



# R&I IN UKRAINE

Oleksandr Kurdydyk, partner, leads the finance and projects practice of DLA Piper, having over 15 years' experience of advising on legal, tax and business matters. Oleksandr focuses on corporate law and banking law. He advises on structuring of mergers and acquisitions, debt finance, currency derivatives, securitisation, project finance, infrastructure and PPPs. He also has significant industry experience in the energy, transport and telecommunications sectors.

Dmytro Pshenychniuk is a senior associate at the Kiev office of DLA Piper. Dmytro has over 10 years of experience as a finance lawyer in the Ukrainian and London financial markets. He advised on

a wide range of financial transactions acting for both borrowers and financial institutions, including international financial organisations. He has also acted as M&A lawyer, dealing with complex cross-border acquisitions.

Zhanna Babych has experience in advising clients on banking and project finance transactions, energy, utilities and infrastructure. She also focuses her practice on assisting clients in the creation of security, its perfection and enforcement of relevant claims, advising clients on currency control, financial monitoring, as well as registration of financial institutions, obtaining NBU licences and permits, etc.

**GTDT: In the past year, have you seen any developments or trends in the nature and volume of insolvency filings?**

**Oleksandr Kurdydyk and Dmytro Pshenychniuk:**

In 2014-2016, Ukraine's banking sector suffered a serious economic downturn. The regulator, the National Bank of Ukraine, cleaned up more than half of the banking institutions involved in related-party lending, non-transparent business models and shadow ownership structures. As a result, 85 banks, which hold 30 per cent of the sector's assets as a whole, went bankrupt. The biggest bank in Ukraine, PrivatBank, was in the spotlight at the end of 2016 due to its bail-in (nationalisation) process launched by the Ukrainian state.

In 2017, the Ukrainian government managed to stabilise the situation in the banking sector and halted the waterfall of insolvency trends and petitions. The financial standing of banks operating on the market was significantly improved by way of restructuring and recapitalisation at the end of the year.

Similarly, general (non-banking) businesses have been hit with a wave of insolvency petitions in recent years. According to recent media reports, in 2016, 1,524 distressed companies were declared bankrupt, whereas insolvency proceedings were commenced against another 2,073 enterprises. Most of the bankrupt companies represented the wholesale trade, construction and agricultural sectors.

**GTDT: Describe the one or two most notable insolvency filings in your jurisdiction in the past year.**

**OK & DP:** Bankruptcy proceedings against Azovmash, one of Ukraine's flagship industrial groups, and Dniproavia, a famous national airline, were the most noteworthy insolvency cases in the past year.

In March 2016, Azovmash's shareholders filed an insolvency petition against PJSC Azovzagalmash. It is worth mentioning that Azovmash is one of the largest industrial complexes in Ukraine, operating in sectors from manufacturing of railway wagons and platforms, road transport, metallurgy and mining equipment.

On 31 October 2017, the commercial court approved the register of creditors' claims, including the largest lenders such as Ukreximbank, Sberbank, Delta Bank, Alfa Bank, Raiffeisen Bank Aval, UkrSotsbank and OTP Bank. The banks have more than 15 billion hryvnia in loans outstanding to PJSC Azovzagalmash.

On 13 November 2017, the commercial court initiated a bankruptcy proceeding against Dniproavia based on a petition of the refining company PJSC Ukrtatnafta.

To that end, Dniproavi is indebted to the fuel Kremenchug refinery, which is a subsidiary of PJSC Ukrtatnafta, to the principal amount of 163.3

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million hryvnia. Earlier, in June 2017, the above debt amount was pleaded and confirmed by the commercial court. Pursuant to the court decision, the debt was originated under the Aviation Fuel Supply Agreement, according to which, over six years Dniproavia has received fuel valued at 440.4 million hryvnia.

**GTDT: Have there been any recent legislative reforms? Is there a perceived need for reform?**

**OK & DP:** During 2017 no legislative reforms were introduced to the Law of Ukraine 'On Restoration of Debtor's Solvency or Declaring it Bankrupt' dated 14 May 1992, although such reforms are critical given the numerous gaps in this law.

Ukrainian insolvency legislation requires improvement in the auction procedure with a view to maximising creditors' returns and recoveries. Special regard should be given to the discounting process, in particular, haircuts applicable to the initial price of assets during the repeated trading sessions. There is also a pressing need for a separate legal treatment for handling the sale of a business unit, rather than sale in pieces. Furthermore, the liability of an insolvency practitioner as a crucial person in insolvency process needs to be strengthened.

Presently, a number of draft laws required for advancing the financial sector reforms are pending approval by the Ukrainian parliament. Among them is Draft Law No. 3132-Д, which intends to improve the protection of legal interests of creditors in insolvency proceedings and simplify the process of selling the debtor's property through an auction. We note that this draft is still being debated and it remains to be seen what the final version will look like.

The draft introduces the following changes in the insolvency regulation:

- insolvency proceedings may be initiated by the debtor's shareholders at an early stage of insolvency before the debtor's financial standing becomes critical;
- unsecured claims against debtors may be filed by general creditors even upon expiry of a statutory deadline;
- the debtor's property must be sold at the highest price through an auction; and
- the business as an ongoing concern must be offered for sale as a whole at first and then offered as separate assets.



It is worth highlighting that in 2016 the Law of Ukraine 'On Financial Restructuring' (the Law) aimed at facilitating an out-of-court voluntary financial restructuring of indebtedness of Ukrainian companies came into force.

The Law appears to be a temporary measure to overcome a huge volume of non-performing loans in Ukraine. The management of a debtor company (other than a bank or a credit institution) may voluntarily propose and promulgate an out-of-court restructuring procedure. The Law allows trade and commercial creditors in addition to banks and other financial institutions (leasing or factoring companies) to join the restructuring with their debts. The contemplated workouts are intended to be a fast-track restructuring tool for viable business models. The Law sets out certain tax breaks, meaning that the tax liability of a distressed companies may be restricted or even written off, which is a considerable benefit. At the same time, the Law provides for a standstill agreement arranging the implementation of a new restructuring strategy commonly focused on the business plan for a specific asset, individual tasks for the debtor or creditor along with a timetable, detailed cash flow and budget. Furthermore, a debtor company can have the advantage of a moratorium protection (90 calendar days, but can be extended up to 180 days) that prevents creditors from taking any enforcement actions against the debtor company or its assets. The outcomes of financial restructuring proceedings are typically documented in the Restructuring Plan, which requires the approval of all participating creditors.

**GTDT:** *In the international insolvency field, has there been any legislative or case law developments in terms of coordination of cross-border cases? What jurisdictions are you most likely to have contact with?*

**OK & DP:** Since 2011 when the Ukrainian Private International Act was amended to reflect in insolvency space the concept of the debtor's centre of main interests (COMI), the Ukrainian legislator has not introduced any novelties into regulation on insolvency of group of companies.

**GTDT:** *In your country, is there a particular court or jurisdiction that sees a higher concentration of insolvency filings? What is the attraction of that forum?*

**OK & DP:** According to the Law of Ukraine 'On Restoration of Debtor's Solvency or Declaring it Bankrupt' and the Commercial Procedural Code, insolvency cases fall within the exclusive jurisdiction of commercial courts and are considered at the debtor's location. Parties are not able to select the jurisdiction.

**GTDT:** *Is it fair to describe your jurisdiction as either 'debtor-friendly' or 'creditor-friendly' in terms of how insolvency filings proceed?*

**OK & DP:** On the whole, insolvency proceedings appear to be long and cost-intensive processes for creditors in Ukraine. Although there are few



Zhanna Babych

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sources of reliable statistical data, Doing Business shows that the average duration of the whole insolvency proceeding amounts to 2.9 years, whereas the cost of average proceeding takes 42 per cent of the debtor’s property and the average recovery rate for a creditor is 7.5 per cent of a dollar.

The Ukrainian Insolvency Act is intended to afford maximum protection to a secured creditor. In theory, there are a number of rules enhancing the position of a secured creditor. First, the collateral shall not be included in the liquidation estate of a debtor and covers security claims only. Second, the sale of collateral shall be made by an insolvency practitioner with the consent of the secured creditors. If, however, the secured creditor does not give its consent to the sale to the insolvency practitioner, such approval may be granted by the courts.

Leaving the theory aside, a secured creditor often loses its control over the secured property during insolvency proceedings. It could be the case that collateral is sold at a price that is well below the market price or the selling procedure takes longer than initially expected.

Aside from that, the procedure for sale of secured property set out as part of an insolvency is not creditor-friendly. The haircuts that are to be applicable during the trading sessions of the public auction allow a decrease in the initial price down to zero, which is detrimental to the secured creditor. In tandem with another provision of the Insolvency Act, which sets forth that the remaining amount of a claim (being discounted by insolvency practitioner) is considered to be satisfied upon sale

by virtue of law, a secured creditor is at a risk of being unable to get even a modest recovery upon security enforcement.

In addition, the existing regulation allowing discounting of the sale price up to one Ukrainian hryvnia also affects the disposal of an integral property complex of an insolvent company. Specifically, the Insolvency Act requires an insolvency practitioner to dispose of the assets of an insolvent entity as a business unit to maximise the sale proceeds. Only if an insolvency practitioner fails to make such a sale, may the whole business unit then be divided into specific assets to be disposed of separately. It is not entirely clear under Ukrainian law how many times the assets must be marketed as a business unit before the insolvency practitioner may undertake the sale of assets by way of separate bids.

As already stated, the Insolvency Act affords a debtor moratorium protection that prevents creditors from taking enforcement actions against the debtor and the security. It is worth noting that the moratorium does not have a statutory time frame and may cover the duration of the whole insolvency proceedings. Hence, it may delay the enforcement process for several years. An unlimited duration of such a moratorium is likely to result in creditors being incapable of protecting their rights and enforcing their claims effectively. This increases the unpredictability and uncertainty of the enforcement proceedings for creditors.

## THE INSIDE TRACK

*What two things should a client consider when choosing counsel for a complex insolvency filing in this jurisdiction?*

We would advise considering the expertise of a counsel and its track-record. In complex multinational insolvency cases, it is quite important that the selected counsel has a business presence in the relevant jurisdictions. This would be helpful in terms of coordination of insolvency filings.

*What are the most important factors for a client to consider and address to successfully implement a complex insolvency filing in your jurisdiction?*

Before commencement of the insolvency the creditor should understand what share of the debt to the distressed company it holds in the total pie: how its debt is ranked as regards others, and who are the other classes of the creditors (banks, trade creditors, institutional investors, etc) of the debtor. It would also be helpful to collect reliable information at the pre-insolvency

stage about the assets and liabilities of the debtor. Based on these factors, it will be much easier to select the right strategy and tactic for the insolvency filing contemplated.

*What was the most noteworthy filing that you have worked on recently?*

We have acted as counsel for the major Ukrainian agriholding and its group in restructuring of multibillion high-yield bonds and debt. We have issued legal opinion for the UK court on the cramp-down effect of the restructuring and other consequences of schemes of arrangement under the Ukrainian law. The restructuring deal has been successfully closed by the Ukrainian issuer who moved its COMI to England for that reason.

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**GTDT:** *What opportunities exist for businesses wanting to purchase assets out of an insolvency, and how efficient is the process? What are the best ways to take advantage of opportunities in this area?*

**OK & DP:** In recent years, electronic trading venues have grown in popularity among Ukrainian enforcement authorities and insolvency practitioners for public sale of assets of distressed and insolvent entities. Today, such a mechanism for asset disposal of insolvent enterprises is considered to be one of the fastest, most transparent and effective in Ukraine. Electronic trading venues allow the automation of e-auction management procedures and the combination of all bidders in a single information space.

In this regard, there are a number of such trading venues in Ukraine. For example, the Ukrainian Universal Exchange enables users to buy assets of insolvent entities in insolvency proceedings in a way prescribed by the Law of

Ukraine 'On Restoration of Debtor's Solvency or Declaring It Bankrupt'.

Another widely used trading venue in Ukraine is SETAM, operated by the Ministry of Justice of Ukraine. This trading venue is built as a web-based platform but is still in the process of development. On 13 April 2017, Ukrainian governance partnered with Bitfury Group, a US-based global technology company, to launch what is probably the largest project on transferring government data on a blockchain platform. This technology initiative was launched with a view to increasing the transparency of data and efficiency of its use by customers. As part of this initiative, the Ministry of Justice of Ukraine is attempting to implement blockchain, an innovation technology for the storage and protection of databases within SETAM. SETAM is commonly used for the sale of assets in enforcement process against the property debtor. However, it is also often used for the disposal of assets of insolvent companies.