

A map of Ukraine showing major cities and regions. The map is light blue and white, with city names in black. Major cities labeled include Lviv, Ternopil, Vinnytsia, Kyiv, Zhytomyr, Rivne, Luts'k, Kovel, Ivano-Frankivsk, Chernivtsi, Kharkiv, Poltava, Sumy, Boryspil, Kyyiv, Kremenchuk, Dnipropetrovsk, Luhansk, Donetsk, Zaporizhzhya, Kirovograd, Kiyiv, Kriviy Rih, Myrnohorod, Mariupol, Simferopol, Kerch, and Sevastopol. Regions labeled include Lviv, Ternopil, Vinnytsia, Zhytomyr, Rivne, Luts'k, Kovel, Ivano-Frankivsk, Chernivtsi, Kharkiv, Poltava, Sumy, Boryspil, Kyyiv, Kremenchuk, Dnipropetrovsk, Luhansk, Donetsk, Zaporizhzhya, Kirovograd, Kiyiv, Kriviy Rih, Myrnohorod, Mariupol, Simferopol, Kerch, and Sevastopol. The map also shows neighboring countries: Poland to the north, Romania to the southwest, and the Russian Federation to the east and south.

# COMMERCIAL LAWS OF UKRAINE

**July 2007**

# AN ASSESSMENT BY THE EBRD

*This Assessment was last updated during the preparation of the 2007 EBRD Strategy for Ukraine and reflects the situation at that time. It does not constitute legal advice. It was prepared by the Office of the General Counsel of the EBRD. For further information please contact [ltt@ebrd.com](mailto:ltt@ebrd.com)*

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**Basis of Assessment:** *This information is based on the experience of the Office of the General Counsel whilst conducting legal assessments on behalf of the Bank. It also draws on EBRD investment and legal reform activities in Ukraine (see [www.ebrd.law](http://www.ebrd.law)).*

## 1. Overall Assessment

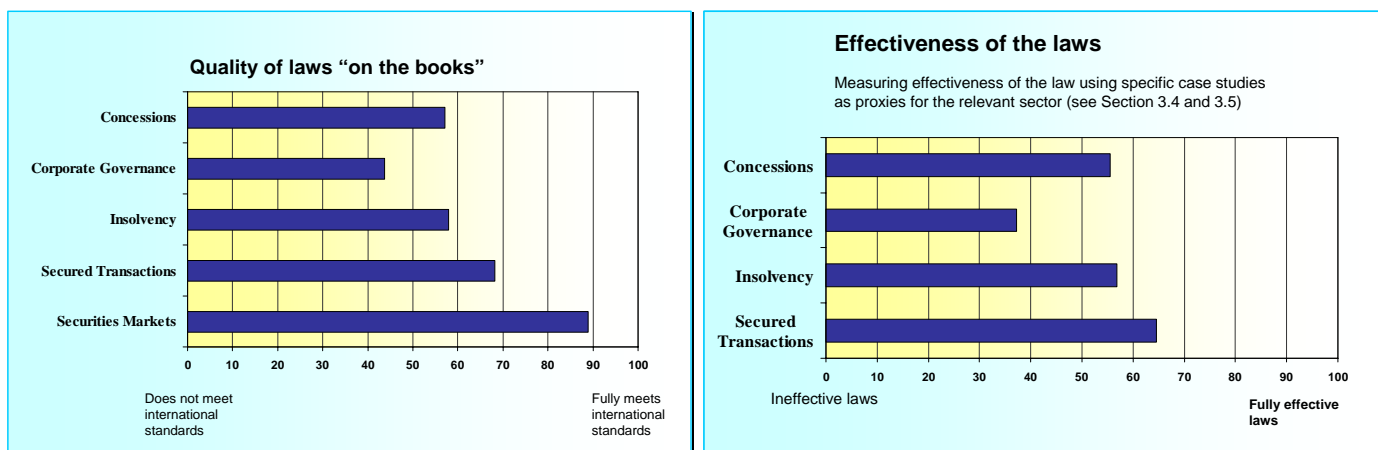
Over the course of the past few years, Ukraine has reformed its legal framework and has adopted a number of important legislative acts; Civil Code, Commercial Code, the Law on Mortgages, Law on Mortgage Finance, Law on the Registration of Rights to Immovable Property, Law on Securing Creditors' Claims, Law on Registration of Encumbrances, the Telecommunications Law and the Law on Securities and the Stock Market.

The adoption of the new Law on Securities and the Stock Market represents a positive initiative towards better harmonisation of the existing legislation in this sector and brings certain improvements to the framework (e.g. new provisions on listing and prospectus requirements, insider trading). The companies law and corporate governance sector is inappropriately regulated due to gaps in the current legislation and the lack of coherence with other relevant legislation. Other possible improvements in this sector are the promotion and submission to parliament of the new draft Law on Joint Stock Companies that is intended to improve the framework and the adoption of the Corporate Governance Code that is applied on a voluntary basis.

In the concession sector the framework is relatively solid for public and private sector collaboration. However, there are issues that need to be tackled such as the adoption and promotion of a policy framework that should contribute to proper implementation of the existing legislation. The insolvency sector is inadequately regulated; the governing law being deficient in most key areas of insolvency, including the restructuring process, bankruptcy administration, lack of set-off provisions, etc. A number of reforms in the secured transactions area have led to positive results providing the market with a fully operating modern system, however there are still some issues regarding the flexibility of the system in line with market developments. Partial alignment with EU standards in the telecommunications sector has led to better functioning of the market, however further developments are necessary in particular regarding competition.

Despite certain improvements, the legal environment remains difficult to navigate as a large proportion of legislation continues to be issued by way of decree and there appear to be large implementation gaps. (See Chart 1) In addition, commentators have noted that many potential investors are discouraged by perceived corruption and arbitrary licensing practices, as well as by continuous political instability.

**Chart 1 – Snapshot of country’s commercial laws**



Source: EBRD legal assessments 2002-2005

## 2. The Legal System

### 2.1. Constitution and courts

Ukraine’s Constitution was adopted by the Verhovna Rada (the Ukrainian Parliament) on 28 June 1996, creating a presidential republic. It was amended in late 2004. State power is held by three branches: legislative, executive, and judicial.

The exclusive body of legislative power in Ukraine is the Verhovna Rada. It has jurisdiction to legislate on any issue of state and social life in Ukraine, except for those that are settled exclusively by the All-Ukrainian Referendum and those reserved to the Autonomous Republic of Crimea. The Verhovna Rada has a membership of 450 Deputies, each elected by proportional representation for a five-year term. The right of legislative initiative in the Verhovna Rada belongs to the Deputies, the President of Ukraine, the Cabinet of Ministers of Ukraine, and the National Bank of Ukraine.

The president of Ukraine is head of state and acts on its behalf. The president of Ukraine is elected by Ukrainian citizens on the basis of common, equal, and direct electoral right by secret ballot for a period of five years. According to the constitution, the president of Ukraine cannot be re-elected for more than two terms. The Cabinet of Ministers of Ukraine is the highest body of state executive power in Ukraine. The President forms the Cabinet, appoints the Prime Minister with the consent of the Verkhovna Rada and controls government operations.

Constitutional amendments to reduce presidential power, enacted on the 8<sup>th</sup> December 2004 and gradually coming into effect by the 2006 Parliamentary elections have left areas of uncertainty concerning the balance of power between the governing branches. Endeavours by both sides to impose their will (culminating, on the 12<sup>th</sup> January 2007, in a parliamentary decree on the increase of prime ministerial powers, overriding a presidential veto on the matter) have led commentators to believe that the demarcation will ultimately have to be defined in court.

The judicial system in Ukraine undertook a significant revamp of its framework when the Parliament passed the Law of Ukraine No. 3018-III On the Judicial System in February 2002. It is now organised according to a four tier system divided along commercial, administrative and criminal/civil lines. These tiers are respectively: general courts of jurisdiction; appeal courts; high courts with specialised jurisdiction; and the Supreme Court. There is a separate Constitutional Court dealing with the legality of legislative acts.

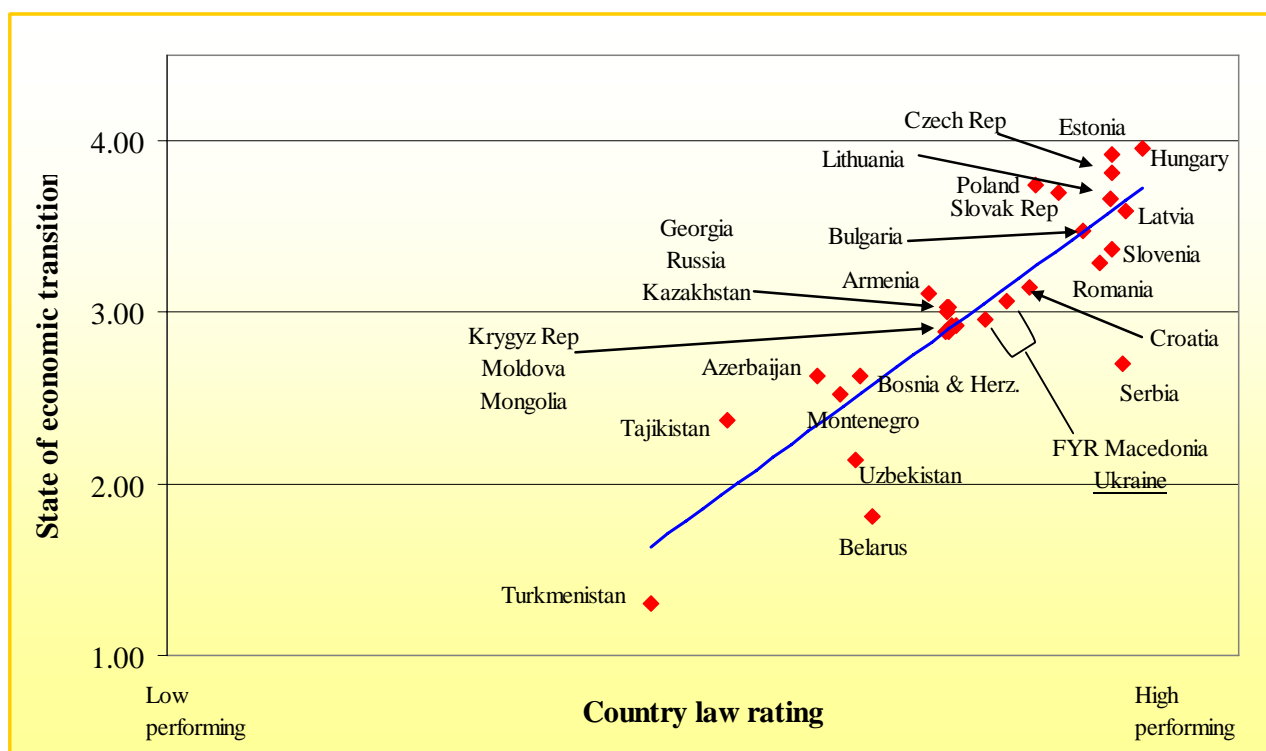
The 2002 legislation further set forth basic requirements for judges, established the principles of judicial self-government, and outlined the general procedure for maintenance of the courts. It also outlined basic principles for the operation of the judicial system generally conforming to European standards. Although the Constitution allows for an independent judiciary, there is a perception that the courts may be subject to political interference, corruption, and other deficiencies. It is unclear whether the Law on the Judicial System will effectively provide any greater independence.

The judicial branch has been criticised by various commentators, including professionals and investors, for lack of independence from the executive branch and local governments, which control funding for courts and allocation of resources (including housing) to judges. In such an environment, the courts cannot be relied upon to enforce constitutional rights nor contracts or determine disputes impartially, particularly where one of the contractual parties is the government. An inadequate court system is an obvious indicator of an impaired legal system.

## *2.2. Relationship between legal transition and economic progress.*

Experience in the EBRD countries of operations appears to suggest that the degree of respect for the rule of law and advancement in economic transition progress or regress hand in hand. (See Chart 2) Given the positive correlation throughout the Bank's countries of operations between these two dimensions, i.e., legal transition and overall economic progress, it is reasonable to expect that the future success of the transition process in Ukraine will be dependent in part on improving the quality of the country's legal system.

**Chart 2 – Rule of law and progress in transition in the EBRD countries of operations**



Sources: EBRD Transition Report 2006, Table 1.1; EBRD Composite Country Law Index, 2006

*Note:* The **horizontal axis** measures the performance of commercial and financial law. The **vertical axis** displays the EBRD transition index as an average of transition indicators between 1997 and 2003, with 1 referring to very early transition stages, and 4 referring to an advanced transition level.

### 2.3. Implications for the investment climate

The recent constitutional reforms have left in their wake a certain lack of clarity as to the ambit of the executive powers. This development, combined with certain areas of conflict between President Viktor Yushchenko on the one hand and the Prime Minister Viktor Yanukovych and his governing Party of Regions (PoR) on the other, has led to a somewhat unpredictable political environment. In spite of differences between the two camps, however, it is quite likely that Ukraine will continue its pro-market reforms given the influence of several cross-party business pressure groups.

Ukraine's economic stability is undermined by dependency on energy imports from Russia and Turkmenistan as well as an export portfolio dominated by primary and semi-processed raw materials which suffers in the case of price drops in corresponding commodity markets. At a macro level, Ukraine is also hindered by shortcomings in the risk assessment practices and accounting and reporting standards of its commercial banking sector and subsequent lack of confidence in the financial system, potentially leading to a bank run as happened in 2004, though this is gradually improving due to the recent emergence of foreign banks. These factors have led to erratic GDP growth in the last three years. The economy did show great resiliency, however, following the Gazprom dispute early in 2006 by absorbing and overcoming the subsequent oil price increase.

The tax regime is also unpredictable. The widely abused Special Economic Zones have been abolished, though this has affected certain vocal bona fide users who have been lobbying the government for a reversal of policy. Mr Yanukovych has reacted by drafting proposals to achieve

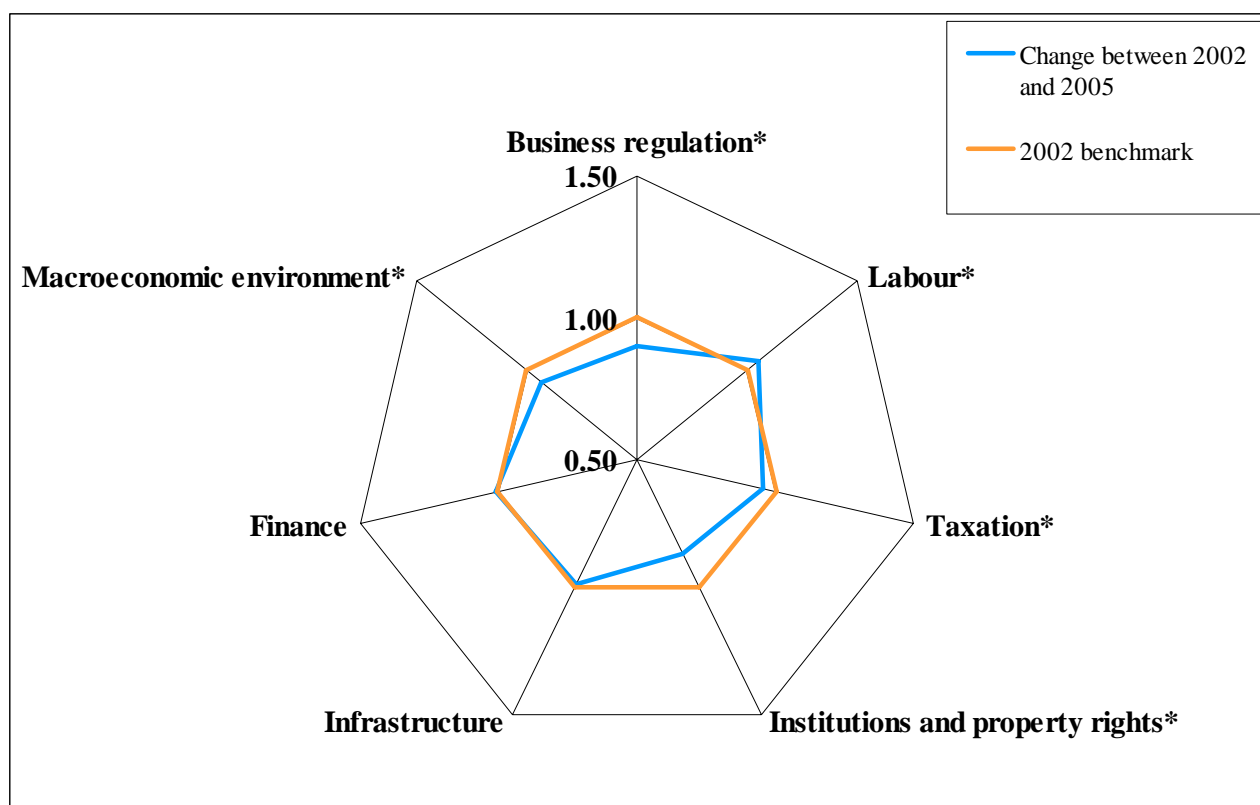
this. Elsewhere, income tax has been flattened to 13% (set to rise to 15% in 2007), and corporate tax is possibly going to be reduced from the current 25% to 20%.

The legal environment still poses certain difficulties for foreign investment. Direct legislative restrictions in specific commercial sectors (notably banking and telecommunications), in privatisation and procurement more generally, as well as in land ownership, are largely responsible for these difficulties, though the lack of independence of the Ukrainian courts certainly contributes as well. Recent reform in land and anti-monopoly legislation is welcome but insufficient.

Corruption is not limited to the courts and poses significant disruption to the right and ability to form business, though the Yushchenko/Tymoshenko initiatives have led to much progress.

Further incentives include stable inflation and interest rates as well as an educated and skilled labour force and improved labour mobility. See chart below for graphical presentation of the changes on the macroeconomic level (see Chart 3).

**Chart 3 – Changes in the business environment in transition countries, 2002-05**



Sources: BEEPS 2002 and 2005

*Notes:* The spider charts show changes in seven aspects of the business environment between 2002 and 2005. The 2002 data represent a benchmark of no change. Where the line falls inside the benchmark, this represents an improvement in that aspect of the business environment. Where the line falls outside of the benchmark, this represents a deterioration in the business environment. Wherever the changes are statistically significant, the relevant categories are marked with an asterisk. The business environment was assessed on a scale from 1 (no obstacle) to 4 (major obstacle).

### 3. Evaluation of selected commercial laws

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, concessions, corporate governance, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of laws (also referred to as "effectiveness").

All available results of these assessments can be found at [www.ebrd.com/law](http://www.ebrd.com/law).

#### 3.1. Capital markets

On 23 February 2006, the Ukrainian Parliament approved a new Law on Securities and the Stock Market. This law entered into force on 12 May 2006, replacing the law passed in 1991. The new law is the principal legislation on securities markets and represents a positive step towards the elimination of a number of gaps and contradictions between the Civil and Commercial Codes with respect to securities and the stock market.

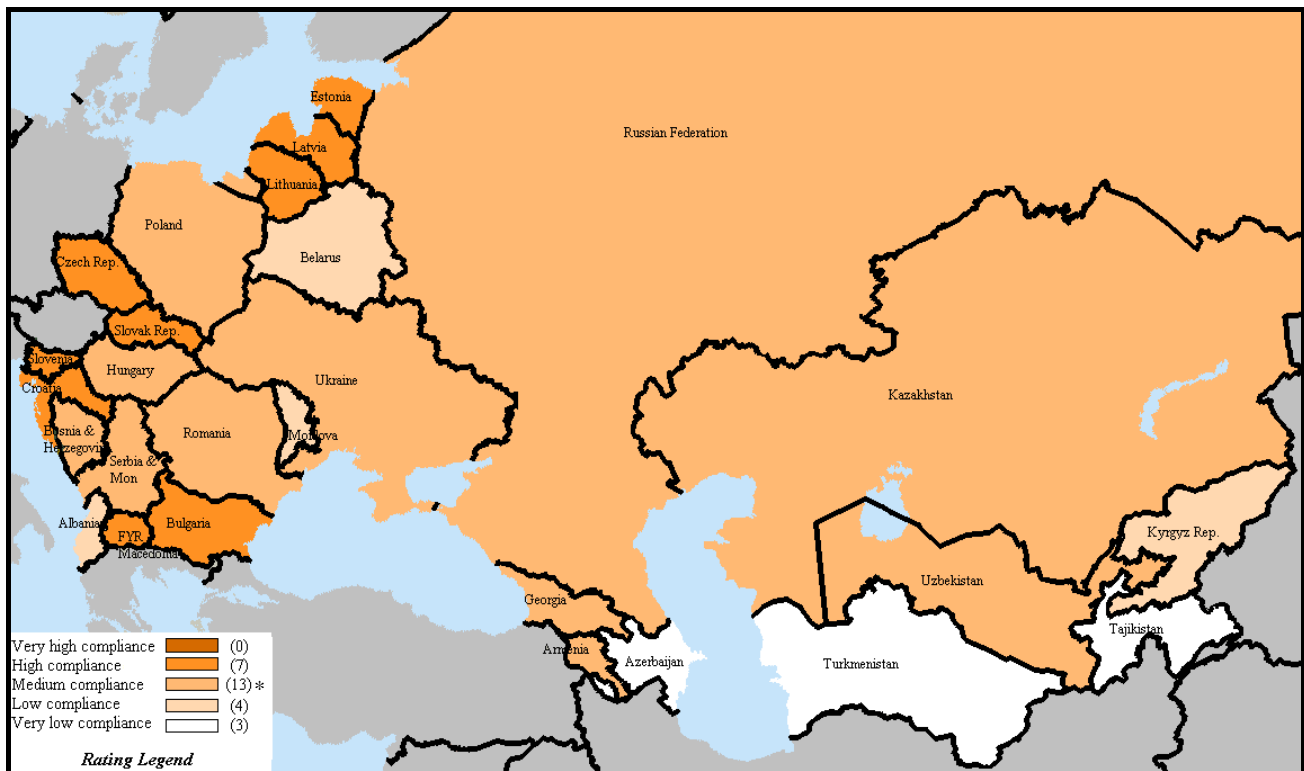
The new law details regulations on issuing and trading securities and on professional brokers while lessening the distinction between open and closed joint stock companies: closed companies are now allowed to offer shares in open subscriptions (provided that the first subscription is limited to founders only). The new law revises the concept of a “preference share”, provides for different classes of preference share, sets out mechanisms for their conversion and increases the percentage of preference shares from 10% to 25% of the authorised capital. The new law also introduces new regulations on listing and prospectus requirements, insider information and trading, and new rules governing the activity of stock exchanges in Ukraine. Since 12 May 2006 the basic law governing stock exchange activity has been the Civil Code, while the relevant provisions of the Commercial Code have been repealed and the contradictions in the definitions and purpose of a stock exchange set out in different laws have been eliminated.

The State Commission on Securities and the Stock Market is the Ukrainian market regulator. The Commission has authority to license and regulate market participants and to register securities issues, including the circulation of securities of foreign issuers in Ukraine. The Commission is financed by the state budget and is an Ordinary Member of IOSCO.

There are two main stock exchanges in Ukraine: (i) the electronic First Securities Trading system (PFTS), opened in July 1996, it is the largest with approximately 220 companies listed and a total market capitalization of about USD 20 billion; and (ii) the Ukrainian stock exchange (USE) with around 54 companies listed and a market capitalisation of about USD 331.3 million.

In 2005, the EBRD benchmarked the Ukrainian securities markets legislation with the “Objectives and Principles of Securities Regulation” published by IOSCO. The results showed the legislation to be in “medium compliance” with international standards, but very close to the “high compliance” category. (See Charts 4, 5)

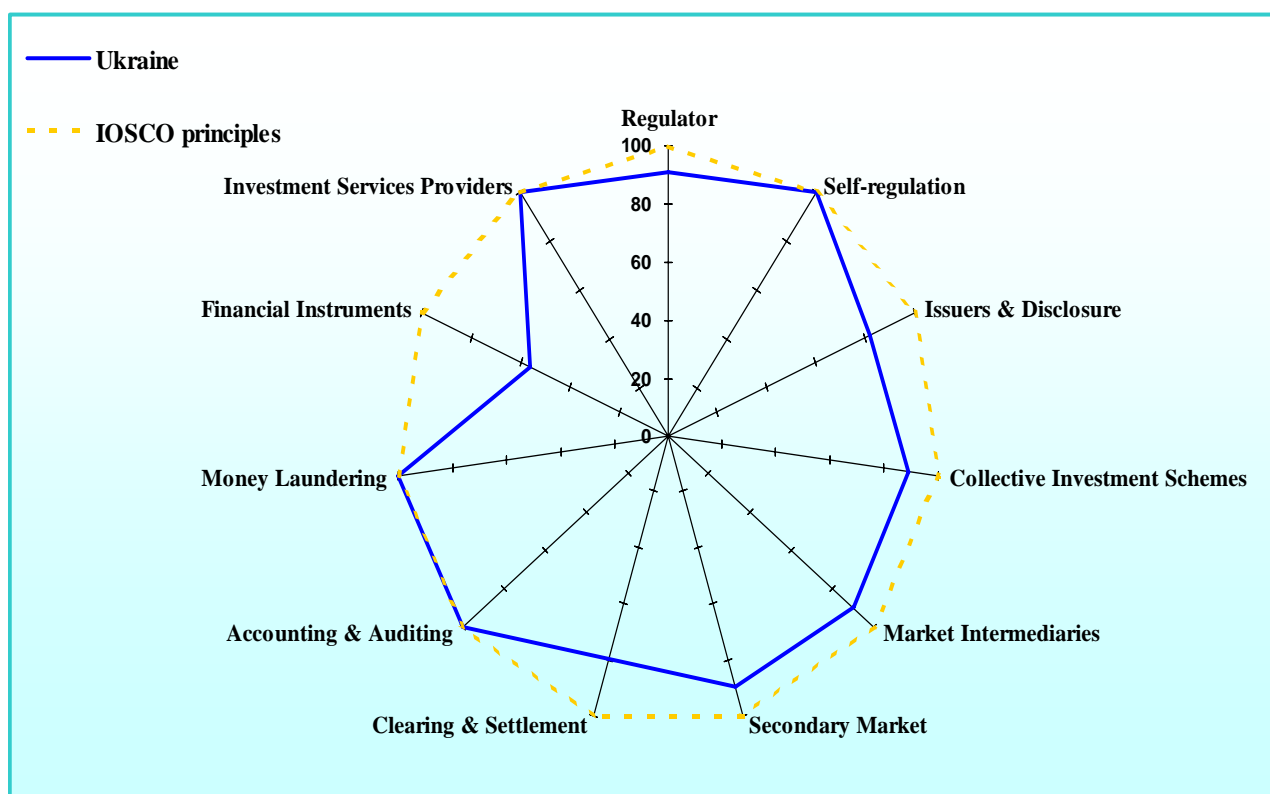
**Chart 4 – Quality of securities market legislation in the EBRD Countries of operation**



*Source: Securities Markets Legislation Assessment 2004*

*Note: The various categories represent the level of compliance of a given country’s legislation (the “laws on the books”) with international standards such as the IOSCO Principles. The asterisk indicates in which category the Ukraine ranks.*

Chart 5 - Quality of securities market legislation – Ukraine, 2005



Source: EBRD Securities Market Legislation Assessment 2005

*Note:* The extremity of each axis represents an ideal score in line with international standards such as the IOSCO Principles. The fuller the ‘web,’ the more closely the country’s capital markets laws approximate these standards.

### 3.2. Concessions

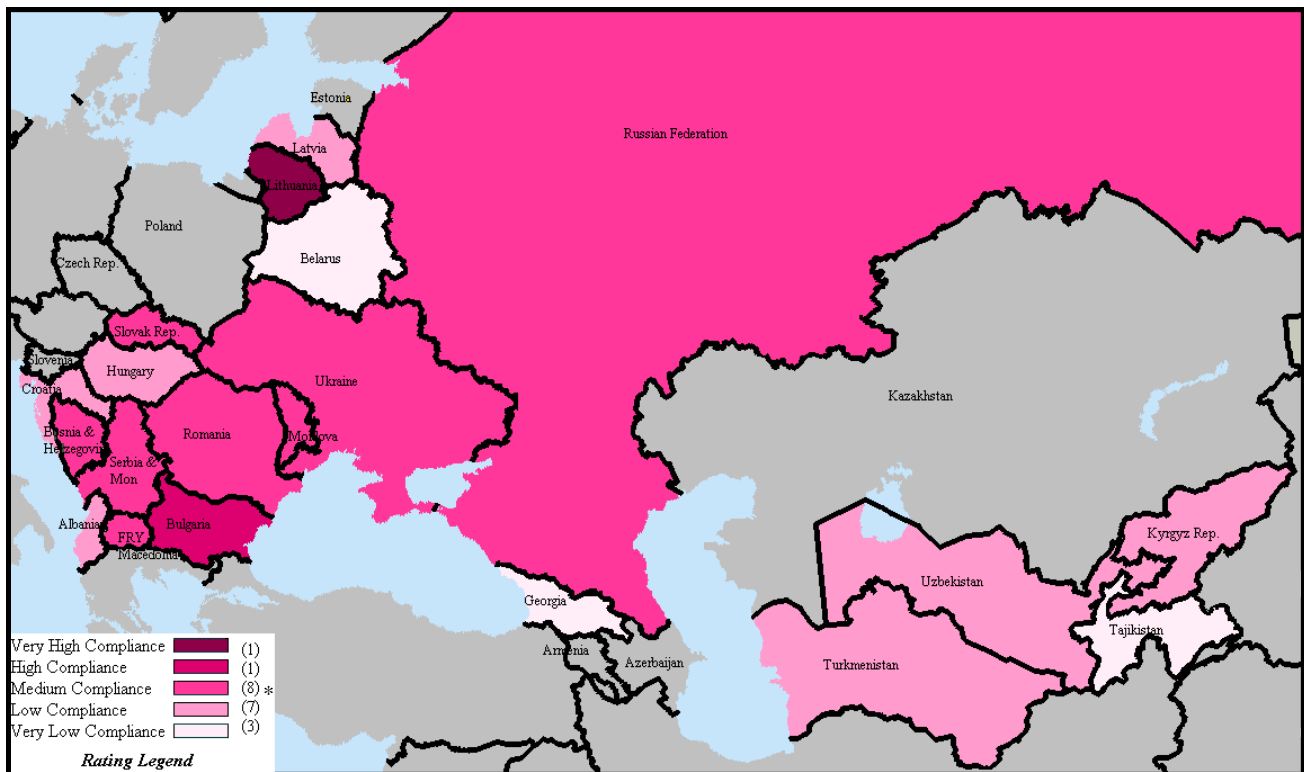
The Ukrainian Law “On Concessions” of 1999 (the “Concessions Law”) serves as a general framework law for concessions. In addition, rules regulating concessions are found in the Economic Code of Ukraine of 2003, as well as in some sector specific acts (for example in the motorway sector). The Concessions Law provides terms and procedures for the concession of state and communal property, including procedures for public tendering. Rules regulating project agreements provide relatively clear guidance on the main issues to be covered and remain sufficiently flexible to allow the parties to negotiate freely.

While the Concessions Law constitutes a relatively solid legal basis for the development of Private Sector Participation (PSP) in infrastructure and utilities sectors, certain improvements, however, would be desirable. In particular, the Concessions Law is somewhat uneven in that, while it clearly defines the scope of application, more detailed tender rules (i.e. incorporation of principles of transparency, non-discrimination, proportionality and efficiency, clear regulation of the pre-selection procedure and of review procedures) should be developed. Additionally, identification of, and collaboration between, different public entities involved in the process should be improved. There is further room for improvement in the Concessions Law relating to the lender’s position where security and step-in rights are concerned, as these remain unregulated.

The 2004/5 EBRD Concession Laws Assessment, undertaken to evaluate applicable regimes throughout the EBRD countries of operations, (the law on the books only, rather than how those

laws work in practice), revealed that Ukrainian laws were in “medium compliance” with internationally accepted standards. (See Chart 6)

**Chart 6 – Quality of Concessions legislation in the EBRD Countries of operation**

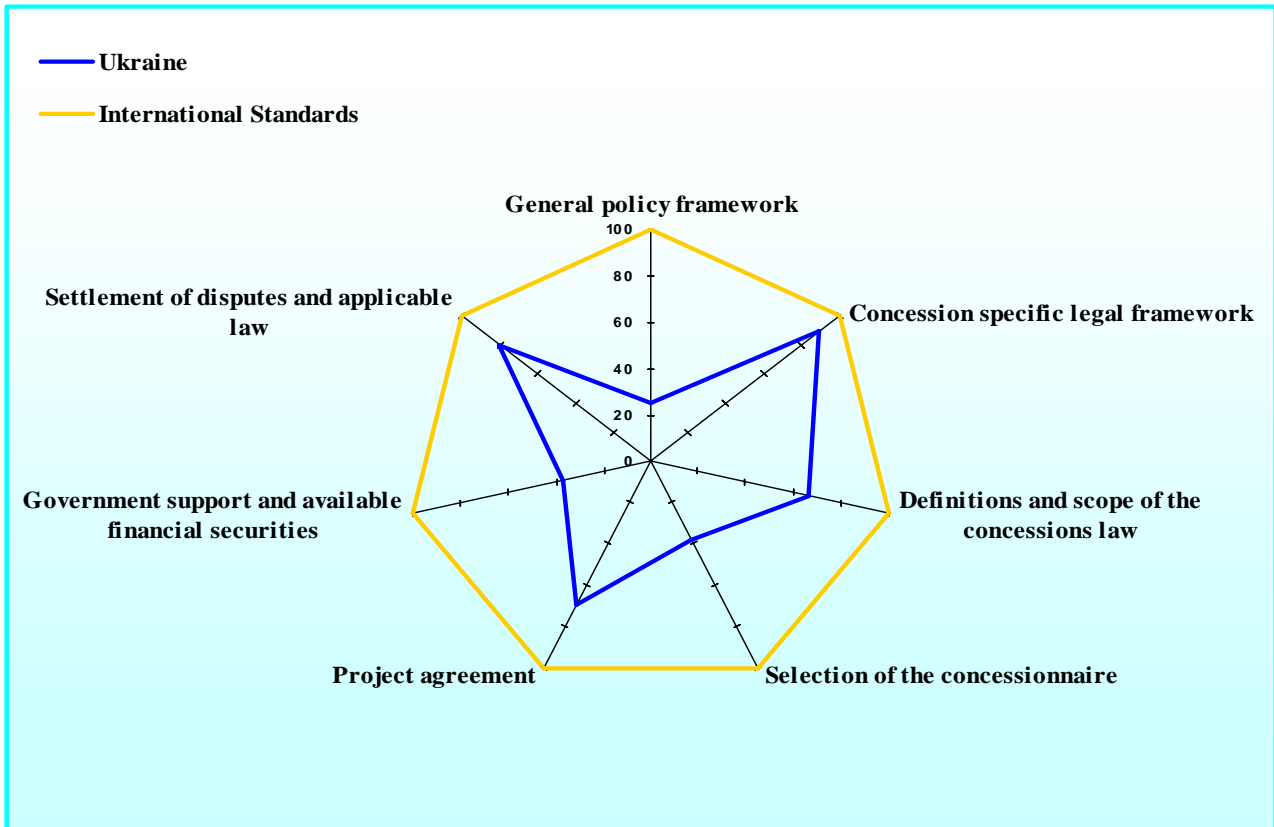


Source: EBRD Concessions Sector Assessment 2004

**Note:** The various categories represent the level of compliance of a given country’s legislation (“the laws on the books”) with international standards such as the UNCITRAL Model Legislative Provisions on Privately Financed Infrastructure Projects. The asterisk indicates in which category Ukraine ranks.

As can be seen from the chart below (see Chart 7), while general framework rules and rules such as those covering settlement of disputes in concession-related arrangements are regulated fairly extensively, most other areas (in particular, selection of a concessionaire, availability of financial instruments and state support) need further improvement to match the standards of a modern legal framework facilitating private sector participation. One further dimension that will inevitably require the attention of the authorities is the policy framework, the absence of which makes any law, even an ideal one, extremely difficult to implement. While a draft policy document has been produced by the Ministry of Economy, it may not be sufficiently robust to guide implementation of the relevant reforms. EBRD advisors have produced another draft policy document produced in the course of a motorway PPP technical cooperation project which may act as a useful comparison for the Ministry in refining its policy document.

Chart 7 - Quality of Concessions legislation – Ukraine, 2004

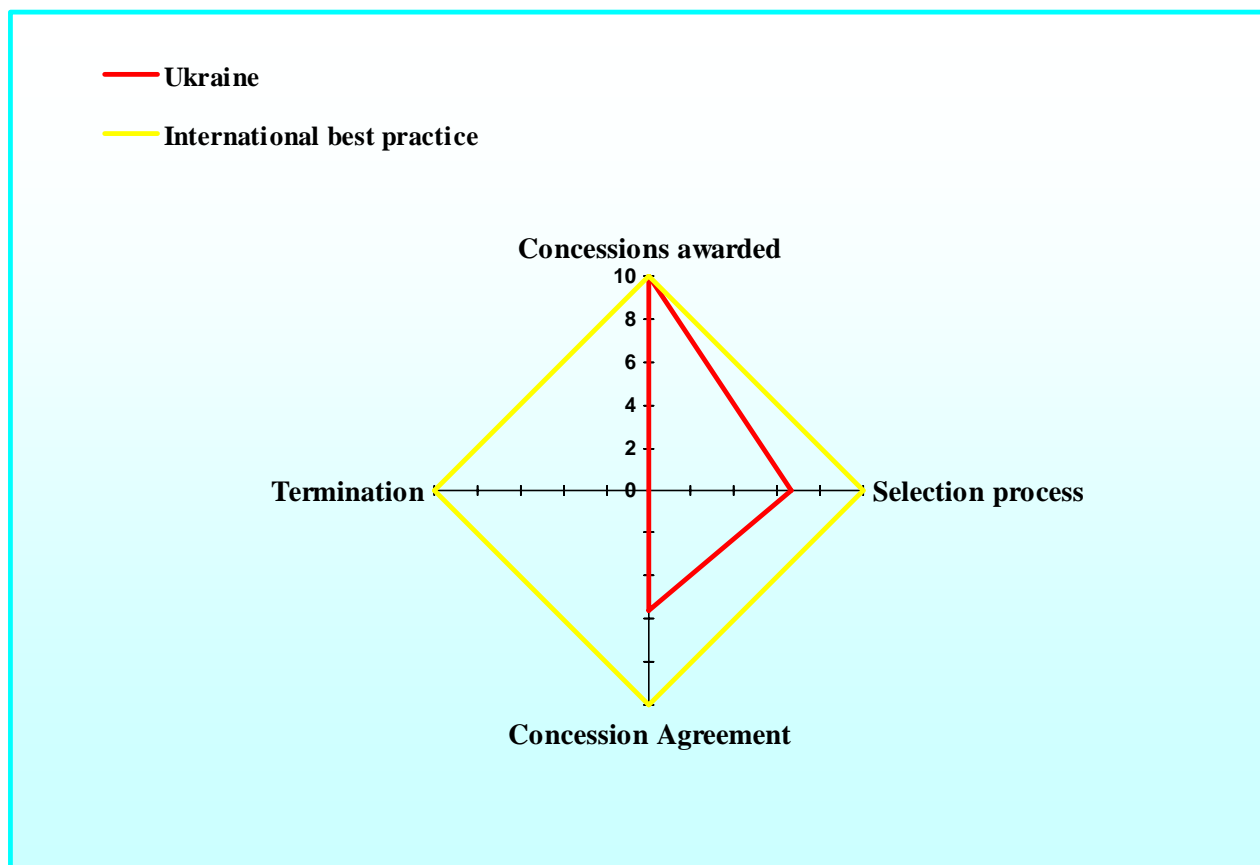


Source: EBRD Concessions Sector Assessment 2004

**Note:** The extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure Projects. The fuller the ‘web,’ the more closely the country’s concessions laws approximate these standards.

According to the 2006 Legal Indicator Survey evaluating the workability of concession regimes in practice, the Ukrainian regime was rated as having a medium level of effectiveness. (See Chart 8) Of particular concern was the possible recovery of investment following termination of a concession agreement.

Chart 8 - Effectiveness Concessions legislation – Ukraine, 2006



Source: EBRD 2006 Legal Indicator Survey on Concessions

Note: The results have been derived from the answers by local law firms to questions about the practical functioning of the concessions regime. The fuller the “web,” the more effective the country’s concessions regime is.

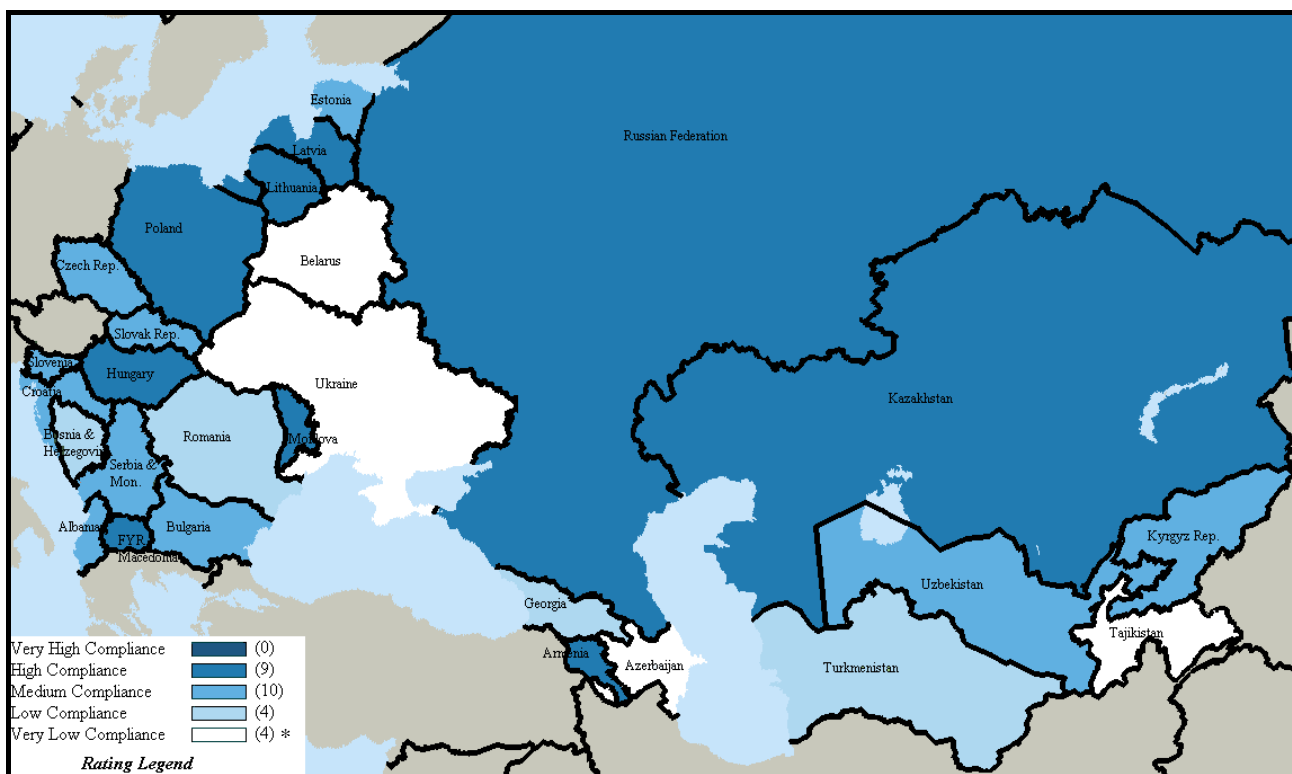
### 3.3. Corporate Governance

The primary sources of law relating to corporate governance in Ukraine are the Law on Enterprises in Ukraine and the Law on Business Associations. On 1 January 2004, a new Civil Code and a new Commercial Code entered into force, substantially amending the existing legal framework. While these codes improved the existing legal framework they also appear to have created several problems relating to interpretation and application: new provisions conflict with each other and a complicated interpretation exercise needs to be performed in order to understand which provision prevails in a specific scenario.

A first important step in resolving this issue was taken with the enactment of the new Law on Securities and the Stock Market. A further important step was the approval, on 14 February 2007, by the Cabinet of Ministers of the most recent version of the draft Joint Stock Companies Law recently, and submission to the Verkhovna Rada (Ukrainian Parliament) for consideration. The next step is for the draft law to be approved by the Rada and signed into law by the president.

When most recently assessed by the EBRD, in 2004, Ukrainian corporate governance legislation was measured as being in “very low compliance” with the OECD principles (see Chart 9).

**Chart 9 – Quality of Corporate Governance legislation in the EBRD Countries of operation**

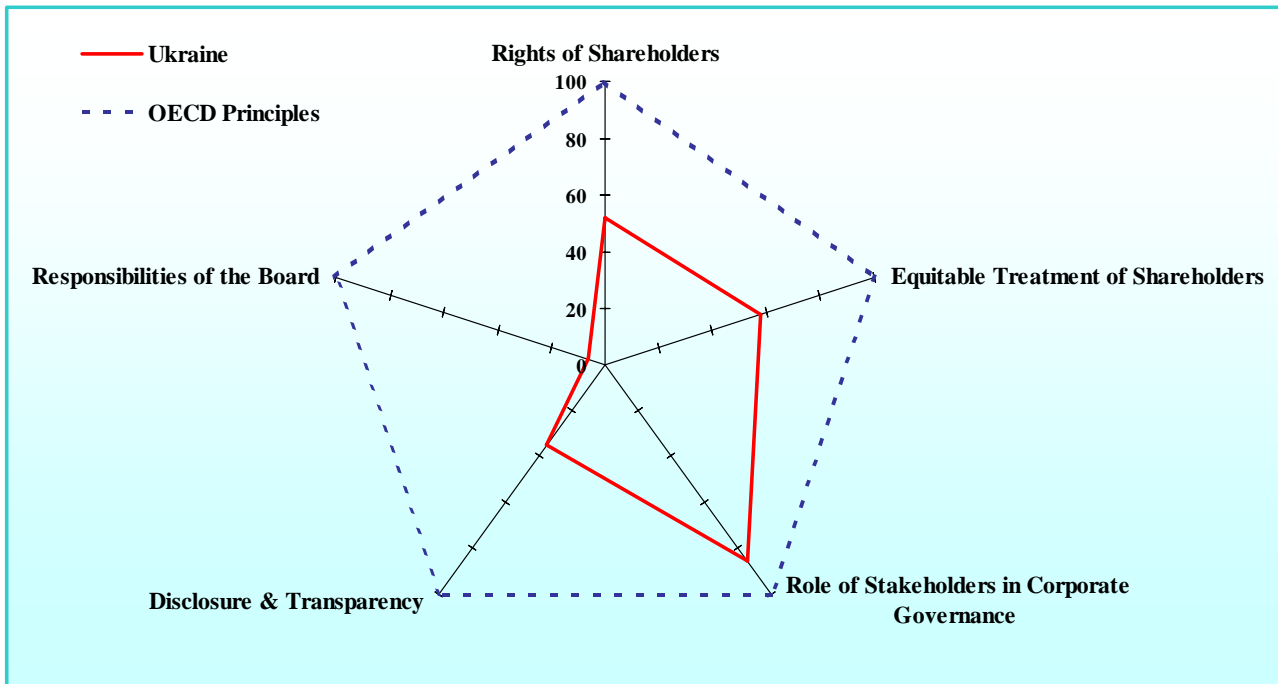


*Source: EBRD Corporate Governance Sector Assessment 2004*

*Note: The various categories represent the level of compliance of a country’s legislation (the “laws on the books”) with international standards as set out in the OECD Principles of Corporate Governance. The asterisk indicates in which category the Ukraine ranks.*

In particular, disclosure rules concerning company information were found to be inadequate, the duties of a company’s board of directors unclear and the provisions concerning shareholders rights insufficient. (See Chart 10)

**Chart 10 – Quality of Corporate Governance legislation – Ukraine, 2004**



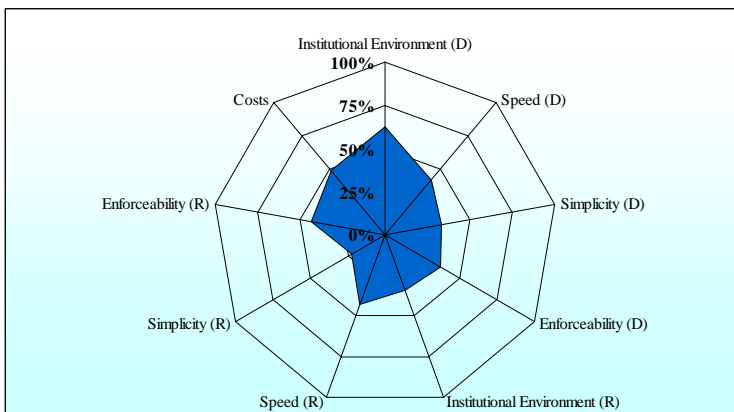
Source: EBRD Corporate Governance Sector Assessment 2004

*Note:* The extremity of each axis represents an ideal score in line with international standards such as the OECD Principles of Corporate Governance. The fuller the ‘web,’ the more closely the country’s corporate governance laws approximate these standards.

In June 2003 a Corporate Governance Code titled “Ukrainian Corporate Governance Principles” was enacted. These principles are intended for open joint stock companies traded on the stock market and are voluntary.

In 2005, the EBRD conducted a survey for testing the effectiveness of corporate governance (how the law works in practice). A case study dealing with related-party transactions was designed. The case study investigated i) the position of a minority shareholder seeking to access corporate information on a presumed related-party transaction was indeed entered into by the company and ii) how compensation could be obtained in case damage was suffered. Effectiveness of the system for both questions was assessed based on four principal variables: complexity, speed, enforceability and institutional environment. (See Chart 11)

**Chart 11 - Effectiveness of corporate governance in Ukraine (2005)**

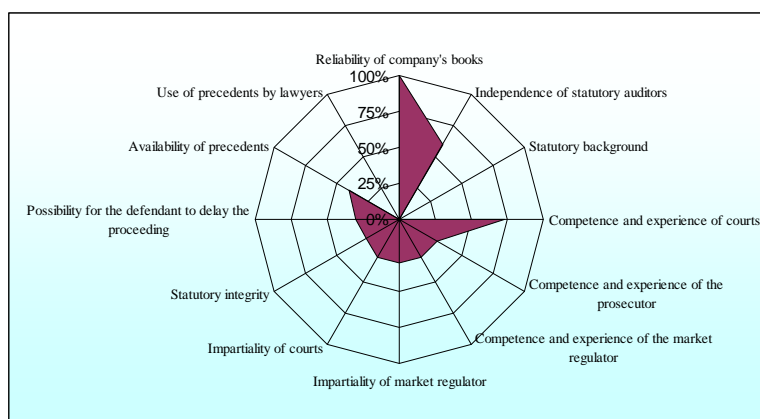


*Note:* The graphs show disclosure, redress and the institutional environment in Ukraine. The average results from the case study scenarios are shown. Disclosure refers to a minority shareholder’s ability to obtain information about their company. Redress refers to the remedies available to a minority shareholder whose rights have been breached. Institutional environment refers to the capacity of a country’s legal framework to effectively implement and enforce corporate governance legislation. Costs refer to the expenses a minority shareholder must pay to take legal

action. The extremity of each axis represents an ideal score: the fuller the ‘web’, the better the corporate governance framework.

The survey revealed that a minority shareholder - owning more than 10% shareholding - has, by virtue of law, access to different avenues to seek disclosure from the company (i.e. he can request an independent audit or call a shareholder’s meeting to ask for information from the management). Unfortunately, all actions are deemed quite complex and lengthy as it is quite easy for the defendant to delay the proceedings. The difficult enforcement and the weak institutional environment add to the complexity of the actions. (See Chart 12)

**Chart 12 - Institutional Environment in Ukraine (2005)**



*Note: Institutional environment refers to the capacity of a country’s legal framework to effectively implement and enforce corporate governance legislation. Statutory background relates to how comprehensive, clear and well structured a country’s definition of related-party, self-interested, self-dealing, or conflict of interest transactions is. In particular, whether this definition covers transactions in which the director or the dominant shareholder has an indirect interest (for example, the party to the transaction is a dominant shareholder’s subsidiary). Statutory integrity refers to the*

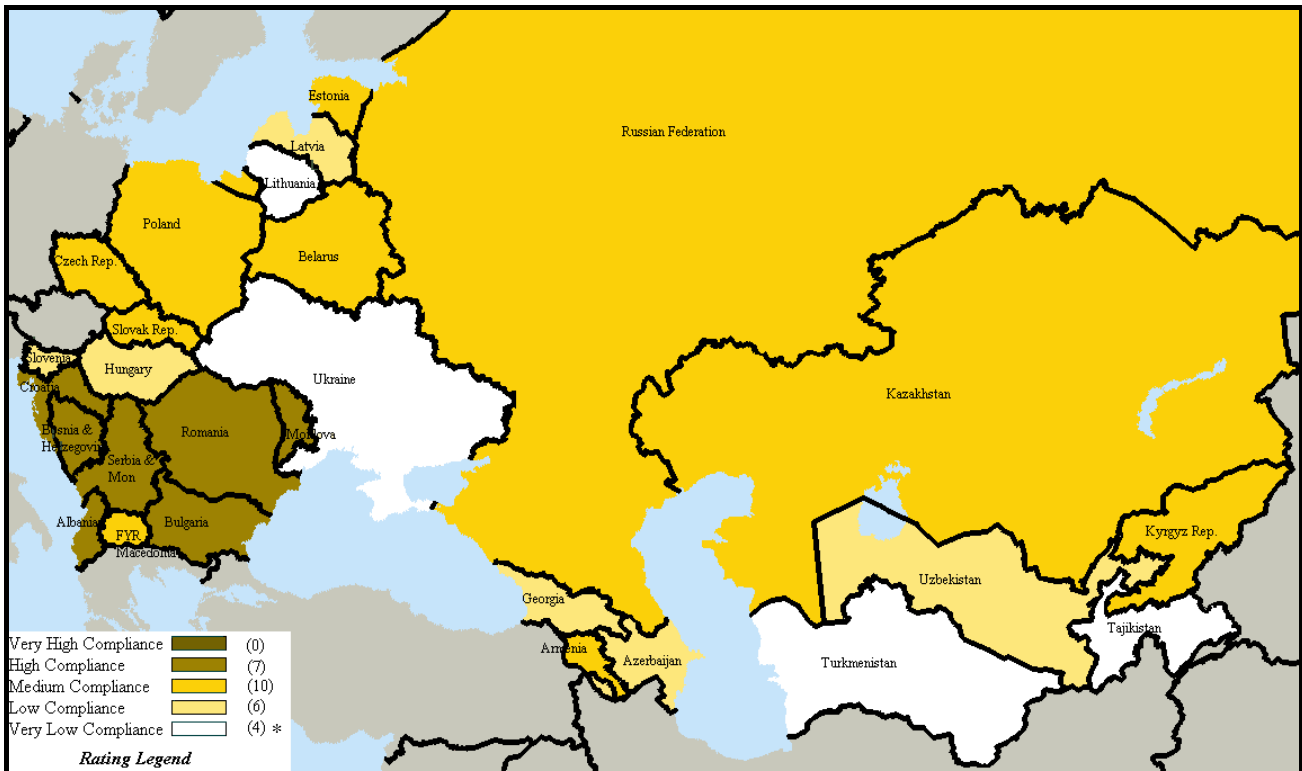
*level of corruption within a transition country, as determined by Transparency International’s Corruption Perception Index 2005. This index is measured on a scale from 1 to 10, with 1 being the most and 10 the least corrupt environment. The extremity of each axis on the graph represents an ideal score: the fuller the ‘web’, the better the institutional environment.*

Company books are considered generally reliable but the framework on related party transaction is weak. The competence and experience of prosecutors and market regulators need to be improved while corruption and partiality of judgements are still reported as presenting major problems.

### 3.4. Insolvency

Insolvency in Ukraine is governed by the Law on Restoring Debtor’s Solvency & Declaring a Debtor Bankrupt (as amended) (the “Insolvency Law”). This law scored “very low compliance” when compared with international standards in the EBRD’s 2003-2004 Sector Assessment Survey. (See Chart 13)

Chart 13 – Quality of Insolvency legislation in the EBRD Countries of operation

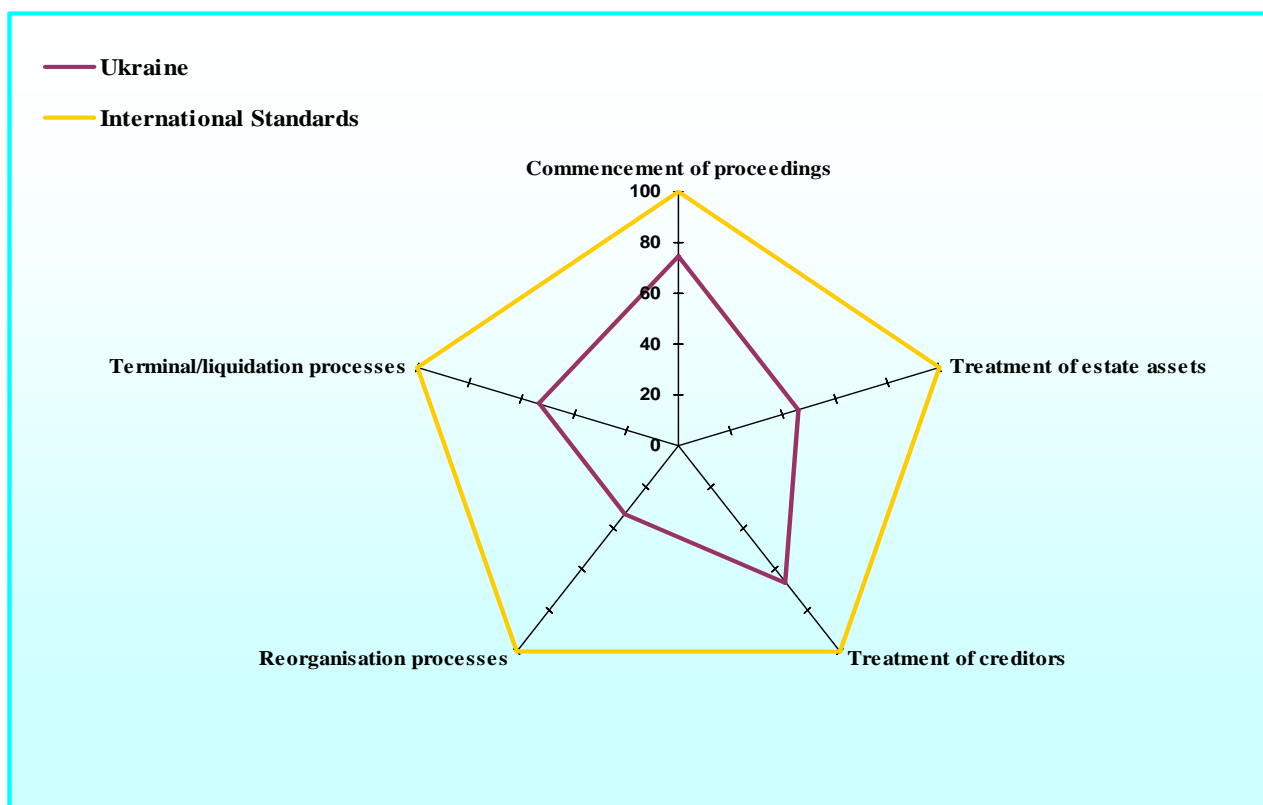


Source: EBRD Insolvency Sector Assessment 2004

*Note:* The various categories indicate the level of compliance of each country’s legislation (the “laws on the books”) with international standards, such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on Legislative Guidelines for Insolvency Law, and others. The asterisk indicates in which category the Ukraine ranks.

As the below chart reveals (see Chart 14), this law is severely deficient in virtually all of the key areas of insolvency. The restructuring process is of particular concern. While the law is notable for allowing the conversion of a bankruptcy to a restructuring and vice versa, the restructuring process is inadequately documented and the few provisions that are included provide no requirement for the independent assessment of the plan of reorganisation, there is very little involvement of the general body of creditors and no supervision of the plan’s implementation. Given these limitations it seems unlikely that an effective, efficient and transparent reorganisation could take place under this law. In addition, the law fails to provide for the timely delivery of property of the debtor to the bankruptcy administrator or for the effective avoidance of suspicious pre-bankruptcy transactions.

Chart 14 – Quality of Insolvency legislation – Ukraine, 2004



Source: EBRD Insolvency Sector Assessment 2004

*Note:* The extremity of each axis represents an ideal score in line with international standards, such as the World Bank’s Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on Legislative Guidelines for Insolvency Law, and others. The fuller the ‘web,’ the more closely the country’s insolvency laws approximate these standards.

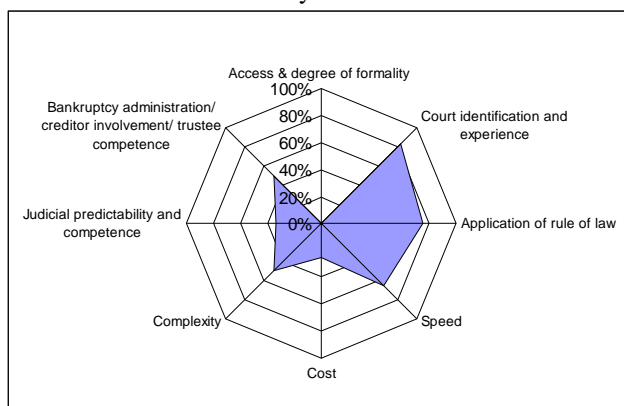
The above deficiencies could be classified as ‘critical’ or ‘threshold’ deficiencies in that they are imperative to the basic functioning of a proper insolvency law. In addition to these fundamental failings, the Insolvency Law has several other important shortcomings. In particular, the requirements for the commencement of bankruptcy proceedings are too complicated; there are inadequate requirements for the qualification of a bankruptcy administrator; there are no provisions for set-off; and, there are insufficient sanctions for failure to comply with the law.

Although the Insolvency Law does contain some positive elements, such as the requirement for a speedy hearing and determination of proceedings and the ability to do a pre-packaged restructuring utilising both a bankruptcy to extinguish debts and a reorganisation to restructure the company, it is unlikely that such provisions work well in practice.

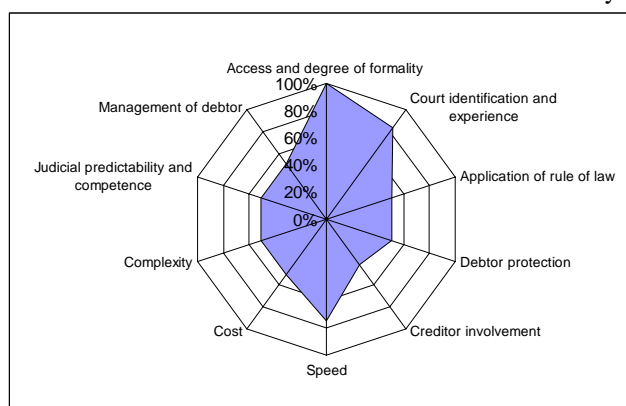
The results of the EBRD 2004 Legal Indicator Survey, which measured the “effectiveness” (or how the laws work in practice) of insolvency regimes in the Bank’s countries of operations, clearly show that the practical application of the Insolvency Law is likely to be expensive, fairly slow and unduly complex. All of these factors would militate against the speedy determination of proceedings provided for in the letter of the law. In addition, the results of the survey show that the predictability and competence of judges hearing bankruptcy cases is generally unreliable. (See Chart 15)

## Chart 15 – Effectiveness of Ukraine insolvency regime

Creditor-Initiated Insolvency



Debtor-Initiated Insolvency



Source: EBRD 2004 Legal Indicator Survey on Insolvency

**Note:** The results have been derived from stakeholder responses to questions about the practical functioning of the insolvency regime. The fuller the “web,” the more effective the country’s insolvency regime is.

### 3.5. Secured Transactions

In the last couple of years Ukraine has undertaken considerable reforms in the field of commercial law, particularly in relation to secured transactions. The adoption of new Civil and Commercial Codes, and specific laws related to security over movable property and immovable property (together with extensive work on the supporting institutions such as registers) has fundamentally changed the conditions under which commercial transactions take place. Despite some confusion and uncertainty (not unusual in transition economies), it appears that these changes have been, by and large, positive, particularly with respect to mortgage finance, which is on the increase.

Security rights over movable assets in Ukraine are, as of today, largely governed by the Law on Securing Creditor’s Claims and Registration of Encumbrances (Securing Creditor’s Claims Law), which entered into force on 1 January 2004. The Law on Pledge of 2 October 1992 (as amended) remains in force but is now of more limited relevance since it only applies for matters not covered by the Law on Securing Creditor’s Claims (although which matters is unclear). The Civil Code of 18 January 2003 also includes relevant provisions in the chapter on security for the fulfilment of obligations. The Securing Creditor’s Claims Law adopts an approach according to which all encumbrances (e.g. pledges, leases) are treated similarly and require registration in the State Register of Encumbrances over Movable Property for the right to be effective against third parties. The register, which replaces the State Register of Pledges of Movable Property, started operating in August 2004 and all encumbrances entered into the latter prior to 1 January 2004 have been automatically transferred to the new Register.

The main weakness of the regime lies in its lack of flexibility in the description of the collateral and of the secured debt. Taking security over generally described assets, or fluctuating pools of assets, remains uncertain, despite fairly liberal provisions in the law and legal advisers are usually reluctant to utilise such security. Also, there remains much uncertainty on taking and enforcing security over bank accounts. The Securing Creditor’s Claims Law introduced new rules applicable to enforcement of the security. In particular, new modes of extra-judicial enforcement are now provided which allow for the transfer of ownership over the collateral to the creditor, the sale of the collateral directly by the creditor, the assignment of the pledged rights to the creditor or the transfer of funds. However, practitioners remain cautious as to their successful implementation.

A major reform issue relates to the ability of taking security over an enterprise. Neither the Mortgage Law nor the Securing Creditor's Claims Law includes specific provisions relating to enterprise charges – such provisions have also been repealed from the Law on Pledges. Although the new Civil Code that entered into force concomitantly authorises the mortgage of an enterprise complex, “enterprise complex” is now defined specifically as “immovable property” notwithstanding the fact that the enterprise mortgage also includes movables and other property rights. This has given rise to a number of practical issues in terms of notarisation, certification and registration of this type of agreements, and most law firms have ceased to recommend to their clients taking enterprise mortgages and prefer instead to take classic mortgages and pledges over the various types of movable assets of the borrower to avoid any subsequent problem.

Security rights over immovable property (mortgages) are governed by the Law on Mortgage of 5 June 2003 (“Mortgage Law”) and the Civil Code's relevant provisions. According to the 2003 Law on Mortgage, a valid mortgage requires a written mortgage agreement, with the signatures of the parties certified by a notary. It becomes enforceable against third parties upon its registration in the Mortgage Register. The Register is separate from the Land Register, where titles and other proprietary rights are recorded and is operated by the Information Centre, a semi-independent agency under the supervision of the Ministry of Justice. The Register is fully electronic and centralised. Searches can be made by any party in the Information Centre or at a connected notary office upon filing an application form and paying a flat fee. Registration of a mortgage is carried out directly and instantly by the notary on-line. The registration fee is flat irrespective of the amount of the claim to be secured.

Mortgages can secure any type of debt as far as it is determinable in monetary terms and the maximum amount has been expressed in the mortgage agreement. Any type of immovable property may be used for security except for agricultural land, for which a moratorium applies until 01/01/2007 (the situation thereafter is unclear) and can only be mortgaged to banks as mortgage creditors. Mortgage right enjoys priority in the mortgaged property from the moment of its entry in the Register. Priority is upheld in practice and in the event of bankruptcy. However, there is some uncertainty as to the precedence of tax liens which are registered in the Register of Encumbrances but enjoy automatic statutory priority by law.

In case of the mortgagor's default, the mortgage right can be enforced without involvement of a court by a direct sale or by a public auction depending on provisions of the mortgage agreement or other agreement concluded subsequently. The mortgage creditor can approach the State Execution Agency, which will conduct the public auction presenting the certified mortgage agreement that has been stamped by a notary (giving it the force of an executory title) and document proving the mortgagor's default. Enforcement is reported to usually take up to 6 months, and the sale proceeds correspond to the asset's market price. However, the current booming real estate market may have eased enforcement, which could be more difficult in a stagnant market. Difficulties are noted in relation to eviction of minors, since the consent of the State Committee for Protection of Rights of Minors is then required.

Mortgage markets participants express full satisfaction on the legal framework and the growth of the market, plus the prospect of the first issue of mortgage-covered bonds, confirm this.

### *3.6. Telecommunications*

The communications sector in Ukraine is currently governed by the Telecommunications Law of 2003 (the “2003 Telecom Law”), as amended, and is formally regulated by the National Commission for the Regulation of Communications (NCRC). According to sector legislation NCRC’s formal regulatory role includes responsibility for licensing and registration of operators, tariff regulation, interconnection, management of numbering resources and resolution of disputes between operators or between operators and consumers. The 2003 Telecom Law dictates that the NCRC be appointed by, and reports to, the President. Policymaking is the responsibility of the Ministry for Transport and Communications (the “Ministry”). Definitive institutional structure of the sector is unclear however, with the president, parliament, cabinet, Ministry, military authorities and anti-monopoly commission all having input to sector policy and regulation.

While the enactment of the 2003 Telecom Law has partly aligned the sector’s legislative base with European Union (EU) standards, elements of the legal framework require further revision to be harmonised with EU principles for the sector.

Ukraine’s communications sector is formally open to competition and competitive fixed line providers are providing some competition to the dominance of state-owned incumbent Ukrtelecom (UT) in the market-place. Though UT’s share of the fixed market has slipped below 80%, there is continuing frustration that the sector reform initiatives in the 2003 Telecom Law have yet to deliver the envisaged sector development. While fixed line penetration (at just above 25%) is only slightly below regional average, much of the fixed infrastructure is in poor condition and requires significant upgrade/expansion. Although successive governments have sought to privatise UT, the company remains in state hands with privatisation initiatives being continually postponed. There are indications that minority stakes in UT may finally be sold during 2007.

A number of operators compete in the mobile sector, with two of the major operators, UMC and Kyivstar controlling in excess of 80% of the market. The remaining share of the market is split amongst the three remaining operators, URS, Golden and Astelit. In 2005 UMC, Kyivstar and UT applied to the regulator for a 3G licence. While none of those operators were successful at that time, in December 2005 UT was awarded a 3G licence without a tender leading UMC and Kyivstar to reportedly complain that the award of the licence without tender was illegal and was likely to be aimed at making UT more attractive to investors ahead of the planned privatisation. Further 3G licences were due to be offered during 2006, but remain unissued.

Private sector led fully competitive provision of service is fundamental to the successful development of the telecom sector in Ukraine. Liberalisation and privatisation and are key to the attraction of private investment. An independent regulator and a transparent, rule based, cost-oriented regulatory regime is essential for meaningful competition to take hold and can do much to enhance investor confidence in Ukraine. Despite recent changes in the legal framework, successive implementation failures continue to result in sector stagnation. While the movement to calling party pays (CPP) has boosted the mobile market, that market remains dominated by two players. Similarly, the fixed market remains dominated by UT with competitive operators making little inroads in the absence of meaningful implementation of the reforms contained in the 2003 Telecom Law.

Going forward the government should re-double efforts to fully implement an EU compliant regulatory framework, revising the legislative framework where necessary. Key to implementation is the sector regulator, NCRC. Government should immediately move to re-state the institutional structure of the sector, confirming NCRC as the sole independent regulator for the sector,

enshrining NCRC independence in law. Key to establishing such independence is providing for NCRC to be appointed by and accountable to parliament and financed through international best practice industry levy. This levy should be set at a level to both provide market reflective salaries to attract sufficiently experienced staff and cover the cost of the full implementation of the 2003 Telecom Law. Additionally, government should fully facilitate NCRC in implementation of all elements of the regulatory framework set out in the 2003 Telecoms Law. NCRC for its part should move swiftly to carry out the market assessments necessary to declare dominant operators to be subject to regulation and pro-actively intervene in segments where competition is absent or insufficient.