



**Galina ZAGORODNYUK**

# Review of the Companies Act

By Galina ZAGORODNYUK

This issue of the *Ukrainian Journal of Business Law* contains the English text of the *Ukrainian Companies Act*<sup>1</sup>. Actually it's absolutely naturally that one of the first issues of the Journal observes the questions of the company's activity and presents to the readers this Act as it is one of the key and most important legal acts in Ukraine.

This Act was adopted in 1991 and was repeatedly amended lately. In spite of its text was subjected to a numerous criticism it is widely used and the types of the enterprises (business associations) stipulated in this Act are the most popular in Ukraine among all the other types of the enterprises.

## Legislative process on the improvement of the company's activity regulation

There is a need to mention that the legislative work on the improvement of the *Companies Act* takes place at the

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*Galina Zagorodnyuk is an associate with Konnov & Sozanovsky (Kiev)*

present moment. In particular, there are some drafts of the amendments to the Act in the Parliament, among them e.g. the draft proposing to change the procedure and the determination of quorum of the members' meeting. It is proposed to decrease the quorum of the second meeting to 50% in a case of the first meeting has not taken place because of the absence of quorum.

Also now there are at least three drafts of the *Joint Stock Companies Act*, one of which was prepared with the participation of foreign consultants, in particular, the Financial Markets International with financial support of USAID. In case of adoption of one of these drafts the appropriate provisions of the *Companies Act* would be revoked.

On 1 January 2004 the new *Civil* and *Commercial Codes* are going to come into force in Ukraine. These fundamental documents also regulate the questions of the establishment and functioning of the companies. The main question and a big problem is that these two documents contain different definitions and different regulation to the same questions.

New *Civil Code* stipulates the same

types of companies (business associations), but contains some provisions which differ from the current *Companies Act*. For example, the *Civil Code*:

- expressly envisages that a limited liability company, an additional liability company and a joint stock company can be established by one person (now — two shareholders is the minimum);
- introduces a concept of a *depending* company (in case when another (*parent*) company owns 20% and more of its shares);
- stipulates that a limited liability company, an additional liability company and a joint stock company should be established on the basis of the foundation agreement which however is *not* a foundation document of the company;
- there is no mention of such a management body of the company as an auditing commission, however such body may be expressly stipulated in by-laws of the company. In contrast to it the Code stipulates the order of auditing of the company's activity by the outside auditor.

New *Ukrainian Commercial Code* contains another structure and types of legal entities. But it stipulates the same

types of companies (“business associations”). However it regulates some questions of the companies’ activity in a different manner, for example:

- only individuals and legal entities registered as business undertakings could be the members of a general partnership and the general members of a limited partnership;

- shareholders of the closed joint stock company have the right of first refusal towards other shareholders’ shares;

- it introduces a concepts of the *associated* enterprises (a group of business entities – legal entities, which are connected with each other economically or

organizationally due to the participation in the authorized capital and / or in management) and a *holding* company (a business entity owning the control stock of a subsidiary company).

### The main problems of the current *Companies Act*

Some of the problems and / or the gaps of the Act are:

1. The order of disposal of stocks of joint stock companies. This question is discussed very actively and there are some court decisions on this matter which unfortunately do not correspond to each other. The problem is whether

shareholder is free to sell (alienate) its shares to any person or other shareholders have the prior right to acquire these shares if such a provision is stipulated in the foundation documents. There are a lot of strong arguments from the both sides. We are persuaded that members being the parties of the foundation agreement (or by-laws) are free to stipulate any terms of disposal including the prior right of the other shareholders to acquire such shares. And in case it is stipulated in the foundation documents this provision is obligatory for the members.

2. The determination of quorum of the higher body of the company (members’ meeting) in case of repeated meet-

## Main Provisions of the Companies Act

The *Companies Act* regulates the order of the establishment and activity of the companies and contains both the common rules for all the types of the companies and individual regulations for each separate type of companies acting in Ukraine. They are:

- a joint stock company;
- a limited liability company;
- an additional liability company;
- a general partnership;
- a limited partnership.

**Company’s Definition:** Under this Act, companies mean enterprises, institutions, and organizations established pursuant to an agreement between legal entities and individuals by means of combining their property and entrepreneurial activities for the purpose of generating profit.

**Founders and Members:** May include enterprises, institutions, organizations, and individuals, with exceptions stipulated in the Ukrainian legislation (e.g. state enterprises). At the same time enterprises, institutions, and organizations which become members of a company are not liquidated as legal entities. Foreign citizens, stateless persons, foreign legal entities, and international organizations may become founders and members of companies on an equal basis with citizens and legal entities of Ukraine, except in such instances as set forth in legal acts of Ukraine.

#### The Members’ Rights:

- to participate in the management of the company’s affairs;
  - to participate in the distribution of the company’s revenues and to receive a share thereof (dividends);
  - to withdraw from the company in the prescribed manner;
  - to receive information regarding the activity of the company.
- Other rights might be stipulated in the foundation documents of the company.

#### The Members’ Obligations:

- to comply with the foundation documents of the company and implement the Resolutions of the general meeting and other managing bodies of the company;
- to fulfill its obligations to the company, including those which are connected with investment in the company, and to make contributions (pay for shares) in such amount and manner and by such method as provided in the foundation documents;
- to refrain from disclosing commercial secrets and confidential information regarding the company’s activity; and

- to have other obligations if so provided in this Act, other acts of Ukraine, or the foundation documents.

**Contributions of members and founders:** May include buildings, structures, equipment and other tangible assets, securities, the rights to use land, water or other natural resources, buildings, structures, equipment, and other property rights (including rights to intellectual property), as well as cash, including foreign currency.

**A company’s activity may be terminated:** by means of its reorganization (consolidation, merger, split-up, spin-off, or transformation) or liquidation.

### Single types of the companies

#### • Joint Stock Company

A company which has an authorized capital divided into a certain number of shares of equal par value and is liable for its obligations only with the property of the company.

Joint stock companies include the following: *open joint stock companies* whose shares may be distributed by means of an open subscription and purchase and sale on stock exchanges; and *closed joint stock companies* whose shares are distributed among the founders and may not be distributed by means of a subscription or purchased and sold on stock exchanges.

#### • Limited Liability Company

A company which has an authorized capital divided into shares whose size is defined in its foundation documents.

#### • Additional Liability Company

A company whose authorized capital is divided into shares whose size is defined in its foundation documents. Members of such company are liable for its debts with all their contributions to the authorized capital, and if these amounts are inadequate, then, in addition, with their property in an amount equal to the contribution of each member increased by a multiple which is identical for all members.

#### • General Partnership

A company all of whose partners engage in joint entrepreneurial activity and are jointly liable for the company’s obligations with all their property.

#### • Limited Partnership

A company which, in addition to one or several partners who are liable for the obligations of the partnership with all their property, also includes one or more partners whose liability is limited to the amount of their contributions to the property of the partnership (limited partners).

ing's convocation. The Act contains the only rule that the quorum consists of 60% of the members' votes in any case. And practically this is a deadlock situation when the owner of the control share holding does not have a possibility to convoke and to hold the meeting to solve the important decisions for the company's activity for years.

3. The absence of the exact regulation of the necessity of adopting and registration of amendments to the foundation documents with respect to the foundation agreement. Article 4 of the *Companies Act* contains the list of information which should be obligatory stipulated in the foundation documents.

Article 7 provides that all the amendments to the foundation documents entered in the state register are subject to state registration according to the same rules as established for the state registration of the company. And practically in a case of changes of the membership of closed joint stock company the question is unclear. The State Committee on the Regulation of the Entrepreneurial Activity adopted a Letter<sup>2</sup> explaining the absence of the necessity to register any amendments to a foundation agreement. But this is a question that has to be clear regulated by the Act. The new *Civil Code* contains the provision according to which JSC, LLC and ALC act only on the

basis of the by-laws and the foundation agreement is not a part of the foundation documents.

Sure there are a lot of other questions raised in practice of application of this Act. Some of them are caused by the uncertainty of the provisions (e.g. the determination of the profit of the company; the presence or absence of the questions being the exceptional competence of the members' meeting of LLC). Some of these questions are caused by their unclear purport (e.g. the decision of the decrease of the authorized capital of LLC comes into effect only after three months after state registration and publication etc). ■

### Comparison Table for Different Types of Companies

Type of the company	Foundation documents	Minimal size of the authorized capital	Liability of the members
<i>Joint Stock Company</i>	Foundation agreement and by-laws	The amount equivalent to 1250 minimal salaries stipulated by the moment of the establishing of the JSC	Shareholders are liable for the obligations of the company only to the extent of the value of the shares owned thereby
<i>Limited Liability Company</i>	Foundation agreement and by-laws	The amount equivalent to 100 minimal salaries stipulated by the moment of the establishing of the LLC	Members of the company are liable to the extent of their contributions
<i>Additional Liability Company</i>	Foundation agreement and by-laws	The amount equivalent to 100 minimal salaries stipulated by the moment of the establishing of the ADC	Members are liable for its debts with all their contributions to the authorized capital, and if these amounts are inadequate, then, in addition, with their property in an amount equal to the contribution of each member increased by a multiple which is identical for all members. The maximum liability of members is provided in the foundation documents
<i>General Partnership</i>	Foundation agreement	Not stipulated by the Act	All the members (partners) are jointly and severally liable for the obligations of the company with all their property
<i>Limited Partnership</i>	Foundation agreement	Not stipulated by the Act	One or a majority of the members (partners) are liable for the obligations of the partnership with all their property, and one or more members (limited partners) are liable only within the amount of their contributions to the property of the partnership. If a limited partnership has two or more general partners, they are jointly and severally liable for the debts of the partnership

1. *Act of Ukraine On Companies of 19 September 1991, No.1576 (the Companies Act).*

2. *Letter of the State Committee of Ukraine On the Questions of the Regulatory Policy and Entrepreneurship of 8 July 2002, No.2-222/4337.*

3. The minimal salary is determined in the amount of UAH 185 since 1 January 2003, and will be increased to UAH 237 since 1 July 2003 according to the *Act of Ukraine On the Determination of the Size of the Minimal Salary for 2003 (the Minimal Salary Act)* of 26 December 2002, No.372-IV.