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Bankruptcy procedure

5.1. General provisions

Bankruptcy is recognized by a commercial court as debtor's failure to restore its solvency through procedures of reorganization and settlement agreement and to repay creditors' monetary claims other than through the liquidation procedure.

Thus, the insolvency should be understood as debtor's failure to meet its financial obligations to creditors when due other than through the restoration of its solvency.

Bankruptcy is aimed at restoring the debtor's solvency, which requires introducing additional protection for the debtor and its property, and appointing an insolvency officer to protect the interests of the parties to the proceedings.

Bankruptcy in Ukraine is governed by the basic laws:

- the Law of Ukraine "On Restoring Debtor's Solvency or Declaring it Bankrupt";
- the Civil Code of Ukraine;
- the Commercial Code of Ukraine.

In addition, certain issues of bankruptcy proceedings are governed by other laws and regulations. Court practice and explanatory statements of the higher courts are also important to be considered.

An important law, aimed at restoring the solvency of the debtor through the negotiation process is the Law of Ukraine "On Financial Restructuring".

5.2. Parties to the bankruptcy

None but legal entity or private entrepreneur may be a bankrupt. Bankruptcy is classified as an economic case subject to proceedings in commercial courts. Courts are governed by the provisions of the Commercial Procedure Code of Ukraine in the proceedings.

The parties to the proceedings in bankruptcy cases are the following: parties, secured creditors, an insolvency officer, the owner of the debtor's property, the state body for bankruptcy (the Ministry of Justice of Ukraine), the State Property Fund of Ukraine, representatives of local authorities, representatives of debtor's employees, an authorized person of debtor's founders and, in some cases, other persons.

The parties to the bankruptcy are the unsecured creditors (or a representative of the creditors' committee) and the debtor (a bankrupt).

5.2.1. Insolvency officer

An insolvency officer is a special figure in bankruptcy proceedings. An insolvency officer is a subject of an independent professional activity. He is equated to the debtor's official. It should be noted that an insolvency officer shall be selected before the initiation of the proceedings by an automated system, in order to ensure his/her independence.

An insolvency officer shall be appointed by the commercial court in order to protect the interests of the parties to the proceedings and supervise law observance. An insolvency officer has a number of rights and duties, which empower him/her to take all possible steps to restore the debtor's solvency and repay its debts.

5.2.2. Debtor

A debtor is a business entity or an individual failing to perform its overdue liabilities within three months confirmed by a court decision.

Pursuant to the Ukrainian law, the bankrupts are only those individuals who have monetary liability. The debtor in respect of which judicial bankruptcy procedures have been applied is considered to be a person who has no outstanding liabilities.

If appealing to the court for bankruptcy is the creditor's right, this is a duty for a debtor. Thus, the debtor is obliged to appeal to court subject to the following circumstances:

- satisfying claims of one or more creditors will result in the debtor's inability to perform monetary obligations to other creditors in full;
- during the debtor's liquidation on the grounds other than insolvency proceedings, the debtor's inability to satisfy the creditors' claims in full has been established.

The law provides the debtor's liability in case of violation of this duty. In particular, the owner of the debtor's property (the person authorized thereby), the head of the debtor, the chairman of the liquidation commission (the commission on termination) who violated the requirements of the law, are jointly liable for the dissatisfaction of creditors.

Upon introducing the procedure of disposition of property and appointment of an insolvency officer – a property administrator of the debtor shall be subject to a number of restrictions on operations. In particular, only subject to the consent of the property administrator shall be taken the decisions on actions, reorganization, establishment of legal entities, establishment of subsidiaries, payment of dividends, issue of securities, alienation of real estate by all means, receiving and issuing any loans or guarantees, as well as administering the debtor's property the balance cost of which exceeds 1% of assets.

In such a case, the property administrator is not entitled to interfere in the debtor's economic activity.

5.2.3. Creditors

Creditor is a legal person or an individual, as well as tax or other state authorities who have documented claims for monetary obligations to the debtor according to the procedures.

The law specifies that a debtor or a creditor is entitled to apply to the court for bankruptcy.

A creditor is entitled to apply to the court if the debtor fails to perform its due liabilities within three months upon the obligation maturity. Such circumstances shall be confirmed by the court decision and decision on initiating enforcement proceedings. The amount of outstanding obligations shall be not less than 300 minimum salaries on the date of application (equal to approximately USD 35,500). It should be noted that this amount shall not include penalties.

Secured creditors are creditors whose claims are secured by pledge of the debtor's (the property guarantor's) property. A peculiar feature of secured creditors is that they have an advisory vote only, i.e. they do not directly affect the decision of the unsecured creditors.

Unsecured creditors are creditors by claims against the debtor that arose before the initiation of proceedings in bankruptcy and execution of which is not secured by pledge of the debtor's property.

Post-bankruptcy creditors are creditors by claims against the debtor that arose after the initiation of proceedings in bankruptcy.

5.2.4. State

In bankruptcy, the State performs three functions: of a creditor, the property owner and the controlling authority.

As a creditor, the State acts in case of some of creditor claims against the debtor, such as those of fiscal agencies, pension and other social funds, local executive bodies and others. As a creditor, the State enjoys the same rights as other creditors.

As a property owner, the State acts in case of bankruptcy of enterprises the state share in which exceeds 50%. As for the bankruptcy of such enterprises, the increased state control is established. In particular, if such an enterprise is a debtor, the commercial court shall involve members of the body authorized to manage the state property to a bankruptcy case with the notification on initiating proceedings in a bankruptcy case of such a company.

Government representatives are entitled to participate (with a deliberative vote) in the creditors' meeting and creditors' committee. An insolvency officer shall be appointed upon the consent of the state body. Plans of reorganization, settlement agreements and lists of liquidation estate and amendments thereto in bankruptcy cases of such enterprises shall be subject to approval by the body authorized to manage the state property. In the absence of such an approval, the plan of reorganization and settlement agreement shall not be approved by the commercial court, and the property included in the list of liquidation estate cannot be sold. Thus, the State protects its interests and prevents the state enterprises bankruptcy.

As the controlling authority, the State acts through the Ministry of Justice of Ukraine, which is the controlling body of insolvency officers, and in the face of law enforcement.

5.2.5. Other parties to the proceedings

Other parties to the proceedings are the following: the owner of the debtor's property, local public authorities, a representative of debtor's employees, an authorized person of the debtor's founders and, in some cases, other persons.

They take part in judicial proceedings and have an advisory capacity at creditors' meetings and creditors' committee.

Other members have no influence on the decisions of judgment creditors of the debtor but are entitled to judicial protection of their interests, including the appeal of judgments in bankruptcy proceedings.

In addition, since filing an application for acknowledging creditors and by the time of the judicial acknowledgment, the creditors are also considered as parties to the proceedings and enjoy the parties' procedural rights.

5.3. Types of bankruptcy

Pre-trial and court proceedings shall be applied to the debtor. The court proceedings are: disposition of the debtor's property, bailout, liquidation and settlement agreement.

It should be noted that changes to the status of bankruptcy procedure shall be published on the website of the Supreme Commercial Court (www.arbitr.gov.ua), so that every interested person can track the debtor's bankruptcy.

5.3.1. Pre-trial proceedings

Pre-trial and court proceedings may be applied to a debtor. Pre-trial proceedings are bailout of the debtor before initiating the proceedings in the bankruptcy and financial restructuring process, which are regulated by the Law of Ukraine "On Financial Restructuring". Bailout of the debtor prior to the initiation of proceedings makes the attempts to restore the solvency of the debtor possible without the use of bankruptcy procedures.

Introducing a pre-trial restructuring requires the consent of the owner of the debtor's property, of the creditors who collectively own more than 50% of the total debt; a plan of bailout of the debtor agreed with the secured creditors and approved by the creditors' meeting. The

term for introducing pre-trial restructuring may not exceed 12 months. The peculiarity is a moratorium on creditors' claims during the pre-trial restructuring.

5.3.2. Disposition of debtor's property

As a general rule, after the initiation of the proceedings, the procedure of disposition of the debtor's property and moratorium on creditors' claims are introduced. This procedure may be called a transition because, on the one hand, the debtor continues to perform economic activity, on the other hand, – a moratorium is valid and there are restrictions on the debtor's property operations. The main goal is to examine the debtor's property and determine the possibility of restoring the debtor's solvency. Also, the aim is to protect the interests of creditors, to which purpose this moratorium is introduced.

During the disposition of property procedure, the debtor shall be prohibited to satisfy the demands of creditors, except for post-bankruptcy creditors and salary payments. To determine the debtor's amount outstanding, the announcement of the initiation of the bankruptcy shall be published on the website of the Supreme Commercial Court. Within 30 days after the publication, creditors should contact the competent commercial court that initiated the proceedings with creditor claims against the debtor. Upon reviewing these applications a registry of creditors of the debtor shall be drawn up, which is the basic document for determining due amounts and the number of votes of each creditor.

It should be noted that creditor's claims, filed upon the expiration of the deadline set for submitting or failed to be filed at all, are not the unsecured creditor's claims, and so such creditor's claims are paid on a sixth-priority basis in the liquidation procedure.

The body that represents creditors' interests in the procedure is the committee of creditors, which is formed of up to 7 people at the general meeting of creditors.

As a result of the property disposition procedure, the decision to transfer to one of the procedures – bailout or liquidation – shall be made.

5.3.3. The procedure of bailout of the debtor

Bailout shall be introduced by the court for up to 18 months if there is a reason to believe that the debtor's solvency can be restored.

Since the introduction of the bailout procedure, the powers of the bankrupt's director shall be terminated and transferred to the bailout manager. During the bailout procedure the debtor together with an investor, involving creditors, develop a plan of bailout – the main procedural document.

The law provides for a number of procedures using which restoration of the debtor's solvency can be scheduled, i.e. increasing the authorized capital of the debtor, sale of property as an integral property complex, disposal of property by replacing assets, sale of part of the debtor's property, restructuring or conversion of production, extension or deferral or indulgence of a part of a debt (via a special settlement agreement).

Following the bailout procedure, the debtor solvency shall either be restored, or if it is impossible to be restored, the debtor passes on to the next procedure – liquidation.

An interesting measure to restore the debtor's solvency is an opportunity for the property owner to drive a debtor out of bankruptcy at any stage of the bailout or liquidation procedure through meeting the requirements of all creditors listed in the registry. It is also an instrument of protecting the owner's property interests as it allows him/her to pay off debt without wasting time and saving assets.

5.3.4. The liquidation procedure

Bankruptcy and transition to the liquidation procedure shall be performed when the debtor's inability to restore its solvency through the procedures of the bailout or settlement agreement was determined, and shall satisfy monetary claims of creditors not only through the application of the liquidation procedure.

After the resolution of the commercial court on declaring the debtor a bankrupt, the post-bankruptcy creditors are entitled to state their claims to be included in the list of creditors.

After commencement of the liquidation procedure, no additional commitments accrue and all arrests of the debtor's property are lifted.

During the liquidation procedure the debtor's assets shall be disposed of in order to satisfy creditors' claims to the full.

Disposition of assets shall be made through an auction process (a public tender). Direct sales to individuals and legal entities shall be an exception for low-value assets or assets not sold at auction. The announcement of the auction shall be published on the website of the Supreme Commercial Court and on the website of the Ministry of Justice of Ukraine (www.minjust.gov.ua/en).

In case if the founders or directors of a debtor are proved guilty in bankruptcy, they shall bear a subsidiary liability.

The law stipulates the order of creditors' claims repayment:

- 1) the first turn: salary claims (including that of an insolvency officer); court fees; procedure costs;
- 2) the second turn: claims of the Social Insurance Fund and repayment for the harm to life and health of citizens;
- 3) the third turn: tax claims and claims on state reserve;
- 4) the fourth turn: claims of bankruptcy creditors;
- 5) the fifth turn: return of the staff contributions and additional remuneration for an insolvency officer;
- 6) the sixth turn: all other claims.

5.3.5. The settlement agreement

The settlement agreement is an agreement between a debtor and creditors on deferral or instalments and debt release. Its special feature is that the settlement agreement may be executed at any stage of bankruptcy proceedings, but no sooner than the list of creditors is approved. The settlement agreement cannot be executed in respect of the first-priority claims, claims of the salaries and similar payments, as well as claims of pension and social insurance premiums. The settlement agreement shall be approved by the court and shall be a ground for termination of the bankruptcy proceeding. In case of failure to fulfil an agreement or its termination the bankruptcy proceeding shall be renewed.

5.3.6. Special procedures in bankruptcy

Individual debtors. The law provides for the peculiarities of the bankruptcy proceedings of certain categories of debtors. These categories are the following: entities with social or another value or a special status, agricultural enterprises, insurance companies, participants of the securities market and joint investment institutions, trustees in charge of real estate development, private entrepreneurs and farm enterprises.

The law also provides for simplified bankruptcy proceedings in case of bankruptcy following the liquidation procedure subject to normal procedure. In this case, insolvency officer's duties may be assigned to the debtor's head official, and the procedure shall commence immediately with the liquidation procedure.

Enterprises with social, another value or a special status. Under the law, enterprises with a special status are city-forming and extremely hazardous enterprises.

When examining a bankruptcy case of such an enterprise, the local public authorities may file to the court a request not to use bankruptcy proceedings to such a company. The request should include the resolution of the entities as well as guarantees for discharge of creditors' claims.

Agriculture enterprises. The feature of their bankruptcy is that in case of sale of real estate used for agricultural purposes and possessed by the agricultural enterprise declared bankrupt, with all other conditions being equal, preferential right to purchase specified facilities is vested in local agriculture and farming enterprises, located in the area.

It should be noted that no benefits are applicable to purchasers under the usual procedure.

Insurance companies. As for managing the bankruptcy of insurers special knowledge is required, none but insolvency officer, additionally trained and having passed the exam program upon bankruptcy of insurance organizations shall participate in the proceedings.

The features are the following: the insurer's integral property complex can be purchased by an insurer only; the integral property complex can be purchased only by the purchaser, who agrees to be bound by the debtor's insurance contracts and statutory requirements for redemption priority for insurance contracts.

Professional participants of securities market. The participant in bankruptcy is the National Commission on Securities and Stock Market. The insolvency officer (a property administrator) shall have a certificate issued by the National Commission on Securities and Stock Mar-

ket. Securities and funds belonging to members (customers) shall not be included in the debtor's liquidation estate and shall be subject to return.

The issuer or the trustee of mortgage certificates. Mortgage assets shall not be included in the liquidation estate.

Private entrepreneur. The law governs only the debts arising in relation to business activities. The application of the debtor may be supplemented with the debt repayment plan to adjourn bankruptcy for up to three months. A businessman shall bear liability to the extent of all of his/her property, except for the property, which subject to the civil procedural law of Ukraine cannot be seized.

Also, the law provides the features of priority of creditors.

Farm enterprise. In case of failure to meet creditors' claims within six months following the end of the period of agricultural works, the debtor's head may within two months bring an action plan to restore solvency to the court. The procedure for disposition of property shall be introduced at the end of the period of agricultural work, taking into account the time required to sell grown agricultural products, for 15 months at the most.