

# LEGAL ALERT

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## **THE NEW BANKRUPTCY CODE OF UKRAINE**

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## Ukrainian Bankruptcy Code to enter into force

On 21 October 2019, the Code of Bankruptcy Proceedings of Ukraine, passed a year ago, shall enter into force.

From the day the new Code of Bankruptcy Proceedings (hereinafter referred to as the Bankruptcy Code) enters into force, further bankruptcy proceedings shall be conducted in accordance with its provisions, regardless of the date of bankruptcy proceedings opening. Bankruptcy cases, undergoing a bailout procedure on the day the Bankruptcy Code enters into force, shall be an exception; proceedings in such cases continue in accordance with the Law of Ukraine On Restoring Debtor's Solvency or Declaring it Bankrupt.

Pursuant to the Bankruptcy Code, bankruptcy shall mean the debtor's inability recognized by a commercial court to restore its solvency through a bailout and restructuring as well as to satisfy creditors' monetary claims other than through a liquidation procedure. The bankruptcy main goal is to restore the debtor's solvency by introducing the debtor and its assets additional protection as well as by appointing an insolvency officer in order to protect the interests of the parties to the proceedings.

Bankruptcy belongs to the category of commercial law cases falling within the jurisdiction of commercial courts. In handling bankruptcy cases, the courts shall be guided by the Code of Commercial Procedure.

The Bankruptcy Code introduces a number of significant changes to the current bankruptcy procedures. The most important changes to the bankruptcy procedures include:

- there is no minimum claim to open bankruptcy proceedings;
- the Bankruptcy Code establishes the bankruptcy procedure for individuals: only the debtor himself/herself has the right to file for bankruptcy with the court;
- the Bankruptcy Code has expanded the debtor's bailout procedure prior to the bankruptcy proceedings initiation;
- the debtor's property may be sold exclusively through the electronic bidding system;
- the Bankruptcy Code provisions have been brought in line with the provisions of the Code of Commercial Procedure;
- the Bankruptcy Code has specified the procedure for invalidating the debtor's transactions. Moreover, transactions occurring within three years prior to the bankruptcy may now be recognized invalid;
- the Bankruptcy Code provides for additional protection of interests of creditors whose claims are secured by a pledge and determines the conditions for claiming their rights to the pledged collateral;
- creditors, failing to assert their claims in court within the statutory deadline, shall be still considered bankruptcy creditors equal to other creditors (however, they do not have a deciding vote at the creditors' meeting and in the creditors' committee).

## Parties to the bankruptcy

The following persons may become a debtor in bankruptcy proceedings:

- a legal entity,
- an individual entrepreneur or an individual.

Moreover, the procedures for legal entities and individuals significantly differ from each other.

The parties to the bankruptcy cases proceedings are the following: parties, an insolvency officer, the state body for bankruptcy, the State Property Fund of Ukraine, local authorities representatives, representatives of debtor's employees, an authorized person of debtor's founders (members, shareholders), and in some cases, other parties to the bankruptcy proceedings whose rights and obligations are the dispute subject matter.

The parties to the bankruptcy proceedings are the bankruptcy creditors (a representative of the creditors' committee), secured creditors and the debtor (a bankrupt).

## Insolvency officer

An insolvency officer is a special figure in bankruptcy proceedings. It should be noted that an insolvency officer shall be selected before the proceedings initiation by an automated system, in order to ensure its independence.

An insolvency officer shall be appointed by the commercial court for the purpose of protecting the interests of the parties to the proceedings and supervise law observance. An insolvency officer has a number of rights and duties, empowering it to take all possible steps to restore the debtor's solvency and repay its debts.

The professional liability of the insolvency officer must be insured (in case of damage caused by unintentional actions or mistakes during the insolvency officer's activities).

## Debtor

Debtor shall mean a legal entity or an individual (including an individual entrepreneur) who is unable to fulfil its/his/her monetary obligations that became due. It should be noted that according to the Bankruptcy Code only the persons, having monetary obligations, may be insolvent.

## Legal entities and individual entrepreneurs as debtors

If for the creditor filing for bankruptcy is a right, it is an obligation for a legal entity that is a debtor. The debtor must, within a month, file for bankruptcy with the court if the satisfaction of the claims of one or more creditors makes it impossible to fulfil the debtor's monetary obligations in full to other creditors (threat of insolvency), as well as in other cases provided for by the Bankruptcy Code.

If the debtor's director violates these requirements, he/she shall be jointly and severally liable for failure to satisfy the creditors' claims. The debtor's director violation of these requirements shall be the subject matter of legal proceedings in a commercial court. If such a violation is established, the creditors' claims may be further asserted against the debtor's director.

In case the debtor's bankruptcy is caused through the fault of its founders (members, shareholders) or other persons (including the debtor's director), who have the right to give instructions binding upon the debtor or are able to determine its actions in any other way, the debtor's members/shareholders (or other persons) may be jointly and severally liable for the debtor's obligations in case the debtor's assets do not suffice.

The Bankruptcy Code does not provide for a minimum claim to open bankruptcy proceedings.

Bankruptcy proceedings having been initiated, a number of restrictions apply to the debtor's activities. Moreover, in order to protect the debtor's assets and the creditors' interests, a moratorium on the creditors' claims satisfaction is introduced simultaneously with the bankruptcy proceedings initiation. During the moratorium, it is prohibited to:

- foreclose the debtor's assets on the basis of enforcement or other documents containing property claims, as well as to satisfy the claims falling under the moratorium scope;
- charge a penalty (fine, forfeit) and other financial sanctions;
- the statute of limitations shall be tolled for a period of the moratorium validity;
- the inflation index and 3% per annum shall not be applied throughout the default entire period.

The moratorium on the creditors' claims satisfaction shall not apply to:

- claims of post-bankruptcy creditors;
- payment of wages and compulsory pension fund contributions as well as other social insurance contributions related to wages;
- compensation for harm to life and health of citizens;
- payment of royalties;
- payment of alimony;
- claims of non-property nature arising from enforcement documents, obliging the debtor to take certain actions or to refrain from certain actions.

## **Individuals as debtors**

Individuals as debtors have a number of specific features. Bankruptcy proceedings for an individual may be initiated only by the individual himself/herself.

A debtor shall be entitled to apply to the court for bankruptcy where:

- the amount of debtor's outstanding obligations to the creditor (creditors) is not less than 30 minimum wages (UAH 125,190 in 2019). Moreover, the monetary claims shall not include a penalty (fine, forfeit) and other financial sanctions;

- the debtor fails to repay loans or to make other scheduled payments in the amount exceeding 50% of monthly payments for each of the credit and other liabilities within two months;
- the enforcement authorities make a resolution in the enforcement proceedings stating that there is no property that can be foreclosed;
- there are other circumstances confirming that in the near future the debtor will not be able to fulfil its monetary obligations or make regular payments.

Thus, it is more difficult to initiate bankruptcy proceedings against an individual than against a legal entity. The Bankruptcy Code also provides for a moratorium introduced for a period of 120 days after the bankruptcy proceedings initiation.

### Creditors

Creditor is a legal entity or an individual, or a controlling authority authorized to take measures to ensure payment of tax debt and unified social contribution arrears, or another state authority having documented claims for monetary obligations to the debtor.

Creditors are divided into the following categories:

**Secured creditors** are creditors whose claims are secured by pledge of the debtor's property. At the same time, secured creditors may completely or partially give up the pledged collateral. If the pledged collateral value is insufficient to cover the entire claim, the creditor shall be considered secured only in respect of the part of the collateral value that is secured.

**Bankruptcy creditors** are creditors by claims against the debtor that arose before the bankruptcy proceedings initiation and not secured by pledge of the debtor's property. Bankruptcy creditors whose claims arose before the date of bankruptcy proceedings initiation must, within 30 days from the date of the official announcement of bankruptcy proceedings initiation, file with a commercial court written applications asserting their claims against the debtor. Creditors asserting their claims after this deadline shall be still considered bankruptcy creditors; however, they do not have a deciding vote at the creditors' meeting and in the creditors' committee.

**Post-bankruptcy** creditors are creditors by claims against the debtor that arose after the bankruptcy proceedings initiation.

The law specifies that a debtor or a creditor is entitled to apply to the court for bankruptcy of a legal entity. The creditor has no right to apply for bankruptcy of an individual.

When applying to the court, the creditor must pay a court fee of 10 subsistence minimums (UAH 19,210 in 2019) and to advance the insolvency officer's salary of 3 minimum wages (UAH 12,519 in 2019).

### Bankruptcy procedures for legal entities

The court proceedings are as follows: disposition of the debtor's property, bailout and liquidation. It should be noted that changes to the bankruptcy procedure status shall

be published on the website of the judiciary in Ukraine for every interested person to be able to track the debtor's bankruptcy.

### **Pre-trial bailout of the debtor before initiating the bankruptcy proceedings**

Bailout of the debtor prior to the bankruptcy proceedings initiation shall not be considered court proceedings.

Bailout of the debtor prior to the proceedings initiation is an attempt to restore the solvency of the debtor without the use of bankruptcy procedures. Introducing a pre-trial bailout requires the consent of the owner of the debtor's property, of the creditors, collectively owning more than 50% of the total debt without taking into account the stakeholders' claims; a plan of bailout of the debtor agreed with the secured creditors and approved by the creditors' meeting.

### **Disposition of debtor's property**

As a general rule, after the proceedings initiation, the procedure of disposition of the debtor's property and moratorium on the satisfaction of creditors' claims are introduced. This procedure may be called a transition because, on the one hand, the debtor continues to perform economic activity, on the other hand, – a moratorium is valid and there are restrictions on the debtor's property operations. The main goal is to examine the debtor's property and determine the possibility of restoring the debtor's solvency. Furthermore, the aim is to protect the creditors' interests for which purpose this moratorium is introduced. During the disposition of debtor's property procedure, the debtor shall be prohibited to satisfy the creditors' claims, except for post-bankruptcy creditors and salary payments.

To determine the debtor's amount outstanding, the announcement of the bankruptcy initiation shall be published on the website of the Ukrainian judiciary. Within 30 days after the publication, creditors should contact the competent commercial court, having initiated the proceedings with creditor claims against the debtor. Upon reviewing these applications, a registry of creditors of the debtor shall be drawn up, which is the basic document for determining due amounts and the number of votes of each creditor.

The procedure of disposition of the debtor's property may not exceed 170 calendar days.

During the disposition of property procedure, a property manager – an insolvency officer – shall be appointed. The insolvency officer shall review creditors' applications, maintain the registry of creditors and analyze financial and economic activities.

The body, representing creditors' interests in the procedure, is the committee of creditors, which is formed of up to 7 people at the creditors' general meeting. A creditor with 25 percent or more of the votes shall automatically become a member of the creditors' committee.

As a result of the property disposition procedure, the decision to proceed to one of the procedures – bailout or liquidation – shall be made.

### **Procedure of bailout of the debtor**

Bailout shall be introduced by the court if there is a reason to believe that the debtor's solvency can be restored. It should be noted that the restoration of the debtor's solvency is the main goal of the bankruptcy procedure, all other procedures are derivative. Firstly, a special regime – a bailout procedure – is initiated in order to restore solvency and prevent the business entity liquidation.

During the bailout procedure the debtor shall, together with an investor (if any), involving creditors, develop a bailout plan – the main procedural document. The insolvency officer shall act in accordance with the bailout plan.

The law provides for a number of procedures using which restoration of the debtor's solvency can be scheduled, e.g.:

- increasing the debtor's authorized capital;
- assets sale;
- property disposal by replacing assets;
- production restructuring or conversion;
- extension or deferral or indulgence of a part of a debt;
- fulfilment of the debtor's obligations by third parties, including the assets owner.

Following the bailout procedure, the debtor solvency shall either be restored, or if it cannot be restored, the debtor passes on to the next procedure – liquidation.

An interesting measure to restore the debtor's solvency is an opportunity for the property owner to drive a debtor out of bankruptcy at any stage of the bailout or liquidation procedure through satisfying the claims of all creditors listed in the registry. It is also an instrument of protecting the owner's property interests as it allows him/her to pay off debt without wasting time and saving assets.

### **Liquidation procedure**

Bankruptcy and transition to the liquidation procedure shall be performed when the debtor's inability to restore its solvency through the procedures of the bailout or a settlement agreement and to satisfy creditors' monetary claims other than through a liquidation procedure is determined.

The liquidation procedure may be introduced for up to 12 months.

After the commercial court resolution on declaring the debtor a bankrupt, the post-bankruptcy creditors are entitled to assert their claims to be included in the list of creditors.

Special features of the liquidation procedure are as follows:

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- no additional obligations, including tax obligations shall accrue;
- all arrests of the debtor's property shall be lifted.

During the liquidation procedure the debtor's assets shall be disposed of in order to satisfy creditors' claims in full. Disposition of assets shall be made through an auction process (a public tender) in the electronic bidding system. Direct sales to individuals and legal entities shall be an exception for low-value assets or perishable items.

In case the debtor's founders or directors are proven guilty of bankruptcy, they shall bear a subsidiary liability.

The law stipulates the following order of payment to the different classes of creditors:

- **the first priority:** salary claims (including those of an insolvency officer); court fees; procedure costs;
- **the second priority:** claims of the Social Insurance Fund and repayment for the harm to life and health of citizens;
- **the third priority:** tax claims and claims on state reserve;
- the fourth priority: claims of bankruptcy creditors;
- **the fifth priority:** return of the staff contributions and additional remuneration for an insolvency officer;
- **the sixth priority:** all other claims.

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