

# Recent Amendments to the Bankruptcy Regulations in Russia

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Russian legislation related to insolvency and restructuring has advanced over the past year with developments generally aimed at making the process more creditor friendly.<sup>1</sup> The key amendments (the “**Amendments**”) to Federal Law No. 127-FZ “On Insolvency (Bankruptcy)” dated October 26, 2002, as amended (the “**Bankruptcy Law**”) discussed in this article relate to the (i) initiation of bankruptcy proceedings, (ii) new notification duty of debtor’s chief executive officer, (iii) additional rights of secured creditors and (iv) rules on challenging transactions in bankruptcy proceedings. The Amendments were introduced to the Bankruptcy Law in December 2014 and June 2015.<sup>2</sup>

## Initiation of Bankruptcy Proceedings

### General Developments

Prior to the Amendments, bankruptcy proceedings could be initiated only by the debtor itself and, if certain requirements were met, by its creditors or authorized governmental bodies (such as the Federal Tax Service or the Pension Fund of the Russian Federation). Such requirements generally included the need to obtain a resolution of a Russian state court, which became effective, or an arbitral award confirming claims against the indebted company prior to launching insolvency proceedings.<sup>3</sup> The minimum claims required to be held by creditors that wished to commence proceedings was quite low and normally would not have posed a practical limit on the creditors’ ability to act—the total amount of claims must have exceeded RUB 100,000 (approx. USD 1,350), and RUB 500,000 (approx. USD 6,760) if the indebted company is a strategic enterprise<sup>4</sup> or a natural monopoly.<sup>5</sup>

### Amendments’ changes to requirements for initiating bankruptcy proceedings:

1. The list of creditors entitled to launch the bankruptcy proceedings was expanded and current and former employees of the company in question became entitled to submit an application for bankruptcy of their employer in case of non-payment of wages or severance payments, as well as apply to court to hold “controlling persons”<sup>6</sup> of the debtor liable.
2. A bankruptcy application based on an arbitral award may be submitted only if a state court’s resolution to issue an enforcement order with respect to such arbitral award has become effective.<sup>7</sup>
3. The total amount of claims must now exceed **RUB 300,000** (approx. USD 4,050). In case of strategic enterprises and natural monopolies, this threshold is **RUB 1 million** (approx. USD 13,525).

### Simplified Procedure for Allowing Credit Institutions to Initiate Bankruptcy Proceedings With Respect to Their Debtors

Another important development introduced by the Amendments was designed to simplify initiation of involuntary bankruptcy proceedings by credit institutions. Credit institutions are now placed in a privileged position and allowed to submit a bankruptcy application with respect to debtors even in the absence of a prior court decision confirming the indebtedness if there are signs of a debtor's insolvency, which means that the debtor's payment obligations are overdue for more than three months (the "insolvency indicators"). Prior to submission of a bankruptcy application, a credit institution is required to publish a notice in the Unified Federal Register of Information on Events with respect to Legal Entities regarding its intention to apply for a debtor's bankruptcy at least 15 days prior to such application. Some Russian banks have already started taking advantage of the simplified procedure:

Date	Filing Bank	Debtor
April 2015	Sberbank	SU-155 (construction company)
July 2015	Bank of Moscow	
October 2015	Sberbank and Alfa-Bank	Transaero (airline company)
November 2015	VTB Bank	

There is some debate over whether this new rule applies not only to Russian but also to foreign credit institutions. Uncertainty still remains as the courts have reached conflicting conclusions to date. In particular, in a recent case,<sup>8</sup> a court held that the Bank of Cyprus as a foreign credit institution was entitled to use the simplified procedure for bankruptcy initiation. However, subsequently, in another case involving the Bank of Cyprus,<sup>9</sup> the same court overruled this conclusion on the basis that the Bank of Cyprus did not have a license issued by the Central Bank of the Russian Federation to perform banking activities specified in the Federal Law No. 395-1 "On Banks and Banking Activities" dated December 2, 1990, as amended, and, thus, did not qualify to use the simplified procedure. It is currently unclear when this uncertainty will be resolved by courts.

### New Notification Duty of a Chief Executive Officer

Prior to the Amendments, the Bankruptcy Law established a number of duties of a debtor's chief executive officer in connection with the debtor's insolvency, including, among others, the following: (i) to apply for voluntary bankruptcy

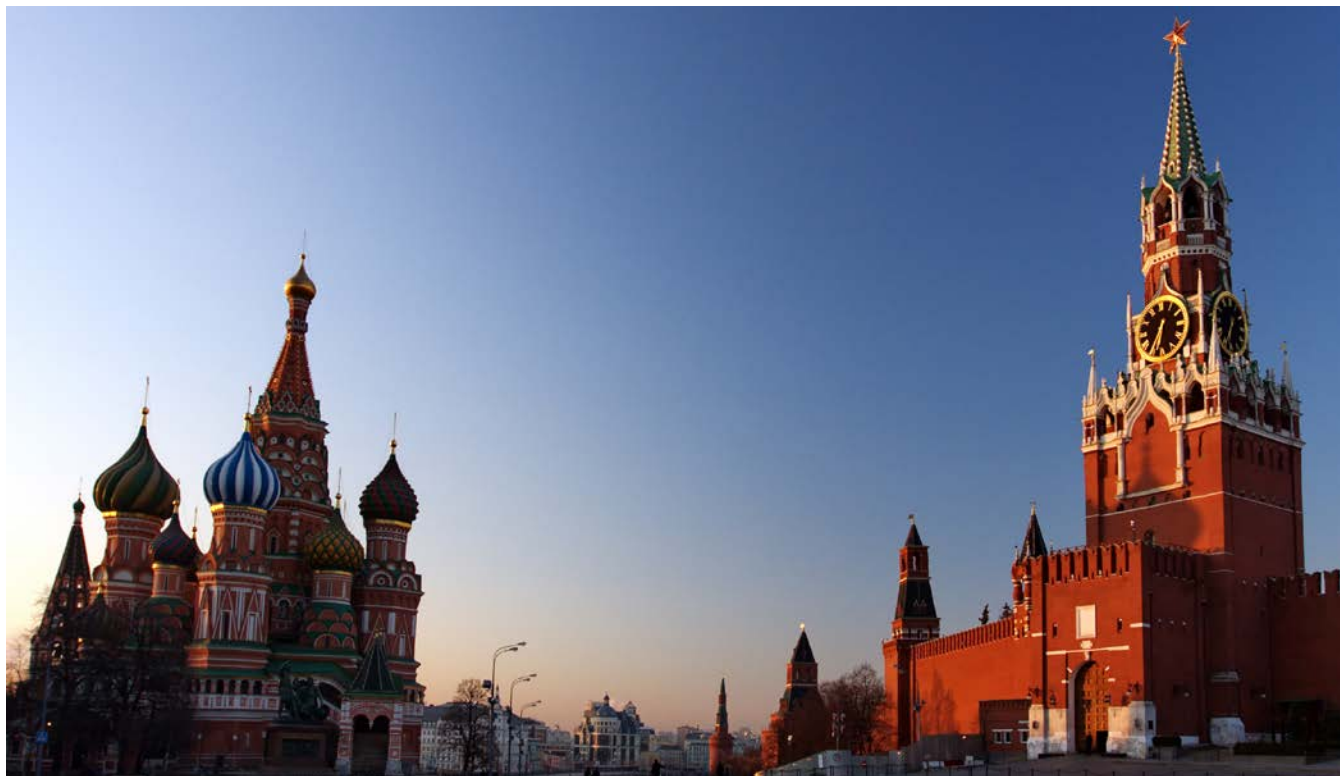
within one month of it becoming evident that (a) the satisfaction of claims of one more creditors will result in the company's inability to perform its payment obligations to other creditors in full, (b) the enforcement of claims against the company's assets will create significant difficulties or make it impossible for the company to continue operations, (c) the company ceases to pay any part of its debts due to insufficiency of funds or has insufficient assets to satisfy its monetary liabilities or (d) in certain other circumstances determined in the Bankruptcy Law, (ii) to provide documents and information requested by a creditors' committee and/or interim manager, (iii) if a supervision procedure<sup>10</sup> is introduced, to propose convening of a general shareholders' or participants' meeting of the debtor and (iv) to notify employees and shareholders or participants of the debtor about the initiation of a supervision procedure. The Bankruptcy Law also provided that a chief executive officer of a debtor is required to compensate damages caused by his non-compliance with requirements of the Bankruptcy Law. In addition, a chief executive officer bore subsidiary liability with respect to the debtor's obligations if he failed to apply for voluntary bankruptcy as required by the Bankruptcy Law. The chief executive officer could also bear administrative or criminal liability for certain violations related to bankruptcy, such as concealing the debtor's property, premeditated or fraudulent bankruptcy.

The Amendments introduced a new requirement for a chief executive officer to notify debtors' shareholders or participants, its board of directors, internal audit committee and the auditor about the insolvency indicators within ten days after the chief executive officer has learned or should have learned about the debtor meeting the insolvency tests. Non-compliance with this duty may result in an administrative fine of up to RUB 50,000 (approx. USD 675) or up to two years of disqualification.

### New Rights of Secured Creditors

Creditors whose claims are secured with a pledge over the debtor's property ("secured creditors") have a special status in the bankruptcy proceedings. Under the Bankruptcy Law, secured creditors have a first priority right to 70 percent, and 80 percent if a claim is based on a credit facility agreement, of the proceeds of sale of their collateral. If the claims of a secured creditor are not discharged with this first priority distribution, they shall be generally satisfied together with claims of all other unsecured creditors.

At the same time, secured creditors have been always restricted in their rights with respect to decision-making and participation in creditors' meetings. Prior to the Amendments, a secured creditor was entitled to attend creditors' meetings but its voting



rights were very limited. In particular, a secured creditor was entitled to vote only in the course of the following stages of the bankruptcy proceedings: (i) financial rehabilitation and external management, but in each case only if a court refused to satisfy a motion to enforce the pledge in the course of the respective stage of the bankruptcy proceedings, and (ii) supervision.

The Amendments granted additional rights to secured creditors with a view to further protect their interests in bankruptcy proceedings.

In particular, the list of issues on which secured creditors are entitled to vote has been expanded to include, among others, the right to vote on (i) the appointment and dismissal of bankruptcy administrator, who may become an instrumental figure in the sale process, and (ii) the termination of the liquidation stage of bankruptcy proceedings and the transfer to external management.

Moreover, secured creditors have now become entitled to (i) establish the starting sale price of secured property at an auction, (ii) determine procedure and conditions at an auction and (iii) determine the procedure and conditions for safekeeping of the secured property. The Amendments also specify that if the secured property is being sold together with other non-pledged assets of the debtor, the procedure for and conditions of such sale may not be established without the secured creditor's written consent.

## Challenging Transactions in Bankruptcy Proceedings

In addition to general grounds for invalidation of transactions set forth in the Civil Code of the Russian Federation, the Bankruptcy Law provides for certain specific grounds for challenging transactions entered into by a debtor within a certain period prior to commencement of the bankruptcy proceedings. In particular, under the Bankruptcy Law the following transactions can be challenged: (i) suspicious transactions, which are transactions with unequal consideration or aimed to prejudice creditors' rights, and (ii) preferential transactions, which result in an unfair preferential satisfaction of claims of one or more creditors under certain circumstances. A suspicious transaction can be challenged if it was performed within one year before acceptance of a bankruptcy application by the court or after such acceptance. If a suspicious transaction was aimed to and resulted in impairment of creditors' rights and another party to the transaction was aware of such aim, the reach-back period for such transaction is three years. A preferential transaction can be challenged if it was performed within one month before acceptance of a bankruptcy application by the court or after such acceptance. If a preferential transaction was aimed to secure debtor's obligations owed to a certain creditor and resulted in a change in priority for the satisfaction of creditors' claims or if the creditor knew of the debtor's inability to pay or insufficiency of its assets, the reach-back period for such transaction is six months.

Prior to the Amendments, the above transactions could be challenged only by an external administrator or liquidator at his own discretion or based on a resolution at the creditors' meeting. If the transaction was not challenged within the term provided for in such resolution, an authorized representative of the creditors' meeting was allowed to challenge the transaction.

The Amendments extended the list of persons entitled to challenge the debtor's transactions during the external management and liquidation stages of bankruptcy proceedings, which now also includes creditors whose claims exceed ten percent of all claims included in the register of creditors' claims (not including claims of creditor that is a party to the challenged transaction, as well as claims of such creditor's affiliates).

In addition, the Amendments specified that rules related to challenging the transactions in bankruptcy proceedings also apply to (i) challenging agreements or orders providing for salary increases, payment of bonuses and other payments in accordance with labor laws of the Russian Federation and (ii) challenging the amounts of such payments.

## Conclusion

While the Amendments represent a significant step forward in enhancing protection of creditors' rights in bankruptcy proceedings, which have been growing in number in light of the financial crisis in Russia, we are yet to see how the Amendments will be applied in practice. ■

1. Controlling person of a debtor is a person, who has or during the past two years had the right to direct debtor's activities. In particular, members of the liquidation committee, a person which was entitled to enter into transactions on the debtor's behalf, a controlling shareholder and general director can be determined to be controlling persons of the debtor.
2. This rule had been applied in court practice before in accordance with the Resolution of the Plenum of the Supreme Arbitrazh Court No. 60 dated July 23, 2009.
3. See Resolution of the 10th Arbitrazh Appellate Court in case No. A41-14262/15 dated June 2, 2015.
4. See Resolution of the 10th Arbitrazh Appellate Court in case No. A41-15150/15 dated August 11, 2015. This Resolution was reversed by the Arbitrazh Court of Moscow District on October 13, 2015, and the case was reconsidered by the court of first instance on February 26, 2016.



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