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Further support for the execution by Ukraine of judgements in respect of Article 6 of the European Convention on Human Rights

ANALYSIS

Procedure and practice on bankruptcy of state enterprises in Ukraine in the context of the execution of the ECtHR judgements in the cases of "Yuri Nikolayevich Ivanov v. Ukraine" and "Burmych and others v. Ukraine"

Executive summary

October 2020, Kyiv

The Ukrainian-language analysis is prepared in the framework of the Council of Europe Project "Further support for the execution by Ukraine of judgements in respect of Article 6 of the European Convention on Human Rights" (the Project), funded by the Human Rights Trust Fund and implemented by the Justice and Legal Cooperation Department of the Council of Europe. The author of the analysis is Mr Ruslan Melnychenko, lawyer, Ph.D. in Law, the national consultant of the Project. The English-language executive summary is a digest of the full text of the analysis.

The analysis is prepared in coordination with the Ministry of Justice of Ukraine in the context of the implementation of certain general measures for the execution of the European Court of Human Rights (the ECtHR) judgments in cases of Ivanov/Burmych. At the final 1369th meeting, which was held on 3-5 March 2020, the Committee of Ministers of the Council of Europe recalled that among the identified root causes of non-enforcement of national judgments the following is included: the inability to launch and finalise bankruptcy proceedings concerning entities owned or controlled by the state and moratoriums that shield enterprises controlled by the state from liability and protect them from enforcement action in certain economic sectors.

In June 2019, the Ukrainian authorities developed a draft National Strategy that defines the necessary general actions to eliminate these root causes, which include actions to implement clear and efficient procedures for initiating bankruptcy of state-owned enterprises or those controlled by the state.

The national consultant was tasked with analysing the following issues based on the judgments of the ECtHR in cases of Ivanov/Burmych, relevant decisions/resolutions of the Committee of Ministers of the Council of Europe, and the draft National Strategy for the implementation of the Ivanov/Burmych judgements:

- To monitor the judgments of the Commercial Cassation Court within the Supreme Court adopted after the entry into force of the Code of Ukraine on Bankruptcy Procedures on the subject of initiating bankruptcy procedures of state enterprises or business entities that are directly or indirectly controlled by the state;
- To analyse the existing legislation of Ukraine on the efficiency of initiating bankruptcy procedures of state enterprises or business entities that are directly or indirectly controlled by the state, as well as on the real completion of the bankruptcy procedures of these enterprises;
- To analyse the statutory bar and/or injunctions (moratorium) on the bankruptcy of state enterprises or business entities that are directly or indirectly controlled by the state;
- To identify the practical bankruptcy issues of state enterprises or business entities that are directly or indirectly controlled by the state;
- To provide recommendations on resolving the issues of state enterprises or business entities that are directly or indirectly controlled by the state in compliance with the Council of Europe recommendations and standards.

To study the issues mentioned above, the national consultant carried out a detailed analysis of the Code of Ukraine on Bankruptcy Procedures, the Law of Ukraine "On Restoring a Debtor's Solvency or Recognizing It Bankrupt" (various revised editions), the Law of Ukraine "On Privatization of State and Communal Property", the Commercial Code of Ukraine, the Law of Ukraine "On List of the State Property Objects which Are Not Subject to Privatization" (various revised editions), the Law of Ukraine "On Recognition as invalid the Law of Ukraine "On List of the State Property Objects which is not Subject to Privatization", the Law of Ukraine "On Enforcement Proceedings".

The analysis of the judgments of the Commercial Cassation Court within the Supreme Court included judgments adopted from 21 October 2019 (the entry into force of the Code of Ukraine on Bankruptcy Procedures) to 30 April 2020. The judgments concerned the issue of efficiency of initiating bankruptcy procedures of state enterprises or business entities that were directly or

indirectly controlled by the state, as well as for the completion of the bankruptcy procedures of these enterprises.

All in all, 30 different judgments of the Supreme Court that had been adopted 'on merits' were analysed during the indicated examination period. Within the framework of this analysis, 7 cases of the Supreme Court were selected to provide for typical and vivid examples of the existing judicial practice in Ukraine on the bankruptcy of state-owned enterprises.

The analysis identified the following major issues:

1. In the vast majority of cases today, it is legally impossible for the court and the official receiver to switch from the judicial procedure for disposing of property to the judicial procedure of financial rehabilitation or winding-up of the state-owned enterprise and enterprise with authorised capital exceeding 50 percent of state property share. The problem is that in such state enterprises the provisions of Part 3 of Article 214 of the Commercial Code of Ukraine directly forbid to apply the judicial procedure of financial rehabilitation or winding-up.

2. Despite the fact that in Ukraine today there is no list of objects of state property rights, approved by the Verkhovna Rada of Ukraine that are not subject to privatisation, the provisions of Part 5 of Article 4 of the Law of Ukraine "On Privatization of State and Communal Property" set a direct bar on the privatization of state enterprises that are secured by the economic management right to have the objects necessary for the state to fulfil its basic functions, to ensure the defence of the state, and the objects of property rights of the Ukrainian people, and property, constituting the material basis of the sovereignty of Ukraine. The latter, in turn, means that it is impossible to apply the judicial winding-up or financial rehabilitation procedure to such objects of state property.

3. In addition to the general direct ban by Part 3 of Article 214 of the Commercial Code of Ukraine, there is an additional moratorium on the financial rehabilitation and winding-up of state enterprises within three years from the date of entry into force of the Law of Ukraine of October 2, 2019, No. 145-IX (entry into force took place on October 20, 2019). This moratorium does not apply only to those state enterprises involved in the implementation of the state defence order, production, development, modernization, repair, maintenance of weapons and military equipment. The problem is that in the judicial law enforcement practice, the issue of ownership and sufficiency of proof of attributing a specific state enterprise with the specified criteria is very controversial.

4. A separate problem is that enforcement processes are forbidden in accordance with the Law of Ukraine "On Enforcement Proceedings" within three years from the date of entry into force of the Law of Ukraine of October 2, 2019, No. 145-IX about the objects of the state property right that were included in the lists approved by the Law of Ukraine "On List of the State Property Objects which Are Not Subject to Privatization" except for the recovery of funds and goods that were pledged under loan agreements. The latter means that today it is impossible to satisfy any judgment made against a state-owned enterprise, except for the recovery of funds and goods that were pledged under loan agreements.

5. Another problem is that the body (entity) authorised to manage state property does not really take any part in the preparation or at least assist in the preparation of the plan for the financial rehabilitation of the state-owned enterprise. The latter has the result that the body (entity) authorised to manage state property does not agree on the financial rehabilitation plan prepared by the official receiver and, thereby, completely blocks the possibility of further court proceedings on the bankruptcy of a state enterprise.

Based on the results of the analysis, the following recommendations were formulated:

1. To legislatively reconsider Part 3 of Article 214 of the Commercial Code of Ukraine, as well as Article 96 of the Code of Ukraine on Bankruptcy Procedures regarding the prohibition by the court of proceeding to the judicial procedure of financial rehabilitation or winding-up of a state enterprise and an enterprise where the share of state property exceeds 50 percent in authorised capital. In particular, pursuant to the practice of the ECtHR, it is recommended to assume at the level of the Code of Ukraine on Bankruptcy Procedures that in case of legislative impossibility of financial rehabilitation or winding-up of a state enterprise, the subsidiary liability for the obligations of the state enterprise should be borne by the body (entity) authorised to manage state property.

2. The legislative wording of the provisions of Part 5 of Article 4 of the Law of Ukraine "On the Privatization of State and Communal Property" is not unambiguous for interpretation and, at the level of law enforcement practice, various approaches to understanding whether the objects necessary for a particular state-owned enterprise are secured for the fulfilment by the state of its basic functions, to ensure the defence capability of the state, and the objects of property rights of the Ukrainian people, property that forms the material basis of the sovereignty of Ukraine. To solve this issue, it is recommended to consider a possibility of approval by the Verkhovna Rada of Ukraine of a clearly defined list of the state property objects not subject to privatisation, based on the proposal of the Cabinet of Ministers of Ukraine.

3. A statutory ban on the enforcement processes against state-owned enterprises, which are not a subject to privatisation, is not in compliance with the Council of Europe standards and recommendations and with the ECtHR case law. Based on the provisions of Article 6 of the ECHR, the statutory ban (moratorium) till 20 October 2022, for the enforcement processes against state enterprises should be made void.

4. It is suggested to introduce a direct responsibility of the body (entity) authorised to manage state property to develop a financial rehabilitation plan in order to prevent the bankruptcy of the state enterprise. Based on the practice and recommendations of the ECtHR, we also recommend introducing a subsidiary liability of the body (entity) authorised to manage state property for the liabilities of a state enterprise at the level of the Code of Ukraine on Bankruptcy Procedures.

5. It is proposed to provide a precise algorithm of the Cabinet of Ministers of Ukraine at the level of the Code of Ukraine on Bankruptcy Procedures regarding actions to prevent the bankruptcy of state enterprises and enterprises where the share of state property exceeds 50 percent in authorised capital. In particular, it is necessary to provide precise deadlines for taking these actions, as well as the personal responsibility of the head of the body (entity) authorised to manage the relevant state enterprise.