

BANKRUPTCY FOR INDIVIDUALS – DOWN WHAT ROAD IS PRACTICE LEADING?

On October 1st, 2015 changes in the Federal Law entitled "On insolvency (bankruptcy)" came into force, according to which in relation to people who do not have the status of a sole proprietor the bankruptcy procedure can be initiated. On October 13th, 2015 the Russian Federation Supreme Court Plenary Assembly, in its Resolution No. 45, gave explanations concerning the application of new bankruptcy law's provisions. Over the one-and-a-half years since the law has been enacted, judicial practice in applying the bankruptcy law's provisions for individuals has already taken shape, and continues to take shape.

Tatyana SVETLOVA,
senior associate
at the VEGAS LEX law firm,
Moscow



The particularities of filing for bankruptcy for an individual

The debtor himself, a creditor, or authorized agency can turn to the courts to file a petition for individual's bankruptcy, if an obligation exists that amounts to more than 500,000 rubles that has not been fulfilled in the course of three months. The law provides for the responsibility of the debtor to file a petition for personal bankruptcy if satisfying one creditor's claim will lead to the inability to fulfill other obligations. These provisions duplicate general provisions in bankruptcy law that apply to legal entities as well.

As a general rule, a bankruptcy case for an individual may be initiated if the creditor files a petition and a debt exists that is confirmed by a court order that has entered into legal force. Meanwhile, clause 2, article 213.5 of the Federal Law "On insolvency (bankruptcy)" provides for exceptions - in particular, initiating a case is possible if documented claims are submitted by the creditor and establish monetary obligations that are recognized by an individual but are not being performed.

Judicial practice, recognizing the possibility of initiating a bankruptcy case against an individual when these documents are furnished, indicates that the courts need to verify creditor's claims such as its financial ability to grant a loan, perform work, or deliver goods. Recognizing the debt, the individual also must confirm, and the court verify, the purpose for which performance of the declared obligation is intended.

An illustration of this is the high-profile bankruptcy case for Mr Telman Ismailov. The court of original jurisdiction, reviewing the petition for Mr. Ismailov's bankruptcy, found the creditor's proof of claim to be justified, the debt for which was confirmed by a signed acknowledgment of receipt for funds in the amount of 15 million rubles. When considering the appeal, the hearing panel overturned the ruling by the court of original jurisdiction, and dismissed the creditor's proof of claim without prejudice, indicating the lack of evidence for the loan agreement's actual execution on the basis that the petitioner did not present evidence of employment, income received from it, tax declarations, proof that funds were received as either a loan or in the form of a line of credit, proof that deposits existed, etc. – and the debtor also did not indicate for what purpose exactly the received funds were spent (Resolution by the Tenth Arbitration Court of Appeal on March 10th, 2016 in case No. A41-94274/15).

This means that when reviewing the proof of claim from the creditor that initiated bankruptcy, in the absence of a court

order that has come into effect, the court's responsibilities include determining the presence, or absence, of signs of a fictitious transaction (Ruling No. 305-ES16-12960 by the Russian Federation Supreme Court dated December 15th, 2016).

The procedure for restructuring an individual's debt

When considering the grounds for an individual bankruptcy petition, the court is entitled to introduce a procedure for debt restructuring.

Debt restructuring is a procedure aimed at restoring the debtor's solvency. For these purposes, a restructuring plan must be drawn up, which is approved at a creditors' meeting, by the debtor and by the arbitration court considering the bankruptcy case. The debt restructuring plan should determine the time frames and procedure for the individual to repay his or her debts.

In the course of two months from the time information is officially published about the individual's bankruptcy creditors are entitled to present their claims against the debtor.

Taking into consideration that the creditors' meeting is the one exercising control over handling the bankruptcy proceedings, at which votes are proportional to their claims included in the register, judicial practice proceeds from the inadmissibility of having creditors' claims registered without grounds.

When considering claims, the court must not only check that the creditor is actually performing its obligations, but exclude attempts to gain control over the bankruptcy proceedings linked to the abuse of rights.

On March 30th, 2017, the Russian Federation Supreme Court adopted a number of decisions in the framework of individual bankruptcy that satisfied complaints vis-à-vis rulings made by courts of original jurisdiction and subsequent rulings by the courts of appeal and cassation about including creditors' claims in the register.

The Supreme Court, in directing disputes to chamber on economic disputes for review, considered justified and worthy of investigation the petitioner's arguments that the interest of creditors towards the debtor called into question whether the surety was impartial, and, consequently, his right to receive a claim through subrogation (Article 384, 387 of the Russian Federation Civil Code, Rulings No. 306-ES16-17647 (1) and No. 306-ES16-17647 (2) by the Supreme Court of the Russian Federation of dated March 30th, 2017).

The conclusions stated by the Supreme Court form judicial practice, which allows the potential for unscrupulous bankruptcy participants to control the procedure to be minimized.

As was stated above, the plan for restructuring needs to be approved at a creditors' meeting, by the debtor, and by

the arbitration court that is reviewing the bankruptcy case.

The Court may also approve the plan for restructuring an individual's debts with no approval from a creditors' meeting, provided that implementing the plan permits satisfying the bankruptcy creditors' claims in full concerning their obligations secured by a deposit, or other creditors' claims, in an amount substantially greater than the creditors would have received as a result of the immediate sale of the individual's property and allocating his average monthly income for six months - and that the amount arrived at amounts to no less than 50% of the amount of the claims made by those creditors and authorized agencies (clause 4, article 213.17 of the Federal Law entitled "On insolvency (bankruptcy)").

When approving a restructuring plan, the courts proceed from the necessity of observing a balance of interests for the parties concerned, even when the creditors insist on handling the procedure for selling off property.

For example, the Volga District Arbitration Court, in its Resolution No. A72-11885/2015 dated February 16th, 2017, refused to satisfy a complaint about the court of original jurisdiction's decision to approve a debt restructuring plan along with that indicating that implementing the restructuring plan would give an opportunity to satisfy the secured creditor's claims in full, as well as more than 50% of other creditors' claims, thereby allowing the individual's debt restructuring plan procedure to achieve its goal.

The Russian Federation Supreme Court Plenum, in its resolution No. 45 dated October 13th, 2015, states that the court reviewing a bankruptcy case is to approve the debt restructuring plan (both those approved and not approved at a creditors' meeting) only if it has been approved by the debtor, since the debtor is a direct participant, and usually he is the one executing performance of the plan himself, and also since the debtor possesses more complete information about his financial condition and prospects.

In the meantime, the Supreme Court Plenum, and judicial practice that duplicates it in terms of approving the debt restructuring plan, proceeds from the inadmissibility of allowing the abuse of rights, including on the part of the debtor. Actions by the debtor concerning the rejection of a debt restructuring plan could be focused on completing the bankruptcy proceedings as soon as possible and releasing himself from the responsibilities of debt, which, in and of itself, is not the goal of bankruptcy. In addition, the signs that a debtor is abusing his rights should be proven. The court's position on this is laid out in Resolution No. 07AP-479/2017 by the 7th Court of Appeal dated February 22nd, 2017.

The maximum time frame to implement a debt restructuring plan is three years.

Based on the results of reviewing the implementation of the plan for an individual's debt restructuring, the court makes a decision either to complete the debt restructuring, terminate the restructuring plan or to declare the individual bankrupt.

This means that the procedure for restructuring an individual's debt is aimed towards satisfying creditors' claims to the fullest extent possible, and when applying it a balance of interests for all parties concerned should be observed, and issues of the abuse of rights on the part of the bankruptcy case's participants should be investigated.

The procedure for selling off an individual's property

The arbitration court makes the decision to declare an individual debtor bankrupt if either the plan is rejected or the courts cancel the debt restructuring plan, and also if, upon reviewing the grounds for the debtor filing bankruptcy, the debtor submits a petition to pronounce him bankrupt in view of his non-compliance with the requirements governing the debt restructuring procedure.

Initiating the procedure for selling off property without applying the restructuring procedure to the debtor has caused some disagreements in practice; however, after one-and-a-half years, a fairly clear position has taken shape, according to which pronouncing an individual bankrupt bypassing the introduction of the debt restructuring procedure is possible if the court is provided with evidence satisfying that the creditors' claims are patently impossible. The court investigates not only the debtor's financial situation, but the level of his professional qualifications, skills, marital status, and also measures that have been adopted to help the debtor improve his financial situation. The procedure to sell off property as per the procedure in clause 8, article 213.6 in the Federal Law entitled "On insolvency (bankruptcy)" can be initiated only by presenting the court with sufficient evidence for obstacles to debt restructuring (Ruling by the Far East District Arbitration Court dated October 10th, 2016 in case No. A10-2655/2016).

Selling off a debtor's property is done in accordance with the bankruptcy law, taking into consideration the provisions in current civil procedural law.

Based on what is stated above, the procedure for selling off a debtor's property has the satisfaction of creditors' claims as its goal, and upon completion the individual is released from debt.

Releasing an individual from debt

The law calls for releasing an individual from debt once the procedure for selling off the debtor's property is completed.

However, the provisions in clause 4, article 213.28 in the Federal Law entitled

"On insolvency (bankruptcy)" stipulate a number of qualifications which, if they exist, mean that the individual's unfulfilled obligations remain in force.

When deciding not to apply the rules for releasing an individual from debt once the procedure for selling off the debtor's property is completed, the courts proceed from the following:

Releasing an individual from debt is impermissible if there are signs of the abuse of rights on the part of the debtor, i.e. actions aimed toward accepting obligations that are patently unfulfillable, which is a reason why bankruptcy occurs. On March 24th, 2016 the Novosibirsk Regional Arbitration Court completed the procedure for selling off the debtor's property without applying the rule about writing off the debts. The courts reached the conclusion that, working as a freight handler and making about 20,000 rubles, the debtor, abusing his rights, deliberately increased the amount of his debt without ever intending to repay it. The debtor, as well as the financial manager, not agreeing with the court order appealed the ruling via appeal and cassation proceedings. However, the higher courts found that the conclusion that sign of the abuse of rights did exist was justified, and declined to write off the debtor's debts (Ruling No. 304-ES16-19557 by the Russian Federation Supreme Court dated February 13th, 2017).

Concerning unscrupulous actions on the part of the debtor during bankruptcy proceedings. The courts categorize those actions to include non-compliance with court orders to present documentation, non-participation in the procedure to sell off property, and not adopting measures to repay debts. While reviewing the issue concerning the completion of the procedure to sell off property, the court did not apply the rule about writing off debt to the debtor, referring to the debtor's unscrupulous behavior during the procedure, and specifically that the debtor did not comply with court orders to furnish documentation, did not show any desire to participate in the procedure to sell off the debtor's property, did not receive correspondence from the court, did not take any steps to pay the debt that had built up, taking into account the arrears in taxes and duties over five years, maliciously evaded paying both the arrears in taxes and duties and liabilities. The conclusion reached by the court of original jurisdiction was upheld by the court of appeal and the district court (Ruling by the Ural District Arbitration Court in case No. A50-16058/2015 dated September 12, 2016).

However, petitioning the court in order to release an individual from debt does not, in and of itself, constitute unquestionable grounds to believe that the actions of the individual are unscrupulous. When making the decision not to write off individual's debts, sufficient evidence that proves the purposefulness and illegality of the debtor's actions during the bankruptcy proceedings must be introduced and reviewed (Ruling by the Fourth Arbitration Court of Appeal dated September 1st, 2016 in case No. A78-13259/2015).

Conclusion

Compliance enforcement practices concerning the provisions in the law on bankruptcy for individuals are being formed, and are going down the road towards minimizing the possibility for unscrupulous bankruptcy procedure participants to take control over the procedure, and are geared towards observing a balance of interests for all parties. When reviewing bankruptcy cases for individuals, the positions of the courts are applied that have formed during experience reviewing bankruptcy cases for legal entities. 🐾