Features of the Distribution of the Burden of Proof in Disputes on Involvement of Controlling Persons of the Debtor in Subsidiary Liability: New Approaches in Judicial Practice

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IIn Russia, in 2023, 6494 applications for involvement in subsidiary liability were submitted, 51% of such applications were satisfied. A total of 5275 individuals were involved in such liability, the amount of liability of such persons amounted to more than 406 billion rubles. 1

A trend towards the satisfaction of such applications by the courts is observed. For comparison, in 2015, only 4% of submitted applications were satisfied. 2

This is primarily related to the establishment of a uniform practice of applying legal norms on the involvement of controlling persons of the debtor in subsidiary liability. The credit for this belongs to the higher judicial instances, which have recently been paying more and more attention to the institution of subsidiary liability.

New trends in the practice of the Higher Courts when considering such disputes will be discussed further in our material. The author will consider the following questions:

- General provisions and grounds for involvement in subsidiary liability;
- Standards of proof in disputes on involvement in subsidiary liability;
- New approaches in judicial practice in the distribution of the burden of proof.

GENERAL PROVISIONS AND GROUNDS FOR INVOLVEMENT IN SUBSIDIARY LIABILITY

The main provisions on the institution of subsidiary liability within the framework of bankruptcy are defined in the Federal Law of 26.10.2002 No. 127-FZ "On Insolvency (Bankruptcy)" (hereinafter also referred to as the Bankruptcy Law).3
As a general rule, if full repayment of creditors' claims is impossible due to the actions and/or inaction of the controlling person of the debtor, such a person bears subsidiary liability for the obligations of the debtor.
The Supreme Court of the Russian Federation clarified 4 that by the actions (inaction) of the controlling person that led to the impossibility of repaying creditors' claims, one should understand such actions (inaction) that were a necessary cause of the debtor's bankruptcy, that is, those without which objective bankruptcy would not have occurred.
The Constitutional Court of the Russian Federation notes 5 that subsidiary liability of controlling persons of the company is a measure of civil liability, the function of which is to protect the violated rights of the creditors of the company, restoring their property position.
It should be noted that a controlling person can be not only the head of the organization (Director, General Director, founder, etc.), but also a person who can in any way influence the activities of the organization (accountant, a person who has a power of attorney to carry out transactions on behalf of the legal entity, actual beneficiary, etc.). Persons who are currently not controlling persons but were so earlier (for example, a former director of the company) can also be involved in subsidiary liability.

It is important to understand that the potential status of a controlling person does not yet indicate that this person is at risk of subsidiary liability. It must be proven that it was precisely as a result of the actions of such a person that the organization suffered losses, without which objective bankruptcy would not have occurred.

Involvement of controlling persons of the debtor in subsidiary liability is possible on several grounds, both within the framework of bankruptcy proceedings and outside of it. We will outline some grounds for involvement in subsidiary liability that are provided for by current legislation.

Subsidiary liability arises **within the framework of bankruptcy proceedings:**

- for the inability to fully satisfy the claims of creditors (Article 61.11 of the Bankruptcy Law);
- for failure to file (untimely filing) a debtor's application for its own bankruptcy (Article 6J.12 of the Bankruptcy Law);
- for violations of the requirements of the Bankruptcy Law, the so-called "liability for damages" (Article 61.13 of the Bankruptcy Law).

The head of the debtor may bear subsidiary liability even outside the framework of bankruptcy proceedings if:

- the bankruptcy case is terminated before the introduction of the first procedure due to a lack of funds to cover bankruptcy expenses (subparagraph 1 of paragraph 12 of Article 61.11 of the Bankruptcy Law);
- after the termination of the proceedings, the debtor is excluded from the Unified State Register of Legal Entities, and at the time of its exclusion, the corresponding claims of the creditor were satisfied by the court (in the case of administrative liquidation of a legal entity, paragraph 3.1 of Article 3 of the LLC Law).

In each specific case, the applicant must prove a set of circumstances that will allow for the assertion that the fault of the controlling person of the debtor is proven and that they indeed should bear such responsibility for similar actions (inactions). In recent years, we can observe some changes in the rules and standards of proof in disputes regarding involvement in subsidiary liability. Higher judicial instances increasingly prefer independent creditors, simplifying the standards of proof for them, which forces controlling persons to take a more active position when considering such disputes in court.

STANDARDS OF PROOF IN DISPUTES ON INVOLVEMENT IN SUBSIDIARY LIABILITY

The Supreme Court of the Russian Federation clarified 6 that when involving controlling persons of the debtor in subsidiary liability in parts not contrary to the special provisions of the Bankruptcy Law, the general provisions of Chapters 25 (liability for breach of obligations) and 59 of the Civil Code of the Russian Federation (liability for causing harm) apply.

From this, it follows that the debt arising from subsidiary liability must be subject to the same legal regime as other debts related to compensation for harm to the property of participants in turnover (Article 1O64 of the Civil Code of the Russian Federation).

In this regard, it is necessary to establish and prove a certain set of facts, namely:

- the occurrence of harm,
- the illegality of the behavior of the harm-causer,
- the causal link between this behavior and the occurrence of harm,
- the fault of the controlling person,
- the amount of such liability.

It is also important to understand that, as a general rule, the burden of proving the presence of fault lies with the arbitration manager or creditor who submits the application for involvement in subsidiary liability. At the same time, the controlling person is obliged to provide evidence that, given the degree of care and diligence required of them under normal business conditions and considering the accompanying entrepreneurial risks, they acted in good faith and took all measures to fulfill the company's obligations to its creditors.

However, the process of proving in cases of involvement in subsidiary liability is accompanied by objective difficulties, which often arise as a result of the applicants' lack of direct written evidence, confirming their arguments due to objective reasons, as well as the unwillingness of members of management bodies and other controlling persons to disclose documents reflecting their status, actual state of affairs, and real turnover. This necessitates taking into account a combination of mutually agreeing **indirect evidence,** formed based on the analysis of the behavior of the mentioned subjects 7.

This constitutes the main difficulty in proving on the part of creditors and the arbitration manager — **in the absence of necessary information about the debtor, its financial condition, and actions taken by the controlling person, it is extremely difficult to prove their guilt, for example, in bringing the company to bankruptcy.**

This approach has led to controlling persons adopting a **passive procedural position** in such disputes, not disclosing necessary evidence, which has resulted in refusals to satisfy applications for involvement in subsidiary liability due to the lack of proof of the circumstances referred to by the applicants.

NEW APPROACHES IN JUDICIAL PRACTICE REGARDING THE DISTRIBUTION OF THE BURDEN OF PROOF

In any case, when considering a claim for involvement in subsidiary liability, the burden of proof should be distributed by the court, taking into account the need to equalize the opportunities for proving legally significant circumstances of the case, bearing in mind that the creditor, as a rule, does not have access to information about the debtor's economic activities, while the controlling persons of the debtor, on the contrary, have such access and can actually limit it at their discretion.

Understanding this, the Supreme Court of the Russian Federation gradually began to form a new approach to proving in disputes regarding the involvement of controlling persons in subsidiary liability.

This was facilitated by the introduction in 2017 of a provision in the Bankruptcy Law stating that if a person being involved in subsidiary liability does not provide a **response** to the application for involvement in such liability for reasons deemed **disrespectful** by the arbitration court, or if there is an **obvious incompleteness of objections** regarding the claims made against them based on the arguments contained in the application for involvement in subsidiary liability, the burden of proof of the absence of grounds for involvement in subsidiary liability may be i**mposed by the arbitration court on the person being involved in subsidiary liability** (clause 4 of article 61.16 of the Bankruptcy Law).

Such a provision found its further development in judicial practice. In 2019, at the level of the Supreme Court of the Russian Federation, an approach began to take shape, according to which, in the case of **procedural inaction** by the controlling person, the burden of proof of their good faith behavior may be shifted onto them 8.

In 2021, the Constitutional Court of the Russian Federation 9 formed a position on the issue of the distribution of the burden of proof when involving controlling persons of the debtor in subsidiary liability concerning clause 3.1 of article 3 of the Federal Law "On Limited Liability Companies." The mentioned provision allows for the involvement of controlling persons of the debtor in subsidiary liability during the administrative liquidation of the company if it is established that the non-fulfillment of the company's obligations (including due to causing harm) is due to the fact that such persons acted in bad faith or unreasonably in managing the organization.

The Constitutional Court of the Russian Federation indicated that according to the meaning of the mentioned provision of article 3 of the Federal Law "On Limited Liability Companies," if the plaintiff has provided evidence of the existence of losses caused by the company's non-fulfillment of obligations to them, as well as evidence of the company's exclusion from the Unified State Register of Legal Entities (EGRUL), the controlling person may provide explanations regarding the reasons for the company's exclusion from this register and present evidence of the legality of their behavior. **In the case of refusal to provide explanations** (including in the event of non-appearance in court) or their obvious incompleteness, the failure of the defendant to provide the court with the relevant documentation

Features of the distribution of the burden of proof in disputes regarding the involvement of controlling persons of the debtor in subsidiary liability. The burden of proving the legitimacy of the actions of the controlling persons of the company and the absence of a causal link between the specified actions and the impossibility of fulfilling obligations to creditors is placed by the court on the defendant. Later, the Constitutional Court of the Russian Federation, within the framework of the ruling of 07.02.2023 No. 6-P, indicated that the court has the right to proceed from the assumption that the wrongful actions (inaction) of the controlling persons led to the impossibility of fulfilling obligations to the creditor if it establishes the bad faith of the behavior of the controlling persons in the process, for example, in the refusal or evasion of the controlling persons from presenting to the court evidence characterizing the economic activity of the debtor, from providing explanations or their obvious incompleteness, and if otherwise does not follow from the circumstances of the case.

The Constitutional Court of the Russian Federation has developed a standard of good faith for controlling persons. Good faith behavior is noted:

• Accumulation and preservation by the controlling person of information about the economic activity of the debtor;

• Its disclosure when presenting claims to the court for compensation for harm caused by bringing the debtor to objective bankruptcy.

The refusal or evasion of the controlling person from presenting to the court evidence characterizing the economic activity of the debtor, from providing explanations or their obvious incompleteness indicates bad faith procedural behavior, obstructing the creditor's right to judicial protection.

This approach implies that controlling persons must fully disclose arguments in their defense; otherwise, the bad faith of their actions will be presumed.

This approach is currently actively implemented in the consideration of applications for bringing to subsidiary liability 10.

CONCLUSIONS AND RECOMMENDATIONS

Taking into account the new approaches in judicial practice regarding the issue of bringing controlling persons to subsidiary liability, we have prepared a certain list of recommendations for both controlling persons and creditors.

For Controlling Persons:

Controlling persons (regardless of whether they are such at the moment or not) should adhere to the following standard of behavior:

1. When managing the organization, as well as when making decisions about concluding individual transactions, controlling persons should avoid entering into suspicious transactions (for example, transactions with a large discount on non-market terms).
2. When alienating or purchasing assets, an expert assessment should be conducted (check information about the object from publicly available information, conduct due diligence of the counterparty, verify information about the purity of the transaction (ownership rights of the seller, absence of encumbrances, consent of the seller's participant, etc.). In a disputed situation, this will allow proving that you acted prudently.
3. When realizing assets, it is also recommended to conduct the transaction with the help of a professional market participant (for example, when selling real estate, attract real estate companies).
4. When realizing an asset, consider the issue of its realization through auctions. This will ensure compliance with an open competition on market terms.
5. When managing the organization, it is recommended to establish the storage (including in electronic form) of documents on the economic activity of the legal entity. When transferring documents to a new director, signing an act of acceptance-transfer of such documents should become mandatory. This mechanism will protect you from certain claims of creditors regarding the concealment of information about the legal entity.

6. When considering a separate dispute regarding your involvement in subsidiary liability, you should take an active procedural position, defend your innocence in causing harm to the society: submit a response to the application, object to the arguments of the applicants, present documents confirming that you acted prudently when making decisions about concluding transactions, etc. When involving former controlling persons, you should present documents that you transferred all documentation regarding the activities of the company to your successor.

To creditors and other applicants:

Persons who submit the relevant application for involvement in subsidiary liability (creditors, arbitration managers) should adhere to the following algorithm of actions:

1. If it is impossible to document your arguments regarding the guilt of the controlling person, you should orient the court to the fact that without the disclosure of the relevant documents by the controlling person, it is impossible to prove the fact of harm caused by their actions.

2. In case the controlling person takes a passive procedural position in such a dispute, you should emphasize the necessity of redistributing the burden of proof, namely – orient the court to the need to impose the burden of proof of the absence of grounds for involvement in subsidiary liability on the person being involved in such liability.

   The above recommendations contribute to a fair distribution of the burden of proof when considering applications for involvement in subsidiary liability of the controlling persons of the debtor.

NOTES:

1. According to Fedresurs data.
2. According to Fedresurs data.
3. Chapter III.2 of the Federal Law dated 26.10.2002 No. 127-FZ "On Insolvency (Bankruptcy)".
4. Paragraph 16 of the Resolution of the Plenary Session of the Supreme Court of the Russian Federation dated 21.12.2017 No. 53 "On Certain Issues Related to the Involvement of Controlling Persons of the Debtor in Liability in Bankruptcy".
5. Resolution of the Constitutional Court of the Russian Federation dated 21.05.2021 No. 20-P "On the Case of Checking the Constitutionality of Paragraph 3.1 of Article 3 of the Federal Law 'On Limited Liability Companies' in Connection with the Complaint of Citizen G.V. Karpuk".
6. Paragraph 2 of the Resolution of the Plenary Session of the Supreme Court of the Russian Federation dated 21.12.2017 No. 53 "On Certain Issues Related to the Involvement of Controlling Persons of the Debtor in Liability in Bankruptcy".
7. Ruling of the Supreme Court of the Russian Federation dated 15.02.2018 No. 302-ЭС14-1472 (4,5,7); Ruling of the Judicial Board for Economic Disputes of the Supreme Court of the Russian Federation dated 06.08.2018 No. 308-ЭС17-6757 (2,3) in case No. A22-941/2006.
8. Ruling of the Judicial Board for Economic Disputes of the Supreme Court of the Russian Federation dated 21.03.2019 No. 308-ЭС18-25635 in case No. A63-9583/2018.
9. Resolution of the Constitutional Court of the Russian Federation dated 21.05.2021 No. 20-P "On the Case of Checking the Constitutionality of Paragraph 3.1 of Article 3 of the Federal Law 'On Limited Liability Companies' in Connection with the Complaint of Citizen G.V. Karpuk".
10. Ruling of the Judicial Board for Economic Disputes of the Supreme Court of the Russian Federation dated 26.04.2024 No. 305-ЭС23-29091 in case No. A40-165246/2022; Ruling of the Judicial Board for Economic Disputes of the Supreme Court of the Russian Federation dated 25.03.2024 No. 303-ЭС23-26138 in case No. A16-1834/2022.