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Ukrainian Insolvency Law: Retrospective And Current Issues

Preface

Insolvency (bankruptcy) law is an integral part of Ukrainian commercial law. Its purpose is to ensure the balance of interests between creditors, the debtor, and other interested parties in the insolvency procedure. More than a thousand new proceedings are initiated each year in Ukraine.

According to the World Bank's Doing Business 2018 survey,¹ Ukraine ranked at an extremely low 149th position in terms of insolvency settlement, although in total it was ranked in 76th place. The main reasons why the Ukrainian position was so low are as follows:

- 1) too long insolvency procedures – 2.9 years (for example, Eastern Europe and Central Asia – 2.3 years; developed countries – 1.7 years) the best country – 0.4 (Ireland);
- 2) the high cost of bankruptcy proceedings in Ukraine – 40.5% of the debtor's property value (Eastern Europe and Central Asia – 13.1%; developed countries – 9.1%); the best country – 1% (Norway);
- 3) the low efficiency of bankruptcy proceedings in Ukraine, *recovery index* (in cents per dollar) – 8.9 (Eastern Europe and Central Asia – 38; developed countries – 71.2); the best country – 93.1 (Norway).²

Such a low position in international ranking became a trigger for a “reload” of Ukrainian bankruptcy legislation. As a result, at the end of 2018, the Ukrainian Code of Bankruptcy Procedures was adopted. This differs significantly from the previous law in terms of structure and content. In this article, the author explains the origins of Ukrainian insolvency law, the advantages of the current Code, and some practical issues that are still unsolved.

¹ *Ease of Doing Business Score on Doing Business topics – Ukraine*, <http://russian.doingbusiness.org/data/exploreeconomies/ukraine#resolving-insolvency> [accessed: 2022.05.01].

² Пояснювальна записка від 26.02.2018 року до Кодексу України з процедур банкрутства, http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=63518 [accessed: 2022.05.01].

Table 1. Number of cases of insolvency proceeding and their results (2010–2019)³

Year	number of cases of insolvency procedures	including						number of judgments on declaration of bankruptcy
		left without consideration	with approval of the report of the reorganization manager	with approval of an amicable agreement	with approval of the liquidator's report	in connection with repayment of all obligations before creditors	for other reasons	
2010	10612	-	-	-	-	-	-	8212
2011	10382	523	8	106	8335	100	1310	6745
2012	7583	275	8	94	6084	101	1021	4631
2013	5697	128	7	82	4948	57	475	3359
2014	3324	55	4	70	2989	29	177	2096
2015	2406	32	8	53	2159	6	148	1799
2016	2101	29	1	48	1844	18	161	1385
2017	1691	12	1	32	1546	14	86	1242
2018	1368	21	-	65	1055	8	219	795
2019	1184	14	4	68	953	2	137	649

³ I.B. Погорольцева, Сучасні тенденції банкрутства вітчизняних підприємств, <https://conf.ztu.edu.ua/wp-content/uploads/2021/01/267.pdf> [accessed: 2022.05.01].

Retrospective

The legal system of Ukraine is one of the so-called post-Soviet legal systems. The state plays a significant role in enforcing bankruptcy law. In addition to providing a legal basis for bankruptcy proceedings, the state: 1) supervises compliance with bankruptcy legislation; 2) keeps records of insolvent companies (including in order to combat fictitious bankruptcies) and, if necessary, intervenes to prevent catastrophic consequences in some cases; and 3) may act as a creditor in bankruptcy cases. Such an important role of the state in post-communist countries is justified by the need to control the relevant sphere until a market economy develops, while independent regulatory mechanisms are absent.⁴

The formation of bankruptcy laws in Ukraine can be divided into three stages:

1) The period from 1991 to 1996 – the replacement of Soviet legislation in an independent state. The Law “On Restoring Debtor’s Solvency or Declaring a Debtor Bankrupt” (1992) was adopted. In the academic literature, there are discussions about the origin of the Law and the model that was taken as . It should be noted that in the 1990s, Ukrainian law was formed under the significant influence of Russian law via model laws of the Commonwealth of Independent States (CIS)⁵ (union of post-Soviet states). However, in terms of commercial law, the development of the Russian and Ukrainian legal systems differs significantly. Ukraine has adopted a codified act of commercial law – the Commercial Code of Ukraine – while Russia has refused to adopt a pandect system and to codify commercial law; in Ukraine (as well as in Poland, Slovakia, the Czech Republic etc.) the system of company law was formed on the German model; Russia adopted the US model of corporate governance (a two-tiered system of corporate governance) and some other elements of Anglo-American company law.⁶ In terms of insolvency law, Ukraine also took the German model as an example.

In Germany, insolvency is regulated by the *Insolvenzordnung*.⁷ The same legal act (*Insolvenzordnung*)⁸ also exists in Austria (1914). In Great Britain, the equivalent is the Insolvency Act (1986),⁹ and in the United States, it is the Bankruptcy Code (1979).¹⁰ The last was substantially amended by the Bankruptcy Abuse Prevention and Consumer

⁴ A. Biryukov, *Ukrainian bankruptcy law in the context of regional and international developments*, “Annual Survey of International & Comparative Law” 2007, vol. 13, issue 1, p. 13–33, <https://digitalcommons.law.ggu.edu/cgi/viewcontent.cgi?referer=https://www.google.com/&httpsredir=1&article=1111&context=annlsurvey> [accessed: 2022.05.01].

⁵ The Commonwealth of Independent States is a regional intergovernmental organization in Eastern Europe and Asia. It was formed following the dissolution of the Soviet Union in 1991.

⁶ O. Hiroshi, *Russian Commercial Law*, Boston 2007, p. 206.

⁷ Deutsche Insolvenzordnung von 05.10.1994, <https://www.gesetze-im-internet.de/inso/> [accessed: 2022.05.01].

⁸ Österreichische Insolvenzordnung RGBl. Nr. 337/1914 von 1914, <https://www.jusline.at/gesetz/io> [accessed: 2022.05.01].

⁹ Insolvency Act 1986, <https://www.legislation.gov.uk/ukpga/1986/45/contents> [accessed: 2022.05.01].

¹⁰ U.S. Bankruptcy Code, <https://www.usbankruptcycode.org/> [accessed: 2022.05.01].

Protection Act (2005). In the Russian Federation, the above mentioned legal relations are regulated by the Law "On insolvency (bankruptcy)".¹¹

In comparison to the insolvency laws of different countries, the Ukrainian Bankruptcy Law of 1992 most resembles the German Bankruptcy Code (*Konkursordnung*), which was in force until January 1, 1999. The German Bankruptcy Code contained in practice only one form of settling debt problems – collective procedure. All cases commenced with the filing of a liquidation proceeding. As a result, many of the shortcomings of German law, such as a lack of flexibility in court proceedings and the factual absence of reorganization procedures were apparent in the first wave of Ukrainian bankruptcy laws.¹²

In general, the main purpose of the first wave of bankruptcy laws was not to restore the debtor's solvency, giving priority to the debtor's interests (US concept) or the creditor's interests (European concept), but to eliminate state ownership in enterprises, to change the type of ownership, and to eliminate the Soviet legal system, based on the principles of a planned economy. As a result, a number of public sector enterprises changed their owners not through privatization, but through bankruptcy and further distribution of their assets.¹³ This contributed to the change of ownership and the emergence of a so-called oligarchy, when most of the industrial heritage of the Ukrainian SSR passed into the hands of a small number of owners (oligarchs).

2) The years 1996 to 2018 – the second stage began by adopting the European doctrine of insolvency law, one of the cornerstones of which is to restore the debtor's solvency. Ukraine became one of the first post-Soviet states to introduce the western doctrine of cross-border bankruptcy. However, the adoption of a new version of the Bankruptcy Law (1999) was also influenced by the CIS Model Bankruptcy Law (1997).¹⁴

3) The year 2018 is the starting point for the current insolvency law based on the Ukrainian Code of Bankruptcy Procedures. Its adoption was caused by revolutionary political changes (2014), signing an Agreement of Association with the EU, and changing the vector of legislative development towards a European *acquis communautaire*. In 2015, the Verkhovna Rada of Ukraine approved the Plan of Legislative Support for Reforms in Ukraine, to provide a legal framework for improving the conditions of doing business in Ukraine in those areas important to the World Bank and the International Finance Corporation.¹⁵

The need to reform insolvency law was outlined by the authors of the draft code in an explanatory note: "The current regulation of bankruptcy procedures allows debt-

¹¹ Закон Российской Федерации "О несостоятельности (банкротстве)" от 26.10.2002 №127-ФЗ, http://www.consultant.ru/document/cons_doc_LAW_39331/ [accessed: 2022.05.01].

¹² A. Biryukov, *Ukrainian bankruptcy law in the context of regional and international...*, p. 14.

¹³ *Ibidem*, p. 17.

¹⁴ The Model Law was developed by the CIS Private Law Advisory Center with the participation of experts from the Netherlands, Germany, and the United Kingdom in order to propose the introduction of uniform rules on bankruptcy proceedings in the region.

¹⁵ Про План законодавчого забезпечення реформ в Україні : Постанова Верховної Ради України від 4 червня 2015 року, <https://zakon.rada.gov.ua/laws/show/509-19#Text> [accessed: 2022.05.01].

ors to evade their obligations to creditors, bankruptcy procedures are too long and inefficient, and the procedure of selling property does not always permit selling the debtor's property at the highest price, and does not provide reliable protection of the buyer's property rights. Because of these facts, the domestic market is uncompetitive in the global struggle for financial resources, and the rights of creditors are unprotected".¹⁶ The institution of bankruptcy was often an instrument of falsification and abuse in order to evade, for example, paying taxes, or to withdraw the assets of the debtor company, or in the event of illegal replacement.

Therefore, in 2018 the Code of Ukraine on Bankruptcy Procedures was finally adopted. Some academics and practitioners claim that a significant influence on the development of the Code was exerted by the US Bankruptcy Code.¹⁷ US insolvency law establishes a so-called "debtor's" concept of insolvency law. Its essence is: to give a bona fide debtor the opportunity to "start anew" by releasing most debts and making payments to creditors in an appropriate manner to the extent that the debtor is able to make them; to rescue the debtor as a viable enterprise, instead of liquidating, because it is economically feasible, as, in this way, jobs are preserved and the production of goods and services does not stop. The Ukrainian Code contains a number of borrowings from US law, not least because of the presence of representatives of the International Monetary Fund in a relevant working group.¹⁸ The current Code is a compromise between "pro-creditor" European law and US law that protects the debtor as much as possible by giving him/her the opportunity to restore solvency (a "fresh start") quickly.¹⁹

The Ukrainian Code of Bankruptcy Procedure: advantages and unsolved issues

One of the most significant novelties of the Code is the introduction of an "easy entry" principle for bankruptcy proceedings. The Code does not require a creditor who files a petition in insolvency to provide any evidence of the indisputability of a creditor's claims or some threshold for such claims. In the previous Law, a bankruptcy petition could be filed only with the following preconditions: 1) evidence of the indisputability of a creditor's claims for an amount exceeding 300 times the minimum wage; 2) such evidence was proved by a court judgment that had entered into force; and 3) a resolu-

¹⁶ Пояснювальна записка до проекту Кодексу України з процедур банкрутства від 26 лютого 2018 року, http://search.ligazakon.ua/l_doc2.nsf/link1/GH67W00A.html [accessed: 2022.05.01].

¹⁷ Д. Козловська, Спроба систематизувати та узагальнити норми банкрутства у вигляді кодексу є революційною, <https://bankruptcy-ua.com/articles/8842> [accessed: 2022.05.01].

¹⁸ Пояснювальна записка від 26.02.2018 року до Кодексу України з процедур банкрутства, http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=63518 [accessed: 2022.05.01].

¹⁹ М. Лазаренко, Чому боржники перестануть боятися банкрутства, <https://finclub.net/ua/blogs-all/chomu-borzhenky-perestanut-boiatisia-bankrutstva.html> [accessed: 2022.05.01].

tion on commencement of enforcement proceedings, provided that no court judgment had been executed within 3 months of the commencement of proceedings (art. 10).

In fact, it was rather difficult to initiate an insolvency procedure according to the previous Law. It could take years for a creditor to secure a final court judgment that could be used as the grounds for insolvency proceedings, and, therefore, international lenders rarely resorted to insolvency proceedings to recover a debt owed by a Ukrainian company. The new Code lifts these barriers and makes it possible to initiate a debtor's bankruptcy if there is a debt for any amount that actually makes bankruptcy proceedings an alternative to enforcement proceedings.

Second, the Code contains novel provisions that have never existed before in Ukrainian insolvency law and in relation to which there is still no case law. Such novelties include, among others, the concept of "individual bankruptcy" (art. 113–137) or "bankruptcy of physical persons", which is designed to allow an individual to restore his/her solvency. Now, each individual may file an application to have insolvency proceedings instituted against him/her or to attempt to have his/her debts restructured on the grounds provided in the Code. It is worth emphasizing that a personal bankruptcy can be initiated by the debtor himself/herself only.

Third, the Code aims to speed up the insolvency procedure. This aim is achieved not just by reducing the number of dates of court proceedings (receivership (art. 44–49), rehabilitation (art. 50–57), liquidation (art. 58–67), which were, in practice, rarely met by commercial courts before. The new approach is: 1) to limit the right of appeal against court judgments in an insolvency case (most of the court rulings are not subject to appeal in cassation); and 2) to tighten requirements for the transition to the next court procedure. It is also prohibited to suspend bankruptcy proceedings (art. 39).

Fourth, the procedure for selling property has been improved. Now it is allowed only through an electronic platform (art. 68–69) approved by the Cabinet of Ministers of Ukraine, and not through "pocket" exchanges with a great risk of abuses by both parties of proceeding.

Fifth, under the Code, the bankruptcy court may declare an agreement of the debtor invalid if the agreement was entered into within a period of three years prior to the commencement of the insolvency proceedings and meets particular criteria (art. 42). The bankruptcy court may declare an agreement of the debtor invalid upon a claim of the insolvency trustee or a creditor, in particular, if the debtor: 1) accepted an undertaking that led to insolvency or breach of obligations towards other creditors; 2) accepted an undertaking without adequate consideration from the counterparty; and 3) granted a security interest over its assets that led to a loss for the debtor or creditors.²⁰

²⁰ A. Nikiforov, G. Kalinichenko, *New Ukrainian Bankruptcy Code – the finance and debt restructuring perspective*, <https://eba.com.ua/en/novyj-kodeks-ukrayiny-z-protsedury-bankrutstva-z-tochky-zoru-finansuvannya-ta-borgovoyi-restrukturyzatsiyi/> [accessed: 2022.05.01].

Sixth, the Code increases the liability of insolvent company officials: if they do not declare bankruptcy in time and do not take measures to initiate appropriate proceedings, they will be jointly and severally liable for outstanding debts to creditors.

Besides its advantages, the Code still has some unsolved issues.

First, the Code does not generalize and systematize the provisions of the Law “On Restoring Debtor’s Solvency or Declaring a Debtor Bankrupt”, but only artificially codifies the provisions of the previous Law, the Commercial Code of Ukraine and the Commercial Procedure Code, increasing the number of relevant provisions. In other words, instead of one old law, there is a new, extended law, but in the form of a code.

Second, despite the new shortened deadlines, it is likely that as a result of certain conflicts in the Code, partial delays will still be possible because of the procedure for appointing an arbitration trustee. The Code establishes an automated procedure for electing an arbitration trustee. If none of the applicants agrees to participate in the proceeding, the appointment will be made by the court. In this case, the question arises, according to what criteria and from which circle of arbitration trustees does the court choose? This can lead to appeals from creditors. Some creditors may prefer one arbitration trustee, while others oppose him/her and so on.

Third, several provisions of the Code are in contradiction to other Ukrainian legislative acts. For example, the Bankruptcy Chamber of the Commercial Cassation Court of the Supreme Court solves the legal problem of whether a ruling to replace the creditor by means of succession can be reviewed in terms of cassation. In pursuance to the Commercial Procedure Code of Ukraine, such a ruling is subject to review in cassation, and under the Bankruptcy Code such rulings are not included in the list of rulings that can be appealed against. This is not the first time the Chamber has heard this issue. Previously, the majority of the judges of the Chamber opposed the possibility of review, but at the same time, a number of judges prepared a dissenting opinion, expressing the opposite position.²¹

Conclusions

Ukrainian insolvency law is characterized by a significant regularity of legislative changes. That is because of the necessity to transform the planned economy of a young post-Soviet state into a market economy.

Taking into account the Code’s structure and content, Ukrainian insolvency law is very close to US law. This trend can be traced in Ukrainian bankruptcy legislation as well as in the company law of Ukraine.

The Code has improved the procedure for regulating insolvency proceedings significantly through: 1) the introduction of an “easy entry” principle for insolvency proceedings; 2) individual bankruptcy; 3) speeding up the insolvency procedure; 4) selling

²¹ O. Volianska, *Changes to the Code of Ukraine on bankruptcy procedures*, <https://lcf.ua/en/news/changes-to-the-code-of-ukraine-on-bankruptcy-procedures/> [accessed: 2022.05.01].

a bankrupt's property via an electronic platform; and 5) creating additional possibilities to declare a bankrupt's previous contracts invalid etc. However, it is currently difficult to analyze the success or failure of these innovations because the Code has only recently been adopted.

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Summary

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Ukrainian Insolvency Law: Retrospective and Current Issues

The article is devoted to the historical and current issues of Ukrainian insolvency law. The author states that the insolvency law after 1991 passed three stages: 1) 1991 to 1996 – the replacement of soviet legislation in an independent state and the adoption of the Law of Ukraine "On Restoring Debtor's Solvency or Declaring a Debtor Bankrupt"; 2) 1996 to 2018 – the influence of European doctrine of insolvency law based on restoration of the debtor's solvency; 3) 2018 – the current stage of insolvency law based on the Ukrainian Code of Bankruptcy Procedures.

It is emphasized that the new Ukrainian Code of Bankruptcy Procedures is a compromise between "pro-creditor" European law and US law, which protects the debtor as much as possible by allowing him to restore solvency ("fresh start") quickly.

Keywords: Ukrainian insolvency law; Ukrainian Code of Bankruptcy Procedures; insolvency of a physical person.

Streszczenie

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Ukraińskie prawo upadłościowe: wybrane problemy

Artykuł poświęcony jest aktualnym problemom ukraińskiego prawa upadłościowego przy uwzględnieniu kontekstu historycznego. Autor wyróżnia trzy etapy kształtowania się ukraińskiego prawa upadłościowego po 1991 r. Pierwszy wyróżniony etap zwiera się w latach 1991–1996, kiedy zastąpiono ustawodawstwo radzieckie ustawą ukraińską „O przywróceniu wypłacalności dłużnika lub ogłoszeniu upadłości dłużnika”. Drugi etap objął lata 1996–2018, w którym uwiódził się wpływ europejskiej doktryny prawa upadłościowego opartej na przywróceniu wypłacalności dłużnikowi. Obecny, trzeci etap, związany jest z wejściem w życie w 2018 r. ukraińskiego Kodeksu Postępowania Upadłościowego.

Podkreśla się, że nowy ukraiński Kodeks Postępowania Ppadłościowego jest kompromisem pomiędzy prowierzycielskim prawem europejskim (w klasycznym ujęciu), a prawem amerykańskim, które w jak największym stopniu chroni dłużnika, dając mu możliwość szybkiego przywrócenia wypłacalności („nowego startu”).

Słowa kluczowe: prawo upadłościowe Ukrainy; Kodeks Postępowania Upadłościowego Ukrainy; niewypłacalność osoby fizycznej.