

Ukraine's recent bankruptcy reform

Alexander Biryukov of Kiev National University explains the origins, provisions and scope of the recently-enacted insolvency legislation in Ukraine, and its importance to economic reform

The first Ukrainian law in recent history to regulate the property problems of financially distressed enterprises, the Bankruptcy Law, was adopted in 1992. Its application revealed the difficulty of devising legislation capable of satisfactorily addressing the financial problems of Ukrainian companies in difficulties.

The first attempt at revising the 1992 legislation was made in 1995. A small group headed by professor N Kuznetsova of the Kiev National University and consisting of professors A Dzera and V Scherbina and the chairman of the Arbitration Court of Kharkov District, N Titov, began work on this task. In addition, the working group included a foreign expert, a Bankruptcy Judge from the Central District of California, the Honorable Samuel L Bufford. The working group developed the new conceptual framework for this area of legislation and drew up a new draft Bankruptcy Law. The results of the working group's efforts were presented to the legal community at a specially organised round table conference at Kiev University in February 1996.

Shortly after that, the Ministry of Economy, the Ministry of Justice and a number of other state bodies finalised their input to the new draft law (bill), which was then submitted to the Verhovna Rada (Parliament) of Ukraine. The bill contained relatively minor changes to the 1992 Law. However, after it passed a first reading in Parliament in June 1996, there was no further progress for two years. Then, in the spring of 1998, work began on preparing the draft law for a second reading.

Thus in June 1999 a much altered draft law finally went before Parliament. It was passed as the Law of Ukraine on Amendments and Supplements to the Law of Ukraine on Bankruptcy, on June 30, 1999. The new

bankruptcy law got a new title – the Law on Restoration of Solvency of the Debtor or Declaring it Bankrupt. It came into force on January 1, 2000, replacing the 1992 Bankruptcy Law.

However, it looks as though this is not the end of reform in this area of the law. Several draft laws proposing amendments to the new law have been submitted to the Ukrainian Parliament since its adoption. One of these now before Parliament proposes important changes in the rules on who can be recognised as bankrupt.

The new bankruptcy law reviewed

Although the new law of 1999 contains a number of provisions that are broadly similar to those in the old law, as a whole it is constructed on completely different foundations. (Indeed, any similarities between the new and old laws are attributable merely to the fact that both are the product of a settled legal tradition which, in turn, is based on principles common to all continental legal systems.)

Much current international thinking was incorporated into the conceptual aspects of the new law; for example, the principle that legislation should protect not only creditors' interests, but also those of debtors, is reflected in the preamble to the law. The

law also emphasises that it is first and foremost directed at restoring the solvency of the debtor, and that only after measures to that end have failed will the debtor be declared bankrupt for the purposes of complete or partial satisfaction of the claims of the creditors.

The new law expands the range of persons that can be recognised as 'bankrupt'. It now includes consumer cooperatives, and charitable and other funds. Bankruptcy proceedings can also be initiated against individuals, but only those who are registered as entrepreneurs. (An 'entrepreneur' is anyone recognised as such by the Law of Ukraine on Entrepreneurship of 1991. After 'special state registration', such persons can conduct businesses at their own expense and discretion without needing to set up a legal entity.)

The new bankruptcy law also sets out a number of exceptions to the general rules on who can be declared bankrupt. 'State-owned enterprises with special status' (*kazenni pidpryemstva*) are one such group. The term '*kazenni pidpryemstva*' was in fact introduced into Ukrainian legislation in 1998 with the adoption of supplements to the 1991 Law of Ukraine on Enterprises. (It should be noted, though, that the concept of 'state-owned enterprise with special status' is imprecisely defined in the legislation.)

On the question of creditors, the new law does not offer any radically new provisions. 'Creditors' must have monetary claims against the debtor, which can include obligations to the Treasury and wage arrears, in order to qualify to file a petition with the Arbitration Court.

As for 'non-resident creditors' (ie businesses registered in other jurisdictions), these are considered creditors under the new law, unless otherwise stipulated by international treaties to which Ukraine is a party. In the Bankruptcy Law of 1992 this category of creditors was not actually mentioned, and the presence of provisions on this in the new law can be attributed to the working group.

The new law also defines those persons who are entitled to participate in a bankruptcy, and who have procedural rights which are more precisely defined than in the old law. Such persons, leaving aside the main 'parties' (ie the

debtor and creditors – or rather the representative of creditors' committee), are defined to include arbitration managers (disposition manager, sanation manager, liquidator), the owner of the debtor, and any other persons who take part in the court proceeding. The latter covers, for example, representatives of the employees, who thus have procedural rights under the law.

The triggering criterion – the grounds on which one petitions may be filed with the Arbitration Court under the law – is the inability of the debtor to meet its obligations three months after the obligations fall due. The Arbitration Court will open a bankruptcy proceeding if a total that is not disputed by the creditor(s) of not less than 300 statutory minimum monthly salaries is due. At the current official National Bank of Ukraine exchange rate, the threshold sum stands at present at just over US\$4,000.

The provisions on which bodies are competent to administer bankruptcy cases remain unchanged; the Arbitration Courts handle a specified category of case. (Another court system, not the arbitration system, handles general civil cases of a non-economic character.) Bankruptcy proceedings are conducted under the procedural rules of the Arbitration Procedural Code of Ukraine.

One of the true innovations of the new bankruptcy law is its provision of a range of procedures (both out-of-court and judicial) to enable debtors to settle their property problems. These include, on the judicial procedure side, the disposal of assets of the debtor, composition (amicable) agreements, sanation (renewal of the debtor's solvency) and liquidation. In addition to the judicial procedures set out in the law, there is an out-of-court procedure (pre-trial sanation).

The law stipulates that owners of enterprises that are debtors, including the enterprise's management, state bodies authorised to operate state-owned enterprises, and community administrations (regional self-governing bodies), have a duty to apply any measures that would tend to prevent the bankruptcy of the enterprises.

The rules on priority in the satisfaction of property claims has also changed from those under the 1992

law. The old law organised the priority of claims into five categories. The new bankruptcy law contains six creditors' claims categories, as follows. The claims of creditors whose obligations are secured by pledge are satisfied with the highest priority – the first turn. The claims of employees relating to their dismissal are satisfied in the first turn too, as are all expenses connected to administering the proceeding (such as

the work of the liquidation commission, the cost of publishing notice of the commencement of the bankruptcy proceeding, etc) at the Arbitration Court.

The claims of employees relating to damage to their life and health are satisfied in the second turn. Tax debts and other obligatory payments to the Treasury are satisfied in the third turn. In the fourth turn, claims that have not been secured with a pledge are satisfied. Claims concerning payments of the employees to the statutory fund (chartered capital) of the bankrupt are satisfied in the fifth turn. All other claims are satisfied in the final, sixth turn.

The new law also extends the range of the professional participants in the bankruptcy proceeding from that of 1992. This is a consequence of having several procedures in the new bankruptcy law. The arbitration court nominates all these participants. In the text of the law, they are given the general title 'arbitration managers'.

A national programme for training specialists to perform certain obligations at bankruptcy proceedings was also launched in Ukraine at the end of the 1990s. The basic function of such specialists is to participate in bankruptcy proceedings that have been initi-

ated by the arbitration court, either as the manager of the debtor's assets (disposition manager), as sanation manager, or as liquidator. An important provision in the new law is that one person can execute all three functions. The new law requires, however, that anyone who executes such must have a special licence to undertake what is classified as entrepreneurial activity.

For the first time in the legislative history of the Ukraine, a special state body on bankruptcy matters (the State Agency on Bankruptcy Affairs) was created by the new law to aid implementation. The central function of the Agency on bankruptcy matters has been to formulate a state policy in this field and create the necessary conditions for staging bankruptcy proceedings at the arbitration courts that relate to state-owned enterprises. However following 'administrative reform', the Agency on Bankruptcy Affairs was liquidated at the beginning of 2000. Its functions and powers have now passed to a newly created part of the Ministry of the Economy .

Court procedure

A court proceeding to declare a debtor bankrupt under the new law begins, as it did under the old law, with the lodging of a petition to open a bankruptcy proceeding that corresponds to the analogous provisions of the Arbitration Procedural Code of Ukraine. Within a period of no more than 30 days, a date for a preparatory session at the Arbitration Court will be fixed, after which a moratorium on the enforcement of claims is entered.

Within three months of the preparatory session, a preliminary session of the Arbitration Court should be conducted. The main task of this session is to determine who are the competitive creditors and who are the 'sanators' (a 'sanator' is a person who agrees to pay the debtor's debts in exchange for ownership or co-ownership in the debtor's business). During that same period, and at the committee of the creditors' request, judicially-supervised sanation may begin, starting with the appointment of a sanation manager. Sanation is limited to 12 months, but also can be extended by six months or reduced when there is less time needed for restoration of the debtor's

solvency.

If the measures directed at recovering solvency fail, liquidation begins and the liquidator is appointed.

At any stage of the bankruptcy proceeding in the arbitration court a composition agreement can be concluded. Only creditors, whose obligations are pledged and the creditors of the second and subsequent turns are subject to such an agreement.

The new law defines a composition agreement as an agreement between the debtor and creditors about a referral or instalment payments plan or the writing off by the creditors of the debtor's debts.

The CIS Model Insolvency Law

A general analysis of the new bankruptcy law of 1999 shows that many of its provisions are the similar to those of the Model Law 'On Insolvency (Bankruptcy)' drawn up by the Scientific Consultative Center of Private Law of Commonwealth of the Independent States and later adopted by the Interparliamentary Assembly of the Commonwealth of Independent States. The Model Law was developed with the active assistance of a number organisations in the Netherlands, Germany and the United Kingdom as exemplary legislation for adoption in CIS countries as they reform the appropriate legislation.

Ukrainian lawmakers borrowed provisions from the Model Law on Insolvency as follows:

- The law extends its effect to non-commercial organisations, and also physical persons (with the exception of physical persons who aren't registered as entrepreneurs).
- It excepts from its effects state-owned enterprises that have been given special status (*kazenni pidryemstva*).
- It uses a minimum aggregated amount of debt as the basis on which a petition to initiate bankruptcy proceedings may be lodged with the Arbitration Court.
- There is an obligation on the debtor to file a petition with the Arbitration Court when there are signs of bankruptcy.
- The Ukrainian Law has provisions on a 'state body on bankruptcy matters'.

The influence of the Model Law is

also noticeable for having definitions and legal constructions in the text that had not appeared in previous Ukrainian legislation. Among these: 'pecuniary obligations', 'arbitration (sanation) managers', 'composition (amicable) agreement', 'kazenni pidryemstva' to name but some.

The Model Law's provisions mandating particular bankruptcy proceedings for particular categories of the debtors appear also to have been transferred to the Ukrainian new bankruptcy law (see Title VI of Ukrainian Law of 1999 and Chapter 7 and 8 of the Model Law).

A further innovation, which has appeared in Ukrainian Law of 1999 and which is a characteristic of the Model Law, is the concept of 'interested persons' (Article 1 of the Ukrainian Law of 1999 and Article 17 of the Model Law).

Thus the Model Law on Insolvency (Bankruptcy) was utilised in Ukraine.

The key points to remember, then, are that:

- Ukraine is one of the first states of the former Soviet Union republics to use the uniform insolvency law devised for CIS countries when undertaking a full revision of its bankruptcy law.
- The economic reforms in Ukraine require exactly that kind of law as they transform the economy from a command economy to free market principles.
- The increasing number of bankruptcy cases proves that insolvency is becoming an important agent of change. Statistics show that only 20 bankruptcy petitions were filed with the arbitration courts in 1992; by 1995, 2,000 bankruptcies were underway in the courts. In the first year of the new law, 12,500 bankruptcy cases were underway.

This is a good sign. It proves that the free-market instrument such as insolvency can work and can help to accelerate economic reforms in Ukraine.

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