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**RECENT CHANGES TO RUSSIAN INSOLVENCY LAW AND THEIR  
IMPACT ON CROSS-BORDER DISPUTES**

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**A SUMMARY OF RECENT CHANGES TO  
RUSSIAN INSOLVENCY LAW (FOR  
CORPORATIONS AND INDIVIDUALS)**



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# RESOLVING INSOLVENCY



*The effectiveness of bankruptcy procedures decreases for the second consecutive year*

→ **The 2017 recovery rate – 5.5% (2015 – 6.3%)**

The average amount of satisfied claims of creditors (per one case) was ₺4M in 2017, 1.5 times less than in 2016

*Russia in the rating Doing Business in 2017 on the indicator "resolution of insolvency" dropped from 51st place to 54th place*

The creditors' claims exceed the amount of the assessment by 19 times (on average per case)

→ **Cases in which the creditors were paid zero - 67%\***

Indicator	Moscow
Recovery rate (cents on the dollar) ⓘ	40.2
Time (years) ⓘ	2.0
Cost (% of estate) ⓘ	9.0



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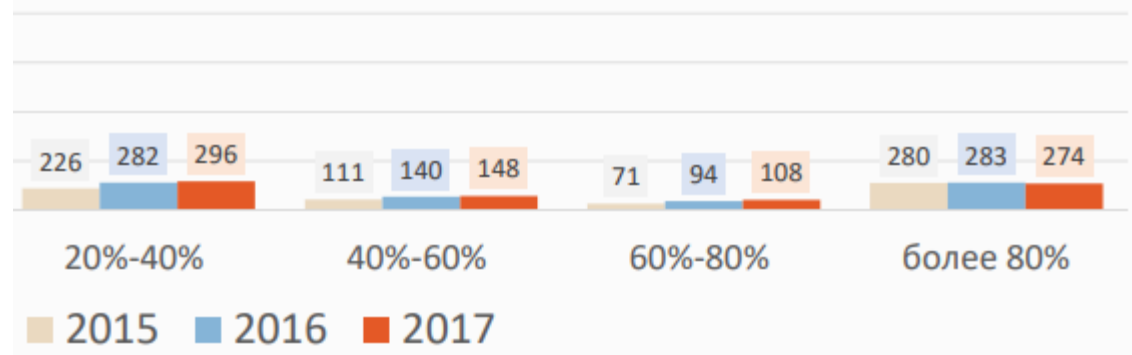
*\*Statistics taken from bankrot.fedresurs.ru*

## WHAT ARE THE TERMS AND COSTS?

In 2017, the duration of monitoring and bankruptcy proceedings was 2.3 years, compared with 2.2 years in 2016 and 2 years in 2015

The average amount of fee paid to the bankruptcy manager (per one case) was ₹176,000 (£2,250) in 2017, 11% less than in 2016

*How to get to the number of those few whose claims are satisfied by 50 or more percent?*



# SUMMARY OF CONSUMER BANKRUPTCY

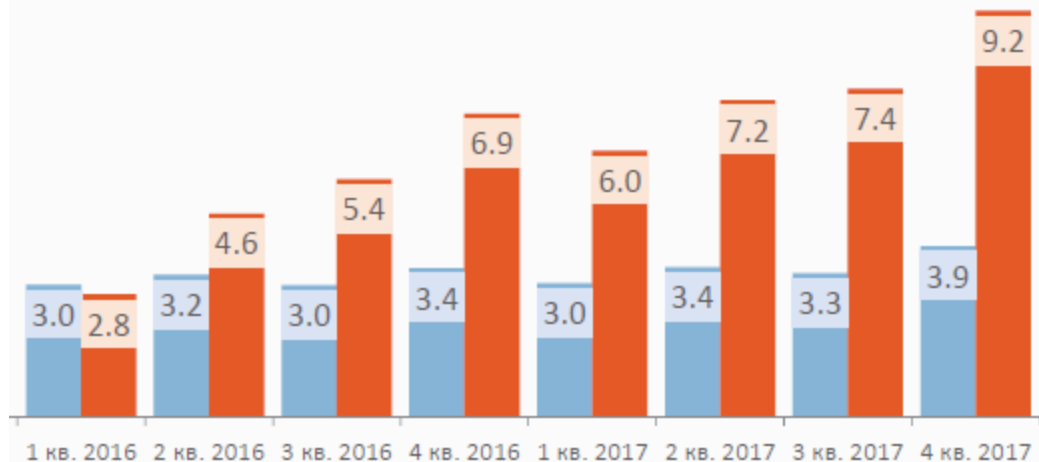
Since consumer bankruptcy came into force – 50,405 individuals became insolvent

29,876 were declared insolvent in 2017, which is 1.5 times more than in 2016

The rehabilitation procedures share - 29% (2% for companies)

The average procedure time - 230 days (2.3 years for companies)

***Individuals in 2017 became bankrupt two times more often than companies***



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## NEVER-ENDING REFORM

The following bills were announced:

### → **BANKRUPTCY MANAGER'S FEE REFORM**

- The fixed part of the fee to be paid as a result of the procedure;
- The fixed part is limited at ₴400,000 (£5,100) for observation, ₴1M (£12,800) for liquidation stage;
- Payment for the other services to be made from the manager's funds;
- To empower the managers to set a ban on alienation of the debtor's property for a period of up to 60 days

### → **INTRODUCTION OF ADDITIONAL REHABILITATION PROCEDURE (October 2018)**

- A debtor can propose a restructuring plan with a term of realization of not more than four years
- If the debtor's application confirms the possibility of restoring the solvency the plan can be accepted;
- Courts will be able to recognize the debtor bankrupt and open a bankruptcy proceeding, bypassing the procedure of observation

*The Bankruptcy law is one of the most amended laws*

*Starting from 2015 the Bankruptcy law was amended more than 15 times*



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# BANKRUPTCY OF FOREIGNERS

**The Bankruptcy of foreign individuals was introduced despite the absence of applicable law**

- Briskin (Germany): Ruling of the Commercial Court of the Moscow District of 08.07.2016 case A40-186978/ 2015;
- Kuznetsova (Ukraine): Ruling of the Commercial Court of the Yamal-Nenets Autonomous District of 30.06.2016 case A81-6187/2015
- Mirzalivalyeva (Uzbekistan): Ruling of the Commercial Court of the Omsk Region of 30.03.2017 case A46-16764/2016
- Danilo (Montenegro): Resolution of the Ninth Commercial Appeal Court case A40-201656/17

***Criterion of close relationship (Art. 247 of CPC) is somewhat similar to COMI Standard***

→ **COMI standard “Russian style”**

Place of residence in Russia

Marriage with Russian citizen

Bank accounts, real estate and place of work in Russia

Registration as an entrepreneur in Russia

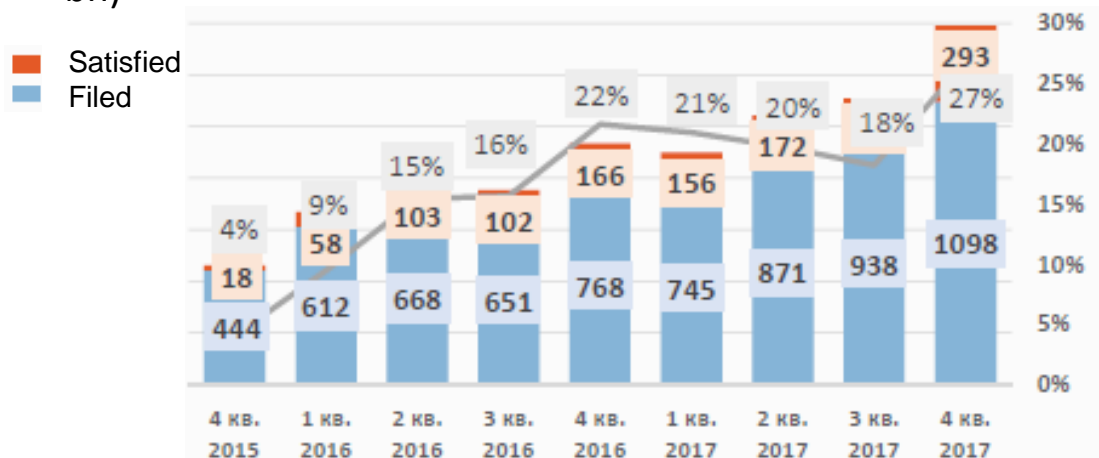


# SUBSIDIARY (VICARIOUS) LIABILITY REFORM

- Federal Law No. 266-FZ of July 29, 2017
- Resolution of the Plenum of the Supreme Court, December 21, 2017 No.53 "On some issues related to the bringing to justice the controlling persons of the debtor in bankruptcy"
- Letter of the Federal Tax Service August 16, 2017 No. CA-4-18/16148@

From October 2015 to December 2017 courts satisfied:

- 27% of the applications for damages - **₽19 bn.** (£242M);
- 18% of applications for subsidiary liability - **₽177 bn.** (£2.2 bn)



*Number of claims to beneficiaries and executives of bankrupt companies grew 2 times more than last quarter of 2016*



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art. 61.14

## LIABILITY WITHOUT LIMITS

**The highly effective piercing corporate veil mechanism** – almost 30% applications were granted

**The right to file a petition on subsidiary liability imposition or on damages recovery have:**

- Bankruptcy manager
- ANY creditors in bankruptcy
- Debtor`s employee representative, employees or former employees
- Tax authority

**The petition may be filed:**

- at ANY stage of bankruptcy case
- beyond the bankruptcy case (if the bankruptcy case was terminated or discharged)

***Almost ANY participant can file a petition***



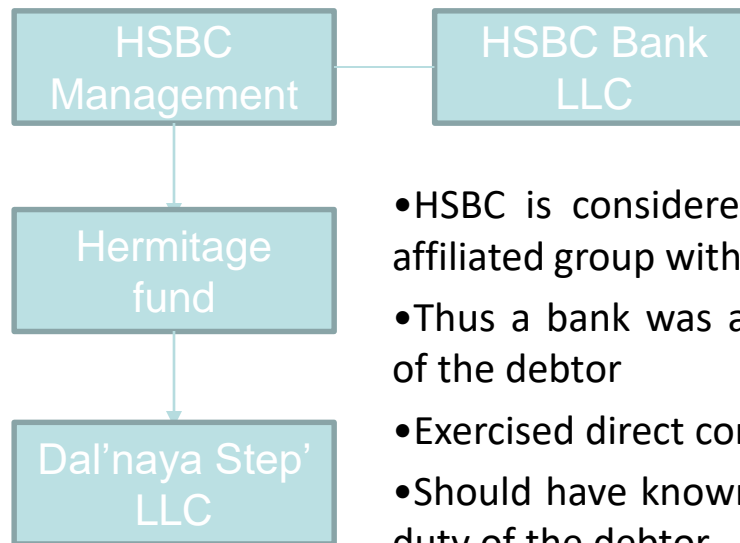


## EXAMPLE

## DAL'NAYA STEP' VS HSBC

2017: HSBC was held subsidiary liable for ₰1,8 bn (~£18M) for bank transfers of Dal'naya Step' LLC conducted in **2005** (!)

### On what grounds?



- HSBC is considered as a member of affiliated group with the fund
- Thus a bank was a controlling person of the debtor
- Exercised direct control of transfers
- Should have known about unpaid tax duty of the debtor
- Limitation terms were interrupted and renewed due to the sentence of criminal court against ex-bankruptcy manager who concealed the transfers

*The Supreme court requested the case and appointed the hearing on March 29, 2018*



No.266-FZ

## APPLICATION IN TIME

→ **The amendments came into legal force on July 30, 2017**

Applicable to the petitions filed from July 1, 2017

→ **The limitation period for imposition is 3 years from the day** when the petitioner became aware or ought to become aware of the grounds for the imposition (*subjective term*)

**BUT** not later 3 years from the day of:

- declaring the debtor bankrupt; termination of the bankruptcy case; return of the bankruptcy petition
- discharge of the bankruptcy case if the petitioner became aware of the grounds for the imposition **after** the discharge of the bankruptcy case and no similar claim with the same grounds was brought/considered within the bankruptcy case
- *+2 years on revival of the period on the basis of valid excuses*

**Overall 10 years from the day when the actions and (or) omissions took place (*Objective term*)**



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# GROUPS FOR SUBSIDIARY LIABILITY

Claims of affiliated parties are not subject to discharge by means of collected subsidiary liability

## → 1. Failure to fully discharge the creditors claims:

- If the full discharge of the claims is unavailable due to actions and (or) omissions of the *controlling persons*\*
- If bankruptcy case was terminated due to lack of funds

The amount of liability = all unpaid claims

*\*5 presumptions*

## → 2. Failure to file (late submission) of the petition on bankruptcy

Amount of subsidiary liability = unpaid claims which arose after lapse of the time period for filing the petition until the bankruptcy case was commenced

No liability if the creditor knew about the inability to pay but concluded the contract anyway



art. 61.11

## PRESUMPTIONS (1)

**Full discharge of the creditors` claims is unavailable due to actions and (or) omissions of controlling person if:**

a substantial damage to creditors` rights was caused as a consequence of suspicious contracts and contracts with unfair preference a controlling person executed or approved in his/her favor

**First presumption is applicable even if:**

- the petition on invalidation of the contract was not filed or is currently under court consideration
- the court refused to invalidate the contract on the basis of: (1) lapse of the limitation period for the contract invalidation (2) lack of proof that the other party to the contract knew or ought to know of the signs of insolvency



**Full discharge of the creditors` claims is unavailable due to actions and (or) omissions of controlling person if:**

- at the time of introducing the observation stage of bankruptcy or declaring the debtor bankrupt the accounting documents, reporting documents and other mandatory documents are absent or corrupted

**Liable persons:** persons which are obliged to (1) manage and (2) record and storage accounting records and (or) bookkeeping (financial) reporting (3) corporate secretary

- 50% of registered claims arose as a consequence of tax violations (*if the major creditor is tax authority*)

**The FNS «...in other words it is the bookkeepers and/or in-house attorneys and/or other persons with regard to their expertise...»**



art. 61.11

## PRESUMPTIONS (NEW)

**Full discharge of the creditors` claims is unavailable due to actions and (or) omissions of controlling person if:**

on the date of commencing the bankruptcy case the public data concerning the legal entity was not submitted, or the data was corrupted

- in the register of companies (EGRUL)
- in the register of the facts and activities of legal entities (Fedresurs) concerning activity of the legal entity

**Liable person:** director, and other persons liable for submissions of documents



art. 61.10

## WHO ARE THE CONTROLLING PERSONS?

**Until defendant proved otherwise the following persons are considered controlling persons :**

- director of the debtor or its managing company, a member of the debtor`s executive body, the debtor`s liquidator or a member of the liquidation commission
- person who had the right of independent or joint disposal together with interested persons of 50% or more of the voting shares of the AO (JSC), or more than half of the authorized capital of the OOO (LLC), or *more than half of the votes in the general meeting of participants of the legal entity or had the right to appoint (elect) the director of the debtor*
- **has benefited from the unlawful or unfair conduct of persons referred to in para. 1 of art. 53.1 of the Civil Code of the Russian Federation (NEW)**

**Exclusion – direct ownership of <10% of a legal entity authorized capital and acquisition of ordinary income associated with this possession**



art. 61.10

## WHO ARE THE CONTROLLING PERSONS?

An individual or a legal entity which has or had not more than **3 years, preceding the emergence of signs of insolvency**:

- the right to give obligatory instructions to the debtor
- the ability to determine conduct of the debtor, including transactions execution and determination of their conditions

**Former edition** - 3 years before the moment of acceptance of the bankruptcy petition (222-FZ) and 2 years (73-FZ)

*The letter of the Federal tax service dated 16 august 2017 № CA-4-18/16148@*

*«any informal personal relationships, including those established by the investigative operations, for example, cohabitation (including so-called civil marriage), long-term joint service (including military service, civil service), co-education (classmates), etc..»*

**Open list of grounds for recognizing a person as debtor`s controlling person**





art. 61.11

## PROTECTION OF THE CONTROLLING PERSON

**In order to be released from subsidiary liability or reduce the amount of subsidiary liability one must prove that:**

**The FTS: «...imposition of subsidiary liability solely on figureheads indicates the incorrect application of the subsidiary liability legal mechanism by territorial tax authorities...»**

- he/she was a figurehead, indicate the controlling person (or) disclose the information concerning assets of the controlling person and its sources, or disclose the scheme of debtor`s assets withdrawal (if the information have not been already available) or;
- absence of guilt (*mens rea*) in the unavailability of full discharge of the creditors` claims;
- he/she acted in compliance with regular course of business, reasonably, in good faith and in the interests of the debtor, its participants, without violating the property rights of creditors;
- the actions were carried out to prevent even greater damage to the interests of creditors



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art. 61.19

## LIABILITY BEYOND BANKRUPTCY

**Subsidiary liability imposition for failure of full discharge of the creditors` claims can be brought as an action beyond the bankruptcy case**

**Before: “The petition on imposition of subsidiary liability on the debtor`s controlling persons` cannot be filed after termination/discharge of the liquidation stage of bankruptcy”**

- The action may be brought by any creditor with unpaid claims to the debtor
- If the similar petition was not considered within the bankruptcy case
- The claimant is obliged to indicate other creditors which claims were not discharged
- The action is considered under the rules of considering cases in favor group of persons
- The motion on joinder to the petition is to be made by announcing it in the Unified Federal Register of Bankruptcy Information (EFRSB)
- The debtor can be even excluded from the register of companies (EGRUL)



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**THANK YOU FOR ATTENTION**  
**QUESTIONS AND ANSWERS**

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