On restructuring, rehabilitation and bankruptcy procedures in the light of the COVID-19 epidemic and the current economic situation

Authors: Tukulov B., Konysbaev A., Isakhanov S., Litigation, GRATA International
The declaration of a state of emergency in the light of the COVID-19 epidemic, the following quarantine, the related restrictions, the fall in oil prices and the subsequent devaluation of tenge, together will have a serious negative impact on the financial situation of whether debtors or creditors. This can lead both to the need to protect debtors from the claims of creditors, and to protect the interests of creditors in order to avoid abuse by the debtors. Therefore, we considered it appropriate to remind readers of the main insolvency resolution regimes that are available to creditors and debtors under the Law of the Republic of Kazakhstan On Rehabilitation and Bankruptcy (the “Law”).

1. Basic procedures

The Law of the Republic of Kazakhstan On Rehabilitation and Bankruptcy provides for the main three procedures for resolving insolvency:

(1) Debt restructuring procedure;

(2) Rehabilitation procedure; and

(3) Bankruptcy proceeding.

The application of the restructuring or rehabilitation procedure is possible upon the occurrence of the so-called “temporary insolvency” of the debtor, i.e. when, for example, the debtor made a delay of four months. Nevertheless, taking into account the amendments adopted to the Law dated 27 December 2019, there is no longer a minimum debt limit that can serve as the basis for such a statement.

The bankruptcy procedure is possible in a situation where the debtor has a “persistent insolvency” if: the debt exceeds its assets at the filing date of the bankruptcy petition and this situation existed at the beginning of the year in which the petition was filed.

2. Restructuring

Debt restructuring may be promising if the debtor is able to negotiate with all creditors to resolve insolvency (for example, by discounting, deferring payment of debt and otherwise).

The procedure provides for the judicial recourse of the debtor, the court orders within 10 business days and gives the debtor a two-month period to reach an agreement with creditors on debt settlement.

If the debtor enters into an agreement with creditors within two months, the agreement is submitted to the court for approval, after which the debtor, among other things, receives protection from creditors' claims for the agreement validity period, exempt from penalty, remuneration, arrests are removed, execution of judicial acts against the debtor is terminated and etc.

The restructuring procedure gives the debtor the opportunity to repay the debt during the performance of the agreement. Violation of the agreement entails its termination, which deprives the debtor of the mentioned protective measures.

3. Rehabilitation

The rehabilitation procedure may be useful in a situation where the debtor is not able to agree on debt settlement with each creditor, however if creditors, to which the debtor has the majority of the debt, are ready to support such a decision.
In accordance with this procedure, the debtor or creditor file petition in court. During the trial, the issue of the presence / absence of grounds for the implementation of rehabilitation proceedings against the debtor is decided. Therefore, a temporary administrator is involved, who studies the financial state of the debtor and expresses a judgment regarding the presence / absence of grounds for the rehabilitation of the debtor.

If the court satisfies the petition, the debtor and creditors have a three-month period for the preparation and approval of the rehabilitation plan (the plan provides for measures that the debtor will take to pay off the debt, and the deadlines for paying off the debt to the creditors). The rehabilitation plan is approved by a majority vote of creditors (on the principle of one tenge - one vote). Failure to approve a rehabilitation plan entails a termination of the rehabilitation procedure.

As part of the rehabilitation procedure, the debtor receives protection from creditors. The accrual of interest, fines, and the execution of court orders against the debtor are suspended. Claiming is possible only within the framework of the rehabilitation procedure. The debtor gains the opportunity to continue activities in accordance with the rehabilitation plan. Meanwhile, serious restrictions are imposed on the debtor, for example, on the conclusion of new transactions.

4. Bankruptcy

Bankruptcy involves a procedure for the forced liquidation of a debtor in a situation where it is no longer possible to rehabilitate a company. The purpose of bankruptcy is the fair division of the debtor's property among creditors. Upon termination of the bankruptcy procedure, the debtor is liquidated and excluded from the register of legal entities of the Republic of Kazakhstan.

5. Advantages and disadvantages

5.1. Rehabilitation procedure

The main advantage of the rehabilitation procedure is the possibility of obtaining a deferral of payment of debt for up to five years with the possibility of its further extension. Another advantage is that the claims of creditors against the debtor are fixed in tenge, which can mitigate the risk of a further increase in debt in foreign currency in the event of a devaluation of tenge. Rehabilitation may allow keeping the existing company if it continues to generate income, but requires temporary protection from creditors.

Meanwhile, the majority of key decisions in the rehabilitation procedure are made by the meeting of creditors. The creditor or creditors, the number of claims (votes) of which is the majority at the meeting of the debtor's creditors, will control the key decisions made in the rehabilitation procedure. For example, they may decide whether to leave the previous management of the debtor to manage a company or to appoint another person. In this connection, for the debtor and its owners, there is a high risk of loss of control over the enterprise, or its ineffective management during the rehabilitation period, which subsequently may increase the risk of bankruptcy. In this connection, caution should be addressed to the rehabilitation procedure.

There are cases when the debtor abuses the rehabilitation procedure to evade responsibility to creditors. There were times, when a debtor could create artificial debt to a third party (which is in fact affiliated with the debtor) in order to such a third party makes a decision in the interests of the beneficiaries of the debtor and to the detriment of the interests of other creditors. There are various methods of counteracting such unscrupulous approaches of debtors.

5.2. Bankruptcy Procedure

The name of the bankruptcy procedure speaks for itself - it provides for the liquidation of the debtor. Not all applications for bankruptcy of a debtor are subject to satisfaction, and creditors may oppose such applications. In some cases, the debtor has the opportunity to go from bankruptcy proceedings to the rehabilitation procedure or
vice versa, which may also affect creditors. Both in the rehabilitation procedure and in the bankruptcy procedure, it is important to timely file a claim in the register of creditors' claims, as well as attend lender meetings.

Bankruptcy proceedings are not always predictable. It can drag on to several years and have some risks, both for the debtor and for its participants / shareholders; it cannot be allowed to go on its own. Constant control of the bankruptcy manager is required; in some cases, its actions must be appealed in a timely manner.

The procedure also provides opportunities for creditors. For instance, in a bankruptcy procedure, a bankruptcy manager has the right to impeach the debtor's transactions, which may entail the obligation of the debtor's counterparties to return money / property of the bankrupt (for example, if an entity bought the assets of a bankrupt, it may be required to return the asset). This may be necessary in cases where the withdrawal of assets took place on the eve of bankruptcy.

In some cases, it is also possible to incur subsidiary managers, participants / shareholders of the debtor in the bankruptcy procedure (subsidiary liability implies the obligation of the director, participant / shareholder to pay off the unpaid part of the bankrupt debt).

Contact details:
Bakhyt Tukulov, Partner, GRATA International
+7 (701) 929-04-93
E-mail: btukulov@gratanet.com
Yerzhan Yessimkhanov, GRATA International
+7 727 2445 777
E-mail: yyessimkhanov@gratanet.com