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Related party transactions and corporate groups : when Eastern Europe meets the West

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3. GENERAL FEATURES OF RPTs

3.1. THE CONCEPT OF A RELATED PARTY AS PROVIDED BY IAS 24

3.1.1. General features of the IASs

The meaning of an RPT varies depending on jurisdiction and what international standards apply. In company law, RPTs refer to transactions involving a party who has a link to a company's officers or shareholders and who is simultaneously transacting with that company.[491] As such, it is essential to understand what related parties are.

Though it is not completely unknown, the notion of a related party is relatively new to academic research and legislation. The national laws of a number of countries and various regional instruments include provisions that define what a related party is. EU law is no exception. In its definition of a related party, the Accounting Directive (which replaced the Fourth and the Seventh Council Directives) refers to the IASs as adopted by the IAS Regulation,[492] as did the SRD II Proposal,[493] which subsequently became the current SRD II.[494] These moves may be regarded as illustrative of the Commission's desire for uniform rules with a view to imposing consistent accounting standards.[495]

The IAS Regulation[496] to which the Accounting Directive and the SRD I refer, amended by a regulation from 2008,[497] by its nature is fully binding and directly applicable in all Member States, under the provisions of the TFEU.[498] The IAS Regulation (in its unchanged, original version) is also specified in the Annexes to the EU-Ukraine Association Agreement as an instrument that national laws should approximate.[499] Interestingly, this is a rare occasion where a regulation, despite its legally binding nature in the EU, does not automatically have direct effect. It has already been harmonized to an extent in Ukraine. The Law of Ukraine 'On Accounting and

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[491] For example, see: McCahery JA and Vermeulen EPM, 'Corporate Governance Crises and Related Party Transactions: A Post-Parmalat Agenda', 215; Mahtani U, 'An Analysis of Related-Party Transactions in India' Working Paper Series Wp No: 2017/01/Fn (Goa Institute Of Management, Poriem, Sattari, Goa 403505), available at: https://wwwgimacin/newpdfs/Related-party-transactions-Group-and-Non-Group-Company-Perspective-Jan2017pdf <http://www.iimb.ernet.in/sites/default/files/WP%20No.%20402_0.pdf>, accessed on 6 December 2018, 1.

[492] Accounting Directive, 27.

[493] Proposal for a Directive of the European Parliament and Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regard certain elements of the corporate governance statement, COM (2014) 213 final 2014/0121 (COD), 9.4.2014, 17.

[494] Directive 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement [2017] OJ L 132/1, 20.5.2017.

[495] Regulation (EC) No. 1606/2002 of the European Parliament and the Council of 19 July 2002 on the application of international accounting standards [2002] OJ L 243, 11.9.2002, recital 5.

[496] Grundmann S and Glasow F, *European Company Law: Organization, Finance and Capital Markets* (2nd edition edn, Intersentia 2012), 427.

[497] Regulation (EC) No. 297/2008 of the European Parliament and the Council of 11 March 2008 amending Regulation (EC) No. 1606/2002 of the European Parliament and the Council of 19 July 2002 on the application of international accounting standards [2002] OJ L 97/62, 9.4.2008.

[498] Treaty on the Functioning of the European Union [2012] OJ C 326/47, 26.10.2012, Article 288.

[499] Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part [2014] OJ L 161/3, Annex XXXV.

Financial Reporting in Ukraine' establishes that enterprises with a public interest, public JSCs, enterprises extracting commercial minerals and enterprises designated by the Cabinet of Ministers of Ukraine[500] must prepare their separate and consolidated financial statements in accordance with officially published international standards that are not incompatible with the national laws of Ukraine. Other companies have only a right, rather than a duty, to do so.[501]

The IAS Regulation itself does not define the accounting standards. Rather, it outlines the framework within which the IASs are to be applied. Companies whose shares have been admitted to trade on the regulated markets in the EU are primarily subject to the duty to prepare their consolidated financial statements using the IASs.[502] For other companies, i.e. companies whose securities are not traded on the regulated markets of EU Member States or companies that do not qualify as groups of companies, the Member States have the discretionary power to permit or require use of the IASs. Accordingly, listed companies – even the ones that are part of a group – may be permitted or required to also apply the standards in their financial statements. For other companies, Member States may opt for use of the IASs and IFRS in consolidated financial statements, separate financial statements, or both.[503] Member States have reacted to this option in a variety of ways. Of the jurisdictions in the focus, Germany, Poland and the Netherlands in general have refrained from making the use of the IFRSs obligatory. Only Germany mandates the use of standards for consolidated financial statements for non-listed companies, and Poland for banks. However, each of these three Member States generally allows application of the IASs with some national features. In Germany, annual financial statements must be prepared according to both national GAAP and international standards. In Poland, non-listed companies are allowed to prepare their financial statements according to the IASs and the IFRSs only if they have applied for admission to trade on a regulated market. In the Netherlands, where both separate and consolidated financial statements may follow international standards, the only exception (i.e. where companies are not permitted to use those standards for their financial statements) is for consolidated financial statements prepared under national law.[504] In general, these Member States have introduced largely discretionary regimes for application of the IASs by entities that do not include listed public companies. This is especially true for the Netherlands.[505]

In Ukraine, the use of the IASs goes further than the requirements under the IAS Regulation. When the JSC Law of Ukraine was first adopted in 2008, it provided for a change in the Law of Ukraine 'On Securities and Stock Market'. All public JSCs were obliged to disclose information about their activities on the basis of the IASs.[506] Later, in 2011, the Parliament amended the Law of Ukraine 'On Accounting and Financial Reporting in Ukraine'. The effect of the IASs was extended to include not only public JSCs, but also banks, insurers and some other business forms, as established by the Cabinet of Ministers of Ukraine.[507] In the Member States discussed above, conversely, the rules are less imperative: for instance, companies rendering

[500] Those other companies that are required to submit financial statements according to international standards are listed in the Order for Submission of Financial Reports, as approved by the Cabinet of Ministers of Ukraine (Resolution No. 419 of 28 February 2000), including credit unions and companies providing financial services.
[501] Law of Ukraine 'On Accounting and Financial Reporting in Ukraine' [Закон України 'Про бухгалтерський облік та фінансову звітність'] of 08 October 1999, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 1999, No. 40, St. 365, Art. 12-1(2,3).
[502] IAS Regulation, Articles 1, 4.
[503] Ibid, Articles 5.
[504] 'Use of options of the IAS Regulation by Member States [table]' (*http://ec.europa.eu/finance/company-reporting/docs/legal_framework/20140718-ias-use-of-options_en.pdf*, 2014).
[505] *Report from the Commission to the Council and the European Parliament on the operation of Regulation (EC) No. 1606/2002 of 19 July 2002 on the application of international accounting standards* (COM(2008) 215 final, 2442008, 2008), 3.
[506] Law of Ukraine 'On Securities and Stock Market' [Закон України 'Про цінні папери та фондовий ринок'], Article 40(6).
[507] For example credit unions, as provided by the Order for Submission of Financial Reports, approved by the Cabinet of Ministers of Ukraine (Resolution No. 419 of 28 February 2000), paragraph 2.

financial services (such as credit unions) do not fall within the scope of these mandatory rules. These moves by the Ukrainian legislature were already regarded as overly inclusive. For some companies that are not inherently public, the cost of preparing financial statements in accordance with international standards is too high (as much USD 50,000 in some cases).[508] On 1 January 2018, Ukraine introduced new rules: banks and insurers were excused from the duty to apply the IASs, while enterprises with public interest and enterprises extracting commercial minerals were added to the group of companies that must prepare their financial statements based on the IASs.[509]

3.1.2. The concept of a related party according to IAS 24

The specific definition of a related party is found in IAS 24, which is available in the annex to the Commission Regulation No. 1126/2008. That annex was updated in Commission Regulation (EU) 632/2010, bringing forward the most recent version of IAS 24 to supersede its 2003 version.[510]

In paragraph 9, IAS 24 defines a related party as a person or entity that is related to the entity preparing its financial statements ('the reporting entity'). The core meaning of a related party, as provided in IAS 24, is therefore concerned with a direct or indirect connection to the reporting entity. Two basic criteria are applied for identifying a related party in IAS 24.9: it is either a person[511] (a) or a legal entity (b).

On the subject of categories of individuals as indicated in IAS 24.9, paragraph (a) covers three types of persons: (i) those having control or joint control over the reporting entity; (ii) those having significant influence over the reporting entity, and (iii) members of the key management personnel of a reporting entity or of a parent of a reporting entity. A close member of the person's family is also regarded as a related party, even if he or she has no direct connection to the reporting entity.

Despite being detailed and elaborate, IAS 24 does not add further detail for some of its stated notions, including the notions of 'control', 'significant influence', 'key management personnel' and 'close members of the family'. As each of these concepts could itself be the subject of a separate and complex study, the present thesis does not discuss them all in detail.

3.1.3. Control, joint control, significant influence and key management personnel in IAS 24 and other sources of EU law

The first category of persons referred to in IAS 24 (category (i)) includes individuals who have control or joint control over the entity. Both control and joint control are explained in IAS 24: '*control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities*' and '*joint control is defined as the contractually agreed sharing of control over an economic activity*'.

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[508] Маренич Т, 'Запровадження міжнародних стандартів бухгалтерського обліку та фінансової звітності у вітчизняну практику' [2012] Економіка агропромислового комплексу 44, 47.

[509] Law of Ukraine 'On Accounting and Financial Reporting in Ukraine' [Закон України 'Про бухгалтерський облік та фінансову звітність'], Article 12-1(2,3).

[510] Commission Regulation (EU) No. 632/2010 of 19 July 2010 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standard (IAS) 24 and International Financial Reporting Standard (IFRS) 8 [2010] OJ L 186/1, 20.7.2010, Annex IAS 24, paragraph 29.

[511] The terminology of IAS 24 has been criticized by some authors (see Ungerer F, 40), as persons can refer to both natural and legal persons, whereas the meaning of a person in IAS 24 is restricted to natural persons only.

These definitions of control and joint control are too abstract to provide clear limits for the terms. This is where other legal sources can be helpful for a legal interpretation of IAS 24, which is not the only legal instrument to use the notion of control in European law, let alone the national laws of the Member States.

European soft law refers to control in Commission Recommendation 2005/162/EC, stating that independent non-executive or supervisory directors may not be controlling shareholders. Control there is defined by reference to the cases mentioned in Article 1(1) of the Seventh Council Directive.[512] A perusal of the Seventh Council Directive, which has already been repealed by the Accounting Directive[513] but is still in place for the purposes of the EU-Ukraine Association Agreement,[514] shows that the Seventh Council Directive uses qualitative, rather than quantitative, criteria.[515] Under the Seventh Council Directive, control means more than simply having a majority of the voting rights.[516] A shareholder in a company, even one with a minority stake, can also exercise control if he or she can appoint or remove a majority of the members of an administrative, management or supervisory body,[517] exercise dominant influence over the undertaking pursuant to a contract, memorandum or the articles of association,[518] have the majority of members of an administrative, management or supervisory body appointed based solely on the shareholder's voting[519] or exercise, either alone or in concert with other shareholders, control over a majority of the voting rights.[520] The idea behind the concept of control has not changed with the adoption of the Accounting Directive, with Article 1(1) of the Seventh Council Directive becoming Article 22(1) of the Accounting Directive. As a result, although control is based primarily on a majority of the voting rights in an undertaking, it may also have a contractual basis or be exercised even through a small shareholding.[521]

Like the Accounting Directive, SRD I similarly recognizes control and controlling shareholders.[522] Unlike the Accounting Directive, however, it does not clarify what they mean.

Another important piece of EU legislation that refers to control in companies is the Takeover Directive. According to that Directive, control is acquired by a natural person or an entity as a result of the acquisition of securities that directly or indirectly give him or her a specified percentage of the voting rights.[523] Here, the criteria are of a more quantitative nature compared with the criteria in the Accounting Directive. Based on the wording used in the Takeover Directive, the more securities a person acquires, the more control he or she obtains. From the perspective of the Takeover Directive, therefore, control is closely associated with share ownership.

Article 5(3) of the Takeover Directive goes on to state that the percentage of voting rights that confers control for the purposes of paragraph 1, and the method of its calculation, must be determined by the rules of the Member State in which the company has its registered office. This means that it is within the Member States' discretion to decide how to define control for the

[512] Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board [2005] OJ L 52/51, 25.2.2005, Annex II, 1(d).
[513] Accounting Directive, Article 52.
[514] Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part [2014] OJ L 161/3, Annex 35.
[515] Лукач І, *Теоретичні проблеми правового регулювання корпоративних відносин в Україні: [монографія]* (К.: Ліра-К 2015), 219.
[516] Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts [1983] OJ L 193, 18.7.83, Article 1(1)(a).
[517] Ibid, Article 1(1)(b).
[518] Ibid, Article 1(1)(c).
[519] Ibid, Article 1(1)(d)(aa).
[520] Ibid, Article 1(1)(d)(bb).
[521] Accounting Directive, recital 31.
[522] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies [2007] OJ L 184, 14.7.2007, Article 10.
[523] Takeover Directive, Article 5(1).

purposes of the takeover rules.[524] No universally applicable rule exists for determining control, and Member States can choose different strategies for determining how to define it. This inevitably leads to the types of control as outlined and described in exhaustive detail by Berle and Means in their celebrated work.[525]

To elaborate, Berle and Means identify five types of control: complete ownership control; majority ownership; legal device control without majority ownership; minority ownership; and management control.[526] Of these five types of control, two are not necessarily based on ownership: control through a legal device and management control. Legal devices used to exercise control as mentioned by Berle and Means include multiple voting rights, pyramid structures and control through trust.[527] Management control essentially refers to cases where ownership is separated from control, if a group of security holders own shares but exercise virtually no control due to their dispersed ownership.[528] This is a common feature of outsider systems more typical of the UK[529] and the US, and occurs less commonly in Continental Europe. On the mainland, family-owned firms and other blockholders are widespread, making regulation more insider or control-oriented.[530] High ownership concentration, which is typical of insider systems, is often coupled with an inactive market for control and low liquidity of capital markets.[531] For instance, the concentration of voting power in German companies has previously been described as extraordinarily high for 82 per cent of the officially listed German AGs. They are controlled by large blockholders with more than 25 per cent of the voting rights.[532] These figures may have changed as the dynamics of voting control evolve and offer more room for dispersed ownership, yet they are still accurate due to the presence of large family-owned firms and foundation-controlled companies.[533] Situations where the largest blockholder holds more than 25 per cent is particularly illustrative; they are known as 'working' control or, to apply the classification used by Berle and Means, cases of minority control where none of the shareholders have a majority of the voting rights and as a consequence the primary role is occupied by the largest shareholders.

The example of 'working' control is especially controversial in light of the requirement under the Takeover Directive that a minimum ownership threshold must be established to trigger the controlling shareholder's duty to make a bid, to protect the minority shareholders.[534] Taking into account that control in these circumstances should preferably be determined on a case-by-case basis, it would be impossible to strictly impose a specific minimum shareholding that would fit every imaginable scenario. At the same time, making control subject to interpretative actions of a

[524] Tomasz Regucki presented his comparative study of the various control mechanisms at the 6th CECL Conference in Warsaw, on 10 July 2016. Two basic approaches have been taken to these rules: defining a specific threshold for control, or applying qualitative criteria (de facto control). Both approaches have their advantages (clarity and certainty in the threshold approach, proper reflection of market dynamics in the qualitative approach) and disadvantages (the threshold approach essentially being detrimental to minority shareholders and not reflecting prevailing market conditions, and qualitative criteria not being sufficiently clear and possibly being to the detriment of majority shareholders).
[525] Berle A and Means G, 70-90.
[526] Ibid, 70.
[527] Ibid, 72-80.
[528] Becht M and Mayer C, 'Introduction', 1.
[529] Also described as a '*full divorce between ownership and control in a British obsession*' (see Searjeant G, 'Plc is Ready to Join Mutuals in Land of the Dodo' *Times* (21 April 2006)).
[530] Cheffins BR, *Corporate Ownership and Control: British Business Transformed* (Oxford University Press 2008), 5.
[531] Keong LC, 'The Corporate Governance Debate' in Low CK (ed), *Corporate Governance: an Asia-Pacific Critique* (Sweet & Maxwell Asia. Hong Kong [u.a.] 2002), 5.
[532] Becht M and Böhmer E, 'Voting Control in German Corporations' (2003) 23 International Review of Law and Economics 1, 26.
[533] Fleischer H, 'A Guide to German Company Law for International Lawyers: Distinctive Features, Particularities, Idiosyncracies' in Fleischer H, Hansen JL and Ringe W-G (eds), *German and Nordic Perspectives on Company Law and Capital Markets Law* (Mohr Siebeck 2015), 9.
[534] Takeover Directive, Article 5(1).

specific body is also impractical. Interpretation is sometimes an abusive exercise, and always a time-consuming practice. In addition, providing specific bodies with interpretative powers would not be conducive to legal certainty. That is why in these situations establishing an exact minimum shareholding required for control is a viable solution, though one that lacks universality. It would be even more ambiguous to have such a threshold established at the EU level, as share ownership could be structured differently at the national level. Consequently, despite everything, the current legislative provisions lead to a more balanced and fair legislative solution than if the issue were resolved by the EU authorities. When choosing the appropriate national model to implement Article 5 of the Takeover Directive, many Member States have opted for a 30 per cent control threshold, such as Germany[535] and the Netherlands,[536] while in Poland the threshold is 66 per cent of the voting rights.[537]

Regardless of how the legislature defines control, it is important to bear in mind that exercising de facto control does not necessarily require a person to have more than 30 per cent of the share capital or voting power. As has been noted, even a 2 per cent shareholding can confer control, if it is combined with other means of influence.[538] That is why the legal definitions of control that Member States have developed at the national level for the purposes of takeover regulation are not universally applicable in all circumstances. They have been designed specifically to deal with situations of mandatory bids, as described in Article 5 of the Takeover Directive. Using the ownership-based definition of control found in takeover laws for other means beyond Article 5 of the Takeover Directive would be taking matters too far. As evidenced by the case of Rockfeller, who exercised control with a 14.9 per cent shareholding only,[539] or by the provisions of the Accounting Directive that refer to 'contract-based' control, control is possible with less than the established percentage of shares.

While the Takeover Directive confers on Member States the power to take legislative steps to clarify the meaning of control in terms of Article 5, IAS 24 does not make any explicit reference to the national laws of the Member States. Rather, it presents its own vision of 'control', 'significant influence' and 'key management personnel'. To better understand the meaning of these concepts, the definitions of 'control' and 'joint control' must be compared with the definitions of 'significant influence' and 'key management personnel'. Although both 'control' and 'significant influence' constitute power, the main difference between them from the perspective of IAS 24 is that control is about the power to govern an entity's financial and operating policies, while significant influence refers to the power to participate in those policies. Significant influence may be based on share ownership, statute or agreement. Although the definitions of 'control' and 'significant influence' lack clarity and are subject to further interpretation, it can be concluded from these definitions that 'control' provides for potentially stronger ties between a related party and a reporting entity, with correspondingly more power. In turn, 'significant influence' has a more differentiated basis, including share ownership, as well as statute and agreements.[540]

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[535] Beinert D, Burmeister F and Tries H-J, 67.

[536] De Brauw C, Groothuis L and Stevens R, *The Netherland Takeover Guide, available at: https://www.ibanet.org/Document/Default.aspx?DocumentUid=8E6BF591-D567-4594-BC81-00E0BA83AF39* (2014), 3.

[537] Andenæs MT and Wooldridge F, *European Comparative Company Law* (Cambridge University Press 2009), 512.

[538] *Groups of Companies in European Laws*, vol 2 (Hopt KJ ed, de Gruyter 1982), 249.

[539] Berle A and Means G, 82-84.

[540] Significant influence is treated on the same footing as the relationships between the entity and key management personnel, whereas control describes a closer relationship between a person and an entity (see also KPMG, *'First Impressions: Amendments to IAS 24 Related Party Disclosures', International Financial Reporting Standards, November 2009*. (Available at: https://home.kpmg.com/content/dam/kpmg/pdf/2010/01/First-Impressions-O-0911.pdf 2009), 10).

One possible source of confusion in the definition of significant influence, as compared with control and joint control, is that according to IAS 24 significant influence may be based on agreements. Conversely, the definition of control does not include any reference to a contractual basis. At the same time, excluding contract-based relationships from the scope of control would be contrary to the core of the concepts of control and joint control. In Germany, the fact that control may similarly be based on agreements stems directly from Article 317 of the AktG, which explicitly provides for the possibility to enter into controlling agreements that allow the controlling enterprise to issue instructions to the subordinate company.[541] It is therefore reasonable to consider that control and joint control may be based not only on share ownership, as stated narrowly in the Takeover Directive, but also on contractual arrangements and the entity's articles of association.

Key management personnel, also identified in IAS 24 as a type of related party, are those persons who have authority and responsibility for planning, directing and controlling the entity's activities, whether directly or indirectly, including any director (whether executive or otherwise) of that entity. This definition in IAS 24 mainly covers the management boards of companies, as is evident from the very name given to this group of related parties. Whether this group also extends to members of supervisory boards as used in the jurisdictions in focus (Germany and Poland enjoy the two-tier system,[542] and the Netherlands has a hybrid system of corporate governance, established after the recent 2013 amendments of corporate laws, which provides for an optional basis in the entity's articles of association[543]) is also subject to interpretation. The broad concepts of 'direct and indirect' 'direction and control of the entity's activities' do not stand in the way of them being regarded as related parties in relationships with the company.[544] Moreover, it is commonly accepted that members of management and supervisory boards should be recognized as related parties for the company. This is rooted in the provisions of the CGCs as used in Germany and the Netherlands.[545] A supervisory board member cannot be equated with the board as a separate body in a company. For this reason, it makes sense to regard transactions between a company and a member of its supervisory board as RPTs. In this respect, IAS 24 is somewhat at odds with IAS 28. The latter standard interprets representation on the board of directors or equivalent governing body of the investee as evidence of significant influence, rather than participating in an entity's key management personnel.[546] Although it has little practical significance, this difference in interpretation does not make the IASs any more helpful.

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[541] Frommel SN and Bonn A, *Company Law in Europe* (Kluwer Academic Publishers 1975), 263.

[542] Teichmann C and Gurman O, 'Directors' Remuneration in Germany' in Van der Elst C (ed), *Executive Directors' Remuneration in Comparative Corporate Perspective*, vol 11 (Kluwer Law International 2015), 174; Radwan A and Regucki T, 'Legal Aspects of Executive Remuneration in Polish Listed Companies' in Van der Elst C (ed), *Executive Directors' Remuneration in Comparative Corporate Perspective*, vol 11 (Kluwer Law International 2015), 301.

[543] Lafarre A and Van der Elst C, 'Executive Pay and Say-on-Pay in the Netherlands' in Van der Elst C (ed), *Executive Directors' Remuneration in Comparative Corporate Perspective*, vol 11 (Kluwer Law International 2015), 208-209.

[544] However, IAS 24 also expressly states that legal entities that have the same persons in key management positions are not necessarily related parties. The reasoning might be that these persons are sometimes retired politicians, civil servants or celebrities serving on multiple boards at the same time (Putra LD, 'Related Party Transaction Disclosures [IAS 24]' (*Accounting, financial and tax, available at: http://accounting-financial-tax.com/*, April 2009) <http://accounting-financial-tax.com/2009/04/related-party-transaction-disclosures-ias-24/>, accessed on 25 July 2016).

[545] German Corporate Governance Code (Deutscher Corporate Governance Kodex), as amended on 5 May 2015; The Dutch corporate governance code, Principles of good governance and best practices provisions, 9 December 2003.

[546] International Accounting Standard 28 Investments in Associates, as adopted by Commission Regulation (EC) No. 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council [2008] OJ L 320/1, 29.11.2008, paragraph 7.

3.1.4. IAS 24 on legal entities as related parties

While IAS 24's rules governing natural persons as related parties concern three types of relationships that give grounds to regard parties as related, the analysis of the IAS 24 provisions for legal entities in category (b) as related parties is more complicated.

First, related parties as described in IAS 24 should not be confused with related companies, the term that some countries use for groups of companies.[547] Although IAS 24 largely deals with groups by referring to their constituent companies as related parties,[548] groups as such are not the only participants identified by IAS 24. Besides groups and their members,[549] IAS 24 also deals with individuals, their close family members[550] and legal entities related to each other through non-group links.

In addition to 'control', 'significant influence' and 'key management personnel' in relationships involving legal entities, IAS 24 also refers to the notions of 'associate' and 'joint venture'. Based on the provisions of IAS 24, legal entities are considered to be related if one is an associate or a joint venture of another.[551] Legal entities are also viewed as being related if two entities are joint ventures of a third party,[552] or if one entity is an associate of a third party while another one is a joint venture of that same third party.[553]

While IAS 24 refers to the notions of 'control', 'significant influence' and 'key management personnel', it does not address these terms in detail. Their meaning is mostly explained in other relevant standards, to which IAS 24 itself also makes reference.[554] IAS 31 'Interests in Joint Ventures'[555] defines a joint venture is defined as a contractual arrangement, whereby two or more parties undertake an economic activity that is subject to joint control.[556] The definition of an associate is given in IAS 28 'Investments in Associates and Joint Ventures',[557] regarding it as an entity over which the investor has significant influence. In other words, while in a joint venture two parties exercise joint control through contractual arrangements, the relationship between an associate and an investor is one of significant influence, which is less serious and stringent than joint control. This means that 'joint venture' and 'associate' are mutually exclusive notions, reflecting a stronger connection between legal entities or 'merely' significant influence, respectively. In light of IAS 28, significant influence is interpreted as meaning, among other scenarios, 20 per cent or more of the voting rights in the investee.[558] This does not necessarily mean that a person with less than 20 per cent of the voting rights cannot have significant influence,

[547] Chong S and Dean G, 'Related Party Transactions - a Preliminary Evaluation of Sfas-57 and Ias-24 Using 4 Case Studies' (1985) 21 Abacus-J Account Bus 84, 86.
[548] International Accounting Standard 24 Related Party Disclosures, as adopted by Commission Regulation (EU) No. 632/2010 of 19 July 2010 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standard (IAS) 24 and International Financial Reporting Standard (IFRS) 8 [2010] OJ L 186/1, 20.7.2010, paragraph 9(b)(i).
[549] Chapter 4 examines groups and RPTs more closely.
[550] See section 3.2.
[551] IAS 24, paragraph 9(b)(ii).
[552] Ibid, paragraph 9(b)(iii).
[553] Ibid, paragraph 9(b)(iv).
[554] Ibid, paragraph 15.
[555] Its more recent version is given shape in International Financial Reporting Standard (IFRS) 11.
[556] International Accounting Standard 31 Interests in Joint Ventures, as adopted by Commission Regulation (EC) No. 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No. 1606/2002 of the European Parliament and of the Council [2008] OJ L 320/1, 29.11.2008, paragraph 3.
[557] IAS 28 Investments in Associates, paragraph 2.
[558] Ibid, paragraph 8.

however: IAS 28 establishes other factors besides voting power that can lead to significant influence.[559]

An analysis of subparagraph (ii) of paragraph 9 of IAS 24 justifies the conclusion that both the reporting entity and the legal entity in a relationship of 'control', 'joint control' or 'significant influence' are related parties. Entities that are 'associates' or 'joint ventures' are also regarded as related parties. This is an example of the principle of symmetry in action: if A is related to B for the purposes of B's financial statements, then A is also related to B in A's financial statements.[560]

For parties to be treated as related, it matters little whether the direct link between them is one of 'control' or one of 'significant influence'. However, the practical value of this distinction is obvious where paragraphs (iii), (iv), (vi) and (vii) describe situations where the link between two entities is indirect.

Firstly, in situations where a third party exercises joint control over two entities, or even joint control over one entity and significant influence over another, those two entities are regarded as being related. Yet the same does not hold true in the case of two entities that are significantly influenced by a third party, i.e. two entities that are both associates of a third.[561]

Secondly, if a natural person exercises control or joint control over two entities, or joint control over one entity and significant influence over another, or controls one entity (singly or jointly) while also being a member of the key management personnel of another, those two entities are considered to be related. Again, however, if the same natural person is only a member of the key management personnel of the two entities or exercises significant influence over them both, those two entities are not related parties.[562]

It can be concluded from the above that if the distance between two parties constitutes two or more 'significant influences' or 'key management personnel' relationships, the parties are usually not related for the purposes of IAS 24. However, indirect relationships with control or joint control in one leg result in related parties.[563] That was not the case under the IASs in the 2003 edition, which included a provision that, if a member of key management personnel is in a relationship of 'significant influence' with one entity, and a close relative has significant influence over another entity, those two entities were related, as opposed to two entities under the significant influence of a corporate investor.[564] This discrepancy was changed in the current 2009 version of IAS 24, where members of key management personnel are regarded together with their close family members as one person.[565] They are treated similarly to groups of companies and members of such groups,[566] meaning that every transaction between a reporting entity and a close relative of a member of its key management personnel is treated as if it were a transaction between the reporting entity and the member of its key management personnel. Under the current rules, if a member of one entity's key management personnel significantly influences another entity, those entities are not regarded as being related.

It has also been claimed that IAS 24 (2009 version) has a greater scope than its previous versions, with the elimination of the previous asymmetry in indirect relationships. For instance, from the perspective of an entity under the significant influence of an investor in another entity, they were related parties, while from the perspective of the investee the first entity was not

[559] Ungerer F, 151.
[560] KPMG, *'First Impressions: Amendments to IAS 24 Related Party Disclosures'*, 4.
[561] Nevertheless, two venturers exercising joint control over one entity are deemed not be related (IAS 24, paragraph 11(b)).
[562] Ibid, paragraph 11(a).
[563] KPMG, *'First Impressions: Amendments to IAS 24 Related Party Disclosures'*, 13.
[564] Ibid, 12.
[565] IAS 24, paragraph 9.
[566] Ibid, paragraph 9(b)(i)(ii).

related.[567] With the removal of this asymmetry, some entities became obliged to comply with the reporting requirements. While this certainly does not alter the fact that the changes mean that some entities no longer fall under the reporting requirements of IAS 24, as noted above,[568] in general this removal has only added to the list of potential related parties triggering duties of reporting entities and expanded the definition of a related party.[569] Though seemingly fair, the new rules have created some reporting difficulties for investees. They might not always be aware of other entities in which the investor has significant influence and the need to report properly on entities as related parties. The investor will have to share the legally relevant information with the investee, to ensure that the latter can comply with its reporting obligations.[570]

Another issue that has merged in the literature on the topic is whether IAS 24 should be applied to relationships between unrelated parties. As suggested by Chong and Dean, '*accountants should be concerned about all non-arm's length transactions and not merely RPTs*'. The authors consider it more reasonable for IAS 24 to encompass '*non-arm's length transactions between unrelated parties in addition to those between related parties*'.[571] Their concern is understandable, as stakeholders are more worried about whether the transaction is on market terms than whether it is with a related party. However, the drafters of IAS 24 clearly preferred to omit transactions with unrelated parties from its scope, explaining this by admitting that '*transactions between related parties may not be made at the same amounts as between unrelated parties*'.[572] It is difficult to disagree with this statement. Besides the fact that transactions with unrelated parties are not numerous, other apparent reasons exist not to use them so widely. The introduction to IAS 24 for transactions with unrelated parties undoubtedly poses challenges for accountants. These types of disclosures require creative professional valuation and the need for detailed disclosure criteria, and the requirements of legal certainty are clearly neglected in favour of extended and arguably more transparent disclosure. The scope of disclosure of RPTs is discussed in Chapter 5 of this thesis.

3.2. THE CONCEPT OF A RELATED PARTY IN CGCs

Both Germany and the Netherlands have CGCs that prescribe rules for conflicts of interest. They cover RPTs where a member of either the management board or the supervisory board is a related party, rather than transactions between a company and its shareholders. They also address persons close to or affiliated with management or supervisory board members.

The general rule contained in the current German CGC requires all transactions between an enterprise and the members of its management board and their related parties[573] to comply with standards customary in the sector.[574] Those provisions have been removed in the 2019 German CGC,[575] which has not yet become effective, however.

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[567] KPMG, *'First Impressions: Amendments to IAS 24 Related Party Disclosures'*, 1, 8.
[568] Under the IAS 24 (2009 version) two entities are not related by the mere fact that one entity's member of key management personnel has a close family member exercising significant influence over another entity.
[569] *Endorsement of the 2009 Revised IAS 24 Related Party Disclosures, Introduction, Background and Conclusions* (European Commission, Brussels, 4 February 2010, MARKT F3, 2010), 2.
[570] However, this investor's duty is of a moral nature and is not based on legally binding provisions.
[571] Chong S and Dean G, 96.
[572] IAS 24, paragraph 6.
[573] The previous version of the CGC used a different wording: instead of 'related parties' the CGC referred to '*persons that are close to or companies they have a personal association with*'.
[574] German CGC, as amended on 7 February 2017, § 4.3.3.
[575] German CGC 2019, section E.

Although the suggestion has been put forward that persons connected to management board members are not covered by the CGC,[576] the rules in the 2017 version do not exclude transactions with those parties from regulation. The regulation of parties connected to the management board differs in that managers still have more obligations than their related parties. For instance, they are required to disclose conflicts of interest to the supervisory board without delay and to inform other members of the management board accordingly. What the 2017 version of the German CGC lacks is a list of persons understood to be related parties or, in the wording of the CGC's earlier version, persons close to the members of the management board. This provision is therefore subject to interpretation.

Surprisingly, with the rules for conflicts of interest of supervisory board members, the 2017 version of the German CGC does not require transactions with persons who are not members of the supervisory board, but who are related parties or, to use older terminology: persons connected to them or companies with which they have a personal association, to comply with the standards customary in the sector[577] – despite the fact that transactions between a company and members of its supervisory board or their related parties could pose greater risks for the company. However, the AktG contains a provision stating that, where a supervisory board member enters into a contract with the company to provide professional services, in addition to his or her role on the supervisory board, the company must be represented by the entire supervisory board in its dealing with that member.[578]

While the current 2017 version of the German CGC requires important transactions where management board members are related parties to be approved by the supervisory board,[579] the Dutch CGC (2016 version) provides for different regulations. The Dutch CGC specifies for both management and supervisory board members that decisions to enter into transactions involving conflicts of interest, including RPTs, are always subject to supervisory board approval if they are of material significance to the company or to the relevant management board member.[580] However, the Dutch CGC has the same rule for supervisory board members,[581] unlike the 2017 version of the German CGC, as noted above.

Another difference between the two CGCs lies in the provisions of the Dutch CGC specifying a list of related parties that are regarded as presenting a conflict of interest for management. The German CGC does not contain a similar rule. According to the Dutch CGC, a conflict of interest arises if a company intends to enter into transaction with a legal entity (a) in which a management or a supervisory board member has a personal material financial interest; or (b) that has a management or supervisory board member who has a relationship under family law with a management or supervisory board member of the company.[582] Additionally, the Dutch CGC prohibits members of management and supervisory boards from demanding or accepting gifts of any substance from other companies. They are also not permitted to take advantage of business opportunities falling to their company for themselves or a spouse, registered partner or other life companion, foster child or relative by blood or marriage in the first or second degree.[583]

The rules described above bring this analysis back to IAS 24, which provides the definition of a person close to a related person. IAS 24 defines them as including all family members who may be expected to influence, or to be influenced by, that person in their dealings with the entity and include: (a) the person's children and spouse or domestic partner; (b) children of the person's

[576] McCahery JA and Vermeulen EPM, 'Corporate Governance Crises and Related Party Transactions: A Post-Parmalat Agenda', 238.
[577] German CGC, as amended on 7 February 2017, § 5.5.
[578] AktG, Article 114.
[579] German CGC, as amended on 7 February 2017, § 4.3.4.
[580] Dutch CGC, section 2.7.4 (§ II.3 in the previous version).
[581] Ibid, section 2.7.4 (§ III.6 in the previous version).
[582] Ibid, section 2.7.3 (§ II.3.2 in the previous version).
[583] Ibid, section 2.7.1 (ii) (§ II.3.1(b)(d) in the previous version).

spouse or domestic partner; and (c) dependents of the person or the person's spouse or domestic partner.[584]

Interestingly, here the Dutch CGC provides more extensive rules to cover related parties. Besides the difference in terminology for the person's partners ('*spouse, registered partner or other life companion*' in the Dutch CGC and '*dependents …, spouse or domestic partner*' in IAS 24), the Dutch CGC also ascribes the status of a related party to 'relatives by blood or marriage in the first or second degree'. This means that the following categories are also regarded as related parties: (i) the person's grandchildren, (ii) the person's grandparents, (iii) the spouses of the person's children and (iv) the parents of the person's spouse.[585] In spite of the fact IAS 24 contains a long list of related parties defined in vague and broad terms,[586] subject to additional interpretation by lawyers and accountants,[587] here the drafters of IAS 24 left a gap. As a result, transactions between a reporting entity and, for instance, the grandfather of a management board member will not fall under the scope of the standard, unless of course the grandfather is established to have control or significant influence over the reporting entity. It would be wrong to overstate the effect of this prohibition in the Dutch CGC:[588] as noted above, it is confined to transactions involving transfers of substantial gifts and business opportunities. Nevertheless, the difference is not so minor that it should go unnoticed. The gap in IAS 24 could be filled by the flexible rule focusing on the substance of the related party relationship, rather than on its form.[589] Interpreted broadly, this rule would allow for a sensible application of the regulations for close relatives, which would then include more than only the relatives explicitly stipulated in the standard: others who are not mentioned there but who nevertheless have close ties to the reporting entity, its shareholders or key management personnel would also be viewed as related parties. Arguably, grandparents, as second-degree relatives, could be covered by this flexible interpretation, although this flexibility does not improve clarity. Rather, it could force practitioners to analyze the substance of every single relationship between parties. For instance, a far degree of relatedness might not necessarily lead to exclusion from the rules on related parties: the person in question could have strong links to the company that also give rise to reporting obligations.

While both Germany and the Netherlands have unified single CGCs,[590] Poland uses the guidelines for companies whose securities are listed on stock exchanges. The Warsaw Stock Exchange has implemented the WSE Best Practice for WSE listed companies.[591] Like other CGCs, the WSE Best Practice employs the 'comply or explain' principle.[592]

The WSE Best Practice contains rules on conflicts of interest for members of both management and supervisory boards. Like the Dutch CGC, the WSE Best Practice requires significant agreements with related parties and also agreements with shareholders having 5 per

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[584] IAS 24, paragraph 9.
[585] Using the instructions for determining degrees of relatedness by marriage and blood, for example as described in Борисова В and Жилінкова І (eds), *Сімейне право України: підручник* (Second edn, Юрінком Інтер 2009), 64.
[586] The notions of 'control', 'significant influence' and 'key management personnel' are highly illustrative examples, and the fact that the word 'includes' is used for the list of close relatives means that other close relatives are also implied. Additionally, the cultural context might influence how a 'close relative' is interpreted, for example depending on cultural origins siblings might not be regarded as close relatives (Putra LD, 'Related Party Transaction Disclosures [IAS 24]').
[587] For example, in 2009 KPMG issued a report clarified some novelties of the revised IAS 24, namely pointed at the fact the disclosure asymmetry existing at that moment was removed (KPMG, *'First Impressions: Amendments to IAS 24 Related Party Disclosures'*).
[588] Dutch CGC, section 2.7.1 (ii) (§ II.3.1(b)(d) in the previous version).
[589] IAS 24, paragraph 10.
[590] Both Germany and the Netherlands are among the countries where reporting entities are required by law to show compliance with the CGC, as opposed to countries where the listing authority officially requires disclosure (see: Cuomo F, Mallin C and Zattoni A, 223).
[591] WSE Best Practice.
[592] Ibid, 2.

cent or more of the total voting rights in the company to be approved by the supervisory board.[593] The rule about the transactions with 5 per cent shareholders is a new addition in the current version of the WSE Best Practice – the previous version referred only to related parties.[594]

Although the terminology used in the WSE Best Practice differs from the German and the Dutch CGCs, the concept is the same: RPTs do not require approval in every situation. The approval requirements do not apply to typical transactions and transactions on market terms made between the company and members of its group in the course of the company's normal operations.[595] Similarly, the earlier version of the WSE Best Practice did not require supervisory board approval for typical transactions on market terms within the scope of a company's normal operations with a subsidiary in which the company held a majority stake.[596] Though not immediately apparent, the difference between the older and the current version seems significant. The current version does not require approval for all typical transactions. In the earlier version, typical transactions were exempted from the approval obligation only in parent-subsidiary relationships, as long as one company had a majority stake. This reflects a shift in the WSE Best Practice towards a more relaxed approach for listed companies.

The WSE Best Practice does not provide a detailed definition of a related party, instead referring simply to the IAS Regulation.[597] The previous WSE Best Practice followed the same approach. However, instead of referring directly to the IASs, it cited the relevant Regulation of the Minister of Finance, which in turn referred the reader to the IASs as approved by the IAS Regulation.[598]

Here the WSE Best Practice goes much further than the CGC currently in place in Germany. Related parties in the IASs are understood to include board members (and their close relatives) and persons having control or significant influence over the company, including shareholders with more than 20 per cent of the shares.[599] The WSE Best Practice contains a stricter threshold than 20 per cent, and introduces a 5 per cent share ownership threshold for approval of RPTs. This is also stricter than the 10 per cent shareholding threshold for supervisory board approval under the revised Dutch CGC.[600] This broad interpretation of related parties in the WSE Best Practice is perhaps the reason for some Polish companies to explicitly derogate from compliance with this rule: from their perspective, it presents an obstacle to the company's functioning, and many companies prefer to explain the reasons for derogation instead of complying with the rules.[601] This is in line with the comply-or-explain standard demanded by the WSE Best

[593] Ibid, section V.Z.5.
[594] Code of Best Practice for WSE Listed Companies (Dobre praktyki spółek notowanych na GPW), approved in 2007, amended and supplemented in 2010 and 2011, §§ II.3, III.9.
[595] WSE Best Practice, section V.Z.5.
[596] Code of Best Practice for WSE Listed Companies (Dobre praktyki spółek notowanych na GPW), approved in 2007, amended and supplemented in 2010 and 2011, §§ II.3.
[597] WSE Best Practice, 17.
[598] Regulation of the Minister of Finance on Current and Periodic Information Provided by Issuers of Securities and Conditions for Recognizing as Equivalent Information Required by the Laws of a Non-Member State [Rozporządzenie Ministra Finansów, w sprawie informacji bieżących i okresowych przekazywanych przez emitentów papierów wartościowych oraz warunków uznawania za równoważne informacji wymaganych przepisami prawa państwa niebędącego państwem członkowskim], as of 19 February 2009 (Dziennik Ustaw 2014.133 z dnia 28 stycznia 2014), section 1 § 2 paragraph 32.
[599] IAS 28 Investments in Associates, paragraph 8.
[600] Dutch CGC, section 2.7.5.
[601] In accordance with the comply-or-explain rule, the website of NEUCA S.A. lists all the instances where the company does not comply with the WSE's rules, and the accompanying reasons (available at: http://www.neuca.pl/en/investor-relations/legal_documents). To make it more appealing for investors, the company still emphasizes that transactions between the company and other subjects are scrutinized closely, and that it is compliant with the Company Income Tax. NEUCA S.A. is not unique in this: Asseco South Eastern Europe S.A.'s 2012 Report on Compliance for the Corporate Governance Standards stated that this condition is applied under § 13 sect. 12 item 24 of its Articles of Association (available at: https://asseco.com/see/assets/Uploads/investor-relations/Legal-environment/2013/en/Group-Asseco-SEE-Corporate-Governance-Report.pdf), while the business

Practice. At the same time, neither the WSE Best Practice nor the Dutch CGC cover ultimate beneficial owners, only shareholders. If shareholders are given a strict and narrow interpretation, it is not difficult to overcome the requirements. It is enough to 'not put all your eggs in the same basket', i.e. to establish multiple legal entities and acquire sufficient shareholdings through them. Those entities then exercise joint control even though each separate entity holds fewer shares than the established threshold.

The Ukrainian analogue to a CGC, despite lacking some features of the CGCs that apply in the jurisdictions in focus in this thesis,[602] is given shape in the Principles of Corporate Governance.[603] The Principles include a procedural safeguard for transactions involving conflicting interests.[604] If a transaction is formed that involves conflicting interests, the conflict must be disclosed and the transaction itself must be approved by the entity's supervisory board.[605] The CGCs discussed above prescribe the same mechanism for RPTs, which must obviously be regarded as falling under conflicts of interest. Unlike the CGCs discussed above, the Principles contain less clear-cut definitions and little clarification. They do not provide very much detail when explaining the nature of a conflict of interest. According to the Principles, a conflict of interest concerns a '*discrepancy between personal interests of an officer or its related parties and his/her official (professional) duties to act in the best interests of the company*'.[606] For instance, this may include '*a contract where an officer or his/her related party acts with the company as a contracting party, as a representative or an agent in the formation conclusion and performance of the contract, receives remuneration from the company or from a person who is a party under the contract, et cetera*'.[607] An analysis of these provisions of the Principles yields at least three observations.

Firstly, the Principles refer to only officers and their related parties as being capable of having conflicting interests. As in the German CGC (both the 2017 version and the new 2019 CGC), and unlike how this issue is resolved in the Dutch CGC and the WSE Best Practice, they make no mention whatsoever of shareholders.

Secondly, the Principles only mention related parties without offering any indication of how broadly that concept should be interpreted, and based on what criteria. It remains unclear whether related parties include officers' family members, and if so to what degree of relatedness, whether legal entities controlled, jointly controlled or significantly influenced by officers are also considered to be related parties and whether further clarification may be drawn from other sources such as the IASs or acts under national law.[608]

Thirdly, transactions involving conflicting interests include not only transactions where related parties are party, in the strict sense, to these transactions: they also cover transactions where parties act merely as representatives or agents, or receive remuneration from a party to a contract, meaning that transactions involving conflicts of interest include a broader list of transactions. They are not confined to RPTs only.[609]

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report of Synthos S.A. for the period from 01/01/2010 to 31/12/2010 (available at: https://synthosgroup.com/uploads/media/6zl-03-00496-11-ptl-sprawozdanie_z_dzia_alno_ci_synthos_sa__2010_v_5_pwc_spell_checked__2__mm_mw_ver_2_enx.pdf) explicitly specified that this principle was not, and would not, be applied, as the company's existing procedures and mechanisms were sufficient, and its supervisory board was authorized to oversee the company's functioning.

[602] See 2.3.3.

[603] Principles of Corporate Governance, approved by the Decision of the National Securities and Stock Market Commission of Ukraine of 22 July 2014, No. 955 [Принципи корпоративного управління, затверджені рішенням Національної комісії з цінних паперів та фондового ринку від 22 липня 2014 року № 955].

[604] Ibid, 1.3.3, 1.3.4.

[605] Ibid, section II, 3.3.2.

[606] Ibid, section III, 36.

[607] Ibid.

[608] Related parties as meant in the national laws of Ukraine are discussed more specifically in section 3.3.

[609] For more detail regarding the issues of conflicts of interest, see Chapter 2.

Lastly, a few comments must be made on how IAS 24 and the CGCs compare. Although IAS 24, in some respect, applies a narrower concept of related parties as opposed to some provisions of the Dutch CGC as referred to above, in general IAS 24 is more detailed than the CGCs and certainly clearer than the Ukrainian Principles of Corporate Governance in defining related parties. Besides natural persons as related parties, the concept also covers legal entities that are associated with the reporting entity via various forms of connection.

3.3. THE CONCEPT OF A RELATED PARTY UNDER UKRAINIAN LAW

3.3.1. General notion of a related party under Ukrainian company law

3.3.1.1. Introduction

No single act in Ukraine deals comprehensively with RPTs in all their aspects. This section provides an overview of legal regulation, with a further discussion of natural persons and legal entities as related parties in the two sections that follow.

3.3.1.2. Related parties in national accounting standards and the Tax Code of Ukraine

As has already been mentioned above, some companies incorporated under Ukrainian laws are required to prepare both separate and consolidated financial statements according to the IASs. These requirements are laid down in the Law of Ukraine 'On Accounting and Financial Reporting in Ukraine' and cover enterprises with a public interest, public JSCs, enterprises extracting commercial minerals and the enterprises designated by the Cabinet of Ministers of Ukraine.[610] The standards are considered to apply if they are not incompatible with the Law, and are officially published on the website of the central financial authority.[611] This includes IAS 24, an official translation of which is published on the website of the Ministry of Finance of Ukraine.[612]

In addition to the applicability of IAS 24, Ukraine also has national accounting standard 23 'Related Party Disclosures'.[613] As standard 23 provides, it is not applied in cases when the IASs apply, which means budgetary enterprises are also excluded.[614] National accounting standard 23 is largely based on the same principles as IAS 24, and outlines two main categories of related parties: legal entities and natural persons. It uses the same concepts as IAS 24, including control, significant influence reflecting 20 per cent or more of the voting rights in the investment object as

[610] Law of Ukraine 'On Accounting and Financial Reporting in Ukraine' [Закон України 'Про бухгалтерський облік та фінансову звітність'], Article 12-1(2,3).
[611] Ibid, Article 12-1(1).
[612] Міжнародний стандарт бухгалтерського обліку 24 «Розкриття інформації про зв'язані сторони» (official 2016 Ukrainian translation), available at: https://minfin.gov.ua/uploads/redactor/files/IAS%2024_ukr_2016.pdf, accessed on 28 December 2018.
[613] Accounting Provision (Standard) 23 'Related Party Disclosures', as approved by the order of the Ministry of Finance of Ukraine of 18 June 2001 No. 303 [Положення (стандарт) бухгалтерського обліку 23 "Розкриття інформації щодо пов'язаних сторін", затверджене наказом Міністерства фінансів України від 18 червня 2001 р. № 303], published in Ofitsiynyi visnyk Ukrayiny, 2001, No. 26, St. 1192.
[614] Ibid, paragraph 2.

defined by IAS 28,[615] key management personnel and close relatives. At the same time, standard 23 is not an exact copy of IAS 24. For instance, it makes no reference to the notion of joint control, offering instead the nebulous term of 'direct or indirect influence', so that entities are regarded as related if they exercise direct or indirect influence over the reporting entity. One basic element that both standards have in common is the prevalence of substance over form.

The concept of a related party is also defined in the Tax Code of Ukraine. The Tax Code was drafted to combat tax evasion and has a specifically taxation-oriented purpose. The tax-related definition of a related party refers to legal entities and/or natural persons with relationships that could influence the terms or economic results of their activities or the activities of persons whom they represent.[616] Being more abstract in nature, the definition is explained using specific criteria for legal entities and for natural persons, and joint criteria for both legal entities and natural persons. In general, parties can be regarded as being related in the following cases: if one party directly or indirectly owns 20 per cent or more of the shares in the other party; if one party has the authority to appoint either the one-person senior management, or at least 50 per cent of the collegiate senior management or supervisory board of the other party; or if one party has loaned or granted sums to the other party in amounts exceeding the latter party's authorized share capital by a multiple of 3.5 (for financial institutions: by a multiple of 10). These provisions in the Tax Code share much common ground with IAS 24 – in particular with regard to the minimum shareholding (20 per cent) necessary to establish a related party relationship. The exception is the financial support criterion, which is a unique feature of related parties under tax law. In addition, the Tax Code explains the difference between direct and indirect ownership, stipulating that the latter case involves shares owned by related parties.[617] Nevertheless, opinions are divided on whether these provisions in the Tax Code may be used to interpret the national accounting standards.

3.3.1.3. Interested persons and transactions with interest within the meaning of the JSC Law of Ukraine, the LLC Law of Ukraine and the Economic Code of Ukraine

Besides related parties, Ukrainian law also uses other notions, including the notions of interested and affiliated persons. Specifically, the JSC Law of Ukraine and the LLC Law of Ukraine both refer to the concept of a person with an interest in a transaction. Both laws contain rules providing for procedures, ex ante and ex post safeguards for transactions with interest formed between a company and an interested person; the difference lies in the legal effect. The rules under the LLC Law of Ukraine apply if shareholders so stipulate in the company's articles of association.[618] Despite their name, transactions with interest as stipulated in the JSC and LLC Laws of Ukraine do not extend to all transactions that might be of relevance to a company, and cover only agreements to which the company itself is a party. This means that transactions with interest are construed through interested persons transacting with a company.[619] For public companies, in order to establish a transaction with interest, it is not necessary for an interested person to actually transact with the company: an interested person can merely be a representative or a broker, or someone who draws a gain from the transaction.[620] For private companies, transactions with

[615] Клименко Я, 'Афілійовані особи: Походження терміну, критерії визначення й застосування у вітчизняній та міжнародній практиках' [2014] Наукові праці Кіровоградського національного технічного університету Економічні науки 215, 223.
[616] Tax Code of Ukraine [Податковий кодекс України] of 2 December 2010, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2011, No.No. 13-14, 15-16, 17, St. 112. sub-clause 14.1.159 clause 14.1 Article 14.
[617] Ibid, paragraphs 21-23, sub-clause 14.1.159 clause 14.1 Article 14.
[618] JSC Law of Ukraine, Article 71(1); LLC Law of Ukraine, Article 45(1).
[619] Боднар Т, 36.
[620] JSC Law of Ukraine, Article 71(3).

interest are worded differently, and include transactions with an interested person.[621] For these reasons, no obstacles preclude transactions with interest from being treated as purely RPTs in private companies.

The notion of an interested person in transactions with interest of public companies encompasses both natural persons and legal entities, and consists of three categories: (a) an officer of one of the bodies of the company, or affiliated persons; (b) a shareholder who singly or together with affiliated persons owns at least 25 per cent of the shares in the company, or affiliated persons; (c) a legal entity in which one of the persons defined at (a) or (b) is an officer. For private companies, interested persons are construed slightly differently, in that shareholders are regarded as interested persons if they hold 20 per cent or more of the company's share capital.

Taking into account these features of interested persons, it is also essential to understand the meaning of affiliated persons. The concept of an affiliated person as explained in the JSC Law of Ukraine[622] also applies in the case of private companies.[623] The following types of affiliated persons are identified: (a) two legal entities, where one is controlled by another or both are jointly controlled by a third party; (b) family members of a natural person – spouse, and parents (including adoptive parents), guardians, siblings, children and their spouses; (c) a natural person, with family members, and a legal entity, if the natural person and/or family members exercise control over the legal entity.

The key concept for a proper understanding of affiliated persons as meant in the JSC Law of Ukraine is 'control'. However, the concept is not actually defined in the act, but by reference to the Law of Ukraine 'On Protection of Economic Competition'.[624] It is defined as '*decisive influence of one or several related parties, legal entities or individuals exercised directly or through other parties*'.[625] The definition itself contains several notions that themselves are also subject to interpretation. That is why the importance of the examples of control listed in the law cannot be underestimated in providing clarity. They include, among other examples: possession or use of all or most of the company's assets; the power to decisively influence appointments, voting and decision-making by the company's management; a contract-based right to determine economic conditions or issue guidelines for the company; the right to replace the chair of the management or supervisory or another body of the company; and the right to occupy the majority of the seats on the senior management or supervisory boards or another body of the company.[626] It follows from these examples that control in the context of both the JSC Law of Ukraine and the Law of Ukraine 'On Protection of Economic Competition' has a greater scope than ownership of half of a company's share capital, and may be established by force of an agreement between a company and its related parties. The forms of contract that give effect to control also include leases, though it is doubtful whether such contract should be considered the appropriate device for establishing control. The lessee under a lease will not necessarily be in a position to exercise control. Quite the contrary: the lessee might be the weaker party in a contractual relationship if the terms of the contract are so negotiated.

The rules governing transactions with interest in the JSC and LLC Laws of Ukraine do not cover RPTs in state and municipal unitary enterprises, which are forms of business activity different from public and private companies. Since 2016, these types of enterprises have also been subject to rules for transactions with interest established by the legislative authority.[627] These

[621] LLC Law of Ukraine, Article 45(1).
[622] JSC Law of Ukraine, Article 1(1)(1).
[623] LLC Law of Ukraine, Article 42(9).
[624] Law of Ukraine 'On Protection of Economic Competition' [Закон України 'Про захист економічної конкуренції'] of 11 January 2001, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2001, No. 12, St. 64.
[625] Ibid, paragraph 4 Article 1.
[626] Ibid.
[627] Law of Ukraine 'On Amending Certain Legislative Acts on Management of State and Municipal Property' [Закон України 'Про внесення змін до деяких законодавчих актів щодо управління об'єктами державної та

newly established rules in the Economic Code of Ukraine differ fundamentally from the norms described in the JSC Law of Ukraine. The distinction is intrinsically linked to public share ownership. In state and municipal enterprises, the state and the municipality exercise their rights through the appropriate governmental or local authorities. It is then not to be wondered that, besides the officers of the actual enterprises, the Economic Code regards officials of ministries or other bodies exercising authority over the enterprises as being interested persons.[628]

In addition, the Economic Code of Ukraine does not refer to the concept of an affiliated person, instead replacing it by the significantly narrower term 'ultimate beneficiary'. The consequence is that other state and municipal enterprises are not considered to be interested persons. However, this narrow legislative wording has not protected it from being criticized in some quarters for imposing excessively onerous and complicated rules for RPTs on companies in the public sector.[629]

3.3.1.4. Interested persons in bankruptcy statute

Besides the JSC and LLC Laws of Ukraine, one other act makes reference to interested persons and transactions with interest: the Code of Ukraine on Bankruptcy Procedures,[630] which recently replaced the Law of Ukraine 'On Restoring a Debtor's Solvency or Recognising It Bankrupt'.[631] These acts use the notion of interested person in their regulations for transactions with interest and some bankruptcy-related procedures. Similarly to how the JSC Law of Ukraine approaches the issue of transactions with interest, the Code of Ukraine on Bankruptcy Procedures and the Law of Ukraine 'On Restoring a Debtor's Solvency or Recognising It Bankrupt' are based on the subject criterion and define transactions with interest as transactions involving interested persons on the part of the debtor, the bankruptcy trustee or the creditors.[632] Taking only the manner in which the definition is worded into consideration, transactions with interest should not be confined to agreements between the debtor and the debtor's interested persons. It would also be reasonable to extend it to transactions between various interested persons (besides the debtor). At the same time, the body of statute mostly handles transactions with interest by identifying the debtor as one of the parties – for instance, contracts that the debtor formed with interested persons during three years preceding the start of the bankruptcy proceedings may be annulled based on a complaint by a creditor or the bankruptcy trustee.[633] The previous law stipulated a similar rule for natural persons only – entrepreneurs – but with a shorter term of one year instead of three years.[634] That is why, although the definitions themselves are broad, transactions between the debtor's interested persons, not including the debtor, largely fall outside the legislator's scope of attention.

комунальної власності'] of 2 June 2016, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2016, No. 228, St. 533.

[628] Economic Code of Ukraine [Господарський кодекс України], Articles 73-1(2), 78-1(2).

[629] Поєдинок В, 'Новели корпоративного управління в державних підприємствах' (Адаптація корпоративного законодавства України до права Європейського Союзу: Збірник наукових праць за матеріалами Міжнародної науково-практичної конференції (30 вересня - 1 жовтня 2016 р, м Івано-Франківськ)), 185.

[630] Code of Ukraine on Bankruptcy Procedures [Кодекс України з процедур банкрутства] of 18 October 2018, published in Golos Ukrayiny, 20 April 2018, No. 77.

[631] Law of Ukraine 'On Restoring a Debtor's Solvency or Recognising It Bankrupt' [Закон України 'Про відновлення платоспроможності боржника або визнання його банкрутом'] of 14 May 1992, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 1992, No. 31, St. 440.

[632] Ibid, paragraph 12 Article 1(1); Code of Ukraine on Bankruptcy Procedures [Кодекс України з процедур банкрутства], paragraph 6 Article 1.

[633] Code of Ukraine on Bankruptcy Procedures [Кодекс України з процедур банкрутства], Article 42(2).

[634] Law of Ukraine 'On Restoring a Debtor's Solvency or Recognising It Bankrupt' [Закон України 'Про відновлення платоспроможності боржника або визнання його банкрутом'], Article 90(10).

The concept of interested person under the Code of Ukraine on Bankruptcy Procedures is much broader than that described in the JSC or LLC Laws of Ukraine. Interested persons on the part of the debtor are not limited to the debtor's relatives, officers of the debtor's bodies, parties controlling the debtor, parties controlled by the debtor or parties controlled by a third party that also controls the debtor. They include all founders and shareholders of the debtor (if the debtor is a legal entity), legal entities founded or owned by the debtor, and the debtor's chief accountant – both the current accountant and any chief accountant dismissed within three years leading up to the bankruptcy proceedings.[635] Most importantly, this list is not exhaustive, and if reasonable grounds exist to regard a particular person as an interested party then they are so considered.[636] This provision is reminiscent of the rules for indirect conflicts of interest in the Dutch BW,[637] which offer the courts freedom of interpretation to consider relationships as constituting conflicts of interest. Taking into account the vague criteria for defining interested persons, Ukrainian economic courts have the authority to elaborate on the existence of interested persons. This applies in situations where bankruptcy proceedings have been instituted against a debtor, and all transactions with interest that were formed within the three years leading up to the start of the proceedings may be declared null and void.[638] While the intentions of the legislators drafting these rules were arguably good, nonetheless little doubt exists that any company officer deciding whether to make an agreement faces serious interpretation uncertainties and runs the risk that the transaction might be challenged in the future. In these circumstances, the possibility to annul a transaction is not necessarily sufficiently commensurate to unclear and excessively broad criteria that form the basis of the definition of an interested person.

3.3.1.5. Concluding remarks on the general notion of a related party in Ukraine

Ukrainian laws do not use a single uniform definition of related parties, employing instead various different notions, including interested and affiliated persons, with different meanings depending on context and purpose. The notion most closely associated with company law is that of an interested person as used in the JSC Law of Ukraine, the LLC Law of Ukraine and the law governing bankruptcy proceedings. In turn, related parties are governed by accounting and tax law regulations.

Despite the attention given to the wording used, or the form that the concepts take, their substance is of greater concern. However, uniformity is similarly lacking in terms of the substance of the notions, and some legal scholars have expressed the opinion that these laws should be aligned more closely.[639]

Notwithstanding the fact that regulations under different laws serve different goals, proper grounds do not always exist for giving a single term multiple meanings, which can only create unpredictability and complication. An example where the difference between notions is not immediately obvious is the use of quantitative criteria for establishing degrees of share ownership. The JSC Law of Ukraine stipulates 25 per cent of the share capital as a requirement for qualification as an interested person in a transaction with interest.[640] Under the LLC Law of Ukraine, IAS 24 in conjunction with IAS 28 and the Tax Code of Ukraine, a person is considered to be a related party by holding a 20 per cent shareholding.[641] In light of the norms of the Tax Code

[635] The three-year term applies not only to accountants, but also to officers of the debtor's bodies.
[636] Code of Ukraine on Bankruptcy Procedures [Кодекс України з процедур банкрутства], paragraph 6 Article 1.
[637] See Chapter 2.
[638] Code of Ukraine on Bankruptcy Procedures [Кодекс України з процедур банкрутства], Article 42(2).
[639] Клименко Я, 224.
[640] JSC Law of Ukraine, Article 71(2)(2).
[641] LLC Law of Ukraine, Article 45(1); IAS 28 Investments in Associates, paragraph 8; Tax Code of Ukraine [Податковий кодекс України], sub-clause 14.1.159 clause 14.1 Article 14.

of Ukraine and relevant international standards, some authors have asked why the figure of 25 per cent is used as an ownership basis for understanding the essence of transactions with interest.[642] They also suggest that the 20 per cent threshold should be used uniformly.[643] To seize this line of argument for adopting a 20 per cent rule and developing it further, another act could be added for a further illustration: the CCU, under which an economic company is understood to be dependant if another entity owns at least 20 per cent of the first company's share capital,[644] triggering the owner's obligation to publicly disclose information about the acquisition.[645]

Together, these arguments contribute to the idea that the regulations require a greater degree of uniformity. However, they do not reveal the reasons for stipulating a precise shareholding (20 per cent) in the definition of an interested person. The true economic reasons for viewing a party with a particular shareholding as a related party must lie in the powers that this exact share ownership conveys. The JSC Law of Ukraine does not contain any rules that grant groups of shareholders with 20 per cent or more of the share capital (and the same proportion of the voting rights) any particular or unique rights. It is then difficult to properly justify both numbers (20 per cent and 25 per cent). That is the reason, despite the use of 20 per cent in some of the other legal instruments discussed, for an apparent lack of arguments, except for the need for uniformity, for lowering the existing threshold of 25 per cent for qualification as an interested persons in the JSC Law of Ukraine.

3.3.2. Natural persons as related parties in Ukrainian law

Classification of related parties depends very much on the nature of the rights that those parties possess relative to the entity. The following types of power are distinguished in literature for categorizing related parties: ownership powers; contractual powers; management powers; and family-based influence.[646] While ownership (share-based) and contractual powers apply in cases of both legal entities and natural persons, under Ukrainian law management powers and family-based influence need be considered only in connection with certain natural persons.[647]

The present section explores the influence that is inherently exercised by natural persons as related parties. In order to be recognized as a person with an interest in a transaction under the JSC Law of Ukraine, an individual must act in one or more of the following roles: (a) a shareholder owning at least 25 per cent of the shares, either singly or jointly with affiliated persons; (b) an officer of one of the company's bodies; or (c) a family member of (a) or (b).

Both legal entities and individuals can own shares. For participation in corporate governance, Ukrainian law does not allow legal entities to be appointed as members of company bodies. This was not always the case, however: before 1 May 2016, legal entities could be members of the supervisory boards of public companies, where they were then represented by a natural person acting under a power of attorney. This policy changed with the introduction of the new

[642] Карчевський К, ""Крупний акціонер"як сторона правочину із заінтересованістю' [2011] Актуальні питання цивільного та господарського права 18, 22.
[643] Засадний БА, 'Формування облікової політики підприємства щодо пов'язаних сторін' [2015] Вісник Київського національного університету ім Тараса Шевченка Серія: Економіка 24, 29.
[644] CCU, Article 118(1).
[645] Ibid, Article 118(2).
[646] Карчевський К, 'Порівняльно-правова характеристика поняття «афілійована особа»' [2013] Вісник Харківського національного університету внутрішніх справ 217, 218; Клименко Я, 220; Лепель Л, 'Поняття афілійованих осіб у конкурентному законодавстві України' [2007] Юриспруденція: теорія і практика 11, 18-19.
[647] Although some jurisdictions allow legal entities to hold positions in company bodies, this is not the case in Ukraine, where only natural persons may be seated on the management board, the supervisory board and other company bodies.

legislative amendments that came into effect on 1 May 2016.[648] Since then, only one specific individual may occupy a position on the supervisory board. Legal entities had previously sometimes abused their rights as supervisory board members by appointing different representatives and replacing them whenever it was convenient. At present, the chairs and members of the supervisory board, the management board, the audit committee (the company's auditor) and other company bodies are regarded as the company's officers.[649] This means that the legislature's opinion, as expressed in the Law, is that conflicts of interest can occur in situations concerning not only management and supervisory boards, but also other company bodies. However, it could be argued that transactions with interest are beyond the scope of the powers of bodies that are not specified in Article 71 of the JSC Law of Ukraine. Only the management board, the supervisory board and the general meeting of shareholders have the authority to enter into RPTs and/or to approve them. Other bodies are not as closely involved in these transactions and, even if they are believed to be able to influence them, can do so only indirectly. Logically, these provisions considerably limit their reach and valid calls have been made to remove persons whose roles have nothing to do with transactions with interest or their approval (for instance members of the audit committee, members of the counting committee and the company secretary[650]) from the list of interested persons. These arguments also reflect the provisions of the various CGCs, where conflicts of interest are ascribed to the management and supervisory boards.[651]

It can be argued that the existing broad notion of a company's officer matches the definition of key management personnel contained in IAS 24. The latter term is also broad, as 'planning, directing and controlling the activities of the entity, directly or indirectly' can be interpreted in a variety of ways, though it still primarily concerns executive and non-executive directors.[652]

A comparison of the JSC Law of Ukraine and IAS 24 and whether they recognize natural persons as related parties yields the following basic differences.

Firstly, as discussed above, the notions of 'control' and 'significant influence' can be interpreted against the backdrop of IAS 24 and IAS 28 as share ownership carrying at least 20 per cent of the voting rights[653] or 20 per cent of the share capital if the 'one share, one vote' principle as currently used in Ukraine applies.[654] In the JSC Law of Ukraine, the threshold is 25 per cent or more of the share capital.[655]

Secondly, 'significant influence', as per the requirements of IAS 24, can derive not only from corporate or official duties, but also from statute or contract. The JSC Law of Ukraine does not define, at least not explicitly, when a person is considered to be an interested person according to statutory requirements or under the terms of a contract.[656]

Thirdly, the lists of close relatives in IAS 24 and the JSC Law of Ukraine are different. What is unique about IAS 24 is that it refers to partners, their children and dependents as close family members, but does not provide an exhaustive list. In turn, under the JSC Law of Ukraine,

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[648] Law of Ukraine 'On Amending Certain Legislative Acts on the Protection of Investors' [Закон України 'Про внесення змін до деяких законодавчих актів щодо захисту прав інвесторів'].
[649] JSC Law of Ukraine, Article 2(1)(15).
[650] Карчевський К, 'Проблеми визначення кола посадових осіб акціонерного товариства, заінтересованість яких у правочині тягне за собою необхідність застосування спеціального порядку його вчинення' [2010] Актуальні питання цивільного та господарського права 91, 108.
[651] For example, see the Dutch CGC, Principle 2.7 Preventing Conflicts of Interest, and WSE Best Practice, V. Conflict of Interest, Related Party Transactions.
[652] IAS 24, paragraph 9.
[653] IAS 28 Investments in Associates, paragraph 8.
[654] Law of Ukraine 'On Economic Companies' [Закон України 'Про господарські товариства'], Article 44(1); Radwan A, Nadzon A and Zdiruk V, 88.
[655] JSC Law of Ukraine, Article 71(2).
[656] For example as in Article 317 of the AktG, which makes specific reference to control agreements.

close family members include parents (and adoptive parents), guardians, siblings, and spouses of children.

Differences in who are qualified as family members exist not only on the level of the JSC Law of Ukraine and the IASs; the meanings of related parties also differ between separate acts adopted in Ukraine. Some laws contain longer lists of related parties, while others stipulate significantly shorter ones. In general, all the acts analyzed in this study commonly refer to the person's spouse (husband or wife) and children as related (i.e. interested) parties. This is a common denominator, which will probably not be contested. Both spouses and children can easily influence a person's decisions and persuade him or her to act in a particular manner. It therefore makes sense to treat transactions with spouses or children of a person as transactions with the actual person.

In other respects, opinions on whether particular persons should be regarded as related or associated are less unanimous. Although neither the national standards nor the IASs unconditionally regard parents as related parties, they are under the JSC Law of Ukraine[657] and following a decision of the Constitutional Court of Ukraine that gave the official definition on how a close family member should be interpreted.[658] The Tax Code of Ukraine also views guardians as related parties,[659] while the JSC Law of Ukraine has the same attitude towards adoptive parents.

Brothers and sisters are similarly not always considered to be related parties. Most of the acts mentioned above, except the accounting standards, include them in this notion. While siblings have blood ties to a person, those ties are in the sideways line, as opposed to direct relationships as seen in, for instance, the relationship between parent and child. Sideways relationships are horizontal, rather than vertical, in nature, which might be why fewer references are made to them in legislation. In horizontal relationships, people do not always have the authority to impose their will on the other participant in the relationship.

Another party that has no direct blood ties to the individual is the spouse of the person's child. As opposed to connections to siblings, relationships with these parties are more vertical than horizontal. They are seen as affiliated persons under the JSC Law of Ukraine, and, consequently, as persons with an interest in a transaction.[660]

The widest network of related parties is found in the Law of Ukraine 'On Banks and Banking', where related parties are not confined to direct relatives (spouses, siblings, parents, children, grandparents and grandchildren), but also include the direct relatives of the person's spouse.[661] This implies that, for instance, the husband of the granddaughter of the person's wife is a related person, while in fact, the individual might be wholly unaware of their existence.

Yet the web of related parties as meant in the Law of Ukraine 'On Banks and Banking' is not where it ends. What precisely the tenets of relatedness actually are becomes even more ambiguous when coupled with the discretion of the courts and other authorities to determine whether or not a specific party is related. For instance, the notion of a person's close family as provided in IAS 24 includes the categories of persons described above (children, spouses, etc.), but also has a larger scope: it extends to any family members who may be expected to influence or be influenced by the person in his or her dealings with the reporting entity.[662] Those other family members can include a wide range of parties, subject to the court's opinion.

[657] JSC Law of Ukraine, paragraph 3 Article 2(1)(1).
[658] *Decision of 3 June 1999 No. 5-pn/99 (case about official interpretation of a term 'family member')* Case 1-8/99, Ofitsiynyi visnyk Ukrayiny as of 2 July 1999, No 24, page 180 (Constitutional Court of Ukraine).
[659] Tax Code of Ukraine [Податковий кодекс України], paragraph 7 sub-clause 14.1.159 clause 14.1 Article 14.
[660] JSC Law of Ukraine, paragraph 3 Article 2(1)(1).
[661] Law of Ukraine 'On Banks and Banking' [Закон України 'Про банки і банківську діяльність'] of 7 December 2000, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2001, No. 5-6, St. 30, paragraph 2 Article 2.
[662] IAS 24, paragraph 9.

The existing ambiguity is hidden in the concept of family as enshrined in the Family Code of Ukraine, which means all persons living together and sharing a common household.[663] In other words, to qualify as family members, persons must live together long enough and have the kind of relationship that is regarded as a family. This meaning has been further clarified in a decision of the Constitutional Court of Ukraine, which confirmed that family is decided not by blood ties only, but also by other connections that, in combination with some additional factors (living together and sharing a household), possess all the necessary features of a family.[664] Unsurprisingly, even persons who have no blood ties can form a family, since in reality they might have a closer relationship with each other than they do with their relatives. In fact, these relationships sometimes have a solid basis, and it is understandable that some scholars have suggested that the rules on transactions with interest in the JSC Law of Ukraine should also apply to relationships between individuals who are not relatives, but who have a strong fiduciary relationship (for example long-standing friends and godparents).[665] At the same time, extending the list of family members to include unregistered partners and other persons living together unofficially as a family would detract from legal certainty. Lawyers would find it difficult to compose lists of related parties in the face of future transactions in public companies. In addition, some clients might be reluctant to disclose all their information about persons who do not have the paperwork to be recognized as registered partners or relatives. A delicate approach is therefore necessary for situations where non-relatives are regarded as related (or interested) parties.

3.3.3. Legal entities as related parties under Ukrainian law

Unlike natural persons, legal entities cannot exercise influence based on family relationships or (at least in Ukraine) positions in the company's bodies. These possibilities lie beyond the legal entity's corporate shield and demonstrate their artificial essence. Legal entities even have their own special terminology as related parties, with the following terms being used specifically to describe connections between legal entities.

The CCU refers to an LLC, an ALC or a JSC as a dependent company if 20 per cent or more of its shares are owned by another company (its parent).[666] As a consequence, a dependent company is required to notify the authorities about the acquisition of its shares. Interestingly, the BW also employs the term 'dependent company' for both open and closed companies, though there 'dependence' has a different meaning: it is based on whether another company solely or jointly contributes at least half the issued capital of a legal person that is deemed dependent, or, where the dependent company is a partnership that has an officially registered business undertaking, the dependence arises from another company's participation in that partnership as a partner and its full liability towards third parties.[667] It is important to stress here that partnerships have a different meaning under Ukrainian law. Unlike under Dutch law, they are legal persons, namely economic companies and on the same level as private and public companies.[668] This difference, however, does not fully explain why partnerships (general and limited partnerships) are omitted from the definition of a dependent company as used in Article 118 of the CCU. Perhaps

[663] Family Code of Ukraine [Сімейний кодекс України] of 10 January 2002, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2002, No. 18, No. 21, St. 135, Article 2(2).
[664] *Decision of 3 June 1999 No. 5-pn/99 (case about official interpretation of a term 'family member')* Case 1-8/99, Ofitsiynyi visnyk Ukrayiny of 2 July 1999, No 24, page 180 (Constitutional Court of Ukraine).
[665] Карчевський К, 'Родинний критерій поняття афілійована особа (в контексті правового режиму правочинів із заінтересованістю)' [2014] Вісник Харківського національного університету внутрішніх справ 160, 169.
[666] CCU, Article 118(1).
[667] BW, Articles 2:152, 2:262.
[668] CCU, Article 113(2).

the CCU could have taken another route and recognized partnerships as dependent companies in which another company is a partner.

The consequences of being a dependent company, under the BW, should be considered in terms of large companies and their governance.[669] To qualify as large, companies must simultaneously meet three criteria: (a) the proper amount of issued capital and reserves, (b) an established works council and (c) at least one hundred employees in the Netherlands.[670] To be covered by the provisions for large companies, it is not necessary for the large company itself to establish a works council and employ one hundred employees: this may be accomplished by the large company's dependent company, which will have the same legal effect as though the large company had done it. Additionally, the BW prohibits large companies from appointing employees of dependent companies to their supervisory boards.[671] It also requires that some decisions by management that affect the functioning of a dependent company be subject to supervisory board approval.[672] Therefore, one of the main results of being dependent is that in some respects the large company is treated as though it forms a single person together with its dependent company.

Control, which is central to the concept of a subsidiary, is defined in several laws. The notion of control has already been discussed above[673] and by itself could serve as a separate research subject. Nevertheless, it is logical to consider it in further detail in the context of subsidiaries.

Control, as defined in the JSC Law of Ukraine and the Law of Ukraine 'On Protection of Economic Competition', is based on decisive influence on a company's governance and activity. The list of examples presented in the Law of Ukraine 'On Protection of Economic Competition' [and applying to relationships governed by the JSC Law of Ukraine] to showcase control includes, among other forms, the power to possess or use all or a considerable part of the controlled company's assets.[674] In other words, control, as described in these laws, concerns de facto latent control. It will change, depending on the circumstances of the case, and could even be held by a minority shareholder, similarly to how the Accounting Directive views control.[675]

Control is also inherent in the definition of controlled and controlling enterprises under the AktG.[676] A controlled enterprise may result from various forms of controlling influence. One of the most obvious is the existence of a majority shareholding, as expressly described in the law.[677] The notion of a subsidiary exists separately, though in fact it is also based on control: it refers to the situation where another enterprise is entitled to the majority of the voting rights in the enterprise or if another enterprise has the majority of the shares.[678] Contractual control is not in the nature of subsidiaries and parent companies, however. Other affiliated enterprises besides controlled and controlling enterprises include members of a group, members with cross-shareholdings and parties to an enterprise agreement, parent companies and subsidiaries.[679] The existence of an affiliated enterprise triggers the application of numerous articles throughout the AktG, including the provisions of Book Three, which specifically covers affiliated enterprises, namely enterprise agreements, their formation, terms, amendment and termination.[680]

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669 BW, Book 2, Title 4 Section 6 and Title 5 Section 6.
670 Ibid, Articles 2:153(2), 2:263(2).
671 Ibid, Articles 2:160(b), 2:270(b).
672 Ibid, Articles 2:164(d)(e)(j)(k), 2:274(d)(e)(j)(k).
673 See 3.1.3, 3.3.1.2.
674 Law of Ukraine 'On Protection of Economic Competition' [Закон України 'Про захист економічної конкуренції'], paragraph 4 Articles 1.
675 Accounting Directive, recital 31.
676 AktG, Article 17.
677 Ibid, Article 17(2).
678 Ibid, Article 16(1).
679 Ibid, Article 15.
680 Ibid, Book Three, Division One.

The KSH makes reference to dependent and associated companies. Associated companies are companies in which another commercial company either has 20 per cent or more of the shares, or has 20 per cent or more of the votes at the general meeting.[681] Dependent companies are primarily those in which another company holds a majority of the votes at the shareholders' meeting or can appoint more than half of the members of the management board.[682] As a consequence of being viewed as a dependent company, a dependent company is regarded in some operations as inseparable from the dominant company; for instance, the dependent company is prohibited from buying the dominant company's shares.[683]

The Polish KSH contributes a peculiar feature to the concept of a dependent company: a company is dependent if more than half the members of a company's management board are represented on the management board of another company.[684] This rule is reminiscent of some provisions of Ukraine national law. Firstly, according to the Tax Code of Ukraine, two legal entities are regarded as being related if the same persons serve as senior managers in both entities.[685] Secondly, the Economic Code adds an important new category of interested person to the definition of persons with an interest in a transaction: legal entities where an officer of the enterprise is an ultimate beneficiary or a member of senior management.[686] These rules are at odds with the provisions of IAS 24 in paragraph 11:[687] for IAS 24, it is not enough for parties to be related if one person is a director in two entities or significantly influences them both. The reasoning is simple: whereas the link between a director and a company is sufficient to call these two parties affiliated, the link between two companies in which one person is a director is nebulous. It is therefore doubtful whether it is necessary to establish relatedness between two companies whose only link is having the same manager; the doubts are amplified in the case of a dependent and a dominant company.

In spite of the fact that legal entities may freely participate in civil turnover by entering into transactions and by suing and being sued, it cannot be denied that ultimately natural persons are behind all corporate business forms. They own and govern them. It is not always entirely clear who is behind the corporate curtain. To reveal those persons, the laws of many states, including Ukraine, provide for techniques to identify these 'ultimate beneficiaries' (controllers) who actually control the legal entity's activity.[688] These persons might own a particular percentage of the company's share capital.[689] At the same time, they are not treated as controllers by reason of share ownership. They might exercise control through other vehicles, regardless of formal ownership, by possessing or using the company's assets, influencing the decision-making procedures or issuing binding recommendations to the company, either singly or jointly with other persons.[690]

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[681] KSH, clause 5 § 1 Article 4.
[682] Ibid, clause 4 § 1 Article 4.
[683] Ibid, Article 366(1).
[684] Ibid, sub-clause d) clause 4 § 1 Article 4.
[685] Tax Code of Ukraine [Податковий кодекс України], sub-clause 14.1.159 clause 14.1 Article 14.
[686] Economic Code of Ukraine [Господарський кодекс України], Articles 73-1, 78-1; it should be stressed that rules on RPTs as covered by the Economic Code of Ukraine apply only to state and municipal enterprises.
[687] IAS 24, paragraph 11.
[688] Махінчук В, *Зняття корпоративної вуалі: монографія* (Івано-Франківськ: "Фоліант" 2017), 102.
[689] The definition of an ultimate beneficiary (controller) in Ukraine can be found in the Law of Ukraine 'On Prevention of and Countering to Legalization (Laundering) of Profits Received by Committing Crimes, Financing Terrorism and Weapons of Mass Destruction' [Закон України 'Про запобігання та протидію легалізації (відмиванню) доходів, одержаних злочинним шляхом, фінансуванню тероризму та фінансуванню розповсюдження зброї масового знищення'] of 14 October 2014, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2014, No. 50-51, St. 3250, paragraph 20 part 1 Article 1. The minimum threshold of share ownership or votes giving a person the ability to directly or indirectly influence the company's activity is 25 per cent of the share capital or the voting rights.
[690] The view has been expressed in German jurisprudence that the power to issue binding recommendation is not sufficient to establish control between two entities (Махінчук В, 102).

Ultimate beneficiaries are not always the shareholders who have a specific proportion of the voting rights in a company. The shares that they own might belong to them on the basis of an agreement with another person. As IAS 24 indicates, the identity of the ultimate controlling party must be disclosed, if that party is not the same as the company's shareholder.[691] Under the JSC Law of Ukraine, however, only share ownership and a position as a company officer are relevant for determining whether a person has an interest or not.[692] This law does not stipulate an obligation to identify who the real ultimate beneficiaries are for the purposes of transactions approval by the appropriate company bodies (the supervisory board and the general meeting of shareholders).

One important comment must be raised here, however. For the purposes of procedural safeguards under the JSC Law of Ukraine, interested persons do not include controllers (ultimate beneficiaries).[693] At the same time, affiliated persons of interested persons do in fact include controllers.[694] The concept of control within the meaning of the Law of Ukraine 'On Protection of Economic Competition' and as used in the JSC Law of Ukraine requires identifying which persons have decisive influence over the company's governance and activity, though the principal focus is still on formal criteria. It is not obvious from the latter concept that the ultimate beneficiaries must be identified. In other words, while the concept of control is limited in scope, if given a broad interpretation it still requires knowing who the ultimate beneficiaries are. Anecdotal situations exist where one person who controls a company through other means besides share ownership is not viewed as a related party for the purposes of procedural safeguards. Meanwhile, stricter and more nebulous identification rules apply to company shareholders with 25 per cent or more of the share capital and company officers if a broad interpretation is used for control, inherent in the concept of an interested person's affiliated person. This hypothetical evidence shows that the notion of an interested person in the JSC Law of Ukraine largely ignores controllers as related parties, except in situations where control is based on share ownership.

The circumstances described here pose a major dilemma, in whether it is necessary to establish ultimate beneficiaries as interested persons for the purposes of compliance with requirements directed at countering tunnelling and other counterproductive activities. Of course, if corporate lawyers do not have to look beyond the company structure with nominal shareholders, it makes their work much easier. The list of related parties is shorter and compliance is less onerous. At the same time, considering only the surface of corporate vehicles without delving more deeply into the key constituencies could undermine the very aim of RPT regulation.[695] It is vital to find the right balance between these two opposing and simultaneously significant directions, in order to protect all the company's stakeholders.

3.4. TERMS OF RPTs

Following this analysis of the parties to RPTs and the discussion of who might be involved in these transactions, the next step is to determine what is stipulated in these transactions.

In a world where it is almost impossible to name a jurisdiction that does not accept freedom of contract, at least on paper, all kinds of transactions may occur – including RPTs. It is no secret that two parties, even if they are related, still possess the freedom of contract and so may enter into

[691] IAS 24, paragraph 13.
[692] JSC Law of Ukraine, Article 71(2)(2).
[693] Ibid, Article 71(2).
[694] Ibid, Article 2(1)(1).
[695] This is discussed in greater detail in Chapter 4. For a concise explanation of the reasons to tackle RPTs, see: Kraakman R and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017), 145-146.

various types of agreement. However, although the parties to a transaction are of primary importance for the legal qualification of a transaction as an RPT, the risks associated with RPTs are hidden in their terms. It would not be necessary to discuss RPTs if they did not pose any potential threat to the company and its stakeholders. The negative effect that RPTs bring to stakeholders does not necessarily lie in the fact that shareholders might experience issues with value creation. The whole company could eventually collapse, as happened with Adelfia, Enron and Parmalat.[696] That is why separate RPTs that, by reason of their terms, pose a potential threat to the company should be distinguished from RPTs that are very unlikely to harm the company. Above all, it is necessary to look at the existing legal instruments that describe these types of transactions and their terms.

IAS 24 gives an illustrative list of transactions with related parties that must be disclosed. These include agreements for the purchase and sale of goods, property or other assets, service contracts, leases, transfers of research and development, transfers under licence and financial agreements, contracts providing guarantees or collateral, commitments to do something in a particular event and settlement of liabilities on behalf of the entity or by the entity on behalf of a related party.[697] Participation in a defined benefit plan[698] within a group of companies, where the members of the group share all the risks, is also treated as a transaction with a related party by the IASs and accordingly must be disclosed.[699] IAS 24 does not define a minimum transaction value for triggering the duty to disclose: it simply points at the duty to disclose, even where no transactions are conducted between the parties.[700] The only factor that could be influenced by the value of transaction, according to IAS 24, is the scope of disclosure. This comes into play with government-related entities that, when preparing their financial statements, must evaluate such factors as whether the transaction is carried out on non-market terms and whether it falls outside the normal business operations.[701]

Unlike IAS 24, the JSC Law of Ukraine does not elaborate in detail on the types of transactions with related parties. It merely indicates that transactions with interest may involve transfers of assets or the rendering of services. The procedural safeguards contained in the law (approval by the supervisory board or by the general meeting of shareholders) apply only when the value of the transaction exceeds 1 per cent of the company's assets according to the company's financial statements.[702] When a transaction is approved, it consequently triggers the disclosure obligations requiring the company to make it public[703] and to submit the 'special' information to the NSSMC in accordance with that authority's procedures.[704] This 'special' information includes

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[696] Vaez SA and Banafi M, 'Prediction of Related Party Transactions Using Artificial Neural Network' (2017) 7 International Journal of Economics and Financial Issues 207, 207.

[697] IAS 24, paragraph 21.

[698] The definition of a defined benefit plan can be found in paragraph 8 of IAS 19 'Employee Benefits' (International Accounting Standard 19 Employee Benefits, as amended and set out by Commission Regulation (EU) No. 475/2012 of 5 June 2012 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Accounting Standard (IAS) 1 and International Accounting Standard (IAS) 19 [2012] OJ L 146/1, 6.6.2012). According to that definition, '*defined benefit plans are post-employment benefit plans other than defined contribution plans*'. A post-employment benefit plan is a formal or informal arrangement under which an entity provides post-employment benefits to one or more former employees. Defined contribution plans are distinguished by two key features: (a) the entity pays fixed contributions into a separate entity (a fund); and (b) the entity is not obliged to pay any further contributions if the fund does have sufficient assets to pay the employee benefits relating to employee service during the current or a prior period. Any arrangement for post-employment benefits that lacks these two features is a defined benefit plan.

[699] Ibid, paragraph 22.

[700] Ibid, paragraph 13.

[701] Ibid, paragraph 27.

[702] JSC Law of Ukraine, Article 71(1).

[703] Ibid, Article 71(10).

[704] Decision of the National Securities and Stock Market Commission 'On Approval of Regulation for the Disclosure of Information by Issuers of Securities' [Рішення Національної комісії з цінних паперів та

the date of the decision approving the transaction with interest, the market value of the goods or services or the amount of money involved in the contract, the carrying amount of the issuer's assets according to its financial statements, the correlation between the market value of the goods or services and the carrying amount of the issuer's assets, the number of votes cast to approve the transaction and the substantial terms of the contract, including the subject of the contract, the names of the parties involved and what their interest is.[705]

The JSC Law of Ukraine and the acts of the NSSMC do not explain in detail what types of transactions are covered by their requirements, simply referring to transactions involving transfers of goods or services or payments of money. The Economic Code of Ukraine conversely explicitly specifies what transactions fall under the rules on transactions with interest where they involve state or municipal enterprises.[706] These transactions include alienations and acquisitions of property, leases of property, transfers of property into free use, works or services, loans and other financing on a repayable or non-repayable basis, guarantees and collateral. Unlike the JSC Law of Ukraine, the Economic Code of Ukraine links these types of transactions to specific multiples of the minimum wage, ranging from 20 to 100 times the minimum wage. The earlier version of Article 71 in the JSC Law of Ukraine used the same approach for determining the minimum threshold for transactions with interest. Since the amendments of February 2017,[707] Article 71 has opted for a threshold of 1 per cent of the company's assets. The practical effect of this change might well be demonstrated shortly in the case of Reiffeisen Bank Aval, one of Ukraine's largest banks and public companies. Its assets, according to its 2016 annual report, had a carrying amount of UAH 57,364,637,000 (almost EUR 2 billion).[708] Using the minimum wage for 2017 of UAH 3,200 (more than EUR 100),[709] the threshold of 100 times the minimum wage as used in the Economic Code of Ukraine would be UAH 320,000 (more than EUR 10,500), whereas 1 per cent of Reiffeisen Bank Aval's assets was UAH 573,646,370 (more than EUR 19 million). Here, 1 per cent of the company's assets is considerably more than 100 times the minimum wage; however, this is not the case for all Ukraine's banks, especially those that are strictly local. For instance, the 2016 financial statements of Asvio Bank in Chernihiv[710] showed assets with a carrying amount of UAH 974,103,000 (more than EUR 32 million).[711] For Asvio, 1 per cent of the company's assets (UAH 9,741,030 or approximately EUR 320,000) is a different figure. These data and calculations show that the criteria for determining a minimum threshold for RPTs might impact public companies differently, depending on their size (see Figure 3). However, 1 per cent of a company's assets reflects the features of the company concerned, while linking procedural requirements for RPTs to the minimum wage could prove inefficient in situations where rapid inflation and economic downturns cause the minimum wage to fall behind the real economic conditions, rendering it too low to use as a fair indicator.

фондового ринку "Про затвердження Положення про розкриття інформації емітентами цінних паперів"], No. 2826, of 3 December 2013, published in Ofitsiynyi visnyk Ukrayiny, 2013, No. 100, St. 3699.

[705] Ibid, subclause 3 clause 5 subchapter 1 chapter III.

[706] Economic Code of Ukraine [Господарський кодекс України], Articles 73-1(3), 78-1(3).

[707] Law of Ukraine 'On Amending Certain Legislative Acts on Improvement of Corporate Governance in Joint Stock Companies' [Закон України 'Про внесення змін до деяких законодавчих актів щодо підвищення рівня корпоративного управління в акціонерних товариствах'] of 23 March 2017, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2017, No. 25, St. 289,

[708] *Reiffeisen Bank Aval 2016 Annual Report [Річний звіт Райффайзен Банку Аваль за 2016 рік], available at: https://www.aval.ua/f/1/about/bank_reports/AR2016_UKR_LoRes.pdf* (2017).

[709] Law of Ukraine 'On State Budget of Ukraine in 2017' [Закон України 'Про Державний бюджет України за 2017 рік'] of 21 December 2016, published in Vidomosti Verkhovnoyi Rady Ukrayiny, 2017, No. 3, St. 31, Article 8.

[710] A city in the north of Ukraine.

[711] *PJSC 'Asvio Bank' 2016 Financial Statements [Фінансова звітність ПАТ "Асвіо Банк" за 2016 рік], available at: https://www.asviobank.ua/tl_files/finance/rich_zvit_2016.pdf* (2017).

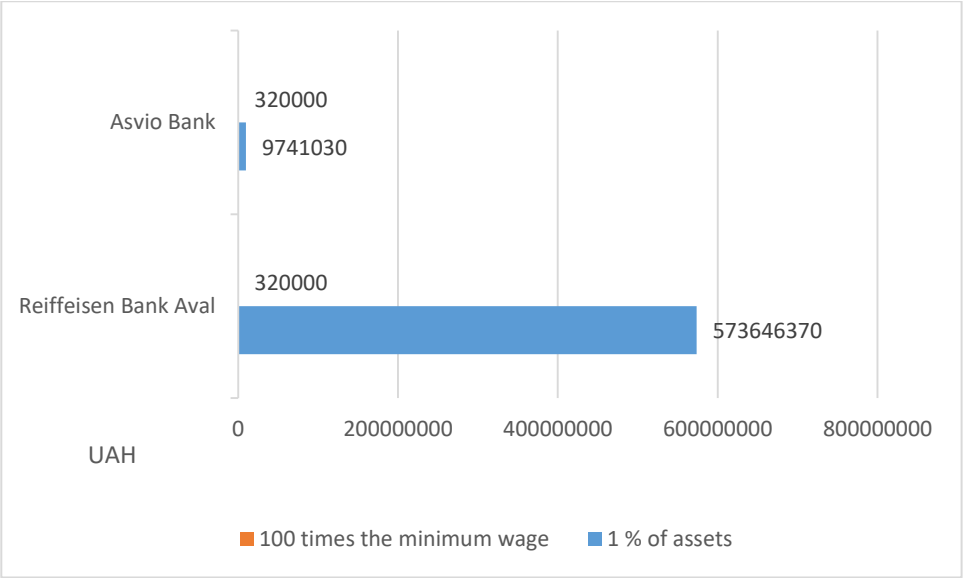

Figure 3. Comparison of the use of thresholds in two Ukrainian banks: 1 per cent of company assets versus 100 times the minimum wage in 2017.

Source: 2016 annual reports of Raiffeisen Bank Aval and Asvio Bank; the Law of Ukraine 'On State Budget of Ukraine in 2017'.

Thresholds constitute an important element in regulating RPTs, and transactions of a particular weight, i.e. with the potential to harm the company to a more than trivial extent, show up on the legislative radar, while transactions with the impact of a mosquito bite are disregarded (unless, of course, they are conducted to conceal bigger transactions in aggregate). However, another significant factor from the perspective of related party monitoring is the nature of transactions.[712] Although both IAS 24 and the JSC Law of Ukraine generally refer to agreements for the provision of goods or services as the types of RPTs, it can be argued that some of these agreements, namely transactions to acquire real estate or to enjoy goods or services, that do not provide for a reciprocal performance, are in essence harmful to a company. In this regard, it is surprising that the Economic Code of Ukraine renders agreements to take receipt of irrevocable monetary aid in excess of 50 times the minimum wage subject to supervisory board approval in state-owned and municipality-owned enterprises.[713] It is highly unlikely that these transactions will have a detrimental effect on the company. The only aspect of such agreements that might give stakeholders cause for concern is if any provisions are stipulated that place additional obligations on the parties besides the rights stemming from the essence of the agreement, for example a non-compete clause or a clause restricting intellectual property rights. That is why even the lightest agreement for delivery of free goods or services must be subject to some form of screening. Still, it is doubtful whether these contractual arrangements should be subjected to examination by the supervisory board, instead of a more modest verification by the company's legal department, compliance department or in-house counsel. The issues concerning the use of decision rights and procedural safeguards for dealing with RPTs are more strategy-related and are discussed in greater detail in Chapter 5.

3.5. RPTs AND SIMILAR INSTRUMENTS

[712] Information about the nature of a transaction is required in the mandatory disclosure within the meaning of SRD II (Article 9c(2)).
[713] Economic Code of Ukraine [Господарський кодекс України], Articles 73-1(3), 78-1(3).

3.5.1. Self-dealing, tunnelling, propping and self-interested transactions

RPTs are sometimes referred to by other names in literature and statute. For example, in German law a special term has emerged and received attention under the name of 'disguised distributions',[714] a concept that is concerned with the maintenance of share capital in companies.

Legal and economic scholars notably refer to 'self-dealing'[715] and 'tunnelling' in the context of RPTs.[716] Both these terms have a negative meaning and are used to describe situations where directors and/or controlling shareholders divert corporate wealth to themselves and away from other stakeholders.[717] Two main opinions have been expressed on how self-dealing and tunnelling are connected in terms of their substance.

The first opinion holds that self-dealing is a broader term. In this approach, tunnelling is most likely to take the shape of transactions.[718] Besides tunnelling, self-dealing also includes other forms of opportunism on the part of management or shareholders, in particular stock dilution through recapitalizations, mergers and squeeze-outs.[719] In the case of stock dilution, minority shareholders are deprived of benefits through corporate changes, rather than through transactions. For instance, if a company's share capital is increased by an undervalued additional contribution from a majority shareholder, the other shareholders' shares would consequently lose value. This process usually requires a decision by the general meeting of shareholders to approve amendments to the articles of association.[720] Similarly, minority shareholders and other stakeholders may suffer from corporate changes from an unfair exchange ratio between shares in merging companies or an unfair share price during a squeeze-out.

The second opinion, as set out in a celebrated article by Simon Johnson, Rafael La Porta and others, has a less restrictive view of tunnelling. The authors argue that it encompasses both direct transfers of assets (i.e. self-dealing transactions, outright theft, excessive remuneration and expropriation of business opportunities) and indirect extraction of benefits using dilutive share issuances, minority freeze-outs, insider trading and other suspicious transactions.[721] This approach ascribes a scope to tunnelling that is broad enough that it even includes insider trading based on the possession of specific information and the exploitation of inside information to the detriment of other stakeholders. This is not the case with the former opinion, which does not include insider trading in its definition of self-dealing, though even without insider trading it covers a considerable array of opportunistic acts.[722]

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[714] Fleischer H, 'Disguised Distributions and Capital Maintenance in European Company Law' in Lutter M (ed), *Legal Capital in Europe* (Walter de Gruyter 2006).
[715] Parkinson JE, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford University Press Catalogue 1995), 200; Goshen Z, 'Controlling Corporate Self-Dealing: Convergence of Path Dependency?' in Milhaupt CJ (ed), *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (Columbia University Press 2012).
[716] Johnson S and others; Aharony J, Wang JW and Yuan HQ, 'Tunneling as an Incentive for Earnings Management during the IPO Process in China' (2010) 29 J Account Public Pol 1; Bertrand M, Mehta P and Mullainathan S, 'Ferreting Out Tunneling: An Application to Indian Business Groups' NBER Working paper No 7952. Available at: https://wwwnberorg/papers/w7952, accessed on 18 November 2018.
[717] Djankov S and others, 'The Law and Economics of Self-Dealing' (2008) 88 Journal of Financial Economics 430, 430.
[718] Conac P-H, Enriques L and Gelter M, 'Constraining Dominant Shareholders' Self-Dealing: The Legal Framework in France, Germany, and Italy' (2007) 4 European Company and Financial Law Review 491, 523.
[719] Ibid, 496.
[720] Ibid, 523.
[721] Johnson S and others, 23.
[722] Conac P-H, Enriques L and Gelter M, 496.

Both these opinions agree that tunnelling can take the form of excessive remuneration, transfer pricing, subsidized loans, non-arm's length agreements and even theft.[723] Depending on the type of siphoned property, various tunnelling techniques have been distinguished: cash flow tunnelling, asset tunnelling and equity tunnelling.[724] Tunnelling implies an extraction of assets, which characteristic is inherent in the concept. RPTs are therefore one of the tools that can be used for tunnelling.

Propping has been described as the twin of tunnelling, for its occasionally beneficial nature for the company[725]. Compared with tunnelling, propping has received less academic focus.[726] As evidenced by the Chinese economy, sometimes shareholders transfer resources to their company to support and attract minority shareholders.[727] Therefore, propping is usually a sign that a company is in need of additional funding. As Eric Friedman and others have claimed, private entrepreneurs sometimes decide to prop their firms in times of a moderate adverse shock to keep them alive.[728] If the crisis is too great, shareholders are more likely to be inclined to tunnel the assets, eventually causing the company to cease to exist.[729] Strongly performing firms are not necessarily safe from tunnelling behaviour of majority shareholders, however. Unlike propping, tunnelling is more likely to occur in companies with solid financial results;[730] in companies suffering temporary losses, propping is more probable.

These two notions (tunnelling and propping) nevertheless share some common features: their essence and the legal background served as a prerequisite for their emergence. Related sales propping is said to be prevalent in regions with weaker investor protection.[731] In systems where corporate governance is more developed and that offer stronger investor protection as a consequence, both tunnelling and propping activities occur more rarely.[732]

Another term that is widely used by scholars and practitioners is 'self-interested transactions'.[733] This is one of the translations from Ukrainian to English of the notion 'transactions with interest' as used in the JSC Law of Ukraine and in the LLC Law of Ukraine.[734] Self-interested transactions should not be understood as always being formed in the interests of the related parties: a related party might enter into a transaction not only in his or her own interests, but also in the interests of a close relative or another affiliated person.

The term 'transaction with interest' as used in the JSC Law of Ukraine[735] and in the LLC Law of Ukraine[736] might seem misleading at first sight. According to the JSC Law of Ukraine, it encompasses transactions in which the company is on one side of the transaction and the interested person is either on the other side, or is a representative, broker or beneficiary in a transaction. The JSC Law of Ukraine also extends its rules on transactions with interest to include transactions

[723] Chen W, Li S and Chen CX, 'How Much Control Causes Tunneling? Evidence from China' [2016] China Journal of Accounting Research (available at: http://dxdoiorg/101016/jcjar201610001), 3.
[724] Atanasov VA, Black BS and Ciccotello CS, 'Unbundling and Measuring Tunneling' (2014) 2014 University of Illinois Law Review 1697, 1700.
[725] Ibid, 1704.
[726] Cheung YL and others, 392.
[727] Friedman E, Johnson S and Mitton T, 'Propping and Tunneling' (2003) 31 Journal of Comparative Economics 732, 732.
[728] Ibid, 748.
[729] Ibid, 748.
[730] Cheung YL and others, 374.
[731] Jian M and Wong TJ, 'Propping through Related Party Transactions' (2010) 15 Rev Account Stud 70, 98.
[732] Gupta P, 'Tunneling and Propping: Indian Evidence' (Thesis within Fellowship Programme in Management, Indian Institute of Management Indore 2017), v.
[733] Parkinson JE, 205; Eisenberg MA, 'Self-Interested Transactions in Corporate Law' (1987) 13 Journal of Corporation Law 997; Farrar JH, 'Note on Dealing with Self Interested Transactions by Directors, A' (2000) 12 Bond Law Review 106.
[734] Antonenko L, 8.
[735] JSC Law of Ukraine, Article 71.
[736] LLC Law of Ukraine, Article 45.

between public companies and companies controlled by an interested person.[737] For private companies, transactions with interest have a narrower scope. Based on the literal wording of the LLC Law of Ukraine, transactions with interest are always formed between a company and its related parties, making them RPTs. The term itself also gives grounds to elaborate on other transactions that present an economic interest but to which the company itself is not a party, i.e. transactions between the company's affiliated persons such as the company's major shareholder and manager, or between the company's affiliated person and a competitor. To quote Luca Enriques, '*transactions between other entities, whose welfare affects that of the company (for example, due to controlling interest of the latter in the former) and a director*'.[738]

The fact that the statutory provisions can be interpreted in multiple ways is clearly an undesirable situation. Therefore, changing the terminology in the text of the act would be the appropriate course of action from an academic perspective. However, taking into account that practitioners, including judges, have already become familiar with the concept of 'transactions with interest', this superficial change would only add to the confusion.

3.5.2. RPTs and executive remuneration

Executive contracts with directors constitute a special category of RPTs, dealing with labour issues in a company. These contracts differ from the sales and services transactions that the director forms on the company's behalf, in that by nature they are more internally oriented. Due to their specific features, their regulation in law is based on multiple separate sources.[739] However, despite some differences with classical tunnelling, employment contracts with executives can very well be used for asset stripping in enterprises if the remuneration is disproportionately excessive. This is where employment contracts pose a threat similar to that of other RPTs.

The relationship between pay and performance is not always clearly established. Proper remuneration does not guarantee that performance will bring substantial success to the company. In addition, even if the company's net income exceeds its outgoings, the possibility remains that the same results could have been achieved with less remuneration for or less effort from the executive. Therefore, the line between proper and excessive levels of remuneration is not always easy to see, depending largely on external factors and subjective preferences. To analyze remuneration and to understand where it is excessive, some countries employ a special strategy known as the 'constraints strategy'.[740] Germany is one of the countries where this strategy is used.

The landmark case that dealt with the issues of unreasonable remuneration in Germany was the *Mannesmann* case.[741] That case concerned the payment of millions of US dollars as 'golden parachutes' to 6 outgoing Mannesmann executives after the company was taken over by Vodafone.[742] The Mannesmann CEO and supervisory board members were charged under criminal law for breaching their fiduciary duties by approving the payments to executives. Legal action

[737] JSC Law of Ukraine, Article 71(3).
[738] Enriques L, 'The Law on Company Directors' Self-Dealing: A Comparative Analysis', 299.
[739] For example, see: Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies [2004] OJ L 385/55, 29.12.2004; Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board [2005] OJ L 52/51, 25.2.2005; Commission Recommendation of 30 April 2009 complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies [2009] OJ L 120/28, 15.5.2009.
[740] Hill JG, 'Regulating Executive Remuneration: International Developments in the Post-Scandal Era' (2006) 3 European Company Law 64, 65.
[741] Ibid, 73.
[742] Kraakman R and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017), 67.

followed, despite the fact that Vodafone, holding 98.66 per cent of the shares, had approved the payout.[743] All 6 executives were acquitted by the Regional Court in Düsseldorf in 2004, but in 2005 the Federal Supreme Court disagreed with the judgment and referred the case for re-trial.[744] The Supreme Court's decision established a 'tough objective' test,[745] which substantially added to the legislative provisions already in place at that time under the AktG. All extra-contractual payments for past performances, without future incentive, are now automatically considered unlawful, regardless of their amount.[746] Although a famous case, *Mannesmann* is far from the only one dealing with executive remuneration: other cases have applied and interpreted the standards introduced by the AktG too.[747] As the first sentence of Article 87(1) of the AktG states, '*in determining the aggregate remuneration of any member of the supervisory board, the supervisory board must … ensure that such aggregate remuneration is reasonable relative to the duties and performances of the member and to the company's situation, and that it does not exceed the standard remuneration without a specific reason*'.[748] The word 'reasonable' or 'appropriate' has been especially problematic for applying the standard in practice.[749] For instance, in the *Mannesmann* case, an attempt was made to justify the 'appropriateness' of the bonuses by referring to the value-creating effect of the executives' conduct.[750] Although this interpretation was not upheld by the courts, it nonetheless demonstrates how a single term can have multiple interpretations depending on the circumstances.

In Ukraine, the constraints strategy is not used in connection with the remuneration of company directors, either of public or private companies. An executive's salary depends entirely on what he or she has agreed with the company and, consequently, with shareholders. Therefore, under Ukrainian company law, it is exclusively for the company's own bodies to decide whether the remuneration is excessive or not, and not for external parties such as in Germany. Nevertheless, as noted above, executive compensation is a complex matter. Although it can be identified as a tunnelling technique, it is too specific to be studied together with RPTs and their strategies.

3.5.3. Transfer pricing and insider trading

The risks that RPTs pose primarily affect private actors: minority shareholders, creditors and employees. Most commonly, a majority shareholder or a manager will act for his or her own benefit and to the detriment of minority shareholders and/or the company itself. These are the issues that company law addresses, by seeking to balance the interests of the various company constituencies. What company law does not cover is the potentially negative and largely external effect of RPTs. Public welfare can also be impacted by RPTs if they harm society by lowering tax proceeds through transfer pricing schemes. Although in practice transfer pricing employs RPTs as a tool, it nonetheless has its own separate set of rules, where the term 'related party transaction' is used in a different sense and for a different purpose. The general perspective is that transfer pricing mainly concerns tax liability management.[751] RPTs here serve to reduce the revenue of companies operating in unfavourable tax jurisdictions and increase the revenue of companies operating under

[743] Ibid, 68.
[744] Harbarth S and Kienle F, 'Director Compensation Under German Law and the Mannesmann Effect' (2006) 3 European Company Law 90, 94.
[745] Kraakman R and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017), 221.
[746] Harbarth S and Kienle F, 95.
[747] Ibid, 91.
[748] AktG, Article 87(1).
[749] Kolla P, 'The Mannesmann Trial and the Role of the Courts' (2004) 5 German Law Journal 829, 830.
[750] Ibid, 834.
[751] Pendse SJ, 'International Transfer Pricing: A Review of Non-Tax Outlook' (2012) 37 Procedia-Social and Behavioral Sciences 337, 342.

more favourable tax conditions.[752] This is usually held to fall under public law, and this thesis does not discuss transfer pricing or analyze the tax aspects of RPTs in detail.

Another concept that, like the previous one, falls beyond the scope of this thesis is insider trading. In the economic sense, insider trading involves trades by parties who are better informed than their business partners.[753] While insider trading with the company's shares may very well be carried out by related parties, it does not necessarily involve RPTs. Insider trading can have a value-decreasing effect for the company and its shareholders, as is often the case with RPTs. However, the difference is that insider trading may cause vulnerable stakeholders to suffer due to indirect abusive enrichment by insiders, while RPTs have a more direct effect: the company's wealth is simply looted, leaving minority shareholders, creditors and employees with less chance of protecting their interests. Insider trading mostly involves transactions with investors for a company's securities, rather than its assets. The company is usually not a party to transactions characterized as insider trading. Also, opinions are divided on the efficiency of insider trading and its regulation.[754] In a way, this unites RPTs and insider trading, although it would be wrong to characterize all RPTs from one perspective (positive or negative). In essence and based on their features, however, these concepts are still substantially different. Therefore, insider trading should be studied separately.

[752] Talab HR, 'Transfer Pricing and Its Effect on Financial Reporting: A Theoretical Analysis of Global Tax in Multinational Companies' (2017) 11 International Business Management 921, 923.
[753] Carlton DW and Fischel DR, 'The Regulation of Insider Trading' (1983) 35 Stanford Law Review 857, 860.
[754] Beny LN, 'Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence' (2005) 7 American Law and Economics Review 144, 145.