

Newsletter

Moratorium on bankruptcy proceedings

April 1, 2020

Dear Ladies and Gentlemen,

In an expedited process, a Federal Law amending several legislative acts was passed by the State Duma and Federal Council of the Russian Federation. In particular, the law envisages use of the power of the Government of the Russian Federation to impose, in extraordinary cases, a moratorium on insolvency proceedings and provides a legal regime of such moratorium. It is highly likely that the law will be signed by the President of the Russian Federation in the nearest future and will become effective on the day of its official publication.

The proposed amendments, in general, are in line with the similar measures being adopted in other countries, in order to avoid mass bankruptcies, amid an economic crisis.

In light of the proposed amendments, we would like to draw the attention of our clients and colleagues to the main provisions and problematic issues of the adopted law.

1 The scope of application of the moratorium

The moratorium will not apply to all debtors, but only to certain categories of entities. The respective list will be determined by the Act of the Government of the Russian Federation, indicating codes of Russian National Classification of Types of Economic Activity, or a list of categories of entities, which suffered from the circumstances, in connection to which the moratorium was introduced ("**Debtors**"). At the moment, there is no information on the possible categories of debtors, with respect to which the moratorium will be introduced. However in the course of a teleconference on 25th March 2020, the President of the Russian Federation, Vladimir Putin, noted that this will concern the debtors "*that work in sectors, most affected by the current complex situation*".

This furthestmost distinguishes the Russian law from the foreign analogues, as most of the latter introduce the moratorium on all debtors.

Besides, it is yet unclear whether the moratorium will extend to the insolvency of individuals, as the law does not mention it directly. Applying the rules of application of general rules of Bankruptcy Law to the insolvency cases of individuals, we presume that the moratorium will be effective with respect to them, as well.

2 The consequences of the moratorium for the creditors

(A) Impossibility to initiate insolvency proceedings

Creditors may not file bankruptcy applications. These applications will be returned by the courts. In addition, applications that were filed before the moratorium, but not yet accepted by the courts at the date of moratorium, will also be returned.

(B) Impossibility to enforce debt recovery

Apart from the submission of the bankruptcy application, creditors may not perform actions aimed at enforcing debt recovery: all execution proceedings are suspended, it is forbidden to enforce the pledge. The law also provides for the suspension of the accruing of financial penalties for non-performance of the debtor's obligations.

3 Consequences of the moratorium for the debtors

(A) Debtors affected by the moratorium may still file for bankruptcy at their discretion

Whereas the debtor's obligation to file for bankruptcy is suspended for the duration of the moratorium.

(B) Debtors may not pay out dividends, and the transactions of a debtor, performed during the moratorium, which fall beyond ordinary business activities, are void.

The latter provision seems to be quite controversial, as it de facto means that the debtor may not conclude any major transactions, including those aimed at restoration of solvency, for example, sale of non-core assets. In substance, the moratorium allows debtors to restore their solvency only by means of the transactions qualifying as ordinary business activities.

On the one hand, the above-mentioned partially undermines the positive effect of the proposed moratorium, while on the other this allows mitigating risks of disposal of the key assets during the moratorium and thus aims to keep certain balance of the creditors' interests

We hope that the subsequent court practice will follow a restrictive approach of the interpretation of this provision.

(C) Delay of the submission of bankruptcy applications by the state bodies and other persons

It is important to note that, besides the discussed law, on 18th March 2020 the Head of the Government of the Russian Federation, M.V.Mishustin, **ordered** the Federal Tax Authority of Russia, state corporations and federal state executive bodies and supervising organizations, to suspend the submission of bankruptcy applications until 1st May 2020. Thus, a "quasi-moratorium" is de facto relating to initiation of bankruptcy cases, based on claims of the state and entities connected to it, regardless of the categories of the debtors. We do not exclude the possibility that this timeline may be prolonged.

Moreover, the Ministry of Economic Development of Russia, together with the interested federal executive state bodies, were ordered to fast-track the preparation of the laws, introducing debt-restructuring procedures of organizations and out-of-court bankruptcy of individuals.

4 Recommendations

Even now, it is evident that the moratorium will help some of the debtors to avoid insolvency; however, with respect to many others, it will only postpone the inevitable bankruptcy. This will lead to a sharp increase in the number of bankruptcies, after the end of the moratorium.

Taking into account the potential introduction of the moratorium by the Government of the Russian Federation and an unprecedented character of the present situation, we recommend to be extra careful in dealing with potential Debtors placed under the moratorium, in particular:

(A) Concluding only those transactions that fall within the ordinary business activities of the debtor;

Bankruptcy Law defines a 'transaction within the ordinary business activities' as a transaction not exceeding 1% of the amount of the balance sheet of the debtor (objective criterion); additionally, such a transaction has to correspond to the main business activity of the debtor (subjective criterion).

Taking into account potential risks of the challenge of any transactions with the Debtors, we recommend to be mindful of the above-mentioned criteria when concluding the transactions with the Debtors, included in the list of the Government of the Russian Federation. In any case, even if the transaction conforms to the criteria of ordinary business activities, we recommend to check the solvency of the contracting party.

(B) Preparation for the bankruptcy of the debtors, obtaining judgements confirming debts;

Introduction of the moratorium is not a ground for refusal of protection of one's own interests, and in this period, it is possible to recover debts in court proceedings, which will allow the submission

of a bankruptcy application after the end of the moratorium, taking advantage of the preferences that the applicant in bankruptcy proceedings enjoys.

(C) Subordination of the claims of controlling and affiliated persons.

In several jurisdictions, legislators softened the approach to the so-called subordination of claims of affiliated creditors (re-qualification of civil claims into corporate claims in insolvency proceedings) for the duration of moratorium, equating such creditors to independent ones. Such a measure is primarily aimed at stimulating the financing of the debtor by its controlling entities, during the crisis.

However, the adopted law does not contain any provisions with respect to consideration of the claims of controlling and affiliated with the debtors' creditors. Most likely, such claims will continue to be subordinated by the courts, which must be taken into account when structuring the financing transactions.

We hope that the information provided herein will be useful for you. If any of your colleagues would also like to receive our newsletters, please send them the link to complete a [Subscription Form](#). If you would like to learn more about our [Restructuring and Insolvency](#) practice area, please let us know in reply to this email. We will be glad to provide you with our materials.

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