



**COMPARATIVE ANALYSIS OF BUSINESS BANKRUPTCY REORGANIZATION IN THE US AND
UKRAINE**

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ABSTRACT

This thesis examines the legal frameworks for reorganization of failed companies in the US and Ukraine. It aims to determine whether the procedure of sanatsiya under the Ukrainian Bankruptcy Law is the same procedure of debtor's rehabilitation as bankruptcy reorganization under the US Bankruptcy Code. The thesis presents a comparative analysis of the two procedures: bankruptcy reorganization and sanatsiya, identifying their meanings, characteristics and elements.

The main finding of the thesis is that the procedures of bankruptcy reorganization and sanatsiya cannot be equated, though the latter may include the former. In fact, the results of the analysis have shown that Ukrainian bankruptcy law lacks an effective mechanism of debtor's reorganization. Acknowledging this problem, it is suggested that the term "business bankruptcy reorganization" and a concept of an automatic stay should be introduced into the Ukrainian bankruptcy law. Furthermore, there is a need to establish legal norms that would assure a debtor's participation in business bankruptcy reorganization by granting this debtor rights to commence bankruptcy reorganization procedure and draft a plan of this procedure. This thesis includes also suggestions for confirmation procedure of a plan of reorganization.

INTRODUCTION

Over the last few decades, the procedure of business bankruptcy reorganization under Chapter 11 of the US Bankruptcy Code has become a successful model for introducing bankruptcy reforms and establishing new bankruptcy regimes all over the world. The attainment of the American system of bankruptcy reorganization can be proven by the data from “big” Chapter 11 cases. For instance, when “Lehman Brothers filed for reorganization, the company had over \$600 billion of liabilities, tens of thousands of creditors and counterparties, and 7000 subsidiaries in over 40 countries”.¹ Nevertheless, in the case of Lehman Brothers “it took only three-and-a-half years in bankruptcy court to emerge with a confirmed plan of reorganization that was approved by 95 % of its creditors”². What is more, according to the World Bank’s rating about the ease of doing business in 2012, the US was ranked fourth out of 185 countries³. These examples suggest that the US Bankruptcy Code offers an appropriate legal framework for successful bankruptcy reorganization. Hence, Chapter 11 of the US Bankruptcy Code can be held up and studied as a benchmark for bankruptcy legislation in several European countries, particularly in Ukraine.

Since Ukraine gained its independence in 1991, Ukrainian bankruptcy law has been primarily designed to defend creditors by forcing a debtor to initiate a procedure of liquidation rather than facilitate its reorganization. However, the goal of acquiring membership in the European Union, pushed Ukrainian lawmakers to introduce several reforms regarding the restoration of a debtor in a bankruptcy case. Recently, the Ukrainian Bankruptcy law has been revised again. As will be discussed further in this paper, many scholars and practitioners claim that these amendments will improve the process of rehabilitation of a debtor and will have a positive

¹ Stuart Gilson, *Coming Through in a Crisis: How Chapter 11 and the Debt Restructuring Industry are Helping to Revive the US Economy*, Journal of Applied Corporate Finance, Vol. 24, 23 (2012).

² *Id.*

³ The World Bank, *Ease of doing business index (most business-friendly regulations)*, 2011, available at: <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ>

impact on both Ukrainian competitive environment and attraction of domestic and foreign investment. That being said, I argue that the recent reforms are not comprehensive and, consequently, will not enhance the process of debtor's bankruptcy reorganization. There is a need for further reforms. Thus, I make a case that it is necessary to adopt amendments into Ukrainian bankruptcy law based on the US experience.

This thesis provides an in depth comparative analysis of the US and Ukrainian bankruptcy reorganization procedures and offers recommendations for additional reforms of the Ukrainian bankruptcy system based on the US experience. The thesis is divided into three chapters. The first chapter deals with the general notions of the US bankruptcy reorganization framework along with an overview of its related concepts. Also, this chapter sets forth a comparative analysis of the existing definitions of the US bankruptcy reorganization, and its equivalent under the Ukrainian bankruptcy legislation. Based on these findings, I propose a clear and accurate definition of business bankruptcy reorganization that can be introduced into the Ukrainian bankruptcy law. The second chapter provides a comparative analysis of business bankruptcy reorganization procedures according to both the US and Ukrainian bankruptcy systems. This chapter defines and evaluates the efficiency of key elements of bankruptcy procedures in the above-mentioned countries. Furthermore, this chapter looks at the disparities between bankruptcy reorganization procedures in the US and Ukraine. In this chapter I argue that the Ukrainian bankruptcy law does not establish an adequate bankruptcy reorganization procedure. The last chapter examines the evolution of Ukrainian Bankruptcy law regarding the procedure of business bankruptcy reorganization. Moreover, this chapter offers recommendations for improvement of the Ukrainian bankruptcy system based on the successful US experience.

CHAPTER 1. CHAPTER 11 OF THE US BANKRUPTCY CODE AS A BENCHMARK

This chapter assesses the general framework of business reorganization under Chapter 11 of the US Bankruptcy Code as the basis for reorganization procedure, which is applied in many countries. As the first step, it is suggested to distinguish the concept of business bankruptcy reorganization from other concepts. The next step is to compare the term of business reorganization with the Ukrainian term *sanatsiya*. This comparison is important, as I would argue that, in essence, these two concepts can not be used interchangeably.

1.1 Summary of Chapter 11 of the US Bankruptcy Code

The business bankruptcy reorganization is primarily governed by Chapter 11 of the United States Bankruptcy Code (hereinafter – the US Bankruptcy Code). Prior to the enactment of Chapter 11, this procedure was regulated by several rehabilitation chapters of the Bankruptcy Act of 1973. However, such system has proven to be inefficient. First, it was often impossible to define the applicable chapter for a specific situation. “It was stated that such chapters contained overlapping rules regarding their availability, which frequently produced pointless and wasteful litigation, as to which chapter would be utilized in a particular case”⁴. Second, the federal trustee model embodied in the Bankruptcy Act of 1973 was largely considered to be ineffective⁵. These problems compelled Congress of the United States to adopt necessary amendments and to consolidate the above-mentioned chapters into one. Hence, the first step in making business bankruptcy reorganization successful in the US was establishment of the unified legal regulation.

The US Bankruptcy Code lies on a key premise that company’s bankruptcy reorganization is

⁴ RICHARD F. BROUDE, REORGANIZATION UNDER CHAPTER 11 OF THE BANKRUPTCY CODE 1-7 (1986), available at: <http://books.google.hu/books?id=ufRAp5A9A7wC&pg=SA1-PA6&dq=bankruptcy+reorganization+in+the+us&hl=en&sa=X&ei=JysqUbK5MciGswbw84Bo&ved=0CCMQ6AEwATgK#v=onepage&q=bankruptcy%20reorganization%20in%20the%20us&f=true> (last visited Mar. 26, 2013).

⁵ John W.M. Butler, Jr., Chris L. Dickerson & Stephen S. Neuman, *Chapter 11 at the Crossroads: Does Reorganization Need Reform? Preserving State Corporate Governance Law In Chapter 11: Maximizing Value Through Traditional Fiduciaries*, 18 AM. BANKR. INST. L. REV. 337, 337, (2010).

a desirable procedure. This policy follows from the main purpose of bankruptcy reorganization, which is “to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources”⁶. In other words, reorganization of corporation as a principal procedure of bankruptcy proceedings will help to preserve the “going-concern value” of a company, save jobs, avoid economic crisis that may occur in case of liquidation. Therefore, not only debtors and creditor are able to benefit from the procedure of bankruptcy reorganization, but also employees, suppliers and the community as a whole.

Although, a sufficient justification for promoting reorganization policy has been provided, its efficiency is still a subject of debates among various scholars. Some of them, like Hart and Moore, argue that “Chapter 11 of the US Bankruptcy Code is inefficient mechanism that rehabilitates economically nonviable firms”⁷. This opinion is justified by the fact that procedures under Chapter 11 are expensive in terms of time and money⁸. Also, according to Hart and Moore Chapter 11 stimulates unfair and inefficient strategic risk taking⁹. Other scholars, such as Varouj A. Aivazian, contend that firms, which have filed for reorganization under the Chapter 11 perform no worse and even better than non-filing firms¹⁰. In my opinion, introducing reorganization of companies in bankruptcy proceedings is more beneficial than detrimental. First, the establishment of a right to file for business reorganization will encourage entrepreneurs to start their own business. It is well known that creating a business is costly and time-consuming. What is more, no guarantees can be given to ensure owners that their business will always remain profitable. Every entrepreneur has to bear a risk of a business failure. Thus, it is necessary to provide a sufficient incentive that

⁶ MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON, STEVE H. NICKLES, *BUSINESS REORGANIZATION IN BANKRUPTCY: CASES AND MATERIALS* 1 (3d ed. 2006).

⁷ Varouj A. Aivazian & Simiao Zhou, *Is Chapter 11 Efficient?*, 41 *Financial Management* 229, (2012); *see also* Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 *YALE L.J.* 10, 43 (1992).

⁸ CHARLES J. TABB, RALPH BRUBAKER, *BANKRUPTCY LAW. PRINCIPLES, POLICIES AND PRACTICE* 596, (2010).

⁹ *Id.*

¹⁰ *Id.*

will stimulate entrepreneurs' interest to run a business. One of such incentives is a right of a company for bankruptcy reorganization.

Second, reorganization is an effective mechanism of avoiding business liquidation of a company. It is widely acknowledged that business liquidation can lead to devastating consequences not only for a liquidating company, but also for a whole society. Liquidation is a harmful procedure for a company because it entails the sale or redistribution of its assets and operations. Moreover, liquidation leads to the loss of jobs with the accompanying financial and emotional stress for workers and their families¹¹. Hence, "the cost of business liquidation to society is high"¹². By filing for business reorganization it is possible to retain jobs. Workers will not only receive their salaries, but also will be able to help a company to keep its business in operation and eventually pay its debts.

Lastly, third reason that reflects benefits of bankruptcy reorganization is that other bankruptcy procedures may be less effective under the particular circumstances. The main goal for creditors in a bankruptcy proceeding is to receive a certain amount of money that a debtor owes to them. It is common for the procedure of liquidation of a company that creditors may not be paid in full or some of them (unsecured creditors, stockholders, partners etc.) may not receive anything at all. Thus, in particular cases it may be more efficient for creditors to maintain the operations of a company in order to receive their money back.

To conclude, the reasons mentioned above are worth acquittal for existing policy of Chapter 11 of the US Bankruptcy Code, which provides that business reorganization is a desirable bankruptcy procedure. At the same time, it is fair to say that this policy does not diminish the role of other proceedings such as liquidation or workouts. Likewise, this policy does not

¹¹ MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON, STEVE H. NICKLES, *BUSINESS REORGANIZATION IN BANKRUPTCY: CASES AND MATERIALS* 2 (3d ed. 2006).

¹² *Id.*

require the compulsory application for business reorganization. In order to exercise the right for bankruptcy reorganization certain conditions must be met. The following section will look at the definition, attributes and conditions for applying rules of bankruptcy reorganization.

1.2 Business reorganization under the US Bankruptcy Code

According to the Black's law dictionary, which reflects the definitions of the majority of legal terms in the United States of America (hereinafter – "The US"), bankruptcy reorganization is "a financial restructuring of a corporation, esp. in the repayment of debts, under a plan created by a trustee and approved by a court"¹³. The other legal definitions of this term are coherent with the meaning provided by the Black's law dictionary as they define reorganization as a rehabilitation procedure of a debtor that permits to satisfy claims of creditors.¹⁴ Although the general meaning of reorganization is clear, the language of these definitions may cause some difficulties since they do not contain full information about reorganization procedure. For instance, the first mentioned definition states that a plan for reorganization is prepared by a trustee. Indeed, a trustee may be empowered to manage reorganization procedure, in particular to form a plan of reorganization. However, in most cases such powers are granted to a debtor, who is known as a debtor-in-possession¹⁵. According to my observations, a definition of business reorganization exposes a general idea of this process. Yet, to apprehend all aspects of business bankruptcy reorganization, it is necessary to examine its main features.

¹³ BRYAN A. GARNER, BLACK'S LAW DICTIONARY 1324, (8th ed. 2004).

¹⁴ Cf. "a thorough reconstruction of a business corporation, comprising a considerable change in capital structure, as effected after, or in anticipation of, a failure and receivership." VICTORIA NEUFELDT, DAVID B. GURALNIK, WEBSTER'S NEW WORLD COLLEGE DICTIONARY 1137, (1996); "a thorough alteration of the structure of a business corporation." THE AMERICAN HERITAGE COLLEGE DICTIONARY 1156, (3d ed. 1993).

¹⁵ It should be stated that Chapter 11 of the US Bankruptcy Code is designed to allow the debtor-in-possession remains the control and management of a distressed company unless it is proved that a trustee should be appointed. See CHARLES J. TABB AND RALPH, BANKRUPTCY LAW. PRINCIPLES, POLICIES AND PRACTICE 598-604 (2010). John WM. Butler, Jr., Chris L. Dickerson and Stephen S. Neuman, *Chapter 11 at the crossroads: does reorganization need reform? Preserving state corporate governance law in Chapter 11: maximizing value through traditional fiduciaries*, 18 Am. Bankr. Inst. L. Rev. 337, 337 (2010).

From the terminology prospective, it is also useful to differentiate the term “reorganization” from the word “rehabilitation” that is often used along with the first term¹⁶. In some countries these two terms are different. For example, according to the chapter 21 of Japan’s Civil Rehabilitation Law, rehabilitation is considered as a procedure that may be commenced prior the occurrence of bankruptcy factors¹⁷.

As Black’s law dictionary suggests, “rehabilitation” means “the process of reorganizing a debtor financial affairs under Chapters 11, 12 or 13 of the US Bankruptcy Code so that the debtor may continue to exist as a financial entity, with creditors satisfying their claims from the debtor’s future earnings”¹⁸. Hence, in the US the understanding of “rehabilitation” is broadest as it includes all types of bankruptcy reorganizations: business reorganization, reorganization of individuals and family farmer reorganization. In this thesis terms “reorganization” and “rehabilitation” will be used as synonymous to mean the procedure of debtor’s and its debts restructuring that enables this debtor to continue the operation of its business so as to be able to pay its debts through future earnings under the supervision of its creditors, a court and former owners¹⁹.

As noted before, business reorganization under Chapter 11 of the US Bankruptcy Code is a desirable procedure. Due to its distinctive characteristics, it can be considered as a more favorable over the other bankruptcy proceedings. In this section, I will focus on key characteristics and in the next chapter of this thesis I will discuss them in more detail.

The first important feature of bankruptcy reorganization is the availability of automatic stay under Section 362 (a) of Chapter 11 of the US Bankruptcy Code. Automatic stay is an

¹⁶ *E.g.* In re Cinole, Inc., 339 B.R. 40, 45 (Bankr. W.D.N.Y. 2006), where the purpose of chapter 11 of the US Bankruptcy Code was indicated as to allow existing business to reorganize and rehabilitate.

¹⁷ Cindy Yoshiko Shirata, *Corporate rehabilitation in Japan: An empirical study*, (2008), available at: <http://www.turnaround.org/Publications/Articles.aspx?objectID=8594> (last visited Mar. 26, 2013).

¹⁸ BRYAN A. GARNER, BLACK’S LAW DICTIONARY 1311, (8th ed., 2004).

¹⁹ MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON, STEVE H. NICKLES, BUSINESS REORGANIZATION IN BANKRUPTCY: CASES AND MATERIALS 2 (3d ed. 2006).

injunction that prevents creditors to take any actions against the debtor or its assets²⁰. Generally, it begins automatically after a debtor files a petition. However, there are some exceptions to this rule²¹. I would like to emphasize that automatic stay serves as an adequate protection for both debtors and creditors. With the help of this injunction, debtors have enough time to conduct their business and eventually return their debts. At the same time automatic stay secures all creditors by preventing all of them from collecting debtor's money until a reorganization plan is affirmed.

The second feature of bankruptcy reorganization is the opportunity to appoint a debtor-in-possession (hereinafter- "DIP") instead of a trustee. Traditionally, a debtor-in-possession is a debtor, who remains in possession of his property, continues to operate the business, develops a plan and generates funds to pay his debts.²² Thus, Chapter 11 of the US Bankruptcy Code empowers a DIP to exercise the same the rights as a trustee. The existence of such provision is justified by the rationale of a reorganization procedure, which is to adjust debtor's obligations and to continue its business operations.

The third feature of bankruptcy reorganization is that the US Bankruptcy Code grants a trustee "avoiding powers". As discussed before, a DIP has the same rights as a trustee. Hence, a DIP may exercise avoiding powers as well. These powers give an opportunity to assume or breach executor contracts (§ 365); the power to void fraudulent conveyances (§ 548, 544 (b)); the power to recover preferences (§ 547); the power to set aside unperfected or late-perfected security interests in the debtor's property (§ 544 (a), 547)²³.

Finally, two important distinguishing characteristics of bankruptcy reorganization are the

²⁰ US Bankruptcy Code, 11 U.S.C. § 362(a).

²¹ A mere filing of a petition to a bankruptcy court will not invoke an automatic stay for certain types of actions listed in § 362(b) of chapter 11 of the US Bankruptcy Code.

²² Phillip L. Kunkel, Jeffrey A. Peterson, Jessica A. Mitchell, *Bankruptcy: Chapter 11 Reorganizations* 1, (2009), available at: <http://www.extension.umn.edu/distribution/businessmanagement/components/DF7296.pdf> (last visited Mar. 26, 2013).

²³ E. WARREN, THE LAW OF DEBTORS AND CREDITORS. TEXT, CASES AND PROBLEMS 396, (6th ed., 2008).

right of a court to impose a cramdown and a requirement that a reorganization plan must satisfy “absolute priority rule”. “Cramdown” is a judicial power to affirm or modify a plan of reorganization against the desires of some classes of creditors²⁴. This right may be exercised by a court only if specific conditions are met²⁵. Therefore, the US Bankruptcy Code provides a sufficient framework for protecting interests of all classes of creditors. Another powerful tool that reassures creditors that their claims will be satisfied is the compulsory application of “absolute priority rule”. This rule means that senior creditors have a right to be paid in full before junior creditors²⁶. Thus, it prevents junior creditors from taking any advantages over senior creditors. That said, very often in practice senior creditors give their content to junior creditors to participate in recoveries even though they will not be able to satisfy their claims in full²⁷.

To conclude, all the above-mentioned features of business reorganization make it more favorable in comparison with the other bankruptcy procedures. Nevertheless, its mere implementation in a national legislation will not likely guarantee the success of bankruptcy reorganization. A brief case studies that will be analyzed later will validate that bankruptcy reorganization is a desirable procedure in the US bankruptcy law because its main features have proven to be effective mechanisms.

Apart from features of bankruptcy reorganization under the US bankruptcy law, the meaning of this procedure is also reflected by identification of certain requirements that have to be satisfied in order to apply rules for bankruptcy reorganization. The main idea of various requirements is to show under what circumstances it is possible and even desirable to use

²⁴ Daniel R. Wong, *Chapter 11 Bankruptcy and cramdowns: adopting a contract rate approach* Northwestern University Law Review, 106(4), 1932, (2012).

²⁵ Note that under Section 1129 (b) of the US Bankruptcy Code a court must determine that the reorganization plan is “fair and equitable” and not unfairly discriminatory to dissenting classes of creditors.

²⁶ Douglas G. Baird and Donald S. Bernstein, *Absolute Priority, valuation uncertainty, and the reorganization bargain*, The Yale Law Journal, Vol. 115, Issue 8, 1932, (2006).

²⁷ *Id.*

certain process. Hence, conditions may not by themselves identify the essence of the term “business reorganization”. That said, they are significant supplements for the definition.

The first requirement concerns the eligibility. In other words, it is necessary to determine who can apply for bankruptcy reorganization under Chapter 11 of the US Bankruptcy Code. According to this chapter any corporation, limited liability entity or partnership (hereinafter – “a firm or company”) except a governmental unit may be considered as a person (a debtor) who may file a petition for bankruptcy reorganization²⁸.

Another important requirement is that such companies have to face insolvency problems, which made impossible to meet their payment obligations. In different countries the level of firm’s inability to pay its debts varies dramatically. For example, in Germany a firm has to be in a situation of over-indebtedness and at the same time it requires to have a sufficient assets to cover the cost accruing from the bankruptcy reorganization²⁹. In the US a company that wishes to file a petition for bankruptcy reorganization has to be financially distressed. Currently, there is no universally accepted definition of the notion “financial distress”. Some scholars like Phillip L. Kunkel and Jeffrey A. Peterson note that “financial distress” means “the firm’s promise to creditors is not fulfilled or honored with difficulty”³⁰. Other scholars like K. Ayotte and D. A. Skeel point out that “a firm is financially distressed if it possesses investment opportunities that are valuable to its investors if these opportunities are

²⁸ Phillip L. Kunkel, Jeffrey A. Peterson, Jessica A. Mitchell, *Bankruptcy: Chapter 11 Reorganizations* 1, University of Minnesota, (2009), available at: <http://www.extension.umn.edu/distribution/businessmanagement/components/DF7296.pdf> (last visited Mar. 26, 2013).

²⁹ Carlos Lopez Guitierrez, Mariam Garcia Oalla, Begona Torre Olmo, *The influence of bankruptcy law on equity value of financially distressed firms: A European comparative analysis*, *International Review of Law and Economics*, Vol. 29, Issue 3, 229 (2009).

³⁰ Lemma V. Senbet and Tracy Yue Wang, *Corporate financial distress and bankruptcy: a survey* 7, (2012), available at: <http://www.tc.umn.edu/~wangx684/assets/documents/research/Corporate-Financial-Distress-and-Bankruptcy.pdf> (last visited Mar. 26, 2013).

undertaken (or continued),³¹ but for which the firm is not able to obtain financing”³². Comparing both definitions, I think that they contain different features of financially distressed company that have to exist simultaneously. Hence, a company shall be considered as financially distressed when it is incapable of paying its debts to creditors, but is able to exercise its obligations if it gets appropriate financing.

Based on the stated above, it is reasonable to conclude that in order to apprehend the meaning of business bankruptcy reorganization under Chapter 11 of the US Bankruptcy Code it is necessary to analyze not only its definition, but also its essential features and requirements. Hence, business bankruptcy reorganization is a specific type of bankruptcy procedure that assumes the restructuring of a debtor and its debts under the supervision of its creditors, a court and former owners to pursue double goals: 1) enable a debtor to fulfill its payment obligations; 2) continue the operation of its business afterwards. Pursuant to Chapter 11 of the US Bankruptcy Code a person is eligible to file a petition for bankruptcy reorganization if it is a corporation, limited liability entity or partnership that is under financial distress. Apart from these requirements, the meaning of bankruptcy reorganization is also defined by its distinctive features such as: the availability of automatic stay, the appointment of a debtor-in-possession, trustee’s “avoiding powers”, the imposition of a cramdown and the satisfaction of “absolute priority rule”.

As will be noted in Chapter 1.4. Ukrainian bankruptcy law does not provide a clear distinction between bankruptcy reorganization and rehabilitation procedures. Therefore,

³¹ It is common for finance scholars to distinguish financial distress companies from economic distress ones. In their opinion a major goal of bankruptcy law is to separate the financially distressed (economically efficient) firm from the economically distressed one, allowing a company with financial distress to continue their business, and liquidating the economically distressed one. See Michelle J. White, *Corporate Bankruptcy as a filter device: Chapter 11 reorganization and out-of-court debt restructurings*, Journal of Law, Economics & Organization, Vol.10, 268 (1994), available at: <http://weber.ucsd.edu/~miwhite/filtering-failure.pdf> (last visited Mar. 26, 2013).

³² Kenneth Ayotte and David A. Skeel Jr., *Bankruptcy or Bailouts?*, The Journal of Corporation Law, Vol. 35:3, 473-474, (2010), available at: <http://blogs.law.uiowa.edu/jcl/wp-content/uploads/2012/01/A1-Ayotte-Skeel.pdf> (last visited Mar. 26, 2013).

before the examination of a bankruptcy reorganization definition in Ukraine, I will analyze in sections 1.3.1, 1.3.2 and 1.3.3 other bankruptcy related concepts such as liquidation, workouts and bailout.

1.3 Related concepts

In the following sections I will focus on the meaning of related to a business bankruptcy reorganization concepts and explain the main differences between them. However, I will not deal with historical analysis of such procedures or analyze economic aspects of each concept as it is not the point of this thesis.

1.3.1 Workouts

As mentioned before, Chapter 11 of the US Bankruptcy code provides a reorganization proceeding that is supervised by a court that allows a debtor to rearrange its payment obligations. For the reason of longstanding criticism of this chapter by various economists and businessmen as being too costly, slow and inequitable new legal strategies were proposed³³. One of them is about the opportunity to apply out-of-court workouts.

According to Black's law dictionary "workout is negotiation with creditors whereby a debtor enters into an agreement with a creditor or creditors for a payment or plan to discharge the debtor's debt(s)"³⁴. Parties of such an agreement may either extend the time period in which the debtor's obligations become due, or may conclude a composition agreement, which will reduce the amount to be paid to creditors over a particular period of time³⁵.

Thus, it can be stated that workout as well as bankruptcy reorganization is a process of rehabilitation of failing firms. However, legal provisions do not regulate this process. This

³³ Stuart Gilson, *Coming Through in a Crisis: How Chapter 11 and the debt restructuring industry are helping to revive the US economy*, Journal of Applied Corporate Finance, Vol. 24, 23, (2012), available at: http://www.hbs.edu/faculty/Publication%20Files/Coming%20Through%20in%20a%20Crisis_1ffcaae3-d616-47f1-875b-de4b09d97b65.pdf (last visited Mar. 26, 2013).

³⁴ BRYAN A. GARNER, BLACK'S LAW DICTIONARY 1638, (8th ed., 2004).

³⁵ Hon. Conrad B. Duberstein, *Out-of-court workouts*, 1Am. Bankr. Inst. L. Rev. 347, 347(1993).

means that workouts do not contain efficient elements of bankruptcy reorganization that make the latter more effective³⁶. For example, due to the availability of automatic stay creditors are not free to invoke collection remedies against a debtor after this debtor file a petition for bankruptcy reorganization. Workout, on the contrary, cannot bar creditors who do not want to conclude and perform restructuring agreement to collect debts³⁷.

Having said that, workout is also proved to be effective. What is more, under particular circumstances workout can be even more desirable procedure than reorganization. “In the case of Realogy Corporation, it was stated that reorganization under Chapter 11 was deemed to be inappropriate for the following reasons: 1) the rejection of franchise agreements under Section 365 of the US Bankruptcy Code could have undermined the company’s relationships with its franchises and hurt the business; 2) by applying bankruptcy procedure the appearance of “giving up” on an important investment could have sent a strong negative signal to the limited partners and its competitors that the firm was not willing to support its less successful investments, undermining future fund-raising efforts or its ability to restructure other portfolio companies”³⁸.

While making a decision whether to apply reorganization or workout the following facts should be considered. First, out-of-court workouts are voluntary and require the ascent of all creditors in order to be effective. This is so, because workouts oblige only those creditors, who agree to the workout agreement. Also, certain advantages of workouts over bankruptcy

³⁶ As was mentioned in a previous section, efficient elements of bankruptcy reorganization are: automatic stay, a position of DIP, “avoiding powers”, absolute priority rule, cram down. Also the supervision of a court and impossibility to compel creditors to obey the rules of bankruptcy reorganization can be regarded as elements that benefit bankruptcy reorganization.

³⁷ Charles J. Tabb and Ralph Brubaker note that a “holdout problem” may arise: even if a workout may become the most suitable procedure for creditors as a group, a dissenting creditor can extort more than its fair share by threatening to undermine the whole reorganization. See CHARLES J. TABB AND RALPH BRUBAKER, *BANKRUPTCY LAW: PRINCIPLES, POLICIES AND PRACTICE*, 597, (2010).

³⁸ Stuart Gilson, *Coming Through in a Crisis: How Chapter 11 and the debt restructuring industry are helping to revive the US economy*, *Journal of Applied Corporate Finance*, Vol. 24, 31-32, (2012), available at: http://www.hbs.edu/faculty/Publication%20Files/Coming%20Through%20in%20a%20Crisis_1ffcae3-d616-47f1-875b-de4b09d97b65.pdf (last visited Mar. 26, 2013).

reorganization are disputable. For example, there is a general view that workout is less expensive than reorganization procedure. Yet, in my opinion, although bankruptcy reorganization may be costly, it does not necessary follow that workouts are less expensive. Moreover, it is much easier to estimate costs according to Chapter 11 of the US Bankruptcy Code as a court discloses them³⁹, rather than in workouts. It is so because no compulsory requirement exists for similar reporting in out-of-court workouts. Hence, the argument that bankruptcy reorganization is more expensive is debatable.

To conclude, both bankruptcy reorganization and workout have certain benefits that make the US restructuring processes more efficient. That said, these procedures have their own benefits and drawbacks. That is why, the choice between workout and bankruptcy reorganization has to be made by examination of specific circumstances in each particular case.

It is also very important to highlight that over the years a very important legal innovation was made. Namely, new methods of restructuring industry emerged: “prepackaged” and “prenegotiated” bankruptcy⁴⁰. The main advantages of these methods are the reduction of time of bankruptcy procedure and lowering the financial costs. These methods combine the most essential features of Chapter 11 and out-of-court workout and, thus, have become very common in practice⁴¹.

1.3.2. Liquidation

Nowadays, filing for bankruptcy reorganization under Chapter 11 of the US Bankruptcy Code does not necessarily mean that a debtor will restructure its debts and continue its

³⁹ Stuart Gilson, *supra* note 35, at 26.

⁴⁰ Stuart Gilson, *supra* note 35, at 30.

⁴¹ Not that in 2009 alone, by using these methods the corporations like CIT Group, Six Flag, Lear Corporation have successfully completed the procedure of bankruptcy reorganization. See more, Stuart Gilson, *supra* note 35.

operations. As Elizabeth Warren points out “Chapter 11 of the US Bankruptcy Code is increasingly used for liquidation of companies”⁴². For this reason, it is important to define main differences between these bankruptcy proceedings.

The procedure of liquidation is regulated by Chapter 7 of the US Bankruptcy Code and assumes that a debtor ceases its operation and its assets will be sold in order to satisfy the claims of creditors⁴³. From this definition it follows that a debtor at the end of this procedure will not be able to continue its business as a going concern. A trustee, who is appointed to supervise the procedure of liquidation, may run a firm as a going concern only during the procedure of liquidation. However, as soon as it will be over, a trustee must sell bankruptcy estate and distribute it among the holders of claims or interests⁴⁴. Therefore, the core idea of liquidation is straightforward: to distribute the debtors property according to the rules set out in Chapter 7 of the US Bankruptcy Code, which entails the termination of a debtor’s business.

As was mentioned earlier, bankruptcy reorganization does not generally require the disposal of debtor’s property. Nevertheless, such sale may take place under certain circumstances⁴⁵. Unlike in liquidation, one of the goals of Chapter 11 of the US Bankruptcy Code is not simply to discharge creditors’ claims, but replace the original claims of creditors to new ones. When a company faces insolvency problems creditors will bare a risk of not being paid in full in case of the sale of such a company. Consequently, creditors are more willing to use another mechanisms, which guarantee the satisfaction of their claims in full. One of such mechanisms is bankruptcy reorganization. When a company is restructured, new claims and

⁴² ELIZABETH WARREN, *THE LAW OF DEBTORS AND CREDITORS: TEXT, CASES AND PROBLEMS* 404, (6th ed., 2008).

⁴³ Liquidation. ICSC Dictionary of Shopping Center Terms [serial online] 23, (2005), available from: Business Source Complete, Ipswich, MA. (last visited Mar. 26, 2013).

⁴⁴ BARRY E. ADLER, DOUGLAS G. BAIRD, THOMAS H. JACKSON, *CASES, PROBLEMS AND MATERIALS ON BANKRUPTCY* 674, (2007).

⁴⁵ Note that under Section 363 of the US Bankruptcy Code a debtor has a right to sell its assets in an open competitive auction overseen by the bankruptcy court. This procedure may help a debtor to raise more proceeds and, hence, reduce the amount of its debts.

interests are distributed among its creditors instead of proceeds from actual sale. Hence, successful business reorganization may benefit creditors more than other bankruptcy proceedings.

The main premise of Chapter 11 of the Bankruptcy Code is to allow companies, which face insolvency problems to survive and remain as a going concern. Tom Jackson states that a criteria for such survival is an economic one: “can a troubled company if properly reorganized be made profitable enough for its new investors to earn a fair rate of return on their money?”⁴⁶ If it is possible to reply to this question in the affirmative, then a company will have a right to trigger bankruptcy reorganization under Chapter 11 of the Bankruptcy Code. Otherwise, a company will be liquidated according to Chapter 7 of the Bankruptcy Code.

Finally, I would like to note that a choice between two procedures: liquidation and business reorganization depends on a person who makes this choice. As Stephen J. Lubben puts it, a debtor usually chooses business reorganization over liquidation because this procedure allows him to remain in possession of his firm with powers and obligations of a trustee⁴⁷. What is more, a debtor will have an opportunity to continue his business after the procedure of business reorganization will be completed.

1.3.3 Bailouts

Over the past few years a lot of debates about practicability and efficiency of application of bailouts programs were generated. In some cases, like the AIG case, governmental bodies agreed to provide a bailout package for a company. In others, for instance in the case of Lehman Brothers, the government declined to offer a bailout. That denial forced Lehman

⁴⁶ Zupan M. University of Rochester, *Roundtable on bankruptcy and bailouts: the case of the US auto industry*, Journal of Applied Finance, 18(2), 98, (2008).

⁴⁷ Stephen J. Lubben, *Business Liquidation*, The American Bankruptcy Law Journal, Vol.81, 66, (2007).

Brothers to file for reorganization under Chapter 11 of the US Bankruptcy Code⁴⁸. Both decisions led to ongoing discussions as well as criticism from bankruptcy scholars, policymakers and practitioners. The purpose of this section is not to define historical, political or economic issues of bailouts system, but to clarify the differences between bankruptcy reorganization and bailouts as well as to conclude, which method is more expedient and effective under current conditions.

According to the Black's Law dictionary "bailout is a rescue of an entity, usually a corporation or an industry, from financial trouble"⁴⁹. This method of salvation has three important elements. The first element is a required government participation that has the power to decide upon the application of bailout program to a failing company. Such intervention may take place through lending, equity injection, purchase of assets, assisted takeover, loan guarantee, other tangible benefit or inaction through regulatory forbearance for failing firms⁵⁰. Therefore, by offering a bailout to a firm a government may obtain a controlling equity interest in it. As a result, such a government will be able to exercise an influence over that company in order to pursue its own interests.

The other element of bailout is that action taken by the government is preemptive⁵¹. In other words, a company that is offered a bailout package will remain as a going concern and, thus, will have an opportunity to benefit creditors and other interested parties. Finally, in the absence of bailout, a failing firm will have no choice but to file for bankruptcy⁵².

⁴⁸ Andrew Ross Sorkin, *Lehman Files for Bankruptcy; Merrill is sold*, The New York Times, 2008, available at: <http://www.nytimes.com/2008/09/15/business/15lehman.html?pagewanted=all> (last visited Mar. 26, 2013).

⁴⁹ BRYAN A. GARNER, BLACK'S LAW DICTIONARY 152, (8th ed., 2004).

⁵⁰ Vern McKinley and Gary Gegenheimer, *Bright Lines and Bailouts to bail or not to bail, that is the question*, Policy Analysis # 637, 2, (2009), available at: <http://www.cato.org/sites/cato.org/files/pubs/pdf/pa-637.pdf> (last visited Mar. 26, 2013).

⁵¹ *Id.*

⁵² *Id.*

The main premise for establishing bailouts is the existence of a systematic risk, which is posed by inability of firms to perform their obligations when they become due⁵³. Unlike in bankruptcy reorganization, such risk is not dangerous only for the failing company itself or its counterparties, but may lead to a global economic crisis. For this reason, government officials have a right to intervene through offering a prompt rescue methods to a certain company so that to prevent a fatal consequences. Yet a government must ensure that the application of such methods is allowed only when there is well-defined, transparent and verifiable policy justification for them⁵⁴.

As stated above, one of the principal arguments for bailing out companies instead of filing for bankruptcy reorganization is the protection of the whole financial system. This system is considered to be a public good and, therefore, must be safeguarded by a government. Another argument concerns the necessity to avoid severe consequences that supposedly would follow from bankruptcy⁵⁵. Stephanie Ben-Ishai and Stephen J. Lubben point out that such consequences are: the diminishing of the value of the firm's assets; and adverse effect on the firm contractual counterparties⁵⁶. Additional arguments for preferring bailouts versus other procedures can be found in the case law. For example, the CEO of General Motors stated three reasons why bankruptcy reorganization was not an option⁵⁷. First, the financing through bankruptcy reorganization was not sufficient to keep General Motors as going concern. Second, the stigma of bankruptcy might have prevented consumers from buying General Motors cars. Third, General Motors was already in the midst of its reorganization.

⁵³ Adav J. Levitin, *In defense of bailouts*, The Georgetown Law Journal, Vol. 99:435, 446, (2011), available at: http://www.law.gwu.edu/Academics/research_centers/C-LEAF/Documents/Junior%20Faculty%20Workshop%20Papers%202011/Levitin%20In%20Defense%20of%20Bailouts.pdf (last visited Mar. 26, 2013).

⁵⁴ Vern McKinley and Gary Gegenheimer, *Bright Lines and Bailouts to bail or not to bail, that is the question*, Policy Analysis # 637, 2, (2009), available at: <http://www.cato.org/sites/cato.org/files/pubs/pdf/pa-637.pdf> (last visited Mar. 26, 2013).

⁵⁵ Stephanie Ben-Ishai, Stephen J. Lubben, *A comparative study of bankruptcy as bailout*, Brooklyn Journal of Corporate, Financial & Commercial Law, Vol. 6, Issue 1, 86, (2011).

⁵⁶ *Id.*

⁵⁷ Fox, J., *Don't call it Bankruptcy*, Time International (South Pacific Edition), Vol. 172, Issue 22, 29, (2008).

Apart from the arguments for bailouts provided above, a lot of counter-evidences against corporations' bailouts were established. In one study, Vern McKinley and Gary Gegenheimer note "Beyond the inconsistencies and implementation problems, bailout policy has been unwieldy, inequitable, extremely costly, disruptive, and lacking oversight and transparency"⁵⁸. In their opinion, the absence of the policy response of bailouts entails the risk of future crisis.

In my opinion, it is also important to mention the following additional counter-evidences. Firstly, a government may abuse its power when compelling taxpayers to pay for failing firms⁵⁹. The main justification for providing bailouts is preventing a collapse of the financial system, which a government has an obligation to safeguard. That said, there is no universal criteria how to identify such situations. Only the US government has the discretion to decide on such a question. Secondly, "bailouts entail the disregard of the free market theory that maintains that bailouts prevent market forces from bringing about necessary corrective moves"⁶⁰. Some Americans believe that offering bailouts is unfair because it rescues failing firm that face problems because of their managers' irresponsibility and avidity⁶¹. Thirdly, the utilization of bailouts may foster corruption. For example, "in the cases of the "green companies" (like Solyndra, Evergreen, Spectrawatt) there was no legal authority for providing bailouts and there were political contributions in a veiled quid-pro-quo"⁶².

⁵⁸ Vern McKinley and Gary Gegenheimer, *Bright Lines and Bailouts to Bail or Not to Bail, That Is the Question* [serial online], Policy analysis 1, (2009), available from: OAIster, Ipswich, MA. (last visited Mar. 26, 2013).

⁵⁹ Note that Senator Bernie Sanders of Vermont provides an example of such situation by commenting on the audit of the US Federal Reserve Bank and the total \$16 trillion in secret bank bailouts. He stated that: "This is a clear case of socialism for the rich and rugged; you're-on-your-own individualism for everyone else. No agency of the US government should be allowed to bail out a bank or corporation without the direct approval of Congress.." See *Lessons Learned from the Bailout* by Ashby, Barry, *Industrial Heating*, Vol. 80, Issue 3, (2012).

⁶⁰ Roy C. Smith, *The dilemma of bailouts*, Vol. 16, # 1, 21, (2011), available at: http://www.independent.org/pdf/tir/tir_16_01_2_smith.pdf

⁶¹ *Id.*

⁶² Ashby B., *Industrial Heating, Lessons Learned from the Bailout*, Vol. 80, Issue 3, 14-14 (2012), available from: Business Source Complete, Ipswich, MA (last visited Mar. 26, 2013).

Corruption will always exist if government supports or penalizes one type of economic activity versus another⁶³.

Finally, bailouts are a risky business. This is so, because the outcome of bailouts is uncertain. What is more, very often in post-bailout stories of a certain company the wording like “new, innovative, bold models” can be found, which simply means risky⁶⁴. Therefore, it is rather difficult to foresee the consequences of bailouts.

Based on the above findings, I argue that bailouts are no longer considered to be an effective procedure. The bailouts lack the appropriate structure. At the same time business bankruptcy reorganization is well-regulated process. Hence, in my opinion business bankruptcy reorganization is more favorable procedure for failing firms than bailouts. Bankruptcy reorganization contains the essential features, which make it an adequate mechanism and flexible enough for handling insolvency problems. Moreover, these features are unavailable outside the bankruptcy proceedings. Due to bankruptcy reorganization firms have an opportunity to preserve their values and return their debts without the participation of taxpayers.

1.4 Bankruptcy reorganization v. Sanatsiya

The purpose of this section is to determine the meaning of “sanatsiya” as one of the main bankruptcy procedures in Ukraine and compare it with definition of bankruptcy reorganization under the US Bankruptcy Law. Based on such comparison, it is conceivable to conclude about the necessity of replacing the term “sanatsiya” for “bankruptcy reorganization”.

Currently, Ukrainian bankruptcy legislation does not contain a term “bankruptcy reorganization”. Instead a term “sanatsiya” is used. From the terminological point of view,

⁶³ *Id.*

⁶⁴ Zupan M., *supra* note 43, at 109.

these words are different. The word “sanatsiya” came from the Latin word “sanare”, which originally meant “recovery or rehabilitation”⁶⁵. “Sanatsiya” is not used in other countries except Ukraine, Russia and Belarus. “This term was introduced in the bankruptcy law when the Soviet Union existed and then was accepted by the former republics of the U.S.S.R.”⁶⁶. When Ukraine gained its independence the early legislative work was chaotic ⁶⁷. Consequently, in the first bankruptcy laws this term was not replaced. That said, a term “sanatsiya” was not determined under the Ukrainian Bankruptcy Law of 1992. Later on, Ukrainian Bankruptcy law was amended several times and eventually was totally revised. In 1999, the new law of Ukraine “On restoring debtor’s solvency or declaring a debtor bankrupt” (hereinafter – “the Ukrainian Bankruptcy Law”) was adopted. Unlike the previous act, this law contains the definition of the term “sanatsiya”. The meaning of “sanatsiya” was more similar to reorganization procedure that was widely used in many other countries.

“Nowadays, sanatsiya is a system of procedures carried out during bankruptcy proceedings with the purpose of preventing the declaration of the debtor’s bankruptcy and its liquidation, and is directed on rehabilitation of financial and administrative state of the debtor, as well as satisfaction in full or partly of creditors claims through crediting, restructuring of the enterprise, debts and capital and (or) change of organizational, legal and industrial structure of the debtor”⁶⁸. This definition sets forth the main principle that declaration of a debtor as a bankrupt is undesirable result and certain measures shall be undertaken in order to prevent it.

⁶⁵ O.V. Kurnienko, *The necessity, meaning and imperfection of financial sanation of Ukrainian enterprises*, News of Khmelnytsky National University, Vol. 2, #4, 176, (2009), available at: http://archive.nbuv.gov.ua/portal/natural/Vchnu/Ekon/2009_4_2/pdf/175-177.pdf (last visited Mar. 26, 2013).

⁶⁶ Alexander Biryukov, *Ukrainian Bankruptcy Law in the Context of Regional and International Developments*, Annual Survey of International and Comparative Law, Vol. 13, Issue1, 17 (2010), available at: <http://digitalcommons.law.ggu.edu/cgi/viewcontent.cgi?article=1111&context=annlsurvey> (last visited Mar. 26, 2013).

⁶⁷ Alexander Biryukov, *The Doctrine of Private Law in the Context of Recent Codifications of the Civil Law: Ukrainian Perspectives*, Annual Survey of International and Comparative Law, Vol. 8, Issue1, 6, (2010), available at: <http://digitalcommons.law.ggu.edu/cgi/viewcontent.cgi?article=1066&context=annlsurvey> (last visited Mar. 26, 2013).

⁶⁸ § 1 article 28 of the Law of Ukraine “Pro vidnovlennya platospromoznosti borznyka abo vyznannya iogo bankrutom” (Ukr.), [The Law of Ukraine On restoring debtor’s solvency or declaring a debtor bankrupt], dated May 14, 1992.

Having said that, mentioned definition is very broad as it includes whole range of identifiable measures for a debtor's rehabilitation. Hence, it is rather vague and unclear.

When analyzing the meaning of the term “sanatsiya”, it is very important to review the academic literature and the case law. Most of Ukrainian scholars believe that “sanatsiya is the aggregate of all possible measures that lead to the financial rehabilitation of a debtor”⁶⁹. Other academics, define “sanatsiya” as procedure of receiving financial aid only from external sources for renewing a debtor's solvency⁷⁰. In my point of view, both definitions are not fully appropriate. The first definition is too general since it does not provide any explanation of suitable measures. Moreover, by applying this definition one may find it difficult to separate the procedure of sanatsiya from other rehabilitation procedures. The second definition is incorrect, because every rehabilitation procedure of a company involves both external as well as internal mobilizations of its financial resources. To conclude, all examined explanations of the term “sanatsiya” need to be clarified.

Unfortunately, the case law that concerns the procedure of sanatsiya does not contain any statutory exposition. In most of courts' decisions⁷¹ judges do not interpret the term sanatsiya. They simply quote the definition of “sanatsiya” from the Ukrainian Bankruptcy Law without providing any clarifications as to what type of measures is used in certain case to rehabilitate a distressed debtor. Hence, the definition of a term “sanatsiya” remains ambiguous.

Before comparing the terms “sanatsiya” with “bankruptcy reorganization” under the US

⁶⁹ A. Cherep, S. Severyna, *The improvement of the classical model of enterprises sanation*, Visnyk Ekonomichnoi Nauky Ukrainy [the Journal of Economics in Ukraine], Vol. 2, 169, (2010), available at: http://archive.nbuv.gov.ua/portal/soc_gum/venu/2010_2/38.pdf (last visited Mar. 26, 2013).

⁷⁰ O.V. Kurnienko, *The necessity, meaning and imperfection of financial sanation of Ukrainian enterprises*, News of Khmelnytskyi National University, Vol. II, 176, (2009), available at: http://archive.nbuv.gov.ua/portal/natural/Vchnu/Ekon/2009_4_2/pdf/175-177.pdf (last visited Mar. 26, 2013).

⁷¹ E.g. the court decision #32/546, dated January 18, 2010, available at: <http://www.reyestr.court.gov.ua/Review/7640060>; the court decision #32/546, dated August 27, 2009, available at: <http://www.reyestr.court.gov.ua/Review/4765599>; the court decision # 27/1666, dated July 13, 2010, available at: <http://www.reyestr.court.gov.ua/Review/10393655> (last visited Mar. 26, 2013).

bankruptcy law, I would like to confront words “sanatsiya” with “reorganization” pursuant to Ukrainian legislation. The word “reorganization” is used in the Ukrainian corporate legislation and means “a process of merger, consolidation, split-up and transformation of a company for the purpose of making it more profitable, better organized, or changing the ownership of the company”⁷². In addition, this process can be used in order to avoid insolvency. Unlike reorganization, “sanatsiya” is any type of procedure aimed to rehabilitate the financial status of a debtor and avoid its liquidation. Hence, “sanatsiya” is a broader term that includes a process of reorganization.

In a quite similar way, “sanatsiya” is connected with business reorganization under the US Bankruptcy Law. As noted before, “bankruptcy reorganization” means the financial restructuring of a debtor and its debts with the purpose to enable a debtor repay its debts to creditors. The procedure of “sanatsiya” includes not only financial restructuring of a debtor, but also other procedures like crediting, modification of managerial and industrial structure of a company etc. Therefore, I would like to advance the idea that “sanatsiya” is not a synonym to bankruptcy reorganization. “Sanatsiya” has to be considered as a broader term of financial rehabilitation procedure that includes business reorganization.

Prominent among the problems that are connected with the use of “sanatsiya” is the fact that this term does not distinguish business reorganization from its related concepts. As indicated above, these concepts have different nature and, consequently, mechanisms to rehabilitate distressed debtors. Therefore, it is impossible to introduce the same legal regulation for all of them.

All in all, despite the fact that both “bankruptcy reorganization” and “sanatsiya” have the

⁷² Bruce Leonard, *Restructuring and Insolvency in 53 jurisdictions worldwide* 496, Getting the Deal Through, (2013), available at: <http://www.hrafdom.com/PDFs/R&I2013%20Dominican%20Republic.pdf> (last visited Mar. 26, 2013).

same purpose, namely they both aim to avoid debtor's liquidation and renew its solvency in order to satisfy creditors' claims, they are different. In my opinion, the ambiguity of a Ukrainian term "sanatsiya" provokes various problems while implementing the provisions relevant for bankruptcy reorganization. Hence, I argue that a term "sanatsiya" must be substituted for bankruptcy reorganization. By doing so, it will be more reasonable to make additional reforms of the Ukrainian bankruptcy system based on the US experience.

CHAPTER 2. STICKING POINTS OF BUSINESS BANKRUPTCY REORGANIZATION PROCEDURE UNDER THE US BANKRUPTCY CODE AND THE UKRAINIAN BANKRUPTCY LAW

This chapter presents a comparative analyses of sticking points in the procedure of corporate bankruptcy reorganization in the US and the procedure of sanatsiya in Ukraine. The main argument of this chapter is that the two procedures are not identical. More precisely, it is claimed that the practice of debtor's reorganization in Ukraine demonstrates a lack of essential legal mechanisms of this procedure, which makes it inoperative in Ukraine. Acknowledging this problem, I suggest that certain elements of US business bankruptcy reorganization shall be introduced into Ukrainian bankruptcy law.

2.1 Commencement of business bankruptcy reorganization and sanatsiya procedures

2.1.1 Commencement of business reorganization proceeding

In order to commence a reorganization procedure under Chapter 11 of the US Bankruptcy Code, it is necessary to file a bankruptcy petition. Filing for reorganization according to the US Bankruptcy Code may be voluntary or involuntary. A voluntary case is initiated by an entity, which may be considered as a debtor under the above-mentioned chapter⁷³. As shown in Section 1.2 of this thesis⁷⁴, a debtor has a capacity to file the bankruptcy petition if it is a corporation, a limited liability entity or partnership (hereinafter – “a firm or company”). However, certain entities like a governmental unit, banks, other financial institutions or insurance companies are not eligible to file for reorganization under Chapter 11 of the US Bankruptcy Code⁷⁵. Apart from being eligible for filing a bankruptcy petition, a debtor must also face insolvency problems. From the Section 101 (32) of Chapter 11 of the US

⁷³ US Bankruptcy Code, 11 U.S.C. § 301, *supra* note 17.

⁷⁴ See page 7 above.

⁷⁵ Note that these entities do not qualify as debtors under Chapter 7 of the US Bankruptcy Code, hence they do not qualify as debtors according to Chapter 11. See more 11 U.S.C. §109 (b), (d).

Bankruptcy Code, it follows that such problems concern a specific financial condition, when the sum of an entity's debts is greater than all of such entity's property at a fair valuation⁷⁶.

The commencement of bankruptcy reorganization involuntary depends on whether a debtor is considered as eligible to be placed into such compulsory procedure. It is worth mentioning that the US Bankruptcy Code limits the categories of debtors against whom involuntary petitions may be filed⁷⁷. To be more specific, involuntary cases may be commenced only by: (1) three or more entities that are holders of claims against a debtor; or (2) if there are fewer than 12 such holders, anyone of whom hold in the aggregate at least \$5,000 of such claims⁷⁸.

Once an eligible person files a bankruptcy petition with a court, all participants of reorganization procedure may benefit from two very important protection mechanisms of bankruptcy reorganization. The first one is that a debtor remains as a debtor in possession. This legal status empowers a debtor to remain in possession of its property and continues to manage business of its firm in the ordinary course. The second mechanism of bankruptcy reorganization concerns the availability of an automatic stay. According to Section 362 of Chapter 11 "[a] petition filed for bankruptcy reorganization operates as stay."⁷⁹ This provision provides a period of time that starts from filing a bankruptcy petition, and during which creditors are precluded from taking any actions against the debtor's property. It is important to note that an automatic stay starts immediately upon filing a bankruptcy petition and no additional court's order is required.

An automatic stay is one of the fundamental protections provided by bankruptcy reorganization for both a debtor and its creditors. Michael A. Gerber, an expert of bankruptcy

⁷⁶ US Bankruptcy Code, 11 U.S.C. § 101 (31), *supra* note 17. Note that the definition of insolvency differs upon who is a debtor: an entity, partnership or municipality.

⁷⁷ In particular, pursuant to § 303 (a) of Chapter 11 of the US Bankruptcy Code, farmers, family farmers, corporations that are not moneyed, business, or commercial corporations are excluded from involuntary relief. See Kenneth N. Klee, *Bankruptcy and the Supreme Court*, American College of Bankruptcy 253, (2008).

⁷⁸ US Bankruptcy Code, 11 U.S.C. § 303, *supra* note 17.

⁷⁹ US Bankruptcy Code, 11 U.S.C. § 362(a), *supra* note 17.

law, notes that “[It] gives the debtor breathing spell from the creditors and stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan. Also, automatic stay provides creditors’ protection. Without it, certain creditors would be able to pursue their own remedies against debtor’s assets”⁸⁰.

It should be stated that an automatic stay is temporal. The reason rests on the fact that an automatic stay was established to provide debtors with an appropriate period of time for conducting the procedure of reorganization. Hence, an automatic stay cannot be considered as a mean for debtors to escape from creditors⁸¹. Section 362 (c) of Chapter 11 of the US Bankruptcy Code contains three circumstances that indicate the cessation of the automatic stay⁸².

Apart from the fact that an automatic stay begins automatically upon the filing of a bankruptcy petition and continues during a certain period of time, it may be lifted by the decision of a court. In Section 362 (d) of Chapter 11 of the US Bankruptcy Code, it decrees specific circumstances, under which secured creditors may request a “relief” from automatic stay. For instance, if a debtor has no equity in the property and such property is not required for an effective reorganization, than a creditor may seek an order for a relief from a stay by terminating, annulling, modifying or conditioning it⁸³.

To conclude, in the beginning of a bankruptcy case both a debtor and its creditors obtain a necessary protection for fulfilling a main goal of Chapter 11, which is to preserve the viability of a debtor’s business, allow a debtor to run its business while restructuring its debts

⁸⁰ MICHAEL A. GERBER, BUSINESS REORGANIZATION 451, (1986).

⁸¹ MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON, STEVE H. NICKLES, BUSINESS REORGANIZATION IN BANKRUPTCY 91, (2006).

⁸² US Bankruptcy Code, 11 U.S.C. § 362 (c), *supra* note 17. An automatic stay is valid until: closing or dismissal of the case, or denial of discharge; granting discharge; removal of the property from the estate.

⁸³ US Bankruptcy Code, 11 U.S.C. § 362 (d), *supra* note 17.

and operations. To be more specific, a debtor due to its status as a debtor in possession obtains a right to manage its business operations in an ordinary course. Moreover, a debtor and its creditors are entitled to the automatic stay provisions of the US Bankruptcy Code.

Since business reorganization under Chapter 11 of the US Bankruptcy Code is primarily regarded as a legal negotiation process, it is necessary to examine its own bargaining framework. After a debtor files a petition for reorganization under Chapter 11, a debtor in possession has a duty to submit the “first day” motions. In the case Colad Group it was stated that “[first] day motions refers generally to any variety of requests made after the filing of Chapter 11 petition, for prompt authorizations needed to facilitate the operation of the debtor’s business”⁸⁴. At the same time, the negotiations between debtor and its claimants begin. Such negotiations are structured around bargaining rounds⁸⁵. In each round a particular class of claimholders⁸⁶ is obliged to represent their reorganization plan. This plan proposes the reallocation of debtor’s liabilities and a projection of a debtor’s activities⁸⁷. That said, a debtor has a preemptive right to propose and file a reorganization plan during the 120 days after the filing of the bankruptcy petition⁸⁸. It shall be added that by giving a debtor such rights does not preclude creditors from participating in the process of making a plan. It is a common practice that a debtor discusses the provisions of plan reorganization with its creditors before its confirmation. Having such negotiations is very important as they guarantee the approval of a reorganization plan by debtor’s creditors.

⁸⁴ Nora A. J., *US Bankruptcy Court for the Western District of NY considers rulings on “first day motions”*, Daily Record, The (Rochester, NY) [serial online]. n.d.; Available from: Newspaper Source Plus, Ipswich, MA. (last visited Mar. 26, 2013).

⁸⁵ Amira Annabi, Michele Breton, Pascal Francois, *Resolution of financial distress under Chapter 11*, Journal of Economic Dynamics and Control, Vol. 36, Issue 12, 1868 (2012).

⁸⁶ In this thesis I will use a term “claimholders” as a general term, which include debtor’s creditors, equity holders (investors) in a procedure of business bankruptcy reorganization.

⁸⁷ Amira Annabi, *supra* note 82, at 1869.

⁸⁸ It should be stated that a court may extend this period up to 18 months in most cases, or up to 300 days in small business cases. See Maria Carapeto, *Bankruptcy Bargaining with Outside Options and Strategic Delay*, Journal of Corporate Finance, Vol. 11, Issue 4, 737, (2005), available at: http://ac.els-cdn.com/S092911990500009X/1-s2.0-S092911990500009X-main.pdf?_tid=fd90b1d4-8c11-11e2-8100-00000aach362&acdnat=1363202147_e701c2b9b7c4791d375cfa63978dc3e8 (last visited Mar. 26, 2013).

In summary, the process of bankruptcy reorganization under Chapter 11 of the US Bankruptcy Code is regulated by various legal norms that comprise its system in a way, where each stage of reorganization procedure proceeds in a certain sequence. Therefore, this bankruptcy procedure is highly structured and prolific.

The next section will look at both the comparative analysis of the commencement of bankruptcy reorganization in the US and sanatsiya in Ukraine.

2.1.2 Commencement of a procedure of sanatsiya

As stated in the previous chapter, the Ukrainian Bankruptcy law contains a procedure of sanatsiya instead of bankruptcy reorganization. According to my findings, sanatsiya is a broader term, which includes different procedures - one of them being business reorganization. The process of sanatsiya is regulated by the Law of Ukraine “On restoring debtor’s solvency or declaring a debtor bankrupt” (hereinafter – “the Ukrainian Bankruptcy Law”) that was revised recently and now comprises certain novelties.

In contrast to the U.S. bankruptcy system, the commencement of sanatsiya procedure starts by filing a petition for the initiation of bankruptcy proceedings⁸⁹. The right to file such a petition is held by both a debtor and creditors. However, the decision to commence a procedure of sanatsiya can only be made by a debtor’s creditors⁹⁰. Therefore, in Ukraine, voluntary bankruptcy reorganization does not exist.

Similarly to the provisions of Chapter 11, the Ukrainian Bankruptcy Law also contains eligibility rules that determine whether a person may file a petition to start a bankruptcy case. According to articles 1 and 10 of the Ukrainian Bankruptcy Law, all insolvent legal entities,

⁸⁹ Article 11 of the Law of Ukraine “Pro vidnovlennya platospromoznosti borznyka abo vyznannya iogo bankrutom” (Ukr.), [The Law of Ukraine On restoring debtor’s solvency or declaring a debtor bankrupt], dated May 14, 1992.

⁹⁰ B. Leonard, *Restructuring and Insolvency in 52 jurisdictions worldwide*, Getting the Deal Through, 496, (2013).

which carry out entrepreneurial activities and their creditors, may apply for a bankruptcy proceeding⁹¹. A debtor is considered to be an insolvent if its debts are: permanent (the debtor has failed to fulfill its payment obligation within three months from the due date); and significant (the total amount of its debts is no less than 300 times minimum wages)⁹².

Essentially, if a person, who files a bankruptcy petition meets all necessary requirements, a judge will make a ruling on the commencement of a bankruptcy case and impose a moratorium on satisfaction of creditors' claims⁹³. A term "moratorium" should not be confused with the identical term used in the US Bankruptcy Code. Moratorium under the US law is a part of out-of-court settlements. It simply means the extension of a period of time for a debtor to meet its payment obligations. According to the Black Law Dictionary, "moratorium is an authorized postponement, usually a lengthy one, in the deadline for paying a debt or performing an obligation; the period of this delay"⁹⁴. Contrariwise, according to the Ukrainian Bankruptcy Law "[moratorium] on the satisfaction of creditors claims is a suspension of the performance of debtor's payment obligations and liabilities to pay taxes that were due prior to the date of moratorium and the termination of procedures aimed to ensure the performance of debtor's obligations that were due prior to the date of moratorium"⁹⁵. Hence, a moratorium pursuant according to the Ukrainian Bankruptcy Law is not just a mere period of time to enable a debtor to meet its obligations, but also to prevent its creditors from collection activities, foreclosures, repossession of property and other similar actions. Therefore, a moratorium has a similar function as an automatic stay under the US Bankruptcy Code.

⁹¹ Articles 1,10 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

⁹² Article 10 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

⁹³ Article 16 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

⁹⁴ BRYAN A. GARNER, BLACK'S LAW DICTIONARY 1031, (8th ed. 2004).

⁹⁵ Article 19 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

Nevertheless, there are certain differences between a moratorium and an automatic stay. Firstly, a moratorium does not begin automatically once a bankruptcy case is filed. As stated before, a moratorium is imposed by a court's decision. Secondly, a moratorium applies only to the obligations of a debtor that arise prior to the filing of the bankruptcy petition⁹⁶. It does not apply to claims of current creditors⁹⁷, payments of wages, alimony, reimbursement of damages caused to health and life of citizens, and for payment of royalties⁹⁸. Thirdly, moratorium can be terminated only upon the cessation of bankruptcy proceeding.

During the operation of a moratorium, there are no penalties for a debtor, which is not able to satisfy the claims of its creditors. As stated by a Ukrainian practitioner K. Olefrienko, this provision is a subject of abuse by debtors. He says that "[Often] a management of heavily indebted but solvent company will file a petition for bankruptcy proceedings in order to benefit from this provision, go into long sanation and pay neither debts nor penalties due"⁹⁹. I think that this provision is reasonable. When a debtor is in a process of sanatsiya, one of its main goals is to present a plan of its financial rehabilitation that will be suitable for all of its creditors. Allowing a debtor to make payments to certain creditors may cause difficulties on the stage of formulation of such a plan and its further confirmation by other creditors. In my opinion, to avoid these impediments as mentioned by K. Olefrienko, it is necessary to adopt several business reorganization tools from the US Bankruptcy Code described in the previous sections.

After imposing a moratorium, the procedure of assets' administration takes place. During this

⁹⁶ Article 19 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

⁹⁷ Note that in Ukraine two main groups of creditors exist: subordinated and current. Current creditors are creditors whose claims occur after the beginning of a bankruptcy case. See O. KHARYTONOVA, THE COMMENTARY ON THE LAW OF UKRAINE "ON RESTORING DEBTOR'S SOLVENCY OR DECLARING A DEBTOR BANKRUPT" 15, (2008).

⁹⁸ ¶ 5 article 19 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

⁹⁹ K. Olefrienko, *Insolvency proceedings in Ukraine* 2, [serial online], Academia.edu, available at: http://www.academia.edu/347901/Insolvency_proceedings_in_Ukraine

bankruptcy proceeding creditors of a debtor have to form the committee of creditors, which will represent all their interests on a permanent basis¹⁰⁰. This committee is entitled to decide upon the commencement of the procedure of sanatsiya. Once they decide to initiate such a procedure, a committee has to obtain a court's approval of their decision¹⁰¹. Then, a court passes a ruling to commence the procedure of sanatsiya. At the same time, a court also appoints rehabilitation manager, who is obliged to conduct the procedure of sanatsiya. One of the key responsibilities of this manager is to make a plan of sanatsiya, obtain its approval from the creditors' committee and submit it to the court for confirmation¹⁰².

Based on the findings described above, the commencement of the procedure of sanatsiya is rather different from the procedure of bankruptcy reorganization in the US. Unlike bankruptcy reorganization, an eligible person cannot instantly initiate the procedure of sanatsiya. First, one has to file a petition for triggering a bankruptcy case, which comprises several procedures. Once a procedure of the assets' administration begins, creditors have a right to make a decision regarding the commencement of the procedure of sanatsiya. Afterwards, this decision has to be approved by a court. Another important distinguishing feature between the procedure of bankruptcy reorganization and sanatsiya concerns the plan of a debtor's financial rehabilitation¹⁰³. In Ukraine, this plan is developed by a rehabilitation manager. In the United States, a debtor and its creditors have a right to design such a plan.

The following section will focus on the differences between meanings, process of proposing and confirmation of a rehabilitation plan under the American procedure of bankruptcy reorganization and the Ukrainian procedure of sanatsiya.

¹⁰⁰ Article 26 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁰¹ ¶ 1 article 18 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁰² ¶ 6 article 28 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁰³ Note that in the US and Ukraine such a plan has different title. For this reason, I will use a term "a plan of rehabilitation" as a general term for both procedures: business reorganization and sanatsiya.

2.2 Plans for business reorganization and sanatsiya: meaning and essential elements

Before comparing the process of developing and voting on a rehabilitation plan, it is first important to understand the nature and basic elements of such a plan. In the US a rehabilitation plan of a debtor in the procedure of bankruptcy reorganization is called a plan of reorganization. The latter means an agreement between a debtor, its creditors and interest holders, which specifies the amount of money that has to be paid and certain conditions that have to be met in order to perform debtor's obligations¹⁰⁴. Therefore, the main aim of a reorganization plan is to assist all parties simultaneously to get what they want. In particular, claimholders may obtain certain amount of money or gain control of a debtor by acquiring the majority of debtor's shares. At the same time, a debtor has an opportunity to remain as a going concern and repay its payment obligations by using future income according to the arrangement made with interested parties.

Ukraine has a different meaning of a rehabilitation plan. As mentioned before, the Ukrainian system of bankruptcy law contains a procedure of sanatsiya instead of bankruptcy reorganization. Therefore, a plan of financial rehabilitation of a debtor in Ukraine is called a "plan of sanatsiya". A lot of Ukrainian scholars consider a plan of sanatsiya as a mere program of financial rehabilitation of a debtor and application of specific procedures prescribed by a bankruptcy law aimed to restore debtor's solvency¹⁰⁵. Henceforth, in contrast to a reorganization plan, a plan of sanatsiya is not considered as an agreement between a debtor and its claimholders. The main reason lies in the fact that this plan is developed by a rehabilitation manager, who is appointed by a court and assumes financial obligations of a

¹⁰⁴ MICHAEL A. GERBER, BUSINESS REORGANIZATIONS, 771 (1986).

¹⁰⁵ O. KHARYTONOVA, THE COMMENTARY ON THE LAW OF UKRAINE "ON RESTORING DEBTOR'S SOLVENCY OR DECLARING A DEBTOR BANKRUPT" 147, (2008).

debtor¹⁰⁶. It is well known that such manager has to act on behalf of a debtor, and, thus has to ensure its interests. Yet, Ukrainian bankruptcy law does not provide any legal provisions aimed to guarantee that result. According to Section 6 of article 28 of the Ukrainian Bankruptcy Law, a rehabilitation manager is obliged to design the plan of sanatsiya and negotiate it with debtor's creditors¹⁰⁷. These discussions are widely regarded as an essential part of a process of developing a plan of sanatsiya because this plan has to be approved by a committee of creditors¹⁰⁸. Consequently, there is no obligation of a rehabilitation manager to discuss a plan of sanatsiya with a debtor. Thus, the risk exists that a rehabilitation manager will not take into consideration interests of a debtor.

It should be stated that the US Bankruptcy Code provides certain provisions aimed at securing a main goal of reorganization plan. For instance, according to Section 1122 of Chapter 11 of the US Bankruptcy Code, in a reorganization plan it is necessary to separate the debtor's liabilities into classes of claims. In addition, a reorganization plan may adjust the debtor's debts, recapitalize the debtor's balance sheet,¹⁰⁹ and restructure its business by transferring assets into a new company¹¹⁰. The same provisions are indicated in the Ukrainian Bankruptcy law. In particular, article 29 (2) of the Ukrainian Bankruptcy Law stipulates inexhaustible list of procedures that may be taken in order to restore debtor insolvency¹¹¹.

Although, the US Bankruptcy Code does not provide sufficient information as to what shape a plan of reorganization should take¹¹², it decrees three basic elements that every plan must

¹⁰⁶ ¶ 2 article 28 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁰⁷ ¶ 6 article 28 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁰⁸ ¶ 5 article 28 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁰⁹ E.g. § 941, 1123(a) (5) (E)-(H) and (J) of Chapter 11 of the US Bankruptcy Code.

¹¹⁰ See KENNETH N. KLEE, BANKRUPTCY AND THE SUPREME COURT 368, (2008).

¹¹¹ For example, sale of assets, recovery of the receivables, debt restructuring, restructuring of assets, sale or cancellation of the debt and the other means. See ¶ 2 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹¹² MICHAEL A. GERBER, BUSINESS REORGANIZATIONS 771, (1986).

contain. First, the plan must designate classes of claims and interest¹¹³. Generally, all claims are placed separately. Only claims that are substantially similar may be placed together in the same class¹¹⁴. Second, the plan must preclude how each class will be treated and identify classes that are not impaired¹¹⁵. Normally all classes included in a reorganization plan are treated equally. However, a holder of a claim may agree to be treated differently. Very important role is given to the holders of claims and interests in the impaired classes. The reason is because these holders have an exclusive right to vote on the plan¹¹⁶. Third, the plan must provide adequate means for implementing its terms¹¹⁷. Apart from these elements, a reorganization plan also contains an effective date. This date is necessary for a court because it helps to make the finding required by the best interest of creditors test prescribed by Section 1129 (a) (7) of Chapter 11 of the US Bankruptcy Code. It is also important to note that a reorganization plan has to serve the best interests of creditors under Section 1129 (a) of Chapter 11 of the US Bankruptcy Code¹¹⁸.

As well as in the U.S., the Ukrainian Bankruptcy Law provides rules about essential elements of sanatsiya plan. Accordingly, a plan of sanatsiya must include definite measures aimed at restoration of debtor's solvency¹¹⁹. What is more, this plan has to comprise a specific period of time given to a debtor for its financial recovery. Also, a plan of sanatsiya has to provide terms and order of satisfaction of monetary obligations. All financial obligations must be satisfied in accordance with the priority of claims prescribed by the law¹²⁰. It is necessary to

¹¹³ US Bankruptcy Code, 11 U.S.C. § 1122 (a) (1), *supra* note 17.

¹¹⁴ US Bankruptcy Code, 11 U.S.C. § 1122 (a), *supra* note 17.

¹¹⁵ US Bankruptcy Code, 11 U.S.C. § 1123 (a) (2),(3), *supra* note 17.

¹¹⁶ US Bankruptcy Code, 11 U.S.C. § 1126 (a) (f), *supra* note 17.

¹¹⁷ US Bankruptcy Code, 11 U.S.C. § 1123 (a) (5), *supra* note 17.

¹¹⁸ *E.g.* SK-Palladin partners, L.P. v. Platinum Entertainment, Inc. No 01 C.7202 Dec. 13, 2001.

¹¹⁹ ¶ 1 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹²⁰ ¶ 5 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

note that without these conditions a plan of sanatsiya will not be confirmed by a court and, hence, will not be implemented¹²¹.

In the US, a reorganization plan is not the only document that has to be filed with an American bankruptcy court. A debtor, along with the plan of reorganization, is also obliged to submit a disclosure statement. This statement has to contain “adequate information” that will give an opportunity to a debtor’s claimholders to make an informed judgment of the reorganization plan¹²². When a court approves a disclosure statement, the process of voting on the reorganization plan begins.

To sum up, both plans - reorganization and sanatsiya have to be considered as an agreement between a debtor, its creditors and equity holders (investors), which is based on the mutual interest to recover debtor’s solvency so that to achieve and share certain benefits. In Ukraine, the above-mentioned meaning is not as common as in the US. That is because under the Ukrainian Bankruptcy Law a plan of sanatsiya is solely developed by a rehabilitation manager. Based on the above findings, by giving such rights to a rehabilitation manager, a legislator deprives debtor from taking part in developing a plan of sanatsiya. Hence, I believe it is necessary to adopt a legal rule, under which a plan of sanatsiya must be discussed not only between a rehabilitation manager and claimholders, but also with a debtor.

2.3 Confirmation of plans in the procedure of bankruptcy reorganization and sanatsiya

As previously noted, the US Bankruptcy Code sets forth a provision, under which a debtor is entitled to develop and present a plan of reorganization to its holders of claims that have to approve it. The Bankruptcy Code provides an exclusive period of time, namely 120 days,

¹²¹ O. KHARYTONOVA, THE COMMENTARY ON THE LAW OF UKRAINE “ON RESTORING DEBTOR’S SOLVENCY OR DECLARING A DEBTOR BANKRUPT” 148, (2008).

¹²² See US Bankruptcy Code, 11 U.S.C. § 1125, *supra* note 17. Note also that the definition of a term “adequate information” is prescribed by § 1125 (a) (1) of Chapter 11 of the US Bankruptcy Code.

during which a debtor has to prepare for filing a plan¹²³. Once bankruptcy reorganization starts, a debtor has to draft provisions of a plan. After that a debtor is supposed to negotiate it with creditors so as to ensure oneself that the plan has sufficient chances of being approved¹²⁴. Only after the termination of an exclusive period other participants have a right to propose an alternative plan of business reorganization¹²⁵.

In Ukraine, a plan of sanatsiya can be drafted only by a rehabilitation manager. Later, it must be approved by a committee of debtor's creditors¹²⁶. In contrast to the American procedure of bankruptcy reorganization, these actions have to be done during very short period of time. According to Section 1 of article 29 of the Ukrainian Bankruptcy Law, a rehabilitation manager is obliged to provide the plan to a court for confirmation within three months from the day of a court's appointment of the rehabilitation manager¹²⁷. Therefore, a period of time given to a rehabilitation manager and debtor's creditors for drafting and approving a plan of sanatsiya cannot be regarded as sufficient.

The plan of reorganization under the US Bankruptcy Code has to be approved by the majority of the creditors. Because all creditors are divided into classes for the purpose of distribution, the voting on a plan is held by each of the class¹²⁸. Hence, creditors accept a plan not individually, but by classes. Every class has either to accept or to reject a proposed plan. According to Section 1126 (c) of Chapter 11 of the US Bankruptcy Code "each class is deemed to accept a plan if it has been accepted by both a simple majority in number of

¹²³ US Bankruptcy Code, 11 U.S.C. § 1121 (b), *supra* note 17.

¹²⁴ MARK S. SCARBERRY, KENNETH N. KLEE, GRANT W. NEWTON, STEVE H. NICKLES, BUSINESS REORGANIZATION IN BANKRUPTCY 634, (3d ed., 2006).

¹²⁵ US Bankruptcy Code, 11 U.S.C. § 1121 (c), *supra* note 17.

¹²⁶ ¶ 6,7 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹²⁷ ¶ 1 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹²⁸ ELIZABETH WARREN ET AL., THE LAW OF DEBTORS AND CREDITORS 628, (6th edition, 2009).

creditors and two-thirds majority in amount of debt”¹²⁹.

Since creditors are voting according to their respective class, a debtor is interested in how these classes are constructed. The US Bankruptcy Code provides some flexibility in creating such classes. As mentioned before, a debtor has to indicate in a reorganization plan classes of creditors and interests, as well as to specify, which classes are impaired and which are not¹³⁰. Such a classification is very important because only impaired classes are entitled to vote on a plan of reorganization. While drafting a plan of reorganization a debtor must indicate how each impaired class will be treated and provide uniform treatment for claims and interests, which are classified together¹³¹. Thus, a debtor in a procedure of bankruptcy reorganization has a power to control how the claims and interests are classified. This right is essential because how that control is exercised may determine whether the plan will be confirmed. In that regard E. Warren notes “[a] careful use of power to create classes can in fact help a debtor to gain support from creditors. This follows from fact that different creditors may be willing to accept different kinds of treatment, and all claims or interests placed in the same class must be treated the same”¹³². To conclude, in the US a debtor is granted a right to draft a plan of reorganization where he may indicate certain classes of claims and interest. This right of a debtor increases the chances of plan’s confirmation by its claimholders. All claimholders will be more willing to accept a plan of reorganization if this plan would likely permit consensual confirmation under Section 1129 (a) of Chapter 11 of the US Bankruptcy Code.

After a plan of reorganization has been discussed between a debtor and its claimholders, it has to be confirmed by a court. Yet, a court is required to confirm a plan of reorganization

¹²⁹ US Bankruptcy Code, 11 U.S.C. § 1126 (c), *supra* note 17.

¹³⁰ US Bankruptcy Code, 11 U.S.C. § 1123 (a) (1), (2) and (3), *supra* note 17.

¹³¹ US Bankruptcy Code, 11 U.S.C. § 1123 (a), (3),(4), *supra* note 17.

¹³² ELIZABETH WARREN ET AL., THE LAW OF DEBTORS AND CREDITORS 656, (6th ed. 2009).

only under certain circumstances prescribed by Section 1129 of Chapter 11 of the US Bankruptcy Code. This section contains two ways of confirming a plan of reorganization. First, when all impaired classes of claims or interests have accepted a reorganization plan¹³³. Second, when “a plan of reorganization is confirmed under the subsection (b) which is commonly referred as “cramdown”. It permits a reorganization plan to go into effect over the objection of one or more impaired classes of creditors”¹³⁴.

When a court has to make a decision relating to confirmation of a reorganization plan it must carefully observe objections to this plan. To do so, a court examines a plan’s feasibility¹³⁵. Pursuant to Section 1129 (a)(11) of Chapter 11 of US Bankruptcy Code a court shall confirm a plan only if it not likely causes liquidation or the need for further financial reorganization¹³⁶. That said, the mentioned rule does not mean that a plan of reorganization will be approved only if it provides guarantees for successful rehabilitation. In the case *In re Yates Development* it was stated “[although] success does not have to be guaranteed, the Court is obligated to scrutinize a plan carefully to determine whether it offers a reasonable prospect of success and is workable”¹³⁷.

In Ukraine, another system of voting on a plan of sanatsiya exists. Alternatively to the U.S. system of bankruptcy reorganization, holders of claims and interests are not divided into classes for voting on a plan of sanatsiya. Debtor’s creditors, whose claims are recognized by a court and included into a register of creditors’ claims, have to elect its committee, which

¹³³ US Bankruptcy Code, 11 U.S.C. § 1129, *supra* note 17.

¹³⁴ *In re U.S. Truck Co.*, 800 F2d 585 (US Court of Appeals, sixth circuit 1986).

¹³⁵ ELIZABETH WARREN ET AL., *THE LAW OF DEBTORS AND CREDITORS* 618, (6th ed. 2009).

¹³⁶ US Bankruptcy Code, 11 U.S.C. § 1129 (a) (11), *supra* note 17.

¹³⁷ *In re Yates Development, Inc.* 275 F. 3d 50 36 (US Bankruptcy Court, M.D. Florida, Jacksonville Division 2000).

will represent their interests and make necessary decisions on their behalf¹³⁸. Investors, who participate in a procedure of sanatsiya, have a right to participate in negotiations relating to a plan of sanatsiya individually. Investors as well as the committee of creditors are obliged to sign a plan of sanatsiya if approved¹³⁹. However, their votes may not have any impact on determining whether a plan of sanatsiya is approved. This conclusion follows from the Section 6 of article 29 of the Ukrainian Bankruptcy Law, which states that a plan is considered approved if at the meeting of creditors' committee more than a half of creditors vote in favor of such a plan¹⁴⁰. Hence, creditors are key players in a procedure of confirmation of a plan.

Similarly to the US, upon approval of a plan of sanatsiya by debtor's creditors, a rehabilitation manager submits it to a court for eventual confirmation¹⁴¹. It should be stated that a court is obliged to verify the presence of essential elements of a plan of sanatsiya. Additionally, a court has to examine the procedures of holding creditors' committee meetings and to confirm the plan. If a plan of sanatsiya does not meet all mandatory requirements prescribed by the Ukrainian Bankruptcy Law, a court has to return it so as to make further revisions to the plan¹⁴².

To conclude, a plan confirmation processes in Ukraine and in the US are very different. Pursuant to the American Bankruptcy Law, every party of bankruptcy reorganization proceeding has an equal right to propose its plan of reorganization. Yet, the US Bankruptcy

¹³⁸ Article 26 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹³⁹ ¶ 1 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹⁴⁰ ¶ 6 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹⁴¹ ¶ 1 article 29 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, *supra* note 86.

¹⁴² O. KHARYTONOVA, THE COMMENTARY ON THE LAW OF UKRAINE "ON RESTORING DEBTOR'S SOLVENCY OR DECLARING A DEBTOR BANKRUPT" 148, (2008).

Code provides a specific order of priorities for presenting a plan by all participants. A first-priority right to draft a plan of reorganization has a debtor. A plan of reorganization is considered as accepted if the majority of creditors approves it. What is more, such majority is determined by the classes. In other words, in order to define whether a plan is accepted it is necessary to analyze the decision of each class. Hence, creditors are not voting individually. It is the will of the majority of each class that binds all. That said, creditors are protected by the best interest and feasibility tests. This system of voting has become really effective as it eliminates hold out problem, which made impossible to reach an agreement between a debtor and its creditors. In Ukraine, only a rehabilitation manager has an exclusive right to draft and propose a plan of sanatsiya to debtor's creditors. This plan must be approved by debtor's creditors and investors. Nonetheless, Ukrainian Bankruptcy Law does not contain provisions that assure participation of a debtor. Moreover, debtor's creditors have all necessary tools to prevent confirmation of a plan.

2.4 Prepackaged plan of bankruptcy reorganization v. plan of pre-trial sanatsiya

One of the essential elements of business bankruptcy reorganization in the US that makes it an effective procedure is the mechanism of a prepackaged plan of reorganization (hereinafter – “prepackaged plan”). This type of a plan was introduced with a purpose of reducing a time of bankruptcy procedure, lowering the financial costs and, hence, minimizing negative impacts of bankruptcy proceeding¹⁴³.

The process of designing a prepackaged plan is the same as the process of a reorganization plan. P. Manganelli notes “[a] debtor who decides to make a prepackaged plan must propose,

¹⁴³ M. Kirschner, S. Marc et al., *Prepackaged bankruptcy Plans: The Deleveraging tool of the 90s in the wake of OID and tax concerns*, 21 Seton Hall L. Rev. 644, 644 (1990-1991).

negotiate it with its claimholders and then solicit votes”¹⁴⁴. The only difference is that a prepackaged plan is made before the beginning of the procedure of bankruptcy reorganization. It means that a prepackaged plan has to be approved by the claimholders of a debtor before filing for Chapter 11 of the US Bankruptcy Code. Having said that, the initiation of the bankruptcy reorganization procedure is compulsory. Therefore, a debtor whose prepackaged plan is confirmed by creditors shall file a bankruptcy petition to a court so as to start reorganization proceeding. In that case, a court has only to verify that all necessary requirements have been met and to confirm the prepackaged plan.

Over the past few years the mechanism of a prepackaged plan has gained popularity. A number of failing firms when using this mechanism reported their anticipated recovery. For example, the Newark Group is expected to exit from bankruptcy reorganization in mid-August 2013”¹⁴⁵. The attainment of such outcome became possible due to a prepackaged plan of reorganization that was approved by the US bankruptcy court just 51 days after the commencement of the case. Another example of successful company restoration under the prepackaged bankruptcy plan is the case of CIT Group, which became the fifth-largest bankruptcy case in the US history. This company was struggling for months to prevent bankruptcy, but eventually filed for Chapter 11 of US Bankruptcy Code in order to restructure its debts¹⁴⁶. While discussing the ways of restructuring CIT’s debts, both a debtor and its claimholders agreed to resort to the mechanism of a prepackaged reorganization plan. They made such a decision based on the following reasons¹⁴⁷. Firstly, the prepackaged plan reduced total debts by 10 billion while allowing the company to continue to do business.

¹⁴⁴ P. Manganelli, *The Evolution of the Italian and U.S. Bankruptcy Systems. A Comparative Analysis*. Journal Of Business & Technology Law, 5(2), 255, (2010).

¹⁴⁵ *Newark Group Expects to Exit Chapter 11 This Month*. Official Board Markets [serial online], August 7, 2010;86(32):3, available from: Business Source Complete, Ipswich, MA. (last visited Mar. 26, 2013).

¹⁴⁶ M. Stephen, *CIT Group seeks prepackaged reorganization in New York bankruptcy court*, Canadian Press, The [serial online]. n.d.; Available from: Newspaper Source Plus, Ipswich, MA. (last visited Mar. 26, 2013).

¹⁴⁷ *Id.*

Secondly, this plan speeded up the process of reorganization procedure. In addition, the prepackaged plan ‘[cut] cash needs over the next three years, which should help CIT group return to profitability more quickly’¹⁴⁸. Also, the prepackaged plan allowed certain claimholders of the CIT to own notes and equity in the restructured firm¹⁴⁹. Therefore, the prepackaged plan was approved by the debtor’s claimholders as well as by a bankruptcy court. Recently, CIT announced about its emergence from bankruptcy, having shed 10, 5 billion of dollars worth of debt¹⁵⁰.

Although, a mechanism of prepackaged plans can be truly effective for certain debtors, for others it may not be appropriate. For example, Hon. Brian K. Tester et al. points out that “[prepackaged] plans are particular useful in restructuring a debtor’s public debt obligations, as the amount of debt is constant and regular, and there are centralized representatives with whom to negotiate”¹⁵¹. Moreover, legal practitioners claim that prepackaged plans are generally suitable for debtors, who have a small number of creditors and that creditors are sophisticated financial or institutional creditors¹⁵². The reason is that such creditors are used to be dealing with such issues and they are interested in a successful reorganization. Besides, they will retain claims and remain constant in the period preceding filing for Chapter 11 of the US Bankruptcy Code¹⁵³.

Notably, prepackaged plans should not be confused with the pre-negotiated plans of reorganization. “In the latter case, a debtor reaches a general agreement with creditors regarding the most material terms and conditions of negotiation plan before filing of the

¹⁴⁸ *Id.*

¹⁴⁹ V. Young, *CIT Anticipates Chap. 11 Exit*. WWD: Women's Wear Daily [serial online]. December 9, 2009;198 (119):14-1. Available from: Business Source Complete, Ipswich, MA. (last visited Mar. 26, 2013).

¹⁵⁰ M. Stephen, *supra* note 143.

¹⁵¹ Hon. Brian K. Tester et al., *Need for Speed: Prepackaged and Prenegotiated Bankruptcy Plans*, 400, American Bankruptcy Institute, available at:

<http://www.abiworld.org/committees/newsletters/busreorg/vol9num7/pack.pdf> (last visited Mar. 26, 2013).

¹⁵² P. Manganelli, *The Evolution of the Italian and U.S. Bankruptcy Systems. A Comparative Analysis*. Journal Of Business & Technology Law, 5(2), 256, (2010).

¹⁵³ *Id.*

Chapter 11 petition. The solicitation of the votes in connection with the proposed plan takes place after the bankruptcy filing”¹⁵⁴. Hence, a pre-negotiated plan, like a prepackaged plan, involves discussions between a debtor and its creditors regarding terms of financial rehabilitation of a debtor. In contrast to a prepackaged plan, a debtor does not have to solicit votes on a pre-negotiated plan prior to filing for Chapter 11 of the Bankruptcy Code. It means that a pre-negotiated plan is not considered as a plan of reorganization and, thus, is not binding on all creditors once the procedure of bankruptcy reorganization starts.

The Ukrainian bankruptcy law provides a mechanism of a plan of pretrial sanatsiya, which resembles a mechanism of prepackaged plan. It should be mentioned that this mechanism has been introduced recently by amending the Law # 4212-VI dated December 22, 2011 (effective since January 19, 2013). Henceforth, a debtor and its creditors have a right to design a plan of pretrial sanatsiya within a process of pretrial sanatsiya. A pretrial sanatsiya is a court-supervised rehabilitation procedure of a debtor. Yet, a pretrial sanatsiya is not a bankruptcy procedure. To follow a pretrial sanatsiya, one does not have to commence a bankruptcy procedure of sanatsiya¹⁵⁵.

In order to apply rules about a plan of pretrial sanatsiya, a debtor or its creditors must meet specific requirements indicated in article 6 of the Ukrainian Bankruptcy Law. In particular, a debtor or a creditor has a right to commence the procedure of pretrial sanatsia only if the following criteria exist: “(1) a written consent of the debtor’s owner or agency authorized to administer the debtor’s assets; (2) a written consent of the creditors whose total claims exceed 50 per cent of debtor’s accounts payable pursuant to the debtor’s accounts and records; and (3) a plan agreed upon by all of the secured creditors and approved by the

¹⁵⁴ P. Manganelli, *supra* note 149.

¹⁵⁵ ¶ 1 article 6 of the Law of Ukraine On restoring debtor’s solvency or declaring a debtor bankrupt, *supra* note 86.

general meeting of the debtor's creditors”¹⁵⁶. Once these requirements have been satisfied, a person, who wants to commence a pretrial sanatsiya, has to file a plan together with all the necessary documents with a court during five days from the date of approval of a pretrial sanatsiya plan¹⁵⁷. A court shall consider all documents, and then pass a ruling to either approve or reject a plan of pretrial sanatsiya¹⁵⁸.

To conclude, a mechanism of a plan of pretrial sanatsiya is dissimilar with a mechanism of prepackaged plan. The formation of a plan of pretrial sanatsiya requires the commencement of separate procedure – “pretrial sanatsiya”. Also, the application of legal provisions about a plan of pretrial sanatsiya is more restricted and less potent in Ukraine than in the US. What is more, the Ukrainian Bankruptcy Law does not contain sufficient collection of norms to regulate the process of pretrial rehabilitation of a debtor and vaguely mentions about the possibility of applying such a mechanism. Hence, the implementation mechanism of a pretrial sanatsiya is not adequate in Ukraine.

¹⁵⁶ ¶ 2 article 6 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁵⁷ ¶ 6 article 6 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

¹⁵⁸ ¶ 8 article 6 of the Law of Ukraine On restoring debtor's solvency or declaring a debtor bankrupt, supra note 86.

CHAPTER 3. WHAT SHOULD UKRAINE LEARN FROM THE US BANKRUPTCY REORGANIZATION EXPERIENCE

Ukraine is one of the largest countries in Europe. It regained its independence only in 1991 with the dissolution of the former Soviet Union. Since then, Ukraine is in a continuous process of forming free market economy and building true democracy. In this context very important role should be given to bankruptcy legislation, as it is a basis for the foundation of fair competition for all participants in economic relations. Over the past few years, a lot of changes in Ukraine's bankruptcy legislation were made. Namely, new laws were enacted with a purpose to change the Soviet system of regulation and adopt European standards and norms. However, this goal has not yet been accomplished.

In the following Chapter, I will look at the evolution of the Ukrainian bankruptcy legislation and the process of sanatsiya. I will argue that certain key elements of the American system of bankruptcy reorganization can be implemented in the Ukrainian Bankruptcy law.

3.1 Evolution of Ukrainian bankruptcy law and the procedure of sanatsiya

The development of bankruptcy legislation regarding the procedure of sanatsiya in Ukraine took place during two periods of time. The first one - from 1990 to 1993¹⁵⁹, was marked by formation of Ukrainian bankruptcy law. In 1992, the first Ukrainian Bankruptcy Law was adopted. This law resembled the German Bankruptcy Code¹⁶⁰, which contained the only form of settling debts' problems – collective procedure¹⁶¹. Debtors, who wanted to initiate a bankruptcy case, had a right to commence only a procedure of liquidation. There were no provisions about financial rehabilitation of a debtor. This caused a number of problems. For instance, a problem when directors of a firm were applying bankruptcy procedures not to

¹⁵⁹ Alexander Biryukov, *Ukrainian Bankruptcy Law in the Context of Regional and International Developments*, Annual Survey of International and Comparative Law, Vol. 13, Issue1, 14 (2010), available at: <http://digitalcommons.law.ggu.edu/cgi/viewcontent.cgi?article=1111&context=annlsurvey> (last visited Mar. 26, 2013).

¹⁶⁰ Note that this German Code was in force until January 1, 1999.

¹⁶¹ Alexander Biryukov, *supra* note 159, at 19.

solve financial problems, but to gain certain benefits for themselves. A Ukrainian scholar A. Biryukov noted that “[such] directors intentionally drove an enterprise into insolvency in order to devalue assets. Then they transferred the ownership of these potentially good but undervalued enterprises to themselves or their relatives without any competition among investors or potential buyers. Also directors were able to avoid using a time-consuming privatization procedure”¹⁶². In addition to the above-mentioned problem, the economic situation in Ukraine was unstable. A lot of enterprises were not profitable. The only way to repay companies’ debts was to commence bankruptcy case, which led to liquidation of such companies. “As a result, by 1996 every third enterprise was practically insolvent”¹⁶³. Thereby, the Ukrainian Bankruptcy Law (1992) contained serious deficiencies, which eventually forced legislators to make necessary reforms.

The second stage of Ukrainian bankruptcy law formation began in 1996. At that time the Ukrainian Bankruptcy Law (1992) was amended several times and its key provisions were significantly revised in 1999. For the first time a new law was enacted not only to protect creditors, but also a debtor. “The Law emphasized that it was foremost directed at the restoration of debtor’s solvency”¹⁶⁴. Thus, the main feature of that law was to first apply available procedures aimed to rehabilitate a debtor before declaring debtor’s bankruptcy. To accomplish this goal new legal instruments were provided.

In the table 1 below I compare provisions regarding the procedure of sanatsiya under the Ukrainian Bankruptcy Law (1992) and the Law of Ukraine “On restoring debtor’s solvency or declaring a debtor bankrupt” (1999).

¹⁶² Alexander Biryukov, *supra* note 159, at 20.

¹⁶³ *Id.*

¹⁶⁴ Preamble of the Law of Ukraine On restoring debtor’s solvency or declaring a debtor bankrupt, *supra* note 86.

Table 1.

The Ukrainian Bankruptcy Law	The Law of Ukraine “On restoring debtor’s solvency or declaring a debtor bankrupt”
The term “sanatsiya” was not implemented.	A term “sanatsiya” was introduced in the Ukrainian bankruptcy system for the first time.
The only procedure provided by the law, which may entail rehabilitation of a debtor, was the assignment of debtor’s obligations to other persons. That said, there was no proper regulation of this procedure within a bankruptcy case.	According to article 1 “sanatsiya” meant an aggregate of various procedures carried out during bankruptcy proceedings with the purpose of preventing the declaration of the debtor’s bankruptcy and its liquidation, and was directed on rehabilitation of financial and administrative state of the debtor, as well as satisfaction in full or partly of creditors claims. Also this article contained a list of possible procedures that could have been used to accomplish the above mentioned goal. These procedures were: crediting, restructuring of the enterprise, debts and capital and (or) change of organizational structure etc.
Authority to decide on procedure of an assignment of debtor’s obligation was determined by management bodies of a debtor.	The procedure of sanatsiya was held by a rehabilitation manager ¹⁶⁵ . A rehabilitation manager undertook all the authority of debtor’s management bodies. Hence, a debtor did not have a right to conduct the procedure of sanatsiya.
Participants of a bankruptcy case did not have such a right.	A rehabilitation manager had a right to abrogate or cancel contracts, which were

¹⁶⁵ Note that rehabilitation manager is a person who under the decision of a court organizes restructuring of a debtor in a procedure of sanatsiya.

	concluded before commencement of a bankruptcy case.
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As shown in table 1, the latest reform made to Ukrainian bankruptcy law with respect to the procedure of sanatsiya was an important step forward. It is worth mentioning that after implementing these changes, the number of bankruptcy cases decreased. The scholar O. Miroshnychenko indicated that in 2000 there were 8,282 cases, then in 2001 – 7277 case, in 2002 – 6460 case¹⁶⁶. That said there was still a need for further improvements. Unfortunately, no such progress been made since.

The inactivity of Ukrainian legislators triggered a negative outcome. According to the report of the World Bank, Ukrainian bankruptcy law is recognized as law that has low level of compliance with the global standards. “In 2010 Ukraine was ranked 145 out of 181 countries in terms of closing a business”¹⁶⁷. In 2011 it was ranked 152¹⁶⁸. It is worth mentioning that most bankruptcy cases end up with liquidation of a debtor¹⁶⁹. Hence, Ukrainian bankruptcy law lacks effective legal framework to rehabilitate a debtor.

In January 19, 2013 the Law of Ukraine “On restoring debtor’s solvency or declaring a debtor bankrupt” (1999) was revised again. A lot of scholars and practitioners claim that this law fixes main bankruptcy procedures like reorganization and introduces the mechanisms aimed at preventing any abuses in the bankruptcy cases¹⁷⁰. For example, a judge of the Supreme Commercial Court of Ukraine states “under the new law procedures applied in

¹⁶⁶ O. Miroshnychenko, The institute of bankruptcy as an instrument of regulating practice of insolvent companies, Theoretical and practical questions of economics, Vol. 1, Issue 27, 326 (2011).

¹⁶⁷ The World Bank, *Ease of doing business index (most business-friendly regulations)*, 2011, available at: <http://data.worldbank.org/indicator/IC.BUS.EASE.XQ> (last visit Mar. 26, 2013).

¹⁶⁸ *Id.*

¹⁶⁹ Jon Ruiss, *Insolvency Laws of Romania and Ukraine: why Romania’s insolvency laws work better for foreign direct investment*, ABI Law Review, Vol. 20:747, 777, (2012).

¹⁷⁰ See Michael V. Pergamenshik, *On Ukraine’s New Bankruptcy Act: Forthcoming changes and potential impact on cross-boarder bankruptcy*, (2012), available at: <http://www.lexisnexis.com/community/international-foreignlaw/blogs/internationalandforeignlawcommentary/archive/2012/12/07/michael-v-pergamenshik-on-ukraine-s-new-bankruptcy-act-forthcoming-changes-and-potential-impact-on-cross-border-bankruptcy.aspx> (last visit Mar. 26, 2013).

bankruptcy cases like restructuring of a debtor are streamlined and improved”¹⁷¹. Yet, based on the findings of my research summarized in Chapter 2, I disagree with this opinion. The only innovation regarding the procedure of debtor’s rehabilitation is the establishment of pretrial sanatsiya. I argue that implementation mechanism of pretrial sanatsiya is not effective and, hence, should be revised. The other changes are also not sufficient enough for the improvement of sanatsiya procedure as they have no positive impact on this procedure. For instance, pursuant to article 28 of the law of Ukraine “On restoring debtor’s solvency or declaring a debtor bankrupt”, a rehabilitation manager must satisfy additional requirements concerning his education, working experience etc. These provisions do not solve main problem, which is to assure a debtor that his/her interests and rights will be appropriately represented by a rehabilitation manager.

All in all, in my opinion the major problem of the Ukrainian bankruptcy law is the adoption of different approaches and concepts without conducting a scrupulous study on which of them are indeed necessary and applicable. From the very beginning Ukrainian legislators were adopting norms that correspond to existing European standards. However, over the past few years they have also adopted similar provisions of the Russian bankruptcy law. As a result, legal norms aimed to regulate the procedure of debtor rehabilitation contradict each other and cause additional problems and inconsistencies in the Ukrainian legislation.

In the following section I will specify key elements of the US procedure of business reorganization that can be implemented into Ukrainian bankruptcy law in order to improve it.

¹⁷¹ Foundation for effective governance, *Reforming the Bankruptcy procedure in Ukraine 2*, (2013), available at: http://www.feg.org.ua/docs/NewsletterIssue12_en.pdf (last visit Mar. 26, 2013).

3.2 Recommendations for improving the procedure of business bankruptcy reorganization under the Ukrainian bankruptcy law based on the US experience

Despite the fact that the bankruptcy reorganization mechanism under Chapter 11 of the US Bankruptcy Code has served as a model for many countries to establish legal regulation of rehabilitation procedure, it is still criticized by certain scholars and practitioners¹⁷². In this section, I will not provide arguments for the efficiency of Chapter 11 of the US Bankruptcy Code. Instead, I will determine main elements of the US procedure of bankruptcy reorganization that, if implemented, will improve the procedure of debtor rehabilitation under the Ukrainian bankruptcy law.

The analysis of two rehabilitation procedures “bankruptcy reorganization” and “sanatsiya” showed that despite having a similar nature, they differ greatly in terms of the instruments they apply. Based on my findings, the following amendments are suggested for improving the procedure of debtor rehabilitation in Ukraine.

First, it is essential to replace a term “sanatsiya” to “reorganization”. As was mentioned in the first chapter, sanatsiya includes various procedures that cannot be regulated by the same rules. In order to have an effective regulation, it is necessary to determine the main object of such regulation. Reorganization is indeed proved to be the most effective procedure, as it helps to realize the highest value of a debtor without harming the competitive process.

Second, a debtor must have a right to commence and conduct the procedure of bankruptcy reorganization as it is established under Chapter 11 of the US Bankruptcy Code. A scholar M. Brouwer claims, a person who either appoints a rehabilitation manager or is such a manager

¹⁷² See ELIZABETH WARREN, JAY LAWRENCE WESTBROOK, THE SUCCESS OF THE CHAPTER 11: A CHALLENGE TO THE CRITICS, Michigan Law Review 107, 605, (2009), available at: <http://ehis.ebscohost.com/eds/pdfviewer/pdfviewer?sid=742dd5bb-90e7-4abe-bba0-93b8296ecf9f%40sessionmgr10&vid=1&hid=8> (last visit Mar.26, 2013).

may not have a clear picture of actual financial situation of a company¹⁷³. Thus, it could be more preferable to let a debtor, who knows the company best, to initiate and be in charge of bankruptcy reorganization. A debtor will have more incentive to save as much of company's value as possible because he is interested not only in meeting its payment obligations, but also in preserving its viability.

What is more, if a rehabilitation manager is appointed, a proper legal mechanism shall be introduced in Ukrainian bankruptcy law to balance its powers and provide sufficient oversight. As was noted before, currently Ukrainian Bankruptcy law does not contain any norms that assure the participation of a debtor in a procedure of *sanatsiya*. Thus, debtor's rights and interests can be easily violated.

Third, I suggest substituting a concept of moratorium to a concept of an automatic stay. In the second chapter of this thesis I concluded that both terms "moratorium" and "automatic stay" have a similar nature. However, a concept of moratorium is less developed and lacks appropriate mechanism of ensuring debtor's protection. For instance, moratorium can be applied only to specific payment obligations of a debtor. Such a provision may preclude creditors from application of reorganization procedure. Thus, it is reasonable to introduce a general rule that a moratorium is imposed on all debtors' obligations. The exceptions to this rule must be clearly defined in the bankruptcy law.

Finally, I think that it is necessary to adopt rules from the US Bankruptcy Code according to which a plan of reorganization shall be negotiated among all participants of this procedure: a debtor, its claimholders and a rehabilitation manager (if appointed). Moreover, I suggest to set up a provision, under which not only creditors, but also all debtor's claimholders have a

¹⁷³ M. BROUWER, REORGANIZATION IN US AND EUROPEAN BANKRUPTCY LAW, *Eur J Law Econ*, 15 (2006), available at: <http://link.springer.com/article/10.1007/s10657-006-8978-2#page-1> (last visit Mar. 26, 2013).

right to vote on confirmation of a reorganization plan or at least take part in the election of a creditors' committee.

To sum up, the procedure of business bankruptcy reorganization in Ukraine lacks a sufficient legal regulation. A lot of provisions under the Ukrainian Bankruptcy Law regarding reorganization of a debtor are controversial and, therefore, must be revised. By implementing the above-mentioned elements of the US bankruptcy system into Ukrainian bankruptcy law, it will be possible to establish an appropriate legal framework for a successful mechanism of debtor reorganization.

CONCLUSION

The in depth comparison of the US procedure of bankruptcy reorganization and the procedure of sanatsiya in Ukraine revealed that they are not similar. While bankruptcy reorganization under the US Bankruptcy Code is a clearly defined procedure that is separated from other related procedures like workouts or bailout, Ukrainian bankruptcy law offers an ambiguous and generic term “sanatsiya”, which embrace various rehabilitation procedures. Therefore, one of the key problems of bankruptcy reorganization in Ukraine is connected with the application of term “sanatsiya” that does not distinguish business reorganization from other related procedures in bankruptcy cases. By having the same legal regulation for all rehabilitation procedures, it is impossible to establish an adequate bankruptcy system, which is aimed to protect both a debtor and its claimholders. Hence, term “sanatsiya” under the Ukrainian bankruptcy law must be substituted for “bankruptcy reorganization”.

The thesis further demonstrates that the process of conducting business bankruptcy reorganization is also different from the process of sanatsiya. Based on the above-mentioned findings, it is reasonable to conclude that the Ukrainian bankruptcy law seeks to protect creditors, instead of providing sufficient legal instruments that will benefit both a debtor and its claimholders. That is because creditors have more rights than debtors. For instance, only creditors have a right to commence a procedure of sanatsiya and decide on the confirmation of sanatsiya plan. What is more, a debtor does not have any rights that assure its participation in a certain rehabilitation procedure. Apart from these problems, this thesis also evaluates the recent Ukrainian bankruptcy law reforms and concludes that they are insufficient and ineffective. Acknowledging this, it is suggested to introduce certain legal elements of US business bankruptcy reorganization into the Ukrainian bankruptcy system.

It is worth mentioning that this thesis looks not only at the problems concerning business bankruptcy reorganization. It also provides specific recommendations on how to improve the Ukrainian bankruptcy system, and the procedure of debtor's reorganization in particular.

All in all, this thesis does not cover all elements of business bankruptcy reorganization procedure and its equivalent under the Ukrainian bankruptcy law – sanatsiya. Yet, it explores and compares main steps and key elements of these procedures. On the basis of this research, a broader legal analysis may be conducted to further evaluate and confer the US and Ukrainian bankruptcy systems.

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