



## **EXPERT NOTE**

# **CONTESTATIONS OF FRAUDULENT TRANSACTIONS: COMPLIANCE OF THE CASE LAW OF THE SUPREME COURT OF UKRAINE WITH THE EUROPEAN CONVENTION ON HUMAN RIGHTS**

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## Introduction

- 1 This note reflects the expert opinion of the Council of Europe’s international consultant Jeremy McBride<sup>1</sup> on the implementation of the European Convention on Human Rights (*hereafter - “the Convention”*) by the Ukrainian Supreme Court in the cases regarding the contestation of fraudulent transactions (transactions committed by the debtor to the detriment of the creditor) in civil disputes. The international expert was engaged under the request of the Supreme Court by the Council of Europe project “Support to the functioning of justice in the war and post-war context in Ukraine”, which is implemented by the Cooperation Programmes Division.
- 2 It examines the practice arising from judgments entered in the Unified State Register of Judgments in 2018-2023 that was summarised in English in the Supreme Court’s publication “Overview of the Practice of the Supreme Court regarding the contestation of fraudulent transactions (transactions committed by the debtor to the detriment of the creditor) in civil disputes” (*hereafter - “the Overview”*), which was provided by the Supreme Court for the expert’s review.
- 3 The provisions that are particularly relevant for the purpose of assessing the compatibility of this practice with the Convention are those in Article 6§1 of the Convention and Article 1 of Protocol No 1 to the Convention which, respectively, guarantee the right to a fair trial and the protection of property.
- 4 The note first examines the essential elements of the practice that has been developed by the Supreme Court. It then reviews the extent to which this practice might be regarded as giving rise to problems of compliance with the Convention, before concluding with an overall assessment of such compliance.

### A. The practice of the Supreme Court

- 5 The Overview groups the case law of the Supreme Court under seven headings:
  - general understanding of fraudulent transactions;
  - application of the fraudulent construction to individual contracts;
  - one-sided transaction as a fraudulent transaction;
  - fraudulent practices in executing a marriage contract;
  - other fraudulent transactions;
  - the right of a public/private bailiff to challenge a fraudulent transaction; and
  - consequences of the invalidity of a fraudulent transaction.
- 6 Many of the cases in the Overview involve transactions transferring of real estate or other property interests that were found to have been concluded by the debtor with a view to preventing it being used for the purpose of enforcing a judgment obtained by the creditor concerned.

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- 7 However, in one instance (case no. 757/33392/16), the same result was achieved by conferring a power of attorney on a person other than the debtor that enabled him to donate the property concerned to a third person.
- 8 Moreover, in another instance (case no. 755/3563/21), the attempt to avoid paying the debt was considered to be the entering into a prenuptial agreement that made the principle of joint ownership of marital property, pursuant to Article 60 of the Family Code, inapplicable as debt was already owed at the time when this agreement was concluded. It was determined that this was an act of obvious bad faith aimed at preventing the foreclosure of the debtor's property or reducing the amount of the debtor's property.
- 9 This was also the situation in another case (no. 2-591/11) but the focus of the proceedings was mainly on the issue of recovery from property jointly owned and did not specifically refer to the prenuptial agreement. Nonetheless, it was stated that a transaction concluded during the period of the obligation to repay the debt which led the debtor ceasing to be solvent should be questioned as to its good faith and acquires the characteristics of a fraudulent transaction.
- 10 In many of the cases, the transaction concerned took the form of a donation but in several instances (cases nos. 755/17944/18, 693/624/19, and 754/18852/21) it was ostensibly for a consideration or price.
- 11 In the first of these cases, it was not considered material to determine whether that price was at the market value and whether there had been any actual payment. In the others, there was no reference to this point in the summary. However, in all of them, the debtor did not appear to have any other means of satisfying the debt concerned.
- 12 All but two of the relevant proceedings included in the Overview were ones brought by the creditor against all the persons involved in the impugned transactions.
- 13 In the first exception (case no. 757/33392/16), the beneficiary of the donation exercised through the power of attorney conferred by the debtor considered was not a party to the relevant proceedings. However, those proceedings are only referred to as having led to the setting aside of the power of attorney concerned and there is no indication in the summary as to what the effect of that was on the interests of the beneficiary of the donation made under it.
- 14 In second one (case no. 2-591/11), the proceedings were brought by a bailiff rather than the creditor against all the alleged parties to the transaction. However, these proceedings sought to determine the share of the debtor's property that was owned jointly with another person, i.e., the other party to the marriage contract involving the debtor.
- 15 That issue was seen as one involving a dispute between the debtor and the co-owner of the property concerned, with the debtor's spouse denying that the property concerned belonged to her and the debtor jointly but instead claiming that she was its sole owner. In these circumstances, it was considered that the issue of ownership could not be resolved within the framework of a dispute between the creditor and the debtor. Particular emphasis

was placed on the procedure being used not enabling the relevant parties to provide an effective, real opportunity to present the evidence and arguments to the court, as required by Article 6§1 of the Convention. This is the only case included in the Overview to which reference is made to that or any other provision of the Convention.

- 16 That ruling meant that the issue of whether there was a fraudulent transaction was not addressed.
- 17 As already noted, the case involving the power of attorney only resulted in that power being invalidated but left unclear what happened to the transaction concluded under that power. However, apart from that case, in all those ones where the transaction was considered to be fraudulent, the consequence was that the transaction involved was invalidated and this was specifically underlined in the cases included in the last section of the Overview.
- 18 Thus, the Supreme Court emphasised that the proper way to protect the rights or interests of the creditor concerned was to return the parties to their original state, i.e., to restore the pre-existing situation, which would entail the cancellation of the registration of any property interest that may have occurred.
- 19 The legal basis for the invalidation referred to in judgments included in the Overview varied. In one case (case 644/5819/20), reference was made to the approach formulated by the Grand Chamber of the Supreme Court in case No. 369/11268/16-ц, according to which it is allowed to qualify a fraudulent transaction in out-of-competition contestation as:
  - fictitious (Article 234 of the Civil Code of Ukraine);
  - one that was committed contrary to the principle of good faith and the inadmissibility of right abuse (Articles 3, 13 of the Civil Code of Ukraine);
  - one that violates public order (parts one and two of Article 228 of the Civil Code of Ukraine).
- 20 Although reference is made to all those provisions in some of the other cases (and in case no. 369/11268/16-u, additional reference is made to Articles 203 and 215 of the Civil Code of Ukraine), there are yet others in which just some of them and not always the same ones are mentioned.
- 21 Moreover, in case no. 569/6427/16, reference was only made to Article 220 of the Civil Code of Ukraine on the basis that the possibility of nullifying an agreement recognised as valid due to lack of notarization not being excluded. The summary for some cases does not mention any legal provision, although this may have been effectively done through the reference made in them to other rulings of the Supreme Court.

## B. Requirements under the Convention

- 22 The kind of cases with which the Supreme Court has had to deal have not really featured in proceedings before the European Court of Human Rights. This is not because they involve disputes between private parties, as the legal framework – both substantive and procedural - in which these are determined has given rise to many applications to it.
- 23 Rather the context in which fraudulent transactions have been an element in proceedings before the European Court of Human Rights has tended to be where those perpetrating them have been prosecuted and are then alleging that the proceedings against them are contrary to their right to a fair trial under Article 6 of the Convention.<sup>2</sup>
- 24 This does not mean that there are no cases of relevance or that there are no provisions of the Convention that need to be taken into account when dealing with cases of the sort that are summarised.
- 25 As regards the latter, the two provisions that are pertinent are Article 6§1 and Article 1 of Protocol No 1 to the Convention.

### *Article 6§1*

- 26 The relevance of Article 6§1 arises from the fact that any person who has acquired real estate or other property interests through contract or other legal transaction will thereby have a civil right for the purpose of that provision.<sup>3</sup>
- 27 As a consequence, any proceedings pursued for the purpose of invalidating that transaction will necessarily entail a determination of that right and there will be a need to ensure that in those proceedings such a person has the right to participate in them as a party, with respect for equality of arms and the benefit of an adversarial procedure.
- 28 The applicability of Article 6§1 in such circumstances was, e.g., recognised in *Topallaj v. Albania*,<sup>4</sup> which concerned proceedings in which the applicant had joined, as a third party, supervisory review proceedings of judgments in which the validity of contracts concerning property rights which he claimed to have acquired and which he allegedly continued to enjoy at the material time was in issue.
- 29 Similarly, in *Tahirov v. Azerbaijan*,<sup>5</sup> it was unsuccessfully argued that Article 6§1 had not been respected by the courts that had determined that a sale and purchase contract was null and void on the basis that involved a fictitious transaction, namely, one that was concluded only for the sake of appearances without the intent to create corresponding legal consequences.

- 30 The European Court of Human Rights concluded that:

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<sup>2</sup> For a recent example, see *Podvezko v. Ukraine* (dec.), no. 10549/18, 20 October 2022.

<sup>3</sup> See *Buchholz v. Germany*, no. 7759/77, 6 May 1981.

<sup>4</sup> No. 32913/03, 21 April 2016. The application concerned only the length of the proceedings involved.

<sup>5</sup> *Tahirov v. Azerbaijan* (dec.), no. 4306/09, 17 June 2021.

*(...) the domestic courts found that the sale and purchase contract had been concluded in breach of the provisions of domestic law. The applicant, assisted by a lawyer, was able to present his arguments at three levels of jurisdiction. The domestic courts gave reasons for their decisions and nothing in the case file suggests that those decisions were arbitrary or manifestly unreasonable, or that their decisions had been somehow unlawfully influenced by the GDEA, as argued by the applicant.<sup>6</sup>*

- 31 Furthermore, an argument that the invalidated contract had only been a preliminary one followed by a main contract had never been raised before the domestic courts. In any event, the European Court of Human Rights considered that there was no indication as to them being preliminary and main contracts as argued by the applicant.
- 32 It is thus clear that there is a need for the procedural requirements of Article 6§1 to be observed in all cases with respect to all who may be able to assert a right in the property involved, even if it is ultimately concluded that such a right is not compatible with the applicable law governing transactions undertaken, whether directly or indirectly, by debtors.
- 33 There is nothing in the cases that are included in the Overview that would suggest that there has been any failure to respect those requirements. Indeed, as already noted, all those affected by the proceedings in respect of the transactions were generally parties to the proceedings and, in case no. 2-591/11 - which concerned a dispute as to existence of any joint ownership – the Supreme Court clearly demonstrated the importance of ensuring that any parties affected by the determination of a case should be provided with an effective, real opportunity to present their evidence and arguments to the court, underlining its appreciation of the relevance of Article 6§1 to these proceedings.
- 34 It is not, of course, the nature of proceedings before the Supreme Court to enter into disputes about the facts. However, it will be important for the lower courts to be mindful of the need to have a proper evidential basis for any findings used to support a conclusion that a particular transaction was fraudulent. The Supreme Court should, in its own rulings, seek to emphasise the importance of demonstrating the existence of such a sound evidential basis for any conclusion reached about the motives behind a specific transaction.
- 35 In this connection, the conclusion in case no. 755/3563/21 that the entering into a prenuptial agreement was an act of obvious bad faith aimed at preventing the foreclosure of the debtor's property or reducing the amount of the debtor's property would have benefited from more substantiation since, even if that might have been the intention of the debtor, it might not have been what the other spouse intended. Failing to consider the other spouse's view in this context could amount to an indirect form of discrimination in cases where a wife is not the debtor.

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<sup>6</sup> *Ibid*, at para. 35.

- 36 Ensuring legal certainty is seen by the European Court as fundamental importance when it comes to the application of Article 6§1.<sup>7</sup> This ought to be borne in mind, therefore, when determining the basis for invalidating transactions that are considered to be fraudulent.
- 37 There is no reason to suggest that the various provisions invoked by the Supreme Court are not sufficient for this purpose in the cases that are included in the Overview. Nonetheless, the variation in the ones relied upon could give rise to the uncertainty which the European Court of Human Rights regards as inconsistent with the rule of law and thus contrary to Article 6.
- 38 It would be appropriate, therefore, if there was more consistency in the particular provisions cited in support of invalidating particular legal transactions or clearer explanations were provided for invoking a specific one in a given case.

*Article 1 of Protocol No. 1*

- 39 The revocation of an interest acquired by a transaction does not mean that the purported beneficiary of it did not have a possession for the purpose of Article 1 of Protocol No. 1 up until it was determined in relevant proceedings that the relevant transaction was invalid.<sup>8</sup>
- 40 However, the recognition that there is a possession for the purposes of Article 1 of Protocol No. 1 up until the transaction is invalidated will, in itself, add more than reinforce the procedural requirements under Article 6(1), which must be observed where there is any interference with the property rights guaranteed by this provision.<sup>9</sup>
- 41 The invalidation of a transaction, where this is consistent with the law applicable at the time the transaction was concluded, would not in principle be inconsistent with the right to peaceful enjoyment of possessions guaranteed by Article 1 of Protocol No. 1 as the European Court of Human Rights emphasised:

*domestic court decisions in accordance with the rules of private law cannot be seen as an unjustified State interference with the property rights of one of the parties.*<sup>10</sup>

- 42 However, that will not be the case where court decisions in such disputes are arbitrary or otherwise manifestly unreasonable.<sup>11</sup>
- 43 Furthermore, the limited applicability of Article 1 of Protocol No. 1 to contractual matters is not appropriate where the dispute affecting a transaction is not a matter of interpretation but concerns the application of a mandatory provision of the law, entailing its annulment.

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<sup>7</sup> *Nejdet Şahin and Perihan Şahin v. Turkey* [GC], no. 13279/05, 20 October 2011.

<sup>8</sup> See, e.g., *Anna Popova v. Russia*, no. 59391/12, 4 October 2016 and *Kurban v. Turkey*, no. 75414/10, 24 November 2020. In the latter case, the European Court considered that a party to a contract that could be nullified had at least a legitimate expectation so that Article 1 of Protocol No. 1 was applicable.

<sup>9</sup> See, e.g., *G.I.E.M. S.R.L. and Others v. Italy* [GC], no. 1828/06, 28 June 2018, at para. 302.

<sup>10</sup> See, e.g., *Kurban v. Turkey*, no. 75414/10, 24 November 2020, at para. 67.

<sup>11</sup> *Ibid.*

- 44 In such a case, there will be a need to consider whether the loss of the interest concerned amounts to the imposition of an individual and excessive burden on the party to the transaction involving and there is a failure to strike a fair balance between the demands of the public interest on the one hand and the party's right to peaceful enjoyment of their possessions on the other.
- 45 A violation of Article 1 of Protocol No. 1 in such circumstances has thus been found where the owner of a flat was deprived of her title to it when it was established that the municipality had lost its title to it as a result of a fraud when unidentified persons forged a privatisation agreement and the owner had not been responsible for the situation it had been the subject of two prior transactions before she bought it and those transactions had been registered after being found to be in compliance with the applicable laws.<sup>12</sup>
- 46 Similarly, a violation of Article 1 of Protocol No. 1 was found by the European Court of Human Rights in a case where a procurement contract had been annulled with *ex tunc* effects and the guarantee provided had been retained on the basis of that the institution of criminal proceedings against him meant that he was excluded from the possibility of it being awarded to him.
- 47 In the view of the European Court of Human Rights, this was disproportionate to the aim pursued, in that he had to bear an individual and excessive burden, having regard to:
- (i) the fact that the applicant was not notified properly of the indictment so that he could refrain from participating in the tender, (ii) the negligence on part of the procurement authority or the absence of coordination with the public prosecutor's office to verify whether there were any circumstances that would exclude the applicant from entering into a contract, (iii) the fact that the measure was applied as an automatic consequence of the fact that he had been indicted, (iv) and the irreversible and permanent nature of the impugned measure with no possibility for the applicant to claim a refund in the event that the criminal proceedings against him ended with a result other than a conviction.*<sup>13</sup>
- 48 Moreover, where a property interest was annulled, there may also be an excessive burden placed on *bona fide* purchasers where their only remedy would be to sue the persons who sold it to them and were themselves *bona fide* purchasers.<sup>14</sup>
- 49 These rulings ought also to be considered in the light of the rulings of the European Court of Human Rights in cases concerned with the forfeiture of assets that are supposedly the proceeds of crime. Thus, it found a violation of Article 1 of Protocol No. 1 where there was no link established between the criminal activity concerned and the assets seized.<sup>15</sup>

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<sup>12</sup> See, e.g., *Anna Popova v. Russia*, no. 59391/12, 4 October 2016. See also the similar rulings in cases such as *Alentseva v. Russia*, no. 31788/06, 17 November 2016 and *Gladysheva v. Russia*, no. 7097/10, 6 December 2011.

<sup>13</sup> *Kurban v. Turkey*, no. 75414/10, 24 November 2020, at para. 87.

<sup>14</sup> See *Dzirnis v. Latvia*, no. 25082/05, 26 January 2017, at para. 92.

<sup>15</sup> *Rummi v. Estonia*, no. 63362/09, 15 January 2015 and *Todorov and Others v. Bulgaria*, no. 50705/11, 13 July 2021.



- 50 Similarly, there ought to be considerations given to establishing that the party to the transaction was actually complicit in its fraudulent objective.
- 51 Although none of these rulings are concerned with the exact situations seen in the cases summarised in the Overview, they do provide some guidance as to how those situations should be addressed from the perspective of Article 1 of Protocol No. 1.
- 52 Certainly, there is a need to review the approach in cases where persons have entered into transactions with the debtors in good faith and have paid them the market value for the property concerned.
- 53 Undoubtedly, that is not the situation in most of the cases where transactions to evade paying debts have been involved, particularly those involving relatives of the debtors concerned.
- 54 It is most likely to be important where there has been a succession of transactions after the initial one involving the debtor.
- 55 Nonetheless, the annulment of transactions concluded by persons who has no knowledge of the claim already existing against the property of the debtors that is the subject of them and could have no such knowledge and who have paid the market value of the property concerned is likely to be regarded as imposing on them a disproportionate and excessive burden.
- 56 Indeed, the interest of creditors who have obtained judgments against debtors might be better protected if such judgments could be entered in the property register so that an intending *bona fide* purchaser would then get notice of the protected interest in the property concerned.
- 57 The case law above also reinforces the importance of ensuring a proper evidential basis for concluding that there has indeed been a fraudulent transaction as otherwise genuinely innocent purchasers are likely to be unjustly prejudiced.

### **C. Interpretation of the legal provisions concerned**

- 58 The conclusions in this Note were based on the provisions that were cited by the Supreme Court, none of which provide explicitly for invalidating fraudulent transactions but which seemed to be a reasonable interpretation of them (especially Article 234). In the circumstances, the fact that there is no explicit provision on invalidity does not seem decisive.
- 59 However, it is necessary to make a reservation here that only the Supreme Court should conclude whether the provisions of the national law can be interpreted in the way indicated in the analysed case law.

- 60 In the context of the case law of the ECtHR it is necessary to note that it does not require everything to be explicitly stated; the law can be interpreted so long as it is foreseeable and thus not inconsistent with the principle of legal certainty.
- 61 So the issue to be resolved is whether there is any reason that would preclude the Supreme Court from the way it interpreted the relevant provisions (although note the reservation on legal certainty in paras. 36-38) regarding the invocation of different provisions of the Civil Code to justify invalidating the transactions.

#### **D. Overall assessment**

- 62 The case law of the Supreme Court regarding fraudulent transactions, as summarised in the Overview, is generally compatible with the Convention.
- 63 There is a need to ensure that there are no unjustified assumptions about the existence of bad faith in the conclusion of particular transactions.
- 64 At the same time, there is a need for the approach adopted to take account of the need to protect a *bona fide* purchaser who paid the market value and was in no position to know any improper objectives being pursued by the debtors involved.
- 65 Finally, it will be important to ensure consistency in the legal basis invoked for annulling transactions found to be fraudulent.