



Royal United Services Institute  
for Defence and Security Studies



Conference Report

# Anti-Corruption Reform and Business Security in Ukraine

## Glass Half Full?

Sarah Lain and Alisa Voznaya

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Conference Report, October 2015



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# Background

**T**HE CURRENT GOVERNMENT of Ukraine came into office with the monumental task of overhauling a broken system of law and order. This has come not only at a time of extreme economic hardship, but also as the country is fighting foreign-backed separatists in its eastern regions. Ukraine is in great need of foreign investment to ensure its own security. To increase the country's attractiveness to investors, the Ukrainian government, with support from the international community, is attempting to understand, prioritise and address the systemic problems within its political, economic and cultural systems.

Corruption has been the most prominent issue of the reform discussion. This has not only caused huge losses for the state and the Ukrainian people, but it has also been one of the most significant deterrents to outside investors. It has eroded any trust in the country's system of governance. The government has placed tackling corruption at the forefront of its reform agenda. It passed legislation in September and October 2014 aimed at tackling this issue. It has established the National Anti-Corruption Bureau and the National Agency for the Prevention of Corruption. It has initiated reform focused on tackling corruption in the judicial system, public administration, public-procurement system and the energy sector, noting feedback from investors operating in the country. One of the key institutions created has been the Business Ombudsman Council, which was set up in December 2014. This represents an unprecedented commitment by the Ukrainian government to engage with the business community on its commercial grievances, particularly regarding government interference in private-business activities.

One of Ukraine's biggest challenges, however, remains its ability to prove that reform genuinely reflects a sustained change in attitude. This is particularly true regarding attitudes towards the way business should be conducted. Guarantees of rule of law, transparency, accountability and sanction of those that break the rules are crucial to improving the country's international reputation and building trust among foreign investors. This takes time, a factor that the Ukrainian government is acutely aware of. Changes to the country's police force, which saw the hiring of 2,000 educated, young officers trained in the US and Canada, demonstrates the government's awareness that the results of reform must be visible for confidence-building purposes. The government is also aware, however, that there needs to be long-lasting substance behind further reforms impacting business.

It is not enough to simply alter legislation to ensure that mindsets and subsequent actions change towards engaging in corrupt practices. It is necessary to understand the root causes as to why people in government or business engage in corrupt practices, based on critical analysis of the system framework they are operating within. For example, one conference participant we spoke to briefly described the electronic system of randomly assigning court cases to judges in the judiciary, which is aimed at creating transparency and non-bias around which judges hear which cases. This individual said that a claimant can withdraw a claim and resubmit it as many

times as he or she likes 'until they get the right judge'. This reflects the problem that, even when e-justice systems are in place to remove potential biased human intervention in decision-making, such systems can still be manipulated if the underlying cause for such manipulation is not addressed. Such issues will be examined in this report.

Training on the damage corruption causes and how to combat it; genuine and impactful deterrence and de-incentivisation to engage in corrupt practices; liability and accountability for those that violate the law; and enforcement of anti-corruption law are crucial. These measures should extend to all levels of society and it is also essential that education on this issue starts early.

## Conference Outline

RUSI, in association with KPMG, Bryan Cave and the Kiev-based International Renaissance Foundation, held a one-day conference on 17 July 2015 entitled 'Anti-Corruption Reform and Business Security in Ukraine', which sought to address some of the issues mentioned above. The aim of the event was to bring individuals with experience and knowledge of doing business in Ukraine together to unpack how corruption in Ukraine continues to hinder business and undermine the credibility of the country's investment climate. It also gathered perceptions of the adequacy of the Ukrainian government's proposed reforms and their implementation so far within Ukraine's unique cultural and political context. Public officials have already made much commentary on this topic, but this event focused solely on private-sector opinion.

The day's events began with a closed, off-the-record roundtable aimed at private-sector practitioners with recent experience in Ukraine. The majority of the candidates that agreed to speak to us were from the legal sector, but there were also participants from banking and one from defence industry. The roundtable was followed by two public panel discussions.

The event's keynote speaker was former Georgian finance minister, now a Kiev-based European Bank for Reconstruction and Development economist, Dmitry Gvindadze. The first panel focused on the nexus between political corruption and the investment climate, particularly in terms of foreign investors' trust in the market. The panellists have all worked on issues related to corruption in Ukraine. They included:

- Oliver Bullough, investigative journalist
- Daria Kaleniuk, executive director of civil-society organisation, the Anti-Corruption Action Centre
- Marta Jaroszewicz of the Warsaw-based research institute, the Centre for Eastern Studies (OSW)
- Audrey Byrne of McCann FitzGerald Solicitors, an Irish law firm.

The second panel focused more explicitly on corruption in business and its impact on investment security. The panellists included:

- Algirdas Semeta, an economist who was recently appointed Ukraine's business ombudsman
- Olivia Allison, a director from KPMG's Forensic practice
- Irina Tymczyszyn of Bryan Cave law firm
- Jonathan Young of Gryphon Emerging Markets.

This report sets out a summary of the key issues raised by participants of the roundtable, the panels and audience Q&A. It also includes policy recommendations based on private-sector perspectives. For the purposes of confidentiality, we will cite any quotations or direct information from individuals attending the roundtable or from the panel Q&A as being from a 'conference participant'. This report is not intended to express the opinions of RUSI or any of the sponsors of the conference, but rather is a summary of the background and content of the discussions at the conference.

Although some issues raised in this report relate to problem areas of political reform, rather than specifically business or even anti-corruption reform, participants raised them as relevant to trust levels in Ukraine's market.



# Executive Summary

Below we provide a brief summary of the key conference conclusions.

## Reform of the Judiciary

- Conference participants highlighted that the priority area of reform was the judicial system. This does not come as a surprise, given the historical legacy of corruption in this area and the damage such corruption does to public trust in the rule of law. Businesses are deterred by the lack of fair justice they believe they will receive in criminal or commercial disputes in Ukrainian courts, and the favour that they think is granted to business or vested interests close to certain justice or public officials
- Key areas where people wished to see change included implementation of a transparent and meritocratic recruitment process for judges, greater clarity over judges' accountability, and liability and reduction of the risk of political interference in the judicial system. Conference participants also wished to see a reassessment of the structure of the judicial system itself. They felt that the roots of corruption within the judiciary were due to vulnerabilities along the 'chain of command' from the top down that enabled corrupt practices without appropriate oversight. Checks and balances, and channels for reporting suspected or known abuse of position, are key to tackling any vertical integration of corruption in the judiciary. Participation of non-judicial and non-governmental players is recommended in monitoring this. A vetting process should be devised to ensure impartiality as far as possible and that judicial officers have appropriate skillsets
- Public access to court information was also raised as a much-needed reform. This does form part of Ukraine's Judiciary Development Strategy 2015–2020, which was compiled in partnership with the EU. Relevant e-justice measures are set to be implemented by 2017. This should be prioritised, as it will be a useful tool in instilling public and business trust in the judicial system, much like the reform of the police force. It will also encourage public engagement with the justice system as an added layer of accountability.

## Civil Service

- Reform of the civil service and public-administration system was the second political priority noted by conference participants. The Ukrainian government has already passed a bill addressing the civil service, but thousands of proposed amendments to the bill have meant there have been delays in ratification of reform in this area. Civil-service decision-making was flagged as the biggest hindrance to business within this area of reform. A 'Soviet-style decision-making process' burdens the bureaucracy and creates huge inefficiencies, according to one conference participant. Decision-making should be streamlined so that responsibility extends beyond the top tier of officials.

- Furthermore, there needs to be clarity on the expectations of middle- and lower-level civil servants. Emphasis of reform has been on the top layer of government, but this has led to confusion and de-motivation among those lower in the hierarchy. This can be rectified even without legislative reform through training and communication. Without it, staff members suffer from a lack of clarity and, thus, are more vulnerable to corrupt practices.

## Communication

- A running theme throughout the day was a clear lack of awareness regarding the progress that has been made on reform. For example, the Ukrainian government has made significant efforts in reforming legislation on the very issues that were raised during discussion, such as the process by which judges are appointed. It has also submitted numerous proposals to the Venice Commission, the Council of Europe's advisory body on constitutional matters. It has taken the Venice Commission's advice on examining changes to the constitution to maximise the effectiveness of provisions in judicial-legislation reform. The Ukrainian government needs to communicate this progress to the public, and specifically investors, highlighting what legislative reform will mean in practice. The next step is to highlight what institutions and mechanisms will be in place to ensure legislation is enforced. It is also crucial that this information is provided in Ukrainian, Russian and English. An overview of what these processes entail should be included in the National Reform Council portal for public access.

## Enforcement

- A concern raised by many conference participants was that legislative reform, although certainly a first step, was not the core test of reform success. Legislation must go hand in hand with measures to ensure fair accountability, liability and enforcement. This was explicitly raised by one conference participant who said 'we need more action rather than declarations ... people need to know they will go to jail if they bribe'
- Although simply arresting more people is not the solution, particularly given the historical politicisation of arrests under the previous government, the lack of trials in certain cases is worrying. Georgian reformer David Sakvarelidze, who has been appointed deputy prosecutor general, publicly complained about what he perceived to be lenient and low bail terms for certain individuals accused of embezzlement. He said this endorsed the idea that crooks can 'steal a million – pay a tenth part and chill out'.<sup>1</sup>

## Changing Mindsets

- Real and consistent enforcement will help to genuinely change mindsets towards corruption's role in doing business in Ukraine. Conference participants flagged, for example, that government bodies such as tax authorities are instrumental in creating a structural framework that often *requires*, or at least encourages, business to engage in corruption

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1. Unian, 'Sakvarelidze: Bail for Arrested Prosecutors "Miserable"', 8 July 2015, <<http://www.unian.info/politics/1098383-sakvarelidze-bail-for-arrested-prosecutors-miserable.html>>, accessed 14 October 2015.

simply to exist in Ukraine's business environment. Addressing the causes of the underlying issues behind this is key to removing the incentives and motivations behind such practices. For example, one conference participant mentioned that corporate structures in Ukraine, in which offshore structures or a confusing array of subsidiaries are used, are often used not to mislead investors, but to protect the business against tax inspections or, more concerning, tax raids. It is crucial that reforms to the framework of doing business are co-ordinated at the central, regional and local levels

- Providing for a culture in which both government and businesses take their responsibilities seriously in terms of deterring engagement in corrupt practices, and protecting those that report malfeasance in business, are crucial. Outlets and protection for whistleblowers were identified as a key provision to support this. This would also facilitate the public-private partnership between government and business that is required to tackle corruption in business more effectively
- Any reform effort should be accompanied by relevant anti-corruption and ethics training. This should begin in schools and universities to ensure that the workforce is prepared to tackle corruption. Educating the next generation of civil servants and judges on the damage corruption causes is key. This should also be coupled with de-incentivising engagement in corrupt practices by implementing a meritocratic, competency-based promotion system and appropriate remuneration.

## International Co-operation

- A key area of discussion from the day's event examined what the international community could be doing to further assist Ukraine in its battle against corruption. Although the international community has already provided immense support to Ukraine in its effort to become more independent in its economic affairs, there are specific areas where it could review its own domestic systems to assist Ukraine in combatting embezzlement and fraud. The UK needs to put more checks in place to assess the source of funds to its real-estate market. The lack of rigorous due diligence on property buyers and the ability to own property through corporations registered offshore facilitates sheltering of illicit funds through the UK
- International companies operating in Ukraine must support government anti-corruption legislation and embed due-diligence principles into company policies and procedures, thus sending an anti-corruption message from the business community. In turn, the Ukrainian government must instil the importance of reporting corrupt activities by protecting whistleblowers and prosecuting wrongdoers. Such co-operation will signal that neither business nor the government is prepared to tolerate corruption, and that such behaviour will be detected and punished
- The Ukrainian government should have a more co-ordinated approach in facilitating co-operative assistance from foreign governments aiding in the process of asset recovery. For example, in one case the assets of a former Ukrainian government official were frozen by the Serious Fraud Office in the UK due to suspicions that they included proceeds of criminal activity. The UK later had to un-freeze the assets because of a lack of investigation into the origins of this wealth in Ukraine. Thus, the challenges of the judiciary impede international recovery efforts as well.



# I. Government-Focused Reform

**A**LTHOUGH THE EVENT'S discussions focused on reforms relevant to Ukraine's investment climate and business security, inevitably certain political reforms were raised as integral to improving investor confidence.

## Reform of the Judiciary

One of the key takeaway messages from the conference was the need to reform Ukraine's judicial system. Conference participants stressed that the existing opacity of the judicial system contributes to the abuse of power by judges, thus contributing to insecurity in the Ukrainian business environment. If individuals and businesses cannot rely on the courts to settle disputes, there will continue to be strong reservations about investing in this country. The barriers to effective reform were perceived to extend beyond the introduction of relevant legislation, which would introduce clarity and transparency to judicial appointments. Participants said that, alongside legislative provisions, policy-makers in Ukraine should consider fortifying these regulatory changes with the introduction of checks and balances, expanding public access to court information, strengthening enforcement mechanisms and continuing to raise awareness of anti-corruption behaviours among Ukraine's citizenry and businesses.

### Recognition of Underlying Issues

The potential for judges to abuse their position with a lack of clear liability and sanction, the judge appointment process and the failure to mitigate the politicisation of judicial decisions were flagged during our discussions as key elements that undermine the judicial system's effectiveness and facilitate corruption.

Addressing these issues within the broader reform of the judiciary has been a key priority in the Ukrainian government's overall packages of reforms. Despite these efforts, there appears to be a general lack of awareness of the progress made so far. The Ukrainian government has passed bills containing proposals to reform the judicial system, which have in turn been examined by the Venice Commission, the Council of Europe's advisory body on constitutional matters. The Ukrainian government has also initiated constitutional reform, based on recommendations already received from the Venice Commission. There has been little communication on these efforts. By describing the complexity of the consultations the Ukrainian government has sought on amendments to the judicial laws, expectations of the pace of reform could be better managed. Below we outline some of the progress on attempts to at least address issues explicitly raised on the subject of judicial reform during the conference.

In February 2015 the Rada, Ukraine's parliament, adopted the Law on Ensuring the Right to a Fair Trial. The aim of this law, according to the Ukrainian government, is to improve the

competence and professionalism of judges; provide effective anti-corruption mechanisms; ensure the independence of judges; eliminate political influence in the judiciary; secure access to justice, transparency and openness of trial; and strengthen the role of the Supreme Court to increase consistency.<sup>1</sup> This law includes amendments to the Code on Administrative Offences, to different procedural codes, to the Law on the High Council of Justice (HCJ),<sup>2</sup> and also to the Law on the Judicial System and the Status of Judges.

Shortly after the Ukrainian government adopted this law, it requested an opinion from the Venice Commission, which was issued in March 2015. The document praised many of the proposed amendments to existing judicial laws and, in particular, Ukraine's willingness to examine what it deemed as necessary amendments to the constitution.<sup>3</sup> For this purpose, Ukraine set up a constitutional-reform commission in March 2015, and since then it has submitted proposed constitutional amendments to the Venice Commission for review.

### Liability of Judges

One of the key positives of the Venice Commission assessment pertained to the disciplinary liability of judges. This is outlined in the Law on Amending the Law on the Judicial System and the Status of Judges. The law covers a variety of areas that specifically target criticisms raised during the conference. For example, disciplinary liability may arise in cases of:<sup>4</sup>

- 'Continuous or a single gross violation of the rules of judicial ethics defaming the justice ship and degrading the authority of public justice'
- 'Use of the status of a judge with the aim of illegitimate acquisition by the judge or a third party of material or other benefits'
- 'A demonstration by a judge, or by members of their family, of expenses exceeding incomes of the judge or incomes of their family members'
- 'Detection of a disparity between the living standards of a judge and property and incomes available to them and members of their family, as established by obtained by monitoring of the judge's lifestyle'
- 'A demonstration of unfair behavior in the course of their integrity examination by an authorized body'.

The key remaining Venice Commission criticism against liability was the provision that a 'violation of oath', which a judge takes upon appointment, was grounds for dismissal if confirmed against a

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1. European Commission for Democracy through Law (Venice Commission), 'Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine', Opinion No. 801/2015, 23 March 2015.

2. This is an advisory judicial body that advises on the appointments and dismissal of judges and disciplinary proceedings.

3. Venice Commission, 'Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine', paras 91–93.

4. Venice Commission, 'Draft Law on Amending the Law on the Judicial System and the Status of Judges of Ukraine', Opinion No. 792/2015, 9 March 2015.

judge. This was considered too vague.<sup>5</sup> To amend this would require constitutional change. The Ukrainian government demonstrated its dedication to taking the Venice Commission's advice and it included abolition of this from the disciplinary proceedings in proposed constitutional amendments submitted in July 2015.<sup>6</sup>

### **Appointment of Judges**

Another positive outlined by the Venice Commission pertained to amendments over the process by which judges are appointed, particularly temporary judges appointed for the first time. The lack of transparency around how judges are appointed was one of the key concerns raised regarding Ukraine's judicial system at RUSI's conference. According to the draft law on Amending the Law on the Judicial System and the Status of Judges, this now includes a qualification examination, the results of which will be published on the website of the judiciary; an interview by the High Qualification Commission of Judges (QCJ);<sup>7</sup> anti-corruption and integrity vetting; year-long 'preparation' training at the National School of Judges;<sup>8</sup> a qualification examination; and a competitive process overseen by the QCJ to fill vacant judge positions. The HCJ, on the basis of a recommendation of the QCJ, then recommends a candidate to Ukraine's president for appointment.<sup>9</sup> The QCJ is a body composed of judges and formed by the Council of Judges of Ukraine.<sup>10</sup> The Venice Commission said 'generally, the procedure for examining and ensuring the suitability of candidates is elaborate and appropriate and appears to provide for good guarantees to avoid favouritism, nepotism or corruption'.<sup>11</sup>

The question of whether judges that had served under former President Viktor Yanukovich's government should be fired, given the entrenched corruption during the period of his rule, was raised in the roundtable discussions. The majority of people felt that judges should reapply for their jobs based on new, more transparent selection criteria. One participant said 'we should be careful in just firing those seen to be corrupt and instead invest in training and changes of mentality'. This question has also been addressed in legislative reform, but there is little knowledge on this. There is a section submitted to the Venice Commission talking about assessments of current sitting judges, although this is not well known. This should be legislated

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5. Venice Commission, 'Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine'.
  6. Venice Commission, 'Preliminary Opinion on the Proposed Constitutional Amendments Regarding the Judiciary of Ukraine', Opinion No. 803/2015, 24 July 2015.
  7. This is a body created by the Council of Judges to screen candidates for their first judiciary position and submit recommendations on the appointment of lifetime officials. It consists of six judges, or retired judges, and three public representatives.
  8. This is a state training and research institute for the judiciary. It operates in line with its law and charter, to be approved by Ukraine's Council of Judges.
  9. Venice Commission, 'Draft Law on Amending the Law on the Judicial System and the Status of Judges of Ukraine'.
  10. This is a body that enforces decisions made by the Congress of Judges, which in turn is the highest judicial oversight body.
  11. Venice Commission, 'Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine'.

for under transitional Article 6 of the Law on the Judicial System and the Status of Judges.<sup>12</sup> This article says that a qualification evaluation will be given within a certain timeframe and, if a judge does not pass, he or she will be dismissed and sent for training at the National School of Judges. He or she will then repeat the qualification examination. This demonstrates a balance between simple lustration and all judges having to reapply for their jobs.

### **De-Politicisation of the Judiciary**

Despite the government's efforts to introduce greater transparency into the judge-appointment process, a criticism remained regarding lifetime judge positions. This mainly related to the involvement of a political body, in this case parliament, in the decision-making process. The Ukrainian government has also been quick to react to this. For a lifetime appointment, the law reads that a candidate should submit a written application to the QCJ. This body reviews the application and if the decision is positive, it recommends the appointment of the candidate to parliament.<sup>13</sup> The Venice Commission recommended against parliament having this role in electing judges, due to the potential politicisation of the decision. To amend this would again require a change to Ukraine's constitution. This has subsequently been addressed by Ukraine in a submission to the Venice Commission entitled 'On the Proposed Constitutional Amendments Regarding the Judiciary of Ukraine' in July 2015.<sup>14</sup> Judges will no longer be elected by parliament but instead will be appointed by the president, from an explicitly ceremonial perspective, upon the recommendation of the HCJ.

The Venice Commission also criticised other potential vulnerabilities regarding political involvement in judicial decisions, advocating greater separation of powers between the justice system and the executive branch. One pertaining to the role of the president appears to be outstanding in Ukraine's reform. A judge within a five-year probationary period, or elected for an indefinite period, may be transferred to another court by the president of Ukraine. This transfer should be competitively contested. However, no contest is required in the case of the reorganisation, liquidation or termination of the court where that judge holds the position. The law stipulates that the president create and dissolve courts, upon proposals from Ukraine's State Judicial Administration. The Ukrainian government emphasised that the president's role in establishing and liquidating courts is purely ceremonial. However, the Venice Commission still raised concerns about the power granted to the president in such decisions. Lessening the president's role generally in judicial matters was recommended.<sup>15</sup> It appears this has not yet been addressed in constitutional-reform proposals.<sup>16</sup>

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12. *Ibid.*

13. Venice Commission, 'Draft Law on Amending the Law on the Judicial System and the Status of Judges of Ukraine'.

14. Venice Commission, 'Preliminary Opinion on the Proposed Constitutional Amendments Regarding the Judiciary of Ukraine'.

15. Venice Commission, 'Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine'.

16. Venice Commission, 'Preliminary Opinion on the Proposed Constitutional Amendments Regarding the Judiciary of Ukraine'.

The Venice Commission also criticised the composition of the HCJ, again highlighting concerns over political influence. This body is formed of twenty individuals. They are appointed by a group of judicial bodies, but the parliament and the president have the right to appoint three representatives each. In addition, the chairman of the Supreme Court of Ukraine, the minister of justice and the prosecutor general are ex-officio members of the HCJ. The Venice Commission proposed that a majority of the HCJ should be judges elected by their peers, which also would require constitutional reform.<sup>17</sup> Again, this has been addressed in recent proposals. The Ukrainian government already proposed that the HCJ should be made of nineteen individuals, and nine of these should be judges elected by the Congress of Judges,<sup>18</sup> which previously only contributed three. The president would continue to appoint three representatives, but the parliament would cease to have a say and the minister of justice would be removed from the HCJ. Demonstrating how complex the process of reform is, the Venice Commission in fact criticised the removal of the parliament from the decision-making process, claiming that this gave too much weight to the president. The suggestion was that ‘the President’s power to appoint members of the HCJ should therefore be counterbalanced by the participation of the Verkhovna Rada [the Ukrainian parliament] in the process of forming the HCJ’, but parliament’s candidates should be elected by a qualified majority to mitigate politicisation.<sup>19</sup>

The Venice Commission also objected to the legal consent of the parliament required for lifting judges’ immunity, since this involves a political body in a decision concerning the status of judges and their immunities.<sup>20</sup> Instead, this should be the role of an independent judicial authority. This would require an amendment to the constitution, which the Ukrainian government has begun reviewing under the draft legislation On Introducing Changes to the Constitution of Ukraine (On Immunity of the Members of the Ukrainian Parliament and Judges). This shifted the power to lift judges’ immunity from the parliament to the HCJ.<sup>21</sup>

## Enforcement

There is clearly acknowledgement on the part of the Ukrainian government as to the key issues within the judicial system. The Ukrainian authorities are particularly aware of the lack of public trust in the transparency and fairness of the system. This was explicitly stated at a meeting in Paris of representatives from the Venice Commission and the Ukrainian authorities. The Ukrainian authorities emphasised almost ‘complete lack of public confidence in either the

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17. Venice Commission, ‘Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine’.

18. Each court of general jurisdiction elects delegates to this body through a secret ballot. Its role is to consider issues on judicial autonomy in accordance with the law.

19. Venice Commission, ‘Preliminary Opinion on the Proposed Constitutional Amendments Regarding the Judiciary of Ukraine’.

20. Venice Commission, ‘Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine’.

21. Venice Commission, ‘Opinion on Draft Constitutional Amendments on the Immunity of Members of Parliament and Judges’, CDL-AD(2015)013, 19 June 2015.

honesty or the competence of the judiciary.<sup>22</sup> A point made in discussions during our conference was that legislating to address this problem is only part of the solution. Implementation and, most importantly, enforcement are crucial to a genuine transition. This was a point explicitly raised by one conference participant. One participant said ‘we need more action rather than declarations ... people need to know they will go to jail if they bribe’.

It is, of course, important to protect the independence of the judiciary against political interference, but it is also crucial to combat corruption within the judicial hierarchy itself. Vertically integrated vested interests and internal pressures within the ‘chain of command’ were raised as concerns by legal professionals with experience in Ukraine. One participant said ‘judges can simply buy out their freedom’ when caught behaving inappropriately. Another said:

it is necessary to consider whether the source of corruption is coming from further up the chain of command in the judiciary; it may be that the head of the particular court has taken a bribe which is then distributed to lower members of the Judiciary or they do not receive any part of the bribe but are simply directed by the superior as to the outcome [of the trial].

This issue also goes beyond judges. Understanding the nexus between lawyers and the legal system is also key in oversight and monitoring. One legal professional said ‘it is not unusual for lawyers to inflate their bills for legal services and from the inflated amount they discharge the relevant bribe ... recently judges are negotiating the amounts of their bribe directly and that the “cost” has generally decreased’.

Furthermore, maintaining the momentum behind the idea that judicial reform is long-term and not a short-term response to governmental change is important. For example, one conference participant said a judge from Kiev that the participant had spoken to noted that local appellate judges have now stopped taking bribes ‘until the dust is settled’, indicating that they are hedging to see how serious the government is about reform. According to this participant, another judge said that ‘it is now becoming again important to be affiliated with some business group or powerful family to be appointed as a first-time judge for five years’, indicating that adaptations to the system may already have taken place to circumvent reform efforts. The legislation outlined above should go some way in combatting this with a rigorous and transparent recruitment process, and clear disciplinary procedures for judges that violate the law. However, given the strong historical legacy of abuse of position in the judicial system of Ukraine, this must be considered in the enforcement of legislation and efforts to incentivise *against* engaging in corruption.

One of the key areas in enforcement that needs particular attention, and was raised during the conference, pertains to the Prosecutor General’s Office (PGO). The reform of this office has been addressed as part of the Law On the Prosecutor’s Office, adopted in October 2014. Georgian reformer David Sakvarelidze has been appointed deputy prosecutor general, and the Department for Reforms and Performance Quality Assurance has been established to oversee

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22. Venice Commission, ‘Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine’.

anti-corruption reform within the PGO. However, media and civil-society reports raise serious concerns regarding the investigatory body's operations, citing the internal schism between old-guard officials intent on maintaining the status quo and reformers.

Several recent cases highlight the contradictory approaches used by the PGO. Sakvarelidze, alongside Ukraine's security service, recently co-ordinated a search of the Investigation Department of the Prosecutor General. As a result, the Ukrainian authorities seized \$500,000, jewellery, sixty-five diamonds, securities and a Kalashnikov rifle, which were reported to have been extorted by the Investigation Department's officials from a local business.<sup>23</sup> The complaint was filed with the authorities by the local business in question. The search and seizure led to the arrest of deputy head of the Main Investigation Department, Volodymyr Shapakin, and the deputy prosecutor of the Kiev region, Oleksandr Korniets.<sup>24</sup> Following the arrests, acting Prosecutor General Volodymyr Huzyr opened a criminal case against the operation, claiming it violated a law on 'seizures of state institutions', leading some to question whether Huzyr was protecting malfeasant public officials. This intervention has undermined the credibility of the investigations into the two officials. Civil-society groups believe that some individuals within the PGO are actively 'sabotaging' reform efforts, with key reforms, like the introduction of a test for new prosecutorial recruits, being blocked.<sup>25</sup> A lack of faith in the impartiality of the PGO will greatly hinder the willingness of businesses to enter Ukraine's market. Conference participants mentioned that they were cautious of the suggestion that 'someone needs to go to jail' as proof that the system was enforcing the law. However, the PGO reflects a worrying trend of protectionism against allies that may still be prevalent within the judicial system as a whole. There have been several failed attempts to prosecute individuals associated with the previous government, and, although there may be various reasons for these failures, these will add to the perception that the underlying prosecutorial system has not changed.

Although there are clearly issues within the judicial system, these examples and perceptions also highlight the progress that has been made in terms of reform. The fact that there is a force for reform within the PGO, which appears to be engaging with civil society to lobby its reform agenda, is already an improvement. Avtomaidan and the Anti-Corruption Action Centre, two prominent civil-society organisations, protested in July 2015 against what they perceived to be pressure from Huzyr in the case involving Shapakin and Korniets. However, as long as there is the perception that vested interests are stalling prosecutions and hindering reform implementation on behalf of their own interests and those of their allies within this organisation, businesses will be deterred from investing.

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23. Johannes Wamberg Anderson, 'Two Prosecutors Arrested in Bribe Sting', *Kyiv Post*, 7 July 2015.

24. Unian, '\$ 500,000 Discovered during Searches of Arrested Prosecutors', 6 July 2015, <<http://www.unian.info/politics/1097419--500000-discovered-during-searches-of-arrested-prosecutors.html>>, accessed 9 October 2015.

25. Oleg Sukhov and Veronika Melkozerova, 'Activists Say Prosecutor General, Who Has Failed to Battle Corruption, Continues to Sabotage Change', *Kyiv Post*, 17 August 2015.

## Perceptions of the Reform Process

Participants at the conference welcomed the prospects of judicial reform, with most speakers emphasising the significance of the judiciary in creating a stable business environment. Several participants were relatively optimistic with regard to the implementation of reforms, with one speaker stating that reform means that it is now possible to win court cases that 'you never could before'. Others were more reserved in their praise, citing the fact that access to fair judicial processes remained within the remit of cases focused on state-owned companies, partly as a result of the popular public support they receive. One speaker said that 'nothing has changed' with regards to private companies, and particularly foreigners, trying to recover their money through the courts in Ukraine.

As mentioned above, some of the participants emphasised the importance of the reform-programme's implementation and subsequent enforcement as opposed to an over-concentration on regulation and legislation. Enforcement is what will make the most impact for businesses operating in Ukraine. Even when systems are set in place to enhance transparency, they should be constantly monitored with the intent of identifying potential corrupt practices. For example, one legal professional with extensive experience in Ukraine said that even the electronic system of assigning judges to certain court claims can be manipulated on behalf of the claimant. This person said that a claimant can withdraw a claim and resubmit it as many times as he or she likes 'until they get the right judge', who the claimant may know will rule in a certain way. Another legal professional simply said 'cases are supposed to be automatically assigned to a particular judge but are not'. This theme was reiterated by the Venice Commission opinion, which stated 'A good law is certainly a good preliminary step in this respect but the political will and effective implementation of the amendments are necessary elements in order to prevent the reform from remaining a mere declaration.'<sup>26</sup>

Apart from enforcement, training and de-incentivising engagement in corrupt practices within the judicial system are key to maximising the impact of reform on breaking the mindset of acceptance towards corruption. Increasing judges' pay is a way to reduce the temptation to engage in bribery, which can be further strengthened by a meritocratic system of promotion. In March 2015, President Petro Poroshenko made efforts to amend laws lifting restrictions on pay for prosecutors and judges.<sup>27</sup> Training has in part been addressed by the government's plans for provisions through the National School of Judges, but there must be specific anti-corruption training tailored to the issues experienced in the judicial system. Making provisions for whistleblowing within the judicial system would be a way to help protect those that are subject to pressure.

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26. Venice Commission, 'Joint Opinion on the Judicial System and the Status of Judges and Amendments to the Law on the High Council of Justice of Ukraine'.

27. Igor Shevchuk, 'Poroshenko razreshil povyshat zarplatu deputatam, ministram y sudyam [Poroshenko Allows a Salary Increase for Deputies, Ministers and Judges]', *Podrobnosti*, 13 March 2015, <<http://podrobnosti.ua/2021771-poroshenko-otmenil-ogranichenija-zarplaty-deputatov-ministrov-i-sudej.html>>, accessed 14 October 2015.

The issue of transparency of judicial information was also raised during the conference. Publication of court notes, electronic notifications of cases, including their time and date, and also hearing notices were flagged as necessary to improve transparency in the judicial system. Increasing the use of e-justice was set out as part of the Ukraine Judiciary Development Strategy 2015–2020. This is an initiative supported by the EU which sets out necessary steps to create a more transparent, fair and efficient judicial system.<sup>28</sup> The EU has stated that by the end of 2017, Ukraine should have operational systems for full electronic case management and tracking; e-notification; random case assignment; audio and video recording of hearings; a legislative database information system; and centralised and local registers. E-justice can still be manipulated, however, and monitoring must be in place to ensure the information entered, and the mechanisms through which electronic systems work, are not open to abuse.

### Conclusions and Recommendations

- The conference participants universally agreed that without assurances that businesses will receive fair justice in commercial or criminal disputes, there is little hope of new investors entering the Ukrainian market. The Ukrainian government should improve its communication regarding the judicial reform it plans to introduce, and on which it has already consulted the Venice Commission, including that of the constitution. Many of the recommendations and suggestions on aspects of Ukraine's reform programme and governance, made by people we spoke to, have in fact already been addressed in reform legislation. In particular, information regarding the new process to appoint judges, proposed transparency and clarity around disciplinary procedures and efforts to tackle political interference in the justice system should be highlighted. The fact that the reform is based on the government's explicit acknowledgement of the need to restore public trust, including that of business, in the judicial system is a key message. How an improved judicial system will positively impact the investment climate should be a clear part of this communication
- A number of legal professionals suggested that the judicial hierarchy and 'chain of command' as a whole needs restructuring, stressing the importance of increasing oversight and separation of powers within the system. Although proposed reform from the Ukrainian government does address the issue of political interference in the judicial system, and seeks to ensure the independence of judges, the corruption of judges and the judicial hierarchy itself remain a concern. Reform does tackle the accountability of judges and proposes a system which aims to assess Yanukovich-era personnel. However, the risk around internal corruption within, for example, the HCJ and QCJ, which are responsible for managing the recruitment process of judges and assessing candidates, is still a vulnerability. Furthermore, this extends beyond just judges, with lawyers and other legal professionals potentially implicated in corrupt practices. Cronyism and conflicts of interest have been historically pervasive in Ukraine's judiciary. We heard worrying comments that it is still essential to be affiliated with a specific business group or powerful

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28. Council of Judges of Ukraine, 'Ukraine Judiciary Development Strategy 2015–2020', 11 December 2014, <[http://www.justicereformukraine.eu/wp-content/uploads/2015/02/Karen\\_en.pdf](http://www.justicereformukraine.eu/wp-content/uploads/2015/02/Karen_en.pdf)>, accessed 9 October 2015.

family when looking to be appointed as a first-time judge. Providing clear messaging around the consequences of abusing one's position, accompanied by real enforcement, is key. This is particularly relevant to the reform of the PGO. An independent body of non-judges that is heavily vetted should be considered to monitor judicial activities and decision-making, containing civil society and legal experts

- Removing the motivation for abusing one's position within the judiciary is also of the utmost importance. Pay increases and anti-corruption training were highlighted in the roundtable as ways to begin combatting this. In August 2015, the Ukrainian government piloted a relevant initiative with the newly retrained police force. The new police officers are paid more than double their previous salaries,<sup>29</sup> with a strict policy against bribe-taking.<sup>30</sup> Investment in training and, crucially, monitoring should complement any reform. Anti-corruption and ethics training should start early within the school system and at universities in order to transform existing belief systems. This training should extend to users of the judicial system, including businesses, so that users can recognise signs of potential practices taking place. This would allow users to recognise when something has gone wrong and raise it to the relevant authorities, thus adding a layer of accountability. Some of the legal professionals at the conference listed the following red flags, which may suggest that court cases may have been tainted by corruption: a judge that continually delays hearings due to alleged illness or holiday; court sessions being held in private; delays in court orders appearing on the register, and thus rendering them unenforceable; one party being invited into chambers; and even the simple factor of continually losing cases without a clear understanding of why. It would be beneficial to create an independent disciplinary board to monitor such concerns, providing literature and policy reviews in light of this
- Transparency was a repeated theme when discussing the legal system. Suggestions made included public access to all court information; electronic notification of cases, including when and where they are taking place; notice of hearings; and avoidance of any closed proceedings except in circumstances where justice would be adversely affected. Certain measures, such as public access to information on hearings, have been included in the Ukraine Judiciary Strategy 2015–2020.<sup>31</sup> The progress of this should be better publicised. One legal practitioner suggested that public participation in the legal process would also help to combat corruption. Introducing trial by jury would assist in evolving and informing civil attitudes towards, and awareness of, Ukraine's judicial system. As this roundtable participant mentioned, it is 'not as easy to fix' a trial by jury. Developing the country's 'legal consciousness' could also be a way to help ensure that the accountability of judges is monitored.

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29. Igor Serov and Kristina Zelenyuk, 'Reforma militsii v politsiyu: vedomstvu ostavili sledstviye, no GAI ischeznet [Reform of the Militsiya to the Police: Investigation Department Remains, but GAI Disappears]', *Sevodnya*, 3 July 2015, <<http://www.segodnya.ua/ukraine/novaya-policiya-uzhe-pod-voprosom-628543.html>>, accessed 14 October 2015.

30. Roman Olearchyk, 'Kiev's Revamped Police Force Takes to Streets to Rebuild Trust', *Financial Times*, 17 August 2015.

31. Council of Judges of Ukraine, 'Ukraine Judiciary Development Strategy 2015–2020'.

## International Co-operation

A topic of discussion that came up on numerous occasions during the event was Ukraine's co-operation with the international community, particularly regarding asset recovery. Specifically, participants focused on London's role as a hub for proceeds of corruption.

There are two key relevant aspects of this international co-operation. First, Ukraine needs to be better prepared and more willing to co-operate with foreign governments and law-enforcement agencies to investigate proceeds potentially linked to corrupt practices. A reported lack of engagement by Ukraine has led to mistrust and abandonment of cases requiring international co-operation. For example, in April 2014 the UK's Serious Fraud Office blocked assets allegedly linked to a former Ukrainian public official and launched a criminal investigation into the source of funds for these assets to establish if they were acquired illegally.<sup>32</sup> The progress of the investigation was dependent on co-operation with Ukraine's prosecutor general in providing evidence. Civil-society representatives pointed out in the press at the time that the investigation would cease and the assets would be unfrozen.<sup>33</sup> One article quotes a Serious Fraud Office spokesperson allegedly saying 'we were not provided with the evidence by authorities in the Ukraine necessary to keep this restraint order in place.'<sup>34</sup> Another media report stated that this had been due to delays from the PGO in passing documents to the Serious Fraud Office.<sup>35</sup>

Conference participants also flagged the UK government's particular responsibility for its role in providing a place for proceeds of corruption to exit Ukraine. London's real-estate market can be used as a way to mask origins of funds, due to low due-diligence checks on buyers and the ability to buy properties through corporations, which are often 'owned' by nominees or proxies.<sup>36</sup> Transparency International has estimated that £122 billion of property in England and

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32. RBK Ukraine, 'Vliokobritaniya zakryla ugovnoye proizvodstvo otnositelno aktivov eks-glava Minekologii Ukraini Zlochevskogo [Great Britain Closes Its Criminal Case into the Assets of Ukraine's Ex-Head of Ministry of Ecology Zlochevsky]', 22 January 2015, <<http://www.rbc.ua/rus/news/velikobritaniya-zakryla-ugolovnoe-proizvodstvo-otnositelno-22012015120400>>, accessed 14 October 2015.
  33. Korrespondent, 'Velikobritaniya arestvovala aktivy ekc-ministra ekologii Zlochevskogo [Great Britain Froze Assets Belonging to Ex-Minister of Ecology Zlochevsky]', 31 October 2014, <<http://korrespondent.net/ukraine/politics/3438807-velykobrytanyia-arestovala-aktyvy-eks-mynystra-ekolohyy-zlochevskoho>>, accessed 14 October 2015.
  34. John Helmer, 'The Hunt for Berisma – When the Pack of Hounds is Missing its Master, the Fox Escapes', Dances with Bears, 19 February 2015, <<http://johnhelmer.net/?p=12755>>, accessed 9 October 2015.
  35. RBK Ukraine, 'Pravookhraniteliy Velikobritanii zakroyut ofis v Ukraine iz-za zatyagivaniya GPU delo Zlochevsogo [British Law Enforcement will Close its Office in Ukraine as a Result of Delays by the Prosecutor General's Office in the Zlochevsky Case]'. 8 July 2015, <<http://www.rbc.ua/rus/news/pravookhranitelnye-organy-anglii-zakroyut-1436353088.html>>, accessed 14 October 2015.
  36. Nick Maxwell, 'From Russia with Cash', Transparency International UK, 8 July 2015, <<http://www.transparency.org.uk/rss/12-blog/1295-from-russia-with-cash/1295-from-russia-with-cash>>, accessed 9 October 2015.

Wales is owned by companies registered in secretive offshore jurisdictions.<sup>37</sup> One conference participant highlighted the complexity of certain schemes by saying there are ‘chains of companies, then buffer companies, then buffers of buffers, which mean the detection of corruption is increasingly difficult’. UK Prime Minister David Cameron recently acknowledged this as a major issue, and pledged to publish Land Registry data on which foreign companies own properties in England and Wales. However, this in itself will not be sufficient, given that offshore jurisdictions are where the trail often stops and that even these foreign companies may be owned by proxies and nominees.

### Conclusions and Recommendations

- The Ukrainian government should better co-ordinate its response to international offers to help co-operate with foreign governments, where appropriate, on processes such as asset recovery. The challenges of divisions between the executive and the PGO appear to impede international recovery efforts
- Ukraine and the UK in particular should co-ordinate more closely on combatting the potential use of the UK market to funnel illicit funds from Ukraine. The UK should examine in more detail how it can prevent abuse of the low market-entry barriers in, for example, purchasing property in order to launder money. Publishing Land Registry data on foreign companies owning properties in England and Wales is not considered sufficient.

## Civil-Service and Public-Administration Reform

After the judicial service, the second most significant area from a political perspective in need of reform is Ukraine’s civil service. The first reading of the bill On the Civil Service was passed in April 2015, but there have been subsequent delays due to a lack of support in parliament.<sup>38</sup> Over 1,000 amendments were proposed.<sup>39</sup> As a result, the government agreed to set up a working group to examine the bill.<sup>40</sup> One conference participant said that this appears to have got ‘stuck’ in the government bureaucracy. This person said this was an example of the problems associated with the over-centralised, still ‘Soviet-style decision-making process’. There is too little delegation from the top level and the decision-making process needs to be streamlined. Even

37. Nick Maxwell, ‘The Case for Ending Offshore Corporate Secrecy in the UK Property Market’, 3 March 2015, <<http://www.transparency.org.uk/news-room/12-blog/1231-case-for-ending-offshore-corporate-secrecy-the-uk-property-market/1231-case-for-ending-offshore-corporate-secrecy-the-uk-property-market>>, accessed 9 October 2015.

38. Apostrophe, ‘Deputaty ne prinyali zakon o reforme gossluzhby [Deputies Have Not Passed the Law on the Reform of the Civil Service], 23 April 2015, <<http://apostrophe.com.ua/news/politics/2015-04-23/deputaty-ne-prinyali-zakon-o-reforme-gosslujby/22278>>, accessed 14 October 2015.

39. Ukrinform, ‘Bez zakona o gossluzhbe Ukraina poteryaet bolee €100 millionov – Shimkiv [Without a Law on the Civil Service, Ukraine will Lose More than €100 Million]’, 23 July 2015, <[http://www.ukrinform.ua/rus/news/bez\\_zakona\\_o\\_gosslugbe\\_ukraina\\_poteryaet\\_bolee\\_100\\_millionov\\_\\_\\_shimkiv\\_1768450](http://www.ukrinform.ua/rus/news/bez_zakona_o_gosslugbe_ukraina_poteryaet_bolee_100_millionov___shimkiv_1768450)>, accessed 14 October 2015.

40. 112.ua, ‘Groysman: nam nuzhen noviy zakon o gossluzhbe [Groysman: We Need a New Civil Service Law]’, 9 July 2015, <<http://112.ua/politika/groysman-nam-nuzhen-novyy-zakon-o-gossluzhbe-243446.html>>, accessed 14 October 2015.

though efforts have been made, for example, towards deregulation and facilitating business in Ukraine,<sup>41</sup> if things take too long for approval due to a lack of linkage between relevant aspects of the government machine or through inefficient decision-making, this will continue to deter business. Another participant agreed with the gravity assigned to this problem, adding that the number of counter-signatures required for any approval is too high. Although the Ukrainian government is not alone in having a civil-service system that suffers from excessive bureaucracy, to attract investment the country needs to demonstrate that it is making the political decision-making process more efficient.

Within the civil service, along with reform, there needs to be greater clarity as to the new expectations of civil servants. Given the delays in implementing reform in this area, there remains confusion as to what role, in particular, the middle and lower levels of the civil service play. Like the judicial system, this concern addresses the interplay of the hierarchy within official civil-service structures. Any changes in rules, roles and expectations from the top as a result of reform must trickle down to the lower and middle levels of the civil service. As one conference participant said, there is ‘corruption seduction’ in the civil service which needs to change. This is in part due to a mindset towards public-sector work, which is often attractive due to the stable nature of the job position. Corruption seduction is supposedly addressed in the civil-service reform bill, which examines remuneration and seeks to introduce competitive criteria for recruitment and promotion, in a bid to reduce the risk of nepotism.<sup>42</sup> Redefining the roles of civil servants very clearly to both the public and civil servants themselves as a result of reform will be important. Another participant noted that, as a result of the dramatic changes in the Ukrainian government over the past eighteen months, part of the problem now is that positions in government are viewed as uncertain and unstable. Thus, some people are viewing their roles and impact in the short term, which affects personal motivation. This uncertainty again adds to the mistrust of the bureaucracy’s reliability, efficiency and vulnerability to corruption which in turn affects the investment climate.

## Conclusions and Recommendations

- Civil-service reform should be a key priority, as the delays have caused concern among those in business. These concerns not only relate to the push-back on implementing much-needed improvements in the bureaucracy but also in the government’s ability to reform more broadly. Priority areas of civil-service reform raised during conference discussions include streamlining decision-making and reducing bureaucratic requirements, such

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41. Uzhgorod.in, ‘Poroshenko Signed the Law on Facilitating Business’, 2 April 2015, <[http://uzhgorod.in/en/news/2015/aprel/poroshenko\\_signed\\_the\\_law\\_on\\_facilitating\\_business](http://uzhgorod.in/en/news/2015/aprel/poroshenko_signed_the_law_on_facilitating_business)>, accessed 9 October 2015.

42. Information and Communication Department of the Secretariat of the CMU, ‘Kostyantyn Vashchenko: The Civil Service Reform is Assigned to Set Clear Limits to Political and Administrative Posts’, 26 March 2015, <[http://www.kmu.gov.ua/control/en/publish/article?art\\_id=248046053](http://www.kmu.gov.ua/control/en/publish/article?art_id=248046053)>, accessed 9 October 2015; Ukraine Crisis Media Center, ‘Implementing Civil Service Reform on the Local Level. Ukraine Crisis Media Center, 22<sup>th</sup> [sic] of July 2015’, accessed 9 October 2015, *Youtube*, <<https://www.youtube.com/watch?v=zMe4ceAo5sE>>, accessed 9 October 2015.

as counter-signatures to a handful of senior officials. This will instil more faith in the administration's ability to act efficiently and decisively

- The roles and expectations of civil servants, including in the sphere of transparency and accountability, need to be made clear to both the public and civil servants themselves at all levels. Reform of the system should be accompanied by training in public administration and ethics. The tone must be set at the top, but must feed down to all levels. This will ensure motivation is maintained within the civil service. Checks and balances must also be in place, with a channel for all civil-service members to report any concerns about behaviour to an independent body
- As part of its communication strategy, the Ukrainian government should give concrete and explicit reasons to the public where possible as to why government reform processes have been delayed or are lengthy by nature. One example can be taken from the anti-corruption reform process itself. It took the government months to set up and formalise the National Agency for Prevention of Corruption and to appoint the head of the National Anti-Corruption Bureau (NACB). One of the legal representatives presenting at the conference said that the delays in establishing key anti-corruption bodies had caused anxiety and represented a 'failing' of the government. However, one source based in Ukraine said that the delay in appointing the head of the NACB, who was named as Artem Sytnyk in April 2015, was in fact a result of the thoroughness of the process and the sheer volume of applications for the role. Although concrete achievements are necessary, more in-depth and honest communication about the nature of the processes the government is undertaking on reform would also enhance the government's credibility if, and when, there is justifiable reason for delay.

## II. Business-Focused Reform

**T**HE STRUCTURAL REFORMS to Ukraine's judiciary and civil service are necessary in order to temper the country's current levels of corruption. However, even their full implementation is not enough to ensure a secure business environment. The government's commitment must be reflected in the responsibilities of businesses themselves in implementing and maintaining effective compliance procedures to support a broader business culture of transparency and accountability.

### The Business Ombudsman

One of the cornerstones of business-focused reforms in Ukraine has been the introduction of the Business Ombudsman Council (BOC), funded by a multi-donor account set up by the European Bank for Reconstruction and Development.<sup>1</sup> The BOC is an independent advisory body whose aim is to establish a transparent business environment and mitigate corruption at all government levels, and in state-owned or state-controlled companies. The BOC serves as a liaison agency between the Ukrainian business community, which can use the BOC to raise concerns regarding corruption and abuse of power by public officials, and the Ukrainian government, which the BOC directly advises. Algirdas Semeta, the former European commissioner for Taxation and Customs Union, Audit and Anti-Fraud, was appointed the BOC's head in November 2014 when the agency was first set up. Semeta's presence at the conference, alongside his agency's commitment to accepting, processing and addressing complaints from Ukrainian and international businesses working in Ukraine, demonstrates a thus-far unprecedented engagement from the Ukrainian government with the business community.

From the launch of its operations in May 2015 to the publication of its first quarterly report on 28 July 2015, the BOC appears to have lived up to its role as a facilitator in the dialogue between the Ukrainian government and business. Semeta has made working trips to the Kharkiv and Chernihiv regions, speaking to business leaders and local heads of government.<sup>2</sup> At the time of publishing the first quarterly report, the BOC has received and processed 172 complaints from businesses across Ukraine.<sup>3</sup> In the report, Semeta emphasised the importance of acknowledging the bigger picture of systemic corruption, rather than focusing on each complaint individually. Nonetheless, the report has already provided useful information regarding the key areas for

1. Donors include Denmark, Finland, France, Germany, Japan, The Netherlands, Sweden, Switzerland, the UK and the US.
2. Viktoriya Ivashkevich, 'Kharkov vperviyе posetil ukrainskiy biznes-ombudsman Algirdas Shemeta [Ukraine's Business Ombudsman Algirdas Shemeta Visits Kharkiv for the First Time]', Obyektiv. tv, 24 June 2015, <<http://www.objectiv.tv/240615/115406.html>>, accessed 14 October 2015; Business Ombudsman Council (BOC), 'Business Ombudsman Met Entrepreneurs of Chernigiv Region', 11 June 2015, <<https://boi.org.ua/en/publications/news/12-business-ombudsman-met-entrepreneurs-of-chernigiv>>, accessed 9 October 2015.
3. At of 14 September 2015, the latest date for which statistics are available, the number of complaints received by the ombudsman's office stands at 318.

complaints and potential ways to target this type of corruption. Specifically, 30 per cent of the complaints concerned the State Fiscal Service of Ukraine, including the State Tax Inspection and the Customs Service, while the PGO garnered 12 per cent of the complaints. Primarily, the complaints focused on improper conduct by these agencies when carrying out their standard procedures. The complaints about the State Tax Inspection dealt with delays in refunding value-added tax (VAT), refusing taxpayer VAT registration and abuse of power during inspections.<sup>4</sup> Other complaints included the failure of central- and local-government officials to enforce court rulings in favour of businesses, the pressure put by government and law-enforcement agencies on businesses through the use of baseless criminal investigations, and excessive regulation of export and import operations.

In his presentation, two weeks before the BOC's July report, the ombudsman said that the most immediate impact on businesses operating in Ukraine was 'the local level chains of people who abuse their power', such as the local police, tax inspectors and judges. Other conference participants echoed this sentiment, saying that, despite the reform initiatives coming from Kiev, there is very little effect at the local and regional level. According to Semeta, regional tax-service authorities, the police and the PGO frequently initiate criminal investigations without any specific grounds, which in turn provide the agencies with various powers and inhibit the functioning of businesses. The ombudsman said that the improper opening of criminal cases was a major complaint among concerns submitted to his office for review. Semeta noted that fiscal services remain the top service for complaints, specifically regarding improper behaviour during inspections.

Some experts believe that the nature of the complaints received by the ombudsman is not a true reflection of the problems facing businesses operating in Ukraine, but rather a symptom of a more fundamental problem.<sup>5</sup> For instance, the concerns regarding the abuse of power by the tax authorities do not shed light on the underlying issue. According to Yuri Fedchin, an analyst at the Ukrainian Institute for Research, the tax authorities rate their performance against two parameters: increasing their budget; and outlining mechanisms for achieving this goal.<sup>6</sup> As such, the tax authorities set out quarterly and annual goals for the amount of money to be collected from businesses and the number of criminal investigations that need to be opened in order to meet the budgetary quotas. The internal strategy of the tax authorities is thus entirely divorced from the realities on the ground. The main problem between businesses and the tax authorities stems from this dissonance. One of the conference participants said 'even best practice can bring trouble to your business'. This participant said that companies in Ukraine sometimes have to resort to knowingly committing small-scale fraud to avoid bigger problems down the road. For example, a firm might purposefully make mistakes in its tax filings to ensure it pays a small fine to the tax authorities in order to avoid a bigger fine later. This participant said that the tax authorities' requirement to fulfil quotas for tax fines drove this pre-emptive response from

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4. BOC, 'Quarterly Report: April–June 2015', 2015.

5. Rian.com.ua, 'Poka shto biznes-ombudsman ne opravdivaet ozhidaniy – Fedchizhin [So Far the Business Ombudsman Does not Live up to Expectations]', 30 July 2015, <<http://rian.com.ua/view/20150730/371375179.html>>, accessed 14 October 2015.

6. *Ibid.*

businesses. Another participant highlighted that, in their current form, the tax authorities are too vulnerable to abuse, saying that ‘the practice of opening a criminal case immediately upon an inspection revealing a perceived underpayment of taxes must be abandoned. Only cases of intentional tax evasion must be prosecuted’.

Although a time lag between initiatives originating in Kiev and their implementation in the rest of the country can be anticipated, the central government must ensure oversight and consistency of reform implementation in the regional administrations. Despite the BOC’s relatively newcomer status, there is reason to believe that its transparent analysis and reporting of incoming complaints is starting to have an effect on policy. On 10 August 2015 the State Fiscal Service, the subject of the majority of complaints to the BOC, appointed a fiscal ombudsman whose task will be to help resolve arising issues between taxpayers and the government.<sup>7</sup> According to the head of the State Fiscal Service, Roman Nasirov, the fiscal ombudsman will serve as another link between the business community and the tax authorities, complementing the work carried out by the BOC.<sup>8</sup> In addition to the response of the tax authorities, changes are expected in the judiciary and the PGO. On 15 September 2015, Semeta signed a memorandum of co-operation with Ukraine’s Ministry of Justice, which set out the terms for information exchange, expert advice for drafting legislation and co-ordination to resolve business concerns relating to the representatives of the Ministry of Justice.<sup>9</sup> The BOC and the ministry will create two expert groups which will deal with problems of registration and implementation of court cases, two key areas concerning the justice sector for which the BOC receives the most complaints.<sup>10</sup>

The introduction of the BOC has created a new forum which can be used by businesses to communicate their grievances to the local and central governments. Its transparent analysis of incoming complaints appears to have galvanised Ukrainian public authorities to re-evaluate their current positions, and the introduction of the fiscal ombudsman and the signing of the memorandum of co-operation with the Ministry of Justice are the first steps in the right direction. However, whether these initiatives will bear any fruit and positively impact businesses remains to be seen.

7. Novoye Vremya, ‘Biznes poluchil “svoego cheloveka” v nalogovoy. Chem emu eto pomozhet, rasskazivat fiskalniy ombudsman [Business Have “Their Man” in the Tax Authority. The Fiscal Ombudsman Tells How it will Help Him]’, 28 August 2015, <<http://nv.ua/publications/biznes-poluchil-svoego-cheloveka-v-nalogovoj-chem-emu-eto-pomozhet-rasskazyvaet-fiskalnyj-ombudsmen-66045.html>>, accessed 14 October 2015.
8. Unian, ‘V Ukraine poyavilsya fiskalniy biznes-ombudsman [In Ukraine There Appears a Fiscal Business Ombudsman]’, 10 August 2015, <<http://economics.unian.net/finance/1109807-v-ukraine-poyavilsya-fiskalnyiy-biznes-ombudsmen.html>>, accessed 14 October 2015.
9. RBK Ukraine, ‘Minyust podpisal memorandum o sotrudnichestve s ofisom biznes-ombudsmena [Ministry of Justice Signed a Memorandum of Co-operation with the Office of the Business Ombudsman]’, 15 September 2015, <<http://www.rbc.ua/rus/news/minyust-podpisal-memorandum-sotrudnichestve-1442319674.html>>, accessed 14 October 2015.
10. Finance.ua, ‘Otkritiye ugolovnikh del protiv biznesa v Ukraine prevratilos v natsionalniy sport – biznes-ombudsman [The Opening of Criminal Cases against Business in Ukraine has Become a National Sport – Business Ombudsman]’, 28 August 2015, <<http://news.finance.ua/ru/news/-/357597/otkrytie-ugolovnyh-del-protiv-biznesa-v-ukraine-prevratilos-v-natsionalnyj-sport-biznes-ombudsmen>>, accessed 14 October 2015.

## Conclusions and Recommendations

- The BOC should be given capacity to maintain its mandate and the Ukrainian central government should ensure that the agency remains independent. Some of the participants expressed concern that the office may become politicised and reflect the existing vested interests. Semeta assured that the office remains independent and, on the basis of the first report's findings, this appears to be true
- The continued improvement of streamlined operations of lower-level governments and their agencies was another concern raised by the conference participants, and is reflected in the BOC's report. The focus is to introduce the systematic application of procedures by business-facing government agencies, including the PGO and the tax authorities. As one legal professional said, 'business can adapt to any situation, but unpredictability hurts it most'. Another participant said that although the Ukrainian government has made an effort to improve the existing taxation system, specifically VAT refunds, which had been an acute concern for businesses operating in Ukraine, 'this reform must go hand-in-hand with how the tax police operate'
- The BOC's findings should be analysed on a regular basis, and relevant actions should be taken to remediate the systemic problems arising within relevant government agencies. Once the BOC has collected longitudinal data, it should provide an analysis on whether there has been a proportionate reduction of complaints regarding specific services in light of ongoing reforms of those agencies (that is, the tax authorities and the PGO). In other words, the BOC needs to address whether reform is having an effect in changing the way that Ukrainian agencies operate *vis-à-vis* the business community.

## Anti-Corruption, and Bribery Systems and Frameworks

The introduction of political and business-focused reforms with a specific aim to ameliorate existing wrongs is a welcome aspect to secure the business environment in Ukraine; however, it runs the risk of reacting to known negative aspects and issues instead of providing an overarching framework that could help ensure not only the mitigation of existing problems but also provide future-proofing. In establishing an all-encompassing framework for tackling corruption, the government will also be able to more successfully communicate with various government departments and agencies, as well as businesses operating in Ukraine.

While the Ukrainian government has a mammoth task on its hands to identify, understand and root out corruption from its structures, the private sector has its own role to play in helping to consolidate reforms and improve the business environment. Companies, both local and international, have the responsibility for implementing and maintaining effective anti-bribery and anti-corruption policies, and compliance programmes, thus setting a 'tone from the top'. One participant said that companies must 'embed due diligence into the principles of the business' they are operating in Ukraine. In reply, the ombudsman said that effective internal policies, including compliance programmes and embedded due-diligence mechanisms, are key to sending an anti-corruption message from a business perspective. According to the law On Prevention of Corruption, effective from 26 April 2015, all companies participating in public

tenders and state-owned companies of a certain size, are required to have a compliance officer who is responsible for the company's compliance policies.<sup>11</sup> The law recommends a number of specific policies, including regular risk assessments, monitoring mechanisms, employee codes of conduct, and whistleblower provisions, but notably, the law does not set out the mechanisms for embedding or enforcing these policies.

The value of such compliance programmes inevitably rests on the effectiveness of their constituent parts. One of the conference participants emphasised the need for 'protection and impunity for whistle-blowers'. Making whistleblower hotlines for reporting bribery, corruption and broader wrongdoing should be made mandatory in business, with an option to escalate cases to law-enforcement authorities where appropriate. The anti-corruption legislation includes a series of protection measures for whistleblowers, but it is unclear how they will be applied. In addition to clarifying and securing protection mechanisms, there is a need to introduce awareness programmes regarding the importance of whistleblowing, a practice which is currently uncommon in Ukraine and other former Soviet Union countries. In July 2015, Transparency International Ukraine, the Ministry of Information Policy and the NGO, the Ukraine National Initiatives to Enhance Reforms, launched a 'They would not keep silent' campaign, whose main message is to convey the importance of fighting corruption by reporting it.<sup>12</sup> This campaign needs to be underpinned with examples of real reporting of malfeasance from businesses, prosecution of wrongdoers and protection of whistleblowers who step forward.

Facilitation payments in businesses are another area where the Ukrainian government and business leaders can co-operate to usher change. The Ukrainian government needs to work with agencies where these actions are prevalent in order to mitigate them. At the moment, facilitation payments are a pervasive problem in Ukraine, with at least three out of ten firms making such payments to expedite the process of obtaining certain licences to operate in, or import goods to, Ukraine.<sup>13</sup> For example, exporting goods to or from Ukraine may take up a certain number of days to be processed legally, but businesses may be able to pay a bribe to get this done more quickly if it means, for example, preventing the disintegration or spoiling of the produce in the cargo. Simply advising companies against paying the bribe would, if practiced, cause damage to the company's commercial viability. A regulated and legal fast-track system in such cases would be more beneficial than the only option of bribery.

In order to improve overall transparency and effectively implement compliance policies, businesses operating in Ukraine will have to reconsider the way that they set up their corporate structures. The abuse of power by Ukrainian tax agencies, as highlighted by the BOC report and various participants at the conference, has significantly influenced the manner in which

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11. Yuliya Kuchma and Thomas Firestone, 'Compliance Officers Required under New Ukraine Anti-Corruption Law', FCPA Blog, 22 April 2015, <<http://www.fcpablog.com/blog/2015/4/22/compliance-officers-required-under-new-ukraine-anti-corrupti.html>>, accessed 9 October 2015.
  12. Transparency International Ukraine, 'Corruption Whistleblowers Proposed to be Active, the State Offered to Protect Them Better, press release, 10 July 2015, <<http://ti-ukraine.org/en/news/official/5407.html>>, accessed 9 October 2015.
  13. World Bank Group, 'Ukraine', Enterprise Surveys, <<http://www.enterprisesurveys.org/data/exploreeconomies/2013/ukraine>>, accessed 9 October 2015.

companies set up their operations. A number of conference participants argued that the majority of businesses operating in Ukraine set up offshore-ownership structures and/or a confusing array of subsidiaries not to deceive investors or avoid tax, as is the aim for certain businesses in various jurisdictions, but instead to protect the company against tax inspections or, more concerning, tax raids. A consolidated holding is an easy target for arbitrary investigations and fines. One participant noted that the lack of transparency within companies exists 'despite there being a legitimate reason as to why these companies do this', suggesting that the government needs to 'take tax away as a weapon'. Ukraine is the first country in Europe to implement a register of beneficial owners, which in part recognises existing criticisms relating to the setup of corporate structures. The use of offshore entities, trusts, proxies and family members to hide beneficial ownership also facilitates tax evasion and embezzlement by government officials. The value of a beneficial-ownership register will be as good as the verification mechanisms put in place to ensure that the information supplied to the register is correct.

The implementation of effective anti-bribery and anti-corruption policies across governmental bodies and businesses has a real chance of improving the relationship between the business community and the government. For this relationship to be effective, both parties need to co-operate in designing, implementing and monitoring effective, and not overly bureaucratic, compliance systems.

## Conclusions and Recommendations

- The Ukrainian government needs to ensure that anti-corruption legislation concerning the introduction of compliance policies relating to businesses operating in Ukraine is being embedded by both state-owned and private businesses. One of the key messages from the participants was the need to instil the importance of reporting malfeasance. The government needs to ensure that awareness campaigns relating to 'blowing the whistle' are supported by robust legislative protections for whistleblowers and prosecution of wrongdoing, in essence delivering the message that malfeasance will be punished
- Businesses in Ukraine need to comply with relevant legislation on compliance policies, but also drive 'top-down' change by enhancing the policies' effectiveness and ensuring their implementation
- The Ukrainian government needs to undertake a critical assessment regarding the corruption risk factors in the current business environment and, subsequently, prioritise addressing the underlying issues that drive business engagement in corrupt practices. This approach will help inhibit the motivation for conducting business in a corrupt way. The tax authorities and local police were raised as key areas of concern by numerous conference participants.

## III. Conclusions

**A**S THE EVENT'S keynote speaker Dmitry Gvindadze mentioned, the political will to open up to foreign investors certainly exists and represents in itself distinct progress from previous attempts. Many of the new ministers in government have spent time in the private sector and speak English, bringing much-needed expertise. Genuine changes have already been made to improve the investment climate, but the sheer scale of the problems to tackle mean that it will take time for reform to positively impact perceptions of the country's investment climate internationally. Thus, prioritisation, efficacy, implementation and enforcement are key. Moreover, vested interests and corruption within the judiciary are important problem areas that need urgent attention.

To many, the glass is 'half full' in terms of Ukraine's reform efforts, but there of course remain some fundamental obstacles. Legislative reform is the first step, and Ukraine has made huge efforts towards this, but implementation of reform and ensuring enforcement and education that genuinely changes mindsets towards corruption are the crucial element. A critical assessment of the government systems and structures to understand the underlying reasons why people engage in corruption in business is key. For example, the fundamental cause of business grievances towards the tax authorities is that corporate entities feel *forced* to engage in corruption simply to conduct their operations, based on rules and requirements set by the tax authorities. Changing the rules to make corruption less of a motivation, less easy to commit and genuinely less rewarding, while also providing strong enforcement as a deterrent, are priority measures.



# About the Authors

**Sarah Lain** is a Research Fellow in Russian studies at RUSI. She focuses on defence and security issues relevant to Russia and the former Soviet Union, including corruption and financial crime. Prior to joining RUSI, Sarah was an Assistant Manager in the Corporate Intelligence team in KPMG London's Forensic practice. Prior to this she worked as an Associate Consultant on the Russia/CIS desk of the Corporate Investigations department at Control Risks. In both roles, she conducted integrity due-diligence research, fraud investigations and anti-bribery and corruption risk assessments, with a focus on Russia and the CIS.

**Alisa Voznaya** is a Manager in KPMG's Risk Consulting department. She is an experienced political-risk and corporate-intelligence professional, who specialises in providing integrity due-diligence, strategic intelligence and political-risk services covering Russia and the former Soviet Union. Prior to joining KPMG, Alisa worked at Control Risks and contracted with Exclusive Analysis (now part of IHS), delivering due-diligence and political-risk projects. Alisa holds a DPhil in Politics and International Relations from the University of Oxford, having completed her doctoral dissertation on the topic of corruption and party systems. She holds an MPhil in Russian and East European Studies, also from the University of Oxford, and has worked as a research assistant and consultant on numerous research projects relating to corruption, governance, and Russia and the CIS.