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EVOLUTION OF PRIVATE LAW

NEW APPROACH



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### Conclusion

The Czech Republic has made a significant change in its corporate governance system. However, a number of important issues remain unresolved at the moment. While it seems obvious that the zone of insolvency approach of the Business Corporation Act is leaning more towards the Anglo-American solution, which requires directors to actively deal with the troubled financial situation of the company, it remains unclear what the implications for opportunistic risk taking are.

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## UKRAINIAN LIMITED LIABILITY COMPANY – SOME ASPECTS OF LEGAL REGULATION

### Introduction

A limited liability company is the most popular type of entrepreneurship throughout the European states, because of its universality and flexibility. However, the meaning of a limited liability company in Ukraine is even wider. Official statistics should be presented. According to the data of the Ukrainian unified register of enterprises, organizations and sole traders nearly 520 228 companies are registered<sup>1</sup>. That is more than 93% of all commercial legal entities (in comparison: in Poland by 01.01.2016 345 135 limited liability companies were registered that is 83% out of the whole number of business organizations (413 813 commercial companies (*spółek handlowych*)<sup>2</sup> in Poland). This fact shows how significant the role of this type of commercial companies is in Ukraine. The dynamics of the last years just confirms this fact. A limited liability company is the most popular type of legal persons for the new formed enterprises<sup>3</sup>. However, a Ukrainian legislator still does not pay enough attention to make its regulation more perfect.

A lot of work was done in the field of business registration during the last years. The reduction of minimal capital, shortening of the time

<sup>1</sup> "Perevagy ta nedoliky organizacijno-pravovych form tovarystv v Ukraini". Retrieved June 15, 2016 from: <http://jurliga.ligazakon.ua/news/2014/4/23/109462.htm>.

<sup>2</sup> Annual report "Structural dimensions in the state's economy" Polish National register, 01.01.2016 r., Warszawa 2016, p. 31, 127.

<sup>3</sup> Earlier private enterprises (Приватне підприємство) were also popular. But today they haven't essential significance in the market.

for registration of business, the implementation of electronic registration are among the most visible measures that were taken by the last two governments. Due to these facts and some others Ukraine changed its position in the International rate (the states all over the world were taken into account) of business from 152-nd (in 2012) to 83-rd position (in 2016)<sup>4</sup>.

But there are some facts that an investor should remember when coming into the Ukrainian capital market. The aim of this article is to show a few aspects of conducting business in a such legal form as a limited liability company.

#### Foundation and incorporation of LLC

The legal status of a limited liability company is stipulated by the Law of Ukraine *On Commercial Companies*<sup>5</sup> (articles 50–64), the Civil Code of Ukraine<sup>6</sup> (articles 140–151), and the Commercial Code of Ukraine<sup>7</sup> (articles 79–92). The legal norms on commercial company are also applicable (articles 1–23 of the Law of Ukraine *On Commercial Companies* and 80–113 of the Civil Code of Ukraine). Nevertheless, legal regulation is characterized by wide dispositivity. The Ukrainian law proposes wide possibilities to regulate the corporate relations at the discretion of shareholders.

LLC's original name is "tovarystvo z obmezhenomu vidpovidal'nist'u". A limited liability company can be established by a natural person or legal entity and it can have one founder or more. The possibility of establishing a company by one founder has been implemented relatively recently. Earlier a minimal number of founders was three persons. However, the Commercial Code stipulates a restriction, bas-

<sup>4</sup> Doing business 2016: measuring, regulatory quality and efficiency, Washington 2016, p. 5.

<sup>5</sup> Law of Ukraine "About commercial companies". Retrieved June 15, 2016 from: [http://search.ligazakon.ua/l\\_doc2.nsf/link1/T157600.html](http://search.ligazakon.ua/l_doc2.nsf/link1/T157600.html).

<sup>6</sup> Civil Code of Ukraine. Retrieved June 15, 2016 from: <http://zakon5.rada.gov.ua/laws/show/435-15>.

<sup>7</sup> Commercial Code of Ukraine. Retrieved June 15, 2016 from: <http://zakon5.rada.gov.ua/laws/show/436-15>.

ing on which a company with a single shareholder cannot be a single founder or a single shareholder of another company.

The articles of Association are used for the foundation and business activity of a limited liability company. They should be made in writing and signed by all shareholders. It is worth mentioning that their signatures should not be authenticated by notary act as it is in Poland<sup>8</sup>, Slovakia<sup>9</sup> or the Czech Republic<sup>10</sup>.

There is no minimum amount of the company's registered capital. By the way, Ukrainian legislation does not have division on contributions. Therefore, shareholder's contribution may be one euro or even less. In the author's opinion, these provisions rise the attractiveness of a limited liability company today (15 years ago the minimum registered capital was nearly 25 000 Euros). As in neighboring states at least 50% of each primary contribution into the company must be paid up before filling in the application for the company's registration in the Commercial Register.

#### Shareholder's rights and duties

The basic rights of shareholders of a limited liability company include: 1) property rights (a right to share in profits; a right to settlement share; a right to share in liquidation balance); 2) other rights: rights related to the management of a company and the supervision over its operations; a right to information;

The duties of the shareholders of a limited liability company include: contributory obligation; obligation of additional contribution; liability for the obligations of the company;

A basic duty of a shareholder is contributory obligation. A shareholder is obliged to pay up his contribution under the conditions and within the terms set forth by law or in the articles of association. However, such a payment must be made within one year following

<sup>8</sup> *Kodeks spółek handlowych, stan prawny: 01.09.2013*, Warszawa, p. 37.

<sup>9</sup> A. Skrinar, Z. Nevolna, L. Kvockacka, *Fundamentals of Slovak Commercial Law*, Plzen 2009, p. 104.

<sup>10</sup> *Zákon o obchodních společnostech a družstvech (zákon o obchodních korporacích)*. Retrieved June 15, 2016 from: <http://www.zakonyprolidi.cz/cs/2012-90#cast1-hlava4>.

the company's incorporation. At the same time Ukrainian legislation does not stipulate responsibility for failure of this duty.

Another important obligation of a shareholder of the limited liability company is the so-called obligation of additional contribution. The obligation of additional contribution consists in the obligation of a shareholder to make a contribution, pro rata to his pledged original contribution. But this obligation is only applicable when it is mentioned in the articles of association.

A sole shareholder is not entitled to take the following actions on behalf of the company: to make claims for damages or other claims that the company has towards an executive; to make claims for the payment of a contribution towards a shareholder who is delayed with the payment of his contribution, to make claims for the refund of payments provided to a shareholder contrary to law. It is due to the fact that indirect (derivative suit) is still under discussion in Ukraine.

Each shareholder, whose contribution reaches at least 20% of the registered capital, is entitled to request the convening of a general meeting. If the executives do not convene a general meeting in such a way as to take place within 25 days from the date of receiving such a request, the shareholders are authorized to convene it themselves.

### Bodies of a Limited Liability Company

The obligatory bodies are the general meeting and the executives. The company can also establish supervisory board or other bodies stipulated in the articles of association. Unlike a joint-stock company, supervisory board in a limited liability company is an optional body.

The general meeting is the supreme body of the company. The shareholders exert their rights related to the management of the company and supervision over its operations in the general meeting. The articles of association may not limit statutory competences. They can only extend the scope of competences. The general meeting constitutes a quorum<sup>11</sup> where shareholders in attendance constitute at least 60 % of all votes. The articles of association may regulate a quorum

<sup>11</sup> Quorum – some minimal quantity of share that shall be present on the general meeting to make it valid.

otherwise they cannot determine a lower number of votes required for a quorum than stipulated in the Law of Ukraine *On Commercial Companies*.

The executives are statutory body of the company. It means they act on behalf of the company outwards. Their competences also include the participation in the company's management in the issues that are not committed under competence of the general meeting by the Law of Ukraine *Commercial Companies* or the articles of association.

### Transfer and transition of a share

The transfer of a share (ownership interest) is the most frequent way of termination of a shareholder's participation in the company during its existence. In principle, a share can be transferred to a third party only if it is not prohibited in the articles of association. A shareholder of a limited liability company may cede his share (its part) to one or several shareholders of the same company or third persons. The shareholders have the preferential right to acquire the share (its part), proportionally to their shares in the registered capital of the company or to the amount agreed upon by and between them (the so-called preferential rights).

The transition of a share can also occur upon: 1) dissolution of a legal entity that is a shareholder of the company; 2) the death of a shareholder. Where a legal entity holding an ownership interest in a company is wound-up, its ownership interest is transferred to its legal successor. Ownership interest can be also inherited. However, the articles of association may forbid ownership interest to be transferred to a legal successor of a wound-up entity or to be inherited. The articles of association may not exclude the inheritance of ownership interest if it has the only shareholder.

An heir who is not the only shareholder may claim dissolution of his participation by the court, if he cannot be reasonably required to be a shareholder.

### Withdrawal of a shareholder's participation

The Law of Ukraine *On Commercial Companies* stipulates the various methods of termination of a shareholder's participation in a limited liability company such as: transfer of ownership interest, winding-up of legal entity that is a partner, the death of a partner, expulsion of a partner in the procedure of expulsion, execution on ownership interest.

The judicial statistics shows that the court refuses a shareholder's claim on expulsion in 99 % of cases. According to Ukrainian legislation the expulsion of a participant is exclusive competence of a general meeting.

The reasons of expulsion are the following: if a shareholder constantly fails to fulfill his commitments; if he unduly fulfils them; if his actions impede the company to achieve its goal.

The procedure is the following: such a person (who has done one of the above mentioned actions) should be withdrawn from the company on the basis of a decision voted through by the shareholders possessing in the aggregate over 50 per cent of all votes. The shareholder does not vote in this case and his votes are not taken into account.

In the author's opinion, this procedure is not very effective. First of all it is worth mentioning that it is rather difficult (sometimes even impossible) to expel the shareholder who has a majority or whose share is 50 % and more of the registered capital. The reason is because of high percentage for a quorum. According to the article 60 of the Law of Ukraine *On Commercial Companies* the quorum is 50 percent and one vote. That is one of the highest levels in Europe.

As a result the general meeting is in a stalemate. The shareholder, who should be expelled, does not visit the general meeting. As a consequence the general meeting is invalid and cannot make any decisions.

Besides the above mentioned fact some other measures are not stipulated in Ukrainian legislation. Calling the shareholder to fulfill his duties and warning him in writing of the possibility of expulsion is a norm in the legislation of many European states<sup>12</sup>. Moreover, the shareholders, whose contribution in the company represent not less than 50% of the registered capital, must agree with such a request.

<sup>12</sup> A. Skrinar, Z. Nevolna, L. Kvockacka, *Fundamentals of Slovak Commercial Law*. Plzen 2009, p. 104.

Therefore, on the one hand the company cannot struggle against a major shareholder (or whose share is significant). On the other hand, a minor shareholder has no guarantees that he will not be expelled from the company. To change such situation, in the author's opinion, the above mentioned measures should be implemented into Ukrainian legislation.

### Winding-up of a Limited Liability Company

Winding-up of a limited liability company is regulated both by the general provisions on winding-up of business companies and by the specific provisions governing winding-up of a limited liability company. In addition to the reasons for winding-up of a company as specified in the general provisions on winding-up and dissolution of business companies, the company can be also wound up according to the court decision made on the basis of a request by a shareholder or an executive for the reasons and under conditions stipulated in law or, as the case may be, in the articles of association. A limited liability company ceases to exist upon its deletion from the Commercial Register.

### Conclusions

A limited liability company is the most attractive form of investment for a small and medium investor while a joint stock company is the most suitable for large business. However, the investor should take into account its advantages and disadvantages.

The advantages are as follows: an easy registration; a small minimal registered capital on start; a dispositive method of legal regulation (a possibility of corporate relations' regulation at the discretion of the shareholders).

The disadvantages include the duplication of regulation by three legal acts (the Law of Ukraine *On Commercial Companies*, the Civil Code of Ukraine, the Commercial Code of Ukraine); a weaker protection of an investor in comparison with the legislations of European states; the absence of a shareholder's liability in case of failure to fulfill the obligation to pay a contribution.