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Alexander Biryukov

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# UKRAINIAN BANKRUPTCY LAW IN THE CONTEXT OF REGIONAL AND INTERNATIONAL DEVELOPMENTS

ALEXANDER BIRYUKOV\*

## FOREWORD

In every human life, there are very special events that happen which change his or her life and sometimes change it dramatically. I am among those with whom such a most remarkable event in my life happened. I am grateful to my fate which brought me in 2001 to Golden Gate University School of Law where I had the privilege to meet Dr. Sompong Sucharitkul. I need to confess that by inviting me as one of the Fulbright Scholars to participate at the Eleventh Annual Fulbright Symposium on International Legal Problems / Tenth Regional Meeting of the American Society of International Law, Dr. Sompong Sucharitkul practically opened for me a promising new road in my life as a scholar. The most

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\* Associate Professor at Kyiv Taras Shevchenko National University (Ukraine) is currently working on a dissertation on Cross-Border Insolvency to acquire a Full-Doctorate / Professorship Degree. He received an LL.M. (High Honors) from Moscow People's Friendship University named after Patrice Lumumba in 1984, and a Doctorate in Law (Kandidat Nauk) from Kyiv National University in 1999. While at the Fulbright Scholar Program at New York University School of Law, he spoke at the Eleventh Annual Fulbright Symposium of International Legal Problems on March 30, 2001. Dr. Biryukov is the author of more than 100 publications in scholarly journals and newspapers, including a monograph, 2 books, and chapters in the Ukrainian Law Encyclopaedia, collective monographs, and comments to one of the chapters of the Civil Code of Ukraine. He also co-authored of LAW AND LEGAL SYSTEM OF UKRAINE, JURIS INTERNATIONAL Inc. (2005) and RESEARCH GUIDE TO UKRAINIAN LAW, NYU GLOBALEX JOURNAL (March, 2006). The author wishes to thank Dr. Christian N. Okeke, Professor of Law and Co-Director of the Center for Advanced International Legal Studies at Golden Gate University School of Law, who graduated from the University where the author of this article teaches, for encouraging him to write this article as a part of his participation in the project initiated in honor of Distinguished Professor of International and Comparative Law Dr. Sompong Sucharitkul. The author is also grateful to Albert Carrera for the help with English in this work.

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unbelievable thing is that, although my stay was short, I remember every minute of those discussions I had with Dr. Sompong Sucharitkul. Now, I have a lot to be thankful for having known Dr. Sompong Sucharitkul – I became more international and feel myself a part of the international law community, where Dr. Sompong Sucharitkul is a leader. I am happy and proud of having, with the help of my friend, Professor Dr. Christian Okeke, the privilege to participate in honoring of the Distinguished Professor of International and Comparative Law Dr. Sompong Sucharitkul.

### SUMMARY

During the period of Soviet rule there was no need for private law remedies to regulate economic relations, particular in the area of bankruptcy. After the Soviet Union's collapse, former republics and newly independent states started developing market-oriented laws to support democratization process. Due to Ukraine's lack of any bankruptcy legislation during the last century, 1992 marked the starting point of bankruptcy law formation in the country. The formation of bankruptcy laws in Ukraine and other countries in the region may be traced to two stages of development: "first wave" laws passed in 1990 through 1993, and "second wave" laws that were adopted after 1996, mostly with the purpose of replacing the preceding bankruptcy laws. If the main goal of first wave bankruptcy laws was to change the Soviet system of regulation based on planned economy principles, the second wave bankruptcy laws absorbed Western doctrines addressing the importance of debtors' solvency restoration. Moreover, a third wave of bankruptcy law developments in this region's countries has already begun. Ukraine is one of the first countries of the former Soviet Union that has started the process of introducing cross-border insolvency rules into the body of Bankruptcy Law through developing relevant amendments.

### I. INTRODUCTION

During the period of Soviet rule, there was no need for private law remedies to regulate economic relations, particularly in the area of bankruptcy. Under the planned economy of the Soviet Union, market instruments were not required to solve the problems that arose between economic players. Rather, the Soviet Government provided financial assistance or granted direct awards to state-owned enterprises when they faced financial difficulties. The other device which was and is still in use in some countries in the region is debts forgiveness—when the State

provides debt-relief to chosen businesses or artificially supporting some sectors of economy, such as agriculture.<sup>1</sup>

After the collapse of the Soviet Union<sup>2</sup>, the former republics and newly independent states started developing market-oriented laws to support the democratization process. Bankruptcy legislation became an important part of national legislation in post-communist countries in the effort to establish fair competition among market players. Now, having become an important factor in the transition of their young economies, the development of bankruptcy law is a *sui generis* indicator of market transformation.

Since modern Ukraine<sup>3</sup> lacked any jurisprudence in the regulation of insolvency relations for the last century<sup>4</sup>, 1992 marks the starting point of the establishment of bankruptcy law in the country.

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1. Vyacheslav Dzhun, INSTYTUT NESPROMOZHNOSTI: SVITOVYI DOSVID ROSVYTKU I OSOBLYVOSTI STANOVLENNYA V UKRAINI 384 (Yuridicheskaya Praktika Publishing House 2006).

2. The Soviet Union was an artificial formation consisting of different political structures, economic levels and cultural peculiarities. It was initially founded in November 1917 following the October Revolution which established the Russian Soviet Federal Socialist Republic (the R.S.F.S.R.). However, the R.S.F.S.R. in 1922 merged with the Ukrainian Soviet Socialist Republic, the Belorussian Soviet Socialist Republic, and the Caucasus Soviet Federal Socialist Republic to form the Union of the Soviet Socialist Republics (the U.S.S.R. or the Soviet Union). A Constitution of newly established federation was adopted in 1924. Uzbekistan was integrated into the U.S.S.R. as a separate republic in 1925; Tajikistan in 1929; and Kazakhstan and Kyrgyzstan in 1936. In 1939 Azerbaijan, Armenia and Georgia were derived from the Caucasus Soviet Federal Socialist Republic. Under the secret Molotov-Ribbentrop Pact, concluded between Germany and the U.S.S.R. in 1939, the Soviet Union received some territories belonging to Poland and Romania (Bessarabia), which became a part of Ukraine and Belarus. Moldova, Estonia, Latvia and Lithuania became a part of the Soviet Union in 1940 as a result of the aforementioned agreement. Notwithstanding all efforts, the Soviet Union could not capture Finland (neither in 1939 when the Soviet Union launched a war against this country, nor later after World War II). Currently, the Russian Federation is trying to revive the Soviet Union through exploiting historical and cultural ties with Belarus and Ukraine, but the way it is seeking to do so is far from fair and democratic. The main arguments that Russia uses are threatening and intimidating.

3. Ukraine is one of the largest countries in Europe, comparable to France in territory and population. The geographical center of Europe is situated in Western part of Ukraine. It is also worth mentioning that Ukraine was one of the founders of the United Nations. Currently, Ukraine, as well as other countries of the former Soviet Union, is in the process of transforming from a command economy to a free-market economy and true democracy.

4. It is true except a short period of the early stages of the young Soviet State existence when so called 'new economic policy' was proclaimed to encourage private initiative in the early 1920s. It is important to note that at that time only private companies could be declared bankrupts. Very shortly after 'industrialization' and 'collectivization' economic policies were realized, the command economy became a ruling regime in the Soviet Union.

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II. THE INSTITUTION OF BANKRUPTCY LAWS IN UKRAINE  
AND OTHER COUNTRIES IN THE REGION IN EARLY 1990S

A. THE EARLY LEGISLATIVE DEVELOPMENTS

Observers of the early legislative work in Ukraine have characterized it as “quite chaotic.”<sup>5</sup> Since Ukraine declared independence, hundreds of new laws have been enacted by the Verkhovna Rada (the Parliament of Ukraine) without any program of legislative work for the transitional period.<sup>6</sup>

The process of adopting bankruptcy laws was relatively similar in all the countries of the former Soviet Union, with the possible exception of the Baltic republics. The uniformity in the bankruptcy laws was due to a draft of bankruptcy laws which were developed in 1990, shortly before the Soviet Union dissolved. In fact, it was one of the last law drafts submitted to the Supreme Soviet of the U.S.S.R. Although that draft inherited the Soviet type of economy, it became the basis for the development of new legislation in the newly independent states.

The adoption of bankruptcy legislation within the countries of the region may be divided into two stages: “first wave” laws passed in Belarus, Estonia, Tajikistan, Turkmenistan, Ukraine, and some others countries throughout 1990 to 1993, and “second wave” laws were adopted after 1996, mostly with the purpose of replacing the early enacted bankruptcy laws.<sup>7</sup> The majority of all the post-communist states in this region underwent these two stages in the development of their bankruptcy laws.<sup>8</sup>

B. THE FIRST WAVE OF BANKRUPTCY LAWS

In 1992, one of the very first pieces of national legislation enacted by the Ukrainian Parliament involved the creation of bankruptcy laws.<sup>9</sup> In doing so, Ukraine became one of the first countries in the former Soviet Union to adopt such laws. Ukraine was preceded by Belarus in 1991. Other countries, such as Estonia, Moldova, the Russian Federation, Taji-

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5. Alexander Biryukov, *The Doctrine of Dualism of Private Law in the Context of Recent Codifications of the Civil Law: Ukrainian Perspectives*, 8 ANN. SURV. INT'L & COMP. L. 53, 58 (2002).

6. Wolfgang Freiherr von Marschall, *Creating the Necessary Instruments for a Market Economy in the Post-communist Countries of Eastern Europe: Policies and Problems*, 39 ST. LOUIS U. L.J. 951, 955 (1995).

7. Victor Burac, *Bankruptcy in C.I.S. and the Baltics*, AM. BANKR. INST. J. 2 (2000).

8. Among those countries are Armenia, Azerbaijan, Georgia, Lithuania, Moldova, Kazakhstan, Kirgizstan, Russia, and other post-communist states of this region.

9. Alexander Biryukov, *Ukraine's Recent Bankruptcy Reform Analyzed*, GLOBAL INSOLVENCY AND RESTRUCTURING REVIEW 27, 26-28 (Mar./Apr. 2001).

kistan and Turkmenistan also followed suit during the next two years with similar bankruptcy laws.

The main goal of this first wave of bankruptcy laws was to eliminate the Soviet system of regulation based on planned economy principles in order to create the basis for the institution of democracy and assure market transformation. With this in mind, Ukrainian 1992 Bankruptcy Law was submitted to the Parliament as a part of a privatization law package intended to facilitate the transfer of state property to private persons using bankruptcy rather than privatization procedures.<sup>10</sup>

### C. CONCEPTUAL UNDERPINNINGS OF FIRST WAVE BANKRUPTCY LAWS

In Ukraine as well as in other countries of the post-communist block, the first laws were drafted practically in the absence of a concept of bankruptcy legislation as a set of general rules and principles.<sup>11</sup> As stated earlier, the first wave bankruptcy laws continued along the planned economy type of regulation.

First wave bankruptcy laws treated insolvent debtors extremely severely. Liquidation remained practically the only procedure widely used that the time. In fact, the Preamble of the Bankruptcy Law of 1992 says that this law is directed to satisfaction of the creditors' claims. Other legal means directed at overcoming economic difficulties, such as employing restructuring schemes under court supervision, were used on very rare occasions and failed to alleviate any of the debt problems. This evidences how those laws reflected a regime of bankruptcy legislation favorable to creditors that was introduced in practically all countries of the region.<sup>12</sup>

Furthermore, the Ukrainian Bankruptcy Law of 1992 suggested that enterprises in financial distress initiate the sanation<sup>13</sup> procedure, which was designed to reorganize an insolvent debtor. Similar procedures were

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10. Mykola Titov, *K Voprosu o Ponyatii Bankrotstva v Zakonodatelstve Ukrainy*, 26 BIZNES 15 (1995).

11. Samuel Bufford, Louise D. Adler, Sidney B. Brooks & Marcia S. Krieger, INTERNATIONAL INSOLVENCY 104 (Federal Judicial Center 2001).

12. See *Zakon Ukrainy O Bankrotstve vid 14.05.92 No. 2343-XII* (Ukraine) available at <http://www.brama.com/law/business1/bankrupt.txt> (last visited April 6, 2007).

13. The term sanation (pronunciation in Russian, Ukrainian, and Byelorussian is *sanatsia*) is not known in other countries of the world. It looks like this term was introduced in the bankruptcy law drafted when the Soviet Union existed and then was accepted by the former republics of the U.S.S.R.

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widely used in other countries of the region.<sup>14</sup> Sanation, through its goals and the means of implementation, is quite similar to reorganization procedures that were widely used in many other countries of the world. Technically, sanation is a form of reorganization which is aimed at solvency recovery. However, one feature of the Ukrainian Bankruptcy sanation procedure is determinative—sanation was defined as a form of settling the creditors' claims through cession (deed of assignment) of the debtor's debts to sanator.<sup>15</sup>

Since sanation lacked a clear definition in Ukrainian law, some problems occurred while implementing the relevant provisions. In order to correct the implementation of these laws, the highest court in Ukraine provided important guidance. The Presidium of the High Economic Court of Ukraine<sup>16</sup> explained that when issuing a court decision on the sanation procedure, a court must take into account that this procedure should contain the following agreements concluded between the debtor and creditors: first, restructuring of legal entity; second, restructuring of charter capital; and third, an obligation of the sanator to pay all debts to creditors with an indication of the terms and the order for those payments. But even this did not give real results since only few sanation plans were approved in the first part of the 1990s.

Additionally, bankruptcy cases in this region are heard in specialized courts (called economic courts in Ukraine<sup>17</sup> and arbitrazh courts in the Russian Federation, etc.), that apply procedural rules set forth in relevant procedural codes. It is necessary to mention that in Ukraine there is a separate system of courts that deals with economic disputes. Now, it is a part of the general system of courts as a separate branch. These economic courts handle all matters concerning bankruptcy. When a bankruptcy dispute is set forth before the economic courts, they apply the Economic Procedural Code of Ukraine,<sup>18</sup> taking into consideration peculiarities set forth in Bankruptcy Law.

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14. Sanation procedure is set forth in the relevant bankruptcy laws in Russian Federation, Belarus, Uzbekistan, and some other countries of the former Soviet Union.

15. As one of the leading Ukrainian scholars noted sanation by its nature should be treated as a civil law cession adapted to bankruptcy procedural law. See Vyacheslav Dzhun, *Tekhniko-Yurydychni Aspekty Zastosuvannya Instytutu Sanatsii u Protseduri Bankrutstva*, 3-4 ZBIRNYK RISHEN TA ARBITRAZHNOI PRAKTYKY VYSCHOHO ARBITRAZHNOHO SUDU UKRAINY 289 (1996).

16. See *Rozyasnennya Vyschoho Arbitrazhnoho Sudu Ukrainy vid 18.11.1997 № 02-5/444* (Nov. 11, 1997) (noting the explanations of the High Arbitral Court of Ukraine).

17. As a result of so called 'small judicial reform' the system of arbitrazh courts in Ukraine was re-named economic (gospodarski) courts.

18. See *Hospodarski Protsesualnyi Kodeks Ukrainy vid 06.11.1991*, 2 VIDOMOSTI VERKHOVNOI RADY UKRAINY 56 (1992).

In comparison to the bankruptcy laws of different countries, the Ukrainian Bankruptcy Law of 1992 most resembles the German Bankruptcy Code<sup>19</sup> (*Konkursordnung*), which was in force until January 1, 1999.<sup>20</sup> The German Bankruptcy Code contained practically the only form of settling debts problems – collective procedure. All cases commenced with a filing of a liquidation proceeding. As a result, many of the shortcomings of German law, such as the lack of flexibility in the court proceedings, and the factual absence of reorganization procedures, were apparent in the first wave of Ukrainian Bankruptcy laws.

Consequently, these common features of the first wave bankruptcy laws of the former Soviet Union countries created problems during their implementation.

#### D. BANKRUPTCY LAWS APPLICATION

There are some rules in the Ukrainian Bankruptcy Law (1992) that govern its implementation. The main rules are the following: (i) only legal entities were eligible for bankruptcy and no individuals were allowed to declare bankruptcy in efforts to start anew;<sup>21</sup> (ii) a requirement to transfer the debtor's debts to a senator;<sup>22</sup> (iii) the law did not allow negotiations between a debtor and his creditors in order to come to a compromise on how to save an enterprise; (iv) only some bankruptcy case participants could be appointed as trustees, among whom were an operating bank's representative or a creditor that did not assure independent treatment to all participants of the case; and (v) the law did not provide a moratorium or other means to preserve debtor's property immediately after filing a case.<sup>23</sup> These are the features of the region's bankruptcy laws that considerably narrowed their effectiveness.

Moreover, sanation, as a form of debt restructuring, was not perfectly developed. The bankruptcy law suggested investors take over the debts of an insolvent debtor at the price fixed in bookkeeping records. But the problem was that those prices were not market-based and obviously did not reflect the real value of the debtor's assets.

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19. Alexander Biryukov, *Bankruptcy and Legislative Reform in Ukraine*, 4 REV. CENT. & E. EUR. L. 583, 581-600 (2001).

20. The new German Insolvency Law (*Insolvenzordnung*) came into force January 1, 1999. German Insolvency Statute, 1994 BGBI. I, 2866; Insolvency Statute (*Insolvenzordnung*, InsO), available at <http://www.iuscomp.org/gla/statutes/statutes.htm> and then click through or go to <http://www.iuscomp.org/gla/statutes/InsO.htm>.

21. This well known American doctrine is already implemented fully or partly in some countries in the world.

22. This was a big obstacle for investors to participate in the bankruptcy proceedings.

23. Alexander Biryukov, BAKRUTSTVO: KURS LEKTSII 23 (Referat Publishing House 2004).



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The application of the first wave bankruptcy laws in the countries of the region disclosed difficulties in achieving the goals proclaimed in the preambles and general provisions of the relevant laws. Additionally, court practice revealed ineffectiveness in providing legal remedies for debts settlement through filing bankruptcy proceedings stipulated by relevant law.<sup>24</sup>

The defects underlying the first wave bankruptcy laws were reflected in a number of bankruptcy cases filed with the courts. Ukrainian economic courts (formerly, the arbitrazh) dealt with 38 cases filed in 1993; 194 cases were filed in 1994;<sup>25</sup> more than 2,000 in 1995; about 2,800 in 1996; 6,700 in 1997; 7,500 in 1998; and 9,539 in 1999.<sup>26</sup>

However, imperfections in the bankruptcy laws generated a very specific innovation that became quite widely used in the former Soviet Union countries. Instead of using bankruptcy procedures to solve financial problems, so-called 'red directors'<sup>27</sup> used this law quite successfully in their favor. It is my belief that they intentionally drove the enterprises into insolvency in order to devalue the assets. Then they transferred the ownership of these potentially good but undervalued enterprises to themselves or their relatives without any competition among investors or potential buyers, so is required by privatization legislation. This maneuver also enabled them to avoid using time-consuming privatization procedures, which require developing and filing with the State Property Fund of Ukraine a privatization plan, and offering shares to the public at market price. All these steps could take two or more years. But through filing bankruptcy proceedings, the directors had only to deal with creditors and could take over the enterprise within several months.<sup>28</sup>

The shortcomings of the first wave bankruptcy laws made the need for reform obvious and inevitable.

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24. Biryukov, *Bankruptcy and Legislative Reform in Ukraine*, *supra* note 19, at 586.

25. A. Rohach, V. Samonis, *Creditor-Led Processes: Enterprise Bankruptcy in Ukraine*, 11 UKRAINIAN INDUSTRIALIST 24 (1996).

26. Alexander Biryukov, INSTYTUT NESPROMOZHNOSTI: PORIVNYALNO-PRAVOVYI ANALIZ 20 (Kyiv University Publishing House 2000).

27. This term existed in almost all countries that were former republics of the Soviet Union, which meant the directors of state-owned enterprises, who remained in management for a long time after market reforms were launched.

28. Alexander Biryukov, *The Barriers to Implementing Ukrainian's New Bankruptcy Law*, 37 BANKRUPTCY COURT DECISIONS 5-7 (2001).

### III. BANKRUPTCY LAW REFORM

#### A. THE URGENT NEED FOR BANKRUPTCY LAW REFORM

The State's inability to solve the debt problems of market players, as well as the condition of Ukrainian economy foreordained the necessity of speeding up reforms in the area of bankruptcy legislation.<sup>29</sup> Shortly after the Soviet Union's collapse, the economies of newly independent states remained quite stable by relying on the system of financing all expenditures from the centralized state budget. However, this became quite problematic due to the constant weakening of state budgets and a lack of restructuring mechanisms available for market players to solve their temporary difficulties.

In 1994, statistics showed that every eleventh enterprise in the country was unprofitable.<sup>30</sup> This number had increased to one in five in 1995.<sup>31</sup> By 1996 every third enterprise was practically insolvent.<sup>32</sup> The agricultural sector was hardest hit as 68% of enterprises were practically in a state of insolvency.<sup>33</sup> Overall, the widespread inability to pay debts struck almost every business around the country.<sup>34</sup> Notwithstanding this fact, the State remained supportive of insolvent businesses, at least virtually all of the state-owned ones.

Ultimately, an understanding and consensus among Government legislators formed around the need for bankruptcy law reform. In order to make this important market instrument workable, reforms had to address problems including combating an economic unbalance and providing a private sector with effective restructuring devices.

Ukrainian Bankruptcy Law was amended five times before it was totally revised in 1999.<sup>35</sup>

#### B. FOREIGN ASSISTANCE WITH BANKRUPTCY LAW REFORM

The first efforts to revise Ukrainian Bankruptcy Law in order to develop the changes for improving bankruptcy procedures were made as early as in 1994

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29. Biryukov, *Bankruptcy and Legislative Reform in Ukraine*, *supra* note 19, at 586.

30. Dzhun, *supra* note 1, at 83.

31. *Ubytki Stabil'ny*, 5 BIZNES 8 (1998).

32. Dzhun, *supra* note 1, at 84.

33. *Id.*

34. *Id.*, at 92.

35. *See* discussion, *infra*.

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In addition, a number of foreign and international organizations rendered their assistance in drafting legislative proposals, and their representatives took part in various working groups to research the application of existing bankruptcy law and to develop improvements.

In 1995, a group of scholars, led by Professor Nataliya Kuznetsova from Kiev Taras Shevchenko University and law professors Oleksandr Dzera and Valentin Shcherbina from that same University, as well as the Head of the Kharkiv Oblast' Arbitration Court Mykola Titov, started working on bankruptcy law reforms in Ukraine. An American expert, Judge Samuel L. Bufford, was also invited to consult with this group, which had been challenged to draft a new bankruptcy law. Judge Bufford, a judge from the Federal Bankruptcy Court of the Central District of the State of California, provided his expertise and contributed some ideas based on American doctrines to the drafted documents.<sup>36</sup>

This group's work resulted in a Conception of Legislation and the draft of a new law on bankruptcy.<sup>37</sup>

The biggest contribution to bankruptcy law reform was made by a project administered by the US Agency for International Development (USAID). Amendments to the existing law were drafted during the period from 1996 until late 1998. As a result of the intensive efforts taken by the group of specialists that had been brought together, the revised draft law was submitted to the Verkhovna Rada for its review. On 30 June 1999, the law draft was passed by the Parliament of Ukraine. According to the Law of Ukraine On Amendments to the Bankruptcy Law of Ukraine, this law was renamed and received a new title: The Law On the Restoration of Solvency of the Debtor or Declaring it Bankrupt.<sup>38</sup> So, the totally revised law entered into force on 1 January 2000, replacing the Bankruptcy Law of 1992. Having entered into force, the law significantly differed from the old law both in size and in the essence of its fundamental provisions.<sup>39</sup>

### C. SECOND WAVE BANKRUPTCY LAWS

In the middle of 1990s, bankruptcy laws in some countries of the former Soviet Union had changed considerably, or totally new laws had been enacted to change the old ones. Although the Ukrainian 1999 Law On

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36. Biryukov, *Bakrutstvo: Kurs Lektsii*, *supra* note 23, at 18.

37. Biryukov, *Bankruptcy and Legislative Reform in Ukraine*, *supra* note 19, at 587.

38. Zakon Ukrainy Pro Vnesennia Zmin do Zakonu Ukrainy Pro Bankrutstvo vid 30.06.1999 No. 784-XIV (hereinafter "Ukrainian Bankruptcy Law").

39. Biryukov, *Bankruptcy and Legislative Reform in Ukraine*, *supra* note 19, at 587.

the Restoration of Solvency of the Debtor or Declaring it Bankrupt has several provisions similar to those of the old law, it is largely based on a different conceptual background.<sup>40</sup> This new bankruptcy law's concept was much like that known in Western countries.<sup>41</sup> The main feature of second wave bankruptcy laws in the countries of this region was that they belong to so-called "pro-debtor type laws."<sup>42</sup> The law emphasized that it was, first and foremost, directed at restoring the solvency of a debtor.

#### D. THE CONCEPT OF UKRAINIAN 1999 BANKRUPTCY LAW

Ukrainian law drafters adopted different approaches and concepts while working on the new bankruptcy law. The new law was designed to protect not only creditors but debtors as well. So, the main feature of the law was that a debtor can be declared bankrupt after the measures undertaken to restore its solvency prove to be unsuccessful.<sup>43</sup> This is a clear requirement of Ukrainian Bankruptcy Law.

For the first time in Ukraine, the bankruptcy law set forth the competence and powers of a specialized state agency on bankruptcy matters. The Ministry of Economy of Ukraine through its Department on Bankruptcy Matters is the only state agency to fulfill the powers prescribed by the law. Among the main functions of this agency is the prevention of bankruptcy and the assurance of the effectiveness of bankruptcy law's application in certain cases.

Among the peculiarities of the countries that belonged to the Soviet legal system concerning insolvency regulation is that the State traditionally plays a considerable role in bankruptcy law application.<sup>44</sup> Besides providing a legal framework for court proceedings in bankruptcy cases, the State normally supervises the bankruptcy law's implementation through carrying out special powers when acting as an owner of state-owned enterprises.<sup>45</sup> Also, it keeps a record of insolvent companies (those towards which bankruptcy proceedings are filed) and intervenes, if necessary, to prevent disastrous effects in some cases. In addition, the State

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40. *Id.*

41. Alexander Biryukov & Myroslava Kryvonos, *Research Guide to Ukrainian Law*, NYU GLOBALEX J. (March, 2006), available at <http://www.nyulawglobal.org/globalex/Ukraine.htm> (last visited April 6, 2007).

42. Biryukov, *Barriers*, *supra* note 28, at 29.

43. Alexander Biryukov & Inna Shyroкова, *LAW AND LEGAL SYSTEM OF UKRAINE* 118 (JURIS INTERNATIONAL Inc. 2005).

44. Burac, *supra* note 7, at 7.

45. Burac, *supra* note 7, at 8.

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can be a creditor in bankruptcy cases. Such an important role for the State in the post-communist countries is justified by an argument that the State should be rather strong in transitioning economies, and should be powerful to better control this sphere of legislative development until the real market takes place when self-regulatory mechanisms are practically absent.<sup>46</sup>

It is worth mentioning that the new bankruptcy law allows not only commercial persons from being eligible for bankruptcy, but some non-commercial entities, such as consumer cooperatives and charity funds can be declared bankrupt. In addition, individuals who are involved in entrepreneurial activity<sup>47</sup> were included as that category of persons toward whom bankruptcy legislation can be applied. Lastly, the activity of professional persons acting as trustees is also covered by the new law.<sup>48</sup>

There are several types of proceedings already available for participants of economic relations that are definitely a positive feature of the new bankruptcy law. Besides liquidation and sanation, a composition agreement is another new procedure, the goal of which is to settle the debt problems while allowing the debtor to continue doing business. A composition agreement is an agreement between the debtor and creditors about a referral or installment payment plan, or the writing off by the creditors of the debtor's debts.<sup>49</sup>

The Cabinet of Ministry of Ukraine adopted on 17 March 2000 Decree No. 515, introducing a pre-trial sanation of state-owned enterprises.<sup>50</sup> The Decree provided for elaboration and enforcement of different measures to turn the debtor profitable again without launching bankruptcy proceedings in a court.<sup>51</sup> In addition, according to the new bankruptcy law, simplified (summary) proceedings can be started when the debtor's place of residence or whereabouts are unknown. In this case, a bankruptcy proceeding can be commenced notwithstanding the amount of a claim (debt). A Judge opens a liquidation proceeding with appointment of the creditor who initiated the case as a trustee, within two-weeks.<sup>52</sup>

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46. Biryukov, *Bakrutstvo: Kurs Lektsii*, *supra* note 23, at 59.

47. The Law of Ukraine *On Entrepreneurship* of 1991 defines natural persons – entrepreneurs as self-employed individuals doing business on their own after being registered with a local self-government body (a Local Council of State Administration) without creating a legal entity. See *Zakon Ukrainy Pro Pidpryemnytstvo vid 07.02.1991 No 698-XII*.

48. See *Ukrainian Bankruptcy Law*, *supra* note 38, at art. 3-1.

49. Biryukov & Shyrokova, *supra* note 43, at 127.

50. *Id.*

51. *Id.*

52. See *Ukrainian Bankruptcy Law*, *supra* note 38, at art. 52.

Institution of a moratorium towards execution of transactions involving debtor's assets is made by a judge's order in the very first stage of bankruptcy case's hearing. The moratorium is an important legal remedy for preserving the debtor's property, to assure future distribution of the debtor's assets among creditors.<sup>53</sup>

Bankruptcy proceedings initiated towards certain categories of persons are applied with regard to specified provisions of Section VI of the bankruptcy law. These categories of persons include town-creating enterprises, highly hazardous enterprises, agricultural enterprises including farming households, insurance organizations, securities traders, individual entrepreneurs, debtors liquidated by its owner and debtors whose whereabouts are unknown.<sup>54</sup> In this regard, it is important to mention the peculiarities of bankruptcy and similar proceedings against banking institutions are provided for under Sections 15, titled Temporary Administration and Liquidation of Banks, and Section 16, titled Liquidation of Banks of the Law of Ukraine *On Banks and Banking* of 2000.

The latest reform of bankruptcy legislation in Ukraine is an important step forward, despite the fact that court proceedings have become more complicated and bankruptcy procedures require more time to finalize the case hearing. These are reasons why the number of bankruptcy cases filed in 2002 decreased by 22% as compared to 2001.<sup>55</sup> In addition, in only twenty-two cases of the 7000 commenced by economic courts in 2002 were bankruptcy case reorganization plans approved (sanation procedures were chosen) where the debtors were not liquidated.<sup>56</sup>

Within a few years, several amendments to the existing law were enacted to encourage creditors to address debts problems in the court system. Notwithstanding the fact that amendments to the law were definitely positive and progressive, there is still room for further improvement and the concept's perfection.

#### E. BANKRUPTCY LAW REFORM AND REGIONAL DEVELOPMENTS

When analyzing Ukrainian Bankruptcy Law, one can draw many similarities to provisions contained in the Model Law on Insolvency (Bankruptcy) adopted for use in the Commonwealth of Independent State (mainly consisting of the former Soviet Union countries except the Baltic

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53. O. Stepanov, *Moratoriy na Zadovolennya Vymoh Kredytoriv: Okremi Problemy Zastosuvannya*, 10 PRAVO UKRAINY 48 (2004).

54. Biryukov & Shyrokov, *supra* note 43, at 130.

55. Dzhun, *supra* note 1, at 87.

56. *Id.*

Republics).<sup>57</sup> The Model Law was developed<sup>58</sup> in order to suggest the implementation of unified rules for bankruptcy proceedings in the countries of the region. Understandably, the influence of the Model Law permeates the texts of the relevant laws in the former Soviet Union countries, and certainly in Ukraine.<sup>59</sup>

As was suggested by the Model Law on Insolvency (Bankruptcy), the bankruptcy laws of the named countries exclude from their effects state-owned enterprises that have been given special status – *kazenni pidpryemstva*. The term ‘*kazenni pidpryemstva*’ was introduced into Ukrainian legislation in 1998 with enactment of amendments to the Law of Ukraine *On Enterprises in Ukraine* of 1991. However, it should be noted that the concept of such enterprises is not yet been clearly defined in the current legislation.<sup>60</sup>

The Model Law proposes establishing a minimum aggregated amount of debt as the basis on which a petition for initiation of a bankruptcy proceeding may be lodged with the court. In Ukraine, the court opens a bankruptcy proceeding if a total amount of initiated creditors’ claim is not less than 300 statutory minimum monthly salaries that are due.<sup>61</sup>

While accepting Western doctrines in the area of bankruptcy law, Russian lawmakers proceeded much further by allowing the filing of bankruptcy cases towards not only those physical persons who are registered as entrepreneurs but every person. However, this will take place only after relevant amendments are made to the Civil Code. Nonetheless, some important provisions of Model Law were accepted in Ukraine. For example, a debtor’s obligation to file a petition with the court when there are signs of insolvency was made a part of Ukrainian Bankruptcy Law after the last reform.

In all, the influence of the Model Law is apparent in the structure of the Ukrainian law texts and in some formulations and definitions—for instance, “pecuniary obligations”, “arbitration managers”, “composition (amicable) agreement”, “*kazenni pidpryemstva*”, and many others.

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57. Modelnyi Zakon O Nesostoyatelnosti (Bankrotstve) was approved by the Inter Parliamentary Assembly of CIS on 6 December 1997.

58. The Law was drafted by the Scientific Consulting Center of Private Law of the Commonwealth of the Independent States with considerable assistance of foreign and international donors, including those from the Netherlands, Germany and the United Kingdom. Ukrainian distinguished scholars took a very active part in the process of its drafting.

59. Biryukov, *Bankruptcy and Legislative Reform in Ukraine*, *supra* note 19, at 589.

60. Biryukov & Shyroкова, *supra* note 43, at 118.

61. At the current exchange rate on December 15, 2006, the threshold sum stands at present at just over US\$23,762.

#### IV. THE BANKRUPTCY LAW IN THE CONTEXT OF INTERNATIONAL DEVELOPMENTS

##### A. BANKRUPTCY LAW IN A GLOBAL WORLD

Today's world development is quite widely characterized with the use of such words as globalization, internalization and regionalization. Notwithstanding that those words are being perceived differently, their meaning is quite understandable—the world becomes more open, allowing persons from different countries to perform cross-border business easily. So, the world becomes more complex. Certainly, this requires new approaches in regulating economic relations between private persons, and bankruptcy gains great importance.<sup>62</sup>

It is necessary to mention that bankruptcy law in each country is quite a unique set of material and procedural norms. There are no two identical or even similar systems of insolvency regulation. Obviously, this creates certain obstacles in harmonizing legal instruments used in different countries. Even the countries of the former Soviet Union, when creating their own systems of bankruptcy regulation came far from a uniform legal system.

Now Ukraine takes part in regional and international life more actively every year. This helps to bring well-known and workable rules into national legislation that deal with cross-border insolvency.

##### B. BANKRUPTCY LAW IN INTERNATIONAL TREATIES OF UKRAINE

The landscape of Ukrainian legal system development has been significantly changed when it declared European integration as a priority. Having become a member of the Council of Europe in 1995, Ukraine started speeding its legal and judicial reforms.<sup>63</sup>

Notwithstanding the fact that Ukraine participates in negotiations on broadening economic relations with some of the former Soviet Union

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62. See, e.g., E. Bruce Leonard, *Internationalisation of Insolvency and Reorganisation*, 24 INT'L BUS. LAW. 5, 203 (1996); Trautman Donald T., Westbrook Jay Lawrence & Gaillard Emmanuel, *Four Models for International Bankruptcy*, 41 AM. J. COMP. L. 574 (1993); and CURRENT ISSUES IN CROSS-BORDER INSOLVENCY AND REORGANISATIONS vii (E. Bruce Leonard & Christopher W. Besant, eds., Graham & Trotman, International Bar Association 1994).

63. Biryukov & Kryvonos, *supra* note 41.



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countries,<sup>64</sup> European integration remains the most important direction of international activity of this country.

The other obligation that Ukraine takes as a State is WTO accession. Nowadays, one of the most important goals that Ukraine carries out when conducting negotiations with WTO members is the adoption of a number of economic laws necessary to lift trade and business barriers. In this context, the bankruptcy procedures should play a special role by providing open and understandable legal remedies to market players when financial problems arise.

It is very important to note that in this context, the European Union pays special attention to bankruptcy legislation, seeing in it a basis for the foundation of fair competition for participants in economic relations.<sup>65</sup> Particularly, the European Commission, in its Decision on Market Assessment for Ukraine, drew Ukraine's attention to the need for establishing effective bankruptcy legislation required by Article 2(7) of the Council Regulation (EC) No 384/96, of 22 December 1995. Article 2(7) aims at protection against dumped imports from countries which are not members of the European Community, and the assurance of equal relations with every participant in a bankruptcy case, notwithstanding whether it is a private or state-owned company. The fact that Ukraine has received the status of a market economy from the European Union and some other countries really was a remarkable achievement in the area of legal reform.

Currently, Ukraine is in the process of adapting its legislation to European norms and standards, with a goal to acquire full membership in the European Union.

### C. BANKRUPTCY LAW OF UKRAINE AND THE EUROPEAN UNION

Although the area of bankruptcy legislation is not listed specifically in Art 51(2) of the Partnership and Cooperation Agreement as a sphere of national legislation for urgent harmonization, it is an important legal

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64. Currently Ukraine is participating in negotiations on the creation of the Common Economic Space with the Russian Federation and Kazakhstan.

65. B. Spinoit & Oleksandr Biryukov, *Bankruptcy Law in the Context of the Accession of Ukraine to Market Economy Status for the Purposes of the Anti-Dumping Laws*, UEPLAC NEWSLETTER (June, 2004).

factor of market transformation and even a sort of indicator of legal reform progress in transition economies.<sup>66</sup>

By ensuring a fair bankruptcy regime, the country shows its readiness to establish equal conditions and a competitive environment for market players, including foreign businesses. In this respect, approximation of Ukrainian bankruptcy legislation to European Union standards is an essential factor in fostering the integration of Ukraine's young market economy into the world system.<sup>67</sup>

#### D. INTERNATIONAL ASPECTS OF BANKRUPTCY LAWS

Cross-border insolvency is that sphere of harmonization which attracts special concern around the world. During the past several decades, numerous international organizations and state alliances have contributed to the development of unified rules to deal with the cases where a so-called foreign element exists. Included in the list of those organizations are the World Bank, MFI, EBRD, and others.<sup>68</sup>

UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997) is of vital importance for the development of legislative proposals in this area, and especially in the transition economies.<sup>69</sup> The World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights System, approved in April 2000, could be helpful in creating a fair bankruptcy regime reflecting modern world tendencies.

It is quite possible to say that there are certain standards and most important principles for insolvency legislation which were developed by some of abovementioned organizations recently, among which are the following: (i) the state should provide understandable and transparent bankruptcy proceedings for solving debt problems; (ii) the legislation should exclude any forms of state intervention into bankruptcy procedures; (iii) equal and non-discriminatory treatment should be assured to all busi-

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66. Alexander Biryukov, *Harmonisation of Insolvency Legislation in Europe and in the World*, 2(7) UKRAINIAN L. REV. 35, 34-38 (Mar. 2003).

67. O. Kotsyba, Oleksandr Biryukov, D. Fouquet, *Scoreboard Paper on Approximation of Ukrainian-EU Law: Rules of Competition. State Aid. Bankruptcy*, 5(10) UKRAINIAN L. REV. 37, 37-48 (March 2004).

68. Alexander Biryukov, *ZAKONODAVSTVO PRO BAKRUTSTVO: ZBIRNYK NORMATYVNYKH MATERIALIV I ANALITYCHNYKH STATEY* 119 (Justinian 2003).

69. United Nations Commission on International Trade Law (UNCITRAL), *Model Law on Cross-Border Insolvency with Guide to Enactment (1997)*, available at <http://www.uncitral.org/pdf/english/texts/insolven/insolvency-e.pdf>.

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nesses participating in a bankruptcy case, either a debtor or creditor; and some others.<sup>70</sup>

According to Art 5(9) of the Ukrainian 1999 Bankruptcy Law, the awards of foreign courts in bankruptcy cases taken in other jurisdictions are recognized and executed in Ukraine according to the rules provided by the relevant international treaties of Ukraine. If there are no international treaties, the awards of foreign courts in bankruptcy cases are recognized on the basis of reciprocity. These are the only provisions of Ukrainian bankruptcy legislation that deal with the perspective of foreigners' participation in cases filed in Ukraine.<sup>71</sup>

E. CROSS-BORDER INSOLVENCY AND UKRAINIAN BANKRUPTCY LEGISLATION

The necessity of implementing cross-border insolvency rules is envisaged by the international treaties to which Ukraine is a party. The aforementioned Partnership and Cooperation Agreement (Art 51), confers on Ukraine an obligation to bring its legal acts in conformity with the norms and standards applied in the Member States as well as their consistency with the European Union legislation. There are 14 spheres of national legislation that are determined as priority areas for approximation.<sup>72</sup> Bankruptcy is not mentioned in this article but it is recognized as an integral part of company law<sup>73</sup> and an important legal device for the support of competition.

Adaptation of Ukrainian laws to European Union norms and standards is detailed in the Action Plan for realization of the National Programme on Approximation of Ukrainian legislation to the Legislation of the European Union (*acqui communautaire*) for 2006.<sup>74</sup>

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70. Alexander Biryukov, *Transkordonna Nespromoznist* in MIZHNARODNE PRYVATNE PRAVO: AKTUALNI PROBLEMY 135 (2001).

71. Biryukov & Shyrokova, *supra* note 43, at 132.

72. According to Art 51 of the Partnership and Cooperation Agreement between the European Communities and their Member States, and Ukraine (PCA) of 16 June 1994 Ukraine undertook to take measures aimed at the gradual bringing of its legislation in conformity with norms of the European Union legislation in the defined spheres. These spheres are as follows: Customs law; Company law; Banking law; Accounting; Tax law, including indirect Taxation; Intellectual property; Labour protection; Financial services; Competition rules; Public procurement; Health protection; Environment protection; Consumer protection; Technical norms and Standards; Transport; Energy, including nuclear. Partnership and Cooperation Agreement Between the European Communities and their Member States and Ukraine art. 51 1998 O.J. (L 49) 19.2.1998.

73. Alexander Biryukov, *BANKRUTSTVO V EVROPEISKOM SOYUZE*, IN KORPORATYVNE PRAVO EC 92 (Kyiv University Publishing House 2004).

74. The National Program was adopted by the Decree of the Cabinet of Ministries of Ukraine No 151-p (Mar. 15 2006).

In order to realize the commitments fixed in the Action Plan, the draft of the Law of Ukraine On Introduction of Changes into Certain Laws of Ukraine regarding Cross-Border Insolvency was developed. This document was drafted by the State Department for Legislation Approximation of the Ministry of Justice of Ukraine.<sup>75</sup> The position of the Ministry of Justice is that a separate chapter containing cross-border insolvency rules is to be included in the body of existing bankruptcy law—in the Law of Ukraine On the Restoration of Solvency of the Debtor or Declaring it Bankrupt.

The law draft is based on the text of the UNCITRAL Model Law. It is partly why the main terminology in the draft was unknown in Ukraine. As it was discovered at the roundtable where the law draft was presented,<sup>76</sup> introduction of the legal constructions which had never been used in a country with Soviet-type of legal traditions can lead to confusion in its application. For example, “representation” is used in Ukraine as it is defined in the Civil Code, which is why usage of this term, together with the word “foreign,” without defining it specifically in the law, can create certain problems. The activities, functions and powers of foreign representatives in Ukrainian courts can be a special area for additional research that could be done while implementing cross-border rules in Ukraine.

The wording “court aid” is unknown in Ukraine but the other legal construction such as legal aid, is mentioned in the procedural laws. Therefore it was advised to use existing terms, rather than introducing those contained in the Model Law. According to Ukrainian procedural laws, a judge can file a court order to acquire aid for collecting evidence, or to execute some actions necessary to finish a court trial opened on the territory of Ukraine.<sup>77</sup>

Some provisions of the law draft on cross-border insolvency should be correlated with the Law of Ukraine On Private International Law of 23 June 2005 No 2709-IV. It is necessary to state that private international

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75. The State Department for Legislation Approximation is a specialized state body in the structure of the Ministry of Justice of Ukraine that is responsible for implementation of the National Programme on Approximation of Ukrainian legislation to the Legislation of the European Union.

76. The expertise of the first draft of this law was made by a Non-Government Organization named Ukrainian Bankruptcy Institute. Results of legal expertise as well as main conceptual provisions of the draft were presented at the roundtable organized by Ukrainian Bankruptcy Institute with the State Department for Legislation Approximation and held on 3 November 2006. The participants discussed some aspects of further improvement of the draft before sending it to the Parliament for adoption.

77. See Civil Procedural Code of Ukraine vid 18.03.2002 No 1618-IV, art 132.

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laws in the countries, where they exist, normally do not regulate insolvency relations through providing conflict-of-laws rules.

Ukrainian Bankruptcy Law does not contain some terms that were included into the law draft on cross-border insolvency. "Interim proceeding" is among those terms. Furthermore, "foreign proceeding," which is part of the UNCITRAL Model Law, also covers an administrative proceeding that is unknown in Ukraine. According to Ukrainian Bankruptcy Law, only courts are entitled to consider bankruptcy cases.

The most uncertain area for practitioners and judges is the concept of main and secondary proceedings, which was suggested by the law draft. At one of the roundtables held recently in Ukraine, the legal format provided by the Model Law was found inappropriate for Ukraine without significant changes in the relevant provisions of the procedural laws.<sup>78</sup>

Quite a big concern arises when introducing some procedural norms of the Model Law into Ukrainian legislation. Bankruptcy cases are tried by economic courts in Ukraine according to the rules set forth in the Economic Procedural Code of Ukraine, but the procedure on recognition of foreign cases and awards of foreign courts are prescribed by the Civil Procedural Code of Ukraine.<sup>79</sup> There are no specified procedures on recognition of foreign proceedings, as well as main or secondary ones. So, sensitive procedural rules provided in the Model Law need to be more gently introduced in the procedural legislation of Ukraine, which is quite conservative area of national legislation.

The most valuable proposition that is ready to be implemented in Ukraine without considerable change in the existing laws and other regulations is a concept of coordination of court proceedings that are opening in different countries. This concept is the oldest one which is widely used around the world, and is a part of bilateral treaties on legal aid normally concluded by many countries.

Based on the findings above, the biggest problem which lawmakers in many countries face is the severe difference between the systems of insolvency regulation around the world. The same is true when talking about international documents, which are implemented in transition countries.

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78. *E.g.*, at the roundtable organized and conducted by Ukrainian Bankruptcy Institute with the State Department for Legislation Approximation of the Ministry of Justice of Ukraine (Nov. 3 2006).

79. A new concept of judicial reform adopted by the Presidential Ordinance in 2006 suggests organizing all specialized courts into a unified court system.

Ukraine and some other countries in the region have just started unifying of their national bankruptcy legislation with relevant law in Western countries and the European Union. UNCITRAL Model Law of 1997 and European Union Regulation on insolvency proceedings of 2000 are going to be samples for young democracies to accept.

## V. CONCLUSION

Ukraine and other countries of the former Soviet Union made dramatic progress in the institution of bankruptcy legislation and its further improvement. Between the first and second waves of bankruptcy laws, adoption by the countries of this region went further in establishing a regulatory model that appreciates market principles and reflects a democratic type of society.

The widening of international economic relations allows companies that are registered in countries with different types of regulation to do business directly, thus increasing the importance of bankruptcy law. This requires introducing cross-border rules to deal with the cases where a foreign element exists. In fact, a third wave of bankruptcy laws development focusing on the cross-border rules implementation is already under way.

The implementation of international documents in Ukraine is quite a new area of law-making activity. It is necessary to note, however, that the mechanical introduction of foreign and international experiences does not always yield a positive result. Therefore, when implementing the cross-border rules reflected in the UNCITRAL Model Law and EU Regulation, the drafters should take into account legal traditions that exist in Ukraine.

It is remarkable that Ukraine is one of the first countries of the former Soviet Union that has started the harmonization of national legislation with international and European standards in order to become an equal member of the international community.