
THE RESTRUCTURING REVIEW

SECOND EDITION

EDITOR
CHRISTOPHER MALLON

LAW BUSINESS RESEARCH

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PREFACE

We are very pleased to present this second edition of *The Restructuring Review*. As with the first edition, our intention is to help general counsel, government agencies and private practice lawyers understand the conditions that have been prevailing in the global restructuring market in 2008/2009 and to highlight some of the more significant legal and commercial developments and trends during that period.

It is widely acknowledged that the global economy is now in the midst of the worst financial crisis since the Great Depression. As readers will have experienced, the past year has seen credit conditions deteriorate further, global asset prices continue to fall and distressed banks reach out for government support. The effects of the current global recession have been enormous: unemployment figures have risen sharply worldwide and economic growth has stagnated. Considerable uncertainty remains as to how best to remedy the current weaknesses in our economic system that have made the downturn so severe.

Although the main stock markets have shown some signs of recovery recently, there is no consensus as to how long this surge will continue and therefore how long this recession will be with us. As banks face the dual obstacles of revenue pressures and rising credit impairments, together with national economies facing fiscal tightening, talk of ‘green shoots of recovery’ in the short to medium term appears premature. In the meantime, it is nevertheless clear that the hostile environment businesses still confront will produce further technical and commercial issues that companies, legislators and practitioners will, of necessity, have to tackle together.

I would like to extend my gratitude to all the contributors for the support and cooperation they have provided in the preparation of this work, and to our publishers, without whom this would not have been possible.

Christopher Mallon

Skadden, Arps, Slate, Meagher & Flom LLP

London

October 2009

Chapter 28

UKRAINE

*Andriy Vyshnevsky**

I OVERVIEW OF RESTRUCTURING AND INSOLVENCY ACTIVITY

This article was written when the impact of the financial crisis became apparent all around the world, including in Ukraine. Its influence deepened the economic downturn in Ukraine, but was not its main cause. The following key events took place in Ukraine in 2008:

- a* the lowest GDP growth for the past nine years – 2.1 per cent;
- b* Ukraine ratified its accession package and joined the WTO;
- c* the government commenced payments for the deposits lost in the former USSR Sberbank; and
- d* the IMF provided Ukraine with a \$16.5 billion currency system stabilisation loan.

The world financial crisis caused a fall in demand for Ukrainian steel and products of the chemical industry in both local and international markets, which brought about a significant reduction in industrial output. The economic downturn in the country caused an unemployment upsurge. Only as recently as September 2008, some 250,000 were reported to be out of work, including 80,000 in building and 150,000 in manufacturing industries. Towards the end of 2008 the unemployment rate in Ukraine rose to approximately 800,000 people. As a result real incomes fell considerably, which, in turn, led to the reduction of retail trade growth by 17.9 per cent in 2008 (as opposed to 29.3 per cent in 2007) and a fall in demand for industrial products.

A large number of companies are now experiencing insolvency, which is often due not to inefficient management, but rather to the insolvency of their customers or partners, which have found themselves in a similar critical state on account of objective reasons. The number of bankruptcy proceedings instituted against sizeable businesses

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has recently grown by 10 per cent compared to the pre-crisis level. It is noteworthy that private business is less receptive to these tendencies. The most powerful companies are expected to survive and continue to maintain their marketability after the crisis.

According to the State Department of Bankruptcy, as of 1 May 2009 the general number of companies undergoing bankruptcy proceedings is 14,136, including 452 state-owned companies. Of these, 167 are at the property disposition stage; 104 are at the restructuring stage; and 154 are at the liquidation stage. There are 160 companies with 25 per cent or more state ownership. 3,136 of the companies currently undergoing bankruptcy proceedings have initiated sets of proceedings. 2,927 sets of proceedings have been terminated due to solvency recovery, including five after the restructuring, 19 by friendly settlement, and 65 by payment of all debts to the creditors. 2,612 firms have been liquidated.

The current situation offers a real opportunity to protect a business against creditors' demands through bankruptcy procedures. However, since Ukrainian law does not provide the opportunity of bankruptcy for an individual, a creditor-entrepreneur is often declared bankrupt. The popularity of this method is proved by the fact that during 2009 more bankruptcies of private entrepreneurs were announced than during the previous two years.

The main advantage of this method consists of the possibility to restructure the debt in cases when the debtor's assets are insufficient to cover the whole debt. A bankruptcy system has existed in Ukraine since 1992 and is governed by the 'Restoration of a Debtor's Solvency or the Declaration of Bankruptcy' Act. The statute governing personal bankruptcy is yet to be adopted.

II GENERAL INTRODUCTION TO THE RESTRUCTURING AND INSOLVENCY LEGAL FRAMEWORK

The main statute governing bankruptcy procedures is the 'Restoration of a Debtor's Solvency or the Declaration of Bankruptcy' Act of 14 May 1992, No. 2343-XII ('the Bankruptcy Act'). In 1999 a new wording of this law was adopted, which is aimed at the restoration of the debtor's solvency, liquidation being applied as a measure of last resort.

From the moment of the initiation of the bankruptcy procedure a special legal regime is introduced, aimed at the restoration of the debtor's solvency. Thus the Bankruptcy Act provisions have priority over other statutes.

The bankruptcy of banks is governed by the 'Banks and Banking' Act. This statute stipulates conditions for initiation of bankruptcy procedures in respect of banks, provides for the relevant juridical proceedings and establishes the circle of persons who can participate in them. The Bankruptcy Act is applied in so far as this is permitted by the 'Banks and Banking' Act.

Specific rules are applied to the bankruptcy of certain categories of debtors, such as town-forming businesses and hazardous enterprises, agricultural and insurance companies. These special rules are provided for in the Bankruptcy Act in Chapter IV 'Special Rules of Bankruptcy Proceedings of Certain Categories of Business Entities'. The provisions of this Chapter have priority over other provisions of this Act.

The Bankruptcy Act does not apply to ‘Kazenny companies’ and, in certain circumstances, to municipal companies. ‘Kazenny companies’ are state-owned entities, based solely on state property; these companies’ rights to assets assigned to them are restricted by the operational management regime. Kazenny companies may be established where:

- a* the business activity is restricted by law exclusively to state-owned companies;
- b* the main (over 50 per cent) customer for products or services is the state;
- c* the specific conditions of conducting business activity rule out free competition among producers or consumers; or
- d* the dominant activity (over 50 per cent) consists of production or provision of socially beneficial products or services.

Due to the above, a Kazenny company cannot undergo the full range of bankruptcy proceedings and cannot service its debts with the assets assigned to it.

Municipal companies may be excluded from bankruptcy proceedings in order to prevent negative social, ecological and other undesirable effects of their winding-up. Therefore municipal authorities are entitled to take decisions to rule out the application of the Bankruptcy Act to particular municipal companies. Such decisions may be adopted only before the institution of the bankruptcy proceedings by the court.

Certain aspects of restructuring are governed by other statutes, such as:

- a* Civil Code of Ukraine of 16 January 2003, No. 435-IV in the part concerning the liquidation of legal entities;
- b* Commercial Code of Ukraine of 16 January 2003, No. 435-IV (Chapter 23 ‘Declaring a Business Entity Bankrupt’);
- c* Code of Commercial Procedure of Ukraine of 6 November 1991, No. 1798-XII;
- d* ‘The Procedure for Repayment of the Taxpayers Obligations to Budgets by Public Funds’ Act of 21 December 2000, No. 2181-III;
- e* ‘The Evaluation of Property, Titles and Professional Assessment Activity in Ukraine’ Act of 12 July 2001, No. 2658-III;
- f* ‘The State Registration of Legal Persons and Private Entrepreneurs’ Act of 15 May 2003, No. 755-IV;
- g* The Ruling of the Cabinet of Ministers of Ukraine No. 922 of 16 June 1998 ‘On Specific Features of Restructuring of Agricultural Companies’;
- h* Guidelines on the detection of the signs of insolvency and concealed bankruptcy, false bankruptcy or enforced bankruptcy (Order of the Ministry of Economy of Ukraine dated 19 January 2006 No. 14); and
- i* Model Restructuring Schedule (Order of the Ministry of Industrial Policy of Ukraine of 29 August 2008 No. 549).

Commercial courts have exclusive jurisdiction over bankruptcy cases. The parties are prohibited from referring bankruptcy cases to arbitration tribunals. Territorial jurisdiction in such cases is linked to the residency of the debtor (its managing body).

The Bankruptcy Act provides for the following stages of proceedings: disposition of the debtor’s property, friendly settlement, restructuring, liquidation. These procedures are aimed at reaching the main goal: the restoration of the debtor’s solvency.

The disposition of property, friendly settlement and restructuring stages are focused on the restoration of the debtor's solvency and are applied by the court at the creditors' request before the debtor is declared bankrupt.

The disposition of property stage is aimed at identification of the real financial state of the debtor and is introduced to prevent improper disposition of its property. It does not apply to private entrepreneurs and in cases of abridged bankruptcy proceedings (liquidation of the debtor by its owner or the absent debtor's bankruptcy).

The main tasks of this stage are:

- a* preservation of the debtors' assets;
- b* identification of creditors;
- c* drawing up of the register of creditors' claims;
- d* holding of the first creditors' meeting; and
- e* taking a decision on the next stage of the bankruptcy proceedings.

The above tasks are achieved through the activity of a receiver, appointed simultaneously with the launching of the disposition of property stage. The law sets out a six-month time limit for this stage, which may be extended by a court at the request of the participants in the proceedings.

A significant drawback of this stage is the absence in the Bankruptcy Act of any criteria for determination of the likelihood of the recovery of the debtor's solvency. The establishment of this issue is highly important because it determines the choice of the subsequent stage of the proceedings: restructuring or liquidation.

Restructuring is applied by the court at the request of the creditors' committee for a maximum of 12 months. This period may be extended by the court for a further six months.

It is to be noted that the period during which the restructuring proceedings lasts does not have to coincide with the period in which the actual payments to the listed creditors are scheduled. The restructuring plan may fix terms for payments to the creditors extending beyond the restructuring period.

A restructuring manager, a person responsible for the conduct of the restructuring proceedings, is appointed by the commercial court in the decision launching the restructuring stage.

According to Article 18 of the Bankruptcy Act, within three months after restructuring procedure is commenced the restructuring manager must draw up a restructuring plan and present it to the creditors' committee for approval.

The restructuring plan must contain arrangements for the recovery of the debtor's solvency and the conditions of participation of investors (if any) in the full or partial satisfaction of creditors' claims. The latter is achieved, *inter alia*, by way of transferring the debt (or a part of it) to the investor. The plan also should set out terms and priority of the payments of debts by the debtor or by the investor; provide for the investor's liability for failure to comply with the undertakings under the restructuring plan, and the terms for recovery of the debtor's solvency.

When approving the restructuring plan for a debtor, where the state's share in the firm is over 50 per cent, a prior approval of the public body authorised to manage state property must be sought.

Within three months after the commencement of the restructuring procedure the restructuring manager is entitled to refuse to perform the debtor's contracts that have been concluded prior to the initiation of the bankruptcy proceedings and are outstanding partly or in full. This can be done on the following conditions: it is proved that the performance of such contract may cause losses to the debtor, or that the contract is long term (more than one year), or that the debtor's benefits are substantially delayed, or that the execution impedes the restoration of the debtor's solvency.

The restructuring manager is required to consider propositions from investors and to notify the court, debtor and creditors of such propositions, regardless of the date of their receipt.

A person successfully applying for participation in the restructuring proceedings obtains the rights and obligations of a party to the bankruptcy proceedings, including the right of appeal against judicial decisions interfering with their rights and obligations.

A liquidation procedure is launched by the court after declaring the debtor bankrupt. It is to be completed within 12 months. This time limit, however, may be extended by the court at the request of the liquidator or the committee of creditors. The overall period of the liquidation procedure may not exceed 18 months. Information about declaring the debtor bankrupt and opening of the liquidation procedure is published in the official gazette.

The court appoints a liquidator to oversee the liquidation procedure. He or she performs such duties until the completion of liquidation proceedings.

The liquidator is required to take the relevant measures and submit a report and a liquidation balance for the court's approval within the period provided by law. However, the liquidator's failure to comply with this time limit does not constitute a ground for termination of the proceedings.

As from the time of the adoption of the commercial court's ruling declaring the debtor bankrupt, and the launching of the liquidation procedure, the competence of the debtor's managing bodies is extinguished and is replaced with the competence of the liquidator.

Creditors whose claims have arisen after the commencement of bankruptcy proceedings (during the property disposition, restructuring and liquidation stages) are to submit these claims to the liquidator and the commercial court during the liquidation procedure. These claims are considered in the course of a procedure, analogous to that applied to listed creditors.

If the bankrupt entity is a joint-stock company, the liquidator, following a court ruling on its liquidation, is obliged to take appropriate steps for annulment of the registration of the share issues and certificates of shares in accordance with the relevant procedure adopted by the decision of the State Commission on Securities and Stock Market of 30 December 1998 No. 222.

A liquidation procedure does not necessarily, however, bring about the cessation of the debtor's activities. According to the Bankruptcy Act one of the possible outcomes of this procedure is a friendly settlement between the debtor and the creditors' committee. Moreover, if, after servicing the creditors' claims the debtor remains in possession of assets substantial enough for the running of a business, the court may find the debtor free of debts and terminate the proceedings.

The friendly settlement, pursuant to the Bankruptcy Act, is an agreement between the debtor and the creditors postponing, extending or excusing the debtor's debts, concluded in the form of a written agreement. The friendly settlement agreement reflects the will of the parties to terminate the bankruptcy proceedings and the settlement of the disputes between the parties. The interested persons (investors, guarantors) that bear a part of the debtor's debts or secure their payment may participate in the agreement.

The friendly settlement may be reached at any stage of the bankruptcy proceedings, including the period after the declaration of bankruptcy by the court. However, the friendly settlement cannot be concluded before the publication in the official gazette of information concerning the institution of the bankruptcy proceedings as this may affect the rights of other creditors. Furthermore, the agreement cannot be concluded after the completion of the payments under the liquidation procedure.

The decision to conclude the friendly settlement agreement in the name of creditors requires a majority of votes of the committee of creditors, on the condition that all the creditors, whose claims are secured by the pledge, expressed their consent to the agreement in writing. This decision in the name of the debtor is taken by its manager or the receiver (the restructuring manager, liquidator), acting as a manager or managing body of the debtor.

The commercial court adopts the decision on the friendly settlement, whereby the lawfulness of the settlement is established. The court's decision also terminates the bankruptcy proceedings and the competence of the receiver (restructuring manager or liquidator).

The proceeds from the sale of the debtor's assets are used for the settlement of the creditor's claims in the order, set out in Article 31 of the Bankruptcy Act:

- a* the first lien claims: the claims under pledge; salary, social benefit payments due in the last three months before the institution of the proceedings and redundancy pay arrears; the expenses of the Individual Deposit Guarantee Fund; claims arising out of insurance contracts; the expenses incurred in the course of the bankruptcy proceedings;
- b* the second lien claims: claims of the debtor's employees except for those falling under the first lien; compulsory social security payments;
- c* the third lien claims: the payment of taxes and other charges;
- d* the fourth lien claims: the claims of creditors not secured by pledge, including those arising during the bankruptcy proceedings;
- e* the fifth lien claims: the restitution of the debtor's employees' investments in the equity capital; and
- f* the sixth lien claims: other claims against the debtor's property.

The current wording of the Bankruptcy Act is mainly focused on the restoration of the debtor's solvency and prevention of its bankruptcy.

The insolvency legislation of Ukraine undergoes constant development and changes, but its main task remains the same: the striking of a balance between the interests of creditors and the debtor in the most painless manner possible for all involved.

III RECENT LEGAL DEVELOPMENTS

The legislation governing the processes of recovery of solvency of the debtor or its bankruptcy undergoes constant changes and amendments on account of the need to refine the law in view of the changes in commercial activity. The state, represented by its bodies, actively participates in this process.

By the Order of the Ministry of Economy of Ukraine No. 912 of 25 December 2008 a state-owned company was established, 'the State Centre of Recovery of Solvency and Bankruptcy'. The company provides services to the state, individuals and legal entities involved in the bankruptcy proceedings, including:

- a* the education and training of receivers;
- b* pre-trial restructuring of companies according to the current legislation;
- c* organisation of auctions for the sale of the companies' assets;
- d* development of restructuring plans; the analysis of such plans; provision of conclusions on the execution of the restructuring plans;
- e* provision of analysis of the financial state of the companies undergoing bankruptcy proceedings;
- f* creation and administration of numerical databases used in the companies' activities;
- g* preparation of analytical papers for companies; and
- b* provision of assistance to individuals and small businesses in their investment activity, etc.

The most recent amendments to the Bankruptcy Act were introduced on 17 December 2008 and concerned the ranking of creditors' claims in the course of bankruptcy proceedings instituted in respect of an insurance company. Thus, the first lien claims are those directly provided for in the insurance contract. These amendments were caused by the adverse effects of the world financial crisis on insurance activity.

An earlier amendment concerned the exclusion of Paragraph 6 of Article 11 of the Bankruptcy Act. That provision obliged the court to suspend the privatisation process if instituted in respect of a state-owned company undergoing bankruptcy proceedings. Therefore, the bankruptcy proceedings do not constitute an impediment to privatisation any more.

As indicated *supra*, the legislation of Ukraine governing the restructuring and bankruptcy procedures undergoes constant refinement.

To prevent the use of bankruptcy proceedings as a means of 'shadow privatisation' a bill was developed forming an 'Amendments to Certain Laws of Ukraine' Act concerning the refinement of bankruptcy proceedings and the licensing of the receivers. This bill provides an increase of the significance of the state's role in bankruptcy proceedings pending against companies in which the state's share is equal to or more than 25 per cent. The lawmakers seek to prevent harming such companies by way of application of remedies different from those provided by law.

Another bill under consideration proposes the enhancement of state control over restructuring proceedings, the securing of production potential and settlement of claims by employees, the budget and state funds.

Propositions are also being discussed regarding the establishment of specific bankruptcy proceedings for individuals. However, for the time being, the only physical persons who may be declared bankrupt are private entrepreneurs.

IV SIGNIFICANT TRANSACTIONS AND INDUSTRIES

The world financial crisis has most affected the financial and banking spheres. Several powerful banks, including Prominvestbank, Bank Kiev, and Kreshchatik Bank, found themselves on the verge of bankruptcy.

In October 2008 the National Bank of Ukraine refinanced Prominvestbank with 7 billion hryvnas. Since the beginning of 2009, the clients of Prominvestbank have deposited 2.8 billion hryvnas. During May 2009, due to the renewed trust in the stability of Prominvestbank, the growth of deposits amounted to 258.3 million hryvnas. The largest shareholders of the bank at present are the Bank for Development and Foreign Economic Affairs (75 per cent share) and Singus LLC (an affiliate of SLAV AG) with a 12.37 per cent share.

Since 9 February 2009 Bank Kiev has been run by a temporary administration, appointed by the National Bank of Ukraine. On 10 June 2009 the Cabinet of Ministers of Ukraine decided to participate in the capitalisation of this bank, by way of increasing the equity capital and acquisition of 99.9 per cent of the additionally issued shares.

Kreshchatik Bank, in its turn, has attempted to overcome its problems independently, without recapitalisation by the state. In March 2009 the shareholders decided to increase the equity capital by 77.76 million hryvnas, i.e., up to almost 618 million hryvnas, by way of reinvesting dividends and the rise in the shares' nominal value.

Furthermore, the steel and chemical industries also suffered from the crisis. The lack of demand and falling prices of their products may cause bankruptcies for companies working in these fields.

In early 2009 Ukraine suffered from a substantial fall in industrial production. Due to the decrease in demand in the iron ore market the iron industry has had to lower its output. Ukrainian non-ferrous metal industry companies compete fiercely with foreign producers. A special feature of this field of industry is a significant change in product prices. The rise of scrap metal prices in 2009 resulted in a decrease in competition in external markets, but also caused a fall in output.

Falls in output have also occurred in both the chemical and machinery production industries. The government is undertaking anti-crisis measures in these industries.

The problems of the consumer goods industries relate to the shortage of raw materials and a lack of foreign customers. As a result, the big enterprises in this industry are decreasing their output.

The internal market-oriented food processing industry has been affected the least by the crisis. As a consequence, the powerful industrial groups are looking to develop agricultural branches. For example, the Donbas Industrial Union leased 40,000 hectares of agricultural land for farming and Smart Group is looking for partners for development of its meat and grain businesses.

V INTERNATIONAL

Ukrainian law does not contain specific provisions governing cross-border bankruptcies. Foreign creditors have equal rights with national creditors as regards bankruptcy proceedings, unless the creditor–debtor relations are governed by an international agreement ratified by Ukraine. Thus specific regulation may be established for genuine non-resident creditors.

If the property of a non-resident debtor subject to seizure under a competent court's judgment is situated in Ukraine, such judgments are enforced in accordance with international agreements of Ukraine. If no such agreement exists, the judgment may be enforced on a reciprocity basis. At the moment a programme of the National Programme of Adaptation of the Legislation of Ukraine to the Legislation of the European Union, adopted by the Cabinet of Ministers of Ukraine on 15 March 2006, is in force. In the context of this programme the Ministry of Justice of Ukraine has drafted a bill of amendments to certain statutes, aimed at introducing the concept of cross-border bankruptcy in Ukrainian law and developing the relevant procedures. The bill is based on the 1997 UNCITRAL Model Law on Cross-Border Insolvency and EU Insolvency Regulation 1346/2000 of 31 March 2000. The adoption of this bill would provide for improved regulation of the business activity of foreigners in Ukraine and that of Ukrainian businesses abroad; would create a legal background for further improvement of the investment climate; and would alleviate the risks of external business activity. The bill is under consideration by the Cabinet of Ministers of Ukraine.

VI OUTLOOK

In 2008 Ukraine hit a record high in foreign direct investments. However, in 2009 numerous companies suffered desperately from a lack of investment. The aggregate debt of Ukraine constitutes \$105 billion. Such indebtedness scares off many foreign investors.

The bankruptcy announcements in banking aggravated the situation further. The Ukrainian banks are highly dependant on the foreign capital sphere of the economy due to major direct investment from abroad, i.e., the acquisition of Ukrainian banks by foreign banks. The debt repayment situation was worsened because the majority of loans were intended to be repaid by refinancing.

The absence of external investments may lead to the disappearance of foreign products from the Ukrainian market. The Ukrainian food and consumer goods industries therefore have an opportunity to reclaim and even improve their positions in the internal market. In January to June 2009 the food and processing industry has shown 3 to 4 per cent growth.

So far as the steel, chemical and building industries are concerned, their best chances lie with government-supported measures.

ANDRIY VYSHNEVSKY

EnGarde Attorneys at Law

Andriy Vyshnevsky is a senior partner of EnGarde Attorneys at Law. He has extensive experience in advising Ukrainian and international clients on a wide range of transactional matters, including business structuring, mergers and acquisitions, tax, and litigation. He also brings his broad expertise to other areas of practice including privatisations, insolvency, and real estate. Andriy's recent activities include advising Smart Holding on structuring the merger of its metallurgical and ore mining assets with metallurgical and ore mining assets of System Capital Management Group and creation of a joint venture on the basis of Metinvest BV (the Netherlands); advising Smart Holding on structuring the acquisition of majority stake in the Veres group of companies and creation of a joint venture in the Netherlands; representing the interests of Eugene LLC in court in the case of *the Government of Ukraine, Football Federation of Ukraine, Kiev City Counsel v. Eugene LLC* regarding demolishing the company's real estate with an approximate value of \$300 million; advising a Ukrainian investor in a €450 million tender bid for acquisition of a major German steel plant; and representing foreign investors in the \$500 million real estate project on development of the Globus trade and entertainment centre.

Andriy is featured in the *PLC Which Lawyer? Yearbook 2009* as a highly recommended lawyer for dispute resolution and in *The Legal 500 – EMEA 2009* as an experienced practitioner in corporate, M&A and taxation matters.

Andriy gained a Diploma in International Law from the Kiev National Taras Shevchenko University in 1985 and a PhD in Private International Law in 1988.

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