

COVID-19 Bankruptcy Moratorium Regime Amended

April 2020

Background

On April 6, 2020 a 6-month moratorium on initiation of bankruptcy proceedings (the **Moratorium**) entered into effect in Russia. The Moratorium is a key governmental relief measure in the COVID-19 pandemic. Given the Moratorium's exceptional and unprecedented nature, unsurprisingly it has received considerable attention — from both the business community and legal practitioners. Some have expressed concerns that certain aspects might be overly restrictive, and that in the absence of further legislative clarifications, some of its provisions create legal uncertainty.

In this light, Federal law № 149-FZ “On amendments to certain legislative acts of the Russian Federation” dated 24 April, 2020 introduces amendments to the Moratorium to achieve a better balance between protecting the interests of creditors and meeting the business objectives of companies included in the list of debtors to whom the Moratorium applies (**Eligible Debtors**). Various governmental acts have also amended the lists of Eligible Debtors since April 6. (These lists are expected to be further updated from time to time, to keep pace with a rapidly changing economic environment.)

Scope of the Moratorium amendments:

The amendments under law № 149-FZ and other governmental acts since April 6 may be summarized as follows:

- Any Eligible Debtor may now **voluntarily withdraw** itself from the list of Eligible Debtors, by filing a notice with the Unified Federal Bankruptcy Register. Upon the publication of such notice, the protections/restrictions of the Moratorium will no longer apply to the debtor.
- However, should the term of the Moratorium be extended by the Russian Government, any such withdrawal notice filed prior to such extension will **expire**, and the entity will need to file a new withdrawal notice in order to continue its exclusion from the Moratorium.
- The law **repeals the “1% rule”** provided for in the original Moratorium. This stated that if bankruptcy proceedings are initiated against an Eligible Debtor within three months of the end of the Moratorium, any transaction entered into by the debtor during the Moratorium will be deemed void, unless it was done in the ordinary course of business and has a value (including interrelated transactions) not exceeding 1% of the debtor's assets. The amendments expressly provide that any transaction, which would have been subject to avoidance under the 1% rule and which was entered into prior to the date of the amendments' coming into force, shall not be deemed void.
- The list of industries impacted the most by the COVID-19 pandemic has been extended to include **museums and zoos** (under the “Culture, Leisure and Entertainment” category). The list furthermore now includes a **new category: “Retail Trade of Non-food Products”**, which covers the retail trading of cars, motor vehicles and motorcycles, parts and accessories, general merchandise, apparel, appliances, IT and communications equipment (including smartphones and computers), cultural and entertainment goods (including newspapers, books, toys and sports equipment) and footwear.

Observations

The Russian business community has generally welcomed these amendments. However, certain questions remain, and the effect of some of the amendments may well cause concern for lenders and other counter-parties providing credit.

On the one hand, the amendments allowing an Eligible Debtor to 'opt out' of (i.e., to withdraw from) the Moratorium provide more flexibility to entities which, having experienced a certain negative effect of the pandemic, still continue business as going concerns. The elimination of the Moratorium's restraints (e.g., limitations on the distribution of dividends, buybacks and enforcement of security) will allow companies to continue enjoying the full spectrum of corporate actions and business objectives.

On the other hand, the impact of an Eligible Debtor's withdrawal on its creditors' interests has its limitations. In particular, an Eligible Debtor may become subject to the Moratorium once again in the future, should the Moratorium be extended. It is also not entirely clear if the withdrawal notice is meant to be irrevocable or whether an Eligible Debtor may 'opt back' into the Moratorium regime. This introduces an element of uncertainty for creditors and counterparties. Subject to further clarification by the legislators or courts, the authors believe the better reading would be that a withdrawal should be treated as **irrevocable albeit subject to potential reintroduction** (i.e., if the Moratorium is then extended, for the period of extension). Because of the risk of **reintroduction**, creditors and counter-parties will presumably either need to 'take a view' on such risk or ensure adequate third-party credit support when contracting with Eligible Debtors despite any withdrawal.

Moreover, the consequences of eliminating the 1% rule are far from straightforward. As originally drafted, the 1% rule was heavily criticized by the Russian business community as being too strict. Some Eligible Debtors' management felt it did not allow them to enter into transactions which might help improve their financial condition and eventually survive the pandemic and associated economic crisis. The adherents believed keeping debtors bound hand and foot by the 1% rule could even lead to some debtors' *de facto* insolvency. The Moratorium arguably merely postponed (or even accelerated) inevitable bankruptcies.

At the same time, the elimination of the 1% rule (previously a key creditor protection against potential abuse) is decidedly unfavorable for creditors. This now permits significant leakage from Eligible Debtors to occur. The 1% rule's elimination will most likely not help lenders to overcome their reluctance to provide new financing for Eligible Debtors during the Moratorium.

The legal community has also had some discussion on the interpretation of certain rules of the Moratorium. Notably, some have expressed the view that the above-mentioned Moratorium restrictions (including limitations on distribution of dividends, buybacks and enforcement of security) should not automatically apply from the date of the introduction of the Moratorium by the Russian Government. Rather, the restrictions arguably should be triggered if and when an Eligible Debtor **defaults** on payment obligations — which would make it a "**debtor**" within the meaning of the Russian Bankruptcy Law. The rationale for such an interpretation is that literally the Moratorium-related provisions refer to the restrictions being binding on those "debtors" to whom the Moratorium applies. Unfortunately, the amendments do not introduce additional clarity on this point. Should the courts and administrators follow such approach, the benefits of Eligible Debtors' 'opting out' of the Moratorium regime may be overstated.

Conclusion

Undoubtedly, the legislators' key objective in adopting these recent amendments was to **improve** Eligible Debtors' financial position whilst attempting to balance the interests of creditors. However, it is far from clear whether the amendments strike the right balance — only time will tell. Creditors and their counsel will undoubtedly keep a watchful eye on how the courts apply these principles going forward.

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