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Analytical Opinion on Development of Bankruptcy Proceedings with Foreign Companies' Assets

A new approach to bankruptcy of foreign companies

In February 2024, the Supreme Court issued a Ruling on the case of Westwalk Projects Ltd. (No. A40-248405/2022), a Cyprus company, which formed new approaches to feasibility of bankruptcy procedures in relation to foreign corporations holding assets in Russia.

The Supreme Court explained: if the entity's centre of main interests is located in a foreign jurisdiction, creditors have the right to distrain the entity's Russian assets by initiating the so-called 'secondary proceedings' in the bankruptcy case in respect of the foreign debtor's property.

This procedure does not entail legal consequences for the entity's foreign management centre, while allowing creditors to enforce their claims at the expense of the Russian assets of the foreign counterparty.

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VERBA LEGAL Bankruptcy Practice has prepared an Analytical Opinion on the development of judicial practice in cases of cross-border bankruptcy (bankruptcy of foreign legal entities).

Tax authorities were the first to take advantage of enforceability of foreign entities' Russian assets

Starting from March 2024, tax authorities, represented by territorial Inspectorates, began to apply to arbitration for 'secondary proceedings' in relation to the assets of foreign companies.

More than 30 foreign legal entities have been involved in bankruptcy proceedings based on applications from the Federal Tax Service, and several dozen more are pending now.

These are general features of cases initiated based on applications from the Federal Tax Service:

- in most cases, the tax authority is the only creditor, no other claims to the property are made;
- the average amount of the Inspectorate's claim: 10-20 mln roubles, there are claims starting from 600 ths roubles;
- the overwhelming majority of cases are initiated in Moscow and Moscow Region.

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Repayment of creditors' claims is a chance to preserve a Russian asset

The law allows both the debtor's owners and any persons not legally related to them to pay off creditors' claims and terminate the bankruptcy case (Article 125 of the Bankruptcy Law).

To do this, after the bankruptcy procedure is initiated, the person wishing to repay must apply to court and, if approved by court, make the repayment within the prescribed period. After all necessary procedures have been followed, the court will terminate the bankruptcy case, and the assets will remain the property of the current owner.

If the tax authorities' claims are not paid off in time, the property will be sold at auction.

In practice, the inventory count of property conducted during the bankruptcy procedure of a foreign company shows the actual availability of assets in 65% of cases. The actual value of the property of foreign entities often significantly exceeds the claims of the Inspectorate and other creditors.

Strategy options

Option 1

In case No. A40-74056/2024 of Melgarven Holding INC (Panama), the owner did not pay the Federal Tax Service's claim of 6 mln roubles.

The debtor's property - part of a building in the centre of Moscow built in 1902 - is offered at auction for 96 mln roubles now.

Option 2

Case No. A40-51313/2024 of Vernand ED Holding LTD (Cyprus) evolved otherwise.

For a tax debt of 15 mln roubles, an apartment of over 600 sq m in Moscow could have been sold at auction, however, timely payment of the debt made it possible to completely terminate the proceedings on the case.

Option 1

Federal Tax Service's bankruptcy application in respect to the property of a foreign company

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introduction of bankruptcy proceedings

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forced sale of property

Option 2

Federal Tax Service's bankruptcy application in respect to the property of a foreign company

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introduction of bankruptcy proceedings

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payment of creditors' claims

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termination of bankruptcy proceedings

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preservation of property

It is important that the owner's right to pay off creditors' claims is retained until the bankruptcy proceedings are over.

None of the cases initiated at the request of the tax authorities since March 2024 against foreign companies has ended up in the property sale, or has been closed by the court.

This means that foreign beneficiaries still have a chance to avoid the forced sale of an asset, which value is significantly less than the creditors' claims, tax inspectorates, in the first place.

Accordingly, it seems reasonable for foreign owners of Russian property to consider paying off creditors' claims and retaining the property for themselves if bankruptcy proceedings against foreign assets are initiated.

How are foreign assets declared bankrupt in non-metropolitan areas?

Unlike Moscow and the Moscow Region, where tax inspectorates have become the most active participants in bankruptcy cases with foreign assets, major creditors in non-metropolitan areas are usually banks and big industrial enterprises.

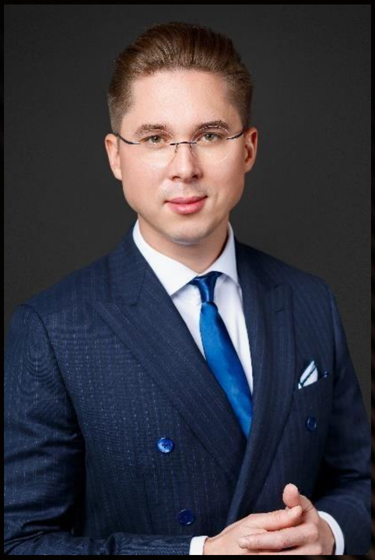
The largest case in terms of creditors' claims was opened in 2023 in Tatarstan against a subsidiary of Gemont, a Turkish chemical company, at the request of SIBUR subsidiary. Creditors' claims are over 6 bln roubles now, major creditors are subsidiaries of Sibur and Gazprom.

Large bankruptcy cases with foreign assets opened in non-metropolitan areas are given in the table:

Case / court	applicant / majority creditor	debtor	List of creditors (mln RUB)	status
A65-23218/2023 Tatarstan Arbitration	Nizhnekamskneftekhim PJSC	GEMONT ENDUSTRI TESISLERI IMALAT VE MONTAJ ANONIM SIRKETI, Stambul	6 853	On 28.11.2023. bankruptcy proceedings were initiated, creditors' claims are being listed
A13-13917/2023 Vologda Region Arbitration	JSC CB Northern Credit (ACB)	PROinvest KFT (Hungary)	161	court hearing to consider the application validity has been postponed
A53-13261/2024 Rostov Region Arbitration	Termel LLC	Energoprojekt Visokogradnja a.d. Belgrade (Serbia)	53	court hearing to consider the application validity has been postponed

In general, non-metropolitan areas have just started the practice of distraining assets of foreign companies through bankruptcy proceedings. The activity of Moscow tax inspectorates has not yet spread to their colleagues in other regions.

V/L However, foreign owners of Russian assets within and outside Moscow are recommended to keep track of and promptly pay off reasonable claims of both tax authorities and counterparties to minimize the risks of forced sale of their property.



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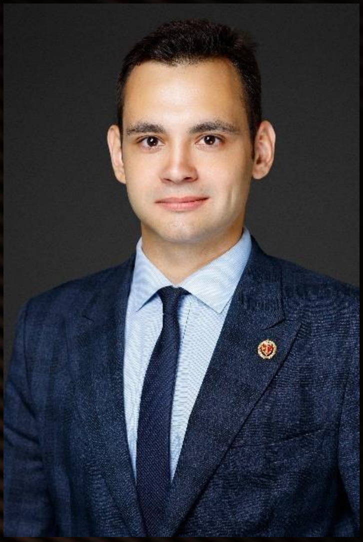

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