GIDE

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newsletter

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DOING BUSINESS

Special regime of Donbas region clarified

Following the 2014 Minsk ceasefire talks on the military conflict in Eastern Ukraine, the Parliament passed the Law On the Special Regime of Local Self-Governance in Certain Districts of Donetsk and Luhansk Oblasts (the Donbas Special Regime Law), which was supposed to establish specific regulations in the territories *de facto* out of Ukraine's control. It attracted considerable criticism for being strikingly 'defeatist' and aimed at preserving the conflict for years. The most criticised provisions included granting municipal authorities broad powers in appointing heads of the prosecutor's offices and courts; introducing immunity from criminal and administrative liability for local militants (widely understood as an amnesty for terrorists); establishing an obligation of the Ukrainian central government to deal with the newly formed regional authorities (including the issues of funding) on the basis of specially negotiated agreements, and (the most controversial) granting local municipalities a right to create local militias, which was believed to legalize terrorist 'militias' and paramilitary troops.

However, while formally the Donbas Special Regime Law entered into force on 18 October 2014 it remained *de facto* unimplemented, as the Parliament failed to set forth the territorial scope of its application (identify the covered territories within the Donetsk and Luhansk regions), which it was supposed to do.

On 17 March 2015, the Parliament passed a law amending the Donbas Special Regime Law by modifying its provisions on entering into force (the Law). The Law expressly states that the provisions of the Donbas Special Regime Law would apply *only* to the local self-government bodies and authorities, which are formed following special elections yet to be called and held. Most importantly, the Law clarified that the majority of provisions of the Donbas Special Regime Law (including the most controversial ones) would become effective as of the date of assuming powers by the newly elected municipal bodies, however, provided that: such elections are held according to the Constitution and other Ukrainian laws, are transparent, public and open, conform to the international standards of human rights protection and democracy; are monitored by impartial observers (such as OSCE, Council of Europe), all unlawful military and paramilitary troops are removed, and a right to vote of internally displaced persons (who now reside outside of the covered territories) is ensured; broadcasting by Ukrainian TV channels and radio stations within the covered territories is resumed.

The Law was signed by the President and entered into force on 21 March 2015 under No. 256-VIII.

Along with the Law, the Parliament also adopted a resolution identifying the 'covered Donbas territories' where the Donbas Special Regime Law would apply (if all conditions for its entry into force are met); as well as a resolution declaring such territories 'temporarily occupied', presumably, with a regime similar to that in the Crimea, however, without introducing any special regulations with respect to customs, trade, bank transactions, business activities, etc. (such regulations may be forthcoming).

CORPORATE

The minimum quorum for joint stock companies reduced, effective immediately

On 25 March 2015 the President signed into law the recently adopted draft On Amending the Joint Stock Companies Law whereby the minimal quorum, required for general shareholders' meetings of joint stock companies (with or without state shareholding) to be competent, was reduced from at least 60% to 50%+1 vote of the entire stock. This novelty is generally believed to help resolve the 'deadlocks' arising in the companies where minority shareholders (holding in total over 40% votes) could block the decision-making process merely by ignoring the general shareholders' meetings; such 'deadlocks' lasted for years and seriously hampered the company's activities.

Another notable provision of the Law is introduction of a simplified procedure of recovery of dividends which were approved at the general shareholders' meeting but which were not paid within 6 months after the respective decision had been passed. Such dividends now will be recoverable by aggrieved shareholders extra-judicially, as 'undisputed' accounts payable, through the execution certificate by a notary, and without recourse to courts.

The majority of the Law's provisions already entered into force on 27 March 2015 (the next day after its official publication). Notably, the Law repealed the earlier law adopted by the Parliament on 13 January 2015 which had introduced similar reduction of quorum but effective as of 1 January 2016 (except for joint stock companies with the state shareholding affected immediately). The Law also specifically establishes that the existing charters of joint stock companies will be overridden by the provisions of the Law.

Derivative suit and other important changes to corporate law to be introduced

On 2 March 2015, a draft law On Amending Certain Laws of Ukraine regarding Protection of Investors' Rights passed the 1st reading in the Parliament (the "Draft Law"). The Draft Law purports to introduce a number of very important and long awaited amendments to corporate and civil laws aimed at strengthening protection of shareholders, primarily *vis-à-vis* unscrupulous and abusive management (corporate officers).

Most notably, the Draft Law introduces a concept of derivative suit, *i.e.*, an action brought by a shareholder of a company against the management (officers) of that company. So far, by virtue of the decision of the Constitutional Court of Ukraine dated 1 December 2004 (case no. 18-rp/2004), shareholders have no right to act and file claims on behalf of the company, including cases when they seek to protect the company against apparent mismanagement. Under the Draft Law, shareholders having at least 5% of company's shares will have a right to file a claim on behalf of the company for recovery of damages caused by the company's officers (management). Such cases will be handled by commercial courts at the place of incorporation of the company in question and will have to be completed in the first instance within 3 months.

It is, however, unclear from the text of the Draft Law whether filing of a derivative action has to be preceded by establishing damages in a separate proceeding (in this regard, the Draft Law is criticized for creating a potential for misuse by minority shareholders of their rights through harassment of the company's management by filing unfounded ('frivolous') derivative actions). This issue is expected to be clarified in process of preparation of the Draft Law for the 2nd and 3rd readings.

Other important changes which are purported to be introduced by the Draft Law concern:

- removal of the maximum number of shareholders in private joint stock companies (currently 100 shareholders) while pre-emptive rights (essentially, the right of first refusal) of other shareholders with regard to the shares offered for sale will be preserved (if provided in the charter) only in joint stock companies with up to 100 shareholders;

- establishment of full liability of the joint stock companies' officers for damages caused to the company;

- introduction of a position of the 'independent director' to represent minority shareholders in public joint stock companies;

- improvement of provisions of the Joint Stock Companies Law on interested party transactions (i.e., contracts in conclusion of which a company's insider (such as an officer or a significant shareholder) is interested) and, in particular sets forth a value threshold of 100 minimal wages over which the restrictions will apply.

In order to enter into force the Draft Law has to pass the second and the third readings and be signed by the President. If signed, the majority of its provisions will enter into force on 1 January 2016.

Rules for disclosure of information by issuers of securities changed

On 1 March 2015 the amendments to the Regulation on Disclosure of Information by Issuers of Securities approved by Resolution no. 2826 of the National Commission for Securities and the Stock Market (the "Commission") dated 3 December 2013 entered into force. The amendments were approved by the Commission on 16 December 2014 and concern the publication of information by issuers of securities on their own websites (web pages).

In particular, the Commission set forth the deadlines for publication of specific and regular information on the company's website, abolished the requirement to submit information to the Commission in paper form, and approved the forms for publication of annual information in the official media for issuers that held public and private placement of shares.

The Regulation on Disclosure of Information by Issuers of Securities was also amended with new Chapter IX regulating the rules of disclosure of information by public joint stock companies on their web pages, including the scope of information and the terms of its publications. The list of information to be disclosed is quite extensive and includes constituent documents of the company and amendments thereto, internal regulations, minutes of the general meetings of shareholders, reports of the audit commission (auditor), reports to governmental authorities, list of persons affiliated with the company, prospectuses for securities, documents related to convocation and holding of general meetings of shareholders, specific and regular information etc.

It should be pointed out that disclosed information must remain on the company's website during the term of its life (except for information related to accounting documents which is kept until the expiry of the documents retention period).

BANKING AND FINANCE

Extension of currency control restrictions

On 3 March 2015 the NBU issued Resolution No. 160 (On Regulation of Capital and Foreign Exchange Market of Ukraine) whereby limitations on capital flow and forex transactions, initially intended to lose effect on 3 March 2015, have been expanded in scope and extended for the next 3 months, until 3 June 2015. The most important limitations on business transactions are as follows:

Trade and Capital Transactions

- the 90 days period for the completion of settlements under export and import contracts;
- mandatory sale of 75% of all foreign currency proceeds received from overseas;
- prohibition of prepayments under foreign loans, including where repayments are shifted to earlier dates;
- ban on national currency loans secured by pledge over foreign currency deposits/ accounts;
- no investment in UAH denominated treasury bonds by foreign investors (except if the treasury bonds are purchased through the stock market using Hryvnias converted from foreign currency on the interbank market);

Banks' Operations

- limitation on banks' own forex transactions where the surplus between the purchased and sold currency or precious metals exceeds 0.1% of the regulatory capital of the bank (except for swaps). Also, banks are prohibited from entering into foreign currency derivatives;
- limit for banks' long foreign currency position at 1%;
- limitation on the issuance of registered deposit certificates by banks with a tenor less than 6 months and prohibition of issuance of open-faced deposit certificates;

Foreign Exchange Transactions

- foreign currency purchase orders will be settled by banks not earlier than on the fourth banking day (T+4);
- foreign currency purchase orders issued by legal entities having own foreign currency in the amount not less than USD 10,000 deposited with Ukrainian banks will be satisfied only for the amount in excess of such deposited currency. Pledged foreign currency, deposits made before 4 March 2015 and currency on accounts held with insolvent banks will be disregarded for the purpose of this limitation;
- foreign currency purchase orders must be accompanied by, in case of import transactions, a tax arrears certificate issued by the State Fiscal Agency or, in case of sale of listed securities, a confirmation of the National Securities and Stock Exchange Commission;

Prohibited Divestment Transactions

- overseas transfer of foreign currency proceeds received from the sale of Ukrainian shares on a non-regulated market;
- overseas transfer of foreign currency proceeds from the sale of corporate rights, decrease of the charter capital or withdrawal of foreign participant from a company;
- transfer of dividends to overseas accounts; and
- transfers under individual licences issued by the NBU - except for (i) licences for the transfer of foreign currency by resident - guarantor under loans granted by IFIs or ECA; (ii) licences for depositing foreign currency onto accounts outside Ukraine; and (iii) licences for payment of membership fees or contributions.

Please note that the limitations applicable to advance payments under import contracts are regulated by NBU Resolution No 124 dated 23 February 2015. For more details please follow the link to access our overview of the above mentioned NBU Resolution.

Expanding liability of the bank's related person

The National Bank and the Verkhovna Rada rushed in a draft law on liability of persons related to banks, which was passed into law 218-VIII on 2 March 2015 and became effective just in five days afterwards. The officials claimed that this law was a core condition, along with a more balanced budget, missing before the IMF Board decision on the 4-Year US$17.5 Billion Extended Fund Facility for Ukraine, with US$5 Billion for immediate disbursement.

The law is mostly concerned with definitions and may appear a healthy compromise between the positivism and prudence: first is an approach of the bureaucracy (do only what the law expressly says), second - the best foreign practices (regulators must foresee developments of the market and drive them to becoming a law). The lawmakers tried to include various non-profitable organisations into the chain of beneficiary ownership, but the accomplishment is dubious: the beneficiary of the trust structure is not a legal owner and may not be a beneficial owner of the stake in the bank; therefore, a new test of ownership 'regardless of control', introduced by the law, misses the point and adds vagueness instead.

In our view, banks should be concerned with the increased burden of compliance, particularly, regarding disclosure of the ownership chain. The sweeping nine categories of 'related persons' leave no safe harbor rule, therefore, in the relatively small banking community of Ukraine, the National Bank should reasonably restrict itself in supervising transactions with related entities under the revised law.

The National Bank of Ukraine has lowered the threshold for reporting of key owners from 10 per cent to 2 per cent, moreover, this information will be published as it becomes available to the regulator. Moreover, banking groups were redefined in less than 3 years of their introduction and new requirements to their consolidated reporting were developed. The most controversial point of the law is that the NBU will evaluate whether banks act in good faith, however difficult this can be. It would be important to put a deadline on the unlimited discretion of the National Bank of Ukraine provided by the law, or, at least, provide for the review of the changes to the law on banking within 2 or 3 years. Currently, however, the market players risk that after the government changes, the discretion of the regulator may be abused in relation to the compliant entities.

The part of the law that increases the administrative and criminal penalties looks superfluous in an effort to modify the substantive description of the respective misdemeanor and offence; we also think that the legislature took a wrong approach to distinguish creditors of the banks to persecute malicious insolvency of their debtors, while depositors and other creditors of other financial institutions (e.g. credit unions, insurance companies) or general corporate entities have remained relatively disadvantaged.

LABOUR

Compensation to companies of average salary of employees called up for military service

On 4 March 2015 the Cabinet of Ministers of Ukraine approved by its Resolution no. 105 the much anticipated Procedure for Compensation to Companies, Institutions, Organizations in the Amount of Average Salary of Employees Called Up for Military Service during Mobilization, for a Special Period (the Procedure).

May we remind you that Article 119 of the Labour Code of Ukraine provides that employees called up for military service, for a special period, however, not more than one year, retain their jobs at the companies where they were working before being mobilized, and receive compensation from the state budget of their average salary (the Compensation). Until now expenses for paying the Compensation were born by the employers. Absence of the procedure for their payment and reimbursement by the state raised many questions, including ambiguous taxation.

According to the Procedure, the Compensation in the amount of average salary must be paid to mobilized employees by employers, irrespective of the form of ownership, and then reimbursed by the Ministry of Social Policy of Ukraine through its territorial divisions based on the reports on actual expenses.

The Law of Ukraine on State Budget for 2015 envisaged funds for the Ministry of Social Policy of Ukraine for paying the Compensation to mobilized employees in the amount of UAH 1.79 bln.

The Procedure sets the deadlines for payment of the Compensation to mobilized employees by employers (they coincide with the terms of salary payment), however, does not define the deadlines when the amount paid will be reimbursed to employers from the state budget.

The Procedure provides that the taxation and collection of single social contribution on the Compensation must be done in accordance with the Tax Code and the Law of Ukraine on Collecting and Accounting of the Single Social Contribution.

TAX

Legislative incentive for salary increase

By virtue of law no. 77-VIII dated 28 December 2014 the Parliament of Ukraine introduced a reduced rate of the Single Social Contribution ("SSC") for 2015 for companies, significantly increasing their employees' salaries. The reduced SSC was meant as an incentive for employers to bring cash-in-hand salaries onto the books.

However, the law's provisions regarding the reduced SSC were recently changed. Whereas under the previous version of the law only salary increases of more than 30% entitled to the reduced rate of the SSC, now even salary increases over 20% are eligible. The Parliament also repealed certain other requirements which might affect small businesses.

According to the new rules, which entered into force on 13 March 2015, in 2015 employers will pay the reduced rate of the SCC, provided that they meet the following requirements:

- salary or other income subject to the SSC is increased by at least 20% over the average monthly salary per insured person in 2014; and
- average SSC per person (after application of the reduced rate) will not be less than the monthly average payment in 2014;
- the number of the employees does not exceed twice their average monthly number in 2014 (not applicable to employers - individuals).

Under the rules mentioned above, employers basically should not pay the SSC on the amount of the salary increase. For example: employee's average salary in 2014 was UAH 5,000.00, the SSC payment was 1,838.00. The employer now increases the salary by 20%, and the new salary amounts to UAH 6,000.00 while the SSC amount remains UAH 1,838.00. However, should the salary be increased by over 250%, the reduced SSC rate will not apply to the excess.

The new rules can be enjoyed not only by employers bringing cash-in-hand salaries onto the books, but also by employers that increase the salaries for other reason (to compensate for inflation, etc).

Starting from 1 January 2016 the SSC rate will be reduced by 60% for all companies (as initially approved by the Parliament).

PHARMACEUTICALS

Law on public procurement of medicines by international institutions adopted

On 19 March 2015, the Ukrainian Parliament voted for Law no. 2150 introducing changes into the Ukrainian public procurements rules (the "Law").

The Law is aimed at streamlining public procurement of medicines and medical equipment in a transparent manner and in accordance with best international standards.

In accordance with the Law, the Ukrainian Ministry of Healthcare will have the right, temporarily - until 31 March 2019, to assign to reputable international institutions (UNICEF, International Dispensary Association, Crown Agents, Global Drug Facility, and Partnership for Supply Chain Management and similar) conducting of centralized public tenders for procurement by Ukraine of medicines. In those cases the Ukrainian Public Procurement Law will be derogated in favour of procurement policies and rules of those institutions.

Besides, the Law envisages that until 31 March 2019, medicines and medical equipment procured by such institutions will enjoy a special public regulatory regime including:

- Exemption from local labeling requirements and local certificates of production conformity;
- Fast-track procedure for registration with the state registers;
- Exemption from local regulatory reference prices;
- Possibly to negotiate advance payments.

Importantly, the Law requires the Cabinet of Ministers of Ukraine to issue subordinate legislation for its implementation, which is expected to be adopted soon.

To become effective the Law needs to be signed by the President of Ukraine. ■

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