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Legal transformations of business disputes in post-Soviet Ukraine

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Abstract

This paper explores mobilisation of law by Ukrainian business people at the pre-litigation stage of disputes, when litigation has not as yet been commenced but a legal claim has been formalised through the *pretenziya* - a formal letter to the delinquent party written to a special template. In Soviet times the *pretenziya* was by law an obligatory prerequisite before filing a claim in a commercial court (*arbitrazh*), but nowadays it is optional. Having analysed the spectrum of legal and extra-legal functions of *pretenziya,* this paper concludes that due to its adaptability, *pretenziya* proved capable of operating both as a token of the public order – the 'shadow of the law' - and as part of a private contract enforcement. *Pretenziya* in a voluntary form has not only survived in market-oriented economy but even opened up new avenues for the creative use of legal forms in post-Soviet business.

Key words

Dispute transformation; mobilisation of law; 'shadow of the law'; post-Soviet transition; Ukraine.

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1. Introduction

Investigation into the ways businesses solve disputes between themselves provides a unique opportunity to grasp the relative importance of law in any society. Although studies of business disputes worldwide invariably point toward a minimisation of the resort to law and courts in business relations (Macaulay 1963; Beale and Dugdale 1975; Arrighetti, Bachmann and Deakin 1997; Fafchamps 1996; Galanter 2001; Hendley 2001; Hendley 2011), the specifics of this resort or non-resort as well as the rationale behind it varies across different societies.

This paper looks more closely at the mobilisation of law by Ukrainian business people at the pre-litigation stage of disputes, when litigation has not as yet been commenced but a legal claim has been formalised through the *pretenziya*[1] - a formal letter to the delinquent party written to a special template.

In Soviet times the *pretenziya* was by law an obligatory prerequisite in all disputes between enterprises before filing a claim in a commercial court (*arbitrazh*), but nowadays it is optional. The old times have passed, Ukraine has changed its economic system toward a market economy, introducing a whole new body of contract law, and yet the resort to *pretenziya* persists.

According to the study herein presented, more than 90% of the court claims of the companies investigated were preceded by service of *pretenziya*. The 2007 International Finance Corporation (IFC) survey found that 73.2% of surveyed Ukrainian companies of all sizes had resorted to *pretenziya* in the latest dispute (IFC 2007). Why has this relic of the Soviet planned economy survived while so many others quickly vanished?

This paper aims to solve this puzzle through an analysis of the pre-trial legal transformations of business disputes through *pretenziya*, and an identification of the various ways law is used to influence the outcomes of disputes in business relations in Ukraine.

Only a few studies have explored Ukrainian business relations (Mcmillan and Woodruff 2000; Akimova and Schwodiauer 2000; IFC 2007; Williams 2009). Within these studies the role of *pretenziya* received little or no attention. Indeed, scholarly interest in Ukraine generally remains low compared to Russia.

Even research into the Russian legal system and business relations have omitted the institution of *pretenziya* (Hendrix 1997; Halverson 1996; Frye 2002), with the remarkable exception of Hendley and colleagues (Hendley, Murrell and Ryterman 2000; Hendley 2001). In their study of contractual relations between Russian industrial enterprises they have analysed *pretenziya* along with contractual penalties and collateral arrangements under the rubric of 'shadow of the law' strategies (Hendley, Murrell and Ryterman. 2000, p. 643). *Pretenziya* was seen as constituting a threat of litigation; debtors were willing to pay at this 'juncture' because 'by paying before the case was filed, the customer could escape paying the filing fees and will often be excused from penalties and interest' (Hendley 2001, p. 26).

Findings of this research suggest that *pretenziya* would be better understood, if analysed separately from the court system. In many instances *pretenziya* proceedings proved unconnected to the courts or to the threat of court action; its functions quite different from those deployed by the courts. Law and lawyers played an even lesser role in *pretenziya* than in court proceedings.

To explore the role and operation of *pretenziya* in Ukrainian business I have built upon the dispute emergence and transformation framework developed by Felstiner, Abel and Sarat (1980), which treated the early, out-of-court stages of disputes as

[1] The language spoken in Eastern Ukraine is Russian; therefore, transliterations in brackets are in the Russian language.

equal in importance to dispute transformations occurring in court. Additionally, the broader literature on relational contracting and contract enforcement has helped to identify the link between the resort to legal formality through *pretenziya* and private ordering mechanisms (Macaulay 1963; Beale and Dugdale 1975; Charny 1990; Fafchamps 1996; Arrighetti, Bachmann and Deakin 1997; McMillan and Woodruff 2000; Hendley, Murrell and Ryterman 2000). Finally, the ideas of Galanter (1974) on specific patterns of behaviour of repeat players in litigation, which have been applied by Hendley, Ryterman and Murrell (1999) to the Russian context, illuminated creative use of *pretenziya* by the repeat players in this study.

The empirical part of this research comprised a case-study of the contract enforcement and dispute resolution practices of three companies located in the most industrialised part of Eastern Ukraine. Although in qualitative research the selection of the sites and of the unit of investigation needs not be systematic or quantitatively representative (Diefenbach 2009), an account of the basic logic behind the selection of the companies for this research is nonetheless due.

The major task of this research was to identify some of the broad contract-enforcement patterns characterising Ukrainian businesses. To this end it was thought best to obviate the influence of regional differences by choosing the companies from within one locality; consequently, three companies were selected from Eastern Ukrainian most industrial region: the cable-manufacturing Plant, the grain Farm, and the small Cafe. These three companies differed from each other in most aspects - their size, age, economic sector, ownership and organisational structure, customer base, staff experience, *etc.* (see Appendix). It was anticipated that if three considerably different companies and their trading partners exhibited broadly similar patterns of dispute resolution, this would give some grounds for attributing these patterns to the working of the wider institutional environment, which would therefore be relevant to all Ukrainian businesses.

Each year over five years from 2007 to 2011 I undertook a two-months' placement with these three companies. During my placements I conducted semi-structured, face-to-face interviews with operational-level sales and supply managers, managers at the upper level, heads of departments, chief executive officers, general directors, owners, and legal counsel. My inquiries into contract enforcement practices were not limited to the companies under research, however. Like the tango, business relations take two; therefore, along with the contract enforcement of the three selected companies, a snapshot of the contractual practices of almost five hundred companies – the trading partners of the three companies – was also made. Furthermore, the interviewees, as business experts, were encouraged to comment on the general practices prevalent in their respective industries. Over five years more than thirty people were interviewed; certain key sources were interviewed more than twenty times. Interviewing was supplemented by on-site observation and by an examination of relevant written records, including contracts, accounting reports, court files, *etc.* A significant amount of data came from public databases.[2]

Such depth and richness of empirical data stemming from varied sources, collected over a five-year period, provided an unique opportunity to render some conclusions about Ukrainian business as a whole. At the same time, it is acknowledged that the generalisability of these conclusions must be treated with the caution intrinsic to highly qualitative research methods. This case-study remains within the descriptive mode aimed at exploring how things work on the ground.

Although this paper concentrates on the legal transformations of disputes, which constitute but a tiny part of commercial dispute resolution, the important point is that the findings derive from a more comprehensive framing of contract

[2] The database of the Unified National Registry of Court Judgments of Ukraine http://www.reyestr.court.gov.ua/; the database of the Securities Market Infrastructure Development Agency of Ukraine (SMIDA) www.smida.gov.ua

enforcement in contemporary Ukrainian business. The paper makes part of a larger research project for my DPhil degree, which analysed both dispute emergence and processing, with and without the express involvement of the law, in court and out of court.

The paper begins with an outline of the major stages through which business disputes typically proceed in Ukraine. I then concentrate on the 'claiming' stage of the dispute, where the law becomes expressly involved – especially the pre-trial claim procedure (*pretenziya*), with particular attention to the role and different 'uses' of law. Alongside the traditional use of law to pressurise settlement through the threat of litigation (the so-called 'shadow of the law'), this study also highlights the 'creative', non-legal functions of *pretenziya*. The paper concludes with a discussion of the reasons behind the persistence of *pretenziya* in the post-Soviet era.

2. Naming, blaming and claiming in the context of Post-Soviet business

Although the dispute transformation approach was developed in the 1980s in the context of the US experience, the general logic has proved transferable to other societal settings (Hendley 2001; Engel 2005; Hendley 2010). Express interest in the early stages of dispute emergence has triggered a cascade of empirical legal research into dispute pyramids, the legal needs of populations, dispute processing, litigation rates, justiciable problems, compensation, and community dispute resolution in many countries (Kritzer 2010).

The transformative approach to dispute resolution was crystallised in the dispute emergence model of Felstiner, Abel and Sarat (1980). Under this model, unperceived injurious experience matures into perceived injurious experience (naming); next, the person responsible is identified and the experience is transformed into grievance (blaming); finally, the grievance is voiced to the person believed at fault (claiming). Only if the claim is rejected by the opponent does the matter acquire the qualities of a 'dispute'. The dispute then develops and transforms; at some later point lawyers, audiences, mediators, and other third parties may become involved; eventually, the dispute may end up in court.

Along this dispute emergence and transformation path many grievances do not mature into claims, and many claims get dropped. Only a tiny proportion of injuries is adjudicated by the courts. The process of dispute emergence is frequently visualised as a pyramid or iceberg, with the grievances making up the base and court cases the apex (Miller and Sarat 1980, pp. 544-546).

In the transformative perspective the early stages of dispute emergence take on paramount importance, as they decisively determine the future trajectory of disputes. According to Lempert (1980, p. 711), 'grievances are the grist for the dispute processing mill. We cannot fully understand what goes on in that mill unless we understand why only a portion of that grist is processed there'.

Grievances and disputes are 'subjective, unstable, complicated, incomplete, and constituted through dispute processing techniques' (Sarat 1988, p. 708). Most importantly, disputes are not static – the subject matter of the dispute; the objectives, interests and positions of the parties; the number and identity of parties themselves; as well as the conceptual framework for analysing the dispute, are all constantly being reshaped (Mather 1990, p. 362).

The role of agents who induce these transformations, such as lawyers, audiences, dispute resolution practitioners, state agencies, and others, is considered an important subject of research in dispute behaviour studies (Mather and Yngvesson 1980, p. 45; Felstiner, Abel and Sarat 1980, pp. 639-649). Thus, the transformative perspective suggests that law and lawyers are not the only agents of transformation in the dispute process, and that law may be used in a number of

different ways, including those that are unexpected, non-legal and/or 'creative' (Macaulay 1977; Merry and Silbey 1984).

Viewed through the prism of the Felstiner, Abel and Sarat model, disputes were rare phenomenon in the business-to-business relations of the Ukrainian companies researched. Relatively stable economic development, at least up until the 2008 world economic crisis, with an annual GDP growth of 7%, contributed to the stability of business relationships. Improvements to the regulatory environment, in particular through tax legislation, made the operation of empty shells and fraudulent schemes problematic, thereby discouraging opportunistic behaviour. Against such a background, one would not expect pervasive contractual violations to be met with at the companies in question. The actual figures proved even less than expected: in 2008-2009 contract-breaches involving the three companies, defined as any deviation from the written contract beginning with one day of delay and so on, did not exceed 8% of transactions.

The Plant was hit the hardest by the 2008 world crisis, and its breaches of contract with suppliers were far more numerous. Nevertheless, in 2009 most of the supply contracts were renegotiated to oblige the Plant to prepay for many of its inputs, thereby decreasing the level of contractual violations. Yet in the remaining contracts with suppliers who still offered the Plant trade credit, the Plant consistently delayed 80% of its payments.

In 2008 and 2009, of the 8% of contract breaches only 6% thereof (or 0.32% of the whole) triggered formal complaints through *pretenziya*, and only 1.7% (or 0.09% of the whole) ended up in court. Altogether, eighty-three *pretenziya* and eighteen court cases were analysed in this study[3], most of which involved the Plant.

One may conclude that resort to *pretenziya* was in no way the preferred method of dispute resolution with the companies researched, but was rather an exception to the general practice of relational contracting.

Based on the transformative model, disputes at the three companies began with naming and blaming. In most cases these two stages overlapped or coincided, as transactions were usually safeguarded by written contracts wherein the identities of the parties, their rights and obligations were clearly spelled out. Essential contract terms such as contract price, delivery and payment dates were extracted from the contracts and stored in managerial databases or electronic calendars. The performance of contractual obligations was closely monitored, and most deviations from the contract were promptly recognised.

Even when the problem consisted of hidden defects in supplied goods, blaming, even though risking being erroneous, occurred practically simultaneously with naming the problem – as soon as the defects were discovered. In most cases claiming immediately followed identification of the problem and the defaulters.

This study did not find evidence of the pattern of waiting for the problem to resolve itself, as described by Hendley (2001, pp. 30-31) in the Russian business context. The grievance stage was always transformed into claiming at all three companies. As bank loans were scarcely available to most Ukrainian enterprises, inputs were financed on the expense of buyers in a fragile balance between liquid resources coming in and going out. The companies researched lacked the luxury of waiting and doing nothing about the debt of the counterparty.

Given the high costs of its inputs (*viz.* copper and plastic), the Plant pursued an official policy of chasing up all debts of whatever amount. Furthermore, the Plant's sales managers had a tremendous incentive to pursue non-payers, as their compensation was tied to the amounts recovered. This was reported to be the

[3] I was able to collect information on the *pretenziya* proceedings and court cases of the Farm and the Café from 2004 to 2011, and of the Plant from 2008 to 2011.

general practice in the sales departments of many manufacturing enterprises and trading companies in Ukraine, similarly to the Russian businesses documented by Hendley (2001, p. 25). Not surprisingly, prompt claiming for past-due payments was regulated in detail by the Plant's corporate Guidelines on Payments.

The Guidelines prescribed that the employee in charge of the transaction makes a telephone call to the debtor after the fifth day of delay and demands the payment or an explanation. Delays of five to ten days prompted the employee to draft and dispatch a letter of reminder signed by the head of the sales department. Delays of ten to fifteen days warranted a second such letter. Delays amounting to more than fifteen days obliged the employee in charge to request that the Director of the Plant transfers the case to the in-house counsel for the pre-trial claim procedure (*pretenziya*). Although the Guidelines allowed for a five-day waiting period before the defaulter was contacted, the Plant's managers routinely made inquiries on the day after the due date.

The Farm and the Cafe were stressed neither by the costs nor the urgency of their supplies, nor by internal corporate regulations. Nevertheless, they too reported claiming promptly in all cases – whether the relationship was of the essence or not. The Farm's managers could occasionally forget about payments or delivery due for a few days, or find no time to inquire of the debtor instantly, but this was rather the exception than the rule.

The general practice of promptly claiming what was due under the contract was exemplified by proverbs like: 'friendship is friendship but business is business'; and 'friendship is friendship but tobacco [in another variant – 'meatpies' (*pirozhki*)] is another thing'.

With a few notable exceptions, claiming was done by informal telephone contact between the operational level managers and their counterparts at the offending company. In this nexus of informal bilateral negotiations the absolute majority of disputes got resolved. References to the contract, legal sanctions for breach of contract, or threats of court action were rarely invoked during informal claiming.

The law became involved, at least implicitly, once the claim was formalised in some kind of letter addressed to the delinquent party. All the letters reviewed in this study referred to the contract signed between the parties, their dates and numbers and the obligations of the defaulter according to the contract. In most instances the threat of lawsuits was omitted, but occasionally this was hinted at in tentative language.

For example, one of the letters was originated right after a technical problem with a newly purchased combine had been discovered by the Farm. It was addressed to the supplier's general director and concluded with the following: 'we hope that you understand the problem and that it will be resolved through negotiations without application to courts and imposing of damages and penalties'.

The threat of courts and legal sanctions gained momentum only if and as the dispute escalated. Eventually, it became express: – the threat of filing a lawsuit in commercial court was pronounced, the penalties were calculated in precise amounts, and the letters took the form of *pretenziya*, a formal letter written to the template provided in the Code of Commercial Procedure.

However, even though legal discourse became expressly involved in disputes at the stage of *pretenziya*, this did not transform disputes unambiguously and everlastingly into legal ones. A general director who received a *pretenziya* could order the accountant to pay the debt straight away, or could refer the matter back to the sales department for another round of settlement negotiations wherein legal discourse would be forgotten; or, if neither of these options were feasible, could refer the *pretenziya* to in-house counsel. Even when counsel from both companies

were involved in negotiations, the sales personnel often continued their non-legal negotiations in parallel with the lawyers.

In any case, *pretenziya* was never the sole means of debt collection; it was always only one weapon in an arsenal of collection tactics known as 'beating out the debts' (*vybivaniye dolgov*). 'Beating out the debts' comprises all possible actions that might put pressure on the debtor at all organisational levels – from operational managers to lawyers to general directors. Such actions include dunning telephone calls; various sorts of official letters, including *pretenziya*; resort to personal contacts within the debtor company; personal meetings between the managers, and eventually the directors.

If *pretenziya* and other efforts did not produce the expected result, and further escalation of the dispute was inevitable, the injured party crossed the courts steps by filing a claim (*isk*) in commercial court. The judgment, once rendered, was executed voluntarily or through the State Enforcement Service, a separate governmental agency under the Ministry of Justice.

All along the dispute emergence and transformation path, including at the stage of enforcement of court decisions, disputants retained the opportunity to settle or drop their claims. This study has documented that only a few claims were dropped without any satisfaction by the sample of companies. A few small debts owed by first-time, and therefore also 'last-time', trading partners were forgiven. All other debts were at least claimed for, and most actually collected through various schemes, with a minority proceeding to litigation. At the same time, if the debtor was willing to pay the debt eventually, following *pretenziya*, damages and contractual penalties were as a rule not claimed.

Contrary to the US-oriented assertion of Felstiner, Abel and Sarat (1980, p. 645) that 'of all the agents of dispute transformation lawyers are probably the most important, ... the result of the lawyer's central role as gatekeeper to legal institutions and facilitator of a wide range of personal and economic transactions', this study has documented no role of Ukrainian lawyers in the transformation of disputes into expressly legal matters. This confirms previous findings by Hendley (2001, pp. 39-41) made in the context of Russian business relations.

Decision to initiate *pretenziya* were in fact taken solely by the general directors of the Plant or by the owners of the Farm and the Café, based on information provided by the operational managers. Lawyers, whether employed in house or hired from outside, were not observed to have any role in this decision process whatsoever. Their input was not required, as at this stage questions of the validity of the legal claim were irrelevant.

After the decision to initiate *pretenziya* was taken by upper management, it was usually the in-house lawyer who drafted the text of the *pretenziya*; however, operational managers of companies without in-house counsel or recourse to outside counsel were reported capable of drafting *pretenziya*s by themselves, based on templates from colleagues or from the Internet.

Lawyers of course became more prominent when legal disputes were transformed into court cases. The general directors or upper management remained the main decision-makers for this transformation as well; however, in most, although not in all cases they consulted lawyers to confirm the validity of the legal claim and to estimate the costs of proceeding to court.

Thus, law became expressly involved in the dispute resolution process of Ukrainian businesses when the dispute was formalised in a *pretenziya*. At the same time, however, the involvement of legal professionals at this stage conditioned neither resort to the courts nor the monopoly of lawyers over the process.

3. Claiming through pre-trial claims - *Pretenziya*

3.1. The Legal Framework of Pretenziya

Pretenziya is a formal letter of a few pages that contains a description of the facts of the case; the claims of the aggrieved party; a calculation of damages and penalties; references to certain Articles of the laws; and includes an appendix with copies of the documents supporting the claim. The formal vocabulary used in *pretenziya* signals that matters have moved a step further toward litigation.

Due to its mixed nature, *pretenziya* presents a bridge between the private and public, business and legal realms. On the one hand, *pretenziya* is a solely private, bilateral mechanism, as no state or governmental agency is actually involved in its operation. *Pretenziya* is exchanged between two trading parties and concerns their commercial relations. On the other hand, *pretenziya* relies heavily on the threat of resort to the public courts. It most notably transforms mere bilateral disagreements into legal disputes through legal discourse.

As *pretenziya* has its historical origin in the Soviet law and practice of the 1960s, this merits looking in more detail into these roots. Under Soviet law all disputes between socialist enterprises were to be resolved by the parties themselves through the procedure of pre-trial dispute resolution (*pretenzionny poryadok)*, normally without intervention of a third party. Only when this did not work could they pursue the matter in court (at that time known as *arbitrazh*). Upon filing the claim in court, the claimant had to present evidence that the *pretenziya* had been rejected by the respondent.

After Ukraine became independent in 1991, this compulsory pre-trial procedure was questioned and eventually abolished in 2002 by a Decision of the Constitutional Court of Ukraine. Article 1333 of the Decision states

> Compulsory pre-trial dispute resolution that excludes the possibility of having the claim considered [by courts], and justice delivered based thereon, violates the human right to a fair trial ... The choice of a certain method of legal defence, including pre-trial dispute resolution, is a right but not the duty of a person.

This decision was followed by amendments to the Code of Commercial Procedure making the pre-trial claim procedure (*pretenziya*) voluntary except in cases involving transportation, communication and state contracts (Code of Commercial Procedure, Article 5). Although voluntary in most cases, the Code nonetheless contains, in Part II, seven articles regulating *pretenziya* in minute detail: - the form and content of the letter which should be sent to the party in breach; the time limit for considering the claim (generally one month); the content and form of the reply, *etc.*

Notwithstanding its voluntary nature, Ukrainian companies nowadays still widely use *pretenziya*. Its form and the legal discourse couching it remain largely unchanged from Soviet times. The templates circulated amongst Ukrainian businesses are almost identical. The text begins with a description of the initial phase of the current transaction – the contract signing. It proceeds to list the contract obligations and to allege which of them have been violated by the debtor. It then demands that the debtor fulfils its obligations duly. Finally, it warns the debtor that should these demands be ignored after a certain time period (usually ten days or a week), the injured party will begin assessing penalties and resort to litigation.

Given this discourse, *pretenziya* is conventionally viewed as a last attempt to settle before going to court; the last warning which evidences the earnestness of intention of the injured party (Hendley, Murrell and Ryterman 2000; Hendley 2001). Apart from this 'legal' function, the research herein presented has also identified a number of socio-legal functions of *pretenziya* which go beyond the

threat of litigation. The legal and non-legal functions of *pretenziya* are explored in more detail in the sections that follow.

3.2. 'Legal' functions of pretenziya*: the threat of court action*

The use of the threat of court action implicit in *pretenziya* has been evidenced by this study at all three companies researched. The interviewees in this study clearly linked it to the likelihood of court action. In turn, the latter depended on a host of objective and subjective factors, such as the urgency of the claimant's need for liquidity; the claimant's ability to pay filing fees; the straightforwardness of the case, and the likelihood of a positive judgment; the claimant's taste for revenge; *etc.*, all which call for separate research. The *pretenziya* initiators themselves were often uncertain at that point whether or not they would actually sue the defaulter. Yet an analysis of the intentions of the claimants in actual cases of *pretenziya* illuminated that at least some likelihood of litigation existed when the amounts in dispute were substantial and the causes beyond reasonable reach of remedy by the parties.

When the amounts in dispute were estimated, the size of the injured party was taken into account. The interviewees in this study considered amounts of more than UAH10.000 (US$1.000) for a small company, and around UAH100.000 (US$10.000) for a large enterprise, to suffice to warrant court intervention.

Additionally, court action was seen likely when the problems were caused by objective circumstances not entirely dependent upon the will of the parties, and therefore unfeasible to be remedied through private contract enforcement mechanisms.

3.2.1. Threat of litigation in disputes caused by (survival) opportunism

Disputes rooted in opportunistic motives triggered by the debtor's financial desperation constituted the most numerous category of *pretenziya* involving non-trivial amounts. Opportunism, justified by the debtor's survival, technically remains to be opportunism - 'self-interest seeking with guile' (Williamson 1985, p. 47). However, the interviewees in this study clearly distinguished between survival-driven opportunism and as Woolthuis *et al.* labeled it – active opportunism – lying, stealing and cheating to expropriate advantage from contracting partner (Woolthuis, Hillebrand and Nootebook 2005, p. 813).

Active opportunism comprised the schemes to 'dump the trading partner' (*kidal'nyye skhemy).* These were dealings originally designed with the sole purpose of deceiving the counterparty and 'hitting the jackpot'. Such schemes often involved multiple intermediaries and/or shell firms, but could also have less elaborate designs; for example, when a firm prepaid its purchases for the first few times, then disappeared with the first trade credit. In dumping schemes a mere breach of contractual promises was often interwoven with purely criminal elements like fraud or forgery of documents.

The interviewees were able to recall only a handful of dumping schemes. Only one case involved the Plant as the victim of the dumping scheme. All others were based on anecdotal evidence or rumours dating back to the 1990s. Such deceptive dealings were unanimously reported to be happening less often in Ukrainian business, and at present were completely absent from the sample companies.

Being questioned about cheating and deceptive behaviour apparently caused some frustration to my interviewees. The demise of dumping schemes was something absolutely clear, logical and evident to all interviewees, including those at the Plant and the Farm. Yet, in small business it was most noticeable. The Café Owner's reaction is illustrative in this respect:

> Now people work more honestly, because firms [in retail trade] are tied to their physical location. A businessman who built his shop with his own money and with

> his 'blood and sweat' would not risk it for a few thousand *hrivnya*s. Why would you soil yourself for mere thousands? Economically it's not profitable to cheat in small business. [the Cafe Owner]

Thus, active opportunism was claimed to be largely absent in researched companies' relations with their trading partners. Instead, they suffered the consequences of opportunistic behaviour arising from debtors' genuine financial distress. A majority of these cases concerned payment delays, and a few, delivery delays. When financial difficulties came into play, the validity of the debts was not disputed but performance was nevertheless delayed indefinitely – 'until we get the money'. If the debtor's financial situation deteriorated to the point of imminent bankruptcy, a quick resort to litigation was deemed practicable, and therefore *pretenziya* was used as the *ultimatum* of earnestness of intention.

In the aftermath of the 2008 global financial crisis, the Plant itself presented a striking example of the debtor whose delays were mounting quickly in multitude and amount. There was no doubt that by 2009 the Plant was already facing a liquidity crisis. The Plant's own in-house counsel estimates that in 2011 up to 80% of the Plant's payments under trade credit contracts were delayed. All the *pretenziya*s served against the Plant, theretofore shielded behind its financial difficulties excuse, arose once the Plant also began delaying wages to its own employees for up to three months.

In a similar vein, interviewees reported that most opportunism in current Ukrainian business was caused by debtors' real financial desperation, rather than the malice to exploit others.

To conclude, *pretenziya* served because of debtors' opportunism constituted the major part of all *pretenziya* registered at the three sample companies. The opportunism prompting these *pretenziya* was partly excused by the real financial distress of the debtors, which were all on the verge of bankruptcy, including the Plant itself. Given the non-trivial amounts of the claims, *pretenziya* in these cases was perceived by the interviewees as a real threat of court action, but only up until bankruptcy proceedings were initiated by the defaulters.

3.2.2. Threat of litigation in disputes arising from circumstances beyond the parties' control

A few *pretenziya* with substantial amounts in dispute arose from circumstances beyond the parties' control – including two at the Plant and one at the Farm. In these cases, to threaten court action was the primary purpose of the *pretenziya.* Circumstances beyond the parties' control meant extraordinary changes in weather conditions, which caused otherwise sound combine to work improperly; a substantial rise in petroleum prices caused by government decree; corporate raiding[4] and a subsequent change of ownership of the trading partner.

The Farm's Newholland Combine Case offered an example in this respect. The Farm bought the expensive Newholland combine which eventually did not work properly. The technical problem causing the breakdown remained unsolved for a month. From the very first days the Farm Owner tried to pressurise the supplier to replace the combine by sending a *pretenziya* to it. However, this *pretenziya* was ignored and the whole matter was never transformed into a legal dispute until both parties agreed that global climate warming was to blame. After unsuccessful face-to-face settlement negotiations, a second letter of *pretenziya* was sent to the allegedly delinquent supplier. The fact that the cause of the problem was beyond the parties' control increased the likelihood of resort to litigation in the perception of the Farm

[4] Corporate raiding or hostile enterprise takeover in the context of post-Soviet business is defined as 'a forced change of ownership and management practiced by influential business groups in relation to large (or medium-sized) enterprises' (Volkov 2004).

Owner and justified his use of *pretenziya*. When neither party was willing to recognise its own fault and pay damages, resort to the law became highly likely.

Thus, where the amount in dispute warrants attention and fault may be excused as owing to circumstances beyond the parties' control, a subsequent lawsuit was deemed possible and *pretenziya* was meant to be a clear threat of court action. Indeed, two out of three *pretenziyas*, caused by circumstances beyond the parties' control, ended up in court.

3.3. Extra-legal functions of pretenziya

Extra-legal functions of *pretenziya* were documented only in the Plant's practice. The Plant possessed more organisational and legal resources than the Farm or the Café; most notably, the Plant had the luxury of two in-house lawyers working full-time at its premises comprising its Legal Department. Furthermore, due to its own and many of its trading partners' complex organisational structures, which triggered numerous misunderstandings, the Plant had more chances to use *pretenziya* in a creative way than the Farm and the Cafe.

In disputes involving trivial amounts or in uncontested matters, litigation was dismissed by the interviewees at the Plant as completely unlikely, yet *pretenziya* were drafted and sent out to the delinquent customers anyway. This section explores the rationale behind these seemingly wasted efforts.

3.3.1. *Pretenziya* as communication tool

Pretenziya as a formal letter always functions as a communication and signaling tool. This function was most evident in business relations involving large industrial enterprises and trading companies with complex internal organisation.

In Ukrainian business, decision-making rests within upper management and sometimes is solely concentrated in the hands of the general director. The hierarchical nature of post-Soviet management dictates strict rules of etiquette whereby an employee of a certain status in one company must be approached by an employee of equal status of another company. Thus, operational managers may speak only to other operational managers, lawyers to lawyers and directors to directors. Given this social environment, because the *pretenziya* letter is signed by the director (though usually drafted by lawyers) and addressed to the counterparty's director, it has a chance at least of being read. In addition to this advantage, *pretenziya* was seen by the interviewees in this study to be a helpful device for discovering the other side's legal position to take further counsel about the method of debt collection.

Thus, *pretenziya* always plays a communicative role. However, as it became evident from the data, communication became the major and even the only function of *pretenziya* in cases of trivial debt – sometimes as little as UAH 100,0 (around US$10,0). Such small amounts presented no threat to the well-being of any company and were often called 'the tails'. Nevertheless, they complicated accounting, drawing frequent complaints from the accountants, and therefore warranted some collection effort. The Plant also believed a policy of chasing up the smallest debt signalled its seriousness to its trading partners.

Many of the Plant's 'tails' originated in the practice of tolerance. A fact of cable manufacturing worldwide is that the cable can be cut off only at certain points. The standard practice is to allow for some flexibility – in industrial terminology 'tolerance'. Therefore, cable as sold had an actual length between 0% and 5% of the length ordered. 'Tolerance' practice was well-known in Ukrainian cable manufacturing, and 'tolerance' clauses were clearly spelled out and agreed in the Plant's written contracts. Nevertheless, some clients did not feel obligated to pay for unordered extra lengths.

Other cases when *pretenziya* was employed, notwithstanding the trivial character of the contractual problems, were termed 'technical mistakes' or 'human factor problems'. Neither the three sample companies nor their counterparties were immune to mismanagement, bureaucratic snafus and other failures; and *pretenziya* helped to overcome consequences of these annoying problems. To give an example, the German company supplying new machinery to the Plant omitted to include one of the operating manuals with the machine. The lawyers had to draft a letter of *pretenziya* and translate it into German to let the German partner know about the omission.

Finally, *pretenziya* played a primarily communicative role in cases where litigation was warranted but ineffective because the judgments could not be enforced. According to current Ukrainian law all Ukrainian enterprises where the state retained at least 25% of shares were shielded by the moratorium on forced seizure of assets.[5] All parties to disputes involving state-owned enterprises clearly realised that these debts were 'dead'; therefore, *pretenziya* sent to state-owned companies was not aimed at pressurising the debtor to pay under threat of litigation. Instead, it operated mostly as a communication tool at informal relational level. The Plant in two cases did finally sue the state-owned enterprises, with a slight hope that someday the moratorium might be repealed. It was also hoped that a judgment would at least make the Plant's account books look better.

Thus, where litigation was out of the question (in the case of petty debts) or useless (in cases against state-owned enterprises), *pretenziya* played above all a communicative role.

3.3.2. *Pretenziya* as a means of neutral mediation

Litigation was considered unlikely over 'technical mistakes' caused by both parties or when the mistake of one party triggered mistakes by the other. Observed examples of such shared failures included the following: the seller served a mistaken invoice and the buyer paid less than the contract price pursuant to the invoice; the buyer delayed upfront payment and therefore the seller could not supply the required model of the machine; the seller erroneously supplied unordered extra goods and the buyer rejected their acceptance; the seller lost the documents and the carrier therefore did not supply the trucks in time.

When disputes arose from mutual mistakes and misunderstandings, recriminations and emotionalism made reasonable resolution at the operational level problematic. Lawyers in these cases played the role of informal mediators using *pretenziya* to discover the facts of the situation. Often what they discovered was that the Plant itself had been claiming debts erroneously or that the Plant's own failures had caused the debts. In consequence, the operational managers were able to settle between themselves.

3.3.3. *Pretenziya* for the sake of formalisation of relationships

Quite a substantial number of *pretenziya* in the Plant's relations with its suppliers were simply fake. Non-existent disagreements or those already settled were repackaged by the lawyers to look like legal disputes by the use of *pretenziya*.

The Plant's lawyers in particular routinely drafted and dispatched *pretenziya* in uncontested matters without much deliberation. All information required to be included in the *pretenziya* was supplied by the other departments in charge of the underlying business relationship. Unsurprisingly, the lawyers had few memories of these matters.

[5] The Law of Ukraine No 2864-III 'On Moratorium on Forced Seizure of Assets' of 29 November 2001; The Law of Ukraine No 2711-IV 'On Measures to Ensure Continuous Operation of the Fuel and Energy Sectors' of 23 June 2005.

Pretenziyas in undisputed cases were either mandated by law or else formalised settlements already achieved on the ground. *Pretenziya* mandated by law mostly concerned quality and quantity deficiencies in goods under the so-called Instructions P6P7 - the Soviet by-law of 1965 that regulated in detail the procedure for inspection of goods by the buyer. The Instructions prescribed that after a joint inspection of goods, the seller and buyer should sign an 'Act of Deficiencies'. This was in essence a settlement agreement, in that the parties waived their rights to raise any claims other than those agreed in the Act itself. Following the Act *pretenziya* was sent out automatically and served to formalise the settlement.

Ukrainian law also mandates prompt bringing of suit in trans-border debt cases. The Law 'On Foreign Currency Exchange Control' aimed at suppressing money-laundering imposes fines on a creditor who has transferred 'payment' abroad but failed to receive in exchange goods or monetary compensation within ninety days. Creditors who file suit in court or invoke international arbitration are exempted from the fine.

To steer clear of this law the Plant was obliged to regularly initiate *pretenziya* against its parent company in Russia, a few of which actually ended up in court after the bankruptcy of the latter. Understandably, the debts in these cases were agreed, and were apparently aimed at so-called 'tax optimisation' (*i.e.* tax evasion).

In a similar vein, the Plant used *pretenziya* to formalise settlement agreements reached by its operational managers. A few examples include off-sets of mutual claims; price reduction on the next contract; provision of additional services; supply of extra inputs; and renegotiation of the specifications.

To sum up, *pretenziya* in undisputed matters served as hard evidence of the problem and its solution, which could be exhibited to the accounting department, to upper management, or to the tax inspectorate.

3.3.4. Invented legal claims in *pretenziya* as bargaining leverage

Many other creative uses of *pretenziya* by the Plant's legal counsel were triggered by changes of law. It is common knowledge that the Ukrainian government is constantly amending numerous laws and by-laws, mostly in the sphere of tax control. These changes negatively affected the dispute resolution practices of the sample companies. For example, within the period of this research the Plant underwent a change of the law governing bills of lading – the so-called TTN (*tovarno-transportnaya nakladnaya*). When the Plant realised that it was legally obligated to safekeep TTNs pursuant to the new regulations, it was already too late and a number of transactions with carriers had been executed without TTNs. When the sales people were unable to pressurise their trading partners to supply the documents, the Plant's in-house counsel had to step in with *pretenziya*.

Although the Plant was at fault for missing the change in law and the carriers were not contractually obligated to do extra paper work for the Plant, lawyers turned things on their head in *pretenziya*. Despite the goods were in fact delivered to the Plant's buyers, the lawyers claimed that the lack of TTNs gives the Plant a formal ground to deem these goods undelivered. Therefore, the Plant demanded damages for 'non-performed' contracts. In this case the Plant's lawyers employed legal discourse and the legal form of *pretenziya* inventively, repackaging the controversy to look like a legal dispute. Here *pretenziya* was being used essentially as 'bargaining chips' and the Plant eventually succeeded in collecting all the necessary documentation from the carriers.

3.3.5. *Pretenziya* as dilatory tactics used by the respondents

Some companies who found themselves in financial distress treated *pretenziya* as an opportunity to play for time and to delay the final payment day. For want of a better alternative the Plant had to rely upon this shady strategy as a survival kit.

Since 2009 the Plant's payment practices have became chaotic and unpredictable, resembling the lottery. The popular joke of the 90s was recalled by the Plant's lawyers when its situation sadly began to resemble that era in 2009.

> The director of the company received a *pretenziya* demanding payment of debts to the supplier. The director answered: 'If you ask for your money again in such a tone your *pretenziya* will be excluded from our premium drawing'. [the Head of the Legal Department, the Plant]

Given that 'to pay or not to pay' decisions were being made by one person – the General Director - under opaque criteria, the selection process was indeed akin to a lottery. After 2009 the Plant's efforts have been redirected mainly toward protraction of the disputes.

The Plant relied upon increasing numbers of suppliers in order to have at least two for each key input and to manoeuvre between them. When the Plant was overdue with one supplier and received its *pretenziya,* it turned to the other and *vice versa*. By doing so the Plant effectively doubled the term of trade credit from its suppliers.

The Plant also differentiated between large debts to important trading partners and smaller debts to those who were expendable. *Pretenziya*s for important debts were settled straightaway, sometimes through small but regular instalments, in order to complicate debt calculation and discourage the debtors from going to court.

Less important *pretenziya*, classified by the Director as 'capable of waiting', were sent to legal counsel with the implicit instruction to delay the payment by all possible means. The means of 'legitimately' delaying payment that the lawyers had at their disposal were few. Some of the *pretenziya*s the lawyers did not answer at all. The number in this category had doubled by 2011. Another lawyerly trick was to wait until the time-period prescribed for answer had expired and only then to send out a formal letter requesting more documents for considering the *pretenziya*; otherwise, they rejected the *pretenziya* on the technical grounds of a lack of documentation. As a last resort, the lawyers would answer *pretenziya*s without any definite payment promise,[6] which meant nothing and in some cases prompted a second *pretenziya* from the creditor. In a few cases the number of *pretenziya* rose to three. The lawyers interviewed reported that the Plant usually paid straightaway after the third *pretenziya*.

Despite every effort utilising all possible strategies, the Plant was never able to escape payment for longer than a few months. While lawyers for both parties were engaged in lengthy and senseless correspondence, the sales people often managed to negotiate settlements and the matter melted away. On still other occasions, dilatory tactics led down a slippery path, and the creditors ended up filing lawsuits in commercial court. From 2008 to 2011 the number of *pretenziya*s against the Plant increased fivefold and the number of court cases from zero in 2008 to four in 2011.

4. Conclusions

This paper has analysed the varied uses of law at the claiming stage of dispute resolution in the business relations of three Ukrainian companies and their trading partners. Without additional research the qualitative methodology of this study does not permit a firm conclusion as to how widespread in Ukrainian business the identified patterns might be; yet the previously unexplored creative uses of the legal form of *pretenziya* by businesses has been illuminated, and one possible explanation for this phenomenon has been offered.

[6] As an example of such terms here is a 2010 *pretenziya* answer of the Plant: 'Our Plant sincerely appreciates the partner relationship that has been developed between our enterprises. At the same time, taking into account unstable financial situation of our enterprise, immediate fulfillment of financial obligations towards you is impossible. As soon as the financial conditions of the Plant improve, we undertake to promptly repay the debt'.

The findings reveal that the law became involved in disputes between Ukrainian companies most conspicuously during exchange of pre-trial claims (*pretenziya*) – those letters in special legal form which were once mandated by Soviet law and continue to be used at present despite having been made optional. This paper has attempted to shed some light on the questions why in Ukraine *pretenziya* has survived two decades after the post-Soviet transition, in what ways it continues to be used, and how it has influenced the outcomes of disputes.

Based on the dispute transformation framework developed by Felstiner, Abel and Sarat (1980), this study identified fairly unproblematic relations among Ukrainian businesses. Before the 2008 economic crisis, 92% of the transactions of the three sampled companies were performed perfectly in accordance with contractual terms. In the remaining 8% of transactions, where problems did arise, this study documented a practice of virtually simultaneous naming, blaming and claiming, which transformed almost all problems into grievances. At this stage 94% of grievances were settled through bilateral negotiations, without express involvement of law or lawyers. The remaining 6% of disputes carried over into formal legal complaints in the form of *pretenziya*. In the aftermath of the 2008 global economic crisis, the number of contractual problems caused by the Plant, and consequently the resort to *pretenziya*, increased substantially. Still, the pattern of prompt claiming of what was due under the contract remained unchanged.

This study has furthermore documented that, contrary to the US experience of legal transformation of disputes (Felstiner, Abel and Sarat 1980, p. 645), and in line with Hendley's findings (Hendley 2001, pp. 39-41), the decision to initiate *pretenziya* was taken almost exclusively by the companies' upper management. Lawyers held neither a monopoly nor even any meaningful role in this dispute transformation, and thus, cannot be seen as major transformation agents.

By looking more closely at the functions of *pretenziya* at the sampled companies, this study has identified multiple uses for it. *Pretenziya* was seen by those interviewed for this study as a pressure, through the threat of court action, toward settlement when the amount of the claim was substantial and the disputes caused by circumstances not easily ameliorated by the parties. Such circumstances included those beyond the control of both parties (*e.g.* governmental decrees, global warming); and the genuinely distressed financial situation of the defaulter, partly excusing the default, which was recognised by all parties as distinct from active opportunism. In these cases it was indeed expected that *pretenziya* would induce the defaulter to 'come to his senses', to voluntarily satisfy the claim and thereby avoid even greater losses in court from contractual penalties and court fees.

While all the *pretenziya*s served by or against the Cafe and the Farm were strictly within the bounds of the legal functions of *pretenziya* discussed above, only one half of the Plant's *pretenziya*s were intended as bona fide threats of litigation, while the other half served non-legal functions.

Extra-legal creative uses of *pretenziya* were identified in the disputes with the petty amount of claims or with uncontested issues in cases where litigation was pointless. This study has uncovered a number of rationales behind these seemingly wasted efforts.

First, when settlements were reached on the ground by sales people and matters no longer disputed, *pretenziya* served as forensic evidence for accounting purposes to formalise the newly restructured business relationship.

Second, when the amount claimed was trivial – so-called 'tails', which arose from technical problems or human misunderstandings, – *pretenziya* served primarily as an attention-getting communication and signalling tool to break through to the main decision-makers, the general directors.

Third, when technical mistakes and human omissions were caused by both sides, and emotions ran high, *pretenziya* played the role of a mediation technique and a quasi-legal discovery procedure to clarify the situation. Often the information obtained in this way by in-house counsel was sufficient to put an end to the dispute.

Fourth, in certain cases *pretenziya*, as a legal form of discourse, was used creatively as a 'bargaining chip' which repackaged seemingly groundless claims into 'nuisance' legal disputes.

Fifth and finally, when the three sampled companies were respondents in *pretenziya* (as for example, the Plant in the aftermath of the 2008 world financial crisis), they took a defensive stance and exploited *pretenziya* as dilatory tactics to improve their own cash-flow at the expense of their contracting partners.

This spectrum of non-legal functions of *pretenziya* illuminates its mixed nature and offers one possible explanation of its persistence in post-Soviet business. Due to its adaptability, *pretenziya* was capable of operating both as a token of the 'shadow of the law' and as part of a private contract enforcement mechanism in repeated dealings. In the latter case the expressly legal form of *pretenziya* was not necessarily seen as insulting the trading partner. Conversely, it was perceived as facilitating the debt collection process through enhanced communication between the parties.

'Creative' non-legal uses of *pretenziya* proved more effective than the threat of court action. Not a single case ended up in court when 'creative' *pretenziya*s were used. In contrast, where the threat of litigation was the primary or only aim of *pretenziya,* it had a slight impact on the outcome of the dispute. More than one third of such disputes proceeded to trial. Indeed, the interviewees in this study reported serious doubts about the capability of the threat of litigation in *pretenziya* on its own to induce debt payment

Irrespective of the prospects of success, the use of *pretenziya* was amply justified by its minimal cost. At companies with in-house counsel the direct costs of *pretenziya* consisted merely of the postage. Even where lawyers were not employed – at the Farm and the Cafe – *pretenziya* was still viewed as a cheap, albeit a last resort to induce the defaulter to settle. The Russian- and Ukrainian-language Internet is flooded with *pretenziya* templates. Given the straightforward nature of most buyer-supplier disputes, operational managers were reported fairly capable of drafting and dealing with *pretenziya* on their own. These factors drastically reduced the expense of mobilising law at this stage of dispute resolution.

Additionally, the use of *pretenziya* by large enterprises was also conditioned by the internal managerial routine left over from the Soviet epoch. For example, the corporate guidelines of the Plant prescribed that *pretenziyas* are to be despatched in all payment disputes where the delay exceeds fifteen days.

To conclude, this study has documented that not all Soviet-style managerial practices are hopelessly outdated, detrimental, and anti-innovative. *Pretenziya* in a voluntary form has not only survived but even opened up new avenues for the creative use of legal forms in business. Its persistent use in post-Soviet Ukraine is best explained by its adaptability to the new system of market-oriented economic exchange by reason of its 'creative', extra-legal functions complementary to private contract enforcement; its low cost; its integration into the managerial routine, and consequent tendency to offset the lawyers' monopoly on legal expertise and practice.

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Appendix: Summary of the background information on the researched companies

	The PLANT	The FARM	The CAFE
Size (number of employees)	552 in 2007, 495 in 2010	58	5
Sectors of economy	Industrial manufacturing	Agriculture	Retail trade and restaurant service
Market size	Ukraine and CIS	Oblast (region)	City district
Founded in	1962	2000	1995
Corporate structure	Open joint-stock company	Limited liability company	Self-employed
Profits from sales in 2007 (UAH)	240.000.000	10.000.000	80.000
Number of buyers and suppliers in 2007	500	122	24
Number of buyers and suppliers in 2007	400	92	23
Lawyers or legally trained personnel	Legal Department of two lawyers. One of the two CEOs had a law degree	The Owner had a law degree	The Owner had experience of self-representation in commercial courts