The Insolvency Law of Central and Eastern Europe

Twelve Country Screenings of the New Member and Candidate Countries of the European Union and Russia: A Comparative Analysis

Jens Lowitzsch (Ed.)

Developed by Inter-University Centre Split/Berlin,
Institute for Eastern European Studies, Free University of Berlin

X. Russian Federation

Natalia Spitsa

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1. Introduction

a) Reforms of Insolvency Law

The Russian insolvency law has a long tradition which was, however, interrupted in the 1930s,[502] so that the analysis of foreign law was decisive for the development of the legal regulation of insolvency at the beginning of transition in the 1990s.[503] However, problems connected with the application of the first post-socialist Russian insolvency law[504] showed that the law had to be adapted to the economic and legal framework whereby the problems determined by the courts were to be considered. The increasing number[505] and complexity of insolvency

[502] See the Code on Bankrupts of 1830, Code on Bankruptcy of 1832, abolished in 1917, and provisions on bankruptcy in the Code of Civil Procedure of 1923 (inserted in 1927, suspended in 1930); for further details on the historical aspect of the Russian insolvency law see V. G. Yudin, Nesostoyatel'nost' (bankrotstvo): istoricheskiy aspekt [Insolvency (bankruptcy): historical aspects], Vestnik Vysshego Arbitrazhnogo suda (hereinafter referred to as VVAS) 2002, vol. 1, pp. 155-162; S. E. Andreev, Kommentariy k Federal'nomu zakonu o nesostoyatel'nosti (bankrotstve) [Commentary on the Federal Law „On Insolvency (Bankruptcy"], Moscow 2005, pp. 11 et seq.; M. V. Telyukina, Konkursnoe pravo: teoriya i praktika nesostoyatel'nosti [Insolvency law: theory and practice of insolvency], Moscow 2002, pp. 65 et seq.; A. Trunk, Anfänge des russischen Insolvenzrechts, Wirtschaft und Recht in Osteuropa (hereinafter referred to as WiRO) 1992, pp. 279 et seq.

[503] See V. V. Vitryanskij (ed.), Postateiynyy kommentariy k Federal'nomu zakonu "O nesostoyatel'nosti (bankrotstve)" [Commentary of the Federal Law "On insolvency (bankruptcy)"], Moscow 1999, p. 6.

[504] Federal Law "On Insolvency (Bankruptcy) of Enterprises" from 19 November 1992 (Rossiyskaya gazeta (hereinafter referred to as RG) 1992, no. 279).

[505] Whereas 1993 less than 100 bankruptcy petitions were filed, the number of petitions has doubled annually from 1998 until 2002 (1998-12,781 petitions, 2000-24,874 petitions, 2001-55,394 petitions, 2002-106,647 petitions). However, the number of petitions has fallen sharply after the new Insolvency Law came into force on 3 December 2002 (from 106,647 petitions in 2002 to 14,277 in 2003, 14,090 in 2004, 32,190 in 2005, 91,431 in 2006). This evidence supports the thesis that the legal regulation and not macroeconomic development determines the development of bankruptcies in the Russian Federation, since there

cases, but especially misuse of the institute of bankruptcy for unlawful economic and political purposes under changing economic and political conditions made a continuing reform of the insolvency law necessary. Since the beginning of the 1990s, three new versions of the insolvency law[506] were enacted whereby each new law had the double volume and contained more complex rules of procedure and more special provisions than the preceding law.

The FIL'92 replaced the Government Order "On insolvency of state enterprises" of summer 1992. Since the Law has been prepared and adopted within a relatively short period of time, there were gaps in regulation and the rules were not adapted to the conditions of transition, so that implementation was problematic. In contrast to insolvency laws of most Central European countries, the Russian lawmaker gave clear priority to the protection of the debtor. The only insolvency trigger was over-indebtedness. For that reason, the proceedings could be commenced only in a very small number of cases, and the economic crisis, which was caused by bad payment discipline, deepened and led to the domino effect also for financially sound enterprises.[507] Additionally, specific problems of certain categories of debtors which needed special protection for political and social reasons (e.g. town-forming enterprises,[508] farms,[509] sole proprietors[510]) could not be solved without

is no correspondence between basic macroeconomic values and the number of bankruptcies; indeed, the trends are opposite, especially between 2000 and 2002. Here and hereinafter statistics of the Supreme Commercial Court are quoted (http://www.arbitr.ru, Log-in: 15.04.2006).

[506] Federal Law "On Insolvency (Bankruptcy) of Enterprises" of 19 November 1992 as amended (hereinafter referred to as FIL'92); Federal Law "On Insolvency (Bankruptcy)" of 8 January 1998 (Sobranie zakonodatel'stva Rossiyskoy Federatsii (hereinafter referred to as SZ RF) 1998, no. 2, pos. 222) as amended (hereinafter referred to as FIL'98); Federal Law "On Insolvency (Bankruptcy)" of 2 November 2002 (SZ RF 2002, no. 43, pos. 4190), amended on 31 December 2004 (SZ RF 2004, no. 35, pos. 3607), on 24 October 2005 (SZ RF 2005, no. 1, pos. 18, 46; 2005, no. 44, pos. 4471) and on 18 July 2006 (hereinafter referred to as FIL).

[507] See V. V. Vitryanskiy (ed.), op. cit., p. 6.

[508] For definition see Art. 169 FIL.

[509] For definition see Art. 257 et seq. of the Civil Code Part I.

[510] For definition see Art. 23 of the Civil Code Part I.

introducing special provisions. Since provisions of the FIL'92[511] were not detailed, orders and instructions of different executive organs could be issued which allowed to misuse the insolvency proceedings for achieving short-term political goals such as combating tax evasion or introduction of additional privatisation methods.[512] For these reasons, the adoption of a new insolvency law was necessary.

For the preparation of the FIL'98,[513] experience of application of the previous law as well as international experience were considered. The CIS Model Insolvency Law which was worked out at the Moscow Research Centre for Private Law was also used.[514] Since there was more time for the preparation of the Law, it was possible to introduce more detailed regulations and to improve the quality of the Law. As compared to the FIL'92, the commencement of bankruptcy proceedings on the basis of a petition by the creditor was facilitated. Under the new Law, over-indebtedness was not necessary; a creditor could file for bankruptcy if a relatively low[515] amount of debt was overdue for three months. Special provisions were introduced for the protection of certain categories of debtors e.g. town-forming enterprises and farms. Provisions on consumers' insolvency were inserted. However, it should be noted

[511] For further details on FIL'92 see A. Trunk, Anfänge des russischen Insolvenzrechts, WiRO 1992, pp. 279 et seq.; A. Trunk, Neues russisches Konkursgesetz, RIW 1993, pp. 553 et seq.; S. E. Andreev, Kommentariy k Federal'nomu zakonu o nesostoyatel'nosti (bankrotstve) [Commentary on the Federal Law „On Insolvency (Bankruptcy"], Moscow 2005, p. 14.

[512] See V. V. Vitryanskiy (ed.), op. cit., p. 8.

[513] For further details on FIL'98 M. Gutbrod , A. Vogel, Das neue russische Insolvenzgesetz – Ausgewählte Aspekte, RIW 1999, p. 37 et seq.; S. B. Brooks, Restatement of the Russian Federation's Insolvency Law: a Guide to the Federal Law on Insolvency, Review of Central and East European Law 1999, no. 1-2, pp. 9 et seq; M. V. Telyukina (ed.), Kommentariy k Federal'nomu zakonu "O nesostoyatel'nosti (bankrotstve)" [Commentary on the Federal Law "On Insolvency (Bankruptcy)"], Moscow 1998; V. V. Vitryanskiy (ed.), op. cit.; M. V. Telyukina, Konkursnoe pravo: teoriya i praktika nesostoyatel'nosti [Insolvency law: theory and practice of insolvency], Moscow 2002.

[514] See V.V.Vitryanskiy, Regulation of insolvency within the framework of the model legislation of the CIS, Review of Central and East European Law 1999, p. 188.

[515] The minimal amount of debt was 500 times the amount of the minimal wages determined by law.

that these provisions which were taken over, almost unchanged, into the current Insolvency Law have never become effective.[516] In the course of application of FIL'98 by the courts, significant deficiencies were found which led first to declaring certain provisions unconstitutional by the Federal Constitutional Court[517] and finally to the adoption of a new law. The rights of debtors were not sufficiently protected. While the pre-conditions for filing the bankruptcy petition in the FIL'92 made the abuse of his position by the debtor possible, the amended pre-conditions in the FIL'98 enabled the creditors to use insolvency proceedings for hostile takeovers and for destroying the competitors (the so-called "redistribution of ownership"). Insolvency proceedings were opened on the basis of a small amount of debt, often on the evidence of falsified documents whereby the debtor had no legal remedy against the opening of proceedings. Moreover, the debtor could not prevent the commencement of bankruptcy proceedings by settling the debt within a prescribed period or conduct reorganisation proceedings himself under creditors' control.[518] Reorganisation was practically impossible, so that more than 99% of the enterprises undergoing reorganisation had to be liquidated.[519] The rights of minority creditors in connection with the voting at the creditors' meeting and especially with the conclusion of a composition agreement with the debtor and the rights of secured creditors in connection with the realisation of assets were not considered. The interests of the state e.g. concerning tax collection were not safeguarded. On the contrary, bankruptcy proceedings were often used for tax evasion.[520] The administrator was, as a rule, imposed by the creditors and

[516] See chapter X (Art. 202 et seq.) of the effective FIL.

[517] See decisions of the Federal Constitutional Court of 16 May 2000, of 6 June 2000, of 12 March 2001 and of 3 July 2001; for further details see M. V. Telyukina, Praktika Konstitutsionnogo suda po delam o nesostoyatel'nosti (bankrotstve) juridicheskikh lits [Rulings of the Constitutional Court on insolvency of legal entities], Zakonodatel'stvo 2002, no. 7.

[518] See the grounds for the draft of the new insolvency law by the Government (www.akdi.ru/pravo/news/pz_zak_b.htm, Log-in: 26.06.2004).

[519] See S. E. Andreev, Kommentariy k Federal'nomu zakonu o nesostoyatel'nosti (bankrotstve) [Commentary on the Federal Law „On Insolvency (Bankruptcy"], Moscow 2005, p. 15.

[520] op. cit.

acted only in their interests[521] whereby the liability of the administrator was not sufficiently regulated. Gaps in the FIL'98 made possible deliberate and fictive bankruptcies. Although such practices are sanctioned under the Criminal Code they could seldom be prosecuted.[522] The above problems were to be solved by adopting a new insolvency law.[523]

The effective FIL was adopted on the basis of the Government draft which was amended according to the requirements of the President of the Russian Federation.[524] It was signed by the President on 26 October 2002 and published in the official gazette on 2 November 2002. Most provisions entered into force on 3 December 2002[525] (see Art. 231 para. 1, 1 FIL[526]). In preparing the new law, European experience has been used, i.a. within the framework of the EU Project "Efficiency of Insolvency Proceedings I" which was implemented by a consortium led by the German consultant GTZ GmbH (Gesellschaft für technische Zusammenarbeit).[527] Special provisions of § 6, Chapter IX on natural

[521] See R. Wedde, Neues im russischen Insolvenzrecht, WiRO 2003, vol. 7, p. 197.

[522] See S. B. Brooks, Three's a charm? Russia's third bankruptcy law in ten years (International Insolvency Institute – http://www.iiiglobal.org).

[523] However, some influential lawyers, e.g. the vice-president of the Supreme Commercial Court V. V. Vitryanskiy, criticized the approach of the lawmaker to adopt a new law with new shortcomings instead of improving the original law by introducing amendments (see V. V. Vitryanskiy (ed.), Nauchno-prakticheskiy postateynyy kommentariy k Federal'nomu zakonu "O nesostoyatel'nosti (bankrotstve)" [Scientific-practical commentary on the Federal Law „On insolvency (bankruptcy)" by articles], Moscow 2003, p. 17).

[524] See the letter of the President of the Russian Federation no. Pr-1345 of 25 July 2002. Interestingly, the draft of 2000 introduced over-indebtedness as the only insolvency trigger. The draft was rejected by the President with the argument that the commencement of bankruptcy proceedings will be impossible if this trigger should be applied.

[525] See the ruling no. 4 of the Plenum of the Supreme Commercial Court of 8 April 2003 (VVAS 2003, vol. 6, pp. 5 et seq.).

[526] Hereinafter Art. without the title of the law are articles from FIL.

[527] Currently, a follow-up EU project "Efficiency of insolvency proceedings II" is being carried out, again under the leadership of GTZ. The expert's reports containing comparative analysis of regulation of selected aspects of insolvency proceedings in major EU member states are used by the experts of the Russian Ministry of Economy and Trade in preparation of drafts of amendments to the

monopolies should replace the respective special law on 1 July 2009 due to the current restructuring of natural monopolies.[528] Provisions on consumers' insolvency shall become effective when federal laws which are not specified in the FIL are amended (Art. 231 para. 1, 2). An amendment proposed by the Government was adopted in the first reading by the State Duma on 12 May 2005; the second reading was postponed and should take place in October 2007. The draft is aimed at reducing the costs of proceedings and at improving control over insolvency administrators. However, the effective law as well as planned amendments have already been criticized i.a. by the Supreme Commercial[529] Court.[530] They are considered to be inadequate for solving major problems, namely the insufficient protection of creditors and prevention of deliberate bankruptcies.

The interpretation of the FIL which is binding for inferior courts is contained in the ruling no. 4 of 8 April 2003[531], the ruling no. 29 of 15 Dec.2004[532], the ruling no. 22 of 22 June 2006, no. 25 of 22 June 2006 and no.67 of 20 Dec. 2006[533] of the Plenum of the Supreme Commercial Court and several so-called information letters of the Presidium of the Supreme Commercial Court.[534] Further, orders of the executive

effective FIL.

[528] See the amendment to the FIL from 31 December 2004.

[529] The term „arbitrazhnyy sud" referring to the state courts on commercial matters is hereinafter translated as „commercial court" in contrast to private arbitration courts.

[530] See the statement of the head of the department for analysis and sistematisation of case law of the Supreme Commercial Court, Mr Andrey Yegorov, of 19 March 2007.

[531] VVAS 2003, vol. 6, pp. 5 et seq.

[532] VVAS 2005, vol. 3, pp. 5 et seq.

[533] Latest rulings of the Plenum are published on the internet under www.arbitr.ru, Log-in: 5.09.2007.

[534] See e.g. information letters of 15 August 2003, 13 August 2004, 30 December 2004, 6 July 2005, 26 July 2005, 13 October 2005, 20 December 2005 etc.

concerning FIL, e.g. the Government orders,[535] should be considered. Apart from the FIL, certain provisions on insolvency are contained in the Civil Code Part I (Art. 25, 61-65)[536] and in the Code of Commercial Procedure[537] (Art. 33, 38 para. 4, 223 et seq.). To the aspects of proceedings not regulated in the FIL, the Code of Commercial Procedure shall be applied (Art. 32 para. 1). Insolvency of credit institutions[538], natural monopolies[539] and certain aspects of insolvency of agricultural enterprises[540] are currently governed by special laws.

b) Enforcement Proceedings

Enforcement proceedings are regulated by the Federal Law "On Enforcement Proceedings"[541] and the Federal Law "On Bailiffs",[542] both of 21

[535] See e.g. Government orders of 20 May 2003 (SZ RF 2003, no. 21, pos. 2012), 22 May 2003 (SZ RF 2003, no. 21, pos. 2015), 28 May 2003 (SZ RF 2003, no. 22, pos. 2169), 25 June 2003 (SZ RF 2003, no. 26, pos. 2662, 2663, 2664), 25 September 2003 (SZ RF 2003, no. 28, pos. 2939, no. 39, pos. 3774), 6 February 2004, 9 July 2004, 21 October 2004, 15 November 2004, 27 December 2004, 3 February 2005, 11 February 2005, 29 May 2005, 17 November 2005 etc.

[536] On conflict between the Civil Code Part I and the FIL see below II.3.

[537] Code of Commercial Procedure of 24 July 2002 (RG 2002, no. 137) (hereinafter referred to as CCP).

[538] Federal Law "On Insolvency (Bankruptcy) of Credit Institutions“ from 25 February 1999 (SZ RF 1999, no. 9, pos. 1097) as amended, for further details see A. Trunk, Auf der Suche nach Wegen aus der Bankenkrise: Das russische Bankeninsolvenzrecht, in: Hofmann, Küpper (eds.), Kontinuität und Neubeginn. Staat und Recht zu Beginn des 21. Jahrhunderts, Festschrift für Georg Brunner, Baden-Baden 2001, pp. 279 et seq. The adoption of the new version is to be expected soon.

[539] Federal Law „On Specific Features of Insolvency (Bankruptcy) of Enterprises of Fuel and Energy Sector“ of 24 June1999 (SZ RF 1999, no. 26, pos. 3179), for further details see A. Reinsch, Russische Föderation: Besonderheiten der Insolvenz von Subjekten der natürlichen Monopole des Brennstoff- und Energiekomplexes, WiRO 1999, pp. 432 et seq. The law shall be abolished on 1 July 2009.

[540] Federal Law „On Financial Rehabilitation of Agricultural Producers" of 9 July 2002 (SZ RF 2002, no. 28, pos. 2787).

[541] SZ RF 1997, no. 30, pos. 3591.

[542] SZ RF 1997, no. 30, pos. 3590.

July 1997. Although both laws have often been amended, the Ministry of Justice has been working on a general reform of enforcement law for several years, including preparation of new versions of both laws or combination of both laws in an Enforcement Code. According to the statistics of the Ministry of Justice, the number of court judgments which were actually enforced and the amount recovered per annum has been steadily increasing, but the enforcement proceedings are still not very efficient. In 2005, 54% of the proceedings commenced were terminated after actual enforcement and only 18.7% of the amount of claims contained in court judgments were recovered as a result of enforcement.[543]

Pursuant to the effective FIL, the insolvency proceedings can be commenced only on the basis of claims for which a writ of execution has been issued by the court and which could not be enforced by the bailiff within a period stipulated by law. This provision should prevent the abuse of the insolvency proceedings by the creditors.

c) Informal Workouts

Informal workouts in insolvency proceedings are neither regulated nor practiced. The reason for this aversion is lack of tradition and contrary overall business culture.[544]

[543] See www.fssprus.ru/material.asp?material_id=164&dept_id=9, Log-in: 5.06.2006.

[544] See also for other Eastern European transition countries A. Bormann, N. Spitsa, Specific features of insolvency law in Eastern European transition countries, Jahrbuch für Ostrecht 2007, vol. 1., pp. 11-36.

2. Commencement of Insolvency Proceedings

Pursuant to FIL, the insolvency proceedings can generally include all forms of procedures (observation, financial rehabilitation, external administration, liquidation) as stages of proceedings. Therefore, the provisions on pre-conditions of commencement, rights and obligations of participants and the effect of commencement are diversified.

a) Stages of Insolvency Proceedings

All forms of procedures are divided in measures preventing insolvency and actual insolvency proceedings. The only prevention measure is the so-called pre-court rehabilitation regulated in Art. 31that should not be confused with the reorganisation proceeding „financial rehabilitation". This is not a formal procedure, but only the possibility to provide funding to the debtor in financial difficulties in order to prevent insolvency; funding can be provided by shareholders or the owner of the debtor, creditors or third parties.[545]

The procedures can generally be embedded into one insolvency proceeding as stages of proceedings in the same order as they are regulated in the FIL. However, it can be assumed that, in practice, only two procedures are conducted in succession in most cases. Rehabilitation procedures (financial rehabilitation and external administration) are not applicable to physical persons and sole proprietors (Art. 27 para. 2).

A composition agreement (Art. 150-167) can be entered into during any of the procedures (Art. 150 para. 1). The parties of the agreement are the creditors' meeting representing the creditors and the director of the debtor (observation and financial rehabilitation) or the administrator

[545] In the literature, this procedure is criticised, since it can be used for hostile takeovers (see V. V. Vitryanskiy (ed.), Nauchno-prakticheskiy postateynyy kommentariy k Federal'nomu zakonu "O nesostoyatel'nosti (bankrotstve)" [Scientific-practical commentary on the Federal Law „On insolvency (bankruptcy)" by articles], Moscow 2003, p. 20).

(external administration and liquidation) representing the debtor as well as third parties if they provided security (Art. 150 para. 2, 3). The agreement becomes effective on approval of the commercial court; the approval is only possible if claims of creditors of the first and second order are satisfied (Art. 158 para. 1). The insolvency proceedings are terminated on approval of the agreement (Art. 159 para. 1). If the agreement is cancelled by the commercial court, the same insolvency procedure during which the agreement was entered into is to be commenced (Art. 166 para. 1).

aa) Initial Proceedings

The observation (Art. 62-75) is the stage of proceedings beginning with the acceptance of the insolvency petition by the commercial court and ending with the court order on commencement of one of three procedures regulated in the FIL on the basis of the proposal of the first creditors' meeting. No observation procedure is conducted in simplified proceedings in connection with assetless liquidation (Art. 225 para. 1) and with liquidation of debtors-in-absentia (Art. 228 para. 1). The duration of observation should not exceed seven months (Art. 62 para. 2 in conjunction with Art. 51). The director of the debtor, generally, remains in office, but his powers are limited (Art. 64 para. 1-3). The provisional administrator can apply for dismissal of the debtor's director to the commercial court, but even if the commercial court dismisses the director, it delegates the powers of the director to the vice-director or other employee of the debtor (Art. 69 para. 1, 4). During the observation, the financial situation of the debtor is analysed by the administrator (Art. 70), the amount of creditors' claims is determined by the commercial court (Art. 71) and the first creditors' meeting, at which the decision on the proposal concerning the appropriate procedure is made, is called and conducted by the administrator (Art. 72-74). The commercial court decides generally on the basis of the proposal of the creditor's meeting which procedure should be commenced (Art. 75 para. 1). If no decision was met at the creditors' meeting, the court has to set a dead-line; if the setting of the dead-line would lead to exceeding the time limit of seven moths, the court decides without the decision of the creditors' meeting on the basis of the provisions of FIL (Art. 75 para. 2). If the pre-conditions of financial rehabilitation stipulated by law are satisfied, the com-

mercial court can overrule the decision of the creditors' meeting and issue an order on commencement of financial rehabilitation (Art. 75 para. 3).

bb) Reorganisation Proceedings

The financial rehabilitation (Art. 76-92) is a new reorganisation procedure which enables the debtor to conduct reorganisation himself. The external administration (Art. 93-123) is a reorganisation procedure in which the administrator replaces the management of the debtor. It was regulated in both preceding FIL, but played only a minor role in practice as compared to liquidation.[546] The duration of both financial rehabilitation and external administration may not exceed two years (Art. 92 para. 2). The core of external administration constitute restructuring measures laid down in Art. 109, which should enable the accumulation of funds in order to satisfy creditors' claims when the proceedings are completed. If claims are not satisfied, liquidation proceedings have to be commenced.

cc) Liquidation and Simplified Proceedings

The liquidation procedure (Art. 124-149) can be commenced after observation, financial rehabilitation or external administration for one year with a possible extension for six months (Art. 124 para. 2) if the debtor is insolvent according to the legal definition, but the pre-conditions for reorganisation do not exist (Art. 53 para. 1).

Furthermore, two simplified procedures are laid down in the FIL: concerning enterprises the assets of which are not sufficient to meet the creditors' claims (Art. 224 et seq.), and concerning debtors-in-absentia

[546] E.g. in 2002, external administration was commenced in 2700 cases, however, recovery of solvency of the debtor was reached only in 21 cases see V. F. Jakovlev, O khode realizatsii Federal'noy tselevoy programmy razvitiya sudebnoy sistemy Rossii na 2002-2006 gody, itogakh raboty v 2002 godu i novykh zadachakh sistemy arbitrazhnykh sudov, VVAS 2003, no. 4, p. 8. In 2006, there were 6.5 times less external administration proceedings than in 2005 according to the statistics of the Supreme Commercial Court.

(Art. 227 et seq.).[547] In both cases, the liquidation procedure is commenced immediately after the petition is filed; the procedure is simplified in so far as creditors have to present their claims within one month (Art. 225 para. 2, 228 para. 2). These procedures are not applied if the director of the debtor presents the petition before the liquidation commission is established (Art. 225 para. 3) or if the administrator finds assets of the debtor-in-absentia (Art. 228 para. 3). The insolvency proceeding against a debtor-in-absentia is not commenced if no funds are available to cover the proceeding costs (Art. 227 para. 2).

b) Scope and Applicability

As compared to FIL'98 according to which only commercial organisations, consumers' cooperatives and foundations were subject to insolvency, the scope of the law has been extended. According to Art. 1 para. 2, the FIL is applicable to all legal entities,[548] with the exception of

[547] According to the Government Order of 21 October 2004 no. 573 "On the conditions of funding of insolvency proceedings against debtors-in-absentia", the insolvency proceedings are funded from the federal, regional or municipal budget if the petition is filed by the respective state organs. The reimbursable costs of proceedings are comprised of the remuneration of the administrator amounting to 10,000 Roubles and other necessary proceeding costs the amount of which is limited by the state. If the administrator finds unknown assets of the debtor, he is entitled to retain 10% of the proceeds from realisation of these assets. Before the Order was issued, only few insolvency proceedings against debtors-in-absentia could be commenced. The increase of the number of petitions in 2005 as compared to 2004 is mainly due to a high number of petitions against debtors-in-absentia (6,968 or 22% of the general number).

[548] Art. 1 para. 2 is in contradiction with Art. 65 para. 1 Civil Code Part I, which has the same content as the respective provision of FIL'98. The Supreme Commercial Court decided, without giving grounds, that the FIL and not Civil Code Part I should be applied (see Ruling no. 4 of the Plenum of the Supreme Commercial Court of 8 April 2003, no. 2); also according to the literature, FIL has priority over the Civil Code Part I, whereby different grounds are given (priority due to the speciality according to Art. 65 para. 3 Civil Code Part I see V. V. Vitrjanskij (ed.), op. cit., p. 24; priority as a later law see Semina, Bankrotstvo [Bankruptcy], Moscow 2003, p. 16).

fiscal enterprises,[549] institutions,[550] political parties[551] and religious organisations[552]. This means that the most non-commercial organisations have become subject to insolvency. The scope of the law was extended to certain categories of social organisations, e.g. art and cultural associations, and chambers of commerce.

Pursuant to Art. 23 para. 1, Art. 25 Civil Code Part I physical persons who perform entrepreneurial activities (see Art. 214-216 for sole proprietors and Art. 217-223 for family farms) are subject to insolvency. The provisions on consumers' insolvency (chapter X, Art. 202 et seq.) were taken over from FIL'98 almost verbatim, and they have not become effective either as a part of FIL'98 or of the FIL 2002.

Since the most, also strategically important state-owned enterprises have been privatised and are now subject to insolvency, special provisions were necessary from the standpoint of the lawmaker for the protection of enterprises important for political or social reasons (town-forming enterprises (Art. 169 et seq.), family farms (Art. 177 et seq.), credit institutions, insurance companies and brokers (Art. 180 et seq.)) and for

549 Fiscal enterprises are enterprises which are not only state-owned, but also are not allowed to dispose of their assets and products without the consent of the competent state organ. They are to be differentiated from the so-called unitary enterprises ("unitarnye predpriyatiya") which can be subject to insolvency (see Art. 113 et seq. Civil Code Part I; Federal Law „On state and municipal unitary enterprises“ of 14 November 2002 (RG 2002, no. 129)) are in state or municipal ownership, but are administrated independently on the basis of the right of economic administration (Art. 294 et seq. Civil Code Part I). The number of fiscal enterprises is very small. For further details on privatisation and administration of state-owned enterprises see N. Spitsa, Privatisierungsinstitutionen in der Russischen Föderation, in: H. Roggemann / J. Lowitzsch, Privatisierungsinstitutionen in Mittel- und Osteuropa, Berlin 2002, p. 220 et seq.

550 In the original "ucherezhdeniya"; for legal definition see Art. 120 Civil Code Part I.

551 For legal definition see the Federal Law „On political parties“of 11 July 2001 (SZ RF 2001, no. 29, pos. 2950) as amended.

552 For legal definition see Art. 117 Civil Code Part I.

strategic enterprises[553] (Art. 190 et seq.) and natural monopolies (Art. 197 et seq.).

c) Grounds for Commencement

The proceeding against a legal entity, a sole proprietor or a family farm can be commenced by the commercial court on the basis of an insolvency petition by the debtor or the creditors, if the debtor does not satisfy the claims of his private creditors and/or claims of the state concerning payment of taxes, levies and social contributions amounting at least to 100,000 Roubles within three months after the claims have fallen due[554] (Art. 3 para. 2, 6 para. 2, 33 para. 2, 214, 217).[555] The amount is still relatively small for large enterprises. Therefore, higher requirements are determined for strategic enterprises (Art. 190 para. 3, 4) and natural monopolies (Art. 197 para. 2, 3) for political reasons: only claims amounting to at least 500,000 Roubles overdue for at least six months. The necessary amount is no longer based on minimum wages stipulated by law, but is expressed as a nominal amount in roubles. The over-indebtedness as trigger was rejected already 1998 due to negative experience with this trigger when applying the FIL'92.

The proceeding against a consumer can be commenced by the commercial court on the basis of a petition by the debtor or by the creditors, if the debtor does not satisfy the claims of his private creditors and/or claims of the state concerning payment of taxes, levies and social contributions amounting at least to 10,000 Roubles within three months after the claims have fallen due and if the amount of claim exceeds the

[553] Which enterprises are to be considered as strategic in the cases of insolvency or privatisation is now defined in the Government Order no. 684 of 17 November 2005 in conjunction with the Decree of the President of 4 August 2004 containing a list of such enterprises.

[554] The maturity of claims is determined according to Art. 314 Civil Code Part I and/or according to provisions of the Special Part of the Civil Code (Part II).

[555] As compared to FIL'98, the amount of claims has been doubled in order to raise the threshold for opening the proceedings and, thereby, to protect the debtor.

value of his property (Art. 3 para. 1, 6 para. 2, 33 para. 2). However, it should be noted that these provisions have not become effective.

In order to determine the criterion for opening the proceedings, only claims which have become due when the petition is filed have to be considered (Art. 4 para. 1). Conventional and administrative penalties are excluded when the amount of claims is calculated for the insolvency trigger (Art. 4 para. 2). Furthermore, claims of physical persons concerning compensation for damage to life or health, claims for payment of wages or professional fees, claims of shareholders against the company (Art. 4 para. 2) and alimony claims if the debtor is a physical person (Art. 203 para. 2) are also not considered for the insolvency petition. If the claims are in a foreign currency, their amount is calculated according to the conversion rate of the Central Bank of the Russian Federation at the moment of opening of the insolvency proceedings (Art. 4 para. 1).[556]

If the petition is submitted by creditors, claims of private creditors can only be considered if they are confirmed by an effective judgement of the court of general jurisdiction, the commercial court or an arbitration court for which a writ of execution has been delivered at least 30 days before submitting the petition, and claims of the state can be considered if they are based on administrative acts of tax or customs authorities issued at least 30 days before submitting the petition (Art. 6 para. 3, 7 para. 2). If the amount of claims is disputed by the debtor, it is to be determined by the commercial court (Art.. 4 para. 4).[557] The validity of creditors' claims is to be examined by the commercial court (Art. 48). The debtor can not prevent the commencement by partly satisfying the claims if the amount of the remaining debt is higher than the amount stipulated by Art. 2 para. 1 (Art. 7 para. 3).

[556] In contrast to the court practice on FIL'98 (see information letter of the Supreme Commercial Court „On certain issues concerning the application of the Federal Law "On insolvency (bankruptcy)" of 14 June 2001, no. 20 (VVAS 2001, no. 9, pos. 73) where different moments were chosen for calculation depending on the form of procedure, the lawmaker has decided on a uniform regulation.

[557] In 2005, most applications of debtors during the insolvency proceedings (72,405 corresponding to 73% of all applications) referred to the amount of creditors' claims.

The debtor is entitled to file for insolvency if he can foresee on the basis of circumstances which ensure him that he will not be able to satisfy the claims within the stipulated period of time and will become insolvent (Art. 8 FIL). By this provision, the trigger of imminent illiquidity was introduced also into the Russian law; however, neither a precise definition nor incentives for early filing were included.

d) Persons Entitled and Persons Obliged to File the Petition

The debtor, private creditors and state organs representing the state as creditor are entitled to file the petition (Art. 7 para. 1; Art. 224 CCP). The petition of the debtor must meet the form requirements stipulated in Art. 37; the documents listed in Art. 38 must be enclosed. If the debtor is a physical person a plan for debt settlement can be enclosed (Art. 204 para. 1). If the form requirements are not satisfied the petition can be returned by the court (Art. 44 para. 1);[558] however, the lacking documents can be submitted at a later time (Art. 42 para. 1). In contrast to FIL'98, the debtor is not entitled to declare his insolvency without filing the petition at the court.

Creditors can file the petition meeting the form requirements of Art. 39 and enclosing the documents according to Art. 40 (Art. 11 para. 1). The state organs representing the state as creditor must, additionally, enclose documents according to Art. 41 para. 2. If the form requirements are not satisfied the petition shall be returned by the court (Art. 44 para. 1); in contrast to the debtor, creditors are not allowed to submit the lacking documents later.[559] Several creditors can submit a joint petition (Art. 39 para. 5). Claimants of tort claims in connection with life or health damage, claims for wages or salaries, fees, alimony and claims of shareholders against the company are not entitled to file for insolvency; all these claims, with the exception of shareholders' claims, can be enforced during the observation, financial rehabilitation and external

[558] In 2005, 20% of all insolvency petitions were returned by the court.

[559] The provisions on form requirements should prevent the commencement of insolvency proceedings on the basis of falsified documents.

administration (Art. 63 para. 1, 81 para. 1, 95 para. 1) and are satisfied in priority to other claims in liquidation (Art. 134 para. 1).

The director of the debtor or the sole proprietor is obliged to submit the petition to the commercial court within one month if the satisfaction of claims of one or several creditors will make impossible the satisfaction of claims of other creditors, if the management body of a company entitled to decide on liquidation or the owner of a unitary enterprise decides to file the petition, if the enforcement against the debtor's property will impede the continuation of the business of the debtor (Art. 9 para. 1) or if it is determined during liquidation that the assets are not sufficient for satisfying all claims (Art. 9 para. 2).[560] If the petition is not submitted within the stipulated period of time the persons obliged to file the petition bear subsidiary liability for all claims arising after one-month term expires (Art. 10 para. 2).

3. Institutional Framework

The control powers of the court and the powers and duties of the administrator depend on the form of procedure. The creditors' meeting and creditors' committee represent the interests of creditors. Powers concerning control and decisions on important issues are within the exclusive competence of the creditors' meeting. Apart from the debtor, creditors and the above-mentioned organs, state organs participate in the proceedings in cases stipulated by law.

[560] A decision of the management body of the debtor is not required (see no. 5 of the Ruling no.29 of the Plenum of the Supreme Commercial Court of 15 December 2004).

a) Courts

Insolvency proceedings are within the subject-matter jurisdiction of state commercial courts (Art. 6 para. 1; 33 para. 1 no. 1 CCP). Private arbitration courts are not authorised to conduct insolvency proceedings (Art. 33 para. 3). Proper venue is determined by the location or domicile of the debtor (Art. 33 para. 1; 38 para. 4 CCP). The insolvency petitions are to be filed with commercial courts of federal subjects (trial court). Insolvency cases are generally heard by three professional judges without jurors (Art. 223 para. 2, 17 para. 2 no. 3 CCP in conjunction with Art. 17 para. 1 CCP). Sole judge is authorised to perform procedural activities preparing the insolvency case (including the order concerning acceptance or rejection of the bankruptcy petition) (Art. 42 para. 2, 43), the court hearing for examination of the validity of creditors' claims (Art. 48), the order concerning expertise on criteria of deliberate or fictive bankruptcy (Art. 50 para. 4)), to issue orders on applications and complaints of participating parties during the proceedings (Art. 60 para. 1) and to conduct simplified proceedings concerning debtors-in-absentia (Art. 228 para. 4). In the appellate and cassation court, three or more professional judges make the orders (Art. 17 para. 4 CCP).

The powers of the court are the following:

- order concerning acceptance or rejection of the insolvency petition (Art. 42 para. 2, Art. 43);
- examination of validity of creditors' claims (Art. 42 para. 6, 48);
- overruling of decisions of the creditors' meeting (Art. 15 para. 5);
- order on commencement of the proceedings (Art. 52 para. 1; Art. 42 para. 6, 62 para. 1 (observation); Art. 75 para. 2, 80 para. 1 (financial rehabilitation); Art. 75 para. 2, 92, 146 (external administration); Art. 53 para. 1, 2, 124 para. 1 (liquidation));
- appointment (Art. 45; 65 para. 1, 2 (observation); 80 para. 2 (financial rehabilitation); Art. 96 para. 1 (external administration); Art. 127 (liquidation)) and dismissal of the administrator (Art. 65 para. 3 (observation); Art. 83 para. 5 (financial rehabilitation); Art. 98 (external administration); Art. 145 (liquidation));
- orders concerning protection of assets (Art. 42 para. 7, 46; 91 CCP);
- orders concerning extension of proceedings (Art. 93 para. 2 (external administration); Art. 124 para. 3 (liquidation));

- order on annulment of the plan of external administration (Art. 107 para. 6);
- decisions on petitions / complaints of participants during the proceedings (Art. 60 para. 1);
- approval (Art. 158), rejection (Art. 160) and annulment of an agreement (Art. 164);
- orders on disputes on the conditions of sale of debtor's assets (Art. 139 para. 2, 140 para. 3);
- approval of the final report of the administrator (Art. 119 para. 4, 5);
- order on the termination of the proceedings (Art. 57 (observation); 88 para. 6 (financial rehabilitation); 119 para. 6 (external administration); 149 (liquidation)).

Generally, rulings and orders of the court become effective immediately after the pronouncement. Appeals against court orders according to Art. 52 para. 1 (order on commencement of insolvency proceedings, on rejection of insolvency petition and on termination of the proceedings) are to be lodged pursuant to general provisions of the CCP (section VI); Art. 223 para. 3 CCP and Art. 61 are not applied.[561] If the appeal is expressly regulated in the FIL, i.a. in Art. 61 para. 1, or in the CCP, it has to be lodged within 10 days after the court order is announced, according to Art. 223 para. 3 CCP. Cassation and recommencement of proceedings due to new evidence are also possible. If the appeal is not expressly regulated, it has to be lodged within 14 days after the court order is pronounced; the court has to decide on the appeal within 14 days. There is no legal remedy against this decision (Art. 61 para. 3). This provision concerns e.g. appeals against court orders on annulment of the decision of the creditors' meeting (Art. 15 para. 5) and court orders on extension of proceedings (Art. 93 para. 2, 124 para. 3).

[561] See the Ruling no. 4 of the Plenum of the Supreme Commercial Court of 8 April 2003, no. 14.

b) Administrator

An administrator[562] is appointed by the competent commercial court for each insolvency proceeding. The FIL contains general provisions concerning all administrators (Art. 20-26) and special provisions on the role of the administrator in different forms of procedures (Art. 65-67 (observation), Art. 83 (financial rehabilitation), Art. 96-99 (external administration), Art. 143-145 (liquidation)). The legal provisions on professional organisation of insolvency practitioners have been substantially amended as compared to FIL'98.[563] According to FIL, administrators shall be organised in the so-called self-regulating associations which are, apparently, structured similarly to associations of attorneys-at-law[564] in the new Law on Attorneys-at-law.[565]

The self-regulating associations must have a compensation fund, be comprised of at least 100 members who participate in at least 100 insolvency proceedings in order to be included in the state register (Art. 21 para. 2). They represent the rights and interests of the members, organise internships for future administrators and continuing education for current administrators, issue internal rules on activities of their members and professional ethics and supervise the activities of the members; the associations are, in their turn, controlled by the Federal Registration

[562] The generic term for all administrators in FIL is "arbitrazhnyy (upravlyajushchiy)" (commercial administrator). The term reflects the fact that the administrator is appointed by the commercial court ("arbitrazhnyy sud"). In the following, the term "administrator" will be used as a generic term.

[563] According to FIL'98, administrators had to acquire a first-level licence (Art. 19 para. 2) and, after having gained experience, to acquire licences of further levels according to the government order no. 1544 of 25 December 1998 which were required for more complicated proceedings. These provisions were abolished after the new version of the Law on Licensing of 8 Aug. 2001 has been adopted.

[564] See R. Wedde, Neues im russischen Insolvenzrecht, WiRO 2003, no. 7, p. 197.

[565] See Art. 29 et seq. of the Federal Law "On Attorneys-at-law and their Activities" of 31 May 2002 (SZ RF 2002, no. 23, pos. 2102) as amended.

Service according to the Government Order no. 52 of 3 February 2005[566] (Art. 21 para. 3, 5).

If the requirements of Art. 21 para. 2 or if the FIL has been violated several times the self-regulating association can be deleted from the register by the commercial court on the basis of an application of the Federal Ministry of Justice (Art. 21 para. 6). The self-regulating association can exclude members if they violate the internal rules (Art. 22 para. 1).

The members of self-regulating associations should be Russian citizens, have a university degree, have worked as senior managers[567] for at least two years, be registered as sole proprietors, have no criminal record, especially in connection with economic crimes, have worked as an intern assisting an administrator for at least six months and passed the theoretical examination (Art. 20 para. 1). Additionally, each member has to insure his liability for at least 3 million Roubles per year, and the insurance must be effective at least one year (Art. 20 para. 8).[568] An administrator can be member in only one self-regulating association (Art. 24 para. 2). In the literature, different possible problems in connection with these regulations were anticipated: on the one hand, the state control over self-regulating associations could be not sufficient,[569] on the other hand, independence of administrators could be limited by the

[566] Originally, control over self-regulating associations was within the competence of the Federal Ministry of Justice according to the Government Order no. 100 of 14 February 2003 (abolished). Since the Federal Registration Service is subordinated to the Federal Ministry of Justice, the change is merely formal.

[567] Senior management is defined as the position of the director or deputy director of a legal entity or of an administrator in a proceeding in which the administrator replaces the debtor's management (Art. 20 para. 4).

[568] During the transitional period (until 3 December 2003), administrators in possession of a licence under the previous law who insured their liability according to the effective FIL, but have not worked as interns, have not passed the examination and were not members of a self-regulating association could be, nevertheless, appointed by the court (Art. 231 para. 4).

[569] See G. Kiperman, Novyy zakon o bankrotstve [The new Insolvency Law], Finansovaya gazeta, regional edition 2002, no. 47.

self-regulating associations.[570] In practice, some of negative presumptions were confirmed: several self-regulating associations were established by large influential companies and are controlled by them; no disciplinary proceedings have been commenced against administrators by the self-regulating associations in the years 2002-2005.[571] Obviously, state organs do not trust administrators and, especially, self-regulating associations, so that regular mass controls of administrators by the office of the attorney public are conducted.

The regulation of appointment has also been reformed. In the petition, the self-regulating association from which the administrator should be appointed should be named (Art. 37 para.2 no. 10, 39 para. 2 no. 10).[572]

The creditor can include additional requirements for the administrator; however, they should not exceed those of Art. 23 para. 1. The order of the competent court on acceptance of the petition is to be submitted to the self-regulating association named in the petition. The self-regulating association has to submit a list of three candidates for the position of the administrator who meet the requirements und have accepted the position, including the grounds and the CV's, to the competent commercial court, the person who submitted the petition and the creditors or the debtor within five days (Art. 45 para. 3).[573] The representatives of the

[570] See. V. V. Vitryanskij (ed.), Nauchno-prakticheskiy postateynyy kommentariy k Federal'nomu zakonu "O nesostoyatel'nosti (bankrotstve)") [Scientific-practical commentary on the Federal Law "On insolvency (bankruptcy)" by articles], Moscow 2003, p. 20.

[571] See Materials of the conference at the Territorial Unit of the Federal Ministry of Justice in the Government District North-West "Russia and the West: The efficiency of the bankruptcy proceedings under current economic conditions", 26-27 May 2005, St.Petersburg (partly published in the journal "Vremya i pravo" („Time and Law"), special edition 2006, no. 2.

[572] According to the order of the Ministry of Economy and Trade no. 56 of 1 March 2006, the competent state organ (in this case the tax authorities) is authorised to select the self-regulating organisation.

[573] In practice, it is considered as problematic that the qualification of an administrator during the selection of candidates is based merely on the number of proceedings conducted by him. However, the number of proceedings can not be a quality criterion: on the one hand, it is not differentiated between regular and simplified proceedings, on the other hand, the administrators are forced not to conduct reorganisations, since reorganisations generally last longer (see N. V.

debtor and creditors can reject one candidate each, so that the commercial court can appoint the remaining candidate, or to renounce the right to reject, so that the commercial court can select the best qualified candidate (Art. 45 para. 4). By this procedure, it should be prevented that the administrator is imposed by one party to the proceedings and acts only in its interests.[574] However, according to the amendment of 18 July 2006, creditors' meeting can apply for appointment of the person who was the administrator during observation for further proceedings without following the appointment procedure pursuant to Art. 45 para. 1-6. Administrators who did not insure their liability, did not compensate the damage from the previous proceedings, are not permitted to act as senior managers according to law, are excluded in connection with conflict of interest according to Art. 19[575] or against whom an insolvency proceeding has been commenced can not be appointed (Art. 20 para. 6).

The administrator has the following functions in all proceedings:

- analysis of the financial situation of the debtor and his business (Art. 24 para. 4 no. 3 und 4; 67 para. 1 (observation), 99 para. 2 (external administration), 129 para. 2 (liquidation))
- protection of the debtor's assets (Art. 24 para. 4; 67 para. 1 (observation), 83 para. 4 (external administration), 129 para. 2 (liquidation))

Fedorenko, P. N. Parkhomenko, Pravovoy status i rol' nekotorykh sub''ektov protsedury bankrotstva v svete federal'nogo zakona 2002 goda „O nesostoyatel'nosti (bankrotstve)" [Legal status of some subjects of bankruptcy proceedings under the Law "On insolvency (bankruptcy)" 2002], Vestnik Vysshego Arbitrazhnogo suda 2005, no. 5, p. 171).

574 Vgl. G. Kiperman, op. cit.

575 According to Art. 19, parent or subsidiary company of the debtor, the debtor's director, members of the debtor's board of directors and supervisory council and the bookkeeper, also if they have left the company within one year preceding the opening of insolvency proceedings, as well as spouses, parents, grandparents, children, grandchildren, siblings, nephews/nieces, great-nephews/great-nieces, father-in-law, mother-in-law, brothers-in-law and sisters-in-law of the above physical persons can not be appointed as administrators due to conflict of interest. In the case of consumer insolvency, the above relatives are excluded.

- registration of creditors' claims[576] (Art. 24 para. 4 no. 5, 16 para. 1, 6-8; 67 para. 1 (observation), 83 para. 3 (financial rehabilitation), 99 para. 2 (external administration), 129 para. 2 (liquidation))
- identification of criteria of deliberate and fictive bankruptcy as well as of offences under Art. 10 para. 3, 4 (Art. 24 para. 4 no. 7)
- calling and conducting the creditors' meeting (Art. 24 para. 3, 14; 67 para. 1 (observation), 83 para. 3 (financial rehabilitation))
- declaring transactions of the debtor null and void (Art. 66 para. 1 (observation), 83 para. 4 (financial rehabilitation), 99 para. 1 (external administration), 129 para. 3 (liquidation))
- applications to the commercial court to prevent the debtor entering into new contracts (Art. 66 para. 1 (observation)) or to rescind the existing contracts (Art. 99 para. 1 (external administration), 129 para. 3 (liquidation))
- contesting creditors' claims (Art. 66 para. 1 (observation), 99 para. 2 (external administration), 129 para. 2 (liquidation)).

In addition, administrators have the following functions in individual procedures:

- application concerning replacement of the debtor's director (Art. 66 para. 1 (observation), 83 para. 4 (financial rehabilitation)
- control over the satisfaction of creditors' claims (Art. 83 para. 3 (financial rehabilitation))
- making the inventory of the debtor's assets (Art. 99 para. 2 (external administration), 129 para. 2 (liquidation))
- disposing of the debtor's assets (Art. 99 para. 1 (external administration), 129 para. 3 (liquidation))
- preparation of the external administration plan (Art. 99 para. 2 (external administration))
- accounting and book-keeping for the debtor (Art. 99 para. 2 (external administration))
- signing the agreement in the debtor's name (Art. 99 para. 1 (external administration), 154 para. 1 (liquidation))

[576] On the basis of the creditors' meeting decision, a registrator can be appointed in order to register the creditors' claims (Art. 16). In this case, the administrator is not obliged to register the claims and is not liable for the register.

- announcing the opening of the liquidation procedure (Art. 128 (liquidation))
- organising the valuation of the debtor's assets by an independent valuer (Art. 129 para. 2 (liquidation))
- dismissal of the debtor's employees (Art. 129 para. 3 (liquidation))
- formulating the proposal on the conditions of realisation of debtor's assets and conducting the sale (Art. 110 para. 6, 111 para. 1 (external administration); Art. 139 (liquidation)).

If the administrator does not perform his duties or does perform them without due care and violates thereby the FIL or the Government Order on the activities of administrators, he shall be dismissed by the commercial court on the basis of the application of the parties of proceedings (Art. 25 para. 1). If the administrator violates the internal rules of the self-regulating association, he can be excluded from the association and disqualified on the basis of the application of the asso-ciation (Art.25 para.2). In order to be able to compensate the damage to the debtor, the administrator must enter into an additional insurance agreement, the amount of which depends on the value of the debtor's assets, within ten days after the appointment (Art. 20 para.8 no.3).

For his work, the administrator receives monthly remuneration the amount of which is to be proposed by the creditors' meeting and approved by the commercial court, but can not be lower than 10000 Roubles (Art. 26 para. 1). Apart from that, additional fees for the success of his mission can be paid upon proposal of the creditors and approval of the commercial court (Art. 26 para. 2).

In consumer insolvency, an administrator shall be only appointed if administration of real estate or valuable assets is necessary (Art. 209 para. 2). In other cases, the debtor's property is realised by the bailiff (Art. 209 para. 1). This is viewed as problematic since the special provisions are applicable not only to consumers, but also to sole proprietors and farms. While the provisions have not yet come into force in relation to consumers, they are already effective in relation to sole proprietors and farms. Since bailiffs can only realise the assets, but not manage the

property and register claims, the proceedings could be inhibited and the creditors' interests could be damaged.[577]

c) Creditors' Committee, Creditors' Meeting

The first creditors' meeting takes place, at the latest, 10 days preceding the termination of the observation procedure (Art. 72 para. 1 no. 3). The administrator has to inform creditors and other persons entitled to take part in the meeting on the time, venue and agenda by mail 14 days before the meeting or in another way 5 days before the meeting (Art. 13 para. 1). If the debtor has more than 500 creditors, a publication according to Art. 28 is sufficient (Art. 13 para. 2). Private as well as state creditors of claims registered in the stipulated time and form grant voting rights at the meeting to the claimants. The debtor's director, a representative of the shareholders or the owner of the debtor and a representative of the debtor's employees are entitled to participate in the meeting without the voting right (Art. 72 para. 2, 3). The number of votes per creditor corresponds to the percentage of his claims in relation to the total amount of the claims registered preceding the meeting (Art. 12 para. 3). The meeting has a quorum if creditors having at least 50% of the votes participate; if the meeting is called the second time, 30% of the votes are sufficient (Art. 21 para. 4). Generally, the decisions are made by a simple majority of votes of the participating creditors (Art. 15 para. 1). For decisions on the powers, composition, election and dismissal of the creditors' committee, on the application concerning commencement of one of the procedures, on the selection of the self-regulating association, on the application concerning the administrator's dismissal, on conclusion of the composition agreement or on the including additional issues in the agenda, the majority of all votes is required (Art. 15 para. 2). The first meeting decides on the form of procedure to be proposed to the commercial court, on the composition and powers

[577] See V. A. Khimichev, O nekotorykh voprosakh realizacii prav kreditorov pri bankrotstve grazhdan [On certain problems concerning implementation of creditors' rights in the case of insolvency of physical persons], Vestnik Vysshego Arbitrazhnogo suda 2003, vol. 7, p. 113.

of the creditors' committee and on the requirements to the administrator and on the self-regulating association (Art. 73 para. 1).

Further creditors' meetings can be called on the initiative of the administrator, of the creditors' committee, of the creditors who possess at least 10% of the total amount of the claims or of one third of all creditors and have to be conducted by the administrator within three weeks after the submission of the application (Art. 14 para. 1). The creditors' meetings must generally take place at the location of the debtor or of his headquarters, unless the creditors' meeting decides otherwise (Art. 14 para. 4 no. 1). The creditors' meeting determines the powers of the creditors' committee, but can not delegate the powers which are within the exclusive competence of the creditors' meeting under the FIL (Art. 13 para. 2). The issues within the exclusive competence of the meeting generally correspond to the list of important issues the decision on which can only be made by the majority of all votes according to Art. 15 para. 2.

The creditors' committee has to be elected by the creditors' meeting if the number of creditors exceeds 50; otherwise, the election is not required (Art. 17 para. 2). 3 to 11 physical persons can be elected to the creditors' committee whereby state creditors can propose candidates who are public servants (Art. 17 para. 4, 18 para. 1).[578] Each creditor has the number of votes corresponding to the amount of his claim in Roubles multiplied by the total number of creditors; these votes can be distributed among the candidates (the so-called cumulative voting – Art. 18 para. 2). The creditors' committee elects a chairman and formulates the statutes whereby each member should have one vote and decisions should be made by a simple majority (Art. 17 para. 5, 6, Art. 18 para. 3). According to Art. 17 para. 3, the creditors' committee is entitled to demand information on the financial situation of the debtor and the status of proceedings from the administrator or the director of the debtor, to call the creditors' committee, to lodge complaints against the activities of the administrator with the commercial court and to recommend

[578] Members of creditors' committee can be, but must not be employed by one of the creditors. They have to vote in person and are not allowed to be represented (see no. 10, 11 of the Ruling no.29 of the Plenum of the Supreme Commercial Court of 15 December 2004).

the creditors' meeting to dismiss the administrator. Further powers can be delegated to the creditors' committee by the creditors' meeting.[579]

d) Other Participants of Proceedings

In cases determined by law, organs of the executive participate in the insolvency proceedings. The competence has been changing in the last three years in the course of the administrative reform. Currently, the development of legal regulation and state policy in connection with insolvency is within the competence of the Ministry of Economy and Trade, representation of the state as creditor in the insolvency proceedings within the competence of the Federal Tax Service,[580] representation of the state as owner in the insolvency proceedings within the competence of the Federal Property Agency[581] and control over self-regulating associations of insolvency practitioners within the competence of the Federal Registration Service.[582] The Federal Property Agency is subordinated to the Ministry of Economy and Trade,[583] the Federal Tax Service to the Ministry of Finance and the Federal Registration Service to the Ministry of Justice.

[579] As compared to FIL'98, the limitation of the powers of the meeting and the committee is clearer under the effective FIL. A higher status of the meeting in relation to the committee by determining exclusive competence of the meeting, extension of the list of issues which can be decided upon only by the majority of all votes and the rules of voting when electing the committee should serve the protection of the interests of minority creditors.

[580] See Government Order no. 257 of 29 May 2004.

[581] Formerly the Ministry of State Property; for details on powers and functions see N. Spitsa, Privatisierungsinstitutionen in der Russischen Föderation, in: H. Roggemann / J. Lowitzsch, Privatisierungsinstitutionen in Osteuropa, Berlin 2002. Presently it is subordinated to the Ministry of Economy and Trade.

[582] See Government Order no. 52 of 3 February 2005.

[583] Recently, a restructuring of the Ministry of Economy and Trade has been under discussion in the Government. One of the possible consequences of the planned reform would be direct subordination of the Federal Property Agency to the Government.

Municipal executive organs and, in some cases, also the executive of the federation and federal subjects can participate in the insolvency proceedings against town-forming enterprises (Art. 170 para. 1, 2). The competent federal ministries, probably the Ministry of Defence in most cases, shall take part in insolvency proceedings against strategic enterprises[584] (Art. 192). The competent regulating agency shall participate in insolvency proceedings against natural monopolies (Art. 198). The participation of the attorney public is not regulated by the effective FIL; however, it is still possible if public interest has to be protected according to the general provisions of CCP.

4. Insolvency Proceedings

a) Effects of Filing the Insolvency Petition and of Commencing the Proceedings

After the insolvency petition has been filed and before the court hearing where the creditors' claims are to be examined takes place, the competent commercial court can issue an order to protect the debtor's assets on the basis of an application of a participant of the proceedings according to Art. 91 para. 1 CCP; against this order, an appeal can be lodged (Art. 46 para. 1, 3, 4). After the court hearing where the order on the commencent of one of the insolvency procedures is issued protective measures are terminated. All the subsequent insolvency procedures have the following effects in common:

- stay of enforcement, with the exception of claims of physical persons concerning compensation for damage to life or health, claims for payment of wages or professional fees, alimony claims, claims concerning compensation of moral damage as well as claims arising

[584] For definition see Art. 190 para. 1 FIL.

from unlawful enrichment[585] (Art. 63 para. 1 (observation), 82 para. 1 (financial rehabilitation), 95 para. 2 (external administration), 126 para. 1 (liquidation))[586]

- prohibition of withdrawal of shareholders (Art. 63 para. 1 (observation), 82 para. 1 (financial rehabilitation), 103 para. 5 (external administration), 126 para. 1 (liquidation))
- entering into contracts which directly or indirectly lead to acquisition, alienation or the possibility of alienation of assets of certain value only upon approval[587]
- granting and accepting credit, providing sureties and guarantees, cession, assumption of debts, establishing a trust on debtor's assets only upon approval[588].

Since the commencement of different insolvency procedures generally has different effects, the effects will be differentiated below according to the form of procedure. During the observation, change of corporate form, establishing branch offices, forming legal entities and purchasing shares of other legal entities and associations of legal entities, emission of obligations and other securities, with the exception of stock

[585] The fact that the last two kinds of claims are not also listed in Art. 4 para. 2 seems to be a technical mistake.

[586] Claims of state organs which have arisen after a procedure is started are to be satisfied outside the insolvency proceedings (see no. 4 of the Ruling no. 29 of the Plenum of the Supreme Commercial Court of 15 December 2004).

[587] According to Art. 64 para. 2 (observation) – more than 5% of the balance value of the debtor's assets only upon the written approval of the administrator; Art. 82 para. 3 (financial rehabilitation) – more than 5% of the balance value of the debtor's assets only upon approval of the creditors' meeting or the creditors' committee; Art. 82 para. 4 (external administration) – alienation of any of the debtor's assets, with the exception of the products in the usual course of business, only upon approval of the administrator; Art. 101 para. 1, 2 (liquidation) – more than 10% of the balance value of the debtor's assets by the administrator, upon approval of the creditors' meeting or the creditors' committee.

[588] According to Art. 64 para. 2 (observation) – only upon the written approval of the administrator, Art. 84 para. 3 (financial rehabilitation) – only granting credit, sureties, guarantees, establishing trust, only upon approval of the creditors' meeting or creditors' committee, Art. 101 para. 4 (liquidation) – additionally, alienation/acquiring of shares by the administrator, only upon approval of the creditors' meeting or creditors' committee.

(Art. 64 para. 3), payment of dividends, set-off (Art. 63 para. 1) are prohibited. If these decisions are made by the management bodies of the debtor in violation of these provisions, they can be contested by the administrator in his own name in the commercial court (Art. 66 para. 1).

During financial rehabilitation, the payment of dividends and set-off is prohibited (Art. 82 para. 1), contracts with the so-called interested persons according to Art. 19 in relation to the debtor (Art. 82 para. 3) and change of corporate form allowed only upon approval of the creditors' meeting or creditors' committee (Art. 82 para. 3). Contracts the amount of which exceeds the total amount of the registered claims by 5% can be entered into only upon approval of the administrator (Art. 82 para. 4). If the total amount of claims arisen after the procedure has been commenced constitutes more than 20% of the registered claims any new contracts can be entered into only upon approval of the creditors' meeting or creditors' committee (Art. 82 para. 3). If these contracts were entered into in violation of these provisions they can be contested by any participants of the proceedings (Art. 82 para. 5).

During external administration, contracts with the so-called interested persons according to Art. 19 in relation to the administrator or one of the creditors can be entered into only upon approval of the creditors' meeting or creditors' committee (Art. 101 para. 1, 3). Further, the administrator is entitled to terminate („refuse to perform") all contracts of the debtor which have been entered into before the commencement of the observation if the contracts were not performed, even partly, by any contract party and if the performance would prevent that the debtor recovers solvency or if the performance would cause higher costs than the performance of similar contracts; however, the other party to the contract is entitled to compensation of damage (Art. 102). This provision is applicable to contracts which are entered into during observation and financial rehabilitation if they were made in violation of the FIL.

The administrator is entitled to terminate contracts also during liquidation under Art. 102 (Art. 129 para. 2). However, these provisions are not applicable to contracts between the state and strategic enterprises connected to defence and security (Art. 195 para. 5) and between natural monopolies and consumers if the supply is prescribed by law (Art. 200 para. 1). Whereas a legal entity is deleted from the state company register after the liquidation is completed (Art. 149 para. 3), a sole proprietor is deleted from the register and loses all licences already with

the commencement of liquidation proceedings (Art. 216 para. 1). By this provision, the sole proprietor is unduly discriminated.

b) Void and Voidable Antecedent Transactions

The FIL differentiates between void and voidable transactions, whereby also in the case of void contracts the administrator has to submit an application to the competent commercial court "to order the legal consequences of invalidity of a void contract". Under the FIL, transactions concerning transfer of shares to shareholders after the insolvency petition is accepted (Art. 103 para. 5) and transactions concerning alienation of assets of a physical person against whom insolvency proceedings have been commenced to the so-called interested persons according to Art. 19 carried out within one year before the commencement (Art. 206 para. 1) are void.
Transactions with creditors or third parties resulting in preferential satisfaction of claims of particular creditors and buy-out of shares from shareholders resulting in violation of creditors' interests if they are carried out within six months prior to the filing (Art. 103 para. 3, 4) as well as transactions with the so-called interested persons if they were or could be detrimental to the debtor or the creditors (Art. 103 para. 2) are voidable. These transactions can be contested by the administrator, buy-out of shares from shareholders also by creditors in the commercial court.

The regulation of contesting voidable transactions is not detailed. Avoidance of inequivalent transactions carried out before the commencement is expressly regulated only in Art. 102 according to which only not performed contracts can be contested. The provision on contesting transactions detrimental for creditors is formulated too generally, so that it is not clear whether transactions carried out before the commencement are within the scope of the provision. In addition, detrimental transactions are limited to transactions with interested persons, whereas also transactions with third parties are often used for asset-stripping.

The Ministry of Economy and Trade has prepared a draft including a new chapter on avoidance of antecedent transactions with detailed provisions partly based on an expert's report from the EU Project "Effi-

ciency of insolvency proceedings II" on avoidance actions in France, the UK, Germany and the Netherlands, but this draft law has not been enacted.

c) Reorganisation

In the effective FIL, two reorganisation proceedings – the new procedure of financial rehabilitation and external administration –are regulated. Both procedures are aimed at recovering the debtor's solvency; however, it should be achieved by different means. Like the composition agreement, the financial rehabilitation is focused on satisfaction of creditors' claims on instalment according to the time schedule approved by the creditors, whereby the debtor or third parties must generally provide securities to ensure creditors' claims, and certain transactions can only be carried out upon approval of the creditors' meeting (Art. 82 para. 3) and of the administrator (Art. 82 para. 4). The debtor's management remains in office. The external administration is focused on restructuring by special means, whereby funds sufficient for satisfaction of creditors' claims should be accumulated as a result of restructuring. The debtor's enterprise is managed by the administrator appointed by the court.

aa) Financial rehabilitation[589]

The order to commence the financial rehabilitation can be issued by the commercial court on the application of the creditors' meeting (Art. 75 para. 1). An application can also be submitted by shareholders / the owner of the debtor or by third parties if they provide securities which amount to the total amount of the registered creditors' claims plus

[589] The requirements for commencement of financial rehabilitation seem to be too high: in 2005, financial rehabilitation proceedings were opened only in 32 cases as compared to 1013 external administration proceedings, in 2006, there were only 39 financial rehabilitation proceedings, whereby the debt could be settled in 8 cases (see statistics of the Supreme Commercial Court under www.arbitr.ru, Log-in: 5.09.2006).

20%.[590] A time schedule dividing the amount of debt to be settled in monthly payments within one year is to be submitted within one month after the order of the commercial court has been issued (Art. 75 para. 3). The duration of the financial rehabilitation can not exceed two years (Art. 80 para. 6). If the time schedule is violated several times or for more than 15 days the financial rehabilitation can be terminated by the creditors' meeting (Art. 87 para. 5). In this case, the external administration or liquidation can be commenced.

The plan of financial rehabilitation, time schedule for debt settlement, decision of the creditors' meeting or another authorised body and, if necessary, also the documentary evidence of provided securities have to be attached to the application of the debtor (Art. 77 para. 5); the time schedule, the documental evidence of provided securities and the respective agreement is to be attached to the application of the third party providing securities (Art. 78 para. 2).[591] Earnest money, retained property and conventional penalty can not be used as security; the debtor's property can not be encumbered (Art. 79 para. 1). The creditors' meeting decides on the commencement of financial rehabilitation and on the time schedule by the majority of all creditors' votes on the basis of the proposal of the debtor or the third party (Art. 15 para. 2) and on the plan of financial rehabilitation by the majority of votes of participating creditors and submits the application to the commercial court.

The commercial court can commence financial rehabilitation on the basis of the application of the creditors' meeting or can overrule the creditors' meeting if the debtor fulfils the criteria and has submitted the application; in this case, the court also approves the time schedule, appoints an administrator and determines the duration of financial rehabilitation not exceeding the period of two years stipulated by law (Art. 75 para. 1-3, 80). If security has to be provided, an agreement

[590] Generally, the financial rehabilitation is also possible without providing securities, but it is doubtful if the creditors would accept the procedure in this case.

[591] The time schedule should enable the satisfaction of all registered claims at least one month before the termination of financial rehabilitation, that of creditors' claims of the first and second priority at least 6 months before and the satisfaction of tax claims according to the respective federal laws, whereby all claims are to be satisfied according to the ranking in Art. 134 (Art. 84 para. 3, 4).

between the administrator and the person providing security is to be signed within 15 days after the commencement in the interest of creditors; according to this agreement, the person providing security is liable for the obligations of the debtor within the value of the security (Art. 79 para. 3). If the debtor is not able to make payments to the creditors according to the financial rehabilitation time schedule, he has to submit an application for amendment of the time schedule to the creditors' meeting and to the administrator within 14 days, and the administrator has to call the meeting within 14 days after the submission of application (Art. 85 para. 1). If the creditors' meeting approves the application, it has to submit an application to the commercial court for approval of the time schedule amendment; if the creditors' meeting does not approve, it has to apply for termination of financial rehabilitation and, considering the debtor's report, for commencement of external administration or liquidation.

The time schedule has to be amended if claims arisen after the commencement of financial rehabilitation amount to 20% of the total amount of the claims included in the time schedule. The administrator has to call the creditors' meeting within 14 days after the claims have been registered; the meeting has to apply either for the amendment of the time schedule or for the termination of financial rehabilitation to the commercial court. If the debtor violates the time schedule several times or for more thant 15 days or if the agreement with the person granting security is not signed, the creditors' meeting called by the administrator within 15 days is entitled to apply for termination of financial rehabilitation to the commercial court (Art. 87 para. 1-4). If the debtor violates the time schedule for more than 5 days and an agreement with the person providing security has been signed, the administrator is entitled to demand the payment from the person providing security (Art. 89). If the financial rehabilitation was commenced by the commercial court in spite of the decision of the creditors' meeting, the commercial court can terminate the procedure on application of one of the proceeding participants and commence the procedure which has been originally applied for by the creditors (Art. 87 para. 6).

If the debtor satisfied claims within the time schedule, he must submit the final report to the administrator within one month before the end of the period of financial rehabilitation stipulated by the court; the administrator has to prepare his evaluation report and submit the

debtor's report and evaluation report to creditors and to the commercial court which issues an order on termination of financial rehabilitation and commencement of external administration or liquidation (Art. 88 para. 1-3). If not all claims are satisfied or if the debtor does not submit his final report to the administrator within the stipulated period, the administrator has to call the creditors' meeting which decides on the commencement of external administration or liquidation and submits the respective application to the commercial court (Art. 88 para. 4).

bb) External Administration

The external administration is to be commenced if the creditors' meeting has submitted the application or if the court considers that the recovery of solvency is possible, although the criteria of financial rehabilitation are not fulfilled (Art. 75 para. 1, 2). However, it is not possible to commence external administration if more than 18 months have passed between the commencement of financial rehabilitation and the court hearing where the order on commencement of the next procedure should be issued (Art. 92 para. 2 no. 2). The duration of external administration is limited to 18 months with a possible prolongation by further 6 months (Art. 93 para. 2). Generally, the administrator replaces the management; however, the management bodies of the debtor are empowered to make certain decisions (Art. 94 para. 1, 2). The administrator has to have the approval of the creditors' meeting for transactions concerning purchase or alienation of more than 10% of the balance value of the debtor's assets or for transactions with the so-called interested persons in relation to the administrator (Art. 101 para. 1-3). A moratorium on all creditors' claims which have become due before external administration was commenced is imposed until the termination of the procedure (Art. 95). The administrator analyses the financial situation of the debtor, works out a plan of external administration within one month after his appointment and submits it to the creditors' meeting. The plan must contain the proposed duration, arguments for the possibility of recovery of solvency by the debtor within this period, measures aimed at recovering solvency and, if the creditors' meeting has made no decision on this issue or if it is necessary due to circumstances, the limitation of powers between the creditors' meeting and creditors'

committee in respect of approval of the debtor's transactions (Art. 106 para. 2, 3).

The administrator has to call the creditors' meeting generally within two months after appointment in order to approve the plan, whereby the creditors must be informed about the content of the plan within 14 days before the meeting (Art. 107 para. 2). The creditors' meeting decides on this issue by the majority of votes of all creditors. It can approve the plan and apply for approval to the commercial court, require from the administrator to amend the plan within 2 months, reject the plan and apply for liquidation or reject both the plan and the administrator and apply for replacement of the administrator (Art. 107 para. 3). If the creditors do not submit the application for approval of the plan or other application within 4 months after commencement of external administration or, if external administration has been commenced according to Art. 87 para. 6, within 2 months after commencement, the commercial court can issue an order on commencement of liquidation (Art. 107 para. 5). The amendment of the plan, i.a. in connection with prolongation of external administration within the period stipulated by law is to be carried out in the same way.

The measures aimed at restoring the debtor's solvency are the change of enterprise profile, closure of non-viable enterprises, collection of debts, sale of a part of debtor's assets, cession of debtor's claims, settlement of the debtor's debts by third parties, capital increase by additional contributions of the shareholders and third parties, issuance and sale of new shares, sale as a going concern, forming a rescue company with debtor's assets and others (Art. 109). Set-off of debtor's claims (Art. 112 para. 1) and an increase of debtor's expenses not addressed in the plan (Art. 105) are allowed only upon approval of the creditors' meeting or creditors' committee. The sale of debtor's assets is only allowed as far as it does not make impossible the continuation of the business of the debtor (Art. 111 para. 1 no. 2).

If the administrator's report is not approved by the commercial court or is not submitted within one month after the end of external administration, the commercial court issues an order on commencement of liquidation (Art. 119 para. 7). If the commercial court considers that the solvency is restored and orders to make payments to creditors, all creditors' claims should be satisfied by the administrator according to Art. 134-138 within six months after the order has been issued; otherwise,

the commercial court orders commencement of liquidation (Art. 120 para. 3).

d) Composition Agreement

The composition agreement which leads to termination of insolvency proceedings can be entered into during every procedure. The creditors' meeting has to decide on the agreement by the majority of all votes, including the votes of all secured creditors (Art. 150 para. 2). The agreement is to be signed by the debtor's director (observation, financial rehabilitation) or by the administrator (external administration, liquidation) for the debtor. The agreement should include terms and periods for debt settlement, whereby, if individual creditors consent, claims can be satisfied not only in money, but also in other forms as accord and satisfaction, exchange of claims against debtor's shares, debt forgiveness (Art. 156 para. 1). In contrast to liquidation, novation is also allowed (Art. 142 para. 8 no. 1). The agreement becomes effective upon approval of the commercial court which can be granted only if all claims of first and second priority have been satisfied.

An appeal against the agreement can be lodged under the CCP if rights and lawful interests of participants of the proceedings have been or could be violated by it (Art. 162 para. 1). The agreement can not be cancelled by the parties, but only by the commercial court. Only creditors who possessed at least ¼ of all claims at the time the agreement was signed are entitled to apply for cancelling the contract if their claims were not or not appropriately satisfied in violation of the agreement (Art. 164 para. 2). If the claims were not appropriately satisfied the creditors are entitled to apply to the commercial court to allow them to enforce claims included in the agreement individually under the CCP (Art. 167 para. 1).

e) Status of Secured Creditors

In contrast to previous insolvency laws, the effective FIL contains provisions protecting secured creditors. Under FIL'98, claims of secured creditors were satisfied in the third of five priority ranks. Under the

effective FIL, secured creditors enjoy preferential treatment: they are satisfied from the proceeds of the sale of the collateral, whereby only claims of the first and second priority arisen before the security was established are granted a higher priority (Art. 82 para. 6, 134 para. 4 no. 5);[592] if the claims of secured creditors could not be satisfied in full from the proceeds, the remaining amount is to be satisfied in the third priority (Art. 138 para. 2 no. 2).[593] On the one hand, the collateral is protected during different insolvency procedures: its alienation, other forms of disposal, encumbrance is allowed only upon approval of the secured creditor (Art. 82 para. 6); transfer of the collateral as a form of performance is prohibited (Art. 142 para. 8 no. 2); the collaterals are separately listed and valued in liquidation (Art. 131 para. 2 no. 2); realisation can be carried out only at an open auction on approval of the secured creditor (Art. 138 para. 3); also if an agreement is signed, the securities are generally retained (Art. 156 para. 3 no. 2). On the other hand, the secured creditor can not enforce the security during the insolvency proceedings.

Additionally, the status of secured creditors is improved by granting special voting rights in the creditors' meeting: for a decision on formation of a rescue company with debtor's assets (Art. 115 para. 1, 141 para. 1) and on signing the composition agreement (Art. 150 para. 2), the approval of all secured creditors is required.

[592] It is criticized that tort claims and claims of employees which have arisen after the security has been granted do not have priority in relation to secured claims, since tort claimants and employees are supposed to be in existential need rather than secured creditors. In this connection, it is proposed to establish reserve funds for payments to employees and tort claimants in the case of insolvency (see V. V. Vitryanskiy (ed.), Nauchno-prakticheskiy postateynyy kommentariy k Federal'nomu zakonu "O nesostoyatel'nosti (bankrotstve)" [Scientific-practical commentary on the Federal Law "On insolvency (bankruptcy)" by articles], Moscow 2003, p. 38, 39).

[593] If the assets are sufficient for satisfaction of all creditors' claims and the secured assets have not been sold, secured creditors are to be satisfied in the third priority (see no. 16 of the the Ruling no.29 of the Plenum of the Supreme Commercial Court of 15 December 2004).

f) Liquidation and Realisation of Debtor's Property

The liquidation procedure is aimed at realising the debtor's property and distributing it pro rata among the creditors. The procedure is conducted by the administrator; the debtor's management is dismissed. If the result of the administrator's analysis of the debtor's financial situation is that solvency can be restored and no reorganisation procedure has been carried out previously, the administrator is obliged to call the creditors' meeting within one month to decide on the application to the commercial court about the commencement of external administration (Art. 146 para. 1). If the creditors' meeting decides to submit such application, the commercial court decides in favour of external administration if the debtor's assets are sufficient for continuation of his business (Art. 146 para. 2 no. 4).

The commencement of liquidation should be announced by the administrator (Art. 128), so that the creditors can register their claims within the following two months (Art. 142 para. 1 no. 3). The debtor's assets are to be valued by independent licensed valuers (Art. 130 para. 1); if more than 25% of voting shares are owned by the state, the state organ for financial control must also participate in the valuation (Art. 130 para. 2). Upon application of the creditors' meeting or creditors' committee, the valuation of the debtor's movable property with the balance value not exceeding 100,000 Roubles can be carried out without an independent valuer (Art. 130 para. 3). All debtor's accounts, with the exception of the main account, are to be closed by the administrator (Art. 133 para. 1).

Property the transfer of which is prohibited or limited by law and which have to be transferred to the owner within 6 months and intangible property closely connected with the person of the debtor, e.g. licences, do not constitute a part of the insolvency estate (Art. 131). Special rules are to be applied to the sale of the so-called units of special social importance (educational, healthcare, sports institutions, parts of the municipal water, gas etc supply system) which are often part of the debtor's enterprise, especially of state-owned enterprises, although there is no direct connection between the business and the institution. The sale of such units was one of the major privatisation problems. According to Art. 132 para. 4, 5, these units are to be separated from the enterprise and to be sold at an open auction under the condition of maintain-

ing the institutions. If no purchasers are found or if the purchaser violates the condition of sale, the institutions are to be transferred to the municipality at a low price or free of charge if they can be only operated at a loss for the owner.

Within one month after the inventory and valuation, the administrator has to present proposals concerning the terms and the time of sale to the creditors' meeting. The debtor's assets are generally to be sold at an open auction according to Art. 110, 111. Other forms of realisation are cession (Art. 140) and formation of a rescue company with debtor's assets and, subsequently, sale of its shares (Art. 141, 115 para. 2-6); thereby, the approval of the majority of all creditors, including the approval of all secured creditors. If the debtor is a physical person, his property is to be sold by the bailiff (Art. 209 para. 1), unless real property and valuables are part of the property for the valuation and sale of which an administrator should be appointed (Art. 209 para. 2).
Since the rankings of creditors are different in the Civil Code Part I and in the FIL, it should be determined which ranking has priority. According to the ruling of the Plenum of the Supreme Commercial Court of 8 April 2003, Art. 64 para. 1 of the Civil Code Part I is only to be applied in the case of solvent liquidation. Therefore, Art. 134-138 FIL are to be applied in the case of insolvency. The creditors' claims are satisfied according to the following ranking:

- Outside the general ranking, asset costs[594] have to be satisfied, whereby the ranking within this category is regulated by Art. 855 of the Civil Code Part II (Art. 134 para. 1) as well as costs incurred to prevent technical and ecological catastrophies which can occur as a result of closure of the debtor's enterprise (Art. 134 para. 1 no. 9).[595]

[594] These are: court costs, including the costs of publication according to Art. 28, 54; remuneration of the administrator and, if necessary, of the registrator; costs of electricity, water and gas supply and exploitation costs of the debtor's enterprise incurred after the commencement; creditors' claims and claims of employees for wages arisen after the acceptance of the petition and before the adjudication and during the liquidation procedure; other costs of proceedings.

[595] In the literature, it was presumed that this provision will act as a deterrent in relation to the investors, since high costs would have to be covered if the interpretation of this provision is extensive (see R. Wedde, Neues im russischen Insolvenzrecht, WiRO 2003, vol. 7, p. 199). Although no court judgments on this

- In the first priority, claims of physcial persons for damage to life and health as a cumulative pension for the period until the tort claimant becomes 70 years old, but at least for 10 years (Art. 135 para. 1) and for moral damage are to be satisfied. If the debtor is a physical person, also alimony claims are of the first priority (Art. 209 para. 3).
- In the second priority, employees' claims for compensations, wages and professional fees are to be satisfied (Art. 136).
- In the third priority, all remaining claims are to be satisfied.

After the creditors are paid, the administrator is obliged to submit his final report to the commercial court which should issue an order on termination of liquidation (Art. 147, 149 para. 1).

g) International Insolvency Law

The FIL contains only rudimentary provisions on international aspects of insolvency law. If foreign creditors participate in the insolvency proceedings in the Russian Federation the FIL is to be applied, unless an international treaty contains deviating provisions (Art. 1 para. 5). The recognition of judgments and orders of foreign courts concerning insolvency is regulated by international treaties; if no international treaties have been signed, the recognition is based on the principle of reciprocity, unless a federal law contains deviating provisions (Art. 1 para. 6). Until now, the Russian Federation has not ratified any international treaties concerning insolvency.

issue have been made yet, it can be anticipated that, since the Russian courts tend to the narrow, literal interpretation of legal provisions, this provision will be applied only in the case of termination and not in the case of continuation of production and only in a very small number of cases where there is a real danger of extreme consequences laid down in the FIL. Therefore, it is to be expected that this provision will be applied very rarely.

h) Criminal Offences in Connection with Bankruptcy

The Russian Criminal Code[596] contains the following offences in connection with bankruptcy:

- *Unlawful acts in connection with bankruptcy* (Art. 195 para. 1 and 2 CC). The director or owner of the debtor or the sole proprietor are deemed to have committed the offence under para. 1 if they conceal property or claims, information on the property, its value, and its location, transfer the property to third parties, alienate or destroy property, conceal, destroy or falsify financial documentation, during the insolvency proceedings or expecting insolvency, and cause a substantial damage by these acts. These offences are punished with limitation of freedom up to three years, or with detention four to six months, or with imprisonment up to two years and with a fine amounting to 200 to 500 minimal wages. The director or owner of the debtor or the sole proprietor are deemed to have committed the offence under para. 2 in the case of preferential satisfaction of claims of individual creditors in order to damage other creditors if the offenders know about their factual insolvency and cause a substantial damage by this act; creditors can be punished under para. 2 if they know about preferential satisfaction, accept the settlement and cause substantial damage by this act. These offences are punished with limitation of freedom up to 2 years, or with detention two to four months, or with imprisonment up to one year and with a fine amounting to 100 to 200 minimal wages.
- *Deliberate bankruptcy* (196 CC). The director or the owner of the debtor or the sole proprietor are deemed to have commited the offence under Art. 196 CC if they deliberately cause or increase insolvency in their own interests or in the interests of third parties and, thereby, cause substantial damage or other serious consequences. It is punished by a fine of 500 to 800 minimal wages or by imprisonment up to six years and by a fine amounting to 100 minimal wages.

[596] Criminal Code of 13 June 1996 (SZ RF 1996, no. 3, pos. 140) as amended (hereinafter referred to as CC).

- *Fictive bankruptcy* (Art. 197 CC). The director or the owner of the debtor are deemed to have committed the offence under Art. 197 CC if they deliberately file a false insolvency petition in order to deceive the creditors and to postpone the debt settlement or to settle debts on instalment or to reach debt forgiveness or not to pay the debts and to cause substantial damage thereby. It is punishable by fines amounting to 500 to 800 minimal wages or by imprisonment up to 6 years and a fine amounting to 100 minimal wages.

The number of registered crimes in connection with bankruptcies (462 between January and May 2006) and the number of convictions (52 between January and May 2006) is low.

Apart from relatively serious punishments which are characteristic of the Russian criminal law in general, the term "substantial damage" is problematic. Under the Federal Law "On administrative offences" of 30 December 2001, administrative liability for deliberate (Art. 14.12 para. 1) and fictive (Art. 14.12 para. 2) bankruptcy is also stipulated, whereby the punishment (no imprisonment, fines amounting to 40 to 50 minimal wages) is much less serious.[597] The only difference in the elements of criminal and administrative offences is the element "substantial damage". According to the doctrine of the Russian criminal law, this term is to be defined by the court in each individual case.[598]

The administrators can be subject to administrative liability in the cases of unlawful acts in connection with bankruptcy (Art. 14.13), acts violating the lawful order of an official exercising state control (Art. 19.5) and concealing information (Art. 19.7).

[597] The number of opened administrative offence proceedings in insolvency cases is steadily increasing (2004 – 381 cases, 2005 – 648 cases).

[598] Vgl. A. Lopashenko, Prestupleniya v sfere ekonomicheskoy deyatel'nosti [Economic crimes], Rostov 1999, p. 41.

5. Summary and Perspectives

The Russian Insolvency Law of 2002 follows a positivist concept. It specifies the provisions of the previous law, but also contains new regulations which should solve the problems arisen in the course of application of FIL'98. It is aimed at reaching balance between pro-debtor and pro-creditor regulations.

The protection of the debtor against the abuse of insolvency proceedings by the creditors should be achieved by the provisions on examination of creditors' claims by the court before the commencement (Art. 4 para. 4, 16 para. 6 no. 1), on the obligation of the creditor to cover the costs of proceedings if the petition is rejected by the court (Art. 59 para. 2), on the prevention of commencement by the debtor if he satisfies the claims within 30 days after the delivery of the writ of execution or after the issuance of the administrative act through the competent state organ (Art. 7 para. 2) or if he takes preventive measures (Art. 30 para. 3, 31), on the possibility of satisfaction of creditors' claims by shareholders / the owner or third parties (Art. 89, 113, 125), on financial rehabilitation (debtor-in-possession reorganisation procedure) (Art. 76 et seq.), on capital increase by issuance of new shares by the debtor as a measure for restoration of solvency (Art. 64 para. 5, 114), on legal remedies against the court order on protective measures (Art. 42 para. 7 no. 5, 46 para. 5), against the court order on commencement of observation (Art. 49 para. 4) and against the court order on commencement of liquidation (Art. 53 para. 4) and against the court order on commencement of external administration (Art. 146).

The provisions on protection of the debtor have been effective in so far as the number of petitions has rapidly fallen and the percentage of petitions rejected by the court has considerably increased. The increase of the number of petitions in 2005-2006 as compared to 2004 is due to introduction of regulations on funding of the proceedings against debtors-in-absentia. However, the reorganisation proceedings as well as composition agreements are still quite inefficient. Especially the newly introduced financial rehabilitation is used extremely rarely. On the one hand, it might be due to the high requirements stipulated by law which

can seldom be fulfilled. On the other hand, it might be attributable to the fact that, in many cases, the state represented by tax authorities is the main creditor, but the tax authorities are not entitled to forgive tax debts under tax law. Additionally, the priority of new money was introduced, but the contributions of investors after the commencement are still subordinated to claims for wages, social contributions and taxes arising after the commencement. No system of debtor-in-possession funding exists. Since efficient reorganisation is the best way of solving problems connected with insolvency, including social problems, the current reorganisation proceedings should be analysed and a concept to improve their efficiency should be worked out. However, no legal drafts concerning reorganisation have been prepared recently.

The protection of creditors' rights is facilitated by the obligation of publishing information according to Art. 28 and 54 and the right to demand information according to Art. 12 para. 2, 76 para. 2, 107 para. 2 and 118 para. 2. The status of minority creditors is improved by the extension of the exclusive competence of the creditors' meeting in relation to the creditors' (Art. 12 para. 2) and by cumulative voting in the election of the creditors' committee (Art. 18 para. 2), the status of secured creditors by preferential treatment (Art. 134 para. 4 no. 5, 82 para. 6) and by the veto right in the voting on forming a rescue company with the debtor's assets (Art. 115 para. 1, 141 para. 1) and on the composition agreement (Art. 150 para. 2).

The economic and sociopolitical interests of the state are protected e.g. by the equal status of the state as creditor and of private creditors (Art. 12 para. 1), by special provisions on town-forming enterprises (Art. 169 et seq.), on strategic enterprises (Art. 190 et seq.) and natural monopolies (Art. 197 et seq.) and by the obligation to prevent technical and ecological catastrophies which can occur as a result of closure of the debtor's enterprise (Art. 134 para. 1 no. 8).

Since the state is the main creditor in many cases, it would be reasonable not to conduct formal insolvency proceedings in the cases where the creditor as well as the debtor is the state, but to introduce a special administrative restructuring procedure instead.

By the new provisions on professional associations of administrators (Art. 20-22, 24), the new administrator appointment procedure (Art. 45) and by the extension of the administrator's liability (Art. 25) and intro-

duction of compulsory liability insurance (Art. 20 para. 8), abuse of his office by the administrator should be prevented.

However, it is doubtful if the new regulation has improved the control over administrators. Actually, many self-regulated associations are controlled by financially strong creditors, so that administrators seem still to protect primarily the interests of creditors. Although there are many complaints about the work of administrators, very few administrators were excluded by the self-regulated associations. On the one hand, the relation between the state control institutions and administrators is determined by deep distrust, so that control raids are regularly conducted by the state control institutions which, however, have no power to exclude an administrator. On the other hand, administrators complain that the remuneration is not sufficient, since, in most cases, only the monthly minimum remuneration and no additional remuneration is paid, and consider this problem as the main cause of corruption. It seems that both the control issue and issue of remuneration should be addressed. At least, a draft on the civil liability of the administrator is prepared by the Ministry of Economy and Trade, but has not been adopted.

The new FIL has achieved its primary goal – to prevent abuse by creditors, but still has certain gaps which have to be addressed. Currently, three drafts of amendments to the FIL, on consumers' insolvency, avoidance of antecedent transactions and liability of the debtor's management and the administrator, have been prepared at the Ministry of Economy and Trade. It would be advantageous if other issues, especially reorganisation and control and remuneration of administrators, could also be addressed in the future.