FAR FROM DISASTER: UKRAINE'S ENERGY SECTOR SEEKS INVESTMENT AND GROWTH

Martin Hunt and Erik Eisele***

* Martin Hunt is a partner at the international law firm of Bracewell & Giuliani LLP. He is based in New York and London and is a qualified English solicitor and New York attorney. Mr. Hunt has significant experience in advising clients that are investing in and transacting business in Ukraine and other countries in Eastern Europe.

** Erik Eisele is an associate in the Washington D.C. office of Bracewell & Giuliani LLP and represents domestic and international corporate clients. Mr. Eisele is a graduate of the University of Houston Law Center.

I. INTRODUCTION

Twenty-two years ago, the explosion at the Chernobyl nuclear power plant in present-day Ukraine and the initial attempt by the Soviet Union to cover up the scale of the disaster exemplified the futility of the secretive Soviet regime and its flawed visions for a nuclear-energy dependent future. Since gaining independence some five years later, Ukraine has worked to shed the vestiges of its oppressive Soviet past by opening up to a market-based economy, creating entirely new business, cultural, and economic environments, and reformulating an energy future that includes a diversified portfolio of on and offshore petrochemical operations. Ukraine, like other countries in Eastern Europe and Central Asia, continues to welcome Western capital and business investment, and offers unprecedented access to its markets. Furthermore, Ukraine's strategic location between Europe and Russia allows it to control gas shipments from East to West. However, the ongoing challenges of privatization and the political and economic changes that resulted have been made far more difficult by the ongoing global financial crisis that emerged in 2008.

Ukraine's problems from the financial upheaval to some extent reflect the success of its integration into the world economy. The country formally became a member of the World Trade Organization (WTO) in 2008,[1] which led to negotiations with the European Union (EU) (its largest trading partner) to replace the myriad of fragmented trade and tariff agreements in place with a more comprehensive free trade agreement—a move that should strengthen EU-Ukraine business relations at the expense of Russia.[2] Since 1999, Ukraine's average annual economic growth of 7.3% was exceeded only by that of Kazakhstan among Eastern European and Central Asian countries,[3] and growth was on track for another 7.0% increase

1. Andrew E. Kramer, *Ukraine, Eager for Ties to the West, Joins the W.T.O.*, N.Y. TIMES, Feb. 6, 2008, at C4.

2. *See EU and Ukraine Launch Free Trade Agreement Negotiations*, EUROPAWORLD, Feb 22, 2008, http://www.europaworld.org/week334/euandukraine22208.html.

3. KEITH CRANE & F. STEPHEN LARRABEE, RAND CORP., NAT'L SEC. RES. DIV., ENCOURAGING TRADE AND FOREIGN DIRECT INVESTMENT IN UKRAINE 33 (2007).

before the financial crisis ravaged Ukraine's stock exchange, causing the government to close down the stock exchange temporarily and dropping the hryvna, Ukraine's currency, to a record low against the dollar, depleting the country's already diminished foreign currency reserves.[4]

Added to this economic tension is the pro-Western government's political stalemate between President Viktor Yushchenko and Prime Minister Yulia Timoshenko, and the government's on-again, off-again relationship with neighboring Russia. It is important to note, however, that the political difficulties do not indicate opposition to Western economic ideas. On the contrary, all political factions united to help Ukraine secure a $16.5 billion loan from the International Monetary Fund (IMF) in late October 2008,[5] and the passage that same month of a long-awaited Joint Stock Company Law by Ukraine's national parliament (the Rada) presages an improved foreign investment climate once the immediate economic crisis passes.[6] Once the global economy emerges from crisis, Ukraine's emergent energy sector should form the basis of a renewed attractiveness to foreign investors.

In recognition of Ukraine's strategic importance to Europe as the energy gateway to Russia and Central Asia, the West has a vested interest in developing Ukraine's energy sector. As a result, investors in the energy sector should be aware of recent developments that are affecting investments, as well as have some basic familiarity with Ukrainian legal entities through which to structure investments. Part II of this Article canvasses several recent developments in the trade, corporate, finance, and energy sectors of Ukraine. Part III explores the general politico-

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4. Maria Danilova, *Ukraine, Other Small Nations Face Crisis Alone*, ABCNEWS, Oct. 14, 2008, http://a.abcnews.com/International/WireStory?id=6032968&page=1.

5. Daryna Krasnolutska & John Martens, *Ukraine Gets $16.5 Billion IMF Loan; Hungary is Next*, BLOOMBERG, Oct. 27, 2008, http://www.bloomberg.com/apps/news?pid=20601085&sid=askgNLqGKiSU&refer=europe.

6. Armen Khachaturyan, *Ukraine: Major Features of the New Law on Joint Stock Companies*, U.S.-UKRAINE BUS. COUNCIL, Sept. 24, 2008, http://www.usubc.org/keyissues/joint_stock092408.php.

economic environment in which Ukraine finds itself currently. Part IV discusses the major business entities utilized in Ukraine for conducting business. Part V discusses recent energy sector developments.

II. RECENT DEVELOPMENTS

The four most significant and positive long-term developments for Ukraine focus on foreign trade, corporate law, finance, and energy.

A. Trade Law

Ukraine's economy is based on agriculture, heavy industry (particularly steel production), and energy.[7] The country's main trading partners are the EU, Russia, Turkey, Belarus, and the United States,[8] and expanding its foreign trade access is vital. The WTO's acceptance of Ukraine's membership in 2008 was the culmination of a process that began in 1993 that stands to expand dramatically its economic integration with the EU.[9] Ukraine's total trade with the twenty-seven EU countries is valued at nearly €35 billion, and has tripled since 2000.[10] A significant portion of Ukrainian goods entering the EU benefit from the General System of Preferences in force since 2006,[11] and one of the immediate benefits of the country's WTO membership is unrestricted exports of steel and textiles to the EU.[12] Another anticipated benefit is the implementation of a Ukraine-EU Free Trade Agreement (FTA) to replace the more general Partnership and Cooperation Agreement. Three rounds

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7. CIA World Factbook: Ukraine, https://www.cia.gov/library/publications/the-world-factbook/geos/up.html (last visited Mar. 1, 2009).

8. *Id.*

9. *See* Kramer, *supra* note 1.

10. Eur. Comm'n Delegation, Ukraine-EU: Bilateral Trade Relations, http://www.delukr.ec.europa.eu/page36088.html (last visited Mar. 1, 2009).

11. *See id.* (indicating the General System of Preferences improves "stability, predictability and simplicity" while benefitting a diversified portfolio of Ukrainian imports to the EU).

12. *Id.*

of FTA negotiations have already taken place, and ongoing domestic economic reforms in Ukraine should help the establishment of a free trade arena.[13]

B. Corporate Law

The majority of the basic concepts and principles of Ukrainian corporate law date back to 1991, when Ukraine gained its independence.[14] Application of these corporate provisions has shown numerous inadequacies over the years, including major inconsistencies with the Civil Code and the Commercial Code adopted in 2004.[15] In particular, Ukraine is unique as the only former Soviet country lacking special legislation on joint stock companies—a situation that too often allowed the breach of investors' rights.[16] This situation at last stands to be rectified with the September 2008 approval by the Rada of a long-awaited Law on Joint Stock Companies, which should become effective six months following its official publication.[17] Additional details on the new law, and the general corporate legal environment of Ukraine, will be examined later in this Article. The new Joint Stock Company law is in line with both EU directives on shareholder protection, as well as Organization for Economic Cooperation and Development (OECD) guidelines on corporate governance.[18]

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13. *Id.*

14. Shevchenko Didkovskly, *Ukrainian Corporate Law*, HG, Jan. 19, 2004, http://www.hg.org/articles/article_400.html.

15. Adam Mycyk et al., *Corporate Governance and Disclosure in Ukraine*, 4 INT'L J. OF DISCLOSURE & GOVERNANCE 59, 61–62 (2007).

16. Denis Lysenko, Op-Ed, *Ukraine's Companies Remain in Legal Limbo*, BUS. NEW EUR., Apr. 22, 2008, http://businessneweurope.eu/story975/COMMENT_Ukraines_companies_remain_in_legal_limbo.

17. *See* Chamber of Commerce in Ukraine, Joint Stock Company Law in Ukraine Passes Another Hurdle, http://www.chamber.ua/success/87 (last visited Mar. 1, 2009) [hereinafter Hurdle]; Press Release, Chamber of Commerce in Ukr., *In-Focus Meeting Entitled "Understanding Challenges and Advantages of the New Joint Stock Company Law"* (Oct. 30, 2008), http://www.chamber.ua/wg/42 (noting that President Yushchenko signed the law on October 22, 2008). The law is expected to come into force on April 29, 2009, although some provisions will not be valid until 2011. *Id.*

18. Hurdle, *supra* note 17.

C. Finance

The $16.5 billion, twenty-four month IMF emergency loan that Ukraine accepted in October 2008 could lead to additional corporate governance changes. The country had already suffered credit rating cuts by major rating agencies (Fitch, Moody's, and Standard & Poor's)[19] and faced default without the additional funds, which were tendered and approved based upon reforms in the country's banking system (including stronger capitalization requirements) and a balanced budget in 2009.[20] Earlier in 2008 inflation had risen to more than 30% but has since fallen, and IMF requirements will likely bring a further emphasis on lower inflation.[21] The state of the economy rides on the coattails of steel prices since the steel industry comprises some 40% of Ukrainian exports.[22]

D. Energy

Ukraine has not yet become as dynamic an energy market as other countries in the region such as Kazakhstan, but it still has significant potential for both production and transport of hydrocarbon resources. It is estimated that the country has nearly 400 million barrels of proven oil reserves, the majority of which is located in the eastern Dnieper-Donetsk basin of the Black Sea.[23] Equally important, Ukraine's geographic location

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19. Daryna Krasnolutska, *Moody's Cuts Ukraine's Outlook on Global, Home Crises*, BLOOMBERG, Oct. 20, 2008, http://www.bloomberg.com/apps/news?pid=20601095&sid=a4mdxDmYO0XA.

20. *IMF Aid for Ukraine and Hungary*, TELEGRAPH.CO.UK, Oct. 27, 2008, http://www.telegraph.co.uk/finance/financetopics/financialcrisis/3266265/IMF-aid-for-Ukraine-and-Hungary.html.

21. Daryna Krasnolutska & Kateryna Choursina, *Ukraine May Default Without IMF Loan, Stelmakh Says*, BLOOMBERG, Oct. 29, 2008, http://www.bloomberg.com/apps/news?pid=20601085&sid=aDTFHsXI7Mvk&refer=europe#.

22. ANDERS ASLUND, CARNEGIE ENDOWMENT FOR INT'L PEACE, A FOREIGN TRADE POLICY FOR UKRAINE (2003), http://www.carnegieendowment.org/publications/index.cfm?fa=view&id=1225.

23. Energy Information Administration, Country Analysis Briefs: Ukraine, http://www.eia.doe.gov/emeu/cabs/Ukraine/Oil.html (last visited Mar. 1, 2009) [hereinafter EIA]. In 2007, Ukraine ceremoniously signed its first production sharing agreement for development of more than 5,000 square miles of the Prykerchenska offshore oil shelf lands. *Ukraine Opens Deepwater Black Sea*, CONSTR. PORTAL FOR UKR., Sept. 23, 2007,

makes it an ideal corridor for oil and natural gas to transit from Russia and the Caspian Sea region to European markets—including more than 20% of Russia's average daily crude oil and natural gas exports.[24] Ukraine's state-owned oil and gas company, Naftogaz Ukrayiny, operates the country's massive natural gas pipeline network and has cooperation agreements with Russia's Gazprom that make Naftogaz the key shipper of Russian gas to markets in the EU. Naftogaz moves up to 80% of Russia's Europe-bound gas supplies.[25] As Ukraine's fledgling democracy matures, so too will its energy sector in response to increased global demand, oil discoveries, and the perceived stability of Ukraine in the face of declining worldwide reliance on Russian exports.

III. GENERAL POLITICO-ECONOMIC ENVIRONMENT

The aforementioned recent economic developments must be viewed in the overall context of Ukraine's politico-economic environment. Progress has been substantial since Ukraine's 1991 independence, but its developing political and judicial system still offers challenges to multinationals locating or investing there. The key to success is an understanding of the country's basic cultural, business, and legal realities.

Ukraine is a democracy that saw largely free and fair parliamentary elections in March 2006 and September 2007.[26] This was in contrast to the highly disputed presidential election in 2004, which was marked by allegations of corruption and voter intimidation that sparked national protests since known as the Orange Revolution, and which ultimately resulted in a revote that ended in the victory of current President

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http://www.constructionukraine.com/next.php?id=64855. However, the PSA was subsequently cancelled by the Ukrainian government, and this decision is currently the subject of a bitter dispute. Tammy Lynch, *Exploring Ukraine's Vanco Dispute*, UNIAN NEWS AGENCY, July 28, 2008, http://unian.net/eng/news/news-264080.html.

24. EIA, *supra* note 23.

25. Mathew Carr & Kateryna Choursina, *EU Will Judge Success of Gas Deal When Flows Resume*, BLOOMBERG, Jan. 18, 2008, http://www.bloomberg.com/apps/news?pid=20601072&sid=aRYTPhZ.Dzcg&refer=energy.

26. Clifford J. Levy, 2 Parties in Tight Race in Ukraine Vote, N.Y. TIMES, Oct. 1, 2007, at A6 (noting that foreign election observers reported few irregularities in the 2007 election).

Yushchenko over the then current prime minister, who had the unofficial backing of Russia.[27] The next presidential election will be in 2010.[28] Unfortunately, the Orange Revolution left unclear the division of authority between the President and Prime Minister positions, which has contributed to the current political controversy, and until 2008, the respective parties of President Yushchenko and Prime Minister Tymoshenko had governed in a coalition arrangement.[29] However, the two split after Russia's invasion of Georgia in August 2008, with the President accusing the Prime Minister of muting criticism of Russia's action.[30] The two leaders did collaborate to secure the country's IMF loan in October.[31]

In September 2008 the Rada approved a number of laws which restricted the power of the President.[32] The President dissolved the ruling coalition and called for new early parliamentary elections in December.[33] However, since many of the "stabilization" measures needed to address the current financial turmoil require the formal approval by the Rada, the President has now suspended the dissolution order of the Rada

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27. Paul Quinn-Judge & Yuri Zarakhovich, *The Orange Revolution: Why Russia, the U.S. and Europe Care so Much About Ukraine's Disputed Presidential Election*, TIME, Dec. 12, 2004, at 50; *Yushchenko Takes Reins in Ukraine*, BBC NEWS, Jan. 23, 2005, http://news.bbc.co.uk/2/hi/europe/4198957.stm.

28. Michael Schwirtz, *Ukraine's Leader Schedules Dec. 7 Vote After Disbanding Parliament*, N.Y. TIMES, Oct. 10, 2008, at A6.

29. *See Ukraine Coalition Deal Confirmed*, BBC NEWS, June 22, 2006, http://news.bbc.co.uk/2/hi/europe/5105192.stm; Adrian Blomfield, *Ukraine's Orange Revolution Revived After Win*, TELEGRAPH.CO.UK, Oct. 2, 2007, http://www.telegraph.co.uk/news/worldnews/1564797/Ukraines-Orange-Revolution-revived-after-win.html.

30. Christian Lowe, *Russia Finds Unlikely Ally in Ukraine's Tymoshenko*, REUTERS, Oct. 5, 2008, http://www.reuters.com/article/latestCrisis/idUSL3323694.

31. Sabrina Tavernise & Graham Bowley, *Ukraine Factions Unite to Secure IMF Loan*, INT'L HERALD TRIB., Oct. 29, 2008, http://www.iht.com/articles/2008/10/29/europe/30ukraine.php.

32. *See Rada Clipping Yushchenko's Wings by Reassigning Prosecutor General and Heads of Oblast and City Administrations*, ZIK, Sept. 4, 2008, http://zik.com.ua/en/news/2008/09/04/148874.

33. *Ukraine Gets Third Election in Three Years*, RADIO NETH. WORLDWIDE, Oct. 8, 2008, http://www.radionetherlands.nl/news/international/5999526/Ukraine-gets-third-election-in-three-years.

temporarily.[34] Although the current political situation has created uncertainties, it may provide an opportunity to correct the deficiencies of the Constitution of 2004, which have been at the core of all political problems since then. Regardless of the end results, a fundamental consensus exists between the major political parties on Ukraine's path towards a market economy, including entering an FTA with the EU, strengthening relations with the West, and land reform.[35]

Corruption does remain an obstacle to Ukraine's economic development. Although Ukraine's recent membership in the Council of Europe's Group of States Against Corruption (GRECO) is a step in the right direction, the Rada has yet to ratify the United Nations Convention on Anti-Corruption.[36] Ukraine's situation with respect to human rights and fundamental freedoms has considerably improved in recent years. Its citizens enjoy considerable freedom of expression, and transformation of the state-owned radio and television companies to public broadcasters is under way.[37] Supporting personal freedoms led to a consumer spending boom during the economic expansion of this decade during which time many Ukrainians bought mobile phones, cars, and apartments on credit; however, the ongoing credit crisis has raised uncertainty over how well-established the personal gains made by consumers will prove to be.[38]

Ukraine has aligned itself with most EU foreign policy and regional cooperation efforts. Since 2005, an EU-Ukraine Action Plan has served as a day-to-day tool for guiding the interaction

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34. *Ukraine Coalition Set to Reform*, BBC NEWS, Dec. 9, 2008, http://news.bbc.co.uk/2/hi/europe/7774328.stm.

35. *See EU and Ukraine Launch Free Trade Agreement Negotiations*, *supra* note 2; *Protecting and Promoting Property Rights: Helping Villagers Secure Private Property Titles Quickly and Fairly*, USAID, Sept. 14, 2008, http://www.usaid.gov/stories/Ukraine/ss_ukraine_land.pdf; *Nato Defers on Georgia, Ukraine*, BBC NEWS, Dec. 3, 2008, http://news.bbc.co.uk/2/hi/europe/7762736.stm.

36. EUR. COMM'N DELEGATION, JOINT EVALUATION REPORT ON EU-UKRAINE ACTION PLAN 2 (2008), http://www.delukr.ec.europa.eu/files/eu_ukraine/ukraine_eu_joint_evaluation_2008_en.pdf [hereinafter JOINT EVALUATION REPORT].

37. *See id.*

38. *Ukraine in for Tough Times Amid Global Crisis*, KYIV POST, Oct. 24, 2008, http://www.kyivpost.com/nation/30579.

of the two sides.[39] The Action Plan remained in place through the end of 2008, and work has already begun on a New Enhanced Agreement to take effect in 2009.[40] The Action Plan has been the foundation for a host of initiatives, none more important than an EU/Ukraine Memorandum of Understanding on energy cooperation. Ukraine will seek to join the European Energy Community Treaty in 2009, and its key strategic location between the EU and Russia underscores the EU's commitment to support development of Ukraine's energy infrastructure as well as its overall socio-political development.[41]

IV. DOING BUSINESS IN UKRAINE

The development of Ukraine's energy sector by foreign investors is a crucial component to realizing the untapped resources of the country. Indeed, as noted earlier, Ukraine has been and remains receptive to Western investment, which should only continue to grow in response to colder relations with Russia. Ukrainian corporate law forms the basis of any energy transaction; however, the bulk of Ukrainian corporate law was passed in 1991 at the country's founding and has not managed to keep up with the wide-ranging market reforms that have vastly altered the country's business landscape,[42] including the business entity regulations contained in the Enterprises Act and the Companies Act as well as the new Joint Stock Company law. The most common forms of domestic legal entities through which foreign investors operate in Ukraine are the closed joint stock company and the limited liability company,[43] and foreign investors should understand the structure and rights of any

39. JOINT EVALUATION REPORT, *supra* note 36, at 1.

40. *See id.*

41. *Id.* at 6–9; Platts, *Ukraine Seeks to Join European Energy Community Treaty in 2009*, PLATTS, Jan. 27, 2009, http://www.platts.com/Natural%20Gas/News/6109188.xml?src=Natural%20Gasrssheadlines1.

42. Shevchenko Didkovskiy et al., *Ukrainian Corporate Law*, HG, Jan. 19, 2004, http://www.hg.org/articles/article_400.html.

43. *Id.*

Ukrainian partners. Alternatively, investment through offshore structures, such as holding companies with wholly-owned Ukrainian subsidiaries, is a viable option for reducing tax liability and minimizing risk.[44]

A. Joint Stock Companies

Rooted in the Law of Business Associations, the joint stock company provides shareholders an opportunity to invest in the company while limiting their liabilities up to the nominal value of their shares.[45] Currently, there are two types of joint stock companies: "open" with publicly held shares that can be openly subscribed to on the stock exchange, and "closed" with shares privately held among the founding shareholders.[46] As for capital structure, a minimum capitalization of 1,250 times the minimum wage amount is required—a fairly arbitrary designation that is subject to change.[47]

Despite some cursory similarities with U.S. corporations, several onerous burdens on shareholders and directors make the joint stock company a less attractive investment vehicle for foreign companies. While only one founder, which includes foreign persons and legal entities, is required to form a joint stock company, founders must hold at least 25% of the shares and pay up at least 50% of the share capital prior to registration, while subscribers in an open joint stock company must pay up at least 30% of the share capital prior to registration.[48] Furthermore, any outstanding amounts must be paid up no less than one year after registration of the joint stock company.[49] If by the end of the subscription term, as determined

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44. Andrew Mac, *Foreign Direct Investment Drives Growth in Ukraine*, http://www.magisters.com/insight/2008-1/fdi-drives-growth-in-ukraine (last visited Mar. 1, 2009).

45. Law No. 1576–XII, Oct. 1, 1991, art. 24 (Ukr.), *available at* http://www.brama.com/law/business1/busin_as.txt.

46. *Id.* art. 25. Under the new law on joint stock companies, there will be two types of companies: public and private. *Id.*

47. *Id.* art. 24.

48. *Id.* arts. 30–31.

49. *Id.* art. 32.

at the time of registration, less than 60% of the shares are subscribed for, then the joint stock company is not considered established and the subscriptions are refunded.[50]

Shareholders are also burdened by the lengthy procedures involved in convening the annual general assembly of shareholders—upwards of forty-five days—which can pose a significant obstacle to the operation of smaller closed joint stock companies.[51] Most Ukrainian business law, in fact, assumes few differences between the operations and structure of a joint stock company owned by a single shareholder and a large, publicly traded open joint stock company. Additional restrictions are placed on the board of directors: joint stock companies with more than fifty shareholders must appoint a supervisory board to oversee the board of directors, and the shareholders of smaller companies are afforded the option of appointing such a supervisory board.[52]

B. Limited Liability Companies

Most Ukrainian entities are organized as limited liability companies (LLC's) since they present numerous advantages for foreign investors or foreign parent companies seeking to establish a local subsidiary. A Ukrainian LLC can be formed with only one founder, and the minimum capitalization required is 100 times the minimum monthly wage with 30% due at the time of registration.[53] The founders of an LLC have the option to make an in-kind initial capital contribution in lieu of cash—another attractive feature for foreign entities.[54]

50. *Id.* art. 30.

51. *See id.* arts. 43, 45 (setting forth the frequency and notice requirements for shareholders' general assemblies).

52. GIDE L. NOUEL, LEGAL ASPECTS OF DOING BUSINESS IN UKRAINE 15 (2007), http://www.gide.com/front/EN/telechargement/pdf/bureaux/GLN_KIEV_DoingBusinessin Ukraine_Mar2007.pdf.

53. PRICE WATERHOUSE COOPERS, DOING BUSINESS AND INVESTING IN UKRAINE 24 (2007), *available at* http://www.pwc.com/extweb/pwcpublications.nsf/docid/975CF16F2D 406D9180257045004291BA.

54. *Id.*

Much like U.S. LLCs, the Ukrainian LLC has limited liability for the members up to the value of their capital contribution, and much like a U.S. partnership, ownership interests give rise to contractual rights as specified in the founding documents of the LLC.[55]

C. New Law on Joint Stock Companies

Corporate law prior to the new law was seen as overly burdensome to smaller closed joint stock companies due to provisions such as the lengthy procedures required for a general meeting of shareholders and the difficulty in converting shareholder loans into company equity. The new law is considerably more shareholder-friendly, offering simplified corporate procedures in joint stock companies with one shareholder. In such circumstances the shareholder can adopt resolutions by polling rather than convening a general meeting, vote on the issuance of shares and approval of the joint stock company's internal regulations, and seek a buyout by other parties.[56]

Other significant changes provide greater protections to joint stock company shareholders, particularly those working with local Ukrainian partners. Examples of such protections include:[57]

- The founders of a joint stock company will be required to pay the full value (not 50%, as provided by the previous law) of initially issued shares before convening the founding meeting of a joint stock company.
- A unanimous vote of all founders (rather than three-quarters vote) is required for adopting resolutions on establishing the joint stock company and on approval of the charter.

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55. *See id.*; Andrey Smityukh, *A Brief Legal Description of the Most Common Commercial Companies in Ukraine*, YURIDICHESKAYA PRACTIKA, http://www.ukrainianlawfirms.com/areas/Corporate/ (last visited Mar. 1, 2009).

56. Khachaturyan, *supra* note 6.

57. *Id.*

- Only monetary dividends may be paid to shareholders (previous law provides that dividends may be either monetary or in kind).
- The shareholders' meeting now has exclusive control over all questions regarding the issuance of shares and approval of the joint stock company's internal regulations.
- The general meeting of shareholders is to be held in the city/town where a joint stock company is incorporated (previously such a meeting could be held at any place in Ukraine).
- Voting at the general meeting of shareholders of a joint stock company with more than 100 shareholders is to take place only by means of voting bulletins signed by a shareholder or a shareholder's proxy.

These provisions are not exhaustive but they do indicate how the new law seeks to reduce the potential for arbitrary actions detrimental to shareholders, particularly foreign ones. It is significant that not only the Ukraine business community but also the World Bank and the EU have urged approval of the law.[58]

D. Investment through Offshore Structures

For those investors leery of putting their money directly into a Ukrainian legal entity, offshore structures have provided measures of relief and stability that, despite the aforementioned recent improvements in the business code, are likely to continue to be used. In addition to avoiding the perceived uncertainty or onerous regulatory hurdles, investors using offshore vehicles are generally often searching for ways to minimize withholding tax and capital gains tax, as well as declare dividends without being penalized.[59] Ever keen to finding a country that can qualify

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58. *See World Bank Urges Yushchenko to Quickly Sign Joint Stock Company Law*, KYIV POST, Sept. 30, 2008, http://www.kyivpost.com/business/29998 (reporting that the World Bank Director for Ukraine, Belarus, and Moldova stated the World Bank supported the law); JOINT EVALUATION REPORT, *supra* note 36, at 4, 9.

59. *See generally* ARTHUR A. NITSEVYCH, WHY TO INVEST IN UKRAINE THROUGH CYPRUS? (2007), http://www.murs.com.ua/en/articles/why_to_invest_in_ua.pdf (noting Cyprus compares favorably with other offshore vehicles because of its tax incentives).

itself as both a tax incentive country and a country with significant economic, political, or other ties with Ukraine, European, and the United States, investors often invest in Ukraine through Cyprus, forming a Cypriot holding company for a Ukrainian entity.[60] Cyprus has signed numerous treaties and agreements with Ukraine that have allowed for continued and sustained growth between the two countries, and a new double tax treaty has been negotiated although it still waits approval by the Rada.[61] Investment through offshore entities has the added benefit for investors from common law jurisdictions in that they can choose to invest in a country following common law principles, such as Cyprus.

V. ENERGY SECTOR DEVELOPMENT

Once the impact of the current global financial crisis subsides, changes such as the new Joint Stock Company Law and the closer ties with the EU could well have a significant impact on accelerating the development of Ukraine's energy sector. Naftogaz Ukrayiny, the state oil and gas company, moves up to 80% of Russia's Europe-bound gas supplies, constituting a quarter of Europe's gas,[62] and Ukraine's pipelines carry 22% of Russia's oil exports.[63] As such, Ukraine occupies a strategic location for controlling gas shipments to Eastern Europe, as illustrated by the recent natural gas-related conflict between Russia and Ukraine.

In the fall of 2008 President Yushchenko sought emergency financing for Naftogaz to save it from defaulting on its debt which was created by buying expensive Russian natural gas and

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60. *See id.* at 2–3.

61. *See id.* tbl.1; Bob Reynolds, *Ukrainian parliament rejects new Cyprus double tax treaty*, INTERNATIONAL TAX REVIEW, June 23, 2008, *available at* http://www.internationaltaxreview.com/default.asp?Page=9&PUBid=210&ISS=24799&SID=708085 (noting that Cyprus and Ukraine negotiated a new double tax treaty to replace the 1982 treaty signed by the Soviet Union, which included Ukraine, but the Rada has yet to approve it).

62. *See* Dmitry Zhdannikov, *Gazprom sends new warning to EU over Ukraine deal*, REUTERS INDIA, Apr. 1, 2009, http://in.reuters.com/articlePrint?articleId=INL196502520090401.

63. Enerpub, Ukraine: Energy Profile, http://www.energypublisher.com/print.asp?idarticle=11203 (last visited Mar. 1, 2009).

reselling it at lower prices on the domestic market.[64] In January 2009, Russia's Gazprom cut off gas supplies to Naftogaz following a dispute concerning allegations by Russia that Ukraine had failed to make the timely payment of an invoice and that Ukraine has been siphoning for domestic use Russian gas meant for transshipment across Ukraine. Furthermore, the two countries fought about a proposed increase in the price of gas charged by Russia to Ukraine and the price of the transshipment of gas charged by Ukraine to Russia.[65] As the dispute dragged on, residents of some European nations saw gas supplies dwindle. While some nations, such as Italy, were affected only slightly by the reduction in supply,[66] other countries, such as Serbia, Bosnia and Bulgaria, saw large numbers of residents without heat in the cold of winter.[67] The standoff lasted from January 7 through January 20, when Russia again began supplying gas through Naftogaz's pipelines following the signing of a ten-year gas shipment agreement.[68]

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64. *See* Associated Press, *IMF Satisfied with Ukraine Loan Plan Amid Crisis*, KYIV POST, Dec. 12, 2008, http://www.kyivpost.com/nation/31918 (noting that Naftogaz is "crippled" by a $2.4 billion debt to Gazprom); Clifford Levy, *Ukraine: Leaders Patch up Rift*, N.Y. TIMES, Dec. 11, 2008, at A22 (noting that Ukraine has applied for a $16.5 billion loan from the IMF).

65. *See generally* David Jolly, *Effort to resolve gas crisis inches ahead*, INT'L HERALD TRIB., Jan. 8, 2009; Miriam Elder, *Behind the Russia-Ukraine Gas Conflict*, BUSINESSWEEK, Jan. 3, 2009, *available at* http://www.businessweek.com/globalbiz/content/jan2009/gb2009013_045451.htm?campaign_id=rss_daily.

66. Pierre Noël, *Beyond Dependence: How to Deal with Russian Gas,* EUR. COUNCIL ON FOREIGN RELS., Nov. 7, 2008, http://ecfr.3cdn.net/c2ab0bed62962b5479_ggm6banc4.pdf (demonstrating that Italy and Germany obtain less than fifteen percent of their energy supply in the form of gas from Russia); *FACTBOX: 18 Countries Affected by Russia-Ukraine Gas Row*, REUTERS UK, Jan. 10, 2009, http://uk.reuters.com/article/oilRpt/idUKL54629920090110 (noting that Italy has "several weeks" of gas reserves and quoting the CEO of oil and gas company Eni as stating that the gas dispute between Russia and Ukraine would not be a cause for concern for Italy regarding energy supplies); Enerpub, *supra* note 63.

67. The impact of the gas cuts was most painful in southeastern Europe, where hundreds of thousands of people in Serbia, Bosnia and Bulgaria were without heat." Jolly, *supra* note 65.

68. Alexander Osipovich, *Russia gas heads to Europe after Ukraine dispute ends*, AFP, Jan. 20, 2009, *available at* http://www.canada.com/Technology/story.html?id=1197478.

The natural gas dispute highlights the importance of Ukraine's energy sector to Europe. With a large portion of Russia's Europe-bound gas and oil supplies crossing Ukraine each year,[69] a decision by Ukraine to restrict access to its pipelines could cause significant harm to the other nations of Europe that rely on Russian gas supplies. Still, Ukraine is on balance an energy importer.[70] Part of the reason that Ukraine, with its vast energy potential, remains a net energy importer is that the government has been slow to adopt policies favorable to oil and gas exploration companies. Exploratory tracts are leased for a mere five years, a strong deterrent to major Western companies, and much of the geological data must be developed by the companies themselves, rather than assembled and divulged by the government.[71] Foreign investors are also hampered by a tariff system that subsidizes gas for individual consumers while leaving industrial consumers with the burden of full payment.[72] It is clear that in order to foster growth in the energy sector, the Ukrainian government must exhibit a willingness to adapt its policies to Western business realities that minimize regulations and red tape, encourage long-term investment, and provide for greater informational transparency.

Corporate joint venture entities are crucial to Ukraine's energy sector development, especially RosUkrEnergo, established in 2004 as a Swiss-registered monopoly joint venture between Russia's Gazprom and a consortium of Ukrainian investors operating through the Swiss entity, which serves as an intermediary between Gazprom and Naftogaz to facilitate natural gas exports to and through Ukraine.[73] Privatization of its refineries has also enabled Ukraine to secure additional oil

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69. Mathew Carr & Kateryna Choursina, *EU Will Judge Success of Gas Deal When Flows Resume*, BLOOMBERG, Jan. 18, 2008, http://www.bloomberg.com/apps/news?pid=20601072&sid=aRYTPhZ.Dzcg&refer=energy.

70. SIMON PIRANI, OXFORD INST. FOR ENERGY STUD., UKRAINE'S GAS SECTOR 11 (noting that Ukraine's energy imports account for 60.7% of its primary energy supply).

71. CRANE & LARRABEE, *supra* note 3, at 33.

72. *Id.* at 34.

73. *See* Rosukrenergo, Company History, http://www.rosukrenergo.ch/eng/pub/company/company_history.html; Catherine Belton, *U.S. to Investigate Gazprom's RosUkrEnergo*, ST. PETERSBURG TIMES, Apr. 25, 2006, *available at* http://www.sptimes.ru/index.php?action_id=2&story_id=17425.

supplies to meet domestic demand, attract funds for necessary renovation work, and boost utilization rates at its refineries.[74] Ukraine has six crude oil refineries, with a combined throughput capacity of approximately 880,000 barrels per day, although they are currently operating well below that level.[75] Ukraine has begun to achieve better results in securing sufficient crude oil supplies for its refineries by offering oil exporters in Russia and Kazakhstan a stake in the country's refineries.[76] Furthermore, Ukraine's government is intent on becoming a transit center for oil from the Caspian Sea region, potentially through the Odessa-Brody pipeline, which was completed in 2001 and extends from Ukraine's Black Sea port of Odessa northward to the city of Brody.[77] The pipeline was initially intended to carry oil northward through the Ukrainian system to Europe, but has largely remained dormant until the rise in oil prices in the summer of 2008 increased interest in the project.[78] Should the pipeline run in its originally intended direction from Odessa to Brody, then Ukraine would like to extend the pipeline from Brody to Plock in Poland, and then to Gdansk on the Baltic Sea. Azerbaijan, Georgia, Kazakhstan, Lithuania, Poland, and Ukraine signed a preliminary agreement in May 2007 to begin working on a multinational agreement for such a project.[79]

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74. EIA, *supra* note 23.
75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*

VI. CONCLUSION

In the short-term it is clear that Ukraine faces major economic, financial, and political challenges. The midterm outlook, however, should see a continuation of the economic growth and development experienced earlier in the decade. The country's membership in the WTO should stimulate exports, which should be further enhanced by the Free Trade Agreement with the EU. The country's population of forty-six million constitutes an attractive market, as well as an abundant and educated labor supply available at wages that are one-third of those in Eastern Europe.[80] Most especially, by bringing its corporate legal system up to date with global standards, Ukraine has enhanced its free market attractiveness to investors and encouraged the exploration and development of Ukraine's energy sector.

80. *See, e.g.*, MARTIN RAISER, WORLD BANK OFFICE, BELARUS, MOLDOVA, UKRAINE, ARE WAGES IN UKRAINE TOO LOW? AND WHAT COULD BE DONE TO INCREASE THEM? 4 (2007), http://siteresources.worldbank.org/UKRAINEEXTN/Resources/wages_in_ukraine_eng.pdf (noting that the average monthly Ukrainian wage in 2006 was $206, compared with $798 in Poland, and $410 in Romania); *Predicted Wages Will Affect only a Minority of Workers*, EUR. INDUS. RELATIONS ONLINE, http://www.eurofound.europa.eu/eiro/2007/01/articles/cz0701039i.htm (last visited Mar. 1, 2009) (stating that the average wage in the Czech Republic will reach €777 per month in 2007).