

on assets, etc, will continue to consume precious time and could be exposed to judicial intervention. Further, collating historical data relating to past debts will be a time-consuming exercise and will require a channelised effort by the Board and the creditors at large.

Lastly, it also is imperative for the judiciary to uphold the letter and spirit of the Code and not indulge in excessive judicial intervention. The first application for insolvency under the Code was filed in December 2016. The application was admitted by the National Company Law Tribunal and the order was passed for appointment of an interim resolution professional. However, the defaulter filed a writ petition before the High Court of Judicature at Bombay with, inter alia, prayers to quash the order of the National Company Law Tribunal and declare the certain sections of the Code as unconstitutional. At the time of writing this Article (in February 2017), the matter is *sub judice* and pending before the High Court of Judicature at Bombay. It is expected that the Code will experience

constitutional challenges in the initial years of implementation. We hope that these are dealt with in an expeditious manner while preserving and upholding the letter and spirit of the Code.

We hope that the various authorities and the government stand up to challenges and undertake the task of creating the effective framework that address the concerns on infrastructure and implementation so that the code can achieve its intended result. For the spirit of the legislation to be realised, the effective implementation and efficient infrastructure is crucial.

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Russia: liability of controlling persons in bankruptcy proceedings

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Introduction

The insolvency of companies in Russia is often caused by the negligent or illegal actions of their shareholders and/or management.

In December 2016, several important amendments (the 'Amendments') to the Federal Law No 127-FZ of 26 October 2002 'On Insolvency (Bankruptcy)' (the 'Bankruptcy Law') were adopted, making the rules stricter on subsidiary liability within bankruptcy proceedings. In our review we summarise the updated regulation of subsidiary liability of persons controlling the debtor companies for the damage caused to the interests of the creditors.

Definition of controlling persons

The most important amendment was made with respect to the definition of a controlling person. The Bankruptcy Law now clarifies that the person is considered as

'controlling' if they have the right to give binding instructions to a debtor company by virtue of kinship or if their relationship in law with the debtor, official position or otherwise is able to determine the actions of the company within three years prior to the court's acceptance of the application on the debtor's insolvency.

As a result the definition was broadened and now a wide range of people fall under the new definition of controlling persons of the debtor (eg, the shareholders, the president, members of the board of directors, the chief accountant, the actual owner, etc).

Conditions for subsidiary liability

Another important amendment of the Bankruptcy Law is connected with regulation of the conditions for bringing the controlling persons to the subsidiary liability for the obligations of the debtor.

Previously the debtor was deemed unable to pay

and considered as insolvent due to the actions and/ or omissions of the controlling persons if one of the following circumstances existed:

- the property rights of creditors have been harmed as a result of the transactions concluded by, for the benefit of or approved by the controlling person(s); or
- the debtor's accounting documents were missing or did not contain full and exhaustive information on debtor's property.

This provision has been supplemented by a new approach: the controlling person may be considered as liable for debtors' insolvency if (1) the creditors' claims were created as a result of a court ruling against the debtor or its management in criminal, administrative or tax infringement cases; and (2) such claims exceed 50 per cent of the total amount of the creditors' claims.

Although these provisions factually imply a 'presumption of guilt' on the controlling persons, they may be exempt of liability if there is evidence provided to say that they have acted in good faith and reasonably in the interests of the debtor. In such case, the burden of proof is on the controlling persons.

Types of liability

Depending on the type of action and its gravity, the controlling persons may be subject to civil, administrative or criminal liability.

Civil liability

The controlling persons may jointly and severally bear secondary liability for monetary claims of creditors when simultaneously:

- the company has acted on instructions received from its 'controlling persons';
- such actions resulted in 'harm to creditors' rights'; and
- the bankruptcy estate is insufficient to satisfy all the creditors' claims.

Additionally the persons who failed to file a petition on initiation of the company's bankruptcy proceedings (in the majority of cases such person is a General Director or CEO of the insolvent company), when they were obliged to do so by law, may bear secondary liability for new debts of the company arising after the date when the bankruptcy petition should have been filed.

Administrative liability

Administrative liability is regulated by the Code on Administrative Offences and relates to the following administrative offences:

- fraudulent bankruptcy;
- deliberate bankruptcy;
- unlawful actions during bankruptcy proceedings;
- unlawful satisfaction of a creditor's claim in prejudice to the other creditors when there were signs of bankruptcy of the company; and
- failure to file a petition on initiation of the company's bankruptcy proceedings.

The law stipulates liability for these acts as a penalty in the form of an administrative fine on officials of between RUB 5,000 and RUB 10,000,¹ or disqualification for a period of one to three years.

Criminal liability

Several articles of the Criminal Code of the Russian Federation under which the controlling persons (the management and the shareholders) are liable directly define as guilty a person who causes the bankruptcy of a company: Article 195 'Misconduct During Bankruptcy'; Article 196 'Deliberate Bankruptcy'; and Article 197 'Fictitious Bankruptcy'.

A court may find the controlling person criminally liable to a sum of up to RUB 500,000² or they may withhold salary or other income for a period of up to three years, or impose a prison sentence of up to six years.

If the acts/omissions caused major damage, the law provides liability in the form of a fine of up to RUB 500,000 or withholding of salary or other income for a period of up to three years, or imprisonment of up to six years.

At the present time, criminal or administrative proceedings against the management of insolvent companies are rare. Nevertheless, such cases have started to arise.

Conclusions

The revised Amendments to the Bankruptcy Law provide necessary clarity in terms of the subsidiary liability of the controlling persons within bankruptcy proceedings. Moreover the Amendments made the provisions on controlling persons more flexible, which may help to increase the amount of cases where the court may make the management and the shareholders of the insolvent company financially liable. As a result these provisions significantly improved the position of creditors acting in good faith and raised their chances to get their claims in bankruptcy proceedings repaid in part or in full.

Notes

- 1 Approximately US\$90 to US\$180.
- 2 Approximately US\$8,900.