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Bankruptcy Law in European Countries Emerging from Communism: The Special Legal and Economic Challenges

by

The Honorable Samuel L. Bufford*

Ironically, one virtue of a market economy is that a business can fail. The strength of a private enterprise system in producing and delivering goods and services depends upon the survival of only efficient businesses. . . . If a private business' product is unwanted or its methods of production are inefficient, the business should ultimately die.1

Bankruptcy2 law is developing rapidly in the countries of Central and Eastern Europe (CEE) that have recently escaped the domination of the Union of Soviet Socialist Republics (USSR). The communist governments fell in those countries that were separate from the USSR in 1989,3 and those countries that were a part of the USSR gained their independence and acquired new non-communist governments in 1989 (the Baltic states) and 1991 (Ukraine, Belarus, Moldova, and Russia).4 While many other areas of law

*United States Bankruptcy Judge, Central District of California. Copyright 1996. All rights reserved. The views expressed herein are those of the author and do not necessarily reflect those of the court or of the United States Government.


2"Bankruptcy" is a word whose meaning varies around the world, and even in Central Europe. In the United States, it refers to the federal law providing for the reorganization or liquidation of the financial affairs of businesses and individuals. See 11 U.S.C. §§ 101-1330 (1994). In Romania, it refers to the liquidation of businesses and merchants, but not to reorganizations. In Hungary, in contrast, it refers to the reorganization of businesses, but not their liquidation. Yet another meaning is found in Australia, where it refers to the liquidation of the assets of individuals, but not of business entities. In this Article, as in the United States, the term includes all insolvency proceedings, whether the goal is liquidation or reorganization.

3It should be noted that the sweep of communists from power in the CEE countries was not complete. While there was a change in government leadership, most of the lower government officials, many of whom had been Communist Party members, remained in place. Indeed, it could hardly be otherwise: a complete removal of all communists from the government of one of these countries would have left it largely without a government altogether, and likely would have led to anarchy.

4Most of the government officials who came into office in the countries newly separated from the
that are basic to the development of a market economy need substantial development or revision, bankruptcy law is leading the way, for the most part, in all of these countries.\textsuperscript{5}

However, the legal structures and economic conditions in the CEE countries are quite different from those in the United States and, in consequence, pose unique problems for the application of bankruptcy law. The most important difference is the process of privatization of state-owned enterprises, in which bankruptcy law has a unique and important role. This Article explores those legal structures and economic conditions and discusses their implication for bankruptcy law in these countries.

This Article is based principally on what I have learned from my experience teaching seminars on bankruptcy law (and other subjects) in the CEE countries, and in advising various government officials on bankruptcy law and other commercial law.\textsuperscript{6} It also draws to a certain extent on conversations with colleagues who have taught seminars similar to those that I have taught in the region.\textsuperscript{7}

I. BACKGROUND

Before launching into the factors impacting on bankruptcy law in the CEE countries, it is necessary to pause to detail the countries involved, and to discuss briefly the legal framework needed for a market economy and the rapid development of bankruptcy law in the CEE countries.

\textsuperscript{5}Development of civil codes, in those countries that lacked such codes, is following fairly closely the development of bankruptcy laws. Other kinds of laws to support a market economy are lagging substantially behind.

\textsuperscript{6}In Romania, I taught two week-long seminars for judges and a week of programs for Romanian bankers in 1996, sponsored by the United States Agency for International Development (USAID); a two-day program on bankruptcy law for all government officials in 1995, also sponsored by USAID; a week-long seminar for government officials and judges in 1994, sponsored by the Central and East European Law Initiative of the American Bar Association and the Romanian Council for Coordination, Strategy and Economic Reform; and a week-long seminar for judges under the Rule of Law Program of the United States Information Agency (funded by USAID) in 1991. Each of the Romanian programs was also co-sponsored by the Romanian Ministry of Justice.

In Ukraine, I taught a two-day program on bankruptcy law, including a day devoted to meeting with judges, in 1996; I spent a week in 1995 advising a drafting committee of University of Kyiv law professors drafting revisions to the Ukrainian bankruptcy law; and spent another week in Kyiv in June, 1995, with a team of fifteen American lawyers working on the entire range of laws necessary to support a market economy.

In 1993, I taught a week-long seminar in Budapest co-sponsored by the International Training Center for Bankers and the International Law Institute.

\textsuperscript{7}USAID contracted with Deloitte & Touche, L.L.P. to present more than twenty week-long seminars for judges in ten countries in the region. Each program was taught by two United States bankruptcy judges and one or two accountants.
A. THE COUNTRIES

The CEE countries that serve as a focus for this Article divide into four groups.8 The first group consists in those countries west of the former USSR, which were never formally a part of the USSR, but came under Soviet domination shortly after World War II. These countries constitute a tier from Poland in the north to Bulgaria in the south, and include the Czech Republic,9 Slovakia, Hungary, and Romania (Central European countries). The communist governments in these countries all fell in 1989.10

The second group of countries consists in those that were part of the USSR since its foundation in 1922,11 and which gained their independence in 1991, after the aborted military coup in Moscow in August of that year.12 This group includes Ukraine,13 Belarus,14 and Russia [NIS countries (newly independent states of the former Soviet Union)].

The third group of countries consists in those countries, not part of the USSR until 1940, which were taken over and incorporated into the USSR in that year.15 This group includes the three Baltic republics (Latvia, Lithuania, and Estonia) and Moldova (which the USSR sliced off from Romania). The Baltic countries gained their independence from the USSR in 1989,16 and Moldova gained its independence a week after the collapse of the Moscow coup in August, 1991.17 The Baltic countries have the legal and economic

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8One former Central European country, the Democratic Republic of Germany (commonly called East Germany in the United States), is not included in this analysis. Its situation is unique: it alone has joined a Western country (the Federal Republic of Germany, the union of which is now simply known as Germany), and received special economic, legal, and political considerations that no other nation in the region has enjoyed.

9The Czech Republic and Slovakia were the single country of Czechoslovakia, from its formation out of the Austro-Hungarian Empire in 1918 until their consensual separation into two countries at the beginning of 1993.

10EASTERN EUROPE AND THE COMMONWEALTH OF INDEPENDENT STATES 1994 [hereinafter EECIS 1994] 468 (Poland), 199 (Bulgaria), 254 (Czech Republic), 605 (Slovakia), 329 (Hungary), 504 (Romania) (2d ed. 1994).

11The USSR was proclaimed on December 30, 1922, and included Russia, Byelorussia (Belarus), Ukraine, and Transcaucasia. UNION OF SOVIET SOCIALIST REPUBLICS, 20 THE WORLD BOOK ENCYCLOPEDIA 37 (1993).

12EECIS 1994, supra note 10, at 548.

13Most of Ukraine was part of Russia from 1654 to 1917. It became an independent country in 1917, and it joined the USSR in 1922. Id. at 677-80.

14Belarus (Byelorussia) became a part of the USSR in 1922. Id. at 166.

15Id. at 287 (Estonia), 398 (Latvia), 415 (Lithuania), 450 (Moldova).

16Id. at 287, 398, 415, 450.

17I was in Romania during the Moscow coup in August, 1991, and during the time when Moldova declared its independence a week later. Our seminar group of six American judges, several Romanian Ministry of Justice officials, and several translators was traveling between Romanian cities on the day of the independence vote in the Moldovan parliament. The roll call vote in the 450-member parliament was carried live on Romanian radio, and lasted more than two hours. (Romanian is the official language of Moldova). It was a moving event, which was all the more poignant because, only a week earlier, the hard-won freedom from communism stood in great peril. Indeed, on the day of the coup a Romanian Supreme
traditions of the Central European countries, and are proceeding on a parallel course. Thus, this Article treats them together with the Central European countries. Moldova, in contrast, is making no effort to retrieve its Romanian historical traditions, and is proceeding on a development track parallel to the countries in the second group: it is thus treated with the NIS group.

The fourth group of countries is the Balkans, and includes Albania and the pieces of the former Yugoslavia (Slovenia, Croatia, Serbia, Macedonia, and Bosnia-Herzegovina). Yugoslavia was controlled by a communist government after World War II, but was not under the domination of the USSR. The Balkans have had a troubled history, and their progress toward a Western style legal system and market economy is different from the other CEE countries. Albania has suffered from self-imposed exile from the entire European community (both East and West) and is centuries behind in development. Bosnia-Herzegovina and Serbia have been preoccupied with an ethnic war since the fall of communism. Croatia is emerging from the war, and is attempting to join Slovenia and Macedonia in their move towards the European mainstream. Because of the unique situations in the Balkan countries, they are a secondary focus of this Article.

This Article examines the specific legal and economic conditions and challenges that are largely shared by the countries in the CEE region that differ dramatically from those in the United States, insofar as they impact on bankruptcy law. An analysis of the bankruptcy laws of the CEE countries as such is beyond the scope of this Article, and is left for another occasion.

B. THE LEGAL FRAMEWORK FOR A MARKET ECONOMY

A market economy needs a legal framework to provide for the rights of the participants and a structure in which transactions can take place. It also

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18Moldova was part of Romania before its incorporation into the USSR in 1940, and shared the statutes and legal traditions that Romania still has. However, Moldova is not utilizing those statutes and traditions, and instead is starting from the beginning in drafting laws to permit its economy to function as a market economy. Thus, its state of progress and its approach to resolution of the transition problems more resembles that of Ukraine and Russia than that of Romania.

19A modern insolvency law in a market economy should accomplish four main purposes: (1) provide for the equitable and predictable treatment of creditors; (2) maximize asset recovery; (3) provide practical opportunities for reorganization in an appropriate case where creditor interests and social needs are better met by maintaining the debtor in operation than by liquidating it; and (4) give the honest debtor an opportunity for a fresh economic start after financial failure. Henry N. Schiffman, Financial Transactions for Lawyers, Introduction to Ion Turcu, Reorganizarea și Lichidarea judiciară 5, 6 (1996). The bankruptcy laws of the CEE countries show varying degrees of meeting this standard.

20Pursuant to the USAID project described supra note 7, Deloitte & Touche, L.L.P. has recently completed a report on bankruptcy in the CEE countries. Deloitte & Touche LLP, Bankruptcy and Restructuring Central & Eastern Europe (on file with the author) (D&T Report).
needs effective governmental fiscal policies, and the development of financial and intermediation institutions. The development of such a legal framework is a principal building block for a sustainable market economy in the CEE region.\textsuperscript{21}

In the CEE countries the paramount civil law is the civil code, which in some countries includes an associated commercial code.\textsuperscript{22} In addition to these codes, a market economy typically requires a system of laws that includes laws in the following areas:\textsuperscript{23}

- Mortgages
- Banking
- Commercial transactions
- Capital markets
- Privatization
- Foreign investment
- International trade
- Personal property collateral
- Antimonopoly
- Intellectual property
- Bankruptcy

As the foregoing list indicates, bankruptcy law is only one of a dozen kinds of legal structures needed for a market economy. However, to a large extent, bankruptcy law is leading the way in the development of the commercial law. This has resulted because of bankruptcy law's strong ties to privatization as a first step in developing a market economy in a market where many businesses are insolvent.

\section*{C. The Rapid Development of Bankruptcy Law in the CEE Countries}

New bankruptcy laws have gone into force since 1990 in all of the countries in the CEE region except Poland, and further bankruptcy laws are pending in a number of the countries. The reasons for the rapid development of bankruptcy law in the CEE countries merit a separate study. For the purposes of this Article, the discussion is limited to a few salient points. Some of these points are developed below, in the discussion of the legal and economic structures that impact the application of bankruptcy law.

\textsuperscript{21}See Patricia Shapiro, Development of a Commercial Law Strategy for ENI Countries (unpublished USAID manuscript, undated, on file with the author).

\textsuperscript{22}The two dominant models for civil codes are the French and the German models. Germany has both a civil code and a commercial code, while France puts all of the private law provisions in a single civil code. Whether a country has a separate commercial code largely turns on whether it follows the French or the German model. \textit{See infra} text accompanying notes 70-82.

\textsuperscript{23}\textit{Cf.} Shapiro, \textit{supra} note 21, at 3.
There are several reasons why bankruptcy law is leading the way for commercial law development in the CEE countries. Perhaps the most important reason that the CEE countries are interested in bankruptcy law, and especially in the law providing for the reorganization of insolvent business entities, is that bankruptcy is perceived as part of the structure needed to provide for the privatization of state-owned enterprises, which constitute a very large segment of the economies in each of these countries. Privatization is still in its initial stages in most of the CEE countries.24

A second group of reasons for the leading position of bankruptcy law arises from its status in the internal legal structure of the CEE countries (and, indeed, of any country). Bankruptcy law is very technical, and the interrelations between the legal provisions and the economic effects are complex. Thus, few politicians understand it, in part because few elected officials in the CEE region are attorneys.25 At the same time, and partially in consequence of its technical complications, bankruptcy tends to be a politically neutral issue (until it is applied to state-owned enterprises), on which the various political factions that exist in each CEE country are not likely to take opposing positions. In addition, bankruptcy is a system of law that has no existing vested interests of substantial consequence in the CEE countries, so that changing the bankruptcy law does not step on very many toes of substantial players in the present legal or economic structure. Furthermore, bankruptcy law can be revised without revising other bodies of law, and for the most part without creating new institutions to administer it. Bankruptcy law reform can be accomplished without a substantial contribution from the public fisc. For the Central European countries, revision of bankruptcy law is made easier by the fact that bankruptcy law has existed there for many years (but has lain dormant), so that its revision is not viewed as a major change in the legal structure.

At the same time, there are substantial international pressures on the CEE countries to institute reform in their bankruptcy laws. The international lending institutions, principally the World Bank and the International Monetary Fund (IMF), have pushed strongly for bankruptcy law reform, and have sometimes even made it a condition of qualifying for international lending. For example, in 1994, the IMF imposed on Romania a requirement of legal reform in four areas as a condition of qualifying for further IMF lending. One of these areas was bankruptcy law.26 Romania immediately scheduled bankruptcy law as the first area for revision because the Ministry of Justice

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24For a further discussion of the role of bankruptcy in the privatization effort, see infra text accompanying notes 38-41.

25For example, there are approximately ten lawyers in the 300-member parliament in Poland.

had already drafted a revised bankruptcy law and had scheduled a week-long seminar on bankruptcy law under the sponsorship of the American Bar Association.27

Furthermore, the United States Agency for International Development (USAID)28 has sponsored a substantial program throughout the CEE region on bankruptcy law development. This program included a large segment designed to teach local judges how to administer bankruptcy cases, and in particular to teach them what they need to know about accounting and business standards and practices to make the judicial decisions necessary for business reorganizations.29

One should not infer, from the development of bankruptcy statutes in the CEE region, that bankruptcy practice is well developed in these countries.30 For the most part, bankruptcy cases are just beginning to be filed in the region, and most are involuntary cases. Financial responsibility for the insolvency of state-owned enterprises is difficult to apportion.31 There are insufficient incentives in the market place or the legal system to force unprofitable businesses into bankruptcy, either voluntarily or involuntarily.32 Such incentives need to be developed: if financial failure is not a credible threat, managers will not pay due attention to the short-term liquidity of their businesses, or to their long-term profitability.33

II. THE NEED FOR REORGANIZATION INSTEAD OF LIQUIDATION

The reorganization of insolvent enterprises, much more than liquidation, is needed in the CEE countries. This is much more true for the large enterprises, which are (or recently have been) state-owned. This need arises from the closely related needs in the CEE countries to privatize these enterprises,

27 The author was one of the leaders of this seminar. See supra note 6.
28 USAID administers approximately one-third of the United States foreign aid budget.
29 The USAID program arose from a grant to Deloitte & Touche, L.L.P. in the fall of 1993. It included three phases: first, a description of the existing bankruptcy law in each of ten countries (Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Macedonia, Poland, Romania, Slovakia, and Slovenia); second, a presentation in each country of a summary of that nation's standing in bankruptcy law development in the region; and third, a presentation of week-long judicial training seminars to small groups of judges (twenty to twenty-five judges) in each country. The instructors were two United States bankruptcy judges for each seminar, plus one or two accountants from Deloitte & Touche. A total of twelve United States bankruptcy judges participated in this program, including the author of this Article. Ukraine was added to this list of countries in 1996, and the second and third phases of the program are still pending for that country. See D&T Report, supra note 20.
30 Id.
32 In Poland, creditor passivity results partly from the banks' efforts to cover their bad assets. Id. at 16.
33 Id. at 5.
and at the same time to resolve the insolvency problems in many of these enterprises.

The economic objectives of bankruptcy reorganization are largely the same as for liquidation. For individual entrepreneurs, bankruptcy provides a "fresh start," free of an unmanageable load of prior debt. At the same time, on the creditor side, it provides for the equality of treatment among creditors. Both types of bankruptcy procedure are designed to ensure the highest and best use of commercial assets following failure of a business. In addition, reorganization is designed to permit the restructuring of a business so that its healthy components can survive, even if other aspects must be jettisoned. In addition, reorganization is designed to preserve the going concern value of a business that is worth more as an operating unit than as dismembered parts.

A. The Results of Liquidation

Consider what liquidation accomplishes in a largely government-owned economy. Most of the creditors are government-owned institutions. In Romania, for example, ninety percent of the economy belongs to formerly state-owned industries, and seventy percent of their debts are owed to the government. The most common mode of liquidation is to sell the assets and to distribute the proceeds to the creditors, which are government entities. This works admirably if the assets can be sold into the private sector.

However, the lack of markets for assets makes it impossible to sell assets into the private sector to a large extent. The private sector lacks the liquidity to absorb the assets, even if markets can be found, in most of the CEE countries. Thus the assets themselves, or ownership interests in them (e.g., shares of stock), must be distributed to the creditors. However, what this accomplishes is to transfer the assets back to the government, the reverse of privatization. Thus, liquidation has a substantial likelihood of producing a reversal of privatization, returning assets to public ownership that the privatization project is trying to take out of public ownership. Some other method for restructuring businesses must be found.

This is where reorganization of businesses under the model of Chapter 11 of the United States Bankruptcy Code has appeal. A reorganization, as opposed to a liquidation, makes it possible to keep the assets in the private sector, and to limit government participation to holding debt in the reorganized debtor. In this manner, privatization is not jeopardized by the restructuring of insolvent businesses.

In addition, reorganization is a way to deal with the lack of markets for

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35 See infra text accompanying note 53.
assets, particularly assets constituting large business enterprises. If the assets are not sold in a reorganization, a market does not have to be found for them. Instead, the reorganization may provide that the assets may remain in the business, and it may rearrange the ownership and debt interests. With suitable changes in the debtor's operations to eliminate operating losses, the business is able to return to profitability and continue in operation, without needing to sell all the assets in an illiquid or nonexistent market.

Furthermore, the liquidation of any substantial quantity of the insolvent business enterprises in the CEE region is not a viable alternative, because they would be too much for the economy to absorb. Thus, it should be the policy of the law in the CEE region to favor reorganizations.

Because United States bankruptcy law provides the dominant model for bankruptcy reorganization, many CEE countries are looking to the United States for the model for reorganization of enterprises under the bankruptcy system.

B. Economic and Structural Conditions

There are several economic factors that make it much more important to emphasize reorganization in the CEE countries than in the Western world. These factors differ from those found in the United States and Western Europe, and have a substantial impact on the possibility of bankruptcy liquidation in the CEE region. These factors include the largely unprivatized status of the economy, the insolvency of a substantial portion of business enterprises, the lack of markets for selling assets in bankruptcy cases, the lack of commercial credit for financing businesses, and a much different competitive environment from that known in the Western world.

1. Privatization

In most CEE countries, there was little private ownership of business during the communist era. Shortly after communist governments came to power in these countries, virtually all privately-owned businesses were nationalized, and remained state-owned until the end of the communist era.

Privatization is the most important step in the development of market economies in the CEE countries: it must be accomplished to a substantial extent before a market economy can function. Since the fall of communism in the CEE countries, every country has committed to returning most of its businesses to the private sector. However, privatization has moved quite

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36 Schiffman, supra note 19, at 15 n. 1; Mizsei, supra note 31, at 3. Smaller businesses, in contrast, may be liquidated if they cannot operate profitably and cannot be reasonably reorganized.

37 In fact, there are countries, such as Poland, where reorganizations are being carried out under a bankruptcy law that principally provides for liquidation.

slowly in many countries. Indeed, in some of the countries it has hardly begun. Most larger businesses in the CEE countries are still state-owned.

The nationalization of private enterprises in the CEE countries was not limited to the state’s acquisition of ownership of shares of stock. Because all industry was state-owned, industrial investment frequently was not identified with a specific enterprise, because there was no need to do so. In consequence, it is frequently difficult to determine what specific business assets belong to a particular business.\(^3\) This problem is solved by the "corporatization" of enterprises, or the formation of new state-owned corporations and the transfer to them of specific assets. Corporatization is in substantial progress in many of the CEE countries. These new corporations are then ready to be privatized, if they are sufficiently solvent or their finances can be restructured.

The next step in privatization of enterprises, whether after corporatization or by sale of assets, has not progressed very far in most of the CEE countries. While most of the countries have a substantial number of privately-owned businesses, most of these are small businesses that have begun in the last several years since the fall of communism. The large state-owned enterprises that existed during the communist era continue under state ownership. A number of them have not been corporatized, and are simply arms of the state. Most of the CEE countries have a specific state property agency that functions as the shareholder for the businesses that have been corporatized. However, state property agencies do not function like typical shareholders, and usually are unwilling to replace management when it does not act to maximize the profits of the shareholders.

Bankruptcy itself can be used as a privatization tool.\(^4\) A state-owned enterprise can be put into bankruptcy, and then the assets (or the shares of stock) are sold into the private sector. Privatization by this means is occurring frequently in Poland and Hungary,\(^4\) and is beginning to occur in

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\(^3\)Privatization in Poland: An Interview with Jeffrey Sachs, 15 SUFFOLK TRANSNAT'L J. 441, 454-55 (1992). A student comment states:

In the former Soviet Union, enterprises did not own property. Property belonged to the State, and the enterprise was merely a convenient unit for the administration of the State's property. The enterprise was a judicial person and had standing before a court of law, but it did not own the property and equipment it used. Under such an arrangement, there could be no race of the creditors because there were no assets for the creditors to tear away from the debtor. Thus, there was no need for a system of orderly disposition of debts and assets. Without private property rights, there is no need for a bankruptcy system.


\(^4\)Scott Horton, The Death of Communism and Bankruptcy Reorganization, 13 AM. BANKR. INST. J. 12, 12, 31 (April, 1994).

\(^4\)Schiffman, supra note 19, at 8.
2. Solvency of Businesses

Another dominant feature of the economies in the CEE countries is the insolvency of a large number of enterprises. A substantial portion of the businesses in the CEE countries are insolvent, in the balance sheet sense that their liabilities exceed the value of their assets. Even more troubling, many of the enterprises are regularly operating at a loss. This is especially true for the large state-owned monopolies. For the most part, these businesses have no hope of making profits without substantial restructuring. They may also need a large amount of new capital investment. The extent of the insolvency problem varies from approximately twenty-five percent of the economy in Hungary and forty-five percent of the economy in Poland to some ninety percent of the economy in Ukraine.

One of the most important reasons that CEE economies are dominated by businesses of questionable solvency is that, for half a century or more, no business has been allowed to fail. The economic landscape in these countries is densely populated with businesses that would have lost the struggle for survival in a competitive economy. Work forces have become bloated because businesses operated as bureaucracies, where there were no incentives for efficiency. In addition, for many years there has been a substantial insufficiency of capital investment, and equipment and facilities are frequently obsolete or in disrepair.

Another factor in the general insolvency of businesses in the CEE region is the collapse of the COMECON market after the fall of the communist governments in the region. Together with prolonged government austerity measures and the liberalization of prices and imports, this has caused a drastic reduction in the profitability of enterprises.

Because of the enormous extent of insolvency of enterprises in the CEE countries, the general liquidation of insolvent businesses is not an economic

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42 The financial statements of many insolvent businesses in the CEE countries do not show their insolvency because neither United States nor international accounting standards are generally followed in that region.


44 Id. at 13.

45 For example, Victor Yushchenko, Chairman of the Board of the Ukrainian National Bank, estimates that ninety percent of the Ukrainian businesses are insolvent. Opening remarks given at Kiev Conference on Restructuring and Bankruptcy in Central and Eastern Europe: Ukraine, May 14, 1996.

46 Mizsei, supra note 31, at 9.

47 Hungary is a limited exception to this rule: in the 1970s, smaller firms in financial crisis were typically merged into larger businesses. Mizsei, supra note 31, at 23.

48 Id. at 6, 22.

49 Id.
or political possibility. In most of the CEE countries, the liquidation of the insolvent enterprises would result in the virtual disappearance of the economy altogether. Restructuring is the only feasible alternative that can be considered for a substantial portion of the larger business entities.

The restructuring or liquidation of insolvent enterprises is an important step toward economic reform. Indeed, economic reform is probably not possible in the CEE countries until the insolvency problem has been resolved. The resolution of this problem, furthermore, is likely to contribute substantially to economic decline as the process goes forward.

3. Markets

Markets like those that are common in the Western world for many kinds of assets do not exist in the CEE countries. Markets are generally available in the United States for most assets that need to be liquidated. Thus, assets can usually be sold by a bankruptcy estate at a price approximating their value in the marketplace. Such markets are much less common in the CEE countries. For many kinds of assets in the CEE countries, there is no recognized or readily available market.

The lack of markets makes it much more difficult to liquidate assets in the CEE countries than in the United States. Furthermore, the lack of markets makes it nearly impossible to value assets to determine whether a plan of reorganization should be confirmed. Some solution to this problem must be found to permit reorganizations to proceed.

4. Commercial Credit

Commercial credit is largely unavailable domestically in the CEE countries, because of the lack of development of a vigorous banking system. Commercial credit in most CEE countries is provided mainly by suppliers, who are generally state owned (because privatization has not proceeded very far). The banking systems are generally underdeveloped, and there are few other large sources of commercial credit. Negotiable instruments are not in use (except letters of credit for international transactions) and are not understood.

In many CEE countries, small banks quickly sprang up in the early 1990s, but they were too thinly capitalized. To attract deposits, they offered interest rates so high that they could only pay depositors by, in effect, operating

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51Id. at 30.
52Id.
54Except for Hungary, Poland, and Yugoslavia, there was no commercial banking at all in the CEE region before the fall of communism. Mizsei, supra note 31, at 29.
55See supra text accompanying notes 38-41.
Ponzi schemes. Furthermore, they frequently made loans to insiders and related businesses at preferential rates, and these loans frequently went into default. Thus, a number of existing banks have their own solvency problems.

In Ukraine, for example, there are a large number of banks, but hyperinflation has so badly eroded their assets that they are only able to make small loans, and a typical loan is for no longer than a month. In Romania, similarly, bank debt accounts for only a small portion of outstanding indebtedness. The development of a viable banking system in the CEE countries is one of the important steps needed for developing a market economy.

An additional economic factor is payment blockage. For a number of years there has been insufficient cash in the economies of many of the CEE countries to permit businesses to settle their accounts. Where businesses were all state-owned, nobody particularly worried about this, so long as cash was available for payrolls. Suppliers and customers simply recorded book entries rather than making actual payments. In a market economy, however, this prevents the marketplace from imposing discipline on businesses. So long as a substantial portion of the finances of businesses are handled by book entries, rather than by real payment, businesses are permitted to lose money without any marketplace impact resulting from their losses. Those businesses that should be closed or go into bankruptcy because they are losing money continue to operate indefinitely under such a system.

5. Competitive Environment

The competitive environment in the CEE countries is complicated by large and inefficient enterprises, obsolete technology, bloated work forces, the disappearance of traditional markets, hyperinflation, a lack of organized market distribution systems, and the imposition on businesses of governmental functions through the "social assets" of large businesses.

Under communism there was no competition for goods and services, and businesses had no need to compete in the marketplace. In addition, many businesses enjoyed monopolies, and none was required to compete for market share. Their production requirements were determined annually, and both their costs and their revenues were determined pursuant to a central

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56Honorable Leif M. Clark, Learnings from Latvia, 15 AM. BANKR. INST. J. 36, 36 (June, 1996).
57Ibid.
58Hyperinflation is generally defined as inflation exceeding fifty percent per month. In 1993, the inflation rate in Ukraine was 4735 percent.
59It was estimated that, at the time of the fall of communism in Poland, half of the work force had jobs that would not have existed in a market economy. Sikorski, Revolution Betrayed, NAT'L REV., July 23, 1990, at 20, 21.
60See, e.g., Mrzsić, supra note 31 (citing examples in Poland such as Moda Polska, which had enjoyed a virtual monopoly in the retail trade of fashion clothing, and which became insolvent because of imports and domestic competition).
plan. In addition to obsolete technology, many enterprises had too many workers. Unemployment was avoided during the communist era by simply adding positions in enterprises, with little consideration for efficiency. In addition, the availability of technology was limited, and lagged far behind that in the Western world. Pollution of the environment was endemic, and in many places the results have been disastrous. In short, there was nothing remotely resembling the discipline of a marketplace on either the revenues generated or the costs incurred by enterprises.

After the fall of communism, this situation has changed to some extent and in some markets. However, much progress remains to be accomplished in creating a market economy in the CEE countries. The partial transition results in a number of features that are distinctive in the CEE countries that affect the operation of bankruptcy law there.

Businesses tend to have a different structure in the CEE countries from what is common in Western countries. While the United States' economy has many smaller businesses that compete with each other and try to find a market niche, in the planned economies under the communist system there tended to be a single nationwide business in each market that enjoyed a monopoly, or at most a handful of businesses that shared a monopoly. For example, there was usually a single telephone company, a single automobile manufacturer, and a single steel company. Furthermore, in the manufacturing sector a single large factory frequently dominates an entire town, and its closure would destroy the town's economy altogether. Even where these businesses have been privatized, they still tend to have extremely large market shares (if they do not continue to be monopolies), and are not required to struggle with competitors for survival. The large businesses need to be broken into parts so that they can compete against each other.

"Social assets" constitute another problem for businesses in Central and Eastern Europe. Large businesses, rather than local governments, tend to own and operate such facilities as schools, parks, libraries, clinics, canteens, commissaries, and vacation facilities. The closing of a business would lead to the closing of these facilities as well, unless an arrangement is made to transfer these functions to a local government. While in principle such a transfer should be made, the transaction costs are substantial, and frequently a transfer cannot be accomplished where the viability of the principal business in a town is doubtful. Governments need to take over the essentially governmental functions of social assets, and the other functions need to be separated from the business enterprises to stand on their own feet.


62 Hungary, for example, divided its retail banking system into a number of independent banks when it privatized the retail sector of what used to be a single central bank.
The private sector in the CEE countries tends to be the focus of bankruptcy activity, while the public sector for the most part has not yet been required to submit to market discipline, and to go into bankruptcy when it cannot operate profitably. Unlike private business enterprises, when a publicly-owned business runs out of money, the government is much more likely to bail it out with the cash needed to meet payroll and other financial obligations. This gives a competitive advantage to the public sector, and businesses in the private sector thus operate at a competitive disadvantage in the marketplace.\(^6\)

If the government itself lacks financial resources to bail out favored enterprises, it is tempted to print money to meet the shortage. Many of the CEE countries have done this, and consequently have suffered extreme levels of inflation. One of the worst examples is Ukraine, where the inflation rate in 1993 was 4735%\(^6\).

Severe inflation of the sort that has occurred in many CEE countries has a number of impacts on the economy that affects the application of bankruptcy law. For example, substantial inflation essentially eliminates the value of assets that are carried on balance sheets at historic cost, unless an inflation adjustment is made.\(^6\) High inflation levels radically distort the banking system, and make it difficult if not impossible to carry out lending activities beyond the shortest term.\(^6\) Inflation has eroded the capital base of the banks in many countries in the region, and has further reduced the market value of the loans that they can offer.

Another factor in most CEE countries is creditor passivity: creditors rarely act aggressively to collect the debts owing to them.\(^6\) This is especially true of creditors that are state-owned enterprises.\(^6\) The lack of aggressive creditor collection efforts results in a lack of motivation for businesses to

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\(^6\)See D&T Report, supra note 20, at 37.

\(^6\)World Economic Outlook: May 1995: A Survey by the Staff of the International Monetary Fund, Table A13 (1995); Deloitte & Touche, Enterprise Restructuring - Ukraine 8 (1996) (unpublished document on file with the author). In a country with inflation of 4735 percent in one year, a loaf of bread that cost one monetary unit (e.g., one dollar) at the beginning of the year would cost 4735 monetary units (e.g., $4,735) at the end of the year.

\(^6\)The Romanian government has enacted legislation on three occasions since 1990 to provide for statutory adjustment of balance sheets to reflect inflation. The adjustments have not exactly matched the level of inflation, however.

\(^6\)In Ukraine, for example, banks normally make only short-term loans that do not extend for more than a month at a time. In addition, most Ukrainian banks are small, and thus are not able to make large loans.

\(^6\)Hashi, supra note 50, at 24-25. There are occasional exceptions, such as the taxing authorities in Ukraine, who file ninety percent of the bankruptcy cases in that country in an effort to collect unpaid taxes.

\(^6\)The state may lack motivation in pushing creditor collection efforts because it typically wears a number of hats in an insolvency situation. Where it fails to act diligently as a creditor, for example, it may benefit directly as a shareholder. Id.
file bankruptcy cases, because they do not need protection against debt collection efforts. More vigorous creditor collection activity is badly needed in the CEE countries, to reduce the number of loss-making enterprises and to push forward the privatization process.

III. THE CEE LEGAL SYSTEMS

In addition to distinctive economic features, the CEE countries have legal systems with distinctive features that impact the operation of bankruptcy law. There are five such features that merit consideration.

First, all of the CEE countries either fall into the civil law tradition based on the French and German civil codes, or have decided that they want to adopt this system. Second, the legal structures underlying the market economies in the Central European Countries prior to World War II remained largely intact during the Communist era, but fell into disuse. In contrast, in the NIS countries there are no traditions of market economies or legal structures to support them. Third, the judiciary needed to make such a legal structure function effectively is largely in place, and eager to make a market economy work. However, the judges badly need training in the principles of a market economy and the application of the legal concepts necessary for such a system. Fourth, the other players necessary to make an insolvency or bankruptcy system function effectively are largely missing and need to be identified and trained for their roles in bankruptcy. Finally, the bankruptcy systems in the CEE countries are complicated by the fact that banks are eligible for bankruptcy in most of these countries, and many of the new banks have systematically made bad loans and have become insolvent.

A. The Civil Law Tradition

All of the CEE countries have adopted, or plan to adopt, the Continental Western European civil law tradition, as opposed to the common law system of the British Isles and the English-speaking nations of the world (including the United States).

Unlike common law systems, civil law legal systems are dominated by a civil code, sometimes linked with a separate, but integrally linked, commercial code, which is normally drafted in a single legislative effort. These

69 Vigorous debt collection practices are not an unqualified virtue. In the Czech Republic, for example, where bank debt collection was vigorous, the transition to a market economy was promoted by less active debt collection efforts. Indeed, a number of states in the United States responded to the Great Depression by enacting mortgage foreclosure moratorium statutes, which postponed the right of mortgage holders to foreclose after default on debts secured by real property. See, e.g., East New York Sav. Bank v. Hahn, 326 U.S. 230 (1945) (upholding eleventh successive annual extension of New York's 1933 mortgage moratorium law).

codes provide a reasonably comprehensive system of law for the non-criminal body of law in such a country. Germany and France provide the two dominant models for civil codes, and civil law countries generally base their civil codes on one of these models.

Civil codes emphasize form, structure, and the formation of general principles of law to govern specific situations. The reasoning process begins with general principles found in the code, and proceeds by deductive reasoning to a particular solution for a given legal problem.

Along with a civil code structure that does not exist in the common law system, the civil law system brings a different approach to lawmaking, case law and the role of the court in the legal system. The most important difference between the two types of legal systems is the allocation of power between the courts and the legislature in a civil law system. In a civil law system, the courts are much more narrowly restricted to interpreting existing statutes, and have little power to “make” law; for the most part, judicial precedent has little impact in a civil law system. Legislatures in civil law countries appear to exert a modestly greater degree of care in drafting legislation than legislatures in common law countries.

Instead of judicial precedent, treatises written by law professors fill the gaps left by the legislature, and are the principal sources of law to supplement the legislative texts. Such treatises play a very important role. The function of treatise writers in the civil law system is to analyze the basic codes and legislation to formulate general theories and to extract, enumerate, and expound on the principles of law derived from them. From the basic principles, the treatise writers derive and recommend appropriate results in specific cases. After legislative texts, treatises are the most important sources of law in the civil law system.

As a result of the systematic elaboration of law in civil codes and treatises, the reasoning process in the civil law system is different from that in the common law system. In the civil law system, reasoning is deductive, and proceeds from the general principles elaborated in the legal sources to the resolution of a specific problem. In the common law tradition, in contrast, reasoning is frequently inductive from past reported case law, to extract the

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71Id. at 19.
72Id. at 34-35.
73Id. at 19-20.
74Id. at 34-35. A notable exception to this rule is found in French tort law, which is largely court-made. There are only five sections of the French Civil Code devoted to tort law, §§ 1382-1386, plus a minor amount of supplementary legislation. Unlike most civil code provisions, these provisions are heavily annotated to French court cases in a standard annotated code such as that published by Dalloz.
75Id. at 36-37.
76Id. at 37-38.
77Id. at 37.
legal principles that may be applicable to new cases.78

The foregoing differences bring practical distinctions between the two legal systems as well. Court structures in the two systems tend to be different: common law courts tend to be general jurisdiction courts, while civil law court systems are frequently specialized, based on the particular code for which a given court is responsible.79 The single-event trial that dominates the model of common law adjudication is unknown in the civil law system: cases are decided by the judge (or judges), usually without a jury, after a series of hearings over a period of time.80 The civil law judge takes a more active role in questioning witnesses and directing the collection of evidence.81

While the civil law tradition is quite different from the common law tradition,82 bankruptcy law is well known in that tradition. Bankruptcy laws function effectively in every Continental Western European country. While some of these laws are somewhat similar to the bankruptcy law in the United States, others are quite different. The importance of the civil law tradition in the CEE countries appears principally in the details of the bankruptcy laws and how they function in these countries, in comparison with how they function in the United States (which is beyond the scope of this Article): in that effort we must keep in mind the differences between a common law and a civil law system.

B. STATUTORY STRUCTURES

The extent to which the legal foundations necessary for a market economy exist in the CEE countries today varies throughout the region. Generally, the countries fall into two groups: the Central European countries that had market economies and Western-style legal systems prior to World War II, and the NIS countries that did not.

1. Central European Countries

Western-style legal systems and market economies existed in the Central European countries, the tier of countries from Poland south to Bulgaria, prior to World War II. In these countries, the Western-style legal systems for the most part remained intact during the communist era. To a substantial extent, the laws governing the business sector were not repealed; instead, they simply fell into disuse. After the fall of communism, it was not necessary to

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78Id.
79Id.
80Id.
81Id.
82One must be careful not to overstate the differences between the civil and common law systems. Particularly in recent decades, there has developed a trend of rapprochement between the two systems. As a result, the differences are more a matter of degree than in kind between the two systems. See, e.g., Ajani, supra note 26, at 117.
begin anew in drafting the laws needed to support a market economy; each of these countries could begin by dusting off the old laws, which mostly remained in force (even though in most countries they had been out of print for half a century), or by readopting the old laws that existed before the communist era. While modernization of the laws was needed in many respects, in each of these countries there was a system in place of Western-style laws and legal traditions to support a market economy and the rule of law.

For example, the Romanian Civil Code, translated from the 1804 Napoleonic Code and enacted in 1862, remains in force today. Similarly, the Romanian Commercial Code, translated from the 1884 Italian Commercial Code and enacted in 1887, is also valid. The legislatures in each of the CEE countries have been active in updating the laws needed to support modern needs. However, legislation is far more urgent in the NIS countries, where there is no such legal structure in place.

In addition, each of the Central European countries has lawyers who are old enough to remember business law systems during the pre-communist era. These lawyers are generally in their seventies today. Each of the Central European countries is relying substantially on these lawyers to help direct it back to market economies. Generally speaking, market economies and Western-style legal systems were strongest in the northern part of Central Europe, and were weaker toward the south.

2. **NIS Countries**

For the NIS countries (formerly part of the Soviet Union), the picture is very different. Imperial Russia was governed by a czar, rather than by Western-style civil and commercial codes, and the czar in principle owned and controlled everything. While there was some statutory support for commerce, it was limited, and the protection of property rights was very weak. The traces of non-communist law in the NIS countries are very ephemeral, because these countries became communist much earlier than the Central European countries, and all sources of Czarist law were repealed early in the

83In Poland, for example, many business statutes (including the 1934 bankruptcy laws) were repealed during the communist era. In 1990, Poland readopted the 1934 bankruptcy laws, and these laws govern bankruptcy in Poland today.

84Accord, Sachs, supra note 39, at 445-47 (recognizing legal traditions from pre-communist times in Poland, Hungary, Czechoslovakia (now divided into Slovakia and the Czech Republic), and Baltic states).

85The bankruptcy portion of the Romanian Commercial Code continued in force until it was replaced by Law 64 of 1993. See CODULUI COMERCIAL §§ 695-971 (1887).

86In general, bankruptcy law does not frequently need substantial revision. The first permanent United States bankruptcy law, enacted in 1898, has been revised substantially only twice, in 1938 and in 1978.

87Sachs, supra note 39, at 447.

88Id.
Imperial Russia included all of Ukraine and Belarus, except for their western fringes (which had been part of the Lithuanian, Polish, and Austro-Hungarian empires during various historical periods).

In the NIS countries, the task of creating a market economy and a legal structure to support it is far more difficult than in the Central European countries. The NIS countries lack substantial traditions of private enterprise, and the picture of a market economy in that region is largely a blank canvas. A substantial portion of the population is still convinced that making a profit should be a crime, and respect for legal obligations is spotty. There is a vast education problem: people must learn how a market economy is supposed to function, and they must come to accept the legal structures that make a market economy possible. Until this learning takes place, neither a market economy nor a system of legal structures on which it is based is likely to take root.

Like the Central European countries, the NIS countries have also decided to adopt the civil law system as their basic legal structure. However, the basic civil codes are not yet in place, and the judiciary needs much training in the operation of a civil law system. Much work remains to be done to bring a Western-style legal system to these countries. Even after it arrives, which will not likely happen for several years at best, there is likely to be less predictability in the outcome of particular legal disputes until the judiciary becomes accustomed to the civil law system and a market economy.

C. THE JUDICIARY

In a region of weak businesses, poor work ethics and insufficient capital, the status of the judiciary is one of the brighter spots. For the most part, the CEE judges are eager to learn Western legal traditions, eager to help in the development of their own laws, and eager to embrace the rule of law in their countries.

The increase in sophistication of the CEE judiciary in the last five years has been dramatic. I taught a Rule of Law seminar (sponsored by the State Department, the United States Information Agency, USAID and the Romanian Ministry of Justice) for some sixty Romanian judges in 1991, a year and a half after the end of the communist era in that country. At that time, the United States government doubted whether there had been a real change in the government (because only the top tier of communist leaders

89 Ajani, supra note 26, at 97 n. 15.

90 Ukraine, in fact, had one of the earliest civil codes, during the era of the Vikings. However, its traces in the Ukrainian economy disappeared many centuries ago.

91 See supra text accompanying notes 70-82.

92 Accord, Sachs, supra note 39, at 446.
had been removed, and the rest remained in place). However, trial level judges from around the country who attended the seminar (at their own expense) showed a remarkable commitment to making democracy work. At that time, however, they had little understanding of what democracy was about, or what was needed to make it effective. In judicial seminars that I have taught in Romania in 1996, where the participants have included some of the same judges, the increase in their sophistication has been quite dramatic. Many of them have a knowledge of their laws and a legal sophistication in the tradition of the rule of law that rivals that of United States judges.

The luster of the judiciary in Central and Eastern Europe is not altogether tarnished. Some judges retain the attitudes of the old days. They refuse to make judicial decisions or they blindly follow the recommendations of prosecutors. Furthermore, the judiciary suffers from low pay scales and inadequate facilities and support. In most CEE countries, many judges (including many of the best and the brightest) are leaving the bench for the much higher incomes that lawyers now enjoy in those countries.

The status of the judiciary in Romania, to pick an example, is illustrated in its bankruptcy law. In revising its bankruptcy law, the Romanian parliament had to choose someone to hold estate funds in liquidation cases pending distribution to creditors. Given many decades of corrupt government and a society dominated by the secret police, there were few public or private players that the Romanians were willing to trust. The parliament found that the judiciary enjoyed a much higher level of trust than any other segment of the business community. In consequence, the parliament gave the syndic judges (those judges to whom bankruptcy cases are assigned) responsibility for the safekeeping of bankruptcy estate funds pending their distribution to creditors.

In most CEE countries, bankruptcy cases go to trial courts of more general jurisdiction. In the Central European countries, these are generally the higher level trial courts of general jurisdiction. The syndic judges in Romania, for example, are Tribunale judges who are given this specific assign-
ment as part of their judicial duties. Slovakia, in contrast, has specialized courts that handle only bankruptcy cases, and fourteen judges are assigned to these courts. In addition, bankruptcy cases in Poland go to the commercial courts, and in Warsaw there is a specialized bankruptcy section of the commercial court (and at least one judge who handles only bankruptcy cases). In the NIS countries there is a separate system of arbitration courts that have jurisdiction over bankruptcy cases. These courts arose during the Soviet era to resolve disputes between state-owned entities, and thus have some experience and sophistication in commercial matters.98

Although eager and capable, the judiciary in the CEE countries is generally inexperienced in business matters. This is somewhat less true for the arbitration courts. This lack of experience is likely to lead to unpredictable results until the judiciary becomes knowledgeable in handling bankruptcy cases and business matters generally. Judicial supervision of bankruptcy cases involves unique skills not normally employed in other litigation.99 A bankruptcy judge, for example, must be able to review and value the business prospects of an enterprise and to determine whether it has a reasonable possibility of reorganization. The judge must be able to ride herd on inexperienced administrators and liquidators, and to make sure that a bankruptcy case proceeds in an orderly fashion to conclusion and distribution of assets to creditors. These are new skills that even experienced judges lack in the CEE countries. Training is needed to prepare the CEE judges for these new responsibilities.

D. The Bankruptcy Players

In addition to a well-functioning judiciary, a bankruptcy system depends on the participation of other players, who are either absent or inexperienced in the CEE countries.100 Attorneys with bankruptcy experience are needed: more than any other players, they are the ones who make a bankruptcy system function, by directing their clients toward effective resolution of their cases. Auctioneers are needed to assist in the sale of assets, and markets are needed where auction sales can take place. Investment bankers may also be needed.

Under the British system, insolvency cases are managed by accountants, rather than by trustees, as in the United States. The major international accounting firms are busy trying to stake out a similar role for themselves in the CEE countries, with a certain measure of success. They are bringing in

98Such courts existed during the communist era in the Central European countries also, but the courts were unified a number of years ago in most of these countries, and the arbitration courts ceased to exist. A similar unification is now under discussion in Ukraine.
99Clark, supra note 56, at 36.
100See, e.g., Horton, supra note 40, at 31 (Russia).
personnel with insolvency experience from Britain and other Commonwealth countries, and are beginning to fill this niche in the bankruptcy system. Deloitte & Touche, for example, has had its accountants appointed as trustees in a number of large bankruptcy cases in Hungary, and in the liquidation of Latvia's largest bank. However, local experts in administering insolvent estates will have to be developed.

Because the CEE countries are (or want to be) civil law countries, they also need law professors to write treatises and commentaries on bankruptcy law. Such commentaries are beginning to develop in the CEE region.

E. BANKS IN BANKRUPTCY

Banks are generally included in the bankruptcy system in the CEE countries. There is no separate insolvency system for banking or insurance enterprises, such as in the United States. There have been few insurance insolvencies, because the insurance industry is even more undeveloped in the CEE countries than the banking system. However, banks have failed and gone into bankruptcy, and this has posed political as well as legal problems.

None of the bankruptcy laws in the CEE countries except Latvia has any special provisions for bank insolvencies. In addition, in most CEE countries there is no system of deposit insurance, such as that which exists in the United States. Thus, in every bank insolvency, a question is posed as to how the depositors are to be protected. If deposits are not protected, this can lead to a lack of confidence in the banking system, and deposits will quickly dry up. For the most part, however, the public treasury is the only available source of depositor protection, given the absence of deposit insurance.

Banks belong in the bankruptcy system. The United States system of providing a governmental liquidation system for the savings and loan insolvencies has proved extremely costly: it has already cost United States citizens approximately $130 billion for the insolvencies in the savings and loan entities that failed in the 1980s, and may eventually cost as much as $480

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101 Schiffman, supra note 19, at 12.
102 It is not conceivable that the CEE countries will permit foreign accountants to dominate this aspect (or any other) of the bankruptcy business.
103 For the importance of commentary by law professors in a civil law system, see supra text accompanying note 76.
104 See, e.g., TURCU, supra note 19 (text on Romanian bankruptcy law). Professor Turcu is both a law professor and a court of appeals judge in Cluj, Romania.
105 See, e.g., Metzger & Bufford, supra note 1, at 137. In July 1996, Romania moved to close three banks, including Dacia Felix Bank, which at one time held ten percent of all the banking deposits in the country. This raised a substantial political crisis for the banking industry.
106 In Hungary, for example, the government covered the deposits for the first two large banks that failed in 1992. However, when a third large bank failed, the government refused to cover all of the deposits. This decision was very controversial.
107 David G. Savage, High Court Says U.S. Reneged on S&Ls, Must Pay, LOS ANGELES TIMES, July 2,
billion. Much of this expense could have been saved if banking institutions had been liquidated in the bankruptcy system, where trained and experienced liquidators could have accomplished the task at a small fraction of the cost. However, special provisions are needed in a bankruptcy code to handle banking insolvencies. Such provisions would be parallel to those that are in place for stock brokerage firms in the United States. In addition, a government agency is needed, similar to the Federal Deposit Insurance Agency, which administered insolvent banks in the United States before the Resolution Trust Corporation was established. No such statutory provisions have yet appeared in any of the CEE countries except Latvia.

CONCLUSION

The rapid development of bankruptcy law in the formerly communist countries of Central and Eastern Europe places bankruptcy in the lead in the development of legal structures needed for the support of market economies in those countries. However, there are features of both the legal systems and the economic systems in these countries that provide challenges for the implementation of bankruptcy law, and that lead it to take on a different color from what we are accustomed to in the United States. The most important difference is the privatization of state-owned enterprises, and the unique role that bankruptcy law has in that effort.

The economies in the CEE countries have distinctive features that affect the functioning of bankruptcy law in these countries. Privatization is in its beginning stages in most of the countries, and many of the state-owned businesses are insolvent. Because no business was allowed to fail under the communist governments, the lands are full of economic dinosaurs that should be extinct. While markets are generally available in the United States for most assets that need to be liquidated, so that they can be sold by a bankruptcy estate at a price approximating their value in the marketplace, such markets are much less common in the CEE countries. For many kinds of assets in those countries, there are no recognized or readily available markets, and it is far more difficult to sell assets or to determine their fair market value. There are a number of differences in the competitive environment in the CEE countries, which include relatively much larger enterprises with larger impacts from their failure, high inflation, and routine government bailouts for loss-making enterprises. In addition, the larger business enterprises are encum-


108 Rosenblatt, supra note 107, at D1.

bered with "social assets" that provide benefits at company cost that are normally provided by governments in the Western world.

The legal context is also different because each of these countries is (or plans to be) a civil law country, as opposed to a common law country. One of the principal differences that this invokes is that courts are somewhat less powerful in the legal system than are common law courts. For the non-NIS countries, there are systems of laws in place to support a market economy, but they need modernization. For the NIS countries, in contrast, there are no such systems of laws in place and no traditions of market economies or the rule of law: these countries must start at the beginning in forming Western style legal systems. However, the judiciary in the CEE countries is for the most part bright and eager to implement the legal changes necessary to support a market economy. Nonetheless, the judges for the most part know rather little about how such an economy is supposed to function, and need a substantial measure of educational assistance. Further, for the effective functioning of a bankruptcy system, the other bankruptcy players need to be identified and trained in the operation of a bankruptcy system. Finally, the bankruptcy systems that are developing in the CEE countries are complicated by the fact that banks are eligible for bankruptcy, and insolvent banks are going into bankruptcy.

As an increasing number of bankruptcy professionals, including judges, attorneys, and trustees are providing advice and assistance to the CEE countries and other developing countries around the world with respect to bankruptcy law and practice, it is important to keep in mind these differences between the legal and economic systems in the United States and those in these countries. Attention to these differences is necessary to make a contribution to the development of bankruptcy law in other parts of the world where the legal traditions, economic systems, and state of economic development are different from our own.