



Anton Korobeynikov

AKorobeynikov@sk.ua
+380 44 499 6000

Debt Restructuring in Ukraine: Foreign Creditor Consideration

By Anton Korobeynikov

SAYENKO KHARENKO

In 2014 and 2015, a lot of external debt of major Ukrainian borrowers is approaching its maturity. Around US\$3 billion of Ukrainian Eurobonds alone (excluding government and municipal bonds) will need to be repaid in the course of the next year. Taking into account the current economic situation in Ukraine aggravated by the recent political turbulence and ongoing military conflict inside the country, one can easily forecast that a large portion of this debt will require restructuring.

Dealing with adverse conditions is hardly something new for Ukrainian borrowers and foreign creditors. Since 2008, Ukraine has seen a number of large debt restructurings (including US\$ 1.6 billion restructuring by Naf-togaz and US\$ 1.2 billion restructuring by Interpipe Group). Today foreign creditors are again looking at the Ukrainian regulatory environment more closely in order to consider their options in case of potential restructuring.



Preparatory Stage Considerations

Absolute majority of debt restructurings in Ukraine are out-of-court restructurings. Insolvency petitions are quite difficult to succeed and will need a prior court judgment confirming the existence and the amount of the creditors' claims. Such concepts as balance-sheet test or cash-flow test are not familiar to the Ukrainian insolvency regulations. Furthermore, many Ukrainian companies attract financing through their offshore holding companies or special purpose vehicles. Taking such cases to court will be an extremely difficult and costly exercise.

Once it becomes evident that restructuring is forthcoming, creditors should focus on two points: information gathering and assessing their position as against the borrower and other creditors. In case of major Ukrainian borrowers, much information may be received through their financial statements. However, due to complex structures of corporate groups and

non-public nature of some Ukrainian companies, a lot of information is often not readily available. As a result, creditors may need to engage their financial and legal advisors into researching various sources in order to see the whole picture of the borrower's legal and financial condition.

Assessing the creditor's position is another important stage of restructuring preparatory work. Where restructuring is not expected to run smoothly due to disagreements with the borrower, knowing creditor's strong points allows using negotiation leverage to the full extent. Even where restructuring is viewed as a routine exercise, the need for prior analysis of a creditor's position should not be underestimated. Any restructuring is a good opportunity to get concessions from the borrower and improve creditor's position to protect itself against any future deterioration of the situation.

From the legal standpoint, creditor's position would largely depend on two factors: security and recourse to third parties (i.e., guarantors). Without a doubt, having a secured claim puts a creditor into a better position as

compared to an unsecured creditor. Still, most of the Ukrainian security is impossible to enforce out of court without the co-operation of the security provider. As a result, a secured creditor would usually face the only route of going through court enforcement, which is likely to be a time and cost consuming process. As a result, secured creditor status may substantially improve the negotiation leverage, but should not be overestimated. Certain security structures may be improved to increase the chances of out-of-court enforcement. Such improvements include using a local security agent, introducing side arrangements in respect of certain types of collateral (direct debit of bank accounts, direct transfer instructions in respect of shares in joint stock companies) enabling creditors to take possession of the collateral without the co-operation of the security provider.

Guarantees issued by Ukrainian companies, much like security, may not be easily enforceable due to Ukrainian currency control restrictions. While in recent years currency control restrictions have been relaxed to a certain extent, payment under a guaran-

tee issued in respect of indebtedness of an offshore holding company will require obtaining by the Ukrainian guarantor of an individual licence of the National Bank of Ukraine.

Transaction Considerations

Once the parties start documenting the restructuring transaction, the environment will become more familiar to foreign creditors. Most of the restructuring documents would be governed by English or other foreign law and consist of the usual arrangements: standstill, intercreditor agreement, override agreement, etc. At the same time, creditors will also usually face certain Ukrainian legal issues that will require some degree of legal creativity to get around.

The major bottleneck in all cross-border restructuring is Ukrainian currency control regulations. Generally, cross-border payments from Ukraine are subject to obtaining an individual approval from the National Bank of Ukraine (fee payments and interest payments are among rare exceptions to this requirement). Facility agreements and amendments to

their terms require registration with the National Bank of Ukraine as a pre-condition to their effectiveness. The National Bank of Ukraine has also established caps on payments in respect of a facility, including interest, fees, costs and indemnities. The level of these caps is now outdated, because they are below the cost of funds that Ukrainian borrowers are able to obtain on external markets (for example, the cap for a fixed rate loan with maturity of over three years is 11% p.a.). Finally, Ukrainian currency control regulations lack flexibility and sophistication. As a result, many common structures used in transactions outside of Ukraine technically do not fit within the Ukrainian currency control regulatory framework and require legal effort to properly implement in Ukraine. Another set of complications in the course of documenting the restructuring is caused by unfamiliarity of Ukrainian legal system with certain concepts which are regularly used in other jurisdictions. Consider contractual subordination which is a common restructuring instrument that may be used to subordinate shareholder or intragroup debt or grant priority to

additional financing provided in the course of restructuring. Contractual subordination will not be effective in Ukraine, because claims of all unsecured financial and commercial creditors have the same statutory priority which may not be altered by an agreement. As with many other Ukrainian law issues, subordination effect may generally be synthesized through other legal means and certain degree of comfort may be available through undertakings by the subordinated creditor to pass all moneys received to a senior creditor. Still, such type of issues may complicate otherwise simpler structures and increase the time and costs of the transaction.

Finally, successful restructuring does not guarantee financial recovery of the debtor. Therefore, when implementing the restructuring arrangement, the parties should take account of the insolvency rules. These include, in particular, voidable transactions provisions which have been modified by a recent restatement of the Ukrainian insolvency law. The new law expanded the list of voidable transactions which now include, for example, any agreement on providing security over

debtor's property. Any such security created within a period of one year before opening of insolvency proceedings may be invalidated by the court upon request of an insolvency officer or a creditor. Addressing this and other Ukrainian insolvency related concerns usually involves both legal and structuring solutions.

Conclusion

This brief outline of legal and practical issues indicates that restructuring of debt of Ukrainian borrowers requires a combination of legal and financial expertise, creativity and practicality. This is especially true for complex restructurings in terms of the number of parties involved and types of instruments being restructured. Hopefully, with increasing number of successful transactions Ukrainian legal environment will adapt to globally accepted standards. Meanwhile, foreign creditors and their advisers should carefully consider the Ukrainian legal pitfalls in order enable the creditor to get maximum recovery regardless of how post-restructuring situation unfolds.

SAYENKO KHARENKO

Anton Korobeynikov is a counsel with the firm specializing in cross-border finance, international debt and equity capital markets transactions.

Mr. Korobeynikov is experienced in advising on all types of offerings by Ukrainian banks, corporates, and public sector issuers. Anton advises extensively on syndicated loans, secured financing, project finance transactions and PXF facilities to major Ukrainian borrowers in various industry sectors.

Apart from his transactional expertise, Mr. Korobeynikov is involved in shaping sector-specific legislation regulating capital markets in Ukraine.

Anton Korobeynikov is recognized among notable practitioners in banking and finance according to Ukrainian Law Firms 2014 by Yuridicheskaya Practika.

