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This article addresses developments in international secured transactions and insolvency during 2009 in Brazil, Spain, Russia, and the United States.

I. Developments in Brazil

Brazilian Labor Courts are very protective when it comes to labor claims. Courts usually apply the law based on the best interests of employees. But there are certain limits to their jurisdiction. These limits were recently defined in a leading case involving Gol Linhas Aéreas Inteligentes S.A. (Gol), a publicly-held corporation with shares listed on the New York Stock Exchange and the Brazilian Stock Exchange (BM&FBOVESPA). Gol is the controlling shareholder of Gol Transportes Aéreos S.A., a Brazilian low-cost airline. At issue was the acquisition of assets under the Brazilian Bankruptcy Law

On March 28, 2007, GTI S.A., a wholly-owned subsidiary of Gol, acquired the shares of VRG Linhas Aéreas S.A. (VRG), formed to operate the brand "Varig," a Brazilian airline company undergoing judicial recovery plan[1] under Law No. 11.101, of February 9, 2005 (the Brazilian Bankruptcy Law or BBL).[2] VRG was a company based on the Isolated Productive Unit (UPI) of Varig (Viação Aérea Rio Grandense S.A.), created in the bankruptcy recovery plan of Varig and its subsidiaries Rio Sul and Nordeste (together, the "Recovering Companies"), and acquired by VarigLog in the Judicial Auction held on July 7, 2006. Under the BBL, the UPI was created and sold free of liabilities of any nature,

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1. The judicial recovery plan in Brazil is a court-supervised proceeding enabling debtors to overcome an economic and financial crisis through a reorganization plan negotiated with and approved by its creditors.

2. Lei No. 11.101, de 09 de fevereiro de 2005, D.O.U. de 09.02.2005. (Brazil), *available at* http://www.planalto.gov.br/ccivil/_ato2004-2006/2005/lei/L11101.htm [hereinafter Brazilian Bankruptcy Law].

including civil, labor, tax, and pension liabilities, and upon completion of the conditions established in the *Auction Edital*, to assure payment of creditors and continuance of the Recovering Companies.

A former employee of "old Varig" claimed that Gol was the successor of Varig and that Gol was consequently liable for Varig's labor debts. The Labor Court accepted this claim. Gol defended the validity of the acquisition of the UPI free of Varig's liabilities as duly ratified by the Bankruptcy Court.[3]

In Brazil, the Bankruptcy Court has universal jurisdiction to resolve any matters or issues related to a bankrupt company or a company undergoing judicial recovery plan. In the case of Gol, the jurisdiction of the Bankruptcy Court was questioned by the Labor Court. This resulted in a conflict of jurisdiction that was submitted to the Brazilian Federal Supreme Court or *Supremo Tribunal Federal* (STF).

The BBL[4] governs recoveries in and out of court, individual bankruptcies, and business company bankruptcies, including the companies performing in the aeronautic industry, whose certificate of formation provides for the exploration of air services of any kind and of aeronautic infrastructure. This law prioritizes the recovery of companies to maintain jobs and safeguard creditors' interests by preserving the company, its social-interest role, and encouraging economic activities, provided that the continuance of the debtor's operations is viable.

Among the alternatives to permit the company's judicial recovery provided for in the BBL, it is possible to structure the deal as a partial sale of assets or the formation of a specific purpose company to adjudicate, in payment of the claims, the debtor's assets.

The realization (disposal) of the bankrupt's assets is also permitted in a company bankruptcy. Under the BBL,[5] assets will be realized in accordance with the established preference order: (i) disposal of the company by selling a pre-determined block of assets; (ii) disposal of the company by selling branches or production units separately; (iii) disposal of pre-determined blocks of assets of the debtor's establishments; and (iv) disposal of assets considered on a case-by-case basis.[6]

The BBL allows a bankrupt company, whether entirely liquidated or not, to discharge its labor, tax, and workers' compensation obligations.[7] The acquisition is not of the bankrupt's liabilities but of the set of assets required for operations, which may include assignment of specific agreements. These benefits are inapplicable where the buyer is a partner of the bankrupt or a company controlled by the bankrupt, direct or indirect family up to the fourth degree, whether consanguineous or the like, of the bankrupt or of partner of the bankrupt, or identified as agent for the bankrupt with a view to defraud through succession.

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3. *Id.* The competent Bankruptcy Court in this case is the 1st Commercial Court of Rio de Janeiro (*1ª Vara Empresarial da Comarca do Rio de Janeiro*).

4. *Id.* The Brazilian Bankruptcy Law does not apply to (i) government-owned entities and mixed-economy companies; and (ii) financial institutions, whether public or private; credit unions; consortia, supplementary pension companies; health care plan companies; insurance companies; special savings companies and other organizations held equivalent by law to those listed above.

5. *Id.* art. 40.

6. *Id.*

7. *Id.* art. 141.

The labor laws and regulations deal specifically with the labor succession issues of the Brazilian Consolidation of Labor Laws and hold the successor (buyer of the whole or part of the bankrupt's assets) liable for the labor debt of the predecessor.[8] The Labor Court decided the matter in GoI based upon these labor laws. In this regard, any buyer (i) acquiring the goodwill (customers) or the commercial or industrial installations and/or assets of a company and (ii) in the same line of business as the seller and using the same employees, is considered a successor and may be held liable for employees' claims. The so-called company succession applies in the event of a merger, acquisition, conversion, amalgamation, or upon the sale of one of its establishments. The buyer undertakes to fulfill all the seller's labor obligations, and the company is held directly liable for any labor obligations. The buyer's right of recourse against the seller may be set forth in a private instrument, but this will not affect the buyer's liability for past and future claims.

Furthermore, the BBL contains specific provisions regarding labor claims[9] which must be followed and applied by the Bankruptcy Court. Labor claims are granted priority in judicial recovery plans and must be paid within one year. In bankruptcy proceedings, priority labor claims are limited only up to 150 minimum wages. The balance of labor claims that exceed this limit and labor-related claims assigned to third parties are considered unsecured claims. Wage-related claims payable within three months preceding the bankruptcy decree, however, are paid as soon as there is sufficient cash available up to the limit of five minimum wages per worker.

The STF[10] expressly recognized the universal jurisdiction of the Bankruptcy Court and confirmed the application of the BBL to this case, ruling that the Bankruptcy Court has authority (and not the Labor Court) to decide on labor claims of companies undergoing a judicial recovery plan or object of judicial alienation.

II. Developments in Spain

In 2009, Spanish legislators passed a set of royal decrees and laws (generally known as Plan E) to stimulate a weak economy. Key among these is Royal Decree-Law 3/2009,[11] issued on March 27, regarding urgent measures in tax, finance, and bankruptcy law due to the development of the economic situation.

The Royal Decree-Law follows a European wave[12] that tries to stabilize financial markets by offering companies with liquidity problems easier access to cash. In the Preamble, the reform justifies itself by the "inadequacies" arising from certain provisions of the

8. Decree 5,452, de 1 de maio de 1943, D.O. de 1.05.1943. (Braz.).

9. Brazilian Bankruptcy Law, arts. 54, 83.

10. S.T.F. No. 583.955-9, Relator: Min. Recardo Lewandowski, 08.06.2009, __ R.T. __ 28.08.2009, 1716 (Braz.), *available at* http://www.stf.jus.br/arquivo/cms/noticiaNoticiaStf/anexo/RE583955RL.pdf.

11. *See* Urgent Measures Concerning tributaria, financiera y concursal ante la evolución de la situación econTax, Financial and Bankruptcy to the Changing Economic Situation (B.O.E. 2009, 78), *available at* http://www.boe.es/boe/dias/2009/03/31/pdfs/BOE-A-2009-5311.pdf. The Royal Decree (R.D.-Ley 3/2009 of Mar. 31, 2009) was officially provided as a decree concerning "*medidas urgentes en material tributaria, financiera y concursal ante la evolución de la situación económica.*"

12. Before the Spanish, it was the German Parliament who passed a law that partially modified the "*InsolvenzOrdnung*" by avoiding the bankruptcy declaration of those companies affected by the depreciation of its assets due to the financial crisis.

Bankruptcy Law,[13] given that it was passed in an "economic environment radically different from the current."[14] The truth is that since the approval of the Law 22/2003, however, several judgments pointed out its weaknesses, partially fixed by the actual reform, the aim of which is to reduce procedural costs, facilitate re-financings of viable companies, improve the legal situation of workers affected by the bankruptcy of their company, stimulate early settlements with creditors, expand fast-track proceedings to companies with liabilities amounting to less than €10 million, and articulate measures to speed up the liquidation of companies.

A. Re-financing Agreements

In the fourth transitory article, the Royal Decree-Law establishes that refinancing agreements will not be affected by the possibility to rescind actions from the two years preceding the declaration of insolvency regulated by Article 71[15] of the Bankruptcy Law if some requisites concur. To receive such protection, the agreement must be subscribed by creditors that represent at least three-fifths of the total liabilities of the debtor, must be supported by an independent expert, and must be formalized in public deed.[16]

B. Early Settlements

Most importantly, the Royal Decree-Law grants debtors negotiating a settlement with their creditors a three-month extension of the usual two-month term to file an insolvency petition once the company is unable to comply with its financial obligations.[17]

C. Early Liquidation

Article 11 of the Royal Decree-Law allows proceeding to an early liquidation once the report of the insolvency administration has been presented to the Court, thus avoiding the period of challenge to the creditors list and the inventory.[18]

In a significant development, the liquidation plan can be proposed by the debtor, not only by the insolvency administration.[19] The latter will only study the proposal and suggest the modifications that they consider needed.

III. Developments in Russia

Russian insolvency legislation has changed dramatically since 1992, when the first Russian insolvency law was adopted.[20] The first insolvency provisions had mainly a declarative nature and minimal practical implementation. Since then, the focus of Russian

13. *See* Bankruptcy Law (B.O.E. 2003, 164) [L.O. 22/2003 of July 9, 2003].

14. *Id.*

15. R.D.-Ley 3/2009, *supra* note 11, art. 71. It states that all detrimental agreements concluded by the debtor within two years before the bankruptcy declaration can be invalidated.

16. *Id.*

17. *Id.*

18. *Id.* art. 11.

19. *Id.*

20. [The Law on Insolvency of Enterprises], Ros. Gaz., 1992, p. 279 [hereinafter Insolvency Law 1992].

insolvency legislation has changed significantly from protecting the interests of creditors pursuant to the law adopted in 1998[21] to establishing a balance between creditors' and debtors' interests according to Federal Law No. 127-FZ as of October 26, 2002, "On insolvency (bankruptcy)" which is currently in force (the Insolvency Law).[22]

Since the end of 2008, significant reforms have been made to the Insolvency Law by the following acts (the Amendments):

(i) Federal law No. 296-FZ dated December 30, 2008;[23]

(ii) Federal law No. 306-FZ dated December 30, 2008;[24]

(iii) Federal law No. 73-FZ dated April 28, 2009;[25] and

(iv) Federal law No. 195-FZ dated July 19, 2009.[26]

A. Current Payments

The Insolvency Law distinguishes between monetary obligations to be included in the register of creditors' claims and current payments, which are not included.[27] Creditors whose claims are included in the register are deemed participants with voting rights in a meeting of creditors. Current payment creditors are not deemed parties to the bankruptcy case proceedings.

Under the former provisions of Insolvency Law, "current payments" meant all monetary obligations and mandatory payments which originated after acceptance of an application for declaring a debtor bankrupt, as well as monetary obligations and mandatory payments the maturity date of which occurred after institution of the insolvency proceeding. The Amendments give a new definition of "current payments" to include only monetary obligations and mandatory payments originating after the date of acceptance of an application for declaring a debtor bankrupt.[28] This widens the set of creditors participating in the bankruptcy case. Creditors may now be parties and participate in the bankruptcy case without waiting for the maturity date of their claims and introduction of the subsequent insolvency procedure if their claims originated prior to acceptance of the application declaring a debtor bankrupt.[29]

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21. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1998, No. 2, Item 222 [hereinafter 1998 Amendment].

22. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2002, No. 43, Item 4190 [hereinafter 2002 Amendment].

23. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2009, No. 1, Item 4 [hereinafter 2008 296-FZ Amendment].

24. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2009, No. 1, Item 14 [hereinafter 2008 306-FZ Amendment].

25. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2009, No. 18 (part 1), Item 2153 [hereinafter 2009 73-FZ Amendment].

26. Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 2009, No. 29, Item 3632 [hereinafter 2009 195-FZ Amendment].

27. 2002 Amendment, *supra* note 22.

28. 2008 296-FZ Amendment, *supra* note 23.

29. *Id.*

B. Initiating the insolvency proceeding

One of the most significant Amendments concerns simplified procedures for initiating the bankruptcy. Formerly, creditors could file an application with a court for declaring a debtor bankrupt upon the expiration of thirty days after the delivery of a writ of execution to the court bailiff service and a copy to the debtor. The Amendments enable creditors to file an application from the date of entry of a court's judgment against the debtor.[30]

C. Contesting debtor's transactions

Another important Amendment concerns avoidance of the debtor's transactions. Under former Article 103, the insolvency administrator could avoid the following transactions:

(i) transactions with the interested parties if they caused or may cause damages to the creditors;
(ii) preference payments to creditors; and
(iii) transfers of the debtor's property to the participant thereof in connection with withdrawal from the debtor's participants.[31]

But the previous version of the Insolvency Law did not sufficiently protect creditors' rights. Parties to the bankruptcy case often had to apply general rules of the Russian Civil Code[32] concerning invalidation of transactions to insolvency proceedings. The Amendments provide detailed regulation for avoiding debtors' transfers. Two types of transactions may be avoided in the bankruptcy case: (1) "suspicious transactions" and (2) preferential transfers. The amended law defines such transactions, and sets forth the limitations and grounds for contesting or avoiding them.[33]

The transaction is deemed suspicious if:

(A) In case of unequal counter-discharge of obligations by the other party to the transaction, in particular the debtor received less than a reasonably equivalent value in exchange for such transfer or obligation.
(B) Such a transaction may be invalidated by an *arbitrazh* court if it was made by the debtor within a year before acceptance of the application for declaring bankrupt or after acceptance of the said application.
(C) The transaction was made by the debtor with the intent to cause harm to creditors' property rights if:
    (i) As a result of the transfer, harm was caused to creditors' property rights; and
    (ii) The other party to the transaction knew of the debtor's intent at time of the transaction. It is presumed that the other party knew about it, if it is recognized as an interested person or if it knew or had reason to know about infringement of interests of the debtor's creditors or of the debtor's insolvency or insufficiency of property.[34]

30. *Id.*
31. 2002 Amendment, *supra* note 22.
32. Grazhdanskii Kodeks RF [GK] [Civil Code] art.166-181 (Russ.); Sobranie Zakonodatel'stva Rossiiskoi Federatsii [SZ RF] [Russian Federation Collection of Legislation] 1994, No. 32, Item 3301.
33. 2009 73-FZ Amendment, *supra* note 25.
34. *Id.*

Such transactions may be invalidated by an *arbitrazh* court if they were made within three years before the acceptance of the application for declaring the debtor bankrupt or after acceptance of the application.[35]

The law also stipulates certain presumptions that must be overcome by the debtor to prove that the transaction was not suspicious.[36] Thus, the intent to injure creditors is presumed, if at the time of the transaction the debtor was insolvent or had insufficiency of property thereof and the transaction was made on a gratuitous basis or in respect of an interested person, or aimed at paying a share in the debtor's property to the participant in connection with withdrawal from the debtor's participants.

A transaction is deemed a preference if one of the following conditions exists:

(A) The transaction is aimed at ensuring the discharge of the debtor's obligation or a third person's obligation towards a creditor which has arisen before making the disputed transaction;

(B) The transaction leads or may lead to changes in the order of satisfaction of a creditor's claims which arose before making the disputed transaction;

(C) The transaction leads or may lead to satisfaction of some creditors' claims whose date comes after the time of making the transaction while there are obligations towards other creditors which are not discharged in due time; or

(D) As a result of the transaction a creditor is given or may be given a greater preference with respect to satisfaction of claims which arose before making the disputed transaction than would be given if settlements with creditors were made in the order of priority in compliance with the legislation of the Russian Federation on insolvency (bankruptcy).[37]

Such transactions may be invalidated by an *arbitrazh* court if they were made by the debtor after acceptance by the arbitration court of the application for declaring the debtor bankrupt or within one month before acceptance by the arbitration court of the application for declaring the debtor bankrupt.[38]

The Insolvency Law also establishes the consequences of invalidation of debtor's transactions. Everything that has been transferred by the debtor or by any other person at the expense of the debtor or on account of discharging obligations towards the debtor, or seized from the debtor in connection with the transaction declared invalid, is returned for inclusion in the bankruptcy assets.[39] If it is impossible to return property in kind for inclusion to the bankruptcy assets, the acquirer shall reimburse the actual value of this property at the time of acquisition thereof, as well as the losses caused by subsequent alteration of the property's value in compliance with the provisions of the Civil Code of the Russian Federation on the liabilities arising as a result of unjust enrichment.[40]

The Insolvency Law provides certain guarantees to creditors and other persons to whom property was transferred, or in respect of whom the debtor has discharged obligations or duties under the transaction declared invalid. If the property obtained under a

35. *Id.*
36. *Id.*
37. *Id.*
38. *Id.*
39. 2009 73-FZ Amendment, *supra* note 25.
40. *Id.*

voided transaction is returned for inclusion into the bankruptcy assets, the creditor shall have a claim against the debtor to be satisfied in the insolvency procedure after satisfaction of third priority claims.[41]

D. SECURED CREDITORS

Under the 1992 Russian insolvency law, secured creditors were not deemed bankruptcy creditors and were not entitled to participate in a meeting of creditors with voting rights.[42] In return, the secured creditors were entitled to receive payments under the secured obligations while all payments in respect to the other creditors were suspended.[43] The secured property was not included into the general bankruptcy assets, and secured obligations were to be discharged out of the winding-up proceedings.[44]

The 1998 Amendments changed the position of the secured creditors, stipulating that their claims were satisfied together with the unsecured claims from all of the debtor's assets in the third order of priority, and the pledged property was included in the general bankruptcy assets.[45]

Under the 2002 Insolvency Law Amendments, secured creditors obtained a special status. Their claims were satisfied from proceeds of the sale of the pledged property prior to the unsecured creditors, except for the claims under the first and the second order of priority that arose before the pledge agreement had been signed and current payments.[46] If proceeds from sale of the pledged property were insufficient to discharge the claims of secured creditors, such claims were included in the third order of priority and were satisfied together with unsecured claims.[47] Thus, the position of secured creditors became more privileged. In practice, however, security interests granted to secured creditors did not function properly because after discharging current payments and claims which arose before the conclusion of the respective pledge agreement, practically nothing remained to satisfy secured creditors' claims.

The December 30, 2008, Amendments provide for satisfaction of secured creditors' claims from proceeds of the sale of pledged property as follows:

(i) Seventy percent of proceeds are used to satisfy the secured creditors' claims;
(ii) Twenty percent of proceeds are used to satisfy the claims under the first and the second order of priority.[48]

The remaining ten percent of funds are used to repay the legal expenses, the insolvency administrator's remuneration, and payment for services of persons engaged by the insolvency administrator in order to fulfill his responsibilities.[49]

Secured creditors are entitled to vote in the meetings of creditors during the observation procedure. Secured creditors may also vote during rehabilitation and external admin-

41. *Id.*
42. Insolvency Law 1992, *supra* note 20, art. 23.
43. *Id.* art. 18.
44. *Id.* art. 26.
45. 1998 Amendment, *supra* note 21, art. 106.
46. 2002 Amendment, *supra* note 22, art. 138.
47. *Id.* art. 138.
48. 2008 306-FZ Amendment, *supra* note 24.
49. *Id.*

istration procedures if they do not levy against the pledged property or if the court rejects enforcement of the pledge.[50]

Thus, secured creditors obtained a right to levy against pledged property during rehabilitation and external administration procedures. Importantly, the court may reject enforcement of the pledge if the debtor proves it would make it impossible to continue his business activities if the pledge is enforced.[51]

Although Russian legislators have managed to find a compromise between the interests of secured creditors, the creditors of first and second order of priority, and the insolvency administrator, it should be noted that the rights of creditors under current payments were not taken into account because under the Amendments such creditors are not entitled to any proceeds from the sale of pledged property.[52]

An important Amendment concerns the legal position of pledgees under the pledge provided by the third persons (not by the debtors under the principal obligations).[53] Formerly the legal status of such creditors was not defined, which caused problems in practice. Some courts regarded said creditors as the bankruptcy creditors of the third order of priority, while others examined their claims in general court proceedings out of the bankruptcy case. The latter allowed debtors to abuse their rights by enabling them to shelter their property from bankruptcy creditors by pledging it to affiliated third persons. The Amendments now protect creditors by stipulating that pledgees under the pledge provided by the affiliated third persons are deemed secured creditors having the above mentioned rights and privileges.[54]

E. Insolvency administrators

The new Law amends the status of insolvency administrators including their duties, activities, procedures, and remuneration, as well as their responsibility for breach of Russian legislation, and for damages incurred by the debtor and third parties.[55]

Insolvency administrators have more independence in regulating insolvency administrators' activity by self-regulating organizations of insolvency administrators (SRO). The representatives of SRO may participate without voting rights in meetings of creditors, and may petition the *arbitrazh* court for the insolvency administrator to be relieved from his duties in a bankruptcy case. An SRO member approved as an insolvency administrator in the bankruptcy case is a party to the *arbitrazh* court proceedings.[56]

But some Amendments regarding insolvency administrators favor the interests of the bankruptcy creditors. The activities of insolvency administrators in a bankruptcy case are no longer deemed entrepreneurial activity. The obligatory registration of insolvency administrators as individual entrepreneurs is cancelled as of January 1, 2010. Consequently, the insolvency administrators' chief purpose is securing the interests of the creditors, not

50. *Id.*
51. *Id.*
52. *Id.*
53. 1998 Amendment, *supra* note 21.
54. 2009 195-FZ Amendment, *supra* note 26.
55. 2008 296-FZ Amendment, *supra* note 23.
56. *Id.*

deriving entrepreneurial profit. The Amendments also limit the insolvency administrators' remuneration.

Moreover, a particular person may be designated as a candidate for insolvency administrator in the bankruptcy application. Previously, the candidate for insolvency administrator had to be approved by the court of arbitration from a list of three persons presented to the court by SRO.

F. Repayment of mandatory payments by third persons

A significant Amendment protects debtor's rights by allowing a founder (member) of the debtor, owner of the property of the debtor, or a third person to repay mandatory payment debts (debts on repayment of taxes and other state duties) during any bankruptcy case.[57] The previous version provided only for repaying all creditors' claims simultaneously.

Mandatory payment creditors pursue one principal aim in a bankruptcy case—to collect the maximum amount of mandatory payments into the budget. Their activities are often focused on the quickest sale of debtor's assets, not on the rehabilitation of the debtor. The sale of a debtor's assets and its liquidation, however, is not always the best way of solving insolvency problems. In some cases, it is better to preserve the debtor's business than to liquidate it. Under the Amendments, persons interested in saving the debtor's business are entitled to repay mandatory payments and, as a consequence, to take the place of mandatory payments creditors in a bankruptcy case.[58]

G. Selling the debtor's property

Sale procedures have also been amended to provide greater transparency and publicity. Auctions on the sale of the debtor's property are held in the form of electronic bidding, a procedure established by the Ministry for Economic Development of the Russian Federation.

The Amendments also facilitated approval by the creditors of proposals for the sale of the debtor's property made by insolvency administrators. Under the former provisions, failure of the creditors to approve sale proposals led to protracted disagreements. The Amendments provide that if the proposals are not approved by the creditors' meeting within two months from the date of the insolvency administrator submitting proposals for the sale of property to the creditors' meeting, the insolvency administrator may petition the *arbitrazh* court for approval of the proposed sale.[59]

The Amendments resolve a principal question that insolvency administrators often faced: what is done in case of failure to sell the debtor's property? Under the Amendments, if a repeated sale of the debtor's property is deemed unconsummated or if no contract of purchase/sale is concluded with the sole participant therein and also if no contract of purchase/sale is concluded after the repeated sale, then the debtor's property is subject to sale by a public auction. In a public auction, the announcement of the sale must include the amount of reduction in the initial selling price of the debtor's property and the

57. *Id.*
58. *Id.*
59. *Id.*

dates by which the initial price will be successively reduced.[60] As this is being done, the initial selling price of the debtor's property is set in the amount of the initial price in the announcement of the sale of the debtor's property at the repeated sale. Therefore, the debtor's property now will not remain unsold after invalid bids.[61]

The Amendments establish accurate and transparent property valuation procedures, subject to approval by the respective state agency (if required by the law) and dispute settlement procedures in regard to agreement on the report.[62] The state agency's decision on compliance or noncompliance of the debtor's property valuation report with valuation practices and standards may be opposed with evidence of the appraisers' self-regulating organization which would be effective as a final document for the purposes of valuation of the market value of property.

On initiation of winding-up procedures, the debtor's owners (shareholders) lose all control over the debtor or transactions disposing of the debtor's property.[63] The exception is that at a general meeting of the debtor's participants, the owners may enter into agreements for provision of funds by a third party to fulfill the debtor's obligations.

The period for winding-up proceedings has been reduced from one year to six months, which is a positive change, because long winding-up proceedings led to unreasonable expenditure of funds from bankruptcy assets.[64]

H. Liability of the Third Persons

The Amendments developed provisions regarding the option to apply responsibility of the debtor to third persons. The former Insolvency Law provided for the possibility to hold the head of the debtor, its founders (participants) and other third persons liable for the debtor's obligations in certain cases.[65] The Amendments provide more detailed regulation of these issues.

The Amendments introduce a new term, "controlling person of the debtor," which means the person who enjoys or has enjoyed within less than two years before acceptance by an *arbitrazh* court of the bankruptcy application the right to give directions to the debtor or the ability to determine in some other way the debtor's actions, including by coercion of the debtor's head or members of its management or by exerting some other influence upon the debtor's head or members management. Controlling persons may be identified by the liquidation commission as the person who, by virtue of the authority based on a letter of attorney, a regulatory legal act, or a special power, could make deals on behalf of the debtor; or the person entitled to dispose of fifty or more percent of voting shares of a joint stock company, or over half of participatory shares in the charter capital of a limited liability company.[66]

The Insolvency Law provides that controlling persons jointly bear subsidiary responsibility for the debtor's obligations from the time of suspension of the settlements with

60. *Id.*
61. 2008 296-FZ Amendment, *supra* note 23.
62. *Id.*
63. *Id.*
64. *Id.*
65. 2002 Amendment, *supra* note 22.
66. 2008 296-FZ Amendment, *supra* note 23.

creditors concerning claims for repair of the damage caused to creditors' property rights as a result of controlling persons' decisions or discharge of the current obligations when the bankrupt's assets are insufficient.

The Amendments expanded the cases where the debtor's head is obliged to file an application for declaring the debtor bankrupt. The debtor's head must file an application if the debtor meets the evidence of property's insufficiency or insolvency. The Amendments introduce definitions stating that "property's insufficiency" means the amount by which the debtor's obligations exceed the value of the debtor's property (assets), and "insolvency" means failure to pay debts as they come due because of "property's insufficiency." With this, insufficiency is presumed, if not proved otherwise.[67]

Thus, under the Amendments, if a company fails to perform its monetary obligations, it is presumed such failure was caused by insufficiency of debtor's assets, and the debtor's head must file a bankruptcy application as soon as possible, but at latest, in one month after the date of emergence of relevant circumstances.[68]

Another important development stipulates new grounds for liability of the debtor's head. The debtor's head bears subsidiary liability for the debtor's obligations, if the accounting documents or reports and statements that have to be collected, drawn up, kept, and stored under the legislation of the Russian Federation, are not available by the time of issuing the ruling on initiating supervision proceedings or declaration of the debtor as bankrupt, or do not contain data on the debtor's property and obligations and their movement, collection, registration, and generalization are mandatory in compliance with the legislation of the Russian Federation, or if the said data are false.[69] These provisions were introduced because accounting documents were often destroyed or concealed by the debtors' head before the arrival of insolvency administrators. Such actions caused significant difficulties in carrying out financial analysis and searching for the debtor's assets, which resulted in reduction of the bankruptcy assets.

Monetary funds recovered from the persons made liable under these provisions are included into the bankruptcy assets.[70]

I. THE PROPOSED DRAFT AMENDMENTS

Along with the recent Amendments, the Ministry for Economic Development of the Russian Federation has prepared the draft federal law on amending the Insolvency Law (the Draft Law).[71] The Draft Law, which changes the name of the current Insolvency Law to the Federal law "On financial rehabilitation and insolvency (bankruptcy)," is currently under discussion and will be introduced for approval to the State Duma of the Russian Federation by the end of 2009.

67. *Id.*

68. *Id.*

69. *Id.*

70. *Id.*

71. Ministry for Economic Development of the Russian Federation, Draft Federal Law on Amending the Insolvency Law and Other Legislative Acts of the Russian Federation With Regard to Improvement of Rehabilitation Proceeding, Dec. 23, 2009, *available at* http://www.economy.gov.ru/minec/activity/sections/CorpManagment/bankruptcy/projectfz [hereinafter Draft Federal Law].

J. Reforming financial rehabilitation proceeding

Financial rehabilitation proceedings appeared in Russian insolvency legislation in 2002 to help debtors restore their solvency, thus avoiding declaration of the debtor as bankrupt and liquidation proceedings.

The Draft Law enables the debtor to file an application to the court for institution of financial rehabilitation without the seven-month period of observation proceeding and without the consent of the creditors.[72] Such an application will be accepted by the court if the claims against the debtor aggregate at least RUB 100,000 (Russian rubles), without regard to the overdue period of the claims. If the court considers the debtor's application well-grounded, the financial rehabilitation proceeding will be instituted for a three-year period, which may be extended to five years after approval of a rehabilitation plan by the court. The debtor will be protected from winding up and the sale of its assets, as well as will have a chance to reorganize.[73]

The Draft Law provides the debtor with certain rights and privileges during the rehabilitation proceeding, as follows:

(i) Suspension of accrual of interests and penalties under loans;

(ii) Retention of the debtor's head during the rehabilitation proceeding;

(iii) The debtor is entitled to determine the procedure of approval of transactions by the insolvency administrator;

(iv) Creditors' claims are divided into separate classes enabling the debtor to offer different terms and conditions of debt repayment or restructuring to the different classes;

(v) In certain cases, the rehabilitation plan may be approved by the court without the consent of the creditors;

(vi) The debtor is entitled to enter into loan agreements to finance the debtor's activity during the rehabilitation proceeding; in certain cases the debtor may borrow money without the consent of the creditors.

An important innovation in the Draft Law concerns pre-trial settlements between debtors and creditors through settlement agreements. Settlement agreements may stipulate that debtors and creditors are obliged to exercise their rights in a certain manner or to refrain from exercising such rights. The Draft Law provides that such provisions are not considered prohibited waivers of rights under the Civil Code of the Russian Federation. These Amendments resolve the problem of risk of declaration of standstill agreements concluded between debtors and creditors under foreign legislation as void by Russian courts.[74] The problem of recognition of such agreements was related to the prohibition of a waiver of rights in the Russian Civil Code. If these provisions are adopted, debtors will have greater flexibility for restructuring their debts and entering into the settlements with their creditors.

72. *Id.*

73. *Id.*

74. *Id.*

K. INSOLVENCY OF AFFILIATED DEBTORS

The Draft Law will allow initiation of a consolidated insolvency proceeding for members of an affiliated group. There are no such current provisions in the Insolvency Law, which leads to difficulties in holding company insolvencies. The Draft Law permits affiliated debtors to be joined in one consolidated proceeding upon the petition of such debtors, their controlling person, the insolvency administrator, or the creditors.[75] The Draft Law also provides for the option to hold the controlling person liable for the debtors' obligations where the debtors' assets are insufficient for the full satisfaction of the creditors' claims.[76] The Draft Law provides that the other members of the group may also bear subsidiary liability for the debtors' obligations in certain cases, such as unfair activities of such members aimed at transfer of debtors' assets or other violation of creditors' rights.[77]

L. CROSS-BORDER INSOLVENCY

The Draft Law also regulates cross-border insolvencies. The Draft Law specifies when Russian Federation courts have jurisdiction over cross-border insolvencies, stipulates the limits of jurisdiction, and sets forth the rules concerning recognition of foreign insolvency proceedings and decisions.

A cross-border insolvency is defined as relationships connected with insolvency of Russian and foreign legal entities, complicated by a foreign element, particularly in cases where the debtors' assets are located abroad, the creditor of the debtor is a foreign citizen or a foreign legal entity, and a foreign proceeding has been commenced in respect of the debtor.[78]

A number of the Draft Law's provisions regarding cross-border insolvency were modeled on the UNCITRAL Model Law on Cross-Border Insolvency (UNCITRAL Model Law) and correspond to the respective provisions of foreign countries.[79] Thus, for instance, the Draft Law adopts the concept of the "center of main interests" and distinguishes between a main and non-main proceeding.[80]

Under the Draft Law, the "center of main interests" means the place of its registration as a legal entity, unless otherwise provided by the law or unless the circumstances otherwise require. The Russian *arbitrazh* courts recognize cross-border insolvencies of Russian and foreign debtors in the following cases:

(i) In respect of a Russian or a foreign debtor having the centre of main interests within the Russian Federation, as well as in case the centre of main interest of a

75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. Under UNCITRAL Model Law, "foreign main proceeding" means a foreign proceeding taking place in the State where the debtor has the centre of its main interests, and "foreign non-main proceeding" means a foreign proceeding, other than a foreign main proceeding, taking place in a State where the debtor has an establishment, i.e. any place of operations where the debtor carries out a non-transitory economic activity with human means and goods or services.

person controlled by or controlling the debtor is located within the Russian Federation (main proceeding);

(ii) Permanent representation or the assets of a Russian or a foreign debtor are located in the Russian Federation, but the centre of principal interests of the debtor is located within the foreign country (non-main proceeding).[81]

Additionally, the Russian *arbitrazh* courts decide cases on recognition and enforcement of foreign courts' judgments in bankruptcy cases.[82]

As with the UNCITRAL Model Law, the Draft Law provides that in commencing a case for recognition and enforcement of judgments under foreign main proceedings, the *arbitrazh* court relies upon the presumption of debtor's insolvency and is not entitled to reconsider the grounds for initiation of a main proceeding.[83]

As the first significant effort to resolve the problem of cross-border insolvencies, the Draft Law is a positive development. The provisions of the Draft Law, should they be adopted in the Russian Federation, will be the first important step to regulation of cross-border insolvency in conformity with cross-border insolvency laws of most of the developed countries.

M. Conclusion

While trying to adopt the insolvency legislation to the current needs of the Russian market, the recent Amendments to the Insolvency Law nevertheless take into account certain provisions of the foreign countries' insolvency legislation and the respective experience of most of the developed countries. The Amendments and Draft Law changes to the Russian Insolvency Law are consistent with international principles of insolvency regulation, including:

(i) increased defense of secured creditors in the bankruptcy cases;

(ii) transparency and publicity of procedures of the debtors property sale;

(iii) option to apply liability to the "controlling persons" of the debtor (debtor's affiliated group);

(iv) option to contest/avoid debtor's transactions/transfers;

(v) development of options for restructuring;

(vi) improved opportunities for rehabilitation proceedings; and

(vii) the regulation of cross-border insolvencies.

In addition to these positive reforms to the Insolvency Law, Russian insolvency law requires further amendments to become an effective mechanism for protecting the rights of debtors and creditors in insolvency proceeding.

81. Draft Federal Law, *supra* note 71.

82. *Id.*

83. *Id.*

IV. Developments in the United States

In 2009, significant decisions issued concerning debtors' and foreign representatives' rights under Chapter 15 of the U.S. Bankruptcy Code (Chapter 15).[84]

In *In re Gold & Honey, Ltd.*, a petition for recognition of an Israeli receivership proceeding was denied. The debtors previously filed Chapter 11 cases in the United States, and the receivers failed to prove each element of Section 1517 required for recognition.[85] Finding the receivership was not a collective proceeding such as a scheme of arrangement or wind-up, the Court held the receivers' appointment violated the automatic stay in the U.S. cases.[86]

In *In re Steadman*, a petition for recognition by a U.K. trustee was denied under Section 1501(c)(2) where the debtor was a non-U.S. citizen "lawfully admitted for permanent residence in the United States."[87]

Where a petition for recognition has been granted, Chapter 15 protections and comity apply. Thus, *In re Spansion, Inc.*, forbade prosecution of patent infringement claims in the United States against a U.S. debtor and its related foreign debtor whose petition for recognition was granted.[88] *In re Qimonda AG* held that the German Insolvency Code governed the assumption and rejection of patents and licenses where the German insolvency proceeding was recognized as foreign main proceeding even though licensees would receive less favorable treatment under the German Insolvency Code.[89] Emphasizing comity, *In re Atlas Shipping A/S* held that Supplemental Rule B maritime attachments would be vacated and the representative of a Danish debtor granted recognition could take possession of attached funds subject to the Danish bankruptcy court's jurisdiction.[90] But Section 543's mandatory turnover provisions requiring turnover of debtor's property by custodians at commencement of a case does not apply in Chapter 15; rather Section1521, which is discretionary, controls.[91] *Atlas Shipping* also criticized the reasoning in *In re Condor Ins. Ltd.*, which held that a foreign representative in a Chapter 15 proceeding cannot bring an avoidance action under foreign law without first filing a U.S. Chapter 7 or Chapter 11, even where the debtor's petition for recognition has been granted.[92]

84. Chapter 15 was enacted in 2005 to promote cooperation between U.S. and foreign courts during multinational insolvency proceedings. *See* Bankruptcy, Ancillary and Other Cross-Border Cases, 11 U.S.C. §§ 1501-1532 (2005) (Chapter 15 incorporates, with modifications, the Model Law on Cross-Border Insolvency).

85. *In re* Gold & Honey, Ltd., 410 B.R. 357 (Bankr. E.D. N.Y. 2009).

86. 410 B.R. at 369-72.

87. In re Steadman, 410 B.R. 397 (Bankr. D. N.J. 2009).

88. In re Spansion, 418 B.R. 84 (Bankr. D. Del. 2009).

89. In re Qimonda AG, No. 09-14766-RGM, 2009 WL 4060083 (Bankr. E.D. Va. 2009).

90. In re Atlas Shipping A/S, 404 B.R. 726 (Bankr. S.D. N.Y. 2009).

91. *Id.* at 746.

92. *Id.* at 744 (discussing *In re Condor Ins. Ltd.*, 411 B.R. 314 (Bankr. S.D. Miss. 2009)).