Insolvency and Bankruptcy Law Reform in the Russian Federation

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Russian insolvency and bankruptcy legislation has developed into a sophisticated system of rules that enjoys a unique place in the world of bankruptcy law. By referring to United States and European bankruptcy laws, the author situates the Federal law On Insolvency (Bankruptcy) within the world's various bankruptcy regimes. The author also compares old Russian laws with the new system in order to provide a vivid snapshot of the present state of Russia's bankruptcy laws.

Part I of the article underlines the historical inadequacies of Russian insolvency law and recent attempts to address these deficiencies. In Part II, the author positions Russia as the golden mean on the global spectrum of bankruptcy regimes that range from radical pro-debtor to radical pro-creditor. To emphasize the point, the author compares and contrasts the new Russian law with United States and European insolvency regimes in light of the possibilities offered for rehabilitation of the debtor, satisfaction of creditors' claims, and criteria for determining bankruptcy. Part III focuses on the evolution of bankruptcy procedures from the old system to the new Federal law. This section includes a detailed discussion of various bankruptcy procedures under the new law: observation, external management, amicable agreement, and bankruptcy proceedings. This section also contains an analysis of bankruptcy procedures applicable to specific categories of debtors including town-forming organizations, agricultural organizations, and banking and other credit institutions (with a consideration of the corresponding effects on individual depositors). The author also contemplates the novel concept in Russian law of the bankruptcy of an individual who does not have entrepreneurial status. Part IV evaluates a recently passed government resolution concerning accelerated bankruptcy. The resolution proposes the adoption of three measures: increased coordination between various state agencies, consolidation of government claims against the debtor, and a decision to apply accelerated bankruptcy procedures adopted at the first meeting of the creditors.

La législation russe sur l'insolvabilité et la faillite s'est développée en un système fort élaboré de règles jouissant d'une place unique dans le domaine du droit de la faillite. C'est à la lumière des régimes américain et européen sur la faillite que l'auteur évalue la Loi fédérale sur l'insolvabilité (faillite) de la Russie. Il compare aussi les anciennes lois russes avec le nouveau système, de façon à nous donner un rapide coup d'œil sur le présent état des lois russes sur la faillite.

La première section de l'article souligne les insuffisances de la législation russe sur l'insolvabilité et les récents efforts investis pour parer à ces manquements. Dans la seconde section, l'auteur montre que la Russie constitue un juste milieu parmi le vaste éventail de régimes sur l'insolvabilité, les uns favorisant les débiteurs et les autres les créanciers. Pour illustrer ce point de vue, l'auteur compare la nouvelle loi russe avec les régimes américain et européen sur l'insolvabilité, à la lumière des critères utilisés dans la détermination de la faillite, mais aussi selon les possibilités offertes dans chacun des régimes pour la réadaptation du débiteur et l'acquittement des réclamations des créanciers. La troisième section de l'article étudie l'évolution des procédures sur la faillite, de l'ancien système à la nouvelle loi fédérale. Cette partie définit différentes procédures de la nouvelle loi : observation, administration externe, convention à l'amicable et démarches en cas de faillite. Cette section contient aussi une analyse des procédures de la faillite applicables à certaines catégories spécifiques de débiteurs, telles que les organisations de développement urbain, agricoles, bancaires et autres institutions à crédit (en considérant les effets correspondants sur les individus). L'auteur considère aussi le concept inédit de la faillite d'un individu qui ne détient pas le statut d'entreprise. Enfin, la quatrième section de l'article évalue une résolution gouvernementale récemment adoptée concernant la faillite accélérée. Ladite résolution propose l'adoption de trois mesures précises : la coordination accrue entre les diverses agences de l'État, la consolidation des réclamations du gouvernement contre les débiteurs et l'application des procédures sur la faillite accélérée adoptées lors de la première assemblée des créanciers.

* Deputy Chairman of the Higher Court of Arbitration of the Russian Federation.
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I. The Necessity of Reform

The former law of the Russian Federation On Insolvency (Bankruptcy) of Enterprises' was adopted by the Supreme Soviet of the Russian Federation on November 19, 1992, and became effective as of March 1, 1993. Cases on insolvency of debtors are heard by the courts of arbitration—the incidence of which over the years has been as follows: in 1993, a little more than 100 cases of this category were considered; in 1994, 240 cases; in 1995, 1,108 cases; in 1996, 2,618; and in 1997, there were over 4,600 cases. The number of debtors annually recognized as insolvent increased during this period from 50 in 1993 to 2,600 in 1997.

The growing insolvency jurisprudence and a systematic analysis of court of arbitration practices reveal important drawbacks in the legal regulation of relationships relating to the insolvency of debtors. The first attempts to apply insolvency law reflected its imperfection and lack of depth, but it also brought to light numerous gaps in legal regulation. The search for ways of perfecting insolvency legislation required an appraisal of Russia's historical experience in the area, including the development and application of insolvency law in the pre-revolutionary period, i.e., prior to 1917. In addition, foreign bankruptcy legislation would have to be studied. Before the Russian Revolution, gaps in domestic bankruptcy legislation were filled in by the active work of the Federal Agency on Insolvency and by the adoption of appropriate measures by the Russian Federation's Higher Court of Arbitration, both of whose goals were to provide a uniform approach in the court of arbitration procedure.

In 1995, the first attempt to reform Russian legislation on insolvency was undertaken when the first draft of the Law on Insolvency of Enterprises was prepared. In December 1995, this draft was adopted by the State Duma of the Russian Federation's Federal Assembly on its first reading. In the process of preparing the draft law for its second reading, over 600 amendments were studied and analyzed. At that time, however, the work on the draft law was suspended for two reasons: (i) the appearance of an alternative draft law (with 70% of the text repeating that of the first draft law), and (ii) the adoption by the State Duma on first reading of the draft Federal law On Insolvency (Bankruptcy) of Banks and Other Credit Institutions—an independent draft law unrelated to the comprehensive law on insolvency. It became obvious, however, that in this disparate form, legislation on bankruptcy would not work effectively. It was necessary to return to the conceptual issues of legal regulation related to insolvency and bankruptcy. To this end, discussions in the respective committees of the State Duma, the National Bank Council of the Bank of the Russian Federation, and the Russian Federation's Higher Court of Arbitration produced a compromise solution to provide for the regulation of relations connected with insolvency through laws on insolvency.

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2 The words “insolvency” and “bankruptcy” are used interchangeably throughout this article.
3 Hereinafter Law on Insolvency of Banks.
solvency and bankruptcy of credit organizations. Meanwhile, it was recognized that the draft Law on Insolvency of Banks should establish only the specifics of regulating procedures related to the bankruptcy of banks and other credit organizations, i.e., pre-judicial procedures aimed at preventing the bankruptcy of these organizations. In this sense, it was thought that the law should be comprehensively brought into line with the principles and norms of the draft Federal law On Insolvency (Bankruptcy). These concerns required that both draft laws be returned for a first reading after considerable revision.

The work has now been completed on the Law on Insolvency of Banks. It has been adopted by the State Duma, but not yet approved by the Federation Council. At the time of writing this article, this draft law is in the process of finalization in the reconciliatory commission established by the chambers of Parliament.

Why should Russia develop new legislation on insolvency? One could answer by pointing to a number of deficiencies in the current legislation. For present purposes, however, we shall focus on the most essential ones.

First, the previously effective Law on Insolvency of Enterprises attempted to combine, in an eclectic manner, elements of different insolvency regimes applied in different countries. In France and the United States there is a pro-debtor bankruptcy system which allows the debtor in difficult financial straits to free itself from debts and to attempt a fresh start. In such systems, the interests of creditors are not fully accounted for. Rather, creditors have to adjust themselves to the conditions established by the court to clear the debts of the debtor. Therefore, in the United States most cases on bankruptcy are commenced on the initiative of debtors.

By contrast, in Europe (with the exception of France) a pro-creditor system has long been applied. The priority of this system has been the best possible satisfaction of creditor's claims, while the interests of the debtor are rarely taken into account. The key element in this system is rigid control over the preservation of the the debtor's assets and the debtor's prompt liquidation. Undoubtedly, the existing bankruptcy regimes borrow from and inform each other. The recent amendments to bankruptcy legislation in the United States, Germany, and other countries is evidence of this fact.

The Russian law offered the possibility of applying both the pro-creditor and pro-debtor systems without attempting to regulate in detail the mechanism for its implementation. What this means is that bankruptcy procedures would be identical regardless of whether the debtor or creditor initiated court intervention—and the same would be true with respect to the bankruptcy procedures.

Second, the very concept and characteristic features of bankruptcy used in the previous law did not accord with present-day commercial reality. In fact, application of the previous law meant that the inability of a debtor to satisfy the claims of a creditor due to "the excess of the debtor's liability over its assets, or in connection

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with an unsatisfactory structure of the debtor's balance threatened to bankrupt the creditor as well."³

It is not just that the debtor, for a lengthy period of time (i.e., over three months), would not pay its debts for it to be recognized as bankrupt, the court also had to check the composition and value of its assets, and evaluate the structure of its balance from the perspective of its assets’ degree of liquidity. Only if the indebtedness toward its creditors exceeded the value of all the assets could such a debtor be recognized as bankrupt. Such an approach allowed commercial actors who were unable to pay to continue in operation, thereby dragging their creditors into insolvency with them. The domino principle thereby took effect, stimulating the non-payment crisis affecting the Russian economy.

Such conditions allowed top managers of commercial organizations who had no reason to fear bankruptcy to withhold debt payment and use the available money as their own enterprise funds, ensuring only that the total amount of accounts payable did not exceed the asset value of the organization. From this, it is obvious that the legal concept and characteristics of bankruptcy that used to be applied protected bad-faith debtors and were thus destroying the principles of commerce.

Third, the old legislation could be characterized by its identical approach to all categories of debtors in bankruptcy proceedings. The law did not make any distinction between a legal person and an individual entrepreneur, a major enterprise and an intermediary organization which did not have its own assets, a commercial enterprise and a peasant (i.e., a farm) enterprise, or an industrial enterprise and a credit organization. Bankruptcy thresholds for all such debtors and the procedures that applied to them were the same, although it was quite obvious how different the consequences of the law would be for different classes of debtors.

Fourth, in the regulation of bankruptcy procedures, the old law absolutely neglected the diverse situations in which the debtor and its creditors could find themselves. For instance, courts of arbitration would most frequently face situations where the top manager of a debtor organization was missing and it was impossible to identify his whereabouts, or where the debtor had no assets sufficient to cover court expenses. In all cases, the court of arbitration was directed by law to declare the debtor bankrupt, start bankruptcy proceedings, and appoint a bankruptcy manager. Naturally, no creditor would agree to transfer to the deposit account of the court of arbitration the money necessary to pay the bankruptcy manager (at least as advance payment). The decisions of the court of arbitration on the bankruptcy of such debtors were impossible to implement. As a result, courts would keep the cases on file, while debtors who were recognized as bankrupt would remain in the register of legal persons.

The gaps in the law stemmed largely from the adoption of many incoherent legal acts. By the time the new insolvency law was adopted, over thirty Edicts of the President of the Russian Federation, Resolutions of the Government, and departmental

³ Law on Insolvency of Enterprises, art. 1.
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regulatory acts had been in effect. What matters of course is not so much the number, but the quality of those acts, which were incoherent and at times contradictory. Furthermore, the recent adoption of a number of legal acts treat insolvency either as a remedy for all economic troubles or as a vehicle to resolve current economic problems—i.e., as a means to struggle with tax evaders or as an additional way to carry out privatization—is cause for concern.

II. General Characteristics of the New Russian Law and its Place in the World Insolvency and Bankruptcy Systems

According to some European experts, the insolvency systems in place throughout the world fall into five categories arranged along a continuum from radical “pro-creditor” legislation to radical “pro-debtor” legislation. Between the boundaries of these extreme categories are “moderate pro-creditor”, “neutral”, and “moderate pro-debtor” legislation. The prevailing protection of either the creditor or debtor serves as the general basis for distinguishing between categories. The degree of creditor or debtor protection is, in turn, determined by the content of the legislative regime subject to analysis.

The first variable taken into consideration is the measure of protection given to secured creditors. From this perspective, the new Russian law cannot be classified as “pro-creditor”. Under article 64 of the Civil Code of the Russian Federation, the property that served as the object of a pledge on the liabilities of a debtor is not excluded from the property mass, and a creditor with a secured claim has no possibility to levy execution against the object of a pledge in priority to other creditors. At the same time, a creditor of a claim secured by a pledge is of the third beneficial priority—not only being placed ahead of most other creditors on civil law liabilities, but also coming prior to the State with respect to tax and other mandatory payments. In contrast to all other regimes, under Russian law a secured creditor receives satisfaction of its claims at the expense of all the debtor’s property (not only the property which is the object of a pledge). Creditors of secured liabilities enjoy certain privileges at creditor’s meetings when key decisions are made. Specifically, to conclude an amicable agreement with the debtor, a unanimous decision of all creditors of secured liabilities is necessary (with more than half the votes of all other creditors participating in the bankruptcy procedure). Therefore, with respect to secured creditors, the Russian legislation cannot be characterized as “pro-debtor”.

Another aspect of the legislation to be analysed is the treatment of assets transferred by creditors to a debtor in possession or use on a contractual basis which do not belong to the latter by right of ownership (i.e., title finance). With respect to this vari-

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able, Russian law cannot be firmly categorized as either “pro-creditor” or “pro-debtor”. On the one hand, if a debtor is declared bankrupt and the bankruptcy procedure starts, the assets that do not belong to the debtor but were transferred to it by the creditors under the contract (i.e., sale by instalment, leasing, etc.) are not included in the bankruptcy estate of the debtor. Instead, the assets are to be returned to the creditors. On the other hand, when the external management procedure is introduced, all such assets remain with the debtor and are used for the purpose of recovering its solvency without any special compensation for the respective creditors.

In assessing any insolvency regime, an important factor is the possibility for the rehabilitation of the debtor provided for by the system. In this respect, account must be taken of the degree to which rehabilitation procedures encroach upon the rights of individual creditors, and how easy it is for the debtor to get such rehabilitation. It is also important to determine whether the legislation entrusts the former administration of the debtor (i.e., the general manager of the organization) with the implementation of rehabilitation measures (i.e., debtor in possession), or requires the appointment of an external manager for that purpose.

Russian law does provide real possibilities for the rehabilitation of the debtor so that it can recover its solvency, both within the external management procedure and through the conclusion of an amicable agreement. At the same time, there are a number of provisions indicating that the legislation cannot be categorized as “pro-debtor”.

First, the very procedure for initiating bankruptcy in a court of arbitration is “neutral” for the debtor. The court of arbitration is not forced to consider the case by conducting a rehabilitation procedure, which is the practice in the United States whereby an application may be filed by a debtor under Chapter 11 of the Bankruptcy Code for the reorganization of business. In this sense, Russian law more closely resembles the French insolvency law of 1994 (effective as of 1999), which employs a neutral insolvency procedure and decides whether or not to apply rehabilitation or liquidation measures to the debtor after the case is considered.

Second, those present at the first meeting of creditors—which is held prior to the main session of the court of arbitration—are granted an opportunity to express their opinion with respect to procedures (i.e., external management or bankruptcy proceedings) that should be applied to the debtor.

Third, Russian law prohibits the old administration of the debtor’s organization from exercising rehabilitation procedures itself. To exercise measures for restoring the solvency of the debtor within the external management system, the court of arbitration must appoint an external manager acting under the control of the creditors.

Finally, it is important to distinguish between the rehabilitation of a debtor’s organization and the rehabilitation of its business (i.e., preserving the business ties, work

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8 Bankruptcy Code and Rules (Philadelphia: Clark Boardman Callaghan, 1993) at 107-34.
places, etc.). It is a mistake to believe that "pro-debtor" legislation aimed at the rehabilitation of the debtor contributes to the preservation of its business. On the contrary, statistical court data confirms that in the United States and France—where legislation is primarily aimed at the rehabilitation of the debtor through various compromises—the percentage of businesses rescued due to court-supervised reorganizations is rather low. Meanwhile, the "pro-creditor" English law—which applies procedures such as receivership and administration—yields only a 50% resuscitation rate for previously bankrupt businesses.

A critical factor for associating the national insolvency regime with one or another legal system is whether creditors have an opportunity to satisfy part of their claims at the expense of third parties who manage the debtor's business or determine its decisions. "Pro-debtor" legal systems, as a rule, grant creditors the right to levy execution only against the assets of the debtor—excluding a possibility to file claims against third persons. In this sense, Russian legislation has made a significant step toward "pro-creditor" jurisdictions due in large part to the foundation laid by the C.C.R.F. It includes the subsidiary liability of founders for bringing the debtor to the state of bankruptcy. Founders are those people who have the right to issue mandatory instructions for the given legal person, or who have the ability to determine its actions in some other manner.9

The Law on Insolvency not only developed these provisions, but it also determined the vehicles for their implementation by granting the bankruptcy manager a right to set up respective claims against third parties whose actions caused the insolvency of the debtor. The amount of such claims must be determined on the basis of the difference between the amount of creditor claims and the value of the debtor's bankruptcy estate. The amounts recovered in this way are included in the bankruptcy estate and may be used by the bankruptcy manager only to satisfy the claims of the creditors in the established order of priority. Moreover, the law expands the list of persons to whom such claims can be filed—including the debtor's top manager and the liquidation commission (i.e., the liquidator) who fail to apply to a court of arbitration, with respect to the debtor's bankruptcy, where required by law.10

Comprehensively, it may be concluded that the Law on Insolvency cannot be classified as either "pro-creditor" or "pro-debtor". It is, rather, neutral. This makes the Russian insolvency system flexible, allowing it to fully account for the conditions of the debtor's insolvency in each specific instance. A few more conceptual issues will now be considered, without which the general characteristics of the new Russian insolvency legislation cannot be fully appreciated.

A brief description should be made of the concept of insolvency and its main features. The approaches of different bankruptcy systems with regard to a debtor's insolvency can be reduced to two separate analyses; the basis for recognizing a debtor

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9 Arts. 56, 105 C.C.R.F.
10 Arts. 9, 101 C.C.R.F.
as bankrupt lies either in (i) the principle of its insolvency—proceeding from the analysis of reciprocal cash flows—or (ii) insufficient repayment capacity—proceeding from the ratio of assets to liabilities on the debtor's balance sheet. The old law used the principle of insufficient repayment capacity as a criterion of bankruptcy. This caused a delay of court proceedings to the detriment of the creditor's interests and, most importantly, made it impossible for the courts of arbitration and creditors to recover through bankruptcy procedures from those insolvent debtors whose asset values formally exceeded their total accounts payable.

It should be noted that some legislative regimes use the criterion of insufficient repayment capacity, which requires an analysis of the debtor's balance sheet. For instance, under German legislation the criteria for bankruptcy—apart from insolvency—includes "debt overhang", which means that the debtor's assets are insufficient to cover all of its liabilities. As a rule, however, this criterion is used in addition to the insolvency criterion and mostly serves as a basis for choosing between liquidation and rehabilitation as the appropriate procedure to be applied to the insolvent debtor.

The new Russian law on insolvency follows the same pattern. The debtor—legal entity or individual entrepreneur—can be declared bankrupt when it is insolvent, but the fact that the debtor owns assets in excess of total accounts payable is grounds for the possibility of restoring solvency. As a consequence, it can serve as a basis for the use of an external management procedure with respect to the debtor. In the event of insolvency of physical persons who do not have the status of individual entrepreneurs, the principle of insufficient repayment capacity (i.e., the excess of accounts payable over the asset value) will be applied.

Particular stress should be placed on the order of priority for satisfying the claims of creditors. The new Russian law on insolvency, following the C.C.R.F., gives preference to the claims of the debtor's employees with respect to payment of wages and salaries, thereby subordinating the claims of creditors on liabilities secured by pledge.

The social aspect of this solution to the problem is significant. The fact is that bankruptcy regimes in many countries give priority to secured creditors, and address the problem of protecting the interests of the debtor's employees in other ways. For instance, German law provides compensation for losses to the bankrupt debtor's employees (i.e., wage arrears falling due in the three months prior to the commencement of bankruptcy proceedings) through a special fund that is financed by contributions paid by all employees. American bankruptcy law provides a detailed regulatory scheme relating to payments to employees of bankrupt businesses under collective agreements, and where such agreements do not apply, payments under various insurance schemes are made."

The absence of provisions protecting the rights of the employees of bankrupt businesses and legal entities under liquidation under Russian legislation is an addi-

tional argument in favour of refusing top priority rights to creditors with secured claims.

The Law on Insolvency, in contrast to the old law, contains provisions in Chapter 9 which provide for the bankruptcy of individuals who do not have the status of individual entrepreneurs. These provisions evoked the greatest number of objections in the adoption process. The key argument addressed by opponents of bankruptcy for individuals is based on the presumption that this kind of provision runs contrary to the C.C.R.F. The C.C.R.F. does not contain an article specifically providing for the bankruptcy of individuals. That there are articles regulating the bankruptcy of individual entrepreneurs and legal entities does not necessarily mean that the prohibition should be read into the text of the Law on Insolvency.

Indeed, the implementation of a large number of provisions in the C.C.R.F. is impossible without regulating the procedure for recognizing the bankruptcy of individuals. First and foremost, this relates to laws providing for subsidiary liability of the founders of (or participants in) legal entities for causing the debtor's bankruptcy, as well as the provisions on the liability of persons who—by virtue of law or the constituting documents of a legal entity—act in the entity’s name. In such instances, the degree of liability imposed upon individuals who do not have the status of individual entrepreneurs may exceed the value of their property with extremely negative consequences, both for these individuals and for some of their creditors. The same problems might arise in the implementation of other provisions of the C.C.R.F. that impose subsidiary or joint and several liability on individuals for the debts of legal entities. The only solution to this problem is to introduce the concept of bankruptcy for individuals who do not have the status of entrepreneurs.

As for the protection of the rights and legal interests of creditors, it is difficult to understand why creditors may apply to a court of arbitration in the event of the bankruptcy of an individual entrepreneur who failed to pay for a small shipment of goods. Yet it is impossible for them to initiate bankruptcy proceedings against a former bank manager who defaulted on a multi-million dollar loan.

There is also another side to this problem. The general global practice is based on the assumption that the concept of individual bankruptcy (i.e., consumer bankruptcy) benefits good-faith individuals since it allows them, in the course of bankruptcy proceedings, to free themselves of their debts while giving their property to settle creditor claims. This is the reason why United States bankruptcy courts annually consider 800,000 to 900,000 consumer bankruptcy cases, i.e., 92% of all bankruptcies in the United States.

\[^{12}\text{Art. 25 C.C.R.F.}\]
\[^{13}\text{Art. 65 C.C.R.F.}\]
\[^{14}\text{Arts. 56, 105 C.C.R.F.}\]
\[^{15}\text{Art. 53(3) C.C.R.F.}\]
Under article 185 of the Law on Insolvency, the provisions on individual bankrupts who do not have the status of an individual entrepreneur will come into force only after the rule on individual bankruptcies comes into effect in the C.C.R.F. The court bailiff service—which is to bear the responsibility for the execution of individual bankruptcy decisions—is still in the process of formation. This, however, does not mean that the provisions on the bankruptcy of individuals contained in Chapter 9 of the Law on Insolvency are not to be implemented prior to the incorporation of amendments to the C.C.R.F. Under the rules of Chapter 9, the bankruptcy of individual entrepreneurs and farm enterprises will be executed. This will ultimately test the provisions on the bankruptcy of individuals and develop certain practices for implementing the decisions of the courts of arbitration.

III. Key Provisions of the New Legislation on Insolvency and Bankruptcy

Under the new Federal law, insolvency will be understood as the inability of a debtor to satisfy the claims of creditors on money obligations, and/or to fulfil its obligation to make mandatory debt payments.

If the debtor is a legal entity, it is considered unable to satisfy the money claims of creditors or fulfil its mandatory payment obligations if the outstanding liabilities have not been met within three months of the due date. If the debtor is an individual, it is also necessary that the total amount of his liabilities should exceed the total value of the property owned. Thus, the concept of bankruptcy is based on the notion that the commercial entity fails to either pay for goods, work, or services provided for under a contract, or fails to pay taxes and other mandatory payments for a certain period of time (i.e., three months) and is unable to meet liabilities vis-à-vis the creditors. To avoid bankruptcy, the debtor must either cover its liabilities, or provide the court with proof that the claims of the creditors, taxing authorities, or other authorized public agencies are unjustified.

The amount of a creditor’s money and taxation claims will be proven if confirmed by a court decision, or by documents showing that the amount has been recognized by the debtor. The debtor can contest all other claims. In such cases, the validity of the claim must be verified by the court of arbitration. Claims not contested by the debtor are treated as undisputed. The value of each liability is identified when the bankruptcy suit against the debtor is brought to the court of arbitration.

As under the old system, the new law gives the right to the creditor, prosecutor, as well as the taxation and other authorized government agencies to bring a bankruptcy suit against the debtor. The novelty, however, lies in the provision that specifies instances when the manager of the debtor organization, or an individual entrepreneur, is obligated to bring a bankruptcy suit against itself to the court of arbitration—for example, when satisfaction of the claims of one or several creditors would make it impossible to cover money liabilities vis-à-vis other creditors, and when the management of the debtor or the owner of its property have made the decision to take a suit to the court of arbitration. In failing to fulfil this obligation, the manager of the debtor
enterprise will bear subsidiary liability for the obligations of the debtor to its creditors, and will be taken to court.

Where evidence of bankruptcy is not adduced, the court of arbitration will refuse to proceed with the bankruptcy claim against the debtor. However, if evidence of bankruptcy exists (i.e., the debtor is unable to cover money liabilities and pay taxes to budgetary and extra-budgetary funds), it does not mean that the debtor will have to be liquidated. Aside from the bankruptcy proceedings instituted in the event of the debtor's liquidation, other procedures—such as observation, external management, or amicable agreement—can be applied. Procedures applied to individuals include either bankruptcy proceedings or amicable agreement. The final choice of procedure, however, always rests with the court of arbitration.

The observation procedure is a new concept introduced into Russian legislation which normally will be applied after the court of arbitration has commenced bankruptcy proceedings against the debtor. The main purpose of this procedure is to ensure the safety of the debtor's assets pending the court of arbitration's decision in the case. At the same time, the manager of the debtor enterprise is not removed from his position and continues to perform usual duties. However, a range of transactions which may lead to the alienation of immovable and other property—depending on the amount of the transaction—may only be executed with the approval of the temporary manager.

Another function of the temporary manager during the observation period is to assist the creditors and the court of arbitration in analyzing the debtor's financial status and establishing if there is a possibility of restoring the debtor's solvency. The temporary manager should convene the creditor's meeting before the court of arbitration has made its decision on the bankruptcy case. The meeting should assess the information provided by the temporary manager based on an analysis of the debtor's financial status and make one of the following decisions: (i) appoint external management, or (ii) apply to the court of arbitration to initiate bankruptcy proceedings. In this way, the court of arbitration may follow the creditor's wishes which—in the case of appointing external management—predetermines the decision of the court of arbitration.

The external management procedure is not new to Russian law. One should note, however, that the new draft law regulates this procedure in greater detail. Twenty-seven articles are devoted to the issue instead of just one in the old law. This in itself is evidence of a more detailed and thorough regulation.

It should also be noted that numerous loopholes in the previous law served to discredit the very idea of restoring the debtor's solvency within the external management period. The basic means for creating conditions for restoring the debtor's solvency is a moratorium on satisfying the claims of creditors. The old law limited the effectiveness of such a moratorium. By stating that "within the period of external management

16 Law on Insolvency of Enterprises, art. 12.
of the debtor’s assets, a moratorium shall be imposed on satisfying claims of creditors vis-à-vis the debtor;” the old law failed to extend the moratorium to cover the accrual of forfeits (i.e., penalties or fines) on money liabilities and financial (i.e., economic) sanctions on mandatory payments. As a result, the debtor’s chances to restore its solvency were nil, since during the whole period of external management and the period when the moratorium was effective it would be threatened by forfeits and financial sanctions. Under the circumstances, the moratorium on old debts was rendered practically meaningless.

Under the new law, the moratorium on satisfying creditor claims will mean more than a mere suspension of court decisions and other compliance documents for withholding payments from the debtor on liabilities which fell due prior to the appointment of external management. There will be no accrual of forfeits on these liabilities, financial sanctions on obligatory payments, or interest on the use of resources belonging to other parties within the same period. With a view to compensating for the losses incurred by the creditors and government (on mandatory payments), only one type of interest should be accrued on all “proven” accounts in accordance with the refinance rate of the Central Bank of the Russian Federation.

External management is carried out by a manager nominated at the creditor’s meeting and subject to the approval of the court of arbitration. The external manager may be the temporary manager who was previously appointed by the court of arbitration for the period of observation. The manager of the debtor organization is then removed. The authority of all units within the legal entity is transferred to the external manager, including the power to dispose of the debtor’s assets. However, the external manager may effect high-value transactions—i.e., transactions in immovable property—if the value thereof exceeds 20% of the book value of the debtor’s assets. This is subject to the agreement of the creditor’s committee, unless otherwise provided for in the external management plan.

The external manager has the right to refuse to honour the debtor’s contracts if they are long-term, or if they are meant to yield positive results only in the long-term. Similarly, the external manager may disregard contracts that would result in grave losses for the debtor. It is true that in such cases the creditors will have the right to claim damages for actual losses incurred as a result of a default on the contracts, but these claims will fall within the moratorium.

Measures aimed at the restoration of the debtor’s solvency will be taken by the external manager in line with the external management plan approved at the creditor’s meeting. The Law on Insolvency specifically provides for such restoration measures as the sale of the business, sale of assets, assignment of the right to the debtor’s claims, and payment of the debtor’s liabilities by a third party.

If the court of arbitration decides to declare the debtor bankrupt, bankruptcy proceedings will ensue. This procedure, as well as external management, is not one of the

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7 Ibid., art. 12(3).
novelties of the new law. The opening of bankruptcy proceedings means that all money liabilities of the debtor will be considered as falling due: accrual of forfeits, financial sanctions, and interest on all types of debtor liabilities will be terminated, and all claims vis-à-vis the debtor—including the claims of taxation authorities—can be filed only within the framework of the bankruptcy proceedings. Moreover, to conduct bankruptcy proceedings, the court of arbitration appoints a bankruptcy manager by choosing one of the candidates nominated at the creditor’s meeting. This individual is responsible for organizing the debtor’s assets in accordance with the order of priority provided by article 64 C.C.R.F.

At any stage of a bankruptcy case before the court of arbitration, the debtor and creditors have the right to conclude an amicable agreement. The conclusion of such an agreement—which envisages a debt deferral or rescheduling, assignment of rights to the debtor’s claims, payment of the debtor’s liabilities by third parties, partial debt write-offs, etc.—is a normal way of terminating bankruptcy proceedings. The old law, however, created a practically insurmountable obstacle for an amicable agreement. It provided that within two weeks of the conclusion of the agreement, the creditors were supposed to have no less than 35% of their total claims vis-à-vis the debtor satisfied. The new law removes this obstacle and facilitates an amicable agreement, which is now regulated as an arm’s-length agreement. The only requirement for the approval of such an agreement by the court of arbitration is satisfaction by the debtor of outstanding debt vis-à-vis creditors of the first and second priority—more specifically, claims of individuals to whom the debtor owes indemnity for accidental or death-causing injuries, severance payments, payments to contractual employees, and payments regarding copyright agreements. The approval of an amicable agreement by the court of arbitration terminates bankruptcy proceedings. If such an agreement is made in the course of bankruptcy proceedings, the decision by the court of arbitration to declare the business bankrupt is considered null and void, and the bankruptcy proceedings are discontinued.

The main players in practically all bankruptcy proceedings are the temporary manager, external manager, and bankruptcy manager, all of whom are covered by the general term, “arbitration manager”. Needless to say, these managers bear immense responsibility and function under extreme circumstances.

The old law did not define the status of these persons. It also did not resolve the problem of remuneration of managers or ensure, at least to a minimal degree, their social security. Under the new law, a physical person registered as an individual entrepreneur and possessing the required knowledge may be appointed as an arbitration manager. Arbitration managers will operate on the basis of a license issued by the State Agency for Bankruptcy and Financial Recovery. With regard to social security issues, the manager appointed in case of bankruptcy must have the same powers as the manager of the debtor organization.

Remuneration, as a rule, consists of two parts. For each month of work as manager, remuneration is determined at the creditor’s meeting and approved by the court of arbitration. A bonus is then calculated and paid depending on the results of the
manager’s work. The maximum and minimum compensation for arbitration managers, as well as the procedure for payment, is established by the government.

A. Specific Features Regarding the Bankruptcy of Certain Categories of Debtors and Legal Entities

The new regime, in contrast to the old system, takes into account the specifics of certain categories of debtors and applies different bankruptcy procedures accordingly. These categories include debtors such as town-forming organizations, agricultural organizations, insurance companies, banking and other credit institutions, professional participants in the securities market, as well as individual debtors including individual entrepreneurs and farm enterprises.

Town-forming organizations are defined as those legal entities whose number of employees—including household members—make up no less than half the population of the city, town, or village where they are located.¹⁸

While establishing specific bankruptcy procedures for town-forming organizations, the law takes into account the possible social consequences of their liquidation. Accordingly, the group of people participating in a bankruptcy case against town-forming organizations must include representatives of the corresponding local administration. The court of arbitration may also require participation in the case of certain federal executive bodies, or executive bodies of a specific division of the Russian Federation. On the application of one of these parties, the court of arbitration may appoint external management to a town-forming debtor organization even if the creditor's committee votes to have the debtor considered bankrupt and to initiate bankruptcy proceedings. In this case, however, the authorities will have to provide a guarantee for the debtor's liabilities, and therefore assume subsidiary liability to the debtor's creditors.

Moreover, on the application of the above agencies, the external management period may be prolonged by the court of arbitration for up to one year. Thus, the total duration of external management—and the duration of the moratorium on satisfying creditor claims—may last two and a half years. Within this period, the concerned authorities may rehabilitate the town-forming organization by investing in its operations, finding jobs for the existing employees, and creating new jobs. In extreme cases, the duration of external management may be prolonged for a period of up to ten years, provided the debtor and its guarantor start effecting settlements with the creditors no later than two and a half years after the external management is appointed.¹⁹

Through authorized representation, the Russian Federation, a subject of the Russian Federation, or a municipal administration may complete settlements with all

¹⁸ Law on Insolvency, art. 132.
¹⁹ Ibid., art. 135.
creditors or satisfy money claims and cover the debtor's arrears on obligatory payments in some other way.

In the process of external management, the town-forming debtor organization may sell the enterprise as a single property complex (i.e., as a going concern), which will make it possible to receive funds necessary for settlements with creditors without liquidating the debtor or eliminating jobs. In addition, if there is an application from a government agency or a local self-governing body, the sale of the enterprise will be carried out through a tender, the mandatory terms of which will be the preservation of at least 70% of the jobs generated by the enterprise. Should the buyer decide to restructure or reinvent the enterprise, there is an obligation to retrain and find employment for any existing employees. Even if the town-forming organization is bankrupt, the bankruptcy manager is obliged to sell the enterprise as a single property complex. Only in the event that there are no buyers will the bankruptcy manager be authorized to sell the assets of the enterprise separately. Provisions relating to the bankruptcy of town-forming organizations will also be applied to organizations employing in excess of 5,000 people.

Bankruptcy of agricultural organizations is regulated with a view to the special activities of such entities, normally characterized by the use of land parcels (primarily of agricultural designation) and the seasonal nature of their work. Under article 139 of the Law on Insolvency, agricultural organizations are defined as legal entities whose primary activity consists of growing agricultural produce whose proceeds amount to no less than 50% of the entity's total revenues.

The essence of the first special rule regulating the bankruptcy of agricultural organizations is that when the immovable property of the bankrupt organization is sold, other agricultural organizations or farm enterprises have priority to buy it. The alienation of land parcels may be carried out to the extent allowed by legislation.

The second special rule is that the duration of external management of an agricultural organization is extended to account for the seasonal nature of its operations and the necessity to wait until the end of the respective agricultural campaign. Taking into consideration the possible time needed for the sale of the grown products, the legislator considered it appropriate to extend the external management period to one year and nine months. Moreover, if a natural disaster occurs in the period of external management, the term may be extended by the court of arbitration for another year. Thus, the maximum period of external management may last up to two years and nine months. Generally, however, the maximum period is one and a half years. In all other aspects, the insolvency procedure for agricultural organizations should be carried out in accordance with the general rules.

The bankruptcy of banks and other credit organizations must be conducted in accordance with the Law on Insolvency of Banks. The norms of the Law on Insolvency, however, will be applied by default in the absence of specific rules.

When the bankruptcy procedures of banking and other credit organizations were regulated by the former Law on Insolvency of Enterprises, the specifics of establishing and monitoring the activity of credit organizations were not yet formulated. All
special rules with respect to banks and other credit organizations contained in the *Law on Insolvency of Enterprises* were limited by article 11. This provision indicated that a commercial bank or other credit institution (in the position of debtor), their creditors, and the prosecutor had the right to apply to the court of arbitration for the initiation of bankruptcy proceedings once the debtor-institution’s licence for performing banking operations was revoked by the Central Bank of the Russian Federation.

The absence of special insolvency procedures for banks and other credit organizations was an unfortunate loophole in the legislation. Applying the old *Law on Insolvency of Enterprises* to the commercial context of the credit industry caused a host of problems in the courts of arbitration which were almost impossible to resolve.

First and foremost, the rights and legal interests of citizens with accounts in commercial banks were inadequately protected. This was manifested in the failure of banks to execute the orders of their depositors on the issuance of funds from the deposits—as well as to perform other bank operations—when the depositors might expect compensation for their losses only after initiating a bankruptcy procedure against the bank. The depositors, or their representatives, act as regular creditors upon whose request an insolvency case may be initiated against a commercial debtor bank.

As a rule, individual depositors first applied to civil courts where they tried to receive appropriate remedies and writs of execution—but since it was impossible to execute court decisions without the assistance of bailiffs, they often requested the court of arbitration to initiate bankruptcy proceedings against the respective bank. The satisfaction of depositors was further arranged in accordance with two schemes that are mutually exclusive: (i) through the bankruptcy manager of the bank, and (ii) through court bailiffs who execute the decisions of civil courts. In the first instance, fair distribution of the money funds is provided for among the depositors on a *pro rata* basis. In the second case, settlements with individuals are often carried out in a voluntary manner.

An alternative to such a procedure for satisfying claims of individual depositors was the insurance of deposits—including mandatory insurance—or the securing of deposits by funds raised through fees levied by banks and credit institutions. In either case, depositors would receive compensation in the amount of the deposit (or a substantial part of it) from the respective insurance funds or organizations providing guarantees on the deposits. These insurance entities, in effect, accumulated their claims against the bank, and in the event of the bank’s insolvency acted as a single creditor on all bank deposits. Thus, claims of depositors who were already fully protected were absolutely excluded.

In June 1996, the State Duma of the Federal Assembly of the Russian Federation adopted, on first reading, the draft Federal law *On Providing Guarantees on the Deposits of Citizens in Banks*. This provided for the creation of the Federal Reserve Corporation for guaranteeing bank deposits in the form of a specialized non-commercial organization. Under this law, the guarantees would be backed by reserve funds of the corporation formed with the mandatory licensing fees paid by banks for the right to attract money funds of individuals for deposits. The corporation would guarantee each depositor in a registered bank the payment of compensation (from 80% to 100% of
the deposit) in the event that the bank's license for attracting the funds of citizens for deposits—or a license for banking operations—is revoked, or if the bank is recognized as insolvent. This implies that after the payment of the appropriate compensation to the depositor, the depositor's claims against the bank would be transferred to the Federal Reserve Corporation.

Unfortunately, in December 1996 the State Duma removed the draft law from consideration until the different positions of various parliamentary factions and the government were harmonized. As for the draft of the Law on Insolvency of Banks, it is not proof of guaranteed deposits that matters, but rather of the mandatory insurance thereof. Under the circumstances, the prospect of adopting such a law in the foreseeable future is uncertain. Until then, individual depositors retain the right to file a claim to the court of arbitration to initiate bankruptcy proceedings against a credit organization.

One cannot ignore the different consequences of initiating bankruptcy proceedings against an ordinary debtor and a bank. The decision of the court of arbitration to commence consideration of a bankruptcy case against a bank often stirs panic among creditors, thereby provoking them to withdraw money from their bank accounts. The consequent drain only assures the bank's insolvency. At the same time, the old legislation did not contain any provisions restricting the number of creditors who could initiate bankruptcy proceedings against a bank—or make the initiation of such proceedings more difficult—compared with the bankruptcy of ordinary debtors.

As noted above, a solution to this problem is to exclude individual creditors from the category of creditors who have the right to bring a bankruptcy suit against a bank by providing guarantees for household deposits, or by implementing mandatory deposit insurance schemes. Another method proposed in the draft Law on Insolvency of Banks is the introduction of special pre-trial procedures to be applied before the court of arbitration commences a bankruptcy suit. Today, before creditors (including creditors of banks) file a bankruptcy suit to the court of arbitration against the debtor, only a notification need be sent to the debtor requesting confirmation of receipt. The better course is for a bank insolvency case to be considered in the court of arbitration only after the creditor has followed an obligatory, strictly specified procedure whereby the Central Bank has to consider the creditor's application or the withdrawal of the commercial bank's licence. Thus, the financial status of the indebted bank will be determined by the Central Bank, taking account of all the indicators characterizing its solvency.

If there are no indications of bankruptcy, the Central Bank will refuse to withdraw the licence. Thus, the possibility of commencing a bankruptcy suit is excluded in such cases, and the creditor will have to confine itself to an ordinary suit following its private law claim. If there are indications of bankruptcy, the Central Bank will have a possibility to apply rehabilitation measures to the insolvent bank, i.e., appoint temporary administration or suggest that its founders or participants reorganize the bank through a merger with a more viable and stable bank. Only if there is no possibility to take any such measures should the court of arbitration pursue a bankruptcy suit against the insolvent bank. Such problems were resolved in the draft Law on Insol-
vency of Banks, which properly takes into account all the specific features typical of this category of debtors.

B. Bankruptcy of Individuals

The bankruptcy of an individual who does not have the status of an entrepreneur is a new concept in Russian law. As noted above, most legal systems have special provisions regulating the insolvency of individuals. The old Russian law allowed the possibility of bankruptcy only where an individual had the status of an entrepreneur; and even then, it did not specifically regulate such bankruptcies.

Meanwhile, the concept of individual bankruptcy is considered in developed legal systems as one of the most effective ways to protect citizens who find themselves in a difficult financial situation—allowing them to rid themselves of their debt burden and start over again. This applies to any individual who receives a loan from a bank or who bought immovable property or expensive goods on an instalment sale. A special chapter regulating the specifics of individual bankruptcy is included in the Law on Insolvency to help address the problem of debtors faced with an unbearable debt burden.20

The grounds for declaring an individual bankrupt are the inability to execute money liabilities or pay taxes and other mandatory payments in connection with the excess of the amount of debts over the individual’s own property. A bankruptcy suit against an individual will be commenced by the court of arbitration upon application by the debtor or his creditors. In conducting the bankruptcy procedure, the claims against the individual also may be filed by creditors on liabilities related to compensating the harm inflicted on the life and health of the individual. Recovery of alimony and other liabilities of the individual will continue to be exigible after the bankruptcy proceedings are over.

After the settlements with creditors are paid out of the proceeds from the sale of the individual’s property—with the exception of the property against which, according to procedural legislation, execution cannot be levied—the individual declared bankrupt will be relieved of all debts, including those that remain outstanding.

Declaring an individual entrepreneur as bankrupt will also mean that his state registration as an individual entrepreneur will lose force, and the licence for exercising certain kinds of entrepreneurial activity will also be cancelled.

The Law on Insolvency as well as the analyses of draft laws prepared in the field of credit organization bankruptcy confirm that in the event that all the draft laws are adopted and put into force, Russia will have a bankruptcy system that is in line with those of other major states in the international community.

20 Ibid., c. 6 (arts. 101-112).
IV. The Practical Application of the New Russian Insolvency and Bankruptcy Regime

Even the most perfect law cannot hope to succeed in its aim without faithful and consistent application. Ultimately, the court of arbitration's practical application of the Law on Insolvency will identify the regime's benefits and shortcomings. The Higher Court of Arbitration has the right to provide explanations with respect to the application of laws. Currently, certain provisions of the legislation are being interpreted in relation to the new law's implementation. However, it will only be possible to take this work seriously after the Higher Court of Arbitration has had an opportunity to analyze cases related to the application of the new law. Adequate analysis cannot be expected before at least a few years have gone by.

There is currently a lot of discussion in Russia about accelerated bankruptcy which relates to the Resolution of the Russian Federation No. 478 “On Measures to Increase Efficiency of Bankruptcy Procedures Application.” In practice, there may be no new accelerated bankruptcy procedures. All the possible procedures—such as observation, external management (i.e., court rehabilitation), bankruptcy proceedings, amicable agreement, simplified bankruptcy procedure (of a debtor who is under liquidation or absent), and voluntary declarations of bankruptcy—are established and regulated by the Law on Insolvency effective March 1, 1998. Resolution No. 478 was not aimed at the introduction of new bankruptcy procedures, but at the increased efficiency of bankruptcy procedures application provided for by the Law on Insolvency. Resolution No. 478 contemplates the achievement of this goal by adopting three particular measures.

The first measure is the coordination of various state agencies, which are granted the right to file a claim to the court of arbitration on the debtor’s bankruptcy, in order to project a unified state position with respect to the debtor organization. Apart from the tax agencies, such agencies would include public extra-budgetary funds (with respect to claims on mandatory payments) and the Federal Service of Russia on Insolvency and Financial Recovery (“Federal Service”). The latter is authorized to represent the interests of the Russian Federation relating to mandatory payments and money liabilities in the event that issues relating to the insolvency of organizations are considered.

To achieve the desired coordination between the above agencies, the Collegium of Authorized Representatives—i.e., the State Tax Service, Pension Fund, Federal Fund for Mandatory Medical Insurance, Social Insurance Fund, and State Employment Fund—are being set up under the Federal Service and its territorial departments. If there are grounds to initiate bankruptcy proceedings against a debtor organization, the taxation department and other authorized agencies submit documents to the Federal Service necessary for filing with the court of arbitration. This centralized process al-

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allows for a single statement of claim to be filed with the court containing a consolidated claim on all mandatory payments.

Government instructions to the state agencies concerning the coordination of their activity cannot refer to the norms contained in the Law on Insolvency (specifically to article 6) which grant the right to tax and other authorized agencies to independently apply to the court of arbitration (on taxation and mandatory payments, respectively). Therefore, such independent applications, without preliminary submission of appropriate documents to the Federal Service and the discussion of the respective issues at the Collegium of Authorized Representatives, should not be accepted by courts of arbitration and considered by them in a general procedure. Another matter for concern is that such independent actions of state agencies that fail to follow government instructions may be considered by the latter as non-compliant with state policy.

Resolution No. 478 also provides for a second measure, namely, the consolidation of government claims against the debtor in the government’s capacity as a public body with respect to taxation and other mandatory payments, and in its capacity as creditor on civil law money liabilities—e.g. with respect to centralized credits from the budget. Apart from the above documents, there are government instructions of an organizational nature aimed at providing representation by the Federal Service—as an institution with the status of a legal entity—of certain creditors. For example, the Gazprom Joint Stock Company, U.E.S. of Russia, as well as enterprises and organizations involved in railroad transportation.

In the latter instance, the Federal Service will act as an agent with power of attorney executed by the respective creditor (i.e., principal). This, however, does not deprive the creditor of the right to independently apply to the court of arbitration with respect to the debtor’s bankruptcy, and directly participate in the consideration of the case, as well as in the creditor’s meetings.

Finally, the coordinated activity of the taxation department and other authorized agencies in consolidating claims on mandatory payments and money liabilities is aimed at ensuring that the first meeting of creditors adopts a decision on the introduction of a rehabilitation procedure and external management. Within this procedure, the so-called “accelerated” procedure for its implementation can be introduced.

However, it is only at the first meeting of creditors, held prior to the main session of the court of arbitration during the observation procedure, that the taxation department and other authorized agencies participate with a right to vote. At other creditor’s meetings, only creditors on civil law liabilities have the right to vote. Under article 65 of the Law on Insolvency, it is at the first meeting of creditors that the decision is made to apply the external management procedure, or to file a statement of claim to the court of arbitration to recognize the debtor as bankrupt. The decision of the creditors’ meeting is binding on the court of arbitration which, under the circumstances, should proceed to order the introduction of external management and appointment of an external manager approved by the first creditors’ meeting.

There are two other issues which should be addressed and resolved at the first creditor’s meeting. These issues are whether to apply accelerated bankruptcy proce-
dures and whether to approve an external management plan. These decisions cannot be considered as mandatory or binding on the external manager. Under article 82(1) of the *Law on Insolvency*, the external manager—no later than a month after his appointment—should develop a plan of external management and submit it for approval at the creditors' meeting. Therefore, an external management plan providing for "accelerated" bankruptcy procedures which is adopted at the first creditors' meeting should be considered only as a recommendation to the external manager, and a creditors' meeting held after external management should proceed in accordance with the procedure provided for by the Federal law. This document may serve as an external management plan only after it is approved at the creditors' meeting.

A few words about the essence of the "accelerated" bankruptcy procedure are in order. Here, "accelerated" is taken to mean a special way of reorganizing and rehabilitating the debtor's business. The essence of this measure is that, on the basis of all the debtor's assets—with the exception of property which is not included in the bankruptcy estate— an open joint stock company is being formed. From this moment on, the assets of the debtor are in the form of shares of a newly established joint stock company. The said shares will be subject to sales at a public auction and the amount received will be used for settling accounts with the creditors.

In the event the amounts received from the sale of shares of a newly established joint-stock company are sufficient to satisfy the claims of all creditors, the proceedings on the bankruptcy case are terminated, and the future of the debtor will depend exclusively on the decision of its founders (i.e., participants) in accordance with the general procedure.

However, if the amount received after the sale of shares is insufficient to settle accounts with all the creditors, the external manager will have to apply to the court of arbitration requesting the termination of the external management procedure and the recognition of the debtor as bankrupt. In short, bankruptcy proceedings will be initiated.

A laudable aspect of such an external management procedure (regardless of the outcome) is the preservation of the debtor as a going concern. However, the disadvantages are inescapable. The most notable downside is the increased risk for creditors that their claims will not be satisfied. Therefore, the issue of whether to apply this procedure of external management should be determined on a case-by-case basis, taking into account all the circumstances and provided that the procedure is approved by the creditors.

Depending on the situation, the external manager and the creditors may choose a different, more desirable way to recover the solvency of the debtor, which will similarly allow for the preservation of the debtor's business and work places, but at a lower risk. Such measures may include the sale of the debtor's enterprise under article 86 of the *Law on Insolvency*. Imagine a situation in which a wealthy buyer is willing

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27 *Law on Insolvency*, art. 204.
to purchase the enterprise as a property complex and is ready to pay the price that will allow for the repayment of all the debts. Why, then, is it necessary to establish a new joint stock company and organize an open auction for the sale of its shares? Incidentally, if an enterprise of the debtor is sold, the external management procedure may be completed a great deal sooner than in the case of the founding of a new joint stock company aimed at the sale of its shares.

Furthermore, in a number of instances “accelerated” bankruptcy may prove to be quite inefficient. For instance, the regime governing town-forming organizations contemplates an external management procedure lasting for two and a half years and, in exceptional cases, for ten years. Given the moratorium on the satisfaction of creditors’ claims, in this period available funds may be used to purchase new equipment and change the profile of the enterprise. Is it reasonable to pass on outdated equipment to the charter capital of a joint stock company and condemn new shareholders to the sad destiny of their predecessors?

**Conclusion**

From the very start of the movement to revive the insolvency and bankruptcy regime in Russia—*i.e.*, from March 1, 1993—proposals never ceased to use this procedure either as a remedy for all economic troubles, or as a means to struggle specifically with tax dodgers or the concern for fostering the growth of privatized industry (there are a number of Edicts by the President of the Russian Federation with respect to this).

The new *Law on Insolvency*, in principle, allows Russia to have a legal system of bankruptcy that would fully conform to all the requirements of the day. There is still something that remains, and this is to ensure an adequate enforcement system that meets these high standards. By all indications, the necessary prerequisites for such an enforcement mechanism are already in place in Russia. Indeed, the country benefits from the extensive experience of the courts of arbitration, the large number of qualified judges specializing in bankruptcy cases, and a marked increase in the number of bankruptcy managers.
References

Legislation


Books
