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LEGAL ALERT

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NEW LAW ON LIMITED LIABILITY COMPANIES IN UKRAINE

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The new law on LLCs in Ukraine to come into force on 17 June

The Law of Ukraine *On Limited Liability Companies and Additional Liability Companies* passed on 6 February 2018 shall come into force on 17 June 2018. The Law is a positive sign for doing business in Ukraine as it introduces significant changes and innovations in the legal regulation of the establishment and activities of limited liability companies, which are the most numerous and the most popular form of entrepreneurial activity in Ukraine (second only to individual entrepreneurs).

Prior to the new Law adoption, the limited liability companies' activities were regulated by the Law of Ukraine *On Business Entities*, adopted in 1991 (with many subsequent

amendments) and which stopped meeting the facts of life, preventing limited liability companies' shareholders from handling the issues of corporate relationships between them easily.

The new Law introduces numerous changes to the regulation of the activities of limited liability companies and additional liability companies, the most important of which are:

- the Law provides for the possibility of concluding shareholders' agreements between the companies' shareholders;
- the requirements for the companies constitutional documents have been changed;
- the Law introduces clear mechanisms of decision-making by the companies' shareholders, in particular the adoption of resolutions by written polls and absentee voting has been regulated;
- the Law provides for the possibility of establishing a supervisory board in limited liability companies and additional liability companies for effective monitoring of the companies' executive bodies;
- the Law introduces the concept of significant transactions, concluded by the company.

All these innovations are intended to help improve the investment climate in Ukraine, in particular the foreign investment inflow, as new legal mechanisms are introduced to allow the companies' shareholders to more clearly regulate relationships between them when establishing a company and to protect the owners from unscrupulous actions taken by the management.

Possibility of concluding shareholders' agreements between LLC shareholders

Upon the entry into force of the new Law, the limited liability companies' shareholders will be entitled to enter into shareholders' agreements, under which they undertake to exercise their rights and powers in a certain way or refrain from exercising thereof.

This amendment is a significant step forward since previously, the limited liability companies' shareholders were not able to enter into shareholders' agreements within the Ukrainian legal system and often turned to other jurisdictions where this issue is legally regulated (in particular, shareholders' agreements were concluded with the participation of LLC foreign shareholders). However, the legal protection of the LLC shareholders, having concluded a shareholders' agreement under the laws of another state in Ukraine, was significantly weakened, as it was necessary to undergo a procedure for recognition of decisions of judicial bodies of a foreign state or international arbitration in Ukraine, which became a significant procedural obstacle on the way to protecting foreign investors' rights.

In addition, the shareholders' agreement allows the LLC shareholders, at their own discretion, to regulate a wide range of issues of their relationships in the course of creating and operating the LLC. In particular, according to the new Law, the shareholders' agreement may stipulate conditions or the procedure for determining the

conditions under which the shareholder is entitled or obliged to purchase or sell the interest in the authorized capital (a portion thereof), as well as to determine cases when this right or obligation arises. The shareholders' agreement may also provide for the waiver of the shareholder's pre-emptive right to purchase the interest of another LLC shareholder, sold to a third party.

The new Law does not specify which relationships (except for those listed) between the LLC shareholders may be regulated in the shareholders' agreement, and this might give rise to discussions. However, in our opinion, in a shareholders' agreement, the company shareholders can also regulate the rights and obligations with respect to each other and their obligations with respect to the company; approval of matters concerning the alienation of interest in the company, including setting the fixed value of the interest that will be sold in the future; the shareholders' duties with respect to company management, including the company management appointment; establishment of the procedure for resolving disputes between the company shareholders, etc.

The content of the shareholders' agreement may not be disclosed and is confidential unless otherwise provided by the law or the agreement (except in cases where the state, territorial community, state-owned or communal enterprise are parties to the agreement).

Special attention should be drawn to the following innovation: the nullity of a contract entered into by a party to the shareholders' agreement in violation of that shareholders' agreement, provided that the other party to such a contract knew or could have known about the violation. On the one hand, such a rule of the new Law protects the shareholders of limited liability companies from contracts, violating the provisions of the shareholders' agreement. On the other hand, this rule introduces a dangerous mechanism for appealing against other contracts that will violate the terms of the shareholders' agreement. In particular, unscrupulous shareholders that are parties to the shareholders' agreement may refer to the nullity of the contract with third parties, arguing that such a contract violates the terms and conditions of the shareholders' agreement, which may lead to manipulation in business relations.

There are also some shortcomings in the legal regulation of the shareholders' agreements. In particular, the new Law says nothing about what happens to the shareholders' agreement when one of the shareholders withdraws from the company or sells its interest to a third party. Will the shareholders' agreement automatically terminate or will the automatic substitution of the party to the shareholders' agreement take place? Obviously, this question needs additional regulation; in particular, it can be regulated in the shareholders' agreement itself.

Corporate governance

An interesting innovation of the new Law is the abolition of the quorum for the general shareholders' meetings, without which the general shareholders' meeting was not authorized to adopt resolutions. Under the old Law *On Business Entities*, the general shareholders' meeting is deemed to be quorate if attended by the shareholders (representatives of the shareholders), in aggregate having more than 50% of the

votes. Therefore, in the companies where the shares were distributed among the shareholders in the 50/50 proportion (or in a different proportion where one shareholder or a group of shareholders had 50%), it was often the case that the company work was blocked by one of the shareholders or a group of shareholders, in aggregate holding 50% of the shares in the company. So, the quorum constraint is now lifted. Nevertheless, the new Law contains a rule, establishing the minimum number of votes needed to adopt a resolution.

Under the new Law, the decisions on most issues of the company's activities are adopted by the majority of votes of the company's shareholders, entitled to vote on the relevant issues (with the exception of issues for which another minimum number of votes is required so that the decision is adopted). In particular, 3/4 of all votes of the company's shareholders are required to adopt decisions to amend the charter, to change the authorized capital, to reorganize or liquidate the company. The shareholders shall unanimously adopt the decisions, inter alia, on the approval of monetary valuation of the shareholder's in-kind contribution, and on the purchase of the shareholder's interest by the company. The company's charter may establish a different number of votes of the company's shareholders (but not less than the majority of votes) necessary for the adoption of decisions on the issues related to the company's activities, except for decisions that shall, pursuant to the new Law, be adopted unanimously. Thus, despite lifting the quorum at the company general shareholders' meeting, the new Law upholds the requirements for the minimum number of votes when adopting the company decisions.

Abolishing the quorum for the company general shareholders' meetings became possible due to introducing new procedures for holding general shareholders' meetings, namely: videoconferences, absentee voting or written polls (i.e. holding general shareholders' meetings "remotely"). This innovation with respect to holding general shareholders' meetings of limited liability companies remotely will significantly simplify the management of the companies where the shareholders are non-residents for whom it is often difficult to physically gather in one place to participate in the general meetings. However, unscrupulous shareholders may still block decision-making by ignoring videoconferences, absentee voting and written polls. Therefore, the procedure for holding the general shareholders' meetings and the obligations (liability) of the shareholders should obviously be regulated in the charter and the shareholders' agreement.

Supervisory board

Another important innovation that creates additional opportunities for the control by the shareholders (including non-residents) over the company executive body is establishing the supervisory board in the limited liability companies (before the entry into force of the new Law, it was possible to create a supervisory board only in joint-stock companies).

The supervisory board shall control and regulate the activities of the company executive body. In particular, the supervisory board competence may include the election of the company sole executive body or members of the company collective

executive body (all or one or several of them), the suspension and termination of their powers, the establishment of the remuneration to the executive body members. The company supervisory board may be delegated the powers of the general shareholders' meeting, except those that fall within the exclusive competence of the general shareholders' meeting.

Significant transactions

The Law establishes rules for the approval by the company of significant transactions (transactions the value of which exceeds 50% of the net company assets as at the end of the previous quarter) and interested party transactions (transactions which are concluded with the persons specified by the Law (company executives, affiliated persons, etc.).

It is assumed that the company executive body may not conclude significant transactions and interested party transactions at its own discretion, but must obtain the consent of the general shareholders' meeting or the company supervisory board to that effect.

In addition, the Law has increased the liability of company executives for the late notification to the company of any conflict of interests.

Other significant innovations

Other significant innovations of the Law include:

- removal of restrictions on the maximum number of the company's shareholders, which previously could not exceed 100, which will allow, if necessary, to reorganize a joint-stock company into a LLC;
- the mandatory scope of information that must be stated in the company charter has been significantly reduced. It is no longer necessary to specify in the charter the list of shareholders, their personal data, the authorized capital, the shareholders' interest. The information to be specified in the charter is limited to the following: the name of the company, the company management bodies, their competence, the procedure for adoption of their resolutions, the procedure for joining the company and withdrawal from the company;
- the time limit granted to the shareholders to make their contributions when founding a company has been reduced twice (it is no longer more than one year as before, but six months). At the same time, the term for paying up the shares can be prolonged, should all the founders decide so, which was previously not possible. The Law also allows the company's shareholders to increase the authorized capital from the retained earnings of the company without additional contributions;
- the procedure for the transfer of the interest to the heir or successor of the company's shareholder has been changed. Earlier, the heirs had the pre-emptive right to join the company only after the respective resolution was adopted by the general shareholders' meeting. The new Law does not provide

for the procedure of obtaining the consent of any company body for the direct transfer of the interest to the heir. However, the company may establish its own mechanism of the interest inheritance in the charter, up to the impossibility of inheritance of the shareholders' interest at all;

- there are new rules for the shareholders' withdrawal from the company. A company shareholder whose interest in the authorized capital of the company is less than 50% may withdraw from the company at any time without the consent of other shareholders. In turn, a company shareholder whose interest in the authorized capital is 50% or more may withdraw from the company only with the consent of other shareholders.

It should be noted that the provisions of the charters of limited liability companies and additional liability companies that are in conflict with the new Law will remain in force within one year after the date of entry into force of the new Law insofar as they are not in conflict with the laws as of the date of entry into force of the new Law. After the expiry of one year, the provisions of the companies' charters, being in conflict with the new Law, will become invalid. Therefore, in order to avoid this situation, the limited liability companies' shareholders should make sure that their companies' charters are brought in line with the new Law requirements.

In general, the new Law, regulating the activities of limited liability companies, has a positive impact on the operation of limited liability companies, in particular, due to the fact that the Law gives the companies an opportunity to resolve the majority of issues related to that company activities on its own. The new Law does not establish unambiguous rules; instead, it allows the company shareholders to establish their own procedures, to create corporate governance bodies necessary for the company, and to find possible ways of resolving potential corporate conflicts. Therefore, the shareholders of limited liability companies should now start considering how to regulate all the issues of the company's activities in the constitutional documents and shareholders' agreements in detail, using all the benefits provided for by the new Law.

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