Civil Liability of an Insolvency Practitioner: Actual Problems

Denis O. Yarovoy
Candidate for a Master's Degree, The North-West Institute of Management — Branch of the Russian Presidential Academy of National Economy and Public Administration, Saint Petersburg, Russian Federation; 9119687@gmail.com

ABSTRACT
The article is devoted to the consideration of the civil liability of an insolvency administrator in the performance of his duties in the framework of insolvency (bankruptcy) cases. Topical issues related to the civil liability of an insolvency administrator (recovery of damages) are considered. Three issues are identified that stakeholders face in the process of determining, proving and recovering losses. The conclusions about the impact of the mechanism for collecting losses on increasing the efficiency of bankruptcy procedures are summarized.
Keywords: insurance of an insolvency administrator, losses, liability of an insolvency administrator, bankruptcy

Insolvency administrator is engaged into professional activity, regulated and covered by Federal Law No.127–FZ of October 26, 2002 "On Insolvency (Bankruptcy)" (hereinafter referred to as the Bankruptcy Law).

Russian legislation provides a whole range of measures to ensure integrity of work of an insolvency administrator, by various types of liability imposed on the administrator[68]. Article 20.4 of the Bankruptcy Law determines liability of the insolvency administrator when the latter performs its duties during insolvency (bankruptcy) procedures. Clause 4 of this article states that one remedy for defaulted duties of the administrator is compensation for losses caused to the debtor, creditors and other persons. This is a civil remedy, and the amount of losses is determined in accordance with Article 15 of the Civil Code of the Russian Federation (hereinafter the Civil Code of the Russian Federation). However, norms of the Civil Code of the Russian Federation are applied with due regard to priority of the Bankruptcy Law, which are special norms.

Since compensation for damages is civil liability, the person claiming their compensation must prove that their rights have been violated, that they suffered losses and specify their amount, that there are cause-effect relations between violation of the right and the losses incurred.

Despite a widespread law enforcement practice in losses recovery, still there are some important issued associated with civil liability of an insolvency administrator.

In particular, the first issue is related to determination of the amount of losses incurred.

The second topical issue arises when the insolvency administrator has no financial sources to compensate for the losses caused.

The third issue relates to proving the liability of an insolvency administrator and determining remedy, in case the insolvency (bankruptcy) procedure involved activities of several insolvency administrators.

Below there is a more detailed description of modern issues related to civil liability of an insolvency administrator.

Clause 11 of Information Letter No.150 of the Presidium of the Supreme Arbitration Court of the Russian Federation of May 22, 2012 "Review of Arbitration Courts Practice in disputes related to dismissal of insolvency administrators " specifies that losses caused to the debtor, as well as to its creditors, shall be deemed as any decrease or loss of possibility to increase the bankruptcy estate, which occurred as a result of illegal actions (omissions) of the insolvency administrator.

In accordance with paragraph 1 Article 15 of the Civil Code of the Russian Federation, there are two types of losses: real damage and lost profits; the latter, as long-term judicial and arbitration practice shows, is extremely difficult to prove[69].

Analyzing characteristics of losses, we should focus on the phrases "loss of opportunity" and "loss of profit". Legislation does not provide a detailed explanation of these definitions, which may result in their different interpretations in legal proceedings and, consequently, affect the amount of recoverable losses.

One of the most common circumstances for recovering losses from the insolvency administrator is improper work to challenge the debtor's transactions, in particular, expiry of the limitation period on actions. In this case, through the fault of the insolvency practitioner, it is impossible to increase the bankruptcy estate. However, if there is no legal instrument that recognizes the transaction as null and void and reverses the transaction (which can either be return of property to the bankruptcy estate or recovery of the market value of the property), the applicant cannot name the amount of the losses caused.

[68] Saharova, Yu.V. Legal Problems of Realization of the Principle of "Good Faith" in the Course of Bankruptcy // Siberian Law Review. 2017. No.2. P. 44–49.
[69] Vasilevskaya, L.Yu. Damages in Russian and Anglo-American Law: Differences between Conceptual Approaches // Russian Legal Journal. 2018. No.2. P. 51–62.

No possibility to increase the bankruptcy estate through reversing the transactions can be considered as a lost profit of the debtor and creditors. Since loss of profits is lost income, in case of disputes related to reimbursement of the lost profit, it should be taken into account that calculations presented by the claimant are usually approximate and probabilistic. However, it cannot serve as a reason to refuse a claim[70]. E.V. Murashkina in her thesis addresses the issue of determining the amount of losses, and believes that it is no good talking about compensation for lost profits in insolvency (bankruptcy) cases; instead of full compensation of losses, the courts should rather consider the damage caused[71].

The position of the Supreme Court of the Russian Federation states: the court cannot legally refuse to satisfy the creditor's claim for compensation for losses caused by defaulted obligation, only because the amount of losses cannot be reasonably established. In such cases, the court shall determine the amount of damages to be compensated, taking into account all circumstances of the case, based on the principles of fairness and proportional liability for defaulted obligation[72, 73].

So, the current judicial practice binds the court to determine cause-and-effect relations between actions of the insolvency administrator and the amount of losses to be recovered, which often results the fact that the courts of first instance refuse to satisfy the claims for losses recovery from the insolvency administrator; and thus their decisions are further appealed in higher instances, which confirmed by current practice (Resolution of the Thirteenth Arbitration Court of Appeal dated 07.08.2020 in case No.A56–76171 / 2016; Resolution of the Thirteenth Arbitration Court of Appeal dated 20.07.2020 in case No.A56–58410 / 2013; Resolution of the Arbitration Court of the North-West District of August 26, 2020 in case No.A44–3084 / 2017)

But even if higher instances reverse court decisions refusing to recover damages, it cannot resolve the issue of determining the amount of damage caused, which ultimately can be a problem both for the insolvency administrator and for creditors with the debtor.

The way out of this problem seems to be severization of requirements for plaintiffs in terms of determining the amount of damages recovered, in particular, use of expert opinions, namely: use of forensic examinations to determine the market value of property, sale of which was not contested by the insolvency administrator and the limitation on actions for which was missed; use of expert examinations to determine the decrease in value of the debtor's property that occurred due to actions or omissions of the insolvency administrator; use of examinations to determine the actual value of the debtor's receivables, which were not collected by the insolvency administrator and the deadlines of which were missed, or the legal entity was excluded from the Unified State Register of Legal Entities (USRLE).

This mechanism allows avoiding uncertainties in the amount of recoverable losses, and minimizes abuse of the creditors' right to impose sanctions on the insolvency administrator for losses, the amount of which is declared arbitrarily.

Another urgent issue is enforcement of losses recovery. If actions of the insolvency administrator are recognized as improper and the losses caused to the debtor, creditors and other persons are to be recovered, the issue of indemnification of the losses, that is, actual enforcement of the judicial deed, is very relevant.

There are several sources to compensate for the damages caused:

- the insolvency administrator compensates for losses at its own expense;
- the losses are paid by an insurance company that insured liability of the insolvency administrator;
- the losses are compensated from a compensation fund of a self-regulatory organization, where the insolvency administrator is a member;
- losses are recovered at open auctions.

As practice shows, the cases when the insolvency administrator compensates for losses at its own expense, come down to compensation of very small amounts. Let's extrapolate statistics of personal bankruptcy. According to the Unified Federal Register of Bankruptcy Information (hereinafter referred to as the UFRBI), at the end of 2019 the share of claims satisfied among the claims filed amounts to 3.5%[74]. Therefore, recovery of losses from an insolvency administrator, including under his personal bankruptcy procedure, is an unpromising and lengthy process.

The bankruptcy administrator's liability for causing losses to parties in the bankruptcy case can be insured for at least 10 million rubles. (Article 24.1 of the Bankruptcy Law), also in cases listed by the Bankruptcy Law, the administrator executes an additional insurance contract (if the book value of the debtor's assets exceeds RUB 100 million; a more detailed calculation of additional insurance is described in paragraph 2 Article 24.1 of the Bankruptcy Law), however, the insurance compensation of 10 million rubles is the most common. Also, requirements to execute an additional insurance contract do not apply to some debtors: private persons and absent debtors.

---

70 Resolution of the Plenum of the Supreme Court of the Russian Federation of June 23, 2015 No.25 "Application of certain provisions of Section I Part One of the Civil Code of the Russian Federation in the courts".

71 Murashkina, E.V. Civil Liability of an Insolvency Administrator: Abstract of... Dis. Can. Legal Entity Sciences. Moscow, 2008. 23 p.

72 Writ of the Supreme Court of the Russian Federation dated 26.10.2017 No.305–ES17–8225 [Electronic resource]. URL: https: // www.vsrf.ru/stor_pdf_ec.php?id=1590162 (date of access: 15.12.2020).

73 Application of clauses of the Civil Code of the Russian Federation on liability for defaulted obligations by the courts: Resolution No.7 of the Plenum of the Supreme Court of the Russian Federation of March 24, 2016 .

74 Results of procedures in bankruptcy cases over 20 19 year [Electronic resource] URL: https://fedresurs.ru/news/d9263eb1–10a9–43db-8755–3dc0add94bd3?attempt=1 (date of access: 15.12.2020).

Another way to reimburse losses caused by an insolvency administrator is payment from a compensation fund of a self-regulatory organization, where the administrator is a member. In accordance with paragraph 11 Article 25.1 of the Bankruptcy Law, the amount of such payment may not exceed 50% of the compensation fund of a self-regulatory organization. The minimum size of the compensation fund is 50 million rubles; so, on average, the payment will not exceed 25 million rubles.

It should be pointed out that paragraph 11 Article 25.1 of the Bankruptcy Law shall apply if the bankruptcy proceedings were initiated after 01.01.2019. Other cases are covered by the previously legal norms, namely, the amount of compensation is not more than 5 million rubles.

Losses recovered from the insolvency administrator are, actually, the debtor's receivables, and, like other receivables, can be sold through electronic trading. As practice shows, in most cases, receivables are sold at the stage of public offering at the price that greatly differs from the nominal value. In this case, costs associated with sale of receivables (losses) should also be taken into account: costs of publications in the Kommersant newspaper, the UFRBI, services of an electronic trading platform, etc., which ultimately make the source of debt repayment unprofitable.

Urgent nature of the issue on losses recovery enforcement is confirmed by statistical data. For instance, from January to September 2019, the UFRBI published 65 applications for losses recovery from insolvency administrator totaling RUB 683 million.[75] It should be noted that these statistics are based only on the data that the insolvency administrator entered into the UFRBI.

In 46% the amount of losses is less than 1 million rubles, in 37% the amount of losses ranges from 1 to 10 million rubles, in 15% — from 10 to 100 million rubles, and in 2% the amount of recovered losses exceeds RUB 100 million.

Thus, 83% of cases presents a real possibility to enforce court rulings on recovering losses from the insolvency administrator (excluding the cases when insurance organizations and self-regulatory organizations fail to perform their obligations to compensate for losses), and in 17% of cases the sum is limited to the amount of 35 million rubles. ... (15 million rubles in case of procedures initiated before 01.01.2019).

Summarizing the facts listed above, we can state that current mechanism of civil liability is focused more on imposing liability on the arbitration manager, rather than compensation for damage caused to the affected parties.

This challenge can be resolved by improving the insuring mechanism for insolvency administrator liability, and generation extra funds in self-regulatory organizations, which could be used to compensate for losses caused by the insolvency administrator. Internal policies of self-regulating organizations of insolvency administrators (SRO IA) have a clause about payment of membership fees by insolvency administrators, such fees are intended to ensure that activities of SRO IA comply with statutory goals and objectives. Apart from a compensation fund is seems reasonable to generate reserve funds form membership fees of insolvency administrators, which could serve as a source of finance for compensation of losses inflicted by insolvency administrators.

The third topical issue (it cannot be called a problem, since there is a well-established judicial practice on this issue), considered in herein, is specification of the liability of an insolvency administrator. By to legal requirement, a person claiming damages shall prove, among other things, a cause-and-effect relation between actions of the inflictor and the damage claimed.

Quite often, under insolvency (bankruptcy) procedures of a debtor, several insolvency administrators operate to perform bankruptcy (external) administrator duties. Accordingly, when applying to the court the applicant shall prove that it was actions of a certain insolvency administrator that caused the losses[76].

This question was discussed in the Resolution No.62 of the Plenum of the Supreme Arbitration Court of the Russian Federation of July 30, 2013 "On some issues of compensation for losses by members of the legal entity bodies", which explains that arbitration courts shall assess whether commissions of a certain person fall within the duties of the manager(external or bankruptcy administrator), taking into account usual business practice and the scope of business of the legal entity.

That is, when assessing actions of the insolvency administrator, the courts shall determine whether during the term of the office the latter had an obligation to perform the actions, which, if failed, could have led to losses in the applicant's opinion.

This case can be illustrated by inventory. In accordance with clause 2 Article 129 of the Bankruptcy Law, a liquidator shall make an inventory of the assets. However, the Bankruptcy Law does not oblige to re-inventory the assets, when the insolvency administrator is changed. Accordingly, if the first insolvency administrator disposes of the assets that were not inventoried and were not known to the second administrator, the court shall assess degree of liability of each insolvency administrator, the cause and effect relations between actions (omissions) of each administrator and the losses caused.

In case the court finds a cause-and-effect relations between actions (omissions) of two (or more) administrators, which resulted in losses, the losses shall be recovered jointly (Resolution No.A52–3471 / 2013 of the Arbitration Court of the North-West District of 16.05.2019)

It may be difficult for the applicant to prove cause-and-effect relations between actions (omissions) of a certain insolvency administrator and the losses incurred. When determining degree of liability of each insolvency administrator who

[75] Bankruptcy procedures: Federal resources statistics [Electronic resource]. URL: https://download.fedresurs.ru/news/Aleksey%20Yukhnin% 20Statistics% 20EFRSB% 20Ural% 20forum% 202019.pdf (date of access: 15.12.2020).

[76] Kolesnikova, S.G. Civil Liability of an Insolvency Administrator for Losses Caused by Non-Performance (Improper Performance) of the Duties Assigned to Him // Arbitration Disputes. 2018. № 1. P. 32–82.

operated in an insolvency (bankruptcy) case, the court shall pay attention to the measures actions taken by each subsequent administrator in order to minimize negative consequences of their predecessors or to hold them liable. In accordance with clause 4 Article 20.3 of the Bankruptcy Law when performing procedures applied in the bankruptcy case, the insolvency administrator shall act in good faith, reasonably and in the interests of the debtor, creditors and the public. Thus, failure to take due action by the insolvency administrator against a previous administrator serves as another reason to be held liable for losses.

In general, the mechanism of civil liability of an insolvency administrator is an effective way in terms of performing federal duties imposed on the administrator, i.e. to act in good faith, reasonably and in the interests of the debtor, creditors and the public.[77] The legal remedy of defaulted liability of an insolvency administrator — losses recovery — is becoming an increasingly common way to protect creditors' interests in insolvency (bankruptcy) procedures every year.

Issues arising out of the application this mechanism affect both creditors (in terms of actual enforcement of court rulings on compensation for the damages) and insolvency administrators (in terms of criteria for determining the amount of recoverable losses and distribution of legal remedy). Therefore, more attention should be paid this issue both in law enforcement practice and at the legislative level.

References

1. Vasilevskaya, L.Yu. Damages in Russian and Anglo-American Law: Differences between Conceptual Approaches [Vozmeshchenie ubytkov v rossiiskom i anglo-amerikanskom prave: razlichie kontseptual'nykh podkhodov] // Russian Legal Journal [Rossiiskii yuridicheskii zhurnal]. 2018. No.2. P. 51–62.
2. Kolesnikova, S.G. Civil Liability of an Insolvency Administrator for Losses Caused by Non-Performance (Improper Performance) of the Duties Assigned to Him [Grazhdansko-pravovaya otvetstvennost' arbitrazhnogo upravlyayushchego za ubytki, prichinennye neispolneniem (nenadlezhashchim ispolneniem) vozlozhennykh na nego obyazannostei] // Arbitration Disputes [Arbitrazhnye spory]. 2018. № 1. P. 32–82.
3. Murashkina, E. V. Civil Liability of an Insolvency Administrator: Abstract of... Dis. Can. Legal Entity Sciences [Grazhdansko-pravovaya otvetstvennost' arbitrazhnogo upravlyayushchego: avtoref. ... dis. k. yu. n.]. Moscow, 2008. 23 p.
4. Saharova, Yu.V. Legal Problems of Realization of the Principle of "Good Faith" in the Course of Bankruptcy [Pravovye problemy realizatsii printsipa dobrosovestnosti v protsesse bankrotstva] // Siberian Law Review [Vestnik Omskoj yuridicheskoj akademii]. 2017. No.2. P. 44–49.
5. Yarovoy, D.O. Fiduciary Duties in Bankruptcy: Performance Limitations [Fidutsiarnye obyazannosti v bankrotstve: ogranicheniya ispolneniya] // Government and Business. Modern Problems of Economics. Materials of the X International Scientific and Practical Conference. Saint Petersburg, April 25–27, 2018 [Gosudarstvo i biznes. Sovremennye problemy ehkonomiki. Materialy X Mezhdunarodnoi nauchno-prakticheskoi konferentsii. SPb., 25–27 aprelya 2018 g.]. The North-West Institute of Management — Branch of the Russian Presidential Academy of National Economy and Public Administration. V. 5. P. 104–108.

[77] Yarovoy, D.O. Fiduciary Duties in Bankruptcy: Performance Limitations // Government and Business. Modern Problems of Economics. Materials of the X International Scientific and Practical Conference. Saint Petersburg, April 25–27, 2018 The North-West Institute of Management — Branch of the Russian Presidential Academy of National Economy and Public Administration. V. 5. P. 104–108.