

# Russian Supreme Court clarifies bankruptcy claims of affiliates

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The Presidium of the Russian Supreme Court has approved a [Review](#)\* of the judicial practice in disputes related to claims made by persons or entities (below referred to as persons) controlling a debtor and its affiliates in bankruptcy proceedings.

The Review provides important clarifications on the specifics of the participation in bankruptcy proceedings of persons affiliated with a debtor and persons controlling the debtor's activities.

The clarifications contained in the Review will primarily be useful to independent creditors. They simplify the task of counteracting any attempts by persons controlling a debtor to unlawfully establish control in bankruptcy proceedings by filing fictitious claims.

Creditors who assist affiliated companies in critical economic situations need to remember that such financing is likely to be deemed "compensatory" (as described below) and – in the event of bankruptcy – they will not be able to control the bankruptcy proceedings.

Banks involved in managing the business of their debtors based on secured transactions also need to consider the resulting risks. If – in bankruptcy proceedings against their debtor – the bank acts in bad faith, the priority of its claim may be downgraded.

Details on the most important clarifications of the Supreme Court are outlined below.

## **A higher standard of proof applies to creditors affiliated with the debtor**

The Supreme Court has confirmed that courts should strictly consider whether claims by creditors affiliated with a debtor are justified. Such claims, unlike those of independent creditors, are subject to an increased standard of proof.

This means that it is not enough for an affiliated creditor to submit to the court a standard set of documents confirming that a debtor owes a debt for a particular obligation. An affiliated creditor is also required to eliminate any reasonable doubt that the debt is fictitious.

## **Financing an affiliate in a critical state creates additional risks**

A significant part of the Review refers to cases where the controlling company provides financing (in one form or another) to subsequently gain control of bankruptcy proceedings or, at the very least, guarantee that it is entered in the register of creditors under the same conditions as external, independent creditors.

According to the Review's general approach, the claims of persons controlling the debtor cannot have the same priority as those of independent creditors. Such claims are recognised as "compensatory financing". Compensatory financing is not included in the third rank of creditor claims, but is next in line before the distribution of the liquidation assets (i.e. assets remaining after settlements with all creditors are made to be transferred to the company shareholders or participants upon its liquidation). Hence, the person providing compensatory financing will be able to satisfy its claims only after settlements with all independent creditors are completed.

The Supreme Court indicated that when a debtor is in a critical economic state, it is obliged by law to file for bankruptcy. If, however, the person controlling the debtor decides to save its business and provides the insolvent company with financial assistance ("compensatory financing"), it takes on an increased risk.

Almost any assistance in a critical situation will be deemed compensatory financing. Granting a loan, deferring a debt, entering into any other transaction on non-market terms and even acquiring rights of claim towards an affiliate from an independent creditor: all these actions can be considered compensatory financing when provided by a controlling person.

**A claim to repay a loan issued by a controlled special purpose vehicle (SPV) is also not included in the third rank of creditor claims**

The Review addresses the issue of the priority of a creditor's claims when it provides financing to an SPV it controls.

In a particular case, the Supreme Court found that a bankrupt company was established for the implementation of a real estate project. At the same time, its charter capital (RUB 10,000 or about EUR 120) is clearly insufficient to conduct such a project. Instead of increasing the charter capital before the project's start, the person controlling the SPV granted it a substantial intercompany loan.

When the SPV went bankrupt, the controlling person started legal proceedings to request the inclusion of its claims under the loan agreement in the register of creditors.

The Supreme Court indicated that this kind of scheme gave the affiliate an undue advantage from the start, since the founder did not risk losing its investment in the SPV's charter capital if the SPV went bankrupt.

In such a situation, the rank of the controlling person's claim for inclusion in the SPV's register of creditors should be downgraded by reference to the claims of independent creditors.

#### Exceptions for good faith controlling persons and banks

The Review deals with the situation when the person controlling a company in a pre-bankruptcy situation provided it with compensatory financing, having first obtained the approval of the company's majority creditor. In such circumstances, the rights of other creditors (i.e. minority creditors) were not violated.

The Supreme Court noted in this case that the controlling person acted in good faith. Consequently, there was no reason to downgrade the priority of its claims in the event of the bankruptcy of the controlled entity.

A similar exception should apply to banks. Even if a bank grants a loan against security that allows it to participate in the debtor's business (e.g. a pledge of shares of the debtor with the right to vote), it still does not control the debtor.

If the bank exercises its rights under this collateral in good faith (i.e. as an ordinary creditor-pledger) and without prejudice to the debtor's business, the priority of the bank's claim cannot be downgraded.

If you have any questions on this eAlert, do not hesitate to contact CMS Russia experts [Konstantin Baranov](#), [Sergey Yuryev](#), [Igor Sokolov](#) or your regular contact at CMS Russia.

\* *In Russian*

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