



ASK THE LAWYER!

Don't Litigate, Negotiate

Question: *We often hear that international investors are hesitant to invest in Ukraine due to fears of being abused or defrauded. What can an international investor do to protect its investment?*

Answer: We have been representing international investors in Ukraine since 1992, and we have dealt with quite a few horror stories in our practice over the years. I will be happy to summarize for you the recommendations we can make based on our experience.

First of all, as a matter of background, I would like to comment that what we now call "corporate raidership" has existed for years. Of course, these days it has become more organized and professional, but this ugly trend emerged almost as soon as Ukraine's market opened up to international investment. There are a number of reasons why this trend has grown to such a dangerous scale: our underdeveloped and chaotic legal system, flawed judiciary and vast bureaucracy that is at best indifferent or at worst hostile to international investors – these are usual factors that investors complain about. I do not want to spend time on these factors because they have been discussed numerous times and because the investment community has little control over them. What is discussed less frequently is the factor of careless behavior by international investors. This factor, unlike the other ones, can be controlled by international investors themselves.

In our practice, quite a few abuses of international investors by their business partners or hired executive management could have been avoided, if the investors had made the necessary efforts to prevent the abuses and used protection mechanisms that are indeed available under the law. In essence, I want to focus on how international investors can help themselves in protecting their investments.

It is understandable that an international investor, when entering a new market, is looking for local partners and executive management. By using the word "local", I do not want to imply at all that dishonest

business partners or executives are always local nationals, although statistically this is often the case. We had several instances in our practice where international investors were defrauded by expats who shrewdly took advantage of the trust vested in them, as well as of the imperfections of Ukrainian law. By "local", I mean partners or executives of any nationality, who are better acquainted with the local conditions, language, legal system, traditions, etc., and on whom international investors are relying.

Most frequently, international investors suffer abuse from their minority local partners, or hired management. The worst-case scenario is when the dishonest minority partner in a company is also hired as the chief executive officer ("General Manager" or "GM"). In this case, the investor has to battle on two fronts: terminating the employment of the GM, and expelling him as a partner in the company. Very often, such a dishonest partner/GM uses illegal means, and unless the international investor resorts to similar means (which does not happen often, and not what we are talking about), the battle will be long and costly for the international investor. Sometimes, it can cost more than the investment itself.

In general, there are two formal protection mechanisms that should be looked at: company charter and employment contract with the GM; and one practical mechanism: setting up an internal system of checks and balances, through which the activities of the local partner/GM can be closely monitored and abuses can be prevented. The international investor, even if it does not participate in the day-to-day management of the company, possesses such important tools, provided by the law, as the company's supreme and supervisory bodies, the possibility to restrict the powers of the GM, the right to review financial and other documents of the company, the right to audit the activities of the company, etc. All these tools should be used to the greatest possible extent through the company charter and employment contract with the GM. And it is really surprising how infrequently international investors are using these tools in practice.

Let's take two examples – the employment contract with the GM and external audits.

It is common knowledge that employment laws in Ukraine are employee-oriented, labor agreements in most cases must be open-ended, and cannot create any disadvantage to the employee compared to the



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law, thus leaving little freedom to the employer to negotiate employment conditions or terminate employment. At the same time, not every international investor knows that the GM is hired on the basis of a different document – an employment contract, which can be made for a limited term, and can contain special provisions on disciplining and dismissing the GM. In the absence of the developed concept of fiduciary duty in our legal system, this is an effective and perfectly legal tool for an international investor to protect its investment.

The same is true for external audits. An investor has the right to hire independent auditors, who should be given full access to company documents. In practice, however, most external audits are ordered not by the investor, but by the GM, often from auditors loyal to him, often based on a limited number of available documents, and often conducted only in Ukrainian, or even if translated, then in the local professional language incomprehensible to an international investor. I have seen many such audit reports, and they were essentially useless in understanding what was really going on at the company, and in protecting the investors' rights. Therefore, it is important for an investor to take full advantage of this tool by directly hiring truly independent auditors, paying their bills directly and demanding complete and comprehensible reports that flag potential risks where necessary. If such auditors come back and report a lack of cooperation from the GM, this should cause immediate concern, and immediate measures should be taken

Jean-Jacques Rousseau - AN IDIOT

(hopefully prescribed in the company charter and in the employment contract with the GM) to ensure full cooperation and disclosure on the GM's part.

Question: *Can you please provide a point-by-point list of recommendations?*

Answer: Yes, here is a list of common-sense and practical "self-help" recommendations for international investors:

- Try to ensure compliance with the law to the best extent possible while setting up and operating your business in Ukraine.
- Focus on monitoring your investment and on preventing abuses. In case of any concern – react immediately.
- Do not make your partner the GM and do not make the GM your partner. Actively use the protection mechanisms available in the law.
- Set up a practical internal system of checks and balances, and make sure this system is in compliance with Ukrainian law (often global internal corporate rules are unenforceable in Ukraine, and need to be "translated" into local legal language and duly adopted).
- In case of a problem, act swiftly and decisively, but in compliance with the law (e.g. even the most dishonest GM, if dismissed improperly, will be restored to his position by the courts, and often will be awarded damages).
- Avoid any dubious activity and verify any recommendations from local partners/GM if you suspect that what they are suggesting may be illegal (if you bend the rules, you will give them ammunition to blackmail you in the future).
- Avoid the court system. Use every opportunity to negotiate and settle. It may be frustrating and unfair, but in the long run it will save you considerable time and money.
- Watch your investment, learn your lessons and have a very successful business in Ukraine! ●

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▶ Jefferson's idea... give credit to his many contemporaries too... saw virtue in the protection of property rights. Democracy was a concept. Liberty, freedom were concepts. Justice in society, a goal. Instinctively they understood. One can't do justice without protecting man's right to his own property.

The inequality that is the result of man's pursuit of happiness is justice if all men's right to the protection of his property is found in the law. The equality that is needed is that before the law. For all mankind. No society, government can appropriate property and distribute it equally. That idea in itself, the idea of taking and making people equal is totalitarianism itself. The late, 'great' Soviet Union is Exhibit 'A'.

A downward spiral of mankind ensued from the French Revolution. The idea of equality of result lay not in the pursuit of happiness or the justice and liberty that came from recognizing the ability of free people to pursue property. The expectation that society would recognize the need for such liberty was demeaned by the equality sought by those who yielded the guillotine. And many who advanced such views died by the same guillotine.

But the ideas advanced. Socialism, utopia, communism would supposedly advance mankind towards equality. Not simply equality before the law, but equality in property, in wealth.

I said above, "a downward spiral". What else can the pursuit be called that in its lifetime has resulted in millions upon millions of deaths.

That time should be done. We know, as Orwell indicated, that under equality of result, some would have to be more equal than others. And to get there, millions must die, in this pursuit of equality. The pursuit of that kind of equality is always totalitarianism. The purpose of this article is to call attention to the fact

that any people seeking, liberty, justice, must recognize and protect the people's right to property.

And in the word property, I do not talk of rights in land, or if so, only partially, and in an overall concept. Man's liberty is his property. And it should not, cannot be debased on the concept of equality of result.

Man's liberty lies in equality of each person before the law, not equality of result. Men are not born equal, with the right to equal wealth, happiness, or even long life. The best result is that we have equal opportunity before the law. People are not born with equal talents. Some people are born more fortunate, to greater wealth, or even with more brainpower. It is only necessary that people be equal before the law.

Ukraine is an example of a society where people are not equal before the law.

There is no 'rule of law' in Ukraine.

Ukraine, a fledgling democracy, must understand at some point that there must be recognition of property rights, there must be no immunity for legislators, and there must not be manipulation of laws against freedom of contract.

In acts such as the recent court decisions related to the telecommunications industry; in actions that have changed contractual rights of grain traders and the people of Ukraine, the countries lack of understanding of rights in property, a system of justice have again been illustrated.

Ukraine is run by those more equal than others.

Ukraine, at the moment has no leaders.

There is no law west of the Pecos. An old Texas saying.

I add, there is no Rule of Law east or west of the Dnipro. ●