

# Insolvency during martial law in Ukraine

Vadym Kizlenko writes on the challenges to the insolvency profession during the period of martial law



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**A**fter the start of Russia's full-scale military aggression against Ukraine and the introduction of martial law throughout the country, almost all processes, except for vital ones, have come to a halt. The efforts of all Ukrainians were directed towards preserving their own lives and health as well as defending the state.

In Ukraine, every sphere of life (economy, politics, culture) has been negatively impacted by the Russian invasion. Enterprises located in areas of active hostilities were forced to evacuate to safer regions or cease operations. However, even businesses located far from the conflict have suffered from logistical problems and a shortage of raw materials.

Since the beginning of the invasion, domestic businesses have suffered significant losses and destruction. According to a survey conducted by the Ministry of Digital Transformation, since the war began, 47% of enterprises have wholly or partially ceased trading. The war has significantly impacted everyone's ability to fulfil their obligations. In this situation, the bankruptcy institute has become an effective tool for resolving contentious legal relationships.

## Martial insolvency regime

Before the war, about 100 bankruptcy cases were opened per month. With the start of the war in March-May 2022, this indicator dropped on average to 10 cases per month. This

happened because as of 24 February 2022, the courts practically stopped working, except for those in western Ukraine. Such a situation has not occurred previously in the history of the state.

Also, on 24 February 2022, the Unified State Register of Court Decisions was closed to public access. This was done to preserve the register, protect it from destruction as a result of massive Russian cyber-attacks as well as to conceal information about judges who were in danger due to the occupation of new territories.

In May 2022, Ukrainian courts resumed full operations, continued to hear cases in previously opened Bankruptcy Procedures and opened new cases of insolvency. From June to December 2022, the number of open bankruptcy cases in Ukraine increased to 50 cases per month.

Currently, access to the Unified State Register of Court Decisions has been restored, and the register is under enhanced monitoring against cyber threats. Moreover, the judicial system of Ukraine has demonstrated its ability to function fully even under conditions of martial law.

## Work of insolvency practitioners in war conditions

With the beginning of the war, the work of many practitioners was impossible due to the hostilities and occupation of territories. The Ministry of Justice of Ukraine reacted promptly to military realities and cancelled planned inspections of arbitration managers. The submission of

mandatory reporting was also postponed, which reduced the regulator's control over the activities of arbitration managers by the Ministry of Justice.

On 30 September 2022, the Ministry of Justice of Ukraine approved the Procedure for the implementation and monitoring of the effectiveness of the state sanctions policy. According to the new Procedure, the Department for Bankruptcy Affairs of the Ministry of Justice of Ukraine began to analyse the sanctions imposed by Ukraine and inform arbitration managers about the subordination of entities associated with bankruptcy procedures. The Department for Bankruptcy Affairs of the Ministry of Justice of Ukraine also started preparing applications and necessary materials to apply to economic courts for appropriate decisions in bankruptcy cases related to the application of sanctions.

The Ministry of Justice of Ukraine has drawn the attention of arbitration managers to the fact that one of the types of restrictive measures applied to individuals and legal entities who have been included in "sanctions lists" is asset blocking. Therefore, when performing their respective powers in bankruptcy cases, arbitration managers must establish the presence of sub-sanctioned individuals and legal entities among creditors and ultimate beneficial owners of debtors.

At present, 3,718 individual persons and 1,993 legal entities have already been verified against whom personal special economic and other restrictive measures



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(sanctions) have been applied. As a result of the verification of sub-sanctioned entities, new court practice has emerged: Bankruptcy Procedures have been initiated and procedures for the disposal of debtors' property have been introduced and creditors under sanctions have been denied the satisfaction of claims.

There are also checks being carried out on bankruptcy cases, where personal special economic and other restrictive measures (sanctions) have been applied to the ultimate beneficial owners of creditors. These checks often yield unexpected results. For example, the Department of Bankruptcy Affairs of the Ministry of Justice of Ukraine informed arbitration administrators appointed in eight unrelated bankruptcy cases that the ultimate beneficial owner of creditor companies in these cases is the sanctioned businessman Vadym Novynskyi.

### Legislative protection measures

Despite the fact that the government of Ukraine is trying to adapt to new circumstances by making changes to legislation, the Code on Bankruptcy Procedure has not undergone any changes in a year of war.

In the summer of 2022, the Ukrainian parliament took the course to simplify the bankruptcy procedure for businesses that are unable to pay off their debts and protect enterprises that are ready to continue working but are currently facing difficulties due to the Russian invasion. In August 2022, the Verkhovna Rada of Ukraine adopted draft Law No. 7442 on the introduction of amendments to the Code on Bankruptcy Procedure regarding the application of bankruptcy procedures during the period of martial law as a basis.

The text, expected to be adopted in 2023, provides for the possibility of imposing arrest on the property of persons who bear subsidiary or joint responsibility with the debtor. It also simplifies the bankruptcy procedure for businesses that have decided to go

via this route in order to recover quickly after the crisis. In particular, debtors whose insolvency was caused by hostilities will be able to initiate a bankruptcy recognition procedure by agreeing on the amount and payment terms for the work of the arbitration manager. Currently, this amount is fixed and must be paid in a lump sum. The draft law also proposes the introduction of a new institution - the "request of the arbitration manager", which is essentially equivalent to a lawyer's request. In this case, the consideration of the bankruptcy (insolvency) case or a separate procedural issue can be carried out by the commercial court in written proceedings without notification and/or summons of the parties to the case and holding a court hearing based on the materials available in the case.

If the law is adopted in its entirety, the accrual of interest and penalty sanctions on the debtor's obligations, which have been restructured in accordance with the financial rehabilitation or debt restructuring plan of the debtor, will be terminated. In addition, the draft law provides for limiting the influence of creditors who have been subjected to sanctions by the National Security and Defence Council.

### War consequences in practice

During the war, new challenges were faced that could not be solved by creditors and debtors, courts, or the Ministry of Justice as a regulator. Businesses have an objective right to compensation for damages caused by the aggressor country.

However, due to the fact that the procedure for compensating such damages has not been agreed upon at the national and international levels, plus the war is ongoing, all that can be done is to properly record the size of the losses and reflect the loss of assets based on the results of the inventory. But what to do with such property rights in Bankruptcy Procedure, how much they cost, and how to dispose of



them is currently unclear.

Another important issue is the implementation of the state's sanction policy in bankruptcy procedures. The sale of property belonging to bankrupts, whose beneficial owners are residents of Russia or Belarus, will inevitably raise questions from authorities who have the right to recover such assets on behalf of the state. In this case, the interests of Ukrainian creditors of such debtors are unprotected.

Since 2014, there has also been no resolution on how to conclude Bankruptcy Procedures for enterprises whose assets remain in uncontrollable territories. Such property cannot be inventoried, and as a result, its sale through transparent mechanisms and at market value is impossible.

All of these issues require urgent resolution by the legislature. Nonetheless, bankruptcy practice during the war in Ukraine continues to evolve and has every chance of becoming an effective mechanism for the restoration and development of the economy after Ukraine's victory in the war. The expected simplification of the bankruptcy procedure could effectively influence the satisfaction of creditors' demands and the protection and restoration of the debtor's interests. ■



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