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RE: Bankruptcy

I. Introduction

From the time of its adoption until its replacement, the Law "On Bankruptcy," No. 2344-XII (dated May 14, 1992, effective July 1, 1992), was never actually very effective. Although it was in force during the most difficult times of the Ukrainian transitional economy, the strict enforcement of the old bankruptcy law would have led to mass bankruptcy of most Ukrainian enterprises since the definition of "bankruptcy" could theoretically have applied to over half of the existing Ukrainian enterprises. Economic collapse, resulting from mass bankruptcies, would be unavoidable if the Ukrainian government tried to apply Article 1 of the old bankruptcy law, which quite fairly defined "bankruptcy" as the debtor's inability to satisfy creditor demands due to insufficient liquidity of funds.

On June 30, 1999, the Parliament passed Law No. 784-XIV "On Introducing Changes to the Law of Ukraine 'On Bankruptcy.'" The modest title of the Law, notwithstanding, these so-called "changes" are actually an entire re-working of the old bankruptcy law, starting with the current name. Henceforth, the Law "On Bankruptcy" shall be referred to as the Law "On Restoration of the Solvency of a Debtor or Recognition of a Debtor as Bankrupt" (the "Law"). The new version of the bankruptcy law took effect on January 1, 2000 and the provision regarding the prohibition of bankruptcy proceedings against the producers of agricultural products until January 1, 2004 has been cancelled. As significant changes are still being introduced to the Law as improvements, below we analyze its current and projected effects.

The difference between the old and new bankruptcy laws is striking: whereas the old bankruptcy law focused primarily on liquidating the indebted enterprise, the new bankruptcy law focuses first and foremost on restoration of the debtor's solvency. Under this approach, an enterprise may accordingly be deemed bankrupt and liquidated only if implementation of the procedures in the new law to restore solvency have failed. At this stage, creditors must put their faith in a so-called "arbitration administrator" to gather up the pieces of the indebted enterprise and attempt to generate a rebirth of the economic activity of the enterprise in order to restore its ability to repay creditors. The role of this new entity in Ukrainian legislation, the arbitration administrator, is discussed in more detail below.

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Importantly, the new bankruptcy legislation provides for bankruptcy of certain physical entities (i.e., individual, citizen entrepreneurs and sole-proprietors). In contrast to the former bankruptcy law, which did not permit the seizure of the property of citizens-subjects of entrepreneurial activity, the new Law provides that property of citizens may be seized during bankruptcy proceedings in order to satisfy the claims of creditors. If enforced, this can prove to be a useful deterrent to those individuals who once felt confident striking deals without the consequence of losing their personal property. The Law also provides a barrier for any legal schemes to alienate property to related persons/entities before bankruptcy proceedings set in. In particular, any agreements on the alienation of the property of citizens made in the year before bankruptcy proceedings are initiated can be recognized as invalid.

As a background, the Law was drafted by the State Agency on Bankruptcy Issues, which has the authority to define policies and set the procedures for preventing the bankruptcy of debtors. Not surprisingly, the drafters of the Law took upon themselves a wide variety of responsibilities in ensuring the proper implementation of the organizational, economical and other terms and conditions of the Law. These responsibilities include: proposing the candidates and providing training for arbitration administrators; creating a unified database of enterprises subject to bankruptcy proceedings; and organizing the expert examination of state-owned enterprises and enterprises with 25% or more state-owned shares for purposes of bankruptcy proceedings, among others.

II. Initiating Bankruptcy Proceedings

In Ukraine, bankruptcy proceedings are carried out in commercial courts (formerly known as arbitration courts), rather than in specialized bankruptcy courts, and take place at the location of the debtor. According to the Law, either creditors or the debtors themselves may submit an application to a commercial court to initiate bankruptcy proceedings. Bankruptcy proceedings may only be initiated if the amount of the indisputable claims of creditors toward the debtor aggregately equal no less than 300 minimum monthly salaries, which were unsatisfied by the debtor for a period of three months after their agreed upon date of extinguishment. As of the date of publication, this figure is approximately 126,000 Ukrainian Hryvnia (or approximately 24,951 US Dollars), based on the current minimum monthly salary of 420 Ukrainian Hryvnia per month (which is expected to increase to 450 after December 1, 2007). This threshold can be critical to the rights of smaller creditors because an enterprise can legally avoid fulfilling its obligations by keeping the amount of its indebtedness within the above limit.

On April 3, 2003, the Ukrainian Parliament adopted amendments to the Law (the amendments came into effect on May 31, 2003), which place creditors into various prioritized groups rather than the formerly established equal possibilities for the satisfaction of creditor claims. Thus, creditors are further broken down into “competitive creditors” and “current creditors.” The former are defined as

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Thank you.

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