Ukraine

Major Revamp of Securities Law

The end of March saw the Ukrainian parliament pass a new law "On Securities and the Capital Market"(the "Securities Law"), intended to replace the very outdated 1991 Securities Act and meet the growing demands of the burgeoning Ukrainian securities market. The Securities Law came into effect on May 12, 2006, and provides a unifying framework for the securities laws enacted in Ukraine to date. It also seeks to regulate areas ignored by previous legislation, such as the disclosure of information on the securities markets.

The biggest impact of the Securities Law appears to be in the area of protection of rights of shareholders, and particularly minority shareholders. The Securities Law has significantly expanded the obligation of an issuer to disclose information about itself, its main shareholders and matters affecting its securities. Also, before the Securities Law was passed, Ukraine had no legally defined concept of insider information, nor was there a requirement not to use such information to the detriment of other share holders. As a result, foreign and Ukrainian investors should be better able to make informed investment decisions on Ukrainian securities. Investors have also been provided with legal remedies to protect against fraudulent practices in the securities market. An indirect effect of the Securities Law should thus be increased investment flows into Ukrainian securities from abroad. Below is a summary of the major changes introduced by the law.

Classification of Securities

The Securities Law distinguishes between issuance and non-issuance securities. Issuance securities are issued pursuant to a statutory procedure and confer equal rights on their owners. They include shares, bonds, mortgage certificates, mortgage bonds, real estate operation funds certificates, investment certificates and treasury notes of Ukraine. Non-issuance securities are created individually, and include certificates of deposit, mortgage notes, promissory notes and drafts.

The Securities Law further recognizes share securities (company shares and investment certificates), bond securities (company bonds, municipal bonds, state bonds, treasury notes, deposit certificates, promissory notes/ drafts), mortgage securities (mortgage bonds, mortgage certificates, mortgage notes, real estate operation funds certificates), privatization securities, derivative securities, and title securities (warehouse receipts, etc.). The Securities Law further classifies securities by form of issuance (in documentary and non-documentary form) and method of transfer (bearer, registered and order securities).

Shares and Bonds

The Securities Law introduces the concept of a securities prospectus for disclosing information about the securities, provides for the registration of each issue of share securities or bonds and the prospectus and sets out the steps and procedures to be followed in issuing shares/bonds.

The Securities Law distinguishes between public and private placements and imposes different obligations on issuers depending on whether an issuance is private or public.

Shares are issued by joint stock companies, and only in registered form. A share must be assigned a nominal value set in Ukrainian currency. Shares may be common or preferred. Common shares accord their owners equal rights, such that no different classes of common shares can be instituted, and cannot be converted into preferred shares or other securities of the issuer. Preferred shares may be of different classes and may be convertible into common shares or preferred shares of other classes. Preferred shares cannot exceed 25% of the share capital of a company.

The Securities Law provides for several categories of bonds, including company bonds, municipal bonds and the state bonds of Ukraine. The Securities Law further permits interest bonds, discount bonds and special purpose bonds (that entitle holders to specific goods or services from the issuer). From 2008, companies will be able to issue bonds for an amount equaling either (i) three times the company's share capital or (ii) an amount guaranteed by a third party, whichever is greater. Until 2008, there (unusually) does not seem to be any limitation on the amount of the bonds issue: the new Securities Law repealed both the old Securities Law limit of 25% of the share capital of the company, and the Civil

Code limitation of 100% of the share capital of the company.

Shares and bonds (except for state bonds) come into existence only after the registration of their issue by the Ukrainian Securities Commission. Prior to registration, transactions with shares and bonds are prohibited.

Disclosure of Information

The Securities Law provides for the disclosure of information about the issuer of publicly placed shares and material events potentially affecting the price of shares and holders of large blocks of shares (from 10%).

Regular information concerning the finances and business of an issuer must be filed with the Ukrainian Securities Commission annually and quarterly. Annual information includes, in particular, the name and location of an issuer, its management, business and financial operations, issued securities, annual financial reports and an auditor's report. Essentially the same information is filed on a quarterly basis, except quarterly financial reports and information on participation of an issuer in other companies also must be filed.

Special information is information about events affecting an issuer that may result in a material change in value of its shares. Such events particularly include placement by an issuer of securities in excess of 25% of its share capital, redemption by an issuer of its shares, listing or delisting of shares of an issuer on a stock exchange, an issuer obtaining loans in excess of 25% of its assets, a change in the officers of an issuer, a change of shareholders owning 10% or more of the shares, and the reduction in the share capital of an issuer.

Insider Information

The Securities Law defines insider information as any information not publicly disclosed about an issuer or its securities or transactions with its securities, the disclosure of which may materially affect the securities'value. Under the Securities Law, insiders include persons in possession of insider information due to the fact that they are owners of voting shares of an issuer, officers of an issuer, or persons with access to insider information in connection with their employment or contractual relations (e.g., lawyers, accountants, consultants, etc).

The Securities Law makes it illegal for an individual to use insider information to (i) enter into contracts on his or her behalf or on behalf of other persons involving the acquisition or transfer of shares subject to insider information and (ii) disclose insider information to third parties, or make recommendations on the acquisition or transfer of shares before public disclosure of such information. Securities traders and other members of the securities markets are required to report to the Securities Commission transactions suspected to be based on insider information. The Securities Law introduces criminal liability for the unauthorized disclosure of insider information.

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Foreign Employee Requirements Clarified

The Ukrainian authority charged with the issuance of work permits has recently clarified the law relating to the employment of foreigners in Ukraine (Letter of the State Employment Center dated March 24, 2006, No. DTs-12-1556/0/6-06 "Concerning the Use by Employers of Foreign Nationals and Persons without Nationality as Hired Labor").

The State Employment Center has confirmed that foreigners who come to Ukraine to work can do so only subject to a work permit. However, no work permit is required for employees of representative offices of foreign firms registered by the Ministry of Economy of Ukraine (i.e., in the normal manner applicable to the registration of foreign representative offices). The State Employment Center also clarified that work permits are not required for foreigners working in Ukraine as 'independent contractors'. This is an important point, since there had been uncertainty as to the legal treatment of independent contractors, and particularly the extent of risk of re-characterization of independent contractors as employees by the labor authorities. It follows from the clarification, however, that where foreigners operate in Ukraine as truly independent contractors, they should not require work permits and should not face the risk of reclassification as employees.

This development should be seen as a positive move for businesses wishing to engage foreign nationals. Not only has the process of obtaining a work permit always been a time-consuming process in Ukraine, it is also never guaranteed, as an employer must show that there are no Ukrainian nationals able to perform the work for which a work permit is sought.

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Ukraine Enacts a New Law on Holding Companies

A new law has been introduced governing the creation, operation and liquidation of holding companies in Ukraine, but foreign investors and Ukrainian companies alike will be disappointed that the new law raises more questions than it answers. Not only does the new law restrict the ability of private companies to qualify as a holding company, it also fails to provide the legal mechanisms for preferential tax treatment or other advantages which holding companies in other jurisdictions enjoy. Significant further amendments are required for a holding company to be considered a beneficial corporate structure in Ukraine in terms of strategic tax planning and management.

The Law "On Holding Companies in Ukraine" (the "Holding Companies Law") came into effect on April 18, 2006. All holding companies and their subsidiaries established in Ukraine before this date must bring their foundation documents into compliance with the requirements of the Holding Companies Law within 3 years.[1] The Holding Companies Law contains a significant number of regulations specifying the rules governing the formation, decision-making process, liability and liquidation of holding companies. The following points are of particular note:

New Criteria

The Holding Companies Law restricts the ability of a company to qualify as a holding company in that it requires the company to meet each of the following three criteria in order to qualify: (a) it must be an open joint stock company; (b) it must own corporate rights in two or more other companies; and (c) it must either control more than 50% of the shares in at least two other companies ormust ensure decisive influence on the economic activity of at least two other companies.

These new criteria therefore preclude limited liability companies and closed joint stock companies from becoming holding companies as defined under the law, even if they have full control or ownership over several other companies. Similarly, a company owning or otherwise controlling only one subsidiary company cannot be a holding company, as it must own 50% + 1 share in each of two or more companies. Since private companies are more frequently established in the form of limited liability or closed joint stock companies, the Holding Companies Law significantly restricts the ability of private companies to establish holdings (compared to state companies, which are generally organized in the form of open joint stock companies). A limited liability company or joint stock com pa ny that wou ld otherwise meet the holding company requirements, will thus be required to reorganize into an open company and then register as a holding company.

The name "holding company" may only be used by those companies whose founding documents and activity are in line with the Holding Companies Law. A legal entity cannot call itself a "holding company" unless it is registered in the form of a holding company.

Holding Company Creation

Article 3 of the Holding Companies Law stipulates that holding companies may be established by: (a) the bodies authorized to manage state property; (b) state privatization bodies; (c) state privatization bodies together with other founders; and (d) other entities on contractual terms. In certain circumstances, the founders of a holding company must obtain the preliminary approval of the Antimonopoly Committee (the "AMC") prior to filing its foundation documents with the relevant registration authorities.

Mandatory Disclosures

Under the Holding Companies Law, holding companies are required to disclose specific information in the official printed media of the State Commission on the Securities and Stock Market and must publicize their own and their subsidiaries' consolidated financial reports at least once a year. Failure to file, late filing or filing false information can result in fines being levied on the holding company (of up to 1,000 times the non-taxable minimum income (UAH 17,000, or US $3,370)) and the company's chief executive (of up to 50-100 times the non-taxable minimum income (UAH 850-1,700, or US $168-337)).

Notable Absences

The Holding Companies Law fails to address a number of significant issues, including the administration of a holding company. Nor does it regulate the interaction of a parent company with its subsidiaries, orthe exercise of control by a holding company over its subsidiaries. The Holding Companies Law also fails to provide any regulation of the rights of subsidiary enterprises, so that subsidiaries could fully realize their rights as independent economic entities.

[1] Previous legislation did not govern the creation of private holding companies (only those holding companies established in the process of privatization and corporatization), and the Holding Companies Law contains a recommendation that the President cancel this earlier legislation.

Furthermore, the Holding Companies Law does not include any provisions for preferential tax treatment of holding companies, which will not provide any incentive to investors to use Ukrainian holding companies in their tax planning, a practice common in more developed countries. For example, if a Ukrainian holding company carries out no operations but owns shares in two or more subsidiaries, each of the subsidiaries will be required to pay an advance corporate tax (the "ACT") of 25% on any dividends it pays to its holding company. Each subsidiary is then permitted to deduct the ACT from its future profit tax obligations. However, when the holding company pays out dividends to its own shareholders, it also must pay a 25% ACT – but since the holding company has no taxable earnings of its own (dividends do not qualify as taxable income), it is unable to set off the ACT against future profit tax payments. So, while the holding company keeps building up its 25% ACT credit, it is unable to utilize that credit. The result is that an additional 25% is effectively lost to tax in such a structure unless the holding company engages in other activities that generate taxable income, against which the 25% ACT on dividends can later be offset.

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