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Analytical Overview of Legislation

Change in the Bankruptcy Moratorium Regime.

Analysis of Expected Amendments to the
Bankruptcy Law

18 April '20

On April 1, 2020 new Article 9.1. of the Bankruptcy Law¹, affording the RF Government the power to announce a moratorium on bankruptcy of legal entities and individual entrepreneurs and determine the duration of the moratorium, took effect.

On April 3, 2020 the RF Government announced a moratorium on bankruptcy of legal entities and individual entrepreneurs whose business was affected by the coronavirus COVID-19² pandemic. The moratorium applies to companies and individual entrepreneurs working in the following nine sectors of economy:

- Air transport, airport operations, road freightage;
- Culture, organization of leisure and entertainment;
- Fitness and sports;
- Travel agencies and other tourist industry organizations ;
- Hotel business;
- Organizations of extended education, non-state owned educational institutions;
- Organization of conferences and exhibitions;
- Personal services (repairs, laundry, dry cleaning, hairdresser's and beauty parlor services)³.

The moratorium went into effect on April 6, 2020⁴ and will last till October 6, 2020.

The RF Government has the right to expand the list of entities to which the moratorium applies and change its term, including extension thereof.

The novel provisions have left business and lawyers asking multiple questions.

On April 17, 2020 the RF State Duma passed in the second reading a draft law⁵ whereby amendments to Art. 9.1 of the Bankruptcy Law are going to be introduced.

¹ Federal Law "On Insolvency (Bankruptcy)" dd. October 26, 2002 N 127-Φ3.

² Resolution of the RF Governments dd. April 03, 2020 N 428 "On Imposition of a Moratorium on Initiation of Bankruptcy Proceedings Against Certain Debtors upon Filing of Bankruptcy Petitions by their Creditors"

³ Resolution of the RF Governments dd. April 03, 2020 N 434 "On Approval of the List of Sectors of Russian Economy Worst Affected amid Deterioration of the Situation as a Result of Spreading of the New Coronavirus Disease".

⁴ <http://agp.ru/analitika/vvedenie-moratoriya-na-bankrotstvo-organizatsiy-i-individualnykh-predprinimateley-v-2020-godu-obzor/>

§ I. Why the bankruptcy moratorium regime is already being amended despite of the fact that it was quite recently enacted?

Art 9.1 of the Bankruptcy Law, as it is currently drafted, setting out specifics of the bankruptcy moratorium, contains a number of provisions which limit to considerable extent current business activities of **companies and individual entrepreneurs to which the moratorium applies** and may in the long run worsen the financial position of both such companies and individual entrepreneurs affected by the quarantine and their contracting parties.

In particular, now the Bankruptcy Law provides that **a deal transacted during the moratorium** may be recognized null and void in case:

- A company to which the moratorium applies is a party to such deal;
- Such deal was made between April 06, 2020 and October 06, 2020, inclusive (the moratorium duration period);
- The deal goes beyond the scope of normal business activities, i.e. is unusual for the company falling within the moratorium;
- The price of the deal exceeds 1 % of the book value company's assets as of the end of the 1st quarter of 2020 (the last reporting period as of the date of enactment of the moratorium);

⁵ Federal Law "On amendment of the Law of the Russian Federation "On Organization of Insurance Business in the Russian Federation" and Articles 15 and 26 of the Federal Law "On Compulsory Civil Liability Insurance of Owners of Motor Vehicles". Link to the draft law: <https://sozd.duma.gov.ru/bill/685368-7>

- A company falling under the moratorium, which made such a deal, has become bankrupt – bankruptcy proceedings against such company were initiated before January 07, 2021, inclusive (during the 3-month period after the end of the moratorium)⁶.

This novelty actually brought to a stand business activities of entrepreneurs and businesses to which the moratorium applies, cutting them off the possibility of obtaining financing for the restoration of their solvency.

The Bankruptcy Law already contains provisions allowing creditors to contest transactions. In contrast to those provisions requiring that parties contesting a deal should meet a certain standard of proof (e.g., prove contracting party's awareness of the debtor's forthcoming bankruptcy), the provision about nullity of a deal is more strict because it would be sufficient for the court to establish that such deals were made with violation of law, that is to say, fall within the above referenced nullity criteria. We believe that it is unlikely that in such a case the court would take a close look into the actual financial situation of the company which made such deal and would not infer cause-and-effect relationships between the deal and the bankruptcy of the company which made it.

It is clear that a company to which the moratorium applies but which has no financial difficulties and, on the contrary, needs urgent financing to continue its operations, should not face restrictions unjustified with respect to it or unsurmountable obstacles to the obtainment of financing.

Setting aside the nullity of deals made during the moratorium

If the amendments are adopted (we consider that it is highly likely) the provision about nullity of deals going beyond the scope of normal business activities and exceeding 1% of the book value of assets of the company falling within the moratorium **will be excluded from the current version of the Bankruptcy Law.**

The right to waive the bankruptcy moratorium

It is also expected that companies to which the moratorium applies will be able to waive it. In order to do this it will be necessary to publish a relevant notice in the Consolidated Federal Register of

⁶ The dates are given assuming that the term of the bankruptcy moratorium would not be further extended by the RF Government.

Bankruptcy Information (CFRBI). Thereafter, effects and restrictions of the moratorium will not apply to such companies. For advantages and disadvantages of waiver of the bankruptcy moratorium please see item 3 below.

Furthermore, it is specifically stated in the draft law that if the RF Government extends the duration of the moratorium, companies' notices of waiver of the moratorium, recorded in the CFRBI prior to the date of such extension, would cease to be in force. Thus, companies and individual entrepreneurs, depending on financial situation in their businesses, may either post a new notice of waiver of the moratorium in the CFRBI or take advantage of the moratorium to get temporary immunity against the threat of bankruptcy.

§ II. Does this mean that deals with companies falling within the moratorium now cannot be held null and void if they are beyond normal business activities of the company or exceed 1% of the book value of its assets?

Deals made during the moratorium period

Until the draft law is approved in the final reading and enacted, the provision about nullity of deals made during the moratorium remains in force and such risk remains in place.

Deals made during the moratorium period prior to the date of enactment (should it happen) of the amendments

The Draft Law provides that deals made between the date of enactment of the moratorium and the date of enactment of the amendments will not be held null and void. Thus, if the Draft Law is adopted, as it is currently drafted, the risk of holding such deals null and void will be mitigated.

Deals made before April 05, 2020 (inclusive)

Article 9.1 of the Bankruptcy Law as it is currently drafted or in its amended (presumably) version does not apply to deals transacted prior to the moratorium. That is to say, in our opinion, deals made before April 05, 2020, inclusive, cannot be held null and void by virtue of this article and in the event of bankruptcy can be contested on the basis of Articles 61.2, 61.3 of the Bankruptcy Law and Articles 10, 168 of the RF Civil Code.

§ III. What will be the consequences of waiver of the moratorium for my company?

Bankruptcy moratorium places a number of limitations both on scope of opportunities available to creditors and on business activities of companies to which the moratorium applies. Limitations applicable to debtors under monitoring procedures apply to such companies.

Therefore, the waiver of moratorium has a number of advantages and disadvantages. Such decision is to be taken by company's management, proceeding from the company's current and forecasted financial situation.

Advantages

- A company will be able to pay dividends, distribute profit among shareholders;
- Shareholders will be able to freely withdraw from the business and request for payment to them of the actual value of shares held by them in the company's charter capital;
- Limitations on redemption of shares do not apply;

- Time period for contesting of suspicious transactions, transactions with unfair preference will start to run on the date of initiation of bankruptcy proceedings – not on the date of enactment of the moratorium;
- A company will be able to set off reciprocal counterclaims;
- Owners of unitary enterprises' property will be able to withdraw the property without limitation.

Disadvantages

- Creditors may file a bankruptcy petition against a debtor at any time provided that a number of mandatory conditions are in place (the debt amount exceeds 300 thousand RUB, the delay in fulfilling obligations exceeds 3 month, a debt enforcement ruling has been rendered by a court⁷, intention to file a bankruptcy petition has been published, etc.);
- Creditors will be allowed to charge penalty for a delay in performance of contractual obligations;
- Enforcement proceedings will not be suspended for the duration of moratorium period;
- Creditors will be able to levy execution on pledged property without limitation through or without recourse to court;
- The general director will be obligated to file his company's bankruptcy notice with a court within one month of the occurrence of signs of objective bankruptcy. A failure to meet this obligation is rife with the risk of incurring of secondary liability. Such obligation of general directors of companies to which the moratorium will apply is temporarily suspended⁸;
- The simplified procedure for making of a settlement agreement in bankruptcy context will not apply to the company.

⁷ This is not applicable in case of credit institutions or tax authorities which are not under the obligation to first enforce recovery of debt through court.

⁸ The risk of incurring of secondary liability for actions undertaken during the moratorium was discussed in our special memorandum on this matter: [http://agp.ru/analitika/subsidiarnaya-otvetstvennost-i-moratoriy-na-bankrotstvo-analiz-riskov-/
/](http://agp.ru/analitika/subsidiarnaya-otvetstvennost-i-moratoriy-na-bankrotstvo-analiz-riskov-/)

§IV • Are there any changes in the risks of invalidation of suspicious transactions or transactions with unfair preference in connection with the moratorium?

We believe that the risks of contesting of suspicious transactions and transactions with unfair preferences, in general, have not changed and creditors will have to meet the standard of proof applicable to contesting of such transactions, which standard has already evolved based on legal precedents.

However **an increased suspicion period**⁹ will apply to contesting of deals made by companies falling within the moratorium.

By way of illustration of expected practical application of this provision of law we will consider a deal made with unequal counter-performance of obligations¹⁰.

Generally, such deal may be invalidated by court if it is made **within one-year** term preceding the date of initiation of the bankruptcy proceedings. Consequently, in the normal course of events, if bankruptcy proceedings commence, for instance, on **June 1, 2020**, then transactions made **between June 1, 2019 and June 1, 2020** fall within the risk group.

For the purpose of challenging of deals made by companies to which the moratorium applies, such term will start to run not on the date of initiation of bankruptcy proceedings but on **April 6, 2020** (the date of enactment of the moratorium) and will embrace the entire duration period thereof.

Transactions made **between April 6, 2019 and October 6, 2020** (inclusive) will be in the risk group. If the effective term of moratorium is extended, the suspicion period will most likely be extended too.

⁹ The suspicion period is an interval between the date of making of a deal and the date of initiation of bankruptcy proceedings. If the deal was transacted during such period, it may be invalidated by court at the request of creditors or the court-appointed receiver.

¹⁰ Section 1 of Art. 61.2 of the Bankruptcy Law.

This rule will apply to those bankruptcy cases which will be initiated within three months after the end of the moratorium, i.e. (if the duration of the moratorium remains without change) from October 7, 2020 through January 7, 2020 (inclusive).

We will keep monitoring developments relating to bankruptcy law and will inform you about key amendments which may influence the present and the future performance of businesses.

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