



The Business & Law Readers Digest

**Corporate dispute resolution:
recent developments
in court practice**

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During the last years, the problem of "raiding" as a method of hostile company takeover has become more topical in Ukraine.

Inadequate and fragmentary legislative regulation of a number of issues such as the incorporation and subsequent business activity of legal entities and the occurrence of conflicts and gaps in legislative instruments in the corporate sphere, lead to courts interpreting and applying corporate legislation in various ways. This results in multiple misjudgements by the courts while considering corporate disputes.

Lack of unified court practice formulated by the highest courts have become fertile soil for "corporate raids", which frequently turn violent due to extensive involvement by police, private guards and organised groups of companies' employees.

The masterminds of these raids often use the Ukrainian court system as an effective tool to implement their strategies of hostile takeovers or similar attacks.

Reform in corporate dispute resolution

Small local courts, often situated in remote rural districts of Ukraine, were frequently used for obtaining illegal injunctions and judgments, which were necessary for the realisation of the raiding schemes. Such a situation led to a total mess in corporate litigation.

Therefore, a new law was adopted on 15 December 2006 which included all corporate disputes in the jurisdiction of business courts. Now, the practice of both parties holding different and often

absolutely contrary injunctions or judgments by different courts (a business court and a general jurisdiction court which could both be used for corporate raids) is eliminated.

After the adoption of this law, business courts have jurisdiction over the vast majority of corporate disputes which allowed elaborating the unequivocal practice of considering this kind of cases.

Recommendations of the Supreme Court

Following the introduction of the above-mentioned law, the Supreme Court of Ukraine developed the Summary review

of corporate disputes during 2006-2007, which generalises the practice of considering cases involving shareholders,



management and companies themselves.

The Summary review detected a number of disputable issues in court practice and determined the methods for uniform application of legislation and corporate dispute resolution.

As court practice shows, one of the deficiencies of the effective law is the ambiguity of grounds and consequences of constituent documents' invalidation.

The Supreme Court of Ukraine has defined that the court may invalidate the company's constituent documents only when the following conditions are simultaneously met:

- (a) the constituent documents contradict the requirements of the effective legislation at the moment of considering the case on merits;
- (b) the infringements made during the process of adoption and approval of the constituent documents cannot be mitigated;
- (c) the relevant provisions of the constituent documents violate the plaintiffs' rights.

The business court should also refrain from amending the constituent documents of a company, as it is beyond the competence of the court and would be deemed as intrusion into the company's business activity. Instead, the courts are

empowered to compel the defendant to amend the constituent documents himself if failure to amend them infringes the third party's rights.

One more lacuna of effective legislation is failure by lawmakers to prescribe the exact list of grounds for invalidation of the company's management bodies' decisions, which was widely used in illegal raiding schemes.

Therefore, the Supreme Court introduced the guidelines for the lower courts which are to be followed during consideration of corporate disputes. The decisions of the general shareholders meetings may be invalidated only in one of the following cases:

- (a) there were breaches of law and/or the constituent documents in the process of convening and holding the general shareholders meeting;
- (b) shareholders have been deprived of the possibility to participate in the general meeting;
- (c) the meeting's decision has infringed the shareholder's rights.

However, not all infringements of the shareholder's rights may be grounds for invalidation. The court should examine whether the violations during the general shareholders meeting could had an effect upon the general meetings' decision.



Specifically, the unconditional reason for invalidation shall be:

- (a) adoption of the decision in the absence of quorum;
- (b) adoption of the decision according to issues which were not included in the agenda;

(c) violation of the procedure of informing the shareholders within the procedure of change of charter capital.

It should also be noted that the court may not annul the minutes of the general shareholders meeting, but rather the decision of the meeting.

Withdrawal of a shareholder

One of the important issues within corporate relations is the withdrawal of shareholders from a limited liability company. Such withdrawal shall result in an important legal consequence - the company's obligation to pay off the shareholder's portion of the LLC's assets.

Due to a lack of legislative regulations, previously the courts had different solutions for how to determine the date which should be considered the date of the withdrawal:

- (a) the date upon which an application on withdrawal from the company was filed;
- (b) the date of the general meeting's decision on withdrawal of the shareholder;

(c) the date of the registration of the amendments to the constituent documents on withdrawal of the shareholder.

The Supreme Court has finally ruled that the moment of the withdrawal should be considered the date of submission by a shareholder of an application to the official of the LLC or the date of filing of such an application with the post office.

It should be additionally noted that the courts are not empowered to make decisions on exclusion of a shareholder from the LLC, nor on admission of the heirs of a deceased shareholder to the LLC; such decisions fall into the exclusive competence of the general shareholders' meetings.



Right to receive information about a company

One type of claim, which is frequently used in corporate raids is a claim to provide information on a company's activity. The Civil Code of Ukraine stipulates for the right of a shareholder to take part in and be informed about the company's business activity.

The Economic Code of Ukraine prescribes the shareholder's right to obtain at his/her request the annual financial reports and other important documents.

However, the legislation does not stipulate the distinct volume of the information which should be provided to a shareholder. The procedure of submission of a respective request and receipt of such information is also not defined; the correlation between the amount of information to be provided to a shareholder and sensitive information which involves a company's trade secrets is one more "black hole" in Ukrainian legislation.

All the abovementioned deficiencies of Ukrainian law have been widely used in raiding schemes (e.g. a minor shareholder filing a suit against the company, claiming to compel a company to present him with a wide range of sensitive documents).

The Supreme Court interpreted the above legislative provisions in the following way. A company is obliged to provide a shareholder at his/her request with only a limited number of documents: the annual balance sheets and income statements; minutes of the company's management and control bodies; information included in the constituent documents.

Moreover, a shareholder may only apply for information on the company's activity for the period starting from the date when he became a shareholder of the company, which in our opinion will protect companies from disclosing their trade secrets to outsiders.

Misuse of court injunctions

One of the principal problems of the Ukrainian court system is the widely spread utilisation of court injunctions to block or constrain a company's business activity. For example, the court can ban a company's general meeting even if the company is not aware of the suit (though

the bill of complaint is not related to the general meeting or the negative consequences of holding it).

Now the courts tend to apply the recommendations of the highest courts, which pointed out that they cannot prohibit the general meeting of the company as this



actually blocks the management of the company. Such prohibition does not correspond to the spirit of court injunction which is supposed to protect the plaintiff's interests and not to hurt the third party's everyday activity.

Court injunctions should conform to the plaintiff's claim and possible negative consequences of both applying and failing to apply the provisional remedies. This also means that courts may not use

the provisional remedies, which are in fact considered to be equal to the satisfaction of the claim.

Additionally, the Commercial Procedural Code of Ukraine does not prescribe such type of the provisional remedies as a prohibition of any actions by the company's management bodies and officials. The court should specify in the injunction exactly which actions are prohibited and the period of such prohibition.

What next?

Ukrainian corporate legislation is a priority during the process of adapting Ukrainian law to the law of the European Union. Considering the progress that Ukraine is making in aligning itself with Europe, the primary goal of the legislative process and court practice should be protection of investors' rights.

Systemising the typical mistakes by the highest courts and implementation of court recommendations by the lower courts will make it impossible to misuse the state machine and the court system of Ukraine as instruments with which to solve business problems of raiders.

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