

Financial Rehabilitation procedure under Russian bankruptcy legislation

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Mikhail Turetsky, Baker & McKenzie



CONTEXT

Statistics of the Supreme Arbitrazh Court of the Russian Federation on bankruptcy proceedings

	2006	2007	2008	1H 2009
Petitions in bankruptcy	91 431	44 255	34367	18279
Financial rehabilitation/ successful	39/ 8	33/ 3	48/ 6	25/ 2
External management/ successful	947/ 31	752/ 41	579/ 40	395/ 6
Bankruptcy management/ rejected	76447/ 737	19328/ 563	13916/ 520	7460/ 322
Settlement agreement	106	126	126	50



Common violations by debtors in bankruptcy proceedings

- Use of bad faith techniques by the debtors (controlled bankruptcy, voluntary liquidation with bankruptcy management, asset stripping, controlled debt)
- In the absence of effective criminal prosecution procedures, it is difficult (but possible) to hold the debtor criminally liable
- A considerable part of the bankruptcy proceedings involves violations (71,000 complaints per 18,000 cases)



Western experience and Russian reality

- Bad faith conduct of debtors is wide spread
- Insufficient depth of control by the courts
- Liability of the bankruptcy administrator – who is his «client»?
- Western experience rarely works in Russia as it depends on good faith conduct of the parties
- Absence of effective control over the activities of the debtor from the creditors' side



PROPOSED AMENDMENTS



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- New regime for financial rehabilitation
- Out-of-court debt settlement agreements
- Joint bankruptcy of group companies
- Rules on cross-border bankruptcies



NEW RULES ON FINANCIAL REHABILITATION



New regime – main issues

1. Debtor may or, sometimes, must initiate financial rehabilitation
2. It is simple for the debtor to commence financial rehabilitation procedure
3. Plan of financial rehabilitation is developed by the debtor
4. Rights of the creditors are limited
5. New possibilities for violations by the debtor



1. The right/obligation to initiate the financial rehabilitation procedure

- Debtor may initiate financial rehabilitation procedure any time when the debts of the company exceed RUR100,000 - and continue with current management
- There is an alternative for the debtor: it may either initiate financial rehabilitation or file a claim for bankruptcy.

Conclusion: creditors may face introduction of financial rehabilitation procedures *en masse*



2. Simplicity of initiation of the financial rehabilitation procedure for the debtor

- The debtor is obliged to initiate financial rehabilitation if it is unable to pay its debts, does not have sufficient funds, according to the decision of its owner, etc.
- Bank guarantee requirement abolished
- The debtor does not bear any risks or liability if it fails to perform the plan of financial rehabilitation
- The debtor nominates an administrator
- The court can decline a petition on the initiation of the financial rehabilitation procedure only if there is a bankruptcy proceeding already



3. The plan of financial rehabilitation is developed by the debtor

- The plan of financial rehabilitation is developed by the debtor
- Financial rehabilitation plan will contemplate a repayment schedule based on different classes of creditors
- After the ratification of the plan by the court, the debtor will be repaying its debts in accordance with the new repayment schedule
- The terms and order of payment of debts of creditors may be changed by the plan of financial rehabilitation
- To approve the plan, 50% of the creditors present at the meeting or (if approved by administrator) 25% of the creditors present are sufficient



4. Limited rights of the creditors

- Only 30 days to file a claim. Late claims are ranked behind all other claims
- Event of default clauses may be disregarded
- Corporate approval procedures may be changed by the financial rehabilitation plan
- The creditors are tied up by the confidentiality of the report on the financial rehabilitation
- Little or no control available to the creditors over the performance of the financial rehabilitation plan



5. New opportunities for violations by debtors

- The right of the debtor to file a claim for bankruptcy of its group companies in the same proceedings
- The debtor has the right to divide creditors into classes
- The rules on counting of the votes of the creditors of different classes open the possibility for the debtors to obtain any results convenient for them
- A simplified process for approving the plan for financial rehabilitation
- The financial rehabilitation plan can be ratified by the arbitrazh court despite the will of the creditors if approved by an administrator



CONCLUSION



Balance of rights of debtors and creditors

- Bankruptcy legislation has to consider interests of both debtors and creditors
- Debtor-in-possession regimes exist in various jurisdictions and can have a positive impact on the economy
- Implementation of such a procedure should be accompanied by a system of «checks and balances» which could help prevent violations by the debtors

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