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Inside Story: Business in modern Russia

This month's Inside Story is brought to you by Vladimir Kasyanik the General Director of NIPU - Legal Practice (<http://www.nipu.biz/en/>), Moscow, Russia.

Modern Russia is becoming increasingly involved in the global economy and in market relations with their own laws of development. This means that the Russian economy can no longer stay away from global crises.

However, Russian proprietors are not always equipped to manage their businesses under market conditions. Lack of necessary management knowledge and skills, lagging technology, inability to compete with other products, corruption risks - in global crisis conditions these negative factors may lead Russian businesses to bankruptcy.

Here is a typical example:

A rather large (and very important for local economy) timber and plywood plant was constructed in the north-west of the country during the Soviet period. The plant is extremely favorably positioned: raw materials, markets and transportation routes are all in close proximity, qualified personnel is available. Some serious investments in the plant were made during the Soviet era.

The disadvantages are (and these apply to all large enterprises established in the Soviet era) the technological gap, environmentally unfriendly production, a significant social burden (on the plant's balance sheet there were various objects of social and municipal infrastructure: boiler rooms, wells, treatment facilities, etc.).

The plant was owned by its CEO, who had been managing the plant since Soviet times. The owner understood the need for bridging the technological gap and developing new competitive products with high margins. To achieve that, he took loans secured over the plant's buildings and structures in a number of large Russian banks and purchased some new manufactured abroad equipment. However, errors made in the assessment of the financial and economic activities of the company and market conditions, as well as some serious blunders during the set-up stage and while fine-tuning the technological process, have led to delays in new products manufacturing and increased the amount of company's debt. The crisis of 2008 has made the situation worse, the company became insolvent, production stopped, talks with the banks on debt restructuring were unsuccessful and the company was declared bankrupt.

During the course of bankruptcy proceedings the CEO was dismissed. Under Russian Law on Bankruptcy when a company is declared bankrupt, its CEO is dismissed and its owner loses all his rights in relation to the insolvent company with the exception of the right to repay debts to the company's creditors.

Creditors brought in a new management team. We have been a part of that team providing advice and legal support to the company in the course of bankruptcy proceedings, as well as assistance in identifying and attracting investors. We have conducted a thorough financial analysis of the plant's activities and suggested a plan for the future.

All parties actively participating in bankruptcy proceedings: the local authorities, banks - creditors of the company, the union and the new management team - saw the potential of the business. The following key questions were on the agenda:

- 1) Ensuring that the plant continues to operate during bankruptcy proceedings (preserving the company's assets, maintaining social infrastructure, manufacturing goods, saving jobs, making routine tax payments, optimising production process and minimising costs);
- 2) Identifying potential investors (both Russian and foreign) interested in acquiring the plant and in its further development;
- 3) Transfer of control over the operating plant to the new owner in the manner prescribed by the Law on Bankruptcy.

There was a general consensus regarding the above issues, as local authorities wished the plant to continue to pay taxes, banks - to have as much as possible of the existing loans repaid and to be able to lend to the company in the future and the union wanted to save jobs.

In accordance with the Russian Law on Bankruptcy, transfer of ownership is achieved through a public auction. It is one of the key and most regulated institutions of the Bankruptcy Law. Since 2001, when the current Law on Bankruptcy has been adopted, the legislator continues to improve public tender procedures, such improvements being made on the basis of the negative experiences of such auctions and judicial practice. The property acquired by a new owner at such an auction is not burdened with debt.

Revolutionary changes to the public auction procedure occurred in 2010, when provisions on compulsory electronic tendering were introduced into the Law on Bankruptcy.

Today the auction procedure looks as follows:

- 1) The notice of the upcoming auction is published in a federal newspaper and reproduced in a special register (Unified Federal Register of Information on Bankruptcies), which can be accessed by any interested person;
- 2) The auction is conducted on a limited number of electronic trading platforms, accredited by the relevant federal authority supervising the sphere of bankruptcy. All auctions are held in accordance with unified basic rules. All electronic trading platforms operate on common principles. All electronic trading platforms are connected with the Unified Federal Register of Information on Bankruptcies through rapid exchange of information via electronic communication channels operating in automatic mode.

Public auctions in bankruptcy proceedings in Russia are held as follows: the first auction (English auction), the second auction (English auction, the starting price is reduced by 10% compared to the first auction), auction by public offer (Dutch auction);

- 3) Results of the auction are published in a federal newspaper and reproduced in the Unified Federal Register of Information on Bankruptcies.

Thus, in Russia there has been established and operates a single infrastructure for sale of property of bankrupt debtors, the main principles of which are transparency and free access to information and trading for all interested parties.

Trading mechanism provided by the Russian Bankruptcy Law assists in the difficult task of identifying and attracting investors.

In the end, by mutual agreement and through the mechanisms established by the Law on Bankruptcy, control over the company was transferred to the new owner and the company was cleared from the burden of debt. The plant received a second chance and some prospects for future development.

In our opinion, lawful and effective implementation of the bankruptcy mechanism can give the necessary push to further economic development in Russia through the advance of new effective owners and by helping to attract foreign capital and technology. Where there is general consensus, the current Bankruptcy Law provides all possibilities for that.

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