FRESHFIELDS BRUCKHAUS DERINGER

BRIEFING

SUMMARY

MAY 2009

New rules on challenging transactions in insolvency

A new set of uniform rules for challenging transactions in insolvency and clarifying the circumstances in which debtors must file for insolvency has been introduced in Russia.

Background

On 28 April 2009, a new law[1] introducing certain modifications to the Russian insolvency legislation was signed by the Russian president following approval by the Russian legislative bodies. Most importantly, the law introduces a new set of uniform rules for challenging transactions in insolvency and clarifies the circumstances in which debtors must file for insolvency (the new rules). The new rules will take effect on 6 June 2009.

Broadly, transactions can still be challenged on the same insolvency-specific grounds as before, namely: *preference*, *undervalue*, *interested party transaction* and *executory contract*, in addition to the general civil law grounds for invalidating transactions. The new rules, however, have introduced specific criteria for determining preference and undervalue, clarified the concept of 'interested parties', set forth new statutory hardening periods for different types of transactions and clarified creditors' rights if a particular transaction is declared invalid.

Furthermore, the new rules have finally harmonised the rules for challenging transactions applicable to Russian credit institutions (banks) and non-banking corporates.

Undervalue or 'suspicious' transactions

The new rules have introduced the new concept of 'suspect' transactions (*podozritelnye sdelki*), which can be:

a transaction concluded by a debtor where the consideration receivable by it from its counterparty is not of equal value (*neravnotsennoe vstrechnoye ispolnenie*: Type A Suspicious transaction).

Type A Suspicious transactions include transactions where the fair value of the consideration payable and/or liability incurred by the debtor materially exceeds that payable or incurred by the counterparty or the terms of which are materially worse for the debtor when compared with those of analogous transactions concluded in similar circumstances; and

b transaction concluded by the debtor with a view to causing harm to the interests of the creditors (*prichinenie vreda imushenstvennym interesam kreditorov*), as a result of which the debtor's creditors may become unable to recover all or part of the debt due to them from the debtor's property, provided that (i) harm was actually caused to the creditors and (ii) the counterparty to the transaction was aware of the true intent of the transaction (Type B Suspicious transactions). The (ii) above is presumed where the counterparty is an interested party[2] or otherwise knew (or should have known) of the debtor's insolvency[3] or insufficiency of assets[4].

[1] Federal Law 'On Introduction of Amendments to Certain Legislative Acts of the Russian Federation' No. 73-FZ, dated 28 April 2009.

[2] The definition of 'interested parties' has now been clarified to include 'affiliates' of the debtor and entities comprising the same 'group of entities' with the debtor, as such terms are defined under Russian law.

[3] The new definition of 'insolvency' has now been introduced meaning essentially suspension of performance by the debtor of a part of its monetary obligations due to insufficiency of funds (which is presumed unless proved otherwise).

[4] The new definition of 'insufficiency of assets' has now been introduced meaning essentially the circumstance where the debtor's monetary obligations exceed the amount of its asset value.

Type B Suspicious transactions include, without limitation, the following transactions:

- transactions resulting generally in the decrease of the debtor's asset base or asset value and/or increase of the volume of the claims towards the debtor;
- transactions concluded by the debtor with an interested party or without consideration at the time when the debtor was already insolvent or had insufficiency of assets;
- transactions (or a series of related transactions) where the aggregate value of consideration payable and/or liability incurred by the debtor exceeds 20 per cent (or, in the case of a bank, 10 per cent) of the debtor's balance sheet asset value; and
- transactions where, after disposal of an asset, the debtor maintained possession and/or control over the relevant asset.

Suspicious transactions may be invalidated by the court, at the request of the insolvency administrator, if concluded within three years prior to the insolvency filing or any time after the filing. In cases of Type A Suspicious transactions, this is reduced to just one year.

Preference

This applies to transactions that lead, or may lead, to preferential treatment for a particular creditor. The new rules set out the following criteria for determining preference (Type A Preference transactions):

a transactions aimed at providing security for pre-existing debt;

b transactions that may alter the order in which the then existing creditors' claims were discharged;

c transactions that may lead to a discharge of unmatured debt owed to a particular creditor; and

d transactions resulting in a discharge of a particular creditor's claims in preference to the statutory priority.

Preference transactions may be invalidated by the court at the request of the insolvency administrator if concluded within one month prior to the insolvency filing or any time after the filing.

Preference transactions referred to in paragraphs (a) and (b) above or any preference transaction where the counterparty is an interested party or a party that should have otherwise known of the debtor's insolvency or insufficiency of assets (Type B Preference transactions) may be invalidated if concluded within six months prior to the insolvency filing or any time after the filing.

Excluded transactions

Transactions made by the debtor (a) on a stock exchange; (b) in the ordinary course of its business unless the value of a given transaction exceeds 1 per cent of the debtor's aggregate asset value; or (c) against adequate consideration, unless intended to cause harm to the interests of the creditors (eg Type B Suspicious transactions) cannot be challenged.

Furthermore, the court may refuse to invalidate a particular transaction on insolvency grounds if (a) the value of the property received by the debtor exceeds the amount that, upon invalidation, would have to be returned to the debtor's bankruptcy estate or (b) the counterparty has returned the consideration received from the debtor to the debtor's bankruptcy estate.

Rights of creditors

Suspicious transactions and preference transactions are *voidable* rather than void *ab initio*: ie they remain valid and binding until set aside by a court. If successfully challenged, all consideration given by the debtor under the relevant transaction will be returned to the debtor's bankruptcy estate, with the counterparty acquiring an unsecured claim against the debtor ranking (a) together with claims of all other unsecured creditors or, (b) in the case of Type B Suspicious or Type B Preference transactions, behind all other unsecured creditors.

Other significant changes

Apart from the above, the new rules also:

a impose an obligation on the debtor's general director to file for insolvency as soon as it becomes aware of the debtor's insolvency or insufficiency of assets, but no later than within one month of becoming aware of these circumstances; and

b introduce rules (with respect to both Russian banks and non-banking corporates) whereby a debtor's controlling person (*kontrolirueshee litso dolzhnika*), founder (participant), director or other managing body may be held liable for the debts of the insolvent debtor.

This material is for general information only and is not intended to provide legal advice.

© Freshfields Bruckhaus Deringer LLP 2009
www.freshfields.com

For further information please contact

Mikhail Loktionov
Partner
T +7 495 785 3000
E mikhail.loktionov@freshfields.com

Yuri Shumilov
Associate
T +7 495 785 3073
E yuri.shumilov@freshfields.com

Freshfields Bruckhaus Deringer LLP is a limited liability partnership registered in England and Wales with registered number OC334789. It is regulated by the Solicitors Regulation Authority. For regulatory information please refer to www.freshfields.com/support/legalnotice. Any reference to a partner means a member, or a consultant or employee with equivalent standing and qualifications, of Freshfields Bruckhaus Deringer LLP or any of its affiliated firms or entities.