



## DEVELOPMENTS IN BANKRUPTCY LEGISLATION: THE RISKS ARE GETTING HIGHER

*For the attention of heads of and employees in companies' financial, tax, legal and litigation departments*

### **Pepeliaev Group would like to advise of far-reaching changes in procedures used in bankruptcy cases.**

This relates to Federal Law No. 222-FZ dated 23 June 2016 "On amending specific items of the legislation of the Russian Federation".

This law provides for stricter liability of controlling entities; amends special grounds for invalidating transactions, makes the procedure of inventory taking, assessment and sale of debtor's property more detailed; changes the procedure for identifying and satisfying claims of creditors; extensively supplements the procedure for bankrupting financial organisations of certain types (insurance companies, in particular); sets out the procedure for individual debtors to dispose of their cash funds and stipulates banks' liability for violations related to servicing accounts of individual debtors.

#### **Stricter liability of controlling entities**

Under Federal Law No. 222-FZ, entities that control a debtor can be subject to secondary liability under obligations of the debtor for acts (omissions) that had taken place within three years (two years in earlier version) preceding the initiation of the bankruptcy case.

The Law introduces an additional presumption of fault of a controlling entity. From now on, the fault of a controlling entity is presumed if third-priority claims arising from violations or crimes of the debtor's officers, including claims related to tax obligations, constitute over 50% of all third-priority claims versus the principal debt.

 Lawmakers have substantially increased the risk of liability of a debtor's officers by extending the period during which activities of these persons can be examined, and also by aiming the newly-introduced presumption of fault at applying secondary liability to obligations of the company to the state budget, including the debtor's tax obligations.

#### **Developments in challenging transactions on special grounds**

There is a new presumption that harm has been caused to interests of creditors on purpose: Before, Article 61.2.2 of the Bankruptcy Law specified only insolvency or insufficiency of assets as of the date of suspicious transaction as a sign that harm was inflicted on purpose. Now, infliction of harm is also presumed if these signs arise as a result of the transaction.

Besides transactions related to the performance of monetary obligations under a loan agreement, it is also now not possible to use Article 61.3 of the Bankruptcy Law to challenge tax payments, if at the time of these payments the debtor had no monetary obligations, which a relevant bankruptcy creditor (authority) was aware of.

**Procedure for taking inventory, appraising and selling the debtor's property**

For the first time, lawmakers have set the deadline for the receiver to take inventory of the debtor's property. The deadline is 3 months from the date the bankruptcy proceedings are initiated and can be extended following a court decision.

Lawmakers described very thoroughly the course of action of the external (bankruptcy) administrator, the creditor and the court to sell the debtor's property.

The Bankruptcy law regarding the procedure, terms and conditions and the timeline for selling the debtor's property and regarding the auction organisers were supplemented with requirements to ensure that the debtor's property is sold at the highest price possible, that the greatest possible number of potential buyers should be invited to participate in the auction, and that certain actions must be taken to search and engage buyers considering the specifics of the debtor's property being auctioned.

**The period for state authorities to file claims is extended**

According to the new rules, for obligations based on claims of state authorities, the time period for filing a motion to be included in the list of creditors in bankruptcy is extended to 6 months. This applies to claims in respect of which, as of the day the list of creditors was closed, a court decision has not been issued or such court decision (a decision of another authority) has not taken effect, for which, however, such decision is required by Russian law to identify the debt to which such claim pertains.



Among other things, the new provisions encourage the tax authorities to perform inspections and recover arrears even during bankruptcy proceedings and to hold the debtor (which also means its controlling entities) liable for its tax obligations.

**A detailed description of particular settlements with creditors and of how the unsold property of the debtor should be handled**

For the first time the Bankruptcy law provides a detailed description of the procedure for discharging creditors' claims by providing compensation.

A significant number of provisions describe how the unsold property of the debtor should be handled during bankruptcy proceedings. If the value of unsold property is equal to or greater than the statutory charter capital, the debtor's management body authorised to decide on the debtor's liquidation, may file a motion to discontinue proceedings on the bankruptcy case.

**Bankruptcy procedure for insurance organisations**

Lawmakers have substantially amended the procedure for bankrupting insurance organisations, which included:

- supplementing the grounds for applying measures to prevent bankruptcies of an insurance organisation;
- expanding the grounds for the regulatory authority to appoint provisional administration for the insurance organisation;
- introducing requirements for the financial standing analysis of the insurance organisation;
- making the procedure for considering the bankruptcy case more detailed;
- regulating the powers of the state corporation "Deposit Insurance Agency" to act as a receiver;
- adjusting the priority of creditors' claims;
- introducing a longer period (three years) for filing a motion to subject the controlling entity of an insurance organisation to secondary liability.

**Developments in regulation of individual bankruptcies**

Bankrupt individuals can now have RUB 50,000 in cash at his/her disposal without receiving consent of the financial administrator. The funds must be deposited in a special bank account with information submitted to the Unified Federal Bankruptcy Register (the "UFBR"). The individual can file a petition to the commercial court to increase the limit of cash that the individual can have at his/her disposal every month.

The debtor can have the cash at his/per disposal on other accounts (deposits) subject to the prior written consent of the financial administrator.

The law stipulates that the credit institution is liable for transactions involving individual's bank accounts and bank deposits, including bank cards, that violate the rules, if, at the time of the transaction, the lender was aware (or should have been aware) of the individual's debt restructuring by virtue of a notice sent by the financial administrator.



Since it is presumed that banks are deemed notified about initiation of individuals' debt restructuring five working days after this information is included in the Unified Federal Bankruptcy Register (the "UFBR"), credit institutions should closely monitor anything published about their individual clients going bankrupt.

**Conclusions and recommendations**

From our experience of providing legal support in bankruptcy cases, especially those involving liability of controlling entities and challenges to transactions, an effective defence largely depends on taking into account the risks of bankruptcy legislation at the stage when business decisions are taken in the course of a company's day-to-day operation.

If a company's managers are ill-informed about the legal implications of violating the Law on bankruptcy, this significantly raises the risks of negative consequences for the company, its top managers and beneficiaries.

In this regard, we advise considering the above developments when running your company's operations.

**Help from your adviser**

Pepeliaev Group's experts possess extensive experience of protecting the interests of any category of persons involved in the procedures that bankruptcy cases entail. Our lawyers also provide qualified legal assistance, including in the above category of lawsuits, when transactions are challenged on special grounds, and in protecting the rights of controlling parties who are held liable.

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