



**CENTRAL EUROPEAN UNIVERSITY
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**FOREIGN DIRECT INVESTMENT IN UKRAINE AND
GERMANY
– A COMPARATIVE STUDY –
BY
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COURSE: DRAFTING AND NEGOTIATING INTERNATIONAL
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Abstract

This thesis focuses on the problems of Foreign Direct Investment (FDI) in modern Ukraine. The main question asked is: Has Ukraine managed to create attractive legal environment for FDI? The analysis of the national Ukrainian legal framework is made through its comparison with the legislation of Germany. The results of the research show that the Ukrainian investment legislation is overloaded with definitions and artificial restrictions for foreign investors which is an obstacle to achieve balance between the national interests and the attractiveness of the country for FDI. With regard to the company law being the central category for FDI, this thesis identifies the necessity to eliminate contradictions between the existing Ukrainian laws and the possibility to follow the German model of regulating limited liability companies and stock corporations with some limitations. As well the comparative study of the two countries demonstrates the efficiency of the German investment promotion institution and the necessity for Ukraine to reform existing national investment promotion institutions into a single one. The thesis also makes recommendations as to the reforms of the Ukrainian dispute resolution system which are necessary to convince potential foreign investors that in case of any dispute they can rely on the effective legal protection.

Abbreviations

AG – *Aktiengesellschaft* [Stock Company in Germany]

Agency - State Agency for Investment and Innovations of Ukraine

Agency Regulation - Regulation on the State Agency for Investment and Innovations of Ukraine

AktG – *Aktiengesetz* [Stock Companies Act of Germany]

AMC – Antimonopoly Committee of Ukraine

AT - *aktsionerne tovarystvo* [Stock Company in Ukraine]

AWG – *Außenwirtschaftsgesetz* [Foreign Trade and Payments Act of Germany]

AWV – *Außenwirtschaftsverordnung* [AWG's implementing regulation, the Foreign Trade Ordinance of Germany]

BGB - *Bürgerliches Gesetzbuch* [Civil Code of Germany]

BIT – Bilateral Investment Treaty

CC – Civil Code of Ukraine

Council - Council for Investments with the President of Ukraine

CUC – Customs Code of Ukraine

Currency Decree – Decree of the Cabinet of Ministers of Ukraine on the System of Currency Regulation and Currency Control

DIS – German Institution of Arbitration

EC – European Community

ECHR – European Court of Human Rights

ECSL – European Coal and Steel Community

EEC – European Economic Community

EIB – European Investment Bank

EU – European Union

Euratom – European Community for Atomic Energy

FDI - Foreign Direct Investment

FRG – Federal Republic of Germany

GDP – gross domestic product

GDR – German Democratic Republic (East Germany)

GewO – *Gewerbeordnung* [Business Practice Act of Germany]

GG – *Grundgesetz* [Basic Law of the Federal Republic of Germany]

GmbH - *Gesellschaft mit beschränkter Haftung* [Limited Liability Company in Germany]

GmbHG - *Gesetz betreffend die Gesellschaften mit beschränkter Haftung* [Limited Liability Company Act of Germany]

GWB - *Gesetz gegen Wettbewerbsbeschränkungen* [Restraints of Competition Act of Germany]

HGB – *Handelsgesetzbuch* [Commercial Code of Germany]

ICAC – International Commercial Arbitration Court (Ukraine)

ICSID - International Convention on the Settlement of Investment Disputes between States and Nationals of other Countries

IIC – Industrial Investment Council (Germany)

Invest in Germany – Invest in Germany GmbH

Investment Law - Law of Ukraine on the Regime of Foreign Investment

InvestUkraine - the State Center of Ukraine for Foreign Investment Promotion

InvZulG - German Investment Subsidy Acts of 1999 and 2005

KonTraG - *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* [Act for Control and Transparency in Companies]

LBA –Law of Ukraine on Business Associations

LC – Land Code of Ukraine

LSSM - Law of Ukraine on Securities and Stock Market

M&A – mergers and acquisitions

MAC – Maritime Arbitration Commission (Ukraine)

MESU - Monetary, Economic and Social Union between the Federal Republic of Germany and the German Democratic Republic of May 18, 1990

MFN – most favored nation

MIGA – Multilateral Investment Guarantee Agency

Model Treaty – German Model Bilateral Investment Treaty (2005)

NBU – National Bank of Ukraine

NGOs – Non-Governmental Organizations

OECD - Organization for Economic Co-operation and Development

OHG - *Offene Handelsgesellschaft* [General Partnership in Germany]

Registration Act - Law of Ukraine on State Registration of Legal Entities and Natural Persons-Entrepreneurs

SAPUL - Law on Stimulating of Automobile Production in Ukraine

SEZ – *svobodni ekonomichni zony* [Free Economic Zones in Ukraine]

SSEC – State Securities and Exchange Commission of Ukraine

TOV - *tovarystvo z obmezenoyu vidpovidal'nistyu* [Limited Liability Company in Ukraine]

Treaty - Treaty between Ukraine and the Federal Republic of Germany Concerning the Encouragement and Reciprocal Protection of Investments of February 15, 1993

Treuhand Law - *Beschluss zur Gründung der Anstalt zur Treuhändischen Verwaltung des Volkeigentums (Treuhandanstalt)*

UCCI – Ukrainian Chamber of Commerce and Industry

UEC – Ukrainian Economic Code

UNCTAD – United Nations Conference on Trade and Development

USSR – Union of Soviet Socialist Republics

VAT – value added tax

VATO - *vidkryte aktsionerne tovarystvo* [Open Stock Company in Ukraine]

West Germany – Federal Republic of Germany in 1949 – 1990

WTO – World Trade Organization

ZATO – *zakryte aktsionerne tovarystvo* [Closed Stock Company in Ukraine]

ZPO - *Zivilprozessordnung* [German Code of Civil Procedure]

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Introduction

Economic development of transition states demands inflows of external (foreign) financial resources. Ukraine is a classical example of a post-communist transition economy in need of foreign capital. It is indisputable that it is better to create a good environment for foreign investment to Ukraine than to borrow money from international financial institutions or foreign states. The task has been very difficult for Ukraine after proclamation of independence for many reasons, first of all because of remaining problems with the state regulation of economic processes, political instability and contradictory legal regulations.

At the same time Ukraine represents a very attractive market for potential foreign investors; many examples of successful foreign investments do exist. Though there is extensive research on FDI in Ukraine, particularly by Daniil Fedorchuk and Arthur Nitsevytch¹ which focused on the question whether Ukrainian state had managed to create an attractive environment for foreign investments, they did not take into consideration latest political and legal developments in Ukraine, namely Orange Revolution and notorious re-privatization of *Kryvorizhstal*, adoption of new company laws and currency regulations; the changes which are very important in the FDI context. Still after all these changes it remains a question whether Ukraine managed to create a good legal framework for the attraction of FDI. Therefore there is a necessity of further research in order to study Ukrainian legal innovations and to find solutions for further improvement of the national legal framework regarding FDI.

Ukraine as the largest EU neighbor long ago declared its course towards the World Trade Organization (WTO) and the European Union (EU). But it is still unclear whether Ukraine satisfies their standards. Thus it is essential to research these standards as well as the existing Ukrainian legal framework (regarding FDI) comparing them. Such work requires comparative legal research involving Ukrainian investment law and the law of another country of comparison. This approach is more effective, whereas comparison of Ukraine with the WTO and the EU/EC standards in general will not be that illustrative and hard to understand. Since the

¹ See most notably Daniil E. Fedorchuk, *Acceding to the WTO: Advantages for Foreign Investors in the Ukrainian Market*, 15 N.Y. Int'l L. Rev. 1 (2002); Arthur Nitsevytch, *Potential for German Investors: Entering the Ukrainian Market*, 5 German L. J. No. 6 (2004) at 579.

Federal Republic of Germany (Germany) is a member state of both the WTO and the EU/EC, one of the leading world economies and one of the most important 'actors' within the EU, I chose it as a country of comparison with Ukraine. Another reason for choosing Germany as a country of comparison is the likeness of Ukrainian commercial law with the German model, especially in the company law issues. German reunification is especially interesting for comparative research with Ukraine, since the German Democratic Republic (GDR) used to be a well established socialist state-planned economy that was difficult to integrate into the Western style of doing business.

The main purpose of the present comparative study is to research the pros and cons of the existing legal framework on FDI in both countries of comparison (Ukraine and Germany) and to identify the aspects of German FDI legal regulation which can be transplanted in the Ukrainian law on FDI. According to the classical comparatist René David, comparative legal research is important in order to understand better, and therefore to improve, one's own national law.² I believe the chosen method will help to achieve this goal.

This thesis will be structured as follows. The first chapter will cover issues on understanding of FDI in modern market economies and development of investment law in the two countries. In the second chapter the existing legal framework on FDI in Ukraine and Germany will be explored. In the third chapter existing investment vehicles will be studied. Public support for FDI as well as investment dispute resolution will be addressed in the final chapter.

² René David, John E.C. Brierley, *Major Legal Systems in the World Today: Introduction to the Comparative Study of Law* 4 (Stevens & Sons 1985) (1966).

1. Foreign Direct Investments in Modern Market Economies

Foreign Direct Investment (FDI) is a very complex notion. It anticipates some foreign (international) component, but at the same time, as will be shown below, there is no legal definition of FDI in international law. The very necessity of such definition in both international and domestic law of host countries is doubtful because of the need of flexibility in practical issues. At the same time FDI and forms thereof are understood more or less equally. This chapter will cover issues concerning understanding of FDI and its types and forms in the modern world, differences in Ukrainian and German approaches to define FDI shortly outlining historic developments of investment law in both countries to show why these approaches are so different.

1.1. Understanding of Investments

To define Foreign Direct Investment (FDI) it is essential to give definition of investment as the main component thereof. The very term “investment” (German – *Investition*, Ukrainian – *investytsiya*) is relatively new. It did not appear, at least in the international context, until after World War II and replaced the older expressions “foreign property” and “foreign assets.”³

According to Gray, “the term investment is used, particularly in political and economic writings where it originated, in two senses and on two levels.”⁴ In economics, investment refers to the process and/or the results of an increase in the (productive) tangible assets of an entity, whether in the form of a new tool, a new factory or a new building. For the individual, on the other hand, investment has the everyday meaning of the mere acquisition or creation of an asset.⁵ These different meanings of investment are to be explained by the respective sizes of the affected groups. In both cases the acquisition is affected “from outside” – from the

³ XVII. International Encyclopedia of Comparative Law. *Foreign Commerce and Foreign Investment in Market Economy Countries* § 22-62 (1989).

⁴ H. Peter Gray, *International Trade, Investment, and Payments* 335–343 (Houghton Mifflin 1979).

⁵ Id.

economic viewpoint this can only occur through the creation of new domestic assets or through *international investment* [emphasis added]; in the latter case, states become the affected groups.⁶

As one may assume from the preceding context, investment is nothing else but transfer of assets. Objects of an “investment” can regularly be money and other tangible, as well as intangible, assets.⁷ The controlling factor in qualifying a transfer of assets as an investment may be, first and foremost, the intended purpose, namely, the placement of capital.⁸

Classification of investments varies from country to country, but in the international (foreign) context it is unified to some extent. For the purposes of this research I will focus on understanding “foreign direct investment” (FDI) as it exists in Ukraine and Germany, whereas FDI is the most welcomed type of investment.

Direct investment together with *portfolio* investment is a category of financial investment. The difference between the two depends on whether effective control of an enterprise is acquired, which is sometimes determined solely by the level of shareholding and/or representation on the managing board.⁹ But the scholars still emphasize that this is not a very precise criterion and varies significantly according to legislative prescription.¹⁰

International investments, legally speaking, usually come into contact with three different legal systems. If a citizen of country A, or the country itself perhaps through a public enterprise like the central bank, makes an investment in country B, the law of country A, the capital exporting country, may apply, as well as the law of country B, the capital importing country.¹¹ The international character of an investment does not depend necessarily, or even primarily, on the nationality of the participants. More relevant are often the “residence” of

⁶ XVII. International Encyclopedia of Comparative Law. *Foreign Commerce and Foreign Investment in Market Economy Countries* § 22-62.

⁷ Carreau, Flory et Juillard, *Droit international économique* (ed. 2 Paris 1980) at 454–464 cited from XVII. International Encyclopedia of Comparative Law. *Foreign Commerce and Foreign Investment—General Observations* § 21-2 (1989).

⁸ XVII. International Encyclopedia of Comparative Law. *Foreign Commerce and Foreign Investment—General Observations* § 21-2.

⁹ XVII. International Encyclopedia of Comparative Law. *Foreign Commerce and Foreign Investment in Market Economy Countries* § 22-63.

¹⁰ Id. § 22-62. Here it is important to stress that other approaches do exist. In particular Michael Stefan and Eric Pfaffmann wrote about “[T]wo categories of criteria used for this distinction: (1) the time horizon of the investment and (2) the motivation of the investors. If an investment is classified as a direct investment, the investor is supposed to have a long-term interest and to exert a significant degree of influence on the management of the affiliate. On the contrary, if the time horizon is short and investors mainly have financial interests, investment are classified as portfolio investment” (see Michael Stefan, Eric Pfaffmann, *Detecting the Pitfalls of Data on Foreign Direct Investment: A Guide to the Scope and Limits of FDI-Data as an Indicator of Business Activities of Transnational Corporations* 4 (Stuttgart 1998)).

¹¹ XVII. International Encyclopedia of Comparative Law. *Foreign Commerce and Foreign Investment in Market Economy Countries* §§ 22-62–22-63.

participating natural persons and the control of capital and/or management of a company, particularly in relation to foreign exchange transactions.¹²

Legal characterization of foreign investments is far from uniform. This is probably due to the large number of applicable legal sources, which nevertheless in many cases only achieve an incomplete and unsystematic regulation of separate aspects of investment.¹³

General public international law does not provide legal definition of international investment. Even the relevant multilateral treaties such as the conventions establishing the International Convention on the Settlement of Investment Disputes between States and Nationals of other Countries (ICSID) and the Multilateral Investment Guarantee Agency (MIGA) deliberately refrained from including a definition. It thus falls to the numerous bilateral and regional treaties as well as to the national law of respective countries to adopt their own definitions.¹⁴ Still such attempts are not always successful.

Article 1 of the German Model Bilateral Investment Treaty (hereinafter Model Treaty) defines investment broadly by providing that

“[i]nvestment shall comprise every kind of asset, in particular:

- (I) Movable and immovable property as well as any other rights *in rem*, such as mortgages, liens and pledges;
- (II) Shares of companies and other kinds of interest in companies;
- (III) Claims to money which has been used to create an economic value or claims to any performance having an economic value;
- (IV) Intellectual property rights, in particular copyrights, patents, utility-model patents, industrial designs, trade-marks, trade-names, trade and business secrets, technical processes, know-how, and good will;
- (V) Business concessions under public law, including concessions to search for, extract and exploit natural resources.”¹⁵

Identical definition is given in Article 1 of the Treaty between Ukraine and the Federal Republic of Germany Concerning the Encouragement and Reciprocal Protection of Investments of February 15, 1993 (hereinafter Treaty).¹⁶

¹² Id. § 22-63.

¹³ Id.

¹⁴ Id.

¹⁵ Model Treaty between the Federal Republic of Germany and ... Concerning Encouragement and Reciprocal Protection of Investments (2005), available at <http://www.fes-globalization.org/publications/Appendix%201%20German%20Model%20Treaty.pdf>; Mahnaz Malik, *Time for a Change: Germany's Bilateral Investment Treaty Program and Development Policy*, 27 Dialogue on Globalization Occasional Papers 15 (2006), available at http://www.fes-globalization.org/publications/FES_OCP27_Malik_German_BITs.pdf.

As one can see, the definition lacks the notion of foreign and direct characterization of the investments and concentrates on material forms thereof. But foreign character of the investments can be traced through the relevant provisions of Article 2(2) of the Model Treaty and Article 2(2) of the Treaty where *inter alia* it is said that “each Contracting State shall in its territory in any case accord investments by investors of the other Contracting State...”¹⁷ By investors both Treaties mean natural persons (Ukrainians and Germans) and juridical persons as well as any commercial or other companies or associations with or without legal personality having their seat in the territory of the Contracting State (Germany or Ukraine), irrespective of whether or not their activities are directed at profit.¹⁸ Foreign character of the investments mentioned in the Treaties follows from the very titles and contents thereof.

May sound surprising, but neither Ukrainian nor German domestic legislation contains definitions of foreign direct investment (FDI).¹⁹ In Article 1 (1) clause 2 of the Law of Ukraine on the Regime of Foreign Investment of March 19, 1996 one may find the definition of foreign investment as follows:

“[f]oreign investments are stores of value which are invested by foreign investors in objects of investment in accordance with the legislation of Ukraine with the aim of obtaining profit or achieving social results.”²⁰

As one can see, in Ukrainian law the main criterion for defining investments as foreign is investing by a special person (subject) – foreign investor.²¹ Here it is important to mention that pursuant to Article 390 of the

¹⁶ Ugoda mizh Ukrainoyu i Federatyvnoyu Respublikoyu Nimechchyna pro spriyannya zdiysnennnyu i vzayemny zahyst investytsiy vid 15 lutogo 1993 roku, ratyfikovana zakonom Ukrainy No. 193/94-VR vid 11 zhovtnya 1994 roku, available at http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=276_415

¹⁷ Model Treaty between the Federal Republic of Germany and ... Concerning Encouragement and Reciprocal Protection of Investments; Ugoda mizh Ukrainoyu i Federatyvnoyu Respublikoyu Nimechchyna pro spriyannya zdiysnennnyu i vzayemny zahyst investytsiy.

¹⁸ Article 1 (3) “a” of the Model Treaty; Article 1(3)-(4) of the Treaty.

¹⁹ In Article 1 clause 1.28.2 of the Law of Ukraine on Corporate Profit Tax there are definitions of financial and direct investments as follows:

“[f]inancial investment shall be an economic operation concerning purchase of corporate rights, derivatives and other negotiable instruments. Financial investments can be distinguished as direct and portfolio ones.

Direct investment shall be an economic operation with the purpose to transfer money or other property to the statutory fund of a legal entity in change for corporate rights issued by this legal entity.”

See Pro opodatkovannya prybutku pidpryemstv: Zakon Ukrainy vid 28 grudnya 1994 roku z nastupnymi zminamy i dopovnenniyamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=334%2F94-%E2%F0>

²⁰ Pro rezhym inozemnogo investuvannya: Zakon Ukrainy vid 19 berezhnya 1996 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1996, No. 19, St. 80.

²¹ Naukovo-praktychnyi komentar Gospodars'kogo kodeksu Ukrainy [Scholastic and Practical Commentary of the Economic Code of Ukraine] (Valentyn Mamutov ed., 2004) at 598.

Ukrainian Economic Code (UEC) foreign investors are the persons engaged in investment activity on the territory of Ukraine:

- legal entities incorporated in accordance with legislation other than that of Ukraine;
- foreigners and stateless persons without permanent residence on the territory of Ukraine;
- international governmental or non-governmental organizations;
- other states; and
- other foreign entities engaged in investment activities defined in accordance with the law.²²

As far as German laws and regulations are concerned, respective definitions are at all absent therein. Possibly it can be explained by the fact that traditionally German drafters refrained from defining purely doctrinal questions. Thus, one will find neither definition nor explanation of such a basic concept as “foreign investment” or “FDI” in any German law and/or regulation.²³ This approach provides for more flexibility in solving practical problems since strict legal definitions limit the freedom of maneuver.

Still what FDI is in general remains a question. Since Germany is a member of the Organization for Economic Co-operation and Development (OECD)²⁴ and the WTO,²⁵ it may be useful to refer to definitions given by the mentioned international organizations.

The OECD proposes so-called benchmark definition, namely:

“[F]oreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy (“direct investor”) in an entity resident in an economy other than that of the investor (“direct investment enterprise”). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated.”²⁶

²² Gospodars'ky kodeks Ukrainy, Vidomosti Verkhovnoyi Rady Ukrainy, 2003, No. 18, St. 144. Similar definition is given in Article 1 clause 1 of the Investment Law. Important to mention that bilateral investment treaties of Ukraine may contain their own different criteria for defining investors as foreign ones. According to Article 400 of the UEC, if an international treaty (agreement) establishes the rules other than those envisaged by Ukrainian legislation on foreign investments, the rules of the international treaty (agreement) shall prevail.

²³ See e.g. *Introduction to German Law* 18 (Mathias Reinmann & Joahim Zekoll eds. 2005).

²⁴ On December 14, 1960 Germany, along with 19 other countries, signed the Convention founding the Organisation for Economic Co-Operation and Development, thereby pledged its full dedication to achieving the Organisation's fundamental aims among which is contribution to the development of world economy.

²⁵ Germany has been a WTO member since January 1, 1995. Ukraine has been negotiating accession since 1993.

²⁶ OECD Benchmark Definition of Foreign Direct Investment 7 - 8 (3rd ed. 1999).

The WTO defines FDI in a shorter wording as an investment occurring "when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset."²⁷

According to Eric M. Burt, there are different motivations for undertaking FDI by the investors, the most important of which are the following: to enhance competitiveness product in the host country's market through "tariff jumping" FDI, to utilize cheaper labor for production facilities, to secure supply of natural resources, to take advantage of a host country's investment incentives etc. But each of these motivations for undertaking FDI is ultimately based on the search for increased profits.²⁸

From the given definitions and motivations it is possible to conclude that the main features of FDI (its main characteristics) are transfer of capital from abroad, control and management over the object of investment in pursue of increased profits.

The OECD definition is an operational guidance for statistic purposes in the OECD Member states. At the same time it is the most concise, neutral and uniform definition for FDI based on international trade usage. Besides, absence of the legal definition does not mean that in Germany or even in Ukraine FDI can be understood in a different way, whereas the words may be different but the essence remains the same.

Ukrainian practice of giving legal definitions for everything including foreign investments seems to be justified by the necessity to provide stability and predictability of the legal framework and its application which is very topical for Ukraine in view of past events described in section 1.2 below. On the other hand, compared to German model this approach ties practitioners' hands. Of course, Ukrainian legal traditions are different but the purpose is the same – to attract more FDI. But that may be a problem if something falls outside the scope of a respective definition. It is better to establish principles rather than to attempt to define everything.

²⁷ World Trade Organization Secretariat, Trade and Foreign Direct Investment, PRESS/57 at 6 (Oct. 9, 1996) cited from Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investments in the World Trade Organization*, 12 Am. U. J. Int'l L. & Pol'y 1015, 1019 (1997).

²⁸ Eric M. Burt, *Developing Countries and the Framework for Negotiations on Foreign Direct Investments in the World Trade Organization* at 1019.

1.2. Development of Investment Law: Economic and Legal Factors

Investment law of both countries of comparison developed in different historic and economic environment. This factor is very important so that to understand the existing peculiarities better. Besides, respective proposals may be made only taking into account these differences, otherwise they will be useless.

1.2.1. Ukraine

On August 24, 1991 Ukraine declared independence from the USSR. To develop national economy and to promote reforms in the social sphere a new-born state needed financial resources which it desperately lacked on domestic level. Thus the issue of FDI became extremely topical for Ukraine.

The first Ukrainian Law on Foreign Investment passed on March 13, 1992.²⁹ Though this law provided extensive tax holidays (up to ten years for some sectors and investments of a given size), it failed to stimulate substantial inflows of FDI to Ukraine. Already in 1993 the mentioned law was suspended³⁰ by the governmental Decree on the Regime of Foreign Investment.³¹ This Decree was also based on tax-incentives but set conditions which had to be met before the investors would qualify for any of them. A new Law on the State Program of Foreign Investment Encouragement followed on December 17, 1993.³² After that a series of laws and regulations followed eliminating all automatic tax-incentives previously granted to foreign investors, since it had been found that incentives alone were not effective in attracting FDI.³³ To illustrate unsuccessful endeavors of the Ukrainian authorities to create a favorable climate for foreign investments the figures should be

²⁹ Pro inozemni investytsii: Zakon Ukrainy vid 13 bereznia 1992 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1992, No. 26, St. 357. It should be noted that an earlier Law on protection of foreign investments was adopted on September 10, 1991 (Pro zahyst inozemnyh investytsiy na Ukraini: Zakon Ukrainy vid 10 veresnya 1991 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1991, No. 46, St. 616) but that was a declaration rather than a set of rules useful for practical purposes.

³⁰ Formally the Law was repealed in 1996.

³¹ Pro rezhym inozemnogo investuvannya: Dekret Kabinetu Ministriv Ukrainy vid 20 travnya 1993 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1993, No. 28, St. 302.

³² Pro derzhavnu programu zaohochennya inozemnyh investytsiy: Zakon Ukrainy vid 17 grudnya 1993 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1994, No. 6, St. 28.

³³ Barbara Peitsch, *Investment in Ukraine*, The OECD OBSERVER, No. 204, February/March 1997 at 30-31.

mentioned: from 1991 until the end of 1995 Ukraine managed to attract only USD 150 million; FDI per capita in 1995 was USD 6.³⁴

On March 19, 1996 the Law on the Regime of Foreign Investment (hereinafter Investment Law)³⁵ was adopted. It was the third revision of FDI legislation in four years. Unlike the previous legislation, which was focused on incentives for enterprises with FDI, the new legislative approach was to strengthen the national-treatment regime – that is, to set up non-discriminatory legal conditions for both foreign and domestic investors.³⁶ The mentioned Law with numerous amendments and supplements remains the basic Ukrainian law on FDI up to date (for details see chapter 2 *infra*).

Real trouble for foreign investors in Ukraine started in 1997. Investment Law expressly introduced a national régime for foreign investors, but was silent on the issue of tax holidays, granting no new privileges to the investors. On May 22, 1997 Ukrainian Parliament enacted the new version of the Law on Corporate Profit Tax which was silent on any tax privileges for foreign investment altogether. It enabled the tax authorities to demand payment of corporate tax by those investors who had been securely exempt from those assessments until 1999.³⁷ After that, a group of foreign investors lodged a petition with the Constitutional Court of Ukraine requesting the official interpretation of the legislative provisions on guarantees of foreign investment protection, as well as interpretation of the allegedly *nunc pro tunc* provisions of the last tax law. The Court dismissed the petition³⁸ on the ground that it had become moot after adoption of certain laws interpreting the investment guarantee provisions - in particular, the Legislative Order on Coming Into Force of the Law on Regime of Foreign Investment (Order) and after the Constitutional Court's ruling on the *nunc pro tunc* laws. Paragraph 5 of the 1996 Order provided that the new rules of the Investment Law would not apply to foreign investment registered under the precedent laws and thereby guaranteed the grandfathering period and tax holidays which had been granted to foreign investors before 1996.³⁹ On February 17, 2000 the Parliament took, as Fedorchuk called it, “the last shot in the “battle” against aliens” and adopted a new Law on Elimination of Discrimination in

³⁴ Id. at 31.

³⁵ Pro rezhym inozemnego investuvannya, *supra* note 20.

³⁶ Barbara Peitsch, *supra* note 33, at 31.

³⁷ Daniil E. Fedorchuk, *supra* note 1, at 49.

³⁸ See Uhvala Konstytutsijnogo Sudu Ukrainy vid 5 zhovtnya 1999 roku u spravi no. 1-4/99, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi>.

³⁹ Daniil E. Fedorchuk, *supra* note 1, at 50.

Taxation of Business Undertakings Incorporated with the Use of Assets and Cash of Domestic Origin.⁴⁰ This law completely repealed Paragraph 5 of the Order and therefore abolished all the remaining guarantees of protection of foreign investors in Ukraine. This case proved that in the absence of strict and rigid standards of treating foreign investors, the state authorities have carte blanche in enacting, amending and abolishing any guarantees previously granted. Undoubtedly, it added significantly to the uncertainty foreign investors faced and continue to face in the unpredictable Ukrainian market.⁴¹

As observed by the experts, the FDI inflow is hampered by the fact that Ukraine is not a member of the WTO and therefore not entitled to (or bound by) the WTO framework agreements' provisions on national treatment, most favored nation (MFN) treatment and elimination of quantitative restrictions.⁴² The existence of a treaty between the investor's home country and the host country of the investment gives the investor much more confidence because a breach of a treaty is a violation of the universally recognized rule *pacta sunt servanda*.⁴³ Unlike an FDI protective régime, which can easily be revoked or limited through the exercise of legislative power and would not be actionable due to the concept of sovereign immunity, or the act of state doctrine, states are generally much less willing to violate treaty obligations specifically owed to other states. The reason for this is that the political repercussions of violating a treaty are usually worse than a breach of contractual obligations toward individual private investors.⁴⁴ Nevertheless, Ukraine did its best to improve the nation's investment image on the international stage. In particular, as of end 2005 Ukraine concluded bilateral investment treaties (BITs) with 61 states;⁴⁵ on April 3, 1998 Ukraine signed the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID) which entered into force for Ukraine on July 7,

⁴⁰ Pro usunennya dyskryminatsii v opodatkuванні subjektiv pidpryjemnytskoi diyalnosti, stvorenyh z vykorystannyam mayna ta koshtiv vitchyznyanogo pohodzhennya: Zakon Ukrainy vid 20 lutogo 2000 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2000, No. 12, St. 97.

⁴¹ Daniil E. Fedorchuk, *supra* note 1, at 50–51.

⁴² *Id.* at 42.

⁴³ See Detlev F. Vagts, *The United States and Its Treaties: Observance and Breach*, 95 A.J.I.L. 313, 326 (2001) (citing that the breach of treaties has been historically seen as "fundamentally wrong"). See generally Gabe Shawn Varges, Book Note, 86 AM. J. INT'L L. 841 (1992) (reviewing J. F. O'CONNOR, *GOOD FAITH IN INTERNATIONAL LAW* (1991)) (defining *pacta sunt servanda* as international good faith and honesty) both sources cited from Daniil E. Fedorchuk, *supra* note 1, at 42–43.

⁴⁴ Daniil E. Fedorchuk, *supra* note 1, at 42–43.

⁴⁵ UNCTAD World Investment Report 2006, at 279.

2000;⁴⁶ willing to facilitate granting of credits for investment projects Ukraine is interested in the Government of Ukraine on June 14, 2005 entered into the Frame Agreement with the European Investment Bank (EIB).⁴⁷

But in general international efforts of Ukraine did not change the situation. As one can see, Ukrainian legislative developments in the field were marked with inconsistency and uncertainty. These factors scared away potential foreign investors. If to speak about the Law of February 17, 2000, it was adopted contrary to the provisions of the Presidential Ordinance on Approval of the Basic Guidelines of Investment Policy of August 18, 1999.⁴⁸

Even after Orange Revolution in Ukraine (winter 2004/2005) investment climate did not change much. Re-privatization of the metallurgical plant *Kryvorizhstal* in 2005 scared investors even more than aforesaid laws. According to the UNCTAD's report, Ukraine showed a low FDI performance in 2004.⁴⁹ Starting from 1991 till October 2006 Ukraine managed to attract only about USD 19.9 billion of FDI. Per capita FDI as of January 1, 2006 used to be USD 349; this was one of the lowest figures in the region.⁵⁰

Current situation in Ukraine retains many of the problems inherited from the former USSR, including cumbersome decision-making, bureaucracy, and unclear responsibilities among government agencies. The existing system of developing, passing and implementing economic policies stalls the implementation of economic reforms that would improve the country's business environment,⁵¹ which is so necessary for high inflows of FDI.

The existing Ukrainian framework on FDI and related issues as well as its lacks will be covered in more details in chapter 2.

⁴⁶ See Pro ratyfikatsiyu Konventsii pro porjadok vyrishennya investytsiynyh sporiv mizh derzhavamy ta inozemnymy osobamy: Zakon Ukrainy vid 16 bereznia 2000 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2000, No. 121, St. 161.

⁴⁷ According to this Frame Agreement, Ukraine granted a set of privileges for the EIB including exemption from taxes and diplomatic immunities. See Ramkova Ugoda mizh Ukrainou ta Evropejskym Investytsijnym Bankom vid 14 chervnya 2005 roku available at <http://www.rada.gov.ua>. EIB-President Maystadt stated that the Framework Agreement forms the basis for the Bank's activity in Ukraine (See EIB and Ukraine sign Framework Agreement, available at <http://www.eib.org/news/press/press.asp?press=2944>).

⁴⁸ Nina Saniahmetova, *Pidprijemnytske pravo* [Business Law] (Kyiv 2001) at 512.

⁴⁹ UNCTAD World Investment Report 2006, at 24.

⁵⁰ Statistics of the Ukrainian State Statistics Committee as of October 10, 2006 available at <http://www.ukrstat.gov.ua/>; US Department of State Background Note: Ukraine (August 2006) available at <http://www.state.gov/r/pa/ei/bgn/3211.htm>.

⁵¹ European Business Association Report *Barriers to Investment to Ukraine 6* (Kyiv 2006).

1.2.2. Germany

Today's Germany is the Europe's largest economy and the third largest economy in the world.⁵² Economic development of modern Germany, as stated by Volker Berghahn, "is best understood against the background of the Industrial Revolution which affected Central Europe with full force in the final decades of the nineteenth century."⁵³

After unification of the scattered German states and creation of the German Empire (*Deutsches Reich*) in 1871, Germany began rapid transition from an economy based on agriculture to one dominated by industry. It was the fastest economic transition of the time.⁵⁴

Merchant/entrepreneur activity within Germany expanded rapidly, especially in the big cities like Berlin, Frankfurt, Hamburg or Cologne which were commercial centers of the Empire. Despite repeated fluctuations, there was a general upward trend in income from investments.⁵⁵

The end of the nineteenth century was marked with adoption of the basic imperial laws on civil and commercial matters, in particular, the Limited Liability Company Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* – GmbHG) was promulgated in 1892, the Civil Code (*Bürgerliches Gesetzbuch* – BGB) – in 1896, the Commercial Code (*Handelsgesetzbuch* – HGB) – in 1897. All these laws became patterns for the legislation of many other countries,⁵⁶ and in Germany they still remain in force being one of the central acts in the field of commercial relations and foreign investment in particular.

Two world wars had a devastating effect on the German economy in the first half of the twentieth century. Militarization during the Nazi years, a checkmate in World War II and a split of the German state in 1949 changed the face of the country for ever. While West Germany and West Berlin experienced impressive growth which was called *Wirtschaftswunder* (growth miracle), East Germany followed the socialist model with

⁵² Central Intelligence Agency World Factbook: Germany (as of January 2007) available at <https://www.odci.gov/cia/publications/factbook/geos/gm.html>.

⁵³ Volkner R. Berghahn, *Modern Germany – Society, Economy and Politics in the Twentieth Century* 1 (Cambridge University Press 1985) (1982).

⁵⁴ Id.

⁵⁵ Id. at 7.

⁵⁶ BGB structure and style inspired the drafters of the new Civil Code of Ukraine (2003), drafters of the UEC justified its adoption by the existence of HGB, and Ukrainian company law is based on the German model as well.

state-planned economy and contempt for “capitalist” foreign investments, therefore, in this section I dwell on the developments in West Germany.

After the end of World War II, the economy of West Germany (FRG) had to be restarted.⁵⁷ The stock of physical capital was heavily damaged by allied bombing, and the old German Reich was torn apart as were many traditional flows of goods and services.⁵⁸

The Currency Reform (June 20, 1948)⁵⁹ in West Germany initiated by the occupation administration had cleared the way for the evolution of a free-market economy.⁶⁰ Marshall Plan money poured into the country. As noted by Volkner R. Berghahn, “the Western Allies and their German administrators at Frankfurt went in the opposite direction from their Communist counterparts and unleashed the energies of private enterprise economy.”⁶¹

On May 23, 1949 the Basic Law (*Grundgesetz* – GG) of West Germany was adopted. In particular, Articles 12 and 13 thereof established guarantee for private and legal persons to freedom of ownership and profession. This also comprised the freedom and the right to use and invest such property. Up to now these freedoms remain the basis for investments in Germany.⁶²

Investment issues in West German context cannot be reviewed outside European integration which started in 1951 with the adoption of the Treaty instituting the European Coal and Steel Community (ECSL). Together with France, Italy, Belgium, Luxemburg and the Netherlands West Germany became the founding member of the ECSL. On March 25, 1957 the Treaties creating the European Community for Atomic Energy (Euratom) and the European Economic Community (EEC)⁶³ were signed. In Article 3 of the latter it was stated that the activities of the EEC shall include, in particular, the abolition, as between Member States, of obstacles to

⁵⁷ Jørgen Drud Hansen, Morten Skak, *The German Growth Miracle – a Lesson for Poland?* Eastern European Economics, vol. 42, no. 3 May – June 2004, at 83.

⁵⁸ *Id.*

⁵⁹ *Reichsmark* was changed for a new West German currency – *Deutsche Mark* (DM).

⁶⁰ Volkner R. Berghahn, *supra* note 53, at 197.

⁶¹ *Id.*

⁶² Basic Law for the Federal Republic of Germany of May 23, 1949 as amended to December 1, 1993 in David P. Currie, *The Constitution of the Federal Republic of Germany* 347, 349 (the University of Chicago Press 1994); 1 *Doing Business in Europe* [1972 – 2000 Transfer Binder] Germany ¶33-215 (CCH International 2000).

⁶³ So-called Treaty of Rome.

freedom of movement for persons, services and *capital*; the establishment of a EIB to facilitate the economic expansion of the Community by opening up fresh resources.⁶⁴ That was the beginning of the common market.

The 1950s and 1960s, and especially the 1950s, are the years of the German⁶⁵ growth miracle. During the 1950s, the West German real GDP per capita was growing at the exceptionally high rate of 6.9 % per year followed by a yearly growth rate of 3.7 % during the 1960s.⁶⁶

West Germany did its best to attract foreign capital it needed so much to restore the economy. On April 28, 1961 Foreign Trade and Payments Act (*Außenwirtschaftsgesetz* - AWG) was promulgated. Section 1 (1) of this Act contained the principle that the trade in goods, services, *capital assets*, payment transactions and any other types of trade with foreign economic territories, as well as the trade in foreign valuables and gold between German residents (foreign trade and payments) is, in principle, not restricted.⁶⁷ In 1965 the most fundamental reform of West Germany's company law took place: the Stock Companies Act (*Aktiengesetz* – AG) of 1937 was drastically amended, as a matter of fact a brand new AG appeared. But here it should be stressed that GmbHG did not changed much at the time. The only important amendment took place in 1980.⁶⁸

From the early 1970s West Germany has become one of the leading export nations in the world.⁶⁹ In 1970 German income per capita was 80% of the American level.⁷⁰ Therefore not surprising foreign investors' interest in the country was growing.

Though, no special law on foreign investments has been ever adopted in West Germany, existing set of laws (GG, BGB, HGB, AWG, AG and GmbHG), as well as laws and regulations on competition, taxation and banking) was quite sufficient a framework for investors. Further developments concerning the EEC, in particular issues on the freedom of movement for capital (Article 67 of the EEC Treaty, and Directive 88/361⁷¹) and establishment of the European Monetary Union only strengthened the attractiveness of the German market

⁶⁴ Stephen Weatherill, *Cases and Materials on EEC Law* 123 (Blackstone Press Ltd. 1993) (1992).

⁶⁵ Relates exceptionally to the FRG.

⁶⁶ Jørgen Drud Hansen, Morten Skak, *supra* note 57.

⁶⁷ Foreign Trade and Payments Act of April 28, 1961 (as amended by Article 1 of the Law of 28 March 2006), available in English at http://www.bafa.de/1/en/service/pdf/export_cotrol_awg_en.pdf.

⁶⁸ *Introduction to German Law*, *supra* note 23, at 158.

⁶⁹ 1 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] Foreign Investment and Immigration § 2.01 (LexisNexis 2006).

⁷⁰ Jørgen Drud Hansen, Morten Skak, *supra* note 57, at 83.

⁷¹ Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, 1988 O.J. (L 178) 5–18.

for FDI, especially among member states. By the end of 1987 total inflow of FDI to the FRG reached DM 102.3 billion, and DM 125 billion by the end of 1989.⁷²

Economic and political events in the GDR in 1990 were the evidence of the close end of the GDR and its re-unification with West Germany. In May 1990 two Germanys agreed on so-called Monetary, Economic and Social Union (MESU)⁷³ which entered into force on July 1, 1990; on the same day DM was adopted in the GDR. The Unification Treaty (*Einigungsvertrag*) was signed on August 31, 1990 by representatives of East and West Germany. Less than in 2 months, on October 3, 1990, East Germany joined the FRG, the GDR officially ceased to exist.

After re-unification German population increased to about 80 million, rendering Germany's internal market Europe's largest and richest.⁷⁴ In order to close the gap between the two parts of Germany, the introduction of a market economy to the former Eastern part was mandatory and necessary. In order to do so the authorities continued the process of privatization of the state-owned companies on the territory of the former GDR. Here it should be noted, that under the MESU, even after re-unification some East German laws remained in force on the territory of the new federal states (*Länder*). In particular, the basis for privatization was the Treuhand Law (*Treuhandgesetz*),⁷⁵ of June 17, 1990. To facilitate the process on March 22, 1991 German Bundestag passed the Law On the Elimination of Obstacles to Privatization and On the Promotion of Investments (*Gesetz zur Beseitigung von Hemmnissen bei der Privatisierung von Unternehmen und zur Förderung und zur Förderung von Investitionen*)⁷⁶ which created the legal basis for the settlement of property matters complicated by the claims of former owners and for the break-through for investments.

During the 1990s Germany continued to attract impressive inflows of FDI, in 1995 their total amount was DM 271 billion, in 1996 – DM 293 billion.⁷⁷ With a view to maintain, to improve Germany's attractiveness as a business location and to facilitate investments to the country in 1998 amendments were made

⁷² 1 Business Transactions in Germany (FRG), *supra* note 69.

⁷³ Staatsvertrag über die Schaffung einer Währungs-, Wirtschafts- und Sozialunion zwischen der BRD und der DDR, Gesetzblatt der Deutschen Demokratischen Republik Mai 18, 1990, BGBI. II, 1990, S. 518.

⁷⁴ Michael E. Murphy, *New Access to Europe: Investing in Eastern Germany*, 48 The Bench & Bar of Minn. 19 (1991) cited from Alexander Reus, *Eastern Germany Report: Investment Incentives in the New Lander*, 4 U. Miami Bus. L. J. 1, 2–3 (1994).

⁷⁵ Beschluss zur Gründung der Anstalt zur Treuhändischen Verwaltung des Volkeigentums (Treuhandanstalt), GB1. DDR I, 1990, S. 107.

⁷⁶ BGBI. I, 1991, S. 766.

⁷⁷ 1 Doing Business in Europe [1972–2000 Transfer Binder] Germany ¶33-200.

to investment and finance legislation with the introduction of the Third Act on the Advancement of the Financial Market (3. *Finanzmarktförderungsgesetz*) and the Act for Control and Transparency in Companies (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich – KonTraG*).⁷⁸

Numerous legislative changes took effect in late 2003 and early 2004, further altering Germany's tax and economic landscape with the aim to improve investment climate. Particularly noteworthy were the Investment Modernization Act (*Investmentmodernisierungsgesetz*), the Basket II Act (*Korb II Gesetz*), and the 2003 Tax Amendment Act (*Steueränderungsgesetz 2003*). As well it ought to be mentioned that Germany is the world's leader in concluding BITs, as of end 2005 it signed BITs with 133 countries,⁷⁹ the quantity which is more than double as much compared to Ukraine.

Still FDI in Germany failed to be that serene and growing for years running. As observed by the KPMG experts, in the recent past, FDI in Germany have been rather slow, and international companies have claimed that the German economy has lost its attraction for foreign investors.⁸⁰ However, there has been a turnaround in FDI at the beginning of the 2000s. The biggest deal by far was Vodafone's takeover of Mannesmann (2000), worth USD 190 billion. Lately, however, global investment confidence has somewhat diminished, which has evidently had an effect on FDI in Germany.⁸¹ According to the UNCTAD data in 2003 total inflow of FDI was USD 29.2 billion, in 2004 the figure diminished by USD 15.1 billion, in 2005 FDI inflows were equal to USD 32.6 billion.⁸²

In chapter 2 existing German framework on FDI and related issues as well as its lacks will be covered in more details.

1.3. Types and Forms of Foreign Direct Investments

In section 1.1 it was already shown that the uniform definition for FDI did not exist. Likewise, there is no uniformity when it goes about types and forms of FDI. While, as will be illustrated below, Ukraine has some

⁷⁸ Id.

⁷⁹ UNCTAD World Investment Report 2006, at 279.

⁸⁰ KPMG Report: Investment in Germany 8 (KPMG 2004).

⁸¹ Id.

⁸² UNCTAD World Investment Report 2006, at 299.

legislative definitions for the forms of foreign investments, in Germany legislators refrained from giving such ones.

For classification purposes in the international legal and economic contexts it is customary to distinguish three main types of FDI:

- i. Greenfield investments
- ii. Mergers and acquisitions (M&A)
- iii. Concessions

Greenfield investments which are divided into 100% greenfield investment, joint venture greenfield investment and so-called semi-greenfield investments,⁸³ as can be assumed from the term itself, are investments in a manufacturing plant, office, or other physical company-related structure or group of structures in an area where no previous facilities exist. The name comes from the idea of building a facility literally on a "green" field, e.g. a farmland or a forest.⁸⁴ In other words it is a foreigner's (legal or natural person's) investment in construction of an absolutely new enterprise.

Different kinds of greenfield investments may be described as follows:

- 100% greenfield investment speaks for itself meaning creation of a brand-new company
- joint-venture greenfield investment is an investment in which a foreign investor establishes a new company (joint venture) together with one or more domestic partners
- semi-greenfield investments represent joint ventures when foreign partner provides capital (financial and/or material resources), and the domestic partner provides the existing premises (factory, plant, office etc.).

M&A, unlike greenfield investments, are transfers of existing assets from local firms to foreign firms. The main accent here should be made on cross-border mergers which occur when the assets and operation of firms from different countries are combined to establish a new legal entity. Cross-border acquisitions take place

⁸³ F.H. van Hastenberg, *Foreign Direct Investments in Hungary* 35 (Utrecht University 1999) cited from Darja Lončar, *Foreign Direct Investments in Croatia – Comparison with India and Germany* 29 (2001) (unpublished LL.M. long thesis, CEU) (on file with the CEU Library).

⁸⁴ Holger Hörig, *Analysing Foreign Market Entry: The Choice between Greenfield Investment and Acquisitions*, Trinity College Dublin Economics Technical Papers, at 981.

when the control of assets and operations is transferred from a local to a foreign company, with the local company becoming an affiliate of the foreign company.

Concessions represent agreements between the host country governments and foreign investor(s) on granting investor(s) the exclusive right to use natural resources and/or to perform activities of the special interest for the host country (e.g. water supply or building highways) for a limited period of time.

Greenfield investments are more welcomed in host countries, whereas they create new facilities, including new jobs, new modernized industry sites etc., while M&A envisage a simple purchase of existing facilities, usually at a relatively low price. Concessions used to be more important in the 19th century and the first half of the 20th century, today in the context of FDI they are no longer topical.⁸⁵

While other variations of FDI classification exist, the one described above is the most commonly used in international business relations. Hence, within the framework of the present thesis other classifications will be skipped. But in conclusion it should be stressed that 100% greenfield investments and creation of joint ventures are the most common types of FDI in modern market economies, including Ukraine and Germany. As for M&A, they are more developed in Germany than in Ukraine, although such kind of FDI has been becoming more and more widely used in Ukraine lately.

As already mentioned, Ukrainian law contains a set of provisions with detailed lists of possible forms for foreign investments. But here it should be stressed that Ukrainian terminology used in the respective laws is confusing, whereas it trades places of forms, types and methods of foreign investments, namely:

Article 2 of the Investment Law lists the following possible *types* thereof:

- 1) foreign currency which is recognized as convertible by the National Bank of Ukraine;
- 2) the currency of Ukraine - while reinvesting in the initial object of investment or in any other object of investment according to the legislation of Ukraine provided that income (profit) taxes has been paid;
- 3) any movable property or real estate and related ownership rights;

⁸⁵ Darja Lončar, *Foreign Direct Investments in Croatia – Comparison with India and Germany* 29.

- 4) stocks, bonds, other negotiable instruments, as well as corporate rights (ownership rights for a share in the statutory fund of the legal entity established according to the legislation of Ukraine or the legislation of other countries) expressed in convertible currency;
- 5) monetary claims and the right to claim for the fulfilment of contractual obligations guaranteed by the first class banks and having value in convertible currency, confirmed in accordance with the laws (procedures) of the investor's country or international trade procedures;
- 6) any kind of intellectual property and related rights including copyright, patents, trade marks (marks for goods and services), industrial samples, know-how, and others, the value of which has been expressed in convertible currency and confirmed according to laws (procedures) of the investor's country or international trade procedures and by the expert's evaluation in Ukraine;
- 7) rights to engage in economic activity including the right to exploration and exploitation of natural resources granted according to the legislation or contracts, the value of which in convertible currency is confirmed according to the laws (procedures) of the investor's country or international trade procedures;
- 8) other stores of value according to the legislation of Ukraine.⁸⁶

The UEC (Article 391) states that foreign investors shall have the right to make investments of the following *types* on the territory of Ukraine: foreign currency recognized as convertible by the National Bank of Ukraine; any movable or immovable property and the property rights related thereto; and other values (property), recognized as foreign investments according to the law.⁸⁷

Article 3 of the Investment Law and Article 392 of the UEC concern *forms* of foreign investments which can be the following:

- ownership interest in entities which are being established jointly with Ukrainian legal entities and natural persons, or acquisition of shares of functioning entities;
- the establishment of entities wholly owned by foreign investors, subsidiaries and branches of foreign legal entities or full acquisition of existing entities;

⁸⁶ Pro rezhym inozemnogo investuvannya: Zakon Ukrainy vid 19 bereznya 1996 roku.

⁸⁷ Gospodars'ky kodeks Ukrainy.

- the acquisition, which is not prohibited by the laws of Ukraine, of movable property or real estate including buildings, apartments, premises, equipment, transportation facilities and other property, by direct acquisition of property and proprietary complexes or in the form of stocks, bonds and other negotiable instruments;
- the acquisition of the rights to use land and/or concessions for the use of natural resources in the territory of Ukraine by foreign investors, independently or jointly with Ukrainian legal entities or natural persons;
- the acquisition of other property rights;
- other kinds of investment, which are not prohibited by the laws of Ukraine, in particular, those based on agreements with agents of economic activity in Ukraine without establishing a legal entity.⁸⁸

Such confusion in terminology can be misleading when it goes about practical aspects of FDI in Ukraine. It is interesting to mention that translators of the Investment Law into English in the title of Article 3 thereof replaced the word ‘forms’ (Ukrainian ‘*форми*’) for the word ‘methods,’ still they could not do so in the body of the Article, the word ‘forms’ remained.⁸⁹

Kinds of assets which may comprise foreign investment, given in Article 1 of the Model Treaty (see *supra* section 1.1) and respective articles of BITs, may be regarded as the only normative definition of possible forms of FDI in the German law.⁹⁰ Overall, as noted by Mahnaz Malik, the definition of investment in the Model Treaty is broad, reflecting the approach in the majority of the German as well as of other EU and North American BITs. Investment in the Model Treaty includes a range of tangible and intangible property and contractual rights beyond the classic forms of direct investment, i.e. “the laying out of money or property in

⁸⁸ See *supra* notes 86 and 87.

⁸⁹ The Law of Ukraine "On the Regime of Foreign Investment" (unofficial translation prepared by the Commercial Law Center), available at <http://www.commerciallaw.com.ua/eng/archive/>

⁹⁰ In Annex I to the Council Directive of 24 June 1988 for the implementation of Article 67 of the Treaty (88/361/EEC) the following types of direct investments are listed:

- 1) establishment and extension of branches or new undertakings belonging solely to the person providing the capital, and the acquisition in full of existing undertakings;
- 2) participation in new or existing undertaking with a view to establishing or maintaining lasting economic links;
- 3) long-term loans with a view to establishing or maintaining lasting economic links.
- 4) reinvestment of profits with a view to maintaining lasting economic links.

business ventures so that it may produce a revenue or income.”⁹¹ This approach has been criticized in the context of FDI; proposals to change the Model Treaty by introducing a narrower and exhaustive definition of investment and in particular by removing references to sovereign debt, portfolio investment; sales of goods and services contracts and intellectual property rights *per se* (i.e. those that are not connected with any investment in the host state) from the definition were made both by German and international legal experts.⁹²

German lawyers pay less attention to definitions (which are very often absent), besides it is not that important within the single European market and leaves space for flexibility. Still in the literature, especially in the investment guides, one may face the following description of possible forms of FDI in Germany, which, as the author presumes, is given for convenience:

“[A] foreign investor may establish a subsidiary by forming an incorporated or unincorporated company, setting up a branch, or within the EC, by forming a European Economic Interest Grouping.”⁹³

Again we do have some confusion in terminology, this time forms of investments are confused with forms of doing business. But, if to be impartial and fair, the abovementioned forms are “the forms of particular practical importance to foreign investors. There are other forms of doing business available that are not addressed [...] since they are, as a rule, of little interest to foreign investors.”⁹⁴ Besides, in the author’s opinion this terminological situation is not that potentially harmful as it is in Ukraine. Anyway, Ukrainian legislators must eliminate terminological errors described.

⁹¹ Mahnaz Malik, *Time for a Change: Germany’s Bilateral Investment Treaty Program and Development Policy*, 17; Jack A. Gottschalk, *The Global Trade and Investment Handbook* 209–210 (Probus Publishing Com. 1993).

⁹² Id. at 18.

⁹³ 1 Business Transactions in Germany (FRG) §2.02[2].

⁹⁴ 1 Doing Business in Europe [1972–2000 Transfer Binder] Germany ¶31-900.

2. Legal Regulation for Foreign Direct Investments: Guarantees, Incentives and Protectionism

It is generally accepted that every country has a sovereign right to regulate and control FDI within its territory. On this occasion Muchlinski has noted that it is necessary to consider the needs of the host country that is charged with the duty of regulating the entry and behavior of aliens into its territory in the public interest. This duty is based on the inherent international legal right of the sovereign State to regulate conduct that occurs upon its territory.⁹⁵

According to Solomon and Mirsky, when regulating FDI policy-makers are obliged to confront at least the following three common problems:

- how to attract foreign investment without incurring a damaging drain on domestic foreign exchange savings and other resources;
- how to preserve the foreign investor's legal rights and give it adequate protection while, at the same time, keeping its domination and negative effects to a minimum; and
- how to design their laws and tax systems in a such a way as to simultaneously foster economic growth and attract foreign investments while concurrently raising enough revenue to meet the budgetary requirements of the government.⁹⁶

Investment laws could, therefore, be seen as a means as well as a consequence of state intervention in the economic process, designed to keep the balance between the above three problems.⁹⁷

This chapter will deal with the analysis of the current Ukrainian and German legal framework on FDI with the exception of the relevant company law issues which will be covered in chapter 3. Comparison of the

⁹⁵ Peter Muchlinski, 'Caveat Investor'? *The Relevance of the Conduct of the Investor under the Fair and Equitable Treatment Standard*, 55 ICLQ Part 3 527, 533 - 534 (2006).

⁹⁶ D. Solomon and D.H. Mirsky, *Direct Foreign Investment in the Caribbean: a Legal and Policy Analysis*, 11 Nw. J. Int'l L. & Bus. 257, 257, 259 (1990 - 1991) cited from Sherif H. Seid, *Global Regulation of Foreign Direct Investment* 33 - 34 (Ashgate 2002).

⁹⁷ Id.

two approaches will be made with the purpose to reveal existing problems in the Ukrainian legal framework and to propose respective changes based on the best German achievements which can be transplanted.

2.1. General Overview of the Current Legal Framework Including Taxation and Customs Issues

2.1.1. Ukraine

The Ukrainian Constitution of June 28, 1996 provides that the right of property may be acquired by citizens, legal persons and the state (Article 14(2)) as well as guarantying the right to own, use and dispose of his or her property, and the results of his or her intellectual and creative activity (Article 41).⁹⁸ These constitutional guarantees are regarded as the basis for free usage of one's property as an investment in or outside Ukraine.

As already noted, the Investment Law is the basic Ukrainian law in the field of foreign investments and FDI in particular.

Other sets of rules essential for FDI in Ukraine can be found in:

- a. Presidential Ordinance on Some Aspects of Foreign Investment No. 748/98 of July 7, 1998;
- b. the Civil Code (CC) of January 16, 2003;
- c. UEC;
- d. the Law on Basics of Creation and Functioning of Special (Free) Economic Zones of October 13, 1992;
- e. the Law on Foreign Economic Activity of April 16, 1991;
- f. the Law on Business Associations (LBA) of September 19, 1991;
- g. the Law on Concessions of July 16, 1999;
- h. the Law on Protection of Economic Competition of January 11, 2001;
- i. the Customs Code (CUC) of July 11, 2002;

⁹⁸ Konstytutsiya Ukrainy, pryinyata na p'yatii sesii Verhovnoyi Rady Ukrainy 28 chervnya 1996 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1996, No. 30, St. 141.

- j. the Land Code (LC) of October 25, 2001;
- k. Decree of the Cabinet of Ministers of Ukraine on the System of Currency Regulation and Currency Control (Currency Decree) of February 19, 1993;
- l. regulations of the National Bank of Ukraine on money transfers and currency issues;
- m. numerous tax laws and regulations;⁹⁹
- n. BITs and other international treaties of Ukraine ratified by the Parliament.

Of course this list is not exhaustive, but it provides an overview of the most important regulations establishing investments guarantees, incentives, and restrictions for foreign investors in Ukraine.

Pursuant to Article 4 of the Investment Law, foreign investments can be made in any objects, investment in which is not prohibited by the laws of Ukraine. Articles 116(5) and 394 (4) of the UEC and article 7(3) of the Investment Law provide that Ukrainian laws may restrict or prohibit activities of foreign investors or enterprises with foreign investments in some sectors of the national economy or on certain territories of Ukraine according to the interests of the national security. For example, foreign citizens, foreign legal entities and stateless persons are banned from creation of television and/or broadcasting organizations but at the same time they can participate in their capital according to the UEC;¹⁰⁰ insurance activity on the Ukrainian territory may be conducted exceptionally by the insurers being residents of Ukraine.¹⁰¹

To commence activities specified in the Law on Licensing of Some Kinds of Business Activity of June 1, 2000 it is compulsory to receive a license.¹⁰² Pursuant to article 1(1) of the Law on Patenting of Some Kinds of Business Activity of March 23, 1996 trading of goods for cash, rendering personal services (barber's, hairdresser's, cleansing etc.), and gambling are subject to patenting by the relevant tax authorities.¹⁰³ Such rules

⁹⁹ Due to the complexity and inconsistency of the Ukrainian tax system it is irrational to list all respective tax laws and regulations within the framework of this thesis. Below in the appropriate context the most important laws and regulations will be covered in more details.

¹⁰⁰ Article 12(2)-(3) of the Law on Television and Broadcasting of December 21, 1993 as amended and supplemented as to January 12, 2006 (Pro telebachennya i radimovlennya: Zakon Ukrainy vid 21 grudnya 1993 roku v redaktsii Zakonu Ukrainy vid 12 sichnya 2006 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2006, No. 18, St. 155). In practice it means that foreigners cannot be the founding members thereof, but they can become shareholders (stockholders) after incorporation.

¹⁰¹ Article 2(1) of the Law on Insurance of March 7, 1996 as amended and supplemented as to December 12, 2005 (Pro strahuvannya: Zakon Ukrainy vid 7 bereznia 1996 roku z nastupnyimi zminami ta dopovnenniyami, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?page=1&nreg=85%2F96%2D%E2%F0>). Pursuant to the Law on Amending the Law on Insurance of November 16, 2006 this restriction will be automatically repealed as of the date Ukraine accedes to the WTO.

¹⁰² At present 76 kinds of business activities are subject to licensing. See Pro litsenzuvannya pevnykh vydiv gospodarskoyi diyal'nosti: Zakon Ukrainy vid 1 chervnya 2000 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2000, No. 36, St. 299.

¹⁰³ Pro patentuvannya deyakikh vydiv gospodarskoyi diyal'nosti: Zakon Ukrainy vid 23 bereznia 1996 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1996, No. 20, St. 282.

can be regarded as a protection of public from risky business practices. This practice of licensing in Ukraine can be regarded as a restriction for business activity of foreigners, whereas existing legislation thereon leaves a lot of opportunities to reject issuance a license.

It is important to mention that pursuant to Article 3 of the Law on Elimination of Discrimination in Taxation of Business Undertakings Incorporated with the Use of Assets and Cash of Domestic Origin special Ukrainian legislation on foreign investments as well as state guarantees of protection for foreign investments specified therein, shall not cover currency, tax and customs legislation of Ukraine unless otherwise provided by the international agreements of Ukraine in force.¹⁰⁴ In practice it means that foreign investors have no privileges regarding taxation, customs and currency issues on the Ukrainian territory compared to domestic investors, i.e. they have to pay taxes, customs duties and remit currency on general basis with Ukrainian businesses.¹⁰⁵ In section 1.2 scandalous circumstances of adoption of this Law were already described; but again the situation is not that easy and transparent, whereas the abovementioned Law does not cover legal relations specified in the Law on Stimulating of Automobile Production in Ukraine (SAPUL) of September 19, 1997 which offered tremendous market advantages to a company that would establish a joint venture with the Ukrainian national motor vehicle manufacturer AutoZaZ. Article 1 of the SAPUL defines investment for the purposes of the law as "investment in cash amounting to at least USD 150 million for production of passenger cars; at least USD 30 million for production of trucks and buses; and at least USD 10 million for production of component parts to the cars and buses." SAPUL guarantees various tax and duty exemptions for a period till 2008 to a qualifying investor who would raise the above listed amount(s), namely:

- (1) exemption from import tax on equipment;
- (2) the privilege to sell motor vehicles in Ukraine VAT-free;
- (3) land tax exemption;
- (4) provision that gross income and gross expenses are subject to indexation on inflation rate;

¹⁰⁴ Pro usunennya dyskryminatsii v opodatkuvani subjektiv pidpryjemnytskoi diyalnosti, stvorenyh z vykorystannyam mayna ta koshtiv vichyznanyogo pohodzhennya: Zakon Ukrainy vid 20 lutogo 2000 roku.

¹⁰⁵ Rates of the main Ukrainian taxes and duties are as follows:

corporate profit tax – 25 %

personal income tax – 15 %

VAT – 20 %

deductions to the Retirement fund – 32 %

excise tax – from 5 to 300 % of the customs value of the goods (depending on the kind, place of manufacture etc.).

(5) provision on lowering annual profit tax dependent upon the amount of money reinvested.¹⁰⁶

Still the UEC (article 394(3)) and Investment Law (article 7(2)) contain contradictory provisions, in particular they state that investment incentives and other economic incentives may be granted to business entities which carry out projects with the attraction of foreign investment that are implemented according to governmental programs for the development of priority sectors of the economy, the development of social services or the development of territories. Thus, it is still possible to introduce new tax and other privileges.

Tax holidays and other privileges were granted to the investors working in so-called special economic zones and territories of priority development.¹⁰⁷ According to article 1 of the Law on Basics of Creation and Functioning of Special (Free) Economic Zones (SEZ), the latter are understood as “a part of the Ukrainian territory where a special legal regime of economic activity and application and operation of the Ukrainian laws shall be enacted and operated. On the territory of the SEZ favorable customs, currency and financial, tax and other conditions of economic activity shall be applied in relation to domestic and foreign legal entities.”¹⁰⁸ According to the mentioned Law the purpose of creation of SEZ was in attraction of foreign investments and in social and economic development of Ukraine. This approach provided for a very good investment incentives, but unfortunately, due to numerous abuses on the part of both domestic and foreign investors, money-laundering problems and political trends in the country in March 2005 Ukrainian Parliament abolished all tax and customs privileges within the existing SEZs. But SEZs laws are still formally in force.

In conclusion a few words about Ukrainian customs legislation. Unfortunately the CUC did not become a sample market oriented law. Numerous customs by-laws and directives continue to exist, making customs issues more complicated and unclear.

To illustrate current customs problems situation with export limitations on specific commodities may be used. Such limitations continue to apply as result of minimum export prices, export customs charges and quotas fixed annually by the Ukrainian Government. Such export limitations do not facilitate export-oriented

¹⁰⁶ Pro stymulyuvannya vyrobnytstva avtomobiliv v Ukraini: Zakon Ukrainy vid 19 veresnya 1997 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1997, No. 47, St. 294; Daniil E. Fedorchuk, *supra* note 1, at 52–53.

¹⁰⁷ By the end of 2006 in Ukraine there were 11 special economic zones and 9 territories of priority development.

¹⁰⁸ Pro zagalni zasady stvorennia i funktsionuvannya spetsialnyh (vilnyh) ekonomichnyh zon: Zakon Ukrainy vid 13 zhovtnya 1992 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 1992, No. 50, St. 676.

investments, which are badly needed by Ukraine.¹⁰⁹ Even temporary export of commodities for repair purposes in accordance with the CUC shall be cleared in the customs regime of so-called “processing outside of the Ukrainian customs border”. In practice it means that upon the entry of such commodities back to Ukraine after repair, import duty and VAT should be paid. Such procedure in many cases might be economically non-expedient.¹¹⁰

2.1.2. Germany

As already noted above, compared to Ukraine in Germany there is no special law on foreign investments. In part that can be explained by German legal tradition with its relatively developed judicial law making, and in part by the EC basic freedoms for the movement of goods and capital established by the EC Treaty which do not need detailed elaboration.

However other main rules on FDI can be found in the following German laws and regulations:

- BGB
- HGB
- AWG
- AWG’s implementing regulation, the Foreign Trade Ordinance (*Außenwirtschaftsverordnung* – AWV) of December 17, 1986
- AG
- GmbHG
- Restraints of Competition Act (*Gesetz gegen Wettbewerbsbeschränkungen* – GWB)
- laws and regulations applicable in Eastern Germany;
- BITs and other international treaties of Germany

GG and AWG in principle contain no limitations to trade and/or to invest in Germany. Foreign and domestic companies are treated identically in all areas, from protection of property rights to investment

¹⁰⁹ European Business Association Report *Barriers to Investment to Ukraine* 106.

¹¹⁰ Id. at 110; Mytny Kodeks Ukrainy vid 11 lupnya 2002 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2002, No. 38 - 39, St. 288.

incentives. However, up to March 2006 AWG (sections 22 and 23) contained limits of the flow of capital in and out of the FRG via transactions between residents and non-residents applicable only in case the DM purchasing power was prejudiced or if the balance of payments was in danger. In fact these AWG provisions have never been used, after introduction of euro (2002) became obsolete and finally repealed by the Law of March 28, 2006.¹¹¹ The same happened with notification requirements which used to be contained in sections 57 – 58 AWV.¹¹²

Still Germany has a variety of restrictions and limitations on acquisition of the existing companies, especially concerning company shares. Such restrictions are covered mainly by competition and company law. Here it is necessary to mention that, like Ukraine, Germany reserves the right to limit foreign investments in some sectors to preserve national security. For example, AWG (section 5) and AWV (section 55) directly say that the acquisition of a resident company, or the direct or indirect participation in such a company that produces military goods specified in the War Weapons Control Act, or motors or gears for combat tanks or other armored military vehicles, or cryptographic systems admitted for the transmission of governmental classified information, by a non-resident or a resident company in which a non resident has at least 25 % voting rights, must be reported by the purchaser to the Federal Ministry of Economics and Technology. According to section 52(2) AWV the Federal Ministry of Economics and Technology may prohibit such acquisition within a one month period after the reception of the completed documents related to the purchase in order to safeguard the vital security interests of the FRG.¹¹³

In comparison with Ukraine the FRG's licensing practice pursuant to the Business Practice Act (*Gewerbeordnung* – GewO) covers fewer activities (only those concerning transportation and driving schools, security, production and trade of arms, real estate, trade of certain investment and finance products, auctions, running retirement homes and pawnshops).

¹¹¹ Foreign Trade and Payments Act of April 28, 1961, *supra* note 67; Doing Business in Europe [1972 – 2000 Transfer Binder] Germany ¶33-230.

¹¹² Regulation Implementing the Foreign Trade and Payments Act of December 18, 1986 as amended by the Announcement of November 22, 1993 and the 76th Regulation Amending the Foreign Trade and Payments Regulation of June 13, 2006, available in English at http://www.bafa.de/1/en/service/pdf/export_control_awv_en.pdf

¹¹³ AWG and AWV.

For centuries Germany has been regarded as a high-tax country with very sophisticated tax legislation. Both domestic and foreign businesses doing business in the FRG are subjects to relatively high tax rates.¹¹⁴ Any corporate entity which either holds its company seat or its administrative office in Germany is deemed to be a German resident and is therefore subject to German corporate income tax on its worldwide income. Corporate entities which are not German residents are subject to German income tax on their German source income (limited taxation). Since 2001 the corporate income tax is 25 % for both resident and non-resident corporate entities. The effective tax rate varies from 9 % - 19 % depending on the municipality.¹¹⁵ Personal income tax tariff is progressive and ranges from 15 % to a maximum of 42 %.¹¹⁶ To finance investments of the Government in Eastern Germany a so-called “solidarity surcharge” is imposed on both income tax and corporate tax. Its current rate is 5.5 %.¹¹⁷ From January 1993 the imposition and abatement of VAT on goods crossing German border applies only to transactions carried out with territories not within the EU (non-EEC countries). The general VAT (both for goods and services) is 16%. For some specific items (e.g. books, newspapers and food) the reduced VAT of 7% applies.¹¹⁸ Welfare deductions, such as health and retirement insurance, amount to 13.5% and 19.5% respectively.¹¹⁹ The system of excise duties is very complicated due to numerous EU directives thereon; excise duty rates vary depending on the kinds of consumption goods, their place of consumption etc. However, Germany introduced a system of some tax incentives applicable in East German states with the purpose to attract potential investors. For example, pursuant to German Investment Subsidy Acts (InvZulG 1999 and InvZulG 2005), for acquisition or manufacture of movable fixed assets in East *Länder* investment subsidy of up to 15% may be claimed from the relevant state’s tax office for certain investments made until December 31, 2006.¹²⁰ Such subsidy is exempt for corporate and personal income tax as well as trade tax.¹²¹

¹¹⁴ Fritz K. Koehler, *Investment in the New German Federal States*, 24 Case W. Res. J. Int’l L. 495, 506 (1992).

¹¹⁵ Industrial Investment Council (IIC) Report: Taxation in Germany (2006) available at http://www.iic.de/uploads/media/Taxation_System_eG.pdf

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ Industrial Investment Council (IIC) Report: Taxation in Germany; KPMG Report: Investment in Germany 78.

¹¹⁹ Industrial Investment Council (IIC) Report: Taxation in Germany.

¹²⁰ KPMG Report: Investment in Germany 158.

¹²¹ Trade tax is based on federal law, but is levied by local municipalities, based on a corporation’s “trade income” (*Gewerbeertrag*). The trade income is multiplied by a basic tax rate of 5% to compute the base amount. The relevant multiplier (*Hebesatz*) for each local municipality is then applied to the base amount. These multipliers typically range between 250- 490%, i.e. a factor of 3 to 4.9, giving a

Provisions of the EC Treaty on the free movement of goods are the basis for respective customs legislation of Germany. Goods can circulate freely within the EU, but must be cleared through customs when imported into German customs territory from a non-EU country. This can be done either by importing the goods under special customs procedures, in which case customs duties do not arise, or by clearing the goods for free circulation (as defined for customs purposes). Clearance for free circulation automatically triggers import duties. These include in particular customs duty, import turnover tax and, where applicable, excise duties. The level of the customs duties depends on the classification of the imported goods within the German customs tariff (based on the Common Customs Tariff of the EU) and on the customs value that is placed on the goods. The EU (and Germany in particular) grants tariff preferences to a large number of non-EU countries for all industrial products and numerous agricultural products. In such cases reduced rates of customs duties or exemption from customs duties apply when goods are cleared for free circulation.¹²²

2.2. State Guarantees for Foreign Direct Investments: Protection of Property, Transfer of Profits and Repatriation of Dividends

State guarantees for FDI have always been of the main interest to foreign investors. Without effective system of legal protection and its enforcement it is impossible to create an attractive investment climate. Both in Ukraine and Germany basic guarantees for FDI protection derive from constitutional provisions on the protection of property and its free usage (Article 14 GG,¹²³ Articles 14 and 41 of the Ukrainian Constitution, see *supra*).

Pursuant to Article 7 of the Investment Law and Article 394(1) of the UEC, foreign investors on the territory of Ukraine shall enjoy national treatment as to investment and other economic activity with the exceptions provided for by Ukrainian legislation and international agreements of Ukraine. National treatment

tax rate of 13-19.7 %. See Industrial Investment Council (IIC) Report: Taxation in Germany; KPMG Report: Investment in Germany 158.

¹²² Industrial Investment Council (IIC) Report: Customs System of Germany (2006) available at http://www.iic.de/uploads/media/Customs_Systems_eG_01.pdf

¹²³ Basic Law for the Federal Republic of Germany of May 23, 1949 as amended to December 1, 1993 in David P. Currie, *The Constitution of the Federal Republic of Germany* 349.

means that foreign businesses have the same rights and obligations as the national ones and applies to all kinds of economic activity within Ukraine connected with investments.¹²⁴

In domestic German legislation such norms are absent. The principle that foreign investors should not be distinguished from domestic ones is implied, but not fixed in any statutory provision.

To ensure stability of the legal regime of foreign investments, the following guarantees have been established for the foreign investors in Ukraine:

- application of state guarantees for protection of foreign investments in case of changes in the legislation on foreign investments (Article 8 of the Investment Law);¹²⁵
- guarantees against forcible withdrawal and illegal actions by state authorities and officials thereof (Article 9 of the Investment Law);
- compensation and reimbursement of losses incurred by foreign investors; guarantees in case of termination of investment activities (Articles 10 and 11 of the Investment Law);
- guarantees of transfer of profits and use of income from foreign investments¹²⁶; and other guarantees of investment activities (Article 12 of the Investment Law).

Both the Investment Law and the UEC establish the guarantee that foreign investments in Ukraine shall not be subject to nationalization. Any kind of confiscation of foreign investments by state bodies and officials thereof is prohibited, with exception of emergencies (rescuing actions, natural disaster and breakage, epidemic or epizootic) and exceptionally in accordance with the procedure established by the law.

In accordance with Article 10 of the Investment Law and Article 397(5)-(6) of the UEC, foreign investors shall have the right to apply for compensation of losses, including lost profit and moral damage,

¹²⁴ Naukovo-praktychnyi komentar Gospodars'kogo kodeksu Ukrainy at 603; Article 7 of the Law on Foreign Economic Activity of April 16, 1991 as amended to November 16, 2006, see Pro zovnishnioekonomichnu diyal'nist': Zakon Ukrainy vid 16 kvitnya 1991 roku z nastupnymi zminamy i dopovnennamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg959%2D12&p=1170361725006273>

¹²⁵ Pursuant to Article 8 of the Investment Law and Article 397(2) of the UEC, if the legislation on foreign investments changes, by request of a foreign investor in cases and in accordance with the procedure established by law, state guarantees shall be applied according to legislation effective as of the moment of investment. Moreover, government guarantees for the protection of foreign investment stipulated by the Investment Law before respective changes shall apply for a period of ten years from the date when such legislation came into force.

¹²⁶ Upon payment of taxes, duties, and other mandatory payments, foreign investors shall be guaranteed unimpeded and prompt remittance abroad of their profits and other sums in foreign currency obtained legally as a result of foreign investments.

resulting from illegal actions or passivity of state authorities or local governments and officials thereof. Losses of foreign investors shall be compensated at current market prices or based upon justified estimations confirmed by an independent auditor (auditing organization) and in the currency in which respective investments had been made.

Given the fact Germany does not have a single statute on foreign investment, it is natural that guarantees for the protection of property, free repatriation of dividends etc. are not listed in some particular statute, as it is done in Ukraine.¹²⁷ In Germany the system of guarantees is much simpler, based on the GG prohibitions of seizure of private property unless otherwise provided by the law and only for the public good with offer of just compensation (Article 14(3) GG). Moreover, the German Constitutional Court has made it clear that takings property cannot be justified simply by providing adequate compensation; GG basically guarantees property itself, not its equivalent of money.¹²⁸ Guarantees as to the free movement of capital (including repatriation dividends) are contained in AWG (section 1) and are based on the EC Treaty (Article 56 (ex-article 67))¹²⁹ and Directive 88/361 which completely abolished all restrictions on the transfer of capital between Member States, namely between persons (natural and legal) having EC residence. In accordance with Article 7(1) of the Directive in their treatment of transfers in respect of movements of capital to or from third countries, the Member States shall endeavor to attain the same degree of liberalization as that which applies to operations with residents of other Member States.¹³⁰

However, pursuant to Ukrainian legislation (Article 13 of the Investment Law and Article 395 of the UEC), to enjoy guarantees specified hereinbefore foreign investor must register his/her investment with respective state authorities (Government of the Autonomous Republic of Crimea, Oblast's (regional), Kyiv and Sevastopol City State Administrations) within three business days of their actual contribution according to the procedure determined by the Cabinet of Ministers of Ukraine in the Regulation on Procedure for State

¹²⁷ For objectivity it should be noted that the same provisions can be found in the UEC (Articles 397 – 399) which was adopted later than the Investment Law. For practical purposes the Investment Law is regarded by Ukrainian lawyers as the special law on the subject, hence it is given priority.

¹²⁸ 24 BVerfGE 367, 400 (1968); David P. Currie, *The Constitution of the Federal Republic of Germany* 291.

¹²⁹ Consolidated version of the Treaty Establishing the European Community, 2002 O.J. (C 325) 56.

¹³⁰ Council Directive 88/361/EEC.

Registration of Foreign Investments enacted by the Resolution No. 928 of August 7, 1996.¹³¹ If a foreign investor failed to register the investment(s), state guarantees on their protection and free transfer of profits shall not apply (Article 13(2) of the Investment Law, Article 395(3) of the UEC). Such registration cannot be viewed as the only unconditional proof of contribution of the respective foreign investment; it influences only the possibility for foreign investor to enjoy guarantees contemplated by the law.¹³²

In the FRG procedure for state registration of foreign investment does not exist. To start a new enterprise it is enough for any business, factory, trade, or industrial establishment, whether German or foreign, to notify the respective local administration and tax authorities about the business prior to commencing its activities in accordance with the procedure specified in GewO.

In Ukraine such notification is essential as well, but it is the integrated part of the state registration of legal entities and natural persons-entrepreneurs and their entry in the State Register according to the Law on State Registration of Legal Entities and Natural Persons-Entrepreneurs of May 15, 2003.¹³³

2.3. Existing Barriers for Foreign Direct Investments, Ukrainian Peculiarities as a Barrier towards the WTO and the EU/EC; German Attitude as a Pattern for Transplantation in Ukraine

Despite the detailed foreign investment legal framework, Ukrainian investment climate suffers from numerous negative factors, such as contradictory legislation, vague privatization procedure, bad enforcement, corrupted judicial system, preferential treatment for some investors and negative political trends which sometimes result in seizure of investors' property.

¹³¹ Polozhennya pro porядok derzhavnoyi reestratsii inozemnyh investytsiy, zatverdzhene postanovoju Kabinetu Ministriv Ukrainy vid 7 serpnia 1996 roku No. 928, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=928%2D96%2D%EF&p=1170361725006273>; Arthur Nitsevytch, supra note 1, at 683.

¹³² Writ of the Higher Economic Court of Ukraine of December 20, 2005, case No. 38/122, available in Ukrainian at http://www.arbitr.gov.ua/docs/28_1138053.html

¹³³ Pro Derzhavnu reestratsiyu yurydychnyh osib i fizychnyh osib-pidpryemstiv: Zakon Ukrainy vid 15 travnya 2003 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2003, No. 31 - 33, St. 263.

First of all problems with Ukrainian currency regulations should be described, whereas they directly influence the basic guarantees for foreign investors to make investments in any form provided by the law and freedom to remit profits.

In accordance with Article 5(1) of the Investment Law foreign investments including contributions to the Statutory Fund of the entity, shall be valued in convertible foreign currency and in Ukrainian currency according to the understanding reached by the parties, on the basis of prices on international markets or on the market of Ukraine. Pursuant to Article 12(2) procedures for the remittance of profits and other sums received as a result of foreign investments shall be determined by the National Bank of Ukraine (NBU). In August 2005 the latter adopted Regulation No. 280 on the procedure of Foreign Investments in Ukraine (hereinafter Regulations).¹³⁴ Article 2.3 of the Regulations establishes a strict rule, under which settlements for investment objects are to be effected through accounts opened with authorized banks. But it is evident that the NBU's authority cannot cover operations between non-residents that take place outside Ukraine which may be the case. Besides in violation of Article 391 of the UEC which says that foreign investment might be spread in foreign currency, recognized as convertible by the NBU and any limitations may be imposed only by law, the Regulations (which are not a law) introduced provisions by which the convertible currency of so-called group 2 (e.g. HUF, PLN, CZK, RUB) may not be used for investment in Ukraine. As a matter of fact enactment of the Regulations (as well of their previous version) is a breach the obligations undertaken by Ukraine under international agreements on promotion and protection of investments.¹³⁵ In particular Article 48 of the Partnership and Co-operation Agreement between Ukraine and EC Members of June 14, 1994 states that Ukraine and Member States will introduce "*no new foreign exchange restrictions on the movement of capital and current payments concerned therewith*" between residents of the EC and Ukraine.¹³⁶

It should be noted that procedure of repatriation of profits, especially acquisition of foreign currency, is complicated as well. To be able to buy currency from a Ukrainian bank with the further purpose to repatriate their profits foreign investors are required to submit a pile of documents some of which are extremely difficult to

¹³⁴ Postanova Pravlinnya Natsional'ogo Banku Ukrainy vid 10 serpnia 2005 roku No. 280 pro vregulyuvannya pytan' inozemnogo investuvannya v Ukrainu, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=z0947-05>

¹³⁵ European Business Association Report *Barriers to Investment to Ukraine* 76.

¹³⁶ Ugoda pro partnerstvo ta spivrobitnytstvo mizh Ukrainoyu ta Evropejskymy Spivtovarystvamy ta jyh derzhavamy-chlenamy vid 14 chervn'ya 1994 roku, ratyfikovana Zakonom Ukrainy vid 10 lystopada 1994 roku, available at http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=998_012&p=1170666190122313

obtain (tax statements, certificates of finalization of the settlements etc.). In violation of the provisions of the Currency Decree banks very often demand individual licences of the NBU permitting transfers of currency abroad,¹³⁷ forcing investors to sue which takes time and expenses.¹³⁸

It may be concluded from the above that Ukrainian authorities should cancel such discriminatory measures and amend NBU Regulations in an appropriate way. German model provided in AWG can be used as pattern, whereas few grounds exist in Ukraine to limit money transfers in foreign currency. The only justified limitations may be connected with prevention of money-laundering and capital flights, which could endanger the economic stability of the country. Such policy is fully rational provided respective regulations are clear and precise which is not the case at the time since unclear regulations could be interpreted too broadly as to have a negative effect on all transactions, including those that are not connected with currency inflows. With due observance of notification procedures and check-outs by financial institutions investors should not suffer from artificial complications in transferring their money.

Problems connected with customs clearance of goods are of particular interest to foreign investors, since they hinder contribution of foreign investments in natural form (equipment, goods). For example, Article 277 of the CUC establishes that a group of countries, customs union of countries, or a particular region or part of a country, may be understood as the country of origin. However, to date there is no mechanism for the implementation of the mentioned article.¹³⁹ In cases when during customs clearance a certificate stating that the goods originate from the EC is submitted it will be impossible to apply a rate of customs duty (since in Ukraine customs rates are established by countries); the customs officers will demand a certificate indicating the exact country of origin. Though the problem seems bureaucratic, it represents the serious threat, whereby foreign investors are discouraged to make contributions with a new high-tech equipment etc. Again such situation represents a violation of the Partnership and Co-operation Agreement between Ukraine and EC Members, particularly Article 10 thereof, stating that *the Parties shall grant each other the MFN treatment according to Article 1(1) of the General Agreement on Trade and Tariff (GATT)*.

¹³⁷ In accordance with Article 5(4) clause "a" of the Decree no license is required for repatriation of foreign investments in case of termination of investment activity or remittance of profits received as a result of foreign investment.

¹³⁸ Fortunately for foreign investors Ukrainian courts take investor-oriented position ordering banks to perform remittance transactions without an NBU individual license. See e.g. writs of the Higher Economic Court of Ukraine of February 10, 2005, case No. 32/635; of August 4, 2005, case No. 37/241, both available in Ukrainian at <http://www.arbitr.gov.ua/doc.php>

¹³⁹ European Business Association Report *Barriers to Investment to Ukraine* 108.

The way out may be simple. First of all a mechanism for application of Article 277 of the CUC Code must be developed. In the context of goods originating from the EC a code for the EC may be introduced as applicable during the declaration of goods.

A few words should be dedicated to existing preferences. The SAPUL applied only to Daewoo Motors whereas at the moment of enactment it was the only company qualifying for the project contemplated by the SAPUL.¹⁴⁰ At the time other interested parties (mostly automotive manufacturers trading on the Ukrainian market), as well as the European Commission, protested, claiming that the law was discriminatory and favoured one party to the detriment of all others as it imposed indirect subsidies and restrictive investment requirements. The EC also alleged violation of Article 15 of the Partnership and Co-Operation Agreement between Ukraine and EC Members on national treatment.¹⁴¹

The similar situation exists in relation to Russian manufacturers of passenger cars working in Ukraine; the latter enjoy privileges on payment of import duties pursuant to the Agreement between the Government of Ukraine and the Government of the Russian Federation on Free Trade of June 24, 1993.¹⁴²

Though privileges granted by the SAPUL will expire on January 1, 2008, the Free Trade Agreement with Russia will continue to exist, representing a barrier towards the GATT/WTO, whereas it has been a requirement made to Ukraine to eliminate privileges on collecting indirect taxes.¹⁴³

Greenfield investments in Ukraine are complicated by numerous obstacles in acquiring landed property. Pursuant to the LC (Article 82(2)) foreigners cannot acquire agricultural land in their possession. Procedures for acquiring non-agricultural land parcels by Ukrainian legal entities jointly with foreign parties (shareholders etc.) are still unresolved though contemplated by Article 82 of the LC.¹⁴⁴

¹⁴⁰ Daniil E. Fedorchuk, *supra* note 1, at 53.

¹⁴¹ See Charles Clover, *Daewoo Sells Part of 40% Kazakh State*, FIN. TIMES (LONDON), Mar. 25, 1998, at 45 (discussing how restrictions the Ukraine placed on imported cars upset the European Commission and may affect the Ukraine's chance of being admitted to the WTO); see also Kevin Done, *A New Wave of Transplants'—Cars*, FIN. TIMES (LONDON), Jan. 8, 1990, at IV (examining how the European Commission has made one of its aims to do away with restrictions on imported cars) cited from Daniil E. Fedorchuk, *supra* note 1, at 53.

¹⁴² Uгода mizh Uryadom Ukrainy ta Uryadom Rosijskoyi Federatsii pro vil'ny torgivlyu vid 24 chervnya 1993 roku, available at http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=643_009.

¹⁴³ Andrey M. Tsvetkov, *Import Duty—New Problem for Importers*, Ukr. J. Bus. L., 17 (August 2004).

¹⁴⁴ Zemel'ny kodeks Ukrainy vid 25 zhovtnya 2001 roku z nastypnyimi zminami i dopovnenniyami, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2768%2D14&p=1170361725006273>; European Business Association Report *Barriers to Investment to Ukraine* 32.

Problems involving landed property issues have been aggravated by constant attempts of the left-wing parties in the Ukrainian Parliament and Government to constrain the whole possibility of private property to land. The LC as well as the provisions of the legislation on foreign investment need amendments and supplements concerning simplification of the procedure for acquiring property rights to land parcels by foreign investors.

And the biggest problem faced by foreign investors involved in FDI to Ukraine is the national company law, which is ambiguous due to existence of three acts (CC, UEC and the Law on Business Associations) regulating the same issues in a different way. To refrain from repetition this problem will be covered in details in the next chapter.

Finally, foreign investors willing to acquire operating businesses through the procedure of privatization have no choice as to the form of the enterprises the state proposes for acquisition. It can be only stock corporations or so-called integral property complexes,¹⁴⁵ whereas Ukrainian legislation on privatization¹⁴⁶ envisages no possibility of transformation of state-owned enterprises into forms other than stock corporations, which is hardly economically feasible in relation to some kinds of enterprises. Besides it leads to rise in price of the stock of enterprises offered for privatization which is aggravated by the fact that privatization is possible only through a public sale thereof.

In this respect Ukraine may follow the ideas of the Treuhand Law which (§ 11) enabled *Treuhandanstalt* to transfer some state-owned enterprises of the former GDR into GmbH (analogues of the Ukrainian Limited Companies) for further privatization. Despite frequent criticism of *Treuhandanstalt*'s activity in 1990-1994 and assertion that the whole concept of Treuhand implemented in the respective GDR laws was unique and inapplicable for transplantation in other countries,¹⁴⁷ the author thinks that the model provided in § 11 of the Treuhand Law may be transplanted in the Ukrainian acts on privatization, whereas the possibility to

¹⁴⁵ Simply speaking it is a property not an entity.

¹⁴⁶ In this respect see Pro pryvatyzatsiyu derzhavnogo majna: Zakon Ukrainy vid 4 bereznya 1992 roku z nastypnymy zminamy i dopovnennamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2163-12> ; Pro pryvatyzatsiyu nevelkykh derzhavnykh pidpryemstv (malu pryvatyzatsiyu): Zakon Ukrainy vid 6 bereznya 1992 roku z nastypnymy zminamy i dopovnennamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2171-12>

¹⁴⁷ Michael Jürgs, *Die Treuhändler. Wie Helden und Halunken die DDR verkaufte* (München/Leipzig 1997); XVII. International Encyclopedia of Comparative Law. *Law and Economic Reform in Eastern Europe – The Transition from Plan to Market during the Formative Years of 1989-1994* § 3-32 (2006).

transfer smaller state-owned enterprises into companies limited by shares will facilitate privatization procedures and reduce red-tape, abuse and infringement of the investors' interests.

As we have seen from the above, Ukrainian legislative framework on FDI is very complex and in many cases it discourages foreign investors to invest to Ukraine. Ukraine has not managed to solve all the problems listed at the beginning of this chapter. Design of the national laws is not that attractive for foreign investors as it could have been. On the one hand the legislator tried to provide the best possible environment for those entering the Ukrainian market, on the other hand existing incentives were repealed without any apparent reasons and chosen investors received very alluring privileges. Such situation can hardly contribute to the formation of the positive image of Ukraine in the foreign investors' opinion. Germany managed to create a simple and effective environment which is not overloaded with regulations. Taking it into consideration, Ukrainian legislators should pay attention to the most important fields, such as currency and customs regulations, land property issues and stability of the provided incentives. Simplicity and transparency of the German approach may be used as a model, though, taking into consideration the Ukrainian legal tradition, it may be necessary to have a concise Investment Law.

3. Correlation of Business Associations and Investment Law: Ukrainian and German Approaches

The main peculiarity of the FDI, as stated in chapter 1, is controlling/managing the object of investment. Creation of a brand-new business or acquisition of an existing one is the best way to achieve this goal. That is the reason which explains the popularity of greenfield investments and M&A as the most widely spread types of FDI. Hence, laws on business associations and establishment enacted in the host-country are of particular interest to foreign investors. Clear and precise rules in company law are a precondition for successful attraction of FDI to the national economy. These issues will be addressed in this chapter, in particular, the most important investment vehicles known in Ukraine and Germany will be compared.

Both Ukraine and Germany offer a potential foreign investor a wide range of possible forms and ways to start business in the country. Under Ukrainian legislation foreign investors can perform their activity on the territory of Ukraine by means of creating an enterprise with foreign investments, a foreign enterprise, a branch or a representative office of the foreign legal entity or in other forms which are not prohibited by the law.¹⁴⁸ Due to the existing contradictions in the Ukrainian company laws it is impossible to speak about a unified classification of business entities which can be created in Ukraine. Since it is not within the framework of the present thesis to review existing contradictions on the issue which are not that easy to describe and explain, the accent in this chapter will be made on the most popular (from the point of practical experience) forms thereof – branches (*filii*), limited liability companies (*товариства з обмеженою відповідальністю – TOV*) and stock companies (corporations) (*акціонерні товариства – AT*). Other forms of business associations known in Ukraine will be covered in general since they are not so popular with the investors.

It is essential to say that pursuant to Article 116(1) of the UEC, an enterprise incorporated under the provisions of the UEC in which at least 10% of the capital were contributed as a foreign investment shall be recognized as an enterprise with foreign investments (*pidpryemstvo z inozemnyimi investytsiyamy*); in

¹⁴⁸ Article 396(1) of the UEC; Article 16(1) of the Investment Law.

accordance with Article 117(1), enterprises with 100% of foreign capital shall be recognized as foreign enterprises (*inozemne pidpryemstvo*). This status can be reflected in the name of the enterprise with the purpose to facilitate availing of the existing guarantees and (in rare cases) privileges.

In Germany foreign individuals may wish to start business as a branch (*Zweigniederlassung*) of a foreign entity, to set up an independent entity by selecting between a variety of forms of corporations (*Kapitalgesellschaften*) and partnerships (*Personengesellschaften*). All these forms of doing business in Germany will be covered in this chapter as well.

3.1. Branches

Ukrainian CC (Article 95) defines a branch (*filiya*) as a separated subdivision of a legal entity situated outside its location that performs all or part of the functions of this entity.¹⁴⁹ The branch receives property from the company and acts on the basis of the regulations approved thereby. It is not a legal entity. The managers of the branch are appointed by the company and act on the basis of the power of attorney granted thereby.

The Ukrainian legislation does not give guidance as to how register a branch of the foreign company in Ukraine. The exception is registration of branches of foreign banks. Under the UEC (Article 58(2)) and Article 28 of the Law on State Registration of Legal Entities and Natural Persons-Entrepreneurs (hereinafter Registration Law) branches shall not be registered separately but information about them is subject to entry in the State Register.¹⁵⁰ The problem here is that Registration Law provides for a procedure which can be followed only by domestic companies.

Normally foreign companies open so-called representation offices (*predstavnytstvo*) in Ukraine. The difference between a branch and a representative office lies in the scope of authority. If a branch performs all or part of the functions of the company, a representative office only represents and protects the company's interests

¹⁴⁹ Tsivilny Kodeks Ukrainy vid 16 sichnya 2003 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2003, No. 40 - 44, St. 356.

¹⁵⁰ Nevertheless, branches of foreign banks shall be accredited by the NBU and entered in the State register of banks (article 24 of the Law on Banks and Banking Activity of December 7, 2000). See Pro banky i bakiv's'ku diyalnist': Zakon Ukrainy vid 7 grudnya 2000 roku z nastupnyimi zminami i dopovnenniyami, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2121%2D14&p=1170361725006273>

without performance of any independent functions (Article 95(2) of the CC). Pursuant to Article 5 of the Law on Foreign Economic Activity, representation offices of foreign companies shall be registered by the Ukrainian Ministry of Economy in accordance with the Instruction on State Registration of Representative Offices of Foreign Subjects of Economic Activity in Ukraine adopted by the Order of the Ministry of Foreign Trade No. 30 of January 18, 1996.¹⁵¹

For registration the following documents shall be submitted to the Ministry: application for registration, extract from the respective register of the country where the company is incorporated, certificate of the bank where the bank account of the office was officially opened, power of attorney granted to the manager(s) of the office by the company in accordance with the laws of the place of incorporation. The registration procedure can take up to 60 days and fees are relatively high amounting to USD 2,500.

In Germany a branch (*Zweigniederlassung*) is understood as a location which, independent from the main business, carries out transactions similar to those of the main business.¹⁵² It is conducted for a certain period by managers competent to act independently on behalf of the company. The branch maintains its own books and balances and operates with its own working capital. It has its own domicile but no legal entity.¹⁵³ According to § 13 b HGB the branch must be registered in the commercial register with the district court where it has its seat.¹⁵⁴ The branch must have a company name which indicates its affiliation with the main office.

Registration of the branch is very simple. To register the branch, respective court will request evidence of the legal existence of the foreign company, copies of the articles of association/incorporation, the names of all managing directors or management boards and their power of representation, the amount of capital, the location of the registered office, its organization as well as the names of the persons who will act for the foreign company in the FRG. This information upon its entry in the commercial register as well as subsequent changes thereto are subject to publication in the German Federal Gazette (*Bundesanzeiger*).

Taking into consideration all this, it is obvious that Ukraine needs to change the existing framework on establishing branches and/or representation offices. There are no obstacles in adopting the German approach,

¹⁵¹ Instruktsiya pro porjadok rejestratsii predstavnytstv inozemnyh subjektiv gospodars'koji diyalnosti v Ukraini, zatverdzhena nakazom MZEZtorgu vid 18 sichnya 1996 roku No. 30, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=z0034-96>
The Ministry of Foreign Trade no longer exists, the Ministry of Economy performs its functions.

¹⁵² 1 Business Transactions in Germany (FRG) §2.02[2].

¹⁵³ Id.

¹⁵⁴ Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] Statutory Material App. 2-18 – 2-19 (LexisNexis 2006).

namely branches and representation offices should be registered by the local Registrar in a place where they have their seat in accordance with the Registration Law which must be amended in appropriate way.

3.2. Limited Liability Companies

A limited liability company (Ukrainian - *товариство з обмеженою відповідальністю* – TOV; German - *Gesellschaft mit beschränkter Haftung* – GmbH) is the most common form of incorporated company both in Ukraine and Germany which can be formed for any lawful purpose.¹⁵⁵

Despite the fact that the limited liability company is a German invention without any precedent in history,¹⁵⁶ there is no statutory definition thereof in the German law (in GmbHG or any other acts). In Ukraine TOV is defined as an association having a statutory capital (fund) divided into shares of the amount specified in the Charter.¹⁵⁷ In Germany it can be defined in the same way.

Both in Ukraine and Germany formation of a limited liability company is relatively simple. It may be formed by one or more persons who may be individuals or legal entities.¹⁵⁸ In both countries the founding shareholders¹⁵⁹ are to draft the articles of association (charter in Ukraine), certified by a notary. This document constitutes the basic corporate document governing the structure and operation of the TOV and GmbH.¹⁶⁰

The contents of the articles of association (charter) shall be as follows:

<i>Ukraine</i>	<i>Germany</i>
<i>(Articles 4, 51 of the LBA; Articles 88, 143 of the CC)</i>	<i>(§ 3 GmbHG)</i>
1. the type of the company (TOV) and its name;	1. the name and the domicile of the company;
2. the purpose of the company, spheres of activity;	2. the purpose of the enterprise;
3. the names of the shareholders;	3. the amount of the share capital;

¹⁵⁵ One of the exceptions in both comparison countries is the creation of banks which cannot be organized as limited liability companies.

¹⁵⁶ *Introduction to German Law*, *supra* note 23, at 157-158.

¹⁵⁷ Article 50(1) of the LBA; Article 140(1) of the CC; Article 80(3) of the UEC.

¹⁵⁸ § 1 GmbHG; Article 140(1) of the CC. It should be noted here that the LBA contains no provisions giving a single person an opportunity to form a TOV. For a while, after the adoption of the new Ukrainian CC, it was impossible to put the novelty into practice.

¹⁵⁹ In Ukrainian CC there is a provision saying that the law may establish a maximum quantity of the shareholders, in case of increase of this maximum limit the TOV shall be either transferred into a stock company or liquidated (Article 141(1)). But no such law has been adopted so far.

¹⁶⁰ Nina Saniahmetova, *supra* note 48 at 188; 2 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] The Limited Liability Company §23.02[4] (LexisNexis 2001).

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| <ol style="list-style-type: none"> 4. the procedure for joining and withdrawal from the company by shareholders (CC only¹⁶¹); 5. the amount of the share capital and procedure of paying thereof; 6. the amount of the contribution to be paid on the share capital by each shareholder; 7. the procedure for transfer (passing on) of shares in the authorized capital (CC only); 8. the amount and procedure for the reserve creation of a reserve fund (CC only); 9. the procedure for distribution of profits and losses; 10. the structure and competence of the management bodies as well as the procedure of taking decisions thereby including specification of cases when the qualified majority of votes is essential ; 11. the procedure for amending the Charter; 12. the liquidation/reorganization procedures. | <ol style="list-style-type: none"> 4. the amount of the contribution to be paid on the share capital by each shareholder; 5. in case the enterprise shall be limited to a certain period of time or, if apart from the payment of the contribution of capital, still other obligations towards the company shall be imposed on the shareholders, then these provisions shall be included as well. |
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As one can see, Ukrainian legislation provides for a more extended list of the essential provisions. To avoid problems connected with discrepancies between the LBA and the CC, practical advice is to include in the Charter all provisions prescribed by both Ukrainian laws.

In case there are a few founding shareholders of the TOV they may opt to conclude a contract regulating their relations on formation of the TOV (Article 142 of the CC).

The laws of both countries establish demands to the minimum share capital which shall be for a Ukrainian TOV equal to UAH 40,000 (approximately EUR 6,000);¹⁶² for a German GmbH EUR 25,000; the share capital contribution of each shareholder shall be at least EUR 100; contribution shall be evenly divisible by

¹⁶¹ To specify discrepancies between Ukrainian company laws, CC and the Law on Business Associations in the case.

¹⁶² To avoid problems connected with inflation of the national currency Article 52(1) of the LBA fixes the amount of minimum share capital as an equivalent of 100 minimum wages, based on the wages rate in force at the moment of incorporation. Pursuant to the Law on State Budget 2006 this rate at the moment is equal to UAH 400; from July 1, 2007 it will increase to UAH 420.

EUR 100.¹⁶³ In Ukraine the founding shareholders before entry in the State Register are supposed to pay 50% of their contribution to the capital; the rest of the share capital is to be paid within the first year of the company's business (Article 144(3) of the CC). If the shareholders failed to pay their contributions to the share capital within the first year, the TOV shall announce a reduction of the authorized share capital or take a decision to liquidate the company (Article 144(3) subparagraph 2 of the CC).¹⁶⁴ In contrast to Ukraine in Germany the requirement is to pay 25% of each shareholder's capital contribution, and only after such payment the application for the entry of the GmbH shall be filed with the district court where the company has its domicile (§ 7 (2) GmbHG). The exception is the case when non-cash contributions have been agreed upon; then the shareholders have to pay at least EUR 12,500. This rule on real contributions is very stringent in Germany, whereas otherwise registration of the GmbH will be denied (§ 9 c GmbHG). In Ukraine State Registrars have an authority to check whether contributions were really made, but at the same time the Registration Law does not entitle them to deny registration.

For registration of the company and its entry in the register the following documents shall be submitted to the State Registrar (Ukraine) or the court (Germany) in the district where the company has its domicile:

<i>Ukraine</i> (Article 24 of the Registration Law)	<i>Germany</i> (§§ 7, 8 GmbHG)
1. the filled in registration card;	1. application
2. the original or notarized copy of the shareholders' decision to form the TOV;	2. the articles of association
3. two copies of the Charter;	3. in cases the articles of association were not signed by all shareholders - the proxies of the persons who acted as their representatives;
4. the receipt of the payment of the registration fee;	
5. in cases specified in the law the concentration or	4. the evidence of the appointment of the managing

¹⁶³ § 5 GmbHG. See Act on Limited Liability Companies of April 20, 1892 with following amendments and supplements in Peter Behrens, *Company Law. National Statutes. Course Materials for IBL Students* 14 - 43 (Budapest 2006/2007); *Introduction to German Law*, *supra* note 23, at 159.

¹⁶⁴ The LBA contains completely different provisions. Pursuant to Article 52(2) thereof the founding shareholders before entry in the State Register are supposed to pay only 30% of their contribution to the capital; the rest shall be paid within a year as well. In case of failure to pay contributions in full the participants shall pay a 10% interest of the overdue amount unless otherwise envisaged by the Charter. This contradiction still exists and no attempts have been made to bring the CC and the LBA in conformity with each other. In the opinion of the judges of the Supreme Court of Ukraine only the CC provisions should apply. See, *Problemmi pytannya u zastosuvanni Tsyvil'nogo i Gospodars'kogo kodeksiv Ukrainy* [Problematic Issues in Application of Civil and Economic Codes of Ukraine] / Pid redaktsiyeyu Yaremy A.G., Rotanya V.G. (Kyiv 2005) at 45.

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| <p>concerted actions permit issued by the Antimonopoly Committee or the Government of Ukraine;</p> <p>6. the document certifying contribution of the share capital;</p> <p>7. the document certifying registration of the shareholder(s) being the foreign legal entity in the court of origin;</p> <p>8. the proxy of the person authorized to submit documents to the State Registrar.</p> | <p>directors unless they are appointed in the articles of association;</p> <p>5. a list of the shareholders signed by the applicants from which the name, first name, birth date, and domicile of the former can be seen as well as the amount of the share capital contributions subscribed to by each of them;</p> <p>6. in case of non-cash contributions – documents to the effect that the value of the non-cash contributions is not less than the amount of the share capital contributions subscribed to in respect thereof;</p> <p>7. the record of the permit should the purpose of the enterprise require any governmental approvals and/or permits thereof.</p> |
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It should be stressed that in Germany the court, if it deems necessary, may request information in addition to that provided with the application.¹⁶⁵ In Ukraine on the contrary the State Registrar is not entitled to demand any additional information and/or documents not directly specified in the Registration Law.¹⁶⁶

The moment of the entry into the register is the precondition for the beginning of the legal existence of both the TOV and the GmbH (Article 91(4) of the CC, Article 6(1) of the LBA, § 11 GmbHG). In Germany registration of the GmbH is subject to publication in *Bundesanzeiger* and in at least one newspaper chosen by the local court (§ 10(1) HGB). In Ukraine such publication must be made in the official printing medium (Article 22 of the Registration Law) *Bulletin Derzhavnoui Reyestratsii* (Article 22 of the Registration Law).

¹⁶⁵ 2 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] Limited Liability Company § 23.02[8] (LexisNexis 2006).

¹⁶⁶ Article 24(8) of the Registration Law.

To describe the legal position of the shareholders, it should be stressed that in both comparison countries a share means the sum of the rights and duties inherent in the position of a shareholder; it represents the membership in the company.¹⁶⁷ The share depends on the share capital contribution of each shareholder.¹⁶⁸

Rights and obligations of the shareholders are determined, first, by the articles of association (charter) and, second, by statutory law. In Germany, statutory law does not provide for a share certificate or a share register, in Ukraine, Article 52(4) of the LBA states that a founding shareholder who has made his/her contribution in full shall be issued a so-called certificate of the company (which can be regarded as a substitute of the share certificate), but in practice this rule is very rarely complied with. In any case share certificates are not securities and thus not transferable as such.

Normally there are two kinds of rights inherent in a share: property rights (e.g., dividends, Article 10(1) clause b of the LBA, § 30 GmbHG) and administrative (controlling) rights (voting rights in the shareholders' meeting, information rights, minority rights etc., Article 10(1) clauses a, g, Article 61 of the LBA, §§ 51a, 51b GmbHG).

In principle shares (not certificates) are transferable in both countries (Article 53 of the LBA, § 15 GmbHG), but the procedure of the share transfer differs. In Ukraine transfer is possible only if consent of the other participants was granted (Article 53 (1) of the LBA); the CC contains contradictory provisions saying that a shareholder is free to transfer his/her shares to other participants (Article 147(1)), in cases of transfer to third persons it is possible to restrict such rights in the charter. In any case other shareholders hold pre-emptive rights to purchase other participant(s)' share (its part) proportionally to their own shares (Article 147 (2) of the CC). Discrepancies between share transfer procedures under the LBA and the CC have been the case in Ukrainian law for four years; unfortunately to date it is unclear what provisions should apply, practice follows the tactics to provide detailed provisions thereon in the company charter.

In cases of M&A, especially with the participation of foreign parties, to acquire shares in a Ukrainian TOV there may be cases when a permit of the Antimonopoly Committee of Ukraine is essential (when competition issues are at stake pursuant to the provisions of the Law on Protection of Economic Competition).

¹⁶⁷ *Introduction to German Law*, *supra* note 23, at 162.

¹⁶⁸ No direct provision thereon in Ukrainian laws; § 14 GmbHG.

In Germany transfer of shares is not subject to any approvals by the shareholders (§ 15 GmbHG), unless otherwise provided in the articles of association (§ 15 (5) GmbHG). Only transfer of parts of a share may only be made with the consent of the company (§ 17(1) GmbHG).

A few words should be said about management structure of the limited liability companies which is crucial for foreign investors as far as it goes about control of the company. In both countries of comparison the limited liability company normally has a two-tier structure, consisting of the shareholder(s) and managing director(s), unless a three-tier structure is provided in the articles of association (charter) or (in case of Germany) is mandatory pursuant to co-determination laws. Under the two and three-tier structure of management, the directors are responsible for the daily representation and the management of the company. In case the founding shareholders opted for the creation of a supervisory board, the latter supervises the managing directors without engaging in management activities.

Shareholders' meeting is the highest body of both the TOV and the GmbH. Pursuant to Article 61(1) of the LBA, the meeting shall be convoked by the chairman of the company¹⁶⁹ at least twice a year unless otherwise provided in the Charter. In Germany it must be called by the management board at least once a year (§ 48(3) GmbHG).

The competence of the shareholders' meeting is as follows:

<i>Ukraine</i> (Article 145 of the CC, Articles 41, 59 of the LBA)	<i>Germany</i> (§ 46 GmbHG)
1. to determine main directions of activities of the company and to approve plans and reports thereon; * ¹⁷⁰	1. to decide on the annual financial statements and the appropriation of the profits;
2. to amend the company's charter and to change the amount of the authorized capital;*	2. to call on payments of the share capital contributions;
	3. to decide on the re-payment of supplementary

¹⁶⁹ This office must not be confused with the director of the company. The chairman is elected by the shareholders' meeting (Article 58(5) of the LBA); the company's director shall not be elected a chairman (Article 62(6) of the Law on Business Associations). His/her competence is limited to purely administrative functions, such as convocation of shareholders' meetings, chairmanship etc. In Germany no such office exists in the GmbH.

¹⁷⁰ The exclusive authorities of the shareholders' meeting are marked with an asterisk (*). These authorities cannot be delegated to the director(s) or the supervisory board. Pursuant to Article 145(4) of the CC the scope of the exclusive competence may be extended in the Charter.

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| <ol style="list-style-type: none"> 3. to form and to recall the company's director(s); * 4. to approve creation, reorganization and liquidation of subsidiaries, branches and representative offices; to approve their charters and regulations; * 5. to establish forms of supervision over the activities of the director(s), to create and establish the authority of the respective supervisory bodies; * 6. to make decisions on bringing officers of the company to account; 7. to approve internal regulations of the company and organizational structure of the company (departments, units etc.); 8. to define conditions of remuneration of the officers and employees of the company, its subsidiaries, branches; 9. to ratify contracts exceeding the sum specified in the Charter; 10. to approve annual reports and balance sheets, to distribute the company's profits and losses; * 11. to resolve an issue of acquisition of shares by the company; * 12. to expel a shareholder from the company; * 13. to make a decision on liquidation of the company, to appoint the liquidation committee, to approve the liquidation balance. * | <ol style="list-style-type: none"> contributions; 4. to take decisions on splitting and the redemption of shares; 5. to decide on the appointment and the removal of managing directors and their discharge from responsibilities; 6. to decide on the measures applicable to the examination and supervision of the management; 7. to appoint <i>Prokurist</i> and holders of a general power of attorney; 8. to decide on the assertion of damage claims against managing directors or shareholders, due to the company from the formation or from the conduct of the management, as well as the representation of the company in litigation with the managing directors. |
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Decisions are made by the passing of resolutions through voting. In Ukraine one share normally grants one vote, though there are no direct provisions thereon in the law. In Germany each EUR 50 of a share grant one vote (§ 47(2) GmbHG). Under Ukrainian laws decisions on the issues specified in the table above as no. 1,

2 and 12 shall be regarded as made if the qualified majority of shareholders (50% + one share) votes for it; all other decisions shall be made by a simple majority of the votes cast.¹⁷¹ In Germany most decisions are made with a simple majority of the votes cast.¹⁷² However, decisions on the basic legal structure or the purpose of the company, on an amendment to the articles of Association, on changes in the capital, on an amalgamation or a merger, on a conversion into a stock company or a public limited partnership by shares and on the dissolution of the company have to be passed by a qualified majority of three quarters of the votes.¹⁷³

In contrast to Ukraine in Germany, provided the articles of association or so-called co-determination laws¹⁷⁴ so prescribe, managing director(s) may be appointed by the supervisory board (if any was created). The articles of association may provide that the appointment of managing directors by shareholders' resolution shall be subject to a greater than simple majority; or that one or more of the directors are to be appointed by specific shareholders, by a specific group of shareholders, or by supervisory board if any.¹⁷⁵

In cases of creation of a supervisory board it should be noted that the German model is much stronger than the Ukrainian, whereas rights and responsibilities of the German supervisory board are wider based on the respective provisions of AktG (§ 52 GmbHG) unless otherwise provided in the articles of association. In Ukraine under Article 63 of the LBA the supervisory board controls the activity of the director(s) and reports the results to the shareholders' meeting. Without supervisory board's conclusion on the financial report and balances the shareholder's meeting shall not be entitled to approve the company's balance.

The managing body (the director(s) in Ukraine, the managing director(s) in Germany) may be appointed from among persons who are not shareholders (Article 62(1) of the LBA, Article 145(2) of the CC, § 6(3) GmbHG). Director(s) may act on behalf of the company in all matters except those which are within the exclusive authority of the shareholders, unless there are no restrictions in the charter (articles of association).

¹⁷¹ Article 59(2)-(3) of the LBA.

¹⁷² § 47(1) GmbHG.

¹⁷³ §§ 53, 60 GmbHG, the Conversion Act of 1994.

¹⁷⁴ In cases the GmbH employs between 500 and more employees it shall be obliged to form a supervisory board where one third of the members shall be from the employees' side; in cases there are more than 2000 employees one half of the members shall be from the labor side; besides one of the managing directors shall be a labor director. See Co-Determination Act of 1976, available in Peter Behrens, *Company Law: National Statutes. Course Materials for IBL Students* 121 - 126 (Budapest 2006/2007). In case the company is involved in business connected with coal or steel the Coal and Steel Co-Determination Law of 1951 shall apply thereto.

¹⁷⁵ § 45(2) GmbHG.

As one may conclude, provisions of the laws of both countries of comparison have their own pros and cons. In Ukraine there are no mandatory co-determination laws, hence, the owners will not face any obligations to permit the employees to participate in the control of the TOV; at the same time unclear procedure of paying contributions as well as stringent provisions on the transfer of shares present an unpleasant problem which is aggravated by contradictions between the CC and the LBA. In this respect provisions of the two laws should be unified; the best way is to repeal the morally obsolete LBA and to amend provisions of the CC on the TOV or to adopt a separate law on limited liability companies.

3.3. Stock Corporations

Stock corporation (Ukrainian – *Aktsionerne tovarystvo* - AT; German – *Aktiengesellschaft* – AG) is a corporation with a fixed capital stock divided into transferable shares (Articles 24 – 25 of the LBA, Article 152(1) of the CC, Article 80(2) of the UEC, §§ 1, 6 - 7 AktG¹⁷⁶). Both in Ukraine and Germany the process of formation of the stock corporation is much more complicated, longer and expensive than formation of a limited liability company.

In Ukraine two types of AT exist, which is not the case in the FRG. The first one is an Open Stock Corporation (*Vidkryte Aktsionerne Tovarystvo* – VATO). Shares of the VATO may be freely distributed by the way of subscription and purchase at a stock exchange. The second type is a Closed Stock Corporation (*Zakryte Aktsionerne Tovarystvo* – ZATO). The shares of the latter must be distributed among the founding shareholders and may not be distributed via subscription and/or sold or purchases at a stock exchange.¹⁷⁷ Noteworthy to mention that the CC does not provide any provisions permitting the existence of ZATOs. The legality of the limitations as to the transfer of shares of ZATO has been disputed within Ukrainian legal community for years. Attempts of some companies and individuals to invalidate relevant provisions of the LBA and the UEC through the Constitutional Court of Ukraine by assertion that these provisions contradict basic property rights failed.

¹⁷⁶ Stock Corporation Act of September 6, 1965 with following amendments and supplements, available in Peter Behrens, *Company Law. National Statutes. Course Materials for IBL Students* 44 - 120 (Budapest 2006/2007); *Introduction to German Law*, *supra* note 23, at 146; 3 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] The Stock Corporation § 24.01[2] (LexisNexis 2006).

¹⁷⁷ Article 25 of the LBA, Article 81(2) – (3) of the UEC.

Ukrainian Constitutional Court in its decision of May 11, 2005 hold that by signing constituent documents of the ZATO stockholders give their consent to be restricted in their rights to alienate shares of the company.¹⁷⁸ It is obvious that takeovers are hardly possible in relation to ZATOs, that is one of the main reasons why they are very popular among foreign investors (for example such companies as Philip Morris, Kraft Foods, ALICO are incorporated in Ukraine as ZATOs).

As well as in case with the limited liability company the founding shareholders of the stock corporation are to compose and to sign articles of association (charter) which must be notarized.¹⁷⁹

The minimum contents of the articles of association (charter) shall be as follows:

<i>Ukraine</i> (Article 4, 37 of the LBA; Articles 88, 154 of the CC)	<i>Germany</i> (§ 23 AktG)
1. the type of the company (VATO/ZATO) and its name;	1. the company's name and domicile;
2. the purpose of the company, spheres of activity;	2. the corporate purposes;
3. the names of the shareholders;	3. the amount of the share capital;
4. the amount of the authorized capital;	4. the names of founding shareholders (incorporators);
5. classes, par value and quantity of the shares issued by the AT; ratio of shares of different classes;	5. the par value, the issue price and, if more than one class of shares exists, the class of shares subscribed by each incorporator; the number of shares of each class;
6. consequences of failure to buy out subscribed shares;	6. information on the form of shares to be issued (bearer or registered);
7. the procedure for transfer of shares (ZAT O only);	7. the paid-in amount of the share capital;
8. the amount and procedure for the reserve creation of a reserve fund (CC only);	8. the number of members of management board or the rules for determining such number;
9. the procedure for distribution of profits and losses; procedure of paying dividends should be described separately;	9. provisions regarding the form of announcements by the company.
10. rights of shareholders (CC only);	

¹⁷⁸ Rishennya Konstytutsiynogo Sudu Ukrainy vid 11 travnya 2005 roku u spravi no. 1-11/2005, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=v004p710-05>

¹⁷⁹ Article 4 of the LBA, Article 154 of the CC; §§ 2, 23 AktG.

- | | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
| 11. the structure and competence of the management

bodies as well as the procedure of taking decisions

thereby; the procedure for amending the Charter;

12. the liquidation/reorganization procedures. | |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|

Under the laws of both countries, the articles (charter) may contain additional provisions, except as to issues which are conclusively dealt with in the respective laws (Article 154(2) of the CC; § 23(5) AktG). Again in Ukraine the main problem concerning the contents of the charter is ambiguity of the relevant provisions, namely the LBA and the CC contain different demands thereon. The tendency is to apply provisions of the CC.

The laws of both countries establish stringent demands to the minimum share capital which shall be for a Ukrainian AT equal to UAH 500,000 (approximately EUR 83,300);¹⁸⁰ for a German AG EUR 50,000 (§ 7 AktG). The minimum value of a share is UAH 0.01 (Ukraine);¹⁸¹ EUR 1 (Germany). In contrast to Germany under Ukrainian securities law it is impossible to issue no-par-value (proportional) shares. In any case the founders are obliged to subscribe for 100% of shares (Article 155(2) of the CC).¹⁸² After payment of the stock capital in full the founders may start open subscription for shares (i.e. offer shares to third parties). Ukrainian model provides the possibility for the founders to pay in only 50% of the par value of shares before the date of the constituent meeting (assembly),¹⁸³ the rest is to be paid within a period specified by the constituent meeting but in any case not later than a year after the incorporation of the AT.¹⁸⁴ Here it must be stressed that due to the new provisions of the CC requiring the founders to subscribe for 100% of shares, it has become unclear what happens if the founders fail to pay the rest within the period specified by the meeting. The LBA (Article 33)

¹⁸⁰ By analogy with provisions on the capital of TOV Article 24(4) of the LBA fixes the amount of minimum share capital for AT as an equivalent of 1250 minimum wages, based on the wages rate in force at the moment of incorporation. Pursuant to the Law on State Budget 2006 this rate at the moment is equal to UAH 400; from July 1, 2007 it will increase to UAH 420.

¹⁸¹ Article 6(3) of the Law on Securities and Stock Market (LSSM) of February 23, 2006. See Pro Tsinni papery ta fondovyi rynok: Zakon Ukrainy vid 23 lutogo 2006 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2006, No. 31, St. 268.

¹⁸² Pursuant to Article 30(1) of the LBA and Article 81(8) of the UEC the founders are obliged to subscribe for shares composing at least 25% of the capital; as well they have to hold these shares for at least two years. This contradiction is one of the most controversial ones in today's Ukrainian company law. There is no general opinion on the choice of applicable provisions even if to search through judicial cases decided after 2004 (new CC and UEC came into force on January 1, 2004). A group of judges of the Ukrainian Supreme Court in their book on the problems regarding the applicability of the new Ukrainian codes expressed an opinion that in the case only the CC should apply. See *Problemmi pytannya u zastosuvanni Tsyvil'nogo i Gospodars'kogo kodeksiv Ukrainy*, supra note 164, at 45 – 46. The judges' opinion is strengthened by the provisions of Article 28(4) of the LSSM which states that the first stock floatation shall be exclusively closed (private) and carried out only among the founders.

¹⁸³ Article 31 of the LBA.

¹⁸⁴ Article 33 of the LBA.

gives the AT the right to sell these partially unpaid shares. What remains unclear is who can buy them (other founding shareholders only or third parties as well). The new CC remains silent on the topic. Under German AktG (§§ 28, 29) the founders have to pay in the amount of capital that is determined in the articles. Pursuant to § 29 AktG, the AG shall be established upon subscription of all shares by the incorporators. Registration of the AG may be possible only after one quarter of the share capital and the entire premium, if any, has been fully paid in (§ 36a AktG).

Incorporation of the stock corporation is a complicated process consisting of the following steps:

<i>Ukraine</i>	<i>Germany</i>
1. The founders' meeting is to make a decision on creation of the AT, appointment a person/persons authorized to perform acts essential for creation of the AT, floatation of shares;	1. Drawing up the articles of association in notarized form (§§ 2, 23 AktG);
2. Conclusion of the joint business activity contract between the founding shareholders. This contract determines shareholders' rights and obligations regarding incorporation of the AT (Article 26 of the LBA, Article 153(2) of the CC);	2. Subscription for all shares by the founders and paying in the amount of capital determined in the articles of association (§§ 2, 28, 29 AktG);
3. Applying to the State Stocks and Securities Exchange Commission of Ukraine (hereinafter SSEC) for registration of the stocks emission with the relevant publication in the printing media of the SSEC;	3. The founders are to elect the first auditors and the supervisory board which in turn appoints the board of directors (§ 30 AktG);
4. Organization of the private floatation of shares of the AT, paying in the amount of capital as	4. Formation audit by the founding shareholders, delivering a written incorporation report that the supervisory board and the board of directors met all conditions for proper incorporation (§ 32 <i>et seq.</i> AktG);
	5. Application to the local court for registration.

¹⁸⁵ Clause 2.1.10 of the Regulation on the Procedure of Stocks Emission Registration during the Formation of Stock Corporation, approved by the order of the SSEC No. 1027 of October 19, 2006. See Polozhennya pro porjadok rejestratsii vypusku aktsij pid chas stvorennja aktsionemyh tovarystv zatverdzhene nakazom DKTSFR Ukrainy No. 1027 vid 19 zhovtnya 2006 roku, available at <http://www.ssmc.gov.ua/7/8/>

- established by the contract between the founders;
5. Conducting constituent meeting at which the charter and the results of the private floatation of shares shall be approved (Article 34 of the LBA);
 6. Notarization of the charter (Article 4 of the LBA, Article 154 of the CC);
 7. Application to the State Registrar for registration;
 8. Applying to the SSEC for registration of the results of the private floatation of shares.¹⁸⁵

State registration of the stock corporation is almost the same as in case with limited liability companies. The only difference is the set of documents filed for registration. In addition to papers specified in subparagraph 3.1.2 registration bodies must receive: the report on subscription for shares certified by the SSEC (Ukraine);¹⁸⁶ report of the AG for registration (instead of application), agreement(s) between the incorporators on reimbursement of formation expenses as well as account(s) thereof, the documents relating to the appointment of the supervisory board, the formation and the audit report together with the underlying documentation; specimen signatures of the members of the management board (Germany).¹⁸⁷

The corporation structure consists of the general shareholders' meeting, management and supervisory boards.

The general shareholders' meeting is the assembly of all shareholders, the highest body of the corporation. It has to be called at least once a year (Article 45(1) of the LBA; § 175 AktG). In addition to that the meetings may be convened at the request of the supervisory board, minority shareholders (holding 10% and

¹⁸⁶ Article 24(5) of the Registration Law. There is no such a requirement for registration of ZATOs.

¹⁸⁷ § 37(4)–(5) AktG.

5% of shares in Ukraine and Germany respectively) and in other cases provided for by the law and/or the articles of association (charter).

Competence of the general shareholders' meeting in Ukraine and Germany differs in many respects. If in Ukraine its competence is relatively comprehensive (almost the same as in case with the TOV, *supra* section 3.1.2), in Germany it is limited. The main difference is the following: the shareholder's meeting cannot elect the members of the management board, whereas it is within the competence of the supervisory board (§84(1) AktG)¹⁸⁸, though the shareholders' meeting discharges responsibility of the management board (§120(1) AktG). In general "the threefold division of responsibilities within the German stock corporation precludes direct stockholder influence on the day-to-day business unless the Management Board has submitted a certain matter to the stockholders for approval".¹⁸⁹ Only decisions concerning the legal and financial structure of the corporation require shareholders' approval. The examples are: capital changes and allocation of profits, conclusion of so-called "enterprise agreements" (transfer of control, profits etc.), changes in the articles of association, appointment of auditors, M&A as well as reorganization and dissolution of the corporation. The decisions are made by the simple majority of votes, but the decisions regarding the changes of the charter, dissolution of the AT and creation of subsidiaries demand a qualified majority of 3/4 of votes (Article 42 of the LBA, Article 159(4) of the CC). In Germany the general rule is the same (§ 133(1) AktG), some decisions (elections, issues concerning preferred stock, amendments to the articles and other ones of fundamental nature) demand a qualified majority of 3/4.¹⁹⁰

German model gets even more complicated in cases where co-determination applies.¹⁹¹ But in a company with a majority shareholder (which is normally the case as far as FDI is concerned) both the supervisory and the management board will be dominated by this shareholder.¹⁹² What is interesting is that employees' members of the supervisory board should be employees residing in the FRG; and the number of

¹⁸⁸ The shareholders' meeting may vote for no confidence, following that the supervisory board is to dismiss the director(s). Still it is very difficult to do, whereas the director(s) may be dismissed only for a cause (§ 84 AktG).

¹⁸⁹ 3 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] The Stock Corporation § 24.03[3]; §§ 111(4), 119(2) AktG.

¹⁹⁰ 3 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] The Stock Corporation § 24.03[3].

¹⁹¹ The same conditions as for GmbH, see *supra* note 174.

¹⁹² Theodor Baums, Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 Am. J. Comp. L., 31, 41 (2005).

members of the board depends on the number of persons ordinarily employed (§ 7 of the Co-Determination Act).¹⁹³ It is normal to have a supervisory board consisting of twenty members.

Appointment of the supervisory board in Ukraine is not mandatory as it is in Germany (§ 102 AktG). Pursuant to Article 46(3) of the LBA its formation is mandatory only in case there are more than fifty shareholders in the AT. Normally such small number of shareholders is the case in ZATOs, VATOs may have hundreds and even thousands of shareholders, so having the supervisory board can be met very often. In contrast with Germany, AT supervisory boards in Ukraine have very limited scope of authority; the LBA (Article 46), the CC (Article 160) contain very vague provisions thereon saying that the supervisory board represents the shareholders' interests in the periods between the shareholders meeting and that the law/charter may entrust it with some functions of the shareholders' meeting.¹⁹⁴ Here one very important contradiction between the LBA and the CC should be mentioned. Pursuant to Article 42(5g) of the LBA the supervisory board may be even entitled to appoint the director(s), pursuant to Article 159(2) this is within the exclusive authority of the shareholders' meeting. But in practice shareholders' of ATs incorporated under Ukrainian laws even prior to promulgation of the new CC tried to avoid any possibility that the supervisory board may appoint the executive body.

In both countries of comparison the stock company's management and representative organ is the board of directors. It may consist of one or more persons, not necessary shareholders (Articles 47, 48 of the LBA, Article 161(2) of the CC; § 76 AktG). While AktG establishes precise rules as to the number of directors depending on the amount of stock capital (§ 76(2)), and limits the maximum period of appointment (§ 84), Ukrainian company laws contain no analogues provisions; rules thereon are established by the shareholders in the charter. If in Ukraine the board must organize fulfillment of the shareholders' meeting decisions (Article 47(4) of the LBA, Article 161(3) of the CC), in Germany the board, as a corollary, is not subject to any instructions from the general meeting (§ 119 AktG); it manages and represents the company with regard to third parties (Article 47 of the LBA, Article 161 of the CC; § 76 AktG). In both countries the articles (the charter)

¹⁹³ 3 Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] The Stock Corporation § 24.03[2].

¹⁹⁴ See *supra* note 170. The functions which cannot be transferred to the supervisory board are marked with an asterisk. As well the supervisory board may demand convocation of the extraordinary shareholders' meetings (Article 45(3) of the LBA).

may require certain decisions/transactions to be undertaken only with the consent of the supervisory board (Germany) or the shareholders meeting (if not within the authority of the supervisory board in Ukraine).

As may be concluded from the above, Ukrainian laws on stock corporations need elimination of the discrepancies, which can be best achieved by cancellation of the LBA and the UEC provisions on AT, amendment of the CC or promulgation of a separate law on ATs.¹⁹⁵ The German pattern can be used only to a limited extent. AktG's provisions on shares and procedures of AG formation may be used as a pattern for transplantation in Ukraine, whereas existing provisions are vague, dispersed between numerous laws and regulations. Here the author has to stress that the present Ukrainian regulations on the emission and floatation of shares discourage foreign investors from formation of ATs in Ukraine. As far as the AG structure is concerned, it should be noted that, according to critics, German companies should be permitted to choose between using a two-tier (supervisory and management board) and a one-tier (board of directors) management structure which is the model set forth in the EC Regulation for a European Corporation (*Societas Europaea*).¹⁹⁶ Besides, German supervisory boards are too large to effectively carry out their duties.¹⁹⁷ In the long-term international investors will not accept nationally appointed supervisory boards because they will (correctly) fear that decisions are made not to further business efficiency but rather to serve parochial interests.¹⁹⁸ Thus, it may be concluded that the complicated German corporation structure, especially mandatory provisions on the powerful supervisory board, should not be transplanted in Ukraine, otherwise it will create more havoc in the national company law, the more so that the German system has been strongly criticized by both German and foreign experts.¹⁹⁹

3.4. Other Forms of Business Associations

Introducing other forms of business associations which can be used by foreign investors for doing business in Ukraine and Germany, first of all it should be mentioned that while in Germany partnerships

¹⁹⁵ A few drafts have been discussed in the Ukrainian Parliament since the 1990s.

¹⁹⁶ Theodor Baums, Kenneth E. Scott, *supra* note 192, at 72. See Council Regulation (EC) No. 2157/2001 on the Statute for a European Company, 2001 O.J. (L 294) 1.

¹⁹⁷ *Id.*

¹⁹⁸ *Id.*

¹⁹⁹ See, e.g., Dieter Sadowski, Joachim Junkes, and Sabine Lindenthal, *Labour Co-Determination and Corporate Governance in Germany: The Economic Impact of Marginal and Symbolic Rights in Corporate Governance*. Essays in Honor of Horst Albach 144-147 (Joachim Schwalbach ed., 2002); Theodor Baums, Kenneth E. Scott, *supra* note 192, at 72.

(*Personengesellschaften*) are widely used, in Ukraine their popularity among both domestic and foreign investors is remarkably low, the exception is so-called contracts on joint investment activity which to some extent resemble German Civil Code and commercial partnerships.

General partnership (Ukrainian - *povne tovarystvo*; German – *Offene Handelsgesellschaft* - OHG) represents a partnership formed for the purpose of jointly operating a commercial enterprise, under a common commercial name and with unlimited liability of all the partners (Article 66 of the LBA, Article 119(1) of the CC; § 105(1) HGB). To form a general partnership in both countries it is necessary for partners to sign a contract (Articles 4, 67 of the LBA, Article 120 of the CC; § 705 BGB).

In Germany to regulate the activity of OHG the law (HGB) in many cases refers to the provisions of BGB on Civil Code partnerships; in Ukraine that is not the case, a general partnership is subject to a separate set of rules established in the LBA and the CC.

The most striking difference between general partnerships in Ukraine and Germany is their legal personality. In Germany they have only so-called partial legal personality but can have rights and obligations, acquire ownership and other rights in real property, and it can sue and can be sued in its own name (§ 124 HGB). In Ukraine such concept does not exist, a general partnership is regarded as a business association with full capacity of a legal entity in accordance with Article 6(1) of the LBA. But anyway the general partnership must be registered in the relevant register (State register in Ukraine, commercial one in Germany).²⁰⁰

In both countries there are no demands to the minimum capital of the general partnership. Partners carry out management jointly, but also they may charge one or more from their midst with the management (Article 68 of the LBA, Article 122 of the CC; § 114 HGB).

Pursuant to Article 75 of the LBA and Article 133 of the CC, a limited partnership (*komandytne tovarystvo*) in Ukraine is defined as a partnership, which along with members carrying out the business activity on behalf of the partnership and incurring subsidiary liability on the partnership's obligations by all their property (full members), includes one or a few members (contributors) who bear the loss risks connected with the partnership activity within amounts of their contributions and do not participate in the partnership activity. The German analogue of the limited partnership is *Kommanditgesellschaft*. Regulations on limited partnerships in

²⁰⁰ Article 6(1) of the LBA, Article 91 of the CC; §§ 106, 107 HGB.

Germany can be found in HGB, while in Ukraine basic provisions thereon are contained in the LBA and the CC. In particular, Article 77 of the LBA and Article 133(3) of the CC state that with the exceptions directly prescribed by the law limited partnerships shall be regulated by the provisions regarding general partnerships.

As can be seen, the only major difference between the two forms of partnerships is the liability of its partners. In a general partnership all partners are jointly and severally liable for all of the partnership's business debts, while in a limited partnership at least one general partner is fully liable and the liability of the limited partners is limited to their subscribed and registered contribution to the partnership. As noted by the KPMG experts, that is the reason why foreign investors usually choose a limited partnership when setting up a partnership structure for their investment in Germany.²⁰¹ In Ukraine the realities of business (first of all unreliability of partners and counterparts) are such that any prospects of being fully liable to the creditors are unacceptable.

As already mentioned, in the FDI context some partnerships agreements are very common in Ukraine. Pursuant to Article 23 of the Investment Law, foreign investors have the right to conclude contracts on joint investment activity (production cooperation, joint production, etc.) which is not connected with establishment of a legal entity according to the legislation of Ukraine. The nature of such contracts is comparable to contracts on simple partnerships. Under Article 1132 of the CC a simple partnership (*proste tovarystvo*) is defined as an agreement according to which the parties (members) shall be obliged to unite their contributions and to act jointly with the purpose to receive profit or to reach another goal.

According to Article 24 of the Investment Law, parties to the contracts on joint investment activity should keep separate accounting and draw up reports on operations connected with the fulfilment of the terms and conditions thereof as well as open separate accounts in Ukrainian bank institutions to make payments under these contracts. These contracts should be registered within the terms and according to the procedure determined by the Cabinet of Ministers of Ukraine (Article 24(3))²⁰² in the Ministry of Economy. The demand for registration is to be taken very seriously, whereas, in contrast to registration of foreign investments (section

²⁰¹ KPMG Report: Investment in Germany 31.

²⁰² See Instruction on State Registration of Agreements (Contracts) on Joint Investment Activities with the Participation of a Foreign Investor enacted by the Resolution of the Cabinet of Ministers of Ukraine No. 112 of January 30, 1997. Polozhennya pro porядok derzhavnoyi reestratsii dogovoriv (kontraktiv) pro spil'nu investytsiynu diyalnist' za uchastju inozemnogo investora, zatverdzhene postanovju Kabinetu Ministriv Ukrainy vid 30 sichnya 1997 roku No. 112, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=112-97-%EF>

2.2 supra), it is the ground for real contribution of investments under the contract on joint investment activity as well as the validity thereof.²⁰³

Property (except for goods for sale or entity's consumption) imported into Ukraine by a foreign investor for not less than three years with the purpose of investment under the registered contracts is exempted from customs duty payment according to the procedure stipulated by the Investment Law. Should this property be alienated within three years from the date of its inclusion to the entity's balance sheet, the customs duty shall be paid.

As one may conclude, contracts on joint investment activity have some resemblance with German Civil Code Partnerships (*BGB-Gesellschaft*). The main difference is the commercial purpose of its Ukrainian analogue. Hence, Ukrainian contracts on joint investment activity may be compared to the German OHG; but again they are not subjects to registration with the State Registrar, registration in the Ministry of Economics is completely different and not public. Of course such practice is strange but for Ukraine it is justified due to the necessity of special treatment to foreign investors and incentives connected with payment of customs duties.

In Ukraine partnerships are not as popular as in Germany. What is amazing is that Ukrainian legislation thereon has no contradictions compared to numerous discrepancies relating to TOVs and ATs which are the most common investment vehicles in the country. Popularization of partnerships is necessary in Ukraine, because partnerships provide for better protection of the creditors. It can be achieved through clarification of tax legislation, establishment of some tax incentives for assuming full liability.

In conclusion the author believes it necessary to say that in Ukraine the present situation with numerous contradictions between the LBA, the UEC and the CC creates artificial practical difficulties, which can hardly be regarded as the positive achievement in attracting FDI. To improve national company law Ukrainian legislators have to repeal the obsolete LBA and the UEC, to amend the Registration Law and made it possible for foreign companies to register a branch in Ukraine without complicated bureaucratic procedures. The CC should be amended and supplemented with provisions on TOVs and ATs, or, as an alternative, separate comprehensive laws may be promulgated. In this respect German experience with *GmbHG* and *AktG* may be very useful.

²⁰³ See writs of the Higher Economic Court of Ukraine of July 19, 2005, case No. 2-8/2367-05 (2-8/17021-04); October 18, 2006, case No. 36/484pn, available in Ukrainian at www.arbitr.gov.ua.

Still not everything from the German model should be borrowed. In particular, strong supervisory board and co-determination have been subjects to criticism even by German experts, thus their transplantation in Ukraine will be detrimental for the national company law.

4. Public Support for Foreign Direct Investments

As already mentioned at the beginning of chapter 2, host countries are interested in the attraction of foreign investments on the one hand, and in the control thereof on the other. In different states the approach to achieve these goals varies; governments may create different institutions within the existing governmental agencies, ministries and departments, create new bodies with own scope of authority, delegate relevant authorities to NGOs. It should be stressed that the chosen approach, as well as the legal framework, in many respects influence the host country's image among potential foreign investors. Besides this, such bodies may be the first points for potential investors to get acquainted with the host country, its business opportunities, legal and tax environment, the culture. Hence, the issues of creating institutions responsible for the attraction and/or control of FDI as well as the rational delegating authorities thereto are of particular importance for the states willing to create an attractive investment climate.

The very essence of FDI envisages complex relations between foreign investors and host states, between foreign investors and business partners in host countries, therefore in many cases it is very difficult to avoid such disputes. Thus, the second important aspect in the process of attracting FDI is to convince the potential investor that in case of a dispute he may rely on an effective system of dispute resolution. The issue of creating and functioning of such institutions as well as investment dispute resolution will be addressed in the present chapter.

4.1. Institutions Responsible for Attraction and Control of Foreign Direct Investments

As already shown, institutions responsible for investment promotion are very important in the process of attracting FDI. They play the role of the host country's first image, in other words these institutions are image makers striving for convincing potential investors to start business in the country. Thus, as already stressed, it is particularly important for the host country to organize their work in the best way.

4.1.1. Ukraine

Ukrainian institutions responsible for attraction and control of FDI²⁰⁴ are very ineffective. Up to 2005 Ukraine had no institutions specializing in these issues. Only in 2005 were the State Center for Foreign Investment Promotion within the Ministry of Economy, the State Agency for Investment and Innovations, and the Council for Investments under the President of Ukraine²⁰⁵ established. From the number of institutions it is obvious that potential investors can be disoriented and lost, setting aside the fact the respective functions and responsibilities of these institutions remain vague even for the national experts. It is doubtful that having three institutions at a time is necessary.

The State Agency for Investment and Innovations (*Derzhinvestytsiy*, hereinafter Agency) is the central executive body with the special status²⁰⁶ coordinated by the Government. The main functions of the Agency are the following:

- 1) participation in the formation and realization of the state investment and innovation policy;
- 2) coordination of the work of the central executive bodies in the field of investments and innovations.²⁰⁷

²⁰⁴ Here I mean institutions created by the Government and President of Ukraine in contrast to private ones (for details see below).

²⁰⁵ Actually this Council was created in 1997 but its activity prior to 2005 had been hardly noticeable, performing nominal functions.

²⁰⁶ To put it shortly, the Agency has the status which resembles the status of Ukrainian ministries but technically it is not a ministry.

Pursuant to clause 4 of the Agency Regulation, the Agency is endowed with very wide authority, namely to take measures for attraction of foreign investments, to conduct expert analysis of investment projects, to control the enforcement of state investment programs, to make proposals as for the formation of the state investment policy. The list is very long, but at the same time very vague and inconclusive, whereas the drafters used the most favorite technique of post-soviet law-making which makes it impossible to distinguish duties given to the Agency and to other state bodies responsible for FDI policy. Specifically, pursuant to clause 4(20) of the Agency Regulation, it performs other duties envisaged by the Ukrainian legislation. Given the fact there are two other main state institutions responsible for FDI promotion issues, the Agency's competence is obscure even for Ukrainian lawyers and officials.

The State Center for Foreign Investment Promotion within the Agency (InvestUkraine)²⁰⁸ is a budget entity with the following tasks:

- attraction of foreign investments to the Ukrainian economy;
- creation of the attractive investment image of Ukraine abroad;
- support of the industry and technology development;
- improvement of the investment climate in Ukraine.²⁰⁹

As the Government's principal agency for promoting foreign investment and facilitating the investment process, InvestUkraine's mission is to promote Ukraine as an investment destination worldwide and to support foreign direct investment.²¹⁰

InvestUkraine is a non-profit organization governed by the Agency on the one hand and controlled by the Supervisory Council created by the Ukrainian Cabinet of Ministers.²¹¹ On a free of charge basis it renders the following services to foreign investors:

²⁰⁷ See clause 3 of the Regulation on the State Agency for Investment and Innovations approved by the Presidential Ordinance No. 1873/2005 of December 30, 2005 (Agency Regulation). Polozhennya pro Derzhavne Agenstvo Ukrainy z investytsiy ta innovatsiy, zatverdzhene Ukazom Prezidenta Ukrainy No. 1873/2005 vid 30 grudnya 2005 roku, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=1873%2F2005>

²⁰⁸ According to the Resolution of the Cabinet of Ministers of Ukraine No. 771 of May 31, 2006 the Center was re-subordinated from the Ministry of Economy to the Agency. Here I would like to stress that such practice is common for Ukraine, where subordination, authority and names of official state bodies may change a few times a year.

²⁰⁹ Polozhennya pro Ukrainskyi tsentr spryannya inozemnomu investuvannu, zatverdzhene postanovju Kabinetu Ministriv Ukrainy No. 666 vid 2 serpnia 2005 roku z nastupnymi zminamy i dopovnenniyamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=666-2005-%EF>

²¹⁰ http://www.investukraine.org/index.php?option=com_content&task=view&id=1&Itemid=10

- i. provides information about investment opportunities;
- ii. assists with identifying and locating project sites, vendors, service providers, and other resources;
- iii. initiates contact with potential investment partners and maintains investment projects database;
- iv. liaises with government agencies and officials;
- v. links investors with regional and local community leaders;
- vi. maintains the Bureau of appeals and pre-Court settlement of disputes.

To render justice to the InvestUkraine's activity it should be mentioned that this is the only FDI responsible body in Ukraine maintaining its own website with very decent information available in English,²¹² while neither the Agency nor the Council for Investments under the President of Ukraine have their own websites.

The Council for Investments (Council) is an advisory body with the President of Ukraine created to form and to incarnate state policy as for the attraction and effective use of foreign investments and to accelerate integration of Ukraine into the world economy (clause 1 of the Regulation on the Council for Investments in Ukraine of April 11, 1997).²¹³ The Council consists of the Ukrainian state officials and representatives of the foreign business²¹⁴ and is headed by the President of Ukraine.

Pursuant to clause 3 of the abovementioned Regulation the Council has the following functions:

- facilitates determination of the main directions of the state policy aimed at the improvement of the Ukrainian investment climate, attraction and effective use of foreign investments;
- analyzes and summarizes the existing problems restricting foreign investments to Ukraine, determines political, legal, economic, organizational and informational measures for the elimination thereof;

²¹¹ As can be seen, such subordination mechanism is very complicated and opaque.

²¹² For details see http://www.investukraine.org/index.php?option=com_content&task=view&id=1&Itemid=10

²¹³ Polozhennya pro Konsultatyvnu rady z pytan' inozemnykh investytsiy v Ukraini, zatverdzheno ukazom Prezidenta Ukrainy No. 323/97 vid 11 kvitnya 1997 roku, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=323%2F97>

²¹⁴ Such persons are appointed by the President only with their consent provided they are representatives of the trustworthy companies, banks, institutions etc., have experience in the promotion of investment policy, take active participation in the formation of the positive investment image of Ukraine. As of November 11, 2005 such names as Bill Gates, Jean Lemierre, Sonia Soutus are among the foreign members of the Council.

- reviews draft legislation in the field of the state investment policy;
- prepares proposals as for the stimulation of the investment activity taking into consideration foreign experience;
- facilitates the formation of the positive investment image of Ukraine.

At local level, investment promotion has been facilitated through chambers of commerce and industry,²¹⁵ local investment agencies²¹⁶ and associations created by foreign investors themselves.²¹⁷

As far as the control functions are concerned, as already discussed, in Ukraine Government of the Autonomous Republic of Crimea, Oblast's (regional), Kyiv and Sevastopol City State Administrations are responsible for the registration of foreign investments.²¹⁸ The Ministry of the Economy is involved in the registration of the contracts on joint investment activity.²¹⁹ The Antimonopoly Committee of Ukraine (AMC) is the primary government agency responsible for monitoring compliance with competition law and implementation of competition policy.²²⁰ No other agency in Ukraine is entitled to exercise functions and powers vested in the AMC unless explicitly provided for in the competition law. For example, the Cabinet of Ministers may authorize concentration²²¹ in exceptional cases despite the AMC's decision to the contrary. AMC's decisions are binding on both private business entities and central/local authorities. Decisions made by the AMC or its offices may be either cancelled or changed by the AMC itself upon review or appealed in court.

²¹⁵ In each Ukrainian region (oblast'), in the cities of Kyiv and Sevastopol, in the Autonomous Republic of Crimea regional Chambers of Commerce and Industry function. In total there are 27 chambers headed by the Ukrainian Chamber of Commerce and Industry.

²¹⁶ E.g. Transcarpathian Investment Agency, see <http://www.investments.uz.ua/index.php?page=service&lang=en>; Kyiv Investment Agency, see <http://www.kiacapital.com.ua/eng/index.html>.

²¹⁷ The most famous of such associations is the European Business Association (EBA) which was established in 1999 as a forum for discussion and resolution of problems facing the private sector in Ukraine. This initiative of business people who saw advantages and benefits in the European business community acting together was supported by the European Commission. At present the EBA - the premier organisation for foreign business in Ukraine – consists of over 600 European, including national, and international companies and offers its members a broad scope of services. For details see http://www.eba.com.ua/about/general_info.html

²¹⁸ See paragraph 2.2. above.

²¹⁹ See subparagraph 3.1.4. *supra*.

²²⁰ For details see the Law on the Antimonopoly Committee of Ukraine of November 26, 1993. Pro Antymonopol'ny Komitet Ukrainy: Zakon Ukrainy vid 26 lystopada 1993 roku z nastupnymi zminamy i dopovnennamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?mreg=3659-12>

²²¹ M&A, pursuant to Article 22 of the Competition Law (see *infra* note 222), are covered by the notion of concentration. In accordance with Article 26(1) of the Competition Law investors are required to get the AMC's permit for concentration in cases when the aggregate value of the concentration participants' assets or aggregate turnover within the last financial year including assets/turnover abroad exceeds EUR 12 million. Such permits are required as well in case the aggregate value of assets or aggregate turnover of at least one concentration participant exceeds EUR 1 million within the last financial year.

Damages resulting from any unlawful decisions made by the AMC or its offices are compensated from the State Budget.²²²

It is obvious that Ukrainian system of institutions responsible for the FDI promotion is very difficult, endowed with confusing scope of authority and doomed to fail. Hereinbefore it was already stated that having three institutions is not necessary. In the following subsection the German experience in this respect will be discussed. Based on the comparative analysis proposals for possible transplantation in Ukraine will be made as well.

4.1.2. Germany

Prior to January 1, 2007 two separate agencies responsible for investment promotion in Germany existed, namely *Invest in Germany GmbH* (Invest in Germany) and the *Industrial Investment Council* (IIC). On January 1, 2007 they formally completed their merger. The new organisation is now called Invest in Germany which is the leading German institutions responsible for attraction of FDI and funded by the Federal Ministry of Economics and Technology. Invest in Germany is the official investment promotion agency and the primary contact for the potential foreign investors' business interests in Germany.²²³ Its mission is to promote Germany and actively identify business opportunities for international investors.²²⁴ Still, the separation of functions between Invest in Germany and the IIC remains.²²⁵

The functions of Invest in Germany are as follows:

- promotion of Germany's advantages as an excellent business location;
- provision of sector-specific information and market analysis;
- connection to Germany's business networks;
- coordination of the investor's site selection process in cooperation with local partners;

²²² See the Law on Protection of Economic Competition of January 11, 2001 (Competition Law). Pro zahyst ekonomichnoji konkurentsii: Zakon Ukrainy vid 11 sichnya 2001 roku z nastupnymi zminamy i dopovnennyamy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2210%2D14&p=1172743268124217>.

²²³ <http://www.invest-in-germany.de/en/>

²²⁴ <http://www.iic.de/>

²²⁵ Two different websites still exist <http://www.invest-in-germany.de> for Invest in Germany, and <http://www.iic.de/> for the IIC.

- any cost-free support for companies wishing to establish a corporate presence in Germany.²²⁶

The IIC supports international investors in their efforts to realize investment projects in Eastern Germany in a time and cost efficient manner.²²⁷ The IIC is involved in the following activities:

- a. evaluates the suitability of different countries or regions for a specific investment project;
- b. determines the availability and cost of investment sites in Eastern Germany;
- c. identifies potential acquisition targets in Eastern Germany;
- d. provides investors with Financial Advisory Services (feasibility assessment, financial structuring, facilitation of contracts etc.) and helps them negotiate with public authorities and officials or other relevant parties involved.²²⁸

Invest in Germany has representative offices in the USA (Chicago, San Francisco), in Japan and China. IIC has offices all over Eastern Germany and representative offices in the USA, China, Japan and France. Unfortunately, InvestUkraine cannot boast of any representative offices abroad. Investment promotion functions in foreign countries are partially performed by trade missions functioning under the auspices of Ukrainian embassies and controlled by the Ministry of Economy.²²⁹

Given the fact Germany is a federal state, *Länder* have their own business development agencies among other things responsible for FDI attraction and support.²³⁰ German Chambers of Commerce abroad are very successful in foreign investment promotion conducting their activity outside the FRG.²³¹

As already mentioned in section 2.2, in Germany the procedure for state registration of foreign investment does not exist. Thus, there are no bodies in Germany with the functions analogous to those allocated to the Ukrainian Ministry of Economy and local state administrations.

Competition control in Germany is restricted by the EC legislation on competition which is vital for the single market. Under the EC Merger Regulation²³² all mergers in the EC which exceed thresholds specified in

²²⁶ <http://www.iic.de/>

²²⁷ <http://www.iic.de/services.0.html>

²²⁸ Id.

²²⁹ See Polozhennya pro torgovel'no-ekonomichnu misiju u skladi zakordonnoji duplomatychnoji ustanovy Ukrainy, zatverdzhene Ukazom Prezidenta Ukrainy No. 200/94 vid 30 kvitnya 1994 roku z nastupnymy zminamy i dopovnennymy, available at <http://zakon1.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=200%2F94>

²³⁰ Full list of these agencies can be found at <http://www.invest-in-germany.de/en/>

²³¹ The list of chambers can be found at <http://www.ahk.de/eng/index.html>

Article 1 of the Regulation must be referred for approval at the European level. Where EC merger control regulations do not apply, M&A of business entities will be subject to German control procedures established by GWB.²³³ The necessity of notification and approval by the Federal Cartel Office (*Bundeskartellamt*) is necessary only in cases where the planned merger could have an adverse effect on competition. Under § 35(1) GWB, this is assumed to be the case when the combined world-wide turnover of the parties involved is more than EUR 500 million and at least one of the parties has a domestic turnover of more than EUR 25 million during the financial year preceding the merger.

The given comparison of the Ukrainian and German institutions responsible for attraction and control of FDI leads to a conclusion that the German approach is more successful. First of all, in contrast to Ukraine Germany does not have a confusing system of investment promotion agencies and governmental (presidential) bodies for these purposes. Invest in Germany with offices in different countries is a perfect sample to follow. It is not a problem to create its Ukrainian analogue on the basis of InvestUkraine. Existence of the Agency is unjustified; its functions with some modifications can be performed by InvestUkraine alone. Presidential Council may continue to exist as it is, but more attention should be paid to its co-operation with InvestUkraine as the principal investment promotion agency.

As far as the AMC's activities are concerned, Ukrainian competition law has been criticized by foreign investors as well as by the national and foreign experts. It is outside the scope of the present research to describe all existing problems.²³⁴ Nevertheless, following the course to harmonization of Ukrainian legislation with the EC/EU standards, it would be reasonable to establish the procedure of obtaining AMC permits for concentration in order of notification, not in advance.

²³² Council Regulation (EC) No. 139/2004 on the control of concentration between undertakings, 2004 O.J. (L 24) 1.

²³³ See Act Against Restraints of Trade consolidated text published on July 15, 2005 available in English in Business Transactions in Germany (FRG) [1983 – 2006 Transfer Binder] Statutory Material App. 3 -1 (LexisNexis 2006).

²³⁴ For details see European Business Association Report *Barriers to Investment to Ukraine* 86 - 87.

4.2. Settlement of Investment Disputes

As noted by Nmehielle, in the world of international economic relations, disputes are bound to arise which require settlement mechanisms to ensure their effective resolution.²³⁵ Such dispute settlement mechanisms will ordinarily entail the assumption of obligations by both parties, or by one party to protect the interest of the other. The assumption of obligations should translate into positive actions of compliance with the measures inherent in the dispute resolution mechanism.²³⁶ It has been observed that one should be wary of the man who urges an action in which he himself incurs no risk.²³⁷

There many ways of settling a commercial dispute, including those of investment character. The main ones are the following:

1. Negotiation
2. Mediation/Conciliation
3. Litigation (in host country's courts of law)
4. Arbitration

Negotiation between the parties or their advisers is the simplest form of settling a dispute. Still it is unlikely to succeed unless those involved are capable of a certain degree of detachment and objectivity, qualities which are sometimes hard to find.²³⁸

In case of mediation/conciliation parties who have failed to resolve a dispute for themselves may turn to an independent third person, or mediator/conciliator, who will listen to an outline of the dispute and then meet each party separately – often “shuttling” between them – and try to persuade the parties to moderate their respective positions.²³⁹

Litigation means foreign investor's legal recourse to the courts of law in the host country, where the dispute will be heard and decided by the local judges. This way is the least popular among foreign investors,

²³⁵ Vincent O. Orlu Nmehielle, *Enforcing Arbitration Awards under International Convention for the Settlement of Investment Disputes (ICSID Convention)* 7 Ann. Surv. Int'l & Comp. L. 21 (2001).

²³⁶ Id.

²³⁷ Giovachino Setani, *Centellas de Varios Conceptos*, cited from Vincent O. Orlu Nmehielle, *supra* note 235.

²³⁸ Alan Redfern, Martin Hunter, *Law and Practice of International Commercial Arbitration* 31 (Sweet & Maxwell 1999) (1986).

²³⁹ Id.

since in case of litigation they will have to play on the foreign territory, deal with judges, stick to their own legal system and law, and very often prejudiced towards foreigners.

Arbitration is a way of resolving disputes which the parties choose for themselves.²⁴⁰ It is one mode of dispute resolution that has become immensely popular in international economic dispute resolution among players in the international economic arena, because it is different from domestic judicial adjudication, and due to the sensitive jurisdictional implications arising from the supremacy of competing legal systems.²⁴¹ Settlement of investment disputes, especially between private investors and host states, is the area where arbitration has assumed great importance. Promulgation of the ICSID Convention on March 18, 1965²⁴² illustrates the importance that the international community attaches to this kind of dispute settlement.

Given the fact negotiation and mediation/conciliation are the not very popular ways of settling investment disputes, I will focus on litigation and arbitration in the countries of comparison.

4.2.1. Ukraine

Investment disputes are everyday occurrence in modern Ukraine. Procedure for their settlement, especially through national courts of law, leaves much to be desired.

Disputes between legal entities and natural persons – entrepreneurs are under the jurisdiction of the three-lane structure of economic courts which consists of:

- regional courts (27 in total);
- courts of appeal (today there are 11 of them in each of the established circuits);
- Higher Economic Court

Disputes between natural persons are under the jurisdiction of:

- local circuit courts (666 in total);
- regional courts of appeal (27 in total);
- Supreme Court

²⁴⁰ Id. at 1.

²⁴¹ Vincent O. Orlu Nmehielle, *supra* note 235.

²⁴² For Ukraine, as noted hereinbefore, ICSID Convention entered into force in 2000, for Germany – in 1969.

Moreover, the Supreme Court of Ukraine acts like a cassation court against the decisions, taken by regional Courts and Courts of Appeal both in economic and local circuit jurisdiction. It should be noted that the system of administrative courts has also been created. Those affected by administrative decisions (taxes, customs, licenses etc.) may seek protection therein. However, due to difficulties in financing, the functions of administrative courts have been temporally entrusted with the economic and local circuit courts.

The Ukrainian judicial system has undergone frequent changes since 2001. Here it should be noted that judiciary reforms which started in 2001 were accelerated by the notorious judgment of the European Court of Human Rights (ECHR) in case *Sovtransavto Holding v. Ukraine*²⁴³ which in fact was of investment nature. Unfortunately, so far, reformatory efforts have not improved the situation with dispute settlement significantly. As stated by foreign investors, court decisions are influenced not only by unbiased but also by subjective factors. It is not widespread practice, but nevertheless such precedents sometimes happen.²⁴⁴

For foreign investors the most convenient way of settling a dispute is to refer to arbitration. The most influential Ukrainian arbitration institutions are the International Commercial Arbitration Court (ICAC) and the Maritime Arbitration Commission (MAC) at the Ukrainian Chamber of Commerce and Industry (UCCI).

ICAC is an independent permanent arbitration institution (third-party tribunal) which activities are regulated by the Law of Ukraine On International Commercial Arbitration of 24 February, 1994²⁴⁵ and the Rules of the International Commercial Arbitration Court at the UCCI.²⁴⁶

ICAC at the UCCI takes into consideration disputes according to its jurisdiction only in case of the presence of written agreement of the parties to refer to it all or certain disputes arising in connection with any concrete relationships nevertheless of their contractual or non-contractual character. Arbitration agreement could be made as arbitration clause in the contract or as separate agreement.

The way of application to the ICAC and the order of proceedings are governed by the Rules of the International Commercial Arbitration Court. The amount of arbitration fee to be paid is determined by the Schedule on arbitration fees and costs.²⁴⁷

²⁴³ *Sovtransavto Holding v. Ukraine*, 626 Eur. Ct. H.R. (2002), available at <http://worldlii.org/eu/cases/ECHR/2002/626.html>

²⁴⁴ Investment Climate in Ukraine, available at <http://www.edgroup.biz/db-investmentclimate.php>

²⁴⁵ Available in English at <http://www.ucci.org.ua/en/legalbase/zua944002.html>

²⁴⁶ Available in English at <http://www.ucci.org.ua/arb/icac/en/rules.html>

The MAC is a permanently functioning arbitral institution (third-party tribunal), that carries out its functioning in conformity with the Law of Ukraine On International Commercial Arbitration, the Statute on the Maritime Arbitration Commission²⁴⁸ at the UCCI and the Rules²⁴⁹. The MAC shall settle disputes arising from contractual and other civil law relationships in the area of merchant shipping, irrespective of whether the parties to a relationship include both Ukrainian and foreign entities, or whether the parties are only Ukrainian entities or only foreign entities.

Awards of the ICAC and the MAC at the UCCI are final and obligatory for the parties and in a case of their refusal to execute them voluntarily are enforced according to the New-York Convention on recognition and enforcement of foreign arbitral awards (1958) in the place of the location of a debtor.

Speaking about investment dispute resolution in Ukraine it is essential to remember that, pursuant to Article 11 of the Treaty,²⁵⁰ divergences concerning investments between a Contracting State and an investor of the other Contracting State should as far as possible be settled amicably between the parties in dispute. If the divergence cannot be settled within six months of the date when it has been raised by one of the parties in dispute, it shall, at the request of the investor of the other Contracting State, be submitted for arbitration. Unless the parties in dispute agree otherwise, the divergence shall be submitted for arbitration under the ICSID Convention. The award shall be binding and shall not be subject to any appeal or remedy other than those provided for in the said Convention. The award shall be enforced in accordance with domestic law. During arbitration proceedings or the enforcement of an award, the Contracting State involved in the dispute shall not raise the objection that the investor of the other Contracting State has received compensation under an insurance contract in respect of all or part of the damage.

Concluding the description of the Ukrainian dispute settlement system one should stress that the national system of enforcement of court decisions, arbitral awards and other orders based on the Law on Enforcement Proceedings of April 21, 1999²⁵¹ is complicated and often non-functional. In practice, a creditor

²⁴⁷ Updated schedule in English can be found at <http://www.ucci.org.ua/arb/icac/en/fees.html>

²⁴⁸ Statute is the Annex No. 2 to the Law of Ukraine On International Commercial Arbitration dated February, 24, 1994, available in English at <http://www.ucci.org.ua/arb/mac/en/statute.html>

²⁴⁹ Available in English at <http://www.ucci.org.ua/arb/mac/en/rules.html>

²⁵⁰ See *supra* note 17. The same approach is employed in the German Model BIT.

²⁵¹ Pro vykonavche provadzhennya: Zakon Ukrainy vid 21 kvitnya 1999 roku z nastupnyimi zminamy i dopovnenniyamy, available at <http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=606-14>

with a court decision for recovery, e.g., of a specific sum of money, is unable to collect the due sum, because, for unknown reasons, the legislation is “loyally” disposed to debtors. This problem as well as the further reforms of the judiciary aimed at the establishment of really independent and impartial courts must be addressed by the Ukrainian lawmakers.

4.2.2. Germany

German judiciary system is famous for its difference compared to other federal states. The courts of the last resort are federal, all other courts are state. There are no separate commercial courts in Germany; chambers for commercial matters (*Kammer für Handelssachen*) existing as separate subdivisions of the higher courts of the first instance (*Landsgerichte*) are responsible for hearing commercial cases. German judiciary can be structured as follows:

1. Administrative courts which protect citizens and companies from arbitrary or incorrect decisions by the authorities. Those affected by administrative decisions may seek legal protection from the administrative courts. A right of appeal is permitted against decisions of the courts of first instance;
2. Ordinary courts hear civil, commercial and criminal disputes. The cases usually go to the local court. A right of appeal is usually permitted against initial decisions, and in this case, higher courts (*Landsgerichte*) up to the level of the Federal Court of Justice (*Bundesgerichtshof*) settle the case;
3. Labor courts are responsible for disputes arising from industrial relations, in particular those relating to collective bargaining agreements or the termination of contracts of employment. A right of appeal against judgments by the labor courts is possible up to the level of the regional labor courts and the federal labor court;

4. Fiscal courts of the *Länder* decide on disputes relating to taxes and charges that are subject to federal legislation, and in the case of an appeal, the dispute is taken to the federal finance court.²⁵²

Compared to Ukraine in Germany litigation risks are minimal and there is less pressure for investors to explore alternatives to litigation. There is also less uncertainty in German civil litigation than in Ukraine because of extensive statutory law and developed legal tradition to respect and to observe the final decisions. However, arbitration is a widely accepted means of dispute resolution in Germany²⁵³ Germany adopted a new arbitration act that entered into force on January 1, 1998 which was incorporated into the German Code of Civil Procedure (*Zivilprozessordnung*, ZPO) with some modifications and additions. Book 10 of ZPO contains the legislative provisions with respect to arbitration. German arbitration law applies to both domestic and international arbitrations.²⁵⁴

The Chambers of Industry and Commerce can act as arbitrators and the procedure is therefore relatively non-bureaucratic. The Chambers of Industry and Commerce have created a number of different arbitration institutions such as courts of arbitration. The German Institution of Arbitration (DIS) being a registered association, with approx. 800 members from Germany and abroad, is the worldwide known arbitration institution with the aim of promoting national and international arbitration. DIS offers an administrated arbitral procedure under the DIS Rules.²⁵⁵

As far as the enforcement proceedings are concerned, German system is very flexible. For example, a creditor can instigate a collection procedure, regardless of the debt. In this procedure, a written reminder is followed by an application to the local court for a notice to pay (*Mahnbescheid*). A small fee is charged for this, a lawyer does not need to be involved. The court issues the notice to pay to the defaulting payer. If no objection is filed, a request can be made for a bailiff to execute the debt. If the debtor files an objection, the court holds a hearing to determine whether the claim is justified. In general, German enforcement of court decisions, arbitral awards etc. is much more effective than in Ukraine.

²⁵² Information from <http://invest-in-germany.de/en/index.php?redirect=http://invest-in-germany.de/en/research/downloads/>

²⁵³ Christian Duve, *Arbitration, Mediation and Alternative Dispute Resolution in Germany*, available at http://www.cpradr.org/EICPR/ARB_MEDandADRinGERMANY.pdf

²⁵⁴ Id.

²⁵⁵ Available in English at <http://www.dis-arb.de/>

In general it should be stressed that, compared to Germany, Ukrainian judiciary as well as the enforcement system are the least desirable ways of legal protection for foreign investors. Despite of positive changes which have taken place lately, reforms must continue. First of all, attention must be paid to the transparency and impartiality of the proceedings. Apart from arbitration Ukrainian authorities should encourage and develop other alternative ways of dispute resolution concerning foreign investors; some attempts were already made (InvestUkraine maintains the Bureau of appeals and pre-Court settlement of disputes). Secondly, the procedure for enforcement of court decisions (awards, orders etc.) should be simplified to ensure that a creditor is able to present a decision to the bailiff or directly to the financial institution where the debtor holds its account(s) for immediate collection of the debt. Not everything from the German model can be transplanted in Ukraine because of differences in Constitutions, legal training and traditions, still the *Mahnbescheid* system is a good example to borrow.²⁵⁶ With reliable judiciary and effective investment promotion institution Ukraine may rely on significant increase of FDI inflows.

²⁵⁶ Analogues procedures were implemented in the Civil Procedural Code of Ukraine (section II) of March 18, 2004. See Tsyvilny Protseusualny Kodeks Ukrainy vid 18 bereznia 2004 roku, Vidomosti Verkhovnoyi Rady Ukrainy, 2004, No. 40 - 42, St. 492. In the Ukrainian economic procedure such simplified collection of debts is unknown.

Conclusion

The purpose of this thesis was to answer the following questions: did Ukraine manage to create a good legal framework for the attraction of FDI? What are the pros and cons of the existing legal framework on FDI in Ukraine and Germany (as countries of comparison)? Which aspects of German FDI legal regulation can be transplanted in the Ukrainian law on FDI? The findings of the conducted research showed that the Ukrainian legal framework on FDI is not very attractive for potential foreign investors, and the changes are necessary.

First of all, the analysis of the German legal framework revealed that Germany as the classical example of a developed market economy does not have a separate system of investment laws. This fact can be explained by the unwillingness to distinguish domestic and foreign investors and to introduce special protection for foreigners, otherwise it would have contradicted the principles of the single market. This approach should be the model for Ukraine to strive for. Ukrainian investment laws should be more predictable without even a possibility to change them with retrospective effect as was the case in the 1990s. Secondly, Ukraine should introduce order in its currency and customs legislation, remove restrictions for foreigners in the land law. Ukraine obliged to do so before different international institutions and organizations such as the WTO and the EC, but the reality is completely different, violations of the 1994 Co-operation Agreement between Ukraine and EC Members on the part of Ukraine illustrate it. Without such steps it is impossible to keep balance between the attractiveness of the country for FDI, protection of FDI on the one part and national interests on the other. Current situation in Ukraine shows that this balance is far away but may be achieved with some efforts on the part of the legislators and willingness to enforce the adopted regulations.

Greenfield investments are the most common and most welcomed way to start a business in a foreign country. That is why company law issues are the most important for FDI. Company laws of both countries of comparison have their own pros and cons. In Ukraine, compared to Germany, there are no mandatory co-determination laws, hence, the owners will not face any obligations to permit the employees to participate in the control of the company; at the same time unclear Ukrainian procedures of paying contributions as well as stringent provisions on the transfer of shares, ambiguous floatation of shares together with contradictions

between the CC, the UEC and the LBA are very unpleasant problems for foreign investors. In this respect provisions of the listed laws should be unified; the best way is to repeal the morally obsolete LBA and the UEC and to amend provisions of the CC on the TOV and the AT or to adopt separate laws on them; German experience with the GmbH and the AG may be very useful in this respect. Some steps are to be made by Ukrainian legislators to popularize partnerships among foreign investors so that to provide for better protection of creditors. The possibility to transfer Ukrainian state-owned enterprises into limited companies based on the German model established for *Treuhandanstalt* in Germany in the 1990s, should be paid special attention to, it will help to minimize negative factors in Ukrainian privatization procedures which currently are not very attractive for foreigners.

Promotion of FDI is a very serious task as far as the issues of the economic development are concerned. To increase its attractiveness for potential foreign investors Ukraine must get rid of the tradition to have numerous bureaucratic agencies pretending to be involved in “investment promotion”. It is a matter of quality not quantity. One principal government agency or an independent institution supported by the government is more than enough to perform the promotion functions. Here German experience with Invest in Germany may be used as a model for implementation in Ukraine.

With any kind of regulations on FDI investment disputes are inevitable, hence, well functioning judiciary and enforcement system as well as the possibility for alternative dispute resolution are of particular importance to achieve a high level of FDI attractiveness. Unfortunately, so far Ukraine has failed to achieve decent results in this respect. Judiciary is still to be improved in many respects. More attention must be paid to the transparency and impartiality issues. Investors should have a wider choice of alternatives in dispute resolution without necessity to recourse to the courts of law or expensive arbitration institutions.

Due to limitations of the present research it was impossible to scrutinize many important aspects such as historical developments in Ukraine (years of the new economic policy, *perestroika* reforms) and Germany (especially in the GDR prior to re-unification and EU/EC developments), aspects which would have given a better understanding of differences in the legal and political environment important for those seeking ways to improve investment attractiveness; as well as taxation, competition law and conflict of laws. These fields of law

are very broad and are of particular interest for potential foreign investors. These topics may be subjects for future research.

Practical realization of the recommendations made in this thesis would definitely improve investment image of Ukraine in the world. Due enforcement of the relevant laws will contribute to the increase of FDI inflows. Of course, the findings of this thesis are topical not only in the investment law context, but in many other related fields, such as company law, banking law, customs law and many others. In addition to that, many other post-Soviet countries face the same problems with FDI. Thus, this study may be useful not only for Ukraine, but for other countries with similar legal systems (e.g. Russia, Moldova, Byelorussia).

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