Opening corporate insolvency procedures in Ukraine: Easy-come, easy-go?

Ivanna Artemovych and Anton Molchanov answer the important questions in Ukraine insolvency law

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The questions of *when* – and even a more important one – under *what* conditions – insolvency protection is to be granted to certain debtor companies are pivotal in determining the efficacy of any insolvency case.

By entering insolvency proceedings, a debtor might at least receive such benefits as,

a) stop the possible race of competing creditors against the debtor's assets and
b) obtain the right to court-governed restructuring based on the system of instalments, write-offs and haircuts, usually not accessible in situations when most of the creditors disapprove any plan.

In turn, from the creditors' perspective, a timely access to the insolvency procedures may result in:

a) protecting assets from other, potentially hostile creditors and thereby increasing the creditor's own debt recovery rate; and
b) proceeding with debt-to-equity swaps or other alternative repayment remedies which usually are not actively supported by the debtor in out-of-court liaison.

Hence, an easily accessible and fairly balanced access to insolvency is of crucial importance for both debtors and creditors in any severely distressed financial situation.

International approach in initiating insolvency action

Generally, there is no unified approach used by either EU or non-EU countries in determining grounds for opening of the insolvency proceedings.

The debtor's perspective

Most of the EU countries have already introduced two different approaches for initiation of insolvency procedures upon a debtor's request. The first approach corresponds to the existence of a likelihood (or threat) of insolvency, while the second one requires the company's actual illiquidity or over-indebtedness clearly shown by the cash flow and the balance sheet tests.

In most of the EU countries, for example in The Czech Republic and Estonia, insolvency proceedings may be opened, as shown in the second approach, in case the debtor companies are unable to pay their debts based on either a cash flow test (unable to pay debts as they fall due) or a balance sheet (liabilities outweigh assets) test[1]. In other Eastern-European jurisdictions, like Slovakia, the condition for insolvency is the debtor's inability to pay at least two obligations to more than one creditor after they have been due for 30 days.

Meanwhile, in a number of EU countries, some predictions of a debtor becoming insolvent (illiquid/over-indebted/ceasing to pay its debts) play a more crucial role, thereby constituting a more dynamic approach. Simultaneously with considering the debtor's over-indebtedness, a court should consider whether the debtor will be solvent and able to meet its debts as they fall due during the current and next year, as in Germany, or up to two years in Austria[2]. An imminently-prospective debt is considered in Denmark.

As a rule, debtors are not obliged to take any additional measures (as a mandatory out-of-court restructuring, for example) in order to be granted the opening of insolvency procedures.

The creditor's perspective

From the creditors' perspective, initiating insolvency proceedings against debtor companies might mean to face a more complex process. As a rule, a creditor seeking to initiate insolvency proceedings against a debtor should prove that:

- the debtor owes the creditor a certain amount to be paid (above a statutory threshold, if it exists). Some of the Eastern-Europe countries (as Hungary, Latvia, Romania) require only a minimum amount being owed by debtor. Quite a similar approach is used in the US where the insolvency proceedings may be grounded on either three or more creditors holding non-contingent claims of at least USD 15,325 in total (unless there are fewer than 12 creditors in respect of one debtor), or by one creditor with a non-contingent claim of at least USD 15,325 . In contrast, to open insolvency proceedings in the Russian Federation creditors are obliged to possess a duty-to-pay exceeding RUB 300,000 in default for at least three months.
- the debtor is facing insolvency or imminent insolvency (in either balance-sheet and cash flow form).

Neither of these countries require the initiating creditor to pre-litigate the claim against an insolvent debtor.

Evolution of the criteria for the opening of insolvency proceedings in Ukraine: past, present, future?

For decades, since Ukraine independence, the domestic insolvency legislation faced three major changes and all of them influenced the criteria for the opening of insolvency proceedings in a varying degree.

At the first stage – from 1991 to 2013 – insolvency proceedings could be opened if, after having received a demanding letter or a court writ, the debtor company failed to repay the matured debt within one month.

At the second stage – from 2013 to 2019 – a debtor company might be subject to insolvency procedures if:

- having a matured debt exceeding 300 minimal Ukrainian wages (app. USD 39,000 as of beginning of 2018),
- being in default for at least three months.

What is more, creditors had the additional obligation to pre-litigate the claim, to open court enforcement via a local bailiff and to wait for three months with no full debt repayment.

With the introduction of the very first Ukrainian Insolvency Code (UIC), from 21 October 2019 the third stage of access to insolvency procedures has begun. The UIC introduced a brand-new set of rules for opening insolvency proceedings – and did so by cancelling both the 300-wages debt threshold mandatory for pre-insolvency litigation and the court enforcement of the debt.

At the same time, in order to receive insolvency protection following either a creditor's or its own request, the debtor company must comply with the following rules:

- *There is a likelihood of insolvency (based on either balance sheet or cash flow analysis).*
  The principal criterion is whether repayment of one due debt would trigger inability of repaying other due debts. In parallel with that, a risk of insolvency also exists when the value of a company's liabilities outweighs the value of its assets.
  This raises a huge concern from the part of creditors who normally have no access to the debtors' financial statements (which, apart from joint-stock companies, are not subject to mandatory disclosure in Ukraine). Having no financial statements to analyse means that neither cash flow nor balance sheet insolvency can be proved by any evidence in court. A similar issue arises from not being aware that there are other claims and out-of-balance liabilities.
- *The debtor does not accept the creditor's claim.*
  If during the preliminary hearing in the insolvency proceedings the debtor refuses to recognize the claim (by referring to such facts as the written notice not duly served; goods at the origin of the debt not supplied, the principal contract between the creditor and the debtor being void, etc.), this would automatically lead to refusing the opening of the insolvency proceedings. Quite surprisingly, apart from the deformalisation benefits, this refusal of pre-litigation concerning the triggering debt has become an enormous ground for speculations among dishonest debtors, leading to mass refusals to open insolvency proceedings.

The court considering a request for insolvency proceedings has a key role in determining whether all these criteria are met. Under Article 35 (2) of UIC, this is to be done in a preliminary hearing to be held within 14-20 days from the date of receiving the insolvency petition.

Conclusions

The Ukrainian Insolvency Code's approach in easing access to insolvency proceedings is definitely a huge step towards harmonisation with the EU insolvency standards. Cancellation of the mandatory pre-litigation, which was for a long time a heritage from the post-Soviet legislation, is certainly welcomed by most of the Ukrainian major lenders as an effective time- and cost-saving tool.

At the same time, possible debtors' speculations with deliberate (or even manifestly ill-founded) challenging of the initial claim's merits may still be a huge issue for creditors. The Code's restrained wording is expected to be clarified by the Supreme Court in the nearest future.

Another issue still needing clarification is whether the Code should lay down concrete and precise economic criteria, describing both the threat of insolvency due to indebtedness and actual insolvency – or, at least, make a reference to certain bylaws determining that. This might be of extreme importance to keep insolvency procedures closer to their economic and financial roots rather than to any sort of excessive legalese. ■

THE UKRAINIAN INSOLVENCY CODE'S APPROACH IN EASING ACCESS TO INSOLVENCY PROCEEDINGS IS DEFINITELY A HUGE STEP TOWARDS HARMONISATION

Footnotes:

1 Gerard McCormack, Andrew Keay, Sarah Brown and Judith Dahlgreen, Study on a new approach to business failure and insolvency, European Commission/University of Leeds, 2016, page 184

2 Gerard McCormack, Andrew Keay, Sarah Brown and Judith Dahlgreen, Study on a new approach to business failure and insolvency, European Commission/University of Leeds, 2016, page 185

3 Gerard McCormack, Andrew Keay, Sarah Brown and Judith Dahlgreen, Study on a new approach to business failure and insolvency, European Commission/University of Leeds, 2016, page 187