RAIDER ATTACKS IN UKRAINE

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Introduction

In the Resolution by the Cabinet of Ministers of Ukraine On Approval of the Declaration of Objects and Missions of the Budget for 2008 (The Budget Declaration), 'raider attack' is defined as “disposal of the state–owned property and corporate rights other than following the privatization proceedings or illegal seizure of a company”. However, in Ukraine, as well as in Russia and in other transitional economies of Eastern Europe the phenomenon is not limited exclusively to the hostile takeover of state property, state-owned companies and enterprises.¹

In practice, hostile takeovers also threaten private enterprises, real estates, land or any valuable assets whether they are with domestic or foreign interest, thus, they have extremely negative effects on the country’s investment climate and sets back the inflow of FDI as well.

Illegal features such as malicious intent, corrupt practices, bribery, blackmail are in general typified of Ukrainian raider attacks and also supported by fake court decisions and the assistance of different law-enforcement agencies in most of the cases.

As state organs such as courts and law-enforcement agencies are deeply involved in the abusive activities, the existence of the ‘raiding’ problem can be also considered as manifestation of the high level of lawlessness in the public administration, inadequate governmental regulation of the business sector and in general the lack of rule of law in the country.

Thus, in order to implement effective measures combating raider attacks, Transparency International advises to apply a blend of corruption and risk assessment tools for business environment and enterprise performance² both for governmental bodies and members of the private sphere with the objective of enhancing transparency in financial regulations³ and creating adequate anti-corruption instruments tailored to/for the Ukrainian conditions.

What ‘color’ fits raider attacks in Ukraine?

Raiders, while performing their activities use a wide range of methods in order to obtain the assets of the target firm, making use of different defects of the public administration system. The transfer of control over the company beyond the will of its owner is also feasible in compliance with the active laws. Such legal methods can be, for instance buying-out of the shares of the minority shareholders, buying its extensive debt or re-electing the management. This is the so-called ‘white’ sort of raider
attacks, when raiders capitalize on the loopholes of the opaque Ukrainian financial regulation system and confusing tax system, but do not violate law by doing this.\textsuperscript{iv}

Since Ukraine’s extremely complicated bureaucratic system sets huge obstacles in the interactions of governmental agencies and business parties, the latter frequently chooses illegal means to foster the processes of gaining licenses, permits, favorable court decision or treatment by authorities. Raiders also make use of this practice, however with the aim to create reasonable legal grounds for the takeover. The application of biased court resolutions, procuring tax inspections to impair the target firm or sabotaging it’s license granting are the most common vehicles of ‘gray’ raider attacks.

“While until 2010 99 percent of major raider attacks were performed by court decisions, after the election of Viktor Yanukovics as president of Ukraine, the pressure comes through the law-enforcement agencies” claims Yuriy Kravets, board chairman of a non-governmental organization named the Anti-Raider Movement.\textsuperscript{v} This indicates the emergence of the third type of hostile takeovers, known as ‘black raider attacks’, where raiders’ instruments also include the use of physical violence, threatening, bullying, supplemented by forgery of documents, files, company records and signatures.

\textbf{Motivation}

As the means of execution, the purposes, executors and procurers of raider attacks also vary. Although their object is mostly economic natured, the reason behind takeovers, can be somewhat different. When hostile takeovers are performed in anticipation of increasing the profit of the company-aggressor, the main goal can be simply to acquire a profitable company, since “today it's easier to take over a business in Ukraine than to buy it”\textsuperscript{vi}. However, in some cases, the selection of targets can be preceded by complex economic consideration.

For instance, the aggressor-firm might improve its market position by gaining confidential information about competitors or simply eliminating competitors by revealing.\textsuperscript{vii} Forced synergy with the target firm can make accessible various devices to reduce production or distribution costs, while corporate mergers may also result in tax benefits. Another possible financial motivation for corporate combinations can be reduction in bankruptcy costs through diversification. Finally, mergers can also serve as a beneficial way of replacing inefficient management, as their costs are still lower than the costs of other alternatives.\textsuperscript{viii}
As a recent example of non-economically motivated raider attacks, the case of the Kiev-based Vsesvit Publishing Company can be mentioned. Since the publisher of the independent journal 'The World' has very limited financial resources, the spring of action suggests political motives in the background.ix

Sometimes the instigator of raider attacks is not even a natural person or management of a rival company: In 2010 the Ilyich Iron and Steel Works and the Zaporizhstal plant, Ukraine’s flagship metallurgical enterprises were subjects of such attacks, when a secretive group of Russian investors claimed that it had acquired the firm. According to Ukrainian officials, the mentioned takeover group is backed financially by Russia’s state-owned Vnesheconombank, chaired by Vladimir Putin, the Russian ex-prime minister.x Under the political circumstances of 2010, these actions could hardly be driven only by the goal of profit maximization, the mainsprings were rather of a political nature.

Deficiencies in regulation*

As we saw, different Ukrainian state organs in various ways shall facilitate the ‘raider phenomenon’. Some passively, merely by negligence create the conditions for the maleficent activities of raiders, certain ones actively assist hostile takeovers, while in some cases state officials are also deeply involved in one way or another. Consequently, regulations should be implemented bearing in mind these particularities.

As far as the corporate and remedial legislation is concerned, the Ukrainian legal system is full of regulatory gaps and contradictions. Ukrainian law does not establish specific legal conditions to a takeover offer and there is no developed case law either. As the system of registration of legal entities does not warrant the protection private information, it provides the possibility of abuse.xi

What regards the incidence of corruption in judicial bodies, it is apparent, that certain judges serially collaborate with raiders, adjudicating in their favor from time to time with remarkably similarly worded judgments. Even if the targets of illegal raider attacks apply with complaints against these judges, impeachment does not follow by .xii In other cases, supervisors instruct junior judges what verdict should be given if they want to keep their jobs.xiii In terms of geographical distribution, biased judgments are more common in courts located in the remote regions of the country, since there is no unified, national, and accessible-by-everyone electronic system of all filed and pending civil cases, therefore the victims usually become aware of the verdict too late.xiv
An increasing number of raider attacks is executed with the assistance of bribed officials of law-enforcement agencies. A well-known example of such methods is the case of Hermitage Capital Management, where corrupt officials of the Russian interior ministry seized documents and corporate seals of the mentioned company, which were later used to forge backdated contracts in the name of the company. Then, these contracts gave ground for the tax-authority to charge the management for tax-fraud.

Preventive measures

Since the possible targets of raider attacks are not limited neither to enterprises of a particular segment of the economy, nor to a certain company-size, it is extremely important for company-managements in general to conduct preventive measures in order to reduce the risk of becoming a victim.

First of all, the current owner of the company has to make sure that the constituent documents, as well as latter settlements and agreements fully comply with the active laws of Ukraine, since haphazard breaches can serve as pretext for malicious judgments of dishonest judges.

It is advisable for the management to maintain full transparency regarding the disposal of large amounts of cash, the borrowing of large loans and in general the execution of all transactions.

Developing the Regulation on Non-Disclosure of Trade Secrets and Confidential Information can secure confidentiality.

Since buying out of shares from minority stakeholders is a potential method for hostile takeovers, major stakeholders should constantly endeavor to extend their shares.

At corporate mergers one should also carefully select partner companies with good reputation and long record of operation, since these agreements make enable various instruments for raiders to take over the target-company.

By performing continuous monitoring of assets and liabilities of the company the purpose of hostile takeovers can be revealed in advance with a good chance. This can be done for instance by periodically obtaining registers of transactions, resolutions of the courts with respect of the company.

It is also advisable to keep private corporate documents in a safe place inaccessible for
unauthorized persons, for example at the notary custody, or in a banking vault. Such documents should include resolutions of the management and controlling bodies of the company, sample signatures of the major shareholders and senior managers, the corporate seal, and official confirmations of the rights for the main assets.

Finally, safekeeping of assets by hiring private security companies is also a good way of scaring away potential raiders.

**Perceiving the signs of raiding**

If the owner of an enterprise becomes aware of buying-up of corporate rights or shares under suspicious circumstances, there is a huge chance that the company is under raider attack. It is even more obvious, if a bailiff delivers a strange resolution of a governmental agency or a notification of a court decision in an unknown case brought without even notifying or summoning the company’s legal representatives. In such a situation it is important to make immediate countermeasures in order to prevent further damages.

If the sort of the concrete case demands, performing a counter buying-up of shares by offering a better price for minority shareholders could stop raiders buying themselves into the company, therefore the takeover can be prevented. When raiders use the ‘stock-buying’ instrument, an additional issue of shares could also be performed in order to keep the majority of rights in the owner's hands. Another solution is that company assets are transferred to the property of a controlled entity, which has a more robust form of legal organization in withstanding the raider attacks. It is important that the transfer is executed legally, for instance by the means of sale or contribution.

In the event of biased court judgments it is advised to notice of appeal as soon as possible and to file a complaint on the improper proceedings of the participating law-enforcement bodies, however, in some extreme cases (like in Russia the case of Sergei Magnitsky and the Hermitage Capital Management) this step could entail further malicious actions from the side of perpetrators in order to avoid impeachment.
Recommendations

The 'reyderstvo' phenomenon appears to be one of the major obstacles for effective business activity in Ukraine. Therefore, fighting it is inevitable in order to improve investment climate in the country and create a corporate legislation system complying international standards.

Courts without Corruption\footnote{vii}

- In order to abolish corruption in courts, judicial independence must be guaranteed.
- Judicial decision-making process must be freed of the influence of senior members, the executive branch and the government.
- The role and influence of the mass media in fighting corruption must be supported by improving the access of journalists to information relevant to judicial corruption.
- It is crucial to conduct constant monitoring of the judicial system in order to assess the impact of reforms. It is possible that new methods of assessment will needed to be developed over time, including improved interaction with the state structures that are responsible for reforming the judiciary.

What regards the private sector\footnote{viii}

- Protection of property: Investor protections matter for the ability of companies to raise the capital they need to grow, innovate, diversify and compete.
- Regulations in the business sector: Strong regulations clearly define related-party transactions, promote clear and efficient disclosure requirements.
- Reforms to strengthen investor protections may move ahead on different fronts—such as through new or amended company laws or civil procedure rules.
- Decrease the administrative burden of complying with taxes.
Appendix

Main laws and regulations of takeovers and mergers in Ukraine (active in 03/01/2012)


The relevant governmental and regulatory authorities

National Bank of Ukraine

**Main area of responsibility.** National Bank of Ukraine is the central bank of Ukraine. The main responsibility of the bank is providing national currency stability, by implementing unified state fiscal policy.

National Stock Market Securities Commission of Ukraine

**Main area of responsibility.** The National Stock Market Securities Commission of Ukraine is a specialised governmental authority regulating relations on the Ukraine securities market.

Antimonopoly Committee of Ukraine

**Main area of responsibility.** The Antimonopoly Committee of Ukraine is a specialised governmental authority with special status, aimed at providing state protection to competition in the field of entrepreneurial activity.

State Property Fund of Ukraine

**Main area of responsibility.** The State Property Fund of Ukraine is a specialised governmental authority carrying out the state policy in the area of state property privatisation.