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Disputable Issues of Imposing Subsidiary Responsibility on Controlling Persons in Case of Bankruptcy

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Abstract: This study considers certain issues of legal regulation of imposing subsidiary responsibility on controlling persons in case of bankruptcy. The problem of relation between the claim for subsidiary responsibility and claim for losses is discussed. The problem of relation between the claim for losses and challenging of the debtor's transactions is also studied. Eventually, the conclusion is drawn that separate categories of controlling persons in a bankruptcy case should be applied, depending on the existence or nonexistence of a responsibility to act in the interests of the debtor and/or creditors.

Key words: Bankruptcy, subsidiary responsibility, controlling persons, claim for losses, challenging the debtor's transactions, actions in the interests of creditors, extracorporate responsibility, sole executive body, assumption of negligence, debtor's manager

INTRODUCTION

According to the Paragraph 31 Article 2 of the Bankruptcy Law (1), the debtor's controlling person is a person that has or had, within less than two years before the acceptance of the bankruptcy petition against the debtor by the arbitration court, the right to give mandatory instructions to the debtor or the possibility to otherwise determine the debtor's actions, e.g., by way of enforcement of the manager or management bodies of the debtor or otherwise exercising definitive influence on the manager or management bodies of the debtor (for instance, the debtor's controlling person can be a member of liquidation commission a person which is empowered by a letter oa attorney a legal act or a special authority could execute deals on behalf of the debtor a person who could dispose of 50 more percent of voting shares of a joint stock company or over a half of the equity capital of a company with limited (auxiliary responsibility or the debtor's manager).

It is notable that the debtor's manager was only recently directly included in this provision as a subject of subsidiary responsibility, namely upon amendment of the Bankruptcy Law by the Federal Law dated 28.06.2013 No. 134-FZ (2). Nonetheless, even before the amendment the wording of Article 10 of the Bankruptcy Law could lead to an assumption that the controlling persons may be also persons executing management functions in regard to the debtor (manager, members of collegial bodies), despite the fact that they are directly mentioned in this provision solely as persons that can be influenced by controlling persons (Pirogova and Yu, 2012).

DISPUTABLE ISSUES OF IMPOSING SUBSIDIARY RESPONSIBILITY ON CONTROLLING PERSONS IN CASE OF BANKRUPTCY

In the legal literature, it is fairly said that this revision of Article 10 of the Bankruptcy Law first of all emphasizes the assumption of negligence and unreasonableness of actions of the controlling person (Anonymous, 2002). So, according to the Paragraph 2 Clause 4 Article 10 of the Bankruptcy Law, until it is proven otherwise, it is assumed that the debtor is declared insolvent (bankrupt) due to the actions and (or) lack of action of the controlling persons of the debtor if any of the circumstances provided for in the same regulation are true. Meanwhile, Paragraph 7 Clause 4 Article 10 of the Bankruptcy Law states that the controlling person bears no subsidiary responsibility if they can prove their innocence or if they were acting reasonably and in good faith in the interests of the debtor.

In the legal literature some scholars are sharing their doubts of whether this assumption coordinates with, above all, the presumption of good faith and reasonability of actions of the participants of the civil transactions stipulated by the Article 10 of the civil code of the Russian Federation. Probably, it is fair to speculate based on the priority of the special rule over the common rule. In this case, the Bankruptcy Law is a special rule in regard to the civil code and can establish exceptions for legal relations of insolvency (bankruptcy) with certain special features; namely to establish its assumptions. Although, it is hard to deny that such appointment of the burdens of

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proof significantly complicates the position of persons joint by the legislator under the notion of "controlling persons". With such a legal structure it is obvious that the legislator, putting the burden of proof of their innocence on the debtor's controlling person, takes the side of the weaker "injured" party, i.e., the creditors.

The legal literature provides an example of joint stock companies, sharing an opinion that there could be no material responsibility of the company chief executive officer towards the creditors of the company in case of a legal entity's bankruptcy. Imposing of subsidiary responsibility on such a person towards the company creditors, along with the shareholders, creates an illusion of a simple partnership where an executive person is put in the same category with a shareholder as a partner who contributes certain professional knowledge and skills and in exchange, gains a share oa profit but such concept does not actually reflect the reality of economic relations between the shareholders, the company and the CEO (Anonymous, 2013). Thus, this opinion is very objectionable. Subsidiary responsibility of the debtor's manager should be first of all substantiated by defense of legal interests and rights of creditors, the party that is in fact affected by the bankruptcy and if such adverse consequences for the creditors occurred due to actions or lack of action on the part of the debtor's controlling persons including the debtor's manager, then it is only fair to justify such accountability.

In this relation, the literature it is reasonably noted that, since in case the responsibility of a person performing functions of a sole executive body of a legal entity is imposed under the grounds provided for by the Bankruptcy Law, then it is the responsibility towards the creditors of the company and such responsibility can be classified as extracorporate, i.e., going beyond the framework of corporate relations (Yu and Bogdanov, 2013).

The existence and standalone nature of extracorporate responsibility is underlined by provisions of Clause 9 Article 10 of the Bankruptcy Law, stating that imposing subsidiary responsibility on the debtor's controlling persons regarding the debtor's commitments does not impede claims for compensation of losses of the debtor by the legal person's bodies addressed to the controlling person by the stakeholders (shareholders) of the debtor based on Clause 3 Article 53 of the civil code of the Russian Federation and respective federal laws, in part not covered by the amount of subsidiary responsibility. It also matters that the said persons can be burdened with subsidiary responsibility only if the debtor is declared bankrupt (Bychkov, 2013). It is rather important to discuss the problem of relation between the claim for subsidiary responsibility and claim for losses of the debtor. To segregate the two, one should keep in mind that the subsidiary responsibility occurs when actions of certain persons have not merely resulted in the debtor's losses but caused bankruptcy of the debtor and the debtor noticeably lacks assets. So, the same action (for instance, withdrawal of assets by way of transactions with unequal counter performance) can either result or not result in the declaration of the debtor's bankruptcy. Should the case be the former, the subsidiary responsibility is properly substantiated (Suvorov, 2013).

It is also of interest to discuss the problem of relation between the concept of tortious responsibility (speaking about the claim for losses) with the concept of challenging the debtor's transactions in case of bankruptcy. Practically it often happens that the losses of a legal entity result from a transaction which in its turn, can be contested according to the rules of Chapter 3.1 of the Bankruptcy Law. In case of a successful contestation all property handed over by the debtor or another person instead of the debtor or towards performance of obligations before the debtor or extricated from the debtor under the transaction is subject to be returned to the bankruptcy estate. It is noted that then "the amount of tortious responsibility of the injuring party having concluded an unprofitable transaction on behalf of a legal person or having pointed at the need to conclude it, has to be reduced due to the elimination of negative consequences of this behavior. Certainly, the expenses for contesting of such a transaction, if they are not compensated by another party shall be charged to the injuring party (controlling person)" (Egorov, 2013). Such a relation is quite fair but it should not be forgotten that this circumstance does not impede imposing subsidiary responsibility on the controlling person.

Federal Arbitration Court of West Siberian District in its Resolution of July 05, 2012 on the case No. A45-3006/2010 has stated that in order to impose subsidiary responsibility on controlling persons, following conditions shall be observed. The person held responsible is entitled to provide obligatory directions to the subordinate legal entity or otherwise determine actions of the legal entity. The person held responsible undertakes actions indicative of the use of such entitlement or opportunity. A causal relation exists between the use of this title and (or) opportunities in regard of the legal entity and eventual insolvency (bankruptcy) of the latter. Property of the debtor is insufficient to satisfy the demands of creditors (Bychkov,

2014). The burden of proof of the facts confirming the causal relation between the declaration of the debtor's bankruptcy and actions of management bodies of the debtor, according to the Article 65 of the Arbitration Procedure Code of the Russian Federation, is imposed on the creditor or another person addressing the court with a claim for imposing subsidiary responsibility. Should such circumstances not be established, the possibility to hold the debtor's controlling persons responsible is excluded.

It has been observed in the literature that the guilty conduct of controlling persons can be confirmed not only by the fact that they took decisions to withdraw assets by a price significantly lower than the market price or assigned the debtor to take responsibility for return of a loan amount to third parties which as a rule are affiliated with persons in control of the debtor or are controlled by them. This may also be concerned with assigning an extraordinary amount of compensation to a company CEO or other managing staff, accepting assignments, etc. (Bychkov, 2014).

However, if a debtor's controlling person's guilty conduct resulted in worsening of financial situation of the debtor but did not result in the bankruptcy, then the subsidiary responsibility cannot be imposed.

CASE LAW

In the legal literature, it is remarked that the courts tend to with increasing frequency, make judgement on the responsibility of controlling persons to act in the interests of both the debtor and thecreditors. Asan illustration, the Judgement of the Seventeenth Arbitration Appeal Court of February 11, 2010, No. 17AP-12819/2009 GK is provided where the court deliberates on the responsibilities of managers as controlling persons of the debtor who is declared bankrupt and his creditors.

The point of the debate was that an LLC addressed to the arbitration court with a claim to impose subsidiary responsibility on the directors for bringing the company to bankruptcy and subsequently to appoint a penalty of a substantial monetary amount. The Court of first instance dismissed the claim, based on the absence of definitive guilt of the managers of the LLC in bringing the company to bankruptcy. Thereby, a conclusion was that the main cause of the bankruptcy of the LLC was discontinuation of its main activity after termination of subcontracts concluded in the course of purposeful business activity of two companies the LLC and a CJSC (Closed Joint-Stock Company) as the main creditor in the scope of the bankruptcy case.

The judgement of the court of first instance was held on appeal whereas the court of appeal has made a conclusion that the defendants acted against the interests of the company. Their wrongful actions were voluntary termination of the subcontracts resulting in discontinuation of the business activity of the debtor and acquisition of non-liquid notes and debentures by the price lower than the nominal price of the notes by the management on behalf of the LLC. The court pointed out that as a consequence from this activity a part of the creditor's requirements remains unsatisfied. Hereby "...managers should be able to foretell that the execution of the above mentioned transactions is against the interests of the company and its creditors, because they constitute a part of the governing body of the company and prioritize gaining profit (Clause 1 Article 50 of the civil code of the Russian Federation)".

Thus, the conclusion of the court demonstrates a decisive point in favor of the right of certain groups of controlling persons in this case, the managers to act in the interests of both the debtor and the creditor and as an independent ground of subsidiary responsibility of such persons, violation of the creditors' interests can be named (Sokolov, 2010). Therefore, it is fair to ask if the managers have a documented responsibility to take care of the interests of the creditors as such, so that the violation of this responsibility could be referred to for substantiation of causing damage to the property rights of the creditors by a manager as a controlling person. The answer is rather that the managers should first of all consider the financial well-being of the company they are in charge of and not of the well-being of its counterparties (the creditors). Here it is worth mentioning a rule already known in the times of the Roman law, saying the following: the creditor should take his own care of his interest. This is even more true because a creditor is normally a participant of entrepreneurial activity that should assess the business risks of its activity and take responsible actions to mitigate them.

Moreover, unlike the managers, persons having a share in the company's equity bear no such responsibility and are free to take care of their own economic interests exclusively. Of course these interests should not contradict the interests of the legal entity. But the wording of clause 4 Article 10 of the Bankruptcy Law suggests that any controlling person of a debtor should prove that its actions were caused solely by the interests of the debtor which is against the legal position of such controlling persons.

CONCLUSION

Therefore, it seems fair to segregate categories of controlling persons based on the condition of presence or absence of responsibility to act in the interests of a debtor

and/or creditors. Not each controlling person is obliged to act even in the interests of the debtor and since there is no binding law for any certain behavior or refraining from certain behavior by such persons, it is impossible to impose the responsibility on them.

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