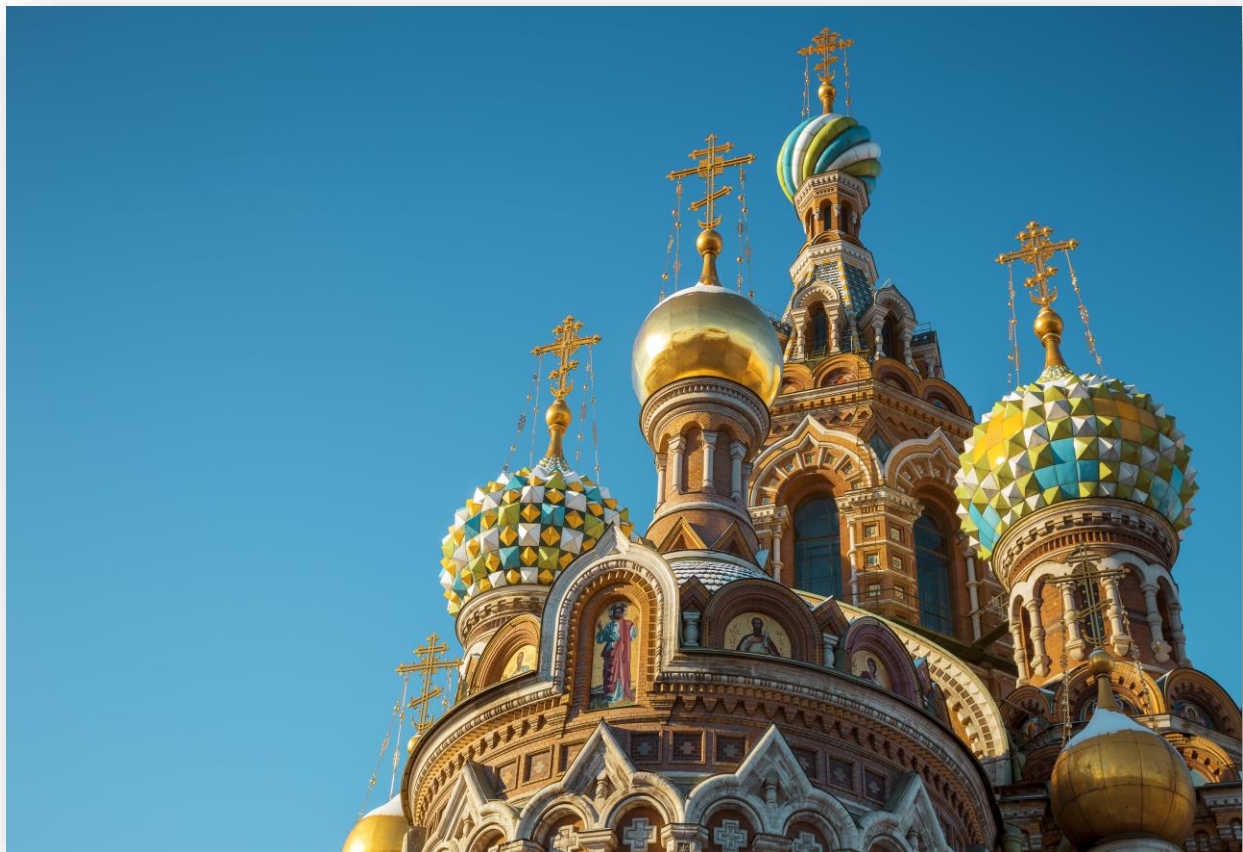




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LIDINGS AND MAXIMA LEGAL ALLIANCE

Bankruptcy, Insolvency & Rehabilitation Proceedings in Russia

ILN RESTRUCTURING & INSOLVENCY GROUP



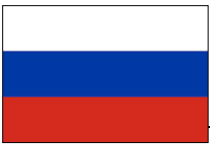
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KEY FACTS OF BANKRUPTCY, INSOLVENCY & REHABILITATION PROCEEDINGS UNDER RUSSIAN LAW

The main piece of the legislation that regulates the activities of parties in insolvency proceedings in the Russian Federation is the Federal Law dated October 26, 2002 No. 127-FZ titled *On Insolvency (Bankruptcy)* (referred to here as the **Insolvency Law**). Bankruptcy procedures are considered by the state commercial court at the place of the debtor's registration and can be initiated by the following persons:

- The creditor;
- An employee of former employee of the debtor, if they have claims for the payment of severance pay and/or wages;
- The competent state authority i.e. the Federal Tax Service;
- The debtor himself (filing a debtor's petition).

The following can be ruled as being insolvent or bankrupt:

- Individuals, including individual entrepreneurs;
- Legal entities (except for state-owned enterprises, institutions, political parties and religious organisations).

A legal entity must simultaneously meet three conditions to be recognized bankrupt:

- The debtor is unable to satisfy monetary claims of its creditors i.e. monetary amount arising from transactions, severance or wage payments, statutory payments;
- The indicated monetary claims are three months overdue;

- The amount of monetary claims is at least RUB 300,000.

Prior to filing a petition for recognizing the debtor bankrupt creditors and employees/former employees must file a claim with the debtor for the debt recovery and obtain a favorable decision on such debt came into legal force. If the debt recovery claim was considered by an arbitration tribunal the creditor obtains the right to file, the petition for bankruptcy if the writ of execution in relation to the decision of an arbitration tribunal is issued. Also, a preliminary notice of the intention to file a petition on recognizing the debtor as bankrupt should be published in the Unified Register of Information on the Activities of Legal Entities at least 15 days prior to the filing with a commercial court. The notification is valid for 30 days since it has been published.

Banks and state authorities do not fall under the requirement of obtaining prior court's decision in relation to the debtor's monetary debt and enjoy less formal procedure of submitting a notification.

The debtor may file for its own bankruptcy when he anticipates the conditions for bankruptcy to appear inevitably in the nearest future. In certain conditions the debtor is obliged to file a claim for its own bankruptcy.

The Insolvency Law stipulates the involvement of external bankruptcy administrator in all the stages of the consideration of the bankruptcy case. His goal is to protect the interests of the creditors and preserve the property of the debtor. The powers of the bankruptcy administrator vary depending on the procedure applied: starting with an analysis of the debtor's activities and drawing up a report on the



possibility of restoring its solvency (supervision procedure), to executing management over the debtor (winding up (liquidation) procedure). The bankruptcy administrator must be an individual with a higher education, managerial experience, who has passed a special exam and is a member of one of the self-regulating organisations of administrators.

The Insolvency Law provides special grounds and procedure for contesting debtor's transactions. Those grounds depend on the time period when the transaction was concluded calculated backwards from the date the bankruptcy petition is adopted for consideration. Transaction contesting is a very useful instrument for the creditors to return the debtor's assets into its bankruptcy estate if they were wrongfully alienated.

Additionally, creditors may bring the debtor's controlling persons to subsidiary liability. The following persons can be recognized as controlling:

- Director;
- Shareholders;
- Ultimate beneficiary owner (UBO);
- Any other person who is proved to have the right to determine the debtor's actions or influence it.

The controlling persons can be brought to subsidiary liability for their actions or omission led to debtor's inability to repay its creditors in full or for the failure to submit the petition for debtor's own bankruptcy when certain conditions are met.

The following stages of bankruptcy proceedings are generally applied:

- Supervision;
- Financial recovery;
- External administration;
- Winding up (liquidation);
- Amicable settlement agreement.

Bankruptcy stages mainly differ by the level of autonomy the debtor retains and can be divided into rehabilitation procedures: financial rehabilitation, external administration; and bankruptcy procedure – winding up. An amicable settlement agreement may be concluded at any stage between the debtor and its creditors and shall be approved by the court.

In general, the supervision stage is mandatory for legal entities, however it could be set aside if simplified procedures apply. If the debtor had adopted a decision on liquidation or ceased its operation and its location could not be established, supervision and other rehabilitation procedures are not applied and the debtor can be declared bankrupt and winding up procedure can be introduced.

Russian bankruptcy proceedings are mainly aimed on the liquidation of the debtor, sale of its assets and actions against the debtor's ultimate beneficiary owners. Thus, it provides numerous mechanisms for the creditors while lacking sufficient protective mechanisms for the debtor. The Information on introduction of any bankruptcy procedure is subject to publishing in *Kommersant* newspaper¹ and in the Unified Federal Register of Insolvency Information².

¹ <https://bankruptcy.kommersant.ru>

² <https://bankrot.fedresurs.ru/?attempt=1>



1. Supervision

The purpose of the supervision procedure is to ensure the preservation of the debtor's property, to analyze its financial state, to draw up a schedule of creditors and to hold the first meeting of creditors. This procedure is followed after the court's ruling on the validity of the insolvency claim.

The duration of supervision procedure is stipulated in the Bankruptcy Act and cannot exceed 7 months from the date the bankruptcy claim is received by the court but can be extended for three months in accordance with the Commercial Procedure Code.

The first claimant proposes, and the commercial court appoints the candidate for the bankruptcy administrator – provisional administrator, who has a significant amount of functions in legal, economic and managerial spheres of the debtor. For example, powers of provisional administrator include the following:

- Conducting the analysis of the debtor's financial statements to evaluate whether the debtor's solvency can be restored and also whether the debtor owns sufficient assets to cover the expenses in the bankruptcy case. The financial analysis also includes the statement on the transactions of the debtor that can be contested on the grounds stipulated in the Bankruptcy Act.
- Filing objections on creditors' claims;
- Holding the first creditors' meeting;
- Adopting measures aimed at preserving the debtor's property.
- Monitoring the commercial activity of the debtor, including powers to request

any information concerning the debtor's activities, accounting and other documents reflecting the debtor's economic activities for the past three years prior to the commencement of the bankruptcy.

Creditors can submit their claims to the debtor only within debtor's bankruptcy proceedings. Any claim submitted against the debtor after the commencement of supervision in ordinary proceedings shall be left without consideration. A creditor should file a petition with the commercial court for including its claims within a month since the information on introduction of supervision is published. Missed deadlines cannot be restored according to the Bankruptcy Act and the claims of the creditors with missed deadlines are to be considered only in subsequent bankruptcy proceedings.

The first meeting of the creditors decides on the next procedure to be applied in relation to the debtor, appoints the bankruptcy administrator for the further procedures and approves the report of the provisional administrator. Only creditors whose claims are included in the creditors' schedule are granted the right to vote on the creditors' meeting.

As a result of supervision procedure, the financial recovery or external administration can be introduced. Also, the debtor can be recognized bankrupt with the commencement of winding up procedure. Termination of bankruptcy proceedings can be an option if the solvency of the debtor is restored, an amicable agreement is concluded, or the parties refuse to finance the bankruptcy procedure.



1.1. Consequences of the introduction of supervision

Supervision implies certain limitations on the debtor, its executive bodies, and the creditors.

The debtor may enter the following transactions only with the consent of provisional administrator:

- Transactions exceeding more than 5% of the debtor's assets value;
- Transactions are related to the receipt and issue of loans, sureties and guarantees, the assignment of right of claim, the transfer of debt.

The debtor obtains the following instruments of protection against its creditors. Enforcement proceedings against the debtor shall be suspended and debtor's property is released from garnishment. No penalties and other financial sanctions are accrued for a default.

Also, the debtor cannot be discharged of an obligation by the means of offsetting a counterclaim. Debtor's executive bodies are not allowed to adopt the decisions on: the reorganization and liquidation of the debtor; the establishment of legal entities or on participation of the debtor in other legal entities; the payment of dividends or distribution of the debtor's profits between shareholders and certain others.

As stated above, supervision is a procedure in which the financial condition of a debtor and the possibility for the debtor to pay off his debts are determined. It influences the follow-up procedure, which can be either rehabilitative or winding-up (liquidation).

Judicial statistics show that the number of cases for which rehabilitation procedures are introduced is extremely small. In the 4th quarter

of 2018, rehabilitation procedures were introduced only in 1.5% of cases. This underscores that in Russia, insolvency procedures almost invariably lead to liquidation.

2. Financial recovery

Financial recovery is a rehabilitation procedure based on the rehabilitation plan which must include measures aimed at repayment of creditors' claims in accordance with the payment schedule set out in the plan. In addition to the financial plan a security for the debtor's payment in accordance with the proposed schedule should be provided. The financial rehabilitation plan shall be approved at the creditors' meeting and the payment schedule must be approved by the court. Under the court's ruling the financial recovery procedure is introduced for no more than two years and the bankruptcy administrator is appointed.

If the debtor violates the financial plan, creditors' claims can be satisfied from the provided security.

As a rule, the debtor is not barred from ordinary business activities with certain restrictions imposed in relation to assets alienation or providing them as security for obligations performance. As a result of financial recovery, bankruptcy administrator submits the results of the procedure for the creditors' meeting which decides on the following procedures. In accordance with the decision of the creditors' meeting, the following results can be achieved:

- If the debtor has no outstanding debts, the bankruptcy case shall be terminated;
- If there are outstanding debts, but the debtor's solvency can be restored, external administration is introduced;



- If the debtor's solvency cannot be restored, the debtor shall be recognized as bankrupt and the winding up procedures to be introduced.

2.1. Consequences of the introduction of financial recovery

Generally, the consequences of financial recovery are like those of supervision as the debtor's executive bodies retain its powers with certain limitations stipulated in the Bankruptcy Act. Instruments of debtor's protection against creditors (suspension of enforcement proceedings, and property release from garnishment) remain the same as in supervision procedure.

The debtor must enter the following transactions with the consent of creditor's meeting:

- Transactions with interested parties;
- Transactions related to acquisition/alienation of property exceeding more than 5% of the debtor's assets value;
- Transactions on granting loans and credits, sureties and guarantees, the assignment of right of claim, the transfer of debt.

The debtor cannot conclude the following transactions without the consent of the bankruptcy administrator:

- Transactions which result to increase the amounts payable to the creditors by more than 5% of the amount of the creditor claims;
- Transactions related to direct or indirect alienation of the debtor's assets,

excluding realization of the debtor's manufactured goods (work, services);

- Transactions related to assignment of rights of claim or debt transfers;
- Transactions related to receiving loans or credits.

Debtor's executive bodies cannot adopt the decisions on debtor's reorganization.

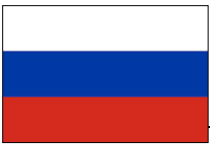
Creditors' claims may only be filed within debtor's bankruptcy proceedings. As in supervision, after introduction of financial recovery, enforcement proceedings against the debtor should be suspended and debtor's property is released from garnishment.

3. External administration

External administration can be ordered if there are reasons to assume that debtor's solvency can be restored. Unlike other rehabilitation procedures at external administration stage debtor's executive bodies are substituted with a third-party manager appointed by the creditors' meeting and approved by the court – external administrator. External administration is introduced for a period of 18 months, which can be extended for 6 months.

External administrator drafts and submits an external administration plan to the creditors' meeting for approval no later than one month after he is appointed by the court. An external administration plan should contain appropriate measures to restore the company's solvency, including, inter alia the measures such as:

- The sale of company's assets or part of the enterprise;
- The recovery of the accounts receivable;



- The increasement of the debtor's share capital;
- The performance of the debtor's obligations by its shareholders, participants or any third parties;
- The assignment of the debtor's rights of claim.

An external administration plan must also include the timeframe for restoring the debtor's solvency and reasoning as to whether such restoration is possible within the established timeframe.

External administrator manages the debtor's activities and, in particular has the following powers:

- To manage the debtor's assets including disposal in accordance with the external administration plan;
- To submit the claims on behalf of the creditor for contesting transactions and decisions of the debtor;
- To repudiate contracts and other transactions of the debtor with specifics introduced in the Bankruptcy Act;
- Other powers.

3.1 Consequences of the introduction of the external administration

As the external administration is introduced, the following consequences, including those aimed at the protection of the debtor from creditors, appear:

- A moratorium is introduced on satisfaction of the debtor's monetary obligations and statutory payments

except for current and certain other payments;

- Previously adopted measures aimed at securing creditors' claims are revoked;
- Major transactions and interested-party transactions are only concluded with the consent of the creditors;
- Transactions related to issue or receipt of loans, issue of sureties and guarantees, the assignment of rights of claim, the transfer of debt, the alienation or acquisition of shares, the interests of business partnerships are concluded by the external administrator with prior approval from the creditors;
- If the debtor's total monetary obligations arose after introduction of external administration exceed total claims of the scheduled creditors included in the schedule of the creditors by 20%, transactions resulting in new obligations for the debtor may only be concluded by the external administrator only with prior creditors' consent.

No penalties or other financial sanctions are accrued for the default. **4. Winding up procedure (liquidation)**

If the debtor's solvency cannot be restored or rehabilitation procedures are ineffective, the debtor should be declared bankrupt and winding up procedure shall be introduced. This procedure is aimed at the fullest possible satisfaction of creditors' claims from the sale of the debtor's assets and its consequent liquidation. The sale of a debtor's property is carried out at an auction. Debtor's property that is subject to a charge and property held in



escrow is considered separately and is subject to mandatory valuation.

Power of the debtor's executive bodies are passed to the bankruptcy manager.

After introduction of winding up procedure creditors' claim should be submitted to the commercial court considering the bankruptcy case within a two-month period which cannot be restored in accordance with the Bankruptcy Act. Generally, claims filed outside stipulated timeframe are not included in the schedule of the creditors and are only satisfied after all of the claims included in the schedule of creditors are repaid.

Creditors with the amount of claims, exceeding 10 % of total claims, and bankruptcy manager obtain the right to contest the transactions concluded by the debtor in a 3-year period prior to initiation of bankruptcy proceedings on specific grounds emphasized in the Bankruptcy Act.

Time period for winding up procedure is 6 months, which can be extended repeatedly.

Bankruptcy manager in winding up procedure has the widest range of powers in comparison to other bankruptcy stages, which also include the following:

- To dismiss debtor's employees, including the managing director;
- To file claims with the court on contesting transactions and decisions concluded or executed by the debtor;
- To file claims against the debtor's counterparties for recovery of existing debts;
- To file claims against third parties, which in accordance with the Bankruptcy Act

can be held liable for the debtor's obligations:

- Other powers.

Winding up procedure results in the distribution of debtor's assets between the creditors in the priority order stipulated in the Bankruptcy Act. If the debtor's assets are insufficient to satisfy the claims of the creditors, the money should be allocated between the creditors of corresponding order of priority proportionate to the amounts of their claims included in the creditor claims schedule. If any assets remain after the satisfaction of all claims, these assets should be distributed between the debtor's shareholders. Any unsatisfied claims are deemed extinguished.

After all settlements with the creditors are completed bankruptcy manager submits the report to the commercial court considering the bankruptcy case. After the court approves the report, the debtor is excluded from the state register of legal entities and winding up procedure is considered completed.

Exceptional cases may include restoration of the debtor's solvency and introduction of financial recovery and/or external administration if these procedures had not been introduced before or creditors may enter into an amicable settlement agreement with the debtor and terminate the bankruptcy case.

4.1. Consequences of the introduction of winding up proceedings

After the introduction of winding up proceedings the following consequences appear:

- All monetary obligations and statutory payments become due and payable;



- Creditors' claims with limited exceptions shall be submitted in winding up proceedings;
- Charter documents cease to be applied
- Paying out dividends or distribution of profit among debtor's founders (shareholders) is prohibited.

Because of introduction of winding up procedure the debtor gains the following protection from the creditors:

- All enforcement proceedings are suspended, the previous attachments of the debtor's assets are lifted, and new ones cannot be imposed;
- Interest, penalties and other fines for non-performance or undue performance of monetary obligations and mandatory payments stop being accrued for a default;

Transactions related to alienation of the debtor's property are permissible only in accordance with specific regulations stipulated in the Bankruptcy Act.

4.2. The order of priority for satisfying claims

Claims of the creditors included in the schedule of creditors are categorized and satisfied in the following order:

- First order of priority – claims of individuals whose lives or health were impaired by the actions of the debtor (these claims are satisfied through the capitalization of corresponding periodical payments), claims for compensation of moral damage and claims for alimony payments;

- Second order of priority – claims related to the payment of severance pay and the wages of individuals who work or worked under an employment contract, and claims for the payment of consideration under copyright contracts;
- Third order of priority – all other creditors (including claims arising out of the compulsory payment and claims by secured creditors).

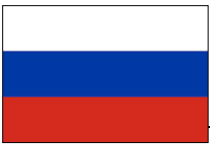
Creditors with claims from current payments (the obligations emerged after the date of initiation of bankruptcy proceedings) are not included in the creditor schedule and are satisfied in chronological order before schedule creditors.

The Insolvency Law provides the specifics for the creditors' claims secured by the pledge of the debtor's assets. Their claims are satisfied from the value of the pledged item pursuant to a special procedure:

- 70% of the proceeds from the sale of pledged assets are allocated for the repayment of the claims of the creditor in respect of the obligation secured by the pledge of the debtor's assets;
- 20% is allocated for the repayment of the creditor's claims of the first and second priority, while the remaining 10% is allocated for the payment of expenses on the bankruptcy case and the payment of the fee to the bankruptcy administrator

5. Bankruptcy moratorium

The Russian government has the authority to introduce a moratorium on insolvency proceedings. A moratorium can be introduced



to ensure economic stability under exceptional circumstances, for example, during a natural or man-made disaster, or in case of a significant change in the Rouble's exchange rate.

In connection with the coronavirus pandemic, the Russian government has adopted a moratorium on insolvency proceedings to protect key and strategic organizations, as well as organizations operating in areas most affected by coronavirus (for example, transport, hospitality and catering, leisure and entertainment organizations) until the beginning of October 2020.

The main goal for the moratorium is to protect the entities suffered from the consequences of the global pandemic. During the moratorium, enforcement proceedings on property foreclosures are suspended, penalties and other financial sanctions are not accrued, and bankruptcy proceedings cannot be initiated. On the other hand, the companies protected by moratorium are banned from paying the dividends or distributing profits and face other restrictions.

The person subject to the moratorium has the right to refuse to use it. In this case the listed restrictions will not apply. A settlement entered in an insolvency case which was started within three months after the end of the moratorium may be approved in a simplified procedure.