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## RESTRICTIONS ON THE EXERCISE OF CORPORATE RIGHTS BY OFFICIALS IN UKRAINE: PROBLEMS AND WAYS OF IMPROVEMENT

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**Annotation:** Politics and entrepreneurship must be separate concepts to create an effective system of public administration. Despite the improvements of the Ukrainian legislation to make the system more transparent, the reality of its implementation has a range of contradicting points. In particular, the question of the importance and necessity of restricting the exercise by officials of their corporate rights, such as the rights to own, organize and manage the business, remains a matter of debate. The article considered the paradoxes of anti-corruption laws of Ukraine and proposed appropriate solutions to these problems. Only with effective anti-corruption legislative and executive state instruments Ukraine will be able to improve its legal framework and reduce the level of corruption.

**Key words:** conflict of interests, official, corruption, corporate rights, economic activity, deputy of local councils, disciplinary responsibility.

The conflict of interests is the main prevention for the officials to conduct the business activity. With a wider range of the power, the cases of abuse of authority are not rare in the country. Experts from the European Union Anti-Corruption Initiative in Ukraine (EUACI) have assessed the effectiveness and efficiency of managing conflict of interest in Ukraine. They have worked out 36 recommendations for improving this process based on the results they obtained from this investigation. [1]. Taking into account the recommendations received, we will consider the implemented mechanisms to prevent the occurrence of a conflict of interest in the case that an official has corporate rights.

The history of the Ukrainian legislation aimed at combating corruption is quite dynamic. For the first time in Ukraine, the prohibition of civil servants and some other categories of public persons to engage in entrepreneurial activity and to be a member of the executive body of a legal entity carrying out entrepreneurial activity was established in 1995 by the Law on Combating Corruption [2]. But at that time the essence of the concepts of "entrepreneurial activity" and "ownership of corporate rights" and their differences were not specified in the normative acts. Therefore, doctrine and judicial practice did not identify these concepts.

Finally, the difference of these two terms was defined in 2003. According to Part 1 of Art. 167 of the Economic Code of Ukraine, corporate rights shall be understood as the rights of a person, whose share is determined in the authorized fund (property) of a business organization, and including legal powers of such person in management of a business organization, receiving a certain part of a profit (dividends) of the organization, as well as its assets in the event of its liquidation according to the law, and other legal powers envisaged by the law and constituent documents [3].

The Economic Code states that the possession of corporate rights is not considered entrepreneurship in Part 2 of Article 167. It defines that persons authorized to perform the functions of the state or local self-government may lawfully own a share in the authorized capital of a limited liability company, acquire ownership of shares, but without direct participation in the management process.

The situation was somewhat complicated by the Law on the Principles of Preventing and Combating Corruption, which in 2011 replaced the Law on Combating Corruption. In addition to the traditional prohibition on doing business, the new law also prohibited persons performing state or local government functions “being a member of the governing body or supervisory board of a for-profit enterprise or organization” [2].

The Ukrainian deputies have not omitted this restriction implementation. They immediately drew attention to the fact that such a prohibition also applies to the general meeting of the company, which automatically includes all owners of its shares, and decided to appeal to the Constitutional Court. The deputies referred to the fact that the statement of the new law contrary to Article 41 of the Constitution of Ukraine does not allow officials to enter the general meeting, which consequently means a ban on owning corporate rights. Such a restriction contradicted the right on corporate rights ownership provided by the main state law. By the decision of the Constitutional Court of 13.03.2012 № 6 / 2012, this provision of the Law regarding the prohibition to participate in the general meeting was declared unconstitutional as contrary to the principle of inviolability of property rights [4].

As a result, the new law, which regulates questions related corruption was worked out. The Law on Prevention of Corruption was introduced in 2014. It prohibits business activities, but does not restrict the right of officials to own corporate rights. Thus, today, any person authorized to perform the functions of state or local self-government can own corporate rights and act as the ultimate beneficiary of any company [5].

The main goal has appeared in front of the Ukrainian legislation. It is to prevent a conflict of interest, the essence of which lies in having a private interest in the area in which official performs his official or representative powers. It can affect the objectivity or impartiality of his decision-making, or the performance or non-performance of actions during the exercise of these powers. According to Part 1 of Article 36 of the Law "On Prevention of Corruption" all persons authorized to perform the functions of state or local self-government, as well as officials of legal

entities under public law and persons who are members of the supervisory board of a state bank, enterprise or profit organization, within 30 days after appointment (election) to the position must transfer to the management of another person their enterprises and corporate rights. Within 1 day after the transfer, the person must notify the National Agency for the Prevention of Corruption (NAPC) in writing form and provide a notarized copy of the contract. In addition to the written notification of the NAPC on the transfer of corporate rights to management, such transfer must also be properly reflected in the electronic declaration. Interestingly, the Law provides for the need to declare information about the person-manager of securities (part 1 of Article 46 of the Law "On Prevention of Corruption"), but does not have a similar direct obligation to declare managers of other types of corporate rights, including shares in LLCs. It is also significant that the interface of the electronic declaration in the section "Corporate Rights" does not contain a separate column "Manager".

While studying the specifics of preventing conflicts of interest in connection with the officials' possession of enterprises or corporate rights, it should be emphasized that it does not consist in an exclusive prohibition of an official to have any private interests. The official can have corporate rights, but his participation in the company's organization or management can be threat to indict him in the conflict of interests.

In addition to the obligation to transfer, the Law also specifies possible ways of such a transfer. In the case of a unitary enterprise (formed by one founder), the transfer of the official's corporate rights to management of another person should be carried out by concluding a property management agreement with the business entity. The common ways of corporate rights transfer in Ukraine are the following:

- 1) concluding a property management agreement with a business entity (except for a securities management agreement and other financial instruments);
- 2) concluding an agreement on management of securities, other financial instruments and funds intended for investment in securities and other financial instruments with a securities trader licensed by the National Commission on Securities and Stock Market to conduct securities management activities. ;

3) concluding an agreement on the establishment of a venture mutual investment fund for the management of transferred corporate rights with an asset management company licensed by the National Commission on Securities and Stock Market to conduct asset management activities.

The most widespread ways are the first and the second ones, they are used in case corporate rights in the unitary enterprise and a joint stock company respectively. The agreement the establishment of a venture mutual investment fund is not common for Ukrainian official due to the procedure complexity.

The law "On Prevention of Corruption" does not allow the officials to transfer to the management of their enterprises and corporate rights for the benefit of family members, as well as to enter into these agreements with entities in which their family members work. Family members of persons authorized to perform the functions of the state or local self-government, as well as officials of legal entities under public law should be understood as persons who are married (spouse), regardless of their cohabitation. If there exist a set of such features as cohabitation, connection with common life and the existence of mutual rights and responsibilities, family members should also be considered children (including adults), parents, caregivers and guardianship, as well as any other persons, including those who live together but are not married (except for persons whose mutual rights and responsibilities are not family ones) [6].

But in most cases the officials have a wider circle to whom they can transfer their corporate rights. And consequently they continue to control the management process and contribute to the welfare of the transferred companies. In particular, one of the recommendations provided by EUACI experts is to expand the circle of such persons. In order to make this process as transparent as it is possible, the prohibition to the officials to transfer their corporate rights to any person with whom they have any personal relationships must be introduced. So, in the list of such persons we should add friends and business colleagues or acquaintances.

At the same time, despite the restrictions on the transfer of corporate rights or enterprises for the benefit of family members, the law does not prohibit their gift or

sale to such persons. This means that officials have one more way how to stay in touch with the actual state of affairs of their enterprises sold or presented to the family members. Under such conditions, international experts recommend banning legal entities that are even partially under the control of a civil servant or members of his family, concluding agreements with the body where the civil servant works or has worked for the last 12 months.

Although in the Guidelines the NAPC presents the transfer of corporate rights to management as "necessary and sufficient actions" to resolve conflicts of interest, in reality this does not work. In accordance with Articles 1033 and 1034 of the Civil Code, the property management agreement does not entail the transfer of ownership rights to the manager of the transferred property, and the benefits of such property still belong to the corporate rights owner, but not the manager [7]. Thus, even after the transfer of corporate rights to management, the official still has a private interest in the understanding of Article 1 of the Law "On Prevention of Corruption", as these corporate rights continue to be in his possession.

Providing in the Law such a way to prevent conflicts of interest, the legislator did not take into account the need to amend the provisions of the Civil Code of Ukraine or establish additional requirements to the property management contract concluded by a civil servant, which would contribute to Article 36 of the Law "On Prevention of Corruption". This conclusion is justified by the fact that the transaction is under the unlimited scope of regulation of Civil Code of Ukraine with its principles of freedom of contract (paragraph 3, part 1 of Article 3) and the presumption of legality of the transaction (Article 204) [7]. These principles of private law allow unscrupulous officials to enter into property management agreements, with the terms, which provide for the possibility to give instructions to the manager or to determine other mechanisms of their influence on the work of their own company.

Undoubtedly, the proposal of EUACI experts to develop a standard contract for the transfer of management of corporate rights or enterprises is very useful, as well as a recommendation to legislate the binding nature of its provisions in compliance with the requirements of Article 36 of the Law "On Prevention of Corruption". In such a

way the official would be obliged to transfer their corporate rights according to common procedure defined in the Ukrainian legislation. The number of possible violations regarding participation in the contribution to their companies development would decrease significantly. It is also appropriate to provide for a rule that would establish the nullity of a transaction entered into in violation of the requirements of such a standard contract.

Deputies of local councils have become hostages of the Ukrainian legislation uncertainties. They belong to the persons authorized to perform the functions of the state or local self-government, consequently they are also obliged by law to transfer their corporate rights to management of some individual. At the same time, unlike deputies and the vast majority of categories of officials, deputies of local councils exercise their powers on a voluntary basis "without interrupting economic or official activities" (Article 6 of the Law "On the status of deputies of local councils") [8]. This causes a paradoxical situation - a local council deputy has the right to engage in entrepreneurial activities and work in commercial structures, but at the same time is obliged to transfer his corporate rights.

In our opinion, deputies of local councils should be excluded from the list of persons to whom requirements to transfer their corporate rights are entailed in Article 36 of the Law "On Prevention of Corruption". A situation in which a person can fully engage in business, but at the same time is obliged to transfer it to another person's management, does not correspond to the legal logic and spirit of the law.

If we compare the experience of the Western countries and Ukrainian one in the question of preventing conflicts of interests, we can claim that their general rules are more effective. Politicians in that countries are more responsible and they transfer the corporate rights with one main aim: to prevent corruption realization. So, foreign officials or others for whom this is important often transfer their personal assets (including investment income) to the management of blind trusts to avoid attention and accusations of conflict of interest when they direct public funds to the private sector. Blind trust is a trust in which persons who have received a power of attorney for property have complete freedom of action regarding the assets, and beneficiaries

do not have any information about the assets of the trust and have no right to interfere in the work of trustees. Blind trusts are commonly used when the founder wants the beneficiaries to be unaware of the specific assets of the trust, for example, to avoid a conflict of interest between the beneficiary and the investment [9].

Ukrainian anti-corruption legislation should adopt Western experience of legitimizing the settlement of conflicts of interest by transferring assets to a blind trust.

The system of liability for failure to comply with the requirements of Article 36 of the Law "On Prevention of Corruption" on the transfer of corporate rights to management is not developed effectively. There is no administrative or criminal liability for this violation. Currently, the only possible form of liability that a person can bear for violating the requirements of Article 36 of the Law is a disciplinary liability.

In case of violation by the official of Article 36 of the Law, the NAPC shall issue an order to the head of the enterprise, institution or organization where the violator works to eliminate the offense, conduct an official investigation and bring such a person to justice. After the receipt of the order, the NAPC imposes a disciplinary sanction on the perpetrator. The type of such penalty depends on the identity of the offender - for example, if it is an employee of a state enterprise, he may be reprimanded or dismissed (Article 147 of the Labor Code of Ukraine) [10], if it is a civil servant - it can be a remark, a reprimand, a warning about incomplete official compliance or dismissal (Article 66 of the Law "On Civil Service") [11]. If the manager has not complied with the requirements of the order and within 10 working days from the date of receipt of the order did not notify the NAPC of its implementation, he is held administratively liable according to the Article 18846 of the Code of Ukraine on Administrative offenses [12].

In this context, another consequence of any corruption offense should be identified and understood by the officials. Even in the case of the most lenient disciplinary measure, the violator in accordance with Article 59 of the Law must be entered in the open Unified State Register of persons who have committed corruption



or corruption-related offenses [13]. Any person can check the presence of an official in the Register, which creates additional reputational risks for him. Moreover, the presence of a violation by a person in the Register can significantly impair his / her career advancement in state bodies or lead to a refusal during the competitive selection for certain positions. Despite periodic media reports of violations by officials of the requirements for the transfer of corporate rights to management, the Register currently contains only 18 records of violations of Article 36 of the Law. In all cases, the offenders were reprimanded or given a milder form of punishment.

Lack of administrative and criminal liability for not following the Article 36 of the Law "On Prevention of Corruption" is a significant disadvantage. Certain categories of persons may not transfer their corporate rights to management, use them for their profit and still stay unpunished. All that remains in this case is political responsibility. Therefore, in order to improve the existing legislation basis, it is necessary to introduce a clear procedure for liability for non-compliance with the law.

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