

## ***International counter raiding experience at regional level***

### ***Міжнародний досвід протидії рейдерству на регіональному рівні***

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***Key words:***

*raiding, administrative liability, criminal liability, securities, takeover economic security, local government, shareholders, insider information.*

***Ключові слова:***

*рейдерство, адміністративна відповідальність, кримінальна відповідальність, цінні папери, поглинання, економічна безпека, місцеве самоврядування, акціонери, інсайдерська інформація.*

*Due to the world processes of economic globalization undergoing significant changes are in the systems of market relations, as well as in the legal framework, which serves as a basis to monitor the legality of the state to prevent economic crime, raider attacks, and acquisitions of various types of ownership. That is the historical experience of legislation of the United States of America in the field of prevention of the above mentioned reasons should be taken into account by the legislator of Ukraine at the stage of the reforming the administrative and legal system, and in the period of economic reforms.*

Analysing the world experience of the emergence and establishment of raiding, there is always the presence of certain factors in the country: the economic crisis, the imperfection of the current legislation, specific political situation, corruption in the government and the abuse of power by officials, import of raiding technologies and teams, improper protection of businesses, property rights, unhealthy competition and so on. Today Ukraine is an ideal place for raiders' activities, because all mentioned factors are present. Acquiring signs of systemic phenomenon every year, raiding threatens not only market economy of the country, but its national security as a whole.

Raiding comes from piracy, privateering (naval attacks on the trade ships) and dates back for more than one century. According to simple definition of the word in Merriam-Webster's Learner's Dictionary a raider is: a person who suddenly and unexpectedly attacks a place or group; a person who enters a place in order to steal or take something; a person who tries to take control of a business by buying a lot of its stock<sup>1</sup>. As a crime raiding appears together with the shares and the possibility of takeover the company against the will of its owner, namely in the USA from the famous American entrepreneur John Davison Rockefeller. The beginning of his activity took place during the Civil War (1861-1865), and it really defined the face of modern America. Initial capital Rockefeller created through military orders, selling oil for the needs of the federal army. In 1867, together with Henry Flagler he opened the firm, later called the Standard Oil Company, which share capital was one million dollars and its destiny was to become the world's first raider company. Rockefeller focused his efforts not on finding oil fields and oil extraction, but on processing and transportation of petroleum products, and he had achieved the monopoly on this type of activity by 1877. In order to obtain control over the illegal transport of oil in all US states, he bought controlling stakes of rail companies through nominees, thus acquiring them by criminal way and created a Union Tanker Car Company. For quite a long time nobody in the USA did not even guess that he had been controlling the company, and thus Standard Oil Company had minimized their transport costs. That is, the raider way the largest oil empire was created<sup>2</sup>.

The former implacable enemies of raiders include Benjamin Franklin, who proposed immediately after the War of Independence to include a special paragraph on the prohibition of raiding into the Treaty of the United States and England. Although that paragraph was not included into the Treaty, Franklin later made directly start recording prohibiting raiding at the conclusion of the agreement with Prussia, thus creating a precedent in the

<sup>1</sup> Raider. Definition [Electronic resource]. – Access mode : <http://www.merriam-webster.com/dictionary/raider>.

<sup>2</sup> Grek B. A concept and historical pre-conditions of development of reydering in Ukraine / B. Grek, T. Grek // Advocate. – 2010. – № 9 (120).

international law. It is logically to consider the experience of the United States in counter raiding and formation of the effective state policy, as a country pioneer in this field<sup>3</sup>.

In 1933 in the area of securities regulation the Securities Act of 1933 was adopted. This law was intended to require all necessary information by investors, primarily financial, securities provided to the public, as well as it prohibited deceit, misrepresentations, and other fraud in the sale of securities. According to the law the securities sold in the US must be registered and the company must provide the following information under the registration form: a description of the company's properties and business; a description of the security to be offered for sale; information about the management of the company; and financial statements certified by independent accountants<sup>4</sup>.

In 1968 a new federal law was passed, and it is the main legal act regulating the market for corporate control in the US, including regulatory procedure activities for acquisitions – the Williams Act. The adoption of this law was caused by a sudden wave of acquisitions (takeovers) in the 1960's, which caught the management of companies by surprise and forced the shareholders to make decisions, which they were not prepared to. The law requires the party that makes the open tender offer to disclose to the federal Securities and Exchange Commission (SEC) the source of the funds used in the offer, and to the company that is the target of absorption (target company). This statement specifies the terms of the tender offer, information about the company that makes the tender offer referred to sources of funds as well as plans for the company in the event of a takeover. The same information within 10 days should be given to any person or company buying more than 5% of the shares of any company. The law sets a minimum period for consideration of proposals – 20 days and allows shareholders for whom the tender was made within 15 days to change their mind. If it is only a limited number of shares, they must be appropriately distributed proportionally among the shareholders of the enterprise for which the bid was made. Within the time candidates are prohibited to perform any acts aimed at the business part of a specific company<sup>5</sup>. The introduction of these restrictions enables shareholders to think about all the "pros" and "cons" including the number of shareholders of unauthorized persons and to prevent illegal seizure of the company management by outsiders<sup>6</sup>.

Also a key law, that prevents criminal manipulation of shares and insider information, is considered the Securities Exchange Act of 1934, which includes:

- 1) requirements to provide the Securities Commission with annual, quarterly and periodic reports by public companies, for that would monitor the financial condition of the organization;
  - 2) requirements for public companies to keep accurate accounting records;
  - 3) requirements prohibiting trading insider information;
  - 4) requirements prohibiting misleading or providing false information to auditors of public companies<sup>7</sup>.
- Thus, any person that intentionally violates one of the following requirements (or any other provision) can be fined up to 5 mln. USD and (or) imprisoned for a period no more than twenty years<sup>8</sup>. According to the law, not all offerings of securities must be registered with the Securities Commission. Some exemptions from registration include: private offers to a limited number of persons or institutions; offers of limited size; domestic supply; securities of municipal, state and federal authorities.

There are some other laws that regulate relations in the field of securities, and they are just as important:

We can't but mention Trust Indenture Act of 1939, which is applied to debt securities such as bonds, debentures as well as to securities offered for public sale, and even if such securities may be registered under the Securities Act of 1933, they may not be offered for sale to the public if the official agreement between the issuer of bonds and the bondholder, known as the trust indenture, conforms to the standards of this Act<sup>9</sup>.

<sup>3</sup> Bidjakov E. «Corporate raid»: history of occurrence and the present stage characteristic / E. Bidjakov // Bulletin of Tambov University. Series: Humanities. – 2009. – № 4. – Vol. 72.

<sup>4</sup> Securities Act of 1933 [Electronic resource]. – Access mode : <http://www.sec.gov/about/laws/sa33.pdf>.

<sup>5</sup> Tarhanova Z. Functioning of the Institute of raiding in Russia : dis. ... cand. of econ. sciences : spec. 08.00.01 / Z. Tarhanova. – Vladikavkaz, 2008. – P. 109.

<sup>6</sup> Koliesnyk M. The world experience of corporate raid counteraction and possibility of its using in Ukraine / M. Koliesnyk // Law and Security. – 2010. – № 5 (37). – P. 12.

<sup>7</sup> Securities Exchange Act of 1934 [Electronic resource]. – Access mode : <http://www.sec.gov/about/laws/sea34.pdf>

<sup>8</sup> The code of laws the United States. 15 United States Code §78ff (a) [Electronic resource]. – Access mode : <http://www.law.cornell.edu/uscode/text/15/78ff>

<sup>9</sup> Trust Indenture Act of 1939 [Electronic resource]. – Access mode : <http://www.sec.gov/about/laws/tia39.pdf>.

Investment Company Act of 1940 which regulates the organization of companies, including mutual funds, that engage primarily in investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. The law aims to minimize conflicts of interest that arise during these complex operations and requires the company to disclose its policy of financial condition to investors while selling shares. The law focuses on public disclosure of information to investors about the fund and investment objectives of the company, as well as the structure of investment and operations<sup>10</sup>.

Investment Advisers Act of 1940 regulates the activities of the investment advisers. With few exceptions, the law requires that a firm or individual consultants practicing on investments in securities must be registered with the Commission and comply with rules designed to protect the interests of investors. The law was amended in 1996 and 2010, and according to the amendments only consultants who have at least 100 mln. USD in assets under management or advise registered investment companies must register with the Commission<sup>11</sup>.

Sarbanes-Oxley Act of 2002 was the next “milestone” in the fight against raiding. It was signed in July 30, 2002 by the President Bush for the sake of the most far-reaching reforms of American business practices since the time of Franklin Roosevelt. The law introduces a number of reforms to enhance corporate responsibility, financial disclosure and combat corporate and accounting fraud. This law also established the “Public Company Accounting Oversight Board” also known as the PCAOB, to oversee the activities of the auditing profession. Analysing the law we can see it provides another instrument of legal protection against potential invaders – Section 906 of the Act contains requirements on the reliability of the information relating to financial condition and results of economic activity, which in order of reporting is provided by managers and financial directors of the company (or persons equated to them) to the Commission for Securities and the US stock market. These periodical financial reports of financial managers and directors (or persons equated to them) are subject to certification and must be accompanied by a written statement of the CEO and CFO of the issuer. Any person, who knowingly provides false certificate with information about the financial condition and results of economic activity, is criminally responsible and can be fined up to 1 mln. USD and (or) subject to imprisonment for a term no more than 10 years. It also provides criminal penalties for intentionally providing a false certificate. The penalty in this case would be a fine of up to 5 mln. USD and (or) imprisonment for a period not more than 20 years<sup>12</sup>.

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is the most large-scale change in the US financial regulation. It significantly changed the activity of federal authorities, governing the provision of financial services and created additional financial regulatory authority – Financial Stability Oversight Council (FSOC). An important direction is financial reform of state regulation and supervision of financial market segment such as trade OTC derivatives (swaps) – the law takes selling swaps to stock exchanges or electronic trading platforms, establishes requirements for mandatory clearing and transmission of information on transactions in the repository, and for transactions that are not cleared there are requirements for capital and adequacy of margin (collateral)<sup>13</sup>.

The Jumpstart Our Business Startups Act (the «JOBS Act») dated 05.04.2012 allows companies to attract initial investments in public markets under the simplified procedure (by minimizing regulatory requirements).

Analysis of the US legal framework in combating raiding suggests more detailed scrutiny of foreign experience. For example, the Law on Securities and Exchange 1934 puts criminal legal barrier to those raiders who for preparing and organizing the seizure of the company are using insider information.

We can see that in the USA in the Laws of 1933 and 1934 of the 21<sup>st</sup> century there are criminal remedies that prevent the criminal of illegal control of the company by changing the registration and (or) legal documents, making false information about a material fact in the application submitted to the registering authority. Moreover, in 1983 in the USA the Insider Trading Sanctions Act was adopted as a separate law prohibiting insider trading, and in 1988 the Insider Trading and Securities Fraud Enforcement Act passed as the law on liability for insider trading and securities fraud. These regulations provide severe sanctions for insider activity.

The Ukrainian legal framework, which would properly regulate the order of the market for corporate control, begins to be formed with the adoption by the Verkhovna Rada of the following laws of Ukraine: “On Busi-

<sup>10</sup> Investment Company Act of 1940 [Electronic resource]. – Access mode: <http://www.sec.gov/about/laws/ica40.pdf>.

<sup>11</sup> Investment Advisers Act of 1940 [Electronic resource]. – Access mode : <http://www.sec.gov/about/laws/iaa40.pdf>.

<sup>12</sup> Sarbanes-Oxley Act of 2002 [Electronic resource]. – Access mode : <http://www.sec.gov/spotlight/sarbanes-oxley.htm>.

<sup>13</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act [Electronic resource]. – Access mode : <http://www.sec.gov/spotlight/dodd-frank.shtml>.

ness Associations" dated 19.09.1991 № 1576-XII, "On Privatization of State Property" dated 04.03.1992 № 2163-XII, "On Privatization of Property of State-Owned Enterprises (small privatization)" dated 06.03.1992 № 2171-XII, and "On Renewal of the debtor's Solvency or Declaring Its Bankruptcy" dated 14.05.1992 № 2343-XII. Thus, the Law of Ukraine "On Renewal of the debtor's Solvency or Declaring Its Bankruptcy" was not worked out properly and it gave broad powers to obtain control of the assets of other economic operators without additional and substantial financial investment.

On the twenty-third of January 2006 the Law of Ukraine "On Securities and Stock Market" was adopted and on the twenty-first of November 2006 according to the decision of the State Commission on Securities and Stock Market number 1344 the information which can be referred to the insider was identified (now the decision invalidated on the grounds of the decision of the State Commission on Securities and Stock Market № 752 (z0946-12) dated 29.05.2012).

According to the Law of Ukraine "On Amendments to Certain Legislative Acts of Ukraine on Insider Information" dated 22.04.2011 number 3306-VI the note of Article 163-9 of the Code of Ukraine on Administrative Offences the first paragraph stipulates that persons who committed the action under this Article are: officials of the issuer, including those who were officials of the issuer at the time of the introduction of insider information; persons who have access to insider information in connection with their performance of labor (service) duties or contractual obligations, regardless of the relationship with the issuer, including members of professional stock market participants; public servants who know insider information as a result of the performance of official (official) duties; persons who looked through the insider information by illegal means; auditors, notaries, experts, appraisers, arbitration managers or other persons performing public powers provided by the law. And Article 232-1 of the Criminal Code of Ukraine sets "a fine from seven hundred and fifty to two thousand non-taxable minimum incomes of citizens, or an imprisonment for up to three years, with disqualification to hold certain positions or to be engaged in certain activities for up to three years or without it for intentional illegal disclosure, transferring or making available insider information, as well as using the recommendations providing such information regarding the acquisition or disposal of securities or derivatives (derivatives), if it led to the persons who committed these acts or by third parties unjustified profits in a significant amount, or avoiding stock market participants or third parties significant damage, or if it caused substantial harm to legally protected rights, freedoms and interests of individual citizens, or state and public interests, or the interests of legal entities", and "commitment transactions using insider information for their own benefit or for the benefit of others, aimed at the acquisition or disposal of securities or derivatives (derivatives) connected with the insider information, if it led to the persons who committed these acts or by third parties unjustified profits in a significant amount, or avoiding stock market participants or third parties significant damage or if it caused substantial harm to legally protected rights, freedoms and interests of individuals or state public interest or the interests of legal entities, – is punishable by a fine of seven hundred and fifty to two thousand non-taxable minimum incomes of citizens or imprisonment for up to three years, or imprisonment for up to two years, with disqualification to hold certain positions or to be engaged in certain activities for up to three years or without such"<sup>14</sup>. According to analyzed normative and legal acts we can conclude that in the national Ukrainian legislation the protection of insider information by means of criminal law appeared only in 2011.

Legislation of Ukraine has a lot of drawbacks and contradictions in the sphere of raiding, and in connection with this some provisions of the laws can be interpreted differently by various state bodies. For example, the raider has the ability to block the work of the state register by obtaining judgments which are not related to the merits of the conflict, but herewith using procedural rights, he can delay the process of trial and change the owner of illegally purchased assets. 10.10.2013 the Verkhovna Rada of Ukraine adopted the Law of Ukraine "On Amendments to some Legislative Acts of Ukraine concerning improvement of legal regulation of legal entities and individuals – entrepreneurs" № 642-18, aimed at resolving the main important aspects of corporate activities and in particular to counteract illegal acquisition and takeover of enterprises<sup>15</sup>

However, analyzing the provisions and amendments of mentioned Law, it is clear that the proposed changes will not completely resolve the problem of counter raiding in Ukraine. Thus the Law amends Article 66 of Economic Procedure Code of Ukraine, namely – the article on the claim. One way for the legal protection of par-

<sup>14</sup> Law of Ukraine On Amendments to Certain Legislative Acts of Ukraine on insider information dated 22.04.2011 № 3306-VI [Electronic resource]. – Access mode : <http://zakon0.rada.gov.ua/laws/show/3306-17>.

<sup>15</sup> Law of Ukraine On Amendments to some Legislative Acts of Ukraine concerning improvement of legal regulation of legal entities and individuals – entrepreneurs dated 10.10.2013 № 642-VII [Electronic resource]. – Access mode : <http://zakon2.rada.gov.ua/laws/show/642-18>.



ticipants and the founders from the raiding attacks is recourse to the courts. At the same time in practice there is the problem of protecting members and founders of the company, as procedural law (means of securing a claim) does not allow a court ban on the general meeting of shareholders or members of companies and decision-making. This deficiency prevents the founder (participant) prohibit illegal raiding to take decisions regarding the conduct of business. So, the raider, who has most of the constituent in the share capital of the company, can eliminate unwanted participants. Even the cancellation of the decision of the general meeting does not deprive the court of its right to exclude such participant again. The Economic Court, which considers the dispute on the ownership of shares (shares) of the company, has the right to impose a ban on making changes to the constituent documents of the changes in the authorized fund<sup>16</sup>.

Considering positive experience of the USA and the current situation in the sphere of raiding in Ukraine, the national legislation requires further changes. Therefore, special attention deserve our proposals for introducing amendments to Article 5 of the Code of Ukraine on Administrative Offences about the powers of local councils to make decisions for the violation of which administrative liability is expected in terms of prevention of economic crimes (raiding) in the location of the communities. Namely the possibility of establishing economic security rules by councils of cities of regional centers, the violation of which provides for administrative liability. And, in this regard, amendments to the Code of Administrative Proceedings of Ukraine in Section II Chapter 1 concerning jurisdiction and administrative jurisdiction of administrative cases. But this calls for further research.

### Summary

The article is devoted to some questions of researching positive historical experience of legislation of the for the prevention of raiding, analysis of certain legal documents, legal regulation and possible ways to minimize the risk of raiding and improvement of the legal framework in this area in Ukraine.

### Анотація

Стаття присвячена деяким питанням дослідження позитивного історичного досвіду законодавства США в області запобігання рейдерству, аналізу певних правових документів, правового регулювання та можливих шляхів мінімізації ризику рейдерства та вдосконалення нормативно-правової бази в цій сфері в Україні.

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<sup>16</sup> The legal problems of counteraction of raiding in Ukraine. Actual methods of business protection against raider attacks [Electronic resource]. – Access mode : [http://sb-sb.com/publications/article/zakonodatelnye\\_problemy\\_protivodeystviya\\_reyderstvu\\_v\\_ukraine\\_aktualnye\\_metody\\_zawity\\_biznesa\\_ot\\_reyderskix\\_zaxvatov](http://sb-sb.com/publications/article/zakonodatelnye_problemy_protivodeystviya_reyderstvu_v_ukraine_aktualnye_metody_zawity_biznesa_ot_reyderskix_zaxvatov).

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