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GENERAL LEGAL CONSIDERATIONS
FOR DOING BUSINESS
IN UKRAINE

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The materials in this Guide have been prepared for informational purposes only and are not legal advice. This information is not intended to create, and receipt of it does not constitute, an attorney-client relationship. We are happy to provide you with further information regarding a specific industry or area of Ukrainian law in which you may have a particular interest. Readers should not act upon the information in this Guide without seeking professional counsel.

I. INTRODUCTION

A. UKRAINE: AN OVERVIEW

1 Geography and Population

Ukraine is situated in eastern Europe, and shares borders with Russia, Moldova, Belarus, Hungary, the Slovak Republic and Romania. In the south, Ukraine borders over 2,700km of Black Sea coastline. It occupies a strategic position at the crossroads of Europe and Asia, and is the second largest country in Europe (after Russia). The population of Ukraine numbers approximately 46 million.

Ukraine benefits from an abundance of natural resources: its 'black soil' enabled it to produce over 46% of the USSR's total agricultural output; and the full extent of its mineral resources (including iron ore, coal, oil, natural gas and graphite), both on the mainland and on its continental shelf, have only recently begun to be explored and exploited.

2 General Economic Overview

Ukraine's transition from a Soviet planned economy to a market economy has been a difficult one, and it still faces challenges in economic restructuring and enforcing market relations. The country that once generated 16.5% of Soviet GNP has undergone tremendous upheaval and partial collapse. Fundamental economic and organizational measures were taken by the government to counteract the decline in Ukraine's economy following its independence from the USSR in 1991, but these suffered a serious blow as a result of the Russian financial crisis in 1998. However, the end of 1999 saw Ukraine start to enjoy a phase of economic stabilization and growth, with GDP growth between 2000 and 2003 totaling 33.1%. 2004 saw real GDP reach 12.1% (an all-time high since independence) which was due, in part, to increased activity in export industries which benefited from high prices on the world metals market.

2005 saw a temporary fall in GDP, with GDP increasing in 2006 and reaching a healthy 7% in 2007. This reflects a shift to a more sustainable growth model based on internal consumption rather than exports of raw materials. Despite the slowdown in growth of GDP, economic analysts are virtually unanimous in their assessment that the Ukrainian market offers tremendous long-term potential for economic growth. Its population is highly educated and the country's natural resources are abundant. It is also worth noting that foreign investment activity in Ukraine has seen a significant rise, rapidly accelerating since 2005, growing by no less than USD 5 billion per annum. This was initially triggered by the reprivatization of Kryvorizhstal steel plant for USD 4.8 billion, but this growth has continued into the financial (principally banking) and real estate sectors of the economy. However, as a result of recent events in the global credit

and financial markets, and the recent fall in the price of Ukraine's main export (steel), Ukraine has recently needed to request funding from the International Monetary Fund (IMF), and has passed legislation approving the USD 16.5 billion stand-by loan offered by the IMF. Although there is highly likely to be a slowdown in economic growth in the short-term, and it is uncertain how the global financial crisis may ultimately impact upon the flow of foreign investment into Ukraine and upon the Ukrainian economy in general, enormous potential exists for rapid economic growth in almost all sectors of the Ukrainian economy in the medium to long-term; and, by exploiting the under-utilized, inexpensive, skilled and educated labor force, for a diversification away from its traditional commodity-based industries.

3 Political Developments

Ukraine has only been an independent country since 1991, and as a result its political and democratic institutions are still in a developing stage. Presidential elections in 2004 were rife with scandal and had to be re-run, with the so-called 'Orange Revolution' (a coalition of centre-right supporters of democracy) leading to the pro-democracy candidate Viktor Yushchenko becoming President. The key aims of the government have since been to strengthen Ukraine's economic policy, deregulate business, reduce taxes, secure financial stability and increased investment, improve productivity in certain industries, and to fight corruption. Yushchenko has also introduced initiatives for Ukraine to accede to the WTO (which occurred on May 16, 2008) and prepare for entry into the European Union. However, there has been widespread discontent among a significant proportion of the population that progress has been slow, and the dividends that many expected from the Orange Revolution have failed to materialize.

Parliamentary elections were held in March 2006 but a period of political uncertainty ensued as a result of the failure by any single faction to obtain a decisive majority or form a workable coalition. The Orange Coalition's failure to agree to the terms on which its various factions would form a government resulted in a parliamentary political coalition of left-oriented parties, with Viktor Yanukovich (a pro-Russian candidate, and leader of the party which won a plurality of votes), becoming Prime Minister in early August 2006. Fresh elections were held on September 30, 2007 as a result of which a reconstituted Orange Coalition came to power, with Yulia Tymoshenko appointed as prime minister. However, on September 3, 2008, Yushchenko withdrew his party from the governing coalition due to political infighting with Tymoshenko, and dismissed Parliament. As a result of the global financial and economic crisis, Yushchenko reconstituted Parliament on an interim basis in order to pass the necessary legislation to obtain the two-year USD 16.5 billion stand-by IMF loan. The political turmoil continues as its Speaker, Arseniy Yatseniuk, who was dismissed from the post on November 12, 2008 has not yet been replaced. It is currently uncertain who will replace Yatseniuk as Speaker, when fresh parliamentary elections will take place or a new governing coalition be formed.

4 Legislature, Executive and Judiciary

The Ukrainian constitution was adopted on June 28, 1996. It provides for a single legislative body, the Verkhovna Rada (*Parliament*), an executive branch and a judicial branch. Ukraine's legal structure is based on a civil law system, with legislative acts being capable of judicial review.

Parliament. The Parliament comprises 450 seats, allocated to 'deputies' on a proportional basis to those parties that gain more than 3% of the national electoral vote. Deputies serve five-year terms. A significant majority of the current deputies are businessmen/ entrepreneurs, and there is a widespread view held in Ukraine that most of the deputies are US dollar millionaires, enjoying a standard of living and lifestyle far removed from the average Ukrainian.

Executive. The Executive branch comprises the President, the Prime Minister and a Cabinet of Ministers. The Cabinet of Ministers are, at least in theory, selected by the Prime Minister (apart from the foreign and defense ministers, who are chosen by the President). The President is elected by a national vote, and continues in this role for five years (with the possibility of being re-elected for a second five-year term). In late 2004, significant changes were introduced into the Constitution which transferred major powers from the President to the Prime Minister - and the Prime Minister is now the most influential political figure in Ukraine.

Judiciary. The judicial branch comprises (i) the Supreme Court and (ii) the Constitutional Court. The first level of the Supreme Court system comprises the lower courts of general jurisdiction, which cover civil, criminal, family, military, commercial and certain administrative cases. Ukraine has an appellate system, whereby the decisions of a lower court may be appealed by one or both of the parties. As part of this system, the courts of appeal (second instance) are entitled to review the judgments of the local common courts. In turn, the Higher Administrative Court of Ukraine (pending creation) and the Higher Commercial Court of Ukraine (the courts of third instance), are entitled to check the validity of the courts of lower instance. The highest judicial body is the Supreme Court of Ukraine, which reviews judgments of lower courts and issues decisions and clarifications on Ukrainian law.

The Constitutional Court was formed to decide solely on questions of interpretation of the Constitution, and accordingly, in practice, a very small number of cases are referred to this court.

B. UKRAINE'S BUSINESS ENVIRONMENT

1 Investment Levels to Date

As of July 1, 2007, total foreign direct investments in Ukraine since independence has accumulated to approximately US\$24.17 billion.

Foreign investors in Ukraine have historically come from a range of European countries, as well as the US. The top investors in Ukraine accounting for 84% of the total FDI coming to Ukraine comprised: Germany - USD 5.68 billion, Republic of Cyprus - USD 4.13 billion, Austria USD 1.96 billion, the Netherlands - 1.86 billion, Great Britain - USD 1.8 billion, the USA - USD 1.38 billion, the Russian Federation - USD 1.24 billion, France - USD 935 million, British Virgin Islands - USD 813 million and Switzerland - USD 580 million.

2 Ukraine's Overall Market Infrastructure

The planned economy of the Soviet Union was run with qualitatively different objectives from those prevalent in a free market system. Thus, most of the businesses in Ukraine do not have any significant history of operating within a market-oriented economy. Relative to companies operating in Western economies, a significant number of companies in Ukraine are characterized by a lack of experienced management, a lack of modern equipment and technology, and insufficient capital with which to develop and expand their operations.

While steps have been taken to strengthen the Ukrainian banking system, there is still some way to go to make it more efficient, reliable and stable - although the consumer population's trust in the banking system has improved markedly since the lows of 1998. As of August 2008, 176 banks held licenses for banking operations in Ukraine. The first large-scale foreign investment in the Ukrainian banking sector occurred in autumn 2005, when Austria's Raiffeisen Banking Group purchased Aval Bank (one of Ukraine's largest banks) for over US\$1 billion. This has been followed by a wave of acquisitions of Ukrainian banks by Western (mainly European) buyers, and currently over a third of the total capital in Ukraine's banking sector is occupied by foreign capital. Foreign investors are attracted by the burgeoning consumer credit, mortgage and small business lending markets which, although in a fairly nascent stage (and currently subject to a slowdown), have capacity for considerable expansion - demand for consumer credit is particularly high.

3 The Ukrainian Securities Market

Ukraine has two main stock exchanges: the electronic First Securities Trading System (*PFTS*), with around 220 companies listed, with a total market capitalization of just under US\$ 140 billion (for comparison the NYSE has USD 25 trillion) and (ii) the Ukraine Stock Exchange (*USE*), with around 49 companies currently being traded. Ukraine also has more than six regional exchanges.¹

The Ukrainian securities markets are still characterized by low levels of transparency, liquidity, efficiency and regulation. There are a large number of disparate laws and regulations which currently govern Ukraine's securities markets, and the piecemeal approach taken to the development of the corporate regime has resulted in conflicts between key pieces of legislation. However, the introduction of the Securities Law (which entered into force in May 2006) has aimed to provide a unifying framework for the securities laws enacted in Ukraine to date, as well as regulating areas ignored by previous legislation, for example, disclosure of information on securities markets. The Securities Law brings important modifications to the Ukrainian stock market, significantly widening the scope of information available to investors. Commentators agree that the new law constitutes a significant improvement compared to the earlier legislation, providing rules which will be clearer to investors, and bringing Ukraine's securities and capital markets more in line with European legislation. However, inconsistencies in the Securities Law have already been identified.

¹ It is reported that none of the local exchanges offer a credible alternative to listing for most Ukrainian companies, since none of them have the technological sophistication or investor base for companies seeking to raise significant capital.

Despite the challenges for Ukrainian companies and domestic/foreign investors in the Ukrainian securities markets, the PFTS was the world's best performing stock market for the first half of 2007 (97% growth).

In addition, 2005 saw the first IPOs of Ukrainian companies on foreign stock markets, when Ukrproduct (a producer and distributor of dairy products) and XXI Century (a real estate developer) both listed on London's Alternative Investment Market (AIM). In June 2007, Ferrexpo (an iron ore producer) listed on the main market of the London Stock Exchange, raising approximately USD 500 million in the process, and for a short period in 2008, joined the FTSE 100. Analysts predict that more Ukrainian companies will list on foreign markets in the future, with dozens of Ukrainian companies publicly stating their intention to list their shares on foreign markets. Currently, however, IPO activity involving Ukrainian companies has ceased due to the global financial crisis.

4 Corporate Governance, Shareholder Rights and Protections

In general, the corporate governance practices adopted by Ukrainian companies fail to mirror the high levels set by other Western European jurisdictions, the US, *etc.* It is a widely held view of commentators that the combination of legislation, regulation and voluntary practice in Ukraine does not yet provide a sufficient level of corporate governance. While there has been an effort in certain sectors to improve corporate governance (for example, in cases where companies are preparing for an IPO or other forms of foreign investment), in practice, a wider drive for increased transparency and diversification of corporate culture has not yet occurred across the broader Ukrainian corporate landscape

The Ukrainian Securities Commission has issued its own (non-mandatory) corporate governance principles which are based (like other international codes) on the OECD Procedures. However, such principles are not mandatory in Ukraine, and a limited number of companies have declared recognition of them.

A number of the basic shareholder rights that are common in Western markets do not yet exist in Ukraine and the infrastructure supporting private ownership of securities, such as depositories and registrars, is still in the process of development. However, a new joint-stock company law has recently been passed and enters into force on April 30, 2009, a primary focus of which will be the protection of minority shareholders interests. Disclosure and reporting requirements and anti-fraud and anti-insider trading legislation were enacted relatively recently and most companies and managers are not accustomed to complying with such restrictions. Redress for violations of shareholder rights has often been unavailable, although this is likely to change once the new joint-stock company law enters into force.

5 Legal and Regulatory Risks Generally

The laws and regulations affecting Western investment and business in Ukraine continue to evolve, at times in an uncertain manner. Although the basic frameworks of commercial laws are developing, for historical reasons Ukraine lacks the extensive body of law, practice and precedent normally encountered in Western business environments.

The independence of the judiciary, and its insulation from economic, political and nationalistic influences, remains largely untested and is subject to considerable doubt.

In addition, courts in Ukraine lack experience in commercial dispute resolution, and many of the procedural remedies for enforcement and protection of legal rights typically found in Western jurisdictions are not available in Ukraine. However, steps are being taken within governmental authorities to reduce corruption within the judiciary, and the salaries of judges and other court officials have recently been increased.

In short, Ukraine, like other former Soviet countries, suffers not only from a lack of suitable legislation and regulation and from considerable doubt as to how the courts will interpret the existing laws and rules, but from the concomitant absence of a belief in and respect for a “rule of law.”

6 Taxation

In the ten years following independence, the domestic tax burden in Ukraine was high, and the discretion of local authorities to create new forms of taxation resulted in a proliferation of taxes. In the last few years steps have been taken to try to simplify and reduce the tax burden, but a degree of uncertainty still exists - not only with respect to the interplay between various tax laws, but also as to the manner in which such laws will be administered by tax authorities.

7 Accounting and Auditing Practice

Accounting, auditing and financial reporting standards in Ukraine are different from the standards of developed countries. While the introduction of internationally accepted accounting standards is underway, there is currently no general legal requirement for any Ukrainian company to adopt IFRS or GAAP. Ukrainian companies with foreign investment often maintain two sets of books to meet both Ukrainian statutory accounting and international accounting standards. (However, while it is not a mandatory requirement, the majority of Ukrainian banks, larger corporates and those seeking to raise finance on international capital markets, now adopt IFRS and have their accounts audited by international accounting firms.)

For the moment, for the remaining Ukrainian companies, financial reports are prepared for tax purposes rather than to establish the financial state of a company. In addition, due to lower quality of information, lack of historical data and high inflation, it may be difficult to assess the financial state of a company from such information.

As is the case for corporate governance, there is a need for Ukrainian regulators to adopt processes and rules that ensure harmonization of legal and accounting documents with international standards. Regulators also need to develop effective regimes, where necessary, for ensuring compliance with such new processes.

8 Crime, Fraud and Corruption

Ukraine suffers from widespread corruption throughout its economic and political system. Many businesses are subject to theft, extortion and fraud. The problem has been exacerbated by the existence of poorly paid police forces which have failed to combat the significant levels of organized criminal activity. However, the State policy to eradicate corruption declared by the President is beginning to succeed to some extent. According to Transparency International's *Corruption Perception Index 2008*, Ukraine ranked 134th out of 180 states surveyed (which is 13 places higher than Russia and all

other CIS states, except Moldova). By comparison, in 2004 Ukraine ranked among the 16 most corrupt states in the world.

9 Currency

The National Bank of Ukraine (*NBU*) launched the new Ukrainian currency, the Hryvnia (*UAH*) in 1996, shortly after the new Constitution was adopted. As of November 28, 2008, the NBU official exchange rates are as follows:

6.74 UAH = 1 USD

8.70 UAH = 1 EUR

10.41 UAH = 1 GBP

II. AVAILABLE CORPORATE STRUCTURES

A. OVERVIEW

Foreign investors entering into a joint venture or conducting any business in Ukraine have a variety of legal forms from which to choose. In addition to contractual joint ventures (for example, for joint manufacturing or production), there are a number of corporate forms through which a company may be incorporated in Ukraine. These comprise:

- joint stock company (*JSC*);
- limited liability company (*LLC*);
- additional liability company;
- general partnerships;
- production co-operatives; and
- limited partnerships.

Business practice in Ukraine shows that JSCs and LLCs are the corporate forms most commonly used, and in our experience foreign investors prefer their subsidiaries or joint ventures to be organized in either of these two forms. The other types of corporate forms are rarely used by either foreign or domestic investors in Ukraine. Such preference is likely to be based on the fact that the applicable legislation *expressly* states that participants in LLCs and shareholders of JSCs are personally liable only to the extent of their participation interest / shareholding in the declared capital in these types of legal entities, whereas participants of additional liability companies and general partnerships (but not limited partnerships) are individually liable for the obligations of such companies/partnerships. In addition, the beneficial tax advantages provided by Ukrainian legislation in respect of JSCs and LLCs do not apply to additional liability companies and partnerships. This section of this Guide therefore focuses on JSCs and LLCs.

Both JSCs and LLCs enjoy a distinct legal personality, and have capacity to enter into contracts in their own name. Foreign citizens, foreign entities, individuals without citizenship and international organizations may all act as founders to JSCs and LLCs, on the same basis as Ukrainian citizens and legal entities.

Foreign companies may also set up representative offices and branches in Ukraine (discussed in further detail in sub-section D below) - but these do not qualify as separate legal entities under Ukrainian law.

Each of a JSC, LLC and representative office may make and receive payments in Ukrainian and foreign currency as well as buy or lease property, including real estate, in Ukraine. A representative office may receive payments into a local or non-resident's overseas bank accounts. JSCs and LLCs must receive payments into a local Ukrainian bank account.

B. JOINT STOCK COMPANY

The activities of JSCs are regulated principally by the Civil Code, the Economic Code, the Law on Securities and Stock Market and the Law on Business Associations. On September 17, 2008, the Supreme Rada adopted the new Law on Joint Stock

Companies ("the JSC Law") which was signed by the President of Ukraine on October 22, 2008. The JSC law was officially published on October 29, 2008 and will come into force on April 30, 2009. The JSC Law contains a number of modifications: for example, it contains a re-classification of JSCs into public JSCs and private JSCs replacing the current grouping of open and closed JSCs respectively which had been established by the Economic Code. According to the JSC Law it is mandatory that shares issued by a public JSC are listed on a stock market. It is also required that public JSCs are audited in accordance with International Financial Reporting Standards. A private JSC may carry out a private placement of its shares (but not a public listing) and the number of shareholders of a private JSC may not exceed 100.

Under the JSC Law the formation of a Supervisory Board becomes mandatory for JSCs if the number of shareholders exceeds 10, as opposed to 50 under current legislation. The JSC Law creates a new post of corporate secretary to be responsible for relations with shareholders; whether such post is filled is within the discretion of the relevant corporate authorities of each company. Under the JSC Law, shares may exist only in electronic form, however this provision only comes into force on October 30 2010. Cumulative voting for the appointment of the members of the supervisory board and the audit commission will be introduced as a new voting mechanism, a mechanism which will be either mandatory or voluntary depending on the type of company and the number of shareholders.

A JSC shares characteristics with US corporations and UK limited companies, to the extent that a JSC is a legal entity with a charter capital (share capital) divided into a specific number of shares, each of nominal value. Before it can be formally established, a JSC must have a minimum charter capital of 1,250 times the Ukrainian official minimum monthly salary (which has been UAH 605 since December 1, 2008) - the minimum amount is therefore currently UAH 756,250 (approximately USD 112,203²). Preferential shares may not exceed 25% of the charter capital of a JSC. The personal liability of shareholders is limited to the value of owned share(s).

JCSs may be either open (public³) or closed (private⁴). Shares of an open (public) JSC are freely tradable on stock exchanges, with no requirement for the shareholder to obtain the prior consent of other shareholders or the company before transferring his shares. In contrast, shares of a closed (private) JSC are distributed among co-founders/a predetermined group and cannot be publicly traded. Shareholders of a closed JSC have a prior right to purchase shares sold by other JSC shareholders. However, due to ambiguous drafting in the JSC law, it is currently uncertain whether shareholders of a private JSC will have such right of pre-emption. A JSC may be founded by one or more shareholders. However, JSCs cannot be established by a commercial company which itself has only one participant.

Corporate Governance Structure of a JSC

² Using the official NBU currency rate as of November 28, 2008 - USD 1 = UAH 6.74.

³ After April 30, 2009, in accordance with the recently adopted JSC Law.

⁴ After April 30, 2009, in accordance with the recently adopted JSC Law.

The corporate governance structure of a JSC consists of a General Shareholders' Meeting, a Supervisory Board, a Management Board and an Audit Committee:

(i) *The General Shareholders' Meeting (GSM)*

A GSM is the highest body of authority of a JSC, and determines the policy of the Company. All shareholders, regardless of the quantity and type of shares owned by them, are entitled to participate in the GSM. Members of the executive body (*Management Board*) also have the right to participate in the GSM, but with an advisory vote only.

Calling a GSM. A GSM must be convened by the Management Board at least once each year. In addition, the Management Board must convene a GSM (i) if requested to do so by the Supervisory Board, the Audit Committee or the holder(s) of more than 10% of the voting shares of the company, (ii) upon the company's insolvency, and (iii) in cases specified in the company's charter.

Agenda. Only decisions which are included in the GSM's agenda may be voted upon by the GSM. In practice, it is the Supervisory Board who often decide the issues to be voted upon in each GSM, although the law gives shareholders who hold more than 10% (5% according to the JSC Law) of the company's voting shares the right to include issues on the GSM agenda, as long as they notify these issues to the Board at least 30 days (20 days according to the JSC Law) before the GSM. Minority shareholders holding less than 10% (or those holding less than 5% according to the JSC Law) of the company's voting shares are entitled to suggest that an issue is included in the agenda, but there is no legal obligation on the Management Board to include such an issue.

Notification of GSM and agenda. The Management Board must notify each shareholder of the date of the GSM and its agenda at least 45 days before (30 days under the new JSC law) the date of the GSM. Any changes to the agenda must be notified to all shareholders at least 10 days before the GSM. The notification should be published in the Ukrainian official press (under the JSC law such requirement applies only to those companies where the number of shareholders exceeds 1,000). Clearly, these rules aim to ensure that shareholders are able to attend the GSM and be involved in the governance of the company. However, in practice it has often been the case that the Management Board do not adhere to the notification requirements, and in practice shareholders often complain that they were not notified of a change in the date of the GSM, nor given details of the agenda.

Participation in the GSM, and voting rights. All shareholders, regardless of the quantity and type of shares owned by them, are entitled to participate in the GSM. Shareholders have the right to appoint a proxy to attend the GSM and vote on their behalf. A valid shareholders' meeting is constituted (*i.e.*, the GSM is at quorum) when the holders of more than 60 per cent of the shares (under the JSC law - holders of not less than 60 per cent) eligible to vote are in attendance. Shareholders' voting rights are based on the principle of 'one share, one vote', apart from holders of preferred shares, which do not have the right to vote unless expressly provided for in the company's charter. Members of the Management Board also have the right to participate in the GSM, but with an advisory vote only. Under the JSC law there may not be more than three adjournments in the course of one GSM.

The majority of issues within the GSM's remit require a simple majority (*i.e.*, more than 50%) of votes present at a quorate GSM. However, three types of decisions require a 75% majority vote of those shareholders present at a quorate GSM: (i) amendment of the company's charter, (ii) insolvency/termination of the company, and (iii) the creation of subsidiaries, branch offices and representative offices. Ukrainian legislation does not currently permit companies to alter the voting requirements referred to above, nor to alter the quorum requirements for a GSM.

Under the JSC law a 75% majority vote will be determined as 75% of the total number of votes of all the shareholders and the following types of decisions will require such a vote: (i) amendment of the company's charter, (ii) cancellation of the companies own shares acquired by the company, (iii) change of the company's type (private or public), (iv) placement of shares, (v) increasing the charter capital, (vi) reducing the charter capital, (vii) reorganization and liquidation of the company, appointment of the liquidation commission, approval of (a) the terms and conditions of liquidation, (b) the distribution of any residuary assets after all creditors claims have been settled and (c) the liquidation balance sheet. The JSC Law permits companies to increase the number of votes required for other decisions with the exception of the following decisions: (i) early dismissal of the company's officers, (ii) suing the company's officers for damages owed to the company, (iii) suing for breach of the JSC Law while entering into a material transaction. The above decisions are to be passed by a simple majority.

The GSM's exclusive right to determine certain matters. The GSM has exclusive competence to deal with the following matters, which cannot be delegated:

- alteration of the company's charter
- reorganization of the company
- establishment and removal of the Management Board and other corporate bodies
- approval of the annual financial statements of the company and any subsidiaries
- approval of the manner and procedure of distribution of dividends and allocation of losses
- approval of the opinions of the Audit Committee
- establishment, reorganization and liquidation of subsidiaries, branch and representative offices
- approval of the articles of association and by-laws of subsidiaries, branch and representative offices
- appointment of proxy shareholders (as and when legally necessary)
- liquidation of the company

Under the JSC Law the GSM has exclusive competence to deal with the following matters, which cannot be delegated:

- defining the main directions of the company's activity
- alteration of the company's charter
- cancellation of the company's shares
- change of the company's type (private or public)
- placement of the company's shares
- increasing the charter capital
- reducing the charter capital

- division of shares and/or consolidation of the company's shares
- approval and amendment of internal regulations of GSM, Supervisory Board, Audit Committee, Management Board
- approval of any other internal regulations of the company unless otherwise stated by the company's charter
- approval of the annual financial statements of the company and any subsidiaries
- distribution of profits and allocation of losses of the company
- share buy-backs
- decision on the class of shares
- approval of the manner and procedure of distribution of dividends
- convening the GSM
- appointment and dismissal of the members of the Supervisory Board, approval of their terms and conditions of employment
- appointment and dismissal of the head and members of the Audit Committee
- reorganization (in most cases) and liquidation of the company, appointment of the liquidation commission, approval of (a) the terms and conditions of liquidation, (b) the distribution of any residuary assets after all creditors claims have been settled and (c) the liquidation balance sheet
- considering the reports and opinions of the Supervisory Board, the Management Board and the Audit Committee
- approval of the company's corporate governance code

The company's charter may include further issues which are in the exclusive competence of the GSM. Typically, such additional items may include approval of certain significant corporate contracts, appointment of executive officers, and creation of corporate internal rules.

(ii) The Supervisory Board

The Supervisory Board controls the activities of a JSC's executive body and should protect the rights of the company's shareholders. A JSC with over 50 shareholders (10 shareholders under the JSC Law) is required by law to establish a Supervisory Board. There are commonly between five and nine members of the Supervisory Board, selected from the pool of shareholders by a vote of the GSM. Since JSCs in Ukraine are commonly controlled by a relatively small number of large shareholders (which often include management), the Supervisory Board frequently does not contain representation from the minority shareholders.

Issues delegated by the JSC's charter to the exclusive competence of the Supervisory Board cannot be transferred by it for decision to the Management Board. Members of the Supervisory Board cannot be members of the Management Board or the Audit Committee.

(iii) The Management Board

The Management Board is the executive body of a JSC, exercising management of its day-to-day operations. It can be a collective (board of directors, directorate) or a single person (director, general director). The general director has the right to act on behalf of the company without a power of attorney. The Management Board resolves all issues of the JSC's operations, other than those within the competence of the GSM and the Supervisory Board. The Management Board reports to the GSM and the

Supervisory Board, and (at least in theory) organises the execution of their decisions. It acts on behalf of a JSC within the limits established by its charter and the law.

The Civil Code introduced the concept of fiduciary duties for officers of the Management Board (and the company's other governing bodies) to act in good faith in the company's interests within the scope of their powers.

(iv) *The Audit Committee*

The Audit Committee may be elected from among the shareholders and carries out audit control over the financial and business activities of a JSC's Management Board. Members of the Management Board or the Supervisory Board cannot be members of the Audit Committee. The Audit Committee's authority derives from statute, and (at least in theory) it has fairly broad authority to control the management of the company, to review company documents, participate in management meetings and audit the activities of the company's managers. The Audit Committee also has an investigatory role, in so far as it is obliged to conduct investigations (e.g., in case of violations or inaction by the Company's managers) and inspections following a request from either the holders of more than 10% of the company's shares, the GSM or the Supervisory Board. In order for the GSM to approve the company's annual balance sheet, the Audit Committee is required to prepare an annual report on the activities of the company. However, some commentators consider that the preparation of this annual report by the Audit Committee merely serves to rubber stamp the activities of the Management Board and, further, that, in practice, the Audit Committee tends to be a largely toothless corporate body.

C. LIMITED LIABILITY COMPANY

An LLC is similar to a JSC, but the ownership interest of investors (referred to as "participants") in an LLC is expressed by "participation interests" in the capital of the company, not by shares or stock. The LLC's capital is set out in its charter, and each participant owns a percentage of the capital. The personal liability of a participant of an LLC is limited to the value of the participant's respective contribution to the company's capital. An LLC may be founded by one or more participants.

An LLC must have a minimum charter capital of 100 times the Ukrainian official monthly salary - the current minimum threshold for an LLC's charter capital is therefore UAH 60,500⁵. Each participant is required by law to pay at least 50 percent of its participation interest before the LLC can be registered by the state. Participants must pay the balance of their contributions in full within one calendar year of state registration.

A participant in an LLC may transfer its ownership interest if it has obtained the consent of the other participants, and only if it has first offered its ownership interest to the other participants (in the proportions in which they hold their own interests).

Corporate Governance Structure of an LLC

⁵ Approximately USD 8,976 using the official NBU currency rate as of November 28, 2008, USD 1 = UAH 6.74.

The corporate governance structure of an LLC consists of a General Assembly of Participants, a Management Board and an Audit Committee:

(i) The General Assembly of Participants

The General Assembly of Participants is the highest governing body of an LLC and has exclusive competence over the following matters: (1) determining the main directions of the company's activities and approval of its plans and reports on their fulfillment; (2) amending the company's charter and making changes to the amount of its authorized capital; (3) forming and dissolving the company's Management Board; (4) establishing forms of supervision over the activities of the Management Board, as well as defining the scope of the authority of the supervisory bodies (e.g., Audit Committee); (5) approving annual reports and balance sheets, distributing the company's profits and allocating its losses; (6) resolving issues relating to the acquisition of a participant's share by the company; (7) expelling a participant from the company; and (8) deciding on liquidation of the company, appointing the liquidation committee, and approving the liquidation balance sheet. Issues attributed to the exclusive competence of the company's General Assembly may not be delegated by it to the company's Management Board.

The number of votes held by each participant is equivalent to its pro rata equity interest in the charter capital of the LLC.

Meetings of the General Assembly are validly constituted when the holders of more than 60% of the participation interests in the LLC are in attendance. In general, resolutions of an LLC require a simple majority vote of the participants in attendance. However, a decision of the General Assembly with respect to the following issues requires a vote of at least 50% of all the LLC's participants (not just those attending the meeting): (1) establishing the main activities of the company; (2) approving amendments to the charter of the company; and (3) excluding a participant from the company (the participant on whose exclusion the General Assembly is voting does not participate in the voting).

(ii) The Management Board

The Management Board is the executive body of an LLC. It is created in the form of a collegial body (board of directors) or one member (director) and is headed by a general director. The Management Board decides on all issues of the company's activity except for issues that are under the exclusive competence of the General Assembly of Participants. The Management Board (Director) is accountable to the General Assembly of Participants and ensures the implementation of its decisions. It also acts on behalf of the company within the limits determined by the charter. The general director has the right to act on behalf of the company without a power of attorney. Other members of the Management Board may also be given such right.

(iii) The Audit Committee

The Audit Committee is established out of the ranks of the General Assembly of Participants, and carries out audit control over the activities of the Management Board. There must be at least three people on the Audit Committee. Members of the Management Board (or the single Director) cannot be members of the Audit Committee.

The Audit Committee's review of activity of the Management Board can be carried out at the behest of the General Assembly, on its own initiative, or upon the demand of any of the company's participants. The Audit Committee has the right to demand from company officials the submission of all necessary materials, bookkeeping or other documents and reports on the results of its reviews to the General Assembly. The Audit Committee has the right to call an extraordinary General Assembly if a threat to the essential interests of the company appears or if abuses by the LLC's officials are discovered.

D. REPRESENTATIVE OFFICE (NOT A LEGAL ENTITY)

Foreign companies are free to set up representative offices and branches in Ukraine, subject to registration with the Ministry of Economics. Non-resident companies operating representative offices and branches are deemed to be engaged in trade or business in Ukraine through a permanent establishment and as such require registration with tax authorities. Failure to obtain the registration qualifies as tax evasion.

Because a representative office is deemed to be part of a foreign legal entity doing business in Ukraine, it is not capable of pursuing commercial activities on its own; the scope of a representative office's activities are therefore limited to promoting business for the foreign company either by creating binding obligations for it or seeking information, *etc.* In practice, representative offices tend to be used primarily to provide a base for the distribution of goods and services within the country (while JSCs and LLCs are better suited to large scale operations).

It is common for representative offices to be created to facilitate export trade. However, legislation provides for specific situations requiring establishment of a representative office. Special rules exist for employment of staff and payment of social security contributions.

A representative office may make and receive payments in Ukrainian and foreign currency into the local or non-resident's overseas bank accounts.

REPRESENTATIVE OFFICE VERSUS AN LLC / JSC

	LLC / JSC	REPRESENTATIVE OFFICE
Legal Status	<ul style="list-style-type: none"> ▪ has a distinct legal personality ▪ capacity to enter into contracts in own name ▪ assumes full liability on contracts 	<ul style="list-style-type: none"> ▪ no distinct legal personality from non-resident company ▪ only able to enter into contracts in the name of the non-resident company (not in its own name) ▪ no liability for contracts (non-resident company is solely liable)
Scope of Activities	<ul style="list-style-type: none"> ▪ better suited for large scale operations 	<ul style="list-style-type: none"> ▪ primarily used to provide a base for distribution of goods or services in Ukraine
Receipt of Payments	<ul style="list-style-type: none"> ▪ may make and receive payments in Ukrainian and foreign currency ▪ may receive payments into local bank accounts only 	<ul style="list-style-type: none"> ▪ may make and receive payments in Ukrainian and foreign currency ▪ may receive payments into local or non-resident's overseas bank accounts
Registration	<ul style="list-style-type: none"> ▪ state normally takes 1-2 weeks (a small fee is charged by the state (currently approximately US\$30)) 	<ul style="list-style-type: none"> ▪ the Ministry of Economics is required to complete registration within 60 days of payment of filing fee (although often done within 30 days)
Work Permits for Non-Ukrainians	<ul style="list-style-type: none"> ▪ work permit is required ▪ must deal with employees' labor books 	<ul style="list-style-type: none"> ▪ work permit is required for employees (but not for a director). The General Directorate for Servicing Foreign Representations (<i>GDIP</i>) deals with obtaining work permits ▪ GDIP deals with employees' labor books
Property	<ul style="list-style-type: none"> ▪ free to buy or lease property 	<ul style="list-style-type: none"> ▪ free to buy or lease property (although may be subject to certain restrictions)

E. PROCEDURES FOR SETTING UP A COMPANY

1 Necessary Founding Documents

JSCs and LLCs are established and carry out their activities on the basis of a charter, and, in certain circumstances, a founding agreement. Previously, a founding agreement (similar to a shareholders' agreement) was a mandatory requirement, but this is no longer the case - although many companies still decide to have a founding agreement.

A company's constituent documents should specify, *inter alia*, the type of entity, field and goals of its activity, its founders and participants, name and location, the amount and procedure for creation of its equity fund, the order of profits and loss allocation, the composition and competence of the bodies of an entity, the order of decision-making, including the list of issues where qualified majority is necessary, the order of introducing changes into constituent documents, and the order of liquidation and re-organization of the entity. Other provisions not contradicting the legislation of Ukraine can also be included in the constituent documents.

A charter of a JSC, in addition to the required information mentioned above, should also include information about the classes of shares that are issued (common or preferred), their nominal value, correlation between different classes of shares, the number of shares that have been bought by founders, the consequences of breaking a commitment to purchase the shares, the terms and conditions for payment of annual dividends based on the company's annual results. The JSC Law provides for certain additional provisions to be included in a JSCs charter, which largely expand upon the existing requirements imposed by legislation (e.g., details of the rights attaching to the classes of shares issued need to be set out).

2 Measures Required for Setting Up a Company

The company's constituent documents should be prepared and signed, and the following steps must be taken before the constituent documents are submitted to the local registration authorities:

Opening a Bank Account. A temporary⁶ bank account must be opened in order for the founders to contribute the amounts of their respective interests/shareholdings in the company (in the amounts specified by law). The sole purpose of this bank account is to accumulate the contributions of the founders; this bank account cannot be used for any other business activities.

Lease of Premises. It is a mandatory requirement to specify the location of the company by the time of its incorporation. Therefore, the chief executive officer of the company must procure documentary evidence proving title to the relevant premises (e.g. enter into a lease agreement) which, after the State registration of the company, will be deemed as the registered location of the company.

⁶ Upon State registration of the company, the temporary bank account should be converted into a normal current account.

State Registration. Upon completion of the two steps outlined above, the founders (or their authorized representative(s)) may proceed with the actual registration of the company. Under the Law on State Registration,⁷ the following documents must be submitted to the State registration authority in order to register a legal entity: (1) application for registration; (2) decision of the owner(s) to establish a legal entity in Ukraine; (3) excerpt from the court or trade register of the owner(s) from the location where the owner is officially a resident confirming the legal existence of the owner(s); (4) power of attorney issued by a company to the authorized person to register a legal entity in Ukraine; (5) founding documents of the Ukrainian legal entity; (6) document confirming payment of the State registration fee; and (7) document confirming that the registered capital for the legal entity has been paid into the account designated to hold the charter capital.

The State registration authority is required to register the legal entity within three business days from the time when the completed set of documents are filed (although in practice it may take up to five business days).

Following registration with the local registration authority, certain other additional registrations must be performed. The new legal entity must be registered with the Ministry of Statistics, the Tax Inspectorate, the Pension Fund, the Social Security Fund on Prevention of Accidents at Work and Professional Diseases, the Social Security Fund on Temporary Loss of Working Efficiency, and the State Employment Center. As a matter of practice such additional registrations could take another 1 to 2 weeks.

F. REGISTRATION OF FOREIGN INVESTMENT

In order to sell shares issued by a Ukrainian company and avail itself of guarantees established by the Foreign Investment Law (in relation to which, see further in Section VIII.B.3 below), a foreign investor investing money in a Ukrainian company may register its foreign investment according to the procedure established by Ukrainian law. The registration of the foreign investment is not mandatory, but guarantees the right of the foreign investor to obtain dividends from the Ukrainian company and to obtain proceeds upon the sale of the company. While, in theory, a foreign shareholder wishing either to receive dividends or sell its shares in a Ukrainian company is only required to show evidence of ownership of its shares in order to do so, in our experience it is prudent for a foreign shareholder to obtain a registration in respect of its shares.

⁷ The Law of Ukraine "On the State Registration of Legal Entities and Natural Persons - Private Entrepreneurs", dated May 15, 2003 (*Law on State Registration*).

III. CURRENCY CONTROL REGULATIONS

A. OVERVIEW

The primary purpose of currency controls in Ukraine is to impede capital outflow by Ukrainian companies and individuals. Therefore, even though repatriation of investments and dividends is not limited (although restrictions have recently been introduced limiting the amount of non-trade related currency transfers to UAH 75,000 per account per month), it is quite intensively controlled. In practice, this control may cause delays and other administrative impediments to repatriation.

In general, foreign investors acquiring shares or assets in Ukraine will be required to pay in hard currency and, under general rules, will not be allowed to pay in UAH. Any proceeds from a sale or termination of the investment in UAH must be converted by foreign investors into hard currency prior to transfer abroad.

The transfer of hard currency out of Ukraine is generally more complicated than transfer into Ukraine. Foreign investors will therefore need to document their investment into Ukraine in order to be able to obtain authorization to repatriate their investment or dividends from Ukraine at a later date.

B. SCOPE OF CURRENCY REGULATIONS

Ukraine's currency rules constitute part of the general currency legislation regulating currency assets (cash and cash equivalents, such as cheques, *etc.*). The Currency Control Decree⁸ determines what transactions are included in the concept of "currency operations": (a) transactions involving the transfer of ownership rights to currency assets; (b) transactions involving the use of currency assets in international commerce as a means of payment or the transfer of indebtedness or other obligations in foreign currency; and (c) transactions involving the transfer of currency assets to Ukraine or from Ukraine. As discussed further below, these transactions are subject to varying degrees of licensing controls depending on the type of transaction and the entity conducting it.

C. RESIDENTS VERSUS NON-RESIDENTS

The Currency Control Decree distinguishes between "residents" and "non-residents", and subjects them to different legal regimes. Residents include entities created and operating under Ukrainian legislation, while non-residents include entities created and operating under foreign laws. This means that entities that are foreign owned but domestically organized are subject to rules governing resident entities.

The main regulatory effect of this distinction is that Ukrainian currency law authorizes foreign investment into Ukraine by non-residents and requires, in most cases, those non-residents to use foreign currency when interacting with Ukrainian entities. Residents, on the other hand, are restricted in their ability to wire hard currency abroad, except in payment for items to be imported into Ukraine or in payment of interest or

⁸ The Cabinet of Ministers' Decree "On the System of Currency Regulation and Currency Control," dated February 19, 1993 (*Currency Control Decree*).

dividends to non-resident investors, among others. Since Ukrainian companies acquired by foreign investors are treated as resident entities, they are subject to the resident limitations on sending hard currency to their parent companies or other entities abroad.

D. CURRENCY OPERATIONS AND LICENSES

The Currency Control Decree places restrictions on certain types of currency operations by subjecting them to a licensing regime. The NBU issues two types of licenses: *general licenses* are issued to banks in order to engage in specified currency transactions on behalf of clients for an indefinite period of time; and *individual licenses* are issued to other entities and individuals for specific currency operations, and these expire after a specific period of time.

A bank's general currency license allows it to make a wide variety of payments abroad on behalf of various entities. For instance, a bank may make a payment for imported goods and services, interest payments and repatriation of a foreign investment upon the investment's termination on behalf of other entities - bank clients - pursuant to its general banking license. The advantage for the bank's client is that it is not then required to obtain an individual license for such payment. An individual license is required, however, for the use of foreign currency as a means of payment or security in Ukraine and for the placement of currency assets abroad by Ukrainian resident entities.

In practice, this system of general and individual licenses provided by the NBU restricts the ability of Ukrainian residents to make payments abroad unless they fall within certain clearly defined parameters. Payments by residents for the export of capital from Ukraine without the respective import of, for instance, a product or a previously acquired loan, require an individual license from the NBU. Such licenses are granted infrequently.

The procedure for obtaining individual licenses generally used to be complicated and could take several months. However, in 2008 the NBU amended some of its regulations which resulted in the simplification and acceleration of the procedure. Now, for example, in respect of certain individual licenses, there is only one set of requirements for companies and individuals, and fewer documents need to be submitted to the NBU. Also, the official timeframe for the application procedure has been almost halved - formerly 40 business days, now 25 business days. In addition, currency operations relating to carrying cash into or out of Ukraine by companies and individuals (subject to certain limits) have now been excluded from the licensing regime.

IV. LABOR LAWS

A. OVERVIEW

Labor relations in Ukraine are still governed by the 1971 Labor Code⁹ promulgated during Soviet times. Its provisions are weighted heavily in favor of employees and can make it difficult to terminate an employee's employment. Termination of an employees' employment is the subject of a considerable body of judicial interpretation, mostly in favor of employees. As such, an acquiring company which hopes to achieve immediate savings by workforce reductions should expect to make significant up-front severance payments during its initial reduction of the workforce. Additionally, investors hoping to acquire recently privatized companies or companies in the process of privatization may find themselves restricted in their ability to dismiss employees by the terms of the privatization.

Ukrainian law treats foreign and domestic employers similarly when it comes to regulation of employment relations. While mandatory payments for employees in respect of pensions and social security payments can be high, the Ukrainian government has recently taken significant steps to reduce such mandatory payments.

The Labor Code provides that the main document which regulates relations between a company and its employees is in the form of a collective agreement - this is similar to a general internal policy. Even though Ukrainian labor legislation envisages that legal entities with a wage-labor system enter into a collective agreement, it does not provide for any liability for failure to conclude such an agreement.

In practice, Ukrainian companies tend to enter into labor agreements with their employees¹⁰ - a labor agreement is a specific document regulating relations between a company and each individual employee (discussed in further detail below). However, even if a labor agreement is not concluded, an implied labor agreement binds the parties, and the applicable provisions of the Labor Code will apply.

B. STANDARD TERMS AND CONDITIONS OF A LABOR AGREEMENT IN UKRAINE

A labor agreement constitutes an agreement between an employee and the owner of a company (or its authorized representative) under which the employee takes on the obligation to perform the work specified in the agreement, and to comply with the internal labor rules and regulations. The company's owner or authorized representative undertakes to pay such employee his or her salary and provide such conditions of labor as are necessary to perform the work envisaged by the labor legislation, the collective agreement and the parties.

⁹ The Labor Code of Ukraine dated December 10, 1971 (*Labor Code*).

¹⁰ Ukrainian law also provides for a 'labor contract', which the employee and employer may conclude and which is not subject to the requirements of the Labor Code - although certain mandatory labor rights (for the employee's benefit) cannot be excluded from the labor contract.

In accordance with Article 23 of the Labor Code, a labor agreement may be: (a) of unlimited duration (*i.e.*, concluded for an indefinite period of time); (b) of fixed duration as agreed by the parties; or (c) of the duration such as may be needed to perform a specific job. A labor agreement of fixed duration is concluded when labor relations cannot be established for an indefinite period in view of the type of work or conditions for its fulfillment, or in the interests of the employee or in other cases stipulated by law.

A labor agreement is generally concluded in writing, although it is not mandatory in all cases. However, a written agreement is required by law: (1) in the event of organized public recruitment of labor; (2) when concluding an agreement for work in areas with special geographical and geological conditions and other conditions presenting a higher risk to human health; (3) when concluding a statutorily mandated contract;¹¹ (4) in those cases when an employee insists on a written agreement; (5) when concluding a labor agreement with a minor; or (6) when concluding a labor agreement with an employer who is an individual.

When entering into a labor agreement, an employee should submit a passport or another form of identification, a labor book (employment record) and, if envisaged by law, an education (qualification) certificate, health record and other documents. The conclusion of an oral labor agreement is legalized by an order or instruction issued by the owner or authorized representative of the company to hire such employee. The conclusion of a labor agreement with an employee should be avoided if he or she may not perform the job offered due to his or her health conditions as proven by a relevant medical determination, if such a job requires that certain health conditions need to be met.

When concluding a labor agreement, employers are prohibited from requesting persons seeking employment to disclose information concerning their political and ethnic affiliation, origin, holding of a residence permit or to require submission of other documents not prescribed by legislation.¹²

In concluding a labor agreement, the parties may agree to a probationary period which may not exceed three months, in order to try out the suitability of the employee to the job for which he or she is employed.¹³ When the trial period expires and an employee continues to work, such employee is deemed to have passed probation, so any subsequent termination of the labor agreement must comply with the general

¹¹ Paragraph 3 of Article 21 of the Labor Code provides for a special type of labor contract whereby the parties agree to its specific duration, their rights, duties and responsibilities, including material liabilities, the terms of material support to and organization of work of the employee as well as of the termination, including early termination. Such contracts are typically concluded with chief executive officers of state companies, chiefs of educational institutions, medical workers employed in educational and cultural institutions, voluntary military servicemen, sportsmen, coaches and attorneys' assistants.

¹² Please be advised that foreigners wishing to be employed in Ukraine are, in the majority of cases, required to obtain a work permit issued by the State Employment Center. The application procedure for issuance of a work permit generally takes about two weeks upon submitting the required documents, although it can take significantly longer.

¹³ In accordance with Article 26 of the Labor Code, a trial period may not be established while hiring: persons under the age of 18; young workers that have finished vocational training schools; young professionals that have graduated from higher education institutions; persons discharged from the military or alternative (non-military) service; disabled persons referred to work in accordance with the recommendation of a medical and social expert examination; employees placed in a job in a different locality or transferred to a different company.

procedure (described below). If, during a trial period, the employee proves to be incompetent, the employer has the right to terminate the labor agreement during this period. The employee then has the right to appeal such termination in compliance with the procedure for settling disputes related to dismissals.

C. LABOR BOOKS

In Ukraine, labor books are the principal documents containing information on the employment history of each worker. When applying for a job, a worker is required to submit his/her labor book.¹⁴ Labor books are kept by the owner or accountant of the company for all employees working at the company for employees who work for more than five days. They are also kept for non-staff workers if they are subject to state mandatory social insurance. An employment record should contain such entries as related to the work performed and incentives and awards for any successes achieved at the previous place of employment; however, data with respect to any penalties should not be entered.

When an employee leaves his/her job, the owner or accountant is required to enter a relevant record into his /her labor book and return it to the former employee.

D. MINIMUM WAGE

Ukrainian legislation provides for a minimum monthly wage, and employers are required to pay their employees a monthly wage which at least equals the minimum wage. As of December 1, 2008, the minimum monthly wage is UAH 605 (approximately USD 90¹⁵).

E. DOWNSIZING OR REORGANIZATION AS AUTHORIZED GROUNDS FOR DISMISSAL

In certain cases, Ukrainian law permits employers to lay off their employees. The Labor Code provides that an employee may be laid off by an employer in connection with changes in the “organization of production and labor,” such as upon the reorganization of the employer's enterprise, or upon a reduction of the workforce. In such event, dismissal may only occur if it is not possible to transfer the employee, with his or her consent, to another position. However, certain categories of employees (such as employees with the highest qualifications and labor productivity) have a priority right to remain in their positions.

When dismissing an employee in connection with a workforce reduction, an employer must personally notify the employee of the employer's intention to dismiss the employee at least two months in advance of the target dismissal date. Moreover, if the workers at the enterprise are organized in a labor union,¹⁶ the Labor Code requires that the employer obtain the prior consent of the labor union before terminating any labor agreements.

¹⁴ The only exception to this requirement is when a person is applying for a job for the first time, in which case a labor book is started by the accountant of the company for the new employee.

¹⁵ Using the official NBU currency rate as of November 28, 2008 - USD 1 = UAH 6.74.

¹⁶ Under Article 243 of the Labor Code, trade unions may be voluntarily created by workers.

According to the Labor Code, the labor union must inform the employer of its response within 15 days of the date when the employer requests the labor union's consent. If the labor union grants its consent, the employer has the right to terminate the labor agreement no later than one month from the date on which it obtains the labor union's consent. The prior consent of the labor union is not necessary to terminate labor agreements of employees who are not members of a labor union or to terminate labor agreements with the general director, deputy director or chief accountant of the enterprise; nor is such consent required if there is no labor union at the enterprise.

In addition to the foregoing, the employer must notify the state employment service (*Employment Centre*) of its lay-off plans in writing, no less than two months prior to the dismissal (including the names of professions, specialties, qualifications and wages of employees), and must provide the Employment Centre with a list of employees actually dismissed within ten days of such dismissal.

Some additional restrictions and/or special requirements for dismissing employees as a result of a reorganization or workforce reduction may be stipulated in a collective labor agreement or founding agreement.

F. OTHER POSSIBLE GROUNDS FOR TERMINATION

Employers are restricted in their ability to dismiss employees for reasons other than a workforce reduction. However, a labor agreement may also be terminated at any time and for any reason by mutual consent. An agreement concluded for a fixed period of time is also deemed terminated upon the expiration of its term unless the employee is permitted to keep working, in which case the parties are held to have entered into a new agreement of indefinite duration.

In addition, Article 40 of the Labor Code provides that it may be possible to terminate a labor agreement prior to its expiration if the employer proves that the employee has systematically failed to fulfill his or her duties as an employee, if the employer can show that the employee's qualifications are not sufficient, or if the employee's health deteriorates. Furthermore, labor relations with certain categories of employees may be terminated on the basis of additional grounds. Company officers may be dismissed for a single, "serious" violation of their duties. Officers include a company's director, deputy director, chief accountant, deputy accountants, and the directors of branch and representative offices. Employees responsible for working directly with cash or other valuables may be dismissed for intentional or negligent conduct which causes the employer to lose confidence in them.

G. LIABILITY FOR WRONGFUL TERMINATION

The principal remedy for wrongful termination is reinstatement and compensation for lost wages. Reinstatement must occur immediately if so ordered, and compensation for lost wages continues to accrue during any delay. Officers are personally liable for back wages and other damages incurred by the employer as a result of unlawful termination. Further, an employer's liability may extend beyond lost wages. The Labor Code specifically permits labor commissions and courts to award employees an unlimited amount of damages for monetary claims unrelated to wages.

H. GENERAL PRACTICE DURING REDUCTIONS IN FORCE

Perhaps the most common method of accomplishing reductions in force is through “mutual agreement of the parties”. Typically, such “mutual agreement” is attained by providing the employee with more than the statutory minimum severance payment. A “dismissal” for any reason, whether by downsizing or by termination for other causes, may always be contested in court by a disgruntled employee. However, unlike a forced dismissal, if an employee challenges his or her termination by reason of mutual consent, the burden of proving that such termination violated Ukrainian labor law (or was otherwise unreasonable) would be on the employee.

I. OBLIGATORY SOCIAL PACKAGES

(i) Vacation

Under Article 74 of the Labor Code, all employees, regardless of the form of ownership of the company they are employed in, or type of business, must be provided with an annual vacation. Such leave is provided with remuneration and guaranteed retention of employment (rank/position) and wage. The annual basic leave of at least 24 calendar days must be granted to workers, for each working year, which starts to run on the date of signing the employment agreement. Persons under 18 years are granted an annual basic leave of 31 calendar days. In addition to annual basic leave, there are ten official holidays each year, and employees may only be required to work on these days in exceptional circumstances. Employers are responsible for continuing to pay their employees during periods of vacation, and are not entitled to seek reimbursement for such sums from the Social Security Fund on Temporary Loss of Working Efficiency.

With regard to certain categories of employees, the laws of Ukraine may stipulate varying terms of annual basic vacations, provided their duration is not less than 24 calendar days. Additional annual vacations are granted to employees: (i) under hazardous and difficult working conditions; (ii) engaged in special types of production; (iii) in other cases envisaged by the law. Employers are also required to provide additional vacation to employees with disabilities, single parents, and parents with disabled children. Research leave is provided to employees to finish work on dissertations, textbooks, and in other cases envisaged by the law.

On dismissal, each employee is entitled to monetary compensation for all unused days of annual leave, including any additional leave. At the worker's request, part of his annual leave may be replaced by cash, provided the duration of the annual or additional vacation is not less than 24 calendar days.¹⁷

In the event of an employee's death, compensation for unused annual leave, including additional vacations must be paid to the deceased's heirs.

(ii) Sick leave

¹⁷ However, as envisaged by Article 83 of the Labor Code, persons aged under 18 are not eligible to receive monetary compensation in lieu of all types of leaves of absence.

The first five days of sick leave are paid by the employer, and the remaining sick period is compensated from the Social Security Fund on Temporary Loss of Working Efficiency. Depending on the length of the employment, a sick period is paid to a worker in full or partially. Employees who have worked in the company for more than eight years are entitled to 100% compensation.

(iii) Accidents at Work and Illnesses

Employees who are injured at work and/or who develop illnesses/diseases due to activities connected with their occupation are entitled to receive compensation from the employer, which is reimbursed by the Social Security Fund on Accidents at Work and Professional Illnesses.

(iv) Trade Union Rights

Employees are entitled to participate in the management of the company through general meetings (conferences), work collectives' councils, trade unions active in work collectives, as well as other authorities empowered by work collectives to represent employees' interests, to submit proposals with regard to improving the operation of the company, and with respect to social and cultural services. An employer is obliged to ensure the participation of employees in the management of enterprises, institutions, organizations, and a company's officials must, within established time frames, consider criticism and proposals submitted by employees and inform them of the measures undertaken in response to such proposals.

According to the Constitution of Ukraine and the Law of Ukraine "On Trade Unions, Their Rights and Guarantees of Activities," citizens of Ukraine have the right to freely establish trade unions, in order to represent, exercise and protect their labor and social and economic rights and interests. Citizens may enter and leave the trade union (as per the procedures provided for in the trade union's charter), and may take part in the work of trade unions.

Trade union organizations exercise their powers via elected bodies set up under their charter; in those organizations where elected bodies are not set up, such powers are to be exercised via a trade union representative authorized to represent the interests of the trade union members according to the trade union's charter. A trade union representative acts within the scope of powers vested in him/her by the charter of the trade union. If several trade union organizations are established at a company, the collective interests of employees of the company should be represented by a joint representative body for the purposes of the collective agreement.

Employers are obliged to support the creation of proper facilities for the trade union to function (e.g., providing rooms for meetings, security, etc.), and allocate funds to the trade union, of at least 0.3% of the company's wage fund, for cultural activities and to improve the health of employees. Employers must, within one week of a request, provide the trade unions with information on labor conditions, the terms of employees' remuneration, the social and economic development of the company, and the implementation of collective agreements.

In the event that the payment of salaries is delayed, the employer must either provide information relating to the availability of funds in the company's bank accounts

direct to the trade union, or grant written permission for the trade union to obtain the information direct from the applicable bank(s). If the employer refuses to provide such information or grant such permission, the trade union may seek recourse from the courts.

V. PROPERTY / OWNERSHIP RIGHTS

A. OVERVIEW

The main legal enactments establishing the basic principles of property law are the Civil Code and the Economic Code. The regulation of property relations with respect to particular categories of assets is often supplemented by separate statutes and regulations. For example, rights in land are governed by the Land Code (as discussed in Section VI (Land Law) below), in natural resources by the Natural Resources Code, and in securities by the Law on Securities.

The Civil Code specifically recognizes, as a general principle, private ownership of property by Ukrainian nationals and foreigners. Under the Ukrainian Constitution, foreign citizens enjoy the same rights and freedoms and bear the same responsibilities as Ukrainian citizens, including property rights. At the same time, Ukrainian law sets certain restrictions on the ability of foreigners to own property in Ukraine. For example, agricultural land cannot be owned by foreigners.

B. ASSIGNMENT AND TRANSFERABILITY

Under Ukrainian law, ownership consists of three components: (i) the right of possession (physical control of an item), (ii) the right of use, and (iii) the right to dispose of the property. Owners may exercise their property rights at their own discretion, subject only to restrictions set out in law. An owner may transfer his property to another completely and unconditionally, or alternatively may grant a more restricted right to use or hold the property (e.g., under a lease agreement). Any privately-owned property is, as a general rule, freely transferable, but statute or contract may set restrictions or attach conditions to certain transfers.

C. RESTRICTIONS ON TRANSFER OF PROPERTY RIGHTS

In order for an encumbrance over movable property to be enforceable against third parties, the encumbrance must be registered in the Ukrainian Registry of Encumbrances Over Movable Property. Similarly, rights over immovable property (particularly security interests, *i.e.*, mortgages) must be registered in the Ukrainian Registry of Rights over Immovable Property in order to be enforceable against third parties. With respect to immovable objects, a creditor may further execute a ban on alienation of an immovable item of property belonging to the debtor so that the debtor is prevented from transferring the property without the creditor's consent. To be effective, an appropriate form evidencing the ban on alienation must also be registered in the Ukrainian Registry of Rights over Immovable Property. Restrictions on transfers of shares, covered in more detail below, should be noted in the securities account of the shareholder with a share custodian or in a company's share register.

D. EVIDENCING PROPERTY RIGHTS

Methods of proof of property rights depend on the type of property. Rights in property that by law are subject to registration (e.g., immovable property rights) are established and proven by such registration. In the case of movable property, a person in possession of an object is presumed to be its owner unless proven otherwise.

Rights in shares are evidenced either by possession of a share certificate (for certificated shares) or by registration in a share register or with a custodian (in the case of non-certificated shares). Shares in a JSC may currently be issued either in certificated form or non-certificated (electronic) form. However, according to the JSC Law JSCs may only issue shares in electronic form after October 30, 2010. If shares are issued in non-certificated form (or if certificated shares have been "immobilized" with a custodian), their ownership is transferred by debiting one securities account (the transferor's) and crediting another (the transferee's).

Regarding third party rights in shares, normally such rights may arise as a result of a pledge of shares or the creation of other encumbrances. To be effective, encumbrances should be noted in the securities account of the relevant shareholder held by a custodian or share registrar. If shares are acquired in the course of privatization, the privatization agreement may establish an encumbrance over the shares that would continue to exist until the investment obligations (if any) undertaken by the investor towards the privatized company have been fulfilled. In that case, a transfer of encumbered shares may only occur with the prior written consent of the State Property Fund of Ukraine. Also, in certain companies, such as closed JSCs and LLCs, the other shareholders/participants will, by law, have a right of first refusal to acquire any shares or participation interests being transferred by a selling shareholder/participant.

As a practical point, where assets other than shares are to be acquired, the relevant property registers need to be reviewed to verify whether the property is subject to any encumbrances.

VI. LAND LAW

A. OVERVIEW

The Land Code is the principal legislation governing rights to land in Ukraine, and sets out rules governing the ownership, use, acquisition and disposal of land by both domestic and foreign entities, individuals, state and municipal bodies and international organizations. The Land Code provides for a number of types of rights to land: (i) ownership, (ii) rights of perpetual use, (iii) leases (both short-term and long-term), and (iv) easements.

B. OWNERSHIP

1 General

The Land Code distinguishes between two types of land¹⁸ ownership: (i) public (state and municipal) and (ii) private.

The Land Code also distinguishes between certain types of land. At present, agricultural land cannot be owned by foreign entities, and there are certain restrictions on the type of non-agricultural land that a foreign entity may own : (a) within already settled areas, a foreign entity may purchase land for the purpose of purchasing and/or constructing real estate with a commercial purpose; or (b) outside settled areas, a foreign entity may purchase the land on which real estate is already situated. Furthermore, there is currently a lack of clarity as to whether a Ukrainian legal entity which is owned 100% by a foreign entity can own land plots in Ukraine.

Rights of perpetual use may now only be granted to state and municipally-owned companies.

There is currently a moratorium prohibiting the sale of agricultural land. Until the Law on State Land Cadastre and the Law on Land Market are adopted, the following are prohibited: (i) the contribution of land parcels¹⁹ into the share capital of companies; (ii) the sale and purchase of agricultural land plots that are in state and municipal ownership, except for their reacquisition by a different government body for public needs; (iii) the purchase, sale or any other means of alienation, as well as any change in the special purpose, of land plots or land parcels which are used for agricultural purposes.

2 Transactions Involving Foreign Investors

The Land Code governs the sale and acquisition of land in Ukraine, and requires a special procedure to be followed and requirements satisfied before a foreign investor can acquire state and communal/municipal land in Ukraine. If a foreign entity has a permanent commercial representative office in Ukraine, then it is entitled to acquire state and municipal land. In order to sell municipal land, the municipal council must apply and receive the consent of the Cabinet of Ministers of Ukraine (CMU) - although there is no

¹⁸ Note that a different regime applies to real estate investments (i.e., buildings).

¹⁹ Land parcel here is a translation of zemelna chastka (pai), which means a parcel of land, that has been transferred into collective ownership

established procedure or criteria for receiving such consent, and in our experience such consent is received on a case by case basis.

For privately-owned land, title to such land passes to the foreign investor and is confirmed upon the registration of the sale transaction with the State Registry. Title of the foreign investor to state and municipal land plots in Ukraine is confirmed by, and is only transferred after the issuance of, a State act on the right of ownership to such land plot.

Certain licenses and permits may be required for the transfer of land in Ukraine, and the applicability of such licenses and permits is primarily dependent upon the form of ownership of the land being transferred (e.g., whether State, municipal or privately-owned land is involved), and the involvement of the foreign investor. For example, in theory an auction should be held for the transfer of State and municipal land, and the consent of the General Directorate for Servicing Foreign Representations is also, arguably, required for the purchase of land by a foreign entity.

C. LEASES

The law relating to leases of land is contained principally in the Land Code and the Law of Ukraine on Land Leasing dated October 6, 1998 (*Land Lease Law*), as well as a number of other regulations. The Land Code stipulates that short term leases are those which are for a term of up to five years, and long term leases comprise leases which continue for a term of up to fifty years.

The Land Lease Law sets out a list of essential terms and conditions which any land lease agreement must contain in order for it to be legally binding and effective, including details of the term of the lease and the price. The parties may include other specific provisions, providing such conditions do not violate Ukrainian law. In 2004, the CMU approved a standard form of land lease agreement, which contains all the essential terms and conditions that are required by the Land Lease Law, as well as certain other optional conditions (e.g., land insurance). It is common for both private parties and state and municipal authorities to use this CMU-approved standard form as the basis for their specific arrangements.

A newly adopted provision of the Land Code provides for a new procedure for both the sale and lease of municipally-owned and State-owned land. Thus, any land in State or municipal ownership can now be alienated or leased only by land auction. However, the relevant leasehold cannot be alienated by its lessee to any third party. The new procedure is not applicable to leases of land plots where buildings/structures belonging to prospective owners or tenants are located; land plots for communal facilities; land plots used for the construction of public buildings; land plots used for exploiting natural resources; and land plots used by registered religious organizations.

The leasing of land (both agricultural and non-agricultural) for commercial purposes is a widespread practice in Ukraine. In fact, the majority of developers prefer to first lease a land plot for their projects either directly or by acquiring a Ukrainian company with a right to lease and only subsequently acquire ownership. The common rationale for this is that leasing land at the initial stage of the investment is frequently cheaper than acquiring it from the outset.

D. EASEMENTS

The Land Code acknowledges third-party rights and contemplates the concepts of 'easements' and 'good neighbor' provisions.

VII. TAXATION

A. OVERVIEW

Ukraine's taxation system continues its development from a command to a market economy and is relatively complex. The tax laws are amended often and sometimes retrospectively. They are still characterized by indistinct composition, lack of precise policy or explanation. A number of government bodies and different levels of the State tax authorities issue their own interpretations of tax legislation which may be contradictory. Many issues still remain open for clarification by way of new regulations. All these factors lead to the risk of a different interpretation of tax legislation by the State tax authorities and taxpayers. There have been initiatives over the last few years to adopt a single tax code incorporating the numerous tax laws that exist and such a development should make tax legislation clearer and easier to comply with.

Among approximately 40 taxes and duties established by the current Ukrainian legislation, the main taxes and duties are as follows:

- 1) Corporate profits tax (CPT);
- 2) Value added tax (VAT);
- 3) Mandatory Social Security Contributions;
- 4) Personal income tax (PIT);
- 5) Pension Fund charges;
- 6) Excise;
- 7) Land tax;
- 8) Stamp duty.

For corporate entities, the two principal taxes are CPT and VAT, which are regulated mainly by the Corporate Profits Tax Law²⁰ and the VAT Law²¹, respectively. Both of these laws are fundamentally based on the same general taxation principles as applied in many developed market economies. However, the laws remain at a comparatively unsophisticated level and do not easily apply to complex and/or international transactions.

B. CPT

CPT payers are deemed to be: (a) resident business entities, institutions, organizations conducting activities aimed at receiving profits both inside and outside the territory of Ukraine, as well as their affiliates, branches and other separate sub-divisions; (b) non-resident individuals and legal entities which receive Ukrainian-source income; (c) permanent establishments of non-residents which receive a Ukrainian-source income or carry out representative functions.

²⁰ The Law of Ukraine "On Taxation of Profits of Enterprises" dated December 28, 1994.

²¹ The Law of Ukraine "On Value Added Tax" dated April 3, 1997.

The standard CPT rate is 25%. CPT is levied on the taxable profits which are computed as the adjusted taxable income as reduced by the amount of deductible expenses and allowed depreciation deductions.

Taxable income is the total amount of revenues received (accrued) by a taxpayer from all economic activities in the tax period in monetary, non-monetary and intangible forms both inside and outside the territory of Ukraine. Taxable income includes, inter alia, the following items: (a) proceeds from sales of goods (works, services) and securities (except for their initial issuance/placement and final redemption/cancellation transactions); (b) income from banking, insurance, and other financial services transactions; (c) income from joint ventures; dividend income received from non-residents; income from interest, royalties, possession of debentures, as well as leases; and (d) amounts of non-repayable financial aid received, the value of goods (work, services) received free of charge.

The main items exempt from taxation are as follows: (a) amounts of output VAT assessed on the sales price of goods (work, services); (b) direct investments or reinvestments received, including contributions made under a contractual joint venture (*i.e.* without the establishment of a legal entity); (c) nominal value of accounted for but unpaid debt securities, as well as payment documents issued by a borrower in the name of a taxpayer as a confirmation of the debt to such taxpayer (*e.g.* bonds, promissory notes).

Deductible expenses include the amount of any expenses in monetary, non-monetary or intangible forms incurred as compensation for the cost of goods (works, services) purchased (produced) by that taxpayer for further use in its own business activities.

The CPT Law establishes restrictions on the deductibility of some types of expenses, as follows: (a) money or the value of goods (work, services) voluntarily donated to the state and local budgets, not-for-profit organizations are deductible in the amount of not less than 2% and not more than 5% of the taxable profits of the previous reporting year; (b) expenses related to the repair of fixed assets are deductible in the amount of 10% of the aggregate book value of all fixed assets as of January 1 of the reporting year (excess is capitalized); (c) payments for goods or services to foreign entities located in tax havens are deductible at 85% of the total; (d) some restrictions on the deductibility of interest exist for a Ukrainian company which is 50% or more owned or controlled by non-resident or tax-exempt persons, if interest is paid to those persons or their related parties.

The deduction of expenses not related to business activities is disallowed. The main non-deductible items are: (a) expenses not supported by relevant documentation; (b) business trip expenses for individuals who are not employees; (c) expenses for organizing and conducting receptions, presentations, celebrations; (d) financing private needs of individuals; (e) purchase and construction of fixed assets, their repair in excess of the 10% limit (referred to above), extraction of minerals, purchase of intangible assets - such expenses are capitalized and may be depreciated; (f) CPT, VAT, withholding tax, personal income tax; (g) any penalties and fines agreed by contracting parties or as decided by court; (h) expenses related to the financing of management bodies; (i) dividend payments; and (j) payment of fees, rewards or other incentives to individuals or legal entities which are related parties to the taxpayer - in the absence of documentary

evidence that such payments were made as compensation for the actually rendered services (hours worked) on arm's length terms.

As a general rule, deductible expenses are recognized on the earlier of the date on which the taxpayer used the inventory or the services (the taxpayer sold the goods), or the date on which he made a prepayment for them. When the taxpayer makes a prepayment to a non-resident, a tax-exempt entity or an entity paying CPT at reduced rates, he can recognize deductible expenses on the date on which he receives the prepaid goods or services.

Depreciation charges on fixed assets are computed quarterly, using the reducing balance method. A taxpayer may use any depreciation rate up to the maximum quarterly rate established by the CPT Law, which equals 2%, 6%, 10% or 15% depending on the type of the asset. Land may not be depreciated. Intangible assets may be amortized using the straight-line method over the lesser of the asset's useful economic life or ten years.

Tax losses of taxpayers which are incorporated in Ukraine may be carried forward indefinitely.

The CPT Law currently provides for very few incentives which apply to, in particular, the publishing, energy and agricultural industries, as well as to non-for-profit organizations.

CPT returns are filed quarterly, within 40 calendar days following the end of the quarter. In 2008, taxpayers are also required to file a CPT return for the first eleven months of 2008. Such returns should be submitted within 20 calendar days of November 30, 2008. Tax should be paid within ten calendar days following the deadline for the submission of a CPT return, that is, within 50 days after the end of the quarter - for quarterly tax returns and within 30 calendar days after November 30, 2008 - for returns for the first 11 months of 2008.

1 Taxation of non-residents. Withholding tax

A Ukrainian-source income payable to a non-resident by a Ukrainian resident or a permanent establishment of a foreign entity is subject to withholding tax.

A Ukrainian source income includes the following main types of income: interest, dividends, royalties, income payable for freight or engineering services, leasing (rental) income, income from the disposal of immovable property located in Ukraine, gains from trade in securities or other corporate rights, income from unincorporated joint ventures in Ukraine, income from operations under long-term agreements in Ukraine, agent fees, premium for (re)insurance of risks in Ukraine or insurance of residents from risks abroad.

Payable proceeds or other compensation for goods and services (supplied by a non-resident or his permanent establishment to a Ukrainian resident) does not qualify as Ukrainian-source income and, therefore, is not subject to withholding tax.

The standard withholding tax rate is 15%. Special tax rates are established for freight income (6%) and insurance activity (0% or 12%). Potentially, the withholding tax rate can be reduced based on a relevant double tax treaty.

Income from advertising services provided by a non-resident in Ukraine is subject to 20% tax payable by a Ukrainian resident from his own funds (*i.e.* not withheld). The income payer cannot enjoy treaty protection in respect of this type of income.

The withholding tax is payable by a Ukrainian income payer to the State not later than on the date of income remittance.

2 Treaties and agreements

Ukraine has a network of 62 treaties in force on the avoidance of double taxation. Treaties allow for the reduction of the withholding tax rate for dividends, interest or royalties to 0%, 2%, 3%, 5%, 7%, 10% or 12%.

The most favorable treaty for foreign investors is the Ukraine-Cyprus treaty, which provides for 0% withholding tax on the payment of dividends, interest and royalties. However, Ukraine is currently renegotiating this treaty and has not ratified a replacement treaty as yet. The new treaty is likely to provide for withholding tax rates for dividends of 5% and a 10% rate for interest and royalties. Also, Ukraine has favorable treaties with the Netherlands, Germany, Sweden, United Kingdom, and the U.S.A.

According to the established procedure for exemption from (reduction of) taxation of a Ukrainian-source income according to double tax treaties, a Ukrainian income payer can reduce the withholding tax rate, provided that it has obtained from a non-resident income recipient its residence certificate issued by the authorities of the counterpart treaty country. The certificate is valid during the calendar year in which it was issued.

A Ukrainian bank or a financial institution paying interest to a non-resident bank can enjoy treaty protection if such payer provides an extract from the international catalogue "International Bank Identifier Code" confirming that the recipient (the non-resident bank) is a resident of a counterpart treaty country. In this case, a Ukrainian payer is not required to obtain a residence certificate from the recipient.

C. VAT

Under the VAT Law, VAT is paid by the following legal entities and individuals: (a) any person that is doing business or planning to start up business and is willing to be registered as a VAT payer voluntarily; (b) any person who imports goods (related services) onto Ukraine's customs territory in volumes that are subject to VAT pursuant to provisions of the VAT Law; (c) any person that shall mandatorily be registered as a VAT payer. The VAT Law provides for a number of cases where mandatory registration as a VAT payer is required. The main case is where the volume of taxable supplies exceeded 300,000 Ukrainian hryvnia (approximately USD 52,080²²) for the previous 12 calendar months; (d) any person that supplies goods or renders services in the customs territory of Ukraine with the use of global or local computer networks (non-residents are allowed to conduct such activities through their permanent establishments registered in Ukraine.)

²² As of October 31, 2008, the official NBU exchange rate was 1 USD = 5.76 UAH

The two VAT rates are 20% and 0% depending on the type of transaction. A 20% rate applies to (a) supply of goods and services where the place of supply is in Ukraine, including when a supply is made without consideration (e.g. by way of gift); (b) importation of goods into Ukraine.

A zero VAT rate is applicable to (a) the export of goods and supply of services ancillary to the export of goods; (b) international transportation of goods (from the Ukrainian border to points outside of Ukraine; from points outside of Ukraine to the Ukrainian border; between two points outside of Ukraine).

The following main transactions are out of the scope of VAT and, as such, are non-VATable: (a) issuance, placement and cash sale of securities; (b) interest or the commission element of lease payments pursuant to a financial lease agreement up to a maximum amount which is not more than double the refinancing rate applied by the NBU; (c) transfer of pledged property pursuant to a loan agreements and its return to the pledgor after expiry of such agreement; (d) provision of insurance and reinsurance services. The VAT Law also provides for a list of transactions exempt from VAT.

A VAT payer can recover input VAT, if it has been incurred on purchases designated for the use in the VATable transactions (either 20% or 0% rated) within his business activities. Input VAT is not recoverable, if incurred on purchases designated for use in non-VATable or exempt transactions. As a result, the tax regime at 0% rate is different from the non-VATable or tax exemption regimes. Under the 0% rate regime, the seller is entitled to recover the input VAT and offset it against its output VAT or receive a refund from the State. For non-VATable or exempt transactions, the seller is not allowed to recover input VAT (it may be deductible for CPT purposes) and receives no refund from the State.

If the acquired goods/services are used in both VAT-able and non-VATable or exempt supplies, then the input VAT is partly recoverable.

For domestic purchases, a VAT payer must support his claim for the recovery of input VAT with a VAT invoice issued by a VAT-registered person. The right to recover arises on the earlier of the date of payment to the supplier, or the date on which such VAT invoice is received.

D. IMPORT VAT

As mentioned, import VAT at a rate of 20% applies to all goods and related services imported into the customs territory of Ukraine, and is collected by the customs authorities at the time of customs clearance. For imported goods, the VAT base is the higher of the contractual price stated in the import invoice, or the customs value, increased by an amount constituting the cost of bringing those goods to Ukraine, excise and duties payable at the time of importation, and any payments for the use of intellectual property incorporated into the goods.

In certain cases Ukrainian VAT legislation provides for the possibility of a deferral of import VAT through an issuance by the importer of a VAT promissory note guaranteed by a bank. There are also special rules for the taxation of goods imported into Ukraine under give-and-take (tolling) arrangements.

For imported goods, the right to claim input VAT arises on the date when a tax is paid at customs. A claim must be supported by an import customs declaration.

Generally, VAT returns are submitted and applicable tax is paid monthly.

E. MANDATORY SOCIAL SECURITY CONTRIBUTIONS

Both employers and employees are statutorily required to pay payroll-based contributions to the four Ukrainian social security funds. The taxable base for the contributions (both employee and employer) is capped. From October 1, 2008 the cap equals 10,035 Ukrainian hryvnia (approximately USD 1,740²³) per month.

A resident employer is liable to pay social security contributions in respect of his Ukrainian and foreign national employees at the following rates: (a) 33.2% to the State Pension Fund; (b) 1.5% to the Temporary Loss of Ability to Work Fund; (c) 1.3% to the Unemployment Fund and (d) from 0.66% to 13.6% (depending on the level of accident risk of an entity's industry sector) to the Accidents at Work Fund.

Employees are required to pay: (a) 2% to the State Pension Fund; (b) 1% to the Temporary Loss of Ability to Work Fund; and (c) 0.5% to the Unemployment Insurance Fund.

The employer is responsible for calculating and deducting all the above contributions (both employee and employer ones) and remitting them to the state budget. Also, the employer shall file monthly reports to the State Pension Fund and quarterly reports to the remaining three funds.

F. PERSONAL INCOME TAX

Taxation of individual's income depends on an individual's tax residency status in Ukraine. The PIT Law²⁴ provides that a person is a tax resident in Ukraine, if his/her place of abode is in Ukraine. If a person also has a place of abode in another country, then a number of tie-breaker rules apply for the determination of a Ukrainian tax residency of such person. An individual may also elect for a Ukrainian tax residence voluntarily. Non-residents are individuals who are not treated as tax residents of Ukraine.

For tax residents of Ukraine (irrespective of whether they are Ukrainian or foreign citizens), PIT is levied on the aggregate taxable income for the calendar year which the individual has received from various sources, both inside and outside Ukraine. A standard rate of 15% applies to most types of income, including salary, dividends, royalties and investment income. Special tax rates apply in some cases (e.g. inheritance, gifts, interest from deposits).

For tax non-residents, PIT is levied on the income sourced in Ukraine. Ukrainian-source incomes earned in the form of interest, dividends or royalties are taxed at the same rates as for residents, unless a respective double tax treaty provides for

²³ As of October 31, 2008, the official NBU exchange rate was 1 USD = 5.76 UAH

²⁴ The Law "On Tax on Incomes of Individuals" dated May 22, 2003.

otherwise. The PIT Law is unclear whether a standard (15%) or double (30%) tax rate applies to the salary income of non-residents paid by a resident employer. Any other Ukrainian-source income, including salary and director's fees paid by a non-resident employer, is taxed at a double tax rate (that is, 30%). However, tax treaties often provide for the exemption of income earned from short-term visits to Ukraine from the Ukrainian PIT.

An employer must calculate and withhold the PIT from payroll income payable to his employees. Tax agents (including employers) shall pay tax to the State not later than the date of payment of income to individuals. Tax in respect of income that is accrued but not paid to individuals should be paid to the State within 20 calendar days following the end of the reporting month. Tax agents file quarterly reports on income paid to individuals and on the amount of the withheld tax.

An individual is not required to file a PIT return if his only income during the reporting year was the income received from the tax agents. An individual who receives taxable income from entities or sources that are not tax agents is required to file a PIT return with the tax authorities by 31 March of the year following the reporting year. Tax due on the return must be paid by 10 April. Also, if an individual wants to claim a tax credit for the expenses incurred during the year or a foreign tax credit, then such individual may file the return.

G. PENSION FUND CHARGES

The law has established the following Pension Fund main charges payable in respect of certain transactions:

- Purchase of foreign currency attracts a 0.5% charge based on the amount of local currency (Ukrainian hryvnia) used for such purchase;
- Car and immovable property acquisitions attract 3% and 1% charges respectively based on the asset's value. The charges are payable by buyers;
- The use of services on mobile connection attracts a 7.5% charge based on the value of services provided. The charge is payable by users.

H. EXCISE

The list of excisable goods and products includes the following main items: alcohol beverages, ethylene, tobacco products, some means of transportation, car bodies and petroleum products. In most cases, excise duty rates are established as a fixed amount for each item of excisable goods (products).

I. LAND TAX

Land tax²⁵ is paid by the owners or users of land. The tax rate depends on the nature and location of the land and on whether the land value has been assessed. The tax is assessed annually and paid monthly.

²⁵ The land tax is regulated by the Law of Ukraine "On the Payment for Land" dated July 3, 1992.

J. STATE DUTY

According to the State Duty Decree²⁶, state duty is charged by court officials, notaries, officials of state bodies for the execution of certain actions or issuance of certain documents (e.g., notarization of contracts, submitting documents to a court, registration of information about emission of securities). The state duty rate for the notarization of the agreement for the sale of real estate is one percent of the amount of the agreement. In the most of the remaining cases the amount of the state duty will be immaterial. For certain types of transactions, the law is sometimes unclear in respect of the state duty rate. This leaves room for fiscal interpretation by the authorities. The sale and purchase of shares is exempt from state duty.

K. TAXATION OF SPECIFIC OPERATIONS: DIVIDENDS

As a result of reporting profits in the company's statutory financial income statement, the company can pay dividends to its shareholders in proportion to the shares owned by them in the charter capital of the company.

A company distributing dividends to its shareholders must pay an advance CPT (*ACT*) calculated at a rate of 25% over the gross amount of the dividends intended for the payment without reducing the amount of such payment by the amount of such *ACT* (*i.e.* *ACT* is not withheld). The company should pay the *ACT* to the State budget before or together with the payment of dividends to the shareholders.

In the period following the period of dividends payment, the company can reduce its CPT liability by the amount of *ACT* paid. Any balance of *ACT* not utilized can be carried forward to future periods. *ACT* is not refunded by the State.

ACT does not apply to payments of dividends by holding companies, which receive more than 90% of their income in the form of dividends from controlled resident entities.

Additionally, Ukraine imposes a 15% withholding tax on dividends paid by Ukrainian residents to non-residents. This rate may be reduced down to a zero rate by virtue of an applicable double taxation treaty, depending on the non-resident's jurisdiction. The tax must be remitted to the State simultaneously with the payment of dividends to shareholders.

1 Payment of dividends in cash is exempt from VAT.

A resident legal entity, which receives dividends from a resident payer, does not include the amount thereof in its taxable income (except for the receipt of dividends by a permanent establishment of a non-resident). If the dividends are received by a resident taxpayer from a non-resident payer, the Ukrainian taxpayer should include the amount of received dividends in its taxable income for the tax period when such dividends were received.

²⁶ The Decree of Cabinet of Ministers of Ukraine "On State Duty" dated January 21, 1993.

In the event of distribution of dividends to the benefit of an individual taxpayer, a resident company distributing dividends should act as a tax agent for the dividend recipient and withhold PIT from the amount of the dividends distributed. The dividends paid by a resident company are taxed at the standard rate of 15%. Dividends are taxed upon payment.

VIII. PROTECTION OF FOREIGN INVESTMENTS

A. OVERVIEW

As a general rule, Ukrainian legislation allows foreign investors to carry out business activities on the same basis, and with the same level of protection, as domestic investors. Ukrainian legislation covers both the protection of investments in general (both domestic and foreign), as well as legislation which addresses specific aspects of foreign investments.

Foreign investors may be: legal entities, established in accordance with legislation other than Ukrainian; individuals with a permanent place of residence outside of Ukraine; foreign states, international governmental and non-governmental organizations; and others who are deemed investors under Ukrainian law.

Foreign investments in Ukraine may be carried out in a foreign currency or, in the event of reinvestment in a Ukrainian entity, in Ukrainian currency, provided that any relevant profit tax has been paid.

B. INTERNAL PROTECTION OF FOREIGN INVESTMENTS

1 Investment Protection Law²⁷

The Investment Protection Law guarantees that the State of Ukraine cannot confiscate investments (domestic or foreign). However, the State can requisition private investments for public use in extraordinary circumstances such as natural disasters, major accidents, and human and animal epidemics. The decision to requisition is made by the Cabinet of Ministers of Ukraine. Under this Law, the state guarantees adequate and effective compensation to foreign investors in the event of requisition, as well as the right to repatriate all profits (provided they have been obtained legally).

2 Investment Activity Law²⁸

The Investment Activity Law sets out the general framework for investment activity in Ukraine, and applies equally to domestic and foreign investors.²⁹ Under the Investment Activity Law, the state of Ukraine guarantees stable investment conditions and observance of investor rights and legitimate interests. In general, agreements signed by participants in investment activities remain valid for the duration thereof, even when subsequent legislation establishes conditions which negatively affect the investor's status or restricts the investor's rights (but this does not apply to tax, customs and currency legislation, or to legislation relating to certain economic activities).

²⁷ The Law "On Protection of Foreign Investments in Ukraine" (*Investment Protection Law*) dated September 10, 1991.

²⁸ The Law "On Investment Activity" (*Investment Activity Law*) dated September 18, 1991.

²⁹ The Investment Activity Law also defines protection of investments as a set of organizational, technical and legal actions aimed at creating conditions for promoting and preserving investments, attaining investment objectives, facilitating efficient investment and re-investment activity, and protecting the legal rights and interests of investors, including the right to receive the profit from the investments.

State bodies and their officials cannot interfere with any subject of investment activity except in accordance with law and within the authority of the given body and/or official. No public official has the right to restrict the investor's choice of investment. The Investment Activity Law provides that if the government or a legislative act violates the rights of investors, any losses incurred must be reimbursed in full by the State/legislative body concerned. Reimbursement disputes are to be settled by the court.

Ukraine guarantees protection of investments, regardless of ownership form, by legislation and international treaties. Investors must be provided with an equitable regime which prevents state discrimination against investors and interference with investment management, investment use and liquidation thereof. Equitable conditions and procedures for the export of investments should also be provided for. State guarantees of investment protection may not be cancelled or restricted during the period of validity of such guarantees.

Investments may not be unconditionally nationalized or confiscated, and must be immune to sanctions resulting in nationalization or confiscation. Such sanctions must be allowed only pursuant to Ukraine's legislative acts, provided the investor is compensated in full for all losses incurred by termination of investments. Each and every such legislative act shall specify reimbursement procedures.

3 Foreign Investment Law³⁰

The Foreign Investment Law addresses specific aspects of foreign investments, and aims to establish one national regime regarding foreign investments in Ukraine.

Article 8 of the Foreign Investment Law guarantees against changes to legislation affecting foreign investments. This means that, in the event that Ukraine's legislation on foreign investments changes in any respect, foreign investments which are in operation prior to the change can continue to apply the benefits which were applicable under the law in effect when the investment was initially made, for a 10-year period after the effective date of the new legislation. However, these guarantees do not apply to changes in legislation relating to matters of defense, national security, enforcement of public order and environmental protection.

Article 9 of the Foreign Investment Law provides guarantees against forced deductions and illegal actions of State bodies and services. The Foreign Investment Law also prohibits the nationalization of foreign investments in Ukraine. State bodies cannot expropriate foreign investments except in extraordinary instances such as natural disasters, major accidents, human and animal epidemics.

Foreign investors also have a right to compensation for loss, including lost profit and moral damage, caused by official action. Any such losses and damage suffered by foreign investors must be compensated at current market prices and/or on the basis of estimates confirmed by independent auditors. Compensation to a foreign investor must be quick, adequate and effective. Such compensation must be made in the currency

³⁰ The Law "On Foreign Investment Regime" (*Foreign Investment Law*) dated March 19, 1996.

which was used for the relevant investment or in any other currency acceptable to the foreign investor.

Upon termination of foreign investment activities and within a period of six months thereafter, a foreign investor has the right to withdraw products or monies in the currency used for the relevant investment in the amount equivalent to the actual investment, as well profit from such investments in the form of money or goods at their market prices. After payment of taxes, duties and other obligatory fees, foreign investors are guaranteed free and prompt transfer abroad of their income and profits in foreign currency (provided they were legally obtained).

The Foreign Investment Law also enables contractual joint ventures to be concluded between foreign investors and Ukrainian entities. Such contractual joint ventures may apply to sectors such as for example, manufacturing or production. Parties to this type of contractual joint investment activity are required to maintain separate accounting books, records and reporting for operations connected with their joint activity, and are entitled to open separate accounts in Ukrainian banks to make payments and settlements connected with their joint activity. Property imported to Ukraine by a foreign investor for the purpose of carrying out a contractual joint venture (and not designated for sale or consumption) is exempt from customs duties. If, however, such property is sold prior to the expiration of the three year period following its entry onto the balance sheet of the relevant contractual joint venture, customs duties must be paid. Agreements creating contractual joint ventures are subject to registration with Ministry of Economy and European Integration.

Enterprises with foreign investment are those enterprises in any organizational form that are created in accordance with Ukrainian legislation, provided that the amount of foreign investment in their respective charter funds constitute not less than 10% of the total.

Ukrainian law requires that State registration of foreign investments by the relevant authorities occurs within three days from the date of actual contribution of the investment.

C. DISPUTE RESOLUTION - TREATY PROTECTION OF FOREIGN INVESTMENTS IN UKRAINE

In general, where a dispute arises in connection with a foreign investment the foreign investor has the option of seeking recourse either in the Ukrainian domestic courts or through arbitration (whether domestic or international).³¹ Specifically, the Foreign Economic Activity Law³² stipulates that disputes arising between Ukrainian and foreign investors may be reviewed by courts and arbitration courts of Ukraine, as well as (upon agreement of the parties) by the International Commercial Arbitration Court, the Maritime Arbitral Commission of the Chamber of Commerce and Industry of Ukraine, and other bodies of dispute resolution (as long as these bodies are stipulated by

³¹ Note that disputes arising between a foreign investor and the State of Ukraine must be settled by Ukrainian courts unless there is an international treaty which expressly provides otherwise.

³² The Law of Ukraine "On Foreign Economic Activity" dated April 16, 1991, as amended (*Foreign Economic Activity Law*).

international agreements entered into by Ukraine and are not inconsistent with the effective laws of Ukraine).

It is worth noting that, in general, foreign judicial awards are unenforceable in Ukraine. Thus, the majority of foreign investors prefer to include arbitration clauses in contracts involving their investments in Ukraine.

1 New York Arbitration Convention³³

Ukraine is a party to the New York Arbitration Convention. Signatories to this Convention agree to recognize and enforce arbitral awards arising from a dispute between two parties, whether physical or legal, issued on territory other than the state where the recognition and enforcement of such award is sought. The New York Convention also applies to arbitral awards not considered to be domestic awards in the state where their recognition and enforcement are sought.

Under the New York Arbitration Convention, Ukraine undertakes to recognize any written agreement³⁴ under which the parties must submit to arbitration all or any differences which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not, concerning subject matter which can be settled by arbitration. According to the New York Arbitration Convention, a Ukrainian court may, at the request of one of the parties, refer the parties to arbitration, unless it finds that the said agreement is null and void, inoperative or incapable of being performed.

As established by the New York Arbitration Convention, Ukraine is required to recognize and enforce all arbitral awards validly issued and binding. A Ukrainian court, under Article 5 of the New York Arbitration Convention, can refuse to recognize and enforce an arbitral award at the request of the party against whom it is invoked, if that party furnishes proof that:

- 1.) The parties to the agreement were incapacitated, under the law applicable to them, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
- 2.) The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
- 3.) The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
- 4.) The composition of the arbitral authority or the arbitral procedure was not in

³³ The Convention on recognition and enforcement of foreign arbitral awards (*New York Arbitration Convention*) dated June 10, 1958.

³⁴ Under Article 2 of the New York Arbitration Convention, the term "agreement in writing" includes an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams.

- accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or
- 5.) The award has not yet become binding on the parties or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.

An arbitration award issued by a foreign tribunal is enforceable in Ukraine if the following conditions are met:

- (a) the award is issued in a state whose court decisions Ukraine recognizes and enforces under an international treaty or according to principles of reciprocity;³⁵
- (b) the award is presented for enforcement in Ukraine within three years of its effective date (except for an award providing for periodic payments for a period of time exceeding three years, in which case the award may be submitted for enforcement for the payment of debt for the last three years).

Enforcement of a foreign court or arbitration award may be hindered either by establishing the lack of Ukraine's jurisdiction to enforce the award or by invoking a specific ground for refusal of the enforcement. If consent is granted by a Ukrainian court to enforce the award in Ukraine, the enforcement proceedings should be initiated within the time period provided by Ukrainian law and the enforcement will proceed in the manner and within the time frame prescribed by Ukrainian law³⁶.

Ukrainian courts by law should grant enforcement consents almost automatically, *i.e.*, without entering into the merits of the award, upon satisfying itself that the award meets specified formal requirements. These requirements may be divided in two groups. First, the enforcement consent is granted if Ukraine is shown to have jurisdiction to enforce the award, *i.e.*, the award is of a type capable of enforcement in Ukraine. An award is capable of enforcement in Ukraine if the debtor is a resident or owns property in Ukraine. Second, the enforcement consent is granted if the award is free of defects specified in the applicable law or international treaty.

With respect to foreign court judgments, Ukrainian law provides that the procedure for recognizing and enforcing such judgments should be stipulated by applicable international agreements entered into between Ukraine and the specific jurisdiction from which the judgment originated or, if on *ad hoc* basis, then based on the principle of reciprocity concerning the mutual enforcement of court judgments with the country in which the judgment was rendered. As a result, unless there is an agreement regarding the recognition of court judgments between Ukraine and the jurisdiction in which the judgment was rendered, or a practice of reciprocal enforcement of such judgments, a Ukrainian court could refuse to enforce a judgment issued by a foreign court in Ukraine.

³⁵ Article 390 of the Civil Procedural Code of Ukraine # N 1618-IV, dated March 18, 2004.

³⁶ Article 84 of the Law of Ukraine "On Enforcement Proceedings" # 606, dated April 21, 1999.

At present, Ukraine is not a party to any multilateral treaties calling for the recognition of judgments of foreign courts of general jurisdiction. Ukraine is, however, a party to certain bilateral agreements concerning the enforcement of such judgments with a variety of former communist countries, but it has not entered into such agreements either with the United Kingdom or the USA. Therefore, it is currently not possible to enforce English or US courts' judgments in Ukraine.

2 Washington Convention³⁷

The Washington Convention was negotiated and prepared under the auspices of the International Center for Settlement of Investment Disputes (ICSID) at the World Bank. Ukraine signed the Washington Convention on April 3, 1998, with an effective date of July 7, 2000. In accordance with the Washington Convention, an investor may bring an action against the government of a contracting state to the Convention for violations of investment protections and due process by officials and courts of that contracting state. The Washington Convention's forum for dispute settlement is available only when both parties to the dispute are from contracting states to the Washington Convention.

³⁷ The Convention on the Settlement of Investment Disputes between States and Nationals of Other States dated 18 March 1965 (*Washington Convention*).

IX. ANTI-TRUST AND COMPETITION REGULATIONS

A. OVERVIEW

Various aspects of Ukraine's anti-monopoly legislation merit consideration when undertaking the formation of a Ukrainian joint venture, or acquiring shares or participation interests of Ukrainian companies.

The Anti-Monopoly Committee of Ukraine ("AMC") is the entity responsible for the enforcement of laws relating to anti-trust and anti-competitive activities. The AMC carries out this task primarily by reviewing proposed transactions for their anti-competitive effects.

B. TRANSACTIONS REQUIRING AMC APPROVAL

In Ukraine, the term "concentration" is used to describe a number of types of merger, acquisitions and other transactions involving legal entities. Ukrainian anti-monopoly law³⁸ requires the prior approval of the AMC for concentrations that fall within certain statutory parameters. A concentration includes:

1. a merger or consolidation of business entities;
2. the direct or indirect purchase or acquisition by other means of ownership or management of a stake that results in the acquirer obtaining 25% or more or 50% or more of the votes in the highest management body of a business entity;
3. the acquisition of control, directly or indirectly through third parties, by one or more business entities in one or more other business entities by various means. The law sets out an illustrative, but not exhaustive, list of methods in which control may be acquired; or
4. the establishment of a business entity by two or more business entities that will engage in business activities independently over a prolonged period (e.g. a corporate joint venture), provided that such establishment does not result in the coordination of the removal of competition between the business entities that originally established such business entity, or between those business entities and the newly established business entity.

1 Thresholds for AMC Approval of the Concentration

If a transaction qualifies as a "concentration" then the AMC's approval must be sought if the following thresholds are met:

- (i) the worldwide aggregate value of assets or net sales turnover of the participants, including all related entities, for the previous financial year exceeds 12 million EUR, and *at the same time*:

³⁸ specifically, the Law of Ukraine "On Protection of Economic Competition" ("Competition Law") and the Regulation On the Procedure for Submitting Applications to the AMC for Obtaining Prior Approval for Concentrations of Economically Active Individuals or Entities (approved by Order No. 33-p of the AMC), dated February 19, 2002 ("Regulation 33-p")

- (a) the worldwide aggregate asset value or net sales turnover of each of at least two of the participants (including all related entities) for the latest financial year exceeds 1 million EUR; and
- (b) the aggregate asset value or net sales turnover in Ukraine of at least one of the participants (including all related entities) for the previous financial year exceeds 1 million EUR;

or

- (ii) the individual or aggregate market share of the participants (including all related entities) in the market concerned or the neighboring market exceeds 35%.

2 Who is a "Participant" in the Concentration?

As can be seen from paragraph 1 above, the rules setting out the threshold criteria in Ukrainian legislation use the term "participants" of the concentration. As a general rule, the participants in:

- (a) a merger are the two companies subject to the merger (*i.e.*, the purchaser and the target);
- (b) an acquisition of stakes in a company, the company directly or indirectly acquiring the stakes and the company in which the stakes are acquired;
- (c) an establishment of a new entity, the founders of such entity; and
- (d) an acquisition of control, the companies acquiring control and the companies over which control is being acquired.

However, the scope of the term "participants" is very wide, and includes not only the "actual" participants, but also all entities and persons who are "related" to those actual participants. In this context a party will be "related" if it either controls, or is controlled by one of the actual participants. Again, the definition of "control" is wide, and includes the notion of affiliated individuals (family members).

The practical effect of this wide definition of "participant" includes the fact that where an actual participant is a member of a corporate group, the asset value/turnover and market share of the *entire* group should be used to calculate whether the thresholds are reached. In many cases, a large number of entities and persons will be deemed to be "participants" in the concentration under Ukrainian law, and the thresholds will be exceeded even where the participants' individual presence in, or connection to, Ukraine is minimal.

C. THE AMC APPROVAL PROCEDURE

1 General

The AMC approval application process is quite extensive and often requires the submission of a substantial, detailed set of documents to the AMC, including information relating to the participants' activities, corporate status and governing bodies, shareholders/owners, advisers, financial results and affiliates. The preparation of the approval application package can be time-consuming, but will depend on how quickly the applicants can pull together the necessary information. The application itself is

required to be in Ukrainian, and certain documents (including foundation documents, certificates of incorporation, powers of attorney) may need to be apostilled (legalized) and also translated into Ukrainian.

Once the application package has been completed it can be submitted to the AMC for review, along with a fee. If the application package complies with all the AMC's formal requirements it is deemed to be accepted by the AMC 15 days after submission (a sort of 'preview' period). The AMC then has 30 days to process and review the application (*i.e.*, a total of 45 days from submission). If the AMC does not render a negative decision or request additional information, the application is considered approved at the end of the 45-day period. However, if the AMC finds a reason to prohibit the concentration it will issue an order initiating a case investigation. The AMC should then complete such investigation within three months - although the AMC Chairman can extend this review period for an additional three months. In reality, the AMC has the right (and invariably exercises this right) to request additional documents at any time to assist with its review of the application, in which case a new three-month period starts from the point at which the requested documentation is submitted to the AMC.

In our experience, it is possible for AMC approval (both preparation of the application and receipt of AMC approval) to be achieved in approximately one month, if the AMC has no objections to the transaction (although the process can take significantly longer in certain cases). As *prior* approval for most transactions is required, this procedure can often significantly slow down a transaction unless the application process is properly managed from the outset.

2 Application Documents and Information

The documentation and information required to be submitted to the AMC as part of the approval package vary depending on the type of corporate transactions. The law requires that the participants to the concentration provide their basic corporate documents, transaction documents as well as further documents which explain the basic nature of the transaction for which approval is being sought.

All applications must contain information about entities controlled by or controlling the parties to the transactions. In particular, the law requires the submission of copies of documents that reflect the legal relations among the parties and among the parties and other business entities.

Finally, for each party to a concentration, including for related entities, the documents submitted to the AMC should also include a variety of information about assets and turnover including:

- (i) information on the main types of activities of each party as well as their market share including information about the main types of activities of each connected subject;
- (ii) a list of persons serving on the supervisory boards or the executive or controlling bodies of the parties to the transaction, persons who carry out the duties of the manager, deputy manager and chief accountant of the parties;

- (iii) an “economic substantiation of the transaction”. The substantiation may include the following issues: the purpose of the purchase; economic rationale for each party; influence of the purchase on the respective goods/services markets in light of the presence of actual and potential competitors, any actual or potential fluctuations in demand and supply, saturation of the market; changes in quality of goods/services; and any economic and financial consequences of the purchase which may affect prices or profits.

3 Criteria for Approval

The law provides that approval for a concentration should be granted if the concentration will not lead to the monopolization of, or a significant limitation of competition on, the applicable market.

4 Penalties

A variety of actions (including acquisitions and mergers) taken without required AMC prior approval are punishable by a fine of up to 5% of the profits of a company's turnover in the financial year which precedes the year when the fine was imposed. In addition, the AMC may unwind the transaction or require that assets or shares in excess of allowable amounts be divested. Additionally, individuals and companies who have suffered loss as a result of concerted practices may file a claim seeking compensation for monetary and "moral" (*i.e.* emotional distress) damages. Also, the court may award damages of up to double the amount of losses suffered by the claimant.

5 Preliminary Approval

It is possible for a participant in a concentration to seek a preliminary ruling from the AMC as to whether (i) it is necessary for the participants to make an application in respect of a specific transaction (*e.g.*, in circumstances where it is unclear if the thresholds are met); and (ii) it is likely that the AMC will give its approval to a particular transaction. The AMC charges a processing fee of UAH 3740 in respect of these preliminary rulings and has 30 days to review and process such an application.

D. ANTI-COMPETITIVE ACTIVITIES

Ukrainian legislation sets out a number of activities which are capable of being classified as anti-competitive:

1 Concerted Practices

Pursuant to the Competition Law concerted practices are essentially any actions of a competitive nature that are agreed by two or more business entities.

Under the Competition Law any concerted practice between entities which has led or could potentially lead to the prevention, elimination or restriction of competition are considered anti-competitive, and are prohibited. Anti-competitive concerted practices include: (i) price-fixing; (ii) market division; (iii) restriction of market access; (iv) distorting

the results of trade activities; (v) substantially limiting the competitiveness of other companies without justification; and (vi) entering into agreements that are conditional on the contracting party's acceptance of additional obligations which are unrelated to the main agreement. The prohibition applies equally to actions which are the result of vertical or horizontal arrangements. The actions need not necessarily result from formal agreements, and may be based on informal arrangements and concerted practices. In order to be prohibited, the actions do not necessarily have to be taken by undertakings having a dominant position.

The Competition Law gives the AMC the right to permit concerted practices in certain circumstances, for example, (a) if the participants can prove that the relevant practices encourage manufacturing, technological or economic development, or the development of small or medium-sized enterprises; and (b) if the practices do not lead to substantial restriction of competition in the market. In addition, in certain circumstances the Cabinet of Ministers has the right to allow concerted practices (even where the AMC has not approved such practices) if the participants can show that the positive social effects of these practices outweigh the negative consequences of the restriction of competition. There is currently no criteria for measuring such positive effects.

The AMC's Model Requirements to concerted practices³⁹ contain exemptions from the need to obtain authorization for concerted practices: the parties may be exempted from authorization (i) if their aggregate market share is less than 5% of the relevant market; or (ii) if their aggregate market share is less than 15% or 20% of the relevant market, as long as certain other criteria are met; or (iii) in certain circumstances where the parties are small or medium-sized enterprises.

If an entity wishes to obtain approval from the AMC in respect of a concerted practice it must complete the application procedure, in which case the AMC has three months to decide whether to authorize the concerted practice. The AMC charges a processing fee of approximately UAH 2550.

As is the case in relation to concentrations (referred to above), it is possible for an entity to seek clarification from the AMC as to (i) whether an activity qualifies as a concerted practice; and (ii) in cases where an activity does qualify as a concerted practice, to seek a preliminary ruling from the AMC as to whether it is likely that the AMC will give its consent to such concerted practice. The AMC charges a processing fee of approximately UAH 1190 in respect of each of these clarifications/preliminary rulings.

Penalties. Where anti-competitive concerted practices are determined, the AMC may impose fines on an undertaking of up to 10% of its sales proceeds for the previous financial year. While the Code of Ukraine on Administrative Offences establishes personal liability on managers for anti-competitive concerted practices, the fines for such activity are low (approximately UAH 255 for the managers of the company, and UAH 510 for individual entrepreneurs). In addition, individuals and companies who have suffered loss as a result of concerted practices may file a claim seeking compensation for monetary and "moral" (*i.e.* emotional distress) damages. Also the court may award damages of up to double the amount of losses suffered by the claimant.

³⁹ approved by the Decision of AMC no. 27-p, dated February 12, 2002

2 Abuse of a Dominant Position

Ukrainian legislation envisages that a dominant position in the market can be held by (i) a single undertaking and (ii) a number of undertakings:

- (i) *a single undertaking* is deemed to hold a dominant position if either (a) it has a market share of 35% or more (unless it proves that significant competition exists), or (b) it has a market share of less than 35% but no significant competition exists as a result of the existence of a large number of competitors who each hold relatively small market shares;
- (ii) *a number of undertakings* are deemed to hold a dominant position if (a) the total market share of up to three undertakings exceeds 50%, or (b) the total market share of up to five undertakings exceeds 70%.

Ukrainian anti-monopoly laws state that a dominant position is capable of being abused if the actions or inaction of the entity holding the dominant position cause the prevention, elimination or restriction of competition, or the infringement of interests of other undertakings, which would not have been possible if a sufficient level of competition existed in the market. The legislation sets out a non-exhaustive list of activities which constitute an abuse of a dominant position, including the following:

- (i) imposition of onerous contract terms, giving to the dominant establishment which imposes such terms unjustifiable profits or terms which are not related to subject of contract, including forcing its counterparts to accept goods which they do not need;
- (ii) limitation or termination of manufacturing and withdrawal of goods from trade which result or may result in establishing or supporting deficiency on the market or establishment of monopolistic prices;
- (iii) partial or complete refusal to distribute or purchase goods if there are no alternative sources of supply or distribution, which result or may result in establishing or supporting deficiency on the market or establishment of monopolistic prices;
- (iv) undertaking any other actions which result or may result in creation of barriers to availability of market to other entrepreneurs or in their withdrawal from the market;
- (v) formation of discriminatory prices or tariffs restricting rights of some customers;
- (vi) establishment of monopolistically high prices, tariffs or rates for goods which result or may result in violation of consumers' rights;
- (vii) establishment of monopolistically low prices, tariffs or rates for goods which result or may result in restriction of competition.

An entity can apply to the AMC requesting a letter clarifying whether the relevant activities constitute abuse of a dominant position. The fee for the issue of such letters is approximately UAH 1360.

Penalties. The AMC may impose fines on an undertaking of up to 10% of its sales proceeds in the previous financial year for abuse of a dominant position. While the Code of Ukraine on Administrative Offences establishes personal liability on managers for abuse of a dominant position, the fines for such activity are low (approximately UAH 255 for the managers of the company, and UAH 510 for individual entrepreneurs). In addition, individuals and companies who have suffered loss as a result of abuse of a dominant position may file a claim seeking compensation for monetary and moral damages. Also, the court may award damages of up to double the amount of losses suffered by the claimant.

3 State and Local Government Authorities' Discrimination

There are a number of ways in which state and local government authorities engage in anti-competitive practices, including passing legislative or regulatory acts, entering into agreements and/or issuing instructions, in each case which leads or may lead to the prevention, elimination or restriction of competition. Examples of such discrimination could include imposing restrictions on the creation of a company in a particular sector, restricting trade between certain markets or classes of sellers or buyers in a particular market, forcing companies to join trade associations.

Penalties. While the Code of Ukraine on Administrative Offences establishes liability on state bodies for anti-competitive concerted practices, the fines for such activity are low (approximately UAH 255). In addition, individuals and companies who have suffered loss as a result of discrimination may file a claim seeking compensation for monetary and moral damages. Also, the court may award damages of up to double the amount of losses suffered by the claimant.

4 Unfair Competition

The general definition of "unfair competition"⁴⁰ includes any activities which contradict the rules, trade and other fair practices of entrepreneurial activity, and the law contains a number of specific acts which qualify as violations. These acts are detailed under three general categories:

- (i) *illegal use of the business reputation of a third-party economically active individual or entity*

A variety of practices are proscribed under the category "illegal use of business reputation". For example, the unauthorized use of another's name, brand name, trade or service marks or other markings, advertising materials, packaging, names of works of literature and art, names of periodicals, and names of the place of a product's origin, is deemed illegal if such unauthorized use may cause confusion with the activities of any economically active individual or entity that has priority rights to use such item, *etc.* Companies engaged in comparative advertising should take heed: if the goods, services

⁴⁰ Contained in the Law of Ukraine "On Protection from Unfair Competition", dated June 7, 1996.

or activities of one economically active individual or entity are compared with another in an advertisement, then that practice may be deemed illegal unless the information in the advertisement is confirmed by actual data and is trustworthy, objective and useful for the purpose of informing consumers.

Other proscribed practices include: placing the products of another manufacturer under one's own label by changing or removing the original manufacturer's label without its permission; and reproducing the external appearance of another's product and marketing that product without a clear specification of the manufacturer of the copy, if this practice may cause confusion with the activities of another economically active individual or entity.

(ii) creation of anti-competitive obstacles and obtaining an unfair competitive advantage.

Under the law, the bulk of practices deemed "unfair competition" fall under this second category. One of the practices prohibited under this category involves discrediting an economically active individual or entity by distributing, in any form, untrue, inaccurate or incomplete information connected with that entity or its activity which causes or may cause harm to its business reputation. Bribing an employee of a competitor's supplier or purchaser (customer) for the purpose of inducing him or her to improperly perform or refrain from performing his or her obligations under a contract between the competitor and the supplier or purchaser (customer), and which results in the entity providing the bribe obtaining certain advantages over its competitor, is also prohibited.

Additional illegal practices falling under this second category can include (a) encouraging boycotts by inducing another entity or individual, directly or through an intermediary, to refuse to enter into contractual relations with a competitor; (b) encouraging discrimination by suppliers by inducing the supplier, directly or through an intermediary, to provide a purchaser's (customer's) competitor with certain privileges over that purchaser (customer) without a sufficient basis for such preference; and (c) inducing an economically active individual or entity to break a contract with one's competitor.

(iii) illegal collection, disclosure and use of commercial secrets

The third category of unfair competition, involving commercial secrets (recognized as such under Ukrainian law), proscribes the following types of practices that effect economically active individuals or entities: illegal collection of commercial secrets which causes or may cause harm to them; unauthorized disclosure, or inducing the disclosure, of commercial secrets which causes or may cause harm to them; and unauthorized use of illegally acquired commercial secrets in one's manufacturing process or in the course of planning or carrying out commercial activity.

Although responsibility for enforcement of the law is given to the AMC, the AMC may only act upon application by a party whose rights have been violated as a result of an unfair practice. Victims of unfair practices must apply to the AMC for redress within six months from the date when they learned or should have learned that their rights were violated. Violators may be subject to fines (as high as 3% of earnings from the sale of

goods, work or services) levied by the AMC as well as additional administrative, civil and criminal liability under Ukrainian law.

X. MISCELLANEOUS

A. CONSUMER PROTECTION LEGISLATION

Ukraine has special consumer protection legislation which attempts to provide strong safeguards for consumers. This legislation, however, is unsophisticated and outdated. Its focus is mainly on the guarantees of consumers against the supply of defective goods and services and product liability issues.

In addition to the special consumer protection legislation referred to above, there are rules in the Civil Code that aim to protect a weaker party to a contract - and these can be invoked by a consumer. The Civil Code provides for (i) *public contracts* and (ii) *contracts of adhesion*:

(i) *Public contracts.* Under a public contract a provider of services is obliged to enter into contracts with all parties requesting the service. A public contract must have the same terms for all consumers of the service (except as otherwise may be provided by statute); a public contract may not provide preferential treatment to one consumer over others, and the provider of the services may not refuse to enter into the contract if, in practice, it has the ability to provide the service.

(ii) *Contract of adhesion.* A contract of adhesion is a contract whose terms are fixed in advance by the party proposing to conclude the contract, such that the contract cannot be concluded other than by the other party's acceptance of all of its terms. The accepting party may rescind or modify the contract if the contract does not provide for rights normally available to that party, or if the contract excludes or limits liability of the proposing party, or if the contract contains oppressive terms.

By law, before the conclusion of a consumer contract the consumer has the right to full, timely and accurate disclosure of material information about the service so as to enable the consumer to make an informed choice.

After conclusion of the contract, the consumer may cancel the contract and claim damages if the service provider has not begun performance in a timely manner or if the performance is so slow that it cannot be completed on time. The consumer may set a time limit for completion of the performance and rescind the contract if the time limit is not complied with. Further, if the service provider fails to perform the contract on time, it is liable by law to the consumer for a penalty in the amount of 3% of the value of the service per day. If performance is defective, the consumer may demand a price reduction, claim damages or rescind the contract. Contract terms restricting statutory consumer rights are invalid and consumers are entitled to full compensation if they suffer a loss as a result of such terms.

In addition to contractual penalties, service providers may be subject to administrative penalties for violation of consumer rights, levied by the Ukrainian agency for the protection of consumer rights.

B. DATA PROTECTION LEGISLATION

Ukraine does not have a separate statute devoted specifically to data protection. The relevant rules are found in the Civil Code, legislation relating to the possession and use of information and certain banking legislation.

The legislation relating to the possession and use of information sets out the basic framework for protecting client confidential information. Information created by legal entities or lawfully acquired by them is the property of those legal entities. The owner of such information has the right to perform any lawful actions in respect of his property. Consequently, companies may lawfully possess certain information on their clients and customers under Ukrainian law. The owner of the information has the right to appoint an individual to act as the person authorized to exercise the possession, use and disposal of that information and also to determine rules for the processing of and access to it, as well as to determine other conditions with regard to the information.

The legislation on information outlines the regime of legal protection for "information with restricted access" (*i.e.*, confidential and secret information). Individuals and organizations possessing lawfully received information independently determine the mode of access to that information, including whether it is of a confidential nature, provided that such information does not infringe any legally established secrecy procedures, and take measures to secure its protection. Persons may obtain, use, disseminate and store information in any form except where prohibited by law. Holders of information are obligated not to abuse it, must use the information in accordance with contracts governing its use, release the information to persons entitled to it under the law, and compensate losses caused by the improper use or handling of the information.

Ukraine's banking legislation specifically refers to "bank secrets", *i.e.*, information relating to the activities and the financial status of a client. A bank secret may only be disclosed in exceptional circumstances strictly defined by the law. Banks are required to employ measures for the protection of their clients' bank secrets and confidential information.

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