

Insolvency in Ukraine: managing legal risks

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In recent years Ukraine has achieved an impressive average annual growth rate of about seven per cent, with a great deal of this growth attributed to substantial foreign investment. By the end of 2008, however, the International Monetary Fund was forced to intervene with a \$16.5bn emergency loan, as Ukraine's 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, Ukrainian companies are at a greater risk of bankruptcy than ever before. As such, it is vital when dealing with Ukrainian companies to conduct extensive due diligence to ensure that they are, and remain, solvent. Key to this is monitoring the official Ukrainian press, as if the 30-day deadline for the submission of creditors' claims against an insolvent Ukrainian company is missed, such claims are deemed to be discharged. This article provides lenders and investors with an overview of bankruptcy proceedings available in Ukraine.

The risk of bankruptcy

In 2008, 11,044 Ukrainian companies entered bankruptcy proceedings. This figure is rising: as at January 1, 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 perilous. Ukrainian banks are themselves experiencing financial difficulty, with 13 out of 199 registered banks being liquidated, another 15 being under the management of temporary administrators that the central bank has appointed, and seven ready to surrender between 75 per cent and 99 per cent of their shares to the state in exchange for recapitalisation.

Bankruptcy proceedings

Ukraine's main bankruptcy law, "on restoring a debtor's solvency or declaring the debtor bankrupt", 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.

In an attempt to stave off insolvency, it is crucial that Ukrainian companies keep a close eye on their finances to ensure that bankruptcy proceedings will not be triggered. This means ensuring that no creditor has an indisputable claim that exceeds 300 minimum statutory wages (currently about €18,000) and is three months overdue. A debtor, however, must initiate proceedings itself if, as a result of paying one creditor, it becomes unable to meet its obligations to others.

Once bankruptcy proceedings have been initiated, the initiating creditor or, as the case may be, the debtor-company itself, must publish a notice on the initiation of bankruptcy proceedings in the official Ukrainian press. The publication of this notice is of importance to a creditor: unless a creditor's claim is submitted to the relevant Ukrainian commercial court within 30 days of the publication date, such claim is deemed to be discharged. As such, it is crucial that companies with business interests in Ukraine monitor the official Ukrainian press. To make this process easier, computer programs are now available that monitor the official press and provide updates on companies that have entered bankruptcy proceedings. It is possible to place certain companies that have a particular importance "on watch".

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. The courts, however, will normally impose a moratorium on the company that prevents any payments being made to creditors and enforcement procedures being initiated against it. There are three possible outcomes to asset management: amicable settlement and sanation, which allow the company to carry on trading, and if these options fail, 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 company's managers, the majority of the registered creditors, all of the secured creditors and the court must approve the agreement.

It is often more attractive for creditors in the long term to accept part payment of their debts, rather than force a company into liquidation and risk getting nothing. For them to support an amicable settlement agreement, however, they must have confidence in the company's business plan, market position and, perhaps most importantly, its managers.

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 Ukrainian company to solvency by appointing a rehabilitation manager to run it. The rehabilitation manager will produce a sanation plan for the next 12 months, which can be extended by a further six months. The creditors must retain confidence in the financial viability of the company; however, in contrast to an asset management procedure the previously underperforming managers will be removed.

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, while maximising the value of its assets.

Creditors' claims are satisfied in strict order of priority, with secured creditors and employees coming before unsecured corporate creditors:

- 1 Secured claims and claims for unpaid salary.
- 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.

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. Over 96 per cent of Ukrainian companies in bankruptcy proceedings in 2008 were liquidated, however, despite the possibilities that amicable settlement agreements and sanation provided. Even if a company does enter bankruptcy proceedings, it may still be able to restore its solvency if the managers, investors and creditors are all committed to regeneration, and not liquidation. For this to happen, there must first be a shift in mindset.

The global financial crisis will be a challenging time for Ukrainian companies. The companies that will be best placed to avoid bankruptcy are those that possess a credible business model, continually monitor their financial performance and take action the moment that any warning signs appear. Creditors should be aware of the potential risk to Ukrainian companies and take appropriate action where possible.

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