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Modern Insolvency Law Developments in the Former Soviet Union States

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We are very pleased to present the 15th Technical Paper titled " Modern Insolvency Law Developments in the Former Soviet Union States" under the INSOL Technical Papers Series. This paper was written by Prof. Alexander Biryukov, Associate Professor of Law, Kyiv National Taras Shevchenko University, and INSOL Scholar for 2009 – 2010 for the Europe, Africa and Middle East Region.

The fifteen Soviet Union Republics that became independent from the Soviet Union have now started introducing economic reforms that are conducive to free market policies. These countries have also recognised that it is important to have the necessary regulatory and institutional arrangements for a sound financial system, and establish a sound legal system if a market economy is to thrive.

As part of their legal reforms, the countries have taken steps to introduce modern insolvency laws that provide effective legal remedies for financially distressed companies that in turn would result in maintaining fair competition in a market environment. Further, the implementation of unified cross-border insolvency rules is an essential factor in fostering the integration of these transiting economies into the global economic system.

This paper provides useful information about the modern insolvency law developments of the former Soviet Union States. It provides background information in relation to the environment in which insolvency law reforms were introduced and the transformation that has taken place so far. The insolvency law reforms have been discussed in three stages - the so-called first, second and current waves of changes. The paper also focuses on the implementation of western concepts into the new reformed insolvency laws and how far the legislators in these countries are willing to proceed in order to accept worldwide known insolvency concepts. The final part of the paper covers the implementation of international unified rules, particularly, in the area of cross-border insolvency into existing insolvency laws in the region.

INSOL International would like to thank Prof. Alexander Biryokov for writing this informative paper on the current status of the insolvency law reforms in these countries. INSOL members will no doubt find this information very useful.

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Modern Insolvency Law Developments in the Former Soviet Union States

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Introduction

With the disintegration of the Soviet Union in 1991, one of the largest (and to some extent unique) systems of law – that is socialist law – ceased to exist. Fifteen former Soviet Union Republics declared their independence from the Soviet Union and the new independent states started building their own legal systems.

Socialist Law (as a part of Soviet political regime) was a highly politicised legal system with the leading role played by the ruling Communist Party. There was a well known expression that characterised the socialist type of law: There could not be anything private – everything must be public. In an environment where everything was administered by the government in a command economy, market instruments played a minor role in the regulation of business.

Obviously insolvency legislation did not exist during the whole period of the U.S.S.R.'s existence. There was no need for insolvency laws in a command economy with only state-owned businesses and no market economy. When a socialist enterprise faced financial difficulties the government provided it with financial assistance or simply granted direct money awards from the budget to cover the losses of insolvent state undertakings. In such an environment, market instruments, among which bankruptcy is the most important, were not required to solve the problems that arose among economic players. Debt forgiveness therefore was quite widespread in the countries of the region with planned economies.

Since declaring independence from the former Soviet Union, practically all former socialist republics have been trying to implement comprehensive political, economic and legal reforms. The central goal of those reforms has been to ensure that the transition from a socialist type of legal system and centrally administered economy to a new system based on the Western concept of 'rule of law' and free market principles, were implemented smoothly.

Insolvency law developments in the states of the region from the introduction of the first laws through to their further development can be described in three stages: Adoption of 'first generation' insolvency laws; early reforms with substantial revisions to the initial insolvency laws; and modern developments. The evolution of insolvency laws corresponds to relative periods of private law reforms and modernisation of legal systems.

These stages are quite similar for practically all former Soviet Union states except for the Baltic Republics.

1. Insolvency Law Reforms in the Former Soviet Union States

1.1 "First Generation" Insolvency Laws

The process of adopting the first insolvency laws in the region was relatively similar in all the states of the former Soviet Union. The first insolvency laws in the region were adopted in 1991-92 and were based on the model developed in the Soviet Union shortly before its dissolution. After the beginning of fundamental reforms in the USSR, the first draft of the law on insolvency (bankruptcy) of enterprises was presented to the Supreme Soviet for consideration on July 8, 1991. The same year the readings of this draft law began, but with the collapse of the Soviet Union and beginning of the creation of laws by the newly independent states, this process stopped.

[*] The views expressed in this article are the views of the authors, Prof. Dr. Alexander Biryukov" Associate Professor of Law, Institute of International Relations of Kyiv National Taras Shevchenko University and not of INSOL International, London.

Notwithstanding the fact that the draft followed the Soviet style of economic administration, the document became the basis for drafting new legislation in the new economies of the former socialist republics.

One of the very first pieces of legislation in this sphere in the former Soviet Union was the Law of the Republic of Belarus on Economic Insolvency and Bankruptcy adopted on 30 May 1991. The Ukrainian Law on Bankruptcy and the Russian Law on Insolvency (Bankruptcy) of Enterprises were enacted in 1992. During the first few years after the Soviet legal system disappeared, insolvency laws were adopted in Estonia, Moldova, the Russian Federation, Tajikistan, Turkmenistan, and Ukraine.

The primary goal of the first generation of insolvency laws adopted in the states of the former Soviet Union was to eliminate the socialist type of regulation based on centralised economies, and to establish the foundation for the effective transfer of state property to private persons using the bankruptcy proceedings. It is for this reason that the first insolvency laws were designed to accelerate privatisation.

The bankruptcy law in Ukraine as well as in other states of the region was part of a package of privatisation laws. The same happened in The Azerbaijan Republic where the Law on Insolvency and Bankruptcy that was adopted by the National Council of the Republic on 22 June 1994 was introduced as one package with the State Program of Privatisation of State Property. They were designed to facilitate the transfer of state enterprises to private persons using bankruptcy rather than privatisation procedures.

The 'first generation' insolvency laws were quite similar. They were small with a limited set of legal remedies to restore the solvency of distressed enterprises.

There were some other common characteristics of the first generation insolvency laws enacted by Eastern European states of the post-communist block in the early 1990s.

i) Only legal entities were eligible for bankruptcy and no individuals were allowed to initiate a bankruptcy proceeding to reorganize their businesses;

ii) The laws provided remedies only for commercial entities;

iii) Assignment of the debtor's debts to an investor was one of the ways to approve sanation (reorganisation) plan;

iv) The law allowed in a limited way for a debtor and his creditors to negotiate in order to come to a compromise;

v) Normally an operating bank's representative could be appointed as an administrator that could not assure independent treatment to all participants of a bankruptcy case; and

vi) The law did not provide a moratorium or other means to preserve the debtor's property immediately after filing a proceeding.

The early insolvency laws treated insolvent debtors extremely severely and therefore liquidation remained practically the only procedure widely used in the courts at that time.[1] From a theoretical point of view such a feature of insolvency regulation shows how those laws reflected pro-creditor regime of insolvency legislation that was introduced in practically all the countries in the region.

Not long after the newly adopted insolvency law came into effect, they showed their difficulties and indeed their impossibility to provide effective legal measures for overcoming problems of companies in financial distress. Instead, the so-called 'red directors' (the directors of state-owned enterprises, who remained in management) used insolvency legislation for their own purposes. They intentionally drove the enterprises they managed into insolvency in order to devalue the assets. Using insolvency law, they then transferred the ownership of these potentially solvent but undervalued enterprises to themselves or their relatives without any

[1] See Horton Scott, The Death of Communism and Bankruptcy Reorganization, 13 Am. Bankr. Inst. J. 12 (1994).

competition from outside investors or potential buyers. The privatisation legislation required the procedure to be run under the control of the public and the state. The insolvency legislation was the favored way for them to avoid using the privatisation legislation that would have required filing a privatisation plan with the State Property Fund of Ukraine, publicizing the fact of filing and disclosing every step of the privatisation process including notifying anybody willing to participate in the privatisation of the enterprise.

1.2 Insolvency Law Early Reforms

The first results of the insolvency laws' application after their introduction in the early 1990s showed the weaknesses of those laws. The court practice revealed the ineffectiveness in providing legal remedies for settling debts through filing bankruptcy proceedings stipulated by the relevant laws. In Ukraine only twenty bankruptcy cases were filed in 1992;[2] in 1993 there were thirty-eight cases heard in arbitration (now economic) courts, and in 1994 there were one hundred and ninety-four cases.[3]

In 1995, some two thousand petitions had been submitted by creditors to the courts,[4] insofar as the debtors themselves did not use this vehicle to save their businesses or to suspend their entrepreneurial activities where they were insolvent. Such a situation no longer fit the development in the context of commercial law and the transformation from a planned to a market economy.

An important reason for revision of the insolvency laws was that the economies of the newly independent states were getting worse. For instance in Ukraine, the statistics for the year of 1994 showed that every eleventh enterprise in the country was unprofitable or practically insolvent. In 1995 this number had increased to one in five.[5] By 1996 every third enterprise was almost insolvent. In addition, 68% of the agricultural sector enterprises were in a state of insolvency. Overall, the widespread inability to pay debts in the middle of the 1990s affected almost every business around the country. Western experts also provided the same analysis.[6] Some surveys showed that 80 to 90 per cent of Ukrainian enterprises were insolvent.

The need for urgent changes in the economy in order to build a market economy also pushed forward the insolvency reforms.

If the main goal of insolvency laws at the initial stage of their implementation was to change the Soviet way of legal regulation, the revision of insolvency laws was aimed at implementing at least some Western doctrines addressing the importance of debtors' solvency restoration. It was a response recognizing the importance of quickly establishing a market environment through adopting new private law regulation to meet the needs of transition economies.

The review of existing insolvency laws mainly resulted in the replacement of the earlier enacted laws. In a number of the former Soviet Union States, new insolvency laws were enacted to fix or correct problems that arose with the earlier introduced laws. In Kazakhstan the Law on Bankruptcy with revised wording was enacted in 1997.[7] In 1998, the Russian Federation enacted a new Federal Law on Insolvency (Bankruptcy), and in the same year Uzbekistan[8] enacted a new Law on Bankruptcy too.[9] In Ukraine the full revision of the bankruptcy legislation was completed in 1999 by the adoption of new wording with another title – The Law on Restoration of Debtor's Solvency or Declaring Debtor Bankrupt.[10]

In some states of the former Soviet Union insolvency laws were just significantly revised in the 1995-1999 period. This happened in Armenia, Azerbaijan, Georgia, Lithuania, Moldova, Kyrgyzstan, and some other states of the region.[11]

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2 See "Sam sebe bankrot", 8 Biznes 23 (2000).
3 See Val Samonis Rohach, Creditor–Led Processes: Enterprise Bankruptcy in Ukraine, Ukrainian Industrialist 24 (November–December 1996). –
4 See "Nel'zia sudit'sia na golodny zheludok", 5 Biznes 11 (1998).
5 See "Ubytki stabil'ny", 5 Biznes 8 (1998).
6 See Helen Kryshtalowych, Ukraine's New Bankruptcy Law: The Demise of the Dinosaurs? Law in Transition 57 (Spring 2000).
7 The Law of the Republic of Kazakhstan on Bankruptcy in a new wording dated 21 January 1997 No. 67–1 with amendments. Available on Internet (in Russian) at http://www.base.spinform.ru/show_doc.fwx?Regnom=1279 (as of 30 July 2010).
8 The Law of the Republic of Uzbekistan on Bankruptcy in a new wording dated 28 August 1998 No. 668–I with amendments. Available on Internet (in Russian) at http://www.base.spinform.ru/show_doc.fwx?Regnom=1279 (as of 30 July 2010).
9 See Vassily V. Vitryansky, Insolvency and Bankruptcy Law Reform in the Russian Federation, 44 McGill Law Journal, 409 (1999).
10 See Alexander Biryukov & Inna Shyrokova, Law and Legal System of Ukraine, New York: Juris International Inc. at 117 (2005).
11 See See Victor Burac, Bankruptcy in C.I.S. and the Baltics, Am. Bankr. Inst. J. 2 (2000).

These new or revised laws were based on a new concept – one that is much more known in Western countries – that is, protection of debtors (pro-debtor regime).[12] The laws assisted to expand the possibilities of reorganisation procedures.
Reform of this area of the legislation in the states of the region is still under way.

1.3 Unification of Private Law in the Region and Insolvency Laws Improvement

Modern developments in the former Soviet Union states in private law generally and of insolvency law particularly are taking place according to some world trends. Among those trends are harmonisation of legal systems of different countries and unification of norms that regulate trade and business activities.

Regionalisation raised a need for unification that is being led by the Commonwealth of Independent States[13] (CIS) with the active participation of the Russian Federation, Belarus, and Kazakhstan. Model laws in different areas of law have been developing within the CIS [14] since 1994.

It is important to note that the harmonisation processes are not being carried out equally throughout the territory of the former Soviet Union. The states situated in the European part of the former USSR (Russia, Ukraine, Belarus, where the legal systems are based on civil law traditions) and Kazakhstan have been more involved in those processes. After acquiring membership in the European Union the Baltic republics adopted their legal system and legislation to the European Union. Muslim traditions dominated in Asian nations in which political, cultural, and legal systems were based on Islamic thinking.

The Model Civil Code became one of the first models to be adopted in 1994 to be used as an example for implementation in the countries of the region.[15] This model was drafted with the assistance of foreign and international donors, including those from The Netherlands, Germany and the United Kingdom. Later the drafters of the civil codes in some states of the CIS among which were Armenia, Belarus, Kazakhstan, the Russian Federation, Uzbekistan, and to a lesser degree Georgia and Turkmenistan, transferred the main concepts of the model to new civil codes. For instance, the general provisions on liquidation of personal assets in the course of their individual insolvency as a basic principle became part of the civil codes in some states of the region.

The Model Law on Insolvency (Bankruptcy) approved by the Inter-Parliamentary Assembly of the Countries of the CIS in December 1997[16] contains unified rules for administering the bankruptcy proceedings to be implemented in the states of the region.

The Model Law on Insolvency introduced some western doctrines that were not known yet in these countries. In addition, the model was drafted taking into consideration the private law developments in the region, mainly in states such as the Russian Federation, Kazakhstan, Ukraine, and Moldova.

The basic concepts presented in the CIS Model Law on Insolvency were borrowed by lawmakers in some states of the region when they drafted their own legislative proposals to improve insolvency laws. Among those concepts that were implemented were the commencement of bankruptcy proceedings against physical persons, an obligation of a debtor to file a petition with the court when there are signs of insolvency, as well as some elements of the ‘fresh start’ doctrine.

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[12] See Alexander Biryukov & Myroslava Kryvonos, A Research Guide to Ukrainian Law. See at: http://www.nyulawglobal.org/globalex/Ukraine.htm (As of 30 June 2010).
[13] The Commonwealth of Independent State was founded on 21 December 1991.
[14] The CIS consists of the some Soviet Union states except Baltic republics.
[15] See W.B. Simons & S.J. Reynolds, The Legal Regulation of Bankruptcy: Russian Legislation and Models for the CIS, 24 Rev. Cent. and E. Eur. L. 581 (1999).
[16] The Model Law on Bankruptcy was developed by the Scientific Consultative Center of Private Law with the active participation of a number of donor organizations and law specialists from The Netherlands and Germany and recommended by the Inter-Parliamantary Assembly of the Commonwealth of Independent States as an example to be followed when reforming relevant legislation in the states of the CIS. See W.B. Simons, Harmonization of Private Law: The CIS Experience, Law in Transition 14 (Spring 2000).

1.4 Overview of Current Insolvency Laws in the Region

As a result of the latest legal reforms in the region insolvency laws became significantly different from the early laws both in size and in fundamental provisions. For instance in Ukraine, the new 1999 Bankruptcy Law consists of 52 expanded articles while the Bankruptcy Law of 1992 contained 22 articles on six pages of text.[17]

The most recent trends in the development of insolvency legislation are mostly reflected in the conceptual provisions of the new insolvency laws. For example the principle of protection of interests not only of creditors, but also of the debtor can be found in the new laws. Here, emphasis is placed on the fact that this law, more than anything, is directed at financial stability of an insolvent debtor. As the new Ukrainian bankruptcy law states, only where such measures do not produce the desired results whereby the claims of the creditors cannot be satisfied in full or in part will the debtor be recognised as bankrupt.[18]

In some countries of the region the group of persons in relation to which bankruptcy procedures may be commenced has been expanded: not only business persons but some non-commercial organisations can also be declared insolvent such as charitable and other foundations (in the Russian Federation and Ukraine). Natural persons (but only those who are registered as entrepreneurs) can benefit from insolvency legislation and recover their solvency under supervision of the court.

The new insolvency laws that have been introduced in mentioned countries have many progressive provisions: For example, a minimum aggregated amount of debts as the basis on which a petition for initiation of a bankruptcy proceeding may be lodged with the court (implemented in the Russian Federation, Kazakhstan, Uzbekistan, Armenia, Georgia, and Moldova) has been changed. At the same time the relevant laws excluded from applying to state-owned enterprises that have been given special status ('kazenni pidpryemstva'). The 'kazenni pidpryemstva' cannot be a basis to apply for bankruptcy in Russia and Ukraine.

Another fairly troublesome provision in Ukrainian bankruptcy law is that it excludes from the operation of bankruptcy legislation legal persons who are in communal ownership. Under a new law local self-governance bodies can decide independently to exempt legal persons subject to the ownership of territorial state organisations from the application of the bankruptcy legislation.

Another world trend in the area of justice administration is being implemented in some countries of the region. Throughout the region bankruptcy cases are administered by specialised courts: called arbitration (arbitrazh) courts in the Russian Federation, and economic courts in Ukraine, Uzbekistan and other states. In these states the bankruptcy cases are governed by the rules set forth in the procedural laws and taking into consideration the special provisions in respect of the insolvency legislation. They are either the Codes of Arbitration Procedure (in Russia) or the Economic Procedural Codes (in Ukraine, etc.).

Professional persons who provide assistance to the judge in bankruptcy cases (arbitration managers) became participants of the bankruptcy proceedings under new insolvency laws in a number of countries of the region. The powers of arbitration managers are defined by the relevant laws. Normally they are appointed in bankruptcy cases to act in each of the defined proceedings: debtor's property administrator, reorganisation (sanation) managers, or liquidators.

When reforming the first generation insolvency laws, special attention was paid to the grounds for filing a petition with the court and criteria for the financial situation of the debtor that allows the judge to commence a bankruptcy case. The inability of meeting financial obligations that are due and owing for a defined period of time (normally from one to three months) are the main and only grounds for commencement of a bankruptcy according to the new laws in the region. Russian legislators chose a better approach: the law contains different grounds for commencement of a bankruptcy case for legal and natural persons. This allows the law to take into account consideration of many non-business aspects of natural persons' activities and the nature of some money obligations.

[17] See A. Biryukov, The Barriers to Implementing Ukrainian's New Bankruptcy Law, 37 Bankruptcy Court Decisions 5–7 (2001).
[18] See Preamble to the Ukrainian Bankruptcy Law revised in 1999.

In some countries of the region there is an obligation on the debtor to file a petition with the court when there are signs of insolvency. In Ukraine, the debtor may submit a petition to an economic court if it has sufficient property to cover the court expenses.

The drafters of the new insolvency laws in these countries have introduced non-judicial procedures, including an amicable settlement. The term 'amicable settlement' is understood as an agreement between the debtor and the creditors that is normally limited to deferring debt payments and / or paying off debts in installments or the creditors' forgiving (writing off) of the debts of the debtor.

Pre-trial reorganisation (sanation) is a form of restoring the debtor's financial obligation which already exists in Ukrainian legislation. The Cabinet of Ministers of Ukraine in 2000 passed a decree which provides a procedure for carrying out the pre-trial sanation of state enterprises, although it is important to mention that this procedure is rarely used in practice. One of the deficiencies of this legislation is that the decree does not provide effective mechanisms for creditors to participate in a decision-making process to suggest measures for the sanation (reorganisation) plan of the debtor in the pre-trial procedure. According to this decree, the decision on pre-trial sanation and on the measures of restoration of the debtor's solvency is made solely by the appropriate state agency operating the enterprise.

The priority for satisfying the claims of creditors provided for in the new insolvency laws is more similar to patterns existing in European states. The established priorities begin with secured claims. Tax obligations and compulsory payments to the budget do not have the highest priority anymore.

In many countries of the former Soviet Union special state agencies with respect to bankruptcy cases are established. In the Russian Federation the name of such an agency is the Federal Service of Russia for Financial Recovery and Bankruptcy. In Ukraine the State Agency on Bankruptcy Matters has been dissolved and has been restructured as a relevant subdivision of the Ministry of Economy of Ukraine. As a rule, such state bodies are charged with carrying out the state policies in a bankruptcy, as well as guaranteeing the realisation of bankruptcy procedures in relation to state enterprises.

2 Modern Developments of Insolvency Laws in the Region

2.1 Application of Insolvency Laws in the Former Soviet Union States

Since the new insolvency laws were revised, the number of bankruptcy cases has been significantly increasing. For instance, in Ukraine in 1999 (the first year after a new bankruptcy law was enacted) there were already more than 12,500 petitions filed with the economic courts. By contrast, in a pre-reform year there were only a few thousand of such cases.[19]

Clearly the new laws that were introduced were effective, as the bankruptcy proceedings became a new form of restructuring insolvent businesses.

In Russia practitioners in the early years of this decade noticed that artificial bankruptcies became a kind of business. In 2002 the Head of the Federal Service of Russia for Financial Recovery and Bankruptcy, Mrs. Nataliya Nechaeva, in an interview noted that of the total bankruptcies in the country, not less than 30 percent were artificial bankruptcies[20]. The main purpose of filing an artificial case was to sell devalued but financially viable businesses to another owner for 10,100 or even 1000 times less their real cost. She named several enterprises in the metal, paper and sugar production industries which were frequently the targets for such arrangements.

In the Russian Federation and to a lesser extent in other countries of the region step by step insolvency laws became an effective legal remedy in corporate wars during the post-privatisation period. Among certain corporate schemes for easy changing of the enterprises' owners were and still remain the following: 1) shares buyout by the investment funds belonged to management of an enterprise or transfer shares of employees to a trust that is controlled by administration; 2) redemption of shares with further sale to employees and administration; 3)

[19] See A. Biryukov, Ukraine's Recent Bankruptcy Reform Analyzed, Global Insolvency and Restructuring Review 26–28 (March/April 2001).
[20] See T. Trefilova, as interviewed by V. Dernovoy 2 May 2002. See at: http://www.bankr.ru/2002/5/2/teper-trefilova.html (as of 23 April 2010).

taking control over shares register and imposing limitations on access to that register, etc. Several types of manipulation involved issues of new shares that allow the owner of a relatively small package of shares to take control over a joint-stock company. Several types of manipulation involved issues of new shares that allow the owner of a relatively small package of shares to take control over a joint-stock company.

The bankruptcy proceedings were used as a final method of corporate restructuring in the name of certain persons. Those methods were legal by virtue of law but in such situations quite often bankruptcy proceedings fulfilled totally other purposes than those prescribed in the law; for example not to help a distressed company to overcome temporary problems but quickly change an owner of such an enterprise.

Statistics proved that such methods as commencement of artificial bankruptcies based on manipulation of the insolvency law became quite 'popular'.[21] The number of bankruptcy cases filed during that time with the arbitration courts in the Russian Federation was dramatically increasing. If in 1998 only 4747 business persons were declared bankrupt, in 1999 there were 8299 such decisions, and in 2000 there were 15143 persons that were declared bankrupt.[22] It is important to note that a number of big, so called city-formation enterprises declared (very large and sometimes the only employers in certain localities) increased dramatically. In 2000 there were 56 such companies and in 2001 there were 322.

One of the common methods of reorganisation was establishing a new company based on the assets of an insolvent person. The scheme is quite simple and not prohibited by law: so called good assets go to a newly established company in order to save 'at least part of the viable assets'; and bad assets remain in a company that is subject to liquidation.[23]

2.2 Newest Insolvency Law Developments in the Region

Recent reforms in the newly independent states of the former Soviet Union demonstrate that the legal systems of those countries are becoming more different from each other. Current reforms are aimed at changing some concepts of insolvency laws that to a larger extent reflected local traditions. When revision occurred, the lawmakers tried to reflect local thinking on political systems, culture and legal traditions. This made the laws vary from country to country.

Globalisation, internationalisation, and now regionalisation has changed today's world and these processes are also occurring in the Eastern European states – the former socialist republics of the USSR Now the states of the former Soviet Union take part in regional and international life more actively. Moldova, Kyrgyzstan, and Ukraine became members of the WTO which requires revision of their private and commercial legislation in order to liberalise trade. Insolvency legislation is an important factor in establishing fair competition. This facilitates introducing well-known and workable international rules into the national legislation.

Internationalisation of trade and globalisation of the world economy invoked a 'third wave' of insolvency law developments in this region where post-communist states tried building market economies. The main goal of the latest revisions of existing insolvency laws is to allow the states of the former Soviet Union to become a part of the world economy. It is quite obvious that this requires implementing relevant unified legal norms.

The landscape of legal system developments in the states of the former Soviet Union pretty much depends on regional developments. For instance, Ukraine has declared European integration as a priority.[24] Earlier having become a member of the Council of Europe in 1995, Ukraine took responsibility to speed up legal and judicial reforms.

Currently, Ukraine is in the process of adapting its legislation to European norms and standards with a long-term goal to acquire the full membership in the European Union. The Partnership and Co-operation Agreement (PCA) signed between the European Communities and their

[21] See Petr Kyryan, Maksim Rubchenko, Ekaterina Shokhina, Zakaznye bankrotstva i drugie zakonnye sposoby gryaznoi konkurentsii, Ekspert (December 2001). See at: http://www.compromat.ru/page_13543.htm (as of 30 July 2010).
[22] See Rabota arbitrazhnykh sudov Rossiyskoy Federatsii v 2000 godu: Report of the Agency on Consultations and Business Information. Available on Internet at: http://www.akdi.ru/vas/rabota/6_1.htm (as of 30 July 2010).
[23] See Petr Kyryan, supra note 22.
[24] Notwithstanding the fact that Ukraine participates in negotiations on broadening economic relations with some of the former Soviet Union countries within so called Common Economic Space, European integration remains the most important direction of international activity of this country.

Member States from one side and Ukraine – from the other on 16 June 1994 confers on Ukraine an obligation to bring its legal acts into conformity with the standards, applied in the member states as well as their consistency with the European Union legislation. EU Regulation 1346/2000 is the main document to be followed during the law reforms which adapt Ukrainian legislation to the EU legislation in insolvency.

Although implementing the cross-border insolvency rules is not specifically envisaged by international treaties, it is an important factor of market transformation and also an indicator of the progress made in legal reforms process in transition economies.

2.3 Foreign Persons in Bankruptcy Cases

The widening of international economic relations allows companies that are registered in different countries to do business widely without a fear of being treated badly. It is quite obvious that this requires introducing specific rules to deal with the cases where a foreign person is involved.

In relation to creditors, the new insolvency laws in the states of the former Soviet Union do not set forth any new principles.

As far as creditors who are non-residents (foreign persons) are concerned, such persons are deemed to be creditors in accordance with the new laws in the Russian Federation,[25] Ukraine,[26] Belarus,[27] etc. These persons can represent themselves as the creditors according to the local legislation, unless otherwise stipulated by the international treaties of relevant countries. Prior to the new insolvency laws that were introduced this category of creditors was not mentioned.

There are only a few provisions in the insolvency laws that deal with the perspective of foreigners' participation in cases filed in Ukraine. According to Art 1 of the Federal Law of the Russian Federation on Insolvency (Bankruptcy), Ukrainian 1999 Bankruptcy Law (Art 5), Belarus 2000 Economic Insolvency (Bankruptcy) Law in a 2003 wording (Art 3) the awards of foreign courts in bankruptcy cases are recognised and enforced in other jurisdictions according to the rules provided by the relevant international treaties. If there are no international treaties, the awards of foreign courts made in bankruptcy cases are recognised on the basis of reciprocity.

The court practice in the states of the former Soviet Union show that the principle of reciprocity sometimes is used as a ground to refuse enforcing a foreign judgment. There are several such court decisions issued in the Russian Federation. For instance, in 2005 one of the arbitration courts in Moscow refused to recognize and enforce a judgment issued by the state court of Berlin (Germany) on the basis that the court has not received information whether a similar court decision issued by a Russian Federation court would be executed in Germany.[28] In 2002 the same decision was given by the court on similar grounds where the court considered a petition to enforce a judgment made in Great Britain.

3 Cross-border Insolvency Unified Rules for Newly Independent States

3.1 Recognition of Foreign Judgments in Bankruptcy Cases

Recognition of foreign judgments can help to extend a court ruling to the territory of a foreign state. All states of the former Soviet Union have relevant procedures but as a rule they are not specifically aimed at judgments in bankruptcy cases.

Many successful examples can be given but only a few bankruptcy cases can be named, in which such recognition has been allowed. There is one judgment awarded in a bankruptcy case filed in Ukraine which was enforced in the territory of the Russian Federation.

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[25] The Federal Law of Russian Federation on Insolvency (Bankruptcy) dated 26 October 2002 No 127–Ф3 with amendments. Available on Internet (in Russian) at http://www.consultant.ru/popular/bankrupt/ (as of 30 July 2010).

[26] The Law of Ukraine on Bankruptcy dated 30 June 1999 No 2343-XII with amendments. Available on Internet (in Ukrainian) at http://zakon.rada.gov.ua/cgi-bin/laws/main.cgi?nreg=2343-12 (as of 30 July 2010).

[27] The Law of the Republic of Belarus on Economic Insolvency and Bankruptcy adopted on 18 July 2000 No 423-3 in the wording of 2003. Available on Internet (in Russian) at http://www.levonevski.net/pravo/razdelb/text210/index.html (as of 30 July 2010).

[28] Reshenie inostrannykh sudov v Rossii: priznanie i privedenie v ispolnenie, 3 Korporativnyi Yurist (2007). Available on Internet (in Russian) at http://www.magisters.com/publication.php?ru/268/articles/ (as of 30 July 2010).

The facts of this case are as follows:[29] An Ukrainian economic court commenced a bankruptcy proceeding and imposed a moratorium. The debtor, a Ukrainian company, had assets in Russia. Earlier a Russian arbitration court issued a decision against this company and that judgment was to be enforced in the territory of the Russian Federation. A debtor filed a petition with the court in the Russian Federation asking to stop enforcement based on the fact that a moratorium on the debtor's assets disposal was imposed.

Russian trial, appellate and cassation courts refused to recognise a moratorium and stop enforcement of the judgment on the territory of the Russian Federation.

Having those court decisions, the debtor applied to the High Economic Court of Ukraine asking to file a request with the High Arbitration Court of the Russian Federation to cease enforcement of that judgment referring to 1992 CIS Convention on economic disputes resolution and to a bilateral convention on legal aid in civil, criminal and family cases of 1993. As a result of that inter-court communication, the petition was accepted and satisfied. Finally enforcement of the judgment on the territory of the Russian Federation involving the assets of the Ukrainian debtor in a bankruptcy case was ceased.

Oleg Polischuk who represented the debtor in this case pointed out that this happened even where there was nothing mentioned about legal aid in bankruptcy cases in the above mentioned international treaties.[30] In addition, the Russian court in its final decision ruled that a judgment awarded in Ukraine on the basis of the principle of international comity would be recognised.

This is a good example that shows how difficult but still successfully the international legal remedy in the area of cross-border insolvency is applied by the courts of two neighbouring countries. In the mentioned case a foreign court decision was recognised and enforced mainly because there are basic multi-and bi-lateral international treaties in force between these two countries. One of the most important arguments for achieving success in this case was that these countries have quite similar legal systems and communication between these two courts could be conducted in the Russian language without translation of the procedural documents.

There is another court practice in the Russian Federation in similar situations. In a bankruptcy case commenced in the U.S.A. where a big Russian oil company Yukos applied for Chapter 11 reorganisation under the U.S. Bankruptcy Code, an American bankruptcy judge granted a temporary injunction prohibiting the sale of a company, Yuganskneftegaz, that belonged to this group for the period of reorganisation.[31]Notwithstanding of this prohibition this company was sold at an auction conducted in Russia. Therefore, the judgment given by an American court in a bankruptcy case was ignored.

It is quite obvious that every decision adopted in any court proceeding should have a cross-border effect. In bankruptcy cases enforcement of foreign judgments and what is more important, recognition of foreign bankruptcy proceedings should be foreseen by national legislation in each country for effective governance of cases with foreign elements.

3.2 Court Practice in Bankruptcy Cases with a Foreign Element

Although cross-border insolvency is quite a new phenomenon in the former Soviet Union states, some cases in which a foreign element appears have already arisen. Some examples can be found in court practices of the countries of the region.

In the Russian Federation one of the most famous bankruptcy cases in which a foreign element existed was the bankruptcy of the company Yukos. This was a group of companies doing business in the oil industry. On 26 March 2006 a bankruptcy case against Yukos[32] was commenced in the court of the City of Moscow. On 14 April 2006 the appointed interim trustee in

[29] See Oleg Polischuk, Transgranichnoe Bankrotstvo, 48 Yuridicheskaya Praktika (28 November 2006). Available on Internet (in Russian) at http://www.yurpractika.com/article.php?id=10006838 (as of 30 July 2010).
[30] *Ib.*
[31] See Sud v SShA prodlil zapret na prodazhu zarubezhnykh aktivov YUKOSA do 19 maya, Newsru Portal (5 May 2006). Available on Internet (in Russian) at http://www.newsru.com/finance/05may2006/bankrot.html (as of 30 July 2010).
[32] See Sud zapretil prodavat aktivy YUKOSA bez soglasiya vremennogo upravlyayuschego, Newsru Portal (20 April 2006). Available on Internet (in Russian) at http://www.newsru.ru/finance/20apr2006/yukos.html (as of 30 July 2010).

the bankruptcy case filed a voluntary bankruptcy petition with the bankruptcy court in the U.S.A.[33] As the trustee explained, this was made in order to protect the company's assets in the U.S.A. Yukos was liquidated and filing a case in the U.S.A. did not have anticipated cross-border insolvency effect.

In the bankruptcy cases where several bankruptcy proceedings in the territory of different states are commenced, a main-secondary proceedings concept can help to co-ordinate those proceedings. Otherwise it is difficult to predict how such a case in several jurisdictions will proceed.

In another example, in 2010 the Kazakhstan-based financial institution, BTA Bank, filed a bankruptcy petition with the bankruptcy court in New York requesting to open a reorganisation procedure. It was made in order to assure a fair consideration of a case under Chapter 15 of U.S. Bankruptcy Code as a measure against actions of some creditors and to protect the bank's assets in U.S.A. (about $1 billion).[34] Shortly before this, the creditors had obtained court rulings to freeze the bank's assets in two Swiss banks.

Early this year another Kazakh bank "Alliance Bank" filed a bankruptcy petition with the same U.S. bankruptcy court for similar reasons – to protect the assets of the bank in the U.S.A. and assure conducting of an effective reorganisation.[35] Both banks are currently in the process of debt restructuring.

These last two examples show how important it is to choose a proper jurisdiction to handle a bankruptcy case. The conflict-of-laws rules can help in some situations but maybe not in every bankruptcy case. It is well known that bankruptcy cases normally last a long time and many participants are involved in the court proceedings during which a judge may issue quite a large number of orders concerning assets wherever they are, situated.

Those examples show that in the absence of a proper cross-border regulation, a successful administering of a bankruptcy case in which a foreign element exists is quite unclear. It is quite obvious that there is a need to have unified cross-border insolvency rules in national legislation of each country.

3.3 Cross-border Insolvency Rules for the Former Soviet Union States

The only example of a successful implementation of unified cross-border insolvency rules in the region, is a Model Law on Bankruptcy of Banks in a new wording adopted on 18th November 2005 (Decree of Inter-Parliamentary Assembly of CIS No 26-8) which contains a chapter on "Cross-border Bankruptcy". There are several articles in this chapter that provide foreign proceeding and foreign representative definitions, rights on commencement of a bankruptcy case, consequences of declaring a person bankrupt, proof of insolvency, local administrator's powers and limitations, exchange of information, powers of a court and regulatory bodies.

At present, there are no cross-border insolvency rules implemented into national legislation of the former Soviet Union states. However, the most recent developments in the area of improving insolvency laws in these countries are marked by attempts to implement unified cross-border insolvency rules into existing legislation. The UNCITRAL Model Law of 1997 and the European Union Regulation on Insolvency Proceedings of 2000 are the models for the countries of the region.

Ukraine from all the countries of the region is the closest to implementing the unified cross-border insolvency rules into existing legislation. Ukraine started the process of introducing cross-border insolvency rules into the body of its bankruptcy law in 2006. After the Partnership and Co-operation Agreement signed between the European Communities and their Member States, and Ukraine came into force in 1998, it became an international obligation of the Government of Ukraine.

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[33] See Khronologiya "YUKOSA", Portal Kasparov.Ru. Available on Internet (in Russian) at http://www.kasparov.ru/note.php?id=4356899A2F9EA (as of 30 July 2010).

[34] See Gosudarstvennyi BTA bank reshyl zaschititsa ot bankrotstva v SShA, Ekonomika (5 February 2010). Available on Internet (in Russian) at http://diapazon.kz/kazakhstan/kaz-economy/24194-gosudarstvennyjj-bta-bank-reshil-zashhititsja-ot.html (as of 30 July 2010).

[35] See Tulegen Askarov, Ne kazhy gop, poka ne pereskochish! 5 Golos Respubliki (12 February 2010). Available on Internet (in Russian) at http://www.respublika-kz.info/news/finance/7588/ (as of 30 July 2010).

Revising Ukrainian legislation to European Union standards is detailed in the Action Plans for realisation of the National Programme of approximation of Ukraine.

By adopting the relevant provisions of the Action Plan, the draft Law of Ukraine on Introduction of Changes into Certain Laws of Ukraine regarding Cross-border Insolvency was drafted. This document was developed by the State Department for Legislation Approximation of the Ministry of Justice of Ukraine.[36] The position of the Ministry of Justice is to introduce a separate chapter containing cross-border insolvency rules into the text of existing bankruptcy law.

The early draft of the law was presented at the roundtable organised by the State Department for Legislation Approximation and held on 3 November 2006 where the main provisions were introduced to the legal community. The participants to the roundtable, after open discussion of some of the aspects that would result in improving the draft law, came to the conclusion that it would be quite difficult to implement certain provisions of the UNCITRAL Model Law mechanically because of the differences in the legal traditions. Some definitions are totally unknown in the legal systems of this region and the legal drafting techniques are quite different from those used by the member-states of the European Union.

The private international laws in the countries where they exist (Ukraine, for instance) do not directly regulate insolvency by providing the conflict-of-laws rules. Instead, the Law of Ukraine on Private International Law of 2005 contains the only provision devoted to bankruptcy – the bankruptcy cases commenced against Ukrainian companies are administed in national economic courts according to procedures set forth in Economic Procedural Code.

The most uncertain issue for judges and practitioners participating in the roundtable turned out to be the concept of the main and secondary proceedings that is suggested by UNCITRAL Model Law. The legal format provided by the Model was found quite difficult to implement in Ukraine without significant changes of the procedural laws.

The procedural legislation in the former Soviet Union states is characterised as quite conservative: the judges have to act in a manner that is strictly prescribed in the laws. The right to directly communicate with a judicial colleague in a foreign court or other state institution should be provided by new legislation.

Normally in the countries of this region procedure on recognition of foreign judgments and awards of foreign courts is foreseen by the Civil Procedural Code at the general jurisdiction courts. The fact that bankruptcy cases are governed by specialised courts can institute conflicts. The mentioned procedure must be a part of Arbitration (Economic) Procedural Codes (Laws).

The most promising proposition that is ready to be implemented in mentioned states without considerable changes in the existing laws is a concept of co-ordination of court proceedings that are opened in these and foreign states. This concept is the oldest one which is widely used around the world. There would not be a necessity of having bilateral Mutual Legal Assistance Treaties specifically in bankruptcy cases.

The cross-border legislative proposals are also currently being developed in the Russian Federation. In early 2010, the Ministry of Economic Development of the Russian Federation finalised preparing legislative proposals containing a set of norms on cross-border insolvency. The definition of entrepreneurial groups in these proposals became broader and now also covers assets in territories other than the Russian Federation. The division of powers between local and foreign courts is formulated more precisely; a new definition 'secondary proceeding' in cross-border insolvencies was introduced.[37] A procedure to recognise and enforce foreign judgments is provided in the draft law. The draft sets forth that a court proceeding in a bankruptcy case commenced in a foreign country should be a winding up proceeding.

[36] The Law Draft was posted on the Ministry of Justice of Ukraine on 15 May 2008.
[37] See Oleg Saposhnikov & Petr Netreba, Zakon o bankrotstve upersya v koflikt interesa. See at: http://mybusinesstyle.blogspot.com/2010/04/zakon-o-bankrotstve-upersya-v-konflikt.html (as of 30 July 2010).

In Belarus and other countries in the region the situation with developing cross-border insolvency rules is quite unclear. Scholars and practitioners express the need to have those provisions in national legislation.[38]

3.4 Insolvency Issues in International Arbitration Institutions

It is important to note that bankruptcy issues arise not only in national courts but also become a subject in the disputes that appear before international arbitration courts.

The AMTO case initiated against Ukraine was heard at the Arbitration Institute of the Stockholm Chamber of Commerce in 2005–2008. A debtor in the bankruptcy case was qualified as a highly hazardous enterprise according to Ukrainian bankruptcy law that created enormous difficulties for its liquidation. The claimant, the Limited Liability Company AMTO (Latvia) asserted that Ukraine failed to assure a fair and non-discriminatory treatment when administering a bankruptcy case. In this case the arbitral tribunal agreed with the position of Ukraine and ruled all claims to be dismissed.[39]

Now there is another case in addition to AMTO in which a claimant was engaged in a bankruptcy case governed in Ukraine and heard by Stockholm Arbitration Court.

Conclusion

Establishment of a fair and competitive business environment with a properly functioning insolvency system helps the countries in transition to demonstrate their readiness to assure equal rights for market players including foreign businessmen. Bankruptcy is an important legal remedy for keeping fair competition in a market environment. In this respect implementation of unified cross-border insolvency rules is an essential factor in fostering the integration of transition economies of the former Soviet Union states into the world economic system.

Currently no insolvency laws in the states of the former Soviet Union contain cross-border unified rules. But the necessity for such rules is proved by recent cases in which a foreign element exists.

Implementation of unified rules in mentioned areas of law into national legislation of those states face many challenges. Insolvency laws as a part of commercial regulations are changing in the region very rapidly. For instance, Ukrainian bankruptcy law has been amended 28 times since its adoption in 1999. It makes this legislation unstable. Procedures for recognition of foreign judgments in these countries are part of procedural laws. Sometimes it creates barriers to enforcing of judgments awarded in bankruptcy cases.

The conflict-of-laws rules in these countries do not solve the most typical problems in cross-border insolvency cases. There is a strict rule (imperative norm) set forth in the laws on private international law (Ukraine) or Civil codes (the Russian Federation) that establishes the only jurisdiction for bankruptcy cases filed against national persons – they must be governed by local courts and according to national legislation.

There is also a cultural problem that still exists in these countries. Ordinary people and what is important – foreign persons operating in these countries – do not believe in the efficiency of the court system which is the heritage of the Soviet era. Usually it takes time, effort, and there is no guarantee that the party with the strongest position will be given a court decision based on the evidence in the case.

In conclusion it should be noted there is a real threat in the former Soviet Union states that corruption can wreck the effective application of the new insolvency law doctrines. Existence of corruption in the courts is a strong belief among businessmen. Even now a businessman might try to settle his financial problems using alternative remedies, and sometimes illegal ones, rather than to go to court.

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[38] See Elena Leanovich, Razvitie mezhdunarodno-pravovogo regulirovania transgranichnykh bankrotstv, 4 Belorusskiy Zhurnal Mezhdunarodnogo Prava i Mezhdunarodnykh Otnosheniy (2004). Available on Internet (in Russian) at http://evolutio.info/index.php?option=com_content&task=view&id=713&Itemid=55 (as of 30 July 2010).

[39] See Note on Internet at the Ministry of Justice of Ukraine: http://www.minjust.gov.ua/0/13626 (as of 30 July 2010).