

# The RUSSIAN approach to Modern Insolvency Management

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**Insolvency procedures in the Russian Federation are now governed by the new Russian Federal Law on Insolvency (Bankruptcy). Like other countries with a history of communism, insolvency law in Russia has**

**a long tradition, but its development was interrupted by the socialist regime. The first Russian insolvency laws were the Code on Bankrupts of 1830, followed by the Code on Bankruptcy of 1832.**

### Recent reforms in the era of transition

A completely new approach to a modern insolvency law only started during the era of transition in the 1990s. The starting point was the Federal Law on Insolvency (Bankruptcy) of Enterprises (FIL), enacted in November 1992 and reformed in 1998. The former insolvency regime paid special attention to the protection of the debtor. As a consequence the only insolvency trigger was over-indebtedness. Both creditor and debtor were able to file a petition. The competent court, hereinafter called Arbitration Court (AC), issued an order with the declaration of the debtor's bankruptcy. The AC then appointed an insolvency practitioner to conduct all the bankruptcy procedures and to manage the business and affairs of the debtor. The Federal Service on Financial Rehabilitation and Bankruptcy (FSFR) of the Russian Federation acted as a regulatory body exercising a control function. If an enterprise was indebted to the Russian state, including unpaid taxes, the Russian Ministry of Taxation informed the authorised body about the debtor's indebtedness. The authorised body was again the FSFR, which represented the state's interests in insolvency procedures. The FSFR then initiated insolvency proceedings and the AC was responsible for appointing an insolvency practitioner. The FSFR also acted as regulatory body during such proceedings.

In the following year the FIL was again subject to reforms. The latest major reform was in 2002, with most provisions entering into force in December 2002. So the current FIL is the third Law on insolvency enacted during the short history of the new Russian economic system. To prepare and to introduce the new law Russian experts worked together with Western European experts within the framework of the EU Project 'Efficiency of Insolvency Proceedings' led by the German consultant GTZ GmbH (Gesellschaft für technische Zusammenarbeit) which included members of INSOL Europe amongst other insolvency professionals.

### The current system

The new law was the beginning of a new stage in the development of the insolvency market in Russia. The new law deals with most mistakes and shortcomings of the two

preceding pieces of legislation. In accordance with the new law a new type of key organisation appeared within the insolvency infrastructure – the so-called self-regulated organisations of insolvency practitioners (SROs). These SROs are structured similarly to Russian associations of attorneys-at-law. Within the framework of the new law the Russian State delegated to the SRO its function of control over the activities of the individual insolvency practitioners as their members.

In 2003 an administrative reform was carried out in Russia. The reform's major goals were to improve the system of state

practitioners;

- To develop and adopt requirements for those willing to become members of SROs;
- To collect, analyse and store information on activities of its members;
- To organise and carry out internships for assistant insolvency practitioners;
- To keep a register of insolvency practitioners (members of the organisation); and
- To build up compensatory fund for cases of damage.

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management and to reduce the number of bureaucratic hurdles. The reform also had an impact on the system of the anti-crisis management in Russia. As a consequence the various interests of the Russian state in insolvency proceedings are now represented by four governmental bodies:

- **The Ministry of Economic Development and Trade** prescribes rules and deals with the methodology of insolvency;
- **The Federal Agency on Management of Federal Property** represents the State as owner of the property;
- **The Federal Registration Service** exercises control over the activities of the self-regulated organisations of insolvency practitioners; and
- **The Federal Taxation Service**, which is a part of the Ministry of Finance, represents the interests of the State as a creditor.

But an important role amongst the key players in the new Russian insolvency regime is now transferred to the various SROs, having the following powers and responsibilities:

- To develop and adopt rules of professional conduct of the individual insolvency practitioners;
- To control the activities of its members (100 minimum);
- To review complaints against insolvency

### Insolvency practitioners in Russia

In Russia today there are 40 self-regulated organisations of insolvency practitioners. This number is probably disproportionate even for Russia with its extensive territory. In any case, as the national insolvency market develops, the number of SROs will decrease. Some SROs will merge, some will be taken over by larger ones, and some will cease to exist for economic reasons. We have observed such developments in other markets before. However, one of the key problems in the Russian insolvency market is the excessive number of insolvency practitioners, currently totalling at more than 6,500. This is a result of a rather low level of qualification for many insolvency practitioners, especially in the outer regions. Some experts believe that this problem can be resolved by imposing more stringent obligations on both insolvency practitioners and SROs. On one hand the number of insolvency practitioners will decrease and insolvency practitioners will be better qualified. On the other hand, it will lead to a proportionate increase in the number of proceedings per insolvency practitioner and their earnings will grow.

*(Further information on becoming an insolvency practitioner in Russia can be found in our detailed article on page 12 of this edition of eurofenix.)*

## Starting an insolvency procedure and the appointment process

In accordance with the current legislation, a creditor who is owed a sum in excess of 100,000 Roubles (about 3,000 Euro) by a legal entity, a sole proprietor or a family farm can file for the commencement of insolvency proceedings if the debtor is more than three months overdue. Special provisions are applicable in the case of consumer and strategic enterprises. In the latter case the sum overdue needs to exceed 500,000 Roubles (about 15,000 Euro). Additionally, the creditor has the right to choose a special SRO. The AC will then send a request to this SRO asking to present the details of three insolvency practitioners which could be appointed as administrator in the proceedings. Upon receipt of the request from the AC or the creditor, the SRO's Appointment Commission will select insolvency practitioners, receive their consents to act in the proceedings and will recommend them to be appointed. The petitioner and the debtor each have a right to dismiss one insolvency practitioner out of the three recommended by the SRO. After the appointment by the AC, the insolvency practitioner will analyse the financial situation of the debtor and will manage its business and affairs. The SRO exercises control over the ongoing procedure and deals with complaints against the actions of the insolvency practitioner.

Besides this, the control is exercised through regular reviews of the reports, which every insolvency practitioner has to submit to the SRO. Accordingly, if anything goes wrong the organisation can suggest another insolvency practitioner who will have full and adequate knowledge of the debtor's situation and the state of the proceedings. Each party involved in the proceedings has a right to apply to the SRO if the insolvency practitioner prejudices his interests. If the review of the insolvency practitioner's activities reveals any breaches of current legislation, disciplinary sanctions will be imposed.

## Various insolvency procedures

The primary objective in conducting insolvency procedures in Russia is to maximise return to the creditors. As in other countries, the Russian law allows for a range of various proceedings:

- **Supervision** is a preliminary proceeding used to safeguard the assets of the debtor, analyse its financial situation and compile a register of creditors (taking up to six months).
- **Liquidation** is used when the debtor is declared bankrupt. The aim is to satisfy

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the claims of its creditors (taking between 12-18 months).

- **External Management** is used to bring the debtor back to solvency.
- **Financial Rehabilitation** is very rarely used. The aim of the procedure is to bring the debtor back to solvency and to repay the debts in accordance with a timetable.
- **Amicable Agreement.**

Statistical data shows that the procedures most widely used now in Russia are *supervision* and *liquidation*. In the course of the *supervision* procedure the court appoints a temporary administrator. His duties are to identify the creditors and to prepare a report on the financial status of the debtor. At the end of the supervision period (lasting up to seven months), but no later than ten days prior to its end, a creditors meeting has to be held. It is then up to the creditors to establish a creditors committee and to determine whether to request that the court commences *financial rehabilitation*, *external management* or *liquidation* of the debtor's entity. When a court decides that a debtor's solvency cannot be restored it declares the debtor bankrupt and appoints an insolvency administrator, known as the Arbitration Manager. Although at the liquidation stage legal proceedings against the debtor can be continued, enforcement actions are prohibited.

## Creditors rights and ranks

As another consequence, all debts of the debtor become due and can only be repaid subject to their ranks according to the FIL. Priority rank is given to the legal costs, the Arbitration Manager's fees, the cost of operating the assets and other expenses as well as for debts arising throughout the proceeding. The following ranks are reserved for:

1. **Personal injury and related claims;**
2. **Employees and copyright fees claims; and**
3. **All other claims (including claims of secured creditors).**

Within the rank of the 'other claims' the claims of the secured creditors will rank

first. These claims are paid out for pledged and mortgaged assets before the other third ranked claims will be settled. However, in the case that a pledge or mortgage was established before one of the debts in rank one and two became due the claim of the secured creditor will prevail. As a general rule the sale of pledged and mortgaged assets needs the consent of the secured creditor beforehand. In the course of the proceedings the assets can be sold, preferably within a sale of the business as a whole or individually. The assets shall be evaluated and will then be sold through a public auction. Only after three unsuccessful actions the creditors committee decides in which way the assets shall be sold, e.g. as a straightforward sale. Besides this, a creditors meeting can be called on the initiative of the administrator of the members of the creditor's committee, and of the creditors who possess at least 10% of the total amount of claims.



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