GAIDAR INSTITUTE FOR ECONOMIC POLICY

RUSSIAN ECONOMY IN 2015
TRENDS AND OUTLOOKS
(*ISSUE 37*)

Gaidar Institute
Publishers
Moscow / 2016

UDC 33(470+571)(066)"2015"
BBC 65.9(2Poc)

R95 **Russian Economy in 2015. Trends and Outlooks. (Issue 37) /**
[V. Mau at al; ed S. Sinelnikov-Murylev (editor-in-chief), A. Radygin];
M.: Gaidar Institute Publishers, 2016. 440 pp. – ISBN 978-5-93255-459-3

The review provides a detailed analysis of main trends in Russia's economy in 2015. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; the real sector; social sphere; institutional challenges. The paper employs a huge mass of statistical data that forms the basis of original computation and numerous charts.

UDC 33(470+571)(066)"2015"
BBC 65.9(2Poc)

ISBN 978-5-93255-459-3

Elena Apevalova, Natalia Polizhaeva, Alexander Radygin

Evolution of bankruptcy institution: from insolvency of state-owned enterprises towards electronic SRO trading facilities[1]

6.2.1. Bankruptcy legislation in post-Soviet Russia

Bankruptcy legislation in the post-Soviet Russia was for the first time introduced in 1992 by the Executive Order of the President "On Measures for the Support and Rehabilitation of Insolvent State-Owned Enterprises (Bankrupt Debtors) and the Application of Special Proceedings to Them" No. 623 of June 14, 1992, which stipulated grounds for liquidation of enterprises, special liquidation proceedings such as reorganization, rehabilitation, direct administration of the enterprise, independent management, auctions for sale of enterprise, and other provisions concerning bankruptcy.

The *first law on bankruptcy* – Federal Law "On Insolvency (Bankruptcy) of Enterprises" No. 3929-1 dated November 19, 1992 – was adopted in late 1992. Although the number of bankruptcy petitions in commercial courts increased visibly in 1995–1997, the number of bankruptcy proceedings remained small in Russia.

The law was based on the concept of inability to pay due to the assets-to-liabilities ratio, and if an enterprise is worth less than its liabilities, it is deemed to be insolvent on a book value basis. The law practice revealed that creditor rights were limited considerably because commercial courts faced difficulties in determining a fair value of debtor's assets, thus delaying with issuing a bankruptcy order against the debtor. Additionally, the state was acting as senior creditor by collecting through tax penalties all liquid assets with the aim of paying tax liabilities.[2]

The *second federal law on bankruptcy* was adopted in 1998, because the first law proved inefficient. The second law was based on the concept of default. An enterprise is deemed to be bankrupt if it is unable to fulfill its obligations as they come due, which is recognized as insolvency on a cash basis.

The law lowered the barriers to initiating bankruptcy proceedings and strengthened the status of creditors. As a result, the scope of insolvency proceedings was broadened progressively. The number of bankruptcies soared because prior to the introduction of bankruptcy proceeding in 1998 companies accumulated a great deal of liabilities to the federal budget and regional budgets, as well as to private creditors.

Under the second law the creditor may file for bankruptcy against the debtor if the latter fails to fulfill its obligations within three months and if the outstanding amount is more than 500 times the wage floor, thereby creating equal opportunities for creditors to initiate bankruptcy proceeding. However, no consideration was made for cash gaps that occurred in practice and for the scope of business operations.

The state had no right to vote on crucial resolutions passed at meetings of creditors, and the issues of affiliation of bankruptcy trustees worsened, etc. The institution of bankruptcy was found to be widely used as a tool of distributing the debtor's estate and of asset stripping. In 1998–2002, the initiation of bankruptcy proceeding was actually turned into a cost effective

[1] Authors of this section: Apevalova E. – RANEPA, Polezhaeva N. – RANEPA, Radygin A. – RANEPA.

[2] See Apevalova E., Radygin A. Bankruptcies in the 2000s: from takeover tool towards double standard policy. – V: Ekonomicheskaya Politika, 2009, No. 4, pp. 91-124.

alternative to hostile takeover by way of purchasing shares in the secondary market. Russia's Federal Service on Financial Rehabilitation and Bankruptcy (FSFO) reported that one in five bankruptcy cases exhibited signs of malicious intentions (in particular, filing for bankruptcy with the aim of writing off debts).

The *third federal law on bankruptcy* which is currently in effect was adopted in 2002. The adoption was necessitated by an array of problems which the first (1992) and the second (1998) laws failed to address. Below listed are most pressing issues that were observed at that period:

– widespread practice of using bankruptcy as takeover tool;

– infringements of the rights of the debtor and of the debtor's founders;

– infringements of the rights of the state as tax creditor;

– writing off the debtor's assets for the benefit of a certain group of creditors as part of receivership and trusteeship proceedings;

– lack of transparency, inadequate regulation of bankruptcy proceedings, allowing bankruptcy trustees and other parties to a bankruptcy process to misuse the loopholes therein;

– lack of efficient arrangements holding bankruptcy trustees liable for bad faith and ineffective performance, etc.

The third law aimed to address these issues and it was adopted as a result of trade-off between the supporters of two opposite views as to further development of the institution of bankruptcy.[1] The law was updated with some critical provisions as follows:

– the state and bankruptcy creditors enjoy equal rights, and claims of the state are consolidated;

– owners acting in good faith enjoy better protection of their rights;

– the risk of abusing the right by creditors is mitigated;

– a new reorganization proceedings – financial rehabilitation – was introduced;

– parties to bankruptcy proceedings, which are acting in good faith are protected from fraudulent actions of other persons;

– supervision over bankruptcy trustees has become more efficient;

– specifics of bankruptcy of certain categories of debtors are set out in a single law;

– a wider-than-normal usage of bankruptcy proceedings for winding up absent debtors is limited.

The introduction of the law resulted in drastic slump of the number of bankruptcy proceedings from 106,600 in 2002 to 14,300 in 2003 because tax authorities almost stopped filing for bankruptcy against absent debtors due to no allocation of budget resources for this purpose. Later, the peak of bankruptcies of absent debtors was reached in 2006, and it was never hit again since then.

The principal initiator of bankruptcy proceedings was identified since the inception of the new law. Most of the bankruptcies until 2011 were initiated by competent public authorities, predominantly by tax authorities which in 2006 accounted for 87% of the total petitions for bankruptcy. The percentage decreased gradually in the following years, reaching 31% by 2011. 2009 and 2010 saw the biggest number of substantiated bankruptcies, 35,200 and 36,600, respectively.[2]

---

[1] See Radygin A., Simachev Y. Russia's bankruptcy institution: specifics of evolution, issues and prospects. – V: Russian Management Journal, 2005, Vol. 2, No. 2, pp. 43-70.

[2] Apevalova E.A. Bankruptcies in 2011–2012: decline in bankruptcies, new regulation and debt restructuring bill. // Russian Economy in 2012: Trends and Outlooks. – M., Gaidar Institute, 2013

An extremely low effectiveness of using the bankruptcy mechanism for the purpose of *restoring the solvency of enterprises* in the course of bankruptcy proceedings is one of the strongest trends.

As regards critical updates, the principal emphasis should be placed on amendments made in the peak of the crisis, that is, between December 2008 and April 2009 (Federal Law of "On the Amendments to the Federal Law "On Insolvency (Bankruptcy)" No. 296-FZ dated December 30, 2008 and Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation") No. 73-FZ dated April 28, 2009. The amendments aimed first of all to *increase transparency of bankruptcy proceedings*, namely the performance of bankruptcy trustees (updating the payment system, broadening powers and raising liability of bankruptcy trustees) and respective self-regulatory organizations (enhancing control over such organizations, introducing mandatory disclosure of the performance of such organizations, establishing a procedure for using the compensation fund).

Additionally, asset stripping countermeasures – mechanisms that challenge debtor's assets stripping transactions – "suspicious transactions" and "transactions giving preference to one of the creditors over the others" were introduced. Thus legislative measures were introduced with the aim of narrowing the "grey" background in the field of bankruptcy. In addition, the liability of debtor's owners – "persons controlling the debtor" – was introduced.[1]

The rest of the 2002–2013 updates were mostly of technical nature. They first of all baked up the state expansion policy (state-owned companies' activity) in the economy or protected the interests of certain groups of persons, and they were not general measures of systemic development of the institute of bankruptcy.

The context changed again in 2014–2015, when the number of bankruptcies reached more than 14,500 in 2014 (against 12,000 in 2013) and was maintained at 14,600 in 2015.[2] Accordingly, this required a response from the regulator, and some systemic updates had to be introduced, too.

6.2.2. Bankruptcy law of 2014–2015: systemic updates

The Federal Law On Insolvency (Bankruptcy)[3] saw many amendments of various types since the start of 2014, which relate to both the general provisions and the specifics of bankruptcy of certain categories of debtors.

The amendments to the *general provisions* were in part related to the disclosure practice (basically Article 28 thereof), the meeting of creditors (Articles 12, 13, 18 thereof), the sale of the debtor's enterprise and estate (Articles 110, 139 thereof).

To prevent any abuse on the debtor and creditor side, the minimum value of creditors' outstanding claims admissible by a commercial court as a grounds for initiating insolvency proceedings against the debtor (legal entity) was raised from RUB 100,000 to RUB 300,000 (Clause 2 of Article 6, Clause 2 of Article 33 thereof). As regards monitoring, it was established that from the date of the commercial court ruling on the initiation of monitoring no financial sanctions shall be imposed on the failure to fulfill financial obligations and mandatory payments, except current payments; the amount of claims of the bankruptcy creditors and of the

[1] Apevalova E.A. Bankruptcies in 2009–2010: Dynamics and trends // Russian Economy: Trends and Perspectives, M., Gaidar Institute, October 2011

[2] Bazanova E. Late last year saw growth of bankruptcies due to ruble devaluation. – Vedomisti, January 13, 2016.

[3] Federal Law "On Insolvency (Bankruptcy)" No. 127-FZ dated October 26, 2002 // RG, No. 209-210, November 2, 2002.

authorized body is subject to an interest charge equal to the key rate of interest quoted by the Bank of Russia on the date of initiation of monitoring (Clauses 1, 4–6 of Article 63 thereof).[1]

It was clarified that bankruptcy is not only the commercial court's declaration of inability of the debtor to satisfy in full the creditors' claims of monetary obligations and/or to fulfill the obligation of mandatory payments, but it is also inability to satisfy the claims of severance benefits and/or of remuneration for the labor of the persons working or worked under labor contract (Article 2 thereof).[2] The other articles were amended and updated accordingly (Articles 3–5, etc. thereof).

The former debtor's employees may file for bankruptcy against the debtor, including but not limited to pooling their claims (Clause 1 of Article 11, Clause 5 of Article 39 thereof).[3] Unlike other claimants, the debtor's employees and former employees have no obligation to cover court costs, fees payable to bankruptcy trustees where the debtor's resources are insufficient to cover such costs (P. 3 Clause 3 of Article 59 thereof).

A new article (Article 12.1) was introduced, which regulates the meeting of debtor's employees, former employees, the appointment of a representative of the debtor's employees, whose services shall be paid by the debtor. This creates preconditions under which qualified representatives of debtor's employees, that are independent of the employer, may emerge in the legal market.[4]

The priority ranking of the claims of creditors was updated (from four to five) because claims of remuneration for the labor of the foregoing persons and the severance benefit claims were classified as second priority claims aside from the claims of remuneration for the labor of the persons engaged by the bankruptcy trustee. Furthermore, a proceedings for satisfying second priority claims on a pro rata basis was established (see Clause 2 of Article 134, Clause 5 of Article 136 thereof).[5]

Hence an attempt was made to *protect the most vulnerable category of creditors, namely the debtor's employees.* However, bankruptcy and further liquidation of the employer may entail undesirable job loss, which to some part will restrain misconduct of workers but not of other persons acting in bad faith (e.g., competitors) who might misuse this tool. This can be avoided by the employer satisfying promptly the claims of remuneration for the labor of the employees.

There is another big package of amendments to the general provisions of the Federal Law "On Insolvency (Bankruptcy)", which govern *bankruptcy trustees* and their self-regulatory organizations (SROs).[6]

For example, the SRO governing board may decide to increase the legally prescribed minimum sum insured under the agreement on compulsory insurance of liability of the bankruptcy trustee (Rb 3m a year). Besides a compulsory liability insurance sub-agreement that is approved

[1] See Subclause "a", Clauses 2, 18 of Article 1, Federal Law "On the Amendments to the Federal Law "On Insolvency (Bankruptcy)"…" No. 482-FZ dated December 29, 2014 // RG, No. 299 of December 31, 2014.

[2] Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation" No. 186-FZ dated June 29, 2015// RG, No. 146, July 7, 2015.

[3] Previously, the claims of remuneration for the labor were considered for detecting signs of the debtor's bankruptcy, but they did not serve as the grounds for submitting the application in question.

[4] Substantial amendments to Federal Law On Insolvency (Bankruptcy) concerning the status of the enterprise's employees // ConsultantPlus SPS. 2015.

[5] First, the claims of severance benefits and/or of remuneration for the labor, not more than Rb 30,000 a month per person. Second, the rest of the claims of severance benefits and/or of labor remuneration. Third, the claims of fees payable to persons for their intellectual deliverables (results of their intellectual activity).

[6] Federal Law "On the Amendments to the Federal Law "On Insolvency (Bankruptcy)" No. 405-FZ dated December 1, 2014 // RG, No. 275 of December 3, 2014; Federal Law No. 482-FZ dated December 29, 2014.

by a commercial court in the course of bankruptcy proceedings, the governing board may also bind the bankruptcy trustee to enter into a separate agreement whereby the sum insured is set by the SRO governing board (Clauses 2, 2.1 of Article 24.1 thereof).

If while approving the bankruptcy trustee under a bankruptcy case the SRO provides information proving that the nominee fails to meet the prescribed requirements, the commercial court may rule not to appoint the nominee as bankruptcy trustee or appoint the nominee as bankruptcy trustee and bind him/her to enter into a liability insurance sub-agreement. The insured sum thereunder must be not less than the SRO's compensation fund value (Clause 5 of Article 45 thereof).

Furthermore, the SRO's compensation fund minimum value must be equal to Rb 20m, and the general rule is that a compensatory payment from the fund may be equal to or less than Rb 5m for a single case of losses (Clauses 2, 11 of Article 25.1 thereof). The bankruptcy trustee whose actions entail a compensatory payment must compensate the SRO members for losses incurred as a result of having to bring the compensation fund value in compliance with the applicable law (Clauses 4, 5 of Article 20.4 thereof).

Hence the subsidiary nature of the SRO liability to the extent of funds available in the compensation fund regarding the bankruptcy trustee and his/her insurer (i.e., the liability occurs only if the trustee and his/her insurer fails to satisfy the damaged party's claims) and the organization's right to increase the sum insured under agreements on compulsory insurance of liability of the bankruptcy trustee *contributes to safety of the SRO's compensation fund*. The bankruptcy trustee's liability to compensate the SRO members for losses incurred as a result of having to recover the compensation fund, and the introduction of the upper level of compensatory payment from the SRO's compensation fund aim to reach the same objective. With the compensation fund minimum value in place, damaged parties have more chances of full compensation for losses incurred by the failure of the bankruptcy trustee to perform his/her duties in a bankruptcy case.

The Federal Law "On Insolvency (Bankruptcy)" rules that the SRO governing board's decision on termination of the bankruptcy trustee's SRO membership if he/she is expelled for the SRO is deemed to be made when approved by two-thirds of the member votes cast (Clause 7 Article 21.1 thereof). Since SRO membership is a mandatory condition for working in the capacity of bankruptcy trustee, it appears that legislators set strict requirements for the expulsion from SRO membership in an effort to *prevent building up barriers to accessing the market*.

As regards bankruptcy hearings in commercial courts, the debtor's application may not specify the nominee interim receiver and it may only specify a SRO duly chosen on a random basis, and one of the SRO members must be approved as interim receiver (Clauses 2, 5 Article 37 thereof).[1]

Extended is the list of grounds allowing SROs to apply to court on dismissal or expulsion of the bankruptcy trustee (a SRO member) from a bankruptcy case, e.g., when an administrative penalty in the form of disqualification for committing an administrative infraction is imposed on the bankruptcy trustee (Clause 2 of Article 22, Clause 2 of Article 20.5, etc. thereof).

Overall, the amendments relating to bankruptcy trustees and their SROs aim first of all to prevent potential abuses by bankruptcy trustees acting in bad faith and to enhance the quality of duties they perform.

[1] This rule is not applied to the application of the bankruptcy creditor and authorized body (Clause 2 of Article 39, Clause 3 of Article 41).

Since December 29, 2015 (1) the term of holding bankruptcy trustees administratively liable was extended to three years;(2) a provision was made for disqualifying the bankruptcy trustee for a period of six months to three years if he/she commits another administrative infraction;(3) it is not permitted to appoint the bankruptcy trustee for new bankruptcy proceedings within three years of the date of his/her exclusion from previous proceedings. On January 1, 2017 the SRO's compensation fund minimum value will increase to Rb 50m and compensatory payment will make up 50% of the compensation fund value.[1]

These strict requirements to bankruptcy trustees and their SROs and the strengthened role of the state may lead to *an increase in bankruptcy proceedings costs*, a reduction in the number of SROs, a *higher corruption in this field* and lower economic value of bankruptcy trustees, wherefore legislators should be extremely cautious with regard to the proposed amendments.[2]

An important amendment is that the debtor's estate or enterprise may be sold electronically in the course of the proceedings as part of a bankruptcy case, provided that the electronic trading facility[3] with whom the bankruptcy trustee or the auction organizer enters into a sale agreement is a member of *electronic SRO trading facilities* established for the purpose of developing and regulating the activity of its members (Clause 20 Article 110 thereof).

Eight new articles governing this new type of SROs were introduced, which regulate the electronic SRO trading facility membership, bodies, rights and obligations, compensation fund, supervision over electronic SRO trading facilities, the liability of electronic trading facilities, and agreement on compulsory insurance of such liability (Articles 111.1–111.8 thereof).

Electronic SRO trading facilities must meet the general requirements set out in the Federal Law "On Self-Regulatory Organizations"[4] and the special strict requirements set forth in the Federal Law "On Insolvency (Bankruptcy)". For example, an electronic SRO trading facility may be registered as nonprofit organization if 50% of the members have 2 years of experience in electronic trading and all the members have a record of 5,000 trading sessions. The value of mandatory compensation fund of electronic SRO trading facilities is equal to Rb 3m per member, and the electronic trading facility must compensate to other members of the electronic SRO trading facilities for damages incurred by a compensatory payment from the fund. To become a SRO member, the electronic trading facility must have an agreement on compulsory insurance of liability. The minimum value of the insured sum thereunder is Rb 30m a year.

Thus, although only 10 members are requires for the registration of electronic SRO trading facility, the foregoing requirements counteract establishing low-quality organizations in large quantities.

Some of the amendments covered *certain categories of debtors* such as nongovernmental pension funds, real estate developers, agricultural organizations, clearing members and clearing members' customers. The requirements for the minimum value to be considered for instituting a bankruptcy proceedings were increased from Rb 500,000 to Rb 1m for enterprises and organizations of strategic importance as well as for natural monopoly entities (Clause 4 Article 190, Clause 3 of Article 197 thereof). In an effort to create an efficient legal regulation of the securitization process, which facilitates an increase of financial resources in Russia's economy and

[1] Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation" No. 391-FZ dated December 29, 2015 // RG, No. 297, December 31, 2015.

[2] Okun S. Regulated self-regulation: bankruptcy proceedings costs to rise // Kommersant, December 25, 2015. URL: http://kommersant.ru/doc/2887181.

[3] Any legal entity or individual as self-employed entrepreneur engaged in electronic trading.

[4] Federal Law "On Self-Regulatory Organizations" No. 315-FZ dated December 1, 2007 // RG, No. 273, December 6, 2007.

broadens the spectrum of securities available for investors, the chapter regulating simplified proceedings in bankruptcy cases was updated with a new paragraph on bankruptcy of special-purpose vehicles and mortgage agents (§ 3, Chapter XI thereof),[1] which contains provisions on irreversible assignment of securitized financial assets to ensure true sale of financial assets for the purpose of securitization.[2]

The provisions on bankruptcy of credit institutions and on bankruptcy of citizens were modified most of all.

The provisions on *bankruptcy of credit institutions* were moved from Articles 181, 182 to a stand-alone paragraph (§ 4.1, Chapter IX)[3] made up of about 100 articles, which makes it the biggest among the sections regulating the specifics of bankruptcy of certain categories of debtors. It is the right time to make sure the legislation on bankruptcy of credit institutions is up to the modern environment and allows for creating a unified regulatory environment and enhancing the effectiveness of law enforcement, because drastic (often adverse) developments in the financial sector in 2014–2015 (devaluations of the ruble, revocations of banking licenses, etc.) posed serious challenges for all Russia's financial institutions.[4]

Two paragraphs came into force on October 1, 2015, namely the paragraph on *citizen's debt restructuring* and sale of the citizen's property, as well as the paragraph on the specifics of hearing thea bankruptcy case of a citizen in the event of his/her death[5] (§ 1.1, 4, Chapter X thereof).[6] The older version of the Federal Law "On Insolvency (Bankruptcy)" contained a paragraph regulating bankruptcy of citizens (§ 1, Chapter X thereof), which did not work[7] and therefore ceased to be in force.[8] A new paragraph includes special provisions – unregulated thereby cases related to bankruptcy of citizens shall be regulated by the provisions regulating bankruptcy of legal entities (Clause 1 of Article 213.1 thereof).

Petitions to initiate bankruptcy proceedings against a citizen may be filed to a commercial court by the citizen, bankruptcy creditor, and the authorized body. A petition may be accepted by the court to the extent that the claims against the citizen are not less than Rb 500,000 (previously Rb 10,000) and have been unsatisfied for a period of three months from the date when they have come due (Article 213.3 thereof). The bankruptcy creditor or authorized body may file petition approved by the court's order entered into legal force and upholding the claims of creditors. No court's order is required for claims of mandatory payments; notarized claims, etc. (Clauses 1, 2 of Article 213.5 thereof).

---

[1] See Clause 38 of Article 1 of Federal Law No. 482-FZ dated December 29, 2014; Clause 13 of Article 12 of Federal Law "On the Amendments to Certain Legislative Acts of the Russian Federation" No. 379-FZ dated December 21, 2013// RG, No. 291, December 25, 2013.

[2] Borisov A.N. Comments to Federal Law "On Insolvency (Bankruptcy)" No. 127-FZ dated October 26, 2002 (CbC). 2nd issue, revised and updated // ConsultantPlus SPS. 2014.

[3] Because Federal Law "On Insolvency (Bankruptcy) of Credit Organizations" No. 40-FZ dated February 25, 1999 *ceased to be in force* // RG, No. 41-42, March 4, 1999. See Clause 22 of Article 7 Federal Law of December 22, 2014 No. 432-FZ "On the Amendments to Certain Legislative Acts of the Russian Federation..." // RG, No. 296, December 26, 2014.

[4] Sintsov V. A few amendments to the legislation on bank bankruptcy // Bankovskoye Pravo. 2015. No. 3. PP. 17-20.

[5] The principal amendment – the bankruptcy case of a citizen may be initiated after his/her death or after the announcement of his/her death, i.e., this refers to bankruptcy of assets of estate.

[6] See Subclause "б", Clause 23 and Subclause "e", Clause 4 of Article 6 Federal Law "On Regulation of the Specifics of Insolvency (Bankruptcy) on the Territory of the Republic of Crimea and the Federal City of Sevastopol.." No. 154-FZ dated June 29, 2015 // RG, No. 144, July 3, 2015.

[7] See hereinafter: Lotfullin R. Bankruptcy of individuals. Proceedings and consequences that creditors to be prepared for // Yurist Companii. 2015. No. 9. P. 16.

[8] See Subclause "a", Clause 23 of Article 6 of Federal Law No. 154-FZ dated June 29, 2015.

The petition of bankruptcy against a citizen shall specify the SRO whose member must be approved as financial manager, but it shall not specify the trustee as required for the petition of bankruptcy against a legal entity filed by the bankruptcy creditor or authorized body (the debtor's (legal entity) petition shall specify only SRO) (Clause 2 Article 39, Clause 3 of Article 41 thereof). The money spent on the financial manager fee equal to the fixed fee paid to the financial manager for a single proceedings, which is used in the bankruptcy case of a citizen (Rb 10,000 (Clause 3 Article 20.6 thereof)), shall be deposited with the commercial court (Clause 4 Article 213.4, Clauses 3, 4 Article of 213.5 thereof).

After considering the validity of the petition the court shall determine that the petition is either invalid or valid and that the citizen's debt restructuring is to be instituted. The citizen must be proved insolvent in the latter case (see Clauses 1–3 of Article 213.6 thereof). If the citizen fails to meet the requirements for approving the debt restructuring plan, the court may declare the citizen bankrupt on the basis of citizen's petition and institute the proceedings of sale of his/her property (Clause 8 Article 213.6 thereof).

However, note that the original amendments suggested that general jurisdiction courts, not commercial courts, should hear bankruptcy cases against citizens, although the former have not much judicial experience in this category of cases. However, the respective provisions were abolished before they came into force.[1] A draft bill is currently under consideration of the State Duma (the lower house of Russia's parliament), which provides for distribution of citizen bankruptcy cases between the foregoing courts.[2]

The bankruptcy proceedings against citizens, namely debt restructuring, sale of assets, amicable agreement (Article 213.2 thereof), is a simplified version of the bankruptcy proceedings against legal entities.[3]

In terms of *amicable agreement*, citizens and legal entities are governed by the same regulations (Chapter VIII, Article 213.31 thereof).

Restructuring of citizen's debts combines proceedings for monitoring and financial rehabilitation of the legal entity (debtor) and aims to restore the citizen's solvency and repay his/her outstanding debt to the creditors under the debt restructuring plan. The citizen's debt restructuring proceedings aims to ensure the citizen's estate are safe, analysis of the citizen's financial status is made, the list of creditors' claims is compiled and the first meeting of creditors is held (Article 213.11 thereof).

Not later than within 10 days from the date of expiration of the two months allocated for filing claims against the citizen (Clause 2 of Article 213.8 thereof),[4] the citizen, creditor or authorized body may forward a draft citizen's debt restructuring plan to the financial manager, bankruptcy creditors, authorized body. However, there is a problem with creditor's access to the information (the list of citizen's assets, the data on accounts payable, etc.) attached to the

[1] See Clause 6 of Article 1 of Federal Law "On the Amendments to the Federal Law "On Insolvency (Bankruptcy)".." No. 476-FZ dated December 29, 2014 // RG, No. 299, December 31, 2014; Article 12 of Federal Law No. 154-FZ dated June 29, 2015.

[2] Draft bill No. 831972-6 "On the Amendments to the Federal Law "On Insolvency (Bankruptcy)" (with regard to changing court jurisdiction for hearing bankruptcy cases against individuals) // URL: http://asozd2.duma.gov.ru/main.nsf/%28SpravkaNew%29?OpenAgent&RN=831972-6&02.

[3] In order to cut the citizen's costs, it is not required to publish in an official edition information on the progress of the proceedings as part of the citizen's bankruptcy case (Clause 1 of Article 213.7).

[4] In case of excusable failure to timely file the claims within the prescribed time line, the time line may be restored by court (Clause 2 of Article 213.8 thereof).

draft plan (Article 213.15 thereof), and with uncertainty of the consequences of failure to forward the draft plan within the prescribed time limit.

Should the financial manager receive no draft plan, he/she shall submit a proposal for consideration of the meeting of creditors for the citizen's bankruptcy and for the initiation of sale of his/her property. The financial manager must hold the first meeting of creditors[1] in no event sooner than 20 days from the date of submission of the draft plan, but not later than within 60 days from the date of expiration of the two months allocated for filing claims against the citizen (Clauses 1, 4, 5 of Article 213.12 thereof).

After considering the citizen's debt restructuring plan, the commercial court may determine that the plan is either approved or not approved, that the citizen is declared bankrupt and that the sale of his/her property is initiated (see Article 213.18 thereof on the grounds for rejection) (Clauses 1, 3 of Article 213.17 thereof).[2]

The plan must be implemented within three years (Clause 2 of Article 213.14 thereof). After considering the results threrefrom, the court shall determine that the citizen's debt restructuring is completed or that the plan is abolished and the citizen is declared bankrupt (Clause 5 of Article 213.22 thereof).

Sale of citizen's property is rehabilitation proceedings similar to trusteeship proceedings for legal entities (as debtors), which for the purpose of equitable satisfaction of the claims of creditors is applied in bankruptcy cases to citizens declared as bankrupt.

If the commercial court declares a citizen bankrupt, the court shall institute the sale of the citizen's property within a period of six months (unlike in trusteeship, the specified tem may be extended) (Clause 2 of Article 213.24 thereof).

All the citizen's property that are available as of the date of court's order declaring the citizen is bankrupt and the sale of the citizen's property is initiated, as well as the citizen's property that are identified after the date of the court's order, are referred to as the bankruptcy estate,[3] except the property that cannot be seized and sold, e.g., household goods (Clause 1 of Article 446 of the Civil Procedure Code of the Russian Federation[4]) (Clauses 1, 3 of Article 213.25 thereof).

In order to minimize costs of bankruptcy cases against citizens, the financial manager by him/herself shall appraise the citizen's property. Should the meeting of creditors resolve to outsource an appraiser, the appraisal costs shall be paid by the persons who voted for the resolution (Clause 2 of Article 213.26 thereof). However, the Federal Law "On Insolvency (Bankruptcy)" does not specify how the financial manager must appraise the citizen's property (Clause 6 of

---

[1] Unlike the meeting of debtor's (legal entity) creditors, the meeting of creditors in the event of citizen's bankruptcy may be held by absentee voting (without a physical meeting) (Clauses 4, 8 of Article 213.8).
A few words concerning the specific features of the legal status of the creditor whose claims are secured by the property owned by the citizen. Such creditor may vote at the meeting of creditors in the course of the proceedings as part of the citizen's bankruptcy case (Clause 4 of Article 213.10) because the debtor (citizen) often has a single secured creditor. In addition, 80% of the amount earned from the sale of the collateral is used to satisfy the secured creditor's claims (Clause 5 of Article 213.27); the citizen's debt restructuring plan must provide for seniority of such creditor's claims which shall be satisfied by using the amount earned from the sale of the collateral (Clause 3 of Article 213.14).

[2] See Articles 213.19-213.23 on the consequences of approval of the plan, on making amendments thereto, on the completion thereof and on the abolishment thereof.

[3] The citizen's property for sale could have been given a proper name instead of the "bankruptcy estate" which is used in the course of trusteeship proceedings – bankruptcy proceedings against legal entities.

[4] The Civil Procedure Code of the Russian Federation No. 138-FZ dated November 14, 2002 // RG, No. 220, November 20, 2002.

Article 213.26 thereof). In practice, the financial manager receives information of the citizen's property only from the citizen himself/herself and public authorities (Clause 7 of Article 213.9 thereof), and the financial manager has no access to the debtor's premises, whereas the bankruptcy trustee does have access to the debtor's (legal entity) premises.[1]

The legislators' attempts to curtail costs of bankruptcy cases against citizens, including a financial manager's small fee[2] coupled with heightened requirements to the financial manager, may discourage financial managers to duly perform their duties.

As regards the specifics of selling the citizen's property, note that the financial manager shall submit the provision regulating the procedure, terms and conditions for selling the property, including the starting price, to the commercial court for approval, not to the meeting of creditors as required for bankruptcy cases against legal entities (Clause 1 of Article 213.26 thereof).

With some exceptions, the property of citizen must be sold by auction, unless otherwise stipulated by the resolution of the meeting of creditors or court's order (Clauses 3, 7 of Article 213.26 thereof). The procedure for satisfying the claims of citizen's creditors are basically similar to the procedure for satisfying the claims of the creditors of a legal entity (Article 213.27 thereof).

As soon as the settlements with the creditors are completed, the citizen declared as bankrupt shall be exempted from satisfying further claims of creditors (Clause 3 of Article 213.28 thereof). In order to prevent potential abuses by debtors, the cases when citizens may not be exempted from their obligations were specified (Clauses 3–6 of Article 213.28 thereof). For example, the claims of creditors on current payments shall remain in force. Furthermore, the rule that exempts the citizen from obligations shall not be applied to the citizen if he/she is once again declared bankrupt within the next five years (Clause 2 of Article 213.30 thereof).

However, it appears the institution of bankruptcy of citizens favors more the interests of debtors, whereas creditors would rather recover debts in court and through enforcement proceedings. This fact coupled with some of the abovementioned loopholes in the applicable regulation allows one to expect new amendments to be made in this field.

It is remarkable that in other countries the citizen debtor is treated as consumer debtor, not as self-employed entrepreneur, because the issue of individuals' bankruptcy is unbreakably bounded to consumer lending. Thirty four million Russians (45% of economically active population) are reported to have outstanding consumer loans. In addition, the total amount of loans to individuals exceeded Rb 9 trillion by the end of 2015, and delinquencies increased more than 40% in 2014 alone. The state of the consumer lending sector has turned into a macroeconomic issue, posing a threat to the sustainability of the Russian banking system.[3]

For a short period of time since the new paragraph regulating the citizen's debt restructuring and the sale of his/her property has been in effect, there have been known cases when petitions

[1] Lotfullin R. Exec. wr. P. 28.

[2] Fixed one-time amount of Rb 10,000 and 2% of the satisfied claims of creditors or the amount earned from selling the citizen's property (Clause 4 of Article 213.4, Clause 4 of Article 213.5, Clauses 3, 4 of Article 213.9, Clause 3, 17 of Article 20.6).

[3] Sishmareva T.P. Federal Law "On Insolvency (Bankruptcy)" and its application in practice: the manual for exams as part of the Single Program on Arbitrazh Receivers Training. M.: Statut, 2015. P. 416; Grishev S.P. Consumer lending. Comments to the legislation // ConsultantPlus SPS. 2015.

for bankruptcy of citizens were declared valid by commercial courts, followed by instituting debt restructuring proceedings and selling the citizen's property.[1]

* * *

All in all, in summary, note that in 20-plus years Russia's bankruptcy legislation has advanced from the first law on bankruptcy which was not widely used, through the second law on bankruptcy which was often used as a takeover tool, to the third law on bankruptcy which is currently in effect and is more viable compared to the previous ones.

Being pro-creditor, the law has solve a number of issues:

– owners acting in good faith enjoy better protection of their rights;

– the risk of abusing the right by creditors is mitigated;

– parties acting in good faith in bankruptcy proceedings are protected from other parties acting in bad faith;

– supervision over bankruptcy trustees has become more efficient;

– specifics of bankruptcy of certain categories of debtors are set out in a single law and some other laws.

The amendments to the third law on bankruptcy in the peak of the crisis of 2008–2009 narrowed the "grey" background in the field of bankruptcy by introducing mechanisms challenging asset-stripping transactions, and enhanced the transparency of bankruptcy proceedings by updating the regulation of bankruptcy trustees of respective self-regulatory organizations.

The 2014–2015 systemic amendments to the third federal law aimed to prevent abuses by persons acting in bad faith mostly in bankruptcy cases, and to ensure the institution of bankruptcy works more efficiently. Overall, although the amendments are positive, not that the issue of inefficient bankruptcy proceedings for restoring the debtor's solvency is still pressing and it could guide the way towards further enhancement of the legislation.

[1] See, e.g., Case No. A56-71378/2015. URL: http://kad.arbitr.ru/PdfDocument/eaf44644-d31e-4a2e-a1c0-90600e2d831a/A56-71378-2015_20151223_Opredelenie.pdf; Case No. A41-94274/15. URL: http://kad.arbitr.ru/PdfDocument/b81ba9a4-cdba-4ed8-85a7-eda7e58b1176/A41-94274-2015_20151221_Reshenija%20i%20postanovlenija.pdf.