

LEGAL NEWSLETTER



Moscow, October 6, 2017

NEW RULES ON CONTROLLING PERSONS' LIABILITY IN BANKRUPTCY CASES

SCOPE FOR DETERMINING CONTROLLING PERSONS

On 29 July, 2017 the President of the Russian Federation signed Federal Law No. 266-FZ "On amendments to the Federal Law "On Insolvency (Bankruptcy)" and Code of Administrative Offences of the Russian Federation" (**hereinafter – the "Law"**). The Law entered into force on **30 July, 2017**. Relevant provisions apply to claims on secondary liability filed after 1 July, 2017.

The Law extends the notion of controlling persons, expanding the scope of the criteria to determine such, and generally grants more discretion to the courts in bankruptcy proceedings. Rules on secondary liability of controlling persons have become significantly stricter, providing potential creditors with more safeguards protecting their financial interests toward a debtor.



A controlling person is defined as an individual or a corporation with the authority to give directions obligatory for the company or to otherwise determine company's actions. Control is now presumed when a controlling person benefits from illegal or mala fide actions of top management of the debtor.

Thus, a person can be held liable due to his or her official capacity in the company or degree of relationship to the company (its management or members of the Board). From now on the company's accountants and financial/commercial directors, etc., are deemed as controlling persons of the debtor.

The Law introduces a number of exemptions from the secondary liability rules. First, minority shareholders owning less than 10 per cent of the company shall be immune from liability. Second, management staff shall be discharged from secondary liability, or their liability can be minimized, granted they simultaneously fulfill the following requirements:

- a) their managing functions have been nominal;
- b) such persons provide data and information, allowing to find real controlling persons and/or discover assets, hidden by them.

Moreover, considering the wording of the newly-introduced amendments, the courts will have more power in applying new secondary liability rules. First, the list of criteria for determining controlling persons has been left open. Second, the court has the discretion to decide on the question of discharging said nominal directors from liability or minimizing it.

PRESUMPTIONS AND THE BURDEN OF PROOF

The Law introduces new rules on secondary liability of the controlling persons, providing for certain conditions when the fault of controlling persons shall be presumed:

- facilitation of the subsequent future weakening of the company's financial standing, despite not being the initial cause of the insolvency;
- non-availability or misrepresentation of documents obligatory for storage according to the legislation on corporations, securities market, investment funds and other;
- misrepresentation or failure to submit legally required data to the Unified State Register of Legal Entities and the Uniform Federal Register of Legally Significant Data about the Facts of the Activities of Legal Entities.

The Law also grants the courts the authority to reapportion the burden of proof in the following cases:

- when a person has failed to file a bankruptcy petition to the arbitration court, the burden of proof of lack of connection between failure to fulfill the obligation and the impossibility to discharge creditors' claims can be reapportioned to such person.
- when a person hasn't assumed necessary measures to contest secondary liability claims, or such measures turned out insufficient, the person can be ordered to prove lack of grounds for holding it secondarily liable.



RULES FOR FILING CERTAIN SECONDARY LIABILITY CLAIMS

Creditors can now claim for secondary liability after the bankruptcy proceedings terminated. The Law, however, establishes a set of rules, provided there are multiple claimants:

- a claim shall contain a scope of persons interested in the secondary liability of the debtor;
- a claim shall be examined according to the rules for class-action suits (lawsuits filed or defended by an individual acting on behalf of a group of people) set forth in Chapter 28.1 of the Arbitration Procedure Code of the Russian Federation;
- an offer to join the Claimant may be issued through the Unified Federal Register of Data on Bankruptcy;
- a court's decision on secondary liability shall establish debt seniority and a sum due for recovery.

SETTLEMENT AGREEMENT

The Law introduces the possibility for the controlling persons and the creditors to enter into a settlement agreement. The agreement is subject to subsequent authorization by the arbitration (commercial) court. The law stipulates the following requirements for such agreement authorization:

- controlling persons are obliged to disclose data on the assets sufficient for settlement of the creditors' demands;
- conditions of the agreement are to be unanimously approved by all the creditors, which have demanded the secondary liability;
- the agreement is legally binding for all persons on the side of the party filing for secondary liability and on the side of the party subject to the liability.

In case controlling persons fail to perform their obligations set out in the agreement, creditors can enforce the agreement by obtaining a court order.

The introduced amendments have significantly changed the status quo both for creditors and the controlling persons. Potential creditors get a substantial range of instruments allowing them to recover debts in bankruptcy cases. Controlling persons will now have to take active participation both in preventing the company's potential financial problems and during the bankruptcy proceedings in order to avoid liability for their actions or omissions.

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