



Andrey
Gorodissky
& Partners



Legal Overview

Bankruptcy Moratorium on Account of COVID-19 Quarantine

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— A moratorium on bankruptcy of organizations and individual entrepreneurs declared in 2020 (overview of key provisions)

In connection with the outbreak of the Coronavirus disease in the territory of Russia, on March 31, 2020 the Russian State Duma adopted a draft Federal Law “On Amendment of Certain RF Laws and Regulations Concerning Emergency Situations Prevention and Recovery” (the “**Draft Law**”)¹.

The said document broadens the powers of the RF Government in case of emergency situations. Along with other multiple population and national economy protection measures the new Draft Law introduces essential amendments in the Bankruptcy Law², the most important of which is granting the RF Government the power to declare a moratorium on initiation of bankruptcy cases. This overview addresses the most significant, in our opinion, provisions of the Draft Law and those of draft Resolution of the RF Government N 428 dd. April 03, 2020 (the “**Resolution**”), concerning bankruptcy of organizations and individual entrepreneurs.

The draft Resolution was posted on the Government’s Website³ on April 04, 2020. That document declares a six-month moratorium on initiation of bankruptcy proceedings by courts in case the relevant bankruptcy petition was filed with the court by creditors after enactment of the said Resolution⁴. It is important that moratorium on bankruptcy filings is declared with respect to certain categories of legal entities and individual entrepreneurs who were most severely affected by restrictions imposed on account of the coronavirus pandemic. The moratorium does not extend to bankruptcy of individuals yet.

Organizations falling within the moratorium will be determined according to their Russian National Classifier of Economic Activities (OKVED) codes. A relevant list of codes has been approved by the RF Federal Tax Service (the FTS of Russia). This list comprises air carriers, tour

¹ As at April 06, 2020 the Draft Law has been approved in the third reading by the State Duma, by the RF Counsel of Federation and submitted to the President of Russia for signing.

² Federal Law “On Insolvency (Bankruptcy)” dd. October 26, 2002 N 127-Φ3.

³ <http://static.government.ru/media/files/q3x1rrVAA325WgKQq3cJu9kAXM1W6Imn.pdf>

⁴ The said six-month term will start to run on the date of official publication of the Resolution in the Rossijskaya Gazeta and other official publications of RF laws and regulations. As at April 06, 2020, the document has not been published and has not come into force.

operators, exhibition and events organizers, hotels, restaurants, etc. The complete list of OKVED codes is posted on the Website of the FTS of Russia⁵.

The moratorium extends to nearly 1.3 million organizations and individual entrepreneurs with relevant OKVED codes recorded in the Consolidated Register of Legal Entities as at March 01, 2020. Furthermore, the FTS of Russia has developed an on-line service⁶ for verifying whether a company or an individual entrepreneur falls under the moratorium.

Beside small and medium-sized businesses entered in the above mentioned list by tax authorities, systemic and strategic enterprises as well as strategic joint-stock companies and organizations that ensure implementation of the unified State policy in economy sectors also fall within the moratorium .

Under the Draft Law the courts are instructed to send back bankruptcy petitions filed by creditors during 6 month of the date of enactment of the moratorium. Enforcement proceedings and bankruptcy cases that had been initiated by a court prior to the moratorium enactment date but in which none of the procedures provided for by the Bankruptcy Law has been initiated, shall be suspended.

Accrual of penalties for late performance of contractual obligations shall also be suspended. Businesses are not allowed to recover liquidated damages, penalties, fines under contracts. Please note that the above rule applies only to such categories of companies and individual entrepreneurs which are entitled to such moratorium.

Furthermore, to ensure additional protection of enterprises' and individual entrepreneurs' financial situation, legislators impose preliminary injunction on levying of execution on property pledged to creditors, including without recourse to court. We expect that during the moratorium courts will also return claims for recovery against debtors' property.

On the other hand, for the protection of creditors' financial interests, companies and individual entrepreneurs falling within the moratorium are disallowed to enter into reciprocal liabilities offset transactions, pay dividends or distribute profit among shareholders.

For the duration of the moratorium the duty of companies' general directors to file for bankruptcy of the company in case it shows signs of insolvency (insufficiency of assets) is also suspended. A similar amendment has been introduced with respect to bankruptcy of individuals. However, as far as currently individuals do not fall under the moratorium, we believe that this novelty is applicable to individual entrepreneurs only.

It is worthwhile specifically mentioning that debtor's CEO shall reserve the right to file a petition in bankruptcy. Furthermore, the Draft Law provides that a bankruptcy case that had been initiated upon creditor's petition and was suspended because of the enactment of the

⁵ https://www.nalog.ru/rn77/news/activities_fts/9713703/

⁶ <https://service.nalog.ru/covid/>

moratorium, shall be closed in the event the debtor has filed its own bankruptcy notice during the moratorium.

The above referenced amendments are intended, in our view, to protect entrepreneurs and company managers from imposition of subsidiary liability for obligations that debtors may incur when being insolvent (having insufficient of assets) during the next 6 months.

Still, it should be emphasized that the Draft Law does not provide for regulation of the managers' subsidiary liability matters during the moratorium. We believe that obligations which may be incurred by a debtor during the moratorium period will not be included in the scope of subsidiary liability in case bankruptcy proceedings are nevertheless initiated against the company upon the end of the moratorium.

For the time being it is hard to tell how the case law concerning subsidiary liability for managers' acts (omissions) during the moratorium would shape up. Therefore, for the sake of additional protection against the risk of imposition of subsidiary liability, we recommend company managers to develop a detailed plan of anti-crisis measures for prevention of their companies' bankruptcy. We will discuss this matter in more detail in our subsequent publications.

The contesting of transactions made by companies and individual entrepreneurs during the moratorium is worth mentioning as a separate point. The Draft Law provides that all transactions going beyond debtor's normal business activities, whereunder pecuniary liability exceeds 1 percent of the book value of debtor's assets, shall be held void.

Besides that, the timeframe for contesting of suspicious transactions and transactions with unfair preference, as defined in Articles 61.2 and 61.3 of the Bankruptcy Law, is extended. The suspicion notice period shall start to run on the date of enactment of the moratorium and last throughout the entire duration thereof as well as a 3-month term after its end. This rule will apply to such bankruptcy cases which will be initiated within 3 months after the end of the moratorium.

One should be especially vigilant about the above provision, as it is laid down in the Draft Law, which provision is rife with considerable risks for prospective counterparties of affected companies because practically any transaction being not usual for the debtor and exceeding 1% of the value of its assets may subsequently be contested in the event bankruptcy proceedings are initiated against the debtor. One cannot rule out that for companies affected by the pandemic it would be much more difficult to obtain additional financing for supporting of their operations. On the other hand, businesses will now have to pay special attention to checks of their contracting parties and their financial situation to mitigate the risk of non-repayment of debt in case of possible bankruptcy of contracting parties.

Another significant provision of the Draft Law introduces a simplified procedure for making settlement agreements between debtors and creditors. As mentioned above, a debtor reserves

the right (but is not obligated) to file with a court a notice of its bankruptcy during the moratorium. In such case a debtor may file with a court a request for approval of a settlement agreement with its creditors even though the meeting of creditors has not approved such agreement. Within the meaning of provisions of the Draft Law, the reasonableness and practicability of such settlement agreement will be determined by court, however creditors may object against approval thereof referring to the fact that such settlement agreement has no economic rationale, is aimed at the protraction of the bankruptcy proceedings, is not conducive to ensuring satisfaction of creditors' claims to a greater extent than through the bankruptcy proceedings and prejudice their financial interests.

This innovation appears to be rather promising and may subsequently contribute to the development of the practice of making of settlement agreements in context of bankruptcy of legal entities, as a rehabilitation procedure focused on the restructuring of company's debts.

Despite of the fact that the Draft Law is largely focused on supporting of companies affected by the coronavirus pandemic, a number of issues remains open, specifically contesting of transactions, subsidiary liability, possible abuse by debtors of provisions of the draft Settlement Agreement Law. We closely monitor the latest developments and will keep informing you about essential changes in bankruptcy laws and regulations.



— Contacts



Dmitry Yakushev

Attorney

Areas of practice:

Dispute Resolution/ International Arbitration,
Insolvency and bankruptcy

Tel.: +7 (495) 933 7567

E-mail: dmitry.yakushev@agp.ru



Andrey
Gorodissky
& Partners

Znamenka 13, bldg. 3, 3rd floor
Moscow, 119019, Russia

Tel.: +7 (495) 933-75-67

E-mail: office@agp.ru

www.agp.ru

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