

# Avoidance of the debtor's transactions within the framework of a foreign insolvency before a Russian court

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Issues concerning cross-border insolvency rarely arise in Russian case law. For this reason, the Decree of the Arbitrazh Court of the Moscow District dated 22.11.2018 docket number N A40-39791 / 2018 is of particular interest to both practitioners and academics.

## **1. The factual background of case No. A40-39791 / 2018**

A bankruptcy procedure had been introduced at a German court against the Russian individual having the status of an individual entrepreneur under German law. After the opening of this procedure in Germany, the Russian debtor donated an apartment in Moscow to her daughter.

As a consequence of the said acts the bankruptcy trustee of the Russian debtor brought an action before the Moscow Arbitrazh (Commercial) Court, requesting the following relief: 1) to recognize the judgment of the German court opening the bankruptcy proceedings; 2) to set aside the agreement for donation of the apartment; 3) to enforce the judgment of the German court by prohibiting the alienation of this immovable property upon the completion of the bankruptcy procedure in Germany; 4) to attach the said immovable property in Russia.

On 01.10.2018 the Moscow Arbitrazh (Commercial) Court (First instance) dismissed the claim relating to the setting aside of the agreement of donation on the ground that that application was not heard by the German court and

consequently it could not be resolved within the framework of the procedure for recognition of the German judgment. The court of First instance specifically held that the question relating to the validity of the agreement of donation should be resolved in separate proceedings to be brought before the Russian courts.

In further proceedings the Moscow Arbitrazh (Commercial) Court (First instance) recognized the judgment of the German court on the opening of the bankruptcy proceedings (decision of 07.12.2018). With reference to Art. 343 of the German Bankruptcy Ordinance and the Russian case Law (docket number No. A56-22667 / 2007), the Russian court acknowledged the existence of reciprocity in relation to the recognition of Russian court judgments in Germany as prescribed by the German Federal Law "On insolvency (bankruptcy)". The Russian court made an express finding that the foreign court order did not violate the exclusive jurisdiction over bankruptcy matters, because the debtor's activities as an individual entrepreneur are regulated by the law of the Federal Republic of Germany (Article 1201 of the Civil Code of the Russian Federation - "The law applicable to determination of the ability an individual to engage in entrepreneurial activity").

However, the Moscow Arbitrazh (Commercial) Court (1-st instance) rejected the part of the foreign insolvency judgment relating to the prohibition of the debtor to dispose of immovable property until the completion of the insolvency proceedings. In the court's opinion, in this respect the exclusive competence of the Russian courts and the public order of the Russian Federation had been violated (Article 248 of the Arbitrazh [Commercial] Procedure Code of the Russian Federation). At the same time, the court of first instance also noted that the bankruptcy trustee is entitled to institute separate bankruptcy proceedings against the debtor in order to set aside the agreement for donation of the apartment before the Russian courts.

## **2. Analysis of case ?40-39791 / 2018**

The key question in this situation concerns the correct procedure for setting aside the transaction for the transfer of the immovable property as the restitution of the proper value is dependent on the said action. In turn the success of the said action depends on the following issues: 1) **procedural capacity of a bankruptcy trustee**, including the issue whether the recognition of a foreign judgment is a prerequisite for granting procedural capacity to a foreign bankruptcy trustee; 2)

## **the law applicable to avoidance of the donation agreement.**

### 2.1. Procedural capacity of a foreign bankruptcy trustee.

In view of the fact that the foreign bankruptcy trustee is regarded as the legal representative of the debtor, his/her powers (including the power to bring an action) are recognized if the corresponding limitation of the capacity of the debtor is recognized in its turn.

Under Art. 1197 of the Civil Code of the Russian Federation, the legal capacity of an individual is governed by his *personal law (lex personalis)*. The *personal law* of an individual refers to the law of the country of his/her nationality (clause 1 of article 1195 of the Civil Code of the Russian Federation). Consequently, the *personal law* of a Russian national is the law of the Russian Federation.

In the present situation, the legal capacity of the Russian debtor had been limited by a foreign judgment. In this case, the legal effect of the foreign judgment on limitation of capacity did not fall within the scope of the applicable substantive law since the judgment was not rendered by the country of his/her nationality. For that reason, the bankruptcy trustee's legal capacity (including procedural capacity) could not be recognized by virtue of the Russian national conflict of laws rule.

In its turn the possibility of recognition of the foreign judgment on the opening of bankruptcy proceedings is questionable for the following reasons. Although in the present matter the Moscow Arbitrazh (Commercial) Court argues that the capacity of the debtor shall be governed by the German law as the law of the country where the defendant was doing business (Art. 1201 of the Russian Civil Code) it needs to be noted that the capacity of the person to conduct business-related activities arises from general civil legal capacity (Art. 1195-1197 of the Civil Code of the Russian Federation). Taking into account the above, the said judgment on the opening of the insolvency proceedings appears to be in conflict with the Russian public order.

### 2.2. Law applicable to avoidance of the donation agreement.

In order to establish that the agreement for donation of the apartment is void the bankruptcy trustee referred to the fact that the apartment forms an integral part of the bankruptcy estate pursuant to paragraph 1 of Art. 35 of the German

Insolvency Ordinance, as well as under clause 1 of Art. 213.25 of the Federal Law “On Insolvency (Bankruptcy)”. With reference to the fact that the agreement for donation of the apartment was concluded after the commencement of foreign bankruptcy proceedings against the Russian debtor, the trustee argued that the transaction should be deemed void under Art. 61.2. of The Federal Law “On Insolvency (Bankruptcy)” as a “suspicious transaction”.

In our view application of Art. 61.2. of The Federal Law “On Insolvency (Bankruptcy)” to invalidate the debtor’s agreements within the framework of a foreign insolvency does not seem to be entirely justified due to the following. Due to the fact that the bankruptcy procedure against the Russian debtor had been opened by a German court, the legal consequences of this procedure should also be determined by German law. Another question is whether these legal consequences are recognized in the Russian Federation). In this case, the fact of initiation of bankruptcy proceedings against a Russian national at a foreign court does not provide grounds for the application of Russian bankruptcy law.

In our view the following ways to set aside the agreement within the framework of the foreign insolvency exist.

Primarily, it appears that the donation agreement entered into after the commencement of foreign insolvency proceedings may be regarded as a void transaction under the Russian law due to the fact that it was intended to defraud creditors (Articles 10 and 168 of the Civil Code of the Russian Federation).

Secondly, it could be argued that the recognition of a foreign bankruptcy entails that the effects of that foreign bankruptcy also apply to all actions that took place in the territory of Russia, including the possibility to apply foreign bankruptcy grounds to avoid contracts. However, this line of argument may not be entirely in line with the provisions of the Russian Civil Code under which Russian law applies to contracts in relation to land plots, subsoil plots and other real estate located in the territory of the Russian Federation (paragraph 2 of Art. 1213 of the Civil Code of the Russian Federation).

## **Conclusion**

The Decree of the Arbitrazh (Commercial) Court of the Moscow District dated 22.11.2018 docket number N A40-39791 / 2018 as well as other court findings represent an interesting interplay between the legal provisions relating to the

recognition of foreign insolvency and the application of Russian law for avoidance of the debtor's transactions. In the present matter the Russian court clearly ruled in favor *territoriality* of foreign insolvency proceedings. However, we remain hopeful that one day the approach will change and the Russian courts will uphold the principle of *universality* of foreign insolvency.