

Illegal Corporate Raiders

Corporate legislative reform needed as a prerequisite for the further development of a competitive Ukrainian economy

White Paper
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Prepared by the Working Group
“On Illegal Corporate Raider Attacks” of the
American Chamber of Commerce in Ukraine

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I. INTRODUCTION

Corporate legislation in Ukraine, as well as in other CIS and Eastern European countries, was developed without a unified strategic approach. As a result, it tends to be fragmented and is incomplete and, in some cases, contradictory in nature. Moreover, such corporate legislation creates obstacles for effective business activity and for the attraction of needed investments; it also causes high transaction expenses for business operations.

Currently many countries are responding to continuous international competition and a growing number of mergers and acquisitions by actively improving their systems of corporate legislation and regulation, thereby gaining a competitive advantage over other nations in attracting and maintaining investment. Ukrainian corporate legislation must comply with international standards and should also ensure competitive rules and regulations for companies, including mechanisms for the protection of property rights and for the incurring of acceptable expenses to implement them. Therefore, the ultimate goal of increasing the competitiveness of the Ukrainian economy within the context of the larger global marketplace requires integrated and combined reforms of Ukraine’s corporate legislation.

The protection of property rights, including the prevention of illegal corporate raider attacks, and the regulation of corporate conflicts play a key role in this process. This White Paper will address the following issues:

- In Ukraine, companies are currently experiencing an increase in illegal corporate raider attacks in different industry sectors.
- Raiders in many cases are perceived as using imperfect legislation and a corrupt legal and regulatory system to violate the tenets of private property ownership, which is a cornerstone for the proper functioning of a free market economy.

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- This issue not only negatively impacts particular companies, but it also harms the investment climate and image of Ukraine worldwide.
- The raider experience is dangerous for both Ukrainian and foreign companies - this is not a “foreign investors only” issue.

II. PROBLEMS:

Gaps and Deficiencies in Current Ukrainian Legislation, Corruption in the Judiciary, and Lack of Discipline and Transparency

According to the 2006 European Bank of Reconstruction and Development’s (EBRD) Transition Report Ukraine is one of the countries with the worst track record regarding corporate legislation (together with Azerbaijan, Belarus, and Tajikistan). However, Russia, together with eight other countries (Armenia, Kazakhstan, Moldova, Latvia, and Lithuania among them), is in a group of countries where such legislation almost fully meets international standards. Nevertheless, these countries still need to make more headway in this regard, as no country with a transitional economy was included in the group of countries with the full compliance of its corporate legislation with international standards.

While the economy of Ukraine is developing rapidly, the quality of corporate legislation in the country is not progressing at the same pace and is perceived as remaining at a very low level. As a result, the problem of illegal corporate raider attacks in Ukraine is significant and each day its significance increases. Some experts believe that there are approximately 2,000 enterprises in Ukraine, which have suffered from illegal corporate raider attacks, and every year the raider’s market share grows by approximately USD 3 billion (“Holos Ukrainy” Newspaper, September 5, 2006).

On October 4th, 2006, during the EU-Ukraine Parliamentary Cooperation Committee meeting in Brussels devoted to the economic situation in Ukraine, issues regarding illegal corporate raider attacks and the need to improve the legislation and judicial systems of Ukraine were raised. Articles on this problem have also been published by several well-known international business media outlets.

Both corporate and remedial legislation (norms and regulations) in Ukraine are far from being perfect and contain contradictions. There is a weak basis for corporate legislation - such as the lack of a Joint Stock Company Law. There are no effective mechanisms of information protection in the system of registration of legal entities or in the stock market’s registration system. Another key problem is the absence of a clearly written and stated system of responsibility of corporate managers for losses and damages to their company and its shareholders.

Recent cases such as “Saturn”, “Ukrspetsavtomatika”, Kyiv Shipbuilding Ship Repair Plant, and “Zhovntnevyi Univermag”, as well as other enterprises, have been the focus of raiders where six or seven different courts are involved, it is apparent that the same surnames of judges stand out and many judgments are written as if they are carbon copies of each other. Even the reversal of such a judgment thereafter by a court of appeal does not guarantee the return of the seized property.

Targets of these illegal raider attacks have often applied to relevant judicial bodies with complaints against the actions of specific judges. The answers of such bodies tended to be along the lines that the judges had adopted their decisions “by mistake, unaware that, in such a way, they had interfered with the economic activity of the company”. Nevertheless, the judges continued to keep their jobs after such cases.

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The following highlights problem areas within Ukrainian legislation as well as the lack of transparency and corruption, all of which must be addressed, in order to rectify the illegal corporate raiding phenomenon:

- Raiders have deliberately brought a case to a court somewhere in a remote region of Ukraine far from the location of the company, so that the company's management is unaware of the upcoming attack and, in a majority of instances, after it is too late to effectively repel the attack. The reason for doing this is that there is no unified, national, and accessible-by-everyone electronic system of all filed and pending civil cases. This issue has recently been addressed by the Law #2258 "On Amending Some Legislative Acts of Ukraine (regarding differentiation of cases, which are subjected to the competency of economic and civil courts)" adopted on December 15th, 2006 with the support of the Chamber.
- Cases on the designation of new directors are considered without the presence or participation of representatives of the companies being raided.
- Blocking, by means of a court judgment, of a controlling block of shares is also a common technique of raiders. In such a case, the court simply forbids the owners of such shares to participate in the general meeting of shareholders. Thereafter, the raiders, who are holders of certain other shares, elect an inside person as the director and gain control over the company.

Willingness of Lawyers to Participate

Many lawyers are ready to participate, and, moreover, already participate in the process of reforming the legislative base related to the matter in question. Many serious lawyers have repeatedly stated publicly in mass media, including Internet publications, their openness and readiness to cooperate with all interested parties. They are striving to form a point of view among their colleagues concerning the relevance of this problem, as well as to actively participate in the activities of those Verkhovna Rada Committees responsible for the development of the necessary laws.

The experience of various Chamber Members confirms the fact that there is concern among market participants regarding the lack of clear mechanisms for the regulation of hostile takeovers in Ukraine, thereby providing raiders opportunities for their activities. Moreover, the names and company names of those, who have repeatedly participated in illegal corporate raider attacks, have been well known among professionals for a considerable period of time.

III. SOLUTIONS

1. To modify the Ukrainian legislation to close the gaps and deficiencies in the current Ukrainian legislation and legal procedures

The following legislation will assist in closing down many of the present gaps and loopholes:

- *Joint Stock Company Law*

The Draft Joint Stock Company Law is a critical piece of legislation providing a legislative basis to assist in closing many loopholes currently utilized by illegal corporate raiders. Currently, joint stock companies are

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responsible for producing approximately 75% of Ukraine's GDP. Without the introduction of the norms contemplated by this draft law, it will become even more difficult to determine the real market value of the shares of national Ukrainian joint stock companies. One of the main problems, which hindered the adoption of the previous versions of the Draft Joint Stock Company Law, was the fact that the major shareholders operating in Ukraine opposed the idea of becoming publicly-known owners. However, it is precisely the publicity about joint stock companies, which allows their shareholders to learn more about the real market value of the shares. (source: <http://securities.org.ua>).

The draft law reflects a movement in the basic concept of shareholding within Ukrainian legislation: the tendency to support majority investing, when an investor attempts to obtain control over the issuer through the consolidation of the relevant substantial holding of shares (usually 50% + 1 voting share or more), so that it becomes possible to appoint new management of the issuer. The main hallmark of this approach is the rise in the powers of the General Meeting (GM) of the shareholders of the issuer, which become virtually unlimited. This may be considered to be a reflection of the new economic trend of the consolidation of majority shareholdings in most joint stock companies in Ukraine, which is now taking place.

The first feature of the draft law is the elimination of the distinction between closed joint stock companies and open joint stock companies which will provide additional transparency in the system and points to the trend of further liberalization of the market.

Another feature of the new approach to regulation is the increase of the powers of the organs of the issuer, which are closely connected with the shareholders, i.e., the GM and the Supervisory Board.

According to Article 30 of the draft law, the GM elects (appoints) and removes all of the members of all of the management of the issuer, except for executive management, although the GM must also consent to their appointment. The GM also appoints the auditors of the issuer and consents to the appointment of the issuer's registrar. Therefore, as we can see, the GM (meaning, of course, the majority shareholder) efficiently controls the management of the company.

In turn, the Supervisory Board of the issuer (being traditionally understood as the constant representative of the majority shareholder) has the substantive means to influence the GM. It is the power and responsibility of the Supervisory Board to organize the convening of the GM, to develop the agenda, to appoint the registration commission and to define the register compilation; the head of the Supervisory Board (or any person appointed by the Supervisory Board) presides at the GM; and so on¹.

Therefore, there is a type of cross-control over the issuer, provided by the GM and the Supervisory Board, also controlling one another. This scheme provides an additional means of opposition to a raider's attack, if it would involve only one of the management teams.

The third innovative element of the draft law is the legal construction of shareholder's duties. Article 26 of the draft law provides that shareholders are obliged to comply with the rules set out in the charter of the issuer and in the issuer's internal regulations. This rule positively (and, in fact, progressively) resolves the ongoing and often disputed question of whether the charter of the company and its internal regulations, such as the Regulation on the Supervisory Board, are obligatory for the company's shareholders. In fact, the obligation of the shareholders to comply with the statutory documents of the issuer was already provided by Article 11 of the

¹ We do not discuss separately the possibility that the minority shareholders may convene the GM, as provided by the draft law.

Law of Ukraine “On Companies” and Article 117 of the Civil Code of Ukraine. At the same time, the obligation to comply with local internal regulations has not been clear and, therefore, additional grounding was needed, e.g., based on decisions of the GM being obligatory or by reference to the internal regulations in the charter of the company. A clear rule, that such regulations as adopted by the GM are obligatory, is a powerful tool to shape the rights of minority shareholders in a more or less acceptable way. Moreover, since such regulations do not require State registration, as is the case with any amendments to the charter, the GM’s power to regulate the company becomes far more efficient.

The same trend to limit the powers of the minority shareholders is seen in the provisions of Section 2 of Article 26 of the draft law, which provide that the decisions of all organs of the issuer are obligatory for its shareholders if made within the powers of such organs. In fact, this provision envisages that at least some of the internal regulations² may be adopted not only by the GM, but also by, for example, the executive organs or the Audit Committee of the issuer.

This short analysis would be incomplete without discussing the newly created problems of majority shareholders. We address only two of them:

1. The most interesting provisions of the draft law are related to the acquisition of a majority interest in a company. First, any person attempting to acquire a majority of the shares must notify the company and the Securities Commission thirty days in advance. If the Commission is of the opinion that the acquisition raises strong objections on the part of the state organs or the company’s competitors, it may suspend the acquisition for a virtually unlimited period of time. Even without that, the current majority owner has enough time to oppose the buyer.
2. The draft law provides the obligation of any person which has acquired a majority of the voting shares of the company, to offer to all of the other shareholders to buy out their shares at the same price, at which the majority stake of the shares was acquired during the last six months. Therefore, in case a person plans to acquire the majority in any company, such an acquisition will require the raising of funds sufficient to buy out all of the shares of the company in the face of the possible demands of the minority shareholders. Both of these provisions make a “surprise” consolidation impossible.

One more innovation in the draft law relates to the commitment of all joint stock companies to pay dividends at a rate of not less than the rate determined to be the percentage of their net profits. This is the first step toward motivating companies to pay their shareholders.

In general, it appears that the draft law has been designed to prevent the redistribution of majority holdings in joint stock companies. The significant powers of the majority shareholders, along with the extensive anti-raider regulations, inevitably lead to the conclusion that the draft law is intended to strictly fix the present status of the ownership of joint-stock companies in Ukraine.

The Draft Joint Stock Companies Law is not a perfect document; however, the need to adopt this law is unquestionable. Genuine public joint stock companies need to appear in Ukraine. The business of such companies must be based on international corporate governance standards.

² See also: some contradiction to Section 10 of Part 1 of Article 30 of the draft law.

The Chamber supports the Government of Ukraine in regards to the development of the Draft “State Program on the Social–Economic Development in 2007” with the focus on the following important point: the formation of attractive conditions for the dramatic increase of investment resources is identified among the Goals and Priorities of the Program. The improvement of corporate governance is named among the priorities, and the criterion for the achievement of improved corporate governance includes the adoption of the Law “On Joint Stock Companies”.

- *New Version of the Commercial Procedural Code* (#0904 dated May 25, 2006; the document is registered at the Parliament Committee on Justice on May 25, 2006)

This draft law is the basic, full legislative act, which determines the fundamentals of commercial proceedings (i.e., consideration of cases in the commercial courts of Ukraine). It is the third in a series of draft Codes of Commercial Procedure introduced by legislative initiative bodies.

The innovations of this draft law include: (1) the institution of a previous court sitting, which is held to clarify the possibility to reconcile the dispute by the rule of the court and to procure the timely and correct settlement thereof (according to the draft law, the sitting must be held by the assistant judge); (2) the absence of an institution for the refusal to accept the applications; (3) the institution of the counter procurement of the possible losses incurred by the respondent as a result of securing a claim; (4) securing a claim (according to the provisions of the draft law, a claimant will be allowed to secure evidence to protect its material interests prior to filing a claim); (5) the institution of a “closed” separate opinion of the judge (according to the draft law, this document is to be included in the case but it is not declared in the court hearing or provided for the participants’ insight); (6) the institution for the allocation of judges (the decision is made by the chairman of the Commercial Court and not by the judge); (7) the provisions on forensic examinations (especially the requirements for experts); and (8) the consideration of cases related to the contravention of regulatory acts and decisions and actions of state bodies, local self-government bodies, and other authorities and officials. These innovations also establish the possibility of a much simpler court proceeding in cases when the debtor does not object against the claimant’s claims, etc.

Furthermore, the special competence of the Commercial Courts includes, among other things, the following cases:

1. Disputes between a shareholder and its joint stock company, the participants of other commercial entities, and those related to the business of commercial entities, with the exception of labor disputes;
 2. Disputes related to the privatization of State and municipal property (except for the privatization of housing properties);
 3. Disputes related to the establishment and liquidation of commercial entities;
 4. Disputes related to the protection of goodwill in commercial activities; and
 5. Disputes related to the protection of economic competition and to unfair competition.
- There is a few Draft Laws registered in Parliament that are related to the improvement of the judiciary system in Ukraine. The Chamber continues to see the reformation of the judiciary as a critical factor in regards to halting the proliferation of illegal corporate raiding activities and will advocate for passage of solid legislation in this regards.

Draft Law “On Amendments to the Law of Ukraine “On the Judiciary” on provision of the appeal of the civil cases” #2294. Supported by the Parliament in the 1st reading on Jan 11th, 2007.

Draft Law “On Amendments to the Law of Ukraine “On the Judiciary” (on the membership of the qualification commissions of judges)” #2564 a revised version dated December 20th, 2006.

Draft Law “On Amendments to the Law of Ukraine “On the Judiciary”” #2834. The Verkhovna Rada’s Main Scientific-Expert Department recommended on February 21st, 2007 to return the Draft for further work. The Draft initially was supported by the National Commission on the Strengthening of Democracy and the Establishment of Rule of Law of the Ministry of Justice of Ukraine in July 2006.

As the Commission stated the Draft Law provides one of the most important guarantees of a judge’s independence – the procedure for the selection and promotion of judges. Such a guarantee can be considered to exist when the appointment or election of a particular individual to the position of judge makes it impossible to create any informal obligations of this future judge owed to any person who may have an effect on this appointment process. Judges must be selected on a competitive basis. Candidate judges must be trained at the National High School of Judges of Ukraine, which, according to this draft law, must: (1) train candidates to work as judges for two years according to the order established by the State Judiciary Administration of Ukraine; (2) annually train for a period of two weeks those judges, who were appointed as judges for the first time; (3) train for a period of two weeks those judges, who were elected for an unlimited time (at least once in every three years); (4) train the judges’ staff; (5) carry out research related to the improvement of the judicial system; study the world experience with how to arrange a judge’s activities; (6) provide guidance for the activities of the judges of the general jurisdiction courts and the Constitutional Court of Ukraine, the judges qualification commission system, the Disciplinary Commission of Judges of Ukraine and the High Council of Justice; and (7) provide guidance for the activities of the judges of the general jurisdiction courts and the Constitutional Court of Ukraine.

On March 2nd, 2007 Minister of Justice, Olexandr Lavrunovych, confirmed that the Government of Ukraine would consider supporting this Draft during upcoming discussions in Parliament.

Draft Law “On Amendments to the Law of Ukraine “On the Judiciary” (on establishment deadlines for document review on heads and deputy heads of the general jurisdiction courts)” #3217 dated February 21st, 2007.

Draft Law “On Changes to the Law of Ukraine “On the Status of Judges”” #2835 dated December 27th, 2006. The Verkhovna Rada’s Main Scientific-Expert Department recommended on February 21st, 2007 to return the Draft for further work. Previously this Draft was supported by the National Commission on the Strengthening of Democracy and the Establishment of Rule of Law of the Ministry of Justice of Ukraine in July 2006.

In the Commission reports it was stated that this Draft Law was developed to: (1) improve the system of social security of judges; (2) improve the salary system of judges, with the simultaneous elimination of any benefits, which are not determined by the judge’s status; (3) establish the exact criteria to determine the amount of the official rate of pay and the other salary conditions of judges; (4) enhance the pension provision guarantees and the lifetime retention of judges; (5) improve the procedure for taking an oath by the judge and bringing the judge to responsibility for its breach; (6) define the procedure and conditions for the judge’s participation in the work of judicial bodies and judicial agencies, whose activities are not related to the court proceedings; (7)

define the mechanism to provide judges with housing; and (8) solve many other problems related to the statutory provisions regulating the status of judges.

On March 2nd, 2007 Minister of Justice, Olexandr Lavrunovych, confirmed that the Government of Ukraine would consider support of Draft Law “*On Changes to the Law of Ukraine “On the Status of Judges”*” together with the Draft Law “*On the Judiciary*” during discussions in Parliament.

At the same time it is necessary to note that there is positive progress in this sphere and the following Drafts have been adopted in the 1st reading by Parliament:

On February 20th the Verkhovna Rada supported by 233 votes in the 1st reading the *Draft Law “On Changes of the Article 72 of the Law of Ukraine “On Judicial System”* #2552. The main goal of the document is to determine the amount of remuneration for a judge should not be less than the officially established living wage.

On February 20th the Draft Law “*On Changes to the Commercial Procedural Code of Ukraine*” #2566. Authors claim that the Draft is designed to improve legal regulations and rules of appeals to commercial courts and Supreme Court for better protection of participants in commercial activities. The document contains certain regulations to streamline appeal procedures of decisions made by courts of primary jurisdiction, to make rules consistent and to define causes to revise court decisions.

2. To Improve Procedures for the Registration of Ownership Rights to Securities

The adoption of the Draft Law “*On Joint Stock Companies*” is only one of the necessary steps required for the further development of corporate management and the securities market in Ukraine. In addition to that document, it is necessary to adopt the new wording of the Law “*On the National Depository System and the Peculiarities of the Electronic Circulation of Securities in Ukraine*” (#710/97-bp dated April 4, 2006).

Many experts see the necessity to organize a central national depository of public joint stock companies. The existing structure, where practically every joint stock company either keeps its own register of shareholders or commissions this to an independent registrar (which is a private company having its own market benefit). This creates a very broad scope for abuse, not only by raiders, but also by the owners of the companies and their managers. The registrar must be a sole registrar, independent from both the government and the company itself, and capable of deciding on matters related to the issuance and circulation of derivative securities, the amalgamation of stock exchanges, and the carrying out of judicial reforms.

The Chamber also expresses support for:

- *Presidential Decree #361/2006 dated May 10, 2006, “On the Concept of the Improvement of Legal Proceedings to Establish Fair Justice in Ukraine According to European Standards”*

The aim of the Concept of the Improvement of Legal Proceedings to Establish Fair Justice in Ukraine According to European Standards (hereinafter the Concept) is to ensure that legal proceedings in Ukraine are established as the sole means for the operation of the judicial system, and that such legal proceedings exist on the basis of the rule of law according to European Standards and guarantee the right to a fair trial.

The Concept determines that the main objectives for the further development of justice in Ukraine lie in the real implementation of the rule of law and in each person's right to a fair trial by an independent and unbiased court. The Concept is also aimed at creating an effective system of free legal support, and introducing open access to court decisions and the approval of every judge's independence.

The Concept was sent to the Council of Europe for examination, as well as to all judicial bodies of Ukraine (at all levels and with all types of jurisdiction) for comments. The Commission received 72 comments with proposals and remarks related to the Concept from the Ukrainian courts of law (*inter alia*, the Supreme Court of Ukraine, the Higher Administrative Court of Ukraine, the Higher Commercial Court of Ukraine, the courts of appeal, and the local courts), from other judicial agencies (*inter alia*, the Judicial Council of Military Courts, the Qualification Commission of Judges of the Courts of Law of the Odessa District of Appeal), and from judges associations (*inter alia*, the All-Ukrainian Independent Judges Association, which includes approximately 1,500 judges of Ukraine). The Concept passed the relevant professional expert examination, both by the wide range of Ukrainian judges and by the European International Organization. The Commission also agreed that, together with the reforms, Ukraine also would need to introduce the following: to ensure that legal proceedings are active, and to use the terminology.

3. To Implement Transparent Mechanisms Related to the Resolution of Corporate Conflicts

It is important to realize that an anti-illegal corporate raider policy can be successful only if it exists as a unified and continuous approach, which is approved by the management and supported by the employees of the company. This is what needs to be done on an individual company basis and the Chamber plans to play a proactive role in promoting an anti-illegal corporate raider policy as an integrated part of the economic security of every company.

The Ukrainian Government, therefore, is responsible for introducing the rules and implementing the set of mechanisms on the macro level, in order to guarantee transparent corporate governance and the resolution of conflicts related to the protection of property rights.

The Chamber would like to encourage the Ukrainian State authorities and their allied organizations to consider the following actions as necessary steps in maintaining a regular anti-illegal corporate raider policy:

- To create a publicly available All-Ukrainian Anti-Illegal Corporate Raider Internet Database, on which files are kept on each raider and on each judge, who has rendered an unlawful decision on the change of company management or on the prohibition of holding a general meeting of the shareholders (this might be supported and maintained by the State Committee on Regulatory Policy and Entrepreneurship; financial support might include the sale of banners except the State Budget).
- To establish a database of all court appeals registered in Ukraine and to inform the business community with such data on a regular basis (this might be supported and maintained by a special body defined by the judicial authorities in Ukraine; financial support might include a fixed fee for users of the database).
- To make the court decisions database publicly accessible; to require the courts to issue their decisions in writing and with reasons; to bind the executive service to inform all of the concerned parties about the initiation of proceedings (this might be supported and maintained by a special body defined by the judicial authorities in Ukraine; financial support might include a fixed fee for users of the database).

- To establish a central national depository of public joint-stock companies (this should be discussed further by the Government and the State Commission on Securities and the Stock Market in particular).
- To hold public discussions about and to consider the establishment of anti-illegal corporate raider centers/institutions dealing with raider attacks in all of the regional capitals of Ukraine, as well as Kyiv and Sevastopol in order to monitor such practices and preventing them. (This might be initiated by the Cabinet of Ministers of Ukraine, and further developed and agreed with the Regional State Administrations and the appropriate Chambers of Commerce).

IV. SUMMARY

Based on the Chamber's understanding of the complex and integrated nature of a policy designed to prevent illegal corporate raider attacks, the Chamber and its multinational Membership have adopted a proactive position aimed at unifying the efforts of all interested parties from the government, donors and private sectors. This problem is not unique only to Ukraine, many countries are realizing that addressing these issues is of crucial importance to further develop their competitiveness in the global environment and are therefore spending time, resources, and effort to resolve many of these issues.

This issue will require time and commitment and it is necessary to start the process of defining short-, mid-, and long-term priorities, as well as specific deadlines. Major efforts need to include the further development and improvement of corporate legislation based on international best practices, radical changes within the judicial system fostering transparency, consistency, and effectiveness, and continuous cooperation between representatives of corporate and governmental entities.

The Chamber firmly believes that progress achieved in diminishing the threat of illegal corporate raiders will serve as an essential measure in the strengthening the competitiveness of the Ukrainian economy.

V. ABOUT THE CHAMBER

The American Chamber of Commerce in Ukraine ("Chamber") is among the most active and effective non-government, non-profit business organizations operating in Ukraine. One of the Chamber's principal activities is to represent the foreign investment community as well as to facilitate the entrance of potential new investors into this market. The Chamber advocates on behalf of our Members not only to the Ukrainian government, but also to all other governments, which are economic partners of Ukraine, on matters of trade, commerce, and economic reform. The Member organizations of the Chamber represent many of the largest strategic and institutional investors operating in Ukraine who have committed a majority of the foreign direct investment into this market. The Chamber's diverse Membership base unites companies from a variety of regions and countries, including North America, Europe, Asia, Russia, and Ukraine. Chamber Members collectively employ hundreds of thousands of Ukrainians, providing them with exposure to international business practices and the opportunity to develop into leading Ukrainian professionals. Chamber Members also bring international expertise and business knowledge to Ukraine, are among some of the largest taxpayers in Ukraine, and strive to be good corporate citizens.

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IV. THANKS TO THE ACTIVE CONTRIBUTORS (in alphabetical order):

The Chamber would like to thank our professional colleagues who provided invaluable assistance in developing this White Paper and who are genuinely concerned about the negative impact of illegal corporate raiders on the business community and international reputation of Ukraine. The Chamber Member companies actively involved include but are not limited to (in alphabetical order): Baker & McKenzie, Bunge Ukraine, Grischenko & Partners, Magister & Partners, USAID - Commercial Law Center. The Chamber thanks them for their proactive involvement and invaluable contribution to the document.

We would also like to express our appreciation to all Members of the Chamber's Legal Committee (Mr. Oleksandr Martynenko, Baker & McKenzie, Co-Chair), the Chamber Board of Directors Policy Committee (Mr. James Hitch, Baker & McKenzie; Mr. Jacques Mounier, Calyon Bank Ukraine; Mr. Myron Wasyluk, The PBN Company; Mr. Sergiy Yanchyshyn, Motorola) as well as to all Members of the Chamber's Illegal Raider Attacks Working Group for their contribution, involvement and support.

GLOSSARY

Raider Attacks / "Raidership": terms applied to the acquisition of someone else's business. There is often a tendency among domestic journalists (and occasionally experts) to mix two quite different notions: "hostile (unfriendly) takeovers" and "illegal corporate raider attacks"/ illegal acquisitions, with the latter sometimes being called "seizures". These are two very different things.

Hostile takeover (HT): the acquisition by a person or a group of jointly acting people (i.e., the acquiring company or companies) of the corporate control of an enterprise (i.e., the Target or Targets) in the form of a joint-stock company (JSC) against the will of, and under the conditions of a hard counteraction with, the Target's owners, i.e., the shareholder (or several shareholders jointly acting as a joint share holding), of the Target's shares ensuring the control the Target exercised by the Target's Management.

The ultimate purpose of any acquisition is to obtain the indirect right to dispose of the Target's assets for the benefit and sake of the acquiring company. The intermediary purpose and instrument for implementing the acquiring company's plans regarding the disposal of the Target's assets is its corporate control over the Target.

In the foreign HT practice, there are three basic legal instruments used by the acquiring company in its fight for corporate control over the Target: (1) a tender offer; (2) a stock market acquisition; and 3) a proxy fight, i.e., the accumulation by the acquiring company of a sufficient number of independent shareholders' votes by obtaining their proxy votes authorizing the acquiring company to represent their interests at the GMS (General Meeting of Shareholders) (source: Vadym Samoylenko, www.antiraiders.org).

Illegal Corporate Raider Attacks: involve violations of the laws and legal procedures, the use of fake documents, the assistance of dishonest professionals, etc.

Greenmail: the involvement of lawyers in a form of "corporate blackmail", who purchase a quantity of shares and start blocking the company's management by bringing a number of the latter claims to the courts. Their task is to pin down the company, so that it will be more expensive for it to litigate than to buy back the shares from the greenmailer at a substantial premium over the market price. Greenmail is absolutely legal, **unlike blackmail**, where different threats and even bodily harm are generally used.

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NOTES & EXAMPLES

1. The classic example of a hostile takeover, approved by the governing body of the European Union as well as by the public opinion of all developed countries, quite recently involved the owner of the world's largest steel concern, Mittal Steel. Mr. Lakshmi Mittal decided to acquire his company's biggest competitor, Arcelor.

Despite being in second place in the world, Arcelor's management was ineffective and the Indian magnate immediately wanted to acquire this competitor with the right to expel its top-managers. As it usually happens in such cases, Mittal as a potential investor made a public offer to the company's shareholders to purchase their shares without the prior approval of the top management of the company. In this regard, all of the procedures were legal: Mittal Steel's offer was considered not only by Arcelor's shareholders, but also by the Government of Luxemburg and the EU Commission. In order to meet the requirements of the European antimonopoly legislation, it was suggested to Mr. Mittal to sell a couple of his company's small-size subsidiary enterprises in Eastern Europe, which he agreed to do so without any complaint. It was quite obvious that the sale of their shares by Arcelor's shareholders was quite voluntary. Any psychological or physical pressure, much less any criminal schemes, were completely out of the question.

Arcelor's management did not apply either to the nearest police station or to an unknown prosecutor, but rather searched for and found a second investor, who was ready to buy control of their company, namely the Russian company "Severstal".

Having realized that his initial plan had failed, Mr. Mittal suggested new, more profitable terms; he also agreed to retain Arcelor's current management. This hostile takeover easily turned into a friendly one, and Severstal was impolitely shown the door. Arcelor's management undertook to pay EUR 140,000,000 to Severstal for breach of contract and everything clicked into place. However, no one in Ukraine used the term "raider" in respect of Mr. Mittal. We witnessed an ordinary investment process, by means of which many western companies change their owners. Therefore, "legal raiding", i.e., the entire property ownership is reallocated in the market legally for the sake and benefit of more efficient companies, is an ordinary activity.

2. According to information from the mass media, a group of serious Ukrainian enterprises, in particular, the plants "Kvant", "Mayak", "Burevesnik", "Arsenal", "Bolshevik", Kyiv Shipbuilding and Ship Repair Plant, OJSC "Knyga", Kyiv Furniture Factory, Reduction Gear Plant, Footwear Factory "Kyiv", and others, have become victims of illegal corporate raiders recently. Their destinies are very much alike, i.e., the purchase and subsequent liquidation of the enterprise in order to receive attractive land plots for speculative resale.

Example: **Institute for Scientific Research "IRVA" (ISR "IRVA")**

The raiders wanted Kyiv ISR of Radio Measuring Equipment only in order to lease its premises. Some years ago, an unknown company, "Gordons Impex", and its director, Frederic Martin Potter, sacked the Kyiv ISR of Radio Measuring Equipment OJSC "IRVA". The scheme was not a new one: first, using someone's high protection, raiders purchased 65% of the total shares from the State and from some individual shareholders (i.e., Institute employees) almost for no consideration; second, the new owners appointed their own people to head the ISR. Then, the labor collective, consisting of 190 scientists and specialists, was dismissed. Finally, the new owners sold for cash to third parties the ISR equipment and inventory. Things of value of the ISR had been created during the course of decades were annihilated. As a final straw, the new owners started diluting the shareholdings of the ISR which were still owned by others, by causing an additional issuance of shares.

As a result, the Institute, which had been included previously into a list of enterprises, approved by the Government as having strategic importance for the economy and the security of the country, was treated like a

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meaningless composite of saleable assets. Moreover, the shares of this strategic enterprise, according to a Resolution of the Cabinet of Ministers of Ukraine issued in August 2000, by then First Prime-Minister Yuriy Yekhanurov, are bound to remain State-owned.

Today, inside as well as outside of the Institute's central building, large-scale "euro reconstruction" is taking place. Its goal is to prepare the premises for future tenants and unfortunately in the process, unique technological equipment and expertise of the Institute may be lost forever. The Cabinet of Ministers and the Ministry of Industrial Policy, to which the Institute is unfortunately subordinated, have kept silence up to the present time.

Example: Dnipropetrovsk Oil Extraction Plant

Unfortunately, not only Ukrainian proprietors and State-owned enterprises, but also foreign companies running businesses in Ukraine, are exposed to similar raider attacks. A recent example is the conflict around Closed Joint-Stock Company with Foreign Investments "Dnipropetrovsk Oil Extraction Plant" (DOEP), in which the multinational corporation, Bunge, owns 94% of the share capital. Although, the situation involving this plant has attracted the attention of numerous mass-media outlets (altogether, more than 240 articles have been dedicated to this subject, including publications in Dow Jones, The Financial Times and European Voice), the attacking party does not hide at all that it has measured how to achieve the further deprivation of Bunge's property rights to 60% of the enterprise's stock.

From the example of the situation surrounding DOEP, the difficulties, which companies-victims face during their attempts to protect their interests from illegal corporate raiders, are clearly visible.

In mid-August 2005, in Dnepropetrovsk, a purchaser, located at the same address where "Slavutich-Capital" is located, declared its purchase of shares of DOEP.

Then, at the beginning of 2006, letters with press-cuttings, containing slanderous information about the plant and Bunge Ukraine's management, were sent to the home addresses of minority shareholders of DOEP. For example, one of these news stories falsely stated that the President of Ukraine, Victor Yushchenko, was colluding with the management of Bunge Ukraine, in order to illegally evade taxation. The address of the company "Slavutich-Capital" was specified as the contact of the sender.

Subsequent to these publications, numerous complaints followed to the company's supervising bodies from the inhabitants of the houses neighbouring DOEP's plant. Later on, part of these complainants declared that they had no claims against DOEP, but rather that the complaints had been signed upon the request of an unidentified person. Simultaneously with the sending of the complaints, illegal picketing of DOEP was conducted.

Since March 2006, DOEP has been subjected to a series of ecological checks. In total, during March, April, and May 2006, the plant was checked 8 times, i.e., more than during the entire year of 2005. All of these checks indicated the absence of any ecological infringements caused by operations of DOEP.

In March 2006, two former employees of DOEP lodged complaints against it with the demand to recognize as illegal the decisions of the company's Shareholders Meetings of 2000 and 1994. A redistribution of the property rights to the share capital of the company was the desired consequence of the satisfaction of their complaints. At present, the Goloseevsky Court of Kyiv has dismissed the first complaint. The second complaint, challenging the legality of the shareholders meeting of 1994, still waits for the court's consideration. Actually, the complainant demands that Bunge should be deprived of its property right to 60% of the company's shares.

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In May 2006, the Tax Militia of the State Tax Administration of the Dnipropetrovsk Region brought a criminal action against the former director of DOEP, A. Zhurid. In their turn, the representatives of the Dnipropetrovsk Prosecutor's Office disrupted 5 consecutive times the court hearings of Mr. Zhurid's complaint of criminal action illegality. On October 12, 2006, the General Prosecutor of Ukraine closed this criminal case due to the lack of evidence. The Prosecutor General also required the Dnipropetrovsk Regional Prosecutor to take measures in view of the breaches of law exposed during the pre-trial investigation of the criminal case. For the time being, the Dnipropetrovsk Prosecutor's Office did not announce any sanctions resulting from illegal criminal case.

During the last week of May and the first week of June 2006, the booklet "Great Poisoners of Mankind" was disseminated in the markets of Dnipropetrovsk. These booklets falsely alleged that Oleina[®], DOEP's trademarked food oil product, is toxic, contains arsenic, mercury, DDT, lead, and strontium, and causes schizophrenia and other dangerous diseases. Law enforcement bodies initiated an investigation of the incident more than a week after the booklet was distributed, but no guilty party has yet to be found.

In September 2006, Sergey Janchenko, who became a shareholder of DOEP after the announcement of the shares purchase at the address where "Slavutich-Capital" is located, made an attempt to register in his name the trademark "Oleina" owned by Bunge.

On September 17, 2006, while commenting to the newspaper "Delo" on the decision of the Goloseevsky Court of Kyiv, the chairman of the supervisory board of "Slavutich-Capital", Gennadiy Korban, declared that he will continue to fight against Bunge, the major shareholder of "DOEP and the owner of Oleina". Explaining his intentions, Mr. Korban stated that: "We will confirm as illegal the issuance of DOEP's shares in general, since this enterprise was privatized illegally".

Accordingly, it is regrettably clear that the policy of non-interference of the regional authorities and the inactivity of the officials of the law enforcement bodies provokes the further escalation of this and other similar conflicts.

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