

# New Developments In Russian Insolvency Law

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Russia

On 5 June 2009 Federal Law No. 73-FZ "On introduction of amendments to certain regulations of the Russian Federation" (the "Law") came into force. The Law introduces changes into the Russian bankruptcy legislation and is designed to protect the interests of creditors' in corporate bankruptcies.

The main areas of change introduced by the Law are those relating to the challenging of certain transactions and liability. The circumstances under which creditors in a bankruptcy can challenge transactions by the debtor, or with respect to the debtor's assets, have been broadened. The amendments expand the previous definition of 'preferential transactions' and introduce a new concept of 'suspicious transactions' with an added presumption of intent on the part of the debtor to prejudice the creditors in certain transactions.

The liability of management and other controlling persons within a debtor has been increased. The Law incorporates a number of new definitions and significantly changes the definition of an interested party applicable to the insolvency-related proceedings.

The provisions of the Law apply to bankruptcy proceedings initiated after 5 June 2009, and to bankruptcy proceedings initiated prior to 5 June 2009 only in relation to transactions open to challenge that are concluded after that date.

## Liability

The Law introduces a new definition of a controlling person who is broadly defined as an individual or a legal entity with the right to give binding instructions on the debtor or to otherwise determine the debtor's actions, including via pressure on the debtors CEO or management bodies. It includes those persons who could do any of the above within a period of two years prior to the initiation of bankruptcy proceedings against the debtor ("**Controlling Persons**").

Where the actions or instructions of Controlling Persons infringe the property rights of the debtor's creditors, and the debtor's assets are insufficient to satisfy all of the creditor's claims, the Controlling Persons will bear subsidiary liability for the debtor's monetary obligations and/or mandatory payments. The court may reduce the amount of such liability of Controlling Persons in certain circumstances.

The Law also imposes responsibility for maintenance of reporting documents. A chief executive officer of the debtor will bear subsidiary liability if the relevant obligations of the debtor regarding accounting and reporting documents are not complied with as at the date of the commencement of supervision proceedings against the debtor, or as at the date of the declaration of the debtor as bankrupt.

## Challenging transactions

The Law provides a more detailed description of methods, limitation periods and consequences of challenging transactions. The rules on challenging transactions extend to

any actions aimed at performing obligations under the civil, labour, tax, customs, family and procedural law.

## 1. Suspicious transactions

The Law defines two types of transaction as suspicious: undervalue transactions and transactions prejudicing the creditors' property rights.

### Undervalue transactions

These are transactions in which the counterparty disproportionately performs its obligations. It includes situations where the value and/or terms of the transaction are materially less favourable for the debtor than in comparable transactions.

For the challenge to succeed the transaction must have been completed by the debtor within one year before, or at any time after, bankruptcy proceedings were initiated against the debtor.

### Transactions prejudicing the creditors' property rights

These are transactions which result in any reduction in the debtor's assets and/or any increase in the amount of property claims against the debtor, or any other consequences of the debtor's transactions or actions, resulting in the full or partial inability of creditors to obtain satisfaction of their claims. For the challenge to succeed:

- (i) the transaction must have been intended by the debtor to, and resulted in prejudice the creditors' property rights;
- (ii) the counterparty to the transaction must have been aware of the above purpose of the transaction; and
- (iii) the transaction must have been completed within three years before, or at any time after, bankruptcy proceedings were initiated against the debtor.

It is assumed that a transaction was concluded for the purpose of prejudicing the creditors' property rights if at the time of its conclusion the debtor met the Inability to Pay<sup>1</sup> and/or the Asset Insufficiency<sup>2</sup> criteria, and:

- (i) the transaction was completed for no consideration;
- (ii) entered into with a related party<sup>3</sup>;
- (iii) aimed at repaying a share in the debtor's assets; or
- (iv) the transaction was completed where the following conditions were met:

<sup>1</sup> Inability to Pay is the failure of the debtor to perform some of its monetary obligations or obligations to make mandatory payments due to a lack of funds.

<sup>2</sup> Asset Insufficiency means the excess of the debtor's monetary obligations and mandatory payments over the value of its assets.

<sup>3</sup> The Law widened the definition of 'related party' to include an affiliate of the debtor, and a person/entity in the same group as the debtor.

- the value of assets transferred equals 20% or more (10% in the case of credit organisations) of the book value of the debtor's assets;
- the debtor changed its address without notifying its creditors immediately before or after the transaction, or concealed its assets or destroyed or tampered with title and filing documents;
- after the conclusion of the transaction, the debtor continued to own and use these assets or instruct the owner on their disposal.

The amendments in this area increase the bankruptcy assets of the debtor available by allowing the challenge of the debtor's transactions in order to alienate its property or assume property-related obligations.

## 2. Preferential transactions

The Law states that the court may declare transactions invalid which result in one creditor's claims being prioritised over another. A transaction gives preference to an existing creditor if such a transaction:

- provides for security to an existing creditor to secure obligations that arose prior to the transaction (condition 1);
- has or may result in a change of ranking in which the existing creditors' claims are satisfied (condition 2);
- has or may result in the satisfaction of claims that have not yet matured, provided there are other unsatisfied but due claims; or
- results in one creditor's claims, that arose prior to the transaction, being prioritised over other creditors' claims.

For the challenge to succeed the transaction must:

- give preference to an exiting creditor as described above; and
- have been completed one month before, or at any time after, the initiation of bankruptcy proceedings against the debtor; or
- have been completed within the six months prior to the initiation of bankruptcy proceedings against the debtor provided that either:
  - conditions 1 and 2 above are met, the transaction provides security to an existing creditor and has or may result in a change to the priorities in which existing creditor's claims are satisfied; or
  - the creditor or another party involved was aware that the debtor met the Inability to Pay and/or the Asset Insufficiency criteria.

## 3. Transactions that may not be challenged

The Law lists a number of transactions that may not be challenged. These are transactions of a debtor:

- made on a stock exchange;
- concluded in the ordinary course of business provided that the value of a transaction does not exceed 1 percent of the debtor's assets, unless intended to prejudice the property rights of a creditor; or

- aimed to fulfill obligations where market value consideration was received, unless intended to prejudice the property rights of a creditor.

## 4. Consequences of an invalid transaction

Once successfully challenged, all consideration received from the debtor under a relevant transaction will be transferred to the debtor's bankruptcy pool. The counterparty under the invalidated transaction will acquire a claim against the debtor and this claim will be satisfied in the following way:

- In the case of undervalue transactions and preferential transactions (other than mentioned in paragraph 2 point (iii) above), the counterparty's claims are satisfied together with claims of other creditors.
- In transactions prejudicing the creditors' property rights and preferential transactions (mentioned in paragraph 2 point (iii) above), the counterparty's claims are satisfied after claims of creditors of a third priority.

The Law was introduced in response to the growing number of bankruptcy cases and suspected cases of asset stripping prior to, and during, the bankruptcy process. The Law has clarified and improved the position of creditors acting in good faith on the insolvency of a Russian company by providing more protection over their interests. It is intended that the Law will create more transparency in the bankruptcy process although it is still too soon to judge how effective this will be.

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