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UKRAINIAN

BANKRUPTCY LAW

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I. INTRODUCTION

From the time of its adoption until its replacement in 1999, the Law "On Bankruptcy," No. 2344-XII (dated May 14, 1992, effective July 1, 1992), was never very effective. Although it was in force during the most difficult times of the Ukrainian transitional economy, the strict enforcement of the old bankruptcy law would have led to mass bankruptcy for most Ukrainian enterprises since the definition of "bankruptcy" would have applied to most of the existing Ukrainian enterprises. Economic collapse, resulting from mass bankruptcies, would have been unavoidable if the Ukrainian government tried to apply Article 1 of the old bankruptcy law, which quite fairly defined "bankruptcy" as the debtor's inability to satisfy creditor demands due to insufficient liquidity of funds.

On June 30, 1999, the Parliament passed Law No. 784-XIV "On Introducing Changes to the Law of Ukraine 'On Bankruptcy.'" Notwithstanding the modest title of the Law, these so-called "changes" were actually an entire re-working of the old bankruptcy law, starting with the current name. Henceforth, the Law "On Bankruptcy" is now referred to as the Law "On Restoration of the Solvency of a Debtor or Recognition of a Debtor as Bankrupt" (the "Law"). This version of the bankruptcy law took effect on January 1, 2000. Changes were constantly introduced to the improved Law up until December 22, 2011, when the Parliament once again passed an entirely new version of the Law, which came into effect on January 18, 2013. Below we analyze the current and projected effects of the latest version of the Law.

As a background, the Law was initially drafted by the State Agency on Bankruptcy Issues, which has the authority to define policies and set the procedures for preventing the bankruptcy of debtors. Not surprisingly, the drafters of the Law took upon themselves a wide variety of

responsibilities in ensuring the proper implementation of the organizational, economical and other terms and conditions of the Law. These responsibilities include: proposing the candidates and providing training for arbitration administrators; creating a unified database of enterprises subject to bankruptcy proceedings; and organizing the expert examination of state-owned enterprises and enterprises with 25% or more state-owned shares for purposes of bankruptcy proceedings, among others.

The difference between the original and current bankruptcy laws is striking: whereas the original bankruptcy law focused primarily on liquidating the indebted enterprise, the latest bankruptcy law focuses, first and foremost, on restoration of the debtor's solvency. Under this approach, an enterprise may accordingly be deemed bankrupt and liquidated only if implementation of the procedures in the new law to restore solvency have failed. At this stage, creditors must put their faith in a so-called "arbitration administrator" to gather up the pieces of the indebted enterprise and attempt to generate a rebirth of the economic activity of the enterprise in order to restore its ability to repay creditors. The role of this new entity in Ukrainian legislation, the arbitration administrator, is discussed in greater detail below.

Importantly, the latest bankruptcy legislation provides for bankruptcy of physical persons (i.e., individuals, private entrepreneurs and sole-proprietors) as well as legal entities. In contrast to the former bankruptcy law, which did not permit the seizure of citizens' (subjects' of entrepreneurial activity) property, the latest Law provides that property of citizens, who are registered as individual entrepreneurs, may be seized during bankruptcy proceedings in order to satisfy creditor claims. If actually enforced, this can become a useful deterrent to those individuals who once felt confident striking deals without the consequence of losing their personal property. The Law also provides a barrier for any semi-legal schemes to alienate property to related entrepreneurs/legal entities before bankruptcy proceedings set in. In particular, any agreements on the alienation of the property of individual entrepreneurs made in the year before bankruptcy proceedings are initiated can be recognized as invalid in certain circumstances at the request of at the request of the arbitration administrator or a recognized creditor.

II. PRE-BANKRUPTCY MEASURES

As mentioned above, the goal of the Ukrainian bankruptcy law is to avoid bankruptcy of the debtor to the extent possible. For this purpose, the Law obliges all debtors to take all steps possible to avoid bankruptcy proceedings. This obligation is laid upon of founders (participants or shareholders – hereinafter "shareholders") of the debtor, the administrator of the debtor's property and the executive branch of the government. If any signs of bankruptcy arise, the chief executive officer of the debtor is obliged to immediately inform its founders (participants or shareholders) and its property administrator.

This strict obligation is designed to provide the shareholders, property administrator, creditors and other parties a timely opportunity to grant financial aid to cover the cash debts of the debtor before its creditors, including the tax authorities and the pension and social insurance funds. Alas, this strict obligation does not oblige the debtor to warn creditors about bankruptcy signs and, therefore, most foreign creditors are never aware that bankruptcy may afflict the debtor in the near future.

The past versions of the Law provided for a so-called "rehabilitation procedure" during bankruptcy proceedings in the event that the debtor or creditor were able to agree upon a system of measures to restore the "health" or solvency of the debtor. This rehabilitation procedure remains in the latest version of the Law; additionally, however, a pre-bankruptcy rehabilitation procedure has been added. This way, prior to bankruptcy proceedings, the debtor's shareholder(s), property administrator, creditor(s) or other party may apply commercial, administrative, investment, technical, financial and/or legal measures under a rehabilitation plan in order to avoid bankruptcy proceedings at all costs.

A. PRE-BANKRUPTCY REHABILITATION

The debtor or a creditor may initiate a rehabilitation procedure prior to bankruptcy proceedings by concluding an agreement either prior to or after the indebtedness of the debtor arises. Thus, if a debtor can foresee or knows that it will not be able to cover its debt before a creditor, then it can make a good-faith suggestion to undergo a rehabilitation procedure even before the repayment date of the debt arises. Unfortunately, most Ukrainian companies never take such precautionary measures, preferring instead to continue admitting to the debt after the repayment period has passed, but not making any effort to repay due to the "current economic crisis".

Again, herein lays one of the many faults of the Ukrainian bankruptcy system: it gives the Ukrainian debtor a chance to recognize its inability to pay and show its willingness to work with the creditor in finding a viable solution, but it would only serve as a warning to the creditor that bankruptcy proceedings may be on the horizon. Unfortunately, Ukrainian companies are notorious for filing for bankruptcy and only giving creditors notice of such filing via Ukrainian newspapers, which are not published outside of Ukraine and seldom followed by foreign creditors. As a result, a Ukrainian court, especially a corrupt court, can rule that foreign creditors were provided with sufficient notice of bankruptcy proceedings and their late credit claims will not be recognized in the bankruptcy proceedings. Unfortunately, all too often foreign creditors only find out about their Ukrainian debtor's bankruptcy proceedings after their numerous requests for repayment lead them to take legal measures or, in the very least, check the unified state register for bankruptcy proceedings against their Ukrainian counterpart.

Nevertheless, the latest version of the Law does stipulate that the parties may set forth in their initial agreement that a pre-bankruptcy rehabilitation procedure is mandatory for the debtor. Accordingly, foreign creditors would be wise to include such obligation into their agreements with Ukrainian counterparts as an argument for being included into the list of creditors should bankruptcy proceedings be initiated without their knowledge.

A pre-bankruptcy rehabilitation procedure may be initiated under three conditions: (i) written consent of the debtor's property administrator (if applicable) is received; (ii) written consent

of all of the debtor's creditors, who have claims in aggregate exceeding 50% of the debtor's overall creditor claims, is obtained; and (iii) the rehabilitation plan is agreed upon in writing by all secured creditors and approved by the debtor's creditor committee (see below). There are no specific requirements for the contents of a pre-bankruptcy rehabilitation plan; however, it may contain the same provisions as those discussed below with respect to rehabilitation plans concluded during bankruptcy proceedings.

The conditions of a rehabilitation plan with respect to the satisfaction of claims of creditors, who did not participate in the voting for pre-bankruptcy rehabilitation or who voted against such rehabilitation, must be on equal conditions with the satisfaction of claims of creditors, who voted in favor of the rehabilitation plan. In general, a pre-bankruptcy rehabilitation plan may separate participating creditors into categories depending on types of claims and whether claims are secured. Moreover, such pre-bankruptcy rehabilitation plan may provide for different procedures for satisfying claims of different categories of creditors. The plan may even provide for the appointment of a sanation administrator for all participating creditors.

Procedurally, the debtor convenes the creditor committee by sending written notice to all creditors in its accounting books. An announcement of the creditor committee's intended meeting must be published on the website of the state bankruptcy body and the highest commercial court of Ukraine. Once a pre-bankruptcy rehabilitation plan is approved by the creditor committee, a petition on its approval must be submitted to the commercial court at the location of the debtor along with the rehabilitation plan, the minutes of the creditor committee meeting, the list of all creditors, written objections of participating creditors (if any), and the court filing fee.

The commercial court will issue a decision to review the rehabilitation plan within five (5) days from the receipt of the petition and appoint a time and place for a court hearing. A copy of the said decision must be sent to the debtor and all creditors indicated in the petition. The commercial court will also publish notice concerning its decision to consider the rehabilitation plan on the website of the highest commercial court. This notice must contain the name and identification code of the debtor, the case number, the name of the relevant commercial court and the date of the first court hearing.

The commercial court has up to one (1) month to consider the rehabilitation plan once it is accepted for consideration. The commercial court is obliged to hear the objections of any creditors who voted against the rehabilitation plan at the creditor committee meeting. The court will reject the plan if it discovers any violations of the law during the creditor committee meeting, which may have influenced the voting. It will also reject the rehabilitation plan in the following cases:

1) if a creditor, who did not participate in the voting or who voted against the plan's approval, proves that in case of the debtor's liquidation its creditor claim would have been satisfied in an amount that exceeds the amount of claims, which will be satisfied pursuant to the rehabilitation plan;

2) the absence of written consent to the rehabilitation plan by all secured creditors;

3) the debtor provided inaccurate information regarding its indebtedness.

If the rehabilitation plan passes the commercial court's examination, then the court will issue a decision to such effect and institute a moratorium on the satisfaction of creditor claims. The moratorium will apply to all creditor claims which arose prior to the court's confirmation of the rehabilitation plan.

Even if the commercial court rules against the rehabilitation plan, the creditor committee may once again approve a rehabilitation plan and the debtor may apply to the commercial court for its confirmation of such plan.

A pre-bankruptcy rehabilitation plan may only be effective for a maximum period of twelve (12) months from the date of the court's confirmation of the plan. During this period, the debtor and any other creditors may not apply for the initiation of bankruptcy proceedings against the debtor. Moreover, the moratorium on the satisfaction of any creditor claims will be effective for the duration of the rehabilitation plan.

III. INITIATING BANKRUPTCY PROCEEDINGS

In Ukraine, bankruptcy proceedings are carried out in commercial courts, rather than in specialized bankruptcy courts, and take place at the location of the debtor according to the rules set forth in the Commercial Procedure Code of Ukraine and the specific provisions set forth in the Law. According to the Law, either creditors or the debtors themselves may submit an application to a commercial court to initiate bankruptcy proceedings.

As a general rule, bankruptcy proceedings may only be initiated if the amount of the indisputable claims of creditors toward the debtor aggregately equal no less than 300 minimum monthly salaries, which remained unsatisfied for a duration of three months after the agreed upon date of repayment. For example, in February 2013 this figure was approximately 344,100 Ukrainian Hryvnias (or approximately 43,012 US Dollars), based on then effective minimum monthly salary of 1,147 Ukrainian Hryvnias per month (which is expected to increase on December 1, 2013 to 1,218 Ukrainian Hryvnias per month). This threshold can be critical to the rights of smaller creditors because an enterprise can legally avoid fulfilling its obligations by keeping the amount of its indebtedness within the above limit.

On April 3, 2003, the Ukrainian Parliament adopted amendments to the Law (the amendments came into effect on May 31, 2003), which place creditors into various prioritized groups rather than the formerly established equal possibilities for the satisfaction of creditor claims. In the latest version of the Law, which came into force on January 18, 2013, creditors are broken down into "competitive creditors", "current creditors" and "secured creditors". "Competitive creditors" are defined as follows: "creditors with claims toward a debtor which arose before the initiation of bankruptcy proceedings, and claims, which are not secured by pledge of property of a debtor". "Current creditors" are

defined as creditors with claims toward a debtor which arose after the initiation of bankruptcy proceedings." The novelty for 2013 is the welcome specification of "secured creditors", which are defined as creditors whose claims are secured by pledge (lien, attachment, mortgage, etc.) of the property of the debtor (or property surety or guarantor).

As a result of this grouping of creditors, the moratorium on the satisfaction of claims (discussed below) will not apply to all of the debtor's obligations that arise after the initiation of bankruptcy proceedings. Thus, the debtor is now able to create new debts, but some obligations of creditors will be covered immediately and other earlier debts subject to the moratorium will be covered in deferment.

A. DOCUMENTATION

1. The Application

In order to initiate bankruptcy proceedings, a written application must be submitted to the relevant commercial court and subsequently signed by the chief executive officer of the debtor, a creditor or a citizen-subject of entrepreneurial activity (or a duly authorized representative). The application must include the following information:

a) the name of the commercial court to which the application is submitted;

b) the name (surname, first name and patronymic), place of location (residence), identification code (for legal entities) and taxpayer registration number (if applicable) of the debtor;

c) the name (surname, first name and patronymic), place of location (residence), identification code (for legal entities) and taxpayer registration number (if applicable) of the creditor;

d) a description of the circumstances substantiating the application;

e) the list of documents attached to the application.

The following documents must be submitted along with the application:

a) an extract from the Unified State Register of Legal Entities and Natural Persons-Entrepreneurs in relation to the debtor;

b) confirmation of the payment of the court fees (except for cases when the law exempts payment);

c) the power of attorney or other document, which confirms the authority of the submitting party's representative (if the application is signed by a representative);

d) proof that the amount of indisputable creditor claims aggregately amount to no less than three hundred (300) minimum monthly salaries, unless otherwise provided by the Law;

e) the legally effective court decision on the satisfaction of creditor claims;

f) the corresponding order of the state enforcement agency on the opening of enforcement proceedings to satisfy creditor claims;

g) proof that the amount of creditor claims is not fully secured by a pledge of property of the debtor (if applicable).

2. Initiation of Bankruptcy by the Debtor

The debtor itself may initiate bankruptcy proceedings only if such debtor has sufficient property/funds to cover the legal costs of the bankruptcy proceedings. In this case, the debtor must submit additional information/documents along with its application, including:

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