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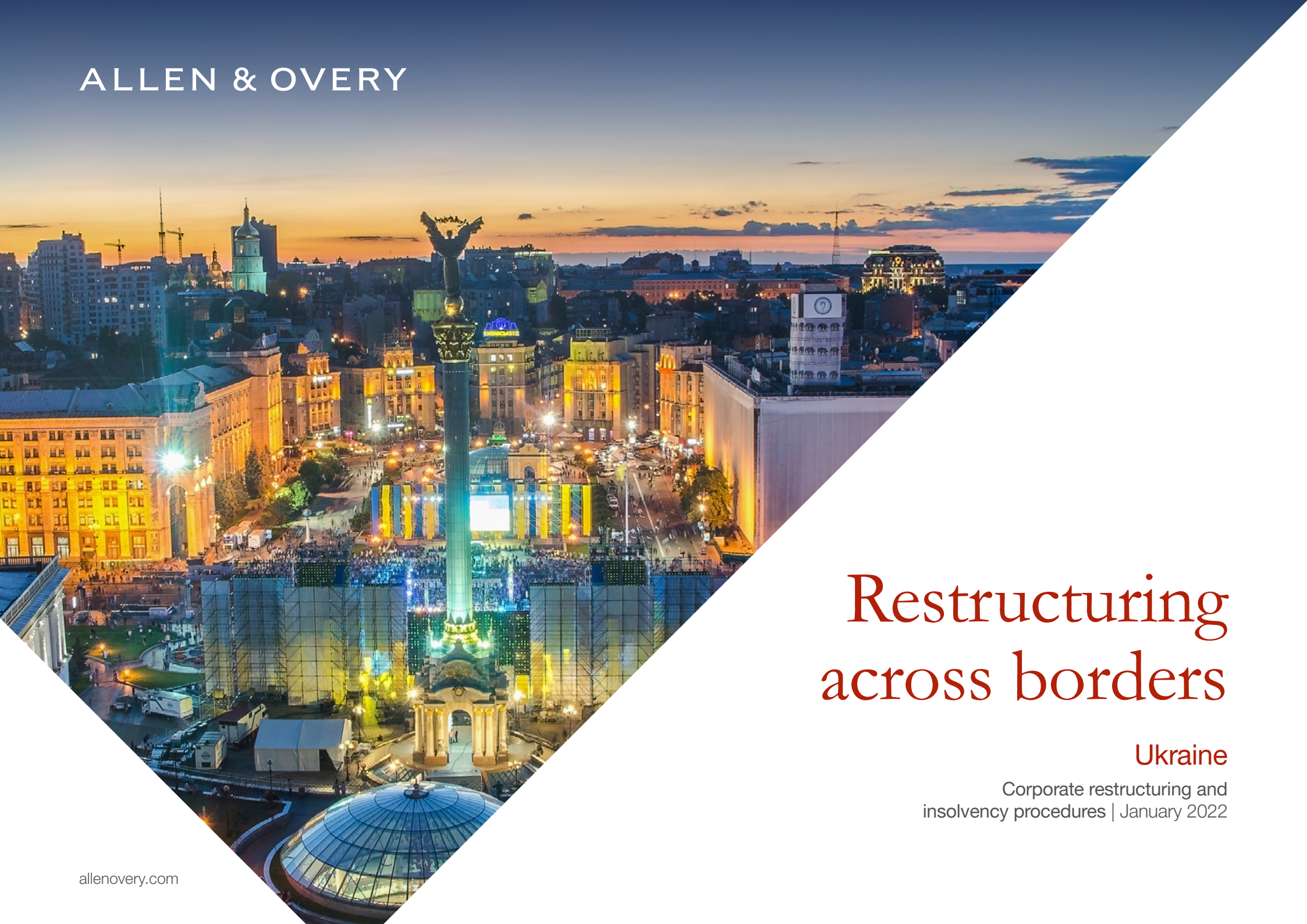

Restructuring across borders

Ukraine

Corporate restructuring and insolvency procedures | January 2022

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Contents

Introduction

The following procedures are available to a company in financial distress under Ukrainian law:

– financial restructuring;

– pre-trial restructuring (*dosudova sanatsia*); and

– bankruptcy proceedings.

Financial restructuring is an out-of-court procedure which is governed by the Law of Ukraine "On Financial Restructuring" No 1414-VIII dated 14 June 2016 (effective until 19 October 2022) (the **Law on Financial Restructuring**), while pre-trial restructuring and bankruptcy proceedings are supervised by the courts and are based on the Code of Ukraine on Bankruptcy Procedures No 2597-VIII dated 18 October 2018 (which entered into force on 21 October 2019) (the **Bankruptcy Code**).

The bankruptcy proceedings consist of three main stages:

– asset management (*rozporyadgennia mainom*);

– in-court restructuring (*sanatsia*); and

– liquidation (*likvidatsia*).

Usually, the stages of bankruptcy proceedings are consecutive, and the court decides to proceed to each next stage only if the previous one fails to resolve the financial difficulties of the debtor. However, the court may skip the in-court restructuring stage and proceed directly to liquidation of the debtor provided:

– the creditors' meeting so requests; or

– the creditors' meeting fails to make any decision in the course of the asset management procedure on how to proceed.

Ukrainian law establishes a separate regime for resolution of banks, as well as different bankruptcy rules for certain state companies.

Financial restructuring

A company may initiate a financial restructuring under the Law on Financial Restructuring provided that:

– it is not subject to bankruptcy;

– its commercial viability is confirmed by a report prepared by an independent expert; and

– its creditor(s) consent to participate in the financial restructuring and approve the restructuring plan.

Financial restructuring is a voluntary procedure and only those creditors that consent to participate in the financial restructuring are designated as "involved creditors". The restructuring plan is prepared only in respect of the claims of involved creditors. A unanimous vote of involved creditors is required to approve a restructuring plan, failing which a 2/3 majority in value of involved creditors may approve the plan if supported by a decision of an arbitrator.

There is a moratorium on enforcement for 90 days (involved creditors may decide to terminate the moratorium at any time), which may be extended by involved creditors, but in any event the moratorium cannot exceed 180 days. During the moratorium, involved creditors cannot enforce their claims and all creditors are prevented from enforcing against the capital assets of a company.

In a financial restructuring, the management retains full control.

If involved creditors fail to approve the restructuring plan in the course of the financial restructuring, a company may use the same plan and available creditor votes (if sufficient) to initiate a "pre-trial restructuring" in court.

Pre-trial restructuring

A company can initiate the so-called pre-trial restructuring, whereby it prepares a restructuring plan, pre-approves it with creditors and then seeks court approval for the plan.

A pre-trial restructuring plan needs to be approved by a court and pre-approved by (i) at least 2/3 of the total secured creditors by value in each class and (ii) at least 50% of the total unsecured creditors by value in each class. Only those creditors whose claims were included in the restructuring plan are permitted to vote.

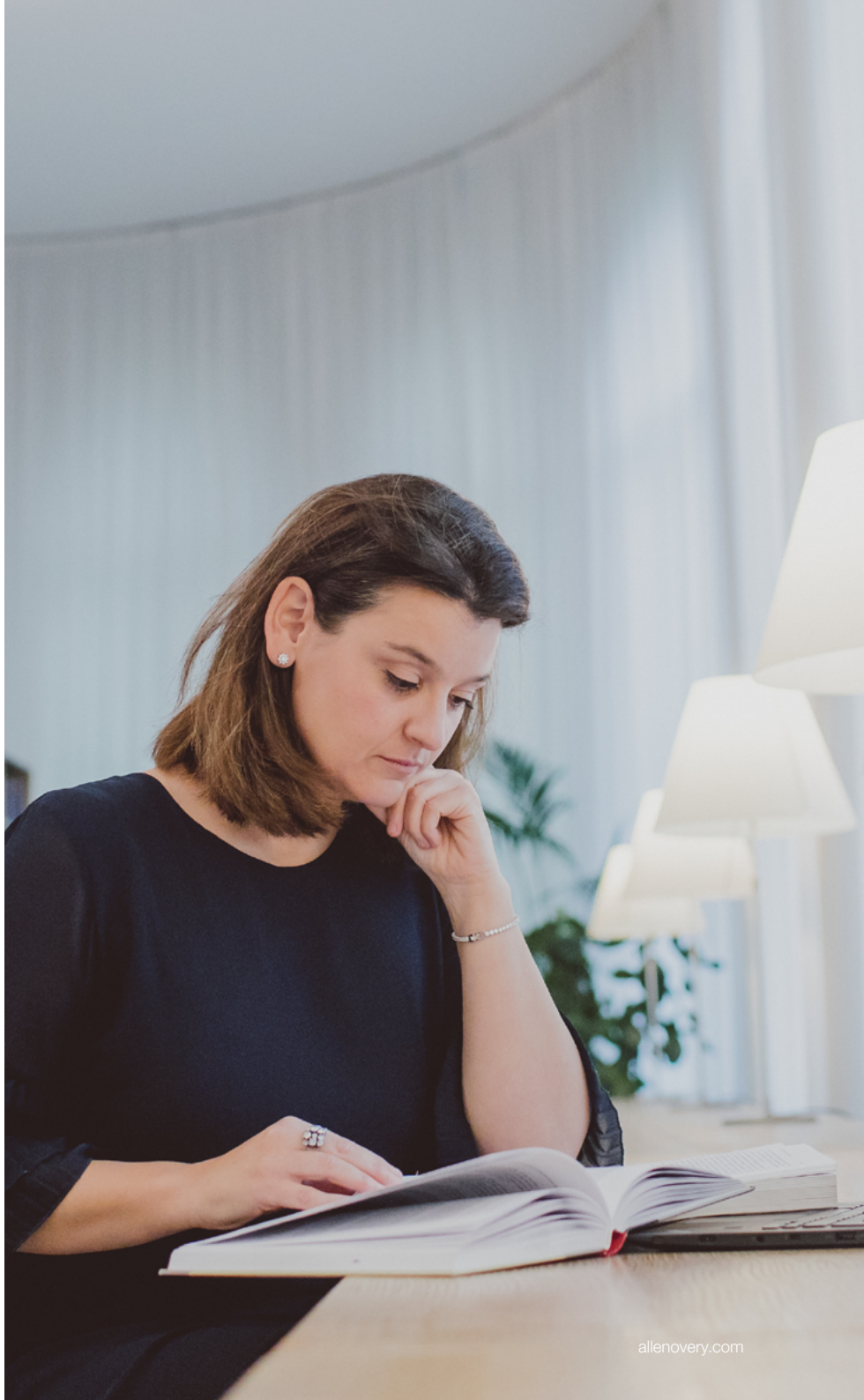
Within a five-day time limit following creditors' pre-approval of the plan, the debtor must file an application for approval of the plan to the court. The court will consider the plan submitted to the court by the debtor at a court hearing with the participation of the creditors. The terms of the restructuring plan for creditors that did not vote or voted against the plan shall not be worse than the terms for creditors who voted for the restructuring plan.

A restructuring plan shall be rejected by the court if any creditor demonstrates that it would receive more in liquidation than under the restructuring plan. If approved by the court, the restructuring plan becomes binding on all creditors whose claims were included in the restructuring plan.

The court may also appoint a restructuring manager if the creditors so agree in the pre-trial restructuring plan. Upon completion of the pre-trial restructuring, the court issues a ruling confirming performance of the pre-trial restructuring plan.

In a pre-trial restructuring, the management retains control, but the court may appoint a restructuring manager (provided his/her appointment and scope of powers are set out in the restructuring plan).

Unsecured and secured creditors may not enforce their rights from the date on which a company files a pre-trial restructuring plan with the court and until the decision of the court (on whether it approves the pre-trial restructuring plan) is issued.



Commencement of bankruptcy proceedings

The bankruptcy proceedings may be initiated by either a creditor or a debtor. A debtor may commence a bankruptcy case if there exists a threat of its insolvency (ie when a payment to one or several creditors will result in making payments in full to all other creditors impossible) by filing an application to the first instance commercial court. A CEO (*kerivnyk*) of the debtor must file for bankruptcy within one month after it becomes apparent that there is a threat of the company's insolvency, ie if payment of a debt to one creditor will result in impossibility of payment to all other creditors. Failure by the CEO to comply with this obligation will result in them becoming jointly and severally liable (with the company) for all unsatisfied claims of creditors.

A creditor may initiate a bankruptcy case if it can demonstrate to the court that the debtor is not in position to pay the debt which has become due, other than by using the procedures contemplated by the Bankruptcy Code. Several creditors may combine their claims against one debtor and file a joint application for bankruptcy.

Prior to commencement of the bankruptcy proceedings, the debtor may demonstrate to the court its proper financial standing and discharge the debt of the initiating creditor(s).

An application for bankruptcy must indicate the name of the court, the name and details of the company, and, if submitted by the debtor, details of all its creditors, as well as an outline of the circumstances that have led to the threat of insolvency.

An application for bankruptcy may only be filed by a debtor if it has sufficient funds to cover the expenses associated with bankruptcy proceedings.

Within five days from the date of the application, the court shall issue a ruling, which shall set the date of the preparatory hearing (to be held not later than 20 days from the date of the ruling).

At the preparatory hearing, the court decides whether to grant or reject the application for bankruptcy. If the application is granted, the following ensues:

- bankruptcy proceedings commence and an asset management procedure is introduced (see below);
- a 170-day moratorium on the satisfaction of creditors' claims is introduced;
- an official publication is made following which all creditors will have 30 days to file their claims in the bankruptcy procedure;
- a preliminary hearing is scheduled (which should be held not later than within three months from the date of the preparatory hearing);
- an insolvency manager is appointed; and
- the appointed insolvency manager prepares an inventory of the company's assets within not more than three months from the date of their appointment.

Creditor representation in bankruptcy proceedings

A creditors' meeting and a creditors' committee are convened/formed in every bankruptcy case. First, a creditors' meeting (composed of unsecured creditors with voting rights and secured creditors with advisory rights) is convened, which then appoints members of the creditors' committee. A creditors' committee shall include no more than seven creditors.

The creditors' meeting and creditors' committee are authorised to take all important decisions in the course of the bankruptcy proceedings.

The creditors' meeting is entitled to: (i) appoint the members of the creditors' committee and terminate their powers; (ii) approve and amend an in-court restructuring plan; (iii) compel a company into liquidation; and (iv) appoint a liquidator.

The creditors' committee consists of not more than seven persons, who are appointed by at least 50% of the votes (by value) of the creditors, present and voting at the creditors' meeting. A creditor with more than a 25% majority of the total creditors' votes becomes a member of the creditors' committee automatically.

The creditors' committee has supervisory authority over the liquidator and can sanction the exercise of the liquidator's powers. The creditors' committee may also apply to the court and challenge the company's preferential transactions.

Asset management

The duration of this stage shall not exceed 170 calendar days.[1] The insolvency manager shall, among other tasks: (i) carry out an analysis of the financial and commercial condition of the company; (ii) prepare a list of the company's creditors; and (iii) acknowledge or reject creditors' claims etc. Within the asset management procedure, the court approves the register of creditors, indicating their class and priority ranking for their claims. The priority ranking under Ukrainian law includes the following potential categories of creditor(s): [2]

1) Secured claims (to the extent of security interest). Secured claims are discharged separately from other claims and do not formally fall into any priority ranking.
2) Claims of gig workers under gig contracts concluded pursuant to the Law of Ukraine "On Stimulating the Development of Digital Economy in Ukraine", employment-related claims, the payment of wages to company employees, claims of the State to a company for damages caused by payment by the State under ECHR judgments, expenditures associated with the conduct of the bankruptcy procedure, and claims under insurance contracts.
3) Obligations arising as a result of harm caused to the life or health of individuals, mandatory pension and social security contributions.
4) Taxes and other mandatory charges, and claims of the State Reserve Fund.
5) General unsecured claims.
6) Claims of employees on return of contributions to the capital of a company.
7) Other claims.

After approval of the register of creditors' claims, a creditors' meeting is called to elect the creditors' committee. In particular, it will be for the creditors' meeting to decide whether to place a company into in-court restructuring (to attempt a recovery of the business) or commence liquidation of a company.

With regard to secured creditors, their claims are registered separately, and such creditors do not have voting rights in the creditors' representation bodies.

Creditors that have filed their claims after the expiry of the 30-day deadline (the deadline being 30 days from the date of official publication of the commencement of proceedings in the bankruptcy case) are still included in the register of creditors. However, such creditors do not have decisive voting rights in the creditors' representation bodies, ie such creditors may participate in the meetings of the creditors' representation bodies but their opinions will be advisory in nature and will not be counted in the voting results.

1. Note that this 170-day rule is relatively recent and is intended to regulate the duration of the asset management stage. Under Ukrainian law, upon expiry of this term the moratorium terminates, and the secured creditors become entitled to commence enforcement against secured assets. However, in practice, there are no additional practical consequences for breach of this time limit. Moreover, this time limit is regularly exceeded, and in such cases the court simply rules on prolongation of the asset management stage, which then carries on without changes.
2. Note that the claims of secured creditors do not fall into priority ranking. Claims listed in items 2-7 of the list are listed in the order of priority prescribed by the Bankruptcy Code.

In-court restructuring

In-court restructuring is a rescue stage in the course of the bankruptcy proceedings aimed at restoring the solvency of the debtor. The creditors may compel a company into in-court restructuring (rehabilitation) after the company's failure to repay debts within a 170-day asset management procedure, provided that: (i) a restructuring plan is prepared by the insolvency manager and pre-approved by the creditors; and (ii) the court approves the restructuring plan, after verifying its compliance with the law.

In an in-court restructuring, each class of creditors is required to be treated equally in the restructuring plan.

An in-court restructuring plan requires approval by a court and pre-approval from (i) at least 50% of unsecured creditors by value in each class (provided that at least 50% in number voted in each class) and (ii) a 2/3 majority by value for secured creditors in each class (provided that at least 50% in number voted in each class).

The court shall approve the restructuring plan provided that creditors who voted against it receive, according to the restructuring plan, not less than they would have received in a liquidation.

In an in-court restructuring:

- contracts entered into prior to the bankruptcy proceeding which remain unperformed in full or in part may be avoided by the insolvency manager (with a right of another party to claim damages) if: (i) their performance is "detrimental to"[3] the company; (ii) such contracts are long term or provide a positive result for the company after more than one year; (iii) performance of such contracts hampers restoration of the company's solvency;[4]
- unsecured assets may be sold pursuant to the restructuring plan provided the sale is approved by the creditors' committee; and
- the management of the debtor is removed.

There are no statutory limits on the duration of the in-court restructuring and therefore the creditors have discretion to define the time limits of the in-court restructuring in the restructuring plan. The creditors' meeting may decide to prolong the in-court restructuring. If, within 15 days from the date indicated in the in-court restructuring plan, the creditors' meeting fails to decide on either prolongation of the procedure, or commencement of the liquidation, the court may decide to proceed with the liquidation of the debtor at its own discretion.

3. Note that the Bankruptcy Code does not establish a materiality threshold for these purposes. This is assessed by the insolvency manager and the creditors based on the financials of the debtor company in each separate case. However, "detrimental" in this context generally means that its performance causes losses to the company. Furthermore, this rule applies only to the contracts which were not included in the in-court restructuring plan. Another party to such terminated transaction may challenge the decision of the insolvency manager on termination in court, as well as claim damages in the bankruptcy proceedings.
4. Note that again this is assessed and determined by the insolvency manager in each separate case.

Liquidation

The statutory duration of liquidation is 12 months. In practice, however, the liquidation may last longer.

A liquidation includes the following steps:

– appointment of a liquidator;

– formation of the company's liquidation estate;

– sale of all the company's assets through auctions; and

– payment to creditors according to the priority established by law (see above in Section "Asset management").

The main aim of the liquidation procedure is to sell the company's assets, discharge the creditors' claims and, where applicable, terminate the insolvent company under Ukrainian law.

If there are insufficient funds to make payment to all creditors, the liquidator is entitled to file a claim against the shareholders, controllers and/or directors of a company with a view to recovering the difference between the value of the company's assets and all of the creditors' claims. In order to succeed with this claim, the liquidator will need to establish that the bankruptcy of the company was caused due to a fault of its shareholders, controllers and/or directors.

Following these steps, the liquidator shall prepare a liquidation report and liquidation balance sheet, which shall be approved by the court.

Consequently, the court may close the proceedings and order an exclusion of records in respect of the company from the Unified State Register of Legal Entities, Individuals – Entrepreneurs and Public Formations. After this, the company shall be considered liquidated and ceases to exist.

Key contacts

If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at Allen & Overy, or email rab@allenovery.com

This factsheet has been prepared with the assistance of Sayenko Kharenko. Any queries under Ukrainian law may be addressed to the key contacts listed below:

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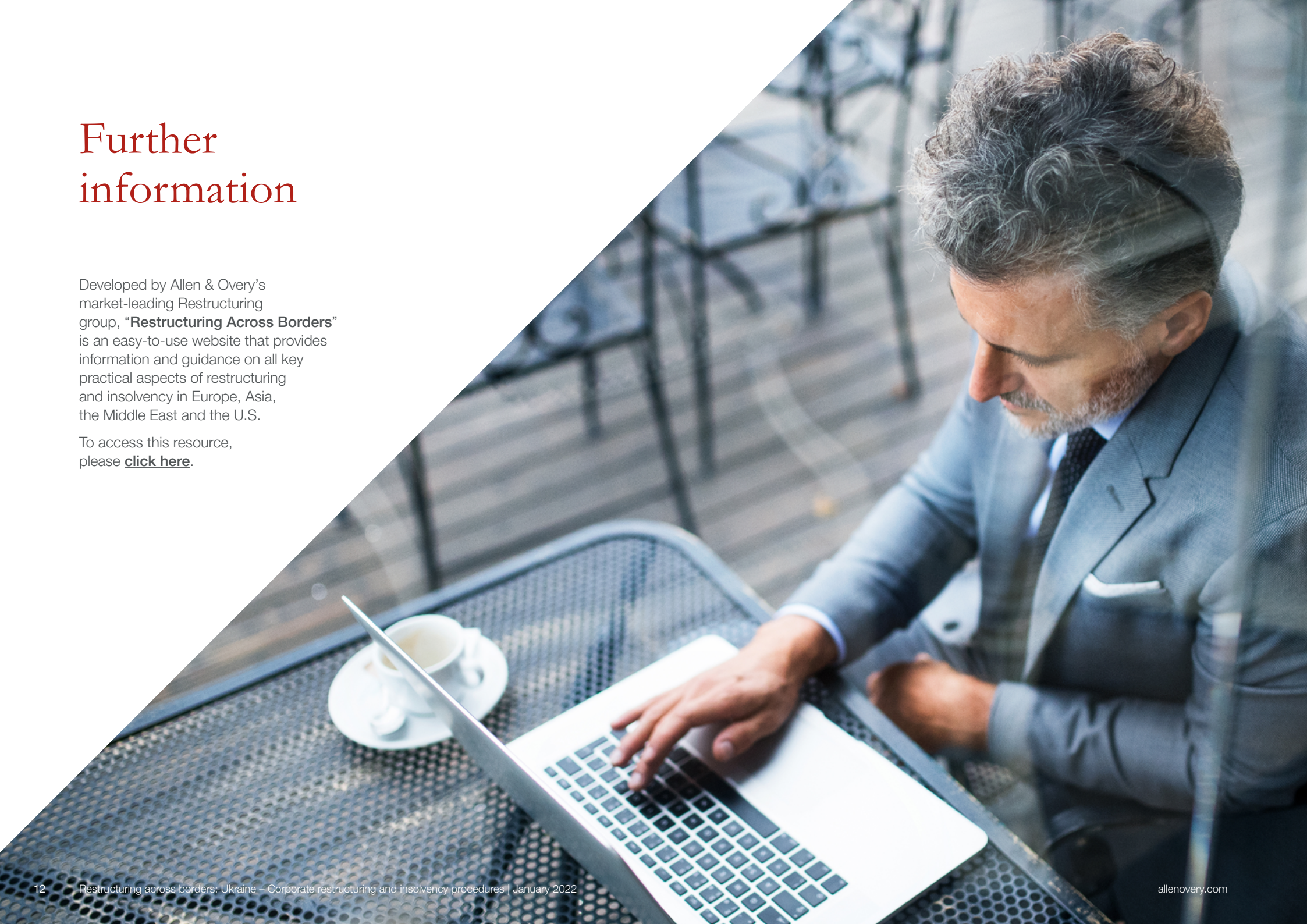
Further information

Developed by Allen & Overy's market-leading Restructuring group, "**Restructuring Across Borders**" is an easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe, Asia, the Middle East and the U.S.

To access this resource, please **click here**.



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