Draft Law #4188 on Amendments to Certain Legislative Acts of Ukraine regarding introduction of the trust property as a way to secure performance of obligations

The main point of this draft law: a way to secure performance of obligations, according to which the property is transferred to the creditor's trust ownership as a collateral, is introduced as an alternative to the pledge.

The draft law was developed pursuant to:

• Section E of Annex XVII-2 of the Association Agreement between the European Union and its Member States, of the one part, and Ukraine, of the other part.
• Article 6 of the Directive 2002/47/EU of the European Parliament and of the Council on financial security arrangements.
• Paragraph 10 of the Action Plan for implementation of the best practices of efficient and quality regulation as reflected in the World Bank Group's methodology of the Doing Business 2016 ranking (approved by the Decree of the Cabinet of Ministers of Ukraine No.1406 dated 12/16/2015).

The Main Scientific and Expert Administration made a conclusion on the draft law with recommendations to reject this draft law. Observations made in this conclusion are not correct and don't take into account either the content of Ukrainian legislation or the international practice of applying the trust property concept as a way to secure performance of obligations (detailed comments are below).

Comments to the conclusion of the Main Scientific and Expert Administration (HNEU)

(1) HNEU thesis: *"Trust property is not a certain type of the property right by its nature as it is determined in the draft law (Article 5971 that supplements the Civil Code of Ukraine), and should be considered as a type of rights in rem to another's property."*

Comment: HNEU conclusion is wrong, since according to part two of Article 316 of the Civil Code of Ukraine, trust property is a special type of the property right.

Moreover, contrary to the HNEU statement, trust property can't be considered as one of types of another's property rights. Types of another's property rights are listed in Article 395 of the Civil Code of Ukraine and there is no trust property among them.

(2) HNEU thesis: *"Civil law doesn't provide for the variety of property right types with a range of different powers of several owners as reflected, particularly, in Article 316 of the Civil Code of Ukraine, according to which the property right is the right of a person for a thing (assets) exercised on his own will under the law and regardless of will of others."*

Comment: Contrary to the HNEU statement, there are owners with a range of different powers. For example, the owner of the property transferred as a pledge and the owner of the property with no pledge have different powers. Similarly, the owner of property transferred into leasing have powers different from the powers of the rented property owner.

Moreover, even if there were no different powers for different owners in the Ukrainian legislation, it wouldn't meant that these different powers couldn't be introduced by the draft law. By its nature, the draft law is a document changing the legislation / legal system and introducing something new.

(3) HNEU thesis: *"Trust property can't be considered as a common property of two persons (owner and his creditor) since the draft law says that they have different powers and make joint decisions only on regulation of trust property items unless otherwise provided for by the contract of trust property ownership."*

Comment: We fully support the HNEU conclusion. Indeed, trust property is not a common property of two persons. However, no provision of the draft law says that the trust property is jointly owned by two persons.

Moreover, the quoted above HNEU phrase of "common property of two persons (owner and his creditor)" is also a mistake. Under the draft law, the owner of property transferred in trust is the creditor. In other words, the owner and the creditor are the same person but not two different people.

(4) HNEU thesis: *"In terms of the civil law theory, an attempt to consider the trust property as a way to secure obligations as proposed in the draft law is also weak. The problem is that ways of securing obligations are related to the right in personam by its nature, but the trust property – to rights in rem, which are independent institutions of civil law characterized, in particular, by the fact that rights in rem are absolute, when the owner or other person having the right in rem is against an indefinite number of people obliged not to violate their rights, but the right in personam arises among certain persons. In turn, this is a basis for various ways to secure these rights: rights in rem are absolutely secured when a lawsuit is filed against any infringer, while in terms of liability relations, a lawsuit may be filed only against a liability party, because only this party can break them."*

Comment: The trust property concept as a security way doesn't have contradictions with the civil law theory. The trust property concept as a way to secure performance of obligations has even a longer history than the pledge. This concept was called *fiducia* (or better – *fiduciacumcreditore*) in Roman law and since then, has been applied in different forms and three titles (fiduciarytransferoftitle – in English-speaking countries, powiernictwo – in Poland, etc.) in a huge number of countries and continues to be applied until now. Moreover, according to the Directive 2002/47/EU of the European Parliament and of the Council on financial security arrangements, each country-EU member is obliged to ensure the possibility to apply the trust law (titletransfer) as a way to secure the performance of obligations.

In addition to the above, these absolute (in rem) and relative (in personam) civil rights are, of course, different (as well as the ways to secure them), but this doesn't mean that there can't be absolute and relative rights with respect to the same property at the same time. Both absolute rights of the owner and relative (in personam) rights of the leaseholder are applied to the rented property.

(5) HNEU thesis: *"The draft law didn't determine duties of the trustee (creditor) in his relations with the property owner (truster) and his liability for the breach of the relevant contract with the truster."*

Comment: This statement is not true. The draft law determines the duties of the trustee where it is necessary: Art.597-7 (duty to enforce a security), Art.597-8 (duty to notify a debtor; duty to pay out the sum in excess of a selling price over a debt amount to a debtor; duty to submit a report on allocation of funds), Art.597-11 (duty to transfer the ownership to a debtor), etc. General provisions of the Civil Code of Ukraine on liability for the breach of obligations (Chapter 51) and provisions of the contract, under which the trust property is used, will regulate liability for the breach of contract.

(6) HNEU thesis: *"The Administration (HNEU) didn't find it necessary to establish a separate procedure to recover against the trust property items as provided for in the draft law."*

Comment: Unfortunately, the quoted above thesis doesn't contain any arguments. Probably, the HNEU meant that it is needed to apply the procedure of security enforcement. However, it would be hard to do that, because the security mechanism provides for the execution against another's property, but as for the trust property, own assets are sold and this fact eliminates the need for a large number of bureaucratic procedures. It is theoretically possible that the security holder sells assets in his own right, but this case is not clearly determined in the law on pledge.

(7) HNEU thesis: "In addition to the above, conspicuous is the fact that the procedure proposed in Art.5979 that supplements the Civil Code of Ukraine is incompatible with the provisions of the Law of Ukraine "On Moratorium on Recovery of Property of Ukrainian Citizens Provided as Collateral for Foreign Currency Loans."

Comment: The draft law can't be incompatible with the Law of Ukraine "On Moratorium on Recovery of Property of Ukrainian Citizens Provided as Collateral for Foreign Currency Loans" (hereinafter – the Law on moratorium), since this law establishes a moratorium on recovery of secured property but not of trust property.

Probably, the HNEU meant that the draft law contradicts the spirit / idea but not the provisions of the Law on moratorium, but even in this case, it is difficult to accept this statement. Law on moratorium was adopted as a temporary measure designed to regulate relations regarding debts that arose on the basis of foreign currency consumer loans and further devaluation in the past. However, trust property as a security way is a new concept. None of foreign currency loan borrowers transferred his real estate in trust ownership, so his interests are no affected by the devaluation.

The Law on moratorium is designed for operation until the law regulating the issues of the restructuring of problem debts comes into legal force. However, as noted above, there are no problem debts on obligations secured by trust property, so it doesn't make sense to expect for the restructuring.

Moreover, one of the main ideas of this draft law is to provide the crediting parties with a new working security instrument that doesn't have a problem debt burden and records of being used by unconscious borrowers and banking institutions as well as may help restore the crediting.