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Bankruptcy disputes: Supreme Court overview of judicial practice in 2023



Russian version

On 15 May 2024 the Russian Supreme Court approved an overview of the judicial practice of resolving bankruptcy cases in 2023 (hereinafter the "**Overview**")^[1].

The Overview includes positions on imposing secondary liability against the controlling persons of a debtor, clarifications on contesting a debtor's transactions, and other issues arising during the application of the provisions of Federal Law No. 127-FZ dated 26 October 2002 "On Insolvency (Bankruptcy)" (hereinafter the "**Bankruptcy Law**").

We would like to draw your attention to the following clarifications.

Secondary liability

If a company has already been struck off the Unified State Register of Legal Entities, then when considering a creditor's

petition to impose secondary liability on controlling persons the court is required to assess the creditor's ability to obtain information on the debtor's business (Clause 8 of the Overview).

Background: A debtor was liquidated, and an entry to this effect was made in the Unified State Register of the Legal Entities. Subsequently, a creditor filed a petition on imposing secondary liability against the controlling persons of the debtor. The lower courts dismissed the petition, as the creditor had failed to submit evidence of grounds for imposing secondary liability.

Position of the Supreme Court: The lower courts should have taken a more proactive position and considered the issue of placing the burden of proof on the defendant rather than the claimant, by virtue of the following:

- the creditor was objectively unable to submit documents on the debtor's business;
- the defendant did not submit a statement of defence to the petition on imposing secondary liability;
- the defendant did not disclose evidence reflecting the actual state of affairs and turnover at the company under its control.

Consequently the de-registration of a company from the Unified State Register of Legal Entities *per se* does not prevent creditors from imposing secondary liability on the controlling persons of a bankrupt company. Moreover, the court is entitled to assign to the defendants the burden of proof of good-faith conduct, since once a company has been liquidated, creditors are unable to demand that the receiver provide documents on the company's activity.

The controlling person of a debtor, whose actions led to the bankruptcy of the company, may be subject to secondary liability based on the totality of the following facts: (1) the debtor has been held liable for tax purposes as a result of the defendant's actions and (2) Additional amounts of tax have been accrued that exceed 50% of the total claims of third-category creditors (Clause 7 of the Overview).

Background: The receiver filed a petition on imposing secondary liability against the former director and the former liquidator. The receiver cited the fact that the debtor had been held liable for committing a tax offence owing to the director's actions. The lower courts concluded that there were grounds for imposing secondary liability against the former director.

Position of the Supreme Court: The imposition of secondary liability against the defendant is contingent on the existence of two facts in aggregate:

- the imposition of tax liability for the non-payment or incomplete payment of taxes as a result of the understatement of the tax base or other unlawful actions;
- the accrual of additional taxes exceeds 50% of the total amount of the main debt to third-category listed creditors.

The Supreme Court thus drew attention to a quantitative criterion, as under the general rule a small amount of tax arrears does not serve as grounds for imposing secondary liability. The indicated position was previously set forth in Judgment No. 53 of the Plenary Session of the Supreme Court of the Russian Federation dated 21 December 2017 "On Certain Issues Related to the Imposition of Liability on the Persons Controlling the Debtor in the Event of Bankruptcy" (Clause 26), but this had not been taken into account by the lower courts.

Challenge of a debtor's transactions

Actions on netting out a contractual penalty accrued by the client for the late performance of work by a contractor against the cost of the work performed by a contractor may not be classified as a void transaction aimed at preferential treatment of the client over the contractor's other creditors (Clause 4 of the Overview).

Background: The client netted out its claims against the contractor (bankrupt company), namely its claim for the compensation of a penalty for the late performance of work, against a counterclaim of the contractor against the client for the payment of the cost of the work already performed.

The contractor's receiver filed a petition challenging the transaction, as the receiver considered the client's actions to constitute an offset resulting in the client receiving preferential treatment over the contractor's other creditors.

The courts supported the receiver's claim, stating that the rights of claim of the contractor against the client had been pledged to a bank prior to the offset. As a result of the offset, the rights of a scheduled creditor had been infringed, while the client had received preferential treatment for its claims.

Position of the Supreme Court: The netting out of a penalty as a form of compensation of the losses of the client (creditor), attributable to the improper performance by the contractor (debtor) of its primary

obligation, does not serve as grounds for declaring such netting to be a void preferential transaction.

If the amount of the contractual penalty to be offset during netting is clearly disproportionate to the consequences of the committed breach of the primary obligation, then the rights and legal interests of the bankrupt entity and its creditors should be protected through the application of Article 333 of the Russian Civil Code on reducing the penalty.

In the event of netting, a violation of Article 319 of the Russian Civil Code is inadmissible, in other words, the client's actions on establishing the net balance may not be taken to settle the claims of a client for a penalty prior to the settlement of its claims on the reimbursement of actual damage by the debtor. A court should verify the above when considering whether to include a client's claim in the creditor claims' register of the contractor.

Consequently, the Supreme Court has once again affirmed the admissibility of netting counterclaims of a similar nature of the parties arising from the same contract, stating that such actions do not constitute a preferential transaction over the other creditors.

[1]. <https://vsrf.ru/documents/thematics/33548/>.

Kind regards,

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