

## **Conversion of debt to authorized capital of a Ukrainian LLC**

- 1. Debt conversion practicability**
- 2. Rendering the decision on the authorized capital increase**
- 3. Making additional contributions by the participants**
- 4. Approval of the results of making additional contributions**

B

### **1. Debt conversion practicability**

An effective tool for repayment of intragroup debts lies in the mechanism of transferring debts of the company to its authorized capital provided by the Law of Ukraine "On Companies with Limited and Additional Liability".

It should be emphasized that this mechanism can also be implemented by taking into account the Ukrainian company's debt, for example, to a foreign supplier or a lender. In this case, the debt incurred based on a supply/loan agreement with a foreign counterparty may be converted into the authorized capital of a Ukrainian LLC, and after making an additional contribution such supplier/loaner becomes one of the participants in the relevant LLC.

To avoid the formation of negative equity capital, as well as the ratio distortion of the company's net assets to the amount of its authorized capital, a parent company can exchange (make an offset) its right to claim a debt against a subsidiary company for a share in the increased authorized capital of the company at the expense of increasing the authorized capital of the Ukrainian subsidiary company.

Related article: Financial assistance for Ukrainian subsidiaries in times of crisis

Proceeding from the norms of Ukrainian legislation, the procedure of increasing the authorized capital of a limited liability company through additional contributions can be divided into several steps/stages:

1. Rendering the decision by the general meeting of the members of a Ukrainian company to increase the authorized capital of the company at the expense of additional contributions;
2. Making additional contributions by the (new) participants;
3. Rendering the decision on approval of the results of making additional contributions and authorization of a new amount of the authorized capital of the company.

### **2. Rendering the decision on the increase of a authorized capital**

Participants of a company shall convene a general meeting and render the decision on the engagement of additional contributions, containing the following information:

- the total amount of the increase in the authorized capital of the Ukrainian company;
- the ratio of the increased amount to the share size of each participant in the authorized capital;
- the planned amount of the authorized capital;
- term for making additional contributions by the company's participants or third parties (e.g. a supplier/a lender);
- consent or prohibition to make additional contributions by the third parties;
- prohibiting or enabling the third parties to make additional contributions after each participant has exercised his pre-emptive right or waived such a right.

In addition, a (new) participant of a company may become the party to a contract on making an additional contribution, under which such a participant undertakes to make an additional contribution in a monetary or a non-monetary form, while the company undertakes to increase the amount of his share in the authorized capital or accept him into the company with a corresponding share in the authorized capital. This agreement should specify the term for making an additional contribution.

The same possibility to conclude an agreement on making an additional contribution is stipulated for the third parties.

### **3. Making additional contributions by the participants**

At this stage, each participant of a Ukrainian company is entitled to the pre-emptive right to make an additional contribution within an amount of the increase of the authorized capital in proportion to his share in the share capital. Such contributions are made by participants within the term determined by the decision of the general meeting on the engagement of the additional contributions, but not later than one year from the date of such a decision.

Third parties and company participants can make additional contributions after realization by each participant of their pre-emptive right or waiver of such a right within a difference between an amount of the increase in the authorized capital and the size of additional contributions made by the participants only if it is provided by the decision of the general meeting on the engagement of the additional contributions.

Third parties and company participants may make such contributions within 6 months after the deadline for making additional contributions by participants who intend to realize their pre-emptive right if at the first stage the participants have not set a shorter period in the decision of the general meeting.

If an agreement for making additional contributions has been concluded and such a contribution has not been made in time and in full, the agreement is considered to be terminated. The exception is the contribution, which has been made partially and the amount of the share from the actually made additional contribution is approved by the decision of the general meeting.

At the same time, to avoid any misunderstandings, it is recommended to conclude an agreement on the termination of liabilities by offsetting homogeneous counter claims (or at least an act on offsetting homogeneous counter claims). Such an agreement should specify a liability, its maturity date, in which amount it is terminated by means of the offsetting homogeneous counter claims, and indicate the term of fulfillment and the amount.

#### **4. Approval of the results of making additional contributions**

Within one month after the end of the term for making additional contributions, the general meeting of the participants of a Ukrainian company makes the final decision on:

- approval of the results of making additional contributions by the company participants and/or the third parties;
- approval of the company participants' amounts of shares and their nominal value, taking into account additional contributions actually made by them;
- approval of the increased amount of the company authorized capital.

The above decision by the general meeting of Ukrainian company participants is the ground for the introduction of amendments to the data on the amount of the authorized capital as well as the share size of each participant, which is stated, in the unified state register of legal entities, physical persons and public formations.

It is worth mentioning that it is important to document in detail every step aimed at converting a debt into the company authorized capital, namely: drawing up an agreement on offsetting homogeneous counter claims, the conclusion of additional agreements to a loan agreement or a supply agreement, etc. That will also help to avoid unnecessary disputes in the future.