Chambers

GLOBAL PRACTICE GUIDE

Definitive global law guides offering comparative analysis from top ranked lawyers

Corporate M&A

Second Edition

Ukraine
Egorov Puginsky Afanasiev & Partners

chambers.com

2019

Law and Practice

Contributed by Egorov Puginsky Afanasiev & Partners

Contents

Egorov Puginsky Afanasiev & Partners is part of the largest law firm in the CIS and focuses primarily on transactions in the technology, financial and agricultural sectors. The team handles corporate restructurings and M&A transactions, and offers strong day-to-day corporate support to multinational and domestic companies. The lawyers are experienced in delivering legal support to global and national investors, and are led by partners who have practised in the region for many years. The practice is supported by a number of English-qualified lawyers based in the firm's London office.

Authors

Oksana Ilchenko has more than 15 years' hands-on experience in corporate, cross-border M&A and competition law. She advises on complex restructurings, assists in the mediation of M&A-related and corporate conflicts, and represents clients in antitrust and merger control cases as part of M&A projects. Oksana also delivers expert opinions on Ukrainian law to foreign courts and assists clients from the EU, the Americas, Israel, Japan and Korea on inbound investment projects. She is a member of the International Bar Association and is noted by clients for her strong intercultural communication skills. She is head of the firm's Corporate and M&A practice.

Ilona Zekely focuses on advising international companies on their activities across the CIS, and acting for CIS-based blue chips in their activities in Europe. She practises in the areas of corporate and M&A, banking and finance, commercial, energy, oil and gas and real estate law, and has more than 25 years of legal experience in Europe and the CIS. Ilona has supported on a wide range of cross-border transactions for various multinational and financial institutions in investment structuring, M&A and corporate law issues, real estate and land projects, insurance and oil & gas matters. She is a partner of the firm and head of its European desk.

Natalia Spiridonova is a senior associate at the firm, focusing on M&A deals and corporate and commercial law. She acts for leading Ukrainian and international companies on corporate transactions, and advises on corporate (including contractual) and employment law, as well as on the intellectual property issues arising out of the transactions, and other related regulatory matters.

Aleksandra Yevstafyeva is a senior associate in the Corporate and M&A practice, and head of the Employment Law practice. She focuses on corporate law, property matters in the public sector, privatisation and labour as part of M&A projects. She has been instrumental in a number of deals involving significant workforce restructurings, and has played a key role in a number of high-profile M&A transactions, corporate restructurings, and anti-raider protection cases. Aleksandra has strong expertise in general corporate matters, structuring relations with key personnel and incentive plans. She is a member of the International Bar Association.

1. Trends

1.1 M&A Market

Mainly due to the election-driven uncertainty, the first three months of 2019 saw some slowdown in inbound M&A activity in Ukraine after a two-digit percentage growth in 2018. It is expected that the M&A growth ratio will be lower this year for the same reason.

1.2 Key Trends

It would be reasonable to expect domestic buyers to remain the driving force behind the larger deals in 2019. The average size of transactions is likely to remain below EUR50 million, with very few – if any – deals above EUR100 million. It is unlikely that privatisation will become a relevant topic.

1.3 Key Industries

The deals pipeline suggests that the agricultural sector, both upstream and downstream, will continue to see significant M&A potential and activity in 2019. Investors are also looking at distressed assets and IT targets.

2. Overview of Regulatory Field

2.1 Acquiring a Company

The majority of acquisitions where the target is a Ukrainian company are structured as share deals. Asset deals are less common due to tax and structuring considerations. Where possible and advisable, share deals are moved to enforcement-friendly jurisdictions.

2.2 Primary Regulators

The following authorities are the primary regulators for M&A activity in Ukraine:

- the National Commission for Securities and Stock Market of Ukraine (for targets that are joint-stock companies);
- the National Bank of Ukraine (for targets that are banks);
- the National Commission for Regulation of Financial Services Market (where the targets are other financial institutions); and
- the Antimonopoly Committee of Ukraine (for merger clearance where applicable).

2.3 Restrictions on Foreign Investments

Ukraine has a very liberal foreign investment regime. With very few exemptions, foreign companies and individuals can freely invest in, own and divest Ukrainian businesses, provided that the capital requirements are met, as the case may be. There are a couple of areas where restrictions apply. TV and radio-broadcasting companies cannot be founded by foreign entities/individuals, nor owned by residents of offshore states and the states-aggressors. Non-residents can own telecommunication networks only indirectly, through a company incorporated in Ukraine. Ukrainian legal entities with 100% foreign ownership cannot be direct owners of land plots.

2.4 Antitrust Regulations

The acquisition of direct or indirect control over a business entity will be subject to the prior merger clearance of the Ukrainian antitrust authority where the parties' relevant revenues or assets (all taken on a consolidated basis) match the following as of the end of the year preceding completion of the transaction:

- the parties' combined worldwide assets or revenues exceed EUR30 million and the Ukrainian assets or revenues of each of at least two parties exceed EUR4 million; or
- the target's Ukrainian assets or revenues exceed EUR8 million and the buyer's worldwide revenues exceed EUR150 million; or
- in the case of the establishment of a business entity, the Ukrainian assets or revenues of one of the parties exceed EUR8 million and the worldwide revenues of the other party exceed EUR150 million.

2.5 Labour Law Regulations

The acquirers are advised to note that Ukrainian labour law is quite outdated. There have been attempts to adopt a new labour code that would cater for the needs of both employers and employees, but no consensus has been achieved among the stakeholders on a number of relevant points.

The majority of employment aspects are covered by imperative provisions of law and, thus, are not subject to amendment by agreement (eg, minimum paid vacation, additional vacations to certain categories of employees, maximum duration of work day).

Change of control over the employing company or its corporate reorganisation are not legal grounds for a restructuring of the workforce. Termination of a labour relationship on the employer's initiative is only possible based on a limited number of grounds. Redundancies are possible but need to be heavily justified.

Termination of labour relations with the members of the management board on the employer's initiative is quite straightforward and requires a resolution of a competent corporate body and the compensation of six average monthly salaries, unless a higher amount is stipulated in the labour agreement (contract).

2.6 National Security Review

Unlike some countries, Ukraine has not introduced any national security review of investments/acquisitions. Specific ad hoc national security-related requirements can be

imposed on the potential bidders by the State Property Fund of Ukraine in the context of any given privatisation process.

3. Recent Legal Developments

3.1 Significant Court Decisions or Legal Developments

The most significant legal developments in M&A in Ukraine in the last three years consist in upgrading the laws on joint-stock companies (JSCs) and limited liability companies (LLCs), simplification of the privatisation law and the currency control regulations, which cover updating mandatory tender offer rules in JSCs, and the introduction of the following:

- squeeze-out and sell-out mechanisms for JSCs;
- escrow accounts; and
- corporate (shareholders') agreements and the corresponding instruments, such as an irrevocable power of attorney.

The parties can now opt for English law and international commercial arbitration in the context of the cross-border acquisition of state-owned enterprises in the privatisation process.

3.2 Significant Changes to Takeover Law

No significant changes to Ukrainian takeover laws are expected in 2019-2020.

4. Stakebuilding

4.1 Principal Stakebuilding Strategies

It is rather unusual for a bidder in a Ukrainian M&A to build a stake in the target prior to launching an offer.

4.2 Material Shareholding Disclosure Threshold

The following disclosure thresholds are established for public JSCs: ≤ or ≥ 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75%, and 95%. In the acquisition of >50% or ≥ 75%, a public irrevocable offer to all the shareholders on the purchase of their shares is also required, in addition to the disclosure.

For private JSCs, > 50% requires disclosure and a public irrevocable offer to all the shareholders on the purchase of their shares.

For all types of JSC:

- ≥ 10% – notification and disclosure on the intention to purchase the shares;
- ≥ 95% – disclosure on acquisition plus squeeze-out or disclosure on acquisition plus sell-out.

In addition, the acquisition of direct or indirect control over a business entity will be subject to the prior merger clearance of the Ukrainian competition authority, provided that the financial thresholds are met (see **2.4 Antitrust Regulations**, above).

4.3 Hurdles to Stakebuilding

A Ukrainian company cannot introduce reporting thresholds or filing obligations other than those established by the law. The most common hurdles to stakebuilding in Ukrainian companies include the specific rules for M&A in the financial sector.

4.4 Dealings in Derivatives

On the one hand, Ukrainian law allows dealings in derivatives, but on the other hand, there is insufficient regulation in the area, which leaves many grey areas.

4.5 Filing/Reporting Obligations

The filing/reporting obligations for derivatives under securities disclosure and competition laws are the same as for shares (see **4.2 Material Shareholding Disclosure Threshold**, above).

4.6 Transparency

Ukrainian law requires that, in an acquisition of >50% or ≥ 75% of the shares in public JSCs, the shareholders disclose their intentions on the company's activities – namely, on future business plans and the plans with respect to any material change of employment terms for the employees and the management.

5. Negotiation Phase

5.1 Requirement to Disclose a Deal

Unlike in some jurisdictions, a target (private or public company) is under no obligation to disclose a deal when it is approached by a bidder, nor is a disclosure obligation triggered by the signing of non-binding/binding offers or definitive agreements.

For the bidder's disclosure obligations, refer to **4.2 Material Shareholding Disclosure Threshold**, above.

5.2 Market Practice on Timing

Market practice on the timing of disclosure is in line with the legal requirements.

5.3 Scope of Due Diligence

Financial, legal and technical due diligence is usually conducted in Ukraine in a negotiated business combination. The scope of diligence exercises would normally primarily depend on the size of the transaction (including the comparative size of the Ukrainian part in a multi-jurisdictional M&A project) and the stake being acquired. Wider scope is

more common where a target is a regulated entity, IP heavy, or acquired by a regulated or public entity.

5.4 Standstills or Exclusivity
Standstills and exclusivity are often demanded and granted at different stages in Ukrainian M&A deals.

5.5 Definitive Agreements
It is not prohibited under Ukrainian law to document/enclose the tender offer terms and conditions in a definitive agreement. However, as the terms of the agreement are expected to comply in all material respects with the terms of the tender offer, the latter would be kept as a separate instrument.

6. Structuring

6.1 Length of Process for Acquisition/Sale
The timing of acquiring/selling a business in Ukraine depends on many factors – eg, how the deal is structured; whether it is purely local or closes in a number of jurisdictions; whether it requires pre-closing restructuring or any government authorisations (including the merger clearance). One should normally factor in anything between three months (where the target is a non-regulated entity) and one year (where the target is a regulated entity) from the inception stage.

6.2 Mandatory Offer Threshold
Ukraine has mandatory offer thresholds of 50% and 75% (applicable to JSCs only).

6.3 Consideration
Cash is more commonly used than shares as consideration in Ukrainian M&A deals, both private and public.

6.4 Common Conditions for a Takeover Offer
In mandatory (irrevocable) offer situations (ie, following the accumulation of 50% or 75% in a JSC), the law provides for the minimum scope of data that must be indicated in such offer: purchaser, buyout price, deadline for the acceptance of the offer and the settlements. The formula for the buyout price calculation is prescribed by the law. Use of conditions (minimum thresholds, etc) would normally be unenforceable. Although not explicitly provided by the law, the minority shareholder who accepted the takeover offer would generally be expected to sell its whole stake.

6.5 Minimum Acceptance Conditions
In mandatory (irrevocable) offer situations, the offeror would not be allowed to establish minimum acceptance conditions. Although not explicitly provided by the law, the minority shareholder who accepted the takeover offer would generally be expected to sell its whole stake.

6.6 Requirement to Obtain Financing
In mandatory (irrevocable) offer situations, the offer must be unconditional. Other than that, the parties to an M&A transaction are free to agree on conditions precedent, including those related to financing. Specific ad hoc conditions can be imposed on potential bidders by the State Property Fund of Ukraine in the context of any given privatisation process.

6.7 Types of Deal Security Measures
In mandatory (irrevocable) offer situations, the bidder would not be entitled to seek any deal security measures. In other cases, deal security measures (escrow, break-up fees, non-solicitation, non-compete, etc) would generally be acceptable. Still, as Ukraine may prove to be not as enforcement-friendly as some other jurisdictions, the deal security measures would normally be implemented at the level of a foreign SPV.

6.8 Additional Governance Rights
The bidder will not have additional governance rights, unless otherwise stipulated by a shareholders' agreement, if any, to which it is a party. The matters that can be addressed by a shareholders' agreement include voting arrangements; veto rights, including on the disposal of shares; specific governance arrangements; and put and call options.

6.9 Voting by Proxy
Shareholders can vote by proxy in Ukraine. Proxies issued outside of the country are subject to notarisation and legalisation (apostil).

6.10 Squeeze-out Mechanisms
A shareholder or a group of shareholders owning at least 95% (the dominant controlling stake) of the shares in a joint-stock company has the right to forcibly buy out the shares of the remaining shareholders by paying them an adequate compensation of not less than the fair market price.

Ukrainian law also allows the minority shareholders to employ a sell-out mechanism and insist that their stakes are bought out by the dominant shareholder.

In the acquisition of the participatory interest in an LLC (unless otherwise provided by the charter) or the shares of a private JSC (if provided for in the charter), the buyer must check if all the non-selling participants/shareholders in the relevant company have waived their pre-emptive rights to buy the participatory interest/shares offered for sale.

6.11 Irrevocable Commitments
For M&A transactions in Ukraine, obtaining and relying on irrevocable commitments to tender or vote by principal shareholders of a Ukrainian target company is quite rare. Up until recently, such commitments would be unenforceable. Therefore, they have usually been implemented at the level of the shareholders of a foreign SPV in an enforcement-friendly

jurisdiction. Such commitments would normally be negotiated as part of the standstill/exclusivity arrangements with or without an exit option.

With the development of the concept of the corporate (shareholders') agreement and the introduction of an irrevocable proxy in Ukraine, it is expected that such commitments will become more common under Ukrainian law.

7. Disclosure

7.1 Making a Bid Public
In mandatory disclosure cases, as outlined in **4.2 Material Shareholding Disclosure Threshold**, the requirements of the content of the bid are set out in more detail in **6.4 Common Conditions for a Takeover Offer**, above. Depending on the stake of shares being sought by the bidder, disclosure can be ex ante, ex post or both. Bid disclosure obligations are applicable to joint-stock companies, not limited liability companies.

7.2 Type of Disclosure Required
Share issuances are disclosable on the stock market (through publishing in the relevant national database), to the regulator (ie, the National Commission for Securities and Stock Market), and also to the National Bank of Ukraine if the target is a bank, or to the National Commission for Regulation of Financial Services Market if the target is a financial institution other than a bank. Public offerings (with respect to shares of public joint-stock companies) require the publishing of a shares prospectus.

7.3 Producing Financial Statements
Bidders are not required to produce their financial statements as part of any public disclosure. If a target is a bank or other type of financial institution, the acquirer will have to provide proof of sufficient capital to finance the acquisition of a substantial interest, along with the audited financial statements, to the relevant regulator that is issuing the approval for such acquisition. The form of the latter is jurisdiction-specific (GAAP), and preference is given to IFRS statements in some cases. The Ukrainian competition authority requires a copy of the acquirer's balance sheet as part of the merger clearance process.

7.4 Transaction Documents
Full disclosure of the transaction documents is usually not required, but the relevant extracts from the SPAs and the shareholders' agreements have to be submitted to the regulators (competition and licensing authorities, as the case may be). The parties would normally be allowed to redact sensitive warranties and indemnities-related information, but not the financial terms. Side letters are used for price-sensitive information, as some regulators exercise their discretion to request full disclosure of the SPAs.

8. Duties of Directors

8.1 Principal Directors' Duties
The directors' principal duty (including in business combination situations) is drafted broadly in the law – it is to supervise and control the activities of the company's management in the best interests of the company and its shareholders. Strictly speaking, directors' duties are not owed to other private stakeholders.

8.2 Special or Ad Hoc Committees
Boards of directors (supervisory boards) of public JSCs, as well as JSCs with a state share exceeding 50%, must establish special committees: the audit committee, the remuneration committee and the nominations committee. The articles of association of any company may provide for the establishment of special or ad hoc committees.

Although not commonplace, in public and private companies with developed corporate governance criteria, ad hoc committees are used when some directors have a conflict of interest.

8.3 Business Judgement Rule
As the law on JSCs is quite new in the relevant part, Ukraine has very limited jurisprudence on takeover situations. Generally, the courts in Ukraine would accept the decisions taken by the company's officers/corporate bodies within their scope of competence and in good faith, but would not defer to their judgement where the decision is not taken.

8.4 Independent Outside Advice
In business combination situations in Ukraine, directors would normally seek independent advice as to the scope of their fiduciary duties, conflicts of interest, and the interpretation and amendment of their labour contracts.

8.5 Conflicts of Interest
As the best market practices on addressing corporate conflicts of interest have not yet crystallised, the conflicts of interest of directors, managers, shareholders or advisers have been subject to internal (disciplinary) corporate assessment rather than judicial scrutiny in Ukraine.

9. Defensive Measures

9.1 Hostile Tender Offers
Hostile tender offers are not permitted in Ukraine.

9.2 Directors' Use of Defensive Measures
As the Ukrainian market is not familiar with hostile tender offers as they are understood in other jurisdictions, directors can use any defensive measures when confronted with hostile actions, provided they act in the interests of the shareholders and the company.

9.3 Common Defensive Measures
Ukrainian law does not provide for any specific defensive measures against hostile tender offers (as the latter are not permitted). At the same time, as a general rule, the directors have the right to appeal to the courts on behalf of the company against any actions that violate the company's legitimate rights and interests.

9.4 Directors' Duties
As a general rule, directors are obliged to act within the scope of their competence, in the best interests of the company and the shareholders, diligently and in good faith.

9.5 Directors' Ability to 'Just Say No'
The directors cannot 'just say no' and prevent a business combination if it was approved by the shareholders' meeting within the scope of the latter's competence. If approving a business combination comes under the directors' competence, they can effectively block it.

10. Litigation

10.1 Frequency of Litigation
Litigation is rather uncommon in connection with Ukrainian M&A deals, although some high-profile deals have been affected by previously dormant disputes between the shareholders. The market has also seen a couple of frivolous law suits brought by the top managers in between the signing of a deal and its completion. Some privatisation processes have proved to be litigation-heavy.

Egorov Puginsky Afanasiev & Partners

17/52 Bohdana Khmelnytskoho St.,
Leonardo Business Centre,
Kyiv, 01030,
Ukraine

Tel: +380 44 4988282
Fax: +380 44 4988282
Email: kyiv_office@epap.ua
Web: www.epap.ua

10.2 Stage of Deal
The majority of disputes related to private M&A are brought to litigation or arbitration post-closing, irrespective of whether the amounts are still on escrow and/or the warranties are in place. Privatisation-related disputes are commonly brought after the tender results are published or post-closing for alleged breach of the privatisation covenants.

11. Activism

11.1 Shareholder Activism
With some jurisdiction-specific exceptions, shareholder activism has not yet been a factor discussed in the boardrooms of Ukrainian companies or with advisers in the context of M&A transactions. As the market hears stronger calls for strengthening governance criteria, however, activism can be expected to become a factor to consider in the next five years.

11.2 Aims of Activists
We have not come across any cases where activists would encourage a Ukrainian company to enter into M&A transactions or restructurings.

11.3 Interference with Completion
We have not come across any cases where activists would try to interfere with the completion of announced transactions in Ukraine.