

Insolvency proceedings in Ukraine during martial law

The Ukrainian financial sector has been significantly impacted by Russia's invasion in February 2022. The war has taken a severe toll on the population and led to the large-scale destruction of productive capital and infrastructure. This situation is significantly affecting the profitability and solvency of businesses, particularly those companies whose assets are located in territories close to hostilities or in temporarily occupied territories.

To meet the realities of martial law, a number of amendments were made to the Bankruptcy Code of Ukraine (the "**Bankruptcy Code**") by the Law of Ukraine "On Amendments to the Bankruptcy Code of Ukraine on the Application of Bankruptcy Procedures during the Period of Martial Law" No. 3249-IX dated 13 July 2023 (the "**Law**"). The Law became effective on 29 July 2023 and will remain in force for the period of martial law and within six months from the date of its termination or cancellation.

This guide provides a general overview of insolvency proceedings in Ukraine, focusing on specific regulations during martial law, which are highlighted as **Nota Bene (NB!)**.

Key issues

- How to commence insolvency proceedings in Ukraine
- Main stages of insolvency proceedings
- Challenging transactions during insolvency proceedings
- Liability for insolvency and actions during insolvency
- Insolvency of private entrepreneurs and natural persons

Commencement of Insolvency Proceedings

Insolvency proceedings of a legal (entrepreneurial) entity can be initiated by creditor(s) or a debtor.

- (a) Creditor(s) may commence insolvency proceedings as soon as a debtor fails to

pay a due undisputed debt, regardless of the amount or duration of the delay.

A creditor should present a comprehensive suite of proofs of claim, which include:

- (i) purchase orders, invoices, contracts, security agreements or promissory notes;
- (ii) bank account statements evidencing the disbursements and repayments;
- (iii) documents relating to set-off transactions, fee letters, disbursement requests, waivers and confirmations;
- (iv) evidence of delivery of the goods, such as customs and tax declarations, transfer-acceptance certificates, etc.; and
- (v) relevant court judgments and enforcement orders, etc.

NB! For the period of martial law and within six months from the date of its termination or cancellation, the court dismisses the insolvency petition against the debtor who:

- (A) has a valid defence contract with the state; or
- (B) is not able to satisfy creditors' claims due to the armed aggression against Ukraine,

including cases when the debtor's single property complex is located in the territory of hostilities or in the temporarily occupied territory.

- (b) A debtor is required to initiate insolvency proceedings within one month of becoming aware that satisfaction of the creditor's claims will lead to its inability to fully perform its obligations to other creditors (risk of insolvency).

If a debtor fails to do so, the court may impose joint and several liability on the debtor's management (and, in certain instances, on its shareholders) for the failure to satisfy creditors' claims.

NB! For the period of martial law and within six months from the date of its termination or cancellation, the debtor's management bodies and shareholders will be exempted from incurring joint and several liability if armed aggression against Ukraine influenced the failure to file for insolvency, in particular due to the location of the debtor's property complex in the territory of hostilities or in the temporarily occupied territory.

A creditor may revoke an insolvency petition for the commencement of insolvency proceedings prior to the date of the preliminary hearing of the court. If a debtor submits an insolvency petition against itself, it cannot revoke that petition. The court commences the proceedings unless there are reasons to postpone or dismiss them, such as:

- a) the debtor has fully satisfied the creditors' claims before the preliminary hearing in the case; or
- b) there is a dispute about the validity or the amount of the debt which must be resolved in the active proceedings.

Once insolvency proceedings have been commenced, the court has exclusive jurisdiction over all property disputes involving the debtor.

The court imposes a moratorium on the satisfaction of creditors' claims. No penalties, fines and interest are accrued for non-fulfilment of the debtor's obligations. The moratorium will continue until the end of the insolvency proceedings. The moratorium on the satisfaction of secured creditors' claims will be automatically terminated after the end of the property administration procedure if the court has not made a resolution to proceed to rehabilitation or liquidation procedures.

NB! For the period of martial law and within six months from the date of its termination or cancellation, the court has the right to extend the deadline of the moratorium on the satisfaction of creditors' claims.

The court appoints an insolvency officer upon the suggestion of an initiating creditor subject to the officer's consent. If an insolvency petition is filed by a debtor, the appointment of an insolvency officer shall be made by the court using the automated system of selection insolvency officers from the Register.

NB! For the period of martial law and within six months from the date of its termination or cancellation,

- a) the court will appoint an insolvency officer chosen by a creditor or a debtor who initiates insolvency proceedings if the relevant agreement with the officer is attached to the insolvency petition;

- b) the court can commence insolvency proceedings without evidence of initial remuneration payment to the insolvency officer by a creditor or a debtor who initiates insolvency proceedings; and
- c) an insolvency officer will be exempted from disciplinary liability for failure to perform actions and duties due to hostilities.

Stages Of Insolvency Proceedings Of Legal Entities

Property administration

During the property administration procedure, which should last no longer than 170 days, the court approves a list of creditors and their demands as well as the composition of the committee of creditors. The asset manager supervises and controls the debtor's property by restricting the debtor's executive body from disposing of the debtor's assets. The procedure pursues the preservation and efficient use of the debtor's property and analysis of its financial condition.

Prior to the termination of the property administration procedure, the creditors' meeting must make a decision to move to the rehabilitation procedure or the liquidation procedure.

NB! For the period of martial law and within six months from the date of its termination or cancellation, meetings and committees of creditors can be held via video conference or survey.

Rehabilitation

The rehabilitation procedure pursues preventing the debtor from being declared bankrupt and liquidated. This stage aims to improve the debtor's financial and economic condition as well as satisfy creditors' claims by restructuring the company, its debts and assets and/or changing the organisational, legal and production structure of the debtor. During rehabilitation, the members of the debtor's executive body are suspended

while all powers are transferred to a certified rehabilitation manager.

NB! For the period of martial law and within six months from the date of its termination or cancellation,

- a) the accrual of interest and penalties on the debtor's obligations to creditors restructured according to the rehabilitation plan will be suspended; and
- b) overdue obligations under the debtor's rehabilitation plan are deferred in instalments for the period of implementation of the rehabilitation plan.

Liquidation

In the liquidation procedure the court declares the debtor insolvent, in particular if:

- (a) the court does not approve the rehabilitation plan within the set deadline;
- (b) the rehabilitation plan is not complied with and/or the debtor's effective obligations are not performed;
- (c) proceeds from the sale of the debtor's property during the rehabilitation period do not satisfy the creditors' claims (within the amounts set by the rehabilitation plan) and the creditors' meeting has not approved amendments to the rehabilitation plan; or
- (d) the time limit of the rehabilitation procedure has lapsed and the creditor's meeting has not applied for its extension.

The winding up of the debtor is organised and carried out by a liquidator appointed by the court. The liquidation

procedure focuses on searching for and recovering the debtor's assets. It involves managing and disposing of the debtor's property and selling the debtor's property through auctions to satisfy the claims entered in the register of creditors' claims.

During the liquidation procedure no new liabilities may arise with the debtor (including tax liabilities), except for those which are closely connected to the liquidation procedure; the conditions of any asset sale may not include any deferral of payments or payments by instalments.

The liquidation proceedings should last no longer than 12 months.

NB! For the period of martial law and within six months from the date of its termination or cancellation, the court may extend procedural deadlines for property administration, rehabilitation or liquidation procedures, the announcement of auctions and some other procedural deadlines.

Ranking Of Claims

If the court declares the debtor bankrupt, proceeds from the sale of its assets will be distributed in the following order of priority:

Rank 1: salary claims and expenses incurred in connection with insolvency proceedings;

Rank 2: payments due to injury claims, pension claims and social insurance tax claims;

Rank 3: other claims for taxes;

Rank 4: unsecured creditors' claims;

Rank 5: claims of employees to receive a distribution from the debtor's share capital; and

Rank 6: other claims.

Assets that are subject to security held by creditors are not included in the general pool of assets sold as

described above. An insolvency officer sells relevant assets and then repays the relevant secured creditor's claims out of proceeds of such sale without application of the above-mentioned order of priority.

Hardening Period. Setting Aside Transactions

Upon the insolvency officer's or creditor's application, the court may invalidate any debtor's transaction during the three years preceding the commencement of insolvency proceedings if it resulted in the debtor:

- a) entering into obligations as a result of which it became insolvent;
- b) disposing of or acquiring assets not at their market value and as a result of which it became insolvent;
- c) making any cash payments or receiving payments in kind when the amount of creditors' claims exceeds the value of the debtor's assets;
- d) disposing of assets, incurring undertakings or waiving proprietary claim(s) without consideration;
- e) performing obligations before they became due;
- f) granting security;
- g) entering into an agreement with an interested party; or
- h) entering into a gift agreement.

If a transaction is invalidated, each party to the transaction should return to the other party all assets it received as a result of the transaction (mutual restitution).

Directors, shareholders or any person who made or approved such invalidated transactions can bear

subsidiary liability for the debtor's obligations to the extent of the losses caused by such transactions.

Expedited Insolvency Restructuring; "Cram-Down"

The expedited insolvency restructuring allows the debtor, with the approval of the majority of creditors by value, to reach an expedited restructuring under the authority of the court, in effect overriding any dissenting minority creditors. The practice of such instrument is still evolving.

The expedited process would work as follows:

- a) A debtor, acting with the consent of the majority of creditors, can apply for expedited restructuring before commencement of the insolvency proceedings if (i) the debtor's shareholder(s) issued a decision on initiating this procedure and (ii) a restructuring plan is pre-approved by both creditors controlling at least 50% of the unsecured indebtedness of the debtor and two-thirds of the secured creditor's votes in each category (claims of interested parties of the debtor shall not be taken into account).
- b) After such pre-approval the restructuring plan is submitted to the court for its approval.
- c) Upon the approval of such plan by the court (which should occur one month after its submission), a moratorium on the satisfaction of creditors' claims will be imposed and the parties involved may immediately start carrying out the restructuring plan.
- d) The debtor restructuring procedure must be completed within the term agreed by the debtor and the creditors in the restructuring plan approved by the court.

- e) The restructuring plan for the expedited insolvency procedure will be able to include a waterfall of claims which is different from the statutory ranking of claims.

Set-Off

During insolvency, the outstanding claims of the same type may be set off upon the creditor's consent and if a set-off does not violate the rights of other creditors. In practice, this means that a set-off should be approved by the creditors' meeting or by the court.

Foreign Currency Claims

The creditor's monetary claim must be determined in UAH. If the creditor's claim is denominated in another currency, it will be re-calculated in UAH based on the official exchange rate of the National Bank of Ukraine as of the date of submission of such creditor's claim to the court. A debtor's foreign currency account may be used to satisfy the non-resident creditor's claim in a foreign currency.

NB! For the period of martial law and within six months from the date of its termination or cancellation, the court may extend procedural deadlines for property administration, rehabilitation or liquidation procedures, the announcement of auctions and some other procedural deadlines.

There are two primary options for foreign creditors seeking to recover funds in bankruptcy proceedings:

- (a) the first option is to open an account in a Ukrainian bank denominated in UAH and then use such funds in Ukraine; and
- (b) the second option is to assign the claim to a Ukrainian party which is able to receive the funds in UAH. In such a case, an assignment agreement will need to be submitted to the court. Upon

the court's review and approval of the assignment agreement, the register of creditors should be amended accordingly, permitting the insolvency officer to disburse the funds to the designated assignee.

Liability Of Directors, Shareholders And Persons With Control

Debtor's shareholders, directors or any other persons having control over the debtor's business or corporate governance may bear subsidiary liability for the debtor's bankruptcy if:

- a) the assets of the debtor are insufficient to satisfy the creditors' claims in full; and
- b) the actions of such a person resulted in the debtor's bankruptcy.

The debtor's management bodies and potentially shareholders may be jointly and severally liable for the debtor's failure to satisfy creditors' claims if the debtor did not initiate bankruptcy proceedings within one month of becoming aware of the risk of insolvency.

NB! For the period of martial law and within six months from the date of its termination or cancellation, the debtor's management bodies and shareholders will be exempted from incurring joint and several liability if armed aggression against Ukraine influenced the failure to file for insolvency, in particular due to the location of the debtor's property complex in the territory of hostilities or in the temporarily occupied territory.

Subordination Of Creditors

The so-called "subordination agreements", which are aimed to subordinate the claims of one creditor before the claims of other creditors, most likely will not be honoured by the court during the Ukrainian insolvency proceedings. However, such an agreement, particularly

if the subordinated creditor is a foreign entity, should still be an effective tool pursuant to the so-called "turn-over" provisions requiring the subordinated creditor, which has received funds in insolvency contrary to the subordination agreement, to return the funds to the senior creditor.

- (a) the debtor failed to pay loans or other scheduled payments in the amount of more than 50 per cent of the monthly payments within two months; or
- (b) the enforcement officer failed to find the debtor's property that may be subject to foreclosure; or
- (c) there is a risk that the debtor will not be able to fulfil its obligations or make ordinary current payments soon (risk of insolvency).

Insolvency proceedings of a private entrepreneur have special features. Once the insolvency officer prepares a report on the debtor's property condition and considers the creditors' monetary claims, the creditors should decide on one of the below procedures:

- (a) Implementation of the debt restructuring plan

The creditors' claims shall be satisfied under the debtor's debt restructuring plan, as approved by the court. The debt restructuring plan should not exceed five years. However, for debts incurred from loans received by the debtor for purchasing housing, this term may be extended to no more than 10 years.

Upon the debtor's request and provided that more than 80 per cent of the creditors' claims have been repaid, the court may extend the implementation term of the debtor's debt restructuring plan beyond the above deadline.

NB! For the period of martial law and within six months from the date of its termination or cancellation,

- (i) the accrual of interest and penalties on the debtor's obligations to creditors restructured according to the debt restructuring plan will be suspended; and
- (ii) overdue obligations under the debtor's debt restructuring plan are deferred in instalments for the period of implementation of the debt restructuring plan.

(b) Debt repayment procedure

The insolvency officer sells the bankrupt's property to satisfy the creditors' claims. If some claims are not satisfied due to the insufficiency of property, they are considered discharged except for non-dischargeable claims (e.g., personal injury claims).

The court cannot open insolvency proceedings of a private entrepreneur within five years after the recognition of a debtor as bankrupt unless the debtor has repaid all debts in full. Within five years after being recognised as bankrupt, the debtor must notify all counterparties to loan, credit, surety or pledge agreements of the fact of his/her insolvency.

Cross-Border Insolvency

Ukrainian legislation provides for the recognition of foreign insolvency proceedings and for cooperation between domestic and foreign courts and insolvency officers in cross-border insolvencies. Ukraine has

incorporated the UNCITRAL Model Law on Cross-Border Insolvency, laying the groundwork for initiating ancillary insolvency proceedings against foreign debtors within its jurisdiction.

Foreign court judgments (including the judgments of foreign insolvency courts) may be recognised in Ukraine:

- (a) if there is a relevant international agreement between the respective foreign jurisdiction and Ukraine; or
- (b) based on the reciprocity principle with a foreign jurisdiction (i.e., in the absence of the relevant agreement, Ukraine will recognise the court judgments of the particular foreign jurisdiction if Ukrainian court judgments are recognised in such jurisdiction).

Despite these legal mechanisms, there is limited case law on cross-border bankruptcy in Ukraine. However, the Ukrainian Supreme Court has recently shown support for the application of cross-border bankruptcy procedures, specifically leveraging the principle of reciprocity to facilitate these processes.

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