

Insolvency in Ukraine



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In recent years, Ukraine has achieved an impressive average annual growth rate of about 7%. However, by the end of 2008, the IMF was forced to intervene with a USD 16.5 billion emergency loan, as

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the Ukrainian banking system teetered on the brink of collapse.

Ukraine entered 2009 in recession, and forecasts for growth in the second half of the year depend heavily on the state of the global economy. As Ukraine struggles to deal with the effects of the financial crisis, companies are at greater risk of bankruptcy than ever before.

The credit crunch

In 2008, 11,044 Ukrainian companies entered bankruptcy proceedings. Unfortunately, this figure is rising: as at 1 January 2009, 14,283 bankruptcy cases were pending. Companies are not only suffering from a decrease in demand and the fall of the Hryvnia; the availability of debt finance in Ukraine is also perilous.

Ukrainian banks are themselves experiencing financial difficulty, with 13 out of 199 registered banks being liquidated, another 15 under management of temporary administrators appointed by the country's central bank, and seven ready to surrender between 75% and 99% of their shares to the state in exchange for recapitalisation.

Ukraine's main bankruptcy law, *On Restoring a Debtor's Solvency or Declaring the Debtor Bankrupt Act of Ukraine*, was significantly revised in 1999. Bankruptcy proceedings now offer four courses of action: asset management (i.e. administration) as an initial stage, followed by amicable settlement, sanation (i.e. financial rehabilitation) and, as a last resort, liquidation.

Yet of the companies in bankruptcy proceedings in 2008, just 3.65% restored their solvency, while over 96% were liquidated. Given these figures, what can be done to stave off liquidation?

Early action

The key to avoiding bankruptcy is taking action as early as possible to forestall the possibility. Collecting debts due, cutting spending, and axing non-core projects could all limit the chances of bankruptcy. Given the current market, a review of any company's business model is more than prudent.

Even before a critical point has been reached, a company could also consider restructuring its distressed debts. This can be done in one of two ways. Firstly, the parties may come to a compromise agreement, by which they agree to the deferral or remission of the debts due (and so renew the original loan agreement). Secondly, the rights and obligations of the original lender may be transferred to a new lender, either by assignment, legal succession (where the borrower has been subject to a corporate reorganisation), subrogation or discharge. Care should be taken to ensure that any security in favour of the original lender is transferred to the new lender.

Alternatively, the borrower may be able to comfort the original lender by providing it with additional security, perhaps in return for restructuring of the loan or deferment of payments.

The company could also try to attract a new investor. This is far from easy: normal lines of international credit have closed down, and Reuters has reported that tensions with Russia will harm Ukraine's ability to attract foreign investment.

It is crucial that companies keep a close eye on their finances to ensure that bankruptcy proceedings cannot be triggered. This means ensuring that no creditor has an indisputable claim that exceeds

300 minimum statutory wages (currently about EUR 18,000) and is three months overdue. However, a debtor must initiate proceedings itself if, as a result of paying one creditor, it became unable to meet its obligations to other creditors.

Once bankruptcy proceedings have begun, the asset management procedure is commenced. This involves the appointment of an administrator who is tasked with evaluating the company's assets and the creditors' claims, and who must approve any important transactions in advance. The creditors will also elect a committee to represent their interests.

During the asset management procedure, the company may continue to trade. However, the courts will normally impose a moratorium on a company preventing any payments being made to creditors (other than current creditors) and enforcement procedures being initiated against it.

There are three possible outcomes to asset management: amicable settlement and sanation allow the company to carry on trading but, if these options fail, the company will go into liquidation.

Amicable settlement

The company can enter into an amicable settlement agreement with its creditors to suspend or defer the repayment of debts or release the company from all or part of its liability for those debts. The agreement must be approved by the company's management, the majority of registered creditors, all secured creditors and a court.

It is often more attractive for creditors in the long run to accept part payment of their debts, rather than force a company into liquidation and risk getting nothing. However, for them to support an amicable settlement agreement, they must have confidence in the company's business plan, market position and, perhaps most importantly, its management. Without these, the company will be unlikely to meet the creditors' demands and will be forced back into bankruptcy proceedings.

Sanation

Sanation aims to return the company to solvency by appointing a rehabilitation manager to run the company.



The rehabilitation manager produces a sanation plan for the next 12 months, which can be extended by a further six months. Sanation requires creditors to still have confidence in the company's financial viability but, unlike an asset management procedure, it also involves the removal of the previously underperforming management.

Liquidation

If an amicable settlement agreement and sanation are unsuccessful or inappropriate, the company will go into liquidation. The purpose of liquidation is to wind up the company, whilst maximising the value of its assets.

The claims of creditors are satisfied in strict order of priority, with secured creditors and employees in the queue before unsecured corporate creditors:

1. secured claims and claims for unpaid salaries;
2. other claims of employees (e.g., for damage to life and health);
3. claims for statutory payments;
4. unsecured creditors claims;

5. claims for return of charter fund contributions by employees;
6. other claims.

Liquidation is clearly the least preferable outcome; a return to solvency allows the company to continue trading and so contributing to the Ukrainian economy. Liquidation was still the outcome in over 96% of companies in bankruptcy proceedings in 2008, despite the possibilities provided by amicable settlement agreements and sanation.

The current global financial crisis will be a challenging time for Ukrainian companies. The ones that will be best placed to avoid bankruptcy are those that have a credible business model, continually monitor their financial performance and take action the very moment any warning signs appear. Even if they do enter bankruptcy proceedings, they may still be able to recover if the management, investors and creditors are all committed to regeneration, not liquidation. But for that to happen there must first be a shift in mindset. ■