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

Title: Related Party Transactions and Corporate Groups: When Eastern Europe Meets the West

Chapter 1. Introduction

This introductory chapter opens with the basic theoretical considerations surrounding RPTs and the strategies that have been developed to deal with them. Neither prohibiting RPTs outright nor positioning them as completely safe instruments is an ideal solution. Instead, limitations and requirements need to be established that govern the decisions of company officers and other related parties when they enter into RPTs.

The next part of this chapter is devoted to the general historical, economic and legal background to RPTs and corporate groups in Ukraine. The development of company law in Ukraine as an independent state began with privatization processes, governed by the Laws of Ukraine 'On Privatization of Property of State Enterprises' and 'On Privatization of Property of Non-Large Enterprises (Small Privatization)'. The first acts dealing with company law issues were adopted in the 1990s, including the Law of Ukraine 'On Economic Companies'. The most commonly used method of privatization was mass privatization; however, much as in Poland, this approach neither generated much income for the national budget, nor led to improvements in the corporate governance of the privatized enterprises. As a result, following an initial phase of increasing ownership dispersion, privatized companies soon became highly concentrated. Besides the various private entities and individuals that used schemes and political influence to gain positions as controlling shareholders, the state also preserved its role as a major shareholder: in 2016, 19 of the country's 200 most profitable companies were state-owned.

By April 2009, when the JSC Law of Ukraine took effect, the aggressive concentration of corporate ownership through privatization was already reality. The 2003 CCU, which brought some changes in the area of company law, was not sufficient to prevent fraudulent business practices. Tunnelling through self-dealing became widespread. Employees with minority shareholding of increasingly dispersed stocks had no means to influence the decisions of controlling shareholders. At that point, the provisions of the JSC Law containing approval safeguards for RPTs (Article 71) were insufficient to protect minority shareholders, as was their intention. Appraisal rights in public companies were non-existent at that time. Moreover, minority shareholders earned a reputation for instituting manifestly baseless suits. This obstacle forced the legislature to further curtail the protection of minority shareholder rights in 2011, by prohibiting derivative suits.

A new legislative trend for RPTs and their enforcement emerged in 2015, when the Law of Ukraine 'On Amending Certain Legislative Acts of Ukraine on Protection of Investors' was adopted. This act took effect on 1 May 2016, and formally allowed derivative suits for shareholders holding 10 per cent or more of their company's share capital. For derivative suits the changes meant only one remedy: damages for loss inflicted by company officers. Besides introducing derivative suits, as of 7 April 2015 the Law tightened the regulation of RPTs with other important new elements: the concept of an interested person, disclosure and procedural safeguards, and rules on mandatory buyouts (appraisal rights).

The chapter then continues with a description and discussion of the statutory regulation of RPTs by public companies in Ukraine, from a historical and comparative perspective. Three main

stages are put forward in the development of legislation on RPTs by public companies during Ukraine's existence as an independent state: (a) regulation before the enactment of the JSC Law of Ukraine (before 29 April 2009); (b) regulation after the enactment of the JSC Law of Ukraine but before the enactment of the 2015 amendments (29 April 2009-30 April 2016); and (c) regulation after the enactment of the 2015 amendments (after 1 May 2016). Among other developments, the 2015 changes modified the definition of interested persons in the JSC Law of Ukraine, established a minimum threshold for applying the approval and disclosure requirements and introduced a new version of the consequences of non-compliance with the procedural requirements. The regulation of RPTs by private companies in Ukraine was subject to amendments to the LLC Law of Ukraine, which was introduced in 2018, instead of the Law of Ukraine 'On Economic Companies'. The LLC Law of Ukraine contains new provisions for conflicts of interest and suggests optional rules for regulating RPTs.

Besides outlining the theoretical and legislative basics of the study, Chapter 1 also describes the research questions and methodology, the reasoning behind the choice of jurisdictions in focus in the research, and the outline of the dissertation.

The main research question is: *What solutions can the laws of Germany, Poland, the Netherlands and the EU offer to help overcome the problems of RPTs within and outside corporate groups in Ukraine and make the current regulation in Ukraine more efficient?*

Based on the key research question as indicated above, the scope of the research also includes the following subsidiary research questions:

1. What is the meaning of RPTs and how do RPTs relate to other associated terms?
2. What standards are used in Poland, Germany and the Netherlands to tackle the problems of RPTs? Which of those standards should be borrowed by Ukraine?
3. How are corporate groups regulated in Poland, Germany and the Netherlands?
4. Under what circumstances could the German, Polish and Dutch strategies for dealing with RPTs be successfully applied in Ukraine?
5. Do any non-classical strategies exist that fall outside the groups of strategies for dealing with RPTs that are described in literature, and that would be useful to borrow for Ukrainian company law?
6. Should regulation be provided not only for RPTs, but also the broader 'conflicted' transactions between actors, surrounding companies (for example transactions between a company's subsidiary and third parties)?
7. What should be the scope of the rules for RPTs in Ukraine: (1) all companies limited by shares (public and private companies), (2) only public companies, (3) only listed public companies, or, even, (4) large companies and large groups even though they are not listed, given that their business endeavours also have a major societal impact ('national champions')?

Ukrainian company law serves as the starting point of the research. Besides Ukraine, the following jurisdictions were chosen for analysis: the Netherlands, Germany, Poland and the EU overall. These jurisdictions were selected for a variety of reasons, including the proximity of their legal systems, their historical and geographical closeness and their success in creating market conditions and harmonizing national law with the requirements of EU law.

One of the reasons for legal transplants from these jurisdictions is the structure of corporate ownership there. The economies of Continental Europe are characterized by increasingly concentrated blockholdings. Of the countries in focus for this research, Germany was reported to have the highest levels of ownership concentration in listed companies, with the average shareholding of the largest blockholder at 57 per cent. Although this figure dates from 2001, the tendency towards large blockholders in big companies emerged much earlier. Although these data may have changed, the status of family firms as influential shareholders has continued through the years, while the role of banks has diminished.

Similarly to Germany, the Netherlands has a long stock market tradition. Despite the similarities, however, including the use of co-determination models to protect employees, the Dutch stock market has some unique features that are rarely found in other countries. While a concentration of capital can be observed in the Netherlands, it is not as strong as in Germany. In addition, the percentage of the share capital owned by foreign investors is high.

More than in Germany and the Netherlands, in Poland the state has been one of the key market players since the end of Communist rule. Privatization processes in the 1990s led to the transfer of public wealth into private hands, and the state has been gradually losing its position as a key shareholder. In 2002 the average largest blockholding in Polish listed companies was 39-45 per cent. Although the corresponding figures in Germany and the Netherlands at that time were higher (57 and 43.5 per cent, respectively), those markets became more dispersed soon afterwards due to a variety of factors, including internalization processes and changes in equity policies of institutional investors, including banks.

Chapter 2. Conflicts of interest in corporate governance and their types

Chapter 2 discusses what constitutes a conflict of interest, and what types of conflicts exist. This part of the work begins by describing where interests conflict, proceeds to explain how conflicts of interest are interconnected with fiduciary duties and who the main holders of fiduciary duties are, and finishes with a section on regulatory responses to conflicts of interest.

Corporate governance and other areas where interests conflict

Conflicts of interest can arise in various different spheres, including corporate governance and financial services. In some companies, those spheres form two layers of conflicts. For instance, in publicly held banks the issues of ownership and control dominate the first layer (corporate governance), while on the second (financial services) the client-manager relationship is crucial.

In order for a particular situation to involve a conflict of interest, one party must have an interest that is contrary to the interest of another party on whose behalf the first party is acting and the promotion of which by definition inevitably has a negative effect on the latter interest. In company law, conflicts of interest originate in ownership and control, which are supposedly separated, according to the classic study by Berle and Means. These two categories refer to two main groups of stakeholders in companies: shareholders and managers. Their importance to the company is beyond any doubt; however, their actions might have different effects, moving the company either towards prosperity, or towards bankruptcy.

Conflicts of interest and fiduciary duties

For a conflict of interest to have legal relevance, it is not enough to establish conflicting interests in a person’s mind. It requires more, namely a real violation of a duty of loyalty. Both managers and shareholders can have a duty of loyalty as one of their fiduciary duties. One of the key principles of fiduciary relationships is that they are based on trust. The ambiguity that lies at the heart of every fiduciary relationship and makes the beneficiary vulnerable is that the fiduciary is not given specific instructions for how to act. The more specific the director’s obligations are made, the greater the possibility is that some element will be overlooked. The possible types of fiduciary misconduct are as numerous and unforeseeable as their counterparts, i.e. successful business decisions that lead to beneficial outcomes.

The research departs from the premise that the duty of loyalty and the duty of care are both regarded as fiduciary duties. The duty of care pertains to the standard of a diligent manager and finds its reflection in the business judgment rule. The purpose of the duty of loyalty is to prevent

conflicts of interest. A director acting in breach of the duty of care is not necessarily in breach of the duty of loyalty, given that inefficient business decisions by directors are not always made on purpose. Like the duty of care, the duty of loyalty is a 'standard'.

While managers have a duty of loyalty, the problem lies in the fact that it is not always clear who the principal is. Two main theories exist regarding which interests managers should pursue: the shareholder theory and the stakeholder theory. In both the Netherlands and Germany, the stakeholder theory is observed to dominate. The shareholder theory, conversely, prevails in the UK and the US. Both theories pose challenges in how conflicts of interests should be treated, including by blurring the line between 'due' and 'undue' interests. The solution suggested for dealing with the beneficiary issue is to prioritize long-term value creation goals as posited by the 'Long Governance' theory, which has been implemented in the revised Dutch Corporate Governance Code.

In Germany, a duty of loyalty is ascribed to shareholders in various company forms, including private companies (GmbHs) and public companies (AGs), and stems from gradually developed case law. In the Netherlands, instead of a duty of loyalty shareholders possess a degree of autonomy, which derives from case law and soft law. This autonomy is limited by the standards of reasonableness, fairness and abuse of power, as set out in Article 2:8 of the Dutch BW. In Ukrainian public companies, the scope of the duty of loyalty of shareholders is limited by the tenets of the mandatory procedural safeguards for RPTs, whereas those requirements are entirely optional for private companies.

Regulatory responses to conflicts of interest

At the EU level, several instruments can be identified that deal with conflicts of interest in company law, including the Takeover Directive, Commission Recommendation 2004/913/EC and Commission Recommendation 2005/162/EC.

Where the EU's harmonized measures meet national company laws, a special place is occupied by corporate governance codes and their provisions dealing specifically with directors' conflicts of interest. The basis for compliance with CGCs is different in various Member States. The legal basis for compliance with the Dutch CGC is found in the BW, and in Germany this function is performed by the AktG. While the CGCs in Germany and the Netherlands exist as separate instruments that are not necessarily attached to a particular institution or body, besides the monitoring commissions that revise the codes, in Poland similar rules are the province of the Warsaw Stock Exchange and its WSE Best Practice. Whereas the Dutch, German and Polish CGCs have a firm basis in EU law, Ukraine's Principles of Corporate Governance lack that feature, which consequently affects their practical significance. This is confirmed by the lack of court decisions that make reference to those mentioned Principles. In addition, unlike the German CGC and the Principles of Corporate Governance, the Dutch CGC covers a wider range of corporate relationships by also considering conflicts of interest involving shareholders with 10 per cent or more of the share capital.

It is arguably more correct to say that RPTs imply conflicts of interest, as related parties can be granted additional advantages by the company, rather than that RPTs are a type of conflicts of interest, since beneficial RPTs are also possible. That having been said in regard to RPTs, and following the analysis of CGCs, the following types of conflicts of interest can be discerned: (a) use of the company's business opportunities, and competition with the company (this category includes transactions entering the sphere of the company's finances, but not transactions between the company and its related parties); (b) use of any advantages of the company, and the grant of advantages to third parties (also within RPTs). These types of conflicts of interest inherently imply the negative consequences for the company that come with the very concept of conflicts. In addition, it does not matter for the company whether the director, as a related party, is granted any

advantages by third parties, as long as this is not harmful for the company. As such, regardless of whether a director receives any additional remuneration, his or her conduct may indubitably be argued to involve a conflict of interest if it is purposively harmful to the company and beneficial to a third party.

The prohibition on using business opportunities and the non-compete obligation are not always clearly distinct. A differentiation can be found in the German CGC, the Principles of Corporate Governance in Ukraine and the Dutch CGC. In addition, the AktG and the KSH contain statutory provisions on non-compete obligation. Unlike Germany and Poland, the Netherlands does not have specific statutory rules prohibiting the use of business opportunities (as opposed to the Dutch CGC). Despite the separation of these concepts in the CGCs, sufficient evidence can be found in literature and case law to justify the conclusion that use of business opportunities also includes competition with the company by the interested person. This conclusion derives from the essence of the concept: competition with the company implies activity in proximity to the company's business. If business opportunities are about the company's business activity (narrow approach), then they probably also include non-competing behaviour. In a broader approach, where this type of conflict includes using business opportunities both within and beyond the company's business, then some business opportunities certainly fall beyond the scope of competing activity. This broad approach has been confirmed in German case law, while in the Netherlands, Poland and Ukraine the doctrine of business opportunities has a narrower application, and does not extend to appropriating business opportunities for private purposes.

Some ambiguity also exists regarding post-employment competition by former directors with the company that they have left: opinions on how better to qualify post-employment relationships are not unanimous. If an employment contract specifies restrictions on the use of business opportunities after the end of office, the consequences are quite clear. Otherwise, the interpretation of the relationship might have a different outcome, largely depending on the jurisdiction. Unlike in Germany, the Polish, Ukrainian and Dutch laws do not require resigning directors to be subject to the non-compete obligation, unless of course the employment contract so provides.

Conflicts of interest can be divided into direct and indirect conflicts. Indirect conflicts of interest arise in situations where it is not a director or a shareholder who is involved in a transaction with the company, but the manager's or shareholder's related parties, for instance a controlled company. Indirect conflicts of interest are given less legislative attention in Germany and Poland than direct conflicts, as the legislators drafting the rules were guided by the principle of legal certainty. In the Netherlands, although indirect conflicts of interest are given a brief mention in statute, their clarification is found in cases decided by the courts. In Ukraine, the rules governing direct conflicts of interest co-exist with the rules on indirect conflicts, as given shape in procedural requirements for public companies (and to a lesser extent private companies), and the broad duties of company officers of private companies under which they are obliged to be aware of any transactions of affiliated persons that might be deemed to qualify as related to the performance of the officer's duties. The latter requirements seem to be onerous. A transaction between an affiliated person and a third party is not necessarily detrimental to the company itself, if it lacks the constituent features of a conflict of interest. It would therefore seem advisable to add the element of a detrimental effect from the gain to the wording of a provision that equates gains received from third parties by company officers and their affiliated persons with conflicts of interest. Otherwise, the broad understanding of conflicts of interest as introduced by the statute places an excessive burden on the shoulders of company officers.

Chapter 3. General features of RPTs

While Chapter 2 focuses on conflicts of interest in general terms, Chapter 3 is dedicated more specifically to RPTs, their main features and regulation. A proper understanding of RPTs in each

of the studied jurisdictions requires a similar understanding of the meaning of a related party, and accordingly the first three sections provide an in-depth discussion of statutory law, CGCs and other sources to explore the notion of a related party and how it is construed in the various sources. Special emphasis is placed on IAS 24 as a starting point for analyzing the concept of a related party. Section 4 focuses on the terms of RPTs, and section 5 is dedicated to a comparative analysis of RPTs with similar instruments.

The concept of a related party as provided by IAS 24 and CGCs

The observations below stem from an analysis of the IASs, the CGCs in the jurisdictions in focus and the Ukrainian Principles of Corporate Governance.

Firstly, the Principles refer only to officers and their related parties as being capable of having conflicting interests. They omit any mention of shareholders entirely, as does the German CGC, unlike how this issue is resolved in the Dutch CGC and the WSE Best Practice.

Secondly, the Principles only mention related parties, without explaining how broadly the concept should be interpreted and on the basis of what criteria. It is not entirely clear whether related parties should be interpreted as including officers' family members and to what degree, whether legal entities controlled, jointly controlled or significantly influenced by officers also qualify as related parties and whether clarification may be drawn from other sources, i.e. the IASs or national laws.

Thirdly, transactions involving conflicting interests as meant in the Principles 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.

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, which also refers to relatives by blood or marriage to the second degree, 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.

The concept of a related party under Ukrainian law

Section 3.3 examines Ukrainian statute in more detail, to provide a comprehensive overview of how RPTs are regulated in Ukraine. The following statutes are outlined and studied: the JSC Law of Ukraine, the LLC Law of Ukraine, the Tax Code of Ukraine, the Economic Code of Ukraine, the bankruptcy statutes and the national accounting standards. Ukrainian law does not apply a single unified definition of related parties, instead utilizing several different notions, including interested and affiliated persons, with different meaning depending on context and goal. 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 in the laws governing bankruptcy proceedings. In turn, related parties have been subject to regulation by accounting and tax law. 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.

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 control 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 three years before the bankruptcy proceedings. Most importantly, this list is not exhaustive, and if reasonable grounds exist to regard a particular party as an interested party, then they are so considered. According to the Code on Bankruptcy Procedures, a transaction with interest may be declared null and void by the economic court if it is formed during the three years prior to the beginning of insolvency proceedings. In these circumstances, the possibility to annul a transaction with interest formed with an interested person is not necessarily sufficiently commensurate to unclear and excessively broad criteria that form the basis of the definition of an interested person.

A comparison between the JSC Law of Ukraine and IAS 24 reveals the following differences in recognition of natural persons as related parties.

Firstly, 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 or 20 per cent of the share capital if the 'one share, one vote' principle as currently used in Ukraine applies. In the JSC Law of Ukraine, the threshold is 25 per cent or more of the share capital.

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 party according to statutory requirements or under the terms of a contract.

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

In general, all the acts of Ukrainian law that are analysed in this study commonly refer to the person's spouse (husband or wife) and children as related (i.e. interested) parties. 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 aspects, opinions on whether particular persons should be regarded as related or associated are less unanimous. Brothers and sisters are similarly not always considered to be related parties. While siblings have blood ties to a person, those ties are in the sideways line, as opposed to the 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 relationships.

For the purposes of procedural safeguards under the JSC Law of Ukraine, interested persons do not include controllers (ultimate beneficiaries). At the same time, affiliated persons of interested persons do in fact include controllers. 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. Anecdotal situations exist where one person who controls a company through other means besides share ownership is not viewed as related party for the purposes of procedural safeguards. 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.

Terms of RPTs

Section 3.4 shifts away from the subjective element, and towards the more substantive aspect of RPTs, to discuss the terms of RPTs and what types of RPTs occur. Unlike IAS 24, 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 procedural safeguards contained in the JSC Law of Ukraine (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. However, 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 in order to use as a fair indicator.

Another factor besides transaction value that is significant from the perspective of related party monitoring is the nature of transactions. For instance, 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.

RPTs and similar instruments

Section 3.5 discusses other constructions that might appear similar to RPTs, but that possess features that set them apart from RPTs. These constructions, which require special regulation and do not fall within the scope of this study, are transfer pricing and insider trading. Some notions are inextricably connected with RPTs or often viewed as synonyms: self-dealing, tunnelling, propping, self-interested transactions and transactions with interest.

Self-dealing and tunnelling 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. 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. 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. 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 corporate opportunities) and indirect extraction of benefits using dilutive share issuances, minority freeze-outs, insider trading and other suspicious transactions. 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.

Chapter 4. RPTs in corporate groups

Chapter 4 examines the features of corporate groups, to understand what constitutes a group. The legal and economic views of groups, how they are handled under national and regional (i.e. at the EU level) statutory law, the challenges of affiliation and the reasons to create corporate groups are analyzed. The second section discusses the types of RPTs within corporate groups, with a particular emphasis on intra-group loans and cash pooling.

The concept of a corporate group, and regulation of corporate groups

Formulating the boundaries of what constitutes a group and defining what types of affiliation are irrelevant in corporate groups poses a number of challenges: (a) the view of a group as a set of separate legal entities, versus the growing demand of economic reality; (b) the use of either formal and sometimes unfair criteria versus substantive criteria that lack clarity and are often tied to policy considerations; and (c) vertical groups versus horizontal groups.

Various reasons can be identified for creating corporate groups: (a) immediate access to resources, workforce and potential, without requiring further internal development of the company; (b) apportionment of risks between multiple different entities; and (c) acquisition of de facto control.

The chapter then proceeds to analyse how different national regimes regulate group issues and whether the notion of a group interest is recognized in the jurisdictions in focus. In contrast to how groups are regulated in Germany, Poland and the Netherlands do not possess similar sophisticated sets of rules for corporate groups. However, as the Dutch example shows, group law is clearly in place, both in statute and in case law. At present, case law in the Netherlands provides for recognition of a group interest and has elaborated the consequences of that recognition. It is important to bear in mind, though, that the extent to which group interest is taken into account in the Netherlands largely depends on the provisions of the subsidiary's articles of association: the less detailed the corporate constituent document of the subsidiary is, the more difficult it becomes to recognize the conduct of the subsidiary's management as legitimate if it is detrimental to the subsidiary but favourable to the group. In a way, this regulation is reminiscent of contract-based groups in Germany, where the parent is authorized to issue binding instructions in the group's interests. At the same time, for de facto groups both in Germany and in the Netherlands, recognition of the notion of a group interest at the EU level, as proposed by the European Commission's Action Plans, would add clarity and predictability. This applies even more for Poland, where the notion of a group interest is recognized in case law.

Ukraine does not have the same sophisticated rules for corporate groups as Germany does. This means, first, that contract-based groups are not relevant for the Ukrainian jurisdiction. Even if two companies enter into an agreement that is reminiscent, in all its separate features, of a control agreement or a profit-transfer agreement, no rules on enterprise agreements exist in Ukrainian company law, nor any legal consequences similar to those described in the AktG. That is why these agreements, if they are formed in Ukrainian territory, are governed by general laws on obligations, including the provisions on formation, performance and validity of contracts. Second, rules on de facto groups as are found in Germany are also missing from Ukrainian law, so even though it would be futile to deny the existence of corporate groups in Ukraine, their formation does not trigger the same compensation obligations as in Germany.

Ukrainian law neither recognizes the notion of a group interest as the Netherlands does, nor does it include rules for contract-based groups as are found in Poland. However, although Ukrainian company law favours the legal entity doctrine and requires directors to act in the exclusive interests of the company, this does not necessarily mean that an external body cannot issue instructions to the subsidiary's management or supervisory board and these bodies can be held liable for following those instructions. First, the instructions may be in the company's interests, meaning that no conflict exists between the parent and the subsidiary, or between the subsidiary and its creditors. Second, if the management or the supervisory board acts in a manner that is incompatible with the company's interests by following the instructions of an external body, any company claiming damages from the company's officers would have to demonstrate several conditions originating in tort law: wrongful conduct on the part of the debtor against the company's interests; harm in the form of damage to the company; a link between the debtor's conduct and the damage; fault on the debtor's part. In other words, the instructions from an external company body are merely one factor for the courts to consider when establishing the other conditions.

RPTs within corporate groups

The study then proceeds to describe the types and specific features of RPTs within corporate groups, i.e. intra-group transactions. While giving some attention to the various types of intra-group transactions, this section is devoted primarily to intra-group loans and cash pooling arrangements, as opposed to loans that are viewed as RPTs but have no group element. Intra-group transactions under Ukrainian law are analyzed relative to the German, Dutch and Polish regimes.

A common factor shared by Germany, Poland and the Netherlands is that these jurisdictions extend the requirements governing unlawful distributions not only to public companies (AG, NV and S.A.), but also to private companies (GmbH, BV and sp. z.o.o.), only with slightly more flexible requirements. Ukraine does not have the same degree of capital maintenance and group law rules as the other jurisdictions in focus. Distributions based on upstream or downstream loans are subject to more relaxed regulation in Ukraine, where distributions are limited only by constraints on dividend payments. At the same time, pre-insolvency statutory requirements show a significant level of correlation with the other national laws. Moreover, the most recent amendments to the bankruptcy regulations in Ukraine make it possible to void RPTs concluded within a three-year 'before insolvency' period, which is far stricter than the one year used in Germany and the Netherlands.

Chapter 5. Strategies for RPTs

Chapter 5 investigates the trends launched by a well-known textbook.[1808] Primarily, it discusses the need to develop strategies for RPTs. As noted above, RPTs should not be regarded as perfectly safe market instruments. The need for strategies to handle RPTs stems from the risks that are associated with RPTs and the related opportunistic practices. At the same time, it is impossible to fully accept one of the two contradicting theories for RPTs (conflict-of-interest hypothesis or efficient-transaction hypothesis) and reject the other. RPTs have the potential to both destroy and increase corporate value. That is why it is vital for regulation to consider their risks and advantages.

This chapter analyzes the following main strategies: procedural safeguards for RPTs; information rights and disclosure of RPTs; and the standards strategy for RPTs. To study these strategies, the features associated with the existence of corporate groups are described, and experiences in Germany, Poland and the Netherlands are examined. This chapter also searches for other strategies that cannot be gathered under the umbrella of the traditional strategies: capital maintenance provisions, group law regulations, bankruptcy regulations, and protection of minority shareholders. The chapter's final section addresses the latest developments in EU law in connection with strategies for RPTs.

Procedural safeguards for RPTs

Each of the studied jurisdictions uses procedural safeguards to govern RPTs, with process regulation carrying weight in Ukraine in particular. These safeguards are given shape in two sub-strategies: the agent incentives and decision rights. The agents incentives strategy is based on the rule that the board is a trustee of the shareholders, authorized to act on behalf of the shareholders and for the company's benefit, while the decision rights strategy places the burden in the hands of shareholders.

As this research shows, Germany uses the system of board approval to prevent or mitigate conflicts of interest involving officers only: conflicts of interest of shareholders are not addressed by this strategy. The same is true for Polish law as far as the statutory provisions (the KSH) are

[1808] Kraakman R and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017), 145-169.

concerned. However, under the WSE Best Practice, supervisory board approval may be requested for significant RPTs with shareholders holding more than 5 per cent of the share capital. No such provision is included in the German CGC, whose scope is confined only to conflicts of interest of management and supervisory board members. Regulation of RPTs in the Netherlands is similar to the system used in Poland. While the BW uses procedural safeguards only for conflicts of interest involving management and supervisory board members, the provisions of the Dutch CGC expand the scope of the requirement of supervisory board approval to include RPTs with shareholders holding at least 10 per cent of the share capital.

Unlike in Germany, Poland and the Netherlands, in Ukraine it is statutory law that dictates supervisory board approval for RPTs with shareholders. Similarly to some of the other jurisdictions in this study, Ukraine uses a setup closer to the two-tier system of corporate governance, in that all listed public companies and non-listed public companies with 10 or more shareholders are required to have a supervisory board. Approval from disinterested directors, as described in the Dutch BW, is not a feature of the management of public companies in Ukraine. The role of management is reduced to taking receipt of information concerning RPTs from potential related parties and passing it on to the supervisory board. The JSC Law of Ukraine contains highly detailed rules for the procedure of board approval for RPTs, compared with the rules for RPTs in statutory law in the other jurisdictions analysed here, and with the Principles of Corporate Governance that are effective in Ukraine. Any breach of the procedural requirements is grounds for an annulment claim. An alternative to the remedy of annulling the RPT that parties have applied in court proceedings is to claim invalidation of the decisions of company bodies to approve the RPT. These remedies are severe if they are used for the smallest procedural violation, however, acting as a deterrent to many efficient transactions. For instance, no reasonable justification exists for annulling RPTs that are approved outside the formal period. At the same time, in the hierarchy of procedural breaches, failure to obtain a fairness opinion cannot be viewed as immaterial, but should trigger negative consequences.

The decision rights strategy shifts the approval requirement from the company's officers to the general meeting of shareholders. The result is a more costly and cumbersome procedure. Nevertheless, it would be negligent to completely reject this form of safeguard: it is particularly useful for situations where the board either consists of interested members only, or is reluctant to decide on a transaction. The shareholder approval system is comparatively less widespread than board approval, and is consigned to significant transactions where, most commonly, the related parties are controllers, or where the shareholders' rights have suffered an impairment. Besides the option of approval of RPTs by the supervisory board, a disinterested body or the general meeting of shareholders alone, another possibility is to render RPTs subject to the approval of multiple company bodies. For example, in the Netherlands the idea has been suggested that Article 2:107a of the BW entitles the general meeting of shareholders to have input on management resolutions regarding RPTs.

Both the agent incentives and decision rights strategies for RPTs have been developed for Ukrainian public companies. Strict rules on approval of RPTs go hand in hand with the formal approach taken by courts to invalidate RPTs concluded in breach of the procedural requirements.

Procedural safeguards can be regarded as efficient if they successfully prevent tunnelling, as the major destructive consequence of abusive RPTs, without deterring value-creating transactions. First, the mechanism must subject only high-risk transactions to the procedural safeguards, while leaving beneficial or unimportant transactions untouched. This is given shape through the definition of a related party and by establishing appropriate materiality criteria (thresholds). Second, once a transaction is subject to the screening by a company's internal bodies, those bodies must possess characteristics that make the result efficient. One of those necessary characteristics is independence. That being said, this does not mean that independent directors are a universal solution for family firms with no outside shareholders, or that they can be regarded as panacea for listed companies.

Information rights and disclosure of RPTs

This section covers the national rules on disclosure of RPTs, including statutory law and CGCs, i.e. what specific Member States have to offer in addition to the requirements. Disclosure rules come in two types: duties of related parties to disclose information about RPTs (often as a part of a more general obligation to disclose conflicts of interest) and duties of the company to make information on RPTs public or available to particular stakeholders, including the duties of disclosure assigned to specific company bodies.

The jurisdictions in focus mostly require company officers to disclose their conflicts of interest, including conflicts that stem from RPTs. Shareholders do not usually have a duty to inform company bodies about any RPTs, except as dictated by the regulation of transactions with interest in the JSC Law of Ukraine. Under the JSC Law of Ukraine, shareholders holding 25 per cent or more of the company's share capital and their affiliated parties are required to inform management of future transactions with interest and submit the relevant information and documents.

As the overview of statutory law and soft law in the studied jurisdictions shows, none of the jurisdictions in focus vests shareholders with a special right to access information about RPTs. Rather, disclosure of RPTs is exercised within a general framework right and a corresponding duty. This absence of specific enabling provisions is compensated by the fact that some RPTs are subject to informational scrutiny in these jurisdictions.

Disclosure is essential to manage conflicts of interest and to handle RPTs. The issue therefore does not lie in the need for disclosure, but in the limits of disclosure. For example, non-listed companies should not be regarded in the same way as listed companies for disclosure purposes. Listed companies should bear the duty of increased disclosure, taking into account the special category of minority shareholders. For non-listed companies, disclosure of RPTs as a potentially harmful technique is justified only for companies that, by their size or workforce, present a public interest.

Standards strategy for RPTs

Besides describing the holders of a duty of loyalty, section 2.2 explained the main beneficiaries of that duty, provided a comparison between the shareholder and stakeholder theories, how they relate to the duty of care and what the business judgment rule means. The present section offers a more specific analysis of standards as a means of dealing with RPTs, without the focus on other expressions of conflicts of interest that Chapter 2 had.

Compared with Germany, Poland and the Netherlands, Ukraine's use of standards is less developed. As shown in the previous sections, RPTs in public companies in Ukraine are subject to detailed procedural and informational scrutiny. Courts tend to invalidate RPTs that are concluded in breach of the procedural requirements. This holds true for the nullification of resolutions by company bodies to approve RPTs. In September 2019, amendments to the JSC Law of Ukraine were adopted that now make it possible to invalidate transactions with interest if they are on terms that are less favourable than market terms. Besides those changes, the CCU also provides for a means to invalidate RPTs on general grounds, namely the principles of law (Articles 3, 509(3)) and moral grounds (Article 203(1)). The latter route has little practical significance, however.

Besides the largely ineffective use of standards for annulling RPTs or approving resolutions, the JSC Law of Ukraine also stipulates liability of a person with an interest in a transaction for harm caused to the company in connection with a breach of an established procedure. In practice, this remedy encounters significant hurdles. Firstly, given that the related

party might have a personal connection to the company's officers or major shareholder, it is doubtful that the company would pursue a claim against that related party. Secondly, the burden of proof as it traditionally applies in cases involving damages, including the requirement to provide evidence of an illegal act or omission by a related party, the negative effect (harm) of an RPT and the causal link between the two, creates another significant obstacle to obtaining an award for damages against a related party.

The standards strategy is beautiful in its flexibility. Its success depends largely on the enforcement actors, who must identify and police harmful transactions. The problem lies in how the enforcer should separate value-creating transactions from their destructive counterparts. Courts in Germany and the Netherlands have a longstanding history of path-dependent scrutiny of RPTs using culture-specific standards: group law (*Konzernrecht*) in Germany versus the legal principles of fairness and reasonableness (*redelijkheid en billijkheid*) in the Netherlands. Poland's approach, in contrast, is more casuistic, while in Ukraine the standards strategy is still in development.

Despite the drawbacks to a standards strategy, I am far from convinced that it is inappropriate. On the contrary: it would be desirable to have efficient institutions deciding cases, making the utmost of their intellectual resources, in order to ensure fairness in transactions between related parties. In the real world, unfortunately, this is not always practicable. Courts in some jurisdictions are insufficiently developed to be entrusted with complex firm-specific corporate solutions, where insiders would perform better and more shrewdly. In Ukraine, the courts are more comfortable deciding cases where no deep substantial review is required. Still, this does not automatically mean that the standards strategy has no chance of succeeding in Ukraine. The Ukrainian jurisdiction, which relies heavily on trusteeship and the decision rights strategies for dealing with RPTs, is at a crossroads in its development. This does not mean that the standards strategy is the future of RPT-related strategies in Ukraine. Rather, I would argue that the standards strategy, if it is implemented in Ukraine, should be introduced in combination with institutional development and must make allowance for the demands specific to the country, for instance proper allocation of the burden of proof in damage claims. An analysis of that institutional development would extend the boundaries of this research considerably, however. The factors that should be taken into account when designing the proper strategy for dealing with RPTs in Ukraine are discussed in more detail in Chapter 6.

Development of strategies for RPTs in the EU

Section 5, lastly, examines the most recent amendments to EU law regarding RPTs, to explain how the various drafts of SRD II evolved until the Directive reached its current form. Besides the development of SRD II, section 5 also briefly addresses the procedural and informational safeguards contained in other sources of EU law. Procedural obligations for RPTs derive, among other sources, from Article 52 of Directive 2017/1132 and the Commission Recommendation of 15 February 2005. Disclosure requirements can be found in the Accounting Directive, the Transparency Directive and the Market Abuse Regulation.

SRD II, which was adopted on 17 May 2017, is the result of several years of heated debate and discussion among its drafters, practitioners and scholars, and substantially expands the provisions of SRD I. Before the draft SRD II reached its current form, it went through a series of draft proposals, which are analyzed in this section: (a) the first proposal of 9 April 2014; (b) the Italian Presidency compromise texts of 10 November 2014 and 5 December 2014; (c) the Latvian Presidency compromise text of 14 January 2015, and a further modified version of 20 March 2015; (d) the discussion version of the EP, made public on 22 July 2015; (e) the Slovak Presidency compromise text of 22 November 2016; and (f) the draft version of SRD II of 2 December 2016.

The final version of SRD II differs from the first proposal issued during the Greek Presidency of the Council in April 2014. An analysis of the first proposal of 9 April 2014 and the

Italian Presidency compromise text provides sufficient evidence to support the argument that the latter version of the draft demonstrated a shift towards a more flexible regulation of RPTs by listed companies. Compared with the provisions of the first proposal of 9 April 2014, the later draft gave Member States freedom to define the materiality criteria for subjecting RPTs to the announcement, report and approval requirements, to authorize a specific company body to approve RPTs and to provide exemptions from the requirements.

Although the Italian Presidency compromise text laid the foundations for the understanding of where and how the announcement, report and approval mechanisms should be triggered, the input provided during the Latvian and Slovak Presidencies should not be underestimated. It was in the Council's text of 20 November 2015, under the Latvian Presidency, where most of the exemptions and specific provisions for transactions between a company's related parties and its subsidiaries made their first appearance. Those provisions were preserved in the Slovak Presidency compromise text and passed into the final Directive.

Based on an examination of the German, Polish and Dutch company law regimes, the conclusion is justified that the existing approval procedures for RPTs of listed companies in these jurisdictions are more relaxed than the new EU rules. This has forced the Member States to take steps to be able to implement SRD II. An analysis of the draft bill submitted by the Dutch government shows a flexible approach for companies and a high degree of alignment with the provisions of SRD II, except for the parts concerning the definition of a material transaction. In those parts, the legislators have decided to use unclear abstract wording and apply a literal, but arguably accurate, interpretation of the Directive's provisions.

Ukraine is not an EU Member State, and even though SRD I is one of the Directives subject to implementation under the EU-Ukraine Association Agreement, this obligation does not extend to newly adopted EU instruments. As such, Ukraine only has a right, and not an obligation, to implement the new rules. Interestingly, however, the procedural safeguards for public companies and (optionally) for private companies that are already in place in Ukraine are similar to what SRD II seeks to achieve. For example, in both cases RPTs must undergo a procedure of approval by a competent disinterested body of the company, be subjected to a third-party expert's the fairness opinion and be publicly announced. Another point that the two regimes have in common is the use of materiality criteria in both the JSC Law of Ukraine and SRD II. The difference here lies in how abstract those criteria are: the materiality criteria in SRD II are no more than guidelines for Member States to consider and interpret in their national laws, while in Ukraine the criteria are more specific. The JSC Law of Ukraine requires that safeguards apply only to RPTs that represent a value in excess of 1 per cent of the company's assets, with approval from the general meeting of shareholders being mandatory for RPTs representing 10 per cent or more of the company's assets.

The provisions concerning RPTs in the JSC Law of Ukraine and SRD II differ in the following respects: (a) the scope of regulation: only listed companies in SRD II versus all public companies under the JSC Law of Ukraine; (b) a broader concept of transactions with interest in the JSC Law of Ukraine, versus the notion of an RPT in the SRD II; (c) a broader concept of related parties, based on IAS 24, in SRD II, versus the concept of a related party as stipulated in the JSC Law of Ukraine; (d) a special exemption in SRD II for RPTs conducted on normal market terms and in the ordinary course of business, for which an internal procedure should be instituted; (e) different lists of exemptions; (f) aggregation of RPTs for the purposes of safeguards in SRD II, versus no specific aggregation requirement for RPTs in the JSC Law of Ukraine; (g) a longer list of persons authorized to provide a fairness report under SRD II; (h) unlike SRD II: no constraints on transactions between a company's subsidiary and its related parties under the JSC Law of Ukraine.

Chapter 6. Choice of strategy for RPTs in Ukraine

While Chapter 5 gives an overview of the various strategies used in the EU, in the national jurisdictions in focus or in general, as recognized in company law theory, the purpose of Chapter 6 is to identify the proper strategy (or strategies) for Ukraine. This chapter first outlines the factors that determine the choice of strategy, then proceeds to discuss the implementation of strategies for RPTs in Ukraine, and finishes with prospects and solutions for developing a Ukrainian regime for RPTs, based on the previously described factors and background.

Factors influencing the choice of strategy

Section 6.1 analyzes the factors that should be taken into account when selecting the appropriate strategy for RPTs. Part 6.1.2 examines how strategies for RPTs can be implemented. The structure of share ownership in companies from the three jurisdictions discussed shows that companies in those jurisdictions appear to have stakeholders with the capability to effectively monitor RPTs. The three jurisdictions employ both ex ante and ex post remedies to tackle RPTs. In the Netherlands, the provisions of tort law in combination with the principles of reasonableness and fairness have been used to successfully penalize shareholder misconduct. In addition, Germany, Poland and the Netherlands have capital maintenance regulations that can be used against shareholders seeking to extract corporate wealth. At the same time, statutory law in Germany, Poland and the Netherlands is not much concerned with procedural and informational scrutiny of transactions with shareholders or their related parties. The focus is primarily on misconduct by managers, supervisory board members and their related parties.

The final part of section 6.1 covers other important factors that must be considered in the design of strategies for RPTs. How share capital in companies is structured provides information to help identify the main players on the market and the context of their corporate governance. Besides share ownership, which in Continental Europe is largely concentrated, other factors also need to be taken into account: the general state of the country's economy and the standard of the legal system; path dependency, making allowance for universally applicable rules; the balance between freedom and coercion; the choice between ex ante and ex post safeguards; the difference between 'law on paper' and 'law in action'; and the overall environment for RPTs.

Implementation of RPT-related strategies in Ukraine

Bearing in mind that the purpose of the research is to identify the best solutions for RPTs in Ukraine, section 6.2 examines the implementation of RPT-related strategies, combined with the factors outlined in the previous section.

Although public companies that emerged from privatization are important to the Ukrainian economy, their role is not overwhelming: of the 200 companies with the largest profits in 2016, more than 100 were private companies and similar business forms. Most of the companies have concentrated ownership. Corporate groups are also a prominent feature of Ukraine's corporate landscape. This configuration of market players poses the key challenge for the company law reform: how to offer better protection to investors, without disincentivizing large shareholders.

Other relevant features of Ukrainian company law and the country's reality include the following: a Romano-Germanic Continental legal system; successful examples of legal transplants from the jurisdictions in focus; an obligation to implement EU law pursuant to the EU-Ukraine Association Agreement; weak institutions and underdeveloped standards; and predominantly formal interpretation of facts by the courts.

Development of Ukrainian law on RPTs: prospects and solutions

The final section of Chapter 6 answers the key research question, outlining the following general directions for improving Ukraine's regime for RPTs: further implementation of EU law for RPTs, including implementation of SRD II and the Second Council Directive (now codified in Directive 2017/1132); improvement of capital maintenance rules; special regulation of corporate groups, including recognition of the notion of a group interest and more sophisticated regulation of intra-group loans; development of regulations of derivative suits and further rights for minority shareholders; development of traditional strategies for RPTs, including procedural safeguards, disclosure and standards; improved regulation of conflicts of interest, including the overly broad definition in the LLC Law of Ukraine; a greater focus on RPTs in CGCs, namely in its Ukrainian analogue, i.e. the Principles of Corporate Governance.

The chapter ends with the conclusion that in Ukraine, and under the conditions that prevail there, minority shareholders as a class remain under-represented. Amendments to company law and corporate governance can therefore not be justified by the need to protect minority shareholders only. Given this situation in Ukraine, the need to reinforce the capital maintenance rules derives more from respect for other stakeholders, including creditors. The prevalence of corporate groups also necessitates implementation of the notion of a group interest, and greater focus on the corporate opportunities doctrine, to expand the scope of conflicts of interest and the duty of loyalty. While the procedural requirements for RPTs under Ukraine's company law regime are already detailed, the country's poorly functioning court system means that the standards strategy remains underdeveloped.

Chapter 7. Conclusions and recommendations

Chapter 7 presents and summarizes the research conclusions and recommendations, with a view to striking the proper balance between transaction freedom and overregulation to ensure protection of all groups of stakeholders in Ukraine.

Despite the focus on the German, Polish and Dutch jurisdictions, in order to understand how Ukrainian company law can be improved, the research shows that, at least as far as RPTs are concerned, Ukraine has the more detailed and nuanced procedural strategies. This might be connected to the relatively underdeveloped nature of the standards strategy in Ukraine and the use of other means instead. Still, even if considered separately from Ukrainian company law, the laws of the EU Member States analysed here seem to be lacking in terms of procedural and disclosure instruments for tackling the issues of RPTs. It appears that this gap will be filled by SRD II, whose development is described in section 5.5, by requiring Member States to implement the announcement, report and approval obligations for listed companies. Moreover, despite the argument that approval and disclosure strategies for RPTs are more developed in Ukraine, it would be far from accurate to conclude that Ukraine's RPT-related strategies reflect the pinnacle of regulation. Although these obligations have been in place for RPTs by Ukrainian public companies since 2009, much room for improvement remains in the current regime of safeguards under the JSC Law of Ukraine – as evidenced by the recommendations suggested above, including implementing SRD II.