Legal Framework for Insolvencies in Uzbekistan

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Despite being relatively new, the current bankruptcy law in Uzbekistan (initially adopted in early 1990s) has improved drastically over the last decades. Uzbekistani insolvency regime, that was upgraded significantly throughout the several redrafts of the law, is still undergoing some changes that are being introduced as a part of its ambitious market-oriented economic reforms.

The main document regulating insolvency regime in Uzbekistan is the Law "On Bankruptcy" adopted in May 5, 1994 (the "Bankruptcy Law"). Adoption of the Bankruptcy Law was aimed at setting up a system of insolvency proceedings for legal entities as well as for individual entrepreneurs. Being a former-Soviet country Uzbekistan at that time had close to none historical background of bankruptcy regulations whatsoever. Unsurprisingly this first version of the Bankruptcy Law had failed to work successfully in practice as it did not cover many vital issues that kept arising thought attempts of implementing the bankruptcy proceedings. There were actually only two cases brought to court during the four-year period of existence of this version.

The evident underdevelopment of the first version of the Bankruptcy Law led to adoption of the second one on August 28, 1998. Compared to the previous one, the updated version expanded the scope of creditors' rights and also attempted to fill in the procedural gaps of the previous insolvency regime. This resulted in apparent progress of Uzbek bankruptcy law: 439 bankruptcy cases were adjudicated in 1998 alone. Nevertheless, there was a lot left to be desired in terms of organization of state staff responsible for

procedural matters, application of the bankruptcy test and intricacies regarding certain categories of debtors.

The third and the latest version of the Bankruptcy Law (i.e. the Law "On Bankruptcy" No. 474) was adopted on April 24, 2003. It provides for the definition of insolvency and the updated criteria for insolvency, as well as for the order of initiating and conducting of bankruptcy procedures. Furthermore, it sets out the scope of authority for those involved in organizing and holding of bankruptcy proceedings as well as relevant obligations of state bodies. The state bodies authorised to carry on governmental control over insolvency matters in Uzbekistan are the Cabinet of Ministers and the Agency for managing state assets ("Agency").

Bankruptcy criteria

Pursuant to Article 3 of the Bankruptcy Law, the terms "bankruptcy" and "insolvency" are used interchangeably and are defined as debtor's incapacity to satisfy its monetary obligations or mandatory payment obligations. In order to be recognized insolvent by the court, a debtor shall meet twofold bankruptcy criteria:

1. Inability to satisfy monetary obligations or mandatory payment obligations owed to creditors or state authorities for a period over 3 calendar months.

2. The aggregate amount of debt owed by the debtor shall exceed 300 basic estimated values (BEV)[1], i.e. approximately US$ 7,000.

It is important to note that the law does not require bankruptcy criteria to be associated with financial insolvency of a debtor, i.e. absence of any funds and assets to settle all accounts payable. The Bankruptcy Law supported by the latest judicial practice sets forth that any inability of a debtor to pay due to any "practical" reasons may lead to bankruptcy procedure. For instance, one of the precedents evidences that a debtor that owes debt denominated in foreign currency and has the required funds available in local currency to pay such debt, but fails to convert its funds into the necessary foreign currency, may still be found insolvent in Uzbekistani court. Although conversion related issues are no longer treated as a risk in Uzbekistan, judicial practice shows that any practical inability of a debtor to pay may lead to initiation of bankruptcy proceeding that are likely to be supported in courts.

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Initiation of bankruptcy proceeding

The bankruptcy proceeding in Uzbekistan can be initiated in the economic courts by the authorized persons as long as the above insolvency criteria are satisfied. The right to file a petition in court for initiation of such proceedings is vested in a debtor, a creditor, a prosecutor and, in case of mandatory payment, tax agency and other state authorities.

Moreover, it should be noted that the Bankruptcy Law, besides the right to initiate proceedings, also imposes an obligation to file a petition on initiation of proceedings to court upon the director of the debtor as soon as the bankruptcy criteria are met. For instance, Article 8 of the Bankruptcy Law obliges a company's director to file for bankruptcy if payment of one creditor's debts in full leads to inability of a company to pay another creditor's debts. In this case, a director of a company must file the bankruptcy lawsuit with an economic court no later than within 1 calendar month from the day this inability became apparent under the debtor's financial reports. A debtor's director who failed to fulfill this obligation may be brought to criminal liability since Uzbek law treats such failure as a concealment of bankruptcy. Depending on the circumstances of the case, this violation may lead to a criminal sanction in the form of a fine starting from 150 BEV (i.e. roughly US$ 3,500) or in the worst case scenario to an imprisonment for up to 3 years.

For a director to be able to bring such petition to court and initiate the proceedings a corporate decision on liquidation of the company shall be made. Such decision is usually adopted via general shareholders meeting (GSM) or by a

sole participant. Depending on the type of a legal entity certain quorum shall be met when adopting such decision (for instance, in case of joint-stock company ("JSC") more than 75% of vote is required while for the limited liability company ("LLC") decision on liquidation shall be made unanimously).

All insolvency cases are resolved by the economic court - the state body that has an exclusive competence to hear bankruptcy cases in Uzbekistan. The term for initiation of bankruptcy proceedings usually takes 1 month, but it may be prolonged for an additional month.

Types of bankruptcy procedures

Once the petition by a debtor, a creditor, a prosecutor, a tax agency or other state authority is successfully filed with the economic court, the bankruptcy procedure is deemed initiated.

All procedures are carried out by court receivers (*судебный управляющий*). Depending on the type of procedure, a court receiver would have a different title (e.g. interim receiver, sanation manager, external manager and liquidation manager). The Bankruptcy Law and Decree of the Cabinet of Ministers "On measures to organize the activities of court receivers" No. 765 dated September 12, 2019, set out qualification requirements for a court receiver: a court receiver must have a higher education, at least 2 years of work experience and certification of the Agency etc. Moreover, court receivers must not be biased, i.e. somehow interested in the faith of either a debtor or a creditor. These are the primary factors considered by the economic courts before approving the decision on appointing of court receiver in each bankruptcy procedure. Furthermore, once appointed court receivers are automatically enrolled into professional associations of court receivers.

SUPERVISION

Supervision is a temporary procedure implemented by courts on the day a bankruptcy lawsuit was filed to an economic court and is aimed at preservation of company assets.

Supervision is the initial stage introduced from the date of acceptance of a petition for bankruptcy by the economic court. For purposes of implementation of this procedure, a temporary manager is nominated by creditors or the Agency and is further approved by the economic court. The manager's primary duties include the conduct of meeting of creditors and monitoring of company's assets.

It is important to highlight that introduction of supervision does not lead to removal of the director and other management bodies of the company. Its aim is to restrict the exercise of their powers in certain matters that may lead to deterioration of assets (e.g. disposal of property, obtaining/issuing of loans (credits), guarantees, assignment of receivables, transfer of debt etc.).

In fact, a supervision procedure is the turning point as a result of which the creditors decide which of the following steps described below should be taken.

SANATION

Sanation is introduced by the economic court on the basis of a decision of creditors. For the purposes of implementation of the procedure, a rehabilitation manager is appointed by creditors and afterwards is approved by the economic court.

The period of sanation shall not exceed 24 months. At this stage, a sanation plan (prepared by the company's management) is to be approved by the meeting of creditors and a debt repayment schedule is to be approved by the court. The plan provides for the means by which the debtor plans to receive the funds necessary to satisfy the claims of creditors in accordance with the debt repayment schedule.

Upon implementation of the means set out in the plan and fulfillment of obligations in accordance with debt repayment schedule, the rehabilitation manager must submit to the economic court a report on the results of these procedures. The court may either approve the report and end the bankruptcy proceedings or refuse to approve the report. The latter would lead to introduction of external management or commencement of a liquidation procedure in respect of the company.

In general, court receivers are entitled to:

— convene a meeting of creditors;

— file a lawsuit and other statements with the court;

— receive remuneration for their services as a court receiver;

— attract other persons on a contractual basis for the ensuring the proper exercise of their powers;

— file an application with the economic court for the early termination of their duties.

In any type of bankruptcy proceedings, court receivers are nominated by either creditors, the Agency or professional associations of court receivers and afterwards are approved and appointed by economic courts. In case the court rejects the proposed nominee, another candidacy should be proposed by the authorized state body or creditors for further approval.

There are 5 types of bankruptcy proceedings in Uzbekistan under the Bankruptcy Law:

1. Supervision
2. Sanation
3. External management
4. Liquidation
5. Amicable agreement

In practice an additional type of bankruptcy proceedings exists which is called "pre-judicial" sanation which is also a financial rehabilitation procedure. Since this procedure is used in respect of state-owned enterprises as well as for the companies financed by the state, it will not be descried in detail in this article.

A brief overview for each bankruptcy procedures may be found below.

EXTERNAL MANAGEMENT

Analogous to sanation, external management is also a procedure aimed at rehabilitation of financial status of an insolvent enterprise.

External management is introduced by the economic court on the basis of creditors' petition or a notice of the state bankruptcy authority. For the purposes of implementation of the procedure, an external manager is appointed by creditors and further approved by the economic court.

External management is introduced for a period of up to 24 months. Nevertheless, the aggregate time period of sanation and external management shall not exceed 36 months. All powers of the director and management bodies of the company are transferred to the external manager. All accounting and other documentation of the debtor is also monitored and controlled by the external manager. Moreover, a moratorium (automatic stay) on satisfying the claims lodged for monetary obligations or mandatory payments is enforced. The moratorium applies to the claims of secured creditors before initiation of external management procedure. There is no explicitly stated period for such moratorium. The term of moratorium depends on the decision of assigned external manager. However, taking into consideration that the maximum period of external management procedure is 24 months, theoretically moratorium may be prolonged up to this period depending on whether the court approves manager's application.

An external manager within a month from the moment of appointment must produce an external management plan, which is further submitted for the approval to the meeting of creditors. Such plan shall include the measures required to restore a debtor's solvency, terms and conditions of implementation of such measures as well as costs and other expenses of the debtor that would be incurred as a result of the implementation of these measures.

Bankruptcy procedure ends after all debts owed to creditors have been repaid and economic court accepts report of the external manager. If no payments to creditors have been made within the external management period or no significant improvement of financial status occurred, the court may decide to commence liquidation procedure.

LIQUIDATION

Liquidation is the final procedure aimed at inventory and collecting of all assets of the debtor for the purposes of liquidating the debtor and payment of all of its outstanding debts to the creditors.

Liquidation is the last resort bankruptcy procedure which is introduced based on the decision of economic court to declare the debtor bankrupt. It can be triggered upon the decision of the economic court after either supervision, sanation and/or external management procedures have been gone through.

For the purposes of implementation of the procedure, a liquidator is appointed by creditors and approved by the economic court. Analogous to an external management a liquidator assumes all the managing powers over the debtor as of the moment of his appointment as well as the ability to control disposal of debtor's property. One of his core responsibilities is preparation of the liquidation plan that should include information on: (i) the financial status of the debtor; (ii) conditions, order of priority and proportionality of satisfaction of creditors' claims; (iii) inclusion of personnel's interests; (iv) the property to be sold; (v) date, time, place and method of sale of property; (vi) terms of payment for legal expenses, remuneration of the liquidator, experts etc. Before being implemented, a liquidation plan must be approved at the meeting of creditors.

Generally, the term of liquidation proceedings is set in 9 months' time frame and may be prolonged for up to 3 months. As a result of this stage a report is to be prepared by the liquidator and reviewed by the court. Once the report is reviewed and approved, the economic court issues a decision on completion of the liquidation proceeding and obliges the liquidator to submit this decision to the state body performing the registration of legal entities – Center of State Services ("CSS"). From the moment a record of the debtor's liquidation is entered into the CSS's register, the powers of the liquidator are ceased, the liquidation procedure is completed and the company is deemed liquidated.

AMICABLE AGREEMENT

Negotiation and execution of an amicable agreement is considered under Uzbekistan law as a separate insolvency procedure that involves participation of all creditors and the debtor. By means of this procedure the parties involved try to restructure the debt and sign an amicable agreement thus terminating the bankruptcy proceedings.

The duration of decision-making on an amicable agreement is not limited since the agreement may be signed at any stage of any on-going bankruptcy procedure. The decision on execution of such agreement may be made at the meeting of creditors. Execution by more than 50% of creditors of an amicable agreement approved by the court ends any bankruptcy procedure. In case of a deadlock on a decision on an amicable agreement, a creditor supportive of the amicable agreement (and who voted for its execution) has the right to fulfill the debtor's monetary obligations or mandatory payment obligations with respect to those creditors who voted against the amicable agreement or did not participate in the voting, thus replacing such creditors and augmenting its claims against the debtor.

If the amicable agreement is executed during the liquidation process, the economic court shall make a decision on the approval of the amicable agreement, which states that the decision to declare the debtor bankrupt and to open liquidation is not enforceable.

Creditors

In each bankruptcy procedure, the interests of all creditors are represented by a meeting of creditors (*собрание кредиторов)* and/or a committee of creditors (*комитет кредиторов*) ("Committee"). The Committee is only required in sanation, external management and liquidation procedures. The Committee is responsible for monitoring the actions of a court receiver. However, in case the number of creditors is less than 20, the meeting of creditors may decide not have the Committee at all and assume the Committee's functions. From the day of commencement of the bankruptcy proceedings in court, all actions against the debtor on behalf of the creditors are carried out via the meeting of creditors or the Committee.

It is important to mention that the recent amendments set out in the Law "On amendment to the bankruptcy law|" No. ZRU-594 as of December 13, 2019 introduced drastic changes in the powers of the creditors, notably with new concepts as "classes of creditors" and "homogenous creditors" (*однородные кредиторы*). As per Article 10 of the Bankruptcy Law, homogenous creditors are defined as the group of creditors with uniform requirements to the debtor, each having equal rights in satisfaction of claim over another.

Homogenous creditors are divided in 5 classes which have different voting rights indicated in table below:

No.	Class of creditors	Voting rights
1.	Creditors whose debt is secured by collateral	Voting rights re following matters: — execution of an amicable agreement; — election of the members of Committee; — applying to the economic court with a request for the introduction of sanation or external management and the extension of its term; — petitioning to the economic court with a notice for declaring the debtor bankrupt and initiating liquidation; — approval of the plan of sanation and approval of the debt repayment schedule; — approval of the external management plan
2.	Creditors whose claims against the debtor arise from the supply contract, service contract or compulsory insurance contract and bank credit insurance contract	
3.	Creditors whose claims against the debtor arise from payment of mandatory obligations	Voting rights only regarding matter of the conclusion of a settlement agreement and on the election of members of the Committee
4.	Creditors whose claims arise from (i) obligation to pay remuneration under employment contracts; (ii) enforcement documents requiring the transfer/issue of funds from the accounts to satisfy alimony claims; (iii) obligation to pay remuneration under copyright contracts; and (iv) damage caused to an individual's property as a result of a crime or administrative offense	No voting rights
5.	Holders of the debtor's shares on accrued dividends	No voting rights

All decisions are adopted by simple majority of votes (<50%) of those creditors present at the meeting of creditors. The creditors of each voting group have equal voting rights. At the same time, the "specific weight" of the vote of each creditor is proportional to its share in the total debt owed calculated as of the date of the meeting of creditors.

As a result of these recent amendments to the Bankruptcy Law, representative of the debtor's employees, the court receiver and the representative of the founders (participants) of the debtor have lost their deliberative vote at such meeting of creditors. These persons are entitled to participate in the meeting of creditors and the meetings of the Committee, but without any voting rights.

The creditors of any classes mentioned above are entitled to appeal the decision of the court, the meeting of creditors, the action/inaction of the court receiver as well as his refusal to satisfy the creditor's claims during the bankruptcy procedure.

Hierarchy on satisfaction of creditors' claims

Pursuant to Article 134 of the Law on Bankruptcy, the following hierarchy of claims should be established in debt repayment schedules, applied in all types of bankruptcy procedures:

— Out of turn payments: legal costs, the remuneration of the court manager, current utility and maintenance payments, expenses for insurance of the debtor's property, payments related to debtor's obligations that arose after introduction of bankruptcy procedure, payments to the individuals to

whom the debtor bears responsibility for causing harm to life or health;

— Once all the above out of turn payments have been satisfied, the following order of payments is to be applied:

- claims (certified by payment (executive) documents) on the issuance of wages, recovery of alimony and payment of remuneration under copyright agreements;
- claims regarding mandatory obligations, compulsory insurance, bank loans and bank credit insurance, as well as claims of creditors secured by collateral in part of the debt which was not covered due to insufficient amount received from the sale of pledged property (subject of pledge) and claims not secured by collateral;
- claims of shareholders on the accrued dividends;
- other claims.

The payments under one category of claims can only be made once all payments of previous category were satisfied.

It should be noted that in practice the priority of creditors' claims is based on the "first come, first serve" basis rather than the one indicated above. This is also supported by the Law "On pledge" No. 614-I as of May 1, 1998 that explicitly states that "as soon as the creditor files foreclosure to the pledged property" starts the procedure of enforcement.

Conclusion

Lack of detailed instructions on conducting bankruptcy proceedings, insufficient level of support from court receivers and "everlasting" bureaucracy- and process-related issues have led to substantial reformation of the Uzbek Bankruptcy law. Implementation of this reform was set as one of the primary goals in Uzbekistan last year. The recent amendments introduced to the Bankruptcy Law have high promises to fix the above mentioned issues as they introduced classification of creditors, strengthened the requirements for court receivers and curtailed the periods of each bankruptcy proceeding. Overall the updated version of the Bankruptcy Law delivers more a transparent approach to the rights of creditors and bankruptcy procedure as a whole.

Nevertheless, certain loopholes such as the recognition in Uzbekistan of foreign court decisions in bankruptcy proceedings have not been addressed completely.

Mostly due to the shortage of treaties regulating the issues of insolvency on the international level, there is no other way but to rely on the principle of reciprocity. However, the nature of this principle imposes no obligation upon the courts to follow it. In fact, in such circumstances the court may recognize the decision of a foreign court only in its own discretion. Therefore, it would be advisable to seek international tools available for creditors' protection inputting insolvency matters in bilateral treaties on recognition of foreign judgements. Another solution may to incorporate the UNCITRAL Model Law on Cross-Border Insolvency as of June 30, 1997 into the Uzbek domestic legislation. Adoption of the Model Law would provide the foreign creditors and companies with guarantee on interstate recognition and hereby encourage the inflow of FDI in the country. ■

1. 1 BEV is equal to 223,000 UZS (approximately $ 24)

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