

Liability of officials in Ukraine: What do investors need to know?

A company's successful operation is inextricably dependent on the actions of its officials. This is why an increased level of control and liability is established for such persons.

Until recently, investors have had little opportunity to effectively bring unscrupulous top managers to liability in Ukraine due to the lack of both clear legislation and established court practice. However, the latest Ukrainian practice is moving towards stricter rules on the liability of officials. Therefore, the issue is becoming increasingly important.

The legislation generally provides for several types of top managers' liability: criminal, administrative, disciplinary, substantive, and civil.

We have collected practical advice and answers on how managers' liability is regulated in Ukraine, what aspects need to be analyzed in the first place, and other common questions regarding the liability of top managers in terms of corporate and labor law.



Which categories of persons are subject to liability rules?

The general rules on liability apply to company officials. The list of officials depends on the organizational and legal form (LLC/AdLC or JSC) but includes members of the supervisory board and executive body (director, board members) in any case.

In addition, officials are also persons defined as such in the charter (no restrictions on positions are set; however, officials include most often heads of individual areas/separate units, deputy directors or chief accountant) for LLCs/AdLCs, and members of the audit commission (an auditor) and other company bodies, if any, for JSCs.

At the same time, the law provides for separate liability relevant in some cases only for (i) the executive body or (ii) the executive body and the supervisory board.



What are officials liable for?

As a general rule, a violation is an action or inaction of officials without observing the principle of good faith and reasonableness, in case of exceeding their powers, lack of prior approval of appropriate actions if necessary, etc. In this case, top managers are liable for damages caused by the respective violation.

More specific obligations and implications of non-compliance regarding liability differ for LLCs/AdLCs and JSCs and are contained in special laws.



What special rules are set for LLC / AdLC managers?

Apart from the general rule of good faith and reasonableness, the following violations are specified for LLC/ AdLC:

- non-compliance with the rules on conflict of interest;
- failure to submit a list of affiliates;
- disclosure of trade secrets and confidential information;
- misleading the shareholders of the company regarding its financial condition, which has affected the payment of dividends;
- violation of the procedure for material contracts/ related-party transactions;
- non-compliance with restrictions on plurality / non-compete clause (applies only to members of the supervisory board and executive body);
- inaction in the event of a significant reduction in the value of net assets (applies only to the executive body).

The mentioned violations imply both compensation for damages and, in some cases, termination of the contract without compensation payable (for violations related to confidentiality, affiliates and conflict of interest/restrictions on combination and non-compete clause) and reimbursement of payments to the company (if the dividend calculation procedure is violated).



How are the rules different for JSC?

In general, the legislation on JSC is less specific in this area and stipulates general grounds for bringing JSC officials to liability, such as damages.

However, the lack of specification does not mean that the specific violations described for LLC/ AdLC have no implications for JSC officials – their relevant actions can be considered a violation of the general principle of good faith and reasonableness.



Are regulatory changes planned in the near future?

Yes, it is currently planned to amend the current Law of Ukraine "On Joint Stock Companies".

The draft law is aimed at moving away from formalism and establishes enhanced requirements for professionalism, integrity, diligence, and independence of officials.

Apart from that, the draft law contains more specific liability provisions for JSC by analogy with those for LLC/ AdLC (e.g. on actions in case of reduction in the value of net assets).

Thus, as soon as the law becomes effective, it will be much easier to bring a JSC official to liability.



How easy is it to end an employment and corporate relationship with unscrupulous managers?

Labor law provides for disciplinary action in case of violations. However, this tool is not effective in Ukraine and is difficult to implement in practice.

A more effective and immediate measure is dismissal based on the termination of an official's powers. This additional ground is specifically meant to protect investors. Termination of corporate and employment relations can occur immediately and without any justification, but subject to a severance pay in the amount of 6-month average earnings. At the same time, individual employment contracts may provide for more serious "golden parachutes".

This is certainly relevant only for top managers who are in an employment relationship with the company (members of the executive body and, in some cases, members of the supervisory board).

An employment relationship with officials who enter into a civil agreement is terminated based on the grounds specified in that agreement.



Who can initiate a lawsuit against an official?

The most common option is the so-called derivative lawsuit, i.e. a lawsuit against an official filed by a shareholder/participant who owns 10%+ of the company's charter capital on behalf of the company.

In some cases (e.g. after the termination of an official's powers), the relevant lawsuit may be filed by the company itself.



Are there real cases of bringing officials to liability?

In the Ukrainian court practice, decisions on collection of damages from officials are becoming more common, and the amount of such damages is also gradually increasing (e.g. in one case the amount of damages exceeded UAH 8 million).



How can an investor minimize violations on the part of top managers?

- 1) Develop and implement the most comfortable corporate governance system, which aims at ensuring real control over the managers' actions and establishing an effective checks and balances system.
- 2) Include provisions on the rights and responsibilities of officials and their liability in the employment/civil agreement/contract, job description (if any).
- 3) Spell out the relevant provisions in the company's charter and internal documents (in particular, in the Regulations on the Management Board,

Regulations on the Supervisory Board) – define the persons deemed officials; expand the list provided for by law, if necessary; detail their basic rights and responsibilities; set clear "rules of the game"; provide for the necessary procedural aspects (e.g. the procedure for notifying participants/shareholders).

- 4) Monitor relevant changes in the legislation, reflect these changes in the relevant documents.
- 5) Document all violations on the part of top managers properly.

