



Subsidiary liability: trends in the recent court practice



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Notwithstanding the moratorium for bankruptcy, the number of applications for bringing subsidiary liability in the course of bankruptcy proceedings is not decreasing in recent times. The courts extend and specify the range of persons against whom the creditors may successfully assert their claims.

List of persons is being enlarged

In one of the disputes the creditor requested to bring subsidiary liability for the debts of the company not only against the General Director (as majority quotaholder) and his wife (being the accountant), but also against the children of the couple since the valuable real estate was in fact donated to them. The lower court refused to bring subsidiary

liability against the children, however the Higher court of Russia did not take this approach. Even though the children were not the persons with significant control and did not cause the insolvency of the company, the parents with their help could have kept the assets away from the creditors¹. As a result, the commercial court of Moscow with the decision dated 27 October 2020 in the case No. A40-131425/16-30-2035 brought the subsidiary liability against the children jointly and severally with their parents.

In another dispute the courts clarified the possibility to recover the debt arising out of subsidiary liability from the heirs. The deputy General Director of the bankrupt company died and the creditors filed a claim to recover money from the heirs. Initially, the claim was not accepted by

¹ Decision of the Higher court of Russia dated 23 December 2019 No. 305-ЭС19-13326



the courts as it is inseparably connected with the personality of the deceased person. However the Higher court of Russia in its decision dated 16 December 2019 No. 303-ЭС19-15056 has considered that the debt is included in the mass of the succession. Otherwise, the assets that are illegally acquired for the account of the creditors would be protected from its claims, which would be unfair.

Position or status does not always result in subsidiary liability

In accordance with the position of the Higher court of Russia², participation in the management bodies does not imply by itself the status of person with significant control. However, there are certain exemptions when the control is presumed, such as, for example, for the directors and those who dispose of at least 50% shareholding in a limited liability company (ООО) or a joint stock company (АО).

For nominal directors the situation is that initially for them the control is presumed. At the same time, based on the provisions of the law on insolvency (bankruptcy)³, the nominal directors could be exempted from liability (either completely or partially) if they helped to disclose the real persons with significant control or to discover the hidden assets.

Even though the Plenum of the Higher court of Russia has foreseen only a decrease of liability (in other words interpreting the law restrictively), there are rare cases in practice when nominal directors were completely exempted from subsidiary liability. In particular, the commercial court of the Far-Eastern district⁴ has completely exempted the nominal director from liability since the director did not take the decisions, did not have access to the documents of the

company and to electronic signature. Moreover, it was not confirmed that the director closed any deals for withdrawal of assets that caused the damage to the creditors. The Higher court of Russia in its decision dated 11 February 2020 No. 303-ЭС19-26853 in the case No. А51-655/2015 has upheld such decision.

In another dispute concerning subsidiary liability of the members of the Board of Directors the Higher court of Russia⁵ has underlined that this status implies the possibility to significantly influence the activity of the debtor. However, even if the members of the Board of Directors have approved substantially detrimental transactions, this does not imply their fault in the bankruptcy. This case was about a contribution to the corporate capital of another company, which determined a cash-out from the company that finally went bankrupt. In this case, the initiator of the transaction (namely, the contributor to the corporate capital) and the potential beneficiary of such contribution (namely, the receiving company) could theoretically face the charges of subsidiary liability.

Liability for inactions

Creditors may even sue not only those who caused the bankruptcy of the debtor by actions, but also those who did it by omissions. Such cases occur quite rarely, but nevertheless have to be considered.

The commercial court of the Far-Eastern district⁶ has resolved the dispute where one of the defendants was the owner of 50% in the corporate capital of the company. Even though he withdrew from control over the company's activity, subsidiary liability was still brought against him. As a result of such inactivity, the company could not settle the debts with its creditors and finally became

² Resolution of the Plenum of the Higher court of Russia dated 21 December 2017 No. 53

³ Federal law No. 127-FZ dated 26 October 2002

⁴ Decision dated 11 October 2019 No. Ф03-3799/2019 in the case No. А51-655/2015

⁵ Decision of the Judicial collegium for economic disputes of the Higher court of Russia dated 22 June 2020 in the case No. 307-ЭС19-18723(2,3)

⁶ Decision of the commercial court of the Far-Eastern district dated 8 April 2019 No. Ф03-1133/2019 in the case No. А37-205/2015

bankrupt. The defendant also could not prove that he struggled to avoid the insolvency of the company.

In another case the commercial court of the West-Siberian district⁷ has upheld the approach of the lower courts regarding subsidiary liability of two quotaholders of the company jointly owning more than 50% of the shareholding in the company.

There was inaction by these quotaholders and no decisions were taken in terms of debts repayment and, in particular, an effective Director was not appointed.

Subsidiary liability for other categories

As confirmed by the Higher court of Russia in the decision of the Judicial collegium for economic disputes dated 25 September 2020 No. 310-ЭС20-6760 in the case No. A14-7544/2014, subsidiary liability may be brought against the management company due to the debts of the bankrupt company.

Initially, the lower courts have not considered the management company as the person that controls the debtor. However, the Higher court of Russia has considered the fact that the majority shareholder of both the management company and the debtor company was the same person (individual). As a result, there was control on both parties and unequal distribution of profit within the group. The management company actually acted as co-executor, and therefore subsidiary liability could also be also brought against it, together with the person with significant control. The dispute was remanded for retrial.

Another case was about complicity of the General Director and Chief Accountant, where the latter recognized false data in accounting and tax reporting. The lower

courts up to cassation instance considered only the General Director as the person with significant control.

However, the Higher court of Russia in its decision dated 27 November 2019 No. 305-ЭС19-21244 in the case No. A40-161770/2014 noted that, even if the position of Chief Accountant does not imply the control over the company (debtor), subsidiary liability for complicity is still possible.

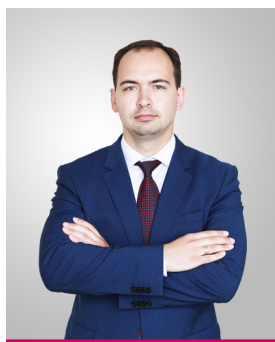
Piercing the corporate veil

In recent practice there are cases when a formal change of legal entity did not exempt from liability for debts. For instance, in one of the disputes in the course of change of a legal entity, its type of activity, actual address, counterparts and management team did not change. Due to the intentional transfer of assets from one entity to the other, the former has lost financial solvency and was not able to satisfy claims of the creditors. The court of first instance considered the change of legal entity as a formal one and brought subsidiary liability against the persons with significant control, the appellate instance overruled the decision, but the commercial court of Ural district upheld the initial decision⁸.

In another dispute the assets and personnel of an entity were transferred to another one with a similar name. Due to the transfer of assets, the former entity became bankrupt. Its General Director and new entity were considered by the courts of first and appellate instance as the persons with significant control and were held liable (tax debt was enforced). The commercial court of the East-Siberian district in its decision dated 20 February 2020 No. Ф02-7497/2019 in the case No. A78-9917/2018 has upheld the approach of the lower court.

⁷ Decision of the commercial court of the West-Siberian district dated 8 October 2020 No. Ф04-5979/2019 in the case No. A27-9347/2016


⁸ Decision of the commercial court of Ural district dated 26 May 2020 No. Ф09-2414/20 in the case No. A60-72617/2018



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