COMMERCIAL LAWS OF UKRAINE
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AN ASSESSMENT BY THE EBRD

Office of the General Counsel

European Bank
for Reconstruction and Development

CONTENTS

Basis of Assessment: *This document draws on legal assessment work conducted by the Bank (see www.ebrd.com/law) and was last updated during the preparation of the 2011 EBRD Strategy for Ukraine, reflecting the situation at that time. The assessment is also grounded on the experience of the Office of the General Counsel in working on legal reform and EBRD investment activities in Ukraine and does not constitute legal advice. For further information please contact ltt@ebrd.com .*

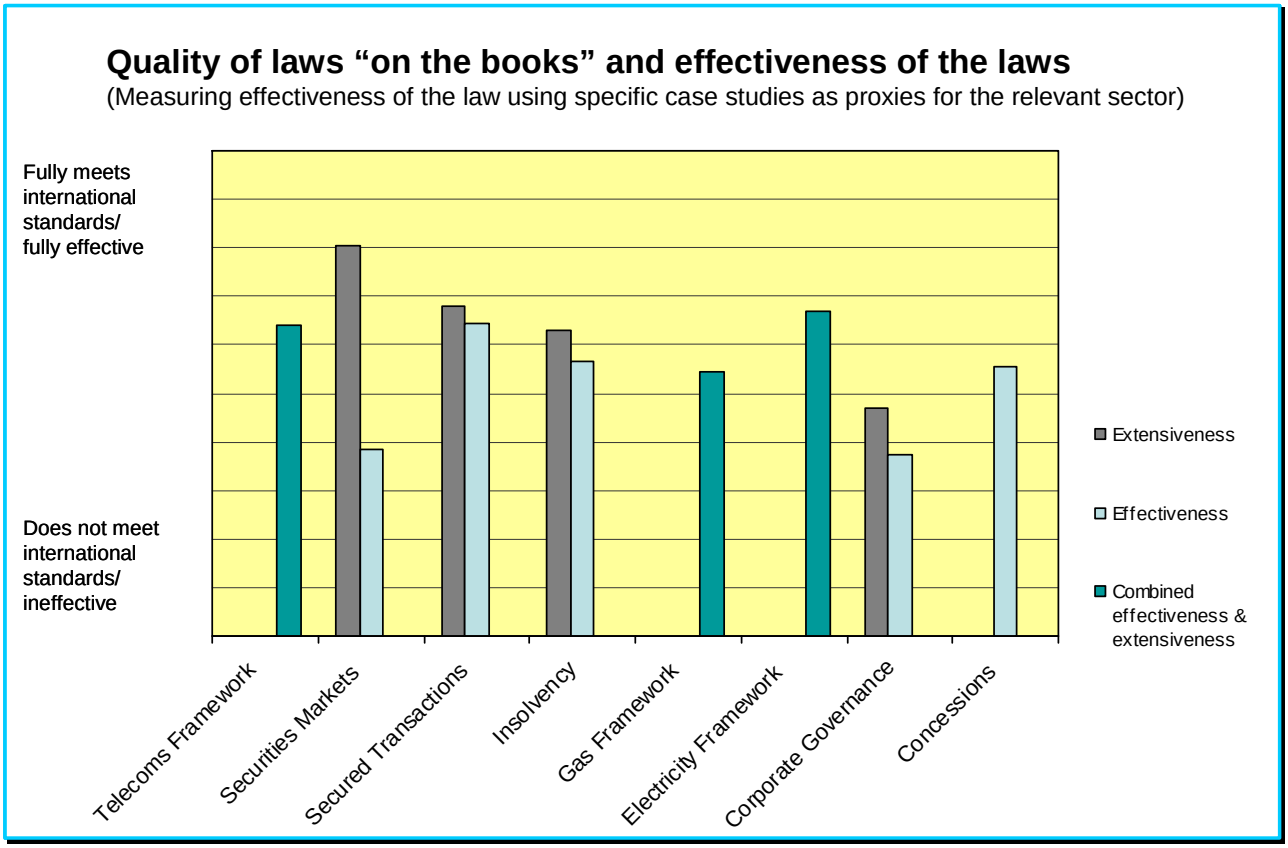
1. Overall Assessment

Ukraine has introduced an impressive amount of legislative changes in the last several years. Such important legislative acts as the 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 have all been reformed during the last decade.

The most recent reforms however, include the amendments to the Judiciary Act (2010), a new law on Public Private Partnership (2010), the new Law on Joint Stock Companies (2009) and the new Public Procurement Law (2010). Another important change occurred in 2010 when the Constitutional Court overturned the 2004 constitutional amendments that changed the organisation of state from the presidential-parliamentary to the parliamentary-presidential. Thus, the 2010 amendments reinstated the semi-presidential system of government provided by Ukraine's original Constitution of 1996. The change strengthens the executive power and is potentially set to improve government stability. Moreover, the efforts of Ukraine to join the World Trade Organisation (WTO) were accomplished in 2008. The country's accession to the WTO may have a positive result on the investment climate in the country and on the commercial legislation in general.

Despite all of these achievements, much remains to be done in order to bring Ukrainian legislation closer to international standards. In particular, the 2009 EBRD Insolvency Sector Assessment found that the Insolvency Law of Ukraine is in low compliance with EBRD's Core Principles for an Insolvency Law Regime. Furthermore, the EBRD 2010 Public Procurement Legal Frameworks Assessment results showed that the Ukrainian public procurement framework is in low compliance with international standards and best practices. The 2007 Securities Markets Assessment showed that the national framework is in high compliance with international standards; however the concurrent Legal Indicator Survey found that the legislation is not being implemented properly and there is a wide gap between the extensiveness and effectiveness of the legislation.

Chart 1 – Snapshot of the commercial laws of Ukraine



***Source**: EBRD legal assessments 2002-2010*

2. The Legal System

2.1 Constitution and courts

Ukraine's Constitution was adopted by the Verkhovna Rada (the Ukrainian Parliament) on June 28, 1996. The 2004 constitutional amendments established parliamentary-presidential form of government. However, in 2010 the Constitutional Court reinstated the semi-presidential system of government provided by Ukraine's original Constitution of 1996.

The exclusive body of legislative power in Ukraine is the Verkhovna Rada, which is competent to legislate on any issues of state and social life of Ukraine, except for those which are settled exclusively by national Referenda, or are within the competency of the President of Ukraine, the executive, the judiciary, the 24 oblasts, the Autonomous Republic of Crimea and agencies of local self-governance. The Verkhovna Rada is composed of a unique chamber of 450 deputies elected directly by the people for four years.

The President of Ukraine is the head of state and acts on its behalf. The President is elected by Ukrainian citizens for a period of five years. A person cannot hold the Presidency for more than two consecutive terms.

The Cabinet of Ministers of Ukraine is the highest body of state executive power of Ukraine. The Cabinet is responsible to the President and reports to the Verkhovna Rada. The Cabinet, *inter alia*, conducts financial, monetary, investment, price, credit, custom and tax policy of the Ukraine; develops and ensures compliance with the state budget; and co-ordinates the activities of ministries,

regional state administrations and other bodies of executive power subordinated to the Cabinet. The new Law of Ukraine "On the Cabinet of Ministers of Ukraine", which came into effect in 2008, changed the structure of the Cabinet of Ministers and the way in which it is formed. It also corrected some discrepancies between the previous law and the Constitution of Ukraine regarding the appointment of the Cabinet of Ministers. The Cabinet of Ministers is now strictly required to ensure the acts of the President of Ukraine are implemented. The President of Ukraine has the right to submit a petition to the Parliament in instances where the Cabinet of Ministers has failed to fulfil its duties.

Ukraine's judicial system consists of the Constitutional Court, courts of general jurisdiction, and specialised administrative and commercial courts. For commercial matters, the courts of first instance are the local commercial courts in each region, and in Kiev, Sebastopol and the Autonomous Republic of Crimea. Appeals from these courts go to the High Commercial Court, and thereafter to the Commercial Chamber of the Supreme Court.

The body responsible for supervision and administration of the court system is the Vyscha Verkhovna Rada (Supreme Judicial Council). It consists of 20 members, including representatives from the Verkhovna Rada, the Presidential Administration, the Assembly of Judges of Ukraine, the Assembly of Advocates of Ukraine, and the Assembly of Representatives of Higher Legal Schools and Scholarly Institutions. It appears that judges constitute a minority of representatives on this body. The Vyscha Verkhovna Rada submits proposals to the President on the appointment and dismissal of judges. The President then appoints judges for an initial period of five years, after which they may be reappointed by the Verkhovna Rada for an unlimited period.

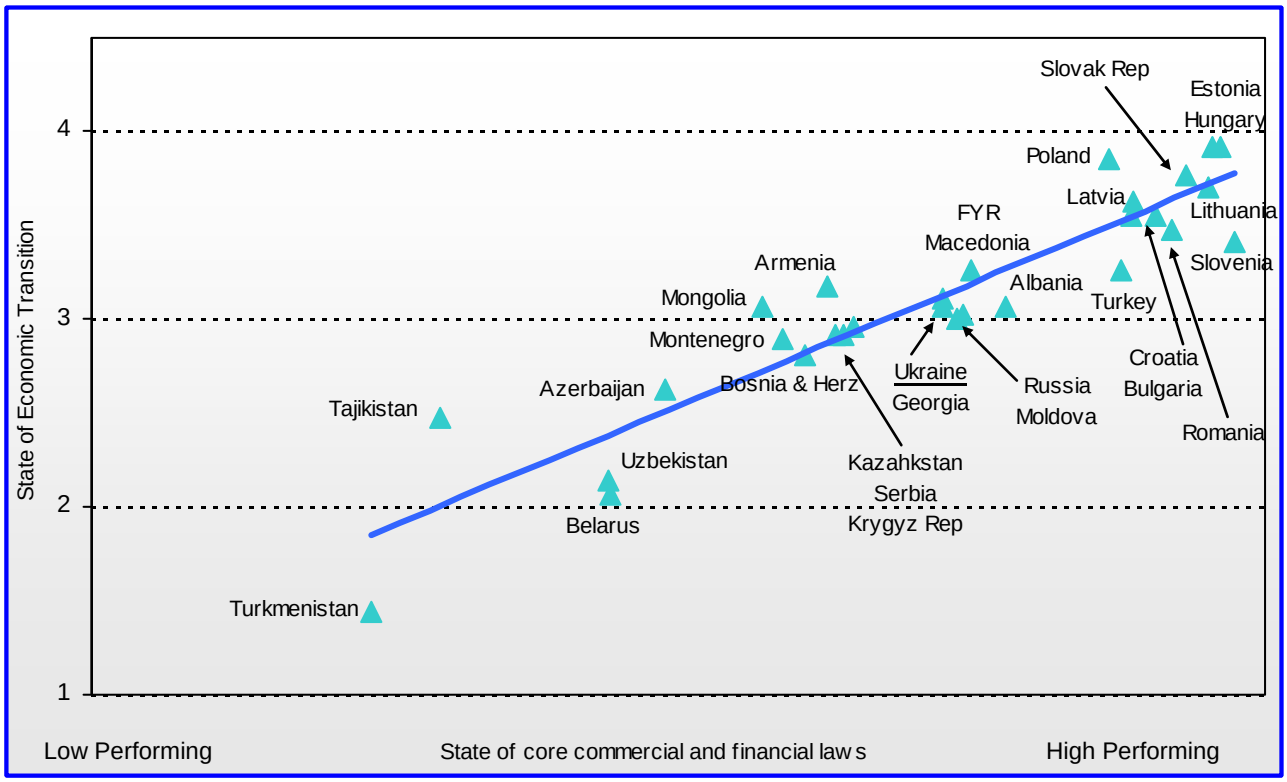
Important judgements are generally published and accessible to practitioners and the public, affording the legal system a certain level of transparency. There is a right of appeal from first-instance court decisions, and a right of judicial review of administrative action. There are constitutional and other formal guarantees of judicial independence. However, although Ukrainian laws provide a legislative framework for an independent judicial system, concerns persist about a lack of impartiality and independence of the courts. Corruption is perceived to be one of the main obstacles to a fully effective judiciary in the country. Ukraine ranked 146th among the 180 surveyed countries in the Transparency International 2009 Corruption Perceptions Index. Further, in the EBRD – World Bank Business Environment and Enterprise Performance Survey 2008-2009 (BEEPS), only 19% of the participants believed that the courts were fair and uncorrupted. Further, only 17% of business respondents considered the court system to be efficient.

In what may prove to be a positive development, the Judiciary Act was amended in 2010 in order to provide that certain decisions of the Supreme Court are binding on courts below and constitute a formal source of generally applicable law. This reform was part of a suite of amendments which in fact limited the jurisdiction of the Supreme Court in many respects, devolving greater powers to the higher specialised courts (e.g. the Higher Commercial Court). However, one important function still performed by the Supreme Court is to hear cases which concern divergent interpretations of law by courts below. In such matters, a decision of the Supreme Court is formally binding on all courts and administrative authorities in Ukraine. The end result of this reform may be greater uniformity in judicial decision-making.

2.2 Relationship between legal transition and economic progress

Experience in the EBRD's countries of operations suggests that overall economic progress goes hand in hand with respect for the rule of law and well-functioning democratic institutions. The legal framework consists of a complex patchwork of sometimes contradictory and often inconsistent laws. Because there is a positive correlation between legal transition and overall economic progress in EBRD countries of operation (as shown in the chart below), the future success of the transition process in Ukraine will depend on the development of the country's legal system and adequate implementation of the legislation.

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



***Source**: EBRD Transition Report 2010 Table 1.1; EBRD Composite Country Law Index, July 2011*

***Note**: The **horizontal axis** measures the performance of commercial and financial laws. The **vertical axis** displays the EBRD transition index as an average of transition indicators between 1997 and 2010 with 1 referring to very early transition stages, and 4 referring to an advanced transition level.*

2.3 Recent developments in the investment climate

The main acts regulating investment in Ukraine are the Law "On Protection of Foreign Investments in Ukraine" (the "Investment Protection Law") (1991); The Law "On Investment Activity" (the "Investment Activity Law") (1991); the Law "On Foreign Investment Regime" (the "Foreign Investment Law") (1996); Cabinet of Ministers' Resolution "On the Procedure for the State Registration of Foreign Investment" (1996); and National Bank of Ukraine Resolution "On Regulation of Foreign Investing in Ukraine" (2005).

The Foreign Investment Law provides (with some exceptions) for equal treatment of foreign and domestic businesses. Moreover, foreign investors are entitled to certain privileges and guarantees under the Foreign Investment Law. Such privileges and guarantees include, *inter alia*: protection against changes in legislation; protection against nationalization; guarantee for compensation and reimbursement of losses; guarantee in the event of the termination of investment activity and guarantee of repatriation of profits.

Since the 2004 Orange Revolution, the Government of Ukraine has listed the improvement of the investment climate as its top priority. Since that time the government has amended several laws that influence the overall investment climate in the country. In particular, on 27 April 2010 Ukrainian Parliament adopted Law of Ukraine "On Introduction of Amendments to Certain Laws of Ukraine on Lending and Stimulation of Foreign Investment". The Law removed onerous legal restrictions in the foreign investment regime and servicing cross-border loans introduced by Ukrainian anti-crisis law in November 2009. In particular the new law abolished a prohibition of (i) early repayment by a Ukrainian borrower of a foreign currency loan from a foreign lender and (ii) amendments to foreign currency loan agreements between Ukrainian borrowers and foreign lenders resulting in accelerated loan repayments. The new law also abolished (i) a legal requirement for foreign cash investments into Ukraine to be made only in Ukrainian Hryvnia (UAH) and through investors' investment accounts in Ukrainian banks and (ii) mandatory state registration of foreign investments by the National Bank of Ukraine. As a result, registration of a foreign investment by Ukrainian local state administrations remains at the discretion of a foreign investor. One more important legislative change that positively affected the investment climate in the country is the new Law of Ukraine “On Joint Stock Companies” (JSC Law), which became effective on April 30, 2009. The new JSC Law introduced principles of sound corporate practices that meet international standards.

In 2008 Ukraine became a member of the WTO. Accession to the WTO means that there is a general recognition of Ukraine as a country with a market economy. Furthermore, the accession to the WTO will promote a more open and transparent trade regime and help improve the investment climate in the country.

Moreover, in 2005 an independent non-profit investment agency (Invest Ukraine – Ukrainian Centre for Foreign Investment Promotion) was established. The main goal of the agency is to help the Ukrainian economy become more productive and globally competitive by increasing the inflow of strategic foreign direct investments.

Despite all of the aforementioned achievements, the present investment climate in the country is far from perfect. Based on the World Bank's Doing Business Report of 2010, Ukraine ranked 142 out of 183 economies. One of the reasons for such a low score might be the fact that the country has significant legal implementation issues and a high level of corruption[1] in the country discourages

[1] Ukraine ranked 146th among the 180 surveyed countries in the Transparency International 2009 Corruption Perceptions Index. Further, in the EBRD – World Bank Business Environment and Enterprise Performance Survey 2008-2009 (BEEPS), only 19% of the participants believed that the courts were fair and uncorrupted.

broad foreign investment. Moreover, the accession to the WTO and some of the aforementioned positive amendments are fairly recent and the outcomes of the changes are yet to be seen.

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: concessions, corporate governance, insolvency, secured transactions, securities markets 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 such laws (also referred to as "effectiveness"). This section presents a summary of the results accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

All available results of these assessments can be found at www.ebrd.com/law.

3.1 Concessions

A new law on Public Private Partnership ("PPP Law") was enacted on 31 October 2010. The PPP Law is a framework act and governs such forms of PPPs as concessions, joint ventures, production sharing and other types of activities.

The enactment of the PPP Law amends and clarifies the 1999 Law on Concessions, which was previously regarded as satisfactory in general terms but in need of further improvement in order to promote a favourable PPP regime in the country. It remains to be seen how the PPP Law will be implemented in practice, and whether any difficulties will arise in the interaction between the PPP Law and the Law on Concessions. Each of these acts is considered below.

The Law on Concessions clearly defines its scope of application. The provisions regulating the project agreement provide relatively clear guidance on the main issues to be covered, and yet the existence of an optional non-binding model agreement makes it sufficiently flexible for the parties to freely negotiate its terms. This law was rated as being in "medium compliance" with international standards according to the EBRD 2008 assessment of concessions laws, which examined concessions legislation in EBRD countries of operations. Amongst the areas that are still in need of improvement are: tender rules relating to the pre-selection procedure; the institutional framework and wider-government support; and the availability of instruments and mechanisms to secure lenders' interests. Nevertheless, the Concessions Law as it stands constitutes a relatively solid legal basis for concessions.

The new PPP Law sets out and is based on a number of important principles common to the EU and other European jurisdictions; notably equal treatment, non-discrimination and fair risk allocation. Its scope of application is broad and clearly defined, in line with international standards. The legislation contains an open-ended list of applicable sectors/activities. PPP projects may have a term of between 5 and 50 years. PPP agreements are to be awarded on the basis of a tender except for certain cases defined by the law. However, the tender rules are still to be defined by the Cabinet of Ministers of Ukraine.

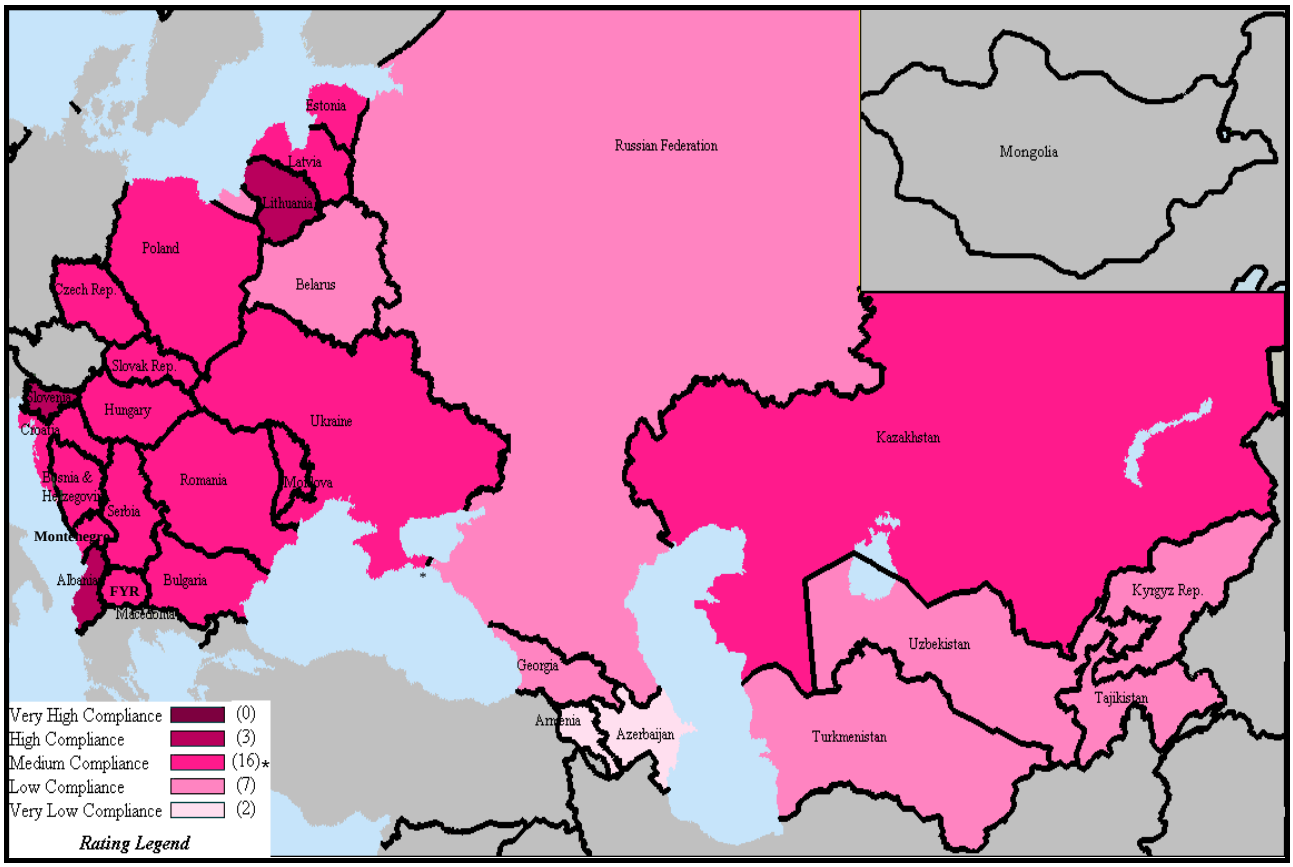
The PPP Law provides for other important rules and principles such as the grand-fathering clause guaranteeing the application of the regime applicable at the moment of entering into an agreement for the duration of that agreement. It introduces an investment return element and market sensitive compensation rules in the event tariffs are set at a rate below what is economically viable for the private sector. Further, the new law specifically prohibits public sector interference in the operational activities of a private party, and provides certain guarantees and state support measures.

The PPP Law establishes and defines the powers of a new specialist PPP agency which will commence work by the end of January 2011, thus paving the way for an enhanced PPP institutional infrastructure.

To date, the Ukraine's experience with PPP has largely been confined to the municipal utilities sector. The new PPP Law has been designed to be conducive to construction projects and modernization, particularly in relation to new sports and infrastructure facilities for the 2012 European Football Championship.

In 2006 the EBRD undertook its Legal Indicators Survey, evaluating the effectiveness of the Concessions/PPP regime in the EBRD countries of operations, as benchmarked against internationally accepted best standards and practices. The assessment focused in particular on the fairness and transparency of the selection process, adherence to project agreements and the possibility of recovery following termination. The results of the survey indicated that the selection process was reasonably fair and transparent, but that effective enforcement of arbitral awards was especially difficult.

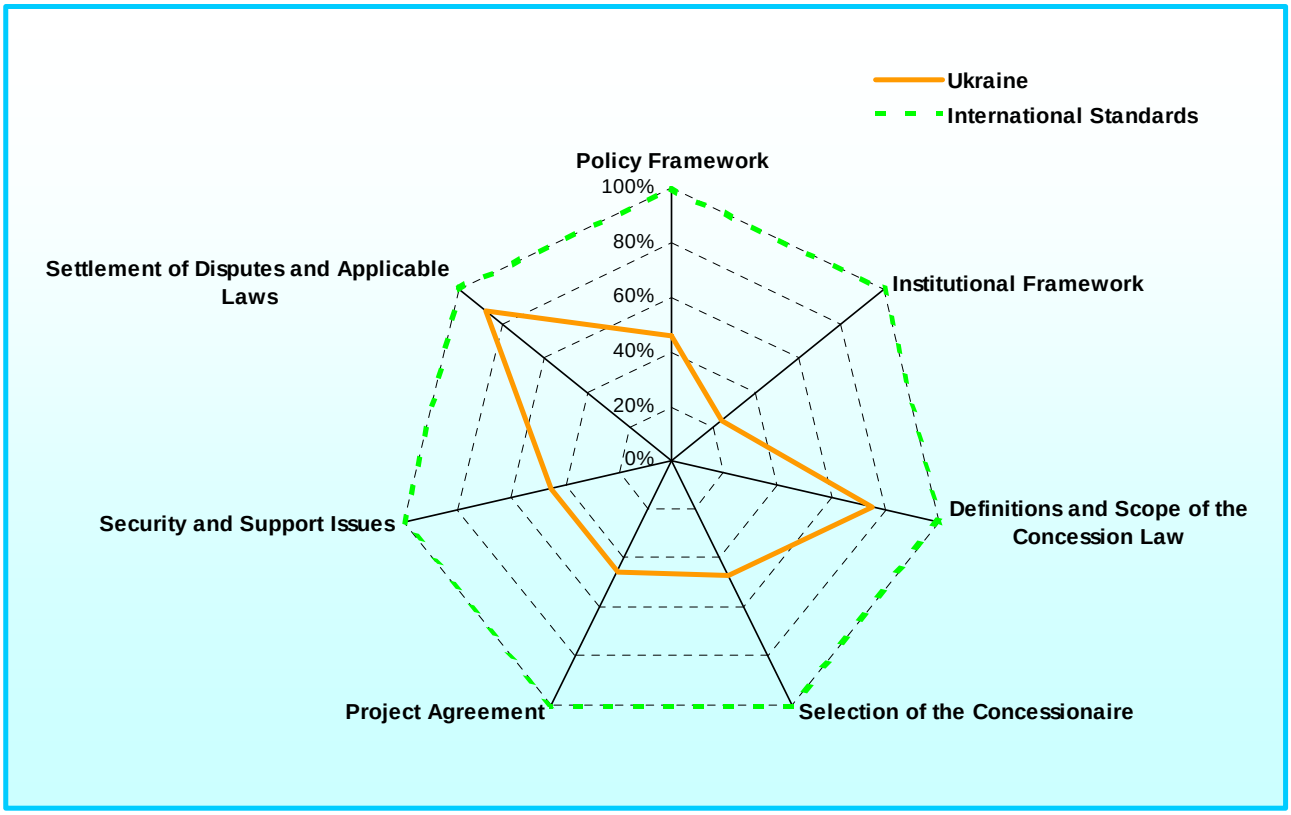
Chart 3 – Quality of concessions legislation in the EBRD countries of operations



***Source**: EBRD Concessions Sector Assessment 2007/08*

***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.*

Chart 4 – Quality of concessions legislation – Ukraine (2007/8)



***Source**: EBRD Concessions Sector Assessment 2007/8*

***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 concessions laws of the country approximate these standards.*

3.2 Corporate governance

The principal legislation dealing with corporate governance in Ukraine is the Law on Joint Stock Companies ("JSCs Law"), approved by the Verkhovna Rada (Ukrainian Parliament) on 17 September 2008. Apart from the JSCs Law other corporate governance regulation can be found in the Civil Code, the Commercial Code and the Law on Business Associations. Further, in June 2003 a Corporate Governance Code entitled "Ukrainian Corporate Governance Principles" was enacted. These principles are intended for open joint stock companies traded on the stock market and are voluntary.

The JSCs Law came into force on 29 April 2009 and introduced substantial improvements to the corporate governance system and the legal status of minority shareholders. A two-year transitional period commenced on 29 April 2009, during which all existing joint stock companies are to be brought into compliance with the JSCs Law. In order to facilitate a smooth transitional period, the Securities Commission recommended that joint stock companies approve amendments to their articles of association at their general meeting in 2010. During the transitional period, two parallel sets of laws are in force: the old framework (the Law on Enterprises in Ukraine and the Law on Business Associations) continues to fully apply to existing joint stock companies, while the JSCs Law applies to new joint stock companies and to existing joint stock companies that have been brought into compliance with the JSCs Law. After the transitional period, the Law on Enterprises in

Ukraine, the Law on Business Associations, the Civil Code and the Commercial Code will be substantially amended by the JSCs Law.

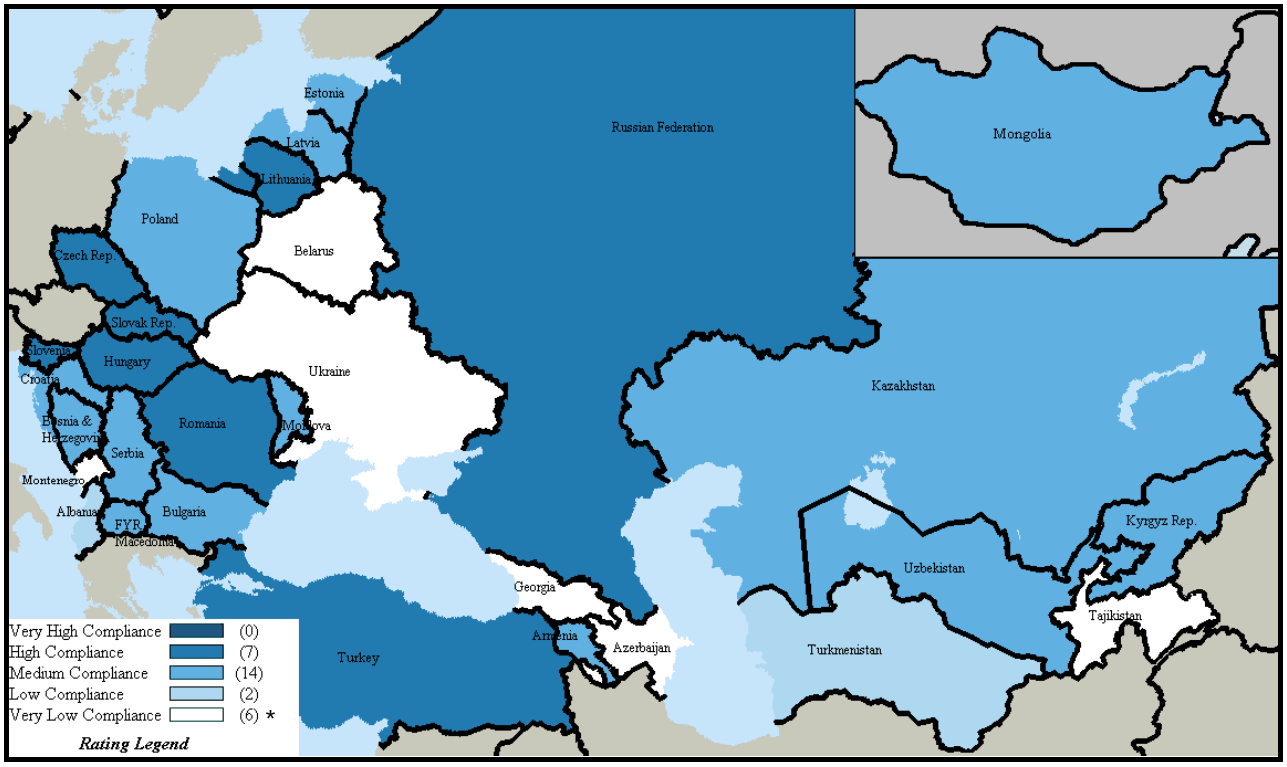
JSCs are organised into a two tier system whereby the general shareholders meeting appoints the supervisory board which in turn appoints the management board.

The JSCs Law requires all shares of joint stock companies to be issued in electronic form from 29 October 2010. Joint stock companies that have shares issued in paper form will have to convert them into electronic shares by April 29 2011 at the latest.

The EBRD's 2007 Corporate Governance Sector Assessment assessed the quality of corporate governance legislation in force in November 2007. According to the results of the assessment, Ukraine was in "very low compliance" with the OECD Principles of Corporate Governance, showing a framework in urgent need of reform in all sectors under consideration.

The new JSCs Law has improved the framework in many respects, but authorities should now make sure that the improvements established by the JSCs Law are fully implemented in practice.

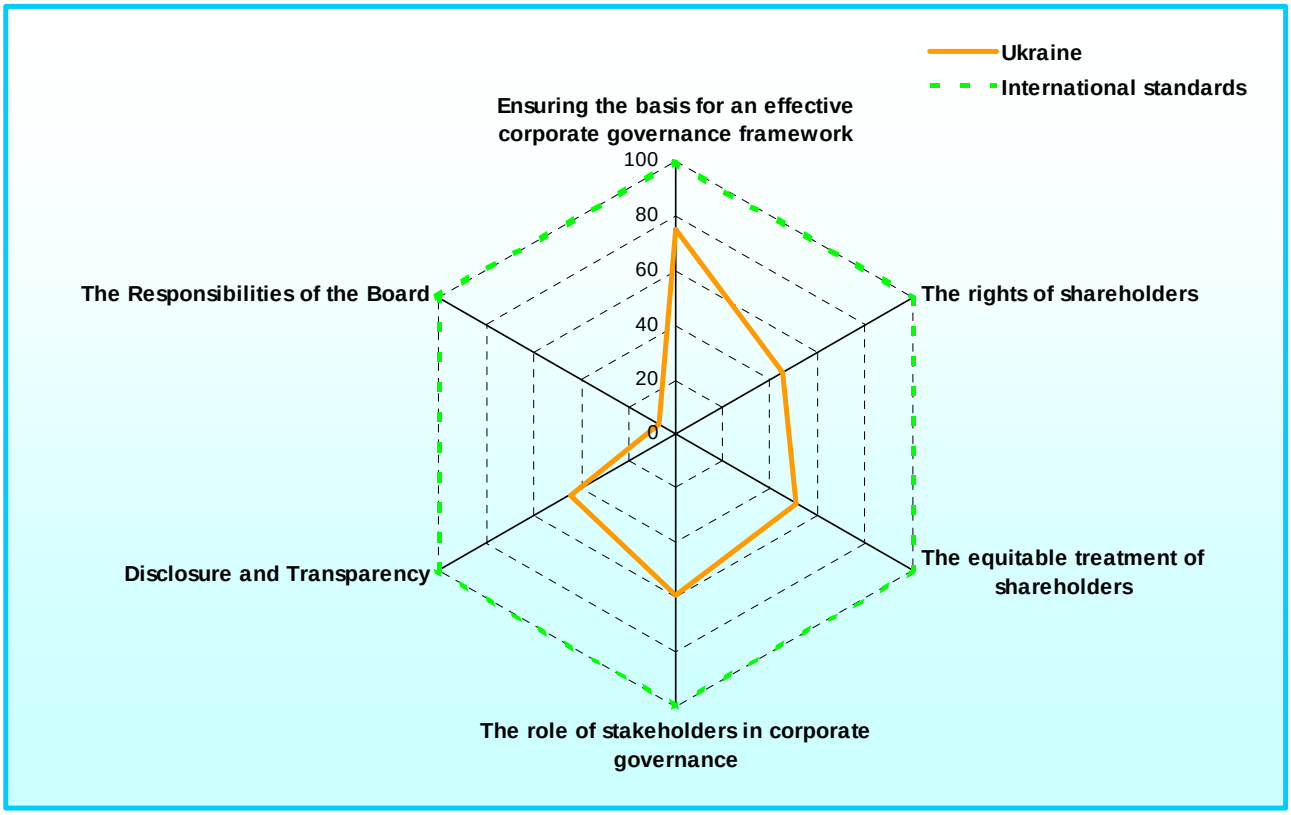
Chart 5 – Quality of corporate governance legislation in the EBRD countries of operations



***Source**: EBRD Corporate Governance Sector Assessment 2007*

***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 Ukraine ranks.*

Chart 6 – Quality of corporate governance legislation in Ukraine (2007)



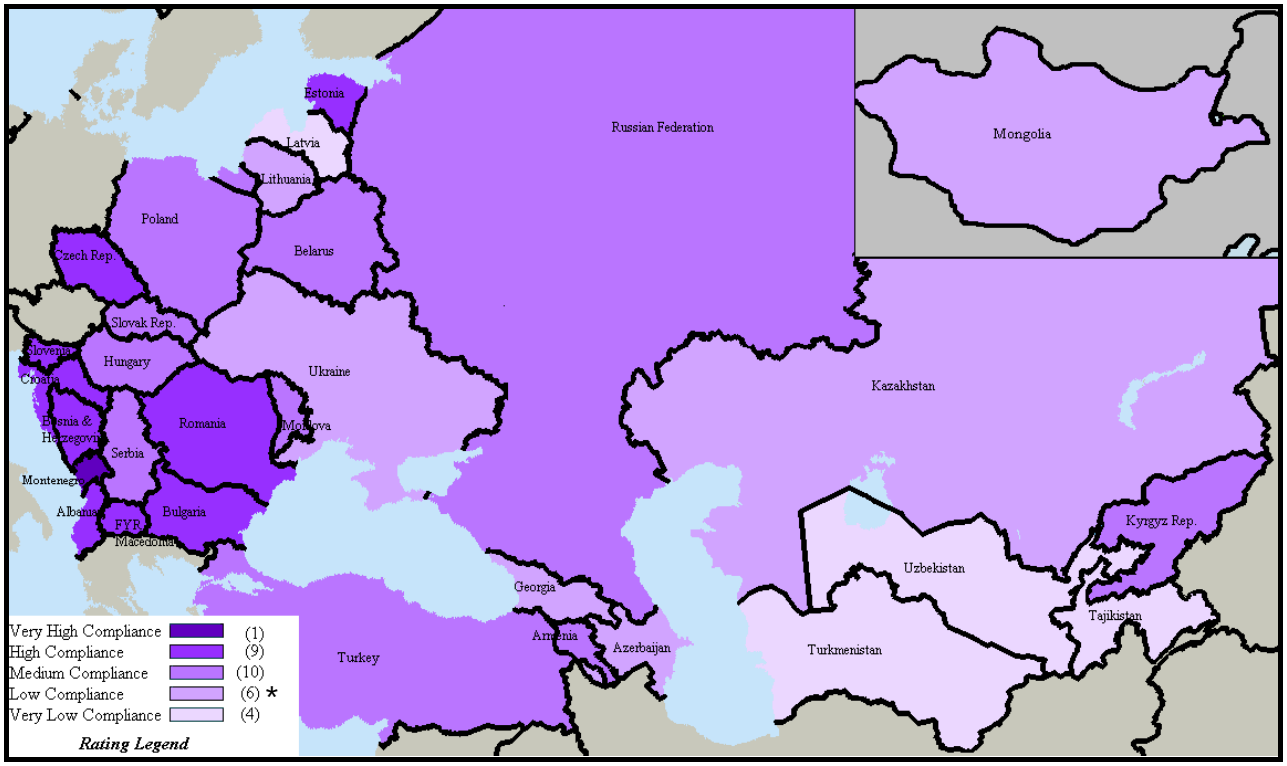
***Source**: EBRD Corporate Governance Sector Assessment 2007*

***Note**: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.*

3.3 Insolvency

At present, bankruptcy and insolvency in Ukraine are primarily governed by the "Law on Restoring Debtor's Solvency and Declaring a Debtor Bankrupt" of 14 May 1992 ("Insolvency Law"). As reflected in the graph below, the EBRD's 2009 Insolvency Sector Assessment found that the Insolvency Law is in "low compliance" with the EBRD's Core Principles for an Insolvency Law Regime, based on five core areas most relevant to the sector. These results are in line with assessments conducted by other international organisations, which have measured Ukraine's insolvency legislation against international insolvency standards, such as those set by the IMF, the World Bank, the Asian Development Bank and the United Nations Commission on International Trade Law (UNCITRAL).

Chart 7 – Quality of insolvency legislation in the EBRD countries of operations

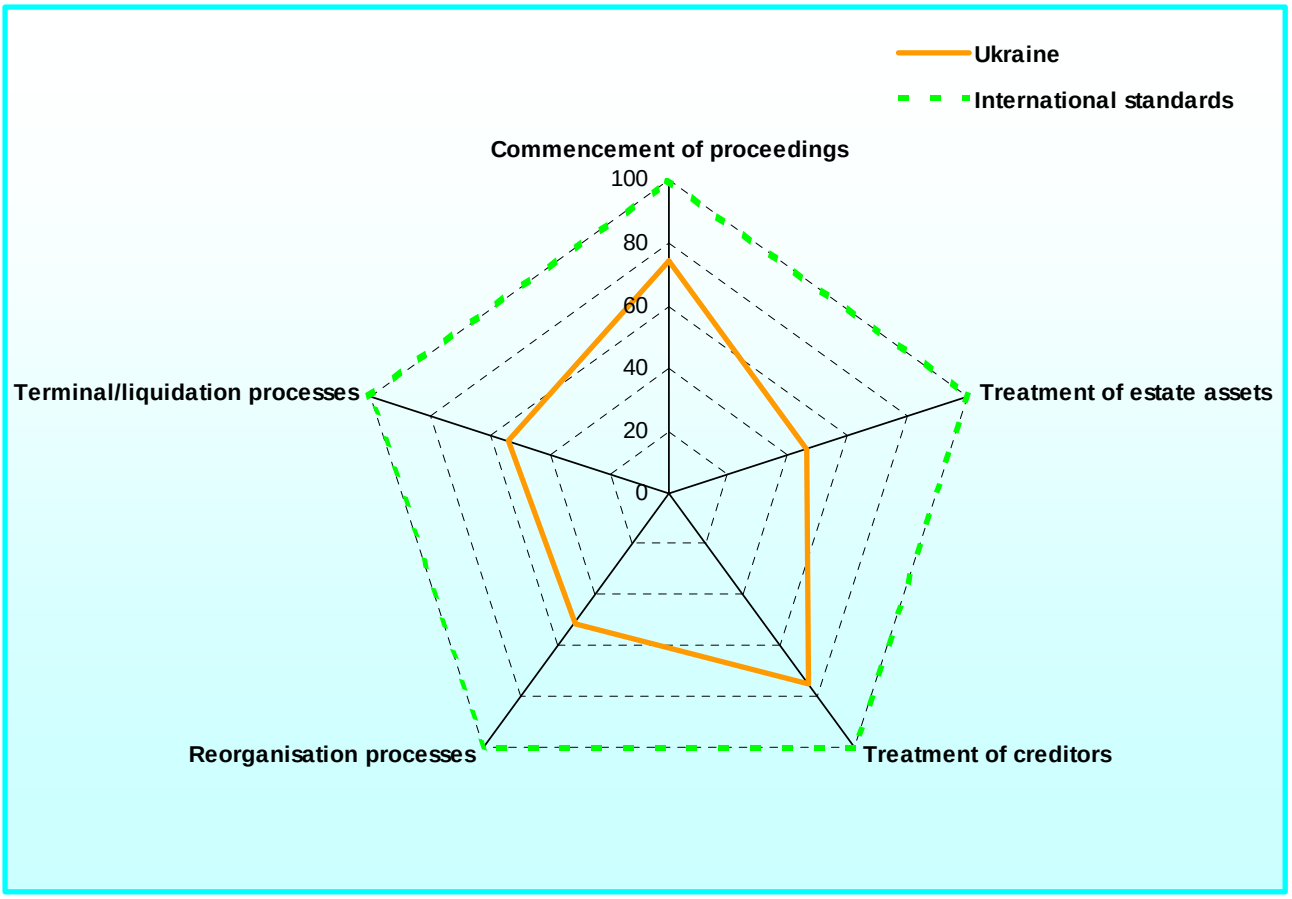


***Source**: EBRD Insolvency Sector Assessment 2009*

***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.*

As the chart below reveals, the Insolvency Law is still deficient in virtually all 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 spelled out. The few provisions that are included provide no requirement for independent assessment of the plan of reorganisation, very little involvement of the general body of creditors and no supervision of the plan's implementation. In addition, the law fails to provide for the timely delivery of property of the debtor to the bankruptcy manager or for the effective avoidance of suspicious pre-bankruptcy transactions.

Chart 8 – Quality of insolvency legislation in Ukraine (2009)



***Source**: EBRD Insolvency Sector Assessment 2009*

***Note**: The extremity of each axis represents an ideal score, i.e. corresponding to international standards such as the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group's "Legislative Guidelines for Insolvency Law", and others.*

The above deficiencies are 'critical' or 'threshold' deficiencies in that they are imperative to the basic functioning of a proper insolvency law. The Insolvency Law has several other important shortcomings. There are inadequate requirements for the qualification, appointment, review and replacement of an insolvency office holder; there are no provisions for set-off; and, there are insufficient sanctions for failure to comply with the law. The Insolvency Law remains weak as regards commencement of proceedings (for instance, there is no provision for a balance sheet insolvency test or anticipatory insolvency). Furthermore, the law does not provide for a mechanism to assist creditors to establish insolvency.

To date there are few professional work standards or ethical rules for insolvency office holders. Supervisory, regulatory and disciplinary provisions applicable to insolvency office holders are substandard.

The Insolvency Law contains some positive elements. There is a formal requirement for a speedy hearing and determination of proceedings. There is provision for pre-packaged restructuring, both by means of bankruptcy to extinguish debts and through reorganisation to restructure the company. However, the results of the EBRD 2004 Legal Indicator Survey, which measured the "effectiveness" of insolvency regimes (i.e. how laws work in practice), suggests that the practical application of the Insolvency Law is expensive, slow and unduly complex. In addition, the results

of the survey show that the predictability and competence of judges hearing bankruptcy cases is unreliable.

However, at present drafts of various laws have been prepared and are being considered by the competent state bodies. For instance, the State Rada of Ukraine adopted in the first reading on 19 October 2010 a draft Law Introducing Amendments to Applicable Legal Acts of Ukraine (related to improvement of bankruptcy proceedings and specifics of licensing of activities of Arbitraj Managers). In general, one of the major objectives of the aforementioned draft law is to develop and further promote the profession of an Arbitraj Manager (also known as "Insolvency Administrator" or "Bankruptcy Trustee" in Ukraine. The draft law introduces, *inter alia*, provisions improving licensing and monitoring of Arbitraj Managers' activities, as well as establishing a duty for Arbitraj Managers to insure their professional liability. The amendments are introduced to several legal acts, including the Code on Administrative Offences and the Criminal Code.

In addition, the IFC and IMF play an active role in the development of Ukrainian legislation applicable to the insolvency proceedings. For instance, the IFC took part in development of the new version of the Law on Insolvency; this has been done in conjunction with local stakeholders, such as the Fund for Efficient Governance (NGO), Clifford Chance Law Firm, Prudence Law Firm, etc. This draft law was assessed by the World Bank and now is being considered in the Administration of the President. If (or when) adopted, these legal acts should improve the existing legal regime and become an important part of the Ukrainian legal framework.

3.4 Public procurement

Public procurement in Ukraine is regulated by the Public Procurement Law ("PPL") which entered into force on 1 July 2010. The PPL covers procurement by national and local government and state-owned companies, but does not include specific rules for the utilities sector.

Three different authorities perform public procurement regulatory functions: the Ministry of the Economy, the State Treasury and the Antimonopoly Committee of Ukraine. The Ministry of the Economy is responsible for regulating the public procurement sector generally, whereas the Treasury monitors the financial aspects of the procurement process. The Antimonopoly Committee deals with complaints regarding public procurements, pursuant to an administrative review process. Complaints cannot be filed with the courts in the first instance; however appeals against decisions of the Antimonopoly Committee are heard by the courts.

Under the current PPL the following procurement procedures are available: open tender (which is required by law to be the default procurement method); two-stage tender; request for quotations; and direct contracting. The PPL provides for a pre-qualification procedure. Furthermore, the PPL requires the contracting entity to set suitable award criteria, and select the winning tender by reference either to those criteria or to the lowest price. The eligibility rules and qualification criteria would be broadly in line with international standards, if not for the question of domestic preferences. It is unclear whether such preferences are allowed; however they are not expressly excluded. Notably, the public procurement contract notices and tender documents are not available on the Internet. Fees are charged for the provision of tender documents. Electronic communication and modern transmission of information is not possible.

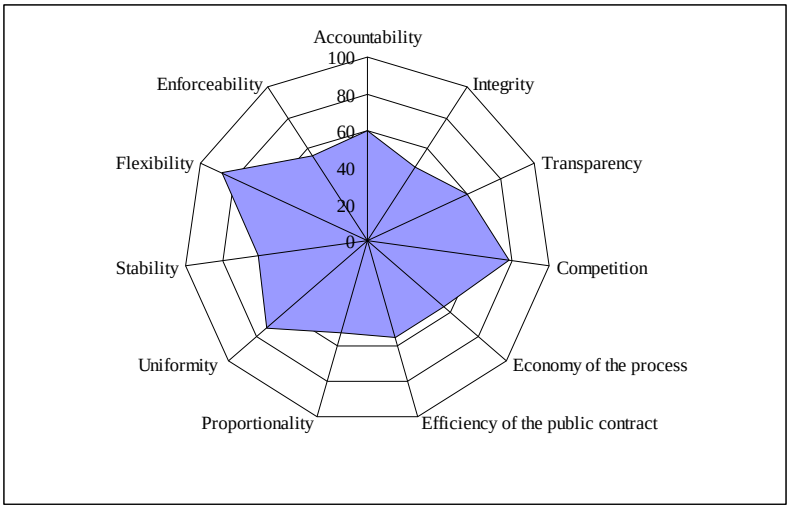
The PPL does not set timeframes for the completion of the procurement process. The procurement process itself is not extensively structured, although the PPL specifies some minimum actions and deadlines for the contracting authorities. Thus, the open tender deadline is 30 days; tenders are required to be opened promptly after the submission deadline; and the contract has to be signed within 30 days. Further, any complaint related to the procurement has to be made within 14 days from the announcement of the winning tender.

The contracting entity may seek a tender security, the maximum amount of which is limited to 5%. The PPL establishes thresholds and maximum tender validity periods, and contains clear rules on the use of foreign languages and currencies.

The PPL does not adequately distinguish between small and large value contracts or between short term and long term contracts. Recent amendments introduced mandatory aggregation of lots, but did not implement contract valuation methods, which would take into account all costs of the purchase or works. In addition, the PPL does not address public contract management.

The EBRD 2010 Public Procurement Legal Frameworks Assessment results show that the Ukrainian public procurement framework is in low overall compliance with international standards and best practice, both in relation to integrity and efficiency dimensions (see chart 9). The low scores for integrity and transparency indicators suggest that the procurement process may be affected by corruption. The PPL is relatively uniform and adheres to the principle of fair competition; however it is not so strong in relation to integrity, transparency, and accountability features (see chart 9). In addition, the evident lack of legal stability may lead to frustration among the stakeholders. In general, the PPL leaves room for inefficiencies and irregularities to occur in the public procurement processes.

Chart 9 - Quality of public procurement legal framework in Ukraine 2010.



Notes: The chart shows the score for comprehensiveness of national PP laws. The scores have been calculated on the basis of a legislation questionnaire, based on the EBRD Core Principles for an Efficient Public Procurement Legal Framework (http://www.ebrd.com/pages/sector/legal/procurement/core_principles.shtml). Total scores are presented as a percentage, with 100 per cent representing the optimal score for these benchmark indicators.

Source: EBRD Public Procurement Legal Frameworks Assessment 2010.

3.5 Secured transactions

In the last couple of years, Ukraine has undertaken considerable reforms in the field of commercial law, in particular 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, have fundamentally changed the conditions in which commercial transactions take place. Despite some confusion and uncertainty (not unusual in transition economies), these changes have largely been positive. The financial crisis, however, has hit Ukraine's real estate and mortgage finance particularly hard and this is unfortunately demonstrating the weaknesses that exist in the institutions surrounding debt enforcement.

Security rights over movable assets in Ukraine are governed by the Law on Securing Creditor's Claims and Registration of Encumbrances of 23 December 2003 (Securing Creditor's Claims Law), which entered into force on 1 January 2004. The Law on Pledge of 2 October 1992 remains in force but is now of more limited relevance since it will only apply for matters not covered by the 2003 Law on Securing Creditor's Claims (although precisely 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. To be effective against third parties, they require registration in the State Register of Encumbrances over Movable Property. This register, which replaces the State Register of Pledges of Movable Property, commenced operation in August 2004. All encumbrances entered into prior to 1 January 2004 have been automatically transferred to the new Register. The main weaknesses of the regime lie with the 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, remain uncertain, despite fairly liberal provisions in the law, and legal advisers are usually ambivalent in this respect. Also, there remains significant uncertainty on successfully taking and enforcing security over bank accounts.

The Securing Creditor's Claims Law also provides for extra-judicial enforcement in the form of transfer of ownership of collateral to the creditor, the sale of the collateral directly by the creditor, the assignment of pledged rights to the creditor or the transfer of funds. However, the practical experience to date in using these mechanisms has not been positive.

Security rights over immovable property (mortgages) are governed by the Law on Mortgage of 5 June 2003 ("Mortgage Law") and the relevant provisions of the Civil Code. 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 registration in the Mortgage Register. The Register is separate from the Land Register, where titles and other proprietary rights are recorded. It 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 anybody 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 also 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 still applies; it can only be mortgaged to banks as mortgage creditors. Mortgage rights enjoy priority in the mortgaged property from the moment of their 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 by law automatic statutory priority.

In cases of mortgagor default, mortgage rights can technically be enforced without involvement of a court by a direct sale or by a public auction, depending on the 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.

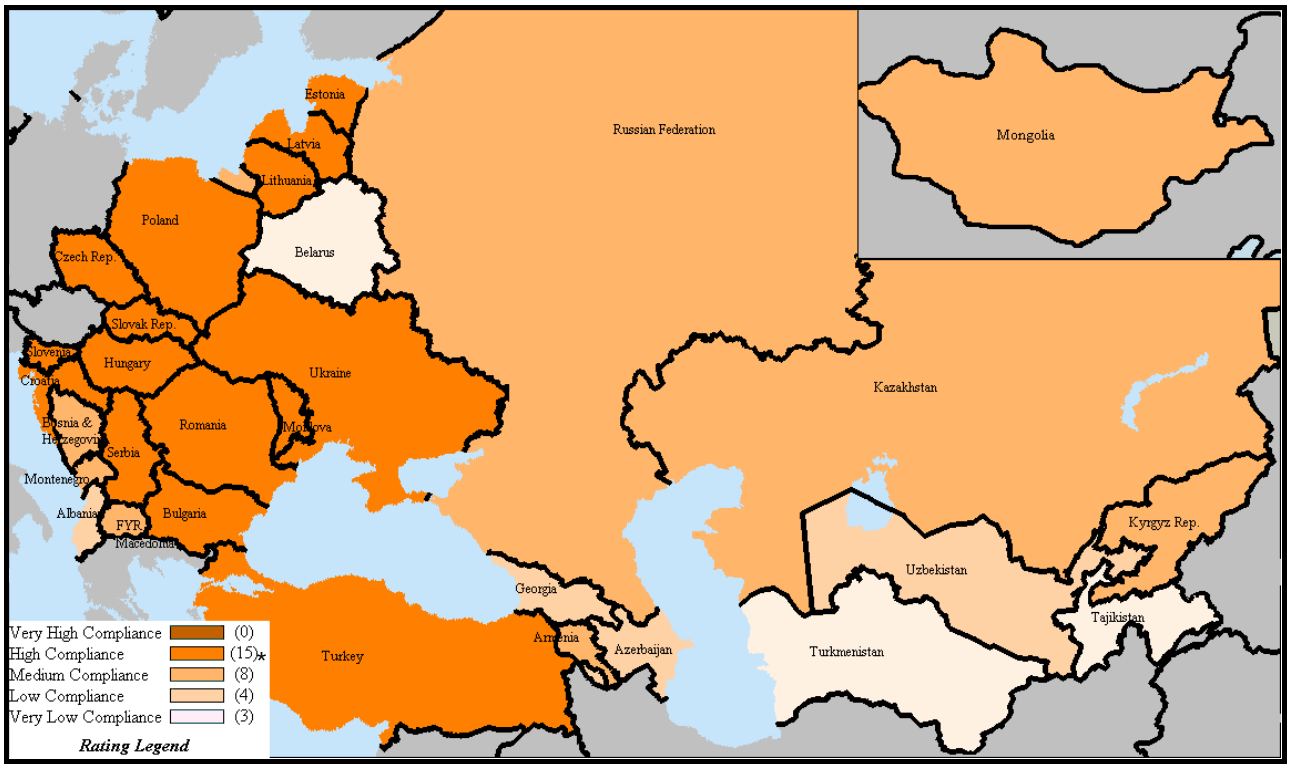
During the booming real estate market up until 2008, enforcement was reported to take usually up to 6 months, and the sale proceeds corresponded to the asset's market price. Since then, however, lenders have been very unhappy with the way they are able to enforce their rights (also due to the fact that the real estate market has crashed, making the value of collateral significantly lower).

3.6 Securities markets

The basic legislation regulating the securities markets is the Law on Securities and the Stock Market enacted on 23 February 2006. The Law regulates the placement and circulation of securities and the conduct of professional activities in the stock market and aims to ensure effective and transparent stock market activities.

The securities market regulator is the State Commission on Securities and Stock Exchange. The Commission was created on 12 June 1995 and operates according to the Law on State Regulation of Securities Market and the Law on Securities and the Stock Exchange. The National Bank of Ukraine is the supervisory authority in charge of the banking sector, while the Authorised Body for Control and Observance of Insurance is in charge of the insurance sector. At the end of 2009, the market capitalisation of the UFB was about 219.93 million USD with 53 companies listed. Clearing and settlement of securities is performed by National Depository of Ukraine.

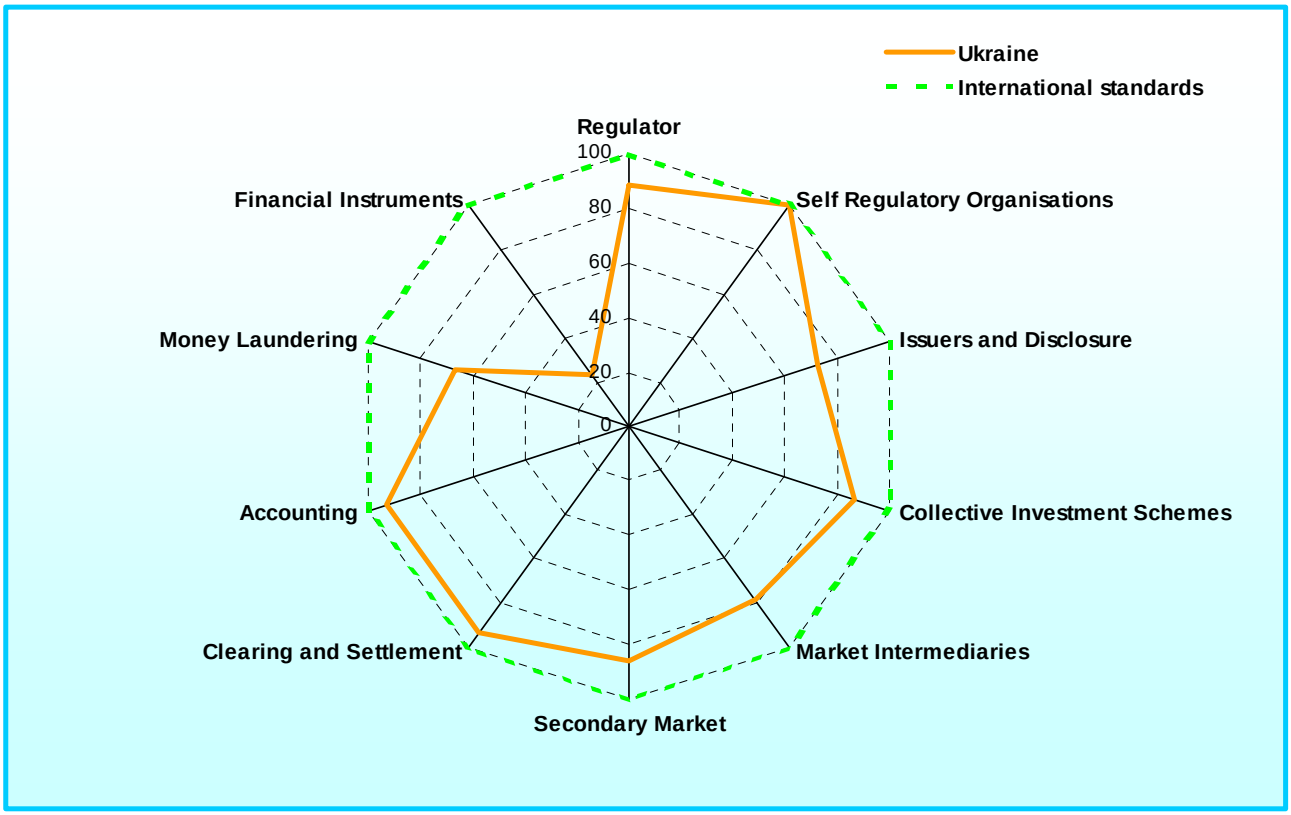
Chart 10 – Quality of securities market legislation in the EBRD countries of operations



***Source**: EBRD Securities Markets Sector Assessment 2007*

***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 Ukraine ranks.*

Chart 11 – Quality of securities markets legislation in Ukraine (2007)



***Source**: EBRD Securities Markets Sector Assessment 2007*

***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 securities markets laws approximate these standards.*

In 2007, the EBRD benchmarked the securities markets legislation of Ukraine against the "Objectives and Principles of Securities Regulation" published by IOSCO. The assessment showed that the national framework is in "high compliance" with international standards (see chart above), but it lacks comprehensive regulation on bonds and derivatives. In order to understand how securities markets legislation works in practice, in the same year the EBRD undertook a Legal Indicator Survey asking practitioners in the region to comment on a hypothetical case study. The Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator. The Survey revealed that IPOs are not common in Ukraine. Information included in the prospectus can be incomplete. Private enforcement mechanisms allow for limited course of action and they are generally lengthy and burdensome. Finally the capacity of courts, regulator and prosecutors in investigating complex securities cases needed to be improved.
As a result, national authorities should consider implementing some specific actions in order to improve the capacity of institutions in effectively implementing the legislation.

3.7 Telecommunications

The communications sector in Ukraine is currently governed by the laws "On Telecommunications" (2003) and "On the Radio Frequency Resources of Ukraine" (2000), as well as the Decree of the Cabinet of Ministers "On Approving Provisions on the National Commission for Communications Regulation" (NCCR) (2007). The sector is formally regulated by the NCCR, the responsibilities of

which include licensing and registration of operators, tariff regulation, interconnection, management of numbering resources and resolution of disputes between operators or between operators and consumers.

In recent times, the communications sector has displayed impressive growth, increasing from 27.5 billion UAH in 2005 to 42.9 billion UAH in 2009, comprising: mobile revenues of 28.5 billion UAH from approximately 57 million subscribers (120 percent penetration); fixed line revenues of 8.8 billion UAH, from approximately 13 million subscribers (28 percent penetration); and broadband revenues of 3.4 billion UAH from approximately 10 million subscribers (2.1 million of which were broadband subscribers). As at the end of 2009, NCCR had issued 1,775 licenses, of which 246 were issued in 2009 alone. However, despite the large number of licenses held by operators, a small number of operators dominate the sector.

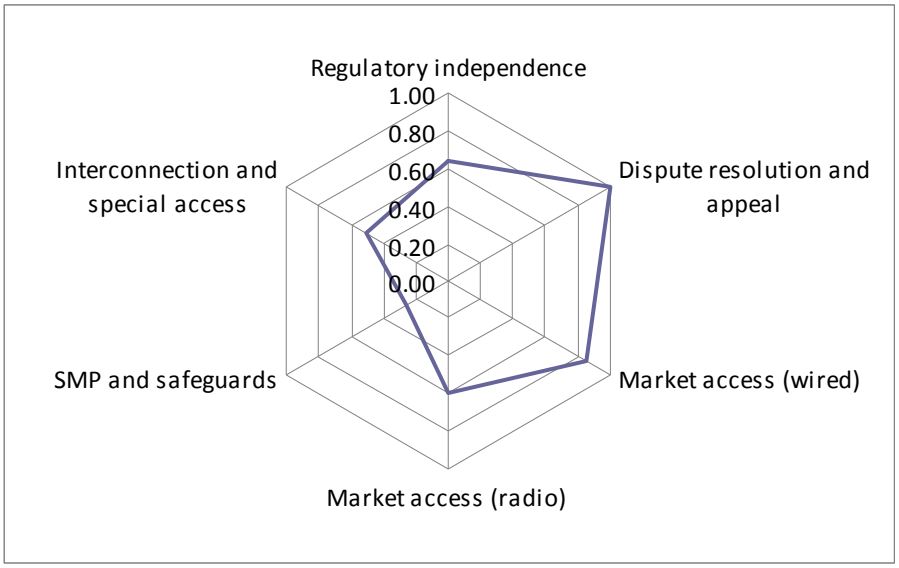
Since the 2003 Law was adopted, the market has changed significantly: mobile has overtaken fixed, new service providers have entered the market, new services have been introduced and prices have declined. In order for the authorities to effectively perform their regulatory tasks in such an environment and facilitate efficient competition, there are a number of significant legal and regulatory issues and bottlenecks which need to be addressed.

Significant among these is the institutional capacity and independence of NCCR. Although the NCCR appears to be independent in law, its independence in practice is seriously compromised by continuing state ownership of UkrTelecom, the role of the state as sector policymaker and the dependence of the NCCR on the central budget for all of its funding.

Another key bottleneck lies in the NCCR's limitations with respect to market regulation. Specifically, for the definition and assessment of the communications market, a comprehensive set of data, including confidential data, should be available to the regulator. The existing law unfortunately does not support this requirement; and as a result a detailed market assessment cannot be carried out by NCCR. Further, the 2003 Law fails to provide sufficient powers for the regulator properly to define the market, assess the market or designate particular operators as holding Significant Market Power (SMP) or market dominance, where appropriate. The NCCR is understood to have defined markets on its own initiative, but because it lacks the power to obtain detailed market data from operators, an appropriate assessment of markets is difficult. Further, under the current law, the NCCR cannot designate operators as having SMP; it is understood that this function is performed by the Anti-Monopoly Committee.

Competitive provision of services, led by the private sector, remains the critical ingredient for successful development of the communications sector. Full liberalisation and privatisation are key to the attraction of private investment. An independent regulator and a transparent, rule-based, cost-oriented regulatory regime are essential for meaningful competition to take hold and can do much to enhance investor confidence. Important steps for the government at this juncture are to significantly amend or replace the 2003 Law, ensuring all necessary guarantees for independence of NCCR are present, both in law and in practice. Crucial to ensuring such independence is providing for the NCCR to be appointed by and accountable to Parliament and financed through an industry levy in accordance with international best practice. This levy should be set at a level which can sustain salaries to attract sufficiently experienced staff and cover the cost of fully implementing the most up-to-date regulatory framework. The revised legal framework should also provide the NCCR with all the powers necessary to efficiently and effectively implement a modern EU-style regulatory framework.

Chart 12 – Quality of telecommunications regulatory framework in Ukraine (2008)

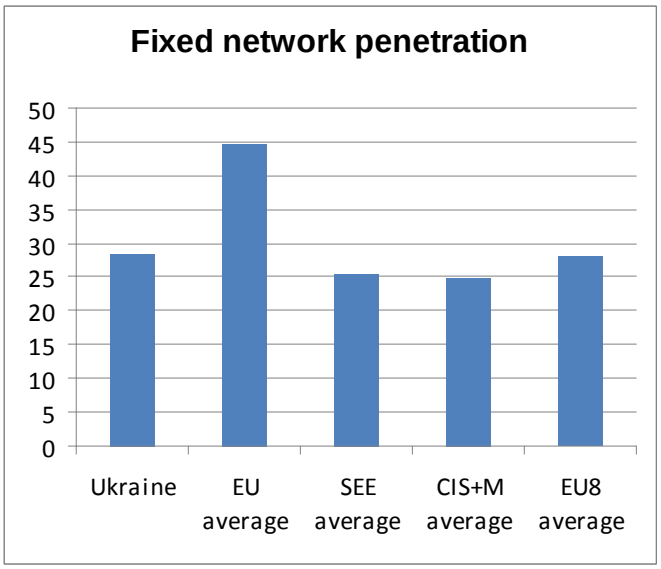


***Source**: EBRD Telecommunications Regulatory Assessment 2008*

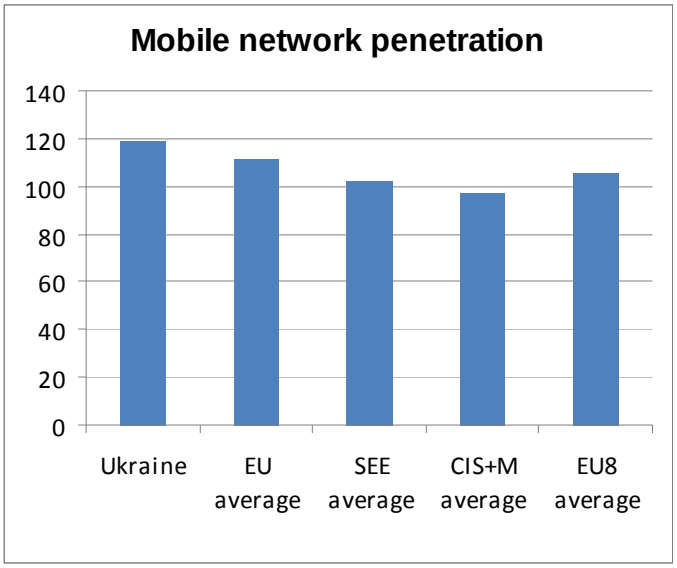
***Note**: The diagram shows the combined quality of institutional framework, market access and operational environment when benchmarked against international standards issued by the WTO and the European Union. The extremity of each axis represents an ideal score of 100 per cent, that is, full compliance with international standards. The fuller the "web", the closer the overall telecommunications regulatory framework of the country approximates these standards.*

Chart 13 – Key indicators for Ukraine (2008)

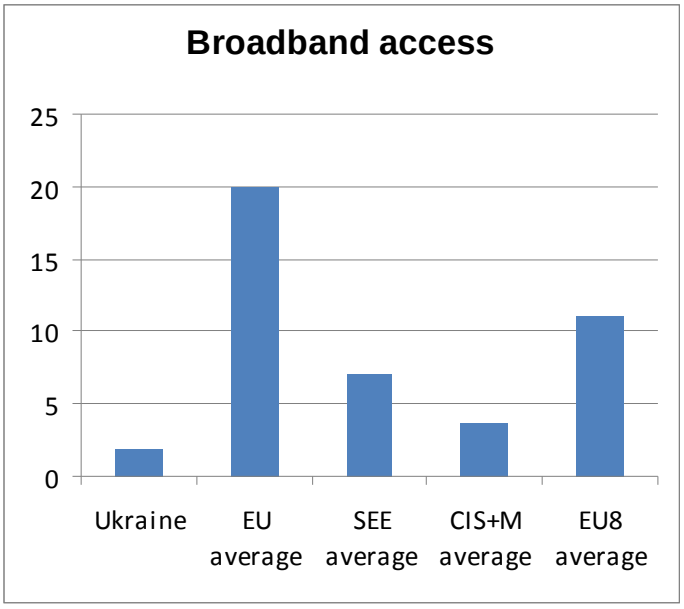
13(a) Fixed Network Penetration



13(b) Mobile Network Penetration



13(c) Broadband Network Penetration



***Source**: EBRD Telecommunications Regulatory Assessment 2008*

***Note**: Key indicators for Moldova provide the fixed network penetration defined as active subscriber lines as a percentage of population, mobile network penetration defined as active pre- and post-paid subscribers as a percentage of population and the broadband network penetration defined as the number of access subscribers with speeds of 144k/bits or more as a percentage of population (broadband Network Penetration less than 1% is not shown on this chart)*