarded by central government authorities), EUR 5,150,000 for public works contracts and concessions and works contracts in the utilities sector, as well as EUR 412,000 for supply and service contracts in the utilities sector.

The Parties to the Association Agreement undertook to gradually, reciprocally and simultaneously open its procurement markets for competition. For this end, within 6 months as of the date of the Agreement entering into force Ukraine will have to start publication of the essential details of the procurement contract to be awarded, the criteria for qualitative selection, the award method, the contract award criteria and any other additional important information for the economic operators who may be interested in obtaining the contract, with a time-limits for expression of interest and for submission of offers to be sufficiently long to allow

economic operators from the other Party “to make a meaningful assessment of the tender and prepare their offer”.

To prevent possible discrimination, the Association Agreement expressly prohibits:

- The description of the characteristics required of a work, supply or service to refer to a specific make or source, or a particular process, or to trade-marks, patents, types or a specific origin or production (unless such a reference is justified by the subject-matter of the contract and accompanied by the words 'or equivalent');
- Introduction of requirement that economic operators interested in the procurement contract must be established in the same country, region or territory as the contracting entity (save for the requirement of business establishment of an economic operator, such as representative office or a subsidiary).

Ukraine undertook to approximate within the time frames of 3 to 4 years its public procurement laws and procedures with the basic EU standards and governing principles in this area, most notably, the Directive 2004/18/EC of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, and Directive 2004/17/EC of the European Parliament and of the Council of 31 March 2004 coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors.

Marking and labelling

The Association Agreement obliges Ukraine to comply with EU standards of marking and labelling of products. The idea of the unified marking and trading is to subject manufactures originating in the Parties to the uniform rules of presenting product information for the consumers.

Approximation with the EU rules on marking and labelling shall ease access of the Ukrainian companies to the EU market. Ukrainian companies which consider a possibility of exporting products should:

- Ensure that packaging and labelling complies with general EU standards;
- Check existence of specific regulations on packaging and labelling provided by the national law;
- Translate the product information into a language of the country of destination;
- Mark the origin of goods;
- Check local laws for such goods in the destination-country (for example, in some countries food products carry a picture thereof).

Finally, according to the Association Agreement, Ukraine should also comply with Article 2.2 of the Agreement on Technical Barrier to Trade requiring the local technical regulations not to create unnecessary obstacles to international trade.

At the same time, the EU rules leave for member states a room for discretion in determining and regulating certain issues in the national law, most notably, the language requirements. However, it is worth noting that certain country-specific cases are not regulated at the EU level. Considering this, the EU law leaves some discretion to country-members to regulate such cases by the national law. Thus, the requirements of the Ukrainian law to have the consumer information in the Ukrainian language will not be affected by the Association Agreement.

DOING BUSINESS

Audit procedure to be liberalized

On 22 July 2014, after several failed attempts, the Parliament of Ukraine finally adopted *the Law on Amendments to Certain Laws of Ukraine for the Purposes of Limiting of Interference into Companies Activities*, which will put a stop to never-ending audit seasons and make life easier for businesses in Ukraine.

The Law limits cases which are not governed by *the Law of Ukraine on the Basic Principles of State Supervision (Control) over Economic Activity*, the key audit law, and, in fact, extends its scope to tax audits and inspections conducted by officials of the State Architectural and Construction Inspectorate of Ukraine which can make them more predictable.

The Law also prohibits any audits on the basis of anonymous or unfounded statements, requests of legal entities which were frequently used by tax and other state authorities for launching audits. Unscheduled audits, however, may be initiated upon reasonable requests of individuals whose rights were infringed by the relevant company. Individuals who filed unreasonable requests will be held liable. Such liability will be provided for by the law.

The Law establishes a "one year-one audit" rule which, however, will apply only to scheduled audits and does not preclude from conducting one or several unscheduled audits within a year. In case a company's audit or inspection is already scheduled by any state authority, other state authorities will have to refrain from conducting another scheduled audits during the same period. In case a company's audit or inspection is simultaneously scheduled by several state authorities during the same period, a complex audit will have to be conducted by the relevant state authorities at the same time. Audits by different state authorities covering the same issues are prohibited. Complex audit plans will be approved by the State Service of Ukraine for Regulatory Policy and Entrepreneurship Development.

According to the Law, state authorities cannot seize originals of a company's financial, accounting or other documents, computers and their elements except as allowed by the criminal procedural laws (seizure of documents and property on the basis of a decision of an investigating judge or a court).

The Law introduces administrative liability for officials of state authorities who breached audit procedure by supplementing the Code of Ukraine on Administrative Offences with a new Article 166^{21}. A company will be indemnified by the state for any losses incurred as a result of illegal decisions, actions or inactivity of officials of supervising state authorities, while the state will have the right of recourse against the relevant official of supervising state authority.

LABOUR

The Military Tax is introduced

On 31 July 2014 the Parliament approved the Law on Amending the Tax Code of Ukraine and Certain Other Laws of Ukraine (Draft No. 4309a), which will come into force upon its signing by the President of Ukraine and official publication.

Among other provisions, the Law introduces a 1.5% military tax to be applied to income in the form of wages, other incentive and compensatory payments or any other forms of consideration paid to extended to the payer in connection with employment or under civil law contracts; state and private lottery winnings, as well as gambling winnings.

The military tax is set to expire on 1 January 2015.

REAL ESTATE

Ministry of Justice to initiate free public access to the Real Estate Register

The Ministry of Justice together with the State Registration Service announced that they were working on the reform of the system of ownership rights registration in order to make it more transparent, prevent corrupt practices and improve the quality of registration services in general. The Ministry has created a working group, including experts from Georgia, to prepare new draft laws.

The reform suggests opening of the State Register of Property Rights to Real Estate and their Encumbrances (*the Real Estate Register*) to free public access. Recently, there have been several unsuccessful attempts to address this longstanding issue (e.g. draft law no. 4728 dated 16 April 2014 was debated in the Parliament but ultimately rejected). Many non-governmental organizations continue lobbying for a free access to the Real Estate Register; and this initiative finds support from the Ministry of Justice. At present, information from the Real Estate Register can be obtained by owners or persons enjoying property rights to real estate, their authorized representatives or heirs.

Supreme Court demonstrates a flexible approach with regard to land lease formalities

The Supreme Court of Ukraine has published a new legal position in land lease disputes (Resolution in case No. 6-88цс14 dated 2 July 2014). The dispute concerned invalidation of a land lease agreement due to a lack of particular essential terms and conditions (as required by the law) in the text of the agreement. Specifically, the parties failed to provide a contractual regulation on pledging and contributing the lease rights into a charter capital.

Article 15 of the law of Ukraine on Land Lease (No. 161-XIV dated 6 October 1998) establishes a list of essential terms and conditions that are compulsory for all land lease agreements. Provisions of Article 15 prove to be unreasonable and bureaucratic: a number of these ‘essential terms’ are barely important for land lease relations, and the parties to lease agreements often overlook them in practice. Regulations on pledging and contributing the lease rights into a charter capital are a bright example.

However, in compliance with the Law on Land Lease, in case of a failure to incorporate all essential terms into a land lease agreement, the agreement may be invalidated by court. This gives room for abuse of law: it is often the case that a party, willing to terminate the lease relations without good excuse, pursues invalidation of a lease agreement in court alleging ‘lack of essential terms and conditions’ in its text. Courts often used to take a formalistic approach and invalidate lease agreements, even where the missing ‘essential term’ was of a minimal importance.

In the case at hand the Supreme Court held that courts are called to protect the rights of *aggrieved* parties. The claimant failed to prove that he or his rights have suffered in any manner through the failure to contractually regulate pledging and contributing the lease rights into a charter capital. The Supreme Court opined: when deciding on invalidation of land lease agreements due to the lack of a regulation on pledging and contributing the lease rights into a charter capital, courts must at all times consider whether and to which extent such failure infringed upon the rights of the claimant.

The position voiced by the Supreme Court is a very positive step, as the Court distanced itself from the formalistic approach suggested by the Law on Land Lease and tried to find a fair solution. This precedent can be used in similar disputes where a party acting in bad faith tries to invalidate a lease merely due to minor formal shortcomings in the land lease agreement.

LOGISTICS

Ukraine closes seaports in Crimea

By its Resolution No. 255 dated 16 June 2014 (entered into force on 15 July 2014) the Ministry of Infrastructure of Ukraine resolved to close the seaports in the Crimea, namely in Kerch, Sevastopol, Feodosiya and Sevastopol, Yalta and Yevpatoria until the effect of the Ukrainian Constitution is restored on the peninsula. In practical terms this means that all vessels ignoring this prohibition will be considered to have violated the Ukrainian laws and may face sanctions from Ukraine.

Draft law on seaport land reclamation under discussion

The Parliament continues considering a draft law (No. 2968 dated 13 May 2013, as amended) regulating seaport land reclamation issues. The draft law aims to cover a legal gap and provide a legal framework for creation of artificial land plots within water areas (aquatic area) of seaports. Pursuant to the draft law, creation of artificial land plots would require preparation of a design, as well as a number of approvals to ensure compliance with the environmental and maritime safety requirements. The Ministry of Infrastructure would be the competent authority to issue permits for development of artificial land plots. In line with the draft law, investors creating artificial land plots would acquire a long-term lease over such land plots (up to 49 years) and such lease could be further transacted with (e.g. sold or pledged).

At present the Land Code of Ukraine and Law of Ukraine on Seaports No. 4709-VI dated 17 May 2012 establish that artificial land plots belong to the property of the State and may be leased out to private companies. However, there is no legal framework for creation of artificial land plots so far. In practice such land plots are often developed at the expenses and risk of private investors. Private developers enjoy no valid right of ownership over created artificial land plots and have no security whatsoever that such land would further be leased to them. The draft law aims to protect private investors who have already developed artificial land plots by placing such lands under private property.

BANKING AND FINANCE

Softer on currency exchange harder on cash

The National Bank of Ukraine slightly liberalised the currency market and released individuals from obligation to convert to Hryvnias the amounts in a foreign currency received from abroad via money transfer and exceeding UAH 150,000 in equivalent per month (Resolution no. 423 dated 15 July 2014). It is possible to withdraw funds in such foreign currency, however, only up to equivalent of UAH 150,000 per day. The excess must be deposited to the recipient's bank account until further withdrawal. Those who decided to leave Ukraine for good can, starting from 22 July 2014 convert Hryvnias into foreign currency without having withdrawn them from the account (Resolution no.360 dated 16 June 2014), thus, increasing the choice for the individuals previously limited to the cash withdrawals and the use of international payment card systems.

The NBU has abolished the requirement according to which the banks were obliged to reserve 20% of the short-term (up to 183 days) deposits and loans in foreign currency obtained from non-residents (Resolution no.419 dated 15 July 2014), allowing Ukrainian banks manage their short-term liquidity and softening pressure on the loan rates.

NBU has also introduced novel interpretations of the requirements to convert 50% of the proceeds in foreign currency by Ukrainian businesses; the regulation has explained that no conversion is required when the funds are deposited by non-resident bank to a Ukrainian bank (i) on the correspondent account or (ii) an "investment" deposit account. From the legal prospective, the NBU's idea is somewhat astonishing: amounts on deposit and correspondent (equivalent of current in the corporate world) accounts of the banks are the proceeds of Ukrainian bank - and not of the customers owning such accounts. This approach may translate into mandatory sale of all amounts that were not specifically exempt by regulation no. 270 dated 12 May 2014 to further surprise of the local businesses.

The National Bank has advanced its strategy of tightening the cash market liquidity and, in addition to the cap on the international transfers, NBU has also imposed universal cap on the UAH cash withdrawals from the deposit and current accounts except compensation under the depositor's protection scheme, salaries and business trip costs (Resolution no. 449 dated 28 July 2014).

Amendments concerning banking activity

Important changes to the Ukraine's main banking laws - "On the National Bank", "On Banks and Banking" and "On the Natural Entities' Deposit Guarantee Scheme" - was voted in Verkhovna Rada on 4 July 2014 and became effective in one week afterwards (Law of Ukraine No. 1586-VII dated 04 July 2014). The minimal authorized capital of a new bank is now set at the level of UAH 500 m instead of UAH 120 m; all operating banks have 10 years to comply with this requirement.

NBU has received additional regulatory instruments such as setting ratios and approval of simplified bank's share issue in the emergency periods.. As a stick, the regulator can now declare the bank insolvent after a single gross violation of cash flow regulations or financial monitoring rules. Moreover, the NBU can apply a range of penalties to a bank's shareholder (owning material stake) if the bank or the shareholder were sanctioned by foreign state or international organization, or if they have engaged in the risky activities *"harmful to the interests of bank's depositors or other creditors and/or to stability of the banking system"*.

The law restates procedures for assisted merger and auction of investors, establishment and closure of the bad bank for utilization of toxic assets on the market. The Individual Depositor Protection Fund can create monopolies in sale of the bank assets and settlements with the bank creditors in the form of fully-owned subsidiaries exempt from the requirements of general laws on financial sector. Such monopolies, absent clear rules on their functioning may hamper market for unwinding of the financial structures and impair the interests of the creditors.

To finance the rescue of the banks or bridge the gap between compensation of the depositor and proceeds from the sale of the bankrupt bank's assets, the Fund is authorized to issue bonds and sign the promissory notes, attract loans from the State Bugdet, non-resident companies and individuals, Ukrainian non-banking financial institutions. The Fund's administrators can hire consultants to restore the solvency or complete the bankruptcy of the bank; make loans to the banks. The Fund can establish duty to repay the loans/financing it has attracted.

Beware transacting with the banks

The customers will be able to rely on the guidelines issued by the Individual Depositor Protection Fund with respect to the contents of the current account and deposit account agreements.

The bank's creditors beware of 1-year hardening period with respect to the following operations by declining bank that are invalid if made within 12 month before the administrator's appointment:

- When the bank provided services, works and assets free of charge or at the price at least 20% below the usual value or if the bank bought the same at the price at least 20% above the usual value;
- Deviating terms of security agreements or of agreements with affiliates;
- Agreements that benefit one creditors over the others except (however, the bank can establish exemptions);
- Excessive obligation that rendered the bank insolvent or made impossible performance of other undertakings or where the bank, on the day of payment had negative value of the assets.

The supplier has no possibility to check appropriate price range. As to the "excessive" obligation, the creditor can make a guess upon careful analysis of the banks financial statements, however, it would be difficult to control the net assets of the bank especially before the end of the relevant day.

Making payments in the emergency situation

The regulator has approved framework directives on emergency banking (Resolution no.435 dated 22 July 2014), which outline strategies in the emergency for the management of the banks and NBU, supervision of the currency and money markets, functioning of the NBU's interbank payment system, suspension and termination of the membership in the government payment system, interaction with the customers, cash management, data system and, accounting records back up and revamping. Resolution 435 can be seen as a supplement to Resolution no. 444 of 2004, which deals with "special period" such as wartime, mobilization, emergency situation, anti-terrorist operation. The latest regulations, however, provide boundless powers to the National Bank of Ukraine, where the regulator entitles itself to act at its own discretion based on the situation and, as it appears, notwithstanding the laws. ■

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