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Ukrainian Bankruptcy Law

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The notion of bankruptcy, with its connotations of financial ruin and hardship, is a political anathema in Ukraine. A succession of Ukrainian governments has postponed attempts to declare most loss-making enterprises legally insolvent because the State still owned many of them.[1] Ukraine's leaders lacked the will necessary to either sell or close such enterprises. Moreover, these leaders have no comprehensive plan for managing the inevitable social disruption.

A functioning bankruptcy system, however, has become an urgent necessity in the Ukraine for several reasons. Initially, the government must regulate the increasing inter-enterprise debt, which periodically threatens to spiral out of control and wreak havoc on the economy. If the government does not regulate the unduly large volume of unsecured commercial paper circulating in Ukraine, it could trigger a non-payment chain reaction.

In addition, the government must threaten to impose genuine penalties for economic failure as an incentive for enterprises to carry out painful but vital reform.

Moreover, an effective system is needed to balance the economic conditions among businesses. If inefficient enterprises continue to escape the penalty of bankruptcy, they will compete un-

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1. Postponing bankruptcy usually means continuing to subsidize an enterprise from the State budget or refraining from collecting long-overdue taxes, however, sometimes postponement takes a more direct form. For example, a member of the Supreme Arbitrazh Court recently complained publicly about a letter received from the Cabinet of Ministers, demanding the postponement of all pending bankruptcy proceedings against enterprises in the coal mining industry. *See* I. Karpenko, *Zhizn' Posle Bankrotstva* [*Life After Bankruptcy*], BIZNES, Nos. 16-17, at 18 (1997).

fairly with efficient enterprises that pay their debts. This inequality discourages enterprises from maintaining financial discipline, thus, compounding the payments crisis.

Finally, the system will redistribute valuable assets into more efficient entities and away from inefficient entities. Moreover, bankruptcy permits the private sector to purchase debt, and participate in reforming troubled enterprises through domestic and foreign investment.

Recent statistics suggest that the Ukrainian bankruptcy system is slowly beginning to function. In 1992, the same year as the legislative enactment of the basic bankruptcy statute, the Arbitrazh Court adjudicated only 20 bankruptcy matters.[2] In 1996, the figure rose to over 3600.[3] This figure continues to rise steadily.[4] Given the significant rise of bankruptcy cases, both foreign and domestic investors should have a basic understanding of Ukrainian bankruptcy procedures.

The Law on Bankruptcy, as interpreted in an Arbitrazh Court decree and a series of "informational letters," governs Ukrainian bankruptcy proceedings.[5] Various provisions of the Civil Code, corporate law, laws on secured interests and privatization, and other statutes and regulations also figure prominently in bankruptcy proceedings. This article examines the current state of Ukrainian bankruptcy. Part I examines the requirements for initiating the bankruptcy proceedings. Part II describes the bankruptcy proceedings. Part III discusses the sanation process. Part IV describes the liquidation process. Part V suggests that the sanation process must be reformed to: (1) encourage consensus among creditors and debtors; (2) enforce the sanation agreements; and (3) allow the debtor, sanator, and creditors to agree on any lawful sanation method.

I. THE INITIATION OF BANKRUPTCY PROCEEDINGS

A. Bankruptcy Defined

Ukrainian law defines bankruptcy as the inability of a juridical person to timely satisfy creditors' claims or fulfill its obligations

2. *See* Karpenko, *supra* note 1, at 18.

3. Approximately 10% of those cases involved the bankruptcy of state enterprises. *See id.*

4. *See id.*

5. *See* Law on the Arbitrazh Court art. 16(3) (Ukr.).

to the budget due to an insufficiency of liquid assets.[6] A juridical person is defined as "an organization which possesses its own property, can acquire property and non-property rights in its own name, can be subject to obligations, and can be a plaintiff or defendant in court, Arbitrazh court or arbitration."[7] Therefore, branch offices, representative offices, and other corporate departments or divisions that lack the legal status of a juridical person will fall outside the scope of Ukrainian bankruptcy law.[8] A provision for individuals to declare bankruptcy in Ukraine does not exist.

B. Debtors and Creditors

A debtor, creditor, or the procurator may file a bankruptcy petition.[9] A debtor may file a petition for voluntary bankruptcy if he is legally declared insolvent, or if he merely faces the threat of insolvency.[10] The Law on Bankruptcy, as amended in 1994, gives state enterprises an incentive to file for voluntary bankruptcy be-

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6. *See* Law on Bankruptcy art. 1 (Ukr.).

7. Informatsionnye Pis'ma Vysshego Arbitrazhnogo Sudu Ukrainy [Supreme Arbitrazh Court Informational Letter] No. 01-8/928 (Dec. 20, 1995) [hereinafter Supreme Arbitrazh Court Informational Letter No. 01-8/928]; *see also* CIVIL CODE [C. CIV.] art. 23 (Ukr.). Juridical persons are governed by a charter and acquire their status upon being registered by the State. They can include private and state enterprises, organizations and institutions. *See id.* arts. 24, 25, 28. Branch and representative offices do not enjoy independent corporate personality, but merely perform representative functions on behalf of their parent juridical entity. *See id.* art. 31.

8. *See id.; see also* CIV. C. art. 28 (Ukr.).

9. The procurator combines the functions of prosecutor in criminal actions and attorney general in civil proceedings. *See, e.g.*, Law on the Procuracy art. 20 (Ukr.). The procurator may initiate actions "in the interest of state agencies and state enterprises or organizations." ARBITRAZH PROCEDURE CODE [ARBITRATION PROC. C.] art. 2 (Ukr.). The procurator generally does so when he determines that a party is for some reason unable to protect its own interests. *See id.* art. 2, *construed in* KHARKOV, COMMENTARY TO THE ARBITRAZH PROCEDURAL CODE 13 (1995). The court must reject a claim or petition filed by the procurator on behalf of non-state entities. *See* O nekotorykh Voprosakh Praktiki Razresheniya Arbitrazhnymi Sudami Sporov Po Iskam Prokurorv [On Certain Issues Related to the Resolution by Arbitrazh Courts of Disputes Initiated by Procurators] Supreme Arbitrazh Court Presidium Decree No. 02-5/20 (Jan. 17, 1995). Creditors may include the Tax Inspectorate, the State Social Insurance Fund, and other authorized entities. The Supreme Arbitrazh Court has ruled that entities which may qualify as creditors in bankruptcy proceedings are listed in Cabinet of Ministers Decree No. 8-93 (Jan. 21, 1993). *See* O VZYSKANII NE VNESENNYH V SROK NALOGOV I NENALOGOVYH PLATEZHEI [ON THE COLLECTION OF UNTIMELY TAX AND NON-TAX PAYMENTS]; O Nekoforykh Voprosakh Praktiki Primeneniya Zakona Ukrainy "O Bankrotstve." Prezidiuma Vyshego Arbitrazhnogo suda Ukrainy, Cabinet of Ministers Decree No. 481, art. 4 (Jan. 21, 1993) [hereinafter Cabinet of Ministers Decree No. 481].

10. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 6.

fore their financial situation becomes hopeless.[11]

To qualify as a creditor, any physical or juridical person must substantiate its unsecured claim against the debtor's assets in proper documentary form.[12] Parties with a secured interest, in the form of a pledge or mortgage of the debtor's assets, may not file a petition, but must file a claim once proceedings are initiated to have that claim approved.[13] Once a bankruptcy petition is filed, however, there is no exception which would allow secured creditors to forego submitting their claims to the court or bankruptcy trustee. On the contrary, the provisions of Article 21, which require that the claims of secured creditors be satisfied in priority fashion, strongly imply that secured creditors' claims must be submitted and considered by the court or trustee in the same manner as unsecured claims.[14]

An unsecured creditor should carefully consider the consequences of filing an involuntary bankruptcy petition.[15] The mandatory publication for the notice of filing allows *all* creditors to accelerate their claims against the debtor and demand immediate payment in full.[16] A creditor should carefully assess his chances for recovery as the filing of an involuntary bankruptcy petition will almost certainly push a marginal enterprise into insolvency, therefore significantly limiting the ability to recover.

There are, however, advantages in filing a petition for involuntary bankruptcy. The petition prevents a debtor from discriminating against certain creditors or from fraudulently conveying assets to avoid payment. It helps creditors who have exhausted their non–bankruptcy remedies. In addition, by having a bankruptcy

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11. *See* Law on Bankruptcy art. 12 (Ukr.). The nature and effectiveness of the incentives are discussed in Part III.C in the context of the sanation process.

12. *See* Law on Bankruptcy art. 3(1) (Ukr.) .

13. Article 5(1) of the Bankruptcy Law lists the parties eligible to file a petition for involuntary bankruptcy, including a creditor. *See id.* art. 5(1). Article 3 defines "creditor" to mean only an unsecured creditor. *See id.* art. 3. Therefore, secured creditors may not file petitions; presumably, they must instead seek to enforce their security agreement.

14. *See id.* art 21.

15. Only unsecured creditors whose debts are not fully guaranteed by mortgage bonds are eligible to file a petition for involuntary bankruptcy. *See id.* art. 3. Presumably, secured creditors must rely upon their security agreements for recovery. Article 21, however, requires that the claims of secured creditors be satisfied in priority fashion, strongly implying that secured creditors' claims must be submitted and considered by the court or trustee in the same manner as unsecured claims. *See id.* art. 21.

16. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 10.

trustee appointed and an audit performed, it helps the creditors obtain information on the debtor's true financial standing. Finally, it enables creditors to participate in the sanation process.[17]

C. Pre–Filing Procedure

Although Arbitrazh courts have limited jurisdiction to resolve commercial disputes,[18] they enjoy complete jurisdiction over bankruptcy proceedings.[19]

The Arbitrazh Procedural Code governs the procedural issues in bankruptcy proceedings.[20] The Code generally requires parties to engage in pre–Arbitrazh dispute resolution before filing certain actions.[21] Specifically, the plaintiff must send formal notice of its claim to the defendant, attaching documents supporting its position and setting forth its precise claim for damages.[22] After receiving the notice, the defendant must respond by either formally accepting or denying the claim within thirty days.[23] The defendant's response must also contain the necessary supporting documentation.[24] A plaintiff may file suit in court only if the defendant fails to respond to its pre–Arbitrazh notice or if defendant rejects plaintiff's claim.[25] A court will decline jurisdiction, however, if the parties fail to engage in the dispute resolution.[26]

A petition for voluntary bankruptcy is, by definition, exempt from pre–Arbitrazh settlement requirements.[27] In addition, the

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17. *See* Law on Bankruptcy art. 12 (Ukr.). For a discussion of the sanation process, see *supra* Part III.

18. *See* ARBITRAZH PROC. C. arts. 12-17 (Ukr.).

19. *See id.* art. 12(2).

20. *See* Law on Bankruptcy art. 4 (Ukr.).

21. *See* D. Mirgorodsky, *Pred'yavlenie Pretenzii: Iskusstvo, Kotorym Nado Vladet*, [*The Necessary Art of Presenting a Claim*], BIZNES Nos. 5-6 at 19 (1997); D. Mirgorodsky, *Ponyatie I Osnovnye Polozheniya Doarbitrazhnogo Uregulirovaniya Khozyaistvennykh Sporov*, [*The Concept and Fundamental Principles of the Pre-Arbitrazh Resolution of Commercial Disputes*], BIZNES, No. 46 at 5 (1996).

22. *See* ARBITRAZH PROC. C. art. 6 (Ukr.).

23. *See id.* arts. 7-8.

24. *See id.*

25. *See id.* art. 5.

26. *See id.* arts. 5-11.

27. *See id.* art. 5; *see also* O Nekotorykh Voprosakh Praktiki Primeneniya Zakona Ukrainy "O Bankrotstve" (Raz'yasnenie Prezidiuma Vysshego Arbitrazhnogo Suda Ukrainy) [On Certain Questions Regarding the Practice of Applying the Law of Ukraine "Regarding Bankruptcy"] Clarification of Supreme Arbitrazh Court Presidium of April 15, 1993, art. 23 (Apr. 15, 1993) (Ukr.) [hereinafter Clarification of Supreme Arbitrazh Court Presidium].

Supreme Arbitrazh Court has ruled that involuntary bankruptcy petitions are also exempt.[28]

To state a claim, a creditor must attach *prima facie* evidence of the debtor's insolvency to its petition.[29] Such evidence may consist of an unsatisfied writ of execution,[30] or a demand for payment that the debtor has acknowledged.[31] In either case, the creditor must attach a notice from the debtor's bank confirming that the debtor lacks sufficient funds to satisfy the writ or claim.[32]

For a writ of execution, the creditor need not engage in pre–Arbitrazh dispute resolution, although it may have been required to obtain the writ.[33] For an unsatisfied demand for payment, the creditor, by law, has already engaged in pre–Arbitrazh dispute resolution.[34] Thus, while bankruptcy petitions *per se* may be exempt, adherence to pre–Arbitrazh settlement requirements at some stage is mandatory to state a bankruptcy claim.

D. The Bankruptcy Petition

A creditor's petition must include: (1) the name of the Arbitrazh court to which it is addressed; (2) the debtor's requisites; (3) the amount of debt owed to the petitioning creditor; (4) information on the debtor's bank; (5) an unsatisfied writ of execution or demand for payment; (6) confirmation of lack of funds from the debtor's bank; and (7) a list of all documents attached to the petition.[35] There is no requirement, however, that the creditor present information on the debtor's general financial condition.[36]

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28. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 2.

29. *See* O Resheniyakh, Prinyatykh Soveshchaniem Po Voprosam Arbitrazhnoi Praktiki [On Decisions Concerning Arbitrazh Practice Adopted at a Convening of the Arbitrazh Court] Supreme Arbitrazh Court Informational Letter No. 01-8/132 (Apr. 14, 1997) (Ukr.) [hereinafter Supreme Arbitrazh Court Informational Letter No. 01-8/132].

30. Writs of execution are listed in Articles 348 and 349 of the Code of Civil Procedure. The Supreme Arbitrazh Court has ruled only these documents are a proper basis for attempting to collect a debt for purposes of filing a bankruptcy petition. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 6.

31. *See* Supreme Arbitrazh Court Informational Letter No. 01-8/132, *supra* note 29.

32. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 6.

33. *See* ARBITRAZH PROC. C. arts. 5-8 (Ukr.).

34. *See* O Nekotorykh Voprosakh Praktiki Primeneniya Razdela II Arbitrazhnogo Protsessual'nogo Kodeksa Ukrainy [On Certain Questions Related to the Application of Section II of the Arbitrazh Procedural Code] Supreme Arbitrazh Court Presidium Decree No. 02-5/78, art. 16(1) (Nov. 1, 1995) (Ukr.).

35. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 11.

36. *See* Supreme Arbitrazh Court Informational Letter No. 01-8/132, *supra* note 29.

A debtor's petition, on the other hand, must append a list of its debtors and creditors, a balance sheet, and "other information about its financial condition and the status of its assets."[37] Such information may include demands for payment, lawsuits filed against the debtor, and the debtor's responses to either. There is no requirement, however, that the debtor answer the creditor's petition.[38]

E. Filing Procedure

The debtor files a bankruptcy petition with the Arbitrazh court in the district where the debtor resides.[39] A debtor's residence is generally determined by its registered legal address, although the Arbitrazh venue and jurisdiction rules allow for exceptions.[40] Unlike the creditor's petition which requires a nominal fee, a debtor's petition does not require a filing fee.[41]

The court will reject a bankruptcy petition in only four situations: (1) the debtor is not a juridical person; (2) the debtor is not listed in the state corporate register; (3) the debtor is located abroad; or (4) the debtor has already been liquidated or reorganized as evidenced by its exclusion from the state corporate register.[42]

II. PRELIMINARY BANKRUPTCY PROCEEDINGS

A. Hearing and Notice

The court is vested with broad discretion throughout the initial and subsequent hearings.[43] For example, the court may determine the manner in which evidence will be admitted,[44] order an

37. Clarification of Supreme Arbitrazh Court Presidium, *supra* note 27, art. 11. The debtor's balance sheet and other financial information must be confirmed by a licensed auditor. *See* Law on Bankruptcy art. 5(3) (1992) (Ukr.).

38. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 11.

39. *See* ARBITRAZH PROC. C. art. 15 (1992); *see* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 3.

40. *See e.g.*, O Nekotorykh Voprosakh Podvedomstvennosti Khozyaistvennykh Sporov (Raz'yasnenie Prezidiuma Vysshego Arbitrazhnogo Suda Ukrainy) [On Certain Jurisdictional Issues Arising in Connection with Commercial Disputes] Supreme Arbitrazh Court Presidium Decree No. 02-5/62, art. 31 (Feb. 8, 1996) (Ukr.).

41. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 9.

42. *See id.* art. 12.

43. *See id.* art. 15.

44. *See* ARBITRAZH PROC. C. arts. 32-34 (Ukr.).

audit of the debtor's financial records,[45] and consider applications to withdraw the bankruptcy petition.[46]

Bankruptcy proceedings must be initiated within five days after the Arbitrazh court accepts the petition.[47] The court initiates the process by sending out notices to the debtor, the debtor's bank, known creditors, the procurator, and other interested parties.[48] The notice provides an initial hearing date, and may include the court's request for additional information.[49] It may also indicate other steps that the notified parties must take.[50]

An initial hearing, which convenes in the presence of relevant parties,[51] must be held within one month after the notices are served.[52] At the hearing, the court directs the petitioner to publish a notice in the official newspapers of the Cabinet of Ministers or Parliament announcing the bankruptcy proceeding to potential creditors.[53]

Thereafter, the court will hold a series of subsequent hearings to: receive and confirm additional creditors' claims; assess the debtor's financial condition and determine whether a trustee should be appointed; consider applications for stays, injunctions, or other forms of interim relief; and finally to determine whether the debtor is a candidate for sanation or liquidation.[54]

B. Interim Relief

The mere filing of a bankruptcy petition does not give rise to an automatic stay. One of the parties to the bankruptcy proceeding usually file a request for a stay or other interim relief.[55] The

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45. *See* Informatsionnye Pis'ma Vysshego Arbitrazhnogo Suda Ukrainy, Supreme Arbitrazh Court Informational Letter, No. 01-8/106 (Mar. 7, 1996) (Ukr.). Curiously, the Court has ruled that an audit, even at the creditors' expense, may only be performed with the debtor's consent. *See* Supreme Arbitrazh Court Informational Letter No. 01-8/132, *supra* note 29.

46. *See* Law on Bankruptcy art. 6 (Ukr.); *see also* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 18.

47. *See* Law on Bankruptcy art. 7 (Ukr.).

48. *See id.*

49. *See* ARBITRAZH PROC. C. art. 64 (Ukr.).

50. *See id.*

51. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 7.

52. *See* Law on Bankruptcy art. 8 (Ukr.).

53. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 21; *see also* Law on Bankruptcy art. 8 (Ukr.).

54. *See* Law on Bankruptcy art. 8 (Ukr.).

55. *See* ARBITRAZH PROC. C. arts. 66-68 (Ukr.).

relief may be in any form necessary to ensure enforcement of the court's decision, including seizure of the debtor's assets or a stay prohibiting creditors from attempting to collect their debts.[56] Violators of interim relief orders are subject to fines and other punitive measures.[57]

The court may grant relief on its own initiative or at the request of creditors intending to file claims.[58] Interim relief may be granted at any stage of the proceedings, including before an initial hearing convenes.[59] Such relief, however, is subject to interlocutory appeal.[60]

C. Creditors' Claims

Creditors must file their claims with the court within one month after publication of the bankruptcy notice.[61] Although the claims must be filed with "supporting documentation," the law does not specify which documents should be appended.[62] A reasonable assumption is that the same documents required to support a petition — an acknowledged but unpaid demand or an unsatisfied writ of execution — are sufficient.[63]

All creditors are entitled to submit claims for confirmation in a bankruptcy proceeding, even if the debtor is not in arrears.[64] To illustrate this, the Supreme Arbitrazh Court instructs that "banks should file a claim for repayment of a loan even if, under the loan agreement, payment is not yet due."[65]

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56. *See* O Nekotorykh Voprosakh Praktiki Primeneniya Mer Po Obespecheniyu Iska (Raz'yasnenie Prezidiuma Vysshego Arbitrazhnogo Suda Ukrainy [On Certain Questions Relating to the Practice of Granting Interim Relief], Supreme Arbitrazh Court Presidium Decree No. 02-5/611, arts. 5, 6(3) (Aug. 23, 1994) (Ukr.) [hereinafter Supreme Arbitrazh Court Presidium Decree No. 02-5/611].

57. *See* ARBITRAZH PROC. C. art. 119 (Ukr.).

58. *See* Supreme Arbitrazh Court Presidium Decree No. 02-5/611, *supra* note 56, art. 1.

59. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 14.

60. *See* ARBITRAZH PROC. C. arts. 66, 106.

61. *See* Law on Bankruptcy, art. 10 (Ukr.).

62. *See id.*

63. *Cf.* Supreme Arbitrazh Court Informational Letter No. 01-8/132, *supra* note 29.

64. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 10.

65. *See id.*

D. Creditors' Assembly

Where there is more than one creditor and the deadline for filing their claims has passed, the court will issue an order directing the formation of a creditors' assembly.[66] The debtor, trustee, and head of the Liquidation Committee may participate in the assembly.[67]

To handle the daily tasks,[68] the assembly may be required to form a creditors' committee. If more than ten creditors exist, the formation of such a committee is mandatory.[69] Subject to the approval of the court, the assembly may determine the composition of the committee and its scope of authority.[70]

The creditors' assembly votes on two principle issues. First, if the debtor is to undergo sanation, the assembly must approve the terms and conditions.[71] Second, if the debtor is to be liquidated, the assembly must approve all liquidation committee decisions concerning the sale of the debtor's assets.[72] Voting is based on the value of the creditors' claims and requires a two–thirds vote for approval.[73]

E. The Trustee

The court may, in its discretion, appoint a trustee to manage the debtor's assets.[74] The trustee may be the debtor's bank, the State Property Fund (if the debtor is a state enterprise), or another person or entity nominated by the debtor or the creditors.[75] The trustee's functions are limited to matters regarding the "management and control" of the debtor's assets.[76] According to the Supreme Arbitrazh Court, the trustee "does not have the right to interfere in the day–to–day commercial operations of the debtor's management if such activity does not relate to the aliena-

66. *See* Law on Bankruptcy art. 11 (Ukr.).
67. *See id.* art. 3(5). The liquidation process is discussed in Part IV.B.
68. *See* Law on Bankruptcy art. 3(4) (Ukr.).
69. *See id.* arts. 3(4), 11.
70. *See id.* art. 11.
71. *See id.* art. 12.
72. *See id.* art. 20.
73. *See id.* art. 3(3).
74. *See id.* art. 9.
75. *See id.*
76. *See id.*

tion or transfer . . . of property belonging . . . to the debtor."[77] In addition, the trustee is also liable for improperly exercising its authority.[78] If the debtor is to be liquidated, the trustee's authority terminates upon appointment of the liquidation committee.[79]

F. Conclusion of Preliminary Proceedings

The preliminary stage of the proceedings concludes when the court issues an order directing termination or further disposition of the case.[80] The court may terminate the proceedings if no creditors' claims have been filed or approved, or if the debtor fulfills its obligations to the creditors.[81] If the court has received applications from potential sanators, it may direct the parties to negotiate the terms and conditions of sanation. If a sanation application has not been filed, the court may deem the debtor bankrupt and issue an order appointing a liquidation committee.[82]

III. SANATION

The term sanation (*sanatsiia* in Ukrainian) means to heal or cure.[83] Sanation refers to the reorganization of a debtor's financial affairs, with the objective of satisfying the creditors' claims and making the troubled enterprise viable.[84] In this process, a party known as a sanator assumes the financial obligations of the debtor.[85] The threat of liquidation gives the debtor a strong incentive to restructure its debts by accommodating the creditors. Nevertheless, sanation is fundamentally a consensual process. The sanation is a success when the debtor, the sanator, the creditors, and the ministries or other state agencies reach an agreement.

Sanation is divided into several stages. Initially, the debtor

77. Cabinet of Ministers Decree No. 481, *supra* note 9, art. 14.

78. *See* Law on Bankruptcy art. 9 (Ukr.). The trustee's ambiguous authority, coupled with the clear statement of his liability, casts doubt on the court's ability to attract high-quality trustees.

79. *See id.*

80. *See* Law on Bankruptcy arts. 12-13 (Ukr.); *see also* ARBITRAZH PROC. C. arts. 79-80 (Ukr.).

81. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 19.

82. *See id.* art. 13.

83. *See* WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 2008 (1986).

84. *See* Vyacheslav Djun, *Tekhniko-Yuridicheskii Mekhanizm Sanatsii v Proizvodstve Po Delam o Bankrotstve [Technical and Legal Aspects of Sanation in Bankruptcy Proceedings]*, BIZNES, No. 12 (1997) at 15-18. Vyacheslav Djun is a member of the Supreme Arbitrazh Court and one of Ukraine's leading experts on bankruptcy.

85. *See id.* at 16.

and the would–be sanator must agree as to how the debt will be transferred to the would-be sanator.[86] The would-be sanator must then obtain the creditors' consent to the terms of the debt transfer.[87] In most instances, the debtor must then legally restructure its debt according to the terms of the sanation.[88] Finally, the sanator must satisfy the obligations that it has assumed from the debtor.[89] Consequently, sanation negotiations are generally long and complex.[90] The following sections explore the relevant portions of the sanation process.

A. Application

The court may not order parties to enter into sanation agreements.[91] Rather, individuals or juridical persons wishing to participate as sanators must file applications with the court within one month of the bankruptcy notice filing date.[92] The application must clearly state the terms and conditions on which the applicant is prepared to assume the debtor's obligations.[93] This includes the manner in which the applicant proposes to restructure the debtor's financial affairs and the time frame in which the applicant is prepared to meet the debtor's obligations.[94] The court will reject an application that fails to clearly state such terms and conditions.[95]

Where several applications are received, the law requires that the sanator be chosen "on a competitive basis."[96] The law, however, fails to specify the selection criteria.[97] This lack of guidance has allowed the Arbitrazh courts to exercise much discretion in selecting sanators.[98] The courts have, for example, allowed several applicants to join forces where a combined application presented

86. *See id.*
87. *See id.*
88. *See id.*
89. *See id.* at 16.
90. To illustrate, the Arbitration Court handled approximately 3600 bankruptcy last year, with only 28 ending with sanation agreements. *See id.* at 18.
91. *See* Law on Bankruptcy art. 12 (Ukr.); *see also* Djun, *supra* note 84, at 15.
92. *See* Law on Bankruptcy art. 10 (Ukr.).
93. *See* Djun, *supra* note 84, at 15.
94. *See id.*
95. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 20.
96. *See* Law on Bankruptcy art. 12 (Ukr.).
97. *See id.*
98. See Djun, *supra* note 84, at 15.

the best proposal.[99] Moreover, the court may also look to statutes governing tenders unrelated to bankruptcy as models for selecting sanators.[100]

B. Debtor's Authority

The right to negotiate the terms and conditions of sanation on behalf of the debtor depends on the debtor's corporate form, the proposed terms of sanation, and the status of the party filing the bankruptcy petition.[101] For example, where the debtor is a joint stock company, its charter will set forth the respective authority of shareholders, board of directors, and management.[102]

By law, joint stock company's shareholders reserve the right to make certain fundamental decisions.[103] Any sanation agreement involving corporate reorganization, as defined by law, requires shareholder approval.[104] In addition, shareholder approval is required when there are changes in the company's fundamental activities, amendment of its charter, replacement of its board of directors or officers, the closure of subsidiaries or branch offices, and where applicable, execution of certain contracts.[105] In short, parties to the bankruptcy proceedings should examine both the debtor's charter and other relevant law to ensure that the sanation agreement will be binding.

Pursuant to conditions set forth in anti-monopoly regulations,

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99. *See id.* at 17.

100. *See, e.g.*, Polozhenie o Konkursnom Otbore Yuridicheskikh Lits (Sovetnikov) Dlya Organizatsii I Provedeniya Prodazhi Gosudarstevennogo Imushestva Na Koukurentnoi Osnove v Protsesse Privatizatsii [Regulation on the Competitive Selection of Juridical Persons (Advisors) for the Organization and Sale of State Assets on a Competitive Basis through Privatization] (1997) (Ukr.), *approved by* State Property Fund Order No. 186; O Podgotovke, Organizatsii I Provedenii Konkursov Po Prodazhe Paketov Aktsii, Prinadlezhashii Gosudarstvu [Regulation on the Preparation, Organization and Conduct of Tenders for Government Shares in Open Joint Stock Companies] (1997) (Ukr.), *approved by* State Property Fund Order No. 46; Pro Zatverdzhennya Polozhennya Pro Poryadok Organizatsii Ta Provedennya Mizhnarodnikh Torgiv (Tenderiv) v Ukraini [Regulation on the Procedure for Organizing and Conducting International Tenders in Ukraine] (1993) (Ukr.), *approved by* Cabinet of Ministers Decree No. 871.

101. *See* Djun, *supra* note 84, at 16.

102. *See generally* Law on Business Associations arts. 41, 42, 47, 48 (Ukr.).

103. *See id.* art. 41.

104. *See id.* art. 19. Ukrainian law defines "reorganization" as the transfer of all rights and obligations of a corporate entity to a successor corporation. *See id.* In the sanation context, therefore, it is quite possible to negotiate a restructuring which does not entail reorganization. *See id.*

105. *See id.* art. 41.

the terms of sanation may also require approval of the Anti–Monopoly Committee.[106] For example, approval is required for the acquisition of voting shares above statutorily specified limits and for assets acquired through merger or acquisition.[107]

C. Authority in State Enterprises

Where the debtor is a state enterprise, its management may have the authority to negotiate the terms of sanation.[108] In most cases, however, the authority rests with the State Property Fund.[109] Depending on the legal structure of the enterprise and the proposed terms of sanation, approval may also be required from the enterprise's branch ministry and/or the Anti–Monopoly Committee.[110] The state enterprise's charter and collective bargaining agreement should also be examined to determine whether consent by trade union, labor collective, or any other entity is necessary to ratify the sanation agreement.[111] Consequently, this division of authority may complicate sanation negotiation with a debtor state enterprise.

In contrast, where a state enterprise files a petition for voluntary bankruptcy, the debtor has the right to select the terms of sanation.[112] Presumably, approvals from the State Property Fund and branch ministry are not required pursuant to this provision.[113]

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106. *See* Polozhenie o Poryadke Rassmotreniya Zayavlenii na Poluchenie Soglasiya Organov Antimonopol'nogo Komiteta Ukrainy na Sozdanie, Reorganizatsiyu (Sliyanie, Prisoedinenie), Priobretenie Aktivov (Tselostnykh Imushestvennykh Kompleksov) ili dolei (Aktsii, Paev), Likvidatsiyu Khozyaistvuyushikh Sub'ektov (O Kontrole Za Ekonomicheskoi Kontsentratsiei [Regulation on the Procedure for Examining Applications for Anti-Monopoly Committee Consent to the Creation, Reorganization (Merger, Acquisition), Purchase of Assets or Shares, or Liquidation of Commercial Entities (On the Regulation of Economic Concentration)] (1995) (Ukr.), *approved by* Anti-Monopoly Committee Decree No. 15-r.

107. *See id.* The procedure for obtaining consent to an acquisition is elaborate and, thus, is best treated in a separate article.

108. *See* Law on Bankruptcy, *supra* note 7, art. 12.

109. *See, e.g.*, Law on the Privatization of Ukrainian State Enterprise Assets art. 7 (Ukr.).

110. *See, e.g.*, Dekret Kabinetu Ministriv Ukraini Pro Upravlinnya Mainom, Sho E I Zagal'noderzhavnii Vlastnost [On the Management of Assets Classified as National Property] Cabinet of Ministers Decree No. 8-92 (Dec. 15, 1992) (Ukr.); *see also* Law on Bankruptcy art. 12 (Ukr.).

111. Regardless of the terms of the parties' collective bargaining agreement, Article 43 of the Labor Code requires management to obtain trade union consent before laying off employees as the result of a reduction-in-force. *See* Labor Code art. 43 (Ukr.).

112. See Law on Bankruptcy art. 12 (Ukr.).

113. *See* Djun, *supra* note 84, at 16.

A reasonable interpretation of the law, however, does not obviate the need for Anti–Monopoly Committee consent where it is otherwise required by anti–monopoly legislation.[114]

The law permitting sanation by state enterprises is designed merely to give state enterprises an incentive to restructure their debts before their financial condition becomes hopeless.[115] Where the debtor is a state enterprise, a provision provides that its labor collective shall have the right to lease the enterprise, provided that the collective assumes the debts of the debtor enterprise.[116] Thus, if their sanation terms are comparable to those proposed by other would–be sanators, the law appears to grant the collective a preferential right to lease the enterprise.[117]

D. The Sanation Agreement

The sanation agreement sets forth the terms governing the assignment of the debtor's obligations to the sanator.[118] The Ukrainian Civil Code requires the creditors' consent to any such assignment of debt.[119] In bankruptcy proceedings, this consent may be manifested in two ways.[120] First, the creditors, or the creditors' assembly or committee, may agree to become a party to the sanation agreement.[121] Second, the agreement may be recorded in a creditors' assembly or committee protocol.[122]

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114. *See id.* at 17.

115. *See id.* at 15.

116. *See id.*; *see also* Law on the Lease of the Assets of State Enterprises and Organizations (Ukr.) (concerning the leasing of enterprises). Under Ukrainian law, labor collectives are not juridical persons and do not have assets of their own. Pursuant to the Law on the Lease of Assets of State Enterprises and Organizations, they may establish joint stock companies or other business entities for the purpose of serving as a sanator. *See* Djun, *supra* note 84, at 17.

117. *See* Law on Property art. 37(3) (Ukr.); *but see* Djun, *supra* note 84, at 17. It is unclear whether the terms of sanation should be judged from the debtor, creditor, or another party's perspective. Nevertheless, the labor collective's preferential right has more political than practical significance. *See* Djun, *supra* note 84, at 17.

118. *See* Djun, *supra* note 84, at 16.

119. *See* CIV. C. art. 201 (Ukr.).

120. *See* Djun, *supra* note 85, at 16 (discussing cases illustrating both approaches). In the Ukraine Cases are considered confidential and are not published. Justice Djun probably discussed these cases because he presided over such cases as a member of the Supreme Arbitrazh Court.

121. *See id.*

122. *See id.* The agreement will be recorded in the creditors' assembly or committee protocol only if voted upon and passed by creditors whose property claims constitute no less than two thirds of the total number of claims. *See* Law on Bankruptcy art. 3(5) (Ukr.).

Upon assuming the debt, the sanator may assert any and all claims or defenses arising out of any original debtor–creditor agreement.[123] As a condition for approving the terms of sanation, the creditors may secure a waiver of the claims and defenses from the sanator.[124] If the original debt was secured by a guarantee or suretyship, such security terminates upon transfer of the debt, unless the guarantor or surety expressly agrees to extend it to the sanator.[125]

Ukrainian law remains ambiguous on the key issue of whether a sanator may purchase the debt at a discount. One authoritative commentator suggests that the sanator may not do so.[126] The basis for that interpretation, however, is not persuasive.[127] Where all parties have agreed to discount the debt, there is no compelling reason to question or prohibit their accord. Ukrainian law does not prohibit the purchase or sale of discounted debt.

On the contrary, the law generally permits investments to be valued by the parties' agreement with few restrictions.[128] For example, the law expressly permits the purchase of shares in open joint stock companies at market prices that the buyer and seller have agreed upon.[129] Moreover, Ukraine already enjoys active discount markets for government and commercial paper.[130] Accordingly, that restrictions on discounted debt in the context of bankruptcy presumably do not exist under Ukrainian law.

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123. *See* CIV. C. art. 201 (Ukr.).

124. *See id.*

125. *See* A. Lamonova & A. Efimov, *Ustupka Trebovaniya I Perevod Dolga (Pravovaya Osnora, Raznovidnosti i Otrazhenie v Bukhgalterskom Uchete)* [*The Assignment of Claims and Debt*], BIZNES, No. 5 (1997) at 27.

126. *See* Djun, *supra* note 84, at 18. Justice Djun writes that the "forgiveness of even a part of the debt by creditors is not provided for" based on the "intent" of Articles 10 and 12 of the Law on Bankruptcy. *See id.* A straightforward reading of Articles 10 and 12, however, reveals nothing either prohibiting or permitting the forgiveness of debt. Under general principles of Ukrainian jurisprudence, unless an activity is expressly prohibited, it is permitted. *See* Law on Bankruptcy arts. 10, 12 (Ukr.).

127. *See id.*

128. *See* Law on Business Associations, *supra* note 103, art. 13; *see also* Law on the Regime for Foreign Investment in Ukraine arts. 2, 5 (1996) (Ukr.) (requiring independent confirmation of the value of contributions in the form of intellectual property or the assignment of monetary claims, but otherwise leaves the parties free to negotiate valuation).

129. *See* Law on Business Associations art. 28 (Ukr.).

130. *See, e.g.*, Patricia Bartholomew, *Guide to Ukrainian Fixed Income Market*, WOOD COMMERZ, June 1997, at 8 (describing the volume and dynamics of the Ukrainian treasury bill market in 1996).

E. Restructuring

In some cases, sanation requires that the debtor be legally restructured.[131] Extensive restructuring may not be necessary, however, where the debtor is already organized as a joint stock or limited liability company.[132] In such a case, the sanator may acquire shares or interest in the debtor, either immediately upon assuming the debt or subsequently during the repayment term.[133] Even then, however, amendments to the company's foundation documents may be required.

Ukrainian joint stock companies may either be open or closed.[134] Where the debtor is a closed joint stock company or a limited liability company, the sanator should take measures to ensure that existing participants or shareholders waive their preemptive rights before it acquires interest.[135] The sanator should also make certain that any shares it acquires, have already been paid for, as the transfer of assessable shares is prohibited.[136] Sanators should also be aware that under certain conditions, Ukrainian law permits other participants in a limited liability company to exclude an interest-holder.[137]

Ukrainian law places a number of restrictions on a corporate debtor's restructuring process.[138] The law prohibits a joint stock company from issuing new shares to cover its debts;[139] it strictly regulates the procedure for increasing or decreasing the size of a company's charter fund;[140] limits the ability of a company to purchase its own shares;[141] and restricts the amount of preferred shares or bonds a company may issue.[142] In each case, the sanator should consult the debtor's charter for additional restrictions on the issuance or transfer of shares. Any necessary amendments to the charter must be properly registered to become effective before

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131. *See* Djun, *supra* note 85, at 16.

132. *See generally* Law on Business Associations art. 28 (Ukr.).

133. *See id.*

134. *See id.* art. 25.

135. *See id.* art. 53.

136. *See id.* arts. 30, 53.

137. *See id.* art. 64. Ukrainian bankruptcy law does not clearly define the conditions where other parties may exclude an interest-holder. *See id.*

138. *See generally* Law on Business Associations, *supra* note 103.

139. *See id.* art. 34.

140. *See id.* arts. 16, 38, 39, 56.

141. *See id.* art. 32.

142. *See id.* art. 7.

such transfer takes place.[143]

A state enterprise that has not yet issued shares must be incorporated by re-registering as an open joint stock company.[144] Privatization legislation governs the process for incorporation and share distribution.[145] On the other hand, state enterprises leased by their labor collectives must be restructured on a case–by–case basis.[146]

F. The Sanation Order

The court must approve the terms of sanation, as set forth in the agreement between the debtor and sanator.[147] The court issues an approval order when an agreement is reached.[148] The order terminates the bankruptcy proceedings because the creditors' claims are deemed satisfied.[149] Furthermore, because the sanation order terminates the court's jurisdiction over the matter, a party injured by a violation of the sanation agreement must file a separate breach of contract or pursue civil law remedies in another action.[150]

IV. LIQUIDATION

A. The Liquidation Order

If the debtor does not file for sanation, or if the parties cannot reach an agreement, the court will issue an order declaring the debtor bankrupt and appoint a Liquidation Committee.[151] A copy of the bankruptcy order must be served on various parties, including the debtor's bank, the National Bank of Ukraine, the State Employment Service, any unions representing the debtor's em-

143. *See id.* art. 6.

144. *See, e.g.*, Procedures of Incorporation in the Process of Privatization of State-owned, Rented Enterprises and Enterprises under Mixed Form of Ownership into Public Joint Stock Companies, *approved by* Cabinet of Ministers Decree No. 1099 (Sept. 11, 1996) (Ukr.); On the Corporatization of Enterprises, Presidential Decree No. 210 (June 15, 1993) (Ukr.) [hereinafter On the Corporatization of Enterprises].

145. *See* On the Corporatization of Enterprises, *supra* note 145.

146. *See id.; see also* Djun, *supra* note 84, at 16-17.

147. *See* Law on Bankruptcy art. 12 (Ukr.); *see also* Djun, *supra* note 84, at 18; Clarification of Supreme Arbitrazh Court Presidium, *supra* note 27, art. 23.

148. *See* Djun, *supra* note 84, at 18.

149. *See* Law on Bankruptcy art. 12 (Ukr.).

150. *See* Djun, *supra* note 84, at 18.

151. *See* Law on Bankruptcy art. 13 (Ukr.).

ployees, and the procurator, if evidence of fraud exists.[152] Issuance of a bankruptcy order results in an automatic stay.[153] Pursuant to the order, the debtor's business activity ceases, its obligations are fixed, the payments of all interest and penalties are terminated, and all rights to manage or dispose of the debtor's assets are transferred to the Liquidation Committee.[154]

B. The Liquidation Committee

The Liquidation Committee consists of representatives from the creditors' assembly, banks, government financial bodies, and if the debtor is a state enterprise, the State Property Fund.[155] The participation of these parties is mandatory, and failure to participate will result in a punishable fine.[156]

If a trustee of the debtor's property was previously appointed, its powers terminate with the appointment of the Liquidation Committee.[157] The Committee assumes the trustee's role[158] and is liable if it fails to properly perform its functions.[159] The debtor, individual creditors, or the creditors' assembly or committee, may seek judicial review of Liquidation Committee decisions at any time.[160]

C. Liquidation Committee Functions

The Liquidation Committee satisfies the creditors' claims in order of statutory priority. This process may be categorized as follows.

1. Notice

Within three days of its appointment, the Committee must publish additional notice of the debtor's bankruptcy, inviting creditors to make further claims.[161] The notice must set forth the pro-

152. *See id.* art. 14.
153. *See id.* art. 15.
154. *See id.*
155. *See id.* art. 13.
156. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 24.
157. *See* Law on Bankruptcy art. 9 (Ukr.).
158. *See id.* art. 16.
159. *See id.* art. 9. The debtor and individual creditors' assembly or committee may, at any time, seek judicial review of committee decisions. *See* Cabinet of Ministers Decree No. 481, *supra* note 9, art. 25.
160. *See* Clarification of Supreme Arbitrazh Court Presidium, *supra* note 27, arts. 25-6.
161. *See* Law on Business Associations art. 20 (Ukr.).

cedure and deadline for making claims.[162] Although its decision may be appealed to the court,[163] the power to accept or reject claims rests with the Committee.[164]

2. Securing the Bankruptcy Estate

The Committee must take steps to collect all debts owed to the debtor[165] and secure the bankruptcy estate.[166] The bankruptcy estate includes all property owned by the debtor,[167] as well as property that the debtor exercises "complete economic management" over similar quasi–ownership rights.[168] The law does not clarify how to treat the debtor's divided or contingent interests, or assets in which the debtor has lease or other use rights, for bankruptcy purposes.[169] Thus, the court decides, on a case–by–case basis, the issue of whether to include such interests in the bankruptcy estate.[170]

3. Seizing Other Property

In the interest of satisfying creditors' claims, the Liquidation Committee may seize assets owned or otherwise controlled by the debtor, and "other property" in those instances permitted by law.[171] The general and unclear reference to "other property" may be intended to assist the Committee in challenging fraudulent conveyances.

The Arbitrazh court may set aside certain transactions requested by the trustee, the Liquidation Committee, the creditors,

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162. *See* Law on Enterprises in Ukraine art. 35 (Ukr.).

163. *See* Law on Bankruptcy art. 16 (Ukr.).

164. *See* Law on Enterprises in Ukraine art. 36(3) (Ukr.).

165. *See* Law on Business Associations art. 20 (Ukr.); *see also* Law on Enterprises in Ukraine art. 35 (Ukr.).

166. *See id.*

167. *See* Informatsionnye Pis'ma Vysshego Arbitrazhnogo Suda Ukrainy, Supreme Arbitrazh Court Informational Letter, No. 01-8/847 (Nov. 22, 1994) (Ukr.).

168. *See* Law on Property arts. 37, 39 (Ukr.) (describing the quasi-ownership rights of complete economic management and operative administration); *see also* HRO, Real Estate Transactions in Ukraine (1996) at 2-3 (unpublished manuscript on file with author).

169. *See* Law on Business Associations art. 21 (Ukr.) (providing that upon liquidation, "property, the use of which has been transferred to a company by [shareholders], shall be returned in-kind without compensation.").

170. Ukrainian law contains a list of individuals' property exempt from seizure, but no assets of juridical persons are exempt from bankruptcy proceedings. *See* CIV. C. art. 379, app. 1 (Ukr.).

171. *See* Law on Bankruptcy art. 18 (Ukr.).

or the procurator.[172] The court may invalidate any sale of the debtor's assets which occurs within three months of the bankruptcy petition date, if the sale was effected on behalf of any interested party on the part of the debtor.[173] Although the law does not define the term "interested party," the clear import of this language authorizes the court to set aside conveyances detrimental to the creditors' interests, with or without evidence of improper motive.[174]

The court may also set aside any transaction, consummated within one year prior to the commencement of bankruptcy proceedings, whereby the debtor either sold assets or assumed debt. At least one of the following conditions, however, must be met: (1) the purpose of the transaction was to conceal the debtor's assets to avoid payment; (2) assets were sold for substantially less than their actual value; or (3) the debtor, at the time the transaction was concluded, was either actually insolvent or became insolvent as a result of the transaction.[175]

Although direct evidence of fraudulent motive is not required, meeting any of the three conditions strongly implies the debtor's intent to deceive its creditors. Transactions may be set aside as part of the bankruptcy proceeding without the need to file a separate action.[176] Consequently, the pre–Arbitrazh dispute resolution process will not apply.[177]

4. Valuing Debtor's Assets

Assets that the Committee seizes must be valued in accordance to Ukrainian privatization law.[178] This law governs the valuation of assets subject to privatization and the methods used to value specific categories of assets, such as intangible assets, leased

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172. *See id.* art. 15.

173. *See id.*

174. The power to set aside transactions concluded within one year of bankruptcy requires at a minimum, indirect evidence of improper motive. Lack of such evidence may deem the motive irrelevant with respect to transactions concluded within three months of bankruptcy.

175. *See* O Nekotorykh Voprosakh Praktiki Primeneniya Razdela II Arbtrazhnogo Protsessual'nogo Kodeksa Ukrainy, Supreme Arbitrazh Court Presidium Decree No. 02-5/781, art. 16(3) (Nov. 1, 1995) (Ukr.).

176. *See* Law on Bankruptcy art. 15 (Ukr.).

177. *See* Supreme Arbitrazh Court Presidium Decree No. 02-5/781, *supra* note 175, art. 16.3.

178. *See* Law on Bankruptcy art. 19 (Ukr.).

assets, and assets purchased by foreign investors.[179] The derived valuations form the starting price for the debtor's assets in an auction.[180] If the Committee receives more than one purchase offer, the auction bidding must start at this price.[181] Bankruptcy law, however, does not mandate the valuation procedure to be used for debtor's assets not seized.[182]

5. Selling Debtor's Assets

The Committee must organize a creditor-approved sale of the debtor's assets.[183] In adhering to the requirements for the sale of State assets through the privatization process,[184] the Committee must arrange for public notice of the terms and conditions of the sale or auction.[185]

6. Satisfying Creditor's Claims

The Committee must apply proceeds from the sale or auction to satisfy the claims of creditors in the following order of statutory priority:[186]

(1) expenses related to the conduct of bankruptcy proceedings, the work of the Liquidation Committee, and the claims of secured creditors;[187]

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179. *See, e.g.*, Pro Zatverdzhennya Metodiki Otsinki Vartosti Maina Nid Chas Privatizatsii [Methodology for the Valuation of Property During Privatization], *approved by* Cabinet of Ministers Decree No. 961 (Aug. 15, 1996) (Ukr); *see also* Procedure for the Expert Valuation of Intangible Assets, *approved by* State Property Fund Order No. 969/97 (July 27, 1995) (Ukr.)

180. *See* Law on Bankruptcy art. 19 (Ukr.).

181. *See id.* art. 20.

182. *See id.* art. 19.

183. *See id.* art. 20.

184. *See id.*

185. *See id.*

186. *See id.* art. 21.

187. *See, e.g.*, Law of Ukraine on Privatization of Small Government-Run Enterprises (Small-scale Privatization) art. 17 (1996). *Compare* Article 36(1) of the Law on Enterprises in Ukraine, which provides that obligations to the budget and expenses for restoration of damage to the environment caused by the enterprise being liquidated shall be satisfied in first order of priority. *See* Law on Enterprises in Ukraine art. 36(1) (Ukr.). Under general principles of Ukrainian jurisprudence, the Law on Bankruptcy takes precedence, since it is more specific and was adopted after the Law on Enterprises. The law does not expressly provide for priority between secured creditors and bankruptcy expenses. One view is that they will be satisfied proportionately. *See* Law on Bankruptcy art. 21(8) (Ukr.). Another possible view is that they will be satisfied in the order in which they are listed: bankruptcy expenses, liquidation committee expenses, and secured creditors.

(2) The debtor's employees' claims for unpaid wages and other compensation, except for sums paid by employees into the debtor's charter capital, or compensation for employee-held stock in the debtor;[188]

(3) taxes, other payments to the budget, contributions to the State Insurance Fund, and other social welfare programs;

(4) unsecured creditors' claims;

(5) employee contributions to the debtor's charter fund and compensation for employee-held stock in the debtor; and

(6) all other claims.

Within this order of priority, the Committee must satisfy claims in the order in which they are received and approved.[189] If the debtor's assets cannot satisfy all claims within a given category, such claims must be satisfied in proportion to the amount owed to each creditor.[190] Remaining claims which cannot be satisfied, because the debtor's assets are insufficient, are deemed extinguished.[191]

The court will return any assets remaining after the satisfaction of all claims to the debtor's owner. If the debtor is a State enterprise, however, any funds remaining after the satisfaction of all claims must be transferred to the appropriate State privatization fund.[192]

7. Liquidation Balance

Upon completing its work, the Liquidation Committee must prepare a liquidation balance and secure judicial approval.[193] The creditors may voice their opinion concerning the liquidation balance, but final approval rests with the court.[194] The liquidation balance must be approved in accordance with Ukrainian account-

188. *See* Law on Bankruptcy art. 21 (Ukr.). Under the Labor Code, redundant employees are entitled to a maximum of three months' wages from their employer. *See* Labor Code arts. 40(1), 49(3) (Ukr.). They are also entitled to State unemployment benefits. *See* Law on Employment art. 26 (Ukr.).

189. *See* Law on Bankruptcy art. 21(7) (Ukr.).

190. *See id.* art. 21(8).

191. *See id.* art. 21(9). *Compare* Article 36(2) of the Law on Enterprises in Ukraine, which permits the liquidation committee to satisfy untimely claims after all other claims have been satisfied. *See* Law on Enterprises in Ukraine art. 36(2) (Ukr.).

192. *See* Law on Bankruptcy art. 21(11) (Ukr.).

193. *See id.* art. 22; *see also* Law on Business Associations art. 20 (Ukr.); *see also* Law on Enterprise in Ukraine art. 35(2) (Ukr.).

194. *See* Law on Bankruptcy art. 22 (Ukr.).

ing rules, which differ from GAAP and from International Accounting Standards.[195]

D. The Termination of Bankruptcy Proceedings

If no assets remain after the satisfaction of all claims, the court issues an order liquidating the debtor.[196] If assets remain, the court may issue an order discharging the debts and permit the debtor to continue doing business.[197] The debtor may be permitted to continue doing business only if the debtor's remaining assets legally allow it to do so, or under special circumstances as set forth in an application by the debtor's owner.[198]

V. CONCLUSION

The sharp rise in the number of proceedings over the past four years suggests that the bankruptcy system is slowly beginning to function. Experience has shown that the Law on Bankruptcy is a beneficial legislative tool. The small percentage of bankruptcies which result in sanation, however, suggests that the law fails to effectively rehabilitate distressed enterprises. Therefore, the sanation process must be reformed.

The sanation procedure must be revised to encourage consensus among creditors and debtors to ensure enforceability, assuming there is an agreement on the terms of sanation. To that end, the sanation process must be streamlined to clarify the debtor's authority, especially State enterprises, to negotiate binding sanation terms. The need for ministerial, Anti-Monopoly Committee, and other third-party approval must also be sharply reduced.

In addition, the enforceability of sanation agreements must be improved. First, the creditor and debtor's terms should be incorporated into the court's sanation order. Second, the court should be granted continuing jurisdiction to resolve sanation claims. The court's familiarity with the sanation agreement will allow it to re-

195. *See* Ukazaniya Po Organizatsii Bukhgalterskogo Ucheta v Ukraine [Regulation on the Organization of Accounting and Financial Reporting in Ukraine], *approved by* Cabinet of Ministers Decree No. 250 (Apr. 3, 1993) (Ukr.); *see also* A. Tverdomed, *Zazerkal'e Ukrainskogo Bukhgalterskogo Ucheta* [*Behind the Mirror of Ukrainian Financial Reporting*], FIN. UKR. No. 9, (Apr. 1, 1997) at 3-11 (discussing important differences between Ukrainian and international accounting standards).

196. *See* Law on Bankruptcy art. 22 (Ukr.).

197. *See id.*

198. *See id.*

view alleged violations expeditiously, and thereby protect the sanation process. Finally, the court's order must provide for remedies beyond those available for breach of an ordinary contract.

Finally, the law should permit the debtor, the sanator, and the creditors to agree on any lawful sanation method, including the purchase or conversion of discounted debt. The parties' interests are protected because the agreement is consensual. The State's interests are protected because the court must approve the parties' agreement. Furthermore, State interests are served by encouraging efforts to restructure unprofitable enterprises.