

Subsidiary liability of the persons controlling a debtor

*Yermilov Valery Borisovich*¹

Russian State Academy of Intellectual Property, Moscow, Russia

Abstract. This article gives a general description of Chapter III.2 of the Bankruptcy Law and considers the issues related to the moratorium on bankruptcy. Attention is drawn to the changes that have been introduced in recent years in the legislation on bringing to the subsidiary liability of persons controlling a debtor for the inability to pay creditors' claims in full, as well as the obligation to apply for the debtor and the liability for failure to do so (untimely application). The author, on the basis of the study, concludes that it is necessary to further improve the legislation on the liability of the head of the debtor and other persons in bankruptcy cases.

Keywords: insolvency, bankruptcy, subsidiary liability, person controlling a debtor, creditor

1 Introduction

Due to the spread of coronavirus infection from April 1, 2020, the Russian government is entitled, in exceptional cases, to impose a moratorium and establish a period of validity for initiating insolvency (bankruptcy) cases at the request of creditors. All this is done primarily for the purpose of ensuring stability of the economy of the Russian Federation.

For the first time, such a prohibition in connection with the epidemic of coronavirus was introduced by the Regulation of the Government of the Russian Federation dated April 3, 2020, No. 428 "On introducing a moratorium on the initiation of bankruptcy proceedings at the request of creditors in respect of individual debtors" [1].

It should be mentioned that the moratorium was extended by Regulation No. 1587 on October 1, 2020, for another three months, namely until January 7, 2021 [2].

2 Methods

In recent years, attempts have been made and undoubtedly a significant step forward for the sustainable development and improvement of the legislation in terms of civil liability of persons controlling a debtor.

In 2017, three important documents the present study is relied on were adopted concerning the vicarious liability of persons controlling a debtor in case of debtor's insolvency:

¹ Corresponding author: ErVB-advokat@yandex.ru

- Federal Law No. 266-FZ introduced a breakthrough chapter [3] III.2 to the Federal Law dated October 26, 2002. No. 127-FZ “On Insolvency (Bankruptcy)” (hereinafter referred to as the Bankruptcy law) [4];
- Decision of the Plenum of the Supreme Court of the Russian Federation dated December 21, 2017. No. 53 “On some issues related to bringing the persons controlling a debtor to liability in bankruptcy” [5];
- Letter of the Federal Tax Service of Russia dated August 16, 2017. No. CA-4-18/16148@ “On the application by the tax authorities of the provisions of Chapter III.2 of the Federal Law dated October 26, 2002. No. 127-FZ” [6].

Chapter III.2 of the Bankruptcy law streamlined the pre-existing rules and now makes them more detailed and understandable for application in practice. The new wording retains the existing types of liability of the persons controlling a debtor.

At present, the legislation has clarified and consolidated the definition of a “person controlling a debtor”.

3 Results and discussion

On the basis of the mentioned Regulation of the Government, the arbitration court returned the applications filed by creditors for the recognition of insolvent debtors who were subject to the moratorium if they had been sent during the specified period of suspension or had been received by the court before the date of suspension, but the issue of acceptance had not yet been resolved.

Recently, despite a moratorium on bankruptcy from April 6, 2020, to January 7, 2021, for some organizations and sole proprietors who suffered from COVID-19, the number of applications for subsidiary liability has not decreased. By the end of 2021, the number of applications for subsidiary liability and a significant increase in the amount of subsidiary liability is expected to increase.

Altukhov, Levichev note: “in conditions of financial crisis and ineffectiveness of criminal sanctions for driving a company to bankruptcy, the mechanism of recovering losses or bringing managers and business owners to subsidiary liability is increasingly popular and is considered by creditors as the only source of compensation for losses incurred” [7].

Thus, persons controlling a debtor refer to natural or legal persons who have or had no more than three years prior to the signs of insolvency, as well as after their appearance before the adoption of the arbitration court declaration of bankruptcy:

1. the right to give binding instructions to the debtor;
2. or the ability to determine the debtor’s actions in other ways, including the execution of transactions.

The Bankruptcy law expanded the range of persons who can be recognized as controlling a debtor. Now the chief accountant, the financial director can be brought to subsidiary liability.

Thus, in a bankruptcy case, other persons are also liable if actual control over the debtor is proven.

Paragraph 5 of Article 61.10 of the Bankruptcy law contains a novelty according to which a person who controls a debtor may also be recognized in court on other grounds.

Thus, the Bankruptcy law currently provides a fairly open list of grounds for control, and when considering cases of this category, the issue of correct determination of the subject of subsidiary liability – the person who controls the debtor – becomes essential.

Zharentsova fairly notes that “it is incumbent upon the court to establish ‘the degree of a person’s involvement in the management process of the debtor’ and ‘the degree of his/her influence’ on making material business decisions regarding the debtor’s activities” [8].

The amended bankruptcy law provides for civil liability for controlling persons:

1. for inability to fully pay creditors' claims if such inability occurred as a result of their actions and (or) (inaction) (Art. 61.11 of the Bankruptcy law);
2. for failure to file (late filing) of the debtor's application (Art. 61.12 of the Bankruptcy law);
3. for violations of the legislation of the Russian Federation on insolvency (bankruptcy) (Art. 61.13 of the Bankruptcy law);
4. in the form of recovery of losses in insolvency (Art. 61.20 of the Bankruptcy law).

The legislator has expanded the list of circumstances in terms of subsidiary liability of the persons controlling a debtor, for the inability to fully repay the claims of creditors. It is presumed that full repayment of creditors' claims is impossible because of the actions and/or omissions of persons controlling a debtor until proven otherwise:

1. absence of documents specified in the law or their misrepresentation (subparagraph 4 of paragraph 2 of Article 61.11 of the Bankruptcy law);
2. failure to enter the necessary (inaccurate) information in the Unified State Register of Legal Entities and the Unified Federal Register of Information on the Activities of Legal Entities (Article 61.11(2)(5) of the Bankruptcy law).

In the legislation on insolvency there is now such a possibility as exemption from liability of such a person as a "nominee director", reducing the amount of his/her liability:

1. if he/she provides evidence that he/she did not actually exert a decisive influence on the debtor's activities;
2. if, thanks to the information provided by him/her, the person who actually controlled the debtor will be identified (e.g. "the debtor's beneficiary") and (or) the debtor's property was found to have been concealed by the latter.

If the debtor did not become bankrupt due to actions and (or) omissions of the controlling person, but after that, the persons controlling a debtor committed actions and (or) omissions that significantly worsened the financial situation of the debtor, in this case, the mentioned liability arises (Article 61.11, paragraph 12, item 2 of the Bankruptcy Code).

The new version of the Bankruptcy law establishes the obligation of the founders (participants) of the debtor to decide on an application to the arbitration court with the insolvency petition within a certain period of time. If such an obligation is not fulfilled within the prescribed period for filing a debtor's own bankruptcy petition with the court, the decision to file such a petition shall be made by the governing body authorized to resolve this matter.

There have also been changes in the Bankruptcy law with regard to the limitation periods for claims on bringing the debtor's manager and other persons to liability. An application for bringing to liability on the grounds provided in Chapter III.2 of the Bankruptcy law may be filed:

1. within three years from the date on which the applicant became aware of the grounds for bringing the controlling persons to subsidiary liability;
2. no later than ten years from the date of the unlawful (inaction) actions;
3. not later than three years from the date of declaring the debtor bankrupt.

It is important that the expiration of the limitation period for the persons controlling a debtor has become an independent ground for the court's refusal to satisfy claims for bringing to liability.

A settlement agreement may now be entered into as part of the application to hold the persons controlling a debtor liable. It can be approved if the defendant has disclosed assets in an amount that will be sufficient to enforce the agreement, and only with respect to all persons.

It should be mentioned that the mechanism of bringing a debtor to the subsidiary liability of the persons controlling a debtor established by the legislation on the insolvency of the debtor has become as accessible as possible to creditors.

The Bankruptcy law now has a clearer and more detailed process for filing and adjudicating a petition to be held liable. It became possible to apply to the court not only as part of the bankruptcy case but also after its termination.

Chapter III.2 of the Bankruptcy law expanded the means of disposing of the right of claim. Thus, creditors can now directly collect the debt from the controlling person, without waiting for the money to arrive in the bankruptcy estate.

The opinion of Dobrachev that “the further development of legislation on vicarious liability should, on the one hand, to cool the ardor of those who still consider it possible to do business at the expense of their contractors, and on the other hand, to protect the bona fide entrepreneur” is correct [9].

4 Conclusion

Based on the research, the following conclusions should be made.

The provisions of Ch. III.2 of the Bankruptcy law adopted in 2017 and the timely clarifications that have been given in this regard, in the Decision of the Plenum of the Supreme Court of the Russian Federation No. 53 has largely expanded the possibility to hold the controlling persons liable for the debtor’s obligations.

At the same time, Chapter III.2 of the Bankruptcy law has a distinctly “pro-creditor” approach, which clearly violates the interests of the debtor’s bona fide participants and beneficiaries in favor of creditors.

The number of issues related to the legal regulation of subsidiary liability in bankruptcy cases is not only not decreasing, but also increasing (based on the data posted on the official website <https://fedresurs.ru>), indicating that a fair balance of interests of bankruptcy participants (creditors, controlling persons of the debtor, arbitration managers, the state) has not yet been achieved.

References

1. *Postanovlenie Pravitelstva RF ot 3 aprelya 2020 goda № 428 “O vvedenii moratoriya na vobuzhdenie del o bankrotstve po zayavleniyu kreditorov v otnoshenii otdelnykh dolznikov”* [Regulation of the Government of the Russian Federation of April 3, 2020, No. 428 “On introducing a moratorium on the initiation of bankruptcy proceedings at the request of creditors in respect of individual debtors”], in Legislation Bulletin of the Russian Federation, **15(4)**, 2282 (2020)
2. *Postanovlenie Pravitelstva RF ot 01.10.2020 № 1587 “O prodlenii sroka deistviya moratoriya na vobuzhdenie del o bankrotstve po zayavleniyu kreditorov v otnoshenii otdelnykh dolznikov”* [Regulation of the Government of the Russian Federation of 01.10.2020 No. 1587 “On extending the moratorium on the initiation of bankruptcy proceedings at the request of creditors in respect of certain debtors”], in Legislation Bulletin of the Russian Federation, **41**, 6429 (2020)
3. *Federalnyi zakon ot 29.07.2017 № 266-FZ “O vnesenii izmenenii v Federalnyi zakon “O nesostoyatelnosti (bankrotstve)” i Kodeks Rossiiskoi Federatsii ob administrativnykh pravonarusheniyakh”* [Federal Law dated 29.07.2017 No. 266-FZ “On amendments to the Federal Law “On Insolvency (Bankruptcy)” and the Code of the Russian Federation on Administrative Offences”], in Legislation Bulletin of the Russian Federation, **31(1)**, 4815 (2017)

4. Federalnyi zakon ot 26.10.2002 № 127-FZ (s izm. i dop., vstup. v silu s 02.01.2021) “O nesostoyatelnosti (bankrotstve)” [Federal Law dated 10.26.2002 No. 127-FZ (with amendments and additions, in force since 02.01.2021) “On Insolvency (Bankruptcy)”] Accessed on: July 09, 2021. [Online]. Available: <https://legalacts.ru/doc/FZ-o-nesostoyatelnosti-bankrotstve/>
5. Postanovlenie Plenuma Verkhovnogo Suda Rossiiskoi Federatsii ot 21 dekabrya 2017 g. № 53 “O nekotorykh voprosakh, svyazannykh s privilecheniem kontroliruyushchikh dolzhnika lits k otvetstvennosti pri bankrotstve” [Decision of the Plenum of the Supreme Court of the Russian Federation dated December 21, 2017. No. 53 “On some issues related to bringing the persons controlling a debtor to liability in bankruptcy”], in Rossiyskaya gazeta, **297** (2017)
6. <Pismo> FNS Rossii ot 16.08.2017 № SA-4-18/16148@ “O primenenii nalogovymi organami polozhenii glavy III.2 Federalnogo zakona ot 26.10.2002 № 127-FZ” [<Letter> of Federal Tax Service of Russia dated 16.08.2017 No. CA-4-18/16148@ “On the application by the tax authorities of the provisions of Chapter III.2 of the Federal Law dated 26.10.2002 No. 127-FZ] Accessed on: July 09, 2021. [Online]. Available: http://www.consultant.ru/document/cons_doc_LAW_227069/
7. A.V. Altukhov, S.V. Levichev, Judge, **4**, 27-32 (2018)
8. Yu.S. Zharentsova, Laws Rus.: Exp., Analysis, Pract., **7**, 26-32 (2018)
9. D.V. Dobrachev, Problemy sudebnoi praktiki privilecheniya k subsidiarnoi otvetstvennosti kontroliruyushchikh dolzhnika lits v protsedure bankrotstva [Problems of court practice of bringing to the subsidiary liability of controlling persons of a debtor in bankruptcy proceedings] (Infotropic Media, Moscow, 2019)